

WITNESSES - VOLUME 4

PAGE NO.

RANDY G. FARRAR

Direct Examination by Mr. Fons . . .	441
Direct Prefiled testimony . . .	449
Supplemental direct prefiled testimony . . .	516
Cross Examination by Mr. Melson . . .	522

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

EXHIBITS - VOLUME 4

1
2
3
4
5
6
7
8
9
10
11
12
13
14
15
16
17
18
19
20
21
22
23
24
25

NUMBER		ID	EVD
20	RGF-1 and 2	443	
21	RGF-3	443	
22	Confidential information relating to Exhibit 21	448	

1 P R O C E E D I N G S

2 (Hearing reconvened at 3:00 p.m.)

3 (Transcript follows in sequence from Volume 3)

4 CHAIRMAN CLARK: Go back on the record. This
5 is -- we are now on Mr. Farrar.

6 MR. FONS: Thank you, Madam Chairman. We passed
7 out some documents that we will address when we get to
8 RGF-3 and I'll indicate to you what, where they will go in
9 RGF-3. And also we passed out some confidential
10 information that is also part of RGF-3. They are in an
11 envelope, and we'll tell you where they are located in the
12 testimony.

13 Whereupon,

14 RANDY G. FARRAR

15 was called as a witness on behalf of Sprint and, having
16 been duly sworn, testified as follows:

17 DIRECT EXAMINATION

18 BY MR. FONS:

19 Q Would you please state your full name for the
20 record?

21 A My name is Randy G. Farrar, F-a-r-r-a-r.

22 Q And by whom are you employed and in what
23 capacity, Mr. Farrar?

24 A Sprint, and I'm manager of network costing and
25 pricing.

1 Q And Mr. Farrar, on November 5, 1996 did you have
2 cause to be filed in this proceeding direct testimony
3 consisting of 44 -- I'm sorry, wrong number -- 67 pages of
4 questions and answers?

5 A Yes.

6 Q And are there any changes or corrections to this
7 direct testimony?

8 A Yes, there are I believe four changes. The first
9 one is on page 7, lines 10 and 11, the words "per unit"
10 should be replaced with "per cent." On page 28, line 21,
11 95 should be replaced with 82.

12 CHAIRMAN CLARK: I'm sorry, what was that page
13 again?

14 MR. FONS: Page 28.

15 CHAIRMAN CLARK: Line what?

16 MR. FONS: 21.

17 CHAIRMAN CLARK: Okay. What was the change?

18 MR. FONS: 82 for 95.

19 CHAIRMAN CLARK: Thank you.

20 A And the last two changes are on page 44, line 7,
21 the word "eleven" should be "ten," and also on line 22,
22 again the word "eleven" should be "ten."

23 BY MR. FONS:

24 Q Any other changes or corrections to your direct
25 testimony?

1 A No, sir.

2 Q If I were to ask you the same questions today
3 that were posed to you in your prefiled direct testimony
4 with the changes that you've just indicated, would your
5 answers be the same today?

6 A Yes.

7 MR. FONS: Madam Chairman, I would ask that
8 Mr. Farrar's direct testimony be inserted in the record as
9 though read.

10 CHAIRMAN CLARK: It will be inserted in the
11 record as though read.

12 BY MR. FONS:

13 Q And Mr. Farrar, attached to your direct
14 testimony, did you have two exhibits, RGF-1 and RGF-2?

15 A Yes.

16 MR. FONS: Madam Chairman, could we have RGF-1
17 identified as the next exhibit, please.

18 CHAIRMAN CLARK: The next exhibit I have is 20,
19 so RGF-1 will be Exhibit 20.

20 MR. FONS: And could we have RGF-2 as Exhibit 21?

21 CHAIRMAN CLARK: I'm is sorry, Mr. Fons, is RGF-1
22 and 2 with his direct testimony?

23 MR. FONS: Yes.

24 CHAIRMAN CLARK: All right. We'll make it a
25 composite exhibit then.

1 MR. FONS: That will be fine, that will be
2 Composite Exhibit 20?

3 CHAIRMAN CLARK: Will be RGF-1 and 2.

4 MR. FONS: Thank you.

5 BY MR. FONS:

6 Q And Mr. Farrar, was Composite Exhibit 20 prepared
7 by you or at your direction and supervision?

8 A Yes.

9 Q Are there any corrections or changes to Composite
10 Exhibit 20?

11 A No.

12 Q And Mr. Farrar, on November 15, 1996, did you
13 cause to have filed in this proceeding supplemental direct
14 testimony consisting of three pages of questions and
15 answers?

16 A Yes.

17 Q And are there any corrections or changes to your
18 supplemental direct testimony?

19 A No.

20 Q If I were to ask you the same questions today as
21 were posed to you in your supplemental direct testimony,
22 would your answers be the same today?

23 A Yes.

24 MR. FONS: And Madam Chairman, I would ask that
25 Mr. Farrar's supplemental direct testimony be inserted in

1 the record as though read.

2 CHAIRMAN CLARK: It will be inserted in the
3 record as though read.

4 BY MR. FONS:

5 Q And Mr. Farrar, did you have attached to your
6 supplemental direct testimony a composite exhibit, Number
7 RGF-3?

8 A Yes.

9 Q And was that --

10 MR. FONS: Madam Chairman, may I have that marked
11 as Exhibit 21?

12 CHAIRMAN CLARK: It will be marked as Exhibit 21.

13 BY MR. FONS:

14 Q And Mr. Farrar, was Exhibit 21 prepared by you or
15 at your direction and supervision?

16 A Yes.

17 Q And are there any corrections and changes to your
18 Exhibit 21?

19 A Yes, there are. We have made changes to four of
20 the cost studies. Most of these changes were pointed out
21 in response to the interrogatories.

22 Q And Mr. Farrar, is the first change to Exhibit 21
23 at pages 95 of 122 pages?

24 A Yes.

25 Q And is that titled "Directory Assistance Database

1 Listing and Update?"

2 A Yes.

3 Q And do the changes -- are there three pages of
4 changes?

5 A Yes.

6 Q And do those pages, are they intended to replace
7 the current pages 95 through 97?

8 A Yes.

9 Q And the next change, is that at page 99 of 122
10 pages?

11 A Yes.

12 Q And is that titled "Directory Assistance Data
13 Base Query Service?"

14 A Yes.

15 Q And are these changes intended to replace pages
16 99 through 101 -- I'm sorry, through 102?

17 A Yes.

18 Q And is the next change at page 104 of 122 pages?

19 A Yes.

20 Q And is that titled "Toll and Local Assistance
21 Service (Live)?"

22 A Yes.

23 Q And do these pages replace pages 104 through 108?

24 A Yes.

25 Q And is the final change at Page 110 of 122 pages?

1 A Yes.

2 Q And is that titled "Directory Assistance Operator
3 Service (Live)?"

4 A Yes.

5 Q And does that replace pages 110 --

6 A Yes.

7 Q -- through 114?

8 A Yes.

9 Q Are there any other changes to your Exhibit 21?

10 A I would just like to point out that there was --
11 again, in response to one of the interrogatories, the cost
12 that is shown on page 86 is incorrect, and that was
13 corrected in one of the interrogatories.

14 Q Do you remember which interrogatory it was or
15 what numbers?

16 A I don't recall off the top of my head, no.

17 MR. FONS: We will determine that and supply it.

18 CHAIRMAN CLARK: We'll go ahead with the summary
19 and cross examination, and then if you will clarify either
20 the interrogatory or the numbers changed.

21 MR. FONS: We will do that, Madam Chairman.

22 There is one other bit of information with regard to this
23 exhibit.

24 BY MR. FONS:

25 Q Were there certain pages of this exhibit that

1 contained confidential information? And would those be
2 pages 63 through 71?

3 A Yes.

4 Q And page 84?

5 A Yes.

6 Q And I believe those have been passed out to the
7 Commissioners and to counsel.

8 MR. FONS: And do we want to identify that as
9 Exhibit 22.

10 CHAIRMAN CLARK: Is that this?

11 MR. FONS: Yes, ma'am.

12 CHAIRMAN CLARK: All right. Let's go ahead and
13 identify it as Exhibit 22. It is a confidential exhibit.
14 Give us the title again.

15 MR. FONS: Yes, ma'am. I'm sorry, I didn't --

16 CHAIRMAN CLARK: My fault too. What is in here,
17 again, the confidential exhibit? I need a title for
18 Exhibit 22.

19 MR. FONS: Confidential information relating to
20 Exhibit 21.

21 CHAIRMAN CLARK: Okay.

22

23

24

25

1 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2 DIRECT TESTIMONY

3 OF

4 RANDY G. FARRAR

5
6 **Q.** Please state your name, occupation, and business address.

7
8 **A.** My name is Randy G. Farrar. I am presently employed as
9 Manager - Network Costing and Pricing for Sprint/United
10 Management Company. My business address is 2330 Shawnee
11 Mission Parkway, Westwood, Kansas, 66205.

12
13 **Q.** What is your educational background?

14
15 **A.** I received a Bachelor of Arts degree from The Ohio State
16 University, Columbus, Ohio, in June 1976 with a major in
17 history. Simultaneously, I completed a major program in
18 economics. Subsequently, I received a Master of Business
19 Administration degree, with an emphasis on market
20 research, in March 1978, also from The Ohio State
21 University.

22
23 **Q.** What is your work experience?

24
25 **A.** From 1978 to 1983 I was employed by the Public Utilities

1 Commission of Ohio. In 1980, I was promoted from
2 Financial Analyst to Senior Financial Analyst. My duties
3 included the preparation of Staff Reports of
4 Investigation concerning rate of return and cost of
5 capital. I also designed rate structures, evaluated
6 construction works in progress, measured productivity,
7 evaluated treatment of canceled plant, and performed
8 financial analysis, for electric, gas, telephone, and
9 water utilities. I presented written and oral testimony
10 on behalf of the Commission Staff in over twenty rate
11 cases.

12
13 I have been employed by Sprint Corporation or one of its
14 predecessor companies since 1983. From 1983 to 1986 I
15 was Manager - Rate of Return. I presented written and
16 oral testimony before state public utilities commissions
17 in Iowa, Nebraska, South Carolina, and Oregon.

18
19 From 1986 to 1987 I was Manager - Local Exchange Pricing.
20 I investigated alternate forms of pricing and rate
21 design, including usage sensitive rates, extended area
22 service alternatives, intraLATA toll pricing, and
23 lifeline rates.

24
25 From 1987 to 1992 I was Manager - Local Exchange Costing.

1 In 1992 I was promoted to Manager - Network Costing and
2 Pricing. I perform financial analyses for various
3 business cases, which analyze the profitability of
4 entering new markets and expanding existing markets,
5 including Custom Calling, Centrex, CLASS and Advanced
6 Intelligent Network features, CPE products, Public
7 Telephone and COCOT, and intraLATA toll. I am an
8 instructor for numerous training sessions for subsidiary
9 companies, designed to support corporate policy on
10 pricing and costing theory, and to educate and support
11 the use of various costing models. I was a member of the
12 United States Telephone Association's New Services and
13 Technologies Issues Subcommittee from 1989 to 1992, and
14 the Economic Analysis Training Work Group from 1994 to
15 1995. In 1996, I have presented written and/or oral
16 testimony before the Illinois Commerce Commission and the
17 New Jersey Board of Public Utilities on the avoided costs
18 of resold services; and before the Pennsylvania Public
19 Utilities Commission on the cost of local loop.

20
21 **Q.** What is the purpose of your testimony?

22
23 **A.** My testimony will cover two areas: Sprint's perspective
24 on cost-based pricing for unbundled network elements; and
25 Sprint's position on the appropriate methodology for

1 determining wholesale rates for retail services.

2
3 Sprint's perspective on the pricing and costing of
4 unbundled network elements and wholesale discounts is
5 neither solely one of a local telephone company, nor
6 solely one of a new competitor. Rather, Sprint's
7 perspective represents an accommodation of interests
8 similar to those that the Commission must balance in this
9 docket. Sprint is a multi-billion dollar company
10 providing traditional local exchange service, long
11 distance service, and PCS/wireless communication. In
12 addition, Sprint Communications Company L.P. will compete
13 as a competitive local exchange carrier (CLEC).

14
15 My testimony is divided into two sections: Section I
16 addresses cost-based pricing for unbundled network
17 elements, and Section II addresses wholesale discounts
18 for retail services.

19
20 **I. COST-BASED PRICING FOR UNBUNDLED NETWORK ELEMENTS.**

21
22 **A. TELRIC-based Pricing Methodology**

23
24 **Q.** What does the Telecommunications Act of 1996 (the Act)
25 require for pricing network elements?

1 **A.** Section 252 (d)(1) of the Act, Interconnection and
2 Network Element Charges, states that,

3

4 Determinations by a State commission of the just
5 and reasonable rate for the interconnection of
6 facilities and equipment for purposes of subsection
7 (c)(2), and the just and reasonable rate for
8 network elements for purposes of section (c)(3) of
9 such section -

10 (A) shall be -

11 (i) based on the cost (determined without
12 reference to a rate-of-return or other
13 rate-based proceeding) of providing the
14 interconnection or network element
15 (whichever is applicable), and

16 (ii) nondiscriminatory, and

17 (B) may include a reasonable profit.

18

19 **Q.** What does the FCC Order say about the pricing of network
20 elements?

21

22 **A.** The FCC requires, at paragraph 672 of its First Report
23 and Order ("FCC Order"), issued August 8, 1996, in CC
24 Docket No. 96-98, that prices for interconnection and
25 unbundled elements should be set at forward-looking

1 economic costs. In the FCC's view, this will mean that
2 prices are based on the Total Service Long Run
3 Incremental Cost (TSLRIC) of the network element, which
4 the FCC titled Total Element Long Run Incremental Cost
5 (TELRIC). Importantly, TELRIC will include a reasonable
6 allocation of forward-looking joint and common costs.

7
8 **Q.** The Eighth Circuit Court of Appeals stayed the FCC Order.
9 In light of this development, what is Sprint's position
10 concerning the cost, price, and unbundling requirements
11 for network elements?

12
13 **A.** Sprint's policy in this area is unchanged. Sprint
14 believes the cost methodology in the FCC Order, TELRIC
15 for unbundled network elements, is correct.

16
17 It is imperative that the same cost standard be applied
18 to all Florida ILECs. Sprint believes the Commission
19 should adopt a TELRIC-based costing and pricing standard
20 for all Florida ILECs. A different pricing standard for
21 different ILECs will produce non-competitive costs and
22 prices among ILECs, disadvantaging some while benefiting
23 others.

24
25 **Q.** Please describe Sprint's pricing policy for network

1 elements.

2

3 **A.** Sprint believes that prices for network elements must be
4 based on economic costs. More specifically, Sprint
5 recommends:

6

7 ▶ Prices for unbundled elements should be developed
8 using a TELRIC-based pricing methodology.

9 ▶ The level of contribution to shared and common costs
10 should be recovered from each network element on a per
11 ~~unit~~ ^{cent} basis.

12 ▶ The reasonable profit level to be included in TELRIC
13 should be the most recent authorized interstate rate
14 of return.

15 ▶ Prices for network elements should be geographically
16 deaveraged; for example, according to high cost,
17 medium cost, and low cost areas, where such cost
18 differences have been quantified.

19 ▶ The same costing and pricing standards must be
20 applicable on a industry-wide and statewide basis.

21

22 **1. TSLRIC (Total service Long Run Incremental Cost)**

23

24 **Q.** Please explain what is meant by TSLRIC.

25

1 **A.** TSLRIC represents the incremental cost of an entire
2 product. In other words, TSLRIC represents all the costs
3 directly caused by a service. TSLRIC is also sometimes
4 called total incremental cost, long run service
5 incremental cost, long run incremental cost - total
6 service, or average incremental cost (when divided by
7 output). TSLRIC includes all of the service-specific
8 fixed costs and volume sensitive costs. It represents
9 the total direct burden that the service places upon the
10 resources of the company. In more precise terms, TSLRIC
11 is the difference between (1) the total cost of a company
12 that provides the study service and a number of other
13 services, and (2) the total cost of that same company if
14 it provided all of its other services in the same
15 quantities, but not the study service.

16

17 **2. TELRIC (Total Element Long Run Incremental Cost)**

18

19 **Q.** Is TSLRIC costing different from TELRIC costing?

20

21 **A.** Essentially, TSLRIC and TELRIC costing methodologies are
22 the same. Their differences are related to the items
23 being costed, not the method of developing the costs.
24 The FCC Order, paragraph 678, states,

25

1 While we are adopting a version of the
2 methodology commonly referred to as TSLRIC as
3 the basis for pricing interconnection and
4 unbundled elements, we are coining the term
5 "total element long run incremental cost"
6 (TELRIC) to describe our vision of this
7 methodology. The incumbent LEC offerings to
8 be priced using this methodology generally
9 will be "network elements," rather than
10 "telecommunications services," as defined by
11 the 1996 Act.

12
13 TSLRIC studies determine the forward-looking, long run
14 incremental cost of services while TELRIC studies
15 determine the forward-looking, long run incremental cost
16 of network elements. Neither TSLRIC nor TELRIC include
17 common costs. Many shared costs at the service level are
18 direct at the element level. The FCC chose the term
19 total "element" long-run incremental cost to reflect that
20 the "services" in question are, in reality, "elements" of
21 the network. The FCC also noted that unlike
22 telecommunication services, network elements correspond
23 to distinct network facilities.

24
25 Q. Please describe Sprint's position on an appropriately

1 developed TELRIC cost of service study.

2

3 **A.** Sprint believes that the major characteristics of an
4 appropriately developed TELRIC cost of service study are
5 as follows:

6

- 7 1. The ILEC's prices for interconnection and unbundled
8 network elements will recover the forward-looking
9 costs directly attributable to the specified
10 element, as well as a reasonable allocation of
11 forward-looking common costs. (FCC Order, para.
12 682.)
- 13 2. Per-unit costs will be derived from total costs
14 using reasonably accurate "fill factors" (estimates
15 of the proportion of a facility that will be
16 "filled" with network usage); that is, the per unit
17 costs associated with a particular element must be
18 derived by dividing the total cost associated with
19 the element by a reasonable projection of the
20 actual total usage of the element. (FCC Order,
21 para. 682.)
- 22 3. Directly attributable forward-looking costs will
23 include the incremental costs of shared facilities
24 and operations. Those costs will be attributed to
25 specific elements to the greatest extent possible.

- 1 Certain shared costs that have conventionally been
2 treated as common costs (or overheads) will be
3 attributed to the individual elements to the
4 greatest extent possible. (FCC Order, para. 682.)
- 5 4. The forward-looking pricing methodology for
6 interconnection and unbundled network elements
7 should be based on costs that assume that wire
8 centers will be placed at the ILEC's current wire
9 center locations, but that the reconstructed local
10 network will employ the most efficient technology
11 for reasonably foreseeable capacity requirements.
12 (FCC Order, para. 685.)
- 13 5. Only forward-looking, incremental costs are
14 included in a TELRIC study. (FCC Order, para.
15 690.)
- 16 6. Retailing costs, such as marketing or customer
17 billing costs associated with retail services, are
18 not attributable to the production of network
19 elements that are offered to interconnecting
20 carriers and are not included in the forward-
21 looking direct cost of an element. (FCC Order,
22 para. 691.)
- 23 7. The TELRIC methodology provides for a reasonable
24 profit and thus no additional profit is required
25 under the statutory language. (FCC Order, para.

1 699.)

2 8. The currently authorized rate of return is a
3 reasonable starting point for TELRIC calculations.
4 (FCC Order, para. 702.)

5

6 **3. Shared and Common Costs**

7

8 **Q.** What are shared costs?

9

10 **A.** Shared costs are costs that:

11

- 12 ▶ support a group of services,
- 13 ▶ are incremental to that group of services, and
- 14 ▶ are unaffected by any individual service.

15

16 Another way of saying this is that shared costs are
17 essential to the provision of more than one service and
18 do not vary with the output of any of the individual
19 services.

20

21 **Q.** What does the FCC Order say about the treatment of shared
22 costs?

23

24 **A.** The FCC Order, at paragraph 682, indicates that shared
25 costs be attributed to specific elements to the greatest

1 extent possible.

2

3 Q. What are common costs?

4

5 A. Common costs are a specific type of shared costs. They
6 are costs shared by all services offered by the company.
7 These are costs that do not change or go away unless the
8 company goes out of business. The classic example is the
9 president's desk. As with TSLRIC, TELRIC does not
10 include common costs.

11

12 Q. What is the magnitude of common costs to be included
13 under the TELRIC-based pricing methodology?

14

15 A. The FCC Order, at paragraph 695, states that the level of
16 common costs for network elements should be less than
17 that for services, because network elements correspond to
18 discrete network facilities that have distinct operating
19 characteristics. Many shared costs of facilities and
20 operations are attributed to specific elements to the
21 greatest extent possible. (FCC Order, para. 682.)

22

23 Q. What is Sprint's recommendation on the size and
24 allocation of shared and common costs?

25

1 **A.** Sprint recommends that shared and common costs be
2 recovered on a percentage basis, above the TELRIC of each
3 individual element, to reflect the forward-looking shared
4 and common costs of a reasonably efficient firm.
5 Sprint's methodology and recommended allocation amounts
6 are explained in Section B. 12, below.

7
8 **4. Return On Investment**

9
10 **Q.** Please describe cost of capital.

11
12 **A.** Cost of capital is what a company has to pay creditors
13 and shareholders for the money the company uses. The
14 payment to creditors is generally called interest. The
15 payment to shareholders is generally called profit.
16 Regulation and economic texts have long recognized that
17 there is a normal level of profit, or return on
18 investment, that shareholders need to receive if they are
19 to continue to invest in the company. This normal level
20 of profit is often referred to as the cost of equity.

21
22 **Q.** Is cost of capital part of TELRIC?

23
24 **A.** Yes. The incremental cost of network elements includes
25 the cost of making additional investments. The money to

1 make these investments comes from creditors and
2 shareholders. As I explained above, the cost of
3 obtaining money from creditors and shareholders is called
4 the cost of capital.

5

6 **Q.** Does TELRIC include profit?

7

8 **A.** Yes. TELRIC provides for a reasonable profit consistent
9 with Section 252(d)(1)(B) of the Act which states that
10 rates for network elements "may include a reasonable
11 profit." Because TELRIC includes the cost of capital,
12 TELRIC includes a normal level of profit.

13

14 **Q.** What level of return on investment does Sprint recommend
15 using?

16

17 **A.** Sprint recommends the use of the current authorized
18 interstate rate of return on investment of 11.25%.

19

20 **5. Other TELRIC Considerations**

21

22 **Q.** Please describe what is meant by "reasonably accurate
23 fill factors."

24

25 **A.** Fill factors are the percentage of available network

1 capacity utilized. Utilization is due to three factors.

2
3 1. When engineering and building telecommunications
4 facilities, LECs attempt to anticipate future
5 needs. For example, it is more cost-effective to
6 dig a trench once and install facilities necessary
7 to meet additional forecasted demand, than to dig
8 up the trench and install new facilities every time
9 a new loop is required.

10 2. It is the nature of the telecommunications industry
11 that capacity is acquired in large blocks. Unused
12 capacity will exist while demand grows into the
13 available capacity.

14 3. An engineering interval, a period of time necessary
15 to plan and construct facilities, is required when
16 replacing or expanding capacity.

17
18 Efficient deployment balances the cost-benefit
19 relationship of unused capacity and the cost of
20 installation. Not enough capacity results in inefficient
21 rework (e.g. digging new trenches every month); and too
22 much capacity is an inefficient use of resources (e.g.
23 burying plant that will never be used).

24
25 Q. What is the significance of applying a standard that

1 requires the use of "current wire center locations and
2 the most efficient technology available?"

3
4 **A.** Forward-looking cost measurements require capturing the
5 costs of network facilities that will be incurred in the
6 future. The use of current wire center locations and the
7 most efficient technology available in determining
8 forward-looking economic costs is the approach that
9 reasonably balances the interests of ILECs, CLECs, and
10 consumers. ILECs need prices that will recover their
11 legitimate forward-looking economic costs. CLECs need to
12 be provided the opportunity compete on an equitable basis
13 with the ILEC. Consumers will benefit the most when
14 there is facilities-based competition.

15
16 The FCC rejected alternative approaches which represented
17 extreme viewpoints that would either frustrate
18 facilities-based competition, or hinder competitive
19 entry. At one extreme, the FCC rejected the use of a
20 hypothetical, least cost network in calculating forward-
21 looking element costs, because this would discourage
22 facilities-based competition (i.e., the incentive to
23 build would be reduced if facilities were already
24 available at least-cost prices). At the other extreme,
25 the FCC rejected cost recovery based entirely on the past

1 network design and technology (i.e., embedded cost),
2 because this would result in inefficient pricing to the
3 detriment of competitive entry.

4
5 Instead, the FCC adopted a standard that uses the
6 existing wire center locations and the most efficient
7 technology deployed as most closely representing the
8 incremental costs ILECs will actually incur in making
9 elements available to new entrants.

10
11 **Q.** Please expand on the use of economic depreciation rates.

12
13 **A.** The use of economic depreciation rates in TELRIC ensures
14 that costs represent the actual useful economic lives of
15 ILEC facilities, instead of regulatory lives. The actual
16 useful economic lives may be different from that
17 reflected in the existing prescribed depreciation rates.

18
19 **6. Geographic Deaveraging**

20
21 **Q.** What does Sprint propose with regard to geographic
22 deaveraging?

23
24 **A.** Sprint believes that geographically deaveraged prices for
25 network elements are appropriate. However, the

1 deaveraging methodology for loops is different than that
2 for switching and transport. Switching and transport
3 costs are a function of traffic density and can be
4 deaveraged to high cost, medium cost, and low cost
5 exchanges based on traffic density characteristics. Loop
6 costs, however, are a function of loop length and the
7 density of end-user locations. These loop cost
8 characteristics should be reflected in deaveraged prices
9 that may vary from the geographic areas used for
10 switching and transport deaveraging. For example, an
11 exchange with low switching costs may have both high and
12 low cost loops.

13
14 **Q.** Why are deaveraged rates important?

15
16 **A.** Deaveraged rates are appropriate to more closely reflect
17 the actual costs of providing network elements in
18 different areas. Loop costs in particular can vary
19 widely across a large geographical area. For example, an
20 ILEC's service area that is composed of both densely
21 populated and sparsely populated areas will have
22 different costs depending on distances, densities and
23 other factors affecting costs.

24
25 While average pricing has served to permit lower prices

1 in sparsely populated areas, average pricing distorts
2 CLECs' entry decisions regarding whether to build or
3 lease unbundled network elements. Deaveraging provides
4 accurate market signals, which will encourage efficient
5 utilization of resources while discouraging uneconomic
6 decisions by CLECs.

7

8 **B. Unbundled Network Elements Costs and Prices**

9

10 **Q.** How should unbundled rates be developed?

11

12 **A.** In keeping with the general guidelines offered by the
13 FCC's Order, Sprint's rates for unbundled elements will
14 recover those costs in a manner that reflects the way
15 they are incurred. (FCC Order, para. 743.) The charges
16 for dedicated facilities will be flat-rated, including,
17 but not limited to, charges for unbundled loops,
18 dedicated transport, interconnection, and collocation.
19 (FCC Order, para. 744.) Recurring costs will be
20 recovered through recurring charges, rather than through
21 a nonrecurring charge. (FCC Order, para. 745.)

22

23 **Q.** How many unbundled elements does Sprint propose to offer?

24

25 **A.** Sprint proposes to offer the following ten unbundled

1 network elements.

2

3 1. Local Loops

4 2. Cross-connect Facilities

5 3. Network Interface Devices

6 4. Local Switching

7 5. Tandem Switching

8 6. Transport

9 7. Digital Cross-connect

10 8. Signaling Links and STP Ports

11 9. Call Related Data Bases

12 10. Operator Services and Directory Assistance

13

14 **1. Local Loop**

15

16 **Q.** What is the appropriate rate structure for unbundled
17 local loops?

18

19 **A.** In essence, the FCC Order, at paragraph 790, requires the
20 use of a TELRIC methodology to establish geographically
21 deaveraged, flat-rate charges for access to unbundled
22 loops. Sprint agrees, and is currently in the process of
23 developing deaveraged unbundled loop costs using the
24 TELRIC methodology and the Benchmark Cost Model forward-
25 looking network.

1 Q. How can BCM 2 be used to calculated the TELRIC of the
2 unbundled loop?

3

4 A. Two relatively easy modifications to BCM 2 can be made to
5 produce the TELRIC of unbundled loop. First, it is
6 necessary to isolate loop investment. Since BCM 2
7 considers all investments associated with basic service,
8 it includes investment not only in loop, but in Network
9 Interface Devices (NID), switching, and central office
10 equipment associated with line termination. Each of
11 these investments are treated separately in BCM 2, so the
12 loop investment can easily be isolated.

13

14 Second, a forward-looking annual charge factor was used
15 to develop TELRIC. The derivation of this annual charge
16 factor is described in Section B. 11, below.

17

18 Q. Is the loop investment developed by BCM 2 appropriate for
19 a TELRIC study?

20

21 A. Absolutely. The result of BCM 2 is a loop network
22 representing a forward-looking network using state-of-
23 the-art technology, employing existing wire centers.

24

25 Q. How are these loop investments converted to a loop cost

1 per month?

2

3 **A.** Loop investments are multiplied by a forward-looking
4 annual charge factor, then divided by twelve to arrive at
5 the monthly recurring cost.

6

7 **Q.** Do these costs include a reasonable allocation of shared
8 and common costs?

9

10 **A.** No. The shared and common cost study methodology is
11 discussed at Section B. 12, below.

12

13 **Q.** How many TELRIC cost zones are calculated?

14

15 **A.** Costs are computed for each Census Block Group (CBG);
16 thus each CBG has its own unique TELRIC. The individual
17 CBG TELRIC results must be aggregated into a manageable
18 number of cost zones. The greater the number of cost
19 zones, the closer the actual CBG cost will be to the cost
20 zone. The lesser the number of zones, the easier and
21 less costly the plan is to administer. The goal is to
22 determine the number and placement of these zones in
23 order to accurately deaverage costs without creating
24 costly administrative burden.

25

1 The following method is proposed to develop the cost
2 zones. First, a distribution of all CBG loop costs is
3 developed. Second, the minimum number of \$5 cost zones
4 were created, such that at least 80% of the loops were
5 included in that number of zones. Third, since the loop
6 cost distribution is not a normal distribution, the \$5
7 cost zones are not contiguous. Thus, for administrative
8 purposes, the \$5 cost zones were expanded to make them
9 contiguous. Finally, the cost of each zone is equal to
10 the weighted average of the cost of all loops within that
11 zone.

12

13 **2. Cross-Connect Facilities**

14

15 **Q.** What are cross-connect facilities? .

16

17 **A.** These are the facilities required to connect the
18 unbundled loop to the CLEC facilities within the ILEC
19 central office.

20

21 **3. Network Interface Device (NID)**

22

23 **Q.** What is a NID, and why is it a distinct network element?

24

25 **A.** The NID represents the interface between LEC-owned loop

1 facilities and customer-owned inside wire and CPE. It
2 provides the following functions:

- 3
- 4 ▶ Cross-connect point
- 5 ▶ Over-voltage protection
- 6 ▶ Electrical ground
- 7 ▶ Testing point
- 8

9 It is unbundled as a distinct network element because the
10 NID will likely possess more intelligence as more
11 sophisticated services are offered over the loop to the
12 end-user customer. Thus the CLEC may wish to provide its
13 own NID, or purchase an unbundled NID from the ILEC.

14

15 There are several loop/NID combinations available to the
16 CLEC. Here are several possible combinations. First,
17 the CLEC can simply purchase both the existing unbundled
18 loop and NID from the ILEC. Second, the CLEC can provide
19 its own loop and NID, interconnecting its NID to the ILEC
20 NID in order to access the customer's inside wire.
21 Third, the CLEC may purchase an unbundled loop from the
22 ILEC, and interconnect (directly or through the existing
23 NID) that loop to another NID, which it may own or lease
24 from the ILEC. One limitation is that the ILEC loop
25 cannot be left disconnected from a NID.

1 **Q.** Please describe your TELRIC methodology for the unbundled
2 NID.

3

4 **A.** A separate TELRIC cost/price has been developed for 1-
5 line NID, 2-line NID, smart jack, and HDSL NID.

6

7 The TELRIC methodology consists of four steps. First,
8 the EF&I (Engineered, Furnished, and Installed) material
9 cost of the NID, ground wire, and ground rod, is
10 determined. This includes the actual equipment vendor
11 price, installation and engineering costs, and any
12 applicable sales taxes.

13

14 Second, a forward-looking annual charge factor is
15 applied. The development of this factor is discussed
16 below in Section B. 11, below.

17

18 Third, this annual cost is divided by twelve to produce
19 a monthly cost.

20

21 Fourth, the shared and common cost factor is added to the
22 above TELRIC result to produce the rate of the unbundled
23 element. The development of the shared and common costs
24 is discussed below in Section B. 12, below.

25

1 **4. Local Switching**

2

3 **Q.** How does Sprint propose to price unbundled switching?

4

5 **A.** Local switching will be priced as three separate
6 components; a flat-rated port, usage sensitive switching,
7 and flat-rated features.

8

9 The port charge will be assessed on a monthly basis on
10 each access line the CLEC interconnects with the Sprint
11 switch. The usage sensitive switching charge will be
12 assessed on two separate per MOU charges, one for line-
13 side switching, another for trunk-side switching. The
14 flat-rated feature will be assessed on each access line.

15

16 **Q.** Please describe Sprint's local switching TELRIC
17 methodology.

18

19 **A.** The TELRIC methodology for local switching consists of an
20 Excel worksheet model, SWIM (Switching Model). SWIM
21 takes output of the Bellcore SCIS (Switching Cost
22 Information System) model, and combines it with actual
23 usage information to derive TELRIC results, deaveraged
24 for two distinct cost zones. These two cost zones are:

25

- 1 1. Host Offices, and remote switches within the same
2 exchange.
3 2. Remote offices outside of the host office's
4 exchange.

5

6 The TELRIC methodology for switching consists of seven
7 basic steps.

8

9 **Q.** Please describe the first step.

10

11 **A.** The first step is to determine the total forward-looking
12 switching investment using the SCIS model. Nortel DMS-
13 100/200 switches in Florida were modeled, assuming a
14 minimum Supernode-60 processor capability. Supernode-60
15 is the minimum processor size currently supported by
16 Nortel. Although earlier vintage processors may be
17 currently in use, they represent obsolete technology and
18 do not represent forward-looking technology as required
19 by TELRIC standards. The DMS-100/200 switch represents
20 the predominate technology deployed by Sprint in Florida,
21 accounting for ~~95~~⁸⁷% of all access lines.

22

23 This investment is segregated into seven investment
24 categories. These are,

25

- 1 1. Getting Started Cost - the minimum investment
2 required to provide switching, regardless of usage.
3 It is composed primarily of the central processor
4 and memory.
- 5 2. Line Termination Cost - the investment required to
6 terminate the local loop in the central office. It
7 is composed primarily of a line card, the main
8 distribution frame, and protector.
- 9 3. Line CCS - the investment associated with usage
10 sensitive line-side switching. It is composed
11 primarily of the line concentrating module, DS-30A
12 links, line group controller, DS-30 links, and the
13 network module. (CCS is an acronym for 100 call
14 seconds.)
- 15 4. Trunk CCS - the investment with usage sensitive
16 trunk-side switching. It is composed primarily of
17 digital trunk controllers, DS1 links, and the
18 network module.
- 19 5. Tandem Trunk CCS - the investment associated with
20 usage sensitive tandem trunk switching.
- 21 6. Umbilical CCS - the usage-sensitive investment in
22 Host-Remote links.
- 23 7. SS7 - investment associated with the SSP (Service
24 Signaling Point) located in the central office.
- 25

1 The SCIS model considers only the hardware investment in
2 the central office. One-time software investment
3 required to provide basic switching must also be
4 included. This proprietary information was provided to
5 Sprint by Nortel.

6

7 The second step is to accumulate the demand data needed
8 to complete the study. Current traffic studies are used
9 to gather MOU and call set-ups by call types.

10

11 The third step is to determine the number of processor
12 milliseconds required to process each type of call.

13

14 The fourth step is to derive monthly expense per
15 investment category by multiplying the investment by the
16 appropriate forward-looking annual charge factor. The
17 development of the annual charge factor is discussed
18 below in Section B. 11, below.

19

20 The fifth step is to calculate the cost per call set-up
21 per call type. This is done by determining the total
22 processor cost per call type, and dividing by the
23 appropriate MOU.

24

25 The sixth step is to calculate the cost per MOU per call

1 type. This is done by determining the total CCS
2 investment by call type, and dividing by the appropriate
3 MOU.

4

5 The seventh and final step is to apply the shared and
6 common cost factor to the above TELRIC results to produce
7 the rate of the unbundled element. The development of
8 the shared and common costs is discussed in Section B.
9 12, below.

10

11 **Q.** Have you completed your TELRIC studies for the features
12 portion of switching?

13

14 **A.** No. These studies will be provided upon completion.

15

16 **5. Tandem Switching**

17

18 **Q.** Please describe the TELRIC methodology for tandem
19 switching.

20

21 **A.** That methodology is the same as included in the local
22 switching discussion in Section B. 4, above.

23

24 **Q.** Have you completed your TELRIC studies for tandem
25 switching?

1 **A.** No. These studies will be provided upon completion.

2

3 **6. Transport**

4

5 **Q.** Has Sprint calculated its TELRIC studies for transport?

6

7 **A.** No. However, we have completed the redesign of our
8 transport costing model, and have completed preliminary
9 studies. These studies will be provided when completed.

10

11 **7. Digital Cross-Connect**

12

13 **Q.** Has Sprint completed its TELRIC studies for digital
14 cross-connect?

15

16 **A.** No. These studies will be provided when completed.

17

18 **8. Signaling Links and STP Ports**

19

20 **a. Signaling Links**

21

22 **Q.** Please describe the unbundled STP Signaling Links
23 service.

24

25 **A.** The signaling links are 56 kbps circuits which

1 interconnect the STP with the end office switching
2 network.

3

4 **Q.** Has Sprint completed its TELRIC studies for unbundled
5 signaling links?

6

7 **A.** No. Until these studies are completed, Sprint proposes
8 to use existing interstate rates. These rates were
9 recently developed, and approximate TELRIC costs.

10

11 **b. STP Ports**

12

13 **Q.** Please describe the unbundled STP Port service.

14

15 **A.** The STP Port is the interface equipment contained in the
16 STP to which the signaling links interconnect.

17

18 **Q.** Please describe your TELRIC methodology for the unbundled
19 STP port.

20

21 **A.** The TELRIC methodology is relatively straight-forward.

22

23 The TELRIC methodology consists of four steps. First,
24 the EF&I (Engineered, Furnished, and Installed) material
25 cost of the Link Port Card, MP1624 Processor Card,

1 Cluster Card Kit, and Frame is determined. This includes
2 the actual equipment vendor price, installation and
3 engineering costs, and any applicable sales taxes.

4
5 Second, these investment are adjusted for fill factors
6 and capacity.

7
8 Third, a forward-looking annual charge factor is applied.
9 The development of this charge factor is discussed below
10 in Section B. 11, below.

11
12 Fourth, this annual cost is divided by twelve to produce
13 a monthly TELRIC result.

14
15 Fifth, the shared and common cost factor is added to the
16 above TELRIC result to produce the rate of the unbundled
17 element. The development of the shared and common costs
18 is discussed below in Section B. 12, below.

19
20 **c. STP Switching**

21
22 **Q.** Please describe unbundled STP switching.

23
24 **A.** The STP switching service is for the routing of the
25 Initial Set-Up and Processing (ISUP) message through the

1 STP. The rate for switching is applied on the basis of
2 equivalent 56 kbps trunks per month. The T-1 rate is
3 equal to 24 times the STP switching rate per 56 kbps
4 trunk per month.

5

6 **Q.** Please describe your TELRIC methodology for unbundled STP
7 switching.

8

9 **A.** Sprint has developed its own levelizing program to
10 develop TELRIC results when investment must be recovered
11 over an extended period of time.

12

13 **Q.** Please describe this levelizing program.

14

15 **A.** Levelizing simply projects total expenses and demand over
16 the expected economic life of the investment, and
17 discounts these projections to the present using the
18 current cost of capital. There are five main components.

19

20 1. Maintenance - Maintenance is stated as a percent of
21 gross investment.

22 2. Depreciation - Actual tax depreciation schedules
23 are used, which reflect a five-year class of plant.

24 3. Economic Live - The tax depreciation rate will not
25 necessarily match the actual useful life of any

1 particular investment. Therefore, the study uses
2 a seven-year economic life.

3 4. Rate of Return - The currently authorized federal
4 rate of return on investment of 11.25% is used.

5 5. Ad Valorem Taxes - The rate in Florida is 1.88%.

6
7 Shared and common costs must be added to the TELRIC
8 result to determine the price.

9
10 **9. Call-Related Data Bases**

11
12 **a. Line Information Data Base (LIDB) Administration Service**

13
14 **Q.** Please describe LIDB Administration service.

15
16 **A.** LIDB Administration service provides administrative
17 support to the Line Information Data Base. This service
18 provides the administrative interface for automated loads
19 and updates of carrier line information, including
20 Alternate Billing Service restrictions (ABS) and Personal
21 Identification numbers in the LIDB data base. In
22 addition, this service monitors queries to the LIDB and
23 responds to alerts initiated by queries exceeding
24 predetermined thresholds.

25

1 Q. Please describe the TELRIC costing methodology.

2

3 A. A simple methodology consists of four steps. First,
4 direct costs were identified. This includes
5 administrative salaries, software right-to-use fees,
6 depreciation, and computer equipment and software.

7

8 Second, shared and common costs will be determined in
9 accordance with the methodology as shown in Section B.
10 12, below.

11

12 Third, average demand over the next five years was
13 estimated.

14

15 Fourth, and finally, total expenses are divided by total
16 demand, and divided by twelve to develop a cost per
17 access line per month.

18

19 **b. Directory Assistance Data Base Listing and Update**

20

21 Q. Please describe the Directory Assistance Data Base
22 Listing and Update service.

23

24 A. Directory Assistance Data Base Listing and Update service
25 is the provision of Subscriber Listing Information. This

1 enables carriers to provision their own directory
2 assistance data bases, which support their provision of
3 directory assistance service to end users.

4

5 **Q.** Please describe the TELRIC methodology.

6

7 **A.** It is similar to the methodology described for LIDB
8 service, above.

9

10 **c. Directory Assistance Data Base Query Service**

11

12 **Q.** Please describe the Directory Assistance Data Base Query
13 service.

14

15 **A.** Directory Assistance Data Base Query Service makes the
16 ILEC's directory listing information data base available
17 for processing. The functions include the directory
18 listing information, the data base equipment, and the
19 local area networking equipment required to provide
20 access to the data base.

21

22 **Q.** Please describe the TELRIC methodology.

23

24 **A.** It is similar to the methodology described for LIDB
25 service, above.

1 **10. Operator Services and Directory Assistance**

2

3 **a. Toll Assistance Service (Live)**

4

5 **Q.** Please describe the Toll Assistance Service (Live).

6

7 **A.** The Toll Assistance Service (Live) provides live
8 assistance to a customer to complete a telephone call.
9 The function includes a live operator and the associated
10 facilities and equipment necessary to bill and/or
11 complete the call.

12

13 **Q.** Please describe the TELRIC methodology.

14

15 **A.** It is similar to the methodology described for LIDB
16 service, above.

17

18 **b. Directory Assistance Service (Live)**

19

20 **Q.** Please describe the Directory Assistance Service (Live).

21

22 **A.** The Directory Assistance Service (Live) provides live
23 assistance to a customer to obtain directory listing
24 information and/or complete a telephone call. The
25 service includes a live operator, a data base of

1 directory listing information, and the associated
2 facilities and equipment necessary to access the data
3 base and/or complete the call. This service does not
4 include customized branding. The calls must be delivered
5 to an existing operator center.

6

7 Q. Please describe the TELRIC methodology.

8

9 A. It is similar to the described for LIDB service, above.

10

11 **11. Annual Charge Factors**

12

13 Q. Please describe Sprint's methodology for calculating the
14 annual charge factor used in the above unbundled network
15 element TELRIC studies.

16

17 A. Sprint has developed its own Annual Charge Factor Program
18 (ACFP) to develop these TELRIC factors.

19

20 Q. What are the main components of the ACFP?

21

22 A. There are five main components.

23

24 1. Maintenance - Maintenance is stated as a percent of
25 gross investment, based upon actual 1995

1 information. This 1995 data is the most up-to-date
2 information available, and represents the current
3 maintenance costs associated with current
4 technology.

5 2. Depreciation. Actual tax depreciation schedules
6 are used, which reflect the MACRS (Modified
7 Accelerated Cost Recovery System) class of plant of
8 each investment category.

9 3. Economic Life - The tax depreciation rate will not
10 necessarily match the actual useful life of any
11 particular investment. Therefore, Sprint's ACFP
12 uses as a study period the predicted economic life
13 of each investment. This forecast are taken from
14 the 1995 study, "Depreciation Lives for
15 Telecommunication Equipment," written by
16 Technologies Futures, Inc., on behalf of the
17 Telecommunications Technology Forecasting Group.

18 4. Rate of Return - The currently authorized federal
19 rate of return on investment of 11.25% is used.

20 5. Ad Valorem Taxes - State specific property tax
21 rates are used. The rate in Florida is 1.88%.

22
23 **12. Shared and Common Costs**

24
25 **Q.** Sprint agrees with the FCC formula where the price of an

1 unbundled element is equal to its TELRIC plus a
2 reasonable allocation of shared and common costs. How
3 does Sprint calculate the appropriate shared and common
4 cost factor?

5

6 **A.** Sprint has created an Excel workbook program, Unbundled
7 Cost Allocation, to determine the shared and common costs
8 using 1995 general ledger information, the most recent
9 financial information available.

10

11 The process for determining shared and common costs to
12 the unbundled network elements consists of four steps.
13 The first step is to identify each General Ledger account
14 at the four-digit level as either direct, shared, or
15 common. Direct expenses are those which are included in
16 the development of the TELRIC annual charge factor, and
17 are excluded from this analysis. Examples of direct
18 expenses include,

19

- 20 ▶ Central office switching (621X)
- 21 ▶ Operator systems (6220)
- 22 ▶ Central office transmission (623X)
- 23 ▶ Cable & wire facilities (64XX)
- 24 ▶ Depreciation associated with direct investment (656X)
- 25 ▶ Portions of following accounts:

1 - Marketing (661X)

2 - Services (662X)

3

4 Shared expenses include,

5

6 ▶ Network support (611X)

7 ▶ General support (612X)

8 ▶ Other terminal equipment (6362)

9 ▶ Provisioning (6512)

10 ▶ Network operations (653X)

11 ▶ Depreciation associated with shared investment (656X)

12 ▶ Portions of the following accounts:

13 - Marketing (661X)

14 - Services (662X)

15

16 Common expenses include,

17

18 ▶ Executive and Planning (671X)

19 ▶ General and Administrative (672X)

20

21 The following accounts were excluded from the analysis
22 because they do not pertain to unbundled network
23 elements.

24

25 ▶ Station apparatus (6311)

- 1 ▶ Large PBX (6341)
- 2 ▶ Public Telephone Terminal Equipment (6351)
- 3 ▶ Access expense (6540)
- 4 ▶ Foreign Directory (portion of 6622)

5

6 The second step is to develop an investment base for each
7 of the ~~eleven~~^{ten} unbundled network elements. The General
8 Ledger investment accounts which are considered direct
9 investment include,

10

- 11 ▶ Central Office (22XX)
- 12 ▶ Cable & Wire Facilities (24XX)

13

14 The investment accounts which are considered shared
15 include,

16

- 17 ▶ General support assets (21XX)
- 18 ▶ Other terminal equipment (2362)
- 19 ▶ Amortizable assets (26XX)

20

21 The third step is to allocate each shared and common
22 expense account to one of the ~~eleven~~^{ten} unbundled network
23 elements based upon one of the following allocation
24 methods.

25

- 1 1. Direct - Allocated directly to a specific element.
- 2 2. Indirect - Allocated based on a cost causative
- 3 linkage to another account.
- 4 3. Generally Allocated - Allocated based on a summary
- 5 of the direct and indirect allocation accounts.

6

7 **Q.** How are these results applied to TELRIC results to arrive

8 at prices for unbundled elements?

9

10 **A.** Investment factors are developed for both shared and

11 common costs. First, the TELRIC result is multiplied by

12 the shared factor. Second, this result is multiplied by

13 the common factor.

14

15 **II. WHOLESALE DISCOUNTS**

16

17 **Q.** What methodology does Sprint propose for determining the

18 level of discounts for its retail services which are

19 resold?

20

21 **A.** Section 252(d)(3) of the Federal Telecommunications Act

22 of 1996 states, "For the purposes of section 251(c)94),

23 a State commission shall determine wholesale rates on the

24 basis of retail rates charged to subscribers for the

25 telecommunications service requested, excluding the

1 portion thereof attributable to any marketing, billing,
2 collection, and other expenses that will be avoided by
3 the local exchange carrier." This is further clarified
4 and interpreted in the FCC Order which specifies
5 particular accounts to be presumed avoided, unless the
6 ILEC proves that specific expenses will be incurred in
7 the provisioning of wholesale services, or that the
8 particular expenses within these accounts are not
9 included in the retail price of the service being resold.

10
11 **Q.** What effect does the stay of the FCC's resale rules
12 (Subpart 6) in CC Docket 96-98 have on Sprint's position?

13
14 **A.** Sprint believes the policy portions of the FCC Order are
15 correct. Sprint agrees with the majority of the FCC
16 Order concerning the appropriate level of the wholesale
17 discount. However, there are two significant areas in
18 the calculation of the wholesale discount in which Sprint
19 believes the FCC made an error. The first is the
20 treatment of common costs as avoided. The second is the
21 inclusion of number services and call completion services
22 expenses. These will be addressed in detail below.

23
24
25

1 **A. Methodology**

2

3 **Q.** Please overview Sprint's avoided cost study methodology.

4

5 **A.** First, Sprint's study identifies and reviews expenses, at
6 seven-digit subaccount level, to determine whether they
7 are avoided or non-avoided in a wholesale environment for
8 the services. Second, an activity-based study
9 methodology is used to identify the appropriate levels of
10 avoided expenses associated with each account. The
11 revenues for the various services and the net avoided
12 expenses are categorized into retail service groups.
13 Third, the net avoided cost for the retail service group
14 is divided by the total revenues for the service group to
15 develop the percent discount applicable to the rates of
16 the individual services included in each retail service
17 group. Exhibit RGF-1, the user guide, provides a more
18 detailed explanation of the avoided cost study
19 methodology.

20

21 **Q.** Please explain how avoided expenses are assigned to the
22 services.

23

24 **A.** The avoided expenses are assigned to services based on
25 the actual activity which creates or drives specific

1 types of expenses. For example, if a specific study
2 indicates that a particular expense activity is unrelated
3 to residential services, activity-based costing will
4 assign this avoided expense only to other services. To
5 the extent that an expense can be associated with a
6 service, an increase (or decrease) in the activity drives
7 an increase (or decrease) in the expense associated with
8 that service.

9
10 **Q.** Please explain how net avoided expenses were developed.

11
12 **A.** In developing the net avoided expenses Sprint calculated
13 both the incremental expenses and avoided expenses
14 associated with providing services on a wholesale basis.
15 The net result is a reasonable estimate of avoided
16 expense.

17
18 **Q.** How were the incremental wholesale expenses developed?

19
20 **A.** Sprint evaluated each category of customer operations
21 expenses presumed by the FCC to be avoided to determine
22 what, if any, expenses in these accounts would be
23 incurred in the provision of services on a wholesale
24 basis. This evaluation included quantification of any
25 incremental expenses incurred directly related to the

1 wholesale offering of Sprint's retail products.

2

3 **Q.** Were these incremental wholesale expenses included in the
4 avoided cost study?

5

6 **A.** Yes. The FCC Order recognizes the need to include these
7 expenses in paragraph 928 of its Order, which states, "We
8 also agree ... that some new expenses may be incurred in
9 addressing the needs of resellers as customers." It
10 would be improper not to include these incremental
11 wholesale expenses in the wholesale prices. Simply
12 discounting retail prices does not make the LEC a
13 wholesaler; the LEC must take additional steps and will
14 incur additional expenses in connection with its
15 wholesaling activities. Exhibit RGF-2, page 3 of 20,
16 includes a summary of the incremental wholesale expenses
17 by service groups.

18

19 **Q.** How many discount levels for retail services were
20 developed?

21

22 **A.** Five, based on classification of all retail services into
23 five retail service groups.

24

25 **Q.** How were the services categorized and what are the five

1 the customer operations expense categories (6611, 6612,
2 6613, 6621, 6622, and 6623) presumed to be avoided by the
3 FCC Order to determine which types of expenses would be
4 impacted by the sale of services on a wholesale versus
5 retail basis. From this analysis, Sprint has determined
6 there are certain functions within these expense
7 categories that will continue to apply to a wholesale
8 marketplace. Therefore, these expenses are not avoided.
9

10 **Q.** What expenses are not avoided in a wholesale environment?
11

12 **A.** Sprint's evaluation of operating company expenses
13 indicates that portions of product management (6611),
14 sales (6612), product advertising (6613), call completion
15 (6621), number services (6622), and customer services
16 (6623) expenses will not be avoided in a wholesale
17 environment. Sprint's methodology evaluated detailed
18 seven-digit subaccounts in each of these categories to
19 determine which specific expenses would be avoided or not
20 avoided. Exhibit RGF1 includes a list, beginning on page
21 16 of 20, of Sprint's expense accounts and indicates
22 Sprint's treatment in the study as avoided, not avoided,
23 or included a mix of avoided and not avoided expenses.
24
25

1 Product Management (6611)

2

3 **Q.** Which subaccounts within product management are not
4 avoided in a wholesale environment?

5

6 **A.** Product management expenses include costs associated with
7 the administrative activities related to marketing
8 products and services. The majority of the expenses in
9 this category are avoided since they are directly related
10 to retail sales. However, there are two subaccounts
11 which are non-avoided. The first is account 6611.06X,
12 Forecasting - ICSC. This account includes the pay,
13 office, travel, and other expenses of employees who
14 coordinate planning sessions between Sprint and the IXCs.
15 Since exchange access services are not subject to resale
16 (see FCC Order, paragraph 874), these expenses are not
17 avoided.

18

19 The second account is 6611.07X, Forecasting - Other.
20 This account consists of four functions:

21

- 22 1. Forecasts of customer demand for all services
23 affecting central office equipment, outside plant,
24 and interexchange facilities.
- 25 2. Administrative forecasts, such as toll message and

1 revenue forecasts, and forecasts of movement and
2 gain used in the preparation of Sprint's
3 construction program

4 3. Local economic forecasts

5 4. Special purpose forecasts, such as those used for
6 determining interexchange service requirements.

7

8 Forecasting is a non-avoided expense. Forecasting is an
9 essential function and will include the forecast for both
10 retail sales and wholesale units in order to ensure
11 Sprint's network is properly sized for wholesale and
12 retail services sold.

13

14 **Q.** Are there any other non-avoided expenses in the product
15 management accounts?

16

17 **A.** Yes. For each of the above product management expense
18 categories, Sprint/United of Florida also receives
19 customer operations expense allocations and charges from
20 the parent company for various services. These are
21 referred to as General Services and Licenses (GS&L)
22 expenses. Many GS&L expenses are avoided. For example,
23 "conduit" GS&L expenses, account 6611.987, are corporate
24 activities performed specifically for Sprint/United
25 Florida, and are considered avoided.

1 However, GS&L expenses such as product research and
2 development are not avoided in a wholesale environment.
3 Therefore, the study results include an avoided expense
4 assignment of GS&L charges equal to the proportion of
5 avoided expense to total expenses within the entire
6 product management expense category.

7
8 The FCC Order in Paragraph 928 indicates that 90% of the
9 expenses in the Product Management account (6611) are
10 presumed to be avoided when calculating a default range
11 for wholesale discounts. Sprint's detailed expense
12 analysis indicates that 63.48% of these expenses are
13 avoided.

14
15 Sales (6612)

16
17 **Q.** Which subaccounts within sales are not avoided in a
18 wholesale environment?

19
20 **A.** Accounts associated with traditional retail sales
21 activity are 100% avoided in a wholesale environment.
22 However, there are two subaccounts which are not avoided.
23 The first is account 6612.02X - Sales - Interexchange
24 Carrier Service Center. This account includes the
25 administrative staff and direct expenses incurred to

1 promote access orders from interexchange carriers, and to
2 implement the associated marketing strategies. Since
3 exchange access services are not subject to resale (see
4 FCC Order, paragraph 874), these expenses are not
5 avoided. This account also includes expenses
6 attributable to intraLATA private line service. These
7 expenses are avoided.

8
9 The second account is 6612.4XX - Engineering and Project
10 Management. This is not a traditional sales activity
11 account, and did not exist prior to 1991. This account
12 includes the expenses incurred by personnel that support
13 project management and administration of sales projects,
14 including provisioning and installation. The positions
15 charged to this account include technical support, sales
16 engineers, project managers, and customer service. These
17 functions will be required for the provisioning and
18 installation of resale services such as Centrex, Key, and
19 PBX trunks.

20
21 GS&L expenses are treated in the same manner as discussed
22 above under product management. An exception is GS&L
23 sales account 6612.986. A special study of this account
24 indicates that 94.83% of these expenses are associated
25 with sales to interexchange carriers. Since exchange

1 access services are not subject to resale (see FCC Order,
2 paragraph 874), these expenses are not avoided.

3
4 The FCC Order in Paragraph 928 indicates that 90% of the
5 expenses in the Sales account (6612) are presumed to be
6 avoided when calculating a default range for wholesale
7 discounts. Sprint's detailed expense analysis indicates
8 that 72.19% of these expenses are avoided. Most of the
9 non-avoided expenses are corporate level sales to
10 interexchange carriers which appear in this account, as
11 discussed below.

12
13 Product Advertising (6613)

14
15 **Q.** Which subaccounts within product advertising are not
16 avoided in a wholesale environment?

17
18 **A.** Product advertising is directly linked to the retail
19 sales of products and services. In a purely wholesale
20 environment, these expenses are avoided. The FCC Order,
21 in Paragraph 928, indicates that 90% of the expenses in
22 this account are presumed to be avoided when calculating
23 a default range for wholesale discounts. Sprint's
24 detailed expense analysis indicates that 100% of these
25 expenses, including GS&L, are avoided.

1 However, Sprint recognizes that products will be
2 advertised to the wholesale market. This study does not
3 include the additional advertising expense needed to
4 support the wholesale function. Note that the FCC
5 assumes that 10% of these expenses are non-avoided. Thus
6 this analysis includes 10% of existing advertising
7 expenses as an incremental wholesale expense, as
8 discussed below.

9
10 Call Completion (6621)

11
12 **Q.** Which subaccounts within call completion are not
13 avoidable in a wholesale environment?

14
15 **A.** Operator Call Completion expenses are non-avoided. In
16 the instance where a reseller provides its own operator
17 services, Sprint would not charge the reseller for
18 operator functions. Therefore, there is no resold
19 service in which to apply a wholesale discount. If a
20 reseller chooses to resell Sprint's operator services,
21 there are no avoided call completion expenses.

22
23 For example, suppose the ILEC currently has 100 operators
24 serving 100% of the market. Two new competitors enter
25 the market. Competitor A captures 30% of the market and

1 provides its own operator services. Competitor B
2 captures 20% of the market but chooses to resell the
3 ILECs operator services. The ILEC will no longer incur
4 the expenses associated with the 30 operators who were
5 serving the 30% of the market now served by Competitor A.
6 However, in the case of Competitor be who is reselling
7 the ILEC's operator services, the expenses associated
8 with the 20 operators serving that 20% of the market
9 remain, i.e. are not avoided.

10
11 Competitor A is not due a discount because it is not
12 reselling the ILEC's service. Competitor B is not due a
13 discount because the ILEC is not avoiding any expenses
14 associated with the 20% of the market served by
15 Competitor B. In other words, while it is true that
16 expenses are not incurred when Competitor A provides its
17 own operator services, neither Competitor A nor B is due
18 a discount on these expenses.

19
20 Number Services (6622)

21
22 **Q.** Which subaccounts within number services are not avoided
23 in a wholesale environment?

24
25 **A.** There are two types of number service expenses. First

1 are expenses associated with provisioning of Directory
2 Assistance. Second are Alphabetical Directory Expenses,
3 which are the expenses of providing white page listings
4 and directory production and distribution associated with
5 the white page section.

6
7 For directory assistance, these expenses are non-avoided.
8 If Sprint provides the directory assistance service on a
9 wholesale basis to the reseller, there are no avoided
10 directory assistance expenses. If the reseller provides
11 directory assistance for their customers, the reseller
12 will not be buying a wholesale directory assistance
13 service from Sprint. Therefore, there is no resold
14 service with an avoided cost-based discount rate.

15
16 For the Alphabetical Directory expenses, these are non-
17 avoided. The reseller buying Simple or Complex Access
18 Services will receive directory listings and publications
19 as part of the bundled access line service. These
20 expenses are not avoided in the provisioning of wholesale
21 services.

22
23 Customer Services (6623)

24
25 Q. Which subaccounts within customer services are not

1 avoided in a wholesale environment?

2
3 **A.** Customer services expenses include business office
4 functions that are directly related to retail sales.
5 These expenses will be avoided for services resold by a
6 local service reseller. However, there are five
7 subaccounts which are not avoided. The first is account
8 6623.05X - Collecting and Reporting Paystations. Since
9 paystations are not a retail service, they will not be
10 offered at wholesale. Therefore, this is not an avoided
11 expense.

12
13 The second account is 6623.1XX - Interexchange Customer
14 Service Center. This account includes the expenses of
15 Interexchange Customer Service Center employees engaged
16 in establishing and servicing customer accounts
17 pertaining to switched and special access and
18 interexchange private line. Only the portion of these
19 expenses attributable to private line is avoided. Since
20 exchange access services are not subject to resale (see
21 FCC Order, paragraph 874), the portion of these expenses
22 attributable to switched and special access are not
23 avoided.

24
25 The third account is 6623.62X - Toll Processing and

1 Control. This account includes the cost of the
2 accounting staff necessary to operate the Toll Processing
3 and Control module. The toll processing function will be
4 required in both a retail and wholesale environment.
5

6 The fourth account is 6623.63X - Carrier Access Billing.
7 This account includes the costs associated with billing
8 interexchange carriers for the use of Sprint's network.
9 It also includes the costs associated with the accounting
10 staff necessary to support the Carrier Access Billing
11 System, including the costs of reconciling general ledger
12 accounts and investigating and correcting billing errors.
13 Since exchange access services are not subject to resale
14 (see FCC Order, paragraph 874), these expenses are not
15 avoided.
16

17 The fifth account is 6623.7XX - Paystation Commissions.
18 This account includes the amount paid to owners or
19 tenants of premises upon which public telephone stations
20 are located. Since paystations are not a retail service,
21 they will not be offered at wholesale. Therefore, this
22 is not an avoided expense.
23

24 The FCC Order in Paragraph 928 indicates that 90% of the
25 expenses in the Customer Services (6623) account are

1 presumed to be avoided when calculating a default range
2 for wholesale discounts. Sprint's detailed expense
3 analysis indicates that 85.49% of these expenses are
4 avoided.

5
6 **Q.** How has Sprint calculated the avoided expenses associated
7 with the indirect expenses General Support Expenses (6121
8 - 6124), Corporate Operations (6711 - 6728) and
9 Telecommunications Uncollectibles (5301) (Indirect
10 Expense)?

11
12 **A.** While the FCC Order considers these expenses "to be
13 avoided in proportion to the avoided direct expenses,"
14 Sprint disagrees.

15
16 What the FCC Order refers to as indirect costs, are the
17 general support and common costs of the firm. Common
18 costs are those costs used to support all of the
19 individual products and services offered by the company.
20 Common costs are, by definition, costs which cannot be
21 attributed to individual services. They are not avoided
22 due to the resale of retail services.

23
24 Uncollectible revenue expenses also fall into the FCC
25 definition of indirect costs. Uncollectibles are avoided

1 only if the ILEC will no longer incur lost revenues in a
2 wholesale environment. The evidence indicates this will
3 not be the case. First, the experience of Sprint's long
4 distance division indicates that problems with revenue
5 collection still exist when dealing with resellers.
6 Their experience with reseller write-offs,
7 unsubstantiated billing adjustments, and fraudulent code
8 abuse, are similar to the rate of uncollectibles
9 experienced by Sprint's local telecommunications
10 division. Although the type of uncollectible revenues
11 are different for a retailer and wholesaler, the problem
12 itself does not disappear.

13
14 Second, a real-life example was referred to by the
15 California PUC in Docket R.95-04-043/I.95-05-044. The
16 final order states, "... Sonic Communications, Inc. ...
17 our recognition of the millions of dollars that company
18 owed Pacific and GTE when it went bankrupt are all too
19 clear in our minds. We therefore cannot accept the
20 assumption of zero uncollectibles at the wholesale level
21 "

22
23 Incremental Wholesale Expenses

24
25 Q. Has Sprint calculated incremental expenses incurred in

1 the offering of wholesale services?

2

3 **A.** Yes. Sprint agrees with the FCC Order, paragraph 928,
4 which states, "We also agree ... that some new expenses
5 may be incurred in addressing the needs of resellers as
6 customers. Much of the incremental wholesale market
7 function will be performed at a national or parent level
8 for Sprint. These parent level incremental wholesale
9 expenses were apportioned to the various state and
10 operating company jurisdictions based upon access lines.
11 Operating company level incremental wholesale expenses
12 were also determined. Wholesale market expenses include
13 advertising, expenses to develop systems for electronic
14 bonding of database information, reseller customer
15 services functions, regulatory/legal support, end-user
16 customer education, employee training, and system
17 modifications for billing and service maintenance.

18

19 The total incremental wholesale expenses were allocated
20 to the five retail service groups based upon the avoided
21 expenses in each of the service groups relative to the
22 total avoided expenses.

23

24 **Q.** What are the results of the avoided cost study for
25 Sprint?

1 **A.** The results of the avoided cost study for Sprint 's
2 Florida operations are as follows:

3

- 4 1. Simple Access - 16.10%
- 5 2. Complex Access - 10.49%
- 6 3. Features - 30.35%
- 7 4. Operator/DA - 10.00%
- 8 5. Other Services - 10.58%

9

10 More detail on the service group revenues and avoided
11 expenses is included in Exhibit RGF-2.

12

13 **Q.** How would these discounts be applied in the development
14 of wholesale rates?

15

16 **A.** While Sprint has segregated its services into five
17 service groups, there are many individual services within
18 each service group. The appropriate avoided expense
19 percent will be applied to each of Sprint's retail rates
20 to determine a service-specific wholesale rate quoted in
21 dollars.

22

23 For example, using Centel's rate group 6, the retail rate
24 for basic residential R1 service is \$9.65. Applying the
25 Simple Access service group discount of 16.10% yields a

1 wholesale discount of \$1.55, which will not change as the
 2 retail rate changes. The wholesale rate is \$8.10. The
 3 following table shows the retail rates, percent
 4 discounts, dollar discounts, and wholesale rates for
 5 several other services in Centel's rate group 6.

6

7 The dollar amount of avoided expenses is independent of
 8 the retail price. As retail prices are increased or
 9 decreased, there is no reason that the dollar amount of
 10 avoided expenses should change. Therefore, the dollar
 11 wholesale discount will remain constant over time,
 12 independent of any retail price changes. However, as the
 13 retail rate changes, the wholesale rate will change.

14

15 Tariff	Retail	Percent	Dollar	Wholesale
16 <u>Service</u>	<u>Rate</u>	<u>Discount</u>	<u>Discount</u>	<u>Rates</u>
17 B1	\$21.75	16.10	\$3.50	\$18.25
18 B1 Rotary	32.65	10.49	3.42	29.23
19 PBX Trunk	43.50	10.49	4.56	38.94
20 Call Waiting -				
21 Residence	3.50	30.35	1.06	2.44

22

23 **Q.** Please summarize your discussion of wholesale discounts.

24

25 **A.** The Act specifies that an avoided cost discount is to be

1 applied to retail rates to determine the wholesale rates
2 for services to be resold. The FCC Order has defined
3 certain expense categories to be presumed avoided, but
4 allows states to consider a company's rebuttal of these
5 presumptions. Sprint considers an activity-based cost
6 methodology appropriate for the determination of avoided
7 expenses in the five retail service groups. Sprint has
8 also quantified additional expenses it will incur to
9 resell its retail services. Consideration of these
10 additional wholesale expenses is appropriate in
11 determining the wholesale discount.

12
13 I recommend that the Commission adopt the results of
14 Sprint's avoided cost study, as summarized above, to
15 establish the appropriate wholesale rates for retail
16 services that will be resold. A copy of the avoided cost
17 study is provided in Exhibit RGF-2.

18
19 **Q.** Does this conclude your testimony?

20
21 **A.** Yes, it does.
22
23
24

25 jjw\utd\farrar.230

1 BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

2 SUPPLEMENTAL DIRECT TESTIMONY

3 OF

4 RANDY G. FARRAR

5
6 **Q.** Please state your name, occupation, and business address.

7
8 **A.** My name is Randy G. Farrar. I am presently employed as
9 Manager - Network Costing and Pricing for Sprint/United
10 Management Company. My business address is 2330 Shawnee
11 Mission Parkway, Westwood, Kansas, 66205.

12
13 **Q.** Did you file Direct Testimony in this proceeding on
14 November 5, 1996?

15
16 **A.** Yes, I did.

17
18 **Q.** What is the purpose of your supplemental direct
19 testimony?

20
21 **A.** The purpose is to provide the results of the TELRIC cost
22 studies; the methodologies were described in my direct
23 testimony.

24
25 **Q.** Are there any changes in the TELRIC methodology described

1 in your direct testimony?

2

3 **A.** Yes, there are two changes. The first deals with
4 Sections I.B.11, Annual Charge Factors, and I.B.12,
5 Shared and Common Costs of my Direct Testimony.

6

7 Paragraph 682 of the FCC order states that the costs of
8 shared facilities and operations should be attributed to
9 the TELRIC of specific elements to the greatest extent
10 possible. Therefore, in Section I.B.12, which describes
11 the derivation of the common cost factor, only common
12 costs (accounts 671X and 672X) are now included in the
13 calculation of that factor.

14

15 The majority of the expenses identified as shared in the
16 direct testimony are now treated as "other direct
17 operating expenses" attributable to network elements.
18 These "other direct operating expenses" are now included
19 as a component of the Annual Charge Factor used in the
20 TELRIC studies.

21

22 **Q.** What is the second change?

23

24 **A.** Sprint has identified and provided cost support and
25 prices for an additional (eleventh) network element, 911

1 Tandem Trunks and Ports.

2

3

4 Q. Would you please address the actual TELRIC cost studies?

5

6 A. Composite Exhibit No. RGF-3, titled "Unbundled Network
7 Elements Cost Studies," consists of fourteen parts (A
8 through N) which sets forth the development of the costs
9 of the unbundled network elements and call termination.
10 This exhibit also provides the cost data for the Common
11 Cost Study (Part O) and the Annual Charge Factors (Part
12 P).

13

14 Q. Has Sprint completed TELRIC studies for all unbundled
15 network elements?

16

17 A. No. There are several unbundled network elements for
18 which Sprint has not completed TELRIC studies. These
19 elements are identified in Exhibit No. MRH-6, sponsored
20 by Mr. Hunsucker in his Supplemental Direct Testimony.

21

22 Q. Does this conclude your supplemental direct testimony.

23

24 A. Yes, it does.

25

jjw\utd\farrar-s.230

1 BY MR. FONS:

2 Q Would you please summarize your testimony,
3 Mr. Farrar?

4 A Yes, first I would like to point out that Sprint
5 is a combined company. It operates as both an ILEC and a
6 CLEC in the State of Florida, and I would also like to
7 point out that all the costs that have been performed here
8 were taken with that in mind, and everything here, all the
9 methodologies, are acceptable to Sprint both as an ILEC and
10 as a CLEC.

11 My testimony is divided into two parts. The
12 first part deals with the TELRIC costs of unbundled
13 elements. The second part has to do with the wholesale
14 discount. Just to summarize the TELRIC portion, I would
15 like to point out that the TELRIC methodology and the
16 TSLRIC methodology which we are more used to are actually
17 the exact same methodology. The TELRIC is simply the
18 TSLRIC methodology being applied to a network element
19 rather than a service. The biggest distinction there is
20 that certain costs, certain costs which are shared at the
21 service level are, in fact, direct at the element level.
22 An obvious example would be land and buildings. I would
23 never include land and buildings in a TSLRIC study of a
24 service such as call waiting. However, when we are dealing
25 with the TELRIC of local switching, or the TSLRIC of the

1 element of local switching, land and building is an
2 essential part of that. You can't set a switch out in the
3 field; it has to have land and buildings associated with it
4 to provide the unbundled service.

5 All of our studies use current or forward-looking
6 technologies, and we take a conservative approach in the
7 sense that we have actually forecasted increased demands in
8 doing all these cost studies. Given that CLECs intend to
9 enter the market and will be facilities-based to a certain
10 extent, to the extent that they are facilities-based, our
11 demand on those facilities managed would decrease in the
12 future; and if you were to try to recognize that, the cost
13 could only go up.

14 I want to point out that our annual charge
15 factors we use in these studies exclude all retailing
16 costs, in particular product management, sales, product
17 advertising and customer service. 72% of those expenses
18 are excluded from our annual charge factors. And in the
19 calculation of our common cost factor, 17.6% of actual
20 common costs that are on the books right now are excluded
21 from the study.

22 In calculation of our TELRIC for unbundled loop,
23 we have not used BCM2 in itself but we have used the loop
24 investment portion of BCM2, and that is analogous to the
25 way we use the SCIS model from BellCore. The BellCore

1 model is used, it's an engineering model and determines the
2 engineering investment necessary to provide switching. The
3 BCM2, the loop investment portion, is an engineering model,
4 and it tells us the amount of investment necessary to
5 provide loop as an unbundled element.

6 And I would like to point out one thing.
7 Contrary to what Mr. Wood said in his testimony, our cost
8 bands have absolutely nothing to do with existing tariff
9 structures. They are one hundred percent a result of the
10 cost studies.

11 Going on to the second part of my testimony, the
12 wholesale discount, there are two areas which we really
13 differ from MCI on. The first is the treatment of operator
14 expenses. MCI considers those an avoidable expense,
15 Sprint does not. And clearly, if you are reselling
16 operator services, those expenses are not avoidable. Those
17 expenses go -- it is true, those expenses go away if MCI
18 does not provide its own operator services; but if you are
19 reselling a service, then by definition those costs do not
20 go away.

21 The MCI approach of having a single discount
22 which reflects operator service expenses as an avoided
23 expense produces the situation of a discount on something
24 like call waiting. That discount is increased because of
25 operator services, and operator services has nothing to do

1 with the provision of call waiting.

2 The second area we disagree in is in the
3 overhead; that is, it's Sprint's position that overheads
4 are not avoidable. By definition, overhead, these are
5 common expenses which are not associated with any
6 individual products. So whether or not you resell or
7 retail a particular product, those by definition will not
8 have any effect upon corporate overheads.

9 Q Does that conclude your summary?

10 A Yes, it does.

11 MR. FONS: The witness is available for cross
12 examination. Before the cross examination begins, though,
13 I can point out where in the answers to interrogatories the
14 changes to page 86 of what is now Exhibit 21 occur, and
15 it's answer to staff's first set of interrogatories number
16 41K, page 3 of 3.

17 CHAIRMAN CLARK: 41K?

18 MR. FONS: Yes.

19 CHAIRMAN CLARK: 41K, thank you.

20 Mr. Melson.

21 CROSS EXAMINATION

22 BY MR. MELSON:

23 Q Good afternoon, Mr. Farrar, I'm Rick Melson
24 representing MCI. Good to see you again.

25 A Hello.

1 Q Let me start backwards, let me start just for a
2 minute with your avoided cost study, and the results of
3 that study are shown on your Exhibit RGF-2 which has been
4 identified as part of Composite Exhibit 20; is that
5 correct?

6 A Yes.

7 Q And if we look at page 3 of that exhibit, page 3
8 of 20 -- it's actually numbered 3 of 20 at the top of the
9 page -- and it's not got page number 1 at the bottom of the
10 page. That is simply a summary of the avoided cost
11 discount that you've calculated by group of service; is
12 that correct?

13 A Yes.

14 Q And then if we look at the next page, page 4 of
15 20, is that simply a spread sheet which shows how the
16 particular dollars in each USOA account listed down the
17 left-hand side of the page are spread across the various
18 categories of service for which you are calculating a
19 discount?

20 A Yes.

21 Q Now on that spread sheet, you show avoided costs
22 in only four USOA accounts; is that correct?

23 A You are on page 4 again?

24 Q Yes.

25 A Yes, that's correct.

1 Q And are those accounts that the FCC classified as
2 containing directly avoided costs?

3 A Yes.

4 Q And would you agree with that characterization
5 that those are accounts that include costs that would be
6 directly avoided?

7 A Yes.

8 Q Now do the other accounts on this page where you
9 have a zero figure, are those all of what you would put
10 into the category of indirect or overhead expenses?

11 A The vast majority of them, yes. I guess the only
12 one I would not consider an indirect would be depreciation.

13 Q All right. What about call completion services,
14 what would you consider that to be?

15 A I would also consider those both. Call
16 completion and number services are both direct type
17 expenses directly associated with operator services.

18 Q So excluding the call completion and number
19 services and the depreciation amortization, the rest of the
20 accounts on that page that shows zero are what the FCC
21 would have referred to as indirectly avoided accounts; is
22 that correct?

23 A Yes.

24 Q And is an assumption implicit in your spread
25 sheet, for example, that even though some product

1 management expenses are avoided and even though that
2 avoidance may result in the reduction of head count, that
3 there is no corresponding avoidance of any human resources
4 expenses or other general and administrative expenses?

5 A Yes.

6 Q Now in New Jersey when you presented a similar
7 avoided cost study, I believe you did treat these accounts
8 as having indirectly avoided expenses; is that correct?

9 A Yes, I did, and that was because we were under an
10 FCC order at that time, which has since been stayed.

11 Q So your New Jersey testimony was based on
12 following the FCC order that was in effect at the time?

13 A That's correct.

14 Q And your position then is that absent that FCC
15 order there should be no treatment of any of these costs as
16 indirectly avoided?

17 A Yes, and that was our position prior to the FCC
18 order. I had testimony filed in Illinois approximately a
19 year ago that said that they were not avoidable. Sprint's
20 original comments to the FCC said that they were not
21 avoidable. When the FCC order came out, we complied with
22 the order in that area.

23 Q If you were going to apply the methodology that
24 you used in New Jersey to this Florida spread sheet, how
25 would you calculate the percentage of these other accounts

1 that would be indirectly avoided?

2 A In New Jersey the ratio was the -- the ratio of
3 avoided expenses to total direct expenses resulted in a
4 percentage, and that percentage was applied to all the
5 overhead and indirect expenses.

6 Q Okay. So the numerator of that was avoided
7 expenses and the denominator was total direct expenses?

8 A That's correct.

9 Q And in that denominator, did that include both
10 direct and -- Strike that.

11 Tell me again what the denominator was.

12 A Total direct expenses.

13 Q All right. So the denominator did not include
14 any of the indirect categories?

15 A That's correct.

16 Q If you did a similar calculation for Florida, do
17 you know what percentage it would produce as an avoided
18 percentage in these indirect categories?

19 A Using that New Jersey methodology, I do not --
20 I'm sure it would be higher, but I do not know what the
21 answer is.

22 Q It would be higher than zero? You said it would
23 be higher. Higher than what?

24 A Oh, I was saying that the bottom line answer --
25 Right now it's 15.47%. The bottom line would be higher, I

1 don't know by how much.

2 Q All right. If I wanted to do that calculation,
3 can you tell me what numbers on this spread sheet I would
4 add and divide?

5 A Basically, if I recall the way the model would
6 work, the numerator would be all the total avoided
7 expenses, which is in the column there, total, off to the
8 right. Your denominator would be your -- and again, the
9 numbers would not be here, but they are all the total
10 expenses off the general ledger less all the indirect
11 expenses.

12 Q And you would expect that number you said to be
13 higher than 15.47%?

14 A Certainly.

15 Q All right. The numbers shown, again, on this
16 same page, avoided cost for product management, product
17 advertising, customer services, those are estimates of
18 costs that would be avoided in the resale environment; is
19 that correct?

20 A I would not call them estimates. What we did is
21 we looked at seven-digit account detail and were able to
22 identify which portions of these ARMIS accounts are, in
23 fact, associated with retail activities; and it was only
24 that retail activity portion which is an avoidable expense.

25 Q And how was that analysis of the seven-digit

1 ARMIS accounts performed?

2 A We had a team which consisted of about -- the
3 core group had about eight people, and we spent many, many
4 days looking through every individual general ledger
5 account, talking to the various subject-matter experts; and
6 we were able to determine which of those seven-digit
7 detailed accounts were associated with retail activities.
8 I should say retail activities associated with products
9 which will be resold.

10 Q All right. Does Sprint propose -- do you propose
11 to monitor the actual avoided costs in any way?

12 A No.

13 Q So essentially your proposal is to establish a
14 discount amount now based on that analysis that was
15 performed by your team, and that would then be a number
16 that would be locked in from here to eternity?

17 A Well, I don't know about the here to eternity
18 part, but until such time as new studies are warranted,
19 yes.

20 Q In determining the avoided cost percentages, you
21 also added back what you call incremental wholesaling
22 expenses; is that correct?

23 A Yes.

24 Q And if I understand correctly, that add back
25 really consisted of two pieces, one piece was a corporate

1 level number, and another piece was a Florida specific
2 number?

3 A That's correct.

4 Q Can you show me in your document where those
5 calculations appear? How about page 19 of 20?

6 A Yes, it's on page 19 of 20. This is a summary.
7 The top of the page is a summary of the corporate level
8 incremental expenses. In this particular spread sheet you
9 see a line here towards the middle of the page called OTC
10 specific, and that is the Florida company specific number
11 which was calculated outside this model. Additional detail
12 on the corporate level discount and detail on the Florida
13 specific discount were included as part of the
14 interrogatories.

15 Q And were they included on a publicly available
16 basis, or are those confidential numbers?

17 A I believe they were confidential.

18 Q Did you participate in the development of the
19 Florida specific number of the dollar two per access line?

20 A Only very indirectly. The core group did develop
21 a methodology for each company to follow when developing
22 their company specific incremental expenses, but that was
23 done by the operating company, and I was not directly
24 involved with the creation of the document.

25 Q And have you done any review of that document to

1 determine if, in fact, the operating company followed the
2 methodology that your core group recommended?

3 A Admittedly, very superficially, but I did look at
4 it. It has the same type of expenses included in it, and
5 the bottom line answer was within the range that the other
6 companies were coming in with, so it seemed reasonable, but
7 I did not give a thorough audit.

8 Q And is it correct to say on page 19 of 20 that
9 you've got some system development costs that are incurred
10 at a corporate level in years 1 through 4?

11 A That's correct.

12 Q And are those -- what is system development cost
13 as you use it there?

14 A These are the actual systems which will be used
15 to bill the CLECs, and this is the additional program that
16 is needed to provide that service.

17 Q And does the method that you use to levelize that
18 cost and the other corporate level costs over five years
19 imply that those system development expenditures have a
20 useful life of five years?

21 A No.

22 Q Would your methodology have been the same
23 regardless of what the useful life of those system
24 development expenses was?

25 A Yes. I mean I assume it wasn't specifically for

1 system development, but I chose to look at a five-year
2 window to try to identify all the expenses that would occur
3 in the next five years, and that just seemed to be a
4 reasonable window of time to be looking at.

5 Q Let's move from your avoided cost study now to
6 the cost studies that you performed for the unbundled
7 network elements, and those are in your Exhibit RGF-3 which
8 has been identified as Exhibit 21; is that correct?

9 A Yes.

10 Q And in general, in preparing these cost studies,
11 you attempted to apply the FCC's TELRIC methodology; is
12 that right?

13 A Yes.

14 Q And is one criteria for a TELRIC cost study that
15 it ought to produce forward-looking costs?

16 A Yes.

17 Q Is it true that the first major step in each of
18 these studies was to calculate the investment in plant
19 necessary to provide the unbundled network element?

20 A Yes.

21 Q And then was the second major step to calculate
22 what you've called a combined annual charge factor that you
23 would then multiply by the investment to obtain an annual
24 cost?

25 A Yeah, that's the generic methodology.

1 Q And the annual cost that comes from multiplying
2 the investment times its combined annual charge factor is
3 what you define as TELRIC costs; is that correct?

4 A Yes.

5 Q And is it correct that that combined annual
6 charge factor in turn consists of two pieces; is that
7 correct?

8 A Well, there are many, many components actually
9 within that annual charge factor, not just two, there are
10 many components.

11 Q Okay. Let me ask the question this way. Is one
12 piece of that a fairly traditional annual charge factor
13 that takes into account such things as depreciation, return
14 on investment, taxes, maintenance?

15 A Yes, that's correct.

16 Q And is another distinct component of that
17 something you've called other direct operating expense
18 factor?

19 A Yes, that's correct.

20 Q Okay. Do you -- just so we can discuss those
21 separately, I know what to call the other direct operating
22 expense factor. What do you call that first piece of your
23 annual charge factor, or what can we use as a shorthand
24 today?

25 A I don't have a name for it. Call it direct

1 versus other direct. That's as good as any.

2 Q Okay. All right. Let's talk about that first
3 piece of it, that direct. Was the list I gave you,
4 maintenance, taxes, depreciation and cost of capital
5 essentially everything that is included in that first
6 factor?

7 A Maintenance, return, taxes, depreciation, yeah,
8 those are the main components.

9 Q Okay. Are there other components beyond that?
10 (WITNESS REVIEWED DOCUMENTS)

11 A No.

12 Q And so I can follow along, what document are you
13 looking at there to help you answer that question?

14 A I was just looking where I listed the main
15 components in my direct testimony.

16 Q All right.

17 A There I identified five components, but there are
18 maintenance, depreciation, and I included economic life as
19 an additional element, but it's really part of
20 depreciation, and then rate of return and taxes.

21 Q Now the second part of that annual charge factor
22 that you call in your exhibits the other direct operating
23 expense factor, does that represent costs that are shared
24 at the service level but that can be directly attributed or
25 assigned to elements if you study them at the element

1 level?

2 A That's correct.

3 Q And is what makes your study a TELRIC cost study
4 rather than a traditional TSLRIC cost study the inclusion
5 of this second other operating expense factor?

6 A Well, yes and no. Again, TSLRIC and TELRIC are
7 the same methodology. It's just that when you apply TSLRIC
8 to an element using the same methodology you get additional
9 costs which are directly attributable to the elements, and
10 those are these other direct.

11 Q If you had done a TSLRIC cost of a service a year
12 ago, you would not have included this other direct
13 operating expense factor, would you?

14 A If I were to do a TSLRIC of a service a year ago,
15 no, I would not have. Had I done a TSLRIC of an element,
16 then I would have.

17 Q Okay. Now just so I understand the way these
18 pieces fit together to produce a cost for a particular
19 item, let me take an example of unbundled loops, and I'm
20 just going to try to use some round numbers. If the
21 investment necessary to provide unbundled loops was a
22 million dollars and this annual charge factor was 30%, then
23 the annual cost of providing unbundled loops would be three
24 hundred thousand dollars or the million times the 30%; is
25 that right?

1 A Yes.

2 Q And if the universe of loops was a thousand
3 loops, you would simply divide the three hundred thousand
4 annual cost by the thousand loops to get an annual per loop
5 cost of three hundred dollars?

6 A Yes.

7 Q And then if you were going to price those or cost
8 those on a monthly basis you would divide again by 12 and
9 get to 25 dollars a month; is that right?

10 A That's correct.

11 Q Okay. Now for unbundled loops, can you tell me
12 what the combined annual charge factor was that was used in
13 your cost study?

14 A I'm not sure that I can answer that because,
15 again, how the BCM actually uses the annual charge factor
16 and if there are more than -- I think there are a couple of
17 different -- There may be a couple of different annual
18 charge factors. Like I said, I would prefer to defer that
19 to Mr. Dunbar.

20 Q Okay. You provided annual charge factors to
21 Mr. Dunbar for use in his BCM study; is that correct?

22 A Yes.

23 Q And you provided them I believe for loop
24 investment and you provided them for circuit equipment; is
25 that correct?

1 A As I recall -- Yes, and I believe that BCM uses
2 those different charge factors for different investment
3 categories, but again, I'm not intimately involved with
4 BCM.

5 Q Okay. Let me not ask how BCM used them. Can you
6 tell me what factor you supplied to Mr. Dunbar for the
7 cable and wire investment? And I believe if you look on
8 page 120 or 122 of your study is about the place you ought
9 to find it.

10 A For the combined outside plant, the number that
11 appears on this exhibit is 29.88%.

12 Q And you're referring there to the number in the
13 lower right-hand corner of page 122 of your exhibit?

14 A Yes.

15 Q All right. Can you break that 29.88% out between
16 the other direct expense factor and the sort of traditional
17 annual charge factor?

18 A Yeah. The traditional, if you will, will be
19 25.82 and then other direct will be 4.06.

20 (Transcript continues in sequence in Volume 5)

21

22

23

24

25