REBUTTAL TESTIMONY OF
J. BRADFORD BRANCH

Before the

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 920260-TL

December 10, 1993

Attachment B
Redacted
Not Proprietary

Q. Please state your name, address and occupation.

A. My name is J. Bradford Branch. My business address is 100 Peachtree Street, N.E., Atlanta, Georgia 30303. I am a general partner in the accounting, auditing and management consulting firm of Deloitte & Touche ("D&T").

Q. Would you briefly summarize your academic and professional background?

A. I received a Bachelor of Arts degree in Business Administration from the University of North Carolina (Charlotte) and a Master of Business Administration from the University of North Carolina (Chapel Hill). Over the past 15 years, I have practiced in the accounting and auditing division of D&T, serving regulated clients in telecommunications, gas and electric industries and public and private commercial entities in a variety of industries including real estate, manufacturing and distribution.

Q. What is your role within D&T?

A. I am D&T's National Audit Partner for the Telecommunications Industry practice. In this capacity, I provide technical support on accounting, auditing and regulatory accounting matters to D&T practice offices serving telecommunications industry clients. My major activities in this role include (i) providing representation to and/or monitoring pertinent activities of groups formulating telecommunications industry accounting policies (e.g. AICPA, Federal Communications Commission), (ii) serving as D&T's representative at industry accounting forums, and (iii) providing technical accounting advice and opinions. I have provided technical consultation on the accounting and reporting requirements for affiliated interest transactions and the reporting requirements pertaining to the Joint Cost Order of the Federal Communications Commission on numerous occasions.

I also serve as an accounting and auditing services partner responsible for the overall supervision of audit and attest services provided to regulated industry clients. In this capacity, I have supervised numerous engagements requiring the application of affiliate transaction rules of the Joint Cost Order of the FCC.

Q. Are you licensed as a Certified Public Accountant?

A. Yes. I am licensed as a Certified Public Accountant in the state of Florida and numerous other states.

Q. Have you previously testified as an expert witness on accounting and regulatory issues?

A. Yes. I previously testified before the Louisiana Public Service Commission (Docket No. U-17949 - Subdocket A) on accounting and management auditing matters pertaining to affiliated interest transactions, joint cost allocations and other regulatory issues.

Q. What is the purpose of your testimony?

A. Southern Bell Telephone and Telegraph Company has requested that I respond to positions taken by Office of Public Counsel witness Kimberly H. Dismukes ("Ms. Dismukes") in testimony filed November 8, 1993 (Docket 920260-TL), pages 62 through 85, and related exhibits.

The positions that I address relate to real estate transactions involving BellSouth Corporation ("BSC") and certain BSC affiliates. Specifically, my testimony: (1) responds to Ms. Dismukes' recommended disallowances pertaining to the Campanile Building, the Miami warehouse, and the Jacksonville warehouse, (2) discusses Ms. Dismukes' application of the affiliate transaction pricing provisions of the Federal Communications Commission, USOA Part 32 and Part 64 and the Joint Cost Order, and (3) corrects substantial factual errors and omissions in Ms. Dismukes' testimony. My testimony is organized in three sections: (1) Campanile building issues, (2) Miami warehouse issues and (3) Jacksonville warehouse issues.

SPECIFIC ISSUES RELATED TO THE CAMPANILE BUILDING

Q. Please summarize the relevant facts surrounding BellSouth Corporation's lease of office space in the Campanile Building in Atlanta?

A. BellSouth Corporation leases office space in the Campanile building at 1155 Peachtree, a location approximately two miles north of what is generally considered downtown Atlanta. The Campanile Building is owned by 1155 Peachtree Associates, a joint venture between BellSouth Corporation and CA Fourteenth Investors, Ltd. The building serves as headquarters office space for BSC and provides space to BSC affiliates and other non-affiliated companies. Attached hereto as **Exhibit JBB-1** is a summary of the primary tenancy of the Campanile as of September 1, 1993 according to Schedule 16 of Ms. Dismukes' testimony. According to this schedule, BSC leases approximately 67.2% of the building and the largest non-affiliated tenant, Coopers & Lybrand, leases 16.3% of the building. Space leased to BSC and affiliated entities totals approximately 72.6% of the building.

BSC treats its lease of the Campanile building space as an affiliate transaction. The affiliate transaction pricing rules applied by BSC to the lease payments to 1155 Peachtree Associates (and subject to allocation to BST, as a component of corporate expense charges) are those dictated by the FCC in CFR 47, Section 32.27(d) of the Uniform System of Accounts, CFR 47, Section 64.901 and the FCC's Joint Cost Order (FCC Docket 86-111). These rules require that transactions between regulated and non-regulated affiliates be governed by the following pricing hierarchy:

> "Services provided to an affiliate pursuant to a tariff, including a tariff filed with a state commission, shall be recorded in the appropriate revenue accounts at the tariffed rate. ["tariff pricing"] Services provided by an affiliate to the regulated activity, when the same services are also provided by the affiliate to unaffiliated persons or entities, shall be recorded at the market rate. ["prevailing market rate pricing"] When a carrier provides substantially all of a service to or receives substantially all of a service from an affiliate which are not also provided to unaffiliated persons or entities, the services shall be recorded at cost which shall be determined in a manner that complies with the standards and procedures for the apportionment of joint and common costs between the regulated and non-regulated operations of the carrier entity." ["fully distributed cost pricing" or "FDC"] (CFR 47, 32.27(d))

BSC's lease of office space in the Campanile Building is not governed by any tariff. BSC believes that 1155 Peachtree Associates participates in a substantial outside market in its leases of space in the Campanile building to non-affiliate tenants, and therefore, has applied the "prevailing market rate" affiliate pricing rule to this transaction. This pricing methodology is specified in BSC's Cost Allocation Manual, filed with the FCC, and has been subject to annual independent audits, without exception.

Of critical importance, if neither the "tariff pricing" provisions nor the "prevailing market rate pricing" provision of Section 32.27(d) and Section 64.901 were applicable to this transaction, then BST would be required to compensate the non-regulated affiliate for its allocation of the charge for leased space using fully distributed cost pricing.

Q. **Please describe how BSC applied prevailing market rate pricing in the Campanile lease.**

A. In applying the prevailing market rate pricing, BSC was required to charge BST, through allocation, not more than the price charged to the most comparable non-affiliate tenant in the building which was, in this case, Coopers & Lybrand (C&L). C&L leases 16.3% of the available building space.

As Ms. Dismukes acknowledges [line 7-9, page 67], BSC performed an appropriate comparison of lease rates between BSC and C&L using a net present value methodology. The comparison considered tenant improvement allowances, rent abatements, moving allowances, differences between the rent per square foot, the timing of the cash flows of each lease and the time value of money. This comparison demonstrated that the lease rate payable by BSC to 1155 Peachtree Associates exceeded the prevailing market rate payable by C&L . The comparison further showed that an amount of $ per square foot of BSC lease space should be retained by BSC beginning in 1993 and should not be subject to allocation to BST. The application of this retention amount was necessary to account for both future and historical differences and equalize net present value, all in compliance with prevailing market rate pricing.

Q. **Does Ms. Dismukes recommend an adjustment regarding the Campanile Building and this retention amount?**

A. Yes. On page 73, lines 7-10, Ms. Dismukes recommends an adjustment of $93,380. The purpose of this adjustment is to "put the BSC lease in terms comparable to the Coopers & Lybrand lease." This adjustment is based upon the $ per square foot figure determined by BSC through the analysis, undertaken of their own volition, as described above.

Ms. Dismukes, however, makes this recommendation based on speculation that BSC is not currently retaining this amount. On page 67, line 19 Ms. Dismukes refers to a memorandum that she reviewed that recommends that BSC increase the amount of the BSC Campanile lease payment that is retained by BSC to $ per square foot on a going forward basis. Instead of verifying that BSC followed through on its stated intention, Ms. Dismukes merely states, "It is unclear however, what option, if any, BSC chose." Had she investigated this matter further, Ms. Dismukes would have learned that BellSouth Corporation, had, in fact, increased the retainage amount to $ per square foot.

According to page 1 of POD item # 736, attached hereto as **Exhibit JBB-2**, produced by BellSouth in response to Office of Public Counsel's 48th POD, an internal BellSouth memo dated November 24, 1992, from Frances Dennis, Operations Manager - BST Comptrollers to John Robinson, Operations Manager - BSC Comptrollers and Mike Denson, Operations Manager - BSC Corporate Support, indicates that the Company intended to increase the retained charge to $ per square foot effective January 1, 1993. Furthermore, I have verified that $ per square foot is actually being retained by BSC.

Given the above facts, no adjustment is warranted or required, as the appropriate amount is already being retained. Any adjustment would overstate the retained amount. Therefore, Ms. Dismukes' recommendation regarding this issue is not substantiated by the facts. In reality, the facts available in this proceeding, readily available from BST, and actually provided in POD item # 736 are in direct contradiction to Ms. Dismukes' recommendation. No action should be taken by the Commission as a result of Ms. Dismukes' recommendation on this issue.

Q. **Do you have any views about Ms. Dismukes' statements regarding the existence of a substantial outside market for purposes of applying prevailing market rate pricing based upon a 16% to 18% share of the total rentable square footage?**

A. Yes. The FCC has not clearly defined what constitutes a "substantial outside market". BSC believes that a substantial outside market exists for the Campanile building. Ms. Dismukes is apparently ambivalent on this point stating that, "basing the BSC lease on the lease rate paid by C&L does not conform to the FCC's JCO rules, unless one believes that 16% to 18% represents a "substantial" outside market." [line 14, page 69] In this case, BSC believes that a lease of 16% to 18% of a building does represent a substantial outside market. Indeed, according to information provided in response to Florida Public Service Commission Staff data requests 2-054, Attachment G and 2-131, over 27% of building space is not leased by affiliates and approximately 27% of 1992 building revenue is not from affiliates. This is a further indication that a significant portion of the building is attributable to non-affiliate activities and a substantial outside market exists.

Q. **What would be the result if a substantial outside market did not exist for the Campanile building?**

A. If prevailing market rate were not the appropriate pricing rule to govern the charges to BST for BSC's Campanile building lease, the fully distributed cost pricing methodology would be required by the affiliate transaction pricing rules specified by CFR 47, Part 32.27(d) and the FCC's Joint Cost Order. In other words, the pricing hierarchy established by the FCC does not allow for the arbitrary selection of a pricing methodology for affiliate transactions. Fully distributed cost is required in cases where tariffs or prevailing market rates are not appropriate for use.

Q. Have you performed an analysis of the cost to BST of the Campanile lease space if fully distributed costing were used?

A. Yes. My analysis shows that if prevailing market rate pricing were not allowed to be used by BSC, and, consequently, BSC was then required to use fully distributed cost as the pricing rule governing the Campanile lease, the cost to the ratepayer would increase significantly. Simply put, the fully distributed cost of BellSouth Corporation's lease of Campanile Building space is much greater than the prevailing market rate. The following table compares the charge per square foot for BSC's leased space under prevailing market rate pricing and the same charge using fully distributed cost pricing for 1992. As shown below for 1992, the total fully distributed cost per square foot for BSC's leased space of [redacted] would increase BSC's charge to BST's regulated operations by 53%. If the fully distributed cost for 1992 of $[redacted] remained the same during 1993, and was used to determine charges to BST for the Campanile lease instead of the market rate for 1993 of [redacted] (after applying the [redacted] retention) the charge to BST's regulated operations would increase by 75%.

	Under Fully Distributed Cost	Under Prevailing Market Rate	Increase Required
Effective 1992 BST Rate	$[redacted]	$[redacted]	53%

Q. Have you prepared an Exhibit which supports your FDC computation?

A. **Exhibit JBB-3** contains the computations supporting the FDC lease rate specified above. **Exhibit JBB-3** was created by extracting estimated cost and investment information from OPC POD #794, by using the current pretax allowable rate of return, and by applying the current BSC and affiliate company occupancy percentage specified by Ms. Dismukes' Schedule 16 (reproduced herein on **Exhibit JBB-1**). Headquarters operating expenses, included in the FDC analysis, were estimated based on historical information provided by BSC, updated at an estimated five percent annual rate of increase.

Q. Can you briefly summarize what this analysis demonstrates?

A. It demonstrates that the discontinuance of prevailing market rate pricing would significantly increase the 1993 cost of the Campanile lease to BST's regulated operations, and therefore, to ratepayers. This is particularly important considering Ms. Dismukes' view about the prospective application of the FCC's proposed revision to affiliate transaction rules expressed in the Notice of Proposed Rulemaking ("NOPR"), FCC Docket No. 93-251, dated October 20, 1993. Ms. Dismukes expresses the view, beginning in line 18, page 70 of her testimony, that "without a doubt the use of the C&L lease does not fall near the FCC's proposed standard" [for use of prevailing market rate]. Fully distributed cost would therefore be required to be used as a consequence. Fortunately, Ms. Dismukes' speculation of the effects of the NOPR is irrelevant for the 1993 test year, as the FCC has made no final ruling.

Q. Does Ms. Dismukes have another recommended adjustment pertaining to the Campanile building?

A. Yes. On page 73, Ms. Dismukes recommends, "that the Commission reduce the lease charged to BSC by 10% to reflect the fact that the marketing costs and business risk associated with the lease should be minimal. This would reduce BSC lease expense for the Campanile building by $ and the amount charged to the Company's intrastate operations in 1993 by $104,777." This recommendation, and the underlying logic offered in its support, is flawed because:

1. Ms. Dismukes' recommendation is arbitrary and ignores the value of the substantial benefits of purchasing from affiliates.

2. The pricing rule recommended by Ms. Dismukes, namely "market rate less 10%" is not recognized by any of the affiliate transaction pricing rules available to the Company; proscribing the use of prevailing market rate pricing would cause the pricing methodology to revert to fully distributed cost, to the ratepayers detriment,
3. Ms. Dismukes' proposal to reduce the amount charged to BSC, a non-regulated entity, and to 1155 Peachtree Associates, another non-regulated entity, is not actionable by BST, and
4. The calculation supporting her recommendation is methodologically incorrect.

First, Ms. Dismukes' recommendation is completely arbitrary. She recommends a 10% adjustment to BSC's market-based lease rate based upon the perception that marketing costs and business risk associated with BSC's lease of office space in the Campanile building are lower than marketing costs and business risk of leases to non-affiliated tenants. But, at the same time, Ms. Dismukes ignores the significant benefits and cost savings to BSC, as lessee, of doing business with an affiliate that has knowledge of BSC's special needs. She offers no quantification or method for measuring the difference in "business risk" between leasing to Coopers & Lybrand versus leasing to BST supporting her determination that a 10% adjustment is appropriate.

Not only does this suggestion of a ten percent reduction have no basis in fact, a pricing rule of "market rate less 10%" is not available to BSC under the FCC affiliate transaction pricing rules. If prevailing market rate was not the appropriate pricing rule to govern the Campanile building lease, BSC would be required under CFR 47, Part 32.27(d) to revert to the fully distributed cost of leasing its space in the building. This reversion would cause a substantial increase in the allocated cost to BST's regulated operations.

Furthermore, Ms. Dismukes proposes reducing the amount charged to BSC [line 3, page 73] a non-regulated entity, which is not actionable by BST, the entity which is subject to the rules of the Florida Public Service Commission.

And finally, based upon the information in Ms. Dismukes' testimony on page 63, line 20, the Company's 1993 intrastate operations were budgeted to be charged $773,000 for BSC's leases of the Campanile building. Applying Ms. Dismukes' recommended 10% reduction yields a result of $77,300, not the $104,777 specified in Ms. Dismukes' testimony [line 6, page 73]. The computation appears to be mathematically incorrect.

Due to the inherent flaws, lack of any meaningful substantiation, and the arbitrary nature of Ms. Dismukes' recommended adjustment that "market less 10%" is the appropriate pricing rule for BSC's Campanile lease, and the potential for reversion to the more costly FDC based lease rate should prevailing market rate pricing not be used, I can find no reason for the Commission to act on her recommendation.

Q. **Do you have any further views about Ms. Dismukes' mention of potential discrepancies between BSC's lease rate as compared with BellSouth Enterprise's ("BSE") lease rate or BellSouth Information System's ("BIS") lease rate?**

A. Yes. There are many factors which influence individual lease rates including the condition in which the space is provided to the tenant, the condition of the market at the time the lease was negotiated, the size of the space, and any amenities. The differences in leasing rates that Ms. Dismukes indicates [line 18, page 68] are primarily due to the differences in the terms of the leases and the condition of the space as provided to BSE and BIS.

For example, the space BIS currently leases is the building's uppermost floor, which is considered substandard for office space; accordingly, the rate is much less. Landlords typically rent such space as storage to enhance revenue. BIS' space on the 21st. floor of the Campanile building is best described as equipment/mechanical space, and has limited access. Therefore, it should be no surprise that the lease rates are different.

Q. Can you summarize your opinion regarding the portion of Ms. Dismukes' testimony concerning the Campanile building?

A. Yes. Ms. Dismukes' conclusions regarding the Campanile building are not supported by the evidence. Her analyses are faulty and incomplete. No action should be taken based upon her testimony and no adjustments are necessary.

SUNLINK'S LEASE OF THE MIAMI WAREHOUSE SPACE TO BST

Q. Ms. Dismukes recommends an adjustment of $54,030 to exclude the expenses associated with the unused portion of the Miami warehouse. Is this adjustment justified?

A. No. Ms. Dismukes bases her recommendation upon the space in the Miami warehouse not being "used and useful" [lines 7-9, page 85]. A brief description outlining the history of the Miami warehouse is needed to correctly describe the facts.

Title to the Miami warehouse, referred to intermittently by Ms. Dismukes as the Miami warehouse or the Ojus warehouse, was transferred to Sunlink as part of the divestiture agreement. From divestiture until 1989, BellSouth Services Incorporated (BSSI) leased the warehouse space from Sunlink. In 1989, BSSI vacated the warehouse due to a consolidation of two warehouses, one in Jacksonville and one in Miami. Ms. Dismukes' testimony is correct on these facts. However, contrary to the testimony of Ms. Dismukes, between 1989 and August, 1992, BSSI or BST did not lease space or pay rental charges for the Miami warehouse.

On August 24th, 1992, Hurricane Andrew hit Florida leaving massive destruction behind. Within the week, BST responded to a request from the Salvation Army for warehouse space and entered into a commitment with Sunlink to lease the unused Miami warehouse. BST committed that it would reimburse Sunlink only for all direct operating costs associated with the space. BST then gave use of the space to the Salvation Army's, "We Will Rebuild" effort as an "in kind" contribution for a period of 13 months ending September 30, 1993. On October 1, 1992, BST entered into a written lease agreement for the Miami warehouse with Sunlink in exchange for $1 per year plus additional charges in the amount of all utility, tax, security and any other direct expenses related to the operation of the warehouse. This information was provided to the OPC in POD items #461 and #826(b). Furthermore, the rent and expense associated with the Miami warehouse were charged to account 7370 - Special Charges (Contributions). According to FCC CFR 47, Part 32.7370, charges booked to the 7370 account series "are presumed to be excluded from the costs of service in setting rates."

Beginning September 1, 1993, BST amended its lease with Sunlink for the Miami warehouse to extend the term to June 30, 1994 in exchange for $ per month rent net of expenses. BST and the Salvation Army's, "We Will Rebuild" entered into a lease for $ per month payable to BST. The includes an additional amount for janitorial services not included in the Sunlink agreement. This contract is to effectively reimburse BST for costs incurred in connection with the Miami warehouse to the Salvation Army's, "We Will Rebuild" campaign.

It is unclear why Ms. Dismukes did not follow through and determine the final resolution of this situation. Ms. Dismukes' analysis is incomplete and the recommended adjustment of $54,030 should not be made.

SUNLINK'S LEASE OF THE JACKSONVILLE WAREHOUSE SPACE TO BST

Q. Ms. Dismukes recommends an adjustment of $295,030, referenced as "Sunlink Lease" on Schedule 19 of Exhibit_(KHD-1). What issues do you have with this recommended adjustment?

A. Ms. Dismukes briefly discusses the comparison she did to "correct for flaws" [line 3, page 82] and based upon this comparison proposes an adjustment of $295,030. Ms. Dismukes fails to provide sufficiently detailed calculations used to determine the value of each factor or the source for the factor if she did not derive it. The $295,030 is an aggregate amount and cannot be broken down into amounts associated with each adjustment. The accuracy and legitimacy of these figures, therefore, cannot be determined.

However, even assuming the values associated with each factor are correct mathematically, there are several problems with her reasoning. First, her assumption that BST will renew its lease [line 17, page 82] is purely speculative. In fact, I understand from the BST Property Management group that BST may purchase three of the Sunlink warehouses. Thus, Ms. Dismukes' argument about BST's exposure to future cost increases is not only speculative, but will perhaps be moot. These charges would simply cease to be affiliate transactions. The potential purchase of the warehouses clearly demonstrates speculation should not be taken into consideration.

Furthermore, Ms. Dismukes calculates ten different figures [Schedule 17 of Exhibit _(KHD)-1] and recommends one without supporting why that particular recommendation is the appropriate adjustment instead of any of the other calculations she derives.

The most important flaw in Ms. Dismukes' argument, however, is that her comparison is based upon a flawed presumption that a fully distributed cost computation should be considered on a net present value basis, but applied only to current and future projected costs. In other words, her comparison ignores prior underrecoveries of allowable costs computed under FDC.

Q. **With regard to the last point, what is wrong with the idea of applying the time value of money concept to FDC comparisons in this manner?**

A. Applying the standard financial concept of time value of money (net present value) is a valid method when comparing known and measurable cash flows for a given period of time. An example of this would be comparing the net present value of two lease payment streams, given the life of the lease and the amount of rent paid in each year. This allows a comparison of the two, taking into consideration the timing and amounts of all future cash flows. Ms. Dismukes, however, seems to equate FDC cost for the warehouse, which is not being paid by BST, to a hypothetical stream of cash flows. She then seeks to compare this to the real stream of lease payments but only for the present and future - ignoring all prior periods. The concept of time value of money cannot be validly applied in this manner to compare a lease payment stream to fully distributed cost. FDC is simply a cost allocation mechanism prescribed by the FCC's Joint Cost Order to allocate historical and current period costs that have been incurred and are known. Costs cannot be precisely forecast into the future, unlike a written lease which explicitly sets the cash flows.

BST's policy for these leases is to limit the cumulative lease payments established under the terms of a lease agreement to not more than cumulative FDC cost for the warehouse space.

The mechanism used by BST to assure that the cumulative lease payments for the Jacksonville warehouse are less than FDC is straightforward. Each year, BST compares the actual lease payments for the current annual period with the affiliated lessor's fully distributed cost of providing the warehouse space. Any excess of lease payments over FDC or, conversely, any excess of allowable recovery by the lessor at FDC over the actual lease payments in the current period is added to the cumulative excess of FDC over BST's actual lease payments for prior periods. This computation determines that, on a cumulative basis for all periods to-date, the prices actually paid by BST are <u>no more than</u> allowable costs which could be recovered by the affiliated lessor under FDC pricing.

If the cumulative charges actually paid by BST were to exceed the cumulative FDC calculations, BST would make an adjustment equal to the difference.

It is equally interesting to note that (although applying net present value to FDC is not appropriate in this instance) a net present value computation, applied in a situation where the actual lease payments are always less than or equal to the fully distributed cost (on a cumulative basis at the end of each year) will produce a result whereby the net present value of those lease payments will always <u>be less than</u> the net present value of the FDC costs. Ms. Dismukes' reasoning is flawed in that her net present value computations conveniently ignore all historical periods where BST's actual lease payments for the Jacksonville warehouse have always been less than the fully distributed cost of providing the warehouse space. Her net present value assessment is applied only to current and future periods, and the cumulative underrecovery of allowable FDC costs are ignored.

Q. Do you have any comments on the way Ms. Dismukes calculated the fully distributed cost she used?

A. Yes. In addition to the above mentioned shortcomings in her analysis, she made several other errors in calculating fully distributed cost, including:

- Removal of certain Sunlink costs from FDC calculations
- Reduction of land value

Q. Can you discuss Ms. Dismukes removal of certain Sunlink allocated costs in her FDC calculations?

A. Ms. Dismukes also recommends removing certain Sunlink costs from the fully distributed cost analyses [line 20, page 83]. It is not clear as to which Sunlink costs Ms. Dismukes is referring, so I am assuming she is concerned with Sunlink working capital costs. Her reasons to exclude these allocated working capital costs include:

- "Dramatic" increase in these costs from 1984 to 1992 [line 16, page 80]
- These costs may have nothing to do with the warehouses [line 23, page 80] and no adequate explanation is given as to why these costs are excluded from the Colonnade office building comparison [line 12, page 80]

Q. What about these "dramatic" cost increases?

A. On page 80, line 6, Ms. Dismukes states, "from 1984 to 1992 this category of expense increased by 326% -- or over 40% annually." This does not take into consideration the compounding effect of the 8 year period. Ms. Dismukes does not take into consideration the time value of money which she espoused just two pages prior, nor does she attempt to determine the underlying reasons for the cost increases. The correct figure of which may be attributable to valid changes in underlying cost allocations, is very different from "over 40% annually".

Q. Why are these Sunlink working capital costs included in the warehouse comparisons, but excluded from the Colonnade comparison?

A. According to C&L workpaper 110.4, BSS pays all operating and maintenance expenses directly for the Colonnade property. Therefore, minimal Sunlink working capital is associated with maintaining and operating the property attributable to the Colonnade leases. Accordingly, these costs are allocated only to the warehouses in conformity with cost causative allocation principles, appropriate under the FCC's Joint Cost Order.

If these working capital costs are removed from the FDC calculations for the warehouses, it would not change the outcome of the comparison as demonstrated by **Exhibit JBB-4.**

Of additional note, the same analysis as JBB-4, prepared to exclude the "allocated costs" appearing on line 4 under the caption "Expenses," instead of excluding working capital, would also not change the outcome of this comparison.

Q. Finally, Ms. Dismukes factored in a reduced land value as a proposed adjustment to the lease rate on the Jacksonville warehouse. What specifically is incorrect with this adjustment?

A. Ms. Dismukes states on page 84, line 7 that her calculations reduced the land value from $426,842 to $275,494 "because in 1990 Sunlink sold a portion of the land that was attributed to the warehouse. Clearly, the land was not needed [during the first six years of the lease] to house the warehouse or it would not have been sold." Ms. Dismukes does not specifically mention the property to which she is referring. However, assuming she is referring to the Jacksonville warehouse, it appears that her analysis is in error.

It is unclear as to how Ms. Dismukes applied her recommended adjustment to the land value for the first six years of the Jacksonville warehouse lease, because, once again, she provides no information to support her recommended adjustment. If her adjustment were appropriate, then it should be applied to reduce the investment associated with the Jacksonville warehouse in the FDC computation. I have performed this calculation.

Using $275,494 as the value of the land in the FDC analysis from 1984 to 1989, as Ms. Dismukes proposes [line 7-9, page 84] does not, in fact, change the net result. This is because the appropriate application of such an adjustment would reduce the fully distributed cost of providing the warehouse space, but not by enough to make the lease payment greater than FDC. As demonstrated in Exhibit JBB-5, the cumulative lease payments associated with the Jacksonville warehouse remain less than the fully distributed cost of providing the warehouse space, even if the land value is reduced to $275,494. Therefore, no adjustment associated with this recommendation is warranted.

Q. Can you summarize your findings regarding Ms. Dismukes suggested adjustment of $295,030?

A. Yes, due to lack of support and incorrect assumptions, I cannot concur with Ms. Dismukes on this adjustment. No action should be taken by the Commission regarding the proposed $295,030 adjustment.

Q. Ms. Dismukes' testimony mentions several issues related to the Jacksonville warehouse expansions. What is your view of these issues?

A. Ms. Dismukes takes issue with the expansion of the Jacksonville warehouse because the Company failed to solicit bids for these projects from companies other than Sunlink [line 17, page 77]. This issue is not quantified nor is it related to any proposed adjustment.

However, I will address this issue so that the Commission may have an accurate understanding of this situation.

The Jacksonville warehouse was part of the property transfer settlement at divestiture. As of January 1, 1984, ownership of this property was transferred from Western Electric to Sunlink. At the time that the expansion was requested by the tenant (BellSouth Services) Sunlink owned and controlled the Jacksonville warehouse. This was not a purchase/lease-back transaction. As owner of the property, Sunlink was within its rights to contract the expansion to whomever it desired, including performing the work itself. As a non-regulated affiliate, Sunlink was not required to seek competitive bids. Sunlink could have also refused BellSouth Services' request for the expansion. Conversely, BellSouth Services was not required to lease this additional space from Sunlink and was free to seek additional space from other lessors if it considered Sunlink's proposal to be unacceptable.

As this issue is not related to any proposed adjustment, this portion of Ms. Dismukes' testimony should be ignored.

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

A. Yes.

EXHIBITS

- JBB-1: CAMPANILE STACKING PLAN (MS. DISMUKES SCHEDULE-16)
- JBB-2: CAMPANILE RETENTION MEMO, POD #736
- JBB-3: CAMPANILE FDC ANALYSIS
- JBB-4: WAREHOUSE FDC ANALYSES WITH WORKING CAPITAL REMOVED
- JBB-5: JACKSONVILLE WAREHOUSE FDC WITH REDUCED LAND VALUE

SOUTHERN BELL
DOCKET NO. 920260-TL
EXHIBIT JBB-1
WITNESS: BRANCH

Southern Bell
Docket No. 920260-TL
Exhibit__ (KHD-1)
Schedule 16
Witness: Dismukes

Southern Bell Telephone and Telegraph Company
Square Feet Leased at the Campanile Building

Floor	Tenant	Rentable Square Feet	Percent of Total
21	BellSouth Information Systems	5,351	1.2%
	BellSouth Corporation	3,107	0.7%
20	BellSouth Corporation	23,296	5.3%
19	BellSouth Corporation	23,296	5.3%
18	BellSouth Corporation	23,296	5.3%
17	BellSouth Corporation	23,296	5.3%
16	BellSouth Corporation	23,296	5.3%
15	BellSouth Corporation	23,296	5.3%
14	BellSouth Corporation	23,271	5.2%
13	BellSouth Corporation	22,886	5.2%
12	BellSouth Corporation	22,609	5.1%
11	Coopers & Lybrand	22,627	5.1%
10	Coopers & Lybrand	22,627	5.1%
9	Coopers & Lybrand	22,392	5.0%
8	BellSouth Corporation	22,392	5.0%
7	BellSouth Corporation	18,523	4.2%
	Carter	3,869	0.9%
6	BellSouth Corporation	8,080	1.8%
	BellSouth Telecommunications	3,079	0.7%
	Available for Lease	11,233	2.5%
5	BellSouth Telecommunications	15,360	3.5%
	Georgia Telco Credit Union	2,205	0.5%
	Coopers & Lybrand	4,827	1.1%
4	Georgia Telco Credit Union	22,392	5.0%
3	BellSouth Corporation	16,494	3.7%
2	BellSouth Corporation	14,526	3.3%
1	Prudential Bache Securities	8,405	1.9%
	Peachtree News	1,101	0.2%
P1	BellSouth Corporation	260	0.1%
P2	BellSouth Corporation	6,108	1.4%
	Total Square Feet	443,500	100.0%

Total BellSouth	298,032	67.2%
Total BellSouth Affiliates	23,790	5.4%
Total BellSouth and Affiliates	321,822	72.6%
Coopers & Lybrand	72,473	16.3%
Other Nonaffiliates	37,972	8.6%
Total Nonaffiliates	110,445	24.9%
Available for Lease	11,233	2.5%

Source: Southern Bell Telephone and Telegraph Company, Response to Staff's Audit Request 2-054 Amended, Attachment G.

November 24, 1992

TO: John Robinson
Mike Denson

FROM: Frances Dennis

Subject: Review of BSC's Lease at Campanile

We have performed an analysis of BSC's lease at Campanile. The purpose of the analysis was to quantify the effect, if any, of implementing the "Comparative Lease Analysis Reference Guide" (Guide) issued by BellSouth in March, 1991. This analysis also includes the effect of changing the date of [redacted] per square foot (psf) increase scheduled for August 15,1992 to January 1, 1993.

BSC leases office space at Campanile from an affiliate, Peachtree Associates. BSC charges [redacted] psf of the rent paid to this affiliate to a BSC retained cost project. The amount psf retained is the difference between the average rate of [redacted] psf paid by BSC to the average rate of [redacted] psf paid by Coopers and Lybrand (C&L), an unaffiliated third party. Amounts charged to retained cost projects are not billed to regulated or nonregulated affiliates.

The Guide's standard for comparing leases is the net present value (NPV) of the tenant's cash outflows under the leases being compared. The effect of applying this Guide to the BSC and C&L leases is that the rate charged to the retained cost project increases from [redacted] psf to [redacted] psf (see Attachment A). The [redacted] psf includes the effect of changing the date of the [redacted] psf scheduled increase from August 15,1992 to January 1, 1993. Therefore, the billing rate to BellSouth Telecommunications and other BellSouth subsidiaries remains the same.

Also, we performed a separate analysis of the Fourth Amendment to this lease. Office space added by the Fourth Amendment to BSC's lease is at the market rate charged to an unaffiliated third party and requires no further action to comply with the FCC's affiliated transaction rules.

Please increase the rate charged BSC's retained cost project from [redacted] psf to [redacted] psf effective January 1, 1993. If you have questions, Please call Dell Coleman at (404) 249-3032 or me at 249-3026.

cc: Zelina Hines
Mike Deans

Attachment

Fully Distributed Cost Analysis
Campanile Building
1992

		1992
	DIRECT COSTS	
6	BLDG. OPERATING EXP.	
7	DEPRECIATION	
8	HQ EXPENSES OVER COMMON	
9	TOTAL	
11	AVG. SQ. FT. OCCUPIED BY BSC	67.20%
12	SUBTOTAL	[redacted]
13	/BSC OCCUPIED SQ. FT.	298,032
14	BSC DIRECT COSTS PER SQ. FT.	[redacted]
	RETURN ON INVESTMENT: 1992 Average	[redacted]
17	Land	
18	Building	
19	Depreciation & Amort.	
20	Deferred Charges	
21	SUBTOTAL	
22	WORKING CAPITAL	
23	TOTAL INVESTMENT	
24	AVG. % OCCUPIED - BSC	67.20%
25	PORTION ALLOCABLE - BSC	
26	ALLOWABLE R.O.R	
27	ALLOWABLE RETURN	
28	AVG. SQ. FT. OCC.	298,032
29	ALLOWABLE RETURN PER SQUARE FOOT	
31	TOTAL FDC PER SQ. FT.	

JACKSONVILLE WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 8/1/87 - 7/31/92

		1984	1985	1986	1987*** 1/1 - 7/31	1987*** 8/1 - 12/31	1988	1989	1990	1991	1992
	Square Feet	186,252	186,252	186,252	186,252	286,252	286,252	286,252	286,252	286,252	286,252
	REVENUES										
9	RENT REVENUE (1)										
	EXPENSES										
11	DEPR - LAND IMP										
12	DEPR - BLDG										
13	PROPERTY TAXES										
14	ALLOCATED COSTS										
	NET INVESTMENT										
16	LAND										
17	LAND IMP.										
18	ACC. DEPR.-LI										
19	BUILDING										
20	ACC. DEPR-BLDG.										
21	DEFERRED TAXES										
22	WORKING CAPITAL										
	OTHER										
24	TOTAL NET INVESTMENT										
25	AVERAGE INVESTMENT										
26	RATE OF RETURN										
27	RETURN										
28	R.S.F. -- EFFECTIVE ACTUAL										
29	R.S.F. -- FDC										
30	CURRENT YEAR DIFF										
31	PRIOR YEAR CUM. DIFF										
32	CURRENT YEAR CUM. DIFF										

***total difference for the entire year is as follows:

		RENT	FDC	DIFF
35				
36	Jan.-July			
37	Aug.-Dec.			

LEASE CHARGES LESS THAN FDC DURING ENTIRE YEAR.

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

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BIRMINGHAM WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 6/1/88-7/31/98

		1984	1985	1986	1987	1988*** 1/1 - 5/31	1988*** 6/1 - 12/31	1989	1990	1991	1992
	Square Feet	162,509	162,509	162,509	162,509	162,509	282,509	282,509	282,509	282,509	282,509
	REVENUES										
9	RENT REVENUE (1)										
	EXPENSES										
11	DEPR - LAND IMP										
12	DEPR - BLDG										
13	PROPERTY TAXES										
14	ALLOCATED COSTS										
	NET INVESTMENT										
16	LAND										
17	LAND IMP.										
18	ACC. DEPR.-LI										
19	BUILDING										
20	ACC. DEPR-BLDG.										
21	DEFERRED TAXES										
22	WORKING CAPITAL										
	OTHER										
24	TOTAL NET INVESTMENT										
25	AVERAGE INVESTMENT										
26	RATE OF RETURN										
27	RETURN										
28	R.S.F. -- EFFECTIVE ACTUAL										
29	R.S.F. -- FDC										
30	CURRENT YEAR DIFF.										
31	PRIOR YEAR CUM. DIFF.										
32	CURRENT YEAR CUM. DIFF.										

***total difference for the entire year is as follows:

		RENT	FDC	DIFF
35				
36	Jan.-July			
37	Aug.-Dec.			

LEASE CHARGES LESS THAN FDC DURING ENTIRE YEAR.

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

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EXHIBIT JBB-4
WITNESS: BRANCH
PAGE 2 OF 3

ST. AUGUSTINE WAREHOUSE FDC ANALYSIS
EFFECT OF REMOVING WORKING CAPITAL FROM COOPERS & LYBRAND FDC ANALYSIS

ORIGINAL LEASE TERM: 10/27/89 - 10/26/99

	Square Feet	57,200	57,200	57,200	57,200
		1989 11/1 - 12/31	1990	1991	1992
	REVENUES				
9	RENT REVENUE (1)				
	EXPENSES				
11	DEPR - LAND IMP				
12	DEPR - BLDG				
13	PROPERTY TAXES				
14	ALLOCATED COSTS				
	NET INVESTMENT				
16	LAND				
17	LAND IMP.				
18	ACC. DEPR.-LI				
19	BUILDING				
20	ACC. DEPR-BLDG				
21	DEFERRED TAXES				
22	WORKING CAPITAL				
	OTHER				
24	TOTAL NET INVESTMENT				
25	AVERAGE INVESTMENT				
26	RATE OF RETURN				
27	RETURN				
28	R.S.F. -- EFFECTIVE ACTUAL				
29	R.S.F. -- FDC				
30	CURRENT YEAR DIFF.				
31	PRIOR YEAR CUM. DIFF.				
32	CURRENT YEAR CUM. DIFF.				

(1) RENT REVENUE = BOOK DEPRECIATION+PROPERTY TAXES+ALLOCATED COSTS+RETURN
(2) SOURCE OF INFORMATION IS C&L WORKPAPERS
(3) DIFFERENCES OF $1 BETWEEN COOPERS & LYBRAND FDC ANALYSIS DUE TO ROUNDING

DOCKET NO. 920260-TL
EXHIBIT JBB-4
WITNESS: BRANCH
PAGE 3 OF 3