COMMONWEALTH OF KENTUCKY
BEFORE THE PUBLIC SERVICE COMMISSION

In the Matter of:	)	
	)	
JOINT APPLICATION FOR APPROVAL	)	CASE NO. 2006-00136
OF THE INDIRECT TRANSFER OF	)	
CONTROL RELATING TO THE MERGER	)	FILED: JUNE 2, 2006
OF AT&T, INC. AND BELLSOUTH	)	
CORPORATION	)	

DIRECT TESTIMONY OF
JOSEPH GILLAN
ON BEHALF OF
NUVOX COMMUNICATIONS, INC.,
XSPEDIUS MANAGEMENT COMPANY SWITCHED SERVICES, LLC, AND
XSPEDIUS MANAGEMENT COMPANY OF LOUISVILLE, LLC

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I. Introduction

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-five years, I have provided testimony before more than 35 state commissions, five state legislatures, the Commerce Committee of the United States Senate, and the Federal/State Joint Board on Separations Reform. I have also been called to provide expert testimony before federal and state civil courts by clients as diverse as the trustees of a small competitive carrier in the Southeast to Qwest Communications. In addition, I have filed expert analysis with the Finance Ministry of the Cayman Islands and before the Canadian Radio-Telecommunications Commission.

I serve on the Advisory Council to New Mexico State University's Center for Regulation (since 1985) and serve as an instructor in their Principles of Regulation program taught twice annually in Albuquerque. In addition, I lecture at Michigan State University's Regulatory Studies Program. I have also been invited to lecture at the School of Laws at the University of London (England) on telecommunications policy and cost analysis in the United States. A complete listing of my qualifications, testimony and publications is provided in Exhibit JPG-1 (attached).

Q. On whose behalf are you testifying?

A. I am testifying on behalf of NuVox Communications, Inc., Xspedius Management Company Switched Services, LLC, and Xspedius Management Company of Louisville, LLC. These carriers provide business services in competition with the Joint Applicants in Kentucky.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to propose a number of important conditions needed before the proposed acquisition of BellSouth by the "new AT&T" can plausibly be found to be in the public interest, as required by KRS 278.020(6). Even with the conditions I recommend, however, the virtual recreation of the Bell System -- of which the BellSouth acquisition represents a near-final step[1] -- is unlikely to benefit anybody other than AT&T's shareholders. Nevertheless, as a pragmatist I understand that the outright denial of the acquisition is unlikely, and that it is more constructive to propose conditions that will mitigate (but not eliminate) some of the concerns presented by it.

As I explain in the testimony below, AT&T's proposed acquisition of BellSouth will extend to the Southeast (including Kentucky) the cumulative competitive harm of four prior mergers, including SBC's acquisition of Pacific Telesis,

[1] I recognize that, even after this acquisition, there will remain some components of the former Bell System that AT&T will not control, most importantly those components consolidated by Verizon. The former Bell System, with its 22 local operating companies, however, was arguably less concentrated (in practice) than the centralized management structure of the "new AT&T" (formerly known as SBC).

Southern New England Telephone, and, most especially, Ameritech and AT&T. The proposed acquisition of BellSouth will further concentrate the business marketplace, including the business market in Kentucky. Accepting as valid BellSouth's own estimates of competitive activity (at least for my purpose here), this acquisition will provide AT&T with a nearly 80% share of the Kentucky business market. In a market that would already be considered "highly concentrated" with a HHI of over 5000,[2] the proposed acquisition will increase the HHI by over 800 points. To place these numbers in perspective, the Department of Justice considers a market with an HHI of 1800 to be "highly concentrated" and, in such markets, any merger producing an increase in the HHI of more than 100 points would "likely to create or enhance market power or facilitate its exercise."[3]

Moreover, AT&T's acquisition of BellSouth directly contradicts the public interest analysis that AT&T (then SBC) put forward when it acquired Ameritech. In that proceeding, SBC fully understood the importance of establishing the largest possible footprint in order to leverage its competitive position in the market of multi-location business customers. The BellSouth acquisition furthers SBC's "national-local" ambitions – not by *competing* out of region, but by becoming the *incumbent* and transforming the Southeast into another of its in-

[2] The Herfindahl-Hirschman Index ("HHI") is a measure of market concentration used by (among others) the Federal Trade Commission and the Department of Justice as an aid to interpret market data.

[3] Merger Guidelines, Federal Trade Commission and United States Department of Justice, Revised April 8, 1997.

region markets. This acquisition will further entrench AT&T's position in the multi-location business market, effectively blocking any other carrier from achieving similar scale.

Finally, this acquisition will extend to the Southeast a critical resource imbalance between competitors and the incumbent that will make it even more difficult for the Commission to ensure that Kentucky's local markets become competitive. AT&T's decision that it would prefer to be the incumbent rather than continue to offer service in Kentucky as a CLEC, underscores just how difficult it is to compete in local markets. Significantly, the federal Act, with its reliance on arbitration and the private enforcement of wholesale obligations and contracts, requires some semblance of parity between the entrant and the incumbent. This acquisition will dramatically increase the resources available to BellSouth, to a point far beyond that of any competitor (either acting alone or through a coalition). The post-acquisition AT&T will enjoy annual revenues exceeding $100 *billion* dollars, derived from a broad array of wireline (4 RBOCs plus SNET), wireless (Cingular) and interexchange (AT&T) assets. Consequently, I have tried to identify conditions that address the concerns presented by the merger, but do so in ways that will lessen the Joint Applicants growing litigation advantage.

II. The Claimed Benefits of the Acquisition are an Illusion

Q. In reviewing the proposed acquisition of BellSouth by AT&T, should the Commission seek to learn from prior acquisitions that have brought AT&T to this point?

A. Yes. Although the Joint Applicants' point to SBC's acquisition of AT&T as the "closely analogous merger,"[4] I believe this acquisition is more similar to SBC's acquisition of other RBOCs, in particular its acquisition of Ameritech. Like the Ameritech acquisition, the BellSouth acquisition will expand SBC's footprint and incumbent advantages into another territory, thereby promoting its "national-local" ambitions in the multi-location business market. The competitive implications of this acquisition, however, are compounded by the additional advantages that SBC now enjoys after acquiring "old AT&T," which includes not only its long distance network, but its base of national businesses and local facilities.

[4] Kahan Direct at 15.

A. Lessons from the Ameritech Acquisition

Q. Why is it useful to consider the explanations that AT&T (then SBC)[5] offered when it acquired Ameritech?

A. There are several reasons why the Commission should review SBC's prior claims when it acquired Ameritech. The first is that comparing the company's explanations as to why prior mergers were in the public interest helps provide the Commission a benchmark to judge their credibility (and sincerity) in this proceeding. Second, it is useful to contrast SBC's characterization of what it takes to successfully compete in the enterprise market when it acquired Ameritech, to how it describes conditions in that market here.[6] Finally, it is worthwhile to consider the effectiveness of SBC's prior commitments, to determine whether vigorous Commission oversight will be needed as BellSouth is absorbed into this massive incumbent.

Q. What was the theory used by SBC to claim that its last RBOC acquisition was in the public interest?

[5] It is important to refer to these prior positions as belonging to SBC (and not AT&T) because AT&T was opposed to SBC's acquisition of Ameritech, noting presciently that it would likely be a pivotal step towards a two-RBOC future.

[6] The Joint Applicants offer no analysis of market conditions for enterprise customers in Kentucky, omitting any analysis which focuses on the loss of (either) AT&T as a competitor to BellSouth (or vice versa). See Application at 58.

A. When it last expanded its incumbent footprint through the purchase of Ameritech, SBC explained that the acquisition would spur competition in the Ameritech region through the process of retaliatory competition. This unusual theory, in which competition is *enhanced* by the incumbent becoming stronger and more dominant, was based on two, seemingly contradictory, claims. The first was that local entry against an incumbent RBOC required enormous financial strength and scale – strength and scale that neither Ameritech nor SBC individually enjoyed, but if joined together, would permit SBC to compete out-of-region. As then explained by SBC witness James Kahan:[7]

> One of the primary reasons for this change [the ability to pursue the National-Local Strategy] is that neither company [Ameritech or SBC] on its own has a sufficiently large customer base to follow outside of its region.[8]
>
> ***
>
> Neither SBC nor Ameritech currently has the scale, scope, resources, management and technical ability to implement the proposed national and global strategy on its own.[9]

The second part of SBC's "public interest" theory was once SBC entered out-of-region, the remaining large carriers would have no choice but to retaliate by competing with SBC within the (expanded) SBC territory:

[7] Mr. Kahan is reprising his role as the Joint Applicant witness that explains the public interest justification for the acquisition.

[8] Direct Testimony of James Kahan, SBC-Ameritech Exhibit 1.0, Illinois Commerce Commission Docket No. 98-0555 ("Kahan Illinois Direct") at 6-7.

[9] Description of Transaction, Public Interest Showing and Related Demonstrations, Federal Communications Commission Docket CC Docket No. 98-141 at 51.

> … the success of our National-Local strategy will, in our judgment, compel other carriers to compete even more aggressively with Ameritech and SBC in all of our states.
>
> As SBC successfully competes for these large business customers, as we will be able to do as a result of our strategy, carriers such as BellSouth, Bell Atlantic and U S WEST will be faced with a decision: do they simply lose these customers to a company that is better able to provide service to customers with multiple locations or do they compete for all those customers?[10]

Q. What are the critical conclusions to be drawn from SBC's prior testimony?

A. There are two aspects of Mr. Kahan's prior testimony that have immediate relevance to this proceeding. The first is that Mr. Kahan recognizes (or at least did) that there are large business customers that desire service across multiple locations.[11] As I explain in more detail in the following section of my testimony, this fact means that the larger the footprint served by a carrier – that is, the larger number of customer locations a carrier can package into a plan – the greater the advantage enjoyed by that carrier.

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[10] Direct Testimony of James Kahan, SBC-Ameritech Exhibit JSK, Indiana Utilities Regulatory Commission Cause No. 41255 ("Kahan Indiana Direct") at 40.

[11] The FCC summarized the importance of the multi-location customer to SBC in its Order approving (with substantial conditions) its acquisition of Ameritech as follows:

> The Applicants' rationale behind the National-Local Strategy is to follow large and mid-size in-region multi-location business customers of the combined firm out-of-region into markets around the country and globe where those businesses have satellite offices or plant facilities…. In this fashion, the Applicants hope to become an end-to-end provider of a full range of telecommunications services to large business customers with multiple locations. These customers would function as "anchor tenants," justifying the Applicants' entry into markets and facilitating the eventual deployment of voice and data services to small businesses and residential customers within those markets.

Order, Federal Communications Commission Docket CC Docket No. 98-141 ¶ 262.

Secondly, and more relevant to the point I am addressing here, the only carriers remotely sized to compete with SBC (even *before* it acquired AT&T), were the *other* RBOCs, including BellSouth. I will return to this point later in the testimony, but it is important to repeat here. To the extent that footprint matters – and I believe that it does, just as Mr. Kahan once testified that it did[12] – then the BellSouth acquisition will further *reduce* competition for large business customers in Kentucky by eliminating one of a very few carriers with a footprint remotely close to that of SBC (AT&T).

Q. Is it reasonable to assume that AT&T could stand idle in the Southeast, even if did not acquire BellSouth?

A. No, at least not if Mr. Kahan's prior testimony is to be believed:

> SBC and Ameritech recognized that they needed to be in a position to compete more effectively for large business customers around the country and to be able to withstand the competitive onslaught each faces in-region.[13]
>
> ***
>
> If SBC and Ameritech were simply to cede these [large business] customers to our integrated interexchange and CLEC competitors, we would quickly find ourselves operating with a shrinking base of large business customers which would result in very heavy upward

[12] SBC further emphasized this very point, arguing in the Ameritech acquisition that it was a virtual requirement in the multi-location business customer market to provide "near national" coverage (equating to 70-80% of customers' telecom needs). SBC/Ameritech Nov. 16 Reply Comments CC Docket No. 98-141 at 21.

[13] Kahan Indiana Direct, at 17.

> pressure on the cost of the network being borne by our remaining small business and residential customers.[14]
>
> ***
>
> ... SBC must develop the capability to compete for the business of large national and global customers both in-region and out-of-region. We cannot remain idle while our competitors capture the huge traffic volumes generated by a relatively small number of larger customers.[15]

Q. Has SBC followed through on its "National-Local" Strategy?

A. No, at least not in the way that it claimed that it would.[16] According to SBC (at the time of the Ameritech merger):

> … the National-Local Strategy is far more intensive and comprehensive than the standard CLEC business model. Whereas those companies tend to target a small and specific number of markets to enter, first through resale directed solely at large business, and then establishing facilities to serve those businesses only after building some market share, the National-Local Strategy will be a broadscale facilities-based strategy providing both business and residential service.[17]

The fact is that it is far simpler to buy incumbents than enter and compete. The BellSouth acquisition furthers SBC's "National-Local" ambitions, but not in the

[14] Kahan Rebuttal Testimony, SBC-Ameritech Exhibit 1.1, Illinois Commerce Commission Docket No. 98-0555 at 17-18.

[15] Affidavit of James Kahan, filed with the Federal Communications Commission CC Docket No. 98-141 ("Kahan Affidavit") ¶ 13.

[16] The FCC went so far as to actually require that SBC "enter" at least 30 markets, although it generally permitted SBC to choose which cities would satisfy the obligation. The FCC's definition of "entry" initially required that SBC install a switch, collocate in 10 offices, and serve three customers. Included among the candidate markets were Louisville, and the areas in Kentucky that are part of the Cincinnati Primary Metropolitan Statistical Area.

[17] Kahan Rebuttal SBC-Ameritech Exhibit 1.1, Illinois Commerce Commission Docket No. 98-0555 (Kahn Illinois Testimony) at 48.

way that it told the FCC and the affected state commissions that it would. The BellSouth acquisition expands AT&T's incumbent footprint to 9 more states, which encompass 17 additional major cities,[18] without having any need to learn the difficult skills of a CLEC.

Q. Please summarize the lessons this Commission should draw from SBC's prior testimony regarding the Ameritech acquisition.

A. I think there are three conclusions that it should draw. The first is that an important segment of the business market is comprised of customers with multiple locations. I will address the *significance* of that conclusion with respect to the competitive harms caused by this merger later in my testimony. What is important here is that this feature of the market was (at least once) readily *admitted* by AT&T, even though the Joint Applicants never explain the implication for multi-location business customers of the admission with respect to this merger.

Second, the fact that SBC never meaningfully pursued its National-Local Strategy is compelling evidence that barriers to entry in local markets are high and persistent, whether or not its regulatory witnesses believe that to be true. Even

[18] As part of its Merger Commitments to the FCC, SBC committed to entering 30 out-of-region cities out of 50 specifically identified by the FCC, including Louisville and Cincinnati (which would include parts of Northern Kentucky). The BellSouth acquisition covers 17 of those 50 listed markets.

after SBC *committed* to entering and competing against BellSouth as a condition of its acquisition of Ameritech, it still chooses to be the incumbent rather than the entrant.

Third, the Ameritech acquisition proves that that conditions need to be as self-effectuating as possible to be useful. Companies change their plans and their priorities, but the regulatory priority needs to endure to be effective. The public interest protections adopted as conditions to the Ameritech acquisition were intended to ensure that competition could succeed *despite* the presence of a larger incumbent. Unfortunately, the reality has been that SBC became stronger incumbent, and it will become stronger still through its acquisition of BellSouth. If the Kentucky Commission hopes to preserve competition, it must adopt conditions that will last.

B. The Claimed Benefits of the BellSouth Acquisition

Q. What are the principal "public interest" benefits of the BellSouth acquisition identified by the Joint Applicants?

A. The Joint Applicants claim that the proposed acquisition of BellSouth by AT&T will benefit Kentucky consumers in five ways. Specifically, the applicants claim that the merger will: (1) more quickly permit Cingular to offer "converged services," (2) facilitate video competition in Kentucky, (3) position BellSouth to

better serve government and respond to natural disasters, (4) permit the integration of BellSouth's local network with AT&T's backbone, and (5) bring customers innovations from AT&T Labs.[19] Notably absent from its list of public benefits is any suggestion that the merger will improve the typical Kentucky customer's *telephone* service, either through higher quality, greater choices or lower prices.

Q. Should the Commission place much weight on the Joint Applicants' claims regarding the effects of the merger on Cingular's wireless services and the potential that BellSouth may, someday, offer video services?

A. No. As a threshold point, even if the Joint Applicants' claims are true, is it really worth it to create a massive monopoly, controlled in San Antonio, merely to minimize the management headache of *coordinating* Cingular's activities, or to *possibly* build an entertainment network in Kentucky (to compete with cable, satellite and over-the-air broadcast stations)?

Moreover, these are unregulated markets, presumably where AT&T and BellSouth already confront strong commercial incentives to invest wisely and work to control costs. To the extent that AT&T's acquisition of BellSouth reduces its costs, why should the Commission expect such benefits to flow to Kentucky consumers, as opposed to the AT&T shareholder?

[19] Joint Application for Approval of Indirect Transfer of Control at 4.

Q. To the extent that the effect of the acquisition on Cingular is relevant, should the Commission conclude that the effect will benefit consumers in Kentucky?

A. No. According to AT&T witness Kahan, one of the reasons that Cingular "must be brought under unified ownership" is to reconcile potentially different priorities:

> While Cingular has been an extraordinary successful joint venture, the sharing of ownership and managerial control by two companies, each with potentially different priorities, has impeded its ability to react quickly to changes in marketplace conditions.[20]

While this may be a sound reason for AT&T to acquire BellSouth, why should the Kentucky Commission conclude that eliminating BellSouth's "potentially different priorities" is in the public interest of Kentucky consumers? To the extent that BellSouth had different priorities than San Antonio, wouldn't those priorities have been more closely aligned with those of its regional customers?

It is also useful to note that a primary source of the alleged benefit is to position Cingular to more easily offer converged wireless and wireline services,[21] even though the Joint Applicants simultaneously claim that wireless service is a competitor to its wireline services.[22] For the purposes of my testimony here, the Commission need not determine which of AT&T's conflicting claims is accurate

[20] Kahan Direct at 7.

[21] *Id*.

[22] *See*, for instance, Aron Direct at 18.

– that is, are wireless and wireline services converging or competing – because there is no serious claim that wireless service is playing a significant role in the business market (which is the focus of my testimony).[23]

Q. Should the Commission place *any* weight on the Joint Applicants' claim that the acquisition *might* lead to the deployment of video services in the BellSouth region?[24]

A. No. The Joint Applicants' claims regarding the effect of its merger on the potential development of its entertainment network (Project Lightspeed) is even more tangential to the public interest than its discussion about simplifying Cingular's management. The Joint Applicants point to AT&T's plan to deploy Project Lightspeed to 18 million homes by the end of 2008[25] to imply that it stands ready to expand the project more broadly. However, as Mr. Kahan indicates, AT&T already serves approximately 33 million households,[26] suggesting that its current plans only call for it to deploy Project Lightspeed to 50% of its subscribers. Which half of AT&T's existing customer base does Kentucky most closely resemble? The 50% of its customer base that AT&T plans

[23] This is not to say that I agree with Dr. Aron that wireless service is an effective competitor to wireline service in the mass market, as she claims. (Aron Direct at 19-23). Rather, my point is that not even the Joint Applicants appear to claim that wireless service is a significant competitor to wireline service for business customers, particularly the high speed digital services underlying the enterprise market.

[24] *See* Kahan Direct at 11-13.

[25] Joint Application at 37.

[26] Kahan Direct at 12.

on offering its entertainment service to, or the 50% that it does not? Even if the merger makes AT&T's entertainment plans more profitable, there is no reason for the Kentucky Commission to believe that these plans will benefit Kentucky consumers.

AT&T even goes so far as to claim that one of the "public interest" benefits of its acquisition of BellSouth is that it will provide it more negotiating leverage with programmers.[27] Is it reasonable to claim – as AT&T clearly does – that the Commission should sanction the virtual recreation of the Bell System so that AT&T can better negotiate with Disney?

I bring the Commission' attention to this point because it demonstrates just how far a-field the Joint Applicants must tread to find a public interest justification for this acquisition. There is little question that AT&T's acquisition of BellSouth furthers AT&T's private interests – it simplifies AT&T's national-local ambitions (by increasing its footprint without the bother of competitive entry), it eliminates the need to coordinate the management of Cingular, and it may even lower AT&T's video programming costs. But there is a difference between AT&T's *private* interest and the *public* interest, and AT&T's public interest testimony confuses the two.

[27] Kahan Direct at 13.

Q. AT&T also points to a number of advantages that are possible by integrating AT&T's backbone network with BellSouth's local network.[28] Are these claims (if accurate)[29] cause for concern?

A. Yes. The fundamental premise of the AT&T divestiture – a divestiture that is being effectively reversed, at least in the Southeast, through this acquisition – was that nondiscriminatory interconnection to the incumbent's local network was needed for competition to thrive. Yet here AT&T is willing to posit the exact *opposite* premise -- that is, that AT&T must enjoy an *exclusive* integration with the BellSouth network to compete in the future.

This proposition is absurd. The BellSouth local network is a unique asset that provides the connectivity to end-users that nearly all of its competitors require. It is this aspect of AT&T's testimony that should be most troubling to the Commission, for it clearly signals AT&T's belief and intention to integrate BellSouth's local network into its retail services through interconnection arrangements that it will deny its competitors. Consequently, the only way that this acquisition should be permitted to proceed is if it is accompanied by needed conditions to ensure that other providers can continue to compete with the "new

[28] *See* Joint Application at 51-52.

[29] For my purpose here, I accept as valid the Joint Applicant's claim that AT&T's backbone network is relevant in Kentucky. I direct the Commission to the Joint Applicants' Confidential Responses to the NuVox and Xspedius Data Requests 8 and 10, however, for potentially useful information concerning the accuracy of the claim.

AT&T," despite its massive size, broad footprint and inherited advantages of incumbency.

III. The Competitive Harm of the Proposed Acquisition

Q. Does your testimony analyze the full competitive effect of the proposed acquisition on all customer segments?

A. No. Because of the accelerated review period and limited resources of my clients, I have narrowly focused my analysis on the effect of the acquisition in the business market.[30] In addition, my testimony focuses on the consequences of the ever-increasing resource imbalance between incumbent and entrant that threatens to fully undermine the federal Act's reliance on the negotiation and arbitration process to open local markets by establishing viable wholesale offerings. This later harm will be experienced by any customer segment that depends on competitors having access to the BellSouth network to offer their service.

[30] My silence regarding the mass market should not be construed as agreement with AT&T that the market is vigorously competitive. (*See* Joint Application at 62). I note that this is a particularly odd claim from a carrier (legacy AT&T) that abandoned the competitive local market because entry barriers were too high.

A. The Effect of the Acquisition on Competition in the Business Market

Q. What is the effect of the proposed acquisition on competition in the business market?

A. The effect of this acquisition will be to further entrench BellSouth's dominance in the business market. This market is already highly concentrated, and adding AT&T's share to that of BellSouth will bring the incumbent share to nearly 80%.[31] In addition, given the importance of a carrier's geographic footprint to providing service to multi-location business customers, the acquisition will further enhance AT&T's national advantage by greatly expanding its footprint throughout important markets in the Southeast generally (and Kentucky specifically). I address each of these conclusions in more detail below.

Q. Have you calculated the HHI in the Kentucky business market, both before and after AT&T acquires BellSouth? [32]

[31] BellSouth routinely collects and reports to the Commission estimates of CLEC activity in Case No. 2003-00304. Although this information is public when it is filed with the Commission, BellSouth has not yet provided the most current (2006) data. As such, the analysis presented here is based on data that BellSouth has collected -- but has not yet filed -- and is currently claiming is highly confidential. The data is presented in Confidential Exhibit JPG-2 attached.

[32] The Herfindahl-Hirschman Index ("HHI") is a measure of market concentration used by (among others) the Federal Trade Commission and the Department of Justice. The HHI is calculated as the sum of the squares of the market shares of participants in a market, with the higher the resulting HHI, the greater degree of concentration.

A. Yes. Based on BellSouth' own estimate of CLEC activity,[33] the business market in Kentucky is already (prior to the acquisition) "highly concentrated" with a HHI of over 5000. To place this measure in perspective, the Department of Justice typically considers a market with an HHI of 1800 to be a "highly concentrated" market.

As shown in Confidential Exhibit JPG-2, the acquisition of BellSouth by AT&T will increase the HHI in this market by over 800 points. The Department of Justice considers that a merger that produces an increase in the HHI of more than 100 points in a highly concentrated market is "likely to create or enhance market power or facilitate its exercise."[34]

Q. Does the proposed acquisition produce even greater competitive harm for customers with multiple locations?

A. Yes. I explained earlier how candid AT&T (then SBC) had been concerning the advantages that a large geographic footprint provided when offering service to

[33] I would note that the evidence suggests that BellSouth routinely overestimates the number of lines served by CLECs. A comparison of BellSouth's August filings in Case No. 2003-00304 to comparable months in the FCC's Local Competition Report for the past several years (June 2003 through June 2005) indicates that BellSouth has, on average, claimed that there were approximately 43% more CLEC lines in its service territory in Kentucky than have been reported to the FCC for the entire state. Although BellSouth's most recent estimate (June 2005) is closer to the Kentucky statewide total reported by the FCC, the systematic bias in BellSouth's estimate suggests that it significantly overestimates the level of CLEC competition in its markets.

[34] Merger Guidelines, Federal Trade Commission and United States Department of Justice, Revised April 8, 1997.

customers with multiple locations in the context of its Ameritech acquisition. The BellSouth acquisition furthers its same national-local ambitions, but through the more profitable avenue of acquiring an another incumbent (rather than competing as an entrant).

Although AT&T acknowledges the advantage,[35] it fails (as one would expect) to address its implication. AT&T is clearly establishing a national footprint unmatched by any other carrier. The number of business lines served by each incumbent provides a useful measure of the relative proportion of the business market that resides within the in-region footprint of the various incumbents.[36] As Table 1 indicates, AT&T already enjoys a scale advantage against the other RBOCs (less so in comparison to Verizon), and an even greater advantage in comparison to its much smaller competitive rivals. Post merger, AT&T's incumbent footprint will include nearly 50% of the nation's business market – a much broader geographic footprint than any other carrier can hope to achieve.

Table 1: Distribution of Business Lines

Service Territory	Share
BellSouth	13.1%
AT&T	35.1%
Verizon	31.7%
Qwest	8.6%
Other ILECs	11.6%

[35] See, for instance, Rice Direct at 5.

[36] Source: ARMIS 43-08 (2005).

Q. If AT&T can offer multi-location customers packages that include nearly 50% of the customer's locations "on-net," how will other carriers be able to compete?

A. There is no question that the incumbent's network is far vaster than any competitive entrant can hope to construct. The only way that meaningful competition can succeed against a carrier (such as the post-acquisition AT&T) with a ubiquitous local network is if the entrant is able to use that network to provision service to its customers as well. This, in effect, was the hope of the federal Act – that by requiring the incumbent to grant its entrants nondiscriminatory access to the local network, the inherited advantages of incumbency would no longer present an insurmountable barrier to entry. I address the importance of protecting this basic promise of the federal Act in the following section of my testimony.

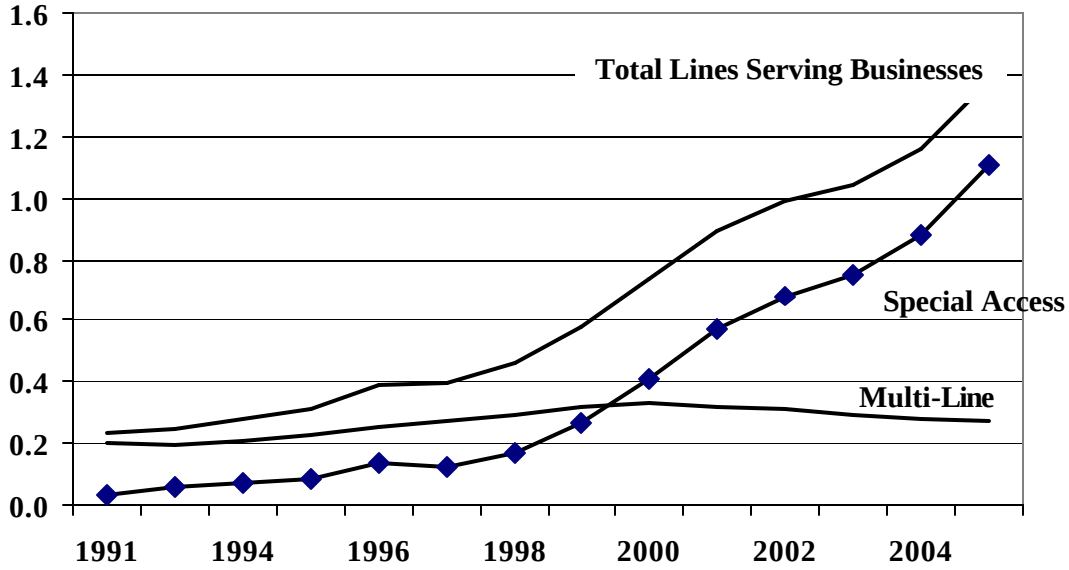
Q. Dr. Aron suggests that the BellSouth's business market is in significant decline?[37] Do you agree?

A. No. Dr. Aron's conclusion is based on the fact that she limited her analysis to switched business lines, without considering the fact that the driver of most demand in the business market is for non-switched lines (which BellSouth records as "special access" lines). In 2000, the number of special access lines eclipsed

[37] Aron Direct at 30.

the number of multi-line business lines[38] and, as shown in the graphic below, are continuing to fuel rapid growth in the number of lines being provided by BellSouth in Kentucky.

The Growth of Business Lines: Special Access and Multi-line Business Lines



As the above chart demonstrates, when *all* types of lines used to serve business customers are included in the analysis, BellSouth's line growth is continuing.

B. The Competitive Harm of the Accelerating Resource Imbalance

Q. How does the proposed acquisition of BellSouth by AT&T threaten the federal Act's mandate that local network facilities be available to competitors?

[38] Source: ARMIS 43-08. Multi-line business lines excluding lines used to provide payphone service

A. A basic goal of the federal Act (as noted by the Supreme Court) was "to reorganize markets by rendering … monopolies vulnerable to interlopers," giving "aspiring competitors every possible incentive to enter local retail telephone markets."[39] The federal Act did more than attempt to reorganize the local market, however, it also effected a subtle shift in the regulatory role of government. For all practical purposes, the Act *privatized* responsibility for the regulation of the RBOCs' wholesale services with their competitive customers, relying on the competitive entrants to arbitrate and enforce their rights. The concentration of incumbent resources into a single firm, as well as the elimination of AT&T as a competitor (a condition that this acquisition would extend to the Southeast), challenges the prerequisite condition for the "privatization of wholesale regulation" to work – specifically, that a reasonable resource balance exist between entrants and incumbents so that the of negotiation and arbitration process could produce just and reasonable wholesale arrangements.

Q. What do you mean by the idea that the Act "privatized" the wholesale regulation of incumbents, including BellSouth?

A. Prior to passage of the federal Act, state regulation was focused at the *retail* level, with an emphasis on retail prices and quality of service. The principal resources

[39] *Verizon Communications, Inc. v. FCC*, 535 U.S. 467, 152 L. Ed. 2d 701, 122 S. Ct. 1646 (2002).

used to police RBOC behavior were publicly funded, through agencies such as the Kentucky Public Service Commission. As regulation moved from traditional rate-base/rate-of-return approaches to more flexible forms of price regulation, these publicly-funded resources continued to monitor earnings, service quality and other issues important to retail regulation.

The federal Act, however, shifted the focus of regulation from the *retail* level, where competition was expected to take root, to the *wholesale* level beneath it.[40] The wholesale tools adopted by Congress were comprehensive – resale of the incumbent's services,[41] access to network elements at cost based rates,[42] and, for RBOCs wanting to offer long distance services in-region, the added insurance of the competitive checklist.

In addition to its shifting of regulatory emphasis from the retail to wholesale levels, however, the Act also shifted the principal responsibility for regulatory effort from the public sector to the private sector. In the wholesale scheme created by the Act, the primary activities of wholesale regulation – i.e., the creation of open cost models, the development of performance penalty plans, the

[40] The Supreme Court recognized that the goal of the federal Act was competition at the retail level, noting in *Verizon* that the Act had been "…designed to give aspiring competitors every possible incentive to enter local retail telephone markets, short of confiscating the incumbent's property." (emphasis added). The path to retail competition chosen by the Act was regulation at the wholesale level, requiring incumbents to open their network under legal mandate and regulatory supervision.

[41] *See* §251(c)(4).

[42] *See* §251(c)(3).

litigation needed to establish and enforce access rights, as well as the monitoring of wholesale offerings – are substantively managed by competitors.[43] Certainly, the Commission must expend considerable effort *evaluating* the respective claims of BellSouth and its entrant-competitors, but the adjudicatory role so central to the Act's implementation depends, in the first instance, upon the creative tension between entrant and incumbent, and the private resources committed to the regulatory process by both.

Q. When the Act was enacted in 1996, did Congress have reason to believe that both sides had the requisite resources needed for the negotiation and arbitration process between entrant and incumbent to produce just and reasonable outcomes?

A. Yes. When Congress decided to rely on the negotiation/arbitration process as the mechanism to create viable wholesale offerings, a reasonable resource balance existed between the monopoly and competitive sectors of the industry.

[43] There is no question that the Commission devotes substantial resources to fulfilling its duties under the federal Act. My point is that the Commission's role adjudicating disputes between entrants and BellSouth is much different than its prior role as direct regulator of BellSouth's retail activities.

Table 2: Incumbent-Competitor Resource Balance When Act Passed[44] (1995 $ millions)

Incumbent LEC Sector		Competitive Sector[45]	
Company	**Revenues**	**Company**	**Revenues**
GTE	$19,957	AT&T	$79,609
BellSouth	$17,886	MCI	$15,265
Bell Atlantic	$13,430	WorldCom	$3,639
Ameritech	$13,427		
NYNEX	$13,407		
SBC	$12,670		
US West	$9,284		
Pacific Telesis	$9,042		
Total	**$109,103**	**Total**	**$98,699**

As the above table shows, at the time Congress was crafting the federal Act, resources were roughly balanced between the monopoly and competitive sectors. The largest expected local entrants were established interexchange carriers,[46] well financed and (at least presumably) positioned to become effective local competitors. The single largest carrier was AT&T, which at the time included the resources of NCR and (what would ultimately become) Lucent. The regulatory model adopted by Congress, with its heavy reliance on bilateral negotiation and arbitration, reflected the relative resource balance that existed at the time.

[44] Source: 1995 10K Reports.

[45] In addition to these large competitors, there were a handful of much smaller entrants with comparatively modest revenues and numbers of employees.

[46] A fourth interexchange carrier (Sprint) was also an incumbent LEC and has not been included in the above table as either a member of the competitive or monopoly sectors of the industry.

Q. What will the resource imbalance look like if AT&T is permitted to acquire BellSouth?

A. There is no question that BellSouth is already larger than its (much smaller) regional competitors. The AT&T acquisition not only creates a massively larger incumbent, but it also ends any hope that AT&T will again champion pro-entry policies. Collectively, the acquisition will further accelerate the resource imbalance between ILECs and CLECs, threatening the very core of the federal Act. AT&T's national resource advantage will swamp the limited resources needed to arbitrate reasonable wholesale arrangements on plausibly equal terms.

Table 3: Incumbent-Competitor Resource Balance Post-BellSouth Acquisition[47] (2004 $ millions)

Incumbent LEC Sector		**Competitive Sector**	
Company	**Revenues**	**Company**	**Revenues**
AT&T	$118,095	Level 3	$3,712
Verizon	$91,973	XO	$1,300
Qwest	$13,809	McLeod	$716
		Broadwing	$672
		Time Warner	$653
		ITC^DeltaCom	$583
		Talk	$471
		Covad	$429
		US LEC	$356
		NuVox	$314
		Trinsic	$251
		Xspedius	$215
		Eschelon	$158
		PacWest	$124
Total	**$223,877**	**Total**	**$9,955**

[47] Source: 2004 10K Reports.

As the above table shows, the "newest AT&T" created by the acquisition of BellSouth will be two orders of magnitude larger than the largest national CLEC (XO), and nearly three orders of magnitude larger than its largest regional competitor (ITC DeltaCom). The creation of a resource imbalance on this scale cannot be ignored. Before the Commission approves this acquisition, it must adopt parallel reforms that ensure that competitors will maintain stable and predictable access to the BellSouth network under reasonable terms and prices, and which eliminate as many points of leverage (*i.e.*, points where AT&T can exploit its resource advantage) as possible.

IV. Proposed Mitigating Conditions

Q. What are the principal objectives of the conditions that you are proposing?

A. As I indicated above, the proposed acquisition of BellSouth by AT&T creates two general areas of concern. The first is that the acquisition will entrench AT&T with a market presence and network footprint that no other entrant can hope to match. The only viable path to ensuring that competition in the business market can continue is for the Commission to make sure that CLECs retain stable and predictable access to existing network, so that other carriers can (at least to some extent) offer service across a comparable footprint.[48]

[48] The Commission should be aware that other policies are vital for CLECs to be able to commercially offer service across as broad a footprint as possible. Such policies specifically

The need to assure stable access to the local network, however, directly brings me to the second general concern I identify above, specifically the dramatic resource imbalance that threatens to undermine the negotiation/arbitration process presently relied upon to establish the terms of wholesale arrangements. What is needed is a more *efficient* system that relies less on litigation, but can still be expected to produce reasonable and stable prices. One reform I propose involves the application of a proven idea to a new area – namely that the prices for BellSouth's wholesale offerings be governed under an incentive framework (i.e., price caps), much in the same way that its retail and access offerings have been regulated in the past.

The application of price caps in this context makes logical sense. In addition to greatly simplifying the wholesale regulation of BellSouth, price caps are a recognized transitional path to a competitive market. As alternatives to BellSouth's network slowly emerge, the price cap mechanism balances flexibility with non-intrusive oversight and is well-suited to markets in transition. As the FCC has explained, "…price caps act as a transitional regulatory scheme until the advent of actual competition makes price cap regulation unnecessary."[49]

include the establishment of just and reasonable §271 rates for network elements, and holding BellSouth to its commingling obligation so that EELs and other combinations of §271 and §251 network elements are available. Because these issues are already before the Commission in Case No.2004-00427, I have not repeated my arguments here.

[49] *Special Access NPRM,* Federal Communications Commission, WC Docket No. 05-25, January 31, 2005, ¶11.

In addition, I propose strengthening BellSouth's §271 performance plan, eliminating the overhang of intrusive audits associated with EEL-availability rules that have long been eliminated (and which, when adopted, where intended to protect BellSouth from long distance carriers like its soon-to-be parent, AT&T), and recommend that a fresh-look window be provided to customers of BellSouth/AT&T. Finally, I will discuss why the Commission should require that BellSouth agree to permit the Commission to enforce the terms of any additional conditions that the FCC may adopt.

A. Applying Price Caps to UNEs

Q. What are the two basic areas that the Commission must address in order to establish a price-regulation plan to govern BellSouth's UNE rates?[50]

A. The advantage of a price cap system is that it can be used to avoid protracted litigation over cost studies. The two basic steps to establishing a price cap plan are: (1) deciding the initial rates that should be used to initialize the plan, and (2) adopting the price-adjusting parameters that would limit BellSouth's UNE prices in the future. Obviously, the initial rates are simple to adopt – the existing UNE rates should be used to initialize the plan.

[50] Although I have focused this section of my testimony on standard UNE rates, a price cap system could also be used to regulate §271 prices for delisted UNEs (once the initial just and reasonable rates are established).

The basic parameters that would govern future prices are the applicable inflation rate (which permits gradually increasing price levels to compensate for inflation) and the productivity factor (that reduces prices based on expected productivity improvements). Together these factors ensure that the nexus between initial prices and costs is maintained. In addition, the Commission must determine how to apply these indices to prices themselves, and whether to group certain services together in baskets to provide some degree of flexibility.

Q. What general approach do you recommend that the Commission use to establish measures of inflation and productivity?

A. As a general matter, I recommend that the Commission adopt the basic parameters that the FCC has adopted with respect to access services. These are the Gross Domestic Product Price Index (GDP-PI) for inflation and a productivity factor of 5.3%. The facilities used to provide access services – *i.e.*, local loops, switching and transport – are the same facilities that BellSouth uses to provide wholesale network elements. Consequently, the same rationale that supports applying these factors to BellSouth's access services can be used to govern changes in network elements prices.

Adopting the appropriate productivity factor (sometimes called the X-factor) is somewhat more complicated. This is because the FCC, in 2000, temporarily

supplanted its formal price regulation system with an industry-negotiated plan sponsored by the CALLS Coalition.[51] In that negotiated plan, there was no productivity factor *per se*, but rather a negotiated schedule of reductions to move rates lower.[52]

The CALLS plan is expiring and, as a result, the FCC has begun a review as to how to structure a replacement. Because of the increasing importance of special access services, the FCC is focusing on the post-CALLS regulation of that service.[53] In the Special Access NPRM, the FCC must confront the same issue as is being raised here – how to efficiently adopt a productivity factor without the need for protracted proceedings.

> Given the complexities of the proceeding we initiate in this NPRM, there is a strong likelihood this proceeding will not be completed prior to July 1, 2005. This record contains substantial evidence suggesting that productivity has increased and continues to increase …. Under the CALLS plan, however, there is currently no productivity factor in place to require price cap LECs to share any of their productivity gains with end users…. One interim option would be to impose the last productivity factor, 5.3 percent, that was adopted by the Commission and judicially upheld.[54]

[51] *CALLS Order*, 15 FCC Rcd 12962.

[52] *Id.*, 15 FCC Rcd at 13028, para. 160.

[53] The second broad category of interstate access services is "switched access." The FCC is separately reviewing those policies as part of a comprehensive review of intercarrier compensation. *See Developing a Unified Intercarrier Compensation Regime*, CC Docket No. 01-92, Notice of Proposed Rulemaking, 16 FCC Rcd 9610 (2001) (*Intercarrier Compensation NPRM*).

[54] *Special Access NRPM*, Federal Communications Commission, WC Docket No. 05-25, January 31, 2005. ¶131.

Based on this discussion, I recommend that the Commission adopt an initial productivity factor of 5.3% and revisit the productivity issue at the conclusion of the FCC's investigation. This appears to be the most reasonable middle-ground between adopting a plan with no productivity factor (which would ensure inflated wholesale rates) or the alternative of this Commission conducting an extensive investigation into productivity that would parallel the FCC addressing the same issue. By adopting the 5.3% productivity factor on an interim basis (which was the productivity factor used by the FCC until it agreed to implement, on a temporary basis, the negotiated CALLS plan), the Commission could wait until the FCC adopts a final order in the Special Access proceeding.

Q. Do you believe that a price-cap plan can be used to ensure that UNE rates remain complaint with the FCC's TELRIC rules?

A. Yes. It is important to note that while the FCC's rules require that prices satisfy the TELRIC standard, the rules do not detail any particular approach to maintaining that relationship over time. The FCC has consistently held that a price cap system can assure that rates maintain the appropriate nexus to cost. For instance, when the FCC first embraced price regulation as a regulatory system,[55] it confronted this very question, concluding unequivocally that a price cap system can be designed to ensure cost-based price changes:

[55] *Report and Order and Second Further Notice of Proposed Rulemaking*, Federal Communications Commission, CC Docket No. 87-313, April 17, 1989 ("First Price Cap Order").

> We proposed to adjust price caps each year according to a predetermined formula that is designed to ensure a continuing nexus between tariffed rates and the underlying cost of providing service.[56]
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> ***
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> A carrier's services are grouped together in accordance with common characteristics, and the weighted prices in each group are adjusted annually pursuant to formulas designed to ensure that rates are based on cost …[57]
>
> ***
>
> … the foundation of the price cap regulatory approach is to ensure that rates follow costs, while creating incentives to reduce costs…[58]

The FCC's conclusion with respect to the ongoing nexus between rates and costs is particularly important because it means that TELRIC-based rate relationships may be maintained by a price cap plan similar to the federal plan.

Q. Why do you say that TELRIC-based rates could be maintained by adopting a price cap plan that is similar to the federal price cap plan?

A. The basic role of the price regulation formula (i.e., an inflation rate reduced by expected productivity) is to act as a proxy for changes in current costs. Because the formula is intended to proxy for changes in current costs, it should closely track the results of TELRIC studies changed to consider new input prices. If a price regulation plan reasonably tracks gains in the productivity of current

[56] *First Price Cap Order*, ¶ 8.

[57] *First Price Cap Order*, ¶ 38.

[58] *First Price Cap Order*, ¶ 865.

technology, then that formula would maintain a reasonable nexus between prices and TELRIC, which is based on the current cost of the most efficient technology.

Q. Is there anything in existing federal rules that would prohibit the Commission from designing a price cap framework to govern future changes in §251 rates?

A. No, there is not. First, federal rules are silent as to how changes in TELRIC-based rates should be reviewed. There are no rules concerning how frequently such rates should be adjusted, or whether an automatic formula may apply.[59] To the contrary, the FCC recognizes that the timing of full UNE cost proceedings is within the state's discretion, and has requested comment on whether the FCC itself should mandate a price-cap system. In the Special Access NRPM, the FCC specifically asked:

> If the use of productivity factors to adjust rates periodically is feasible, should it be mandatory? Or should states retain the ability to conduct a full UNE-pricing proceeding at their discretion? [60]

Given the FCC's extensive history finding that price-regulation formulas *maintain* the appropriate nexus between costs and prices, it would be counter to precedent

[59] The FCC requested comment on whether the FCC itself should adopt a price-regulation framework in 1996 (in the context of its original Interconnection Order) and concluded that no such rules were needed at the federal level. *First Report and Order, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996*, Federal Communications Commission, CC Docket 96-98, August 8, 1996, (*"Local Interconnection Order"*), ¶ 838.

[60] *Notice of Proposed Rulemaking*, Federal Communications Commission, WC Docket No. 03-173, September 15, 2003, (*"TELRIC NPRM"*), ¶ 140, emphasis added.

to expect it would suddenly reverse course and conclude that such formulas cannot be used. Moreover, as the above indicates, to the extent the FCC has expressed interest in a price-regulation framework, it has been to query whether such a system should be made *mandatory*, not to suggest that a state-developed system would run afoul of federal rules. As the above citation makes clear, the FCC recognizes that under its existing rules, states have complete discretion as to when to conduct a full UNE-pricing proceeding.

Q. How do you recommend the annual change in the price cap index be applied to specific rates?

A. I recommend that any change in the price cap index (PCI) be applied uniformly across all rate elements.[61] This approach would ensure a very tight nexus between costs and the rates for §251 network elements, consistent with federal rules.

Q. Should the PCI be applied to each rate element within each basket?

A. No. In keeping with the view that price cap regulation provides a transitional path to a less regulated environment, I recommend that some flexibility be provided to BellSouth. Specifically, while the overall price level of each sub-basket would be limited by the PCI, I do recommend that BellSouth be granted some flexibility to

[61] That is, if the PCI requires a reduction of 2%, then each rate element should be reduced by 2%.

change individual rate elements. Because this is the initial application of a price cap framework to wholesale services, I recommend that no individual rate element should be permitted to increase more than 10% per year.

Q. How frequently should BellSouth be permitted to adjust prices in compliance with the price cap plan?

A. I recommend that an annual filing procedure be established that is keyed to BellSouth's filing of ARMIS business line data. Whether high-capacity loops and/or transport are offered under §251 or §271 of the Act is determined by a wire center's "tier assignment" as detailed in the TRRO. Thus, in order to determine the split of annual network element demand between §251 and §271 arrangements requires that any potential change in tier assignment be made a part of the price cap filing process. Because one of the parameters used to assign wire centers to their various tiers are the number of business lines reported in ARMIS 43-08,[62] I recommend that BellSouth's annual price cap filing occur at that time (April 1st of each year).

[62] The other parameters used to assign wire centers to the tiers adopted by the TRRO are UNE Loop volumes and the number of fiber based collocators.

B. Strengthening the §271 Performance Plan

Q. Are there other changes that the Commission should make to the UNE regime as a condition of this acquisition?

A. Yes. The price cap plan described above is intended to replace cost studies with a formula that avoids case-by-case litigation. A similar concept underlies the §271 performance/penalty plans that are intended to provide a deterministic set of penalties to assure compliance with certain minimum standards. To ensure that this plan operates as intended, I recommend that:

* All penalty payments be increased in proportion to the increase in Kentucky revenue (i.e., revenues earned in Kentucky) by the combined BellSouth/AT&T. As BellSouth grows larger, the incentive provided by these penalties diminish in relation to its greater revenues. This adjustment would assure that the existing penalties remain proportional.

* AT&T/BellSouth should be required to have the performance plan independently audited by an auditor selected by the Commission every three years. "Privatizing" this function in the much smaller CLEC community is no longer appropriate, given the dramatic resource imbalance discussed above. As such, the more traditional regulatory method of periodic audit should be instituted to ensure that BellSouth operates the plan correctly.

* The Commission should make clear that the Kentucky §271 performance plan is a stand-alone obligation, unrelated to performance plans in other states. I have been informed that BellSouth has, in the past, used "overpayments" in some states to reduce its obligations in others. The Commission should make clear that underperformance in Kentucky cannot be offset by BellSouth's obligations in another state – when BellSouth violates its performance requirements in Kentucky, it should appropriately pay under the terms of the Kentucky plan.

C. The Pre-TRO EELs Standards Should Be Permanently Retired

Q. Are there other actions the Commission can take to diminish the litigation-advantage enjoyed by BellSouth?

A. Yes. As the FCC implemented the UNE regime, it recognized the possibility that interexchange carriers (such as the old AT&T) could use high capacity loop and transport UNE combinations (EELs) in place of the special access services that had been used to connect to large users. Because the FCC was concerned that these interexchange carriers could engage in "regulatory arbitrage" by obtaining UNEs to provide long distance services (instead of the local services for which they were intended), the FCC adopted rules to ensure that EELs were not used in this manner.

The FCC's initial attempt to "wall off" the use of UNEs by interexchange carriers like AT&T was through a requirement that the carrier may only use UNEs if they provided "a significant amount of local exchange service" to the customer. The

FCC attempted to provide guidance by adopting certain "safe harbors" that carriers could use to demonstrate sufficient local usage.[63] In the *TRO* (adopted over 3 years ago), however, the FCC abandoned this approach, recognizing that CLECs had submitted "evidence that that the safe harbors and auditing procedures have proved to be unworkable and susceptible to abuse by the incumbent LECs."[64]

Q. If the FCC eliminated the "safe harbor" approach 3 years ago, why is it relevant to this proceeding?

A. The reason is that BellSouth is continuing to press for audits under the pre-TRO regime, which is giving rise (and will give rise) to continuing litigation. I recommend that the Commission put an end to this dispute for three simple reasons.

First, the entire "EEL qualification" regime was adopted to protect BellSouth from an interexchange carrier using "the incumbent's network without paying their assigned share of the incumbent's costs normally recovered through access charges."[65] It is fundamentally anachronistic for BellSouth to try and hold onto a

[63] *In the Matter of Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Supplemental Order Clarification*, 15 FCC Rcd. 9587 (2000), ("*SOC"*), *pet. for review denied, CompTel v. FCC*, 309 F.3d 8 (2002).

[64] *TRO* ¶ 5.

[65] Supplemental Order Clarification, Federal Communications Commission CC Docket 96-98, June 2, 2000, ¶ 2.

system designed to protect BellSouth from AT&T, even as AT&T is buying BellSouth.

Second, the EELs provisions that BellSouth is seeking to apply were abandoned by the FCC (and rightly so) in February 2003, more than three years ago. The pervasive theme of the Joint Applicant's testimony is that the Commission should recreate the Bell System because "things have changed." While I would disagree that markets have changed as fundamentally as the Joint Applicants assert, if this acquisition is approved, they have certainly changed enough for BellSouth to start afresh under the new architectural safeguards of the *TRO* and move on from there.[66]

Third, it is my understanding that AT&T (formerly SBC) has not attempted to conduct audits under the safe harbor provisions reported by any CLECs operating in its region. If BellSouth's own soon-to-be parent has not engaged in this behavior, then shouldn't BellSouth conform its practice to this standard as well?

In summary, the safe harbor EEL requirements have outlived their usefulness (to the extent the requirements were useful to begin with); the *TRO* abandoned the approach more than four years ago because it was unworkable; and BellSouth's approach is apparently inconsistent with that of its proposed owner. There is

[66] It is useful to note that the FCC continues to protect RBOC special access revenues from interexchange carriers, even as the interexchange carriers themselves are absorbed into RBOCs.

nothing to be gained by allowing this source of disagreement to continue. BellSouth should terminate all efforts to audit the abandoned safe-harbor provisions and simply move forward with the architectural safeguards adopted in the *TRO.*

D. Fresh Look

Q. What "fresh look" requirement is appropriate as a condition on this acquisition?

A. A number of customers in Kentucky may have chosen BellSouth or AT&T because they were simply uninterested in obtaining service from the other. This acquisition effectively reverses that choice, causing customers that have left BellSouth for AT&T (or the reverse) to be repatriated without choice. While some (perhaps many) of these customers may, when given the opportunity, decide to stay with the post-acquisition provider, they should at least be given the opportunity to vote again with their feet. Accordingly, the Commission should give all such customers relief from tariffed or contractual termination penalties and a one-year window to choose a new provider.

E. The State-Enforcement of Federal Conditions

Q. What is the final condition that you recommend be placed on any approval of the proposed acquisition?

A. The past decade experience under the federal Act has shown that the States are best positioned to oversee and implement the detail requirements of even federally-adopted policies. To the extent that the FCC ultimately approves this acquisition with conditions that protect and advance competition, it is important that CLECs have access to an efficient forum to address any disputes that arise under those conditions. Because state commissions are better positioned for dispute resolution -- particularly the resolution of any dispute that raises factual issues -- I recommend that this Commission require the Joint Applicants to agree that the Commission may enforce conditions adopted by the FCC.[67]

Q. Does this conclude your testimony?

A. Yes.

[67] Of course, some conditions may not be amenable to state resolution. But the Commission would be better served by a process whereby BellSouth raised such an argument as a defense against Commission action on a particular condition, rather than using the question of Commission authority as a shield against its oversight.