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PUBLIC SERVICE COMMISSION

COMMONWEALTH OF KENTUCKY

BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:

INVESTIGATION CONCERNING THE	)	
PROPRIETARY OF INTERLATA SERVICES	)	
BY BELLSOUTH TELECOMMUNICATIONS,	)	CASE NO. 2001-105
INC., PURSUANT TO THE	)	
TELECOMMUNICATIONS ACT OF 1996	)	

TESTIMONY OF JOSEPH GILLAN
ON BEHALF OF
SOUTHEASTERN COMPETITIVE CARRIERS ASSOCIATION

JULY 9, 2001

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I. Introduction And Witness Qualification

Q. Please state your name, business address and occupation.

A. My name is Joseph Gillan. My business address is P. O. Box 541038, Orlando, Florida 32854. I am an economist with a consulting practice specializing in telecommunications.

Q. Please briefly outline your educational background and related experience.

A. I am a graduate of the University of Wyoming where I received B.A. and M.A. degrees in economics. From 1980 to 1985, I was on the staff of the Illinois Commerce Commission where I had responsibility for the policy analysis of issues created by the emergence of competition in regulated markets, in particular the telecommunications industry. While at the Commission, I served on the staff subcommittee for the NARUC Communications Committee and was appointed to the Research Advisory Council overseeing the National Regulatory Research Institute.

In 1985, I left the Commission to join U.S. Switch, a venture firm organized to develop interexchange access networks in partnership with independent local telephone companies. At the end of 1986, I resigned my position of Vice

President-Marketing/ Strategic Planning to begin a consulting practice. Over the past twenty years, I have provided testimony before more than 35 state commissions (including Kentucky), four state legislatures, the Commerce Committee of the United States Senate, and the Federal/State Joint Board on Separations Reform. I currently serve on the Advisory Council to New Mexico State University's Center for Regulation.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of the Southeastern Competitive Carriers Association (SECCA). SECCA is a broad coalition of carriers and their representative associations committed to bringing the full range of competitive services to consumers and businesses in the Southeast, including Kentucky.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide an overview of competitive conditions in the Kentucky local exchange market and to address the competitive harm that would occur if BellSouth prematurely receives authorization to provide interLATA services in Kentucky. BellSouth's assertion that local competition in the Kentucky market is meaningful – much less "irreversible" – is contradicted by the facts. Local competition in Kentucky remains nascent, in large measure due to the success of BellSouth's delaying tactics over the past five years.

Before BellSouth is granted permission to offer interLATA services in Kentucky, the Commission must confirm that BellSouth provides entrants access to its network on terms that are nondiscriminatory and cost-based. The most telling evidence in this regard should be the emergence of measurable and meaningful local competition. However, as I explain in more detail below, the observed level of competition in Kentucky does not support such a finding for a number of reasons, including the rates charged by BellSouth for network elements, as well as BellSouth's provisioning policies and practices.

Not only does the level of competition *today* not justify BellSouth's claim that it has opened its markets to entry, the most likely effect of BellSouth' gaining interLATA authority would be for it to gain even greater dominance in the *future*. Unless entrants are assured nondiscriminatory access to the inherited network, only BellSouth will be positioned to offer packages that combine local service with other products (such as Internet access and long distance) broadly across the market.[1] Consequently, granting BellSouth interLATA authority will increase

[1] For instance, BellSouth's CEO Duane Ackerman has been quoted as predicting that BellSouth would quickly win "in the 25 to 30 percent market share range," with a "quick couple of billion" flowing to the bottom line as profit. *See* "BellSouth Remains Confident, But Cautious About Growth," Atlanta Journal and Constitution, June 3, 2001.

its market position at the very *same* time that the Act's sole financial incentive to comply with its market opening provisions is removed. It is, therefore, critical that the Commission establish the means to prevent backsliding (where compliance has been achieved) and to resolve future disputes expeditiously.[2]

Q. Please summarize the principal conclusions of your testimony.

A. The principal conclusions of my testimony are that:

* BellSouth exaggerates the level of local competition in Kentucky, ignoring critical trends and limitations that affect each of the three entry strategies: resale, UNEs and CLEC facilities.

* Resale activity offers little probative value because evidence suggests it is neither viable nor irreversible. Resold lines in Kentucky have declined by more than 28% *just in the last three months*.

* UNE-based competition is beginning to emerge, but is still only 1.5% of the market, and even less when both switched and special access lines are

[2] The most effective means to such an end would be to place BellSouth's retail operations on the identical footing as any other CLEC through a structural solution. In the absence of a permanent solution that would correct BellSouth's underlying incentives, however, the Commission should establish administrative remedies – such as an expedited dispute resolution procedure – to curb anticompetitive conduct as best as possible.

included in BellSouth's share. UNE-share is the most critical measure of Section 271 compliance because UNEs *are* the nondiscriminatory access to the existing network that is the focal point of the federal Act.

* BellSouth's SGAT rates preclude UNE-based competition in Kentucky. In fact, not even BellSouth could profitably offer local service if required to lease UNEs at its rates that it has proposed.

* BellSouth's estimate of facilities-based activity ignores the unique traffic characteristics of many CLECs that indicate limited competition for a select customer segment.

* BellSouth has offered no evidence concerning its ability to support the resale of advanced services, as required by the *Ascent Decision.*[3]

Although the Commission has worked diligently to establish local competition – including its orders requiring BellSouth to offer UNE combinations – BellSouth's delays have meant that competition is only now in its infancy, and is still less than 5% of the market. To achieve meaningful (and irreversible) competitive entry, at

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[3] Association of Communications Enterprises v. FCC, 235 F.3d 662 (D.C. Cir. 2001) ("ASCENT Decision").

a minimum, the Commission should take another look at the UNE rates charged in Kentucky and establish an expedited dispute resolution procedure.

II. Competitive Conditions in the Kentucky Local Market

Q. What should be the starting point of the Commission's review?

A. The starting point of the Commission's review should be with review of the actual level of competition. It is BellSouth's obligation is to provide "actual evidence demonstrating ... *present compliance* with the statutory conditions for entry, instead of prospective evidence that is contingent on future behavior."[4] Actual commercial activity offers the most important measure of compliance because such competition is the goal of the Checklist itself. Where the observed level of competition *contradicts* BellSouth's claims as here, however, the Commission must begin its investigation with a healthy dose of skepticism.

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[4] Present compliance is a clear and established standard for review of regional Bell operating company compliance with the Act. *See In the Matter of the Application of Ameritech Michigan Pursuant to Section 271 of the Communications Act of 1934, as amended, to Provide In-Region, InterLATA Services In Michigan,* Memorandum Opinion and Order, Docket 97-137, ¶55 (August 19, 1997) "[w]e find that a BOC's promises of *future* performance to address particular concerns raised by commenters have no probative value in demonstrating its *present* compliance with the requirements of section 271. Paper promises do not, and cannot, satisfy a BOC's burden of proof (emphasis added)." More recently, the FCC stressed that "...a(n) RBOC, under all circumstances, retains the burden of demonstrating that it has "fully implemented the competitive checklist in subsection (c)(2)(B)."*In re: Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act to Provide In-Region InterLATA Services in the State of New York,* Memorandum Opinion and Order, 15 FCC Rcd. 75 (December 22, 1999), aff'd, AT&T Corp. v. FCC, 220 F. 3d 607 (D.C. Cir. 2000) at para. 44.

Q. Have you reviewed BellSouth's claims regarding the level of local competition in Kentucky?

A. Yes. Importantly, BellSouth's empirical estimates of competition are contradicted by other evidence, while its anecdotal information relies heavily on the early (and presumptive) announcements by CLECs that have either experienced financial difficulty or deployed technologies that fell well short of expectations. Far from illustrating a competitive local marketplace in Kentucky, the underlying data demonstrates that the promise of a competitive local market in Kentucky remains an elusive goal.

Q. Please summarize BellSouth's claims concerning the level of local competition in Kentucky.

A. According to BellSouth, competitive activity is occurring using each of the three basic entry strategies: resale, unbundled network elements (either alone or in combination), and CLEC facilities.[5]

[5] The term "facilities-based" is frequently used in the BellSouth testimony to include lines served by the lease of facilities as network elements (UNEs), it is more useful to consider each strategy separately. Accordingly, I have separately listed UNEs from lines served exclusively over CLEC facilities.

Table 1: Level of Competition Claimed by BellSouth (February 2001)

Mode of Entry	BellSouth Estimates		Relative CLEC Share[6]
	Method 1	Method 2	
Resale	34,733	34,733	2.7%
UNEs[7]	19,434	19,434	1.5%
Facilities[8]	41,134	15,498	2.2%
Total	95,301	69,665	6.3%

Based on these statistics -- and a number of anecdotal observations -- BellSouth claims that competition in Kentucky is not only "economically viable," but "irreversible" as well. As I explain below, however, it is important to understand the trends affecting each of these entry strategies, as well as whether BellSouth's claims are reasonable in light of other information. When scrutinized more carefully, it is clear that BellSouth's claims are exaggerated and that the existing level of competition does more to challenge BellSouth's assertions than confirm its compliance.

Q. Does BellSouth's analysis provide an accurate portrayal concerning the "economic viability" and "irreversibility" of entry based on <u>resale</u>?

6 "Relative Percentage" is based on the two estimation methodologies used by BellSouth.

7 "UNEs" includes lines served by individual loops and UNE-Platforms. Source: VW-6.

8 "Facilities" is calculated as the difference between the number of lines explained by Resale and UNEs and the total claimed by BellSouth.

A. No. A closer examination of BellSouth's resale volumes demonstrates that this entry strategy is in rapid decline, fundamentally contradicting *any* claim that such entry is either economically viable or irreversible. Consider the following trend in resale activity in Kentucky:

Table 2: Rapidly Declining Resale – Kentucky

	Dec 2000	March 2001	Decline	%
Resold Lines	48,425	34,733	(13,693)	(28.3%)

As the above trend demonstrates, resale activity in Kentucky is in a state of rapid decline, with the number of resold lines declining by more than 28% *in just the quarter alone.*[9] More than 40% of competitive activity that BellSouth claims exists – and an even greater percentage of the actual competition once proper adjustments are made to BellSouth's estimate of facilities-based entry – are based on an entry strategy that is not only not irreversible, it is in full reverse already.

Q, Why is resale in decline?

A. There are clearly a number of explanations for the vanishing resale-based competitor. First, there are the unattractive economics. With only a small margin

9 The actual decline is resale activity may be even greater. In Alabama, BellSouth filed testimony that indicated it was using a very "comprehensive" definition of resale in its 271 applications. If so, then the reported volumes for March (using BellSouth's "comprehensive definition") would be inflated relative to December, 2000. As such, if a consistent definition was used for both months, the decline between December and March could be even larger.

between the wholesale and retail rate, most carriers that experimented with resale either moved to a different strategy or fell into bankruptcy.[10] Moreover, resale neither permits a carrier to innovate, or effectively offer integrated local/long-distance packages.[11]

Q. Does the level of <u>UNE-based</u> competition indicate that Kentucky's local market is irreversibly open to competition?

A. No. It is clear that UNE-based entry is the most likely path to bring competitive benefits to the average Kentucky consumer or small business. UNE combinations, in particular, hold the most promise in this regard.[12] UNE volumes are also critical because UNEs are the means by which carriers obtain nondiscriminatory access to the existing network to offer services in competition with BellSouth. To date, however, UNE-based competition in Kentucky is only just beginning to make any headway.

Q. What share have UNE-based forms of entry accomplished in Kentucky?

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[10] Further, what negligible margins exist now may be subject to further reduction in light of the Eight Circuit Court of Appeals vacation of the FCC's avoidable cost methodology.

[11] This latter limitation on service-resale arises because BellSouth continues to assess access charges on the reseller's lines. As a result, the reseller is limited in the toll rates it may offer because it must pay access on each of its customer's long distance calls.

[12] The Kentucky Commission has been a leader in requiring that BellSouth support access to UNE combinations. Despite its clear directives, however, even BellSouth has acknowledged that it was not making such combinations available until February of last year.

A. The two most prevalent forms of UNE-based entry are UNE-Loops (combined with a CLEC-provided local switch) and UNE-Platform (loop combined with unbundled local switching). As shown in Table 3, UNE-based entry has achieved roughly a 1.1% market penetration in Kentucky after more than five years of competition.

Table 3: UNE-Based Entry in Kentucky

	BellSouth Switched Lines Only	**BellSouth Total Lines**
UNE-Loop	5,127	5,127
UNE-Platform	14,307	14,307
BellSouth[13]	1,227,166	1,643,790
UNE Share	1.5%	1.1%

Q. Why did you compute the market share in Table 3 by comparing CLEC lines to BellSouth's switched lines alone, as well as to BellSouth's total lines?

A. BellSouth appears to have computed each of the market share statistics in its testimony by comparing the CLECs' *total* lines to BellSouth's *switched access* lines alone. This calculation inflates the CLECs' share by sharply reducing the number of lines served by BellSouth.

13 Source: BellSouth 2000 ARMIS 43-08, Table III.

The principal difference between BellSouth's "switched" line count and its "total" line count are lines that BellSouth considers "special access." The "special access line" is largely a consequence of the interLATA line-of-business restriction that BellSouth seeks to have removed in this proceeding. In simple terms, customers make two types of calls: local calls and long distance calls. Many larger customers separate these calls between two types of connections – so called "switched access lines" (for calls that BellSouth can handle), and "special access lines" (for calls that BellSouth cannot).[14] This distinction, however, does not fundamentally change the service the customer is receiving, it only changes which carrier (BellSouth or a long distance company) terminates the call. Significantly, CLECs typically offer integrated services that render any distinction between "switched" and "special" lines irrelevant – CLEC lines are *both* "switched" and "special" because they handle both local and long distance calls. Consequently, to accurately compare CLEC lines to BellSouth lines requires that *all* of BellSouth's lines be included, with the result being a CLEC market share (using UNEs) of approximately 1.1%.

Q. Why do you believe that UNE-based competition has failed to develop in Kentucky?

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[14] These "special access lines" connect directly to a long distance carrier's switch.

A. There are a number of reasons why UNE-based competition has failed to develop. The first is quite simply that the rates charged to lease network elements in Kentucky are high. As I explain in more detail later in my testimony, not even *BellSouth* could afford to offer service in Kentucky if it had to lease UNEs from itself to do so. The rates in BellSouth's SGAT preclude meaningful entry, much less irreversible competition.

Second, BellSouth has been very slow to provide access to network combinations, delaying the availability of this important strategy until February of last year.[15] Consequently, even the most fundamental forms of UNE-based competition – that is, entry using the UNE-Platform – was delayed for approximately four years by BellSouth's refusal to honor its legal obligation. The compounding effect of BellSouth's high prices, intransigence and threatening behavior, have together frustrated the development of UNE-based competition in Kentucky (as elsewhere).

Q. Have you also reviewed BellSouth's estimate of the level of competition using the third and final entry strategy, i.e., the exclusive use of CLEC facilities?

[15] Source: BellSouth Ex Parte, Federal Communications Commission, CC Docket 96-98, October 13, 2000.

A. Yes and my analysis demonstrates that BellSouth has significantly overstated this form of competition as well. BellSouth claims that CLECs serve between 15,498 and 41,134 lines over their own facilities – a range that is so large that the Commission should be skeptical as to its accuracy. That said, however, if even *one* of these estimates were accurate, then BellSouth should be able to confirm such a sizeable CLEC share by the number of interconnection trunks between itself and CLECs. According to BellSouth, there are 40,211 interconnection trunks between itself and CLECs.[16] While this may seem adequate to the number of lines BellSouth claims are being served by CLECs over their own networks, it is important to understand that most CLEC traffic is unidirectional due to the early marketing success of CLECs serving ISPs. When adjusted to remove this one unique customer segment, the remaining trunks are clearly inadequate to support the facilities claimed by BellSouth.

Q. Have you reviewed usage statistics for Kentucky that would provide a more useful indicator of CLEC facilities-based activity?

A. Yes. As recently as June 1999, BellSouth filed interconnection usage statistics with the FCC.[17] This data indicated an originating market share for facilities-

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16 Source: VW-6.

17 Source: BellSouth Response to the Common Carrier Bureau's Fifth Survey on Local Competition, data as of June 30, 1999.

based CLECs (including UNE loops used with a CLEC's own switch) of less than 0.4%. CLEC s have disproportionally focused on serving customers that <u>received</u> local calls – most likely, providers of Internet access. In June 1999, nearly 94.5% of the CLECs' minutes originated with BellSouth customers and terminated on the CLECs' networks. Applying this traffic data,[18] I estimated the number of facilities-based lines implied by the number of interconnection trunks. Specifically, the analysis (1) reduced the number of interconnection trunks by the number of trunks used to serve terminating traffic, (2) converted the trunks to lines, and (3) subtracted the number of UNE-Loop arrangements to avoid double counting.[19]

Table 4: Facilities-Based CLEC Estimate
Based on Interconnection Trunks and Usage Statistics

a	Number of Interconnection Trunks	40,211	
b	Percentage of CLEC Traffic That Is Terminating	0.9448	
c	Terminating Trunks	37,991	a*b
d	Originating Trunks	2,220	a-c
e	Line-to-Trunk Ratio	4	
f	Originating Lines using Interconnection Trunks	8,879	d*e
g	Less UNE-Loops	5,127	
	Estimated Facilities-Based Lines	3,752	f-g

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[18] I have requested from BellSouth updated usage statistics to refine this analysis with more current data. Based on that discovery, I reserve the right to update my testimony.

[19] UNE-Loops are connected directly to a CLEC switch and would send traffic through interconnection trunks in the same manner as a facilities-based line. Because my analysis includes UNE-Loop arrangements in the UNE category, it is necessary to remove such lines from the number of facilities-based lines to avoid double counting.

As shown in Table 4, even when trunks are converted to lines using a line-to-trunk ratio of 4:1 -- a conversion rate that is *quadruple* that used by BellSouth and is, therefore, far more aggressive at estimating the number of CLEC lines than that used by BellSouth[20] -- the expected number of facilities-based lines (other than those serving ISP-like customers) is significantly reduced.

Q. **Based on these trends and data ignored by BellSouth, have you prepared a corrected estimate of CLEC market share in Kentucky?**

A. Yes. Table 5 summarizes the estimated CLEC share, after adjusting for the unique traffic pattern of certain CLEC customers and including all of BellSouth's lines in the analysis.

Table 5: Corrected CLEC Market Share

	BellSouth	**Corrected Analysis**	**Corrected Share**
Resale	34,733	34,733	2.0%
UNEs	19,434	19,434	1.1%
Facilities[21]	28,316	3,752	0.2%
Total CLEC	82,483	57,919	3.4%
BellSouth	1,219,080	1,643,790	

20 BellSouth assumed a 1-to-1 conversion of interconnection trunks to CLEC lines. The purpose of the much higher 4:1 ratio used in Table 4 is simply to illustrate how insignificant facilities-based competition is in Kentucky, even where far more aggressive assumptions are used to estimate it.

21 Facilities-based estimate for BellSouth is the average of Method 1 and Method 2.

A couple of points are important. First, it is useful to appreciate that even if BellSouth's exaggerated estimate of CLEC market share were accurate, an average share of only 6.3% after 5 years is not indicative of the level of competition that would be expected if CLECs truly enjoyed nondiscriminatory access to the existing network. Moreover, given the rapid decline in resale activity, as well as its inherent limitations, the more appropriate measure of BellSouth compliance should be UNE and facilities-based competition – which stands at less than 2%.

Q. Do you have any other evidence that confirms your estimate that CLEC market share in Kentucky is less than 4%?

A. Yes. The FCC recently released its statistics on local competition.[22] This report indicated that there were roughly 56,392 "voice grade equivalent" CLEC lines in Kentucky. Voice Grade Equivalents (VGEs) are a larger measure than lines because they are adjusted to reflect the different capacity capabilities of different types of "line." The number of voice grade equivalents – for either a CLEC or BellSouth – exceeds the number of lines due to the growing prominence of higher speed data services.[23] Because of the way that the FCC tabulated ILEC data,

[22] *Local Competition Report: Status as of December 31, 2001*, Industry Analysis Division, Common Carrier Bureau, Federal Communications Commission, May 2001, Table 6.

[23] Because of the growing popularity of higher capacity digital services, capacity is being reported in 64kbps (i.e., the capacity needed for a single voice connection) increments. These

however, the Local Competition Report essentially compares CLEC voice grade equivalent lines to ILEC switched access lines – ignoring the ILECs' special access lines as well as their voice-grade equivalent.[24] When both CLEC and BellSouth statistics are placed on an equivalent footing – that is, the comparison measures voice grade equivalents (VGEs) for both the CLEC and BellSouth – the estimated CLEC market share is roughly 2.0%.[25]

Q. Have you also reviewed BellSouth's "anecdotal evidence" concerning the level of competition in Kentucky?

A. Yes. In addition to exaggerating its "quantified" estimate of local competition, BellSouth has also supplied a number of "anecdotes" that it claims support its allegations. For the most part, these anecdotal citations are derived from out-of-date press statements that bear little relationship to present-day reality. Consider for instance BellSouth's description of Pathnet as a robust competitor:

"voice grade equivalents" enable reasonable comparisons between voice and data capacity and is now routinely reported by ILECs and CLECs.

[24] Many ILEC higher capacity services are sold as "special access." Consequently, by not including special access lines, the FCC eliminated most of the ILECs higher capacity services as well.

[25] Because CLECs do not generally draw the same distinctions in their offerings as the ILEC – for instance, as explained earlier, CLECs typically offer integrated products that blur any distinction between switched and special access – there is no evidence to indicate that not all CLEC lines have been counted (and counted as voice grade equivalents) in the FCC's report.

> "Pathnet completed 300 additional route miles of network and 20 additional collocations during the quarter, bringing its total network to 7,700 route miles and 106 collocations in 73 cities."[26]

Significantly, BellSouth's portrayal of Pathnet is drawn from a 3rd Quarter 2000 press statement and overlooks Pathnet's subsequent announcement on April 2, 2001 that it would file for Chapter 11 bankruptcy. In addition, BellSouth places great emphasis on "new" technologies (such as Lucent's "PathStar"[27]), even though it is well known that Lucent has abandoned the project. The Commission should place little weight on *predictions* of competitive activity – predictions that have disappointed investors as well as policymakers.[28]

III. More Needs to Be Done

Q. Are there additional actions needed to bring the benefits of local competition more broadly to Kentucky consumers?

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26 Wakeling Affidavit, page 12.

27 Wakeling Affidavit, page 14 (emphasis added by BellSouth):

> "Network Telephone ...will deploy Lucent's PathStar Access Server ... The PathStar solution will enable service providers to **deliver eight or more telephony subscriber lines and high-speed data services over a single unbundled local loop.**"

28 Moreover, as I indicated at the outset, the relevant standard is whether BellSouth has demonstrated *present* compliance, not its claim that conditions will improve in the future.

A. Yes. As I explain below, the Kentucky Commission should place particular emphasis on establishing cost-based rates for UNEs, continuing to require that BellSouth provision UNEs in most efficient manner possible, and adopting measures to prevent backsliding and expedite dispute resolution.

Q. Is there evidence to demonstrate that BellSouth's SGAT prices are not cost-based?

A. Yes. To provide a benchmark for comparison, I estimated what BellSouth's financial results would look like (for 2000), assuming that it was required to lease UNEs to offer its conventional switched services (i.e., local service and access) at the rates in its SGAT.[29] Based on BellSouth's ARMIS data for 2000, I constructed the following estimate of BellSouth's Kentucky operating income assuming that BellSouth's reported levels of customer and corporate operations expense were unchanged, and added an estimated cost to lease UNEs.[30] Because it would be leasing UNEs rather than running its network, the analysis does not include any expense for depreciation, or plant-related operating costs.

29 The analysis does not estimate the costs and revenues associated with providing dedicated private line and special access services.

30 The analysis assumes that BellSouth offered service leasing the UNE-Platform. The estimated average UNE-P cost was developed assuming 1,000 local minutes, 50 intraLATA toll minutes and 200 interLATA toll minutes (with 300 local calls and 52 toll/access calls) per month. Based on BellSouth's ARMIS data concerning local calls and Dial Equipment Minutes, these would appear to be conservative assumptions for an average user.

Table 6: BellSouth's Financial Performance if UNE-Based Carrier (Kentucky -- 2000)

	Cost/Revenue (000s)
Switched Services Revenues[31]	$541,795
Expenses	
UNE Lease Payments	$506,869
Marketing Expense (Acct 6610)	$19,778
Customer Service Expense (Acct 6623)	$41,377
Executive and Planning (Acct 6710)	$7,041
General and Administrative (Acct 6720)	$51,285
Total Operating Expense	$626,350
Operating Income	(84,555)

Because the above analysis does not include any of the costs that it would incur to order UNEs, the table provides a <u>conservative</u> estimate of the expenses that BellSouth would actually incur if it attempted to compete leasing network elements from itself. For instance, the analysis does not include the substantial non-recurring costs that would be incurred each year to serve new lines and migrated customers. While BellSouth actually enjoyed operating income of more than $346 million in Kentucky, its "UNE-self" would have run squarely in the red. Clearly, if *BellSouth* could not even operate in Kentucky if required to lease the existing network, it should not be surprising that CLECs have failed to achieve any significant competitive gains.[32]

[31] Switched services revenue is the total of Basic Local, End User, Switched Access, State Access and LD Message Revenues for 2000 (ARMIS 43-03).

[32] It is also useful to understand that the analysis in Table 6 assumes that BellSouth does not cannibalize its retail revenues by offering selective discounts or special promotions. As the Commission is aware, BellSouth is offering lower prices to some customers. Between the

Q. Can you provide an example of a UNE-rate that is not plausibly cost-based?

A. Yes. As an illustration, consider the rates that BellSouth proposes to impose simply to *provide* the call detail records needed for billing. These rates are ODUF (for the provision of daily usage files) and ADUF (for the provision of access usage files) and would appear to apply on a per-message basis.[33] Applying these charges to BellSouth's reported calling volumes in Kentucky for 2000 produces a "cost" simply for the usage information of nearly $60 million annually.

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additional charges that I did not include, and the potentially lower revenues that BellSouth would evidentially accept from its *favored* customers, the projected net income in Table 6 likely overstates what BellSouth would actually obtain.

[33] There is some confusion concerning the application of these charges. During the Alabama cost proceeding, BellSouth was asked to identify the unbundled network element charges that a CLEC would incur to offer basic local service (*see* Item No. 6 of DeltaCom's 1st Data Request, Docket No. 27821, February 20, 2001). In its response, BellSouth *did not* include charges for daily usage files. For purposes of the analysis described above, however, DUF charges are assessed on all local and access messages.

Table 7: Estimated Cost of "Billing Information"
(BellSouth SGAT Rates)

Traffic Type	Calls (1000s)		Total Calls	SGAT Rate	Annual Cost
	Originating[34]	Terminating			
Local	4,427,113	4,427,113[35]	8,854,226	$0.004811	$42,598,124
Access	770,025	1,323,817[36]	2,093,842	$0.008174	$17,115,947
			Average UNE Rate	$0.005454	$59,714,071

Q. **Are BellSouth's proposed charges for daily usage files out-of-line to the rates charged by other RBOCs?**

A. Yes. The following table compares BellSouth's proposed charges in Kentucky to the rates charged by Ameritech (Michigan) and Qwest (Arizona),[37] as well as the average monthly cost per switched access line (based on Kentucky usage data).

[34] Source: ARMIS 43-08, Table IV.

[35] Assumes local calling is balanced – that is, for every originating minute there is a single terminating minute.

[36] Source: Estimated from originating calling information by applying the average originating-to-terminating ratio for carrier common line minutes (1997 and 1998). ARMIS 43-01, Table IIa. Terminating switched access usage typically exceeds originating usage because of the prevalence of dedicated connections to some large customers.

[37] Proposed by Qwest in Docket T-00000-00-0194, Testimony of Maureen Arnold.

Table 8: UNE Rate Comparison
(Daily Usage Files)

	UNE Rate	Average Cost Per Line
BellSouth - Kentucky[38]	$0.00545	$4.06
Ameritech - Michigan	$0.00070	$0.52
Qwest - Arizona	$.000762	$0.57

Consider the practical effect of the cost imposed on any CLEC requiring daily usage information to bill its customers, to audit its UNE bills (or perhaps even comply with CALEA obligations). Any carrier relying on the use of the UNE-Platform (which is the network arrangement used by carriers offering competitive services to the typical analog customer) would see its costs – and, therefore, would need to increase its rates to end-users – by more than $4 per month just to obtain billing information. It is no wonder that so little competition has developed in Kentucky.

Q. In addition to pricing, what other actions should the Commission take to foster local competition?

A. I recommend that the Commission focus on two additional areas. First, the Commission should make sure that xDSL services are available for resale under wholesale-arrangements. Second, the Commission should evaluate

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38 Average rate for local and access usage files based on calling data in Table 7.

additional measures to assure that the market remains competitive in a post-271 environment by adopting expedited dispute resolution procedures.

Q. What action should the Commission take with respect to BellSouth's obligation to support the resale of advanced data services?

A. Yes. As indicated earlier, the *Ascent Decision* makes clear that BellSouth must permit the resale of its advanced data services at a wholesale discount. BellSouth has not shown through commercial usage or other information, however, that it is prepared to honor this obligation. The Commission should require that BellSouth fully document its ability to support the resale of advanced services such as xDSL.

Q. Should the Commission prepare to take additional measures, even if it (ultimately) endorses BellSouth's application for interLATA authority?

A. Yes. It is important to appreciate that the Commission's oversight does not end with a 271 application – indeed, quite the opposite, the Commission should expect enforcement issues to become even *more* pronounced. The fundamental assumption of the Telecommunications Act is that incumbent LECs (such as BellSouth) would ultimately establish "normal" supplier-customer relationships with CLECs. The reality has demonstrated, however, that BellSouth's conflicting incentives as supplier and competitor preclude such a relationship from forming.[39] As a result, the Commission must be prepared to increase its vigilance and regulatory oversight – or, more simply, adopt a structural approach that would align BellSouth's incentives with the Commission's objective of a competitive local market. At a minimum, the Commission should establish an expedited dispute resolution procedure, such as that outlined in the attached Exhibit JPG-1.

Q. Does this conclude your testimony?

A. Yes.

[39] For instance, consider BellSouth's position concerning network element combinations – would any rational firm *desiring* the business of CLECs ever propose the Byzantine procedures and processes that BellSouth seeks to impose? No, of course not. The Commission rightly rejected this approach.

Certificate of Service

A copy of the foregoing was served this 9th day of July, 2001, by first class, United States mail, postage prepaid, upon all parties of record.

C. Kent Hatfield

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