ORIGINAL

BELLSOUTH TELECOMMUNICATIONS, INC.

DIRECT TESTIMONY OF WALTER S. REID

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NOS. 960833-TP, 960846-TP, 960757-TP, 960916-TP, 971140-TP

NOVEMBER 13, 1997

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

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

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

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

Florida. Since that time, I have held various positions of increasing responsibility in the areas of budget and forecast preparation, cost accounting, separations, and regulatory matters. I was transferred to my current position at Company Headquarters in October, 1987. Overall, I have over 26 years experience dealing with the financial issues of the Company.

Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

A. I am responsible for the preparation and analysis of the Company's financial results, the provision of accounting and cost information requested in proceedings before state regulatory commissions and the coordination of other regulatory activities related to accounting and finance.

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

A. Yes. I have testified in Florida proceedings for many years. Most recently, I testified in Florida in Docket No. 96-358-C regarding the appropriate resale discount for BellSouth. I have also testified in numerous regulatory proceedings in Alabama, South Carolina, Georgia, Kentucky, Mississippi, North Carolina, and Tennessee.

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

A. The purpose of my testimony in this proceeding is to address the appropriate methodology for including a reasonable amount of forward-looking shared and common costs in BellSouth's Total Service Long-Run Incremental Cost ("TSLRIC") plus Shared and Common cost studies (BellSouth Cost Studies). In its Order No. PSC-96-1579-FOF-TP ("Order") issued December 31, 1996, the Florida Public Service Commission stated, "Upon consideration of the evidence in the record and based on the Act, we find it appropriate to set permanent rates based on BellSouth's TSLRIC cost studies. The rates are for the unbundled network elements we consider to be technically feasible. The rates cover BellSouth's TELRIC cost and provide some *contribution toward joint and common costs.*" (*Order at page 33*). BellSouth's approach for treating shared and common costs consists of a study which develops appropriate shared and common cost factors for use in unbundled network element ("UNE") rate calculations.

Q. HAS THE COMPANY PROVIDED ITS STUDY WHICH DEVELOPS THE SHARED AND COMMON COST FACTORS TO THE FLORIDA PUBLIC SERVICE COMMISSION?

A. Yes. The Company provided the study which calculates the shared and common cost factors as part of the data filed with its revised cost

studies submitted with the Company's testimony on November 13, 1997. In addition, the Company filed its supporting documentation on the shared and common cost study as part of its cost support documentation.

Q. FROM A HIGH LEVEL PERSPECTIVE, CAN YOU BRIEFLY DESCRIBE BELLSOUTH'S APPROACH FOR TREATING SHARED AND COMMON COSTS AS A COMPONENT OF UNE RATES?

A. Yes. The ultimate objective of BellSouth's methodology, which I have depicted on my Exhibit WSR-1, pages 1 through 3, is to split the Company's total forward-looking cost of business between its wholesale and retail functions and to specifically identify three major categories of wholesale costs: 1) wholesale direct costs; 2) the portion of shared costs attributed to wholesale; and 3) a reasonable portion of common costs applicable to wholesale operations. It is further necessary to split categories (1) and (2) above between those wholesale costs that are related to recurring investment related transactions (UNE related) and those that are related to "other wholesale" transactions, such as non-recurring (e.g., service order activities) or special purpose transactions (e.g., operator services). Shared costs assigned to "other wholesale" are not included in the development of investment related shared cost factors.

Because the Uniform System of Accounts ("USOA") does not uniquely identify these desired cost categories, a study was required to determine the appropriate amounts to include in each category. Fortunately, the BellSouth Cost Allocation Manual ("CAM") and the reporting procedures which the Company follows to separate its costs on a cost causative basis between regulated and non-regulated costs provided a good model on which to base this study. Therefore, the Company utilized the basic attribution principles of its CAM and the underlying cost pools and sub-pools which it maintains for cost attribution purposes as the underlying methodology for determining the desired breakdown of wholesale costs into categories. The wholesale costs identified through this process are the appropriate costs to apply to a cost methodology that defines the cost for UNEs.

Once all of these costs are properly categorized, cost factors for use in the BellSouth cost study can be developed. For instance, the relationship between wholesale common costs and the total of wholesale direct and wholesale shared costs yields the common cost factor. In this study, the common cost factor equals 5.39%. Page 1 of WSR-1 illustrates this calculation.

A second set of factors is derived by determining the relationship, by investment type, between wholesale shared costs related to investment accounts and the associated network investment. These are the shared cost factors. Page 2 of WSR-1 illustrates this calculation.

A third set of factors reflects the relationship between shared costs and labor costs. These factors are calculated so that shared costs can be included in labor rates. These labor rates are primarily used to compute non-recurring cost study charges or other special purpose charges which have labor components. Page 3 of WSR-1 illustrates this calculation.

All three types of factors are used as inputs to the BellSouth cost study development methodology described in BellSouth Witness Daonne Caldwell's testimony. Application of these factors in the cost development process allows BellSouth to associate a reasonable amount of forward-looking shared and common costs with each UNE.

Q. PLEASE DESCRIBE IN MORE DETAIL THE MECHANICS OF BELLSOUTH'S PROCEDURE TO DETERMINE A REASONABLE PORTION OF ITS FORWARD-LOOKING SHARED AND COMMON COSTS FOR INCLUSION IN ITS COST STUDIES.

A. The starting point in the procedure is BellSouth's regional regulated 1995 expenses and regulated mid-year 1995 investment. This data is obtained at a very detailed (cost pool and cost sub-pool) level from BellSouth's financial system which applies the methods and procedures described in the CAM. The primary goal of the CAM is a reasonable, supportable apportionment of total costs between regulated services

and nonregulated activities. As a general rule, this methodology for shared and common costs which I am addressing in this proceeding follows the same attribution procedures for the various accounts and cost pools as are identified in the CAM for comparable accounts and cost pools.

Q. WHAT IS THE NEXT STEP IN BELLSOUTH'S METHODOLOGY?

A. The next step in the methodology is to develop a projection of expenses and investments for the years 1997-1999. This is accomplished by utilizing 10 months actual cost data from 1996, annualizing the amounts and normalizing the annual cost data for unusual events. These 1996 normalized costs are then converted into forward-looking costs by applying forecasted growth factors and, in the case of investment accounts, factors which reflect the relationship of current cost to original book cost. The application of these factors converts the historical cost data into cost levels that are representative of the forward-looking average costs for the period 1997 to 1999.

In order to reflect the proper capital carrying costs for investment accounts, annual cost factors are applied to the forward-looking investment amounts. These annual cost factors include the cost of money at 11.25%, income taxes, depreciation expense, and ad valorem taxes.

Q. HOW IS THE FORWARD-LOOKING FINANCIAL DATA ANALYZED?

A. BellSouth's study recognizes that total costs can be placed into four clearly identifiable categories. First, there are the "direct wholesale costs." These are the costs which are clearly and directly assignable to the "wholesale" function. Costs of switches, for example, would fit into this category. The wholesale direct costs are further divided between those that are related to recurring investment costs and those that are related to other wholesale transactions such as non-recurring or special transactions. The direct costs of providing telecommunications services, such as the carrying cost on investment and plant specific expenses related to the investment, are segregated by each specific investment account.

Second, there are the "direct retail costs." These are the costs which are clearly and directly assignable to the "retail" function. All retail costs are excluded from the calculation of UNE costs.

Third, there are "shared costs." Shared costs are costs that are incurred in the production of two or more products or services by the same production process that do not span all activities of the business. Typical shared costs include costs for items of general support equipment, procurement, engineering expenses, etc. Exhibit WSR-2 to my testimony provides a more detailed list of typical shared costs.

Fourth, there are "common costs." Common costs are those costs that generally span the activities of the business, and the products and services it produces. These costs are not directly assignable to one product or service, but are necessary for the operation of the business as a whole. Typical common costs are items such as accounting and finance costs, executive costs, etc. A more detailed list of common costs is also shown on my Exhibit WSR-2.

Clearly, all of those costs which are applicable to the wholesale function (direct costs, shared costs, and common costs) must be recovered by UNE rates, while all of those costs applicable to the retail function should be excluded. The difficulties are: (1) separating the "shared costs" and the "common costs" between the "wholesale" and "retail" functions; and (2) attributing the wholesale shared costs to each network investment category.

Q. HOW HAS BELLSOUTH ACCOMPLISHED THIS SEPARATION OF "SHARED COSTS" AND "COMMON COSTS"?

A. The process BellSouth has followed to reach this goal has two fundamental steps. First, the "shared costs" are segregated into cost pools similar to those utilized in the CAM. The costs accumulated in these cost pools are attributed to "wholesale" and "retail" functions as I will describe below.

In the second step, the "common costs" are apportioned between "wholesale" and "retail" functions based on the relative proportion of the direct and shared costs that have been assigned to these functions.

Q. CAN YOU PROVIDE A MORE DETAILED EXPLANATION OF THE FIRST FUNDAMENTAL STEP YOU MENTIONED ABOVE?

A. Yes. The costs which are treated as shared costs can be segregated into cost pools because the historical data which was obtained at the beginning of the process was collected at the cost pool or cost sub-pool level. This detail was maintained as the historical data was projected to forward-looking data. Therefore, the forward-looking shared costs can be identified by cost pool.

Next, attribution factors, such as central office equipment ("COE") investment percentages and the relative percent distribution of salary and wages, are developed. These factors are similar to the attribution bases described in the CAM. When the factors are applied to the respective shared costs accumulated in the various cost pools, the result, which takes more than one iteration, is the assignment of the shared costs to either: 1) a related "wholesale" network investment category (pair gain equipment, buried cable, etc.); 2) the "other wholesale" category; or 3) the "retail" category. Shared costs which are not assignable to one of these categories after two iterations of the

attribution process are treated as common costs. Wholesale shared costs assigned to an investment category are used to calculate the shared cost factor for that investment item. A shared cost factor is the ratio of the shared cost assigned to a particular type of investment divided by the projected average investment. My Exhibit WSR-3 provides the various shared cost factors calculated by this analysis.

Q. HOW ARE FORWARD-LOOKING COMMON COSTS TREATED IN BELLSOUTH'S METHODOLOGY?

A. Forward-looking common costs are proportionally split between wholesale common costs and retail common costs. The wholesale common cost factor is then calculated as the ratio of total wholesale common costs divided by the total of wholesale direct costs and wholesale shared costs. This wholesale common cost factor is an input in the development of the UNE costs as described in Ms. Caldwell's testimony. My Exhibit WSR-4 demonstrates the calculation of the wholesale common cost factor.

Q. HOW ARE THE FACTORS DEVELOPED FOR USE IN CALCULATING LOADED LABOR RATES?

A. First, salaries and wages are accumulated on a basis consistent with specific work force groups. Next, shared costs attributable to salaries and wages are accumulated on a basis consistent with the

development of the respective work force group's labor rate. A factor is then developed for each work force group by dividing the attributed shared costs (human resources, office equipment, motor vehicles, land and building space, etc.) by the related salaries and wages. This factor is applied to the salary and wage portion of the incremental labor rate for each work force group, and the result is added to the incremental labor rate to determine the loaded labor rate. My Exhibit WSR-5 provides a list of the work force group factors used in the BellSouth cost studies.

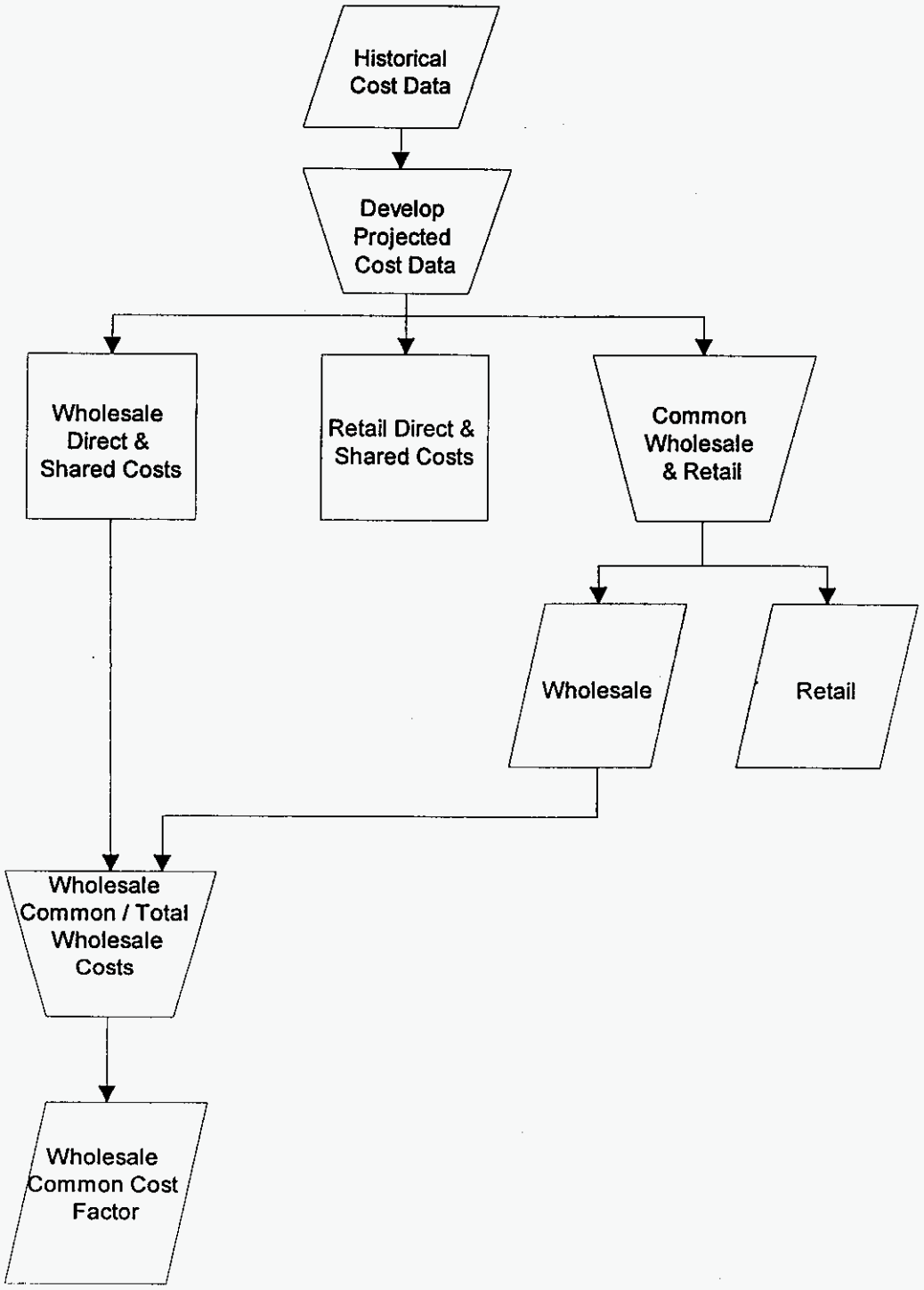
Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My testimony provides a reasonable and supportable method for determining forward-looking shared and common costs attributable to the provision of unbundled network elements. The outputs of this methodology are a set of wholesale shared cost factors by investment category, as reported on my Exhibit WSR-3, a wholesale common cost factor of **5.39%**, as shown on Exhibit WSR-4, and a set of shared cost factors for use with labor rates. These factors represent the appropriate level of forward-looking shared and common costs for inclusion in BellSouth's cost studies.

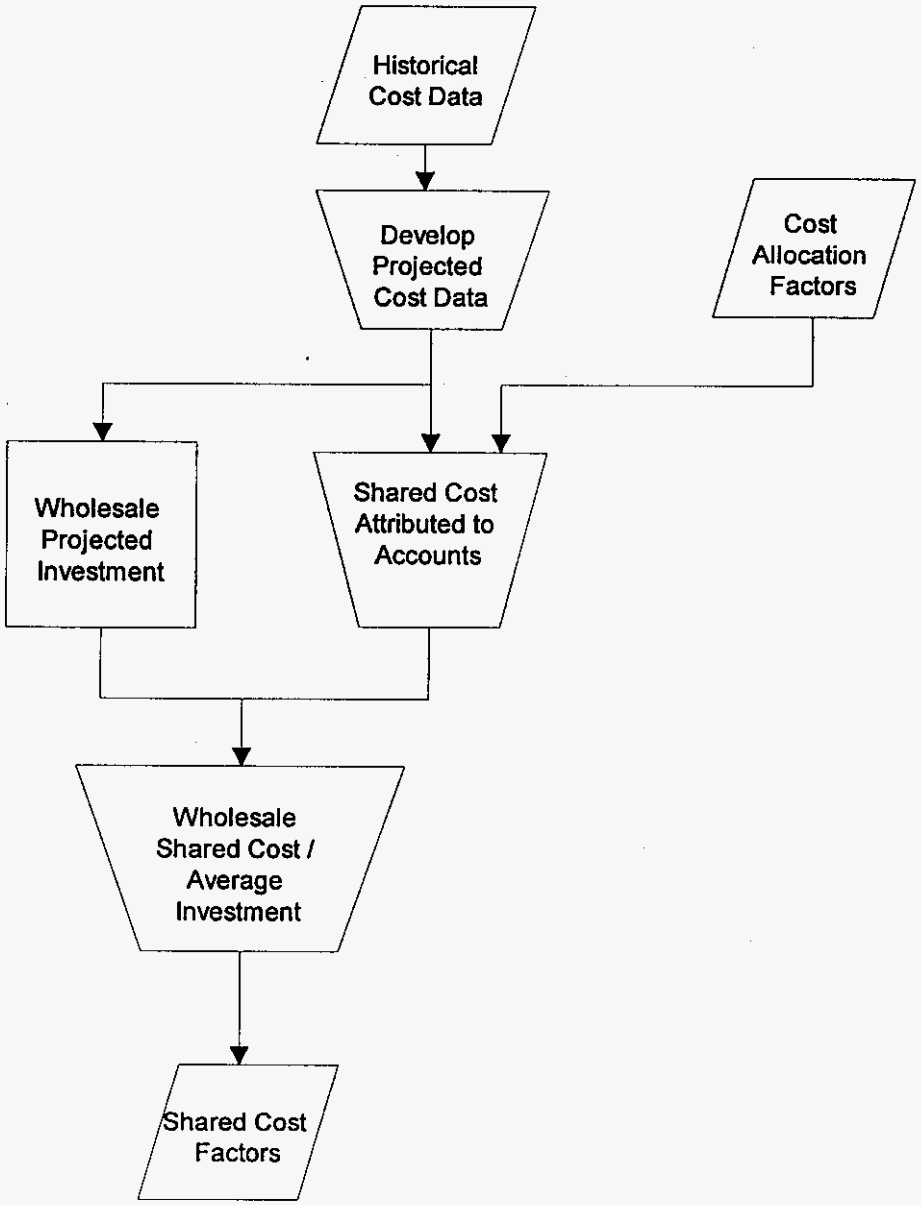
Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

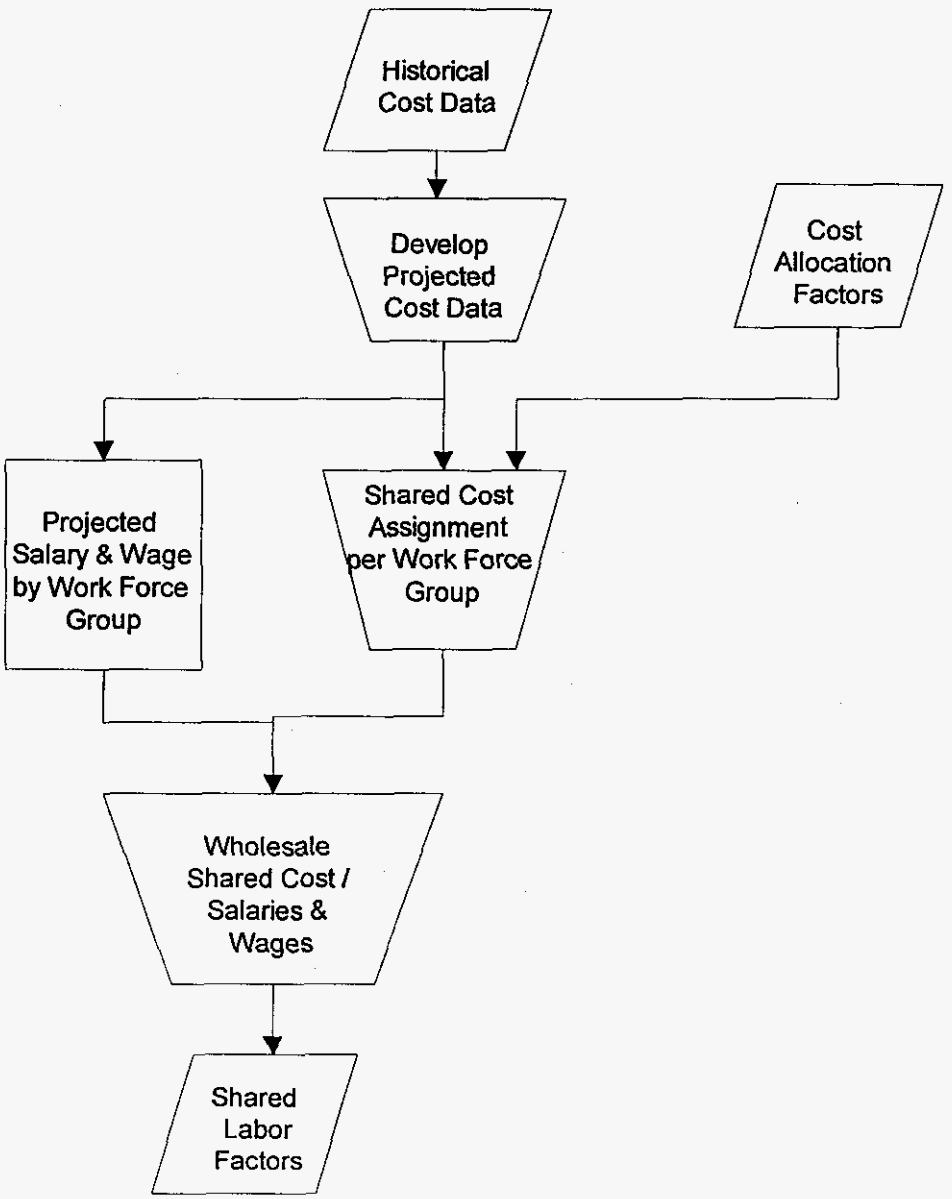
BST's Methodology for Computing Common Cost Factor



BST's Methodology for Computing Shared Cost Factors



BST's Methodology for Computing Work Force Group Factors



Typical Shared Costs

General Purpose Computers
Information Management
Plant Opns Admin Expenses
Engineering Expense
Land and Buildings (non COE)
Procurement
Network Administration Expenses
Inventories
Human Resources
Motor Vehicles
Office Equipment

Typical Common Costs

Other General and Admin Expenses
Accounting and Finance
External Relations
Executive (portion)
Planning
Plant Under Construction
Intangibles

Shared Costs Factors

Account	Description	Attributed Shared Cost	Projected Average Investment	Shared Cost Factors
2121	Building - Central Office	1,894,662	3,163,539,171	0.0006
2212	Digital Electronic Switching	239,229,126	7,158,884,505	0.0334
2220	Operator Systems	5,933,412	155,900,110	0.0381
2232	Digital Circuit - DDS	2,815,546	88,911,385	0.0317
2232	Digital Circuit - Pair Gain	160,852,444	5,642,915,225	0.0285
2232	Digital Circuit - Other	117,968,434	4,091,200,644	0.0288
2411	Poles	36,274,535	2,257,999,097	0.0161
2421	Aerial Cable - Metal	266,095,589	6,948,782,576	0.0383
2421	Aerial Cable - Fiber	8,513,465	372,619,220	0.0228
2422	Underground Cable - Metal	86,630,774	3,659,015,484	0.0237
2422	Underground Cable - Fiber	11,729,402	679,292,407	0.0173
2423	Buried Cable - Metal	377,955,662	12,557,727,607	0.0301
2423	Buried Cable - Fiber	14,278,288	779,660,988	0.0183
2424	Submarine Cable - Metal	421,250	30,687,419	0.0137
2424	Submarine Cable - Fiber	89,760	6,484,727	0.0138
2426	Intrabuilding Network Cable - Metal	4,362,439	266,075,317	0.0164
2426	Intrabuilding Network Cable - Fiber	38,049	2,079,619	0.0183
2441	Conduit Systems	46,194,052	3,665,519,225	0.0126

WHOLESALE COMMON COST FACTOR CALCULATION

WHOLESALE	RETAIL	COMMON
WHOLESALE (Direct Costs) Directly Assigned and Attributed Costs (assigned to elements and functions) 15,632,716,753 A		
WHOLESALE (Common Costs) Directly Assigned and Attributed Costs 88,687,124 B	RETAIL Directly Assigned and Attributed Costs 1,843,296,174 G	COMMON (to be allocated) (WHOLESALE & RETAIL OPERATIONS) 842,009,415 C
WHOLESALE (Common Costs) Allocated Portion of Common Costs ((A + B) / (A + B +G) * C) 753,646,236 D	RETAIL (Common COSTS) Allocated Portion of Common Costs (G / (A + B + G)) * C 88,363,179 H	
WHOLESALE TOTAL COMMON COSTS (Direct plus Allocated Common Costs) B + D 842,333,360 E	RETAIL TOTAL COMMON COSTS (Direct plus Allocated Common Costs) G + H 1,931,659,353 I	
WHOLESALE COMMON COSTS FACTOR (Wholesale Total Common / Wholesale Direct Costs) E / A 5.39% F		

WORK FORCE GROUP FACTORS

WORK FORCE GROUPS	Projected Salary and Wage Attributed Costs	Projected Salaries and Wages	Projected Shared Labor Factors
ADDRESS & FACILITY INVENTORY (AFIG)	411,623,005	847,328,150	0.4858
INSTALLATION & MAINTENANCE CENTER (IMC)	435,782,457	897,060,510	0.4858
INSTALLATION & MAINTENANCE SPEC SVCS	435,782,457	897,060,510	0.4858
CO INSTALLATION & MAINTENANCE - CIRC. & FAC.	88,045,715	319,990,469	0.2752
TRUNK & CARRIER GROUP (TCG)	448,640,905	981,864,797	0.4569
CIRCUIT PROVISIONING GROUP (CPG)	37,017,900	134,536,648	0.2752
ACCESS CUSTOMER ADVOCATE CENTER (ACAC)	499,668,720	1,167,318,618	0.4280
WORK MANAGEMENT CENTER (WMC)	523,828,172	1,217,050,979	0.4304
NETWORK PLUG-IN ADMINISTRATION (PICS)	88,045,715	319,990,469	0.2752
OUTSIDE PLANT ENGINEERING	411,623,005	847,328,150	0.4858
CUSTOMER POINT OF CONTACT - ICSC	21,942,414	49,453,301	0.4437
NETWORK SERVICES CLERICAL	23,913,860	49,298,788	0.4851
OSPC	411,623,005	847,328,150	0.4858
OPAC	411,623,005	847,328,150	0.4858
CRT	411,623,005	847,328,150	0.4858
COIM - SW. EQ.	88,045,715	319,990,469	0.2752
RCMAG	88,045,715	319,990,469	0.2752
SW/TRK BASED TRANS	88,045,715	319,990,469	0.2752
COIMA- SFTWR	88,045,715	319,990,469	0.2752
NRC	523,828,172	1,217,050,979	0.4304
PAR	523,828,172	1,217,050,979	0.4304
EBAC	523,828,172	1,217,050,979	0.4304
BRC	523,828,172	1,217,050,979	0.4304
RRC	523,828,172	1,217,050,979	0.4304
FG10	3,061,671	14,638,258	0.2092
FG20	523,828,172	1,217,050,979	0.4304
CABS ACCTG	20,243,132	45,623,500	0.4437
POTS OP	16,113,081	51,879,228	0.3106
DA OP	44,679,660	143,854,939	0.3106
COIN COLL	20,243,132	45,623,500	0.4437
COLL REP -RES	107,647,206	242,612,766	0.4437
COLL REP - BUS	107,647,206	242,612,766	0.4437
BO SVC REP - RES	1,699,281	3,829,800	0.4437
BO SVC REP - BUS	1,699,281	3,829,800	0.4437
COMPT CLER	107,647,206	242,612,766	0.4437
ACCT EXEC	6,518,334	14,690,870	0.4437
SYSTEMS DES	6,518,334	14,690,870	0.4437
SVC CONS	6,518,334	14,690,870	0.4437
TOTAL IOT & OSP	435,782,457	897,060,510	0.4858
TOTAL COE	88,045,715	319,990,469	0.2752
OTHER THAN IOT, COE & OSP	797,471,869	1,641,073,480	0.4859