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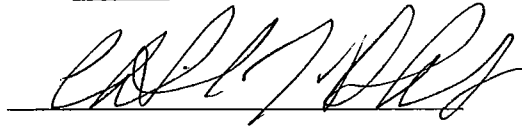
STATE OF CALIFORNIA

COUNTY OF ALAMEDA

BEFORE ME, the undersigned authority, duly commissioned and qualified in and for the State and County aforesaid, personally came and appeared Christopher J. Pleatsikas, who, being by me first duly sworn deposed and said that:

He is appearing as a witness before the Kentucky Public Service Commission in Case No. 2003-00379, Review of Federal Communications Commission's Triennial Review Order Regarding Unbundling Requirements for Individual Network Elements, and if present before the Commission and duly sworn, his rebuttal testimony would be set forth in the annexed testimony consisting of 18 pages and 0 exhibits.

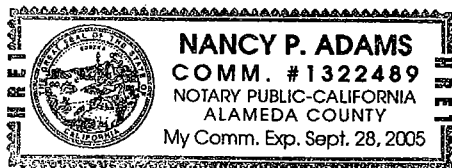
*Number of pages + exhibits to
be filled in later*



Christopher J. Pleatsikas

SWORN TO AND SUBSCRIBED BEFORE ME
THIS 23 DAY OF MARCH, 2004

Nancy P Adams Notary Public



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BELLSOUTH TELECOMMUNICATIONS, INC.
REBUTTAL TESTIMONY OF
DR. CHRISTOPHER JON PLEATSIKAS
BEFORE THE KENTUCKY PUBLIC SERVICE COMMISSION
DOCKET NO. 2003-00379
MARCH 31, 2004

I. INTRODUCTION

**Q. ARE YOU THE SAME CHRISTOPHER JON PLEATSIKAS WHO FILED
DIRECT TESTIMONY IN THIS PROCEEDING?**

A. Yes, I am.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

**A. My rebuttal testimony responds to the economic arguments regarding market
definition made by Dr. Mark T. Bryant on behalf of MCI and Mr. Joseph Gillan on
behalf of CompSouth.**

**Q. ALL PARTIES HAVE DIRECTED THIS COMMISSION TO VARIOUS
PORTIONS OF THE TRO AND TO THE RULES IN SUPPORT OF THEIR**

1 **POSITIONS IN THEIR DIRECT TESTIMONY. WHAT IMPACT DOES**
2 **THE D.C. CIRCUIT COURT’S ORDER HAVE ON THE USE OF THE TRO**
3 **IN THIS PROCEEDING?**

4
5 A. I’m not a lawyer, but it appears to me that the impact of the Court’s opinion on the
6 TRO and the rules is unclear. At the time of filing this testimony, my
7 understanding is that the Court had vacated large portions of the rules in the TRO,
8 but stayed the effective date of the opinion for at least sixty days. I understand that
9 the TRO remains intact for now, but that the TRO and the rules must be viewed
10 warily, especially in light of the Court’s apparent harsh criticism of large portions
11 of the TRO. Accordingly, I would like to reserve the right to supplement my
12 testimony, as circumstances dictate, and as the situation becomes clearer.

13
14 **II. RESPONSE TO DR. BRYANT**

15
16 **Q. PLEASE DESCRIBE DR. BRYANT’S MARKET DEFINITION**
17 **RECOMMENDATION.**

18
19 A. In his direct testimony, Dr. Bryant concludes that each customer location represents
20 a unique market. (Bryant Direct 40-41) Dr. Bryant notes that for administrative
21 practicability, the Kentucky Public Service Commission may aggregate these
22 “mass market customer locations” to the wire center level. (Bryant Direct 42)

1

2 **Q. IS EACH CUSTOMER LOCATION A UNIQUE MARKET?**

3

4 A. No. In his direct testimony, Dr. Bryant bases his proposed market definition
5 merely on the observation that a customer wants landline telephone service at his or
6 her location, and the assertion that having telephone service available at another
7 (even nearby) location is not a substitute. (Bryant Direct 41) This is neither an
8 accurate characterization of the demand for telecommunications services nor does it
9 comply with the FCC's requirement, and basic economics, that a market definition
10 consider whether an efficient CLEC serving only one area could take advantage of
11 the available scale and scope economies that might be available by serving a wider
12 market. (TRO fn. 1536)

13

14 Dr. Bryant's observation that customers want telephone service in their own homes
15 or businesses and that service to other locations is an inadequate substitute, is an
16 observation focused solely on some aspects of demand-side substitutability,
17 whereas markets should be defined with reference to both demand-side and
18 supply-side substitutability. That is, you have to look at the market definition not
19 solely from the viewpoint of the person (or entity) receiving the service, but from
20 the viewpoint of the person (or entity) providing the service. Moreover, even
21 ignoring supply-side substitutability, as a general economic proposition in terms of
22 the demand for telecommunications services, advances in technology have

1 undermined the validity and applicability of Dr. Bryant's views on demand-side
2 substitutability, including for the purpose of defining geographic markets. For
3 example, the provision and use of telecommunications services via wireless (i.e.,
4 mobile) technology demonstrates that, for some end users in at least some
5 circumstances, the customers' premises is not the only geographic location at
6 which customers demand telecommunications services.

7
8 In discussing the issue of market definition, the FCC recognizes the importance of
9 supply-side considerations, that is, looking at the market definition from the
10 viewpoint of the supplier of the service. The FCC specifically instructs state
11 commissions on this issue:

12
13 We make clear that state commissions cannot define a market as
14 encompassing an entire state and that they should not define the
15 market so narrowly that a competitor serving that market alone
16 would not be able to take advantage of available scale and scope
17 economies from serving a wider market. (TRO fn. 1536)

18
19 Dr. Bryant's direct testimony on proposed market definition does not consider the
20 FCC's requirement that the market definition incorporate relevant supply
21 considerations, and as a result his definition fails to meet the FCC's expectations

1 that “one would expect a broader market definition for switching than for loops or
2 transport.” (TRO fn. 1536)

3
4 **Q. PLEASE COMMENT ON DR. BRYANT’S ARGUMENT THAT “A**
5 **MARKET DEFINITION THAT IGNORED LOCATION SPECIFICITY**
6 **WOULD FLY IN THE FACE OF THE ENTIRE FOUNDATION OF**
7 **ANTITRUST AND REGULATORY ECONOMICS.” (BRYANT DIRECT**
8 **43)**

9
10 **A.** I agree that location specificity can be an important aspect of a product or service.
11 However, location specificity in demand, by itself, is insufficient to imply that each
12 individual location is a separate market. As I described, location specificity in
13 demand for (landline) telecommunications services is related to a particular existing
14 delivery technology as much as, or possibly more than, customer demand. In any
15 event, location specificity is not unique to telecommunications services. There are
16 other products that provide location specific services, but, like telecommunications,
17 one cannot infer from this alone that each location is a separate market.

18
19 To illustrate how Dr. Bryant ignores supply-side considerations, consider the
20 market for house painting services. House painting is location specific in demand
21 because having the service “delivered” to a neighbor’s house is not an adequate
22 substitute for having those services “delivered” to your own house (i.e., having

1 your own house painted). Yet, each individual home clearly does not constitute a
2 separate geographic market because most firms that provide house painting services
3 would not organize themselves so as to serve only one particular home. Available
4 scale and/or scope economies (e.g., that can be captured through ladders,
5 scaffolding, and other capital supplies or advertising one's services in the Yellow
6 Pages), among other factors affecting supply substitutability, imply that the
7 geographic market for house painting is larger than a single-house location.

8
9 **Q. DOES DR. BRYANT CONCLUDE THAT CUSTOMER LOCATIONS ARE**
10 **MARKETS?**

11
12 A. No, in his direct testimony Dr. Bryant confusingly suggests that although customer
13 locations are apparently "the relevant geographic market for local
14 telecommunications services" (Bryant Direct 43), there are several "factors that
15 support a market definition at the wire-center level" (Bryant Direct 45) and so it is
16 "most practical to conduct impairment analysis at the wire-center level" (Bryant
17 Direct 46). In short, Dr. Bryant provides no unambiguous indication whether he
18 prefers customer locations over wire centers as a market definition. In my opinion,
19 neither of these definitions meets the guidance in the TRO.

1 **Q. YOU HAVE DEMONSTRATED THAT CUSTOMER LOCATIONS ARE**
2 **NOT MARKETS. IS DR. BRYANT’S WIRE CENTER PROPOSAL A**
3 **REASONABLE ALTERNATIVE?**

4
5 A. No, his wire center proposal is not reasonable because it also does not sufficiently
6 consider substitutability in demand or supply. For example, it fails to consider
7 whether efficient competitors using self-provisioned (or third-party) switching to
8 provide service in certain wire centers could, within a sufficiently short period of
9 time, render supracompetitive pricing by the incumbent in another, proximate wire
10 center unprofitable (i.e., because a sufficient number of the incumbent’s customers
11 would switch to one of the competitors in response to such pricing). If these
12 competitors could do so, then the relevant geographic market *must be larger than*
13 *the individual wire center*. In fact, the scale and scope economies available to
14 efficient entrants (TRO fn. 1536) are generally not consistent with the existence of
15 geographic markets defined along wire center boundaries. These scale and scope
16 economies, which exist in part because of similarities in certain costs and demand
17 and other economic characteristics shared by groupings of proximate wire centers,
18 facilitate competition across broader geographic areas than individual wire centers.

19
20 Wire centers were organized years ago to permit the ILEC to efficiently serve all
21 customer locations using the technology of the day. With (1) the continued growth
22 of competition, and with each competitor (and the ILEC) serving fewer than the

1 total number of customer lines in a wire center; (2) technological change that
2 permits carriers economically to serve multiple wire centers using a single switch
3 rather than by replicating the traditional network; and (3) the use by at least some
4 CLECs of mass media advertising to attract customers, single wire centers may not
5 adequately reflect substitutability in supply and therefore may not constitute
6 distinct geographic markets.

7
8 **Q. DO COLLOCATION COSTS BY THEMSELVES DEFINE A MARKET?**

9
10 A. No. Collocation costs can influence where a CLEC may seek to offer service in a
11 market, but they do not, by themselves, determine the geographic scope of the
12 market. As I noted earlier, the geographic scope of a market is defined by
13 considering *both* demand and supply substitutability.

14
15 A key issue for market definition in the context of this proceeding is whether an
16 efficient competitor serving one part of an area reasonably could serve another part,
17 recognizing that in so doing it could incur additional costs such as additional
18 collocation costs in the event that it is not already collocated. Dr. Bryant contends
19 that CLECs make such decisions on a wire center-by-wire center basis because net
20 operating income from a CLEC will vary across wire centers. (Bryant Direct 46)
21 However, most CLECs that provided information on this point stated, contrary to
22 Dr. Bryant's assertion, that they do not make entry decisions at the wire center

1 level. (See FCCA Response to BellSouth Florida 1st Set of Interrogatories No. 1-
2 18, which I understand is applicable to Kentucky as well. I note also that 7 of the 9
3 respondents to those Interrogatories currently operate in Kentucky.) Moreover,
4 while it is true that certain costs vary across different wire centers, the “zoning”
5 concept for UNE prices is intended to address, at least in part, this specific issue by
6 identifying wire centers with similar cost characteristics.

7
8 Dr. Bryant has not demonstrated either that efficient CLECs make entry decisions
9 in the manner he asserts or that demand and supply substitutability would generally
10 result in geographic markets confined to wire center boundaries. To the contrary,
11 the ability of CLECs to capture economies of scope and scale across a wider area
12 because aggregations of wire centers share certain cost and other economic
13 characteristics is inconsistent with Dr. Bryant’s assertions. In deriving my market
14 definition as the intersection of UNE Zones and Component Economic Areas
15 (CEAs) I specifically considered factors relating to both homogeneity in certain
16 costs and economic commonality, both of which affect supply substitutability.

17
18 **Q. DID ANY CLECS SUPPORT A CLAIM TO CONSIDER ENTRY**
19 **DECISIONS ON A WIRE CENTER-BY-WIRE CENTER BASIS?**

20
21 A. No. In its response to BellSouth’s first set of interrogatories in Florida, the FCCA
22 notes that the members who responded usually did not claim to “enter a market at

1 the wire-center level.” (FCCA Response to BellSouth Florida 1st Set of
2 Interrogatories No. 1-18) When given the opportunity to identify the factors that
3 influence its market entry decisions, one of the CLECs that claimed to enter at a
4 wire center level, MCI (which is a party in this proceeding), listed ILEC retail
5 prices, ILEC access charges, and ILEC UNE-P/UNE pricing—none of which is
6 determined solely at the level of the wire center. Indeed, ILEC retail prices, ILEC
7 access charges, and ILEC UNE-P/UNE pricing generally extend across multiple
8 wire centers.

9
10 **Q. DR. BRYANT MAINTAINS THAT CLECS WILL NOT OFFER SERVICE**
11 **IN A PARTICULAR WIRE CENTER IF THEY DO NOT BELIEVE THAT**
12 **THE WIRE CENTER WILL “CONTRIBUTE TO THE BOTTOM LINE.”**
13 **(BRYANT DIRECT 49) IF TRUE, DOES THIS IMPLY THAT EACH WIRE**
14 **CENTER REPRESENTS A DIFFERENT MARKET?**

15
16 **A.** No, Dr. Bryant’s perspective is too simplistic in that it ignores both the import of
17 the concept of supply substitutability and the manner by which firms evaluate and
18 exploit business opportunities. For example, if a firm were to analyze the
19 profitability of entry into a single wire center in isolation from the opportunities
20 available in contiguous and/or proximate wire centers, it might find that entry was
21 likely to be unprofitable given all of the costs associated with entry. By contrast, if
22 at least some such costs (such as switching, marketing and administrative costs)

1 could be amortized over multiple wire centers, entry might be profitable over a
2 broader area. Of course, firms generally use the latter method for evaluating
3 opportunities – by assessing financial and economic viability over reasonably-sized
4 geographic (and product) spaces, not by artificially confining themselves to
5 providing services within arbitrarily defined narrow areas (such as individual wire
6 center boundaries). Thus, an efficient CLEC will select the geographic area for
7 entry – which in general will include more than one wire center – that maximizes
8 its profits. Insofar as there are economies of scale and scope that are captured by
9 serving multiple wire centers, an efficient CLEC will generally ultimately enter and
10 serve an area that spans that broader geography.

11
12 Wire centers can be grouped together, in part, because either (1) an efficient CLEC
13 that decides to enter one wire center due to its perceived profitability would
14 generally be willing (and able) economically to enter another nearby wire center
15 with similar cost characteristics and market prospects and/or (2) an efficient CLEC
16 may initially decide to enter multiple wire centers (either sequentially or
17 simultaneously) if it believes that serving the combination of wire centers is likely
18 to be profitable even if serving some or any of the wire centers individually (in
19 isolation) would not be profitable. Because a CLEC can use some of its assets
20 (e.g., the switch) to serve customers in a broader area, economies of scale and
21 scope associated with those assets are relevant to determining the market definition.

1 Indeed, this is precisely the relevance of my proposal for defining a market as the
2 intersection of the UNE Zones in BellSouth's territory with the relevant CEAs.
3 The UNE Zone/CEA intersection identifies those areas that are economically
4 related and where costs are relatively homogeneous (and thus where one might
5 expect a reasonable likelihood of substitutability in supply). These areas are
6 reasonably likely to correspond to the market area considered by an efficient CLEC
7 in deciding whether to enter.

8
9 **Q. IS THE ACTUAL COVERAGE OF FACILITIES-BASED CLECS AN**
10 **INDICATOR OF THE GEOGRAPHIC MARKET AREA?**

11
12 A. Not necessarily, in part due to the impact that widespread availability of UNE-P
13 has on facilities deployment. The extent of coverage offered by a service provider
14 can be one indicator of the geographic scope of the market. However, as is noted
15 by FCC Chairman Michael Powell in his Separate Statement to the TRO, the
16 situation is different in telecommunications because there may be an incentive in at
17 least some circumstances for CLECs to use UNE-P rather than self-provided or
18 third-party switching even in instances where there is no impairment. Mr. Powell
19 contends that the availability of UNE-P provides incentives for CLECs to use that
20 method of service even when they economically could serve customers using UNE-
21 L. As Dr. Aron describes, this can occur because UNE-P provides the promise of
22 higher profits than UNE-L.

1
2 As a result, if we observe a CLEC that offers mass-market service from its own
3 switch to customers in an economically meaningful area (such as a UNE
4 Zone/CEA) that is served by multiple wire centers, we can conclude that the
5 relevant geographic market is likely to be broader than a single wire center.
6 However, we cannot necessarily conclude that we have observed the full scope of
7 the UNE-L marketplace just from the current deployment of UNE-L (e.g., because
8 the real-world CLEC's business plan may be influenced by the availability of
9 UNE-P). For this reason, it is more appropriate to consider the UNE Zone/CEA
10 method that I propose. This approach identifies areas that are economically related
11 and where costs are relatively homogeneous. If an efficient CLEC economically
12 can offer service in one part of the area without access to the unbundled element, it
13 may well be able to offer service in any other part of that area, even if, in the real
14 world, this capability is being obscured by CLECs' choice of UNE-P rather than
15 self-provisioning of switching. Furthermore, the evidence provided by BellSouth
16 witness Pam Tipton demonstrates that CLEC switches generally provide service
17 across multiple wire centers.

18
19 **Q. DR. BRYANT CLAIMS THAT WIRE CENTERS ARE NATURAL**
20 **GEOGRAPHIC BOUNDARIES BECAUSE COSTS VARY WIDELY**
21 **ACROSS WIRE CENTERS. (BRYANT DIRECT 29-30) PLEASE**
22 **COMMENT.**

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A. Even though some costs may vary across wire centers, this does not necessarily imply that each wire center is a distinct relevant market. As I noted earlier, in general an efficient CLEC would not seek to enter only one particular wire center without also evaluating whether it would be more profitable (due to economies of scale or scope) to enter a broader group of wire centers that have comparable (but not necessarily exactly the same) costs and are economically related. Indeed, as I discussed, there may be cases where it would not be economic for an efficient CLEC to enter only one wire center *without* also (ultimately) entering others, due to the existence of certain joint and/or common costs that are relevant to providing service to multiple individual wire centers.

UNE Zones are intended to distinguish between “significant cost variations.” (FCC First Report and Order at ¶¶ 760, 765) The FCC also noted that the state commissions should consider separating zones with high and low UNE loop rates for purposes of assessing impairment. (TRO fn. 1538) Moreover, I also understand that this Commission has grouped wire centers that have similar cost characteristics into different UNE Zones. It follows that Dr. Bryant’s contention that “it is not possible [to] draw conclusions about one wire center from an analysis of another wire center” (Bryant Direct 30) is unsupported. In fact, the opposite is the case: it is reasonable for the purpose of defining a geographic market to draw inferences about the ability of an efficient CLEC to serve in one area of a UNE

1 Zone/CEA from observations of CLEC service in other areas of that UNE

2 Zone/CEA.

3

4 **Q. PLEASE COMMENT ON DR. BRYANT’S ASSERTION THAT IT IS LESS**
5 **COSTLY FOR A CLEC TO SERVE NEW CUSTOMERS IN A WIRE**
6 **CENTER WHERE THE CLEC ALREADY IS COLLOCATED THAN IT IS**
7 **TO SERVE NEW CUSTOMERS IN A WIRE CENTER WHERE THE CLEC**
8 **HAS NOT YET ESTABLISHED COLLOCATION. (BRYANT DIRECT 30)**

9

10 A. Even if this assertion is true, it is not necessarily directly relevant to market
11 definition. To understand this, consider the following observation. A publishing
12 firm may find that it is less costly (and more profitable) to sell cookbooks to
13 customers that already subscribe to the firm’s homeowner’s magazine than to new
14 customers (i.e., people to whom the firm currently sell no products). This may
15 occur for several reasons – e.g., the firm understands the tastes and needs of current
16 subscribers, the current subscribers have developed a level of trust in and/or a
17 preference for the firm’s products, and/or it is relatively less expensive to market
18 the cookbook to current subscribers (e.g., through an advertising insert that could
19 be included in the magazine at relatively low incremental cost). As a result, the
20 firm’s costs of sales may be lower (and the firm’s success rate as measured by sales
21 per contact higher) for its existing magazine subscribers than to new customers.
22 Nevertheless, this does not imply that new customers are in a separate relevant

1 market for cookbooks. A cost differential of the sort described by Dr. Bryant does
2 not, by itself, determine the extent of the market.

3
4 Indeed, a CLEC that has established collocation in one wire center could establish
5 collocation in a nearby wire center that has similar costs (e.g., the same loop rates)
6 and that shares a close economic relationship with the collocated wire center.

7 Moreover, by doing so the CLEC could increase its overall profitability by taking
8 advantage of scale and scope economies available from serving this wider area.

9 After all, collocation costs are not the only costs that are relevant to determining
10 market area.

11
12 As I noted, the competitive entry decision occurs at the *market* level (which
13 generally would span multiple wire centers) even if a particular CLEC may elect
14 not to enter a *particular* wire center (immediately or ever). The UNE Zone concept
15 helps ensure that network-related costs (e.g., the price of a loop), which are related
16 to supply-side substitutability, are comparable within any geographic market.

17 Using these zones in conjunction with CEAs to define geographic markets helps
18 ensure that these areas are relatively compact and share certain economic
19 characteristics.

20
21 **III. RESPONSE TO MR. GILLAN**
22

1 **Q. PLEASE DESCRIBE MR. GILLAN’S DEFINITION OF GEOGRAPHIC**
2 **MARKET.**

3

4 A. Mr. Gillan claims that he does not propose a geographic market definition. (Gillan
5 Direct 21) However, Mr. Gillan also contends that the Commission should define
6 its geographic area in a “manner that permits [the Commission] to recognize the
7 unique competitive signature of UNE-P, so that it may test other entry strategies to
8 see whether they could produce the same level of competitive choice.” (Gillan
9 Direct 29) In other words, Mr. Gillan contends that the geographic market,
10 however defined, should permit a competitive entry strategy that would replicate
11 the same geographic pattern of market penetration that has occurred for CLECs
12 with the use of UNE-P.

13

14 **Q. PLEASE COMMENT ON MR. GILLAN’S “COMPETITIVE SIGNATURE”**
15 **APPROACH TO MARKET DEFINITION. (GILLAN DIRECT 29)**

16

17 A. As discussed above, it is not proper as an economic matter to define markets
18 merely by evaluating the competitive entry strategies of individual firms. I will
19 also note that, in response to BellSouth Florida 1st Set of Interrogatories No. 1-09,
20 Mr. Gillan identified no treatises, articles or literature addressing the “competitive
21 signature” approach to market definition and specifically stated that his opinion
22 relied upon no such treatises, articles or literature.

1

2 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

3

4 **A. Yes, it does.**