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August 27, 2003

Mrs. Blanca S. Bayó
Director, Division of the Commission Clerk
and Administrative Services
Florida Public Service Commission
2540 Shumard Oak Boulevard
Tallahassee, FL 32399-0850

030869-TL

Re: New Docket – Petition for Implementation of Section 364.164, SB654

Dear Ms. Bayó:

Enclosed are an original and fifteen copies of BellSouth Telecommunications, Inc.'s Direct Testimony for Daonne Caldwell, Steve Bigelow, Jerry Hendrix, John Ruscilli, Dr. Kenneth Gordon and Dr. William Taylor, which we ask that you file in the captioned docket.

A copy of this letter is enclosed. Please mark it to indicate that the original was filed and return the copy to me. Copies have been served to the parties shown on the attached Certificate of Service.

Sincerely,

Nancy B. White

Nancy B. White (KA)

cc: All Parties of Record
Marshall M. Criser III
R. Douglas Lackey

Testimonies
DNs 08015-03
thru 08020-03

CERTIFICATE OF SERVICE
Petition by BellSouth Telecommunications, Inc.
for Implementation of Section 364.164, Florida Statutes

I HEREBY CERTIFY that a true and correct copy of the foregoing was served via

Hand Delivery this 27th day of August, 2003 to the following:

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Nancy B. White

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030869-TL

BELLSOUTH TELECOMMUNICATIONS, INC.

DIRECT TESTIMONY OF D. DAONNE CALDWELL

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

AUGUST 27, 2003

Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.

A. My name is D. Daonne Caldwell. My business address is 675 W. Peachtree St., N.E., Atlanta, Georgia. I am a Director in the Finance Department of BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth"). My area of responsibility relates to the development of economic costs.

Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I attended the University of Mississippi, graduating with a Master of Science Degree in mathematics. I have attended numerous Bell Communications Research, Inc. ("Bellcore") courses and outside seminars relating to service cost studies and economic principles.

My initial employment was with South Central Bell in 1976 in the Tupelo, Mississippi, Engineering Department where I was responsible for Outside Plant Planning. In 1983, I transferred to BellSouth Services, Inc. in Birmingham, Alabama, and was responsible for the Centralized Results System Database. I moved to the Pricing and Economics Department in 1984 where I developed

methodology for service cost studies until 1986 when I accepted a rotational assignment with Bellcore. While at Bellcore, I was responsible for development and instruction of the Service Cost Studies Curriculum including courses, such as, "Concepts of Service Cost Studies", "Network Service Costs", "Nonrecurring Costs", and "Cost Studies for New Technologies". In 1990, I returned to BellSouth and was appointed to a position in the cost organization, now a part of the Finance Department, with the responsibility of managing the development of cost studies for transport facilities, both loop and interoffice. My current responsibilities encompass testifying in cost-related dockets, cost methodology development, and the coordination of cost study filings.

Q. HAVE YOU HAD ANY PREVIOUS EXPERIENCE IN TESTIFYING?

A. Yes. I have testified in arbitration hearings, generic cost dockets, and Universal Service Fund proceedings, providing evidence on cost-related issues before the state public service commissions in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, and South Carolina, the Tennessee Regulatory Authority, and the Utilities Commission in North Carolina.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. My testimony presents the costs associated with providing access to basic local service, whose current rates may be impacted by this filing. Exhibit DDC-1 attached to this testimony is the cost study in electronic (CD-ROM) and paper

format[1]. The recurring costs, by rate group, resulting from this study are also outlined in proprietary Exhibit DDC-2. Furthermore, Exhibit DDC-2 also compares the existing monthly rates found in the General Subscriber Service Tariff ("GSST")[2] and their costs. A review of this exhibit confirms that implicit subsidization exists for basic local exchange service based on the existing rates and rate structure. The testimony of BellSouth witness John Ruscilli discusses rate increases that will move the existing basic local exchange rates closer to cost.

Q. DESCRIBE THE UNDERLYING NETWORK COMPONENTS OF BASIC LOCAL SERVICE.

A. One of the first steps in cost development is to determine the network components required to fulfill the technical service description of the offering, in this case access to basic local service. The description of the service and the tariff structure (including the rate group rate structure) determine what needs to be considered in a cost study. In order to attain access to the network (which is equivalent to basic local telephone service), a customer requires all of the following network components: a loop, a physical point of presence in the switch (termination), and interoffice connections. In order to make and complete calls, the customer also utilizes components of BellSouth's signaling system 7 ("SS7") network, tandem switches, and end-office switch functionality. Costs associated with these pieces of equipment are directly caused by the customer's request for this service and

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[1] The entire cost study has not been printed, however, all input and output files are contained on the CD.

[2] The current Subscriber Carrier Line ("SLC") charge of $6.50 is also considered in this comparison.

thus, are appropriately included in the cost analyses conducted by BellSouth. Exhibit DDC-3 illustrates the basic network components considered in the cost study.

The local loop is the facility that extends from the main distributing frame ("MDF") in the BellSouth central office to the customer's premises. The loop costs reflect the MDF, all the outside plant components required for transmission, such as copper cable, fiber cable, electronic equipment, poles, conduit, etc., as well as all cable up to and including the connection at the customer's premises, the network interface device ("NID").

The line termination is the facility used to connect the local loop to a BellSouth end office switch. The line termination costs include the jumper to the switch and the non-traffic sensitive termination in the switch, for example the line card in the DMS100 switch.

Local usage costs include the traffic sensitive switching cost of the end office for both intra-office and inter-office calls within the local calling area of that end office. Additionally, local tandem switching, interoffice transport, and signaling costs are considered in the flat-rate usage costs considered in Exhibits DDC-1 and DDC-2. Customer usage characteristics (e.g., calls per month and minutes per call) were used to convert "per minute of use" elements to a flat-rate monthly cost.

Q. WHAT TYPES OF COSTS ARE REFLECTED IN THE COST STUDIES?

A. Cost studies normally reflect both recurring and nonrecurring costs. Recurring costs include both capital and non-capital costs. Capital costs are associated with the purchase of an item of plant, i.e., an investment. In addition to the material price of the equipment, capitalized labor is also considered part of the investment in accordance with Part 32 of the FCC's Code of Federal Regulations which states: "In accounting for construction costs, the utility shall charge to the telephone plant accounts, all direct and indirect costs." Included in the direct and indirect costs are the "wages and expenses of employees directly engaged in or in direct charge of construction work." Thus, BellSouth has appropriately included these labor-related costs (construction costs) in the calculation of the investment; i.e., as part of the capitalized plant account. BellSouth considers these labor-related costs in its study through the use of in-plant factors that augment the material price to recognize the associated labor and incidental material required to install the piece of equipment. By including these costs as part of the investment, they are recovered over the useful life of the plant. The costs associated with the investment (material plus installation costs) are expressed on a recurring (monthly) basis and are comprised of capital costs (depreciation, cost of money, and income tax) and operating expenses (plant-specific expenses, such as maintenance, ad valorem taxes and gross receipts taxes).

Nonrecurring costs, on the other hand, reflect activities associated with provisioning the service after the equipment has been installed. In other words, these are costs BellSouth incurs as a result of a service request. Included in the basic basket are those rate elements contained in the A4 Section of the General Subscriber Service Tariff ("GSST") – Service Charges. All of these costs are

nonrecurring in nature and are associated with connecting or changing service: Line Connection Charge, Line Change Charge, Secondary Service Charge, and Premises Work Charge. Updated costs have not been developed for these rate elements. The last time these elements were filed was in conjunction with Florida Special Docket 980000-A (Fair & Reasonable). The costs produced at that time are contained in proprietary Exhibit DDC-4.

Q. WHAT COST METHODOLOGY IS USED IN THE COST STUDIES?

A. The Florida Public Service Commission ("Commission") has previously defined the cost standard to be used in preparing cost support for retail services as Total Service Long Run Incremental Cost ("TSLRIC") based Section 364.3381 (2), Florida Statutes. Specifically, the Commission has defined TSLRIC as "the costs to the firm, both volume sensitive and volume insensitive, that will be avoided by discontinuing, or incurred by offering an entire product or service, holding all other products or services offered by the firm constant." (Commission Order PSC-96-1579-FOF-TP, page 25) This was the methodology adhered to by BellSouth. In fact, these are the same types of incremental cost studies that BellSouth has filed in tariff filings and other proceedings before the Commission.

Additionally, the models that were used to develop the recurring costs for basic local service are the same as those that the Commission reviewed in the generic cost docket, Docket No. 990649-TP, conducted to establish cost-based rates for unbundled network elements ("UNEs") and interconnection. Specifically the

BSTLM© was used to develop the loop costs; the SST© was used for switch-related costs; and the BellSouth Cost Calculator© converted investments into recurring costs. Furthermore, the factors that were used are consistent with those currently under review in the Collocation Docket Nos. 981834-TP and 990321-TP.

As this Commission is aware, the BSTLM is a proxy model that reflects the least cost, most efficient network configuration in accordance with the Federal Communications Commission's ("FCC's") pricing rules for UNEs. Thus, costs based upon the hypothetical network produced by the BSTLM, a network in which only the minimum cable route is considered and most-technically advanced equipment is placed, result in an understatement of the real-world loop-related costs. In other words, the costs BellSouth actually incurs, even from a forward-looking perspective, exceed those produced by the BSTLM.

Q. PLEASE EXPLAIN THE TSLRIC METHODOLOGY IN MORE DETAIL.

A. TSLRIC methodology uses incremental costing techniques to identify the additional costs associated with providing a service. Incremental costs are based on cost causation and include all of the costs directly generated by expanding production, or alternatively, costs that would be saved if the production levels were reduced. The production unit could be an entire service, or a unit of a service. For basic telephone service, if the level of production increased, additional costs would

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be incurred for loops, switch terminations, and interoffice connections, i.e. the physical network components of the service. Conversely, if the telecommunication providers discontinue the basic service, these costs would be saved (avoided).

Direct costs may be volume sensitive and/or volume insensitive. Volume sensitive costs are considered to be Long Run Incremental Costs ("LRIC"). LRIC identifies the price floor, i.e. the level below which rates cannot be set and still cover their direct costs. TSLRIC includes both volume sensitive and volume insensitive costs. TSLRIC studies are the basis for testing for cross-subsidization. Additionally, long run incremental cost studies ensure that the time period studied is sufficient to capture all forward-looking costs affected by the business decision being studied. Another corollary to the long-run principle is that all costs are variable in the long run. The implication here is that all resources will exhaust and new purchases must be made to meet demand for the service or product.

Q. DO STUDIES BASED ON TSLRIC METHODOLOGY INCLUDE SHARED AND COMMON COSTS? IF NOT, WHY NOT?

A. No. A definition of shared and common costs will explain why they are not included. A shared cost is incurred when producing two or more services but is not a direct cost caused uniquely by any one of those services. An example of a shared cost is a licensing fee paid to a vendor that supports two or more services.

Common costs are costs that are incurred by a firm to produce all of its services, but cannot be directly attributed to (i.e., are not caused uniquely by) any single

service or service combination that includes fewer than all of the services provided. Such costs do not change with changes in the firm's service mix or volume of output. Examples of common costs are executive, accounting and legal costs. Thus, both shared and common costs are not included at the individual service level since only direct costs are considered in a TSLRIC analysis.

Q. IN PAST PROCEEDINGS IN FLORIDA, PARTIES HAVE CLAIMED THAT THE LOOP COSTS SHOULD BE TREATED AS A COMMON COST. IS THIS APPROPRIATE?

A. No. This is incorrect for a number of reasons. First, common costs do not vary with the demand. However, an increase in demand for basic service requires additional loop investment and thus, increases loop costs since the loop is the main vehicle required for access to the telephone network. Secondly, the customer's request for service triggers loop costs. The loop cost is directly caused because of the request for the service, thus it is appropriately included in a TSLRIC study. Furthermore, the loop provides a dedicated means of access, since no one else can use the customer's loop even if the subscriber never uses the loop to place a call.

Treatment of loop costs as shared or common costs also violates the cost-causation principle inherent in TSLRIC methodology. A cost is caused when an activity takes place; if BellSouth provisions a loop, the cost is incurred. That is the cost causation standard. That standard does not depend at all on how the loop is used, or how the product or service is used, or the benefit or value that is created from that use.

In fact, in a 1999 report to the Florida Legislature, the Commission rejected the claim that the cost of the loop should be recovered from non-basic local telecommunications service.[3] In that report, the Commission stated:

> Is the cost of local loop facilities properly attributable to the provision of basic local telecommunications service? By definition, yes. Section 364.02(2), Florida Statutes, defines "basic local telecommunications service as"
>
> > Voice grade, flat-rate residential and flat-rate single-line business local exchange services which provide dial tone, local usage necessary to place unlimited calls within a local exchange area, dual tone multi-frequency dialing, and access to the following emergency services such as "911," all locally available interexchange companies, directory assistance, operator services, relay services, and an alphabetical directory listing.

Q. SHOULD RATES BE SET EQUAL TO THE TSLRIC RESULTS?

A. No. TSLRIC methodology recognizes only the direct, forward-looking, long-run incremental cost of providing a service. As mentioned previously, shared and common costs are not addressed by TSLRIC methodology. Yet, shared and common costs are true costs to the company and should not be ignored. In fact, if a company were to consistently set their rates at TSLRIC, the company would soon fail. Thus, in setting rates, consideration must be given to a reasonable level of

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[3] *See*, "Report of the Florida Public Service Commission on the Relationship Among the Costs and Charges Associated with Providing Basic Local Service, Intrastate Access, and Other Services Provided by Local Exchange Companies, in Compliance with Chapter 98-277, Section 2(1), Laws of Florida," Florida Public Service Commission Tallahassee, Florida February 15, 1999.

contribution toward the joint and common costs of the corporation. In fact, the FCC in establishing the pricing standards associated with UNEs recognized that it is appropriate to recover shared and common costs.

Q. ARE THERE ANY DIRECT COSTS NOT REFLECTED IN BELLSOUTH'S COST STUDY FILED AS EXHIBIT DDC-1?

A. Yes. None of the direct costs required to promote and support retail services, e.g. billing, collections, marketing, sales, advertising, and product management have been considered in the costs displayed in Exhibit DDC-1. These additional costs are a direct result of having customers, including those subscribing to basic local service. However, direct assignment of these costs is very difficult and complex. Based on a cost allocation process similar to that used to develop the shared and common cost factors in the generic cost docket, it is estimated that an additional 9.59% is required to account for these costs. Exhibit DDC-2 considers the application of the estimated 9.59% factor. Additionally, the calculations used to develop this factor (Customer Operations Cost Factor) are contained in Exhibit DDC-1 in Appendix J.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Caldwell Exhibit DDC-1

Proprietary

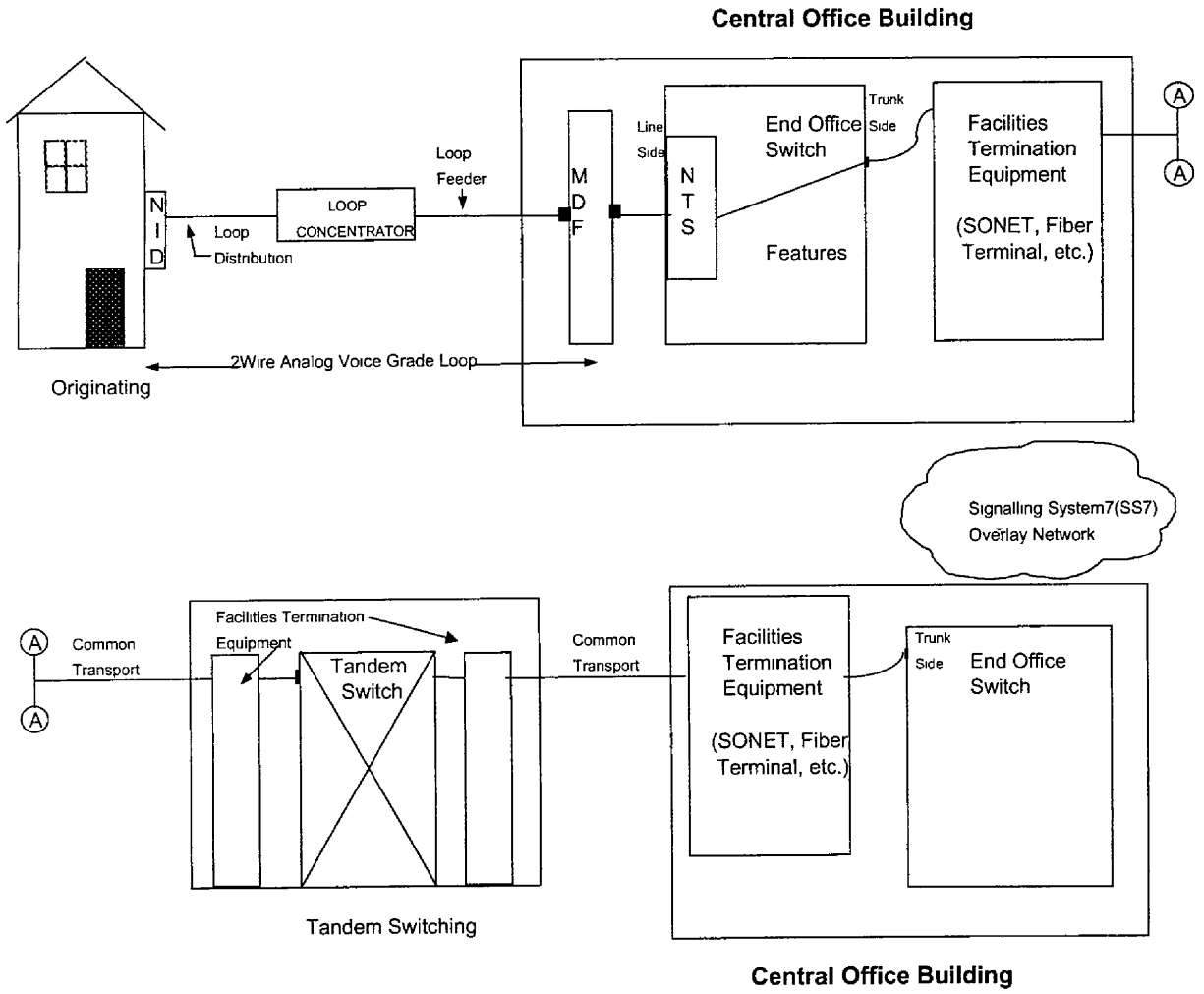
(76-pages)

Caldwell Exhibit DDC-2

Proprietary

(2-pages)

Basic Local Exchange Service



Caldwell Exhibit
DDC-4

Proprietary

(1-page)