BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

REBUTTAL TESTIMONY

OF

KENT W. DICKERSON

Q. Please state your name, business address, employer and current position.

A. My name is Kent W. Dickerson. My business address is 6450 Sprint Parkway, Overland Park, KS 66251. I am employed as Director - Cost Support for Sprint/United Management Company.

Q. Are you the same Kent W. Dickerson who filed Direct Testimony in this case for Sprint-Florida?

A. Yes.

Q. What is the purpose of your Rebuttal Testimony?

A. The purpose of my Rebuttal Testimony is to respond to the Direct Testimony of BellSouth witnesses James W. Stegeman, Dr. Debra J. Aron, and W. Keith Milner. My Rebuttal Testimony, along with the Rebuttal Testimony of Sprint Witness Dr. Brian Staihr, addresses why BellSouth's claim that CLECs are not impaired without access to BellSouth's unbundled switching in 10 of 18 "markets" (Dr. Staihr's testimony addresses BellSouth's errant market definition) using the FCC defined "potential deployment" methodology is wrong.

Q. Please describe how your testimony is organized?

A. My testimony is organized into three sections of analysis and discussion. The first section addresses the BellSouth Analysis of Competitive Entry (BACE) model and the associated testimony of BellSouth witness James W. Stegeman. In this section, I explain how the BACE model as filed in this case is grossly inadequate for completing a full and fair examination of the economics resulting from a CLEC using a self provisioned switch to serve Mass Market customers within BellSouth's Florida markets. As I discuss more fully below, the inadequacy of the BACE model is exacerbated by BellSouth's failure to provide a visible, functioning version of the model critical to examining, testing, validating and correcting the extremely complex calculation and "optimization" routines contained therein.

Second, I will discuss those areas of the BACE calculations/methodologies that Sprint's external analysis to date demonstrates to be fatally flawed thus rendering both the BACE model results and BellSouth's market impairment conclusions invalid.

In the final section of my testimony, I present the results of nine distinct BACE model runs containing necessary modifications to those limited inputs and model toggles which BellSouth's unreasonably limited model access will allow. I also present the cumulative results of these nine distinct modifications to BellSouth's potential deployment case and, by doing so, I am able to demonstrate the unworkable economics of a CLEC serving Mass Market customers using a self

provisioned switch from day one and thus the error in BellSouth's unimpaired market conclusions.

SPRINT'S ANALYSIS OF BELLSOUTH'S COMPETITIVE ENTRY (BACE) MODEL

Q. Have you reviewed the testimony of BellSouth witness James W. Stegeman and the BACE Model, BACE Model Methodology Manual and User Guide?

A. Yes, I have.

Q. Based on this review, have you been able to validate the internal workings of the BACE Model?

A. No, I have not. As I detail below, BellSouth has chosen to unreasonably prevent external users' access to numerous critical areas of the model's calculations, inputs, subroutines and results, thus rendering BellSouth's potential deployment case an unverifiable "Black Box".

Q. Why has BellSouth denied the external user's access to numerous critical areas within the BACE Model?

A. BellSouth attempts to justify this unreasonable access restriction based upon the need to protect intellectual property rights associated with the BACE Model. While Sprint does not object to BellSouth's desire to protect intellectual property rights associated with the BACE Model, their approach seeking to block all external user's access to critical inputs and calculations within the model is an unreasonable and unworkable restriction.

I have attached as Exhibit KWD-2 a Protective Agreement Provision used by Sprint-Nevada to protect intellectual property rights associated with Sprint's internally developed UNE cost model while allowing the necessary full and complete external user access to all Sprint UNE model inputs, calculations, routines and results. Sprint offered to sign a similar document in this case but BellSouth refused this necessary solution. Thus, as I explain more fully below, BellSouth's BACE model cannot be sufficiently reviewed and validated. BellSouth's claims of non-impaired Mass Markets cannot be accepted for that reason alone.

Q. Please explain the BACE Model Input and Results Tables which are restricted and unavailable for viewing and validation to external users.

A. The BACE model uses four significant groupings of complex calculations. These four groupings of calculations are the Price Process (P-Process), the Quantity Process (Q-Process), the Revenues Process (R-Process) and the Operations and Network Process (ON-Process). Within each process are input data tables which are used in the model computations to develop the final output table. Many of the referenced input data tables are not available to the user for input or viewing. Numerous intermediate results tables and final results tables, which are used in subsequent calculations, are also not available to the user for viewing. I will now elaborate on each routine and the currently known deficiencies.

Process (P-Process)

The first routine in the BACE model process is the Price Process (P-Process). Through the use of 5 data tables and 7 tasks, market prices are determined for the 5 main products offered. In addition, individual component prices are developed

for the bundles. Only 4 of the 5 input data tables are available to the external user for input changes and viewing. The Baseline Product Price table is not available for input changes or viewing. The Baseline Product Price table "defines the initial prices of á *la carte* products by geographic area." [1] This table houses the starting price for all products. BellSouth witness Dr. Aron refers to the data in this table as coming from "...a pre-processing program...."[2] Tasks 2, 3 and 4 use this table as a starting point to develop discounted product prices (task 2), prices over time (task 3), and the individual component prices for bundles (task 4). It is an unworkable repetitive and laborious task of trial and error to determine the impact of input changes for discounts and prices over time since the user is unable to know the starting price point. PMaster is the output data table for this routine.[3] The PMaster results table is not available for review and thus cannot be validated.

Quantity Process (Q-Process)

The second routine in the BACE model process is the Quantity Process (Q-Process). Through the use of 11 tables and 10 tasks, demand quantities for á *la carte* products and bundled products are developed. Two of the tables are not available for input and viewing by the user. The Exchange Demographics table is not available for input changes or viewing. The Exchange Demographics table contains "the customer population of each wire center. The wire center population is divided into residence and four business segments described earlier. This segmentation supports granular demand, pricing, market share considerations, and revenue analysis."[4] Based on this description, this table is

[1] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 30.
[2] Direct Testimony of Debra Aron, December 4, 2003, page 23.
[3] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 32.
[4] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 33.

used to drive critical numbers surrounding demand, market share and revenue. This table is the starting point for determining the year ten CLEC customer counts, yet is unavailable for viewing. The Baseline Demand table is also not available. This table has data regarding the expected initial demand for products and services offered by the CLEC. Several intermediate results tables are created and subsequently used throughout the 10 task routine of the Q-Process. None are available for reviewing. These intermediate tables include BACE processing table Q2 during task 1, BACE processing table Q4 during tasks 2, 3 and 6, BACE processing table Q6 during task 6, BACE processing table Q3 during task 7.[5] QMaster is the output data table for this routine.[6] The QMaster results table is not available for review and validation by external users.

Revenue Process (R-Process)

The third routine in the BACE model process is the R-Process (Revenue Process). Through the use of 5 tables and 3 tasks, gross revenue is derived along with the net present value of the revenue. Two of the 5 tables are not available for input and viewing by external users. The PMaster results table and QMaster results table, discussed earlier, are used as input tables to this routine. These tables are not available for review as discussed earlier. RMaster is the output data table for this routine. The RMaster results table is not available for review.

Operations and Network Process (ON-Process)

The fourth routine in the BACE model process is the Operations and Network Process (ON-Process). Approximately 7 tables and approximately 27 tasks calculate investments and operations costs associated with the CLEC network.

[5] Direct Testimony of James W. Stegeman, December 4, 2003, pages 36-39.
[6] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 35.

The 7 referenced tables are available for input changes and viewing. However, this routine uses the QMaster and RMaster tables that are developed in prior routines and, as discussed earlier, are not available for review. Examples of the use of the QMaster table include: "Results from the Q-Process that identify demand (where appropriate) for each of the various levels of the product, customer and location hierarchies provide the basis for establishing an appropriately sized CLEC network architecture."[7] "For non-capital cost records that have a ***Frequency*** of Recurring or NonRecurring, BACE uses the demand requirements in each year (from the Q-Process) based on the product, customer and location hierarchies and the ***UNEZone*** and ***RateCenter*** entries in the Network and Operations Cost Input tables."[8] The RMaster results table is used in the Optimization Phase of the ON-Process in determining whether an EEL or Collocation is the most economic approach to the network architecture. The RMaster results table is also used for any additional user flagged optimization. BellSouth's decision to hide the QMaster and RMaster table results from external users makes any independent verification and validation of the ON-Process impossible.

Q. Are the numerous hidden tables described above housed in a central database within the BACE Model?

A. Apparently yes. Conversation with BellSouth witness James W. Stegeman reveals the existence of a central database file within the BACE Model containing extensive interim and final results tables. BellSouth, however, has chosen to

[7] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 54.
[8] The BellSouth Analysis of Competitive Entry Model-Methodology Manual, page 55.

password protect the file and has refused to allow distribution of the password thus denying the external user access to over 1.0 Gigabyte of data inputs and calculation results.

Q. Can the external user review, trace, test and verify the calculations within the BACE Model?

A. No. Actual calculations within the BACE Model cannot be seen nor verified by the external user. Rather, in place of viewable, functioning model calculations, BellSouth has merely provided a soft copy document in the form of an Adobe Acrobat (.pdf) file. The file cannot be printed and each page has 3 vertical lines stating "Proprietary and Confidential" written across the code, therefore, making it extremely difficult to read. There are references to variables and routines that are not defined within the file. Without access to the password protected file described directly above, a programmer cannot follow the field names that are used in the code calculations, thus rendering the file, as is, effectively useless.

Q. Has the BACE Model benefited from any previous public review and scrutiny?

A. No it has not. It is my understanding that this case is the first opportunity for the BACE Model to undergo necessary peer review within the industry, thereby making it all the more critical that complete and full access to the BACE model inputs, calculations and results be afforded. BellSouth's filing falls far short of what is required to complete a full and independent investigation.

Q. Based on your experience with UNE and USF models, would you expect an extremely complex first generation prototype model such the BACE model to be error free?

A. No, I expect quite the opposite. Sprint has been an active industry sponsor of the Benchmark Cost Model (BCM) leading to the Benchmark Cost Proxy Model (BCPM) since the passage of the 1996 Telecommunications Act. Sprint has also been very active in the critical review and validation of numerous other industry UNE/USF models including the Hatfield model (evolving eventually to the HAI model) and the FCC Hybrid Cost Proxy Model (HCPM). The BCM evolved over four years and eight different model versions to its current "BCPM 3.1" state. The Hatfield model included some fourteen model releases since its 1995 introduction. Similarly the FCC HCPM has been released at least 23 different times since 1997. A large part of these model releases resulted from objective external critical review efforts which identified errors and shortcomings in the various model releases which required correction in order to generate reliable and accurate results. All of this relevant industry experience instructs that this first generation prototype BACE model could not be reasonably expected to be error-free given the complete lack of objective external critical review at the juncture of its first public filing.

Q. Do you have any other instructive examples of the need for, and benefits of, full and objective industry peer review of complex cost models?

A. Yes. I have attached as Exhibit KWD-3 to this testimony a letter filed by BellSouth in the UNE pricing Docket No. 990649A-TP. The letter describes the numerous corrections needed to BellSouth's BSTLM loop cost model including,

notably, several errors that surfaced as a result of external party review and comment. It provides yet another validation that neither the BACE model nor the non-impairment conclusions alleged by BellSouth can be relied upon, particularly in light of the extreme lack of model access, disclosure and support for critical inputs that I highlight in this testimony.

BACE Model Collocation Costs are in Error

Q. Have you been able to perform any independent verification of the BACE Model?

A. Yes. While the unreasonably limited access to critical BACE Model tables, calculations, "optimization" routines and results makes a complete independent review of the BACE Model impossible at this time, I have been able to perform analysis which demonstrates significant errors in the area of Collocation and EELs cost. As I will explain below, I have computed CLEC initial collocation build-out costs and ongoing monthly collocation power consistent with BellSouth's assumed CLEC demand and then compared these figures to the internally generated BACE Model costs for the same. The comparison shows the BACE Model costs to be drastically understated **(554% and 198% respectively)**. This evidence of severely understated BACE Model collocation costs completely taints the model's Collocation/EELs "optimization" routine and ultimately renders the financial results and BellSouth's associated claims of 10 un-impaired mass markets unreliable and invalid.

Q. Looking first at Exhibit KWD-4 "Summary of Collocation Build Out NPV Differences", please explain your analysis and conclusion.

A. Column b titled "BACE Calc of ColloBuildOut NPVs" shows the CLEC collocation build-out cost estimates contained in BellSouth's filing for 6 randomly selected Central Office Collocations. I would first note that the BACE Model cost estimates in column b for the [redacted] wire center of [redacted] show only a [redacted] increase over the cost estimate of [redacted] for the wire center [redacted] This despite the fact that the [redacted] CLEC DSO lines served in wire center [redacted] exceed the [redacted] CLEC DSO lines served in wire center [redacted] by a factor of **51 times**. As line quantities at a specific CO collocation increase, a CLEC must deploy more equipment giving rise to increases in collocation floor space requirements and even greater increases in DC power quantity requirements. This then results in increased monthly floor space preparation charges from the ILEC and increased DC power cable installation costs. DC power cable installation costs are a very material portion of overall collocation build-out costs and the lack of variability in the BACE Model collocation build-out costs to lines served is immediately suspect and cause for investigation.

Q. Were you able to examine the specific BACE Model calculations used to generate the figures in column b?

A. No, once again these important calculations are not visible to the external user. However, according to documentation in the BACE Model, the ColloBuildOut cost center includes cable record requests, space availability reports, space prep charges, applications, and security charges. The BACE Model documentation makes no mention of DC power cabling costs and, based on the dramatically

understated values contained in BellSouth's filing coupled with the lack of proper cost variability to lines served; there is good reason to suspect they have been excluded entirely. On pages 2 through 7 of Exhibit KWD-4, I have estimated collocation build-out costs which include the DC power cable costs consistent with the DC power requirements at that central office and the DSO, DS1 and DSL demand served. These DC power cable costs were estimated using the same costs as Sprint filed in collocation Docket Nos. 981834 and 990321-TP. I have summarized these costs in column a, page 1, of Exhibit KWD-4. Sprint's analysis shows the BACE model cost estimates for ColloBuildOut to be dramatically understated (554% for the 6 collocations analyzed). I conclude that the BACE Model cost estimates for ColloBuildOut are utterly unreliable for both the purpose of overall cost estimation and for the collocation/EELs "optimization" routine BellSouth claims to incorporate into the BACE model.

Q. Have you performed a similar analysis of the BACE Model cost estimates for DC power consumption charges?

A. Yes. I have prepared Exhibit KWD-5 which computes the annual DC power consumption charges a CLEC would pay to BellSouth. Exhibit KWD-5 computes the 10 year NPV of DC Power consumption charges based on DC power quantities necessary to serve the DSO CLEC line demand assumed in BellSouth's filing. Based on conversation with BellSouth Witness James W. Stegeman, I learned the BellSouth DC power cost estimates assume a cost based on 60 amps of DC power for every collocation site. Page 2 of 2 of Exhibit KWD-5 shows that 1,056 DS0 lines can be served with 60 amps of DC Power. BellSouth's use of a single 60 amp DC Power assumption for every wire center results in 82% of

CLEC collocation sites having inadequate DC Power and associated understated costs. This is caused by the BellSouth modeled DS0 line demand for 82% of all CLEC collocation sites exceeding 1,056 lines (which is all that can be served with BellSouth's assumed 60 amps of DC Power). Comparing Sprint's externally computed NPV of DC power costs to that of the BACE model shows the dramatic 198% understatement of BellSouth's estimated DC power costs. I would note that the actual understatement of BellSouth's cost estimate exceeds the amount on this schedule as Sprint's DC power requirement reflects only the power required to serve the DSO line demand in BellSouth's filing. The additional DC power required to serve DS1 and DSL CLEC demand is not included in Sprint's DC power requirements and would increase the amount of understatement in BellSouth's cost estimate.

BACE Model Expense Estimates

Q. Are there other areas of BellSouth's base case that appear unrealistic and inconsistent with a real world startup CLEC?

A. Yes, I find the area of G&A expenses contained in BellSouth's filing to be highly suspect and unsupported in several respects. This category of operating expense accounts makes up [redacted] or [redacted] of the total CLEC operating expenses and yet BellSouth's filing contains not a single workpaper supporting this expense input assumption. Rather at page 35 of her testimony, Dr. Aron offers a meager discussion of G&A costs which she characterizes as "... relate to the overall management of the firm (such as executive, legal, human resources , and the like)." She goes on to mention a mapping of these costs which she fails to

provide with her testimony but claims to have used to "... harmonize ILEC data with general CLEC accounting practices." Later at page 40 of her testimony, she references the use of 1992-2002 ARMIS reporting company data to perform a "... 'weighted regression' to determine the linear relationship between G&A and revenue", resulting in the [redacted] percent of revenue factor being used to predict the [redacted] in operating expenses labeled as G&A in BellSouth's filing. As was the case with her "account mapping" and "harmonizing of ILEC and CLEC account structures", Dr. Aron did not provide any of her referenced analysis with her testimony and thus I have been unable to examine it further.

Q. Does BellSouth's filing contain any other discussion or evidence supporting this [redacted] CLEC operating expense estimate which comprises [redacted] of total operating expenses?

A. No.

Q. Is BellSouth's method of estimating CLEC G&A expenses reasonable?

A. No, quite the opposite. BellSouth's approach to predicting CLEC G&A expenses during all phases of startup operations assumes they are perfectly scaleable to revenues. Dr. Aron in effect proposes to estimate CLEC G&A expenses as though they are a direct variable cost of sales. This approach is counter intuitive when dealing with this most classic of the common cost categories. Were Dr. Aron's suggestion true in the real world then we should see firms with no sales also have zero G&A costs. Further, G&A costs would perfectly double in lock step as revenues doubled and yet we see neither of these conditions in real world data. While it would be indeed wonderful if CLECs could somehow perfectly

manage G&A costs so to perfectly correlate to sales growths or declines, the fact is they bear no direct linear relationship to sales growth or decline. In fact, the G&A expenses referenced in Dr. Aron's testimony are a classic example of an expense category where large firms typically enjoy considerable economies of scale versus smaller firms. This would be all the more true of the CLEC startup venture that the BACE model purports to depict. It would be hard to select a more polar opposite to CLEC startup ventures than the largest established ILEC companies in America underlying the ARMIS data Dr. Aron relies upon in her referenced but unseen "weighted regression" analysis. It would also be difficult to select a more defective method of G&A cost estimation than the perfectly scaleable to revenues assumption used in BellSouth's BACE model results. The intuitively unsound approach used by BellSouth to estimate [redacted] of total operating expenses suggests that BellSouth's claim of CLEC non-impairment fails on this single issue alone.

Q. Can you suggest a correction to BellSouth's G&A expenses?

A. No, not at this time. The essentially complete lack of detail in BellSouth's filing regarding what specific expenses this [redacted] of total expense category is attempting to predict makes any corrections, at this time, pure guesswork.

Q. Have you been able to validate the Operations/Maintenance and/or the Cost of Goods Sold expense estimates in BellSouth's filing?

A. No. These expense estimates also suffer from an equally dismal quantity and quality of detail, description, and support in BellSouth's filing. This coupled with the hidden tables and BACE model calculations make a complete review of

BellSouth's expense estimates impossible until that problem is rectified. Effectively little, if any, validation of BellSouth's expense assumptions, calculations, inputs, or results can be completed until they are required to provide reasonable access to all of the BACE model inputs and calculations.

BACE Model Inputs

Q. Has Sprint completed its review of the BACE Model Inputs?

A. No. BellSouth's lack of reasonable access to numerous tables integral to the BACE Model results precludes a full and complete examination and validation of key model inputs. Additionally, Dr. Aron's testimony offers scant factual support and analysis for numerous critical model inputs, leaving BellSouth's case substantially unsupported. Thus, Sprint's review of inputs reflects a best effort under the circumstances of an overall unworkable lack of access to the BACE model itself and near total absence of data allegedly used to develop the model's inputs and assumptions. Sprint has completed nine distinct model adjustments and one cumulative run which I present as Exhibit KWD – 6 (Revised 2/12/04) to this testimony.

Q. Please describe Exhibit KWD-6 (Revised 2/12/04).

A. Exhibit KWD-6 (Revised 2/12/04) provides the ten year cumulative Net Present Value (NPV) of cash flows for the Mass Market customer segment for 10 distinct BACE Model scenarios. Scenario 1 of Exhibit KWD-6 (Revised 2/12/04) starts with the 10 year cumulative NPV of cash flows for Mass Market customers from BellSouth's BACE model filing with no modifications other than to group the

wire center results into the MSA markets as advocated by Sprint Witness Dr. Staihr. Scenarios 2 through 6 reflect Sprint's modifications to BellSouth's direct testimony BACE filing supported and described in the rebuttal testimony of Dr. Staihr. My testimony below describes the BACE model input adjustments reflected in Scenarios 7 through 10. Dr. Staihr describes in his testimony why it is essential to first set the BACE model filters correctly so as to properly allow the modeled results to be consistent with serving the Mass Market customer segment. Sprint Scenarios 3 through 10 each reflect the stand alone impact of their respective input modification on a stand alone basis overlaid upon Scenario 2 as the base case. This is necessary to avoid a constantly shifting geographic market and Mass Market customer base that the BACE Model filters otherwise produce. Finally, I have reflected the cumulative results of the combined Sprint Scenarios 2 through 10 in Scenario 11 titled "Sprint Scenarios 2-10 Cumulative Changes".

Q. Please describe Sprint Scenario 7 "Sprint Base Case: Adjust Purchasing Power".

A. Page 26 of the BACE Methodology Manual contains a brief description of a key model input factor titled "PurchasePower", described as follows, "To the extent that a CLEC has the same purchasing power as BellSouth, the ***PurchasingPower*** factor should be set to 100 (e.g. the CLECs PurchasePower as a percentage of BellSouth's Purchasing Power) ... CLECs with less purchasing power may have a ***PurchasePower*** factor greater than 100." Scenario 7 in Exhibit KWD-6 (Revised 2/12/04) reflects the effect of changing the PurchasePower factor input from the 100 used in BellSouth's base case filing to a factor of 125. The 125 in effect recommends a CLEC vendor cost equal to $1.25 for every dollar BellSouth would

pay for the same equipment. The effect of this single input adjustment in Scenario 7 overlaid upon Sprint's base case Scenario 2 is to reduce cumulative NPV of cash flows by $41,689,824~~42,293,051~~.

Q. Why do you believe this adjustment is appropriate?

A. It is a well accepted fact in our industry that telecommunication equipment vendor prices are directly influenced by the volume of equipment purchased. It defies logic to suggest that a startup CLEC would require the same level of equipment purchases as the incumbent LEC (in this case BellSouth), and yet that is the premise BellSouth's factor of 100 asks this Commission to accept. Even assuming the CLEC in question is Sprint and is then able to leverage vendor prices of Sprint's Local Telephone Division, the overwhelming threefold size advantage of BellSouth's operations versus Sprint's operations supports the conclusion that Sprint's CLEC ventures would pay higher equipment vendor prices than a threefold larger competitor (i.e. BellSouth). While the extremely confidential nature of company specific vendor prices makes it difficult to share actual purchase data, my extensive experience reviewing and preparing cost study inputs for USF, UNE, and TSLRIC purposes leaves me confident that the 25% vendor cost increase for CLECs above BellSouth is a conservative best case estimate for CLEC equipment costs.

Q. Please describe Scenario 8 "Sprint Base Case: Adjust Sales Expense" of Exhibit KWD-6 (Revised 2/12/04).

A. Scenario 8 reflects the effect of increasing the sales expenses contained in BellSouth's base case to a level consistent with Sprint's actual CLEC experience.

The actual sales expense input corrections to BellSouth's understated values are shown in Exhibit KWD-7 to this testimony. The effect of Scenario 8 on the Sprint Base Case Scenario 2 is to reduce cumulative NPV of cash flows by ~~$138,265,222~~138,362,683.

Q. Does the BACE model account for customer acquisition (i.e. "sales") costs?

A. The BACE model accounts for CLEC customer acquisition costs on a very simplistic level. The BACE model has one input for the customer sales cost for each of the five customer size categories. In contrast, the COGS expense category has thousands of inputs used to calculate the COGS expense. The "sales" expense input category should have more than five inputs to allow greater granularity in the sales expense category to input actual or forecasted sales expense experience.

Q. Do you agree with the BellSouth BACE model customer sales costs inputs?

A. No. Although BellSouth's input is a known quantity, there is no way of knowing what expense accounts are included in the input number. Dr. Aron states in her direct testimony dated December 4, 2003, on page 35, lines 22 through 24, that she created "a mapping of ILEC SG&A accounts to CLEC SG&A accounts" so she can "harmonize CLEC data with general CLEC accounting practices". However, this mapping was not presented. It is not known what costs are included in the BellSouth sales expense inputs. Using Sprint's extensive relevant experience to analyze what should be included in customer sales costs, the original BellSouth inputs for customer sales costs are dramatically understated.

As explained below, Sprint has calculated the cost of sales for customer acquisition and entered the corrected inputs in the BACE model. Separate inputs have been created for residential, SOHO, small business (SME/A), medium business (SME/B), and large business (SME/C) customers to match the five BACE model input requirements. (See Exhibit KWD-7 for corrected customer sales acquisition cost inputs used in the BACE model).

Q. What are the major categories of customer sales acquisition costs that should be identified and used for the correct calculated customer sales acquisition costs?

A. Customer sales acquisition costs include sales expenses that are incurred to obtain a customer. Major categories include: sales and marketing, media advertising, and order processing costs.

Q. Can you describe the sales and marketing costs that are included as a major component of the correctly calculated customer sales acquisition costs?

A. Yes. Sales costs include commissions and other fees paid to acquisition channels per each line added. Marketing costs include the cost of sales acquisition products such as direct mail pieces and bill inserts. Sprint has extensive experience selling telephony products through many channels including inbound telemarketing, outbound telemarketing, PCS wireless sales channels, direct mail, bill inserts and direct field sales personnel. Affinity groups (i.e. United Airlines, US Air, and AOL) are acquisition channels that have an ongoing cost of acquisition. New customers are typically rewarded with big upfront rewards (i.e.

10,000 United Mileage Plus airline miles) and then are continuously rewarded for monthly usage (i.e. airline miles for monthly dollars spent). The upfront and ongoing reward expenses are sales acquisition costs that actually increase per customer gross add costs as the base of affinity customers grows. This extensive experience had been used to calculate a sales and marketing cost per gross add for each customer size segmentation utilized in the BACE model.

Q. Please describe the media costs that should be included as a major component of the correctly calculated customer sales acquisition costs.

A. Media spending for a mass market advertising campaign is a major cost component in the sales acquisition category. In the direct testimony of Dr. Aron, Exhibit No. DJA-06, the source reference states that her customer acquisition sales cost excludes television advertising. Sprint's actual CLEC advertising experience was used to calculate an annual advertising budget needed for a CLEC to sustain an advertising campaign required to sell telephony services in BellSouth's Florida territory.

Q. Please describe the order processing costs that are included as a major component of the correctly calculated customer sales acquisition costs.

A. Order processing is a customer acquisition cost. Sprint has used an input for order processing based on actual cost experiences through the use of a current outside vendor. The existing contractual arrangement for CLEC order processing has a declining cost based on the volume of installs. The volume-sensitive

declining order processing costs have been used to calculate the cost of order processing.

OMSC (Order Management Service Center) acquisition costs are expenses incurred internally by a CLEC for the set-up of each new order. The OMSC performs the labor for account set-up and data entry within the internal CLEC customer database. The OMSC also performs the coordination of the long distance and local PIC changes.

Third-party verification is a regulatory requirement and a customer acquisition cost. Each order for a long distance or local service change requires a voice recording authorizing all changes. Contractual arrangements with an outside vendor perform all third-party verifications. Sprint's contracted rates have been used in the acquisition costs calculations.

Q. Please explain Scenario 9 of Exhibit KWD-6 (Revised 2/12/04).

A. Scenario 9 of Exhibit KWD-6 (Revised 2/12/04) reflects the effect of setting the BACE model "CLEC Study Properties" value of "IncludeTerminalValue" to N (for No). BellSouth's base case filing reflects the "IncludeTerminalValue" set to Y (for Yes) and is described at page 56 of the BACE Model Methodology Manual as follows: "By setting the ***CLEC Study Properties*** value of ***IncludeTerminalValue*** to 'Y' the model will include the net book value of the assets into the NPV value. This NPV addition is based on a 10-year discount

value (i.e., at the end of the 10th year, not midyear of the 10th year)." The effect of setting the "IncludeTerminalValue" to N in Sprint Scenario 9 reduces the cumulative NPV of Sprint's base case Scenario 2 by ~~$28,013,836~~27,241,356.

Q. Please explain why you believe it is appropriate to set "IncludeTerminalValue" to N and thereby exclude the net book value (NBV) of assets from the business case cumulative NPV of cash flows?

A. Setting the "IncludeTerminalValue" to Y as BellSouth has done essentially reflects the addition of positive cash flows equal to NBV of assets at the end of year 10 as described in the methodology quoted above. This alleged positive cash flow addition could only be realized were the CLEC to discontinue operations after year 10 and sell all of its operating assets for NBV. Effectively it assumes the CLEC goes out of business as it is impossible to generate the positive cash flows assumed in BellSouth's base case while retaining the necessary assets to continue providing service to Mass Market customers. Thus, the cash flows assumed in BellSouth's case by virtue of setting "IncludeTerminalValue" to Y are not from continuing operations but are obtained only from discontinuing operations and thus it is incorrect to include them as a source of positive cash flow generated from serving Mass Market customers.

Q. Even assuming the CLEC has discontinued service in BellSouth's territory at the end of year 10 and seeks to sell its assets; do you believe the cash proceeds from such sale would equal the NBV as assumed in BellSouth's base case?

A. No, I do not. BellSouth's capital reinvestment associated with CLEC provisioned switching equipment is based on an 11 year economic life. It is most probable

that switch technology at the end of year 10 of an 11 year economic life cannot be sold at all. Rather, it is in all likelihood, a severely outdated technology which real world economics suggest will likely generate a negative cost of removal and no cash sales value were the CLEC to discontinue operations at the end of year 10.

Q. Please describe Scenario 10 "Sprint Base Case: Adjust Bad Debt" of Exhibit KWD-6 (Revised 2/12/04).

A. Scenario 10 "Sprint Base Case: Adjust Bad Debt" reflects the quantification of replacing the Bad Debt assumption of [redacted] of revenues for all years contained in BellSouth's filing with a conservative level of Bad Debt more consistent with Sprint's actual CLEC and Long Distance experience. More specifically, Sprint's Scenario 10 uses a Bad Debt expense factor of 10% for year 1 improving to 6% for year 2 and 5% for years 3 through 10. These Sprint proposed values assume substantial improvement in the actual bad debt expense experienced by Sprint's Mass Market CLEC ventures to date. The effect of Scenario 10 using Sprint's more realistic Bad Debt estimate is to reduce the NPV of cash flows from Sprint's base case Scenario 2 by ~~$54,577,350~~53,434,146.

Q. Please describe Scenario 11 "Sprint Scenarios 2 – 10 Cumulative Changes".

A. Sprint Scenario 11 reflects the cumulative effect of including all of Sprint's corrections to BellSouth's base case (Scenarios 2 through 10) in a single run. The cumulative NPV of cash flows resulting from these corrections is a negative ~~$133,625,579~~136,455,897, which is a reduction of ~~$453,711,979~~444,422,035 from the BellSouth base case scenario. I would emphasize this cumulative result

does not and cannot incorporate corrections to all of the areas of concern I discuss in this testimony. It does not, for example, include necessary corrections to the erroneous approach to G&A expense estimation nor collocation build-out or DC power consumption costs discussed elsewhere in this testimony. Additionally, it leaves yet invalidated all of the extensive calculation routines and associated inputs that BellSouth has excluded from review and validation.

Despite the significant areas which I was unable to correct in BellSouth's filing, Exhibit KWD-6 (Revised 2/12/04) nonetheless supports the opposite conclusion asserted by BellSouth witness Dr. Aron. Rather, Exhibit KWD-6 (Revised 2/12/04) demonstrates the unworkable economics of a CLEC serving Mass Market customers using self-provisioned switches from day one of market entry. As discussed in Dr. Staihr's testimony, this substantial cumulative negative NPV of cash flow values is consistent with real world CLEC results evidenced over the seven, going on eight, years since the passage of the 1996 Telecommunications Act.

Q. Have you performed any other independent validation of BellSouth's BACE model results used to support Dr. Aron's claims of non-impairment?

A. Yes. I have prepared a Net Present Value analysis of the cash flows produced by the BACE model results contained in BellSouth's filing and the results are shown in Exhibit KWD-8. As shown, the net present value of each yearly net cash flow was calculated using the discount rate which generated an overall net present value of zero for the 10-year planning period. This discount rate of [redacted] is, by definition, the internal rate of return (IRR) on this project. In other words, this is

the rate of return that a competitor entering BellSouth's territory in Florida (utilizing UNE loops and self-provisioned switching) should be expected to earn while providing competitive telephone service, if the assumptions in the BACE model are correct. This rate of [redacted] far exceeds the weighted average cost of capital of 13.09% for a "representative CLEC" as calculated and described in BellSouth witness Dr. Billingsley's testimony and used in the BellSouth inputs to the BACE model. Given Dr. Billingsley's comments that "many [CLECs] have declared bankruptcy over the last two years and a significant number of the others operate under severe financial distress"[9] and that "CLECs as a whole continue to demonstrate some degree of financial instability",[10] it seems unfathomable that any local telephone competitors are currently achieving such rates of return or will achieve such rates in the future. Also, while not an exact comparison, the [redacted] IRR is well above BellSouth's own reported return on total capital for the periods of 1999-2002 (which ranged from 9.9% to 16.3% when the effect of the change in accounting principle in 2002 is excluded). Since a given CLEC will not have the economies of scale and scope available to BellSouth, it seems unreasonable to suggest that any CLEC will be able to generate rates of return two to three times higher than BellSouth's own reported return on total capital.

Q. Does this conclude your rebuttal testimony?

A. Yes.

[9] Direct Testimony of Randall Billingsley, December 4, 2003, p. 3.
[10] Direct Testimony of Randall Billingsley, December 4, 2003, p. 10.