

1 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**

2 **SURREBUTTAL TESTIMONY**

3 **OF**

4 **KENT W. DICKERSON**

5
6 **INTRODUCTION**

7
8 **Q. Please state your name, business address, employer and current position.**

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

12
13 **Q. Are you the same Kent W. Dickerson who filed Direct and Rebuttal**
14 **Testimony in this case for Sprint?**

15 A. Yes.

16
17 **Q. What is the purpose of your Surrebuttal Testimony?**

18 A. The purpose of my Surrebuttal Testimony is to provide additional evidence and
19 discussion regarding errors contained within BellSouth's potential deployment
20 case. Specifically, I will further highlight problems with BellSouth's BACE
21 model (Model) inputs and potential deployment case relative to CLEC collocation
22 costs, General and Administrative (G&A) expense estimates, and Customer
23 Acquisition Costs. I will also provide and discuss four straightforward sensitivity
24 analyses of the BACE model which demonstrate its results to be illogical and

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1 unreliable, thus rendering BellSouth's claims of non-impairment based on
2 potential deployment lacking credible evidence or support.

3
4 **BACE Model Errors – Collocation**

5
6 **Q. In your rebuttal testimony you presented an analysis of Sprint's externally**
7 **computed collocation build-out costs to those estimated by the BACE model**
8 **(See Exhibit KWD-4). Has Sprint's discovery requests to BellSouth resulted**
9 **in any evidence from BellSouth which could explain the dramatic**
10 **understatement of collocation build-out cost demonstrated by Exhibit KWD-**
11 **4 (554%)?**

12 **A.** No. In fact BellSouth's response to Sprint's Fifth Set of Interrogatories, No. 15
13 (See Exhibit KWD-9), provides further evidence that the BACE model cost
14 estimates severely understate a CLEC's cost to establishing collocations within
15 BellSouth central offices. I would first point out that BellSouth's response admits
16 that the BACE model collocation build-out cost calculations cannot be seen as
17 follows:

18 Sprint Request

19 "e. Where in the model can calculations of such engineering costs be viewed?"

20 BellSouth Response

21 "e. The calculations cannot be viewed within the BACE Model."

22 This same Sprint Interrogatory No. 15 requested that BellSouth identify if the
23 BACE model accounted for CLEC engineering costs for DC power cables, cross
24 connect cables and collocation equipment and, if so, where in the Model it was
25 located. BellSouth's response claims these necessary CLEC collocation costs are

1 buried in “In-Plant Factors” derived from BellSouth’s internal cost records while,
2 at the same time, admitting none of their claim can be viewed and thus verified by
3 an external party such as Commission Staff or Sprint.

4
5 **Q. Do you believe BellSouth’s claim that “In-Plant Factors” derived from**
6 **BellSouth’s internal cost records and then buried somewhere in the BACE**
7 **Model’s invisible calculations, provides adequate assurance these costs have**
8 **been properly estimated and included in the estimate of CLEC collocation**
9 **build-out costs?**

10 **A.** No, for several reasons. The first and most obvious reason I do not accept
11 BellSouth’s claim is because of the extreme understatement (554%) of CLEC
12 collocation build-out costs demonstrated in Exhibit KWD-4 of my rebuttal
13 testimony. Construction costs of DC Power cables are an integral part of a CLEC
14 collocation build-out costs and, while it is convenient for BellSouth to offer
15 unsubstantiated claims that these costs are, in some fashion, buried in “In-Plant
16 Factors” contained elsewhere in the BACE Model, this explanation does not
17 stand up to a simple test of logic. As stated above, CLECs’ construction costs of
18 DC Power cables are integral to the “build-out” costs of CLEC collocation space
19 and yet BellSouth now claims these costs are not logically intended to be captured
20 in their understated BACE model ColloBuildOut calculations. Rather, BellSouth
21 asks the Commission and all other parties including Sprint to accept, without
22 evidence, that these costs are buried in factors and unseen calculations contained
23 elsewhere in the “private” BACE Model. This is, at a minimum, an extremely
24 illogical approach to estimating CLEC costs of constructing DC Power cables as
25 part of collocation build-outs.

1 BellSouth's assurance is also implausible given the fact that BellSouth does not
2 perform the engineering and construction of DC power and Cross-connect cables
3 on behalf of CLECs. Instead, BellSouth requires CLECs to bear these costs
4 directly via the CLECs contracting this work themselves using BellSouth
5 approved contractors. Therefore, "In-Plant Factors" derived from BellSouth's
6 internal records would not reflect a CLEC's construction costs (which were never
7 incurred by BellSouth) and thus never reflected in BellSouth's internal accounting
8 records.

9
10 **Q. Ignoring for the moment the fact that BellSouth's internally derived "In-**
11 **Plant Factors" do not include CLEC's collocation construction costs (which**
12 **are never borne by BellSouth), does BellSouth's assurance otherwise make**
13 **sense?**

14 A. No, it does not. Starting at the bottom of page 40 of the BACE Model
15 Methodology Manual, the following explanation is provided:

16 "ApplyLoadings (Network Cost table only)"

17 "The Yes/No flag indicates whether BACE should apply the InPlant and Loadings
18 factors from the InPlantAndLoadings table to the cost record. Possible entries
19 include Y or N. Typically, costs that are capital expenditures represents material
20 only and will require the application of InPlant and Loading factors and have
21 ApplyLoadings set to "Y". "

22
23 The ApplyLoadings indicator for all ColloEquipment items contained in
24 BellSouth's filing (including Cross-Connect cabling, which was a subject of
25 Sprint Interrogatory No. 15) was set to "N" thus rendering BellSouth's claim

1 unquestionably false. Even if their “In-Plant Factors” could somehow be
2 accepted to include CLEC costs never incurred by BellSouth, the fact that
3 BellSouth’s filing did not apply those factors to CLEC collocation equipment
4 proves BellSouth’s filing excludes these substantial and necessary costs. This
5 omission of CLEC collocation build-out costs understates each CLEC collocation
6 within the BACE Model and renders the EELs vs. Collocation “Optimization”
7 unreliable as well. Ultimately, this substantial cost omission renders BellSouth’s
8 cumulative NPV figures and their associated claims of CLEC non-impairment
9 inaccurate and unreliable as well.

10
11 **BellSouth Potential Deployment Errors – G&A Expenses**

12
13 **Q. In your rebuttal testimony you expressed concern with BellSouth’s use of a**
14 **linear factor relationship to revenues in order to estimate what Dr. Aron**
15 **described as CLEC General and Administrative expenses. Do you have**
16 **further evidence to offer on this subject?**

17 **A.** Yes. Attached as Exhibit KWD-10 to this testimony is Sprint’s Third Set of
18 Interrogatories, No. 6 and BellSouth’s corresponding response. Starting at the top
19 of page 2 of 3 and continuing on to page 3, it is immediately evident that Dr. Aron
20 has erroneously classified numerous FCC Part 32 investment related expense
21 accounts as “G&A expenses”. Obvious errors in Dr. Aron’s G&A expense
22 groupings include her inclusion of Network Support expense (Accounts 6110 –
23 6116), General Support expense (Accounts 6120 – 6124), Provisioning (Account
24 6512), Network Operations expense (Accounts 6530 – 6535) and Customer
25 Services expense (Accounts 6620 – 6623). Even a casual examination of the FCC

1 Part 32 account structure instructs that these expense accounts are not General and
2 Administrative expenses as Dr. Aron asserts, but rather are costs associated with
3 either investment related activities (Accounts 6110 - 6116, 6120 - 6124, 6512, and
4 6530 - 6535), or customer related activities (Accounts 6620 -6623). These errors
5 in Dr. Aron's "expense mapping" are compounded through her use of a linear
6 factor relationship of 28.4% of revenues (15% for long distance revenues) to
7 estimate these expenses. Investment related expenses such as Network Support,
8 General Support and Network Operations cannot be perfectly managed in lock
9 step with revenues as Dr. Aron's approach argues. Further, varying levels of
10 customer churn will directly affect customer service expenses while having a
11 much lower impact, or potentially no impact, on revenues. These additional errors
12 in BellSouth's CLEC expense estimation process provide yet another
13 demonstration that BellSouth's BACE Model NPVs are inaccurate and unreliable
14 for purposes of examining CLEC non-impairment in Mass Market Switch self-
15 provisioning.

16
17 **BellSouth Potential Deployment Errors – Residential Customer Acquisition Costs**

18
19 **Q. In your rebuttal testimony, you discussed your concerns with BellSouth's**
20 **proposed values for estimating CLEC customer acquisition costs. Have you**
21 **performed additional research in this area?**

22 **A.** Yes. As part of her testimony, Dr. Aron presented an Exhibit DJA-06 which
23 presented some figures alleged to be CLEC mass market customer acquisition
24 costs. In Sprint's First Request for Production of Documents (POD), Item No. 21
25 Sprint requested, and received from BellSouth, the external documentation

1 referenced in Exhibit DJA-06 enabling me to now comment further on this area of
2 concern.

3

4 **Q. According to Exhibit DJA-06, Z-Tel's customer acquisition target cost is \$50**
5 **and Z-Tel's actual cost is \$60-\$70. Do you agree with these figures?**

6 A. No. The actual quote from the DJA-06 referenced source document (POD Item
7 No. 21), the Thomas Weisel Partners report on Z-Tel Technologies (Exhibit
8 KWD-11) states,
9 "Z-Tel is making an increased effort to lower its customer acquisition costs to
10 below \$50 from roughly \$100-\$120 excluding TV advertisements..."
11 (Emphasis added.)

12

13 **Q. Are Z-Tel's customer acquisition costs representative of those that would be**
14 **incurred by a CLEC building market share, as BellSouth's BACE Model**
15 **filing purports to model?**

16 A. No. Dr. Aron fails to mention that Z-Tel was reporting a loss of 40,000 customers
17 and a 6% decline in revenue for that current quarterly period. This loss followed a
18 loss of 80,000 customers for the previous quarter. This cumulative loss of 120,000
19 customers on a starting base of 380,000 customers is a negative growth rate of
20 (31%) for just a six-month period. This does not represent the extremely fast
21 growing CLEC depicted in BellSouth's BACE Model filing. As noted above, the
22 Z-Tel actual costs exclude mass market television advertising which is also
23 inconsistent with the CLEC market penetration assumed in BellSouth's BACE
24 Model filing.

25

1 **Q. According to Exhibit No. DJA-06, Talk America's residential customer**
2 **acquisition cost is \$80. Do you agree with this number?**

3 A. No. Documentation in Talk America's Form 10-K filed with the SEC for the
4 fiscal year ended December 31, 2002, indicates a much higher cost. Talk
5 America's Form 10-K indicates the company incurred \$27.1 million in sales and
6 marketing expenses during 2002 while adding 154,000 new bundled (local and
7 long distance) customers. This would compute to an average customer acquisition
8 cost of \$175 per customer ($\$27,100,000 / 154,000$) or more than double the \$80
9 figure used by Dr. Aron.

10

11

BACE Model Calculation Errors

12

13 **Q. Have you performed any further analysis which evidences errors in the**
14 **BACE Model calculations?**

15 A. Yes. In Exhibit KWD-12 (Revised 2/10/04) to this testimony, I provide the
16 Commission with four straightforward sensitivity analyses, which demonstrate the
17 BACE Model's internal workings and resulting NPVs to be illogical and
18 unreliable. I will now explain each of these.

19

20 In Exhibit KWD-12 (Revised 2/10/04) , I present key BACE Model results pulled
21 from the BACE Model output reports, NetIncome-Total (lines 7-19 of Exhibit
22 KWD-12 (Revised 2/10/04)) and CEA UneZone Reports (lines 23-34 of Exhibit
23 KWD-12 (Revised 2/10/04)). Columns D-G represents four distinct BACE Model
24 sensitivity analyses which demonstrate extreme problems with the BACE Model
25 NPV results.

1

2 **Q. Please describe Column D of Exhibit KWD-12 (Revised 2/10/04).**

3 A. Column D of Exhibit KWD-12 (Revised 2/10/04) presents the results of running
4 the BACE Model with the cumulative input changes contained and described in
5 Exhibit KWD-6 (Revised 2/12/04), Sprint Scenario 11 titled "Scenarios 2-10
6 Cumulative Changes", with one exception, that being the use of BellSouth's filed
7 values for customer acquisition costs as shown on rows 38-42 of Column D. This
8 BACE Model run produced a negative Pre-Tax NPV for Mass Market of
9 (\$16,197,39325,161,287) (1a) and a positive Pre-Tax NPV for Enterprise of
10 \$47,486,82343,993,504 (2a). Yet the BACE Model's after-tax NPV for Mass
11 Market is a positive \$17,280,92454,424,268 (1b) and a negative after-tax NPV for
12 Enterprise of (\$50,663,47295,158,656) (2b)! While it is proper to consider the
13 positive NPV impacts of reduced income taxes associated with a pre-tax negative
14 NPV for Mass Market, it is not conceivably possible for this to reverse the pre-tax
15 negative NPV to a positive after-tax NPV. Conversely, it is not possible for
16 income taxes to reduce the Enterprise NPV from a positive pre-tax value to a
17 negative after-tax value. Yet those are the results produced by the BACE Model!
18 While the BACE Model calculations cannot be traced within the model, it is
19 obvious that the Model's estimated Tax NPVs and after-tax NPVs for both Mass
20 Market and Enterprise are grossly in error.

21

22 **Q. Please describe Column E of Exhibit KWD-12 (Revised 2/10/04).**

23 A. Column E of Exhibit KWD-12 (Revised 2/10/04) presents the results of running
24 the BACE Model with the inputs used to generate Column D, except that Column
25 E uses the increased sales cost input values as shown on rows 38-42 of Column E

1 (versus the lower BellSouth values used in Column D). Please note this single
2 input value modification increases sales costs for both Mass Market and
3 Enterprise. (This single change can be verified by comparing the values on rows
4 7-13 in the respective columns and noting that they remain constant but for Sales
5 Expenses on Row 11 as described for each column.) Yet this single value change,
6 which increases sales costs for all customers including Enterprise, drives the after-
7 tax NPV for Enterprise from a negative (\$95,158,65650;663,472) (2b) to a
8 positive \$8,144,28013;268,463 (2c)! It defies logic to suggest than an increase in
9 sales costs would drive the NPV results of serving Enterprise customers from
10 negative to positive and yet that is the erroneous result the BACE Model yields.

11

12 **Q. Please describe Column F of KWD-12 (Revised 2/10/04).**

13 A. Column F starts with Column E and reduces only the sales cost for Enterprise
14 customers as shown in rows 39-43 of Column F versus the same in Column E.
15 Once again the BACE Model produces extremely anomalous results. Under this
16 scenario, the BACE Model results depict that it is somehow possible to increase
17 the losses for negative after-tax NPV Mass Market from
18 (\$133,625,579136,455,897) (1c) to (\$200,876,950227,115,584) (1d), when no
19 changes were made to Mass Market input values and in fact, a sales cost reduction
20 for Enterprise was the only input value altered!

21

22 **Q. Please describe Column G of KWD-12 (Revised 2/10/04).**

23 A. Column G simply reverses the sensitivity performed in Column F and reduces the
24 sales cost input values for Mass Market from the levels used in Column E, while
25 holding the values for Enterprise customers in Column G constant to Column E.

1 This BACE Model run yields effectively the same error described for Column F
2 above. Although the Enterprise customer sales costs are held constant and the
3 Mass Market customer sales costs are reduced, the BACE Model results from this
4 run increasedreduced the after-tax NPV for Enterprise customers from a positive
5 \$8,144,28013,268,463 (2c) to a negative (\$66,137,65276,855,450) (2d).

6

7 These straight forward sensitivity analyses presented in Exhibit KWD-12
8 (Revised 2/10/04) demonstrate the BACE Model NPV results to be fatally flawed
9 and unsuitable for the conclusions asserted by BellSouth.

10

11 **Q. Does this conclude your Surrebuttal testimony?**

12 **A. Yes.**

13

14

15

16