

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

In re: Petition by AT&T)	DOCKET NO. 960833-TP
Communications of the Southern)	DOCKET NO. 960846-TP
States, Inc., MCI)	DOCKET NO. 960916-TP
Telecommunications Corporation,)	
MCI Metro Access Transmission)	
Services, Inc., American)	
Communications Services, Inc.)	
and American Communications)	
Services of Jacksonville, Inc.)	
for arbitration of certain terms)	
and conditions of a proposed)	
agreement with BellSouth)	
Telecommunications, Inc.)	
concerning interconnection and)	
resale under the)	
Telecommunications Act of 1996.)	

THIRD DAY -- AFTERNOON SESSION

VOLUME 16

Pages 2275 through 2439

PROCEEDINGS:

Hearing

BEFORE:

CHAIRMAN SUSAN F. CLARK
 COMMISSIONER J. TERRY DEASON
 COMMISSIONER JULIA L. JOHNSON
 COMMISSIONER DIANE K. KIESLING
 COMMISSIONER JOE GARCIA

DATE:

Friday, October 11, 1996

PLACE:

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APPEARANCES:

(As heretofore noted.)

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P R O C E E D I N G S

(Transcript follows in sequence from Volume 15.)

D. DAONNE CALDWELL

having been called as a witness on behalf of BellSouth, and being duly sworn, continues her testimony as follows:

CONTINUED CROSS EXAMINATION

BY MR. LEMMER (Continuing):

Q And as I understand this page, it gives an example of how the cost of cable was determined for purposes of the study; is that correct?

A Yes, sir.

Q And in the middle of that page, there are utilization percentages; do you see that?

A Yes, sir.

Q And those percentages are the actual percentages used in this study; is that correct?

A Yes, sir.

Q And what we're talking about here from a utilization standpoint relates to the discussions we had previously regarding utilization?

A Yes, sir.

MR. LEMMER: Let me ask a question: Is the number in this study regarding utilization considered proprietary? I'm looking at specific utilization factors in the middle of this page; are those numbers proprietary?

1 MR. LACKEY: Can I ask Ms. Caldwell that?

2 BY MR. LEMMER (Continuing):

3 Q Ms. Caldwell, do you know whether these numbers are
4 proprietary?

5 MR. LACKEY: I tell you what --

6 WITNESS CALDWELL: I don't know for sure.

7 MR. LACKEY: I'll make an executive decision: They're
8 not proprietary.

9 MR. LEMMER: I'm sorry. They're not proprietary?

10 MR. LACKEY: Mr. Alford will probably get me, but I'll
11 survive probably.

12 CHAIRMAN CLARK: Makes two of us, I suppose.

13 MR. LEMMER: Thank you. That will help move it along.

14 BY MR. LEMMER (Continuing):

15 Q Ms. Caldwell, will you look at the utilization
16 percentage for copper that's used on that page of 38.8%; do you
17 see that?

18 A Yes, sir; for the distribution.

19 Q So is it fair to say that in this study, BellSouth has
20 considered in a forward-looking manner that they will use only
21 approximately 39% of that cable over its life?

22 A At any point in time from a projected actual, yes, it
23 would be the 39%. And let me stress again, this is the
24 distribution and it is at that level for all the reasons I've
25 mentioned before.

1 Q Now if you turn over to the next page, the example
2 that is on the next page shows the numerical impact of that
3 utilization factor; doesn't it?

4 A Yes, it does.

5 Q And the end result of this application, this
6 utilization factor, is to increase the cost of the cable to a
7 user of that cable; isn't that correct?

8 A I'm not --

9 Q Increase in terms of if you had, say, let's say we had
10 75% utilization. A higher utilization factor would lower the
11 cost to the individual user; isn't that correct?

12 A Again, it -- I want to be sure in terms of the user
13 versus the element that we're studying, but, yes, a lower
14 utilization factor on a per loop creates a higher investment.

15 Q And then if you'd turn over to tab D, please. You see
16 on tab D, the chart in the right hand column says in-plant
17 factor; do you see that?

18 A Yes, I'm with you.

19 Q Is it correct that those in-plant factors are applied
20 to the investment number that was developed in tab C?

21 A I'm not sure I follow exactly from tab C, but what
22 these in-plant factors do is they are applied to the material
23 price to account for contract labor, TelCo labor, those type
24 items. So they take a material pricing and convert it to an
25 installed investment.

1 Q Okay. If you would turn quickly back to page 2 of tab
2 C. The end result of that calculation is 25. Excuse me.
3 That's probably a proprietary number. I'm sorry. There's a
4 number that is represented at the end calculation there; isn't
5 that correct?

6 A Yes, it is.

7 Q And that number is the same number that appears over
8 on tab D, where it says "Circuit Level Cable Investment"?

9 A Yes, sir.

10 Q And if you would turn over to page 4 of tab D. As I
11 understand it, this is a schematic of the various architectures
12 of potential loops; is that correct?

13 A Yes, sir.

14 Q Do any of these represent an integrated digital loop
15 carrier loop?

16 A Yes, sir. An example would be I believe No. 4.

17 Q So we're looking down in the second block on the left
18 hand side where it says No. 4?

19 A Yes, sir.

20 Q How was No. 4 used in this study; do you know?

21 A No. 4 was not included in the unbundled because the
22 integrated was not included as part of the calculation.

23 Q Okay. Let's move away from the study for a moment.

24 CHAIRMAN CLARK: Mr. Lemmer, how much more do you
25 have?

1 MR. LEMMER: I would estimate 10 or 15 more minutes.

2 CHAIRMAN CLARK: Okay.

3 BY MR. LEMMER (Continuing):

4 Q Would you agree with me that looking at how the
5 various costs of the loop architectures were developed, that
6 there is a duplication of costs relating to the main
7 distribution frame in the sense that that cost is represented
8 on the loop and that it's also included in the switch?

9 A No, sir; I would not agree that there is a
10 duplication. Let me clarify that in the unbundled loop, what
11 we have looked at is a termination on the main distribution
12 frame. That includes a connector and protector. That is to
13 allow that loop to be connected to anything from that point,
14 such as a collocated space or connected to facilities to go to
15 the ALEC switch.

16 The port, however, is associated again with main
17 distribution frame. There must be something for the individual
18 ALEC who brings their loop in from their collocated space to
19 connect to. So the connector/protector identified in the port
20 study represents the connection for the port to the ALEC's
21 loop.

22 Q So if a provider were to purchase the loop in the
23 switch, there in fact would be a double charge; isn't that
24 correct?

25 A I think what we have to consider is that in terms of

1 the loop and the port, that would be combining two network
2 elements that I believe Mr. Scheye has discussed. We do have
3 customers who are buying -- we are unbundling a loop as a voice
4 grade facility to deliver to anyone; same thing for the port.

5 Q Turning to your Rebuttal Testimony just briefly,
6 please. Excuse me. It's your Supplemental Testimony. I'm
7 sorry.

8 A Yes, sir.

9 Q And I'm looking at page 4 of your Supplemental
10 Testimony beginning at line 13. And there's a discussion in
11 this regarding depreciation rates; is that correct?

12 A Yes, sir.

13 Q And it talks about potential risk adjustment of the
14 depreciation rates; do you see that?

15 A Yes, sir.

16 Q Are the depreciation rates used in your TELRIC study
17 adjusted for the risks that you reference in this paragraph?

18 A I do not know how the depreciation rates are actually
19 adjusted in reference to this particular statement. This was
20 in reference to what the Order says.

21 The depreciation are forward-looking projected lives
22 and they are developed by the capital recovery depreciation
23 department and provided to us.

24 Q Ms. Caldwell, have you done any analysis that would
25 assess whether the depreciation recovery going forward -- Let

1 me restate the question. Have you done any analysis to
2 determine whether depreciation recovery under TELRIC based
3 costs would be greater than your depreciation recovery on an
4 embedded cost base?

5 A No, I have not.

6 Q If in fact future costs for items were going up, in
7 other words, they were greater than your embedded costs and
8 assuming that your years of life for that asset were the same,
9 then your depreciation would be greater; wouldn't it?

10 A Let me state again that I'm not a depreciation expert
11 and I do not follow that question.

12 Q Do you understand how depreciation is calculated?

13 A Yes, sir; I do.

14 Q You understand the concept of an acquisition cost and
15 then a useful life?

16 A Yes, sir.

17 Q And that depreciation results from dividing the
18 acquisition costs by the useful life?

19 A Yes, sir; that's the calculation we use.

20 Q So if your embedded cost was say \$10 and your forward-
21 looking cost was \$12 and you have the same useful life, the
22 depreciation on a going-forward basis would be greater than on
23 an embedded base; wouldn't it?

24 A I'm sorry, I've never been able -- You asked me the
25 same question in North Carolina and I'm still having trouble

1 following the concept. I deal with forward-looking
2 investments. I do not deal with embedded calculations.

3 Q One last line of questioning and then I will be
4 through.

5 Would you turn back to the TELRIC study and turn back
6 to Section 3, where the proposed loop rates are indicated. Do
7 you have that page?

8 A Yes, sir.

9 Q Now let me ask you a couple of questions and then
10 we'll come back to this page. Are you familiar with an ESSX
11 service, an ESSX line, I should say?

12 A Yes, sir.

13 Q And have you ever seen or have you been involved in
14 any cost studies relating to ESSX?

15 A I have seen the studies. I believe the last ESSX
16 studies were done prior to my working with the loop.

17 MR. LEMMER: Madam Chairman, I'd like to show the
18 witness a document and I'd like to have it identified and
19 marked, please. The document is a February 19 -- excuse me --
20 February 16th, 1996 memorandum from the Division of Auditing
21 and Financial Analysis. And the copies that are being
22 distributed are certified copies.

23 BY MR. LEMMER (Continuing):

24 Q Ms. Caldwell, have you ever seen this document before?

25 A No, sir.

1 Q If you would turn in to the document, you will see
2 that it talks about an audit conducted regarding ESSX services.
3 And do you recollect ever having calculated any or performed
4 any cost studies relating to ESSX services?

5 A Most of the ESSX studies were completed before I
6 actually came in to the job. It could have been I did do some
7 analysis on the numbers after the studies had been completed.

8 Q Let me ask you to turn to the fifth page of this
9 document and direct your attention to the numbers that are at
10 the bottom and there's a series of numbers relating to loop
11 costs.

12 A Yes, sir.

13 Q Do you see those numbers?

14 A On page 5?

15 Q That's correct. Do you see those numbers?

16 A Yes, sir; I see them.

17 Q Those numbers are substantially lower than the numbers
18 that are on your TELRIC exhibit; aren't they?

19 A Yes, sir; the numbers are lower.

20 Q Do you have any explanation for that?

21 A Well, in terms of the numbers, I didn't calculate
22 them. I can testify to the TELRIC numbers and how they were
23 actually done.

24 The only thing that I would speculate, maybe that's
25 not the correct word, but in terms of the ESSX study, we

1 actually looked at a service and at that point in time we were
2 considering the ESSX service. So the example of the directly
3 attributable engineer would have definitely been different.
4 There also would have been no allocation of common costs in
5 these numbers.

6 Q Now if you did not participate in the cost study
7 that's discussed in this audit report, how do you know that?

8 A In dealing with -- That was a general term -- excuse
9 me -- That was a general answer in terms of the methodology.
10 BellSouth, as I mentioned in my summary, we've done TSLRIC and
11 LRIC cost studies for many years and that methodology did not
12 include shared and common and it did not include the directly
13 attributable.

14 Q Now, have you read Dr. Emmerson's testimony in this
15 case?

16 A I've read it. It's been awhile.

17 Q Do you recollect in there that he provides an estimate
18 of common and joint costs being approximately 50% of Bell's
19 costs; do you recollect that?

20 A I do not remember the exact number. I remember he
21 quoted -- I believe it was in the Florida testimony -- two
22 different studies from one of them mentioned I believe
23 BellSouth and the other one mentioned another region.

24 Q Well, let's assume that in fact his testimony does say
25 that in his estimate it's 50%, common costs are 50%. If you

1 double the prices or, excuse me, the costs that are indicated
2 on page 5, they would still be less than what's on your TELRIC
3 study; isn't that correct?

4 A Yes, sir.

5 MR. LEMMER: No further questions.

6 CHAIRMAN CLARK: Do you want this marked as an
7 exhibit?

8 MR. LEMMER: Please.

9 CHAIRMAN CLARK: We'll mark it as Exhibit 71 and it's
10 a February 16, 1996 report from the Commission's AFAD.

11 COMMISSIONER KIESLING: It's 72.

12 CHAIRMAN CLARK: Did I say 76?

13 COMMISSIONER KIESLING: You said 71.

14 CHAIRMAN CLARK: 72. It's from our Auditing and
15 Financial Analysis Division and it's an audit of ESSX.

16 (Exhibit No. 72 marked for identification.)

17 CHAIRMAN CLARK: With that, we will take a lunch break
18 until 1:30 and we will reconvene at 1:30.

19 I would point out it's still my goal to get out of
20 here about 5:00 o'clock, so we need to hustle a little bit.

21 (Luncheon recess.)

22 CHAIRMAN CLARK: We'll call the hearing back to order.

23 Mr. Mutschelknaus.

24 MR. MUTSCHELKNAUS: Thank you very much, Chairman
25 Clark.

1 Well, the advantage of the break has enabled me to
2 greatly shorten my cross, take advantage of the ground covered
3 so ably by AT&T and MCI.

4 CROSS EXAMINATION

5 BY MR. MUTSCHELKNAUS:

6 Q Good afternoon, Ms. Caldwell. I'm Brad Mutschelknaus;
7 I'm here for ACSI.

8 A Good afternoon.

9 Q Just to fill in a few areas maybe the others didn't
10 talk about: Counsel for AT&T touched on the fact that your
11 costs are statewide average costs?

12 A That is correct.

13 Q Did you make any attempt to break those down on any
14 sort of geographically deaveraged basis?

15 A At this time, no.

16 Q When you say "at this time," is there an effort going
17 on?

18 A I believe this morning it was discussed that we were
19 ordered to file in Georgia a deaveraged loop, so what we're
20 doing is looking at the other states as far as methodology to
21 be sure it would be appropriate.

22 Q And where are you on that?

23 A I do not know as to which states we are completed or
24 still working on.

25 Q Haven't you used cost studies for geographically

1 deaveraged costs to establish your expanded interconnection
2 rates already?

3 A In terms of the expanded interconnection, I believe we
4 use the zone pricing areas that was filed in the federal
5 environment and then moved to the states. The actual cost
6 itself was not provided on a deaverage basis.

7 Q Those rates are broken down into three density zones;
8 are they not?

9 A That's my understanding.

10 Q And hasn't BellSouth also urged the use of zone
11 density pricing for its access services?

12 A I know that in the area of access service we have
13 advocated or provided three zone density areas. That's out of
14 my realm. I only deal with the costs that supports them.

15 Q You did break that cost down based on density zones,
16 though; didn't you?

17 A I do not believe so.

18 Q Do you see any impediment from the point of view of
19 BellSouth to using loop densities to create a geographic --
20 excuse me -- to compute costs on a geographically deaveraged
21 basis?

22 A In terms of the costs, I believe Mr. Scheye addressed
23 that from the density area this morning. We are looking at the
24 cost components to see how density and other items might be
25 impacted together or be used together.

1 Q What are those other items?

2 A One could be possibly the locations of the wire
3 centers, possibly distance; we continue to analyze.

4 Q If this Commission decides consistent with the FCC's
5 Order to order BellSouth to implement geographically deaveraged
6 rates, what would you propose that the Commission use to create
7 the geographic zones for rating purposes?

8 A I do not believe that I can really address that
9 question. That's more of a rates question. I would have to --
10 Mr. Scheye would have to address that.

11 Q Very well. Thank you.

12 Turning to the subject of nonrecurring charges.

13 A Yes.

14 Q I would like to make reference to the Exhibit No. 68,
15 which is the TELRIC cost study documentation.

16 A Yes, sir.

17 Q And I caution you that obviously there's a lot of
18 information there that the Company considers confidential. So
19 we'll go slow and try to avoid revealing any of that.

20 Can I direct your attention to -- Well, let me first
21 ask: In calculating the nonrecurring costs, let's ask a little
22 bit about the assumptions that you made underlying the study.
23 Did BellSouth assume that the installation would be a new loop?

24 A What we have assumed is that this would be for a new
25 loop. However, I think I mentioned earlier that in the testing

1 environment, if it was existing, we have made that adjustment.
2 So, we would not have to test and travel to the --

3 Q Did you make the --

4 A -- existing loop.

5 Q I'm sorry; I didn't mean to interrupt you. I thought
6 you were done.

7 Did you make the adjustment for anything other than
8 testing?

9 A No, we did not.

10 Q In computing the nonrecurring costs, did BellSouth
11 assume that the installation would be of a special access
12 service of a basic local exchange loop or something else?

13 A I'm sorry, I didn't follow that because you used the
14 terms together. I'm sorry.

15 Q Okay. Sure. When -- Let me return to the previous
16 category. You did say that you assumed that it would be a new
17 loop. Can you tell me who told you to make that assumption?

18 A We talked with the individuals who work with the team
19 that looks at what would consist of an unbundled network
20 element.

21 Q Would that be the RUINIT group perhaps?

22 A Yes.

23 Q And then could you tell me whether you were asked to
24 assume that the unbundled loop that you would be installing or
25 taking an order for would be the equivalent of a special access

1 circuit?

2 A Yes, in terms of it would require the additional
3 testing from a special services aspect.

4 Q And who told you to make that assumption?

5 A Again, it would be the individuals responsible for
6 that team.

7 Q Be the RUINIT group again?

8 A Yes.

9 Q Well, take a look then at Exhibit No. 68 and I direct
10 your attention to -- Well, they don't have page numbers, so
11 we'll do our best to find it. Section 5 is I believe the cost
12 development for nonrecurring charges?

13 A Yes, it is.

14 Q And if you go back about four pages into that section,
15 there's a work paper?

16 A Yes.

17 Q For the 2-wire analog voice grade loop?

18 A Yes, I'm with you.

19 MR. MUTSCHELKNAUS: Okay. Thank you. Now, counsel,
20 stop me if I get off the mark here, but --

21 MR. LACKEY: I have to catch up. I'm not at the right
22 page yet.

23 CHAIRMAN CLARK: Would you indicate again where we
24 should be?

25 MR. MUTSCHELKNAUS: Certainly. We're at Section 5 of

1 the TELRIC Cost Study, which is entitled "Florida Unbundled
2 Loop Cost Development Nonrecurring." You go back four pages,
3 there's a spreadsheet that -- Well, I'll let the witness
4 describe it. It appears to me to be the basic cost development
5 information used to compute the nonrecurring costs for a 2-wire
6 loop. It's entitled "Development of Nonrecurring TELRIC 2-Wire
7 Analog Voice Grade Loop, Level 1997 to 1999."

8 Yeah, there's a handwritten page number, but it's
9 indecipherable. I think it may be 52, though.

10 BY MR. MUTSCHELKNAUS (Continuing):

11 Q Okay. Are you with me, Ms. Caldwell?

12 A Yes, I am.

13 Q Thank you. Now let me start by asking if you are
14 aware, without giving me any numbers, what the relationship --
15 Well, let me ask this: The total nonrecurring TELRIC cost in
16 your view of the nonrecurring cost for the 2-wire analog loop,
17 I assume is this number down at the very bottom where it says
18 "Nonrecurring TELRIC" and then it's the second column from the
19 right hand side, second column to the left?

20 A That's correct.

21 Q And do you have a -- Can you make a general comment as
22 to how that relates to the TSLRIC cost that you came up in your
23 TSLRIC study for the same functionality?

24 A In looking at this analysis, when you talk about the
25 TSLRIC portion, instead of using the TELRIC labor rate that had

1 directly attributable costs in it, we would have used a
2 directly assigned labor rate. And right off I do not remember
3 the difference between those two. The work times would have
4 been the same.

5 Q It went up quite a bit, though; didn't it?

6 A Yes, sir.

7 Q Would you accept, subject to check, that it went up
8 95%?

9 A I don't quite know how you got those numbers.

10 Q Okay. Do you have the TSLRIC study?

11 A No, I do not.

12 MR. MUTSCHELKNAUS: Okay. That's fine. We'll go
13 ahead. Let's just go through the particular categories here.
14 You see on the -- I assume, counsel, that the categories in the
15 left hand side are not confidential. They're merely the
16 listing of what you need to do in your view to install the
17 loop, I assume.

18 MR. LACKEY: Madam Chairman, I assume they're not
19 confidential. I have the same problem that I have every time
20 we do something like this. You can take a confidential
21 document and if you go pick out every fifth word, you know, it
22 doesn't tell you anything. There is nothing, no breach of
23 confidentiality there. The question is as you take one here,
24 well, that's not confidential by itself, then here. I don't
25 think the column and row headings --

1 CHAIRMAN CLARK: I don't think we've identified a
2 whole lot out of this study that you could put it together and
3 get the whole study.

4 MR. LACKEY: That's right. But my hesitation is I
5 don't think the columns and the row headings are confidential,
6 you know, standing by themselves.

7 MR. MUTSCHELKNAUS: Well, let us proceed and if you
8 think something is confidential, stop me.

9 MR. LACKEY: Well, unfortunately, I think the client
10 is the one who has to determine what's confidential. All I can
11 do is assert it for her. So if Ms. Caldwell thinks that
12 something is confidential, I'm sure she'll speak up.

13 MR. MUTSCHELKNAUS: Fine.

14 MR. LACKEY: Since I don't know what most of this
15 stuff is.

16 MR. MUTSCHELKNAUS: Well, that's what I'm endeavoring
17 to find out.

18 MR. LACKEY: Good luck.

19 BY MR. MUTSCHELKNAUS (Continuing):

20 Q Ms. Caldwell, you see on the left hand side there,
21 there's something called a "Work Management Center;" do you
22 follow me?

23 A Yes.

24 Q Do you know whether the Work Management Center was
25 included in the TSLRIC study?

1 A Some of these work centers were actually renamed from
2 the original TSLRIC study. I believe that one actually was
3 included as -- And I cannot remember the name of that center.
4 I have some reference material. I could find that out, but I
5 don't readily remember. It was included with a different name.

6 Q I guess, you don't have -- And you don't have that
7 study here, so you can't point to me what that was?

8 A I don't believe so.

9 Q Okay. Well, let's look at another one. The "Access
10 Customer Advocate Center." Do you see that?

11 A Yes, sir.

12 Q Do you see it shows up twice in this list?

13 A Yes, sir.

14 Q Can you tell me what they do?

15 A This particular group of individuals is responsible
16 for handling the service order and they're in the special
17 services area and they also do joint testing with the
18 installation field technician. So, therefore, the amount of
19 time that is indicated under the service order is for actually
20 receiving the order, processing it and getting it ready to
21 dispatch. The connect and test is the time these individuals
22 from their remote location would test with the field
23 technician.

24 Q Can you tell me why they didn't appear on the TSLRIC
25 study?

1 A When we provided -- excuse me -- When we started
2 developing all of the TELRIC information, at that point in time
3 we verified every work time we had with the individuals doing
4 the work. And this particular group, originally some of the
5 testing time was included in another center. They have since
6 specified them as a different center. So we identified it
7 appropriately.

8 Q Isn't it true that the Access Customer Advocate Center
9 and the Work Management Center are dedicated to providing
10 access services?

11 A They deal with special services, not necessarily just
12 access services.

13 Q Are either of those organizations used by BellSouth in
14 provisioning loops for its own basic exchange service?

15 A From a -- I cannot say 100%, but from a general
16 testing environment from the special services, that is unique
17 to the special services world.

18 Q So you don't use them?

19 A I said I'm not positive 100% that there is none in
20 there.

21 Q If you were to do a cost study in support of the
22 nonrecurring charges for your own unbundled loop, you wouldn't
23 include those, I gather?

24 A You mean for the loop --

25 Q I mean for your own basic exchange loop. Excuse me.

1 A The loop we offer in basic exchange, we would identify
2 all -- We would go through the same process and identify all
3 the centers. I know there is testing in terms of the loop --
4 excuse me -- the basic exchange loop to some degree. I just do
5 not know the center that does it and how much it is.

6 Q Were you here yesterday when ACSI witnesses testified
7 that they didn't need the functionality provided by these
8 organizations in installing their loops?

9 A I believe I came in after ACSI testified.

10 Q Well, if they don't, not ordering a special access
11 circuit and they want something, they want just to obtain the
12 same loop you use in your basic exchange service, would it be
13 appropriate to take all of this cost out of this study?

14 A I do believe Mr. Scheye addressed this morning in
15 terms of the nonrecurring associated with a -- excuse me -- a
16 basic exchange type loop. If I were requested to do a cost
17 study specifically and was told that there would be no testing,
18 then, yes, I would include no testing if it was not required.

19 Q Do either of those organizations have anything to do
20 if you -- have any work to do if you just changed the loop, an
21 existing exchange loop from BellSouth service to ACSI service?

22 A I cannot answer that in terms of just changing one
23 from the other. This study was built on the fact that it would
24 require the testing. We would provide the detail layout --
25 excuse me -- the detail layout record. All of that would be in

1 the analysis. I cannot say that whether or not there would be
2 any testing at all if we just transferred it.

3 Q The Work Management -- Can you -- I asked you what the
4 ACAC, the ACAC did. I don't think I followed up and asked you
5 what work was performed by the Work Management Center.

6 A I do not remember exactly what they do in this center.
7 I do know that since it would be listed on this form under the
8 service order area, they would be responsible for taking in the
9 service order and processing it. I just do not remember
10 exactly what's in there.

11 Q Isn't that what the ICSC or the so-called customer
12 point of contact does?

13 A In the -- Again, in the service order area, your ICSC
14 that's listed here as customer point of contact just take the
15 order, but maybe I should clarify that a service order taken
16 from a customer then flows to various centers to be
17 distributed. So, when I use the term "working with the service
18 order," that's what I meant.

19 Q Sounds like an overhead function.

20 A No, because this particular cost is associated with
21 handling that particular service order. So it's not a general
22 overhead.

23 Q Isn't it the Work Management Center's job to tell the
24 install and maintenance field people what to do to install the
25 circuit?

1 A I'm sorry. Like I said, I just don't remember what
2 they do exactly.

3 Q All right. That's fair. Thank you. Can you explain
4 why the total cost for the ICSC went up 40% over the TSLRIC
5 study?

6 A I didn't realize it did to begin with, but if the
7 number did increase it was the result of the verification with
8 all the centers that these numbers were appropriate for the
9 unbundled network element.

10 Q Do you know what's included in the engineering
11 category in here, not the numbers, the functions?

12 A In the engineering category, I can't totally
13 differentiate between the two centers, but the activity is for
14 processing the order through our TIRK system that provides the
15 digital layout record and provides all the transmission
16 requirements necessary, if any.

17 Q So, if I was going to try to determine the cost to
18 BellSouth of providing the DLR, it would be in this engineering
19 category?

20 A That would be the predominant cost. There could be a
21 few, a little somewhere else, but that's the predominant cost.

22 Q The DLR would be a subset of the engineering costs; is
23 that correct?

24 A I can't totally say that it would be a subset. I know
25 those are the activities there. That total amount would be

1 fairly close to the DLR.

2 Q Well, just to make it clear, what I'm trying to get at
3 is Mr. Scheye testified this morning that in his view one of
4 the key differences between the nonrecurring charge for basic
5 exchange service and the nonrecurring charge on an unbundled
6 loop was that BellSouth had to create a DLR. What I'm trying
7 to say is that cost of that DLR I assume is in this engineering
8 number on this page?

9 A Like I said, the predominant cost of the DLR is here.

10 Q Which, as far as I can see, is the entire engineering
11 category is less than 4% of the total nonrecurring costs; is
12 that correct?

13 A I do know it's in the neighborhood of that range, but
14 let me point out Mr. Scheye was talking about customers who
15 requested a DLR. I do not know if he went any farther. I
16 didn't listen to all of his testimony, but the cost here is
17 associated -- Where you see a good deal of the cost is in the
18 testing associated with the circuit.

19 Q If ACSI orders an unbundled loop and hooks it up to
20 its own switch, isn't it appropriate for ACSI to provide its
21 own testing?

22 A That's out of my realm of expertise. I mean, I do not
23 know what's been negotiated in that type area.

24 Q If ACSI does not ask BellSouth to provide any testing,
25 should it be in this cost study?

1 A Let me answer that -- That's not a yes or no answer.
2 The study that I have provided is for the unbundled loop with
3 the understanding from a nonrecurring standpoint how it would
4 be treated. If there is going to be another offering, say, for
5 instance, a loop that is not, does not meet the specifications,
6 then there would be a cost study particular for that offering.

7 Q Okay. Just a couple of clarification items and then
8 we'll be done, Ms. Caldwell.

9 Can I draw your attention -- Do you recall speaking
10 with counsel earlier about Exhibit No. 72, which was relating
11 to the ESSX audit report?

12 A Yes.

13 Q Did BellSouth include any ESSX loops in its sample
14 that it used for creating the loop cost study?

15 A The sample data that was collected was for residence,
16 business and I believe there was also an ESSX class of service.
17 The unbundled 2-wire used only residence and business, so there
18 is no ESSX.

19 Q There is no ESSX at all in the sample? It was
20 excluded?

21 A No, sir. Let me clarify. In the sample data there
22 was a class of service that could have had ESSX calculated.
23 The 2-wire analog is based on residence and business, which is
24 your predominant customer.

25 Q Isn't the ESSX loop provided to business customer?

1 A Yes, it is.

2 Q So why was it excluded from the study?

3 A It was the single-line business that's included in
4 this study.

5 Q You didn't include any multi-line businesses in your
6 study?

7 A In the analysis for the 2-wire analog, no, we did not.

8 Q Do you know what percentage the business lines in
9 Florida are served -- are single-line business customers?

10 A No, I do not.

11 Q Is that information that BellSouth has available?

12 A Yes.

13 MR. MUTSCHELKNAUS: Could we make a late-filed record
14 request for that?

15 CHAIRMAN CLARK: Would you give me a title?

16 MR. MUTSCHELKNAUS: The percentage of business lines
17 in Florida which are from businesses with single business
18 lines.

19 CHAIRMAN CLARK: Ms. Caldwell, do you understand what
20 he's asking for?

21 WITNESS CALDWELL: I believe, but let me just clarify:
22 He wants to know the percent of ESSX lines for the State of
23 Florida or multi-line.

24 MR. MUTSCHELKNAUS: No, as I understood, maybe we're
25 talking past each other, Ms. Caldwell, and maybe we can get

1 this straight.

2 BY MR. MUTSCHELKNAUS (Continuing):

3 Q I understood your testimony to say that you excluded
4 from your study any businesses that had more than one business
5 line?

6 A Yes, we included the single-line business only.

7 Q All right. And so what I'm trying to get at is what
8 percentage of your business lines are attributable to
9 businesses that have only one line?

10 A Yes, sir; I understand that now.

11 CHAIRMAN CLARK: Okay. The title I have, "Percentage
12 of Business Lines in Florida That Have a Single Line," that
13 would be Late-Filed Exhibit 73.

14 (Exhibit No. 73 marked for identification.)

15 BY MR. MUTSCHELKNAUS (Continuing):

16 Q Do you have a ballpark knowledge of what that might
17 be?

18 A No, I'm afraid not.

19 Q Can you tell me where that assumption came from?

20 A In studying the 2-wire analog, the unbundled offering,
21 it was considered that the type customers that would be buying
22 the 2-wire analog from an unbundled standpoint would be
23 residence and single-line business.

24 Q Did you include -- What assumption did you make in
25 that regard with respect to the 4-wire connection?

1 A The 4-wire analog was predominantly business
2 customers, if I remember appropriately.

3 Q And you included multi-line business customers in that
4 study?

5 A That I don't remember. That may be actually indicated
6 in the cost study. I have to look. I don't remember right
7 off.

8 MR. MUTSCHELKNAUS: I guess I would make a late-filed
9 record request as to whether they included multi-line business
10 customers in their cost study for the 4-wire loop, if I could.

11 CHAIRMAN CLARK: Okay.

12 MR. MUTSCHELKNAUS: It could be part of the same
13 late-filed if it would make it easier.

14 CHAIRMAN CLARK: Tell me again what it is you are
15 asking for.

16 MR. MUTSCHELKNAUS: Certainly, Madam Chairman. The
17 question that we need answered is whether the Company included
18 multi-line business customers in the sample data for the TELRIC
19 cost study information for the 4-wire unbundled loop.

20 BY MR. MUTSCHELKNAUS (Continuing):

21 Q Do you understand that, Ms. Caldwell?

22 A Yes, sir; I do.

23 Q Thank you. Okay. Just so we're clear, because we all
24 got surprised as we went along: Am I correct then that in
25 performing the study for the 2-wire loop, you excluded all ESSX

1 loops?

2 A Yes, sir.

3 Q And did you also exclude ESSX loops when you did the
4 study for the 4-wire loop?

5 A That was what I was going to check in the late-filed
6 for you.

7 Q Okay.

8 A I don't remember right now.

9 Q So you're going to make that part of the late-filed as
10 well?

11 A Yes.

12 MR. MUTSCHELKNAUS: All right.

13 CHAIRMAN CLARK: Just so I'm clear: Late-Filed
14 Exhibit 73 will now have percentage of business lines in
15 Florida that have a single line and also the percentage of
16 multi-line business customers included in the sample data for
17 the 4-wire TELRIC study?

18 MR. MUTSCHELKNAUS: Yes, and now she's amended that to
19 say she's also going to state whether or not ESSX lines were
20 included in the study data for the 4-wire loop.

21 BY MR. MUTSCHELKNAUS (Continuing):

22 Q Wasn't that what you just testified? I don't want to
23 put words in your mouth.

24 A That will be fine.

25 Q Okay. All right. Well, I think that will take care

1 of that. Thank you, Ms. Caldwell. Let me see. I have one or
2 two things here.

3 Do you know or can you tell me where I would find what
4 the service lives you used for aerial, buried and underground
5 copper cable in the TELRIC studies were?

6 A I do not believe they're actually listed in the cost
7 study. I thought they were provided in one of the late-filed
8 exhibits, but right off I do not know.

9 Q You think that that is already included in one of the
10 late-filed?

11 A I thought it was, but I could be wrong. You're
12 talking about the service lives on the account or the service
13 lives on each of the -- like for the unbundled loop location
14 life?

15 Q The service lives that you used for the accounts in
16 the study.

17 A I do not remember if that was in the late-filed.
18 We've discussed it before.

19 MR. MUTSCHELKNAUS: I'm going to do this one more time
20 and that will be the end of it. Could I make a late-filed
21 record request that they provide us with the service lives used
22 for aerial, buried, and underground copper cable in the TELRIC
23 study?

24 CHAIRMAN CLARK: All right. We'll add that to
25 Late-Filed Exhibit 73 and that will also include the service

1 lives used for aerial, underground and copper cable?

2 MR. MUTSCHELKNAUS: That's correct.

3 CHAIRMAN CLARK: For the TELRIC study.

4 MR. MUTSCHELKNAUS: Thank you.

5 BY MR. MUTSCHELKNAUS (Continuing):

6 Q One final question, Ms. Caldwell: Did BellSouth
7 include any joint and common costs attributable to its non-
8 regulated operations in its TELRIC study?

9 A No, it did not.

10 MR. MUTSCHELKNAUS: Okay. Thank you. Madam Chairman,
11 that's all I have for Ms. Caldwell.

12 Thank you, Ms. Caldwell.

13 CHAIRMAN CLARK: Thank you. Staff.

14 CROSS EXAMINATION

15 BY MS. CANZANO:

16 Q Good afternoon, Ms. Caldwell.

17 A Good afternoon.

18 Q Is it correct that Staff asked for certain late-filed
19 deposition exhibits from your October 7th, 1996 deposition?

20 A That is correct.

21 Q Has BellSouth provided Late-Filed Deposition Exhibits
22 2 and 3?

23 A I believe we have not provided 2 and 3. I understand
24 that they are ready, but we're waiting for the filing of the --
25 and I can't remember the name of it -- proprietary information.

1 MS. WHITE: I believe Ms. Caldwell means the Notice of
2 Intent; is that what you mean?

3 WITNESS CALDWELL: Yes, ma'am.

4 BY MS. CANZANO (Continuing):

5 Q You mean they have been prepared but they haven't been
6 filed because they were pending like for confidentiality?

7 A Well, my -- Excuse me. I was going to say my
8 understanding is they just got to Tallahassee today. The third
9 one may actually have a delivery date of next week. I believe
10 it was pushed out a little bit.

11 MS. CANZANO: At this time Staff requests Late-Filed
12 Exhibits -- and we will call them just like we did in the
13 depositions -- Late-Filed Exhibit 2 would be an explanation/
14 calculation --

15 CHAIRMAN CLARK: Wait a minute. I'm on Exhibit 74.
16 Why don't you tell us what you would like. Are you asking for
17 a late-filed exhibit?

18 MS. CANZANO: Yes, I'm going to ask for late-filed
19 exhibits, the one that we had asked previously from the
20 depositions that have not yet been filed.

21 CHAIRMAN CLARK: Okay. Well, tell us what they are.

22 MS. CANZANO: They're the explanation and calculation
23 of the ACFs and other factors for the TSLRIC study, and that
24 would be Late-Filed Exhibit 2. Well, I mean, we will give it a
25 different number.

1 CHAIRMAN CLARK: Is what you're saying is it was
2 Late-Filed Exhibit 2 to the deposition?

3 MS. CANZANO: Yes.

4 CHAIRMAN CLARK: Well, you can just let her know, just
5 in case you don't know, that it's the same thing that they
6 asked for in the deposition. Go ahead.

7 MS. CANZANO: And we would also like the same exact
8 thing except for the TELRIC study. So that would be the
9 explanation and calculation of ACFs and other factors for the
10 TELRIC study.

11 CHAIRMAN CLARK: Donna, we will label them as
12 Late-Filed Exhibit 74.

13 MS. CANZANO: Thank you.

14 (Exhibit No. 74 marked for identification.)

15 MS. CANZANO: Staff has no further questions.

16 CHAIRMAN CLARK: Redirect.

17 MR. LACKEY: Thank you, Madam Chairman.

18 REDIRECT EXAMINATION

19 BY MR. LACKEY (Continuing):

20 Q I want to follow-up on a couple of issues that you
21 were asked about dealing with Exhibit 72, Ms. Caldwell. That's
22 this staff audit. Do you recall that you were asked
23 specifically about the loop costs that are on page 5 of that
24 staff audit?

25 A Yes, sir.

1 Q Have you had an opportunity to read this audit at this
2 point?

3 A Yes, sir.

4 Q Can you tell me what these loops related to in this
5 study?

6 A In the paragraph directly above the numbers, it
7 indicates that they are for correctional institutions, unique;
8 in particular, there were four of them.

9 Q So, the studies were done on four prisons?

10 A Yes, sir.

11 Q Okay. And do you -- I know you're not a statistician,
12 but do you have any reason to believe that the loops associated
13 with four prisons might be representative of loops in the state
14 as a whole?

15 A No, sir; I do not believe so.

16 Q Now let's talk about the utilization factors for a
17 moment. And if you will turn to I believe it's tab C in the
18 TELRIC study and it's page, it's the first page in tab C, where
19 the utilization factors are listed. Do you remember being
20 asked about those?

21 A Yes, sir.

22 Q Now the utilization factor for the distribution
23 facility is considerably lower than the others reflected on
24 that page; is that correct?

25 A That is correct.

1 Q I want to talk a little bit more about the utilization
2 factor in distribution facilities. Maybe we better make sure
3 we know what we're talking about generally. What are
4 distribution facilities?

5 A They would be the cables that normally serve areas
6 such as subdivisions. They would be the facilities beyond the
7 serving area interface that branches out to each one of the
8 individual home locations.

9 Q So, distribution cable is what runs down the street in
10 front of the house?

11 A Yes, sir.

12 Q Okay. If I have a street that's got five houses on
13 it, what size distribution cable do I have to use?

14 A Well, the smallest copper cable that's available is a
15 25-pair.

16 Q So what would be the fill factor on that distribution
17 run?

18 A Twenty percent.

19 Q And if I had a street that branched off of it or went
20 the other way and I had five houses on that street, could I use
21 5-pair out of that first cable I was talking about?

22 A No, you could not.

23 Q What would I have to do?

24 A You're going to have to place another cable a minimum
25 of 25-pairs along that street.

1 Q And for that cable along that street, what would be
2 the utilization factor?

3 A Again, it's going to be the 20%.

4 Q Now does that sort of occurrence explain why at least
5 in part the utilization rate for distribution is lower than
6 feeder?

7 A Yes, sir; it does.

8 Q Okay. Now in addition to that, you're talking about
9 the distribution that runs in subdivisions and what have you.
10 Is a lot of that trenched?

11 A Yes, sir; you have a lot of buried trench cable in
12 subdivisions.

13 Q Okay. And does that mean that if you don't properly
14 size the cable going into the subdivision, that you would have
15 to retrench it at a later date?

16 A Yes, sir. And it's a very costly effort to come back
17 and retrench.

18 Q Okay. So do those two things we just talked about
19 help explain the utilization level that we're seeing on this
20 tab C?

21 A Yes, they do.

22 Q Okay. Now there was considerable discussion about
23 integrated digital loop carrier; do you recall that?

24 A Yes, sir.

25 Q And there was a question about whether there was any

1 integrated digital loop carrier in your loop sample; do you
2 recall that?

3 A Yes, sir.

4 Q Now your cost study is supposed to be a forward-
5 looking cost study; is that correct?

6 A That is correct.

7 Q And was the purpose to determine the cost of an
8 unbundled loop?

9 A Yes, sir.

10 Q Okay. Now is an unbundled loop connected to a switch?

11 A No, sir.

12 Q Okay. Is an integrated digital loop carrier inter-
13 connected with a switch?

14 A Yes, sir. It's direct integration into the switch.

15 Q So can you tell us what you have assumed -- and I
16 think you used the initial "COT" but didn't explain it -- what
17 you've assumed on your forward-looking study with regard to
18 these loops?

19 A From a forward-looking standpoint, if the facility is
20 served on digital loop carrier, we assume that we would place a
21 COT or central office terminal that breaks the incoming digital
22 signals down to voice grade so it could be handed off to the
23 ALEC at the voice grade level.

24 Q Do customers know or particularly care whether they're
25 served by copper or integrated digital loop carrier?

1 A No, they do not.

2 Q And when ACSI or AT&T or MCI shows up and says we want
3 Jone Jones' loop moved over to our switch, do they care whether
4 it's copper or integrated digital loop carrier?

5 A No, they do not.

6 Q If the customer is on integrated digital loop carrier,
7 can you move it from our switch to ACSI's, for example?

8 A No, you're going to have to do something very unique.

9 Q And what would you have to do?

10 A One of the things is, I believe Mr. Milner discusses
11 this in more detail, but you would convert that customer to
12 some type of copper facilities or you would have to unintegrate
13 that customer from the switch.

14 Q And the purpose of your study was to determine the
15 cost of unbundled loops; correct?

16 A Yes, it was.

17 Q Now you recall that there were some questions asked of
18 you about, by the ACSI -- ACSI? -- ACSI attorneys regarding
19 moving loops to their switch and the cost of simply converting
20 one of our customers?

21 A Yes, sir.

22 Q Is there physical labor involved in moving a loop from
23 one of our switches to one of theirs?

24 A Yes, there would be.

25 Q And would that mean that there would be travel time,

1 dispatches, that sort of thing?

2 A In dealing with moving it from one switch to a
3 collocated space, you may not have travel for that individual
4 customer and that was indicated in our study, as I mentioned.

5 Q If one of our customers moves out of their house and
6 another customer moves into the house, is there a nonrecurring
7 charge for converting the new householder to our service?

8 A Yes, sir.

9 Q Do we have to dispatch anybody or move copper when
10 that happens?

11 A No, sir.

12 Q So would it surprise you that the nonrecurring costs
13 for unbundling the loop would be different than the cost of
14 simply giving service to one of our customers?

15 A Yes, sir. Did I misunderstand?

16 Q You and I are having a problem.

17 A I know.

18 Q The question -- Let me make sure the answer is right.
19 The question I asked was would you expect -- Maybe it wasn't;
20 it should be. Let me ask the question again because I think
21 you misunderstood me.

22 MR. MUTSCHELKNAUS: I liked that.

23 MR. LACKEY: I figured you did.

24 BY MR. LACKEY (Continuing):

25 Q Might that explain why the costs of the nonrecurring

1 costs of an unbundled loop might be different than the cost of
2 service provided to our customer?

3 A Let me clarify since I misunderstood you the first
4 time. The cost of changing a customer from our switch to ACSI
5 would be different than the nonrecurring costs associated with
6 our customer.

7 Q That would be because of why?

8 A One of the things is you're going to have to determine
9 whether or not the customer can be, is served on what type of
10 carrier, whether or not they would have to be unintegrated,
11 what type of facilities would be required and you would need to
12 physically move it from the switch to the mainframe and then to
13 the collocated space or wherever.

14 Q You were asked some questions about multi-line
15 customers and single-line customers in your loop sample; is
16 that correct?

17 A Yes, sir.

18 MR. LACKEY: All right. Is it -- I'm sorry. I don't
19 know how to answer the question. I'm through; thank you.

20 I have no further questions, Madam Chairman.

21 CHAIRMAN CLARK: Exhibits.

22 MR. LACKEY: Madam Chairman, I move 65 through 68.

23 CHAIRMAN CLARK: They will be admitted in the record
24 without objection.

25 (Exhibit Nos. 65, 66, 67 and 68 received into

1 evidence.)

2 MS. CANZANO: Staff moves 69 through 71.

3 CHAIRMAN CLARK: They will be admitted in the record
4 without objection.

5 (Exhibit Nos. 69, 70 and 71 received into evidence.)

6 MR. LEMMER: AT&T moves Exhibit No. 72.

7 CHAIRMAN CLARK: Will be admitted in the record
8 without objection.

9 (Exhibit Nos. 72 received into evidence.)

10 CHAIRMAN CLARK: And then 73 and 74 are late-filed
11 exhibits.

12 MR. MUTSCHELKNAUS: Yeah, ACSI would move 73, and
13 subject to any objections that are raised at that time.

14 MR. MELSON: Chairman Clark, I've got a question about
15 whether certain information in Exhibit 68 is regarded as
16 proprietary. I've had a conversation with Mr. Lackey and I'd
17 just like to get on the record what I believe is my
18 understanding: That the Section 3 page summary of results in
19 Exhibit 68 is not proprietary, and understanding his concern
20 that you can piecemeal one of these to death, the utilization
21 percentages on tab C are not proprietary. If I could get
22 that -- If Mr. Lackey agrees with that, that will substantially
23 help us in preparing our brief.

24 MR. LACKEY: Yes. My position is that the outputs
25 that are on page, that are in section 3, the outputs of the

1 TELRIC study -- and that would be, for instance, the total
2 monthly cost for a 2-wire analog voice grade loop of \$24.15 is
3 not proprietary. The outputs are not proprietary. And that
4 the utilization factors that we've already discussed are not
5 proprietary; again, subject to Mr. Melson's comment that I
6 could get piecemeal, if I go to every state and everybody gets
7 a different number, eventually -- I mean, a different piece of
8 it, you can eventually put it together, but I will not assert
9 that either of those two things are proprietary.

10 CHAIRMAN CLARK: Okay. With respect to the late-filed
11 exhibits, why don't we leave them pending right now and we'll
12 handle all late-filed exhibits at once.

13 Ms. Caldwell, you're excused.

14 WITNESS CALDWELL: Thank you.

15 CHAIRMAN CLARK: Mr. Reid.

16 MR. LACKEY: Mr. Reid. Madam Chairman, Mr. Reid I
17 don't believe has been sworn in, and I think we have two other
18 witnesses who are presently here who have not been sworn in yet
19 either.

20 CHAIRMAN CLARK: Okay. Will the other witnesses that
21 are here that will be presenting testimony this afternoon,
22 please stand and be sworn in at the same time as Mr. Reid.

23 (Witnesses sworn collectively.)

24 CHAIRMAN CLARK: Thank you. You may be seated.

25 THEREUPON,

1 A That is correct.

2 Q And on August 23rd, 1996, did you file Supplemental
3 Testimony consisting of seven pages with one exhibit?

4 A That's correct.

5 Q And on August 30th, 1996 did you file Rebuttal
6 Testimony consisting of 21 pages with no exhibit?

7 A That's correct.

8 MR. LACKEY: All right. Madam Chairman, may I move to
9 the next one because we have a correction we need to make
10 that's common to them.

11 BY MR. LACKEY (Continuing):

12 Q I'm going to direct your attention to Docket
13 No. 960846. Did you file on September 9th, 1996 Direct
14 Testimony in that proceeding?

15 A Yes, I did.

16 Q Consisting of 26 pages accompanied by 3 exhibits?

17 A That's correct.

18 Q And on September 16th, 1996 did you file Rebuttal
19 Testimony consisting of 12 pages accompanied by 2 exhibits?

20 A That is correct.

21 Q All right. Now do you have any changes or corrections
22 to the testimony that you have caused to be prefiled in this
23 proceeding?

24 A Yes. I would like to make a change in one section of
25 my testimony that's repeated in the two dockets. The same

1 wording is repeated in both dockets.

2 In Docket No. 960833, it appears at page 8, lines 5
3 through 12. And I do have a handout that shows the revised
4 wording.

5 It also appears in Docket 960846 on page 8, lines 20
6 through page 9, line 7.

7 MR. LEMMER: Excuse me, if I could interrupt. Is that
8 his Direct Testimony?

9 WITNESS REID: Yes, that is my Direct Testimony.

10 MR. LEMMER: Thank you.

11 WITNESS REID: The correction I'm making is to an
12 example or a display that I used to explain why residence and
13 business discounts are appropriate individually.

14 I can -- On the AT&T testimony in the Direct
15 Testimony, starting at line 5, I would replace --

16 MR. LACKEY: Wait a minute. Before you do that,
17 Mr. Reid -- Madam Chairman, I have typed copies of it. It will
18 make it easier to follow if I can have them handed out.

19 He's changing four or five lines and I think it will
20 be easier to see where he's going if you have got it in front
21 of you.

22 WITNESS REID: While he's handing it out, the basic
23 reason for the change is I composited the residence and
24 business in the example based on the number of customers and I
25 believe it's more representative to composite it based on the

1 revenues provided by the customer classes. So I'm changing the
2 example to be more representative of how it really would be
3 composited.

4 BY MR. LACKEY (Continuing):

5 Q I think everybody has got a copy of it. If you would
6 now give the changes, Mr. Reid.

7 A Okay. What I would like to do is just on line 5,
8 starting with the words "If residential customers" to the end
9 of the paragraph at the end of line 12. I'll replace it, that
10 wording, with the wording on the typed sheet, which reads: "If
11 residential customers provided 49% of total retail revenues and
12 business customers provided 51%, the composite discount for
13 total customers would be 15.5% (i.e., 49% x 19% + 51% x
14 12.2 %). However, the use of the composite discount would give
15 inappropriate results, because in the case of a business
16 customer, the Company would give the reseller a discount of
17 \$6.63 (i.e., the average monthly bill of \$42.75 x the wholesale
18 discount of 15.5%), but the Company would only avoid \$5.20 of
19 cost. Thus, in this example the Company would lose \$1.43 on a
20 net basis from the resale transaction."

21 With that correction, that corrects my Direct,
22 Supplemental and Rebuttal Testimonies.

23 Q And that's in both -- That's in both dockets?

24 A That same wording is in both dockets at the locations
25 shown on the top of the sheet.

1 Q With that correction, if I were to ask you the same
2 questions that appear in your prefiled testimony in both
3 dockets today, would your answers be the same?

4 A Yes, they would.

5 MR. LACKEY: Madam Chairman, could I have that
6 prefiled testimony included in the record as if given from the
7 stand?

8 CHAIRMAN CLARK: It will be inserted in the record as
9 though read.

10 BY MR. LACKEY (Continuing):

11 Q And do you have any corrections or changes to your
12 exhibits, Mr. Reid?

13 A No, I do not.

14 MR. LACKEY: Madam Chairman, could I have his exhibits
15 marked. He's got two in the 833 case attached to the Direct
16 and one to the Supplemental.

17 CHAIRMAN CLARK: Okay. Is it WSR-1 and -2 attached to
18 the Direct?

19 MR. LACKEY: Yes, ma'am. And it's WR-3 to the
20 Supplemental.

21 WITNESS REID: WSR-3 to the Supplement.

22 MR. LACKEY: WSR-3 to the Supplemental.

23 CHAIRMAN CLARK: Okay. WSR-1 and -2 will be marked as
24 Composite Exhibit 75 and WSR-3 will be marked as Exhibit 76.

25 (Exhibit Nos. 75 and 76 marked for identification.)

1 MR. LACKEY: And accompanying his testimony in 950846,
2 there were three exhibits attached to the Direct: WSR-1, -2
3 and -3, and two exhibits attached to his Rebuttal.

4 COMMISSIONER KIESLING: I'm sorry; could I get that
5 clarified? On the MCI testimony, I've got three exhibits
6 attached to the Direct and nothing attached to the Rebuttal.

7 MR. LACKEY: On the MCI, Commissioner, I'm showing two
8 attached to his Rebuttal, WSR-4, and WSR-5.

9 COMMISSIONER KIESLING: I don't seem to have those.

10 CHAIRMAN CLARK: I do have them.

11 COMMISSIONER KIESLING: Okay.

12 CHAIRMAN CLARK: The testimony concludes on page 12?

13 COMMISSIONER KIESLING: Yes.

14 CHAIRMAN CLARK: And you don't have them attached?

15 COMMISSIONER KIESLING: I have nothing attached.

16 Okay.

17 MR. LACKEY: The only explanation I might have is
18 those exhibits were filed separately from the testimony, so
19 that might have caused it.

20 CHAIRMAN CLARK: Mr. Lackey, WSR-1, -2, -3, filed in
21 Docket 960846 will be marked as Exhibit 77. And WSR-4 and -5
22 in that same docket will be marked as Exhibit 78.

23 MR. LACKEY: Thank you, Madam Chairman.

24 COMMISSIONER KIESLING: And I would just indicate our
25 Staff has given me copies now. Thank you.

(Exhibit Nos. 77 and 78 marked for identification.)

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1 **BELLSOUTH TELECOMMUNICATIONS, INC.**

2 **TESTIMONY OF WALTER S. REID**

3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

4 **DOCKET NO. 960833-TP**

5 **AUGUST 12, 1996**

6
7 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND POSITION
8 WITH BELLSOUTH TELECOMMUNICATIONS, INC.

9
10 A. My name is Walter S. Reid and my business address is 675 West Peachtree Street,
11 Atlanta, Georgia. My position is Senior Director for the Finance Department of
12 BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth" or
13 "the Company").

14
15 Q. BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND
16 BUSINESS EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY.

17
18 A. I received bachelor and master of science degrees in industrial engineering in
19 1969 and 1971, respectively, from the Georgia Institute of Technology. I was
20 employed by BellSouth in November, 1971, as a management trainee in the
21 Comptrollers Department in Jacksonville, Florida. Since that time, I have held
22 various positions of increasing responsibility in the areas of budget and forecast

1 preparation, cost accounting, separations, and regulatory matters. I was
2 transferred to my current position at Company Headquarters in October, 1987.
3 Overall, I have over 24 years experience dealing with the financial issues of the
4 Company.

5
6 Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

7
8 A. I am responsible for the preparation and analysis of the Company's financial
9 results, the provision of accounting and cost information requested in proceedings
10 before state regulatory commissions and the coordination of other regulatory
11 activities.

12
13 Q. HAVE YOU TESTIFIED PREVIOUSLY REGARDING FINANCIAL ISSUES
14 IN STATE REGULATORY PROCEEDINGS?

15
16 A. Yes. I have testified in numerous regulatory proceedings before this Commission,
17 as well as the Commissions in Georgia, North Carolina, and South Carolina.
18 Most recently, I testified in Georgia Docket No. 6352-U, "Petition of AT&T for
19 the Commission to Establish Resale Rules, Rates, Terms and Conditions and the
20 Initial Unbundling of Services". My testimony in that docket addressed an
21 AT&T study used to support its proposed wholesale discount for total local
22 service in Georgia.

1

2 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS PROCEEDING?

3

4 A. The purpose of my testimony in this proceeding is to address the appropriate
5 methodology for use in determining BellSouth's retail costs which will be
6 avoided when sales are made to resellers rather than to end user customers, and to
7 present the study that calculates the appropriate wholesale discounts for the
8 Company's Florida operations based on the determination of the costs that will be
9 avoided. The study results for Florida are wholesale discounts of 19.0% for
10 residential services and 12.2% for business services. A summary of BellSouth's
11 study is included as Exhibit WSR-1 of my testimony.

12

13 In addition, my testimony will comment on the methodology used by AT&T in its
14 "avoided retail cost study" for Florida. Details of AT&T's study are included as
15 an attachment to AT&T's petition in this docket at Bates page numbers 700000
16 through 700248. This study calculates a wholesale discount for total local
17 service in Florida equal to 41.7% based on "avoidable costs". AT&T also
18 proposes additives to this wholesale discount that would further inflate the
19 discount to 71.7% (AT&T petition at pages 22-24). This is an unreasonable
20 result even before the additives are applied, and would certainly not allow
21 BellSouth to recover its cost of providing the services which are being resold.
22 Based on my review of AT&T's study presented in this docket, it is obvious that

1 the mechanics of its “avoided retail cost model” are flawed, and that these flaws
2 cause a significant overstatement of its proposed wholesale discount factor. The
3 flaws in the mechanics of AT&T’s model are inherent in its whole approach to the
4 calculation of a wholesale discount factor and render its study unusable for
5 determining wholesale prices in this proceeding.

6
7 Q. DOES YOUR TESTIMONY ADDRESS THE DIRECT TESTIMONY OF
8 AT&T WITNESSES IN THIS PROCEEDING?

9
10 A. No. My testimony does not address the testimony which AT&T has filed
11 subsequent to the filing of its petition. Responses to AT&T’s testimony will be
12 included in the Company’s rebuttal testimony in this docket.

13
14 Q. HOW IS YOUR TESTIMONY ORGANIZED?

15
16 A. My testimony begins with an identification of the federal requirements included in
17 the Telecommunications Act of 1996 (hereinafter referred to as “the Act”) related
18 to wholesale pricing. The subject of the testimony then focuses on the
19 Company’s methodology to fulfill the federal requirements and the computation
20 of wholesale discounts specific to BellSouth’s Florida operations. Finally,
21 AT&T’s proposed methodology for determining the wholesale discount is
22 addressed.

1

2 **FEDERAL REQUIREMENTS RELATED TO WHOLESALE PRICING**

3

4 Q. WHAT DOES THE ACT REQUIRE AS IT RELATES TO THE
5 DETERMINATION OF WHOLESALE RATES TO BE CHARGED BY
6 BELLSOUTH?

7

8 A. Section 252(d)(3) of the Act under the caption, "WHOLESALE PRICES FOR
9 TELECOMMUNICATIONS SERVICES", states:

10

11 "For the purposes of section 251(c)(4), a State commission shall determine
12 wholesale rates on the basis of retail rates charged to subscribers for the
13 telecommunications service requested, excluding the portion thereof attributable
14 to any marketing, billing, collection, and other costs that will be avoided by the
15 local exchange carrier."

16

17 Q. DOES YOUR TESTIMONY ADDRESS THE RECENTLY ISSUED FEDERAL
18 COMMUNICATIONS COMMISSION (FCC) RULES RELATED TO
19 WHOLESALE PRICING?

20

1 A. No. The FCC's rules were not received in time to be incorporated into this
2 testimony. Comments related to the impact of the FCC's rules will be included
3 in subsequent testimony in this docket.
4

5 **BELLSOUTH'S METHODOLOGY FOR DETERMINING WHOLESALE**
6 **DISCOUNTS**
7

8 Q. WHAT IS THE APPROPRIATE METHODOLOGY TO USE IN
9 CALCULATING A WHOLESALE DISCOUNT?
10

11 A. The basic equation for calculating the discount is displayed on Exhibit WSR-2,
12 page 1 of 2. The discount is based on the relationship between avoided costs and
13 revenues and is calculated by dividing the 1995 costs that will be avoided by the
14 amount of 1995 revenue subject to being discounted. Separate calculations are
15 performed for residential service and business service. The result of applying this
16 equation is that on average, for each residential customer that buys
17 telecommunication service from a reseller, the costs that will be avoided as a
18 percent of revenue equals a wholesale discount of 19.0%. Similarly, for business
19 customers buying service from a reseller, the costs that will be avoided as a
20 percent of revenue result in a wholesale discount of 12.2%. Using residential
21 service as an example, if the customer consumes \$20.00 (based on retail tariff
22 rates) of local and toll services per month, then BellSouth will avoid \$3.80 of

1 costs on a monthly basis when the customer is served by a reseller. The Company
2 would charge the reseller \$16.20 (\$20.00 less a discount of \$3.80) for the same
3 level of consumption of service for this customer.

4
5 Q. WHY DOES BELLSOUTH RECOMMEND SEPARATE DISCOUNTS FOR
6 RESIDENCE AND BUSINESS RETAIL SERVICES IN DETERMINING
7 WHOLESALE PRICES?

8
9 A. Because characteristics and levels of revenues and costs vary between residential
10 and business customers, the Company is recommending two separate discounts.
11 Inherent in the Company's methodology and application of the wholesale
12 discounts is the assumption that residence or business customers that choose to go
13 with a reseller will be average revenue customers for that class of service. To the
14 extent that a reseller targets higher than average revenue customers, the monetary
15 discount that the reseller will receive will logically exceed the costs that will be
16 avoided by BellSouth.

17
18 An example of the calculations will demonstrate the impact that the loss of
19 customers with differing average levels of monthly revenue will have on the
20 Company. Assume a situation in which the Company would avoid approximately
21 \$3.45 in average retail costs for residential customers and the average monthly
22 bill for residential customers is \$18 per customer. Based on this information, the

1 residential wholesale discount would be 19% (i.e., \$3.45/\$18). Also, assume that
2 the Company will avoid approximately \$5.20 in average retail costs for business
3 customers and the average monthly bill for business customers is \$42.75. Based
4 on this information, the business wholesale discount would be approximately
5 12.2% (i.e., \$5.20/\$42.75). ~~If residential customers represented 70% of total~~
6 ~~customers and business customers represented 30%, the composite discount for~~
7 ~~total customers would be 17% (i.e., 70% x 19% plus 30% x 12.2%). However,~~

8 If residential customers provided 49% of total retail revenues and business
9 customers provided 51%, the composite discount for total customers
10 would be 15.5% (i.e., 49% X 19% plus 51% X 12.2%). However, the
11 use of the composite discount would give inappropriate results, because in
12 the case of a business customer, the Company would give the reseller a
13 discount of \$6.63 (i.e., the average monthly bill of \$42.75 times the
14 wholesale discount of 15.5%), but the Company would only avoid \$5.20
15 of cost. Thus, in this example the Company would lose \$1.43 on a net
16 basis from the resale transaction.

14 This effect is also present for customers within the residence and business
15 categories who have different average monthly bills, but the Company has only
16 addressed the disparity at the total residence and total business level. If resellers
17 target high revenue customers within the residence and business categories, a
18 likely scenario, then the Company's calculated wholesale discounts will generate
19 more monetary discount for the reseller than the costs that will be avoided by the
20 Company.

21

1 Q. HOW DID THE COMPANY DETERMINE WHICH RETAIL COSTS WILL BE
2 AVOIDED WHEN THE COMPANY PROVIDES SERVICES ON A
3 WHOLESALE BASIS?
4

5 A. To determine the costs that will be avoided, the Company analyzed the work
6 functions that are currently being performed to provide retail services to the
7 Company's customers. The Company has an internal accounting system that
8 identifies the major work functions of the business and tracks the costs associated
9 with various work functions being performed. The information from this system
10 is used both for management of the business, as well as for input to the system
11 that assigns costs between regulated and non-regulated operations. The Company
12 analyzed each of its work functions for the categories of expense that would be
13 impacted by a wholesale situation and identified, using 1995 Florida operating
14 data, the level of expense for each work function that will be avoided with resale.
15 A graphic representation of the approach is given on Exhibit WSR-2, page 2 of 2.

16
17 Q. PLEASE DESCRIBE THE NATURE OF THE COSTS THAT WILL BE
18 AVOIDED.
19

20 A. The costs that will be avoided are included in the expense categories for customer
21 services, billing, sales, uncollectibles, and advertising. These costs are volume
22 sensitive amounts that are associated with the provision of regulated residential

1 or business retail services. Further, the avoided costs are associated with work
2 functions that directly relate to interaction between the Company and the
3 customer, an interaction which will normally not occur under resale. For
4 example, it is assumed that the Company will not mail a bill to customers of local
5 service resellers and therefore, the costs of postage, paper, printing, labor, etc.,
6 associated with the customer billing work functions are identified as avoided costs
7 for that customer.

8
9 If, however, the customer subscribes to any service from BellSouth, such as
10 intraLATA toll, in addition to subscribing to service from a reseller, the avoided
11 costs identified for billing are overstated because the interaction with the customer
12 represented by the bill would not be avoided. In addition, to the extent billing
13 costs are incurred to prepare the bill for the reseller, the amount of avoided billing
14 costs and the wholesale discount are both overstated.

15
16 Q. HOW DID THE COMPANY DETERMINE THE AMOUNT OF CUSTOMER
17 SERVICES COSTS THAT WILL BE AVOIDED?

18
19 A. The costs associated with customer services are recorded in Account 6623 under
20 the FCC's Uniform System of Accounts ("USOA"). The Company's internal
21 accounting system identifies and tracks the costs for numerous work functions
22 which underlie the total charges to this account. The study examined the nature of

1 each of these work functions in order to determine whether or not that function
2 would continue to be performed for the customer under resale. The functions that
3 will not be performed for the resold accounts include remittance operations,
4 service representative training, service order entry, collections, account inquiry,
5 demand sales, address information, and customer payment operations. Many
6 functions in Account 6623 will continue to be performed for the resold accounts.
7 Therefore, the costs associated with those functions will not be avoided. These
8 functions include, for example, local and toll message processing, accounts
9 operations, message investigation, support and indirect supervision.

10
11 Q. WHAT ARE THE BILLING COSTS THAT WILL BE AVOIDED?

12
13 A. The costs for billing are also recorded in Account 6623. The only billing costs
14 that will be avoided due to resale are the costs associated with printing and
15 mailing a bill to the customer. These costs are captured in a unique job function
16 code underlying the charges to Account 6623. The Company will still be
17 maintaining a customer record for each customer served by a reseller. BellSouth
18 will record and maintain usage and service characteristics of each customer so that
19 it can render a bill to the reseller. While the Company will incur an additional
20 cost in sorting, printing and mailing the customer bill information to the reseller,
21 the Company did not include costs for this additional work in its study.

22

1 Q. WHAT ARE THE SALES EXPENSES THAT WILL BE AVOIDED?

2

3 A. The Company's sales expenses are recorded in Account 6612. The Company's
4 study assumes sales expenses for customers that choose to buy service from a
5 reseller will not be incurred. In this regard, the Company identified all regulated
6 residential and business sales expenses in Account 6612 as avoided costs.

7

8 Q. DID THE COMPANY IDENTIFY ANY PRODUCT MANAGEMENT OR
9 ADVERTISING COSTS AS AVOIDED COSTS?

10

11 A. The Company identified some advertising costs associated with bill inserts as an
12 avoided cost. Because the Company will not be sending the customer of the
13 reseller a bill, it follows that this type of advertising will also be avoided. Product
14 management and advertising costs, other than through bill inserts, will not be
15 avoided however, because these costs are not volume sensitive. The level of these
16 costs is not dependent on whether an individual customer obtains service from a
17 reseller or from BellSouth.

18

19 The activities associated with product management span functions that include
20 research and development, product introduction, tariff application, methods and
21 procedures, and product delivery. The level of costs associated with these
22 functions is not sensitive to whether or not the services will be resold. In addition,

1 product advertising costs, which are associated with individual products or
2 families of products, are not sensitive to the volume of customers and will not
3 decrease with customer migration to resellers. Therefore, these costs do not
4 represent avoided costs, and it would be inappropriate to include them in the
5 calculation of the wholesale discount.

6
7 Q. HOW DID THE COMPANY TREAT UNCOLLECTIBLES IN ITS STUDY?

8
9 A. For purposes of this study, the Company assumed that uncollectibles from
10 customers who buy from resellers will be avoided by BellSouth. The reseller is
11 responsible for absorbing any bad debt on the part of its customers. If BellSouth
12 experiences reseller related uncollectibles, then it may be appropriate to reduce
13 the level of avoided costs by the amount of reseller uncollectibles and decrease
14 the wholesale discount.

15
16 **COMMENTS RELATED TO AT&T'S PROPOSED WHOLESALE DISCOUNT**

17
18 Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE FINANCIAL
19 MECHANICS OF AT&T'S STUDY.

20
21 A. According to AT&T's petition in this docket, AT&T's study utilized, as a data
22 source, the 1995 booked revenues and expenses/costs data for the Company's

1 Florida operations. This data was obtained by AT&T from certain Automated
2 Report Management Information System (ARMIS) reports filed by BellSouth
3 with the FCC. AT&T then used its own methodologies to assign these Company
4 revenues and expenses/costs to various product categories. Based on the amounts
5 which it allocated to selected product categories, AT&T derived amounts it
6 attributes to BellSouth's total local exchange service revenues and costs for its
7 Florida operations.

8
9 It is obvious from the reported results of AT&T's study that a substantial portion
10 of the costs that AT&T is attributing to BellSouth's local business operations are
11 not covered by the revenue streams the Company is receiving from all local tariff
12 rates. A comparison of the total local expenses/costs of \$2,198,378,000 shown on
13 Bates page 700111 of AT&T's study with the local revenues of \$1,495,388,000
14 shown on Bates page 700110 results in a revenue shortfall for BellSouth of
15 approximately \$703 million. I will explain later in my testimony how AT&T's
16 study results distort the calculation of a wholesale discount factor.

17
18 The next step in AT&T's approach was to attempt to identify, through arbitrary
19 assignments, components of local exchange service expenses/costs which it
20 characterized as the "avoided retail amount". AT&T then calculated its proposed
21 wholesale discount factor based on the relationship between its totals for the
22 avoided retail amount and local revenues.

1

2 Q. WHAT ARE THE MAJOR FLAWS YOU SEE IN THE MECHANICS OF
3 AT&T'S AVOIDED RETAIL COST STUDY?

4

5 A. AT&T's approach for the calculation of a wholesale discount factor overstates the
6 calculated discount in at least three broad areas. The first area of overstatement is
7 caused by the procedures AT&T used to assign amounts for expenses/costs to
8 local exchange service. These amounts are reflected under the column heading
9 "Total Local BU" (business unit) on Bates pages 700110 and 700111 of AT&T's
10 study. The second area of overstatement is caused by AT&T's arbitrary
11 identification of avoided retail costs. The third area of overstatement is caused by
12 the limited revenue base (AT&T's revenue base does not include intraLATA toll
13 revenue) which AT&T uses to divide into the avoided costs from its study.

14

15 Q. PLEASE ELABORATE ON THE FIRST BROAD AREA OF
16 OVERSTATEMENT OF THE DISCOUNT FACTOR WHICH YOU HAVE
17 IDENTIFIED.

18

19 A. The nature of the first overstatement problem can be demonstrated by referring to
20 the data in the first column (headed "Total Local BU") of AT&T's study at Bates
21 page 700111. The total local service expense which AT&T identifies in this
22 column is \$2,198,378,000. In addition to these local expenses, AT&T identified

1 local net other interest deductions of \$21,426,000, income taxes of \$156,257,000
2 and local return requirements of \$435,243,000. Based on these local expense/cost
3 assignments, one can calculate that local revenues should be \$2,811,304,000 (the
4 sum of each of the amounts previously described) in order to cover all local
5 expenses/costs including a return on assets. This is not the revenue amount which
6 AT&T assigns to local service, however. As shown on the first line of Bates page
7 700110 AT&T has only attributed \$1,495,388,000 to local service revenues.

8
9 Because AT&T is arbitrarily assigning amounts to avoidable expenses/costs from
10 a potential allocable pool of expenses/costs of \$2,811,304,000 and then dividing
11 by revenues of only \$1,495,388,000, it is obvious that the resulting discount factor
12 will be significantly inflated. Another way to demonstrate this problem is to
13 compute the percent of non-avoided local expenses to total local revenues from
14 AT&T's study. This can be computed by subtracting AT&T's total avoided retail
15 expenses/costs of \$624,305,000 from its total local expenses/costs of
16 \$2,811,304,000 and dividing this result by their local revenues of \$1,495,388,000.
17 This computation indicates that the non-avoided local costs from AT&T's study
18 are 146.3% of the total local revenues.

19
20 Based on AT&T's model, the discount factor could even exceed 100% if the
21 avoidable local expenses/costs amounted to 53.2% or greater of total local
22 expense/cost. Stated another way, using the AT&T model, if one calculated that

1 BellSouth could avoid 90% of its retail local costs in a wholesale transaction, the
2 resulting wholesale discount factor would be 169% of the tariff rate (i.e., the
3 Company would have to pay AT&T 69% of the tariff rates in a resale situation).
4 This is an unreasonable result, demonstrating the inherent bias in AT&T's
5 approach.

6
7 Q. ARE THERE OTHER INDICATIONS THAT THE AT&T ANALYSIS IS
8 UNRELIABLE?

9
10 A. Yes. Even a cursory review of AT&T's assignment of expenses to the local
11 business unit raises serious doubts about the reliability of its cost assignments.
12 For instance, a category of expense for directory assistance services assigned by
13 AT&T to the local business unit reflects a total, \$55,640,000, which equals the
14 entire amount of both interstate and intrastate directory assistance (DA) expense
15 and intercept expense reported by the Company to the FCC on ARMIS Report
16 43-04 for 1995. There is no logical justification why all of this expense would be
17 assigned to local service. Certainly, a portion of these expenditures are related to
18 the toll and access services provided by the Company. In fact, the Company
19 reported on the ARMIS Report 43-04 that the FCC's Part 36 and Part 69 Rules
20 would assign over \$6 million of directory assistance expense to the interstate
21 information element of access expense. AT&T's methodology obviously
22 reassigns this expense to the local service category, with no explanation. In

1 addition, the Company collects over \$2 million in intrastate directory assistance
2 revenues related to intrastate toll calls in Florida. AT&T has treated all of the
3 directory expenses as local and has ignored the fact that current cost assignments
4 and revenue recoveries treat some of this directory assistance expense as access or
5 toll. AT&T's treatment of this expense demonstrably shows the overstatement
6 bias inherent in its proposed discount factor. By overstating expense categories
7 that it has treated as 100% avoided, AT&T distorts the resulting relationship
8 between avoided expense and local revenues.

9
10 Regarding the treatment of uncollectible expense, AT&T has assigned
11 \$41,943,000, or approximately 95%, of the Company's total intrastate regulated
12 uncollectible expense of \$44,272,000 (ARMIS Report 43-04, page 17.1 of 30.3)
13 to the local category. AT&T then treats 100% of this local uncollectible amount
14 as an avoided cost. This is not a reasonable calculation. AT&T claims that local
15 revenues are \$1,495,388,000, which is approximately 59% of total intrastate
16 revenue. Even if intrastate access revenue is excluded from total intrastate
17 revenue, AT&T's local revenue amount is only about 67% of total intrastate
18 revenue. These relationships certainly call into question a 95% assignment of
19 uncollectibles to local.

20
21 In another category of expense, marketing, AT&T's assignment of approximately
22 \$110.5 million of the Company's product management, sales, and advertising

1 expenses to the local business unit exceeds the amount of \$96.3 million reported
2 by the Company on the ARMIS Report 43-04 for the total intrastate jurisdiction
3 by approximately \$14 million. This is not a reasonable result and is further
4 evidence that the AT&T analysis of “avoidable” retail costs is flawed and should
5 not be relied upon in this proceeding.

6
7 AT&T’s cost assignments also do not meet overall reasonableness tests. The total
8 amount of 1995 local exchange service expenses/costs which AT&T identified in
9 its study, \$2,811,304,000, exceeds the total intrastate revenues BellSouth reported
10 for 1995 (see BellSouth’s 1995 Surveillance Report) from all sources (local, toll,
11 access and miscellaneous), by over \$268 million. This test indicates that AT&T’s
12 cost assignments to local service are unreasonable.

13
14 Q. WHAT ARE YOUR COMMENTS RELATIVE TO YOUR SECOND AREA OF
15 CONCERN, AT&T’S ASSIGNMENT OF LOCAL EXPENSES/COSTS TO ITS
16 TOTAL AVOIDED RETAIL AMOUNT?

17
18 A. My second area of concern with the AT&T study is with the arbitrary and
19 unreasonable approach they used in identifying avoided retail amounts. In one
20 category of expense, Product Management, AT&T treated 100% of this expense
21 as avoided. Product Management expense, per the USOA, includes costs
22 incurred in performing administrative activities related to marketing products and

1 services. This includes competitive analysis, product and service identification
2 and specification, test market planning, demand forecasting, product life cycle
3 analysis, pricing analysis, and identification and establishment of distribution
4 channels. The nature of this expense is not volume sensitive. Therefore, resale of
5 some quantity of the Company's services should not result in avoided product
6 management expenses. In fact, resellers will just be one of the distribution
7 channels considered in the management of the service. In addition resellers will
8 benefit due to the fact that the Company is offering a particular service because
9 they will be able to resell it to their customers. It is unreasonable to treat this
10 expense as avoided.

11
12 In another category of expense, which AT&T entitled G&A (General &
13 Administrative), it arbitrarily allocated 27.5% of the amount they assigned to local
14 expenses to the total avoided retail amount even though the nature of these
15 expenses is such that the Company does not expect to see reductions due to resale.
16 For example, 24% of the total G&A expense category is related to Account 6724,
17 Information Management expense. Account 6724 includes costs incurred in
18 planning, developing, testing, implementing and maintaining data bases and
19 application systems for general purpose computers. The Company has not
20 identified any data bases or application systems that it will eliminate due to the
21 existence of resellers. In fact it is more likely that enhancements or new systems
22 will have to be developed to meet the special needs of resellers. AT&T's

1 arbitrary approach treats 27.5% of this expense as avoided, however. These are
2 just a few examples of the unreasonable components in AT&T's study.

3
4 Q. PLEASE EXPLAIN YOUR THIRD AREA OF CONCERN WITH THE AT&T
5 STUDY.

6
7 A. In AT&T's study, the revenue base they utilized in Florida to divide into
8 identified avoided costs was limited to basic local revenues including local
9 vertical services. In BellSouth's study, the Company included both local and
10 intraLATA toll revenues in the revenue base, because some costs such as billing
11 costs, are shared among customer services and will not be avoided unless the
12 entire customer contact is broken. AT&T's approach raises many problems, all of
13 which seem to result in an overstated discount factor. For instance, as I have
14 previously pointed out, AT&T's assignment of cost to local service far exceeds
15 the local revenues identified. This means, inherently, that it is attributing heavy
16 amounts of contribution to cover local costs from other services, including
17 intraLATA toll. When, under AT&T's approach, a BellSouth customer switches
18 to AT&T under resale, if AT&T also displaces BellSouth as that customer's
19 intraLATA toll provider, the Company loses twice and AT&T wins twice. Using
20 AT&T's discount calculation, BellSouth would give AT&T a local discount that
21 includes costs that are actually being recovered through intraLATA toll revenues.

1 Then, as a second bite, AT&T would take away the intraLATA toll revenues that
2 were providing the contribution toward local costs.

3

4 Q. WHAT IS YOUR OVERALL OPINION OF AT&T'S ANALYSIS?

5

6 A. My testimony highlights only a few of the more glaring flaws in AT&T's
7 analysis. I believe these flaws demonstrate that the analysis is so biased and
8 illogical as to render it unusable for this proceeding. Based on the amount of
9 expense, income tax, and return requirements that AT&T has assigned to local
10 exchange service in Florida, it would take more than the total intrastate revenues
11 (local, toll, access and miscellaneous) to cover these identified expense and cost
12 requirements. The relationship which AT&T develops between the portion of
13 these expenses and costs that AT&T portrays as avoided and the local service
14 revenues it has identified is unreasonable. Therefore, AT&T's request for a
15 41.7% wholesale discount factor should be rejected.

16

17 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

18

19 A. BellSouth's methodology for calculating wholesale discounts for residence and
20 business services is a reasonable approach which meets the federal requirements
21 of the act. The study is generous to resellers in at least three areas: 1) the study
22 does not include increases in cost that the Company may incur to serve resellers;

1 2) the study does not include any uncollectibles related to resellers; 3) the study
2 assumes that resellers will serve average revenue customers even though it is
3 likely that high revenue customers will be targeted. AT&T's study which was
4 included in their petition is demonstrably biased, arbitrary and unusable for this
5 proceeding.

6

7 Q. DOES THIS COMPLETE YOUR TESTIMONY?

8

9 A. Yes.

10

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1 **BELLSOUTH TELECOMMUNICATIONS, INC.**

2 **SUPPLEMENTAL TESTIMONY OF WALTER S. REID**

3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

4 **DOCKET NO. 960833-TP**

5 **AUGUST 23, 1996**

6

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

9

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

14

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

17

18 A. Yes. I filed direct testimony on behalf of BellSouth on August 12, 1996.

19

20 Q. WHAT IS THE PURPOSE OF YOUR SUPPLEMENTAL TESTIMONY?

21

1 A. The purpose of my supplemental testimony is to provide information relative to
2 the impact on this proceeding of the resale provisions of the Federal
3 Communications Commission's (hereinafter referred to as the "FCC" or "FCC's")
4 First Report and Order ("Order") in CC Docket No. 96-98, In the Matter of
5 Implementation of the Local Competition Provisions in the Telecommunications
6 Act of 1996, including Appendix B- Final Rules ("Rules"), which was released on
7 August 8, 1996. Specifically, I will provide the calculation of a wholesale
8 discount for retail services in Florida based on the FCC's criteria, as described in
9 its Order, for wholesale cost studies, and the Company's analysis of the accounts
10 for which the FCC allows for rebuttable presumptions. The Company does not
11 agree with the FCC's criteria regarding the determination of avoided/avoidable
12 costs, and it believes that BellSouth's study complies with the Act. However, in
13 order to provide the Commission with information relative to the impact of the
14 FCC's Order, I have prepared Exhibit WSR-3 to demonstrate this methodology
15 and to provide the calculations for the resulting Florida wholesale discount.
16 Based on this methodology, the wholesale discount applicable to all retail services
17 (business and residence) would be 19.7%.

18
19
20 Q. IS THE COMPANY SUBSTITUTING THIS CALCULATION OF THE
21 WHOLESALE DISCOUNT FOR THE STUDY IT HAS FILED IN THIS
22 PROCEEDING?

1

2 A. No. Exhibit WSR-3 does not replace the Company's study. The Company still
3 supports its study as the most appropriate calculation of wholesale discount
4 factors. However, Exhibit WSR-3 provides additional information to the
5 Commission regarding the impact of the FCC's Order and Rules.

6

7 Q. PLEASE DESCRIBE EXHIBIT WSR-3.

8

9 A. The format for Exhibit WSR-3 shows in the first column of page 1, the accounts
10 within the FCC's Uniform System Of Accounts (USOA), which the FCC has
11 treated either as presumptively avoided direct expense accounts or as indirectly
12 avoided overhead and general support expense accounts. The second column
13 reports the amount of regulated expense for each account shown in column 1 as
14 reported by BellSouth to the FCC on the ARMIS Report 43-03 for 1995 Florida
15 operations. The third column reports for the direct avoided accounts, the
16 Company's analysis regarding the amount of expense in these accounts which the
17 Company believes may qualify as avoidable under the FCC's stated criteria in the
18 Order. For the indirect accounts, the third column reflects an allocation to
19 avoided expense based on the ratio of total avoided direct expenses to total
20 expenses. The indirect expense allocation ratio is calculated in Column 2, below
21 the total for overhead and general support expenses.

22

1 I have computed the wholesale discount at the bottom of Exhibit WSR-3. The
2 first step in this calculation was to add the indirect avoided expenses to the direct
3 avoided expenses to compute total avoided expenses. The next step was to
4 determine the revenues subject to discount. This amount was determined by
5 adding the residence and business revenues subject to discount from the
6 Company's study and adding to this total non-recurring revenues, contract service
7 arrangement (CSA) revenues, and grandfathered service revenues. The total of
8 these revenue amounts equals the revenues subject to discount. Finally, the
9 wholesale discount is calculated by dividing the avoided costs by the revenues
10 subject to discount. The calculation yields a wholesale discount of 19.7%
11 (\$351,571,000 of avoided costs divided by \$1,788,314,000 of revenues subject to
12 discount).

13
14 Q. WHAT IS THE BASIS FOR THE COMPANY'S ANALYSIS REGARDING
15 THE AMOUNTS SHOWN ON EXHIBIT WSR-3 FOR THE DIRECT
16 AVOIDED EXPENSE ACCOUNTS IN COLUMN 3?

17
18 A. The FCC's Order and Rules treat accounts 6611-6613 and 6621-6623 as
19 presumptively avoided, but allows the incumbent local exchange carrier ("LEC")
20 to rebut this presumption to the state commission (the Order at paragraph 917).
21 The amounts in Column 3 for the direct avoided expense accounts represents the

1 Company's analysis, utilizing the FCC's avoided/avoidable criteria, of the work
2 operations performed applicable to these accounts.

3
4 For account 6611 (product management), the Company analyzed each job
5 function and its associated costs. The majority of these functions are non-
6 avoidable. They include such functions as: developing rates and tariffs for new
7 services, developing product plans, enhancements of existing services, forecasting
8 demand for products and services, and support for these functions. These
9 functions comprise the majority of costs in account 6611. Therefore, most of the
10 cost in this account is non-avoidable.

11
12 In this analysis for accounts 6612 (sales), and 6613 (advertising), the Company
13 treated as non-avoidable those 1995 expenses recorded in the accounts which
14 were related to carrier services, public services, and operator services. A
15 significant portion of the expense in these accounts is treated as avoidable.

16
17 For accounts 6621 (call completion) and 6622 (number services), the Company
18 treats these expenses in the analysis as non-avoidable for resale purposes. To the
19 extent AT&T takes over the operator services functions from BellSouth by direct
20 routing of local telephone calls to its operators (see AT&T witness Mr. Art
21 Lerma's direct testimony at page 11, lines 7-9), it is taking over a line of business
22 with its own revenue stream. Call completion and number service expenses are

1 appropriately not treated as avoided because they are not associated with the retail
2 lines of business that the Company would retain under AT&T's scenario. If on the
3 other hand AT&T continues to secure operator services from BellSouth, these
4 expenses are non-avoidable because the functions will continue to be performed
5 as currently.

6
7 Finally, for account 6623 (customer services), the Company utilized the data from
8 its avoided cost study for this account but added as avoidable certain indirect and
9 other expenses. The amount treated as non-avoidable includes customer service
10 expenses associated with carriers, public services, and operator services. In
11 addition the Company included additional amounts as non-avoidable for customer
12 services functions that would be required for alternative local exchange
13 companies.

14
15 Q. HOW DID YOU DETERMINE THE SPECIFIC OVERHEAD AND GENERAL
16 SUPPORT ACCOUNTS TO INCLUDE ON EXHIBIT WSR-3?

17
18 A. In paragraph 918 of the Order, the FCC stated: "General support expenses
19 (accounts 6121-6124), corporate operations expenses (accounts 6711, 6612 (sic.),
20 6721-6728), and telecommunications uncollectibles (account 5301) are presumed
21 to be avoided in proportion to the avoided direct expenses identified in the
22 previous paragraph." I have used these accounts on Exhibit WSR-3, with the

1 exception of account 6612 which is most likely a typographical error and should
2 have been account 6712 (planning).

3

4 Q. WHAT IS THE BASIS FOR THE CALCULATION OF THE INDIRECTLY
5 AVOIDED ALLOCATION FACTOR?

6

7 A. The indirectly avoided allocation factor is computed as the ratio of direct avoided
8 expenses to total expenses. The basis for this factor comes from the section of the
9 FCC's Order at paragraph 918, which I previously mentioned. In addition, in
10 paragraph 929 of the Order, the text concerning the calculation of the default
11 range for wholesale discounts states: " We have, therefore, substituted a more
12 straightforward approach in which we apply to each indirect expense category the
13 ratio of avoided direct expense to total expenses."

14

15 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

16

17 A. Yes.

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**
2 **REBUTTAL TESTIMONY OF WALTER S. REID**
3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
4 **DOCKET NO. 960833-TP**
5 **AUGUST 30, 1996**

6
7 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
8 POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

9
10 A. My name is Walter S. Reid and my business address is 675 West
11 Peachtree Street N. E., Atlanta, Georgia. My position is Senior Director
12 for the Finance Department of BellSouth Telecommunications, Inc.
13 (hereinafter referred to as "BellSouth" or "the Company").

14
15 Q. ARE YOU THE SAME WALTER S. REID WHO FILED DIRECT AND
16 SUPPLEMENTAL TESTIMONY IN THIS DOCKET?

17
18 A. Yes. I filed direct testimony on behalf of BellSouth on August 12, 1996,
19 and I filed supplemental direct testimony on August 23, 1996.

20
21 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

22
23 A. The purpose of my rebuttal testimony is to address the positions taken
24 in the direct and supplemental direct testimonies of AT&T witness Mr.
25 Art Lerma and in the direct testimony of AT&T witness Mr. Joseph

1 Gillan in this proceeding related to the issue: "What is the appropriate
2 rate for BellSouth to sell its services to AT&T for resale?" Mr. Lerma's
3 direct testimony describes AT&T's Avoided Retail Cost Model (as
4 identified on page 5, line 18 of Mr. Lerma's direct testimony), one of
5 two avoided cost studies AT&T has filed in this proceeding. Mr.
6 Lerma's supplemental direct testimony presents AT&T's second
7 avoided cost study, called the AT&T simplified avoided cost study (as
8 identified on page 2, lines 1-2 of Mr. Lerma's supplemental testimony).
9 Mr. Lerma claims that the second AT&T study complies with the
10 regulations regarding wholesale prices as set forth in the Federal
11 Communications Commission's ("FCC's") Order released August 8,
12 1996. My testimony will show that both of these AT&T studies result in
13 an overstated wholesale discount rate and that the second study does
14 not comply with the FCC Order. I will also address Mr. Gillan's so-
15 called "simple model" for estimating avoided costs.

16

17 Q. HOW IS YOUR REBUTTAL TESTIMONY ORGANIZED?

18

19 A. My rebuttal testimony is organized in four major sections: 1) response
20 to Mr. Lerma's direct testimony (the AT&T avoided retail cost model);
21 2) response to Mr. Lerma's supplemental testimony (the AT&T
22 simplified avoided cost study); 3) response to Mr. Gillan's simple
23 model; and 4) a summary of my testimony.

24

25 **RESPONSE TO MR. LERMA'S DIRECT TESTIMONY**

1

2 Q. DID YOUR DIRECT TESTIMONY, FILED IN THIS PROCEEDING ON
3 AUGUST 12, 1996, INCLUDE COMMENTS ON AT&T'S FIRST
4 STUDY, THE AVOIDED RETAIL COST MODEL?

5

6 A. Yes. Beginning at page 13 of my direct testimony, I discussed
7 numerous flaws which are present in this AT&T study. AT&T attached
8 its Avoided Retail Cost Model (the first study) to its petition in this
9 proceeding. Therefore, I was able to prepare comments for my direct
10 testimony regarding its study methodology based on the attachment to
11 its petition. Mr. Lerma's direct testimony, which was filed subsequent
12 to AT&T's petition, describes the AT&T study methodology and
13 provides additional comments and discussion regarding AT&T's
14 rationale. Because my direct testimony already identifies many of the
15 flaws in AT&T's first study, I will primarily focus my rebuttal comments
16 regarding this study on the criteria and rationale Mr. Lerma says AT&T
17 utilized in determining avoided cost amounts. I will describe the major
18 differences between the BellSouth avoided cost study as presented in
19 my direct testimony and the AT&T avoided retail cost model as
20 presented in Mr. Lerma's direct testimony.

21

22 Q. WHAT ARE THE MAJOR AREAS OF DIFFERENCE BETWEEN THE
23 BELL SOUTH METHODOLOGY FOR CALCULATING A WHOLESALE
24 DISCOUNT AND THE METHODOLOGY AT&T USED IN ITS FIRST
25 STUDY?

1

2 A. There are least two major areas of difference between the studies as
3 presented in the direct testimonies of AT&T and BellSouth. The first
4 area of difference is the type of costs which are considered by each
5 company to be avoided by BellSouth in resale transactions. The
6 second area of difference is AT&T's segmentation of BellSouth
7 revenues and expenses into service categories.

8

9 Q. PLEASE EXPLAIN THE FIRST MAJOR AREA OF DIFFERENCE
10 BETWEEN BELLSOUTH AND AT&T?

11

12 A. The first major difference between the BellSouth study and the AT&T
13 study is in the determination of the types of costs that will be avoided
14 by BellSouth when the Company sells its services to a reseller, rather
15 than to a residence or business customer. AT&T's first study treats
16 certain amounts of depreciation, network expense, call completion
17 expense, number services expense, general and administrative
18 expense, product management, product advertising, return, taxes and
19 interest on customer deposits, as amounts that will be avoided.
20 BellSouth does not believe expenses of this type will be avoided with
21 resale, and therefore, did not identify them as avoided in its study. My
22 direct testimony gives examples of these expenses (Reid direct
23 testimony pages 19 - 21), which AT&T's study inappropriately identified
24 as avoided, and which BellSouth believes will not be avoided. In Exhibit
25 AL-5 attached to Mr. Lerma's testimony, the sum of the avoided retail

1 amounts for these expense categories in AT&T's study is
2 \$349,766,000. Removing this amount from AT&T's total avoided cost
3 of \$624,305,000 would drop AT&T's total avoided cost to \$274,539,000
4 and its calculated wholesale discount to 18.4% ($\$274,539/\$1,495,388$)
5 from 41.7%.

6

7 Q. WHAT ARE THE DIFFERENCES IN THE CRITERIA USED BY AT&T
8 AND BELL SOUTH TO DETERMINE THE VARIOUS TYPES OF
9 COSTS THAT WILL BE AVOIDED?

10

11 A. Mr. Lerma lists three criteria (Lerma direct testimony, page 9, lines 19
12 through 21) that AT&T's first study utilized to identify direct costs that
13 will be avoided. AT&T's criteria defines avoided direct costs as: "(1)
14 one of three types of costs that the Act specifically identifies as costs
15 that will be avoided; (2) costs that will be duplicated by the reseller
16 when it sells at retail; or (3) costs that are caused by BellSouth's retail
17 activities." Mr. Lerma identifies avoided indirect costs by assuming that
18 these costs will vary directly in proportion to the changes in direct costs
19 that will be avoided (Lerma direct testimony page 12, lines 11-13).
20 AT&T's criteria and assumptions are inappropriate. For example, while
21 AT&T uses costs that will be duplicated by the reseller when it sells at
22 retail as a criteria to treat a BellSouth cost as avoided, the Act does
23 not. The Act also does not say that all costs in the categories of
24 marketing, billing, and collection should be treated as avoided, but
25 AT&T's first criteria apparently applies this logic. In addition, the Act

1 does not refer to costs that are assumed to vary in proportion to
2 avoided direct costs. However, AT&T's methodology uses this logic to
3 allocate many overhead costs to avoided expense.

4
5 In BellSouth's study, the Company utilized the basic criteria that costs
6 avoided are any marketing, billing, collection, and other costs that will
7 be avoided by BellSouth when it sells to a reseller. In this regard the
8 Company identified volume sensitive costs, primarily associated with
9 customer contact functions, that will not be performed in a resale
10 transaction. The Company's study is based on a detailed analysis of
11 the work functions BellSouth performs related to its retail business that
12 would not be performed in resale transactions. Operating cost data for
13 1995 was used.

14
15 Q. WHAT IMPACT DO THESE DIFFERENCES IN CRITERIA HAVE ON
16 THE TYPES AND AMOUNTS OF COSTS THAT ARE TREATED AS
17 AVOIDED IN THE AT&T AND BELLSOUTH STUDIES?

18
19 A. AT&T has utilized its assumption regarding indirect costs to arbitrarily
20 treat some of BellSouth's general and administrative expenses and
21 investment related costs for depreciation, network support, return, and
22 taxes as avoided costs. The impact of these indirect allocations is to
23 add approximately \$205,725,000 to AT&T's total avoided costs on Mr.
24 Lerma's Exhibit AL-5. This amount is equivalent to 13.76 percentage
25 points of AT&T's 41.7% proposed wholesale discount. BellSouth does

1 not agree that these indirect amounts represent costs that will be
2 avoided. Investment related costs (those amounts relating to costs of
3 fixed assets such as buildings) will not be avoided because of resale.
4 These costs are not volume sensitive and they represent past
5 expenditures which must be recovered from all of the Company's
6 services. Likewise, general and administrative expenses are generally
7 fixed in amount and will not be avoided with resale. AT&T's approach
8 for identifying avoided amounts for these expenses is arbitrary and
9 unreasonable.

10

11 AT&T also treats product management and product advertising
12 expenses as avoided costs. Mr. Lerma states, beginning on page 10,
13 line 5: "The Act specifically lists 'marketing' costs as costs that will be
14 avoided." He also states at line 14: "In addition, AT&T will incur all of
15 these types of costs when selling at retail." As stated in the discussion
16 regarding AT&T's criteria 1 and 2, BellSouth does not agree that the
17 Act summarily treats marketing costs as avoided, nor does it believe
18 that the types of costs that a reseller incurs is a relevant criteria under
19 the Act. For example, product management expense includes
20 expenditures for such functions as developing rates and tariffs,
21 forecasting product revenues, developing and enhancing products,
22 etc., which BellSouth will continue to incur in its provision of wholesale
23 services as well as retail services. It is unreasonable to treat BellSouth
24 product management expenses as avoided because AT&T may incur
25 similar types of costs in its retail operations. AT&T's treatment of

1 product management and product advertising costs adds \$52,606,000
2 to avoided costs and equates to approximately 3.52 percentage points
3 of its 41.7% proposed wholesale discount.
4

5 Q. ARE THERE DIFFERENCES, OTHER THAN THE BASIC CRITERIA
6 USED, WHICH CAUSE AT&T TO INCLUDE ADDITIONAL TYPES OF
7 COSTS AS AVOIDED?
8

9 A. Yes. AT&T is requesting that BellSouth unbundle parts of its retail
10 services for purposes of calculating a wholesale discount. It further
11 proposes to treat the costs for certain of these unbundled parts
12 (operator services and certain repair services) as avoided costs . For
13 example, Mr. Lerma states at page 11, lines 7-9: "Moreover, if AT&T
14 achieves direct routing of local telephone calls to its operators, as
15 AT&T has requested, all operator costs become costs that BellSouth
16 will avoid." In effect, this request is an attempt to mix the concepts of
17 unbundling and the resale of telecommunications services.
18 BellSouth's believes that the unbundling of services should be handled
19 through the unbundled tariffs not through the wholesale tariffs. The
20 wholesale service price should correspond to the related retail service
21 provided by BellSouth. Company witness Mr. Bob Scheye discusses
22 the Company's position regarding AT&T's request to route certain local
23 telephone calls to an AT&T operator and repair calls to an AT&T repair
24 center on pages 23-28 of his direct testimony in this docket.
25

1 Q. IS THERE ANOTHER REASON WHY OPERATOR SERVICES
2 COSTS SHOULD NOT BE TREATED AS AVOIDED?

3

4 A. Yes. In addition to the fact that unbundling and resale should not be
5 intertwined, to the extent AT&T takes over the operator services
6 functions from BellSouth by direct routing of local telephone calls to its
7 operators, it is taking over a line of business with its own revenue
8 stream. Under this scenario, the Company is not selling its retail
9 operator services to AT&T at wholesale. Instead, AT&T is taking over a
10 competitive line of business and one can reasonably assume that
11 AT&T will be receiving revenues from customers to compensate it for
12 its operator services expenses. Certainly it is inappropriate for
13 BellSouth to be required to give AT&T an increased discount on other
14 services it is providing to AT&T just because AT&T chooses to take
15 over this business. However, AT&T has inappropriately treated
16 BellSouth's costs for these functions as avoided costs. This treatment
17 adds \$90,533,000 to AT&T's total avoided costs and equates to
18 approximately 6.05 percentage points of its 41.7% proposed wholesale
19 discount.

20

21 Q. ARE THERE ANY OTHER TYPES OF COSTS WHICH AT&T TREATS
22 AS AVOIDED?

23

24 A. Yes. AT&T also identifies \$902,000 of interest related to customer
25 deposits as an avoided cost. To the extent that the Company has any

1 reduction in interest related to customer deposits due to resale, it
2 follows that it would also experience a reduction in customer deposit
3 funds used in operations. Therefore, the Company would have
4 offsetting costs related to this issue. Any reduction in interest cost paid
5 to customers would be offset by interest cost paid on the funds needed
6 to replace the use of customer deposits. AT&T's approach to this issue
7 is inappropriate.

8

9 Q. PLEASE EXPLAIN THE SECOND MAJOR AREA OF DIFFERENCE IN
10 THE STUDIES?

11

12 A. The second major difference is the fact that AT&T used BellSouth's
13 total revenues and expenses and attempted to allocate a portion to
14 what AT&T refers to as "the local services market" or "the local BU"
15 (local business unit). AT&T then used the revenues and expenses
16 allocated to this "local BU" to calculate the amounts for avoided costs
17 and the wholesale discount. My direct testimony points out numerous
18 flaws in the methodology AT&T used to accomplish this allocation (Reid
19 direct testimony pages 15 - 19). For example, a category of expense
20 for directory assistance ("DA") services assigned by AT&T to the local
21 business unit reflects a total which equals the entire amount of both
22 interstate and intrastate DA expense and intercept expense reported by
23 the Company to the FCC on ARMIS Report 43-04 for 1995. Certainly,
24 a portion of these expenses are related to the toll and access services
25 provided by the Company and should not be assigned to local. It is

1 clear from the results of AT&T's study, as presented on Mr. Lerma's
2 Exhibit AL-5, that AT&T's arbitrary cost allocations are not
3 representative of the costs that underlie the local retail tariffs. In its
4 study, AT&T allocates costs to the local BU that exceed all sources of
5 local revenues by over \$1.3 billion. Therefore, it is not surprising that
6 AT&T's approach leads to a distorted wholesale discount rate.

7

8 Q. HOW DOES AT&T'S APPROACH DIFFER FROM BELLSOUTH'S?

9

10 A. In contrast to AT&T's approach, BellSouth did not attempt to allocate its
11 costs to certain markets or services. BellSouth believes that the retail
12 costs that will be avoided with resale will be avoided because of the
13 loss of the customer contact work operations and not because of the
14 loss of individual services. The Company recognizes that there are
15 many joint and shared costs that are common to numerous services
16 and that these costs will not be avoided unless all services sharing the
17 cost are affected. The Company's study analyzed the costs of
18 customer contact work functions for all retail services. Based on
19 internal accounting data that tracks expenses associated with work
20 functions, the Company determined costs that will be avoided when the
21 customer moves all of his/her services to a reseller. The Company's
22 study calculates separate discounts for services provided to residence
23 customers and services provided to business customers. AT&T's study
24 calculates a wholesale discount that would apparently be applicable
25 only to local retail services, excluding operator services.

1

2 Q. DO YOU HAVE ANY OVERALL COMMENTS RELATED TO THE
3 SECOND MAJOR DIFFERENCE BETWEEN AT&T'S FIRST STUDY
4 AND BELLSOUTH'S STUDY?

5

6 A. Yes. Mr. Lerma's testimony describes a very complex methodology
7 that involves arbitrary allocations of BellSouth costs to local service and
8 then further arbitrary allocations of these local service costs to an
9 avoided cost category. Mr. Lerma describes the methodology as being
10 "reasonable" (Lerma direct testimony page 6, line 12), but I strongly
11 disagree. As I pointed out in my direct testimony, AT&T's whole
12 approach to the calculation of wholesale discounts is unreasonable and
13 produces overstated results. My direct testimony gives several
14 examples of flaws in AT&T's methodology.

15

16 Q. DOES MR. LERMA COMMENT ON BELLSOUTH'S ABILITY TO
17 RECOVER ITS JOINT AND COMMON COSTS UNDER AT&T'S
18 APPROACH?

19

20 A. Yes. Mr. Lerma addresses this subject in response to questions
21 beginning at page 15, line 21 of his direct testimony and ending at line
22 14 of page 16. The first question addressed is: "DOES AT&T'S
23 MEASUREMENT OF COSTS THAT WILL BE AVOIDED ALLOW
24 BELLSOUTH TO RECOVER ANY OF ITS JOINT AND COMMON
25 COSTS?". Mr. Lerma's initial response to this question is misleading.

1 He responds: "Absolutely. Joint and common costs that are caused by,
2 or provide benefit to wholesale functions, would be recovered by
3 BellSouth in the wholesale price it charges AT&T for wholesale
4 services.....". This response is not consistent with the study submitted
5 by Mr. Lerma. Referring to his Exhibit AL-5, if AT&T's proposed
6 discount of 41.7 % is applied to the total local revenues subject to
7 discount, \$1,495,388,000, the resulting BellSouth revenues on a
8 discounted basis would be approximately \$871,811,000
9 ($\$1,495,388,000 \times (1-0.417)$). This amount is not even sufficient to
10 cover the non-avoided depreciation and network expenses for local
11 service of \$1,254,244,000, identified from his Exhibit AL-5 (total local
12 amounts less avoided retail amounts). The point here is that the
13 discounted local service rates per AT&T's study are well below the
14 costs AT&T's study indicates BellSouth incurs to provide local service.
15 Based on this study, the local service wholesale rates charged to AT&T
16 would cover only about 40% (discounted local revenues of
17 \$871,811,000 divided by local non-avoided costs of \$2,186,999,000) of
18 the wholesale costs of providing local service. Thus, the AT&T study
19 indicates that BellSouth would be dependent on the continuation of
20 sufficient revenues from other services for coverage of the remaining
21 60% of the wholesale costs for local service.

22
23 Mr. Lerma goes on in his testimony to clarify his initial response to the
24 question beginning at page 15 line 21. On page 16 lines 12-14, he
25 states: "Thus, although wholesale prices for particular services might

1 appear to be under cost, BellSouth continues to receive these
2 subsidies and, thus, is fully compensated for its wholesale costs." The
3 corollary to his statement is that if BellSouth does not continue to
4 receive these subsidies, then wholesale prices will not compensate
5 BellSouth for its wholesale costs.

6

7 Q. DOES THE METHODOLOGY USED BY BELL SOUTH TO COMPUTE
8 ITS PROPOSED WHOLESALE DISCOUNT ASSUME THAT
9 SUBSIDIES TO LOCAL RATES WILL CONTINUE?

10

11 A. Yes. Because BellSouth's study identified the total costs that will be
12 avoided with resale and divided this amount by only the local revenues
13 that are subject to resale, there is an underlying assumption that
14 subsidies to local rates will continue.

15

16 **RESPONSE TO MR. LERMA'S SUPPLEMENTAL DIRECT TESTIMONY**

17

18 Q. MR. REID, HAVE YOU HAD THE OPPORTUNITY TO REVIEW MR.
19 LERMA'S SUPPLEMENTAL DIRECT TESTIMONY FILED IN THIS
20 PROCEEDING ON AUGUST 23, 1996?

21

22 A. Yes. However, I only had a very short period of time in which to review
23 his supplemental direct testimony before filing my rebuttal testimony.
24 After further review of his workpapers, I may have additional
25 comments.

1

2 Q. DOES AT&T'S SIMPLIFIED AVOIDED COST STUDY (SECOND
3 STUDY), AS PRESENTED IN MR. LERMA'S SUPPLEMENTAL
4 TESTIMONY, COMPLY WITH THE REGULATIONS REGARDING
5 WHOLESALE PRICES FOR SERVICES SUBJECT TO RESALE AS
6 SET FORTH IN THE FCC'S ORDER RELEASED AUGUST 8, 1996?

7

8 A. No. Even though in response to some questions, Mr. Lerma claims
9 that AT&T study complies with the FCC's Order (see Lerma
10 supplemental testimony page 2, lines 2 - 4, and page 5, lines 4 - 7), his
11 response to another question indicates that the AT&T study treats at
12 least one item differently. On page 10 of his supplemental testimony,
13 beginning at line 11, is the question: "IS AT&T'S TREATMENT OF
14 UNCOLLECTIBLES DIFFERENT FROM THAT REFLECTED IN THE
15 FCC ORDER AND REGULATIONS? IF SO, WHY? His response to
16 this question is yes and he goes on to give an explanation of why AT&T
17 chose to differ with the FCC Order and regulations. However,
18 regardless of his reasons for not complying with the FCC order, the
19 simple matter is that at least on this issue his study does not comply
20 with the Order. This variance from the Order has the impact of
21 increasing AT&T's calculated wholesale discount.

22

23 In addition to the variance from the Order mentioned above, AT&T also
24 continued to treat certain of BellSouth's repair costs as though they
25 were unbundled from local service (see Lerma testimony at page 8, line

1 23 through page 9, line 20). The FCC's Order at paragraph 877 states:
2 " On the other hand, section 251(c)(4) does not impose on incumbent
3 LECs the obligation to disaggregate a retail service into more discrete
4 retail services. The 1996 Act merely requires that any retail services
5 offered to customers be made available for resale." AT&T's treatment
6 of these repair costs as if they were unbundled from the associated
7 retail services is, therefore, not in compliance with the Order.

8
9 Finally, AT&T's study produces a wholesale discount for Florida that is
10 approximately 15 percentage points (39.99% less 25%) or 60% higher
11 than the highest discount rate in the FCC's default range. AT&T's
12 proposed wholesale rate is approximately 20.8 percentage points
13 (39.99% less 19.2%) or 83% higher than the discount rate of 19.2%
14 reported for BellSouth in the FCC's Order (paragraph 930 of the
15 Order). The wholesale discount rate that BellSouth has calculated for
16 Florida based on the FCC's criteria is 19.7%. This is well within the
17 default range and is 0.5 percentage points (19.7% less 19.2%) higher
18 than the number reported by the FCC for BellSouth. This is a further
19 indication of the unreasonable results produced by the AT&T
20 methodology.

21
22 Q. BASED ON YOUR REVIEW, DO YOU HAVE ANY OVERALL
23 COMMENTS REGARDING MR. LERMA'S SUPPLEMENTAL
24 TESTIMONY?

25

1 A. Yes. AT&T's second study contains almost all of the same
2 inappropriate types of avoided costs that caused its first study, the
3 avoided retail cost model, to yield an overstated wholesale discount.
4 The only exception that I note is the apparent absence of a calculated
5 avoided amount related to interest on customer deposits. Therefore, it
6 is not surprising that AT&T calculated another excessive wholesale
7 discount with its second study. It appears as though AT&T's approach
8 to the second study is basically to continue to treat as avoided all of the
9 same types of costs which it previously treated as avoided and to argue
10 its reasons for doing so under the rebuttable presumptions language in
11 the Order. My previous responses related to these inappropriate types
12 of avoided costs, therefore, apply equally well to the study attached to
13 Mr. Lerma's supplemental testimony. For example, AT&T's simplified
14 avoided cost study continues to treat operator costs as avoided
15 expenses based on the rationale that AT&T would perform this
16 function. As I previously responded, this treatment is inappropriate
17 because operator services is a line of business with its own retail tariffs.
18 By taking over this business, AT&T will receive revenues from
19 customers for performing the service and BellSouth will lose the
20 revenues associated with the services. It is entirely inappropriate for
21 BellSouth to then give AT&T an increased discount on other retail
22 services because of this competitive loss.

23
24 In addition, because AT&T does not attempt to allocate BellSouth's
25 revenues and costs to a local business unit, one would think that my

1 concerns related to its arbitrary cost allocations would be eliminated.
2 However, on closer review, I notice that Mr. Lerma has again used
3 arbitrary allocations to impact the calculations.

4

5 Q. PLEASE EXPLAIN WHAT YOU MEAN BY YOUR COMMENT THAT
6 MR. LERMA HAS USED ARBITRARY ALLOCATIONS?

7

8 A. My comment refers to Mr. Lerma's determination of access and
9 miscellaneous expenses to remove from his total calculated avoided
10 expenses. Beginning on page 6, line 22 of his supplemental testimony
11 and continuing through line 11 of page 7, Mr. Lerma explains that he
12 needs to remove access and miscellaneous costs from his study. He
13 makes the following statement on lines 5 - 7 of page 7: "Access
14 services (see 47 C. F. R. § 51.607(b)) and miscellaneous services are
15 not generally offered to 'subscribers that are not telecommunications
16 carriers' and are excluded from the ASAC study." I had some difficulty
17 following his methodology for calculating the amount of access and
18 miscellaneous expenses he excluded because it appears as though he
19 inadvertently provided as support for his Florida study a workpaper for
20 a Bell Atlantic - Pennsylvania study (see Lerma Exhibit ALS-2, page 3
21 of 4). However, I can tell from the unreasonable amount of access
22 expense that he has identified, that his study methodology does not
23 even approximate the method by which access expenses have been
24 determined in previous regulatory proceedings. For example, on his
25 exhibit ALS-1, he reports that access costs associated with the

1 expenses in Accounts 6610, 6620, 6220, 6533, 6534, and 6560
2 amounts to only \$6,677,000.

3
4 A quick check of the reasonableness of this amount can be made by
5 referring to the Florida Surveillance Report for 1995 for BellSouth. On
6 page 2 of the surveillance report, the total combined regulated amounts
7 for Accounts 6610 and 6620 for 1995 are shown on line 10 column 1 as
8 \$489,048,000 (customer operations expense). This approximates the
9 \$489,121,000 total that can be obtained by adding the amounts from
10 Mr. Lerma's Exhibit ALS-1 for these same accounts (\$134,143,000 +
11 \$354,978,000 = \$489,121,000). The differences in total amounts can
12 be attributed to differences in FCC and PSC accounting for certain
13 costs. Continuing to refer to the data on sheet 2 of the surveillance
14 report, the Company identifies in column 2 that the interstate amount
15 (primarily interstate access) of customer operations expense is
16 \$91,622,000 and in column 5 that intrastate access amount is
17 \$36,114,000. Therefore, the traditional regulatory approach for
18 determining the access portion of customer operations expense would
19 identify approximately \$127,736,000 (less any small amount related to
20 interstate intraLATA services) of expense as access related. However,
21 Mr. Lerma's study determines that only \$6,677,000 of the expenses for
22 customer operations and his other listed avoided direct accounts are
23 related to access. This is not a reasonable result. His allocation
24 procedure obviously assigns very little of the Company's expenses to
25 access and certainly cannot be related to the traditional regulatory

1 procedures for allocating costs to access that have impacted the
2 current retail prices.

3

4 **RESPONSE TO MR. GILLAN'S SIMPLE MODEL**

5

6 Q. WHAT ARE YOUR COMMENTS RELATED TO MR. GILLAN'S
7 SIMPLE MODEL?

8

9 A. Mr. Gillan's direct testimony regarding his simple model concerns me
10 due to his misuse of certain BellSouth state level information. Mr.
11 Gillan states on page 26 beginning at line 3 that he has performed a
12 linear regression to estimate the relationship between the level of
13 corporate expenses and retail revenues using 1995 actual data for the
14 nine BellSouth states. He goes on to say that his Exhibit JPG-2 shows
15 that the "modeled" relationship closely predicts the actual data (Gillan
16 testimony page 26, lines 10 - 12). I believe his analysis is misleading
17 because the corporate expenses that he is correlating with revenues
18 are predominantly centrally incurred expenses that are allocated to the
19 states. His correlation is more an indication that BellSouth allocates
20 corporate expenses to states based on size related factors than it is
21 proof that revenues are a predictor of corporate expenses. Therefore,
22 his Exhibit JPG-2 does not provide any useful information for this
23 proceeding.

24

25 **SUMMARY**

1

2 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

3

4 A. BellSouth has provided a calculation of a reasonable wholesale
5 discount based on an analysis of the costs of the customer contact
6 related work functions which the Company believes it will avoid with
7 resale. The Company believes that its study is in compliance with the
8 Act. In addition, the Company has provided a study in my
9 supplemental testimony that reflects the criteria included in the FCC's
10 Order and Rules. AT&T has conducted two studies which are based
11 on criteria that lead it to include costs that will not be avoided by
12 BellSouth. AT&T's first study is complex and contains many arbitrary
13 allocations and many flaws. AT&T's second study does not comply
14 with the FCC's Order and still contains arbitrary allocations and many
15 flaws. BellSouth's discounts are in compliance with the Act and should
16 be approved in this proceeding.

17

18 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

19

20 A. Yes.

21

22

23

24

25

1 BELLSOUTH TELECOMMUNICATIONS, INC.
2 DIRECT TESTIMONY OF WALTER S. REID
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 960846-TP
5 SEPTEMBER 9, 1996
6

7 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
8 POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.
9

10 A. My name is Walter S. Reid and my business address is
11 675 West Peachtree Street, Atlanta, Georgia. My
12 position is Senior Director for the Finance
13 Department of BellSouth Telecommunications, Inc.
14 (hereinafter referred to as "BellSouth" or "the
15 Company").
16

17 Q. BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND
18 BUSINESS EXPERIENCE IN THE TELECOMMUNICATIONS
19 INDUSTRY.
20

21 A. I received bachelor and master of science degrees in
22 industrial engineering in 1969 and 1971,
23 respectively, from the Georgia Institute of
24 Technology. I was employed by BellSouth in November,
25 1971, as a management trainee in the Comptrollers

1 Department in Jacksonville, Florida. Since that
2 time, I have held various positions of increasing
3 responsibility in the areas of budget and forecast
4 preparation, cost accounting, separations, and
5 regulatory matters. I was transferred to my current
6 position at Company Headquarters in October, 1987.
7 Overall, I have over 24 years experience dealing with
8 the financial issues of the Company.

9

10 Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

11

12 A. I am responsible for the preparation and analysis of
13 the Company's financial results, the provision of
14 accounting and cost information requested in
15 proceedings before state regulatory commissions and
16 the coordination of other regulatory activities.

17

18 Q. HAVE YOU TESTIFIED PREVIOUSLY REGARDING FINANCIAL
19 ISSUES IN STATE REGULATORY PROCEEDINGS?

20

21 A. Yes. I have testified in numerous regulatory
22 proceedings before the Florida Public Service
23 Commission ("Commission"), as well as the Commissions
24 in Georgia, North Carolina, and South Carolina.

25

1 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
2 PROCEEDING?

3

4 A. The purpose of my testimony in this proceeding is to
5 address the appropriate methodology for use in
6 determining BellSouth's retail costs that will be
7 avoided when sales are made to resellers rather than
8 to end user customers, and to present the study that
9 calculates the appropriate wholesale discounts for
10 the Company's Florida operations based on the
11 determination of the costs that will be avoided. The
12 study results for Florida are wholesale discounts of
13 19.0% for residential services and 12.2% for business
14 services. A summary of BellSouth's study is included
15 as Exhibit WSR-1 of my testimony. Exhibit WSR-2,
16 page 1 depicts the basic equation used in the
17 Company's study, and page 2 of this exhibit depicts
18 the analysis of work operations performed in the
19 study.

20

21 In addition, my testimony will provide information
22 relative to the impact on this proceeding of the
23 resale provisions of the Federal Communications
24 Commission's (hereinafter referred to as the "FCC" or
25 "FCC's") First Report and Order ("Order") in CC

1 Docket No. 96-98, In the Matter of Implementation of
2 the Local Competition Provisions in the
3 Telecommunications Act of 1996, including Appendix B-
4 Final Rules ("Rules"), which was released on August
5 8, 1996. Specifically, I will provide the
6 calculation of a wholesale discount for retail
7 services in Florida based on the FCC's criteria (the
8 Order, paragraphs 911 through 920, also the Rules,
9 Section 51.609) for avoided cost studies, and the
10 Company's analysis of the accounts for which the FCC
11 allows for rebuttable presumptions. The Company does
12 not agree with the FCC's criteria regarding the
13 determination of avoided/avoidable costs, and it
14 believes that BellSouth's study complies with the
15 Act. However, in order to provide the Commission
16 with information relative to the impact of the FCC's
17 Order, I have prepared Exhibit WSR-3 to demonstrate
18 this methodology and to provide the calculations for
19 the resulting Florida wholesale discount. Based on
20 this methodology, the wholesale discount applicable
21 to all retail services (business and residence) would
22 be 19.7%.

23

24 Q. HOW IS YOUR TESTIMONY ORGANIZED?

25

1 A. My testimony begins with an identification of the
2 federal requirements included in the
3 Telecommunications Act of 1996 (hereinafter referred
4 to as "the Act") related to wholesale pricing. The
5 subject of the testimony next focuses on the
6 Company's methodology to fulfill the federal
7 requirements and the computation of wholesale
8 discounts specific to BellSouth's Florida operations.
9 Finally, the impact of the FCC's Order and Rules on
10 the methodology for determining the wholesale
11 discount is addressed.

12

13

14 FEDERAL REQUIREMENTS RELATED TO WHOLESALE PRICING

15

16 Q. WHAT DOES THE ACT REQUIRE AS IT RELATES TO THE
17 DETERMINATION OF WHOLESALE RATES TO BE CHARGED BY
18 BELLSOUTH?

19

20 A. Section 252(d)(3) of the Act under the caption,
21 "WHOLESALE PRICES FOR TELECOMMUNICATIONS SERVICES",
22 states:

23

24 "For the purposes of section 251(c)(4),
25 a State commission shall determine

1 wholesale rates on the basis of retail
2 rates charged to subscribers for the
3 telecommunications service requested,
4 excluding the portion thereof attributable
5 to any marketing, billing, collection, and
6 other costs that will be avoided by the local
7 exchange carrier."

8

9 BELLSOUTH'S METHODOLOGY FOR DETERMINING WHOLESAL

10 DISCOUNTS

11

12 Q. WHAT IS THE APPROPRIATE METHODOLOGY TO USE IN
13 CALCULATING A WHOLESAL DISCOUNT?

14

15 A. The basic equation for calculating the discount is
16 displayed on Exhibit WSR-2, page 1 of 2. The
17 discount is based on the relationship between avoided
18 costs and revenues and is calculated by dividing the
19 1995 costs that will be avoided by the amount of 1995
20 revenue subject to being discounted. Separate
21 calculations are performed for residential service
22 and business service. The result of applying this
23 equation is that on average, for each residential
24 customer that buys telecommunication service from a
25 reseller, the costs that will be avoided as a percent

1 of revenue equals a wholesale discount of 19.0%.
2 Similarly, for business customers buying service from
3 a reseller, the costs that will be avoided as a
4 percent of revenue result in a wholesale discount of
5 12.2%. Using residential service as an example, if
6 the customer consumes \$20.00 (based on retail tariff
7 rates) of local and toll services per month, then
8 BellSouth will avoid \$3.80 of costs on a monthly
9 basis when the customer is served by a reseller. The
10 Company would charge the reseller \$16.20 (\$20.00
11 less a discount of \$3.80) for the same level of
12 consumption of service for this customer.

13

14 Q. WHY DOES BELLSOUTH RECOMMEND SEPARATE DISCOUNTS FOR
15 RESIDENCE AND BUSINESS RETAIL SERVICES IN DETERMINING
16 WHOLESALE PRICES?

17

18 A. Because characteristics and levels of revenues and
19 costs vary between residential and business
20 customers, the Company is recommending two separate
21 discounts. Inherent in the Company's methodology and
22 application of the wholesale discounts is the
23 assumption that residence or business customers that
24 choose to go with a reseller will be average revenue
25 customers for that class of service. To the extent

1 that a reseller targets higher than average revenue
2 customers, the monetary discount that the reseller
3 will receive will logically exceed the costs that
4 will be avoided by BellSouth.

5
6 An example of the calculations will demonstrate the
7 impact that the loss of customers with differing
8 average levels of monthly revenue will have on the
9 Company. Assume a situation in which the Company
10 would avoid approximately \$3.45 in average retail
11 costs for residential customers and the average
12 monthly bill for residential customers is \$18 per
13 customer. Based on this information, the
14 residential wholesale discount would be 19% (i.e.,
15 \$3.45/\$18). Also, assume that the Company will avoid
16 approximately \$5.20 in average retail costs for
17 business customers and the average monthly bill for
18 business customers is \$42.75. Based on this
19 information, the business wholesale discount would be
20 approximately 12.2% (i.e., \$5.20/\$42.75). ✕

21 **If residential customers provided 49% of total retail revenues and business**
22 **customers provided 51%, the composite discount for total customers**
23 **would be 15.5% (i.e., 49% X 19% plus 51% X 12.2%). However, the**
24 **use of the composite discount would give inappropriate results, because in**
25 **the case of a business customer, the Company would give the reseller a**
discount of \$6.63 (i.e., the average monthly bill of \$42.75 times the
wholesale discount of 15.5%), but the Company would only avoid \$5.20
of cost. Thus, in this example the Company would lose \$1.43 on a net
basis from the resale transaction. -8-

1 ~~results, because in the case of a business customer,~~
2 ~~the company would give the reseller a discount of~~
3 ~~\$7.27 (i.e., the average monthly bill of \$12.75 times~~
4 ~~the wholesale discount of 57%), but the company would~~
5 ~~only avoid \$3.20 of costs. Thus, in this example the~~
6 ~~company would lose \$2.07 on a net basis from the~~
7 ~~resale transaction.~~

8
9 This effect is also present for customers within the
10 residence and business categories who have different
11 average monthly bills, but the Company has only
12 addressed the disparity at the total residence and
13 total business level. If resellers target high
14 revenue customers within the residence and business
15 categories, a likely scenario, then the Company's
16 calculated wholesale discounts will generate more
17 monetary discount for the reseller than the costs
18 that will be avoided by the Company.

19
20 Q. HOW DID THE COMPANY DETERMINE WHICH RETAIL COSTS WILL
21 BE AVOIDED WHEN THE COMPANY PROVIDES SERVICES ON A
22 WHOLESALE BASIS?

23
24 A. To determine the costs that will be avoided, the
25 Company analyzed the work functions that are

1 currently being performed to provide retail services
2 to the Company's customers. The Company has an
3 internal accounting system that identifies the major
4 work functions of the business and tracks the costs
5 associated with various work functions being
6 performed. The information from this system is used
7 both for management of the business, as well as for
8 input to the system that assigns costs between
9 regulated and non-regulated operations. The Company
10 analyzed each of its work functions for the
11 categories of expense that would be impacted by a
12 wholesale situation and identified, using 1995
13 Florida operating data, the level of expense for each
14 work function that will be avoided with resale. A
15 graphic representation of the approach is given on
16 Exhibit WSR-2, page 2 of 2.

17

18 Q. PLEASE DESCRIBE THE NATURE OF THE COSTS THAT WILL BE
19 AVOIDED.

20

21 A. The costs that will be avoided are included in the
22 expense categories for customer services, billing,
23 sales, uncollectibles, and advertising. These costs
24 are volume sensitive amounts that are associated with
25 the provision of regulated residential or business

1 retail services. Further, the avoided costs are
2 associated with work functions that directly relate
3 to interaction between the Company and the customer,
4 an interaction which will normally not occur under
5 resale. For example, it is assumed that the Company
6 will not mail a bill to customers of local service
7 resellers and therefore, the costs of postage, paper,
8 printing, labor, etc., associated with the customer
9 billing work functions are identified as avoided
10 costs for that customer.

11

12 If, however, the customer subscribes to any service
13 from BellSouth, such as intraLATA toll, in addition
14 to subscribing to service from a reseller, the
15 avoided costs identified for billing are overstated
16 because the interaction with the customer represented
17 by the bill would not be avoided. In addition, to
18 the extent billing costs are incurred to prepare the
19 bill for the reseller, the amount of avoided billing
20 costs and the wholesale discount are both overstated.

21

22 Q. HOW DID THE COMPANY DETERMINE THE AMOUNT OF CUSTOMER
23 SERVICES COSTS THAT WILL BE AVOIDED?

24

25

1 A. The costs associated with customer services are
2 recorded in Account 6623 under the FCC's Uniform
3 System of Accounts ("USOA"). The Company's internal
4 accounting system identifies and tracks the costs for
5 numerous work functions which underlie the total
6 charges to this account. The study examined the
7 nature of each of these work functions in order to
8 determine whether or not that function would continue
9 to be performed for the customer under resale. The
10 functions that will not be performed for the resold
11 accounts include remittance operations, service
12 representative training, service order entry,
13 collections, account inquiry, demand sales, address
14 information, and customer payment operations. Many
15 functions in Account 6623 will continue to be
16 performed for the resold accounts. Therefore, the
17 costs associated with those functions will not be
18 avoided. These functions include, for example, local
19 and toll message processing, accounts operations,
20 message investigation, support and indirect
21 supervision.

22
23 Q. WHAT ARE THE BILLING COSTS THAT WILL BE AVOIDED?
24
25

1 A. The costs for billing are also recorded in Account
2 6623. The only billing costs that will be avoided
3 due to resale are the costs associated with printing
4 and mailing a bill to the customer. These costs are
5 captured in a unique job function code underlying the
6 charges to Account 6623. The Company will still be
7 maintaining a customer record for each customer
8 served by a reseller. BellSouth will record and
9 maintain usage and service characteristics of each
10 customer so that it can render a bill to the
11 reseller. While the Company will incur an additional
12 cost in sorting, printing and mailing the customer
13 bill information to the reseller, the Company did not
14 include costs for this additional work in its study.

15

16 Q. WHAT ARE THE SALES EXPENSES THAT WILL BE AVOIDED?

17

18 A. The Company's sales expenses are recorded in Account
19 6612. The Company's study assumes sales expenses for
20 customers that choose to buy service from a reseller
21 will not be incurred. In this regard, the Company
22 identified all regulated residential and business
23 sales expenses in Account 6612 as avoided costs.

24

25

1 Q. DID THE COMPANY IDENTIFY ANY PRODUCT MANAGEMENT OR
2 ADVERTISING COSTS AS AVOIDED COSTS?

3

4 A. The Company identified some advertising costs
5 associated with bill inserts as an avoided cost.
6 Because the Company will not be sending the customer
7 of the reseller a bill, it follows that this type of
8 advertising will also be avoided. Product management
9 and advertising costs, other than through bill
10 inserts, will not be avoided however, because these
11 costs are not volume sensitive. The level of these
12 costs is not dependent on whether an individual
13 customer obtains service from a reseller or from
14 BellSouth.

15

16 The activities associated with product management
17 span functions that include research and development,
18 product introduction, tariff application, methods and
19 procedures, and product delivery. The level of costs
20 associated with these functions is not sensitive to
21 whether or not the services will be resold. In
22 addition, product advertising costs, which are
23 associated with individual products or families of
24 products, are not sensitive to the volume of
25 customers and will not decrease with customer

1 migration to resellers. Therefore, these costs do
2 not represent avoided costs, and it would be
3 inappropriate to include them in the calculation of
4 the wholesale discount.

5

6 Q. HOW DID THE COMPANY TREAT UNCOLLECTIBLES IN ITS
7 STUDY?

8

9 A. For purposes of this study, the Company assumed that
10 uncollectibles from customers who buy from resellers
11 will be avoided by BellSouth. The reseller is
12 responsible for absorbing any bad debt on the part of
13 its customers. If BellSouth experiences reseller-
14 related uncollectibles, then it may be appropriate to
15 reduce the level of avoided costs by the amount of
16 reseller uncollectibles and decrease the wholesale
17 discount.

18

19 IMPACT OF THE FCC'S ORDER ON THE WHOLESALE DISCOUNT

20

21 Q. DOES THE COMPANY'S STUDY YOU HAVE JUST DESCRIBED
22 FOLLOW THE CRITERIA SET OUT BY THE FCC IN ITS ORDER
23 REGARDING RESALE ISSUES?

24

25

1 A. No. The Company's study does not comply with the
2 FCC's Order. However, BellSouth believes that its
3 study does comply with the Act.

4

5 Q. WHAT ARE THE DIFFERENCES BETWEEN THE COMPANY'S STUDY
6 AND THE CRITERIA FOR AN AVOIDED COST STUDY AS SET
7 FORTH IN THE FCC'S ORDER?

8

9 A. There are three major points where the criteria used
10 in the Company's study differ from those contained in
11 the FCC's Order. First, the Company's study
12 identifies those retail costs that will be avoided
13 (the terminology used in the Act) when services are
14 sold at wholesale to a reseller. The Company assumes
15 for this purpose that it will provide both retail and
16 wholesale services. In contrast, the FCC's Order
17 uses the terminology "reasonably avoidable" when
18 referring to costs to be considered avoided. The
19 FCC's criteria treats avoided costs as those that an
20 incumbent LEC would no longer incur if it were to
21 cease retail operations and instead provide all of
22 its services through resellers. The Company
23 disagrees with the FCC's "reasonably avoidable"
24 criteria because this approach overstates avoided
25 costs. Avoided costs are overstated by the FCC's

1 approach because certain costs that are not volume
2 sensitive or that are joint and shared in nature are
3 treated as avoided when in fact the Company will
4 continue to incur the costs. For example, the
5 Company believes that it will continue to incur
6 product advertising expenses, but the FCC's approach
7 presumptively assumes that 100% of product
8 advertising expenses will be avoided.

9
10 The second major difference between the Company's
11 study and the FCC's criteria is the requirement in
12 the FCC's Rules (Section 51.609(c)(2)) that a portion
13 of indirect costs in certain general support and
14 corporate operations expense accounts be included as
15 avoided retail costs. The Company does not believe
16 that these indirect costs will be avoided with resale
17 transactions. Therefore, the Company's study does
18 not allocate indirect costs to the avoided retail
19 costs total in its study. The inclusion of indirect
20 costs is another area where the FCC's criteria
21 overstates the amount of avoided cost.

22
23 The final major difference between the Company's
24 study and the FCC's criteria is the treatment of
25 operator services expenses. The FCC's criteria

1 treats operator services expenses for call completion
2 and number services as presumptively avoidable
3 expenses because resellers have stated they will
4 either provide these services themselves or contract
5 for them separately from the local exchange carrier
6 or from third parties. The Company believes that
7 access to its operator services is part of its retail
8 offerings and should not be unbundled for purposes of
9 determining wholesale discounts. Therefore, the
10 Company's study does not treat operator services
11 expenses as avoided retail costs because they will
12 not be avoided as a result of resale transactions.
13 For purposes of its criteria for an avoided cost
14 study, the FCC has allowed the Company the option to
15 rebut the presumption that these expenses are
16 avoidable. This third difference can, therefore, be
17 cured if the Company can prove to the state
18 commission that specific costs in these accounts will
19 be incurred with respect to services sold at
20 wholesale, or that costs in these accounts are not
21 included in the retail prices of the resold services
22 (the Order at paragraph 917). The Company believes
23 that these required conditions exist for its operator
24 services expenses, and for this reason these expenses
25 should not be treated as avoidable.

1 Q. DOES YOUR EXHIBIT WSR-3 PROVIDE AN AVOIDED COST STUDY
2 WHICH COMPLIES WITH THE CRITERIA ESTABLISHED IN THE
3 FCC'S ORDER AND RULES?
4

5 A. Yes. Exhibit WSR-3 shows the calculation of a
6 wholesale discount rate that is based on the criteria
7 set forth in the FCC's Order and Rules.
8

9 Q. IS THE COMPANY SUBSTITUTING THIS CALCULATION OF THE
10 WHOLESALE DISCOUNT FOR THE STUDY IT HAS FILED IN THIS
11 PROCEEDING?
12

13 A. No. Exhibit WSR-3 does not replace the Company's
14 study. The Company still supports its study as the
15 most appropriate calculation of wholesale discount
16 factors. However, Exhibit WSR-3 provides additional
17 information to the Commission regarding the impact of
18 the FCC's Order and Rules.
19

20 Q. PLEASE DESCRIBE EXHIBIT WSR-3.
21

22 A. The format for Exhibit WSR-3 shows in the first
23 column of page 1, the accounts within the FCC's
24 Uniform System Of Accounts (USOA), which the FCC has
25 treated either as presumptively avoided direct

1 expense accounts or as indirectly avoided overhead
2 and general support expense accounts. The second
3 column reports the amount of regulated expense for
4 each account shown in column 1 as reported by
5 BellSouth to the FCC on the ARMIS Report 43-03 for
6 1995 Florida operations. The third column reports,
7 for the direct avoided accounts, the Company's
8 analysis regarding the amount of expense in these
9 accounts which the Company believes may qualify as
10 avoidable under the FCC's stated criteria in the
11 Order. For the indirect accounts, the third column
12 reflects an allocation to avoided expense based on
13 the ratio of total avoided direct expenses to total
14 expenses. The indirect expense allocation ratio is
15 calculated in Column 2, below the total for overhead
16 and general support expenses.

17

18 I have computed the wholesale discount at the bottom
19 of Exhibit WSR-3. The first step in this calculation
20 was to add the indirect avoided expenses to the
21 direct avoided expenses to compute total avoided
22 expenses. The next step was to determine the
23 revenues subject to discount. This amount was
24 determined by adding the residence and business
25 revenues subject to discount from the Company's study

1 and adding to this total non-recurring revenues,
2 contract service arrangement (CSA) revenues, and
3 grandfathered service revenues. The total of these
4 revenue amounts equals the revenues subject to
5 discount. Finally, the wholesale discount is
6 calculated by dividing the avoided costs by the
7 revenues subject to discount. The calculation yields
8 a wholesale discount of 19.7% (\$351,571,000 of
9 avoided costs divided by \$1,788,314,000 of revenues
10 subject to discount).

11

12 Q. WHAT IS THE BASIS FOR THE COMPANY'S ANALYSIS
13 REGARDING THE AMOUNTS SHOWN ON EXHIBIT WSR-3 FOR THE
14 DIRECT AVOIDED EXPENSE ACCOUNTS IN COLUMN 3?

15

16 A. The FCC's Order and Rules treat accounts 6611-6613
17 and 6621-6623 as presumptively avoided, but allows
18 the incumbent local exchange carrier ("LEC") to rebut
19 this presumption to the state commission (the Order
20 at paragraph 917). The amounts in Column 3 for the
21 direct avoided expense accounts represents the
22 Company's analysis, utilizing the FCC's
23 avoided/avoidable criteria, of the work operations
24 performed applicable to these accounts.

25

1 For account 6611 (product management), the Company
2 analyzed each job function and its associated costs.
3 The majority of these functions are non-avoidable.
4 They include such functions as: developing rates and
5 tariffs for new services, developing product plans,
6 enhancements of existing services, forecasting demand
7 for products and services, and support for these
8 functions. These functions comprise the majority of
9 costs in account 6611. Therefore, most of the cost
10 in this account is non-avoidable.

11

12 In this analysis for accounts 6612 (sales), and 6613
13 (advertising), the Company treated as non-avoidable
14 those 1995 expenses recorded in the accounts which
15 were related to carrier services, public services,
16 and operator services. A significant portion of the
17 expense in these accounts is treated as avoidable.

18

19 For accounts 6621 (call completion) and 6622 (number
20 services), the Company treats these expenses in the
21 analysis as non-avoidable for resale purposes. To
22 the extent MCI takes over the operator services
23 functions from BellSouth by direct routing of local
24 telephone calls to its operators, it is taking over a
25 line of business with its own revenue stream. Call

1 completion and number service expenses are
2 appropriately not treated as avoided because they are
3 not associated with the retail lines of business that
4 the Company would retain under this scenario. If on
5 the other hand MCI continues to secure operator
6 services from BellSouth, these expenses are non-
7 avoidable because the functions will continue to be
8 performed as currently.

9
10 Finally, for account 6623 (customer services), the
11 Company utilized the data from its avoided cost study
12 for this account but added as avoidable certain
13 indirect and other expenses. The amount treated as
14 non-avoidable includes customer service expenses
15 associated with carriers, public services, and
16 operator services. In addition the Company included
17 additional amounts as non-avoidable for customer
18 services functions that would be required for
19 alternative local exchange companies.

20
21 Q. HOW DID YOU DETERMINE THE SPECIFIC OVERHEAD AND
22 GENERAL SUPPORT ACCOUNTS TO INCLUDE ON EXHIBIT WSR-3?

23
24 A. In paragraph 918 of the Order, the FCC stated:
25 "General support expenses (accounts 6121-6124),

1 corporate operations expenses (accounts 6711, 6612
2 (sic.), 6721-6728), and telecommunications
3 uncollectibles (account 5301) are presumed to be
4 avoided in proportion to the avoided direct expenses
5 identified in the previous paragraph." I have used
6 these accounts on Exhibit WSR-3, with the exception
7 of account 6612 which is most likely a typographical
8 error and should have been account 6712 (planning).

9

10 Q. WHAT IS THE BASIS FOR THE CALCULATION OF THE
11 INDIRECTLY AVOIDED ALLOCATION FACTOR?

12

13 A. The indirectly avoided allocation factor is computed
14 as the ratio of direct avoided expenses to total
15 expenses. The basis for this factor comes from the
16 section of the FCC's Order at paragraph 918, which I
17 previously mentioned. In addition, in paragraph 929
18 of the Order, the text concerning the calculation of
19 the default range for wholesale discounts states:
20 " We have, therefore, substituted a more
21 straightforward approach in which we apply to each
22 indirect expense category the ratio of avoided direct
23 expense to total expenses."

24

25

1 Q. DOES THE AVOIDED COST STUDY YOU HAVE SHOWN ON EXHIBIT
2 WSR-3 OVERSTATE THE CALCULATED WHOLESALE DISCOUNT?

3

4 A. Yes. Because the criteria used for this study was
5 the FCC's "reasonably avoidable" criteria, and
6 because the study includes an allocated portion of
7 indirect costs, the resulting wholesale discount rate
8 is overstated.

9

10 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

11

12 A. BellSouth's methodology for calculating wholesale
13 discounts for residence and business services is a
14 reasonable approach which meets the federal
15 requirements of the Act. The study is generous to
16 resellers in at least three areas: 1) the study does
17 not include increases in cost that the Company may
18 incur to serve resellers; 2) the study does not
19 include any uncollectibles related to resellers; 3)
20 the study assumes that resellers will serve average
21 revenue customers even though it is likely that high
22 revenue customers will be targeted. The separate
23 wholesale discount rates of 19.0% for residence and
24 12.2% for business should be approved.

25

1 Q. DOES THIS COMPLETE YOUR TESTIMONY?

2

3 A. Yes.

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1 BELLSOUTH TELECOMMUNICATIONS, INC.
2 REBUTTAL TESTIMONY OF WALTER S. REID
3 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION
4 DOCKET NO. 960846-TP
5 SEPTEMBER 16, 1996

6
7 Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, AND
8 POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

9
10 A. My name is Walter S. Reid and my business address is
11 675 West Peachtree Street N. E., Atlanta, Georgia.
12 My position is Senior Director for the Finance
13 Department of BellSouth Telecommunications, Inc.
14 (hereinafter referred to as "BellSouth" or "the
15 Company").

16
17 Q. ARE YOU THE SAME WALTER S. REID WHO FILED DIRECT
18 TESTIMONY IN THIS DOCKET?

19
20 A. Yes. I filed direct testimony in this docket on
21 behalf of BellSouth on September 9, 1996.

22
23 Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

24
25

1 A. The purpose of my rebuttal testimony is to respond to
2 the positions taken in the direct testimony of MCI
3 witness Mr. Don Price related to the issue concerning
4 the appropriate wholesale rate for BellSouth to sell
5 its services to MCI for resale. My testimony
6 specifically identifies areas of overstatement in the
7 MCI methodology for calculating a wholesale discount
8 rate for BellSouth in Florida. My direct testimony
9 in this docket supports wholesale discount rates for
10 BellSouth of 19% for residential services and 12.2%
11 for business services. I also provided the
12 Commission in my direct testimony with a priceout
13 using the FCC's criteria for an avoided cost study
14 that resulted in a single wholesale discount rate of
15 19.7%. The Company believes that the FCC's criteria
16 for an avoided cost study results in an overstated
17 wholesale discount rate. Therefore, the 19.7% rate
18 which I provided on my Exhibit WSR-3 is itself
19 overstated. Mr. Price's testimony proposes a
20 wholesale discount rate of 25.38% for all retail
21 services. In this rebuttal testimony, I will
22 explain how MCI's approach incorrectly treats certain
23 expense amounts and leads to this overstated result.

24
25

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

4

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

12

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

16

17 A. Yes. I obtained a complete copy of the MCI
18 spreadsheet model which Mr. Price filed in another
19 jurisdiction. Using this spreadsheet format and
20 specific BellSouth-Florida ARMIS data for 1995, I was
21 able to compute the wholesale discount rate of
22 25.06%, which Mr. Price reports on his Exhibit DGP-3
23 for 1995. I did not recompute the years 1991 through
24 1994 which he also reports on his exhibit. I have
25 included my reconstruction of the MCI spreadsheet

1 model as my Exhibit WSR-4 to this testimony. On this
2 exhibit, I have reorganized the MCI calculations into
3 direct avoided, indirect avoided, and not avoided
4 categories so that the results can be more easily
5 compared to the cost studies I have filed. In this
6 rebuttal testimony, I will refer to Exhibit WSR-4 to
7 identify the magnitude of certain MCI overstatements.

8

9 Q. PLEASE DESCRIBE EXHIBIT WSR-4.

10

11 A. Exhibit WSR-4 is structured to display the formulas
12 used by MCI in its spreadsheet model to calculate a
13 wholesale discount factor. I formatted the display
14 of the data in a manner similar to the format I used
15 for Exhibit WSR-3 which was attached to my direct
16 testimony. The first column of Exhibit WSR-4 reports
17 the line number on BellSouth's 1995 ARMIS Report
18 43-04, from which the intrastate expense amounts
19 shown in column 3 were obtained. Column 2 reports
20 the type of expense which is included on the
21 particular line in the analysis and the account
22 numbers associated with the expense. The expenses
23 are grouped into categories representing those that
24 are direct avoided, indirect avoided, and not
25 avoided. These groupings correspond to the treatment

1 that MCI accorded the expense in its Model and to the
2 FCC criteria for avoided cost studies. Column 4 of
3 the exhibit reports the percentage of the intrastate
4 expenses in Column 3 that MCI treated as avoidable in
5 its study. The percentages shown for the direct
6 avoided accounts represent the FCC default
7 assumptions which MCI adopted for its analysis. The
8 percentage shown for indirect avoided expenses
9 represents the ratio of direct avoided expenses to
10 total operating expenses. Column 5 reports the
11 calculated avoided direct and indirect expenses
12 obtained by multiplying the amounts in Column 3 times
13 the percentages in Column 4. The total avoided
14 expenses and the wholesale discount rate are
15 calculated at the bottom of Column 5. The wholesale
16 discount rate of 25.06% agrees with Mr. Price's
17 Exhibit DPG-3 for Florida in 1995.

18

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

22

23 A. There are two major differences between the MCI Model
24 and the Company's calculations based on the FCC's
25 criteria that cause the MCI Model to incorrectly

1 produce higher results. The first difference is that
2 the MCI Model inappropriately treats operator
3 services expenses as 100% avoidable. As I explained
4 in my direct testimony, operator service expenses
5 (amounts charged to account 6621, call completion,
6 and account 6622, number services) are not avoidable
7 under a resale environment. To the extent MCI takes
8 over the operator services functions from BellSouth
9 by directly routing local telephone calls to its
10 operators, it takes over a line of business with its
11 own revenue stream. This situation represents a
12 competitive loss to BellSouth and a competitive gain
13 to MCI. It does not represent the resale of
14 BellSouth's operator service tariffs to MCI at a
15 discount. MCI's position on this issue would result
16 in a windfall to MCI and a penalty to BellSouth,
17 because MCI would receive both the revenues from
18 operator service charges to customers and an
19 increased discount on local services from BellSouth
20 (due to the treatment of the operator services
21 expenses as avoidable). With MCI's position,
22 BellSouth loses the revenues associated with operator
23 services charges and also revenues associated with
24 other services that will be discounted further
25 because of MCI's treatment of the operator services

1 expenses as avoidable. To correct this overstatement
2 in MCI's Model, the operator services expenses of
3 \$65,567,000 shown in Exhibit WSR-4, which MCI has
4 treated as 100% avoidable, should be removed and
5 treated as not avoidable. This correction in the MCI
6 Model would reduce its calculated discount for 1995
7 from 25.06% to 21.07%, a reduction of 3.99%.

8

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

11

12 A. The second major difference relates to MCI's
13 mishandling of published directory listing expenses.
14 As shown on Exhibit WSR-4 associated with ARMIS
15 Report 43-04, line number 7076, MCI identified
16 \$45,776,000 of intrastate published directory listing
17 expenses and treated 100% of this amount as
18 avoidable. MCI's treatment of this expense is wrong
19 for at least two reasons. First, this category of
20 expense on the ARMIS Report 43-04 primarily includes
21 the cost of classified and white page directories
22 published and distributed by the Company's affiliate,
23 BellSouth Advertising and Publishing Company (BAPCO).
24 This expense is clearly not avoidable because BAPCO
25 will continue, in a resale environment, to publish

1 and distribute these directories including listings
2 for both the Company's customers and other local
3 exchange carriers' customers. These amounts appear
4 on the ARMIS Report only in order that a portion of
5 the white page expense can be included in the
6 interstate jurisdiction.

7
8 In addition to being not avoidable, these expenses
9 are not included in the costs underlying the retail
10 tariffs subject to a wholesale discount. The Company
11 has an historical relationship with BAPCO, under
12 which BAPCO incurs the costs related to publishing
13 and distributing directories in the Company's
14 franchise territory. These costs have not been
15 assigned to the intrastate jurisdiction and,
16 therefore, have not been included as costs that need
17 to be covered by intrastate tariffs. To the extent
18 that any state jurisdiction has imputed BAPCO
19 earnings to the Company in a rate proceeding, these
20 imputations have been reductions in intrastate
21 revenue requirements and not increases. These costs
22 are, therefore, not being recovered in the Company's
23 intrastate tariffs. To correct MCI's mishandling of
24 this expense, it is necessary to remove the
25 \$45,776,000 in published directory listing expenses

1 from both MCI's direct avoided expense amount and its
2 total operating expense amount. This correction
3 would further reduce its calculated discount from
4 21.07% (after the correction for operator services
5 expense) to 18.8%, a reduction of 2.27%.

6

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

10

11 A. Yes. I have prepared Exhibit WSR-5 to show the
12 revised MCI Model calculations with the two major
13 differences corrected. This exhibit has the same
14 format as Exhibit WSR-4, but has the corrections
15 applied for operator services expenses and published
16 directory listing expenses. As this exhibit shows,
17 the MCI methodology adjusted for these two problem
18 areas would actually produce a calculated discount of
19 18.8%, or 0.9% below the calculation I provided on
20 Exhibit WSR-3 (the study the Company provided based
21 on the FCC's criteria).

22

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

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

3
4 A. No. As I explained in my direct testimony on page
5 19, the Company still supports its study as the most
6 appropriate calculation of wholesale discount
7 factors. The Company's study was provided as Exhibit
8 WSR-1 to my direct testimony. The appropriate
9 wholesale discount rates are 19.0% for residential
10 services and 12.2% for business services. Both of
11 the avoided cost studies shown on Exhibit WSR-3 and
12 Exhibit WSR-5 are calculated based on the FCC's
13 criteria for avoided cost studies. In my direct
14 testimony on pages 16 through 18, I described the
15 differences between the FCC's criteria for avoided
16 cost studies and the Company's position on the
17 appropriate study methodology according to the plain
18 words of the Telecommunications Act of 1996 ("the
19 Act"). The FCC's criteria overstates the wholesale
20 discount rate through, among other things, the use of
21 a "reasonably avoidable" concept to identify avoided
22 expenses and by allocating indirect expenses as
23 avoidable amounts. Therefore, the appropriate
24 wholesale discount rate should be less than the 19.7%
25

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

3

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

7

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

13

14 Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.

15

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

1 18.8%. The Company supports its study which
2 calculates wholesale discount rates of 19.0% for
3 residential services and 12.2% for business services.
4

5 Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

6

7 A. Yes.

8

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25

1 BY MR. LACKEY (Continuing):

2 Q Mr. Reid, do you have a summary of your testimony?

3 A Yes, I do.

4 Q Can you -- Do you have an exhibit to use with your
5 summary?

6 A Yes, I do. I've got an exhibit of three sheets that
7 two of the sheets represent exhibits to my testimony and the
8 third sheet represents a summary of one of the points that I'm
9 making. So if we would could hand those out as I go through my
10 summary, I think I can explain those exhibits as we go.

11 Q And consistent with our discussion earlier in the
12 week, the third sheet is not to be marked as an exhibit or
13 included in the record, but is illustrative; is that correct?

14 A That is correct.

15 Q If I could get those handed out, Madam Chairman, we
16 can go ahead and get his summary going.

17 CHAIRMAN CLARK: Mr. Lackey, so I'm clear, the other
18 two pages are already in an exhibit?

19 MS. LACKEY: Yes, ma'am. He's just going to use them
20 to talk from in his summary. The first two pages are already
21 exhibits in his testimony or from exhibits in his testimony.
22 The third one is this summary illustrative page.

23 CHAIRMAN CLARK: Okay.

24 BY MR. LACKEY (Continuing):

25 Q I have that right; don't I, Mr. Reid?

1 A That's correct.

2 Q All right. Mr. Reid, go ahead with your summary.

3 A My testimony presents BellSouth's proposed methodology
4 for use by the Florida Public Service Commission in determining
5 the appropriate wholesale discounts off of retail rates that
6 the Company will offer to resellers of its services.

7 BellSouth's methodology is consistent with the
8 Telecommunications Act of 1996, which specifies that wholesale
9 rates shall be determined on the basis of the retail rates,
10 less the portion thereof attributable to costs that will be
11 avoided by the Company. Exhibit WSR-1 attached to my testimony
12 provides the calculations for wholesale discounts to be offered
13 to resellers of BellSouth's services in Florida. The resulting
14 wholesale discount percentages are 19% for residential services
15 and 12.2% for business services.

16 The basic equation used in BellSouth's methodology is
17 shown on my Exhibit WSR-2, page 1 of 2, and is provided as the
18 first sheet of the handout.

19 The points I would like to make regarding the equation
20 used by the Company, at the top of the sheet, if you'll notice
21 under "Basic Equation," the "% discount is equal to the cost
22 avoided as a result of resale transactions divided by the
23 revenue subject to resale x 100."

24 Now, in applying that equation, the Company identified
25 costs in the areas of customer services, billing, sales,

1 advertising through bill inserts and uncollectables. The
2 denominator of the equation related to local network service
3 revenues, which are primarily revenues in accounts 5001 through
4 5069, and intraLATA long distance, that's intrastate intraLATA
5 long distance in the 5100 series accounts.

6 Couple of points I would like to make sure are
7 understood: One is that this formula would insure that the
8 Company's avoided costs, those that will be avoided, will be
9 passed on to the reseller through the discount because the
10 revenue subject to resale in the denominator and the avoided
11 expense is in the numerator. And using this formula, BellSouth
12 should be indifferent to whether we provide the service through
13 resell or through retail, because basically we would have a net
14 indifference in the financial situation on that.

15 For determining the amount of avoided costs to be used
16 in the numerator of the wholesale discount equation, the
17 Company recognized that the costs subject to impact from resale
18 would be customer related costs, such as those identified on
19 Exhibit WSR-2, page 2 of 2, and displayed on the next sheet of
20 the handout.

21 Now on this sheet, to the left column, I have shown
22 the costs not subject to impact from resale and to the right
23 hand side I've shown the costs subject to impact from resale.
24 And I would like to point out this is the Company's basic
25 resale study, which is provided through WSR-1 in this

1 proceeding. On WSR-3, I have provided a FCC compliance study,
2 which does move some of the costs from the left hand column
3 over to the right hand column.

4 Some of the points I would like to make regarding this
5 exhibit are that the Company used a criteria that the volume
6 sensitive costs of the business, those customer related/volume
7 sensitive costs would be those that will be avoided with
8 resale.

9 In order to carry out that criteria, the Company
10 utilized the most relevant information it had available to it,
11 which was its activity based information from its job function
12 detail within its internal accounting system. That detail
13 allows us to track what activity we are incurring costs for and
14 who we are incurring the costs for. For example, if we're
15 incurring the costs on behalf of carriers, it would be
16 inappropriate to remove those costs as avoided because they
17 were not costs subject to the resale transactions. They're
18 costs subject to serving carriers.

19 The major costs that we identified in the BellSouth
20 resale study were marketing sales, customer services, bill
21 inserts, postage and billing and uncollectable revenues.
22 Regarding uncollectable revenues, we had the basic assumption
23 that we would not incur any uncollectables associated with
24 dealing with the resellers. Now, to the extent that does not
25 occur, then obviously we've been generous to the resellers or

1 we need to adjust that assumption at some later point in time.

2 The criteria to be used for determining BellSouth's
3 avoided costs is one of the primary contentious issues in this
4 proceeding concerning wholesale pricing. The FCC released on
5 August the 8th, 1996 its First Report and Order in CC Docket
6 96-98, which among other issues addressed its conclusions
7 regarding the resell provisions in the Act. BellSouth does not
8 agree with the FCC's criteria for determining avoided costs as
9 presented in the Order and has appealed the FCC's decisions.
10 The FCC has based its criteria for avoided cost studies on the
11 hypothetical of BellSouth as a 100% wholesale company and the
12 costs that would be reasonably avoidable under this scenario.
13 The Company believes that it will be both a retailer and a
14 wholesaler and that the FCC's hypothetical criteria treats some
15 of the Company's costs as avoided that will not actually be
16 avoided.

17 However, in order to provide the Commission with a
18 wholesale discount calculation which is consistent with the
19 FCC's Order, I have prepared an exhibit to demonstrate the
20 calculations. Exhibit WSR-3 provides a calculation based on
21 the FCC's Order and the FCC's allowed rebuttal for the
22 treatment of expenses in certain accounts as avoided.

23 Various parties to this proceeding have presented
24 avoided cost studies which claim to be consistent with the
25 FCC's Order. One of the most contentious issues with the

1 largest impact on avoided cost studies is the treatment
2 associated with operator services. Both MCI and AT&T claim
3 that an avoided cost study should treat BellSouth's call
4 completion and number service expenses as avoidable. AT&T goes
5 to an even further extreme and proposes to treat certain
6 operator services equipment, depreciation expense return
7 requirement, and related income taxes as avoidable. MCI and
8 AT&T's rationale for proposing this treatment is that these
9 companies want to perform operator services for themselves.

10 The problem with this rationale related to an avoided
11 cost study is that this situation does not represent resale of
12 BellSouth's operator services to a reseller but merely
13 represents a competitive loss for BellSouth.

14 I have prepared the next chart to demonstrate the
15 windfall that would accrue to MCI and AT&T if avoided cost
16 treatment was ordered regarding operator services expenses. It
17 is obvious from the demonstration, from this demonstration that
18 it is totally inappropriate to treat operator services expenses
19 as avoided. This issue has inappropriately added 3.99% to
20 MCI's calculated wholesale discount and approximately 5.9% to
21 AT&T's wholesale discount.

22 And I would like to refer to the last sheet, which is
23 my summary of that particular issue. At the top of that sheet,
24 I'll go quickly through it. In today's environment, I'm
25 assuming that the revenues for operator services, for example,

1 if they were \$1,000, and call completion expenses were \$500,
2 and number services expense was \$500, if the reseller provides
3 this service, BellSouth would not receive the \$1,000 of
4 revenues because those revenues would not be charged to our end
5 user customers. We would not incur the call completion and
6 number services expenses. That leaves us at a net zero impact.

7 At the bottom part of the sheet, you will see what
8 happens if AT&T and MCI's proposal is used. Under today's
9 environment, we would still have the same situation of \$1,000
10 of revenues for us and \$500 of call completion and \$500 in
11 number services. If the reseller provides the service, we
12 would lose the revenues and we would not incur the expenses,
13 but through the discount on services such as 1FRs, we would
14 pass on to the resellers an additional \$1,000, which would
15 represent the treatment of those call completion and number
16 services expenses as an avoided expense. So, BellSouth's final
17 impact would be a net loss of \$1,000 with a windfall of \$1,000
18 to AT&T and MCI.

19 BellSouth's position is that its resale study, which
20 calculates a 19% discount for residential services and a 12.2
21 discount for business services, is appropriate for resale under
22 the provisions of the Act. However, if the Commission decides
23 that it should comply with the FCC's Order, the Company has
24 provided information regarding the impact of the Order which
25 demonstrates that the discount rate using the FCC's provisions

1 should be 19.7%.

2 And that concludes my testimony.

3 Q Thank you.

4 A Excuse me. My summary.

5 MR. LACKEY: Thank you. Mr. Reid is available.

6 CHAIRMAN CLARK: Mr. Melson.

7 MR. MELSON: Thank you.

8 CROSS EXAMINATION

9 BY MR. MELSON:

10 Q Mr. Reid, I'm Rick Melson, representing MCI. How are
11 you doing this afternoon?

12 A Good afternoon.

13 Q In a regulated environment, BellSouth's rates were set
14 on the basis of separated cost data; is that correct?

15 A I would agree with that, yes.

16 Q Okay. Let me show you a document. It's previously
17 been admitted in this Docket as Exhibit 16. It was exhibit
18 Staff put in with respect to Mr. Lerma, and I'm going to direct
19 you to page 105 of that exhibit.

20 Would you look at Account No. 6620 for service
21 expense. Is that the account that includes the expenses
22 related to call completion and number services?

23 A Yes, it includes the call completion, number services,
24 and, as shown on this particular sheet, it also includes
25 customer services expense.

1 Q And what are customer services expenses?

2 A Those are expenses, for example, of billing customers
3 and the service representative, salary and wages and so forth
4 for people that receive customer's calls.

5 Q And the amount of -- And the amounts in those three
6 sub accounts, 6621, -22 and -23, are rolled up into a summary
7 account, 6620; is that correct?

8 A That is correct.

9 Q And the amounts subject to separations for that
10 summary account is I guess \$401,982,000; is that correct?

11 A That's correct, on this particular form, which is, as
12 I will identify it, it's an ARMIS Report to the FCC. It's
13 ARMIS Report No. 43-03. And on that particular form, the
14 subject to separations amount is 401,982,000.

15 Q And that is for BellSouth Florida for calendar 1995;
16 is that correct?

17 A That is correct. That is -- I will say that that
18 amount exceeds the amount of those expenses that are on our
19 books and records and would also greatly exceed the amount that
20 we would include in intrastate expense in regulation in
21 Florida.

22 Q But the amount subject to separations is ultimately
23 the amount that flows through and is the basis on which rates
24 are set in a regulated environment?

25 A That is not correct.

1 Q And why is that not correct?

2 A That is not correct because if -- On the sheet that
3 you passed to me, there's a column that says "Other
4 Adjustments." And on this particular form for these accounts,
5 what that represents is -- I will use an analogy of a pro forma
6 type adjustment that we would have in a rate proceeding in
7 Florida, where we would adjust the book numbers for certain
8 items. This particular adjustment is to include in this
9 category of expense amounts related to white and yellow page
10 costs that we are assigning a portion of the white page expense
11 to interstate.

12 For intrastate ratemaking purposes, however, those
13 expenses are not included as expenses on our surveillance
14 report. For example, if you go to our intrastate expense on
15 the Florida surveillance report and you pull the intrastate
16 amounts for these same accounts and you compared them to the
17 intrastate expense that Mr. Price has on his exhibit, for
18 example, which he obtained from a further downstream part of
19 this form, you will find that the intrastate expense we
20 reported to the Florida Commission is about 47 million dollars
21 less than the amount Mr. Price used. So it is not the
22 intrastate expense used in rate setting in this state.

23 Q Understanding that you think you have used the correct
24 number, let me ask if you had used the subject to separations
25 amount shown on page 5.4, the calculated discount would have

1 been greater; is that correct?

2 A Yes, from a mathematical calculation, but that would
3 be an inappropriate calculation because that, as Mr. Price
4 said, his attempt was to use the expenses that are in
5 regulation and rate setting in Florida. And those are not the
6 expenses that are used in Florida in ratemaking. The expenses
7 used in Florida ratemaking are more indicative of the total
8 regulated column, which appears on the preceding page of this
9 and were used in my exhibit, not the ones used by Mr. Price.

10 MR. MELSON: That's all I've got. Thank you,
11 Mr. Reid.

12 WITNESS REID: Thank you.

13 CHAIRMAN CLARK: Mr. Lemmer.

14 MR. LEMMER: Yes. Thank you, Madam Chairman.

15 CROSS EXAMINATION

16 BY MR. LEMMER:

17 Q Good afternoon, Mr. Reid. Tom Lemmer, once again for
18 AT&T.

19 A Good afternoon, again, Mr. Lemmer.

20 Q Not too many days separate these; do they?

21 A No, this seems like this is the third time in a couple
22 of weeks; isn't it?

23 Q Let me direct your attention to the first page of what
24 you handed out while you were giving your summary, the page
25 with the equation on it, please. And if we look at the top

1 equation, the one that says "Basic Equation," the numerator of
2 that equation speaks to "cost avoided as a result of resale."
3 Does the statute, and I'm talking about 252(d)(3), use the word
4 "avoided"?

5 A The statute uses the words "will be avoided."

6 Q So then it's correct that the statute does not use the
7 word "avoided"?

8 MR. LACKEY: I must have missed something.

9 COMMISSIONER KIESLING: I must have, too. You just
10 said the word "avoided" is in that statute, costs that will be
11 avoided.

12 MR. LEMMER: Will be avoided; that is correct.

13 COMMISSIONER KIESLING: That's the word "avoided."

14 MR. LEMMER: Let me rephrase that. Okay.

15 BY MR. LEMMER (Continuing):

16 Q The statute as it is written uses words in addition to
17 "avoided;" isn't that correct?

18 A Yes. There's several lines to the statute, the
19 sentence that incorporates the word "avoided."

20 Q Now that sentence -- Do you have the statute available
21 to you?

22 A Yes, it's in my testimony on page 5, at line 11.

23 Q If you would look at that provision, please.

24 A Yes, sir.

25 Q The pertinent language that we're talking about says

1 "excluding the portion thereof attributable to any marketing,
2 billing, collection, and other costs that will be avoided by a
3 local exchange carrier." Do you see that?

4 A Yes, I see that as part of the statute.

5 Q Now, if you look down at the second part of this page,
6 where it says "Equation Applied" and look at your numerator,
7 your numerator has "customer service, billing, sales, bill
8 inserts, and uncollectables." That does not correspond to
9 "marketing, billing and collection;" does it?

10 A Yes. Part of marketing is sales. The billing is
11 included in there. Collection is included in our customer
12 service amounts and in the billing. "And other costs that will
13 be avoided," the Company interprets that wording to mean that
14 the "will be avoided" applies to marketing, it applies to
15 billing, collection and other costs. If it will not be
16 avoided, then it should not be included in the formula to pass
17 on costs to resellers, because if we're still going to incur
18 it, it wouldn't be appropriate to pass it on to the reseller.
19 We wouldn't be indifferent to that.

20 Q Now you've used the word "indifferent" in your summary
21 and you just used it again. Is the word "indifferent" anywhere
22 in the statute?

23 A No, not -- Well, not to my knowledge.

24 Q So then it's fair to say that the numerator of the
25 "Equation Applied" as well as the word "indifferent" result

1 from an interpretation of the wording of the statute; is that
2 correct?

3 A It's an interpretation and I think it's based on the
4 plain wording of the statute. I believe the plain wording says
5 related to these marketing, billing, collection and other
6 costs, those that will be avoided.

7 Q And I believe in your summary you stated that there
8 were two basic criteria for identifying what you included in
9 the numerator of what you call your "Equation Applied" and that
10 you used a term "customer related and volume sensitive;" is
11 that correct?

12 A That's correct.

13 Q Isn't it a fact that if you apply those terms, what
14 you end up with is a standard whose bottom line is costs that
15 are actually avoided?

16 A Yes, I think you would end up with costs that are
17 actually are or will be avoided, which is what a plain
18 interpretation, plain wording interpretation of the Act would
19 be. It says costs that will be avoided. I think in order to
20 be avoided, it has to be actually avoided.

21 Q Would you agree with me that the statute does not
22 contain the word "actually"?

23 A To my knowledge this section of the statute does not
24 include the word "actually."

25 MR. LEMMER: If we could just take one moment to hand

1 out several documents, please.

2 Madam Chairman, what's being distributed are four
3 different documents.

4 CHAIRMAN CLARK: Hang on a minute. Mr. Tye, would you
5 help him distribute these things so we can get this moving, and
6 would you make sure that BellSouth has them so they can be
7 looking at them.

8 Mr. Lemmer, how many documents do you want me to have?

9 MR. LEMMER: There are four separate documents and if
10 we could identify the four separately, please.

11 CHAIRMAN CLARK: Okay.

12 MR. LEMMER: The first document would be what I will
13 call a chart of comparative requested discount levels.

14 CHAIRMAN CLARK: Okay. That's a one-page document?

15 MR. LEMMER: That is correct.

16 CHAIRMAN CLARK: All right. The one-page document,
17 "Comparison of Discount Amounts and Dollar Impacts Within
18 BellSouth Territory," that will be marked as Exhibit 79.

19 MR. LEMMER: I'm sorry; 79?

20 CHAIRMAN CLARK: Yes.

21 (Exhibit No. 79 marked for identification.)

22 MR. LEMMER: The second document that I would like to
23 have identified is an Order from the Georgia Public Service
24 Commission in Docket 6352; it's dated May 29th, 1996.

25 CHAIRMAN CLARK: That will be marked as Exhibit 80.

1 (Exhibit No. 80 marked for identification.)

2 MR. LEMMER: The next document will be an Order
3 entered by the Kentucky Public Service Commission in Case No.
4 355.

5 CHAIRMAN CLARK: That will be Exhibit 81.

6 (Exhibit No. 81 marked for identification.)

7 MR. LEMMER: And the last document would be an Order
8 entered by the Louisiana Public Service Commission and it's in
9 Docket No. U22020.

10 CHAIRMAN CLARK: That will be Order -- That will be
11 Exhibit 82.

12 (Exhibit No. 82 marked for identification.)

13 BY MR. LEMMER (Continuing):

14 Q Mr. Reid, let me direct your attention to what has
15 been identified as Exhibit No. 79, which is the chart of
16 numbers. Do you have that in front of you?

17 A Yes, I have that in front of me.

18 MR. LACKEY: Madam Chairman, may I ask a question
19 before we go further about this Exhibit 79?

20 CHAIRMAN CLARK: Yes.

21 MR. LACKEY: Under Tennessee, there's a PSC Order
22 discount of 25% and a note that says "interim discount," but I
23 notice there is no order from Tennessee. Could we ask a
24 clarification of what the source of that is?

25 MR. LEMMER: I believe the clarification should be

1 that the notes are incorrectly placed I believe. There is no
2 order. Tennessee has the 25% interim order, but, you're
3 correct, we did not distribute the order.

4 MR. LACKEY: There is a 25% order in Tennessee?

5 MR. LEMMER: There is an interim number, yes.

6 BY MR. LEMMER (Continuing):

7 Q Mr. Reid, directing your attention to this chart, I
8 would ask you to look at the column that's labeled "BellSouth
9 Rate." Do you see that column?

10 A Yes, I see that column.

11 Q Do you have knowledge regarding what BellSouth's basic
12 rates are in the listed states?

13 A Not that I can verify these. I'm familiar with
14 Florida being approximately what you have here.

15 Q So the Florida rates look accurate?

16 A It looks reasonable.

17 Q Are there any numbers on here that appear to you to be
18 unreasonable to the best of your knowledge?

19 CHAIRMAN CLARK: Are you asking are they unreasonable
20 or are they the rates?

21 MR. LEMMER: I'm asking to establish whether he
22 believes that they are accurate representation of the rates.

23 CHAIRMAN CLARK: Of the rates?

24 MR. LEMMER: Of the rates, correct.

25 CHAIRMAN CLARK: I think that's a different question

1 than if they're reasonable.

2 WITNESS REID: Subject to check, I will take these as
3 that. I cannot verify them myself because I'm not sure.

4 BY MR. LEMMER (Continuing):

5 Q Directing your attention to the next column, which
6 says "AT&T Discount Requested" and there is the percentage
7 column, are you knowledgeable about the various discounts that
8 AT&T has requested before the various public service
9 commissions in BellSouth's area?

10 A Yes, but I don't -- I won't say that I can remember
11 every one of them from memory.

12 Q Will you accept these subject to check?

13 A Yes, subject to check.

14 Q And then the third column, which has to do with
15 BellSouth proposed discounts; again, my question would be do
16 you have knowledge regarding the accuracy of these rates?

17 A I will also accept those subject to check.

18 Q And in the last column, the last column it says "PSC
19 Ordered Discount" and where I'm talking Georgia, Kentucky,
20 Louisiana, Tennessee. Do you see that column?

21 A Let me go back to the previous column, because it
22 appears, for example, in the column you've got labeled
23 "BellSouth's Proposed Discount," you've reported the -- A
24 number, for example, for the residence, the 18.99; in my
25 testimony I say 19% for Florida for residence. Okay. This is

1 the 1FR; I see at the top of the page. So this is just a chart
2 of the residence.

3 Q That's correct.

4 A Okay. I'm sorry.

5 Q Directing your attention to the last column, the "PSC
6 Ordered Discounts," and you see those percentages identified
7 with four different states, are you familiar with the orders in
8 those particular states?

9 A I'm familiar with the Order in Georgia and Kentucky.
10 I have not read the Louisiana Order, which I think just came
11 out within the last couple of days. And the Tennessee Order I
12 don't believe was an order based on any avoided cost studies.
13 I think this predates any of the FCC Orders or other filing of
14 studies. So I think that's a discount that may have been from
15 an interim order before any avoided cost studies were provided.

16 Q Now, up to this point previous to handing out this
17 chart and other documents, we had been discussing BellSouth's
18 interpretation of the Act and how a discount should be
19 calculated; isn't that correct?

20 A That's correct.

21 Q And the interpretation that you were using or that you
22 were speaking to is the -- is it correct that that is the
23 interpretation that underlies the percentages in the "BellSouth
24 Proposed Discount" column?

25 A Yes.

1 Q Now, if you look at the State of Georgia, for
2 instance, and if you need to you can refer to the Order by the
3 Georgia Public Service Commission. That Public Service
4 Commission ordered a rate of 20.3%; isn't that correct?

5 A To my recollection, that's correct. I can -- Subject
6 to check, that sounds like the rate I remember.

7 Q And if you would turn to Exhibit No. 80, please, which
8 is the Georgia Order.

9 A Yes, I have that in front of me.

10 Q If you would turn to page 9, and the last paragraph on
11 that page; would you please read that paragraph?

12 A The paragraph that starts with "BellSouth"?

13 Q That's correct.

14 A "BellSouth has interpreted the relevant portion of the
15 Federal Act relating to the determination of a wholesale
16 discount in a very strict manner. BellSouth maintains that
17 many functions now performed for the provisioning of retail
18 services will not be avoided in a resale environment. The
19 Company believes that significant advertising sales and other
20 related expenses will not be avoided in a wholesale situation.
21 BellSouth's position reflects a narrow, constrained view of an
22 avoided cost approach."

23 Q Isn't it correct that the Georgia Public Service
24 Commission reached this decision by interpreting the Act?
25 Stated another way: That this was before the issuance of the

1 FCC Order?

2 A Yes, this particular hearing and proceeding in Georgia
3 was before the FCC's Order. It was after the Act and it was an
4 interpretation of the Act.

5 In this particular proceeding we filed only the study
6 comparable to my WSR-1. We did not file an FCC Compliance
7 Study. So in that particular docket the only issue was the
8 study provided on my WSR-1.

9 Q But in this docket here before this Commission, what
10 is on your WSR-1 is the study that BellSouth is proposing this
11 Commission to adopt; isn't that correct?

12 A That is correct, in accordance with the plain wording
13 of the Act.

14 Q And that WSR-1 that's before this Commission, the
15 methodology underlying that is the same methodology that
16 underlied the study in Georgia; isn't that correct?

17 A I believe there may have been one or two changes to
18 the study methodology, but basically I would agree with that
19 statement.

20 Q Okay. Now, if we're looking at the number chart
21 again, if you look at Kentucky, BellSouth proposed 10% and the
22 Commission ordered 19.2%. And my question to you is the
23 proposed 10% was based on the same methodology you're proposing
24 to this Commission in WSR-1?

25 A With the same -- Yes, with the same qualification that

1 I gave you previously regarding the Kentucky study was filed
2 early, too, and there could be a couple of changes to it. I
3 will say that the 19.2 that Kentucky has ordered is just an
4 adoption of the FCC default for BellSouth. It's not -- It's
5 pending the filing of another study that's FCC Order complaint.
6 So in that particular situation, Kentucky just adopted on an
7 interim measure the FCC's default number for BellSouth.

8 Q But, again, the Kentucky Commission was considering
9 BellSouth's methodology that has been presented to this
10 Commission to underlie WSR-1; isn't that correct?

11 A That is correct.

12 Q And isn't it correct that the Kentucky Commission
13 stated that it found BellSouth's methodology "too simplistic,
14 has insufficient detail and does not comply with the FCC's
15 criteria"?

16 A Do you have a reference for me?

17 Q You can reference page 13 of the Kentucky Order, which
18 is Exhibit 81.

19 A At that point it does say that the study did not
20 comply with the FCC's criteria; yes, sir.

21 Q But it says more than that; doesn't it? I mean, it
22 does say "too simplistic and insufficient detail;" doesn't it
23 say that?

24 A It uses those words.

25 Q And then you mention the recent Louisiana Order, which

1 is two or three days old, where BellSouth proposed 11% and the
2 Commission ordered at least in an administrative law judge
3 recommendation over 20%. That 11% was based -- Was that 11%
4 based on the same methodology put before this Commission?

5 A Yes, it was.

6 Q Mr. Reid, I want to spend just a few minutes talking a
7 little bit more about WSR-1. And what I'm going to put up is a
8 chart prepared by AT&T that compares its numbers versus
9 BellSouth's numbers. And I will represent to you that the
10 BellSouth column, the third column over to the right is a
11 combined or a combination of the residential and business
12 figures that you prepared.

13 Does that chart look reasonably accurate to you?

14 CHAIRMAN CLARK: Mr. Lemmer, tell me how much longer
15 you have.

16 MR. LEMMER: My guess would be 15 to 20 minutes.

17 CHAIRMAN CLARK: All right. We're going to go ahead
18 and take a break until 20 after 3:00.

19 Yeah, we are; we're going to finish today.

20 Well, maybe not by 5:00, but we're finishing today.

21 COMMISSIONER GARCIA: I'm going to go ahead and put on
22 the record that I'm going to be leaving at about 3:45. I've
23 got a flight to catch. So just so that you all know, I'll be
24 looking at the transcripts later.

25 (Brief recess.)

(Transcript follows in sequence in Volume 17.)

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