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BELLSOUTH TELECOMMUNICATIONS, INC.

REBUTTAL TESTIMONY OF WALTER S. REID

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 960846-TP

SEPTEMBER 16, 1996

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

A. My name is Walter S. Reid and my business address is 675 West Peachtree Street N. E., Atlanta, Georgia. My position is Senior Director for the Finance Department of BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth" or "the Company").

Q. ARE YOU THE SAME WALTER S. REID WHO FILED DIRECT TESTIMONY IN THIS DOCKET?

A. Yes. I filed direct testimony in this docket on behalf of BellSouth on September 9, 1996.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the positions taken in the direct testimony of MCI witness Mr. Don Price related to the issue concerning the appropriate wholesale rate for BellSouth to sell its services to MCI for resale. My testimony specifically identifies areas of overstatement in the MCI methodology for calculating a wholesale discount rate for BellSouth in Florida. My direct testimony in this docket supports wholesale discount rates for BellSouth of 19% for residential services and 12.2% for business services. I also provided the Commission in my direct testimony with a priceout using the FCC's criteria for an avoided cost study that resulted in a single wholesale discount rate of 19.7%. The Company believes that the FCC's criteria for an avoided cost study results in an overstated wholesale discount rate. Therefore, the 19.7% rate which I provided on my Exhibit WSR-3 is itself overstated. Mr. Price's testimony proposes a wholesale discount rate of 25.38% for all retail services. In this rebuttal testimony, I will explain how MCI's approach incorrectly treats certain expense amounts and leads to this overstated result.

Q. DOES MR. PRICE PROVIDE THE CALCULATION OF MCI'S PROPOSED WHOLESALE DISCOUNT RATE FOR BELLSOUTH-FLORIDA IN HIS DIRECT TESTIMONY?

A. No. Mr. Price provided a description of MCI's methodology in his testimony, but he only provided detailed calculations for Bell Atlantic - DC (as an example of MCI's spreadsheet model) in his testimony. Unfortunately, he must have inadvertently left out the second sheet of the spreadsheet model, because it is incomplete in his testimony as filed in Florida.

Q. WERE YOU ABLE TO RECONSTRUCT THE ACTUAL CALCULATIONS THAT MCI FOLLOWED IN DERIVING ITS PROPOSED WHOLESALE DISCOUNT RATE?

A. Yes. I obtained a complete copy of the MCI spreadsheet model which Mr. Price filed in another jurisdiction. Using this spreadsheet format and specific BellSouth-Florida ARMIS data for 1995, I was able to compute the wholesale discount rate of 25.06%, which Mr. Price reports on his Exhibit DGP-3 for 1995. I did not recompute the years 1991 through 1994 which he also reports on his exhibit. I have included my reconstruction of the MCI spreadsheet model as my Exhibit WSR-4 to this testimony. On this exhibit, I have reorganized the MCI calculations into direct avoided, indirect avoided, and not avoided categories so that the results can be more easily compared to the cost studies I have filed. In this rebuttal testimony, I will refer to Exhibit WSR-4 to identify the magnitude of certain MCI overstatements.

Q. PLEASE DESCRIBE EXHIBIT WSR-4.

A. Exhibit WSR-4 is structured to display the formulas used by MCI in its spreadsheet model to calculate a wholesale discount factor. I formatted the display of the data in a manner similar to the format I used for Exhibit WSR-3 which was attached to my direct testimony. The first column of Exhibit WSR-4 reports the line number on BellSouth's 1995 ARMIS Report 43-04, from which the intrastate expense amounts shown in column 3 were obtained. Column 2 reports the type of expense which is included on the particular line in the analysis and the account numbers associated with the expense. The expenses are grouped into categories representing those that are direct avoided, indirect avoided, and not avoided. These groupings correspond to the treatment that MCI accorded the expense in its Model and to the FCC criteria for avoided cost studies. Column 4 of the exhibit reports the percentage of the intrastate expenses in Column 3 that MCI treated as avoidable in its study. The percentages shown for the direct avoided accounts represent the FCC default assumptions which MCI adopted for its analysis. The percentage shown for indirect avoided expenses represents the ratio of direct avoided expenses to total operating expenses. Column 5 reports the calculated avoided direct and indirect expenses obtained by multiplying the amounts in Column 3 times the percentages in Column 4. The total avoided expenses and the wholesale discount rate are calculated at the bottom of Column 5. The wholesale discount rate of 25.06% agrees with Mr. Price's Exhibit DPG-3 for Florida in 1995.

Q. HOW DOES MCI'S MODEL DIFFER FROM THE AVOIDED COST STUDY, BASED ON THE FCC'S CRITERIA, THAT YOU PROVIDED IN YOUR DIRECT TESTIMONY AS EXHIBIT WSR-3?

A. There are two major differences between the MCI Model and the Company's calculations based on the FCC's criteria that cause the MCI Model to incorrectly produce higher results. The first difference is that the MCI Model inappropriately treats operator services expenses as 100% avoidable. As I explained in my direct testimony, operator service expenses (amounts charged to account 6621, call completion, and account 6622, number services) are not avoidable under a resale environment. To the extent MCI takes over the operator services functions from BellSouth by directly routing local telephone calls to its operators, it takes over a line of business with its own revenue stream. This situation represents a competitive loss to BellSouth and a competitive gain to MCI. It does not represent the resale of BellSouth's operator service tariffs to MCI at a discount. MCI's position on this issue would result in a windfall to MCI and a penalty to BellSouth, because MCI would receive both the revenues from operator service charges to customers and an increased discount on local services from BellSouth (due to the treatment of the operator services expenses as avoidable). With MCI's position, BellSouth loses the revenues associated with operator services charges and also revenues associated with other services that will be discounted further because of MCI's treatment of the operator services expenses as avoidable. To correct this overstatement in MCI's Model, the operator services expenses of $65,567,000 shown in Exhibit WSR-4, which MCI has treated as 100% avoidable, should be removed and treated as not avoidable. This correction in the MCI Model would reduce its calculated discount for 1995 from 25.06% to 21.07%, a reduction of 3.99%.

Q. WHAT IS THE SECOND MAJOR DIFFERENCE BETWEEN MCI'S MODEL AND YOUR EXHIBIT WSR-3?

A. The second major difference relates to MCI's mishandling of published directory listing expenses. As shown on Exhibit WSR-4 associated with ARMIS Report 43-04, line number 7076, MCI identified $45,776,000 of intrastate published directory listing expenses and treated 100% of this amount as avoidable. MCI's treatment of this expense is wrong for at least two reasons. First, this category of expense on the ARMIS Report 43-04 primarily includes the cost of classified and white page directories published and distributed by the Company's affiliate, BellSouth Advertising and Publishing Company (BAPCO). This expense is clearly not avoidable because BAPCO will continue, in a resale environment, to publish and distribute these directories including listings for both the Company's customers and other local exchange carriers' customers. These amounts appear on the ARMIS Report only in order that a portion of the white page expense can be included in the interstate jurisdiction.

In addition to being not avoidable, these expenses are not included in the costs underlying the retail tariffs subject to a wholesale discount. The Company has an historical relationship with BAPCO, under which BAPCO incurs the costs related to publishing and distributing directories in the Company's franchise territory. These costs have not been assigned to the intrastate jurisdiction and, therefore, have not been included as costs that need to be covered by intrastate tariffs. To the extent that any state jurisdiction has imputed BAPCO earnings to the Company in a rate proceeding, these imputations have been reductions in intrastate revenue requirements and not increases. These costs are, therefore, not being recovered in the Company's intrastate tariffs. To correct MCI's mishandling of this expense, it is necessary to remove the $45,776,000 in published directory listing expenses from both MCI's direct avoided expense amount and its total operating expense amount. This correction would further reduce its calculated discount from 21.07% (after the correction for operator services expense) to 18.8%, a reduction of 2.27%.

Q. DO YOU HAVE AN EXHIBIT THAT CORRECTS THE MCI MODEL FOR THE TWO MAJOR DIFFERENCES YOU HAVE JUST DESCRIBED?

A. Yes. I have prepared Exhibit WSR-5 to show the revised MCI Model calculations with the two major differences corrected. This exhibit has the same format as Exhibit WSR-4, but has the corrections applied for operator services expenses and published directory listing expenses. As this exhibit shows, the MCI methodology adjusted for these two problem areas would actually produce a calculated discount of 18.8%, or 0.9% below the calculation I provided on Exhibit WSR-3 (the study the Company provided based on the FCC's criteria).

Q. DOES THE COMPANY SUPPORT THE USE OF EITHER THE 18.8% WHOLESALE DISCOUNT RATE SHOWN ON WSR-5 ATTACHED TO THIS TESTIMONY OR THE 19.7% WHOLESALE DISCOUNT RATE

CALCULATED ON WSR-3 WHICH WAS ATTACHED TO YOUR DIRECT TESTIMONY?

A. No. As I explained in my direct testimony on page 19, the Company still supports its study as the most appropriate calculation of wholesale discount factors. The Company's study was provided as Exhibit WSR-1 to my direct testimony. The appropriate wholesale discount rates are 19.0% for residential services and 12.2% for business services. Both of the avoided cost studies shown on Exhibit WSR-3 and Exhibit WSR-5 are calculated based on the FCC's criteria for avoided cost studies. In my direct testimony on pages 16 through 18, I described the differences between the FCC's criteria for avoided cost studies and the Company's position on the appropriate study methodology according to the plain words of the Telecommunications Act of 1996 ("the Act"). The FCC's criteria overstates the wholesale discount rate through, among other things, the use of a "reasonably avoidable" concept to identify avoided expenses and by allocating indirect expenses as avoidable amounts. Therefore, the appropriate wholesale discount rate should be less than the 19.7%

amount shown on Exhibit WSR-3 and the 18.8% as shown on Exhibit WSR-5.

Q. HAVE YOU RECEIVED ANY ADDITIONAL INFORMATION RELATIVE TO MR. PRICE'S DIRECT TESTIMONY SINCE HE FILED IT ON AUGUST 21?

A. Yes. Shortly before I filed this rebuttal testimony, I received a copy of MCI's actual calculation of its Florida wholesale discount rate for 1995. The calculations were consistent with those presented on my Exhibit WSR-4.

Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

A. My rebuttal testimony points out two major problems in MCI's Model for calculating a wholesale discount rate for BellSouth in Florida. When these two problems are corrected, MCI's Model produces a wholesale discount rate of 18.8%. This discount rate is still overstated because it is based on the FCC's criteria which leads to overstated results. However, the correction of MCI's Model does indicate that the appropriate overall discount rate (residence and business combined) should be something less than

18.8%. The Company supports its study which calculates wholesale discount rates of 19.0% for residential services and 12.2% for business services.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes.