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# BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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| In the Matter of: | ) | |
| | ) | |
| Investigation Into Pricing of Unbundled Network Elements | ) | Docket No. 990649-TP |
| | ) | Filed: September 10, 1999 |
| | ) | |

## REBUTTAL TESTIMONY AND EXHIBIT

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## JOSEPH GILLAN

## ON BEHALF OF

## THE FLORIDA COMPETITIVE CARRIERS ASSOCIATION

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**Before the Florida Public Service Commission**
**Rebuttal Testimony**
**of**
**Joseph Gillan**
**on behalf of**
**The Florida Competitive Carriers Association**
**Docket No. 990649-TP**

## *I. Introduction*

**Q. Please state your name.**

A. My name is Joseph Gillan. I am filing rebuttal testimony on behalf of the Florida Competitive Carriers Association. I previously filed direct testimony in this proceeding.

**Q. What is the purpose of your rebuttal testimony?**

A. The purpose of my rebuttal testimony is to address a number of issues raised by BellSouth (BS) and GTE-Florida (GTEFL) and other parties. Remarkably, there is a broad consensus emerging on the *principal* issue in the proceeding -- i.e., identifying which network elements should have deaveraged prices. While there may be disagreement with regards to timing, and whether other actions must occur prior to (or coincident with) deaveraged network element prices, every party agrees that the loop network element should be the first to be deaveraged.

The core disagreements fall into three critical areas. Specifically, BellSouth and GTEFL recommend (with varying degrees of emphasis) that the Commission should:

* Redefine this proceeding into a debate as to how the Federal Communications Commission (FCC) should respond to the Supreme Court's remand of its list of mandatory network elements, most particularly how the FCC should interpret and apply the "necessary and impair" standard in the Federal Telecommunications Act of 1996.

* Abandon its long standing policy of using forward looking economic costs to establish network element prices and, in particular, price network elements in combined form differently than network elements obtained individually.

* Delay the deaveraging of loop or other UNE rates until these ILECs substantially adjust their retail rates or obtain a public universal service subsidy from the Florida Legislature.

**Q. Does your rebuttal testimony address each of these issues in detail?**

A. No. My rebuttal testimony does not respond to the issues involving interpretation and application of the "necessary and impair" standard. This issue is far beyond the

scope of this proceeding and is appropriately before the FCC at this time. The "necessary and impair" standard is used to determine whether a particular network capability must be made available as an unbundled network element (UNE). The Supreme Court's decision in *Iowa Utilities Board* rejected the FCC's initial interpretation of this standard, and therefore vacated the FCC's list of mandatory network elements (codified in Rule 319).

The only *certain* effect of the Supreme Court's remand is that the FCC must adopt a revised interpretation of the "necessary and impair" standard and apply that new interpretation to determine which network functions must be offered as UNEs. The FCC has been focused on this very issue for several months and has placed this item on its agenda for September 15th, five days after this rebuttal testimony is due.

**Q. Should the Commission address the "necessary and impair" standard in this proceeding?**

A. No. There is no reason to clog this proceeding with a replay of the debate before the FCC. At best, reviewing this testimony would only be useful if the Commission were interested in *predicting* how the FCC will respond to the Supreme Court's remand. The FCC bears the burden of interpreting the "necessary and impair" standard and, at least in the first instance, applying the standard to determine the minimum list of network elements that will be offered.

Obviously, this issue is highly contentious with substantial disagreement between competitive entrants and incumbents such as BellSouth and GTE. As a general proposition, the consensus competitive view is that the BS/GTEFL analysis of the "necessary and impair" standard and application is dead wrong as a matter of law, economics, policy and fact. But rather than duplicate the entire record from the FCC's proceeding, it is far simpler to wait until the FCC has ruled issued its decision before this Commission should (or even could) determine whether *any* of the costing/deaveraging issues in the proceeding have been affected.

**Q. How do you recommend the Commission should proceed with respect to the "necessary and impair" issue?**

A. The FCCA will not be sponsoring testimony at this point attempting to respond to BS/GTEFL on this issue. No productive purpose could be served by joining this debate, in this proceeding, at this time. Obviously, if the FCC concludes that a certain function is no longer a network element, then conducting a cost study for that element will *probably* not be necessary (Chapter 364 empowers the Commission with an independent basis to order unbundling). Similarly, if the FCC adds a network element, then a cost study will be needed to establish its price. Which elements fall into which category, however, can only be known after the FCC issues its decision.

To keep this proceeding focused on its primary objective (deaveraging and updating network element prices), FCCA has filed a motion to strike those portions of the BS/GTEFL testimony that speculatively address the proper interpretation of "necessary and impair." If the Florida Commission later determines that some question is relevant here, then FCCA would request the opportunity to file supplemental rebuttal testimony (at the conclusion of an appropriate discovery period) to respond to BS/GTEFL's claims. There is nothing to be gained here, however, by placing the "necessary and impair" cart before the "FCC remand" horse, and my rebuttal testimony provides no further discussion on this issue.

## *II. Separating Consensus From Dispute*

**Q. Is there consensus on the core issue in this proceeding?**

A. Yes. As noted above, although there is disagreement concerning issues of timing and preconditions (topics I address in the next sections of my testimony), there is general agreement that the loop network element is the network element most amenable to deaveraging at this time. This consensus includes such diverse interests as BellSouth, the FCCA, and even GTEFL:

> BellSouth believes that a possible candidate for deaveraging is the loop, if the loop is indeed determined to be a UNE at the conclusion

of the 319 proceeding, and only in those areas in which it is so determined. The loop element exemplifies the market and cost differences that are dependent on the geographic area in which it is located. (BellSouth witness Hendrix, page 4 and 5).

At a minimum, the Commission should require the incumbents deaverage the prices for all forms of unbundled loops and for all combinations of elements including unbundled loops. (Covad witness Murray, page 3).

Since loop length is considered to be a major cost driver in the provision of a loop, it is reasonable for the Commission to geographically deaverage the rates for an unbundled loop. (Florida Cable Telecommunications Association witness Barta, page 5).

Accordingly, the prices for unbundled loops should be deaveraged, but there is no support at this time for deaveraging other network elements, such as OSS. (GTE witness Trimble, page 8).

Based on this broad consensus -- modified only by the expected caveats concerning the Rule 319 remand, as well as proposals to tie UNE price deaveraging to other policies -- the Commission should quickly conclude that the loop network element

(in all of its forms) should be deaveraged.

**Q. Should other network elements also be deaveraged?**

A. It is impossible to determine based on this record whether it is appropriate to deaverage other network elements. Although Sprint indicates that its analysis concludes that local switching and transport should also be deaveraged, it would be premature based on the cost evidence it has supplied here to either support or challenge this conclusion.

The fact that *specific* deaveraged prices are the subject of Phase II carries an implication to this proceeding that cannot be ignored. The basis for deaveraging is cost, and the specific cost of each element will be determined in Phase II. Consequently, no final determination on any specific deaveraging proposal can be made in this phase. On this point, I agree with GTEFL:

> A *final* decision cannot be made in the absence of appropriate cost studies. Nevertheless, the Commission can, in this first phase, establish the fundamental criteria for deaveraging. (Trimble, page 8).

In a similar vein, I recommend that each ILEC should be *required* to file cost-based deaveraged loop rates in Phase II, while Sprint should be *permitted* to propose

additional deaveraging at that time, without prejudice or prejudgment. The sole issue presented by Sprint's proposal to deaverage additional elements is whether such deaveraging is justified by underlying costs, and this determination is most properly addressed in Phase II.

**Q. Can the Commission adopt general criteria at this time?**

A. Yes. Of the proposals made, Sprint's suggestion that the *starting* point for considering a deaveraging plan is when the averaged UNE price would deviate from its underlying cost by 20% or more appears to be the most reasonable. This guideline would provide a useful framework for the Commission to use to *organize* cost data and *evaluate* specific deaveraging proposals in Phase II. Of course, a final decision on a specific proposal should only be done after Phase II information is available

## *III. Revisiting the Pricing Debate*

**Q. Should the Commission abandon its general pricing philosophy (i.e., to establish network element prices on TELRIC) in this proceeding?**

A. No. The purpose of this proceeding is to determine to what extent UNEs should be deaveraged and to update any other cost analysis appropriate to UNE pricing.

BellSouth, however, has used this opportunity to argue that the Commission should revisit its earlier findings concerning the appropriate cost-standard (TSLRIC or TELRIC) for the pricing of UNEs. This policy was first adopted by the Commission in 1996 (Order PSC 96-0811-FOF-TP, Docket 950974-TP) and has been reaffirmed in several arbitrations since (see, for instance, Order PSC 96-1579-FOF-TP, Dockets 960833-TP, 960846-TP and 960916-TP). Specifically, BellSouth argues that individual UNE prices should be priced to cover "actual cost," while UNE combinations should be "market priced" (BellSouth witness Varner, page 21).

**Q. Should the Commission accept BellSouth's "invitation" to revisit its UNE pricing policies?**

A. No. First, with respect to BellSouth's recommendation concerning the pricing of *individual* elements, even BellSouth acknowledges that its recommendations would violate effective federal rules (Varner, page 21):

> With regard to individual UNEs, BellSouth recognizes that the appropriate policy cannot be implemented until the FCC's pricing rules are changed. The merits of those rules are currently being reviewed by the Eighth Circuit Court of Appeals which will, hopefully, permit appropriate prices for UNEs to be established. However, the limitations of existing rules should not deter this

Commission from establishing the appropriate policy. Implementation of that policy may be delayed by the FCC's rules. But this Commission should ensure that it has a clear identification of the appropriate objective so that it can achieve that objective when the rules permit it to do so.

As a metaphor, BellSouth's recommendation is equivalent to placing the cart before the *foal*. First, as noted above, the Commission has *already* addressed the appropriate pricing standard for network elements and concluded that Total Service Long Run Incremental Cost (not BellSouth's "actual" costs) is the relevant approach. In this regard, Mr. Varner's testimony is little more than a request for reconsideration, albeit several years late.

Moreover, however, even BellSouth acknowledges that its recommendation would only be relevant *if* the Eighth Circuit vacates the FCC's rules and the FCC later adopts (on remand) rules which would accommodate BellSouth's expansive view of pricing. Given that this Commission has *already* decided under its own authority that forward looking, cost-based rates are appropriate -- and, further, that federal rules would *require* such an approach even if the Commission had not -- there is no reason to address Mr. Varner's testimony on this point any further.

**Q. What should be the appropriate approach to pricing network elements in**

**combined form?**

A. The appropriate standard for pricing network elements is the same whether the element is used alone or in combination. The only difference in price must relate to a cost difference caused by an element being provided in combined, versus individual, form. For instance, the Commission has determined that lower non-recurring costs are associated with a loop/port combination than are incurred when these elements are obtained individually (see Docket 971140).

In this proceeding, the Commission should establish the cost-based rate for the loop/transport combination known as "extended link" discussed extensively in the testimony of e*spire witness James Falvey. By requiring ILECs to provide this combination, entrants will be able to serve customers more efficiently. This is clearly a configuration that the ILEC "currently combines" in its network today, and it would be discriminatory to deny entrants access to these same facilities.

**Q. Is Mr. Varner correct when he alleges (page 22) that the Commission may ignore federal rules (and the Telecommunications Act they implement) when developing the prices for network elements in combined form?**

A. No. By this point, there should be no doubt that entrants are entitled to network elements, both individually and in combined form. The Supreme Court specifically

rejected the ILEC's position that the network element obligation (Section 251(c)(3)) and cost-based pricing standard (Section 252(d)(1)) apply only to individual network elements and not combinations:

> It [Section 251(c)(3)] forbids incumbents to sabotage network elements that *are* provided in discrete pieces, and thus assuredly contemplates that elements *may* be requested and provide in this form (which the Commission's rules do not prohibit). But it does not say, or even remotely imply, that elements *must* be provided only in this fashion and never in combined form. (Iowa Utilities Board at p. 737.)

Despite losing its core position at the Supreme Court, BellSouth continues its opposition to network element combinations by now claiming that the entire framework of FCC rules applies only to network elements obtained in discrete, but never combined, form. Given the exceptional prominence that this issue has experienced over the past four years, however, it strains credulity to argue that the FCC's rules *silently* exclude network elements in combined form, without a single footnote (much less paragraph) of explanation or intent.

**Q. Are there any FCC rules which support BellSouth's remarkable assertion that these federal rules do not apply to network elements in combined form?**

A. No. Exhibit _____ (JPG-1) to my rebuttal testimony reproduces the most relevant sections of the FCC's pricing rules. As Exhibit ____ (JPG-1) shows, there is nothing in the FCC's rules to indicate that they apply only to network elements obtained discreetly, but not in combined form.

BellSouth's fundamental claim is that is appropriate to charge carriers different rates for the same network element, based on whether the element is obtained individually or in combined form. However, such an approach would be clearly discriminatory. As the FCC determined in its Local Interconnection Order (CC Docket 96-98, August 1, 1996, ¶¶'s 859 - 861), only price differences that are justified by cost differences are lawful:

> We [the Federal Communications Commission] conclude that the term "nondiscriminatory" in the 1996 Act is not synonymous with "unjust and unreasonable discrimination" in section 202(a), but rather is a more stringent standard.
>
> ***
>
> Section 252(d)(1), for example, requires carriers to base interconnection and network element charges on costs.

***

> On the other hand, price differences based not on cost differences but on such considerations as competitive relationships, the technology used by the requesting carrier, the nature of the service the requesting carrier provides, or other factors not reflecting costs, the requirements of the Act, or applicable rules, would be discriminatory and not permissible under the new [nondiscrimination] standard.

Given the clear and unambiguous commitment to a discrimination-free environment for UNEs, it is simply unreasonable to assume that the FCC would exclude an entire category of network elements -- i.e., network elements provisioned in combined form -- from its pricing rules without any textual reference to this result. Yet, this is the *threshold* conclusion that must be accepted before BellSouth can even suggest that different prices should apply. BellSouth has presented no valid policy, economic or legal rationale to price network elements in combined form differently than network elements obtained individually (other than cost) and its proposal should be rejected.

## *IV. Preconditioning UNE Rate Deaveraging on Retail Rate Rebalancing and/or a Universal Service Subsidy Fund*

**Q. What is the final area addressed by your rebuttal testimony?**

A. The final area addressed by my rebuttal testimony are the requests by GTEFL and BellSouth to delay the deaveraging of network element prices until these carriers have either rebalanced their retail rates or a universal service fund has been implemented. GTEFL takes this concept even further, arguing that a "deaveraging adjustment charge" should be implemented to assure its revenue neutrality no matter what happens to network element prices.

**Q. Is it necessary to rebalance rates or implement a universal service fund prior to deaveraging network element prices?**

A. No. From the day that local competition first became possible, these ILECs have argued that competition would rapidly erode their revenues, requiring either substantial rate rebalancing or the creation of new (and substantial) public subsidy funds. For instance, as the Commission noted in its first universal service investigation (Order PSC-95-1592-FOF-TP, 12/27/95):

> ... SBT and GTEFL contend that emerging competition will erode their ability to carry out their US/COLR obligations and that they need US/COLR funding beginning January 1, 1996, or immediately upon competitive entry. SBT and GTEFL failed, however, to

demonstrate that local competition will have such an immediate and overwhelming effect or, indeed any effect whatsoever.

**Q. Has local competition developed rapidly as these ILECs predicted?**

A. No, not at all. Table 1 below details the level of loop-based local competition for Sprint, BellSouth and GTE for the 3rd and 4th quarters of 1998. This comparison is developed from the data supplied by each of these ILECs to the FCC to monitor the development of local competition.

**Table 1: Status of Local Competition in Florida**
**(3rd and 4th Quarters of 1998)**

| ILEC | 3rd Quarter | 4th Quarter | Change |
|---|---|---|---|
| **BellSouth** | | | |
| Residence Lines | 4,377,439 | 4,434,908 | 57,469 |
| Business Lines | 1,893,249 | 1,935,514 | 42,265 |
| UNE Loops | 2,990 | 3,742 | 752 |
| CLEC Share | 0.048% | 0.059% | |
| **GTE** | | | |
| Residence Lines | 1,622,343 | 1,623,987 | 1,644 |
| Business Lines | 593,853 | 640,168 | 46,315 |
| UNE Loops | 0 | 46 | 46 |
| CLEC Share | 0.000% | 0.002% | |
| **Sprint** | | | |
| Residence Lines | 1,387,864 | 1,413,518 | 25,654 |
| Business Lines | 590,667 | 599,137 | 8,470 |
| UNE Loops | 0 | 43 | 43 |
| CLEC Share | 0.000% | 0.002% | |

**Q. What conclusions can be drawn from Table 1?**

A. There are a number of important lessons from Table 1. The first is that local competition, particularly local competition based on UNE loops, is developing *very*

slowly. Nearly *four years* after local competition in Florida was first authorized, loop-based competition has captured far less than 1% of the market (even if only the business market is considered) and the entrants' cumulative position is growing far slower than the ILEC is adding lines.

In addition, Table 1 implies that deaveraging UNE loop prices may not change this result substantially, even though such prices would better reflect underlying costs. Notably, Sprint deaveraged loop prices in its interconnection agreement with MCI and is experiencing competition at a level comparable to GTE with its averaged UNE rates.

**Q. Should the Commission link the deaveraging of UNE loop prices and the ILECs requests for rate rebalancing and a public subsidy fund?**

A. No. The Commission should adopt deaveraged network element prices in this proceeding as expeditiously as possible without *any* precondition with respect to the ILEC rebalancing rates or waiting for the Legislature to establish a public subsidy fund. History shows that there is no reason to expect rapid changes in local market conditions. Furthermore, it is important to appreciate that there are already mechanisms in place for the ILECs to respond by "rebalancing" their rates or obtaining universal service relief if conditions warrant.

**Q. What do you mean when you say that there "are already mechanisms in place for the ILECs to respond"?**

A. BellSouth and GTE claim that if network element prices are deaveraged, they must either substantially modify their retail rates or be assured a public subsidy to serve high cost areas. As noted above, however, empirical data does not support this claim -- local competition (with and without deaveraged network element prices) is developing slowly and is far from any level that could justify these carriers' fears. However, if entry does accelerate and competitive pressures do increase, the companies have in place the means to respond.

First, with respect to a universal service subsidies, the Commission's "interim mechanism" stands ready to address any legitimate concern. The "interim mechanism" was adopted (as shown earlier) because BellSouth/GTEFL's claims of imminent doom from competition could not be proven. As a result, the Commission determined (Order PSC-95-1592-FOF-TP, 12/27/95):

> As found above, SBT and GTEFL have not demonstrated that competition will erode their ability to sustain US [universal service] as a COLR [carrier of last resort] on January 1, 1996.

***

> However, if a LEC finds that its ability to sustain US as a COLR has, in fact, been eroded due to competitive pressures, it may file a petition for company-specific US relief. Its petition would be handled on an expedited basis. The petition must specifically demonstrate that competitive entry has eroded its ability to sustain US as a COLR, and specifically quantify the alleged shortfall that is due to competitive entry... It is the LEC's burden to demonstrate the appropriateness of any amount requested and the reasonableness of the proposed method to recover that amount.

The Commission, of course, has never received any such a request despite the BellSouth/GTEFL claims that such need would be immediate. As Table 1 so clearly demonstrates, the empirical evidence required by the Commission's "interim mechanism" would never support a claim of need. Nor is there any reason to expect that having network element prices track underlying costs more closely by the deaveraging recommended here would materially change this equation.

**Q. Do the ILECs also enjoy the flexibility to respond to greater competition?**

A. Absolutely. Both BellSouth and GTE have elected to be regulated under the more flexible price regulation provisions of the Florida Act (Chapter 364.051). This statute provides these ILECs with substantial flexibility to reduce their prices in

response to competition. It is not the need to respond to competition that concerns these carriers, it is the desire to respond without receiving fewer revenues.

Like the Commission's "interim mechanism" described earlier, however, Florida statute offers BellSouth and GTE an opportunity to elect out of constraints of price cap regulation if rate increases are needed due to competition (or other factors). As stated in Chapter 364.051(5):

> Notwithstanding the provisions of subsection (2), any local exchange telecommunications company that believes circumstances have changed substantially to justify any increase in the rates for basic local telecommunications services may petition the commission for a rate increase, but the commission shall grant such petition only after an opportunity for a hearing and a compelling showing of changed circumstances.

There is no reason to delay deaveraging network element rates, or condition such deaveraging on an automatic "rebalancing" of BellSouth/GTEFL's retail rates given these provisions. The Commission can move forward with deaveraging secure in the knowledge that if problems really arise, BellSouth and GTEFL can avail themselves of the appropriate "safety valve."

**Q. Is your recommendation consistent with prior Commission policy?**

A. Yes. In fact, my recommendation is *identical* to prior Commission policy. As noted, this is not the first case where an ILEC has argued that the Commission must tie their retail rates and/or universal service reform to any change in competitive conditions. In 1995, as the local market first "opened" to competition, GTEFL made essentially the same arguments that they offer here. In rejecting these arguments, the Commission found (PSC-96-0811-FOF-TP, Docket 950984-TP, 6/24/96):

> In anticipation or speculation that GTEFL will experience lost revenues as a result of unbundling, GTEFL believes that this Commission must order an immediate rate rebalancing or explicit subsidy payments when unbundled rates go into effect. Even if we agreed that there was a possibility of major revenue losses, that mere possibility would not give rise to an immediate rate increase. To the extent that GTEFL does experience revenue losses, there are specific procedures for relief set forth in Chapter 364. First, under Section 364.051(5), *Florida Statutes*, if GTEFL believes that circumstances have changed substantially to justify any increase in the rates for basic local telecommunications services, it may petition the Commission for a rate increase. This Commission shall grant such a petition only after an opportunity for a hearing and a compelling

showing of changed circumstances. Second, under Section 364.025, *Florida Statutes*, GTEFL may seek a subsidy towards it universal obligations. Specifically, GTEFL must file a petition showing that competition has eroded its ability to support universal service and identify the amount of subsidy needed.

There is no reason in this proceeding to depart from a policy that the Commission has applied for nearly four years without any ILEC stepping forward with a documented request for relief. The *deaveraging* of loop rates is no more competitively significant than the *introduction of* unbundling itself and this action (like the actions before it) should not be held hostage to ILEC claims of imminent competition, revenue losses and claims for public subsidy.

**Q. Does this conclude your rebuttal testimony?**

A. Yes.

## Relevant FCC Rules Concerning Pricing

There is no indication in the FCC's pricing rules to suggest that network elements in combined form are excluded. For instance, the overall scope of the FCC's pricing rules are defined as follows:

> § 51.501 Scope.
>
> (a) The rules in this subpart apply to the pricing of network elements, interconnection, and methods of obtaining access to unbundled elements, including physical collocation and virtual collocation.
>
> (b) As used in this subpart, the term "element" includes network elements, interconnection, and methods of obtaining interconnection and access to unbundled elements.

In addition, there is no suggestion that a differential approach is intended by those FCC rules that prescribe the general pricing methodology that must be applied:

> § 51.503 General pricing standard.
>
> (a) An incumbent LEC shall offer elements to requesting telecommunications carriers at rates, terms, and conditions that are just, reasonable, and nondiscriminatory.
>
> (b) An incumbent LEC's rates for each element it offers shall comply with the rate structure rules set forth in §§ 51.507 and 51.509 of this part, and shall be established, at the election of the state commission--
>
> (1) pursuant to the forward-looking economic cost-based pricing methodology set forth in §§ 51.505 and 51.511 of this part; or
>
> (2) consistent with the proxy ceilings and ranges set forth in § 51.513 of this part.
>
> (c) The rates that an incumbent LEC assesses for elements shall not vary on the basis of the class of customers served by the requesting carrier, or on the type of services that the requesting carrier purchasing such elements uses them to provide.

## CERTIFICATE OF SERVICE

**I HEREBY CERTIFY** that a true and correct copy of the Rebuttal Testimony of Joseph Gillan has been furnished by (*)hand delivery and U.S. Mail this 10th day of September, 1999 to:

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