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DIRECT TESTIMONY OF

ART LERMA

AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 960833-TP

Q. PLEASE IDENTIFY YOURSELF.

A. My name is Art Lerma and my business address is Promenade I, Room 5082, 1200 Peachtree Street, Atlanta, Georgia, 30309.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL AND PROFESSIONAL BACKGROUND AND EXPERIENCE.

A. In 1974, I received a Bachelor of Arts degree in Mathematics from Trinity University in San Antonio, Texas. In 1994, I received a Master of Business Administration from St. Edwards University in Austin, Texas with a concentration in General Business and Telecommunications Management.

Q. PLEASE DESCRIBE YOUR CURRENT EMPLOYMENT, THE SCOPE OF YOUR RESPONSIBILITIES, AND YOUR PRIOR WORK EXPERIENCE.

A. I am employed by AT&T as Area Controller - Regional Controller Organization. As Area Controller, I have responsibility for AT&T's financial matters and for certain local exchange carrier ("LEC") cost analysis functions in the southern states area. In 1974, I began my career with Southwestern Bell as a supervisor in Accounting Operations responsible for accounts receivable processing and revenue journalization. From 1975 through 1983, I held various line and staff positions at Southwestern Bell Accounting Centers where I was responsible for data processing operations, toll operations, customer billing and collection, payrolls, accounts payable and the

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1 production of corporate books and records. In July of 1983, I transferred to AT&T
2 and accepted the position of Manager - Accounting Regulatory Support responsible
3 for AT&T financial regulatory matters in Texas. From 1983 through 1988, I was
4 primarily involved with the review of LEC cost information filed before the Texas
5 Public Utility Commission or in other regulatory proceedings involving potential
6 changes to access charges. In 1989, I accepted the position of District Manager -
7 Financial Regulatory Matters.

8 **Q. PRIOR TO THIS DOCKET, HAVE YOU REVIEWED ANY BELLSOUTH**
9 **AVOIDED COST DATA?**

10 A. Yes. In conjunction with regulatory proceedings in Georgia and Tennessee, I have
11 had the opportunity to review avoided cost studies that were filed by BellSouth. In
12 addition, I also have had the opportunity to review similar cost study data for other
13 BellSouth states that was recently made available as part of AT&T's negotiations
14 with BellSouth under the Telecommunications Act of 1996 (the "Act").

15 **Q. DESCRIBE THE LEVEL OF YOUR FAMILIARITY WITH BELLSOUTH'S**
16 **AVOIDED COST DATA.**

17 A. I have been able to compare the above referenced BellSouth data with data filed by
18 BellSouth in its Automated Reports Management Information System ("ARMIS")
19 reports, with the Federal Communications Commission ("FCC"). This is publicly
20 available data. Specifically, by using Uniform System of Accounts ("USOA")
21 account level details found in some of the ARMIS reports, I have been able to
22 compare data in the ARMIS reports with BellSouth's avoided costs results contained
23 in the above referenced BellSouth data. This has allowed me to perform detailed
24 analyses in an effort to assess BellSouth's compliance with the Act.

25 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE ANY COMMISSION OR**

1 **OTHER REGULATORY AUTHORITY?**

2 A. Yes. I filed testimony before the Texas Public Utility Commission in Dockets 7330
3 and 8585. I have filed testimony before the Arkansas Public Service Commission in
4 Docket No. 86-159U. I have filed testimony before the Tennessee Public Service
5 Commission in Docket No. 95-02499 and Docket No. 96-00067. I have also testified
6 before the North Carolina Public Utilities Commission in Docket Nos. P-7, Sub 825
7 and P-10, Sub 479. Lastly, I have filed testimony before the Georgia Public Service
8 Commission in Docket No. 6352-U.

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

11 A. The purpose of my testimony is to describe AT&T's recommendation for establishing
12 wholesale rates for services sold by BellSouth to AT&T for resale by AT&T to
13 Florida consumers.

14 More specifically, I discuss:

- 15 1. my opinion regarding the requirements of the Act with respect to wholesale rates
- 16 for services subject to resale;
- 17 2. the methodology used by AT&T to calculate an avoided retail cost percentage
- 18 reduction of 41.7% (see Exhibit AL-4) that should be applied to BellSouth's retail
- 19 local rates to determine wholesale rates; and
- 20 3. the results of my analysis of BellSouth avoided cost data studies made available in
- 21 other regulatory proceedings and in conjunction with AT&T's negotiations with
- 22 BellSouth under the Act.

23 **Q. DOES THE ACT ADDRESS HOW THIS COMMISSION SHOULD**
24 **DETERMINE WHOLESALE RATES FOR BELL SOUTH SERVICES THAT**
25 **MAY BE RESOLD?**

1 A. The Act provides substantial guidance for determining the wholesale rates for services
2 that incumbent LECs, such as BellSouth, must sell to other carriers for resale. The
3 specific language in 47 U.S.C. § 252(d)(3) is that "a State commission shall
4 determine wholesale rates on the basis of retail rates charged to subscribers for the
5 telecommunications service requested, *excluding the portion thereof attributable to*
6 *any marketing, billing, collection, and other costs that will be avoided by the local*
7 *exchange carrier."* (Emphasis added.) Thus, to determine wholesale rates, the Act
8 identifies three specific categories of costs that are to be excluded from retail rates:
9 marketing, billing, and collection costs. The Act also prescribes the removal from
10 retail rates of any "other costs that will be avoided." Effectively, the Act prescribes
11 that *all* retail-related costs are to be removed from retail rates to establish wholesale
12 rates.

13 **Q. WHAT IS THE BASIS FOR YOUR CONCLUSION THAT THE ACT**
14 **REQUIRES THAT WHOLESAL PRICES NOT INCLUDE ANY**
15 **BELLSOUTH RETAIL-RELATED COSTS?**

16 A. The Act's specific reference and exclusion of marketing, billing, and collection (which
17 includes physical payment processing costs as well as uncollectible costs) from retail
18 rates suggests that the Act's language "other costs that will be avoided" describes
19 costs other than marketing, billing, and collection that will not be incurred because of
20 resale. In other words, if Congress had intended to limit avoided costs only to
21 marketing, billing, and collection costs, there would have been no need for Congress
22 to have included "other costs that will be avoided" in the Act. There are various types
23 of costs that vary with volumes of customers lost to resellers so that when any
24 incumbent LEC loses a customer, the incumbent LEC's retail costs decrease.
25 However, the Act's specific exclusion of marketing, billing, and collection costs from

1 retail rates also shows that "other costs that will be avoided" must include not only all
2 costs directly caused by retailing functions, but also any costs from functions that
3 indirectly benefit or support retailing activities. As an example, with respect to
4 marketing costs, I believe this conclusion is logical because Congress must have
5 realized that competition in some cases will cause incumbent LECs to spend more,
6 not less, for certain marketing activities as the local service market becomes more
7 competitive. Thus, for some types of marketing costs, such as those related to
8 advertising, BellSouth may opt to maintain or increase its current levels of retail
9 advertising although not for the benefit of resellers who will be purchasing wholesale
10 services. The basis for the Act's exclusion of marketing costs to arrive at a wholesale
11 rate, therefore, is that such costs reflect functions that vary with volumes (such as
12 retail sales functions) and functions caused by or only benefiting retailing activities.

13 **AT&T'S MODEL**

14 **Q. PLEASE SUMMARIZE HOW AT&T DETERMINED THE AMOUNT OF**
15 **BELLSOUTH RETAIL COSTS THAT SHOULD BE EXCLUDED FROM**
16 **BELLSOUTH'S RETAIL RATES.**

17 **A. AT&T used its "Avoided Retail Cost Model" (the "Model") to identify all types of**
18 **BellSouth costs associated with retail activities occurring in the local services market.**
19 **The end result is a percentage that should be used to reduce BellSouth's local services**
20 **retail rates in order to reflect the retail costs BellSouth will avoid when it provides**
21 **local services on a wholesale basis to AT&T.**

22 **Q. WHAT ARE LOCAL SERVICES?**

23 **A. Local services include basic area message services such as flat rate local services,**
24 **measured local services, "vertical" features such as call waiting and forwarding and**
25 **expanded area calling plans.**

1 Q. **WHY DOES THE MODEL FOCUS ON LOCAL SERVICES?**

2 A. AT&T has focused on the development of wholesale local services rates because this
3 is the first services category in which AT&T intends to compete with BellSouth.
4 However, the Model also can be used to develop separate wholesale rates for a
5 number of other services categories, such as toll and private line.

6 Q. **DOES AT&T'S MODEL DEVELOP REASONABLE WHOLESALE RATES
7 FOR BELLSOUTH'S LOCAL SERVICES?**

8 A. Yes.

9 Q. **WHY DOES AT&T'S MODEL DEVELOP APPROPRIATE WHOLESALE
10 RATES FOR BELLSOUTH'S LOCAL SERVICES?**

11 A. The Model uses a methodology that is reasonable, as described further in this
12 testimony, and that reflects the best available public data. Thus, I believe it generates
13 appropriate wholesale rates for BellSouth's local services. If BellSouth wishes to
14 challenge the results of AT&T's study based upon "better" data, then, in all fairness
15 to AT&T and this Commission, BellSouth should disclose *all* necessary data for
16 analysis by AT&T and this Commission. Until that happens, the most reasonable
17 means for measuring wholesale rates are the data that are currently available.

18 Q. **UPON WHAT PUBLICLY AVAILABLE DATA DOES AT&T RELY?**

19 A. AT&T relies upon the ARMIS reports that BellSouth filed with the FCC for the year
20 1995. The specific data that AT&T uses are obtained from the following ARMIS
21 reports:

22 ARMIS 43-03 (Joint Cost Report): This report provides the regulated annual
23 operating results of BellSouth for every account in the FCC's Part 32 Uniform
24 System of Accounts ("USOA"). Those data are used to supplement the data from the
25 ARMIS 43-04 report.

1 ARMIS 43-04 (Access Report): This is the primary data source for the Model. The
2 report provides regulated financial and operating data separated in accordance with
3 Part 36 and Part 69 of the FCC's Rules.

4 ARMIS 43-08 (Operating Data Report): This report is used as a source of operating
5 data. Table III of the report is used to identify access lines associated with switched
6 services. Information on toll calls and billed access minutes is derived from Table IV
7 of the report.

8 **Q. PLEASE SUMMARIZE THE AT&T MODEL.**

9 A. The objective of the Model is to measure all retail costs which will be avoided by
10 BellSouth when wholesaling services to AT&T and to express the total of the costs as
11 a percentage of BellSouth's retail rates. The Model is divided into three "phases,"
12 each of which is described in detail below. Overall, Phase I assigns revenues and
13 costs into seven separate categories; Phase II reorganizes revenues and costs for those
14 seven categories into the five traditional lines of business; while Phase III analyzes the
15 costs assigned to local services to identify costs that will be avoided, and calculates
16 the appropriate reduction to local services retail rates to produce wholesale local
17 service rates. The modeling process is displayed graphically as shown in Exhibit AL-
18 1.

19 **Q. PLEASE DESCRIBE PHASE I IN MORE DETAIL.**

20 A. Phase I of the Model assigns revenues and costs from the ARMIS 43-04 report to one
21 or more of six separate functional categories and the residual is accumulated in an
22 unassigned seventh category: Billing and Collection; Directory; Intrastate Private
23 Line; Special Access; Subscriber Line; Minute Driven; and Unassigned. For certain
24 line items on the 43-04 report that appear on an aggregated basis, the relative
25 percentages calculated from the more detailed 43-03 accounts are applied to separate

1 the aggregated line items. These Phase I categories are more fully described by
2 expense categories in Exhibit AL-2 (Treatment of ARMIS Data). Wherever possible,
3 revenue and expenses are directly assigned to a functional category. For expenses
4 that cannot be directly assigned, they are apportioned based on the characteristics of
5 the expense incurred, operational data, and factors as set forth in Exhibit AL-3 .

6 **Q. PLEASE DESCRIBE PHASE II IN MORE DETAIL.**

7 **A.** Phase II of the Model takes the revenues and costs assigned to the seven categories in
8 Phase I and ultimately groups the revenues and expenses into five traditional lines of
9 business: Miscellaneous; Private Line; Local; Access; and Toll. Phase II has four
10 steps. Step 1 groups the seven Phase I categories into four consolidated operational
11 categories: Miscellaneous (Billing & Collection, Directory and Public Telephone);
12 Private Line (Intrastate Private Line and Special Access); Subscriber Line; and
13 Minute Driven. Step 2 assigns Minute Driven expenses to Subscriber Line, access
14 service and Interoffice categories. Step 3 assigns Interoffice expenses to Toll Service
15 and Local interoffice. In Step 4, Local Interoffice and Subscriber Line are
16 consolidated to generate Local costs. The Phase II assignment of revenues and costs
17 to lines of business is further detailed in Exhibit AL-2 by type of expense.

18 **Q. THE ALIGNMENT PROCESS YOU JUST DESCRIBED SEEMS**
19 **COMPLEX--WHY DO YOU BELIEVE THE ALIGNMENT PROCESS TO**
20 **BE REASONABLE?**

21 **A.** As stated previously, AT&T has used the best information available to determine
22 costs that will be avoided when BellSouth provides local services on a wholesale
23 basis. Adequate, *service-specific* data is currently unavailable. The AT&T Model,
24 therefore, aligns BellSouth's ARMIS revenues and costs with logical categories of
25 services using direct assignment where possible and reasonable apportionment

1 elsewhere. Every cost reflected on the ARMIS 43-04 report that could not be directly
2 assigned is apportioned to a category of services identified in the Model using
3 assignment methodologies and factors that are consistent with the unique
4 characteristics of the function generating the cost. Because apportionment of costs to
5 several services categories is necessary, in some cases complex calculations are
6 required. The alignment process used in the Model is as reasonable as possible, given
7 information that is publicly available .

8 **Q. PLEASE DESCRIBE PHASE III IN DETAIL.**

9 A. In Phase III, local services costs that will be avoided when BellSouth provides
10 wholesale services to AT&T are identified, aggregated and expressed as a percentage
11 of local services retail revenues. The Model identifies local services costs that will be
12 avoided in two steps : (1) identifying *direct* retail costs; and (2) identifying costs
13 incurred in support of direct retail functions performed (*indirect* costs).

14 First, the model identifies *direct* costs that will be avoided based on the following
15 criteria: (1) one of three types of costs that the Act specifically identifies as costs that
16 will be avoided; (2) costs that will be duplicated by the reseller when it sells at retail;
17 or (3) costs that are caused by BellSouth's retail activities. The types of costs that
18 the Model identifies as direct costs which will be avoided based upon these criteria,
19 including the FCC USOA account or ARMIS line item reference, and the rationale
20 for that identification, are as follows:

- 21 1) **Uncollectibles (included in account 5300):** Costs related to uncollectibles will be
22 avoided 100 percent because the risk for collection of open accounts receivables from
23 retail end user customers moves from the incumbent LEC to the reseller (*i.e.*, if the
24 end user does not pay, the reseller accepts the financial responsibility).
- 25 2) **Marketing (includes accounts 6611-Product Management, 6612-Sales, and 6613-**

1 Product Advertising): The Act specifically lists "marketing" costs as costs that will
2 be avoided. The FCC's Uniform System of Accounts for Telecommunications
3 Companies states that marketing "shall be used . . . to summarize" the costs of
4 Product Management, Sales and Product Advertising. 47 C.F.R. § 32.6610.
5 Moreover, in the USOA, the descriptions of Product Management ("administrative
6 activities related to marketing products and services"), Sales ("cost incurred in selling
7 products and services"), and Product Advertising ("costs incurred in developing and
8 implementing promotional strategies to stimulate the purchase of products and
9 services") clearly reflect that each of these costs are marketing costs. In addition,
10 AT&T will incur all of these types of costs when selling at retail. Thus, the Model
11 identifies 100 % of all such BellSouth costs as costs that will be avoided.

12 In addition, all costs related to end user order processing and other customer
13 operations, such as investigating customer accounts and instructing customers in the
14 uses of customer services and products, also are reflected under the marketing
15 category in AT&T's Model. These types of costs are included in account 6623.
16 AT&T intends to perform all end user customer service functions utilizing electronic
17 interfaces. Thus, the Model identifies 100% of BellSouth's marketing costs as costs
18 that will be avoided.

19 3) **Billing and Collection** (included in account 6623 along with other customer
20 expense): Again, the Act specifically lists billing and collection costs as costs that
21 will be avoided. AT&T's Model includes all billing related costs such as postage and
22 billing inquiries, as well as bill payment collection costs. The Model identifies 100%
23 of these BellSouth costs as costs that will be avoided.

24 4) **Operator-Related Expense**, includes accounts 6621 - call completion services, 6622
25 - number services (directory assistance), ARMIS 43-04 line 6040 - Depreciation-

1 Operator Systems, and account 6220 - Network-CO operator systems: Operator
2 costs clearly are retail related. They are not caused by nor do they provide a benefit
3 to a reseller buying wholesale services. Moreover, if AT&T achieves direct routing
4 of local telephone calls to its operators, as AT&T has requested, all operator costs
5 become costs that BellSouth will avoid. The Model identifies 100% of BellSouth's
6 operator related costs as costs that will be avoided.

7 6) **Operations Testing and Operations Plant Administration (included in account**
8 **6533 and 6534):** AT&T has requested an electronic interface with BellSouth's
9 service trouble reporting database. This will allow AT&T to perform both immediate
10 and high quality initial trouble analysis when a customer reports trouble on his line.
11 Based on AT&T's experience, about 50% of its own testing and plant administration
12 costs involve end user customers. Based on this data, AT&T conservatively
13 estimates that approximately 20% of BellSouth's customer related testing and plant
14 administration costs will be avoided.

15 Second, moving from *direct* cost categories, the Model also identifies that portion of
16 *indirect* costs (including common costs and other indirect costs) that relate to retail
17 activities that also will be avoided. In summary, not identifying indirect costs that are
18 attributable to retail activities will result in resellers subsidizing the cost of
19 BellSouth's retail functions. Moreover, such costs likely will be duplicated by
20 resellers. Thus, those portions of indirect costs attributable to retail services are costs
21 that will be avoided under the Act. The measurement of the portion of these indirect
22 costs that retail functions cause or benefit from, and thus which will be avoided in a
23 wholesale environment, is described below:

24 1) **Network Support Expenses (included in account 6110) and General Support**
25 **Services (included in account 6120):** Network support expenses include all costs of

1 transport, including motor vehicles, aircraft, other special purpose vehicles and
 2 maintenance equipment. General Support Services includes Accounts 6120 through
 3 6124 - General Support Expenses includes Land, Building, Furniture, Artwork,
 4 Office Equipment and General Purpose Computer. The amount of Network and
 5 General Support Expenses that will be avoided equals :

$$\begin{array}{r} \text{Expense} \qquad \qquad \qquad \times \qquad \text{Direct local costs that will be avoided} \\ \hline \text{Total local costs minus total local} \\ \text{indirect costs} \end{array}$$

6 This formula results in a ratio that reflects the relationship between "total avoided"
 7 local direct costs and "total" local direct costs. The application of this ratio is
 8 reasonable because support expenses will vary directly in proportion to the changes in
 9 direct costs that will be avoided. For example, in a wholesale environment,
 10 BellSouth's retail sales expenses will be avoided, and therefore, support assets
 11 utilized in the retail sales function no longer will be necessary for the wholesale
 12 provisioning of local services.

13 2) **Depreciation-General Support** (as reflected on ARMIS line 6020): These avoided
 14 costs are determined using the formula and for the same reasons described in
 15 preceding paragraph 1 above.

16 3) **Executive and Planning** (account 6710), **General & Administrative** (account
 17 6720), and **Operating Other Taxes** (account 7240). These avoided costs are
 18 determined using the formula and for the same reasons described in paragraph 1
 19 referenced above.

20 4) **Return and Income Taxes**: Generally, cost studies reflect return and income tax
 21 components of costs. The portion of return related to support assets that are avoided,
 22 and the appropriate federal income taxes that should be assigned to this category of

1 costs that will be avoided is multiplied by a factor determined by the following
2 formula:

$$\begin{array}{l} 3 \quad \frac{\text{General Support facilities investment}}{\text{Total Telephone Plant-in Service}} \quad \times \quad \frac{\text{Direct costs that will be avoided}}{\text{Total local costs minus total local indirect costs}} \\ 4 \end{array}$$

5) **Other Interest deductions:** This category represents that portion of costs associated
6 with interest on customer deposits (as reflected in account 7540) which will be
7 avoided because deposits will now be held by resellers. Consequently, the interest
8 that must be paid on deposits will be incurred by resellers and thus avoided by
9 BellSouth.

10 **Q. HOW IS THE AGGREGATE AMOUNT OF COSTS THAT WILL BE**
11 **AVOIDED DETERMINED IN AT&T'S STUDY?**

12 **A** Exhibit AL-4 provides a summary and Exhibit AL-5 provides the details of the
13 results of the AT&T Model. These exhibits identify both the direct and indirect retail
14 costs that will be avoided, as well as the appropriate local services category revenues.
15 Total avoided direct and indirect retail costs are then divided by the appropriate local
16 services revenues to derive the specific percentage of 41.7%. This percentage
17 represents the amount of BellSouth's retail costs that will be avoided when BellSouth
18 sells local services to AT&T on a wholesale basis. This percentage then is applied to
19 all local services rates to arrive at the wholesale price BellSouth should be entitled to
20 charge AT&T for local services.

21 Exhibit AL-5 provides supporting detail for all local revenues and costs considered by
22 the Model. The first column, labeled "Total Local BU," provides BellSouth's
23 revenues and costs pertaining to a total local business unit or line of business
24 developed through phases I and II of AT&T's model. The column labeled "avoided
25 retail cost factor" is the percentage of each local cost category that relates to retail

1 functions, as just discussed. The column labeled "avoided retail amount" is the
2 product of the specific local services costs in the first column multiplied by the
3 avoided retail cost factor in the second column.

4 All pertinent revenues and costs then are converted to a per subscriber line basis. The
5 retail costs that will be avoided is obtained, by dividing the per line local services
6 retail costs that will be avoided, by the local services revenues per line. The local
7 services revenues per line then serves as average rates per line. With respect to
8 BellSouth, the Model identified the local services retail costs that will be avoided by
9 BellSouth to be \$ 9.54 per line per month. The per line retail costs that will be
10 avoided, divided by the local services revenues of \$ 22.84 per line per month,
11 produces 41.7 percent, which is the percent amount by which BellSouth retail prices
12 should be reduced to achieve wholesale prices.

13 **Q. WHAT IS THE SIGNIFICANCE OF THE AVOIDED RETAIL COST**
14 **PERCENTAGE?**

15 **A.** This percentage, when applied to the retail prices of particular BellSouth local
16 services, effectively removes the costs of retail functions from BellSouth's retail rates
17 for those services.

18 **Q. DOES THE AVOIDED RETAIL COST PERCENTAGE PRODUCED BY**
19 **THE MODEL DIRECTLY RESULT IN A SINGLE WHOLESALE RATE**
20 **FOR LOCAL SERVICES?**

21 **A.** No, it only leads to arriving at the wholesale rate for local services. The Model
22 develops a single avoided retail cost percentage for local services. However, to
23 calculate wholesale rates for services, that percentage is applied to the retail prices
24 which BellSouth charges its retail subscribers for any local services sold at retail.
25 This process is as follows:

1
$$P_W = P_R - (P_R \times \text{Avoided Retail Cost Percentage})$$

2
$$P_W = \text{Price at wholesale}$$

3
$$P_R = \text{Price at retail}$$

4 **Q. WHY DOES AT&T PROPOSE A SINGLE AVOIDED LOCAL RETAIL**
5 **COST PERCENTAGE?**

6 **A.** The primary reason is that avoided cost data, relating to specific local services that
7 BellSouth offers, currently is not available to AT&T or to this Commission for that
8 matter. This includes a lack of revenues and avoided cost data relating to residential
9 versus business customers.

10 If this data is made available to AT&T, AT&T will be able to analyze it to determine
11 if the data is sufficient and appropriate for use in developing an avoided retail cost
12 percentage for individual types of services to which the data applies.

13 **Q. DOES THE AT&T MODEL INCLUDE COSTS, OTHER THAN DIRECT,**
14 **AS COSTS THAT WILL BE AVOIDED?**

15 **A.** Yes, as I discussed earlier in my testimony, that portion of indirect costs that are
16 caused by or that benefit retail functions are considered costs that will be avoided.

17 **Q. DOES AT&T'S MEASUREMENT OF COSTS THAT WILL BE AVOIDED**
18 **ALLOW BELL SOUTH TO RECOVER ANY OF ITS JOINT AND**
19 **COMMON COSTS?**

20 **A.** Absolutely. Joint and common costs that are caused by, or provide benefit to
21 wholesale functions, would be recovered by BellSouth in the wholesale price it
22 charges AT&T for wholesale services. Remember, the avoided retail cost percentage
23 only removes those direct and indirect retail costs, including portions of joint and
24 common costs, which are associated with retail functions. Joint and common costs
25 associated with wholesale functions remain in the wholesale price.

1 Q. DOES A WHOLESALE RATE THAT EXCLUDES ALL RETAIL COSTS
2 RESULT IN A BELOW COST RATE?

3 A. No. The key to understanding this concept is to appreciate that BellSouth's local
4 services rates cover all of its costs because of either of two factors: (1) the rates
5 themselves cover all of BellSouth's wholesale costs, or (2) the rates, plus subsidies
6 received from other local services rates (e.g., custom calling services) or other classes
7 of service (e.g., subscriber line charges), cover all of BellSouth's wholesale costs.
8 Thus, although wholesale prices for particular services might appear to be under cost,
9 BellSouth continues to receive these subsidies and, thus, is fully compensated for its
10 wholesale costs.

11 Q. HAVE YOU PERFORMED AN ANALYSIS OF ANY AVOIDED COST
12 STUDY DATA PREPARED BY BELLSOUTH?

13 A. As stated previously, I specifically have analyzed avoided cost studies filed by
14 BellSouth in regulatory proceedings in Georgia and Tennessee. I also have reviewed
15 BellSouth's Florida avoided cost studies obtained in negotiations and have the
16 following concerns regarding BellSouth's methodologies and assumptions:

17 1. BellSouth did not attempt to break its costs down to any specific tariffed services
18 categories in either the Georgia or Tennessee avoided cost studies. Instead, BellSouth
19 provided only proposed discounts for the general categories of residence and business
20 services because data for these categories of services was readily available.

21 2. BellSouth did not provide cost information for all categories of costs. There are
22 several categories of costs that will be avoided and that should not be reflected as
23 costs recovered in wholesale rates. Specifically, BellSouth has not calculated any
24 avoided retail direct costs related to product advertising, product management,
25 operator call completion services, operator directory assistance services, network and

1 depreciation costs related to operator systems, and customer reported testing and
2 plant administration. In addition, BellSouth has not reflected any avoided indirect
3 costs including network and depreciation support costs, general and administrative
4 costs, customer deposit expense, return pertaining to support assets, and income taxes
5 on return.

6 3. BellSouth assumes a very short run perspective in performing its avoided cost
7 study, contrary to AT&T's Model which has a long run perspective. For example,
8 BellSouth assumes that resellers will not have electronic interfaces and therefore
9 concludes that BellSouth will perform most customer service functions.

10 4. In conjunction with negotiations, AT&T obtained avoided cost studies for Florida
11 and has determined that the same shortcomings exist with respect to these studies.
12 Exhibit AL-6 provides a line by line comparison of AT&T's Model to BellSouth's
13 studies. A review of this Exhibit AL-6 allows one to appropriately conclude that
14 BellSouth has omitted numerous categories of cost details which it believes are not
15 avoided. For illustrative purposes, I also have prepared and attached Exhibit AL-7 in
16 an effort to restate BellSouth's study to reflect the missing avoided costs details using
17 AT&T's assumptions.

18 **C. OTHER ISSUES**

19 **Q. SHOULD THIS COMMISSION ORDER A REDUCTION OF RETAIL**
20 **RATES TO WHOLESALE RATES FOR ALL SERVICES AVAILABLE TO**
21 **NON-CARRIER SUBSCRIBERS FOR RESALE?**

22 **A. Yes.**

23 **Q. DOES YOUR ANSWER INCLUDE CONTRACT SERVICE**
24 **ARRANGEMENTS ("CSAs") OR SPECIALLY PRICED SERVICES, SUCH**
25 **AS PROMOTIONAL SALES?**

1 A. Yes The testimony of Joe Gillan establishes that BellSouth's duty under 47 U.S.C. §
2 251(c)(4) is to offer for resale at wholesale prices any telecommunications services
3 which BellSouth offers at retail to non-carrier subscribers, whenever AT&T requests
4 the services for resale, regardless of how BellSouth might be pricing those services.
5 To the extent BellSouth offers services to retail consumers, AT&T is entitled to resell
6 those same services at the wholesale rates discussed above.

7 In summary, if BellSouth is obligated to sell services to AT&T for resale, then
8 BellSouth must offer those services to AT&T at wholesale rates determined in
9 accordance with the Act. Under the Act, the measurement of the wholesale rates
10 begins with BellSouth's retail rates (defined to mean what BellSouth actually charges
11 its retail customers, not merely published retail rates) for those services, whatever
12 they may be at any given time, regardless of the justification for the rates. Thus, I
13 believe that wholesale rates are required for services sold as CSAs, promotions or
14 otherwise.

15 Q. WOULD YOU PLEASE SUMMARIZE AT&T'S RECOMMENDATIONS IN
16 THIS PROCEEDING?

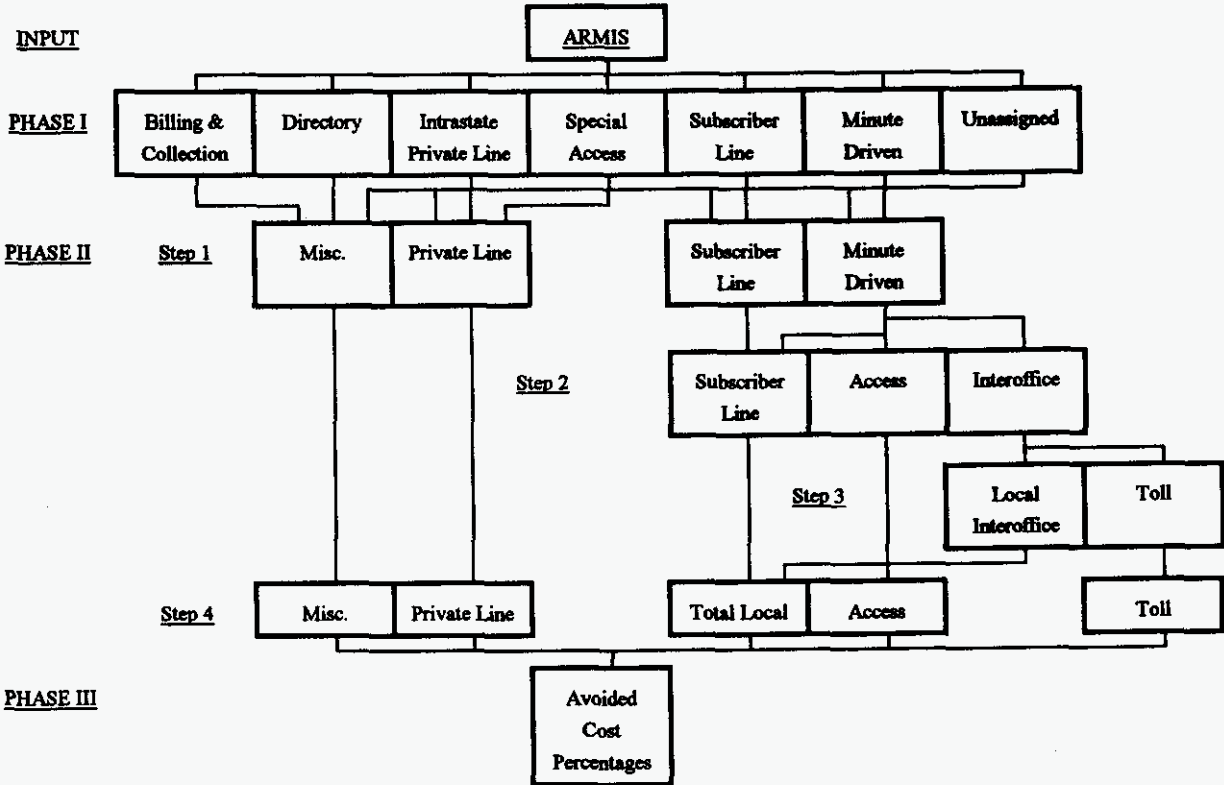
17 A. Yes. AT&T recommends that wholesale rates for BellSouth's services subject to
18 resale be based upon a minimum avoided retail cost percentage of 41.7% . In support
19 of this percentage reduction, AT&T has presented as Exhibits AL-4 and AL-5 a
20 summary and a supporting cost study of BellSouth's costs that will be avoided when
21 BellSouth provides local services on a wholesale basis. The direct retail costs that
22 BellSouth will avoid include all billing costs, collection costs, costs pertaining to
23 operator functions and systems, marketing, advertising, and uncollectibles. BellSouth
24 also will avoid indirect retail costs, such as those related to General & Administrative
25 expenses and costs resulting from support assets used in performing the retailing

1 function. In addition, if this Commission decides to utilize BellSouth's studies,
2 special attention should be given to AT&T's analysis provided in Exhibit AL-6. It is
3 clear from Exhibit AL-6 that BellSouth has omitted from its study numerous
4 categories of avoided costs that should be excluded from its retail rates. Additionally,
5 AT&T's alternative analysis, attached as Exhibit AL-7, shows that when the missing
6 categories of avoided costs are included, the results are dramatically different and are
7 more appropriate than those prepared by BellSouth.

8 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

9 **A. Yes, it does.**

FLOW OF INFORMATION WITHIN AT&T'S
AVOIDED COST MODELING PROCESS



TREATMENT OF ARMIS DATA

Revenue

ARMIS data are provided in sufficiently detailed sub account classifications to allow for direct assignment of revenues to each business unit except for Network Access Interstate which is distributed to Interstate IX & EU LD and Minute Driven based on a Switched Access Factor (see Exhibit AL3). The assigned revenues for each business unit will be used as the denominator in the wholesale discount percentage rate calculation; therefore the proper assignment is key to the reasonableness of the discount rate. Further, the revenues used in the denominator are (must be) the same set of services that the discount rate will be applied to.

ARMIS Revenue Category

Business Unit Assignment

Private Line: Local Service	Private Line
Public Telephone: Local Service	Miscellaneous
All Other Local Service Revenues	Local
End User Access Charges (Subscriber Line Charges)	Access
Interstate Special Access	Private Line
Interstate Switch Access	Access
Intrastate Access	Access/PL
Toll Revenues (Long Distance)	Toll
Billing & Collection Revenue	Miscellaneous
Directory Revenue	Miscellaneous

Intrastate Access revenue is disaggregated to the Access and Private Line Business Units using the Switched Access Factor (see Exhibit AL3).

Interconnection/Access

Any expense incurred by the incumbent LEC to interconnect with another LEC for the completion of intraLATA traffic that is recorded to the interconnection/access expense line is processed through the Model and assigned to Toll.

Uncollectibles

Uncollectible revenues for all products are recorded and reflected on a single line in the ARMIS reports, therefore assignment to each functional category is required. The ARMIS data for private line services are used to directly assign uncollectibles to the Private Line business unit. The Model simulates an uncollectible amount for toll service by

multiplying toll revenues by an uncollectible rate developed by AT&T based upon experience. The Model assumes no uncollectibles for the Access line of business. The remaining balance in the Uncollectible Revenue account is assigned to the Local business unit.

Depreciation

Phase I - Functional Categorization

In Phase I, the distribution of Depreciation line items is generally determined by the underlying investment. Depreciation is distributed to the various functional categories in proportion to the underlying investments functional category assignment. Equal Access and Operator Systems Depreciation are directly assigned to Minute Driven. Support Depreciation is distributed in accordance with the Big Three Factor which represents the relative functional category expenses of network operations, sales and service. Other Depreciation is distributed based upon the relative functional category subtotals of Depreciation before Other and less Equal Access. Lastly, Interstate Special is directly assigned for all Depreciation line items based on the 43-04 Special Access column.

Phase II - Line of Business Assignment

In Phase II Step 1, Unassigned is distributed based upon the relative percentages of the previously distributed depreciation expenses to Miscellaneous, Private Line, Subscriber Line and Minute Driven for all Depreciation line items except Switching and Information Originating/Terminating. Switching is distributed to Subscriber Line and Minute Driven based on a Subscriber Switching Factor (see Exhibit AL3). Information Originating/Terminating Unassigned is assigned to Miscellaneous. In Step 2, Equal Access is assigned to Access, Operator Systems is assigned to Interoffice, Switching is distributed to Subscriber Line, Access and Interoffice based on the Switching Minute Driven Factor (see Exhibit AL3) and all other line items are distributed to Access and Interoffice based on the Trunking Minute Driven Factor (see Exhibit AL3). In Step 3, Switching Interoffice is distributed to Local Interoffice and Toll based on the Switching Interoffice Factor (see Exhibit AL3) and all the other line items' Interoffice except Equal Access are distributed by the Trunking Interoffice Factor (see Exhibit AL3) to Local Interoffice and Toll. Equal Access is directly assigned to Access.

Network

Phase I - Functional Categorization

Network Central Office Operator Systems, Switching, Circuit, Information Originating/Terminating and Cable & Wire Facilities line items are distributed to the various functional categories in proportion to the underlying investments functional

category assignment. Network Support is distributed in accordance with the Big Three Factor which represents the relative functional category expenses of network operations, sales and service. Network Operations and Network Other Property, Plant & Equipment is distributed based upon the relative functional category subtotals of Composite Investment which includes Cable & Wire Feeder, Information Originating/Terminating, Circuit, Switch and Operator Systems. Interstate Special is directly assigned for all Network line items based on the 43-04 Special Access column. Lastly, Call Completion,¹ Directory Assistance² and Published Directory are assigned respectively to Minute Driven, Subscriber Line and Directory categories.

Phase II - Line of Business Assignment

Network expenses, identified in Phase I, are distributed to the various Business Units through the use of six factors in a three step process. In Step 1, all Network expenses with the exception of Network Switching and unassigned are distributed to the Miscellaneous, Private Line, Subscriber Line, and Minute Driven categories. Unassigned expenses are distributed to functional categories based on the ratio of functional category's total Network expense to total company Network assigned expense from Phase I. Network CO Switching is assigned to Private Line and distributed between Subscriber Line and Minute Driven categories through the use of the Subscriber Switching Factor (see Exhibit AL3).

In Step 2, Network Circuit, Cable & Wire Facilities, Equal Access, Other Plant Property and Equipment are distributed from Minute Driven to the Access and Interoffice categories through the use of the Trunking Minute Driven Factor (see Exhibit AL3). Operations- Power, Network Administration, Testing, Plant Administration., Engineering and Support are distributed from Minute Driven to the Access and Interoffice categories using a Hybrid Switching Trunking Methodology (see Exhibit AL3). Additionally, Network CO Switching is allocated to Subscriber Line, Access and Interoffice categories from Subscriber Line and Minute Driven by using a Switching Minute Driven Factor (see Exhibit AL3). In Step 3, Network Circuit, Cable & Wire Facilities, Equal Access, Other Property and Plant, Power, Network Administration, Testing, Plant Administration, Engineering and Support expense categories are distributed from Interoffice to Local

¹ Line item Call Completion is equal to Tot Tel Op LN 7060 minus the Directory Assistance line item.

² Line item Directory Assistance is zero if there isn't any investment in Total Auxiliary Service Boards - LN 1154. If there is an investment and call completion LN 7010 is zero, then line item Directory Assistance is the percent of Total Auxiliary Service Board Equipment to Total Operator Systems Equipment LN 1170 times Total Telephone Operator expense LN 7060. If there is an investment and call completion is not zero, Directory Assistance is equal to Intercept LN 7020, Directory Assistance LN 7030 and Other LN 7040 added together.

Interoffice and Toll categories using the Trunking Interoffice Factor (see Exhibit AL3). In one other calculation CO Switching is similarly distributed from Interoffice to Local Interoffice and Toll using the Switching Interoffice Factor (see Exhibit AL3).

Marketing, Sales & Advertising

Phase I - Functional Categorization

Product Management, Sales and Advertising

Product Management, Sales and Advertising line items received their proportional share of Marketing 43-04 Special Access column LN 7000 for their Interstate Special functional category assignment. The remainder of each of these line items is assigned to the Unassigned category.

Service Order Provisioning

Customer Operations Service Order Provisioning is distributed as delineated below: Interexchange Carrier Service Order Processing Expenses are distributed as follows: PL & Special LN 7147 Interstate column is assigned to the Interstate Special category; Interstate IX & EU LD is zero if the associated investment in Total Special Non-WideBand equipment LN 1243 is zero, otherwise it is Total IXC Service Order Expense LN 7150 Subject to Separations column minus the Interstate Special assignment above times the ratio of State PL Weighed Average Contacts LN 7141 divided by Total Weighted Average Contacts LN 7140; Total IXC Service Order Expense LN 7150 Subject to Separations column less the two prior assignments is assigned to the Minute Driven category. Order Processing - End User is directly assigned from LN 7092, PL & Special Service Order Processing, Total Intrastate Column; Interstate Special Access is LN 7092 Total Interstate; Subscriber Line functional category is lines 7089 and 7090, Local Service Order Processing and Presub Service Order Processing, respectively; Minute Driven functional category is LN 7096, Total Service Order Processing, less the expenses identified above.

Other Customer Operation

The LN 7300 Other Cust Srv Special Access column is assigned to Interstate Special category, the Billing and Collection column is grossed up by the ratio of LN 4031 B&C Revenue Subject to Separations column to the Total Interstate column and assigned to the Billing and Collection category and LN 7300 Other Cust Srv Subject to Separations column minus the two prior assignments is assigned to the Unassigned category.

Phase II - Line of Business Assignment

Marketing expenses from Phase I are distributed or directly assigned to the functional categories in three steps. In Step 1, Sales, Product Management, Advertising, IXC and EU Order processing and Other Customer Service/Operations identified in the Phase 1 functional categories with the exception of unassigned functional category are assigned to the Miscellaneous, Private Line, Subscriber Line and Minute Driven categories. The Unassigned category is distributed to the four categories based upon the relative percentages of the previously distributed Marketing, Sales & Advertising; Order Processing and Other Customer Operation expenses. In Step 2, Order Processing IXC and Other Customer Operations are directly reassigned from Minute Driven to the Access BU. In the same step, Order Processing-EU is directly reassigned from Minute Driven to the Interoffice category. Sales, Product Management and Advertising is distributed from Minute Driven to Access and Interoffice based on percentage of Order Processing and Other Customer Operations in each category. In the final step, Sales, Product Management, Advertising, and Order Processing-EU are reassigned from Interoffice directly to the Toll BU.

Billing

Interexchange Carrier Bureaus and LEC Billing

Phase I - Functional Categorization

In Phase I, the Interexchange Billing related to Message Processing, Insertion/Postage, Inquiry and Collection is distributed between the IX and LEC.

Phase II - Line of Business Assignment

IX Message Processing is all assigned to the Billing and Collection category and is the Total Interstate column LN 7236, Total Message Processing grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. Total Message Processing Subject to Separations column LN 7236 less the IX Message Processing Total is assigned to LEC Message Processing Minute Driven.

IX Insertion Processing is all assigned to the Billing and Collection category and is the Billing & Collection column LN 7283, All Other Cat 2 less Interstate column LN 7236, Total Message Processing grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. IX Insertion Processing is subtracted from Expense Subject to Separations column LN 7259, Total Other Billing and Collection to arrive at LEC Insertion Processing. LEC Insertion Processing is distributed to Subscriber Line and Minute Driven based on the ratio of EX & Semi Users LN 7244 and MSG Toll Users LN 7241 respectively to Total Current Users LN 7240. The remainder is distributed to Intrastate

EU Local and Intrastate IX & EU LD based on the relative composite investment in both of these categories.

IX Inquiry is all assigned to the Billing and Collection category and is Total Bill Inq LN 7132 Interstate column plus Total IC Bill Inq Interstate column LN 7190 divided by (Total Bill Inq LN 7132 Interstate column plus Total IC Bill Inq Interstate column LN 7190 plus Total EU Pay & Col Interstate column LN 7112 plus Total IC Pay & Col Interstate column LN 7170) grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. This amount is subtracted from the sum of Total Billing Inquiry Subject to Separations column LN 7132 and Total IC Bill Inquiry Subject to Separations column LN 7190 to arrive at LEC Inquiry Processing. Part of LEC Inquiry Processing is allocated to Subscriber Line based on the ratio of # Other WAC (Weighted Average Contacts) LN 7126 to #Total WAC LN 7120. Another part to Intrastate EU Local and Intrastate IX & EU LD based the ratio of #State PL WAC LN 7121 to #Total WAC LN 7120 and then their relative percentage of composite investment for Intrastate EU Local and Intrastate IX & EU LD. Interstate Special is assigned a part equal to Total Cat 1 Special Access column minus PL & Special Total Interstate column from lines 7092, 7147 and 7167. Minute Driven is assigned the remaining part.

IX Collecting is all assigned to the Billing and Collection category and is the Total Cat 1 Billing and Collection column LN 7220 minus (IX Inquiry determined above before the gross up) grossed up by the ratio of Total B&C Revenue to Interstate B&C Revenue. This amount is subtracted from the sum of Total EU Pay & Col Subject to Separations column LN 7112 and Total IC Pay & Col Subject to Separations column LN 7170 to arrive at LEC Collecting. LEC Collecting is distributed as follows: PL & Special Total Interstate column 7167 is assigned to Interstate Special. Subscriber Line is assigned LEC Collecting Total times the ratio of #Local Bill Rev LN 7105 to #Total Bill Rev LN 7100. Intrastate EU Local and Intrastate IX & EU LD are distributed from LEC Collecting Total based the ratio of #State PL Billed Rev LN 7101 to #Total Bill Rev LN 7100 and then their relative percentage of composite investment for Intrastate EU Local and Intrastate IX & EU LD. The remaining LEC Collecting Total is assigned to Minute Driven.

Carrier Access Billing System

Phase I - Functional Categorization

In Phase I, the Carrier Access LN 7281 Special Access Column is assigned to the Interstate Special category. Carrier Access LN 7270 Subject to Separations column minus the Interstate Special assignment is distributed to the Intrastate IX & EU LD and Minute Driven categories based on the relative percentages of composite investment in the Intrastate IX & EU LD.

Phase II - Line of Business Assignment

In Phase II, Unassigned is distributed based upon the relative percentages of the previously distributed billing expenses to Miscellaneous, Private Line, Subscriber Line and Minute Driven. Minute Driven is assigned to the Toll BU.

Coin Collection/Administration

Phase I - Functional Categorization

In Phase I, the Coin Collection/Administration is assigned to Unassigned.

Phase II - Line of Business Assignment

For all Billing Line Items, in Phase II, Step 1, Coin Collection/Administration Unassigned is assigned to Miscellaneous. In Step 2, Minute Driven for CABS is assigned to Access and all LEC Billing Items are assigned to Interoffice. In Step 3, all LEC Interoffice is assigned to the Toll BU.

G & A

Corporate Operations

Phase I - Functional Categorization

In Phase I, the Corporate Operations Special Access column LN 7334 and the Billing and Collection Column LN 7334 grossed up by the ratio of B&C Revenue Subject to Separations column to the B&C Revenue Total Interstate column are assigned to Corporate Operations line items based on their relative proportions of Corporate Operations subtotal. All the other functional categories except Unassigned receive a distribution based on the Big Three Factor. Unassigned receives the remaining undistributed portion of the line items. Corporate Operations items were distributed by Big Three in Phase I in total as well as for the Information Management line specifically. Lastly, Phase I is adjusted by moving all line item totals except Information Management to Unassigned.

Phase II - Line of Business Assignment

In Phase II, the Network, Billing and MS&A subtotals are used to determine percentages for distributing Unassigned to Miscellaneous, Private Line, Subscriber Line and Minute Driven; the Minute Driven column to Access and Interoffice categories; and the Interoffice column to Local Interoffice and Toll categories.

Operating Taxes

Phase I - Functional Categorization

In Phase I, the Total Other State & Local LN 8005 Special Access column is assigned to the Interstate Special category. Direct Other State & Local LN 8002 Subject to Separations column and All Other State & Local LN 8003 Subject to Separations column minus the Interstate Special category assignment is assigned to the Unassigned category.

Phase II - Line of Business Assignment

In Phase II, the Network, Billing and MS&A subtotals are used to determine percentages for distributing Unassigned to Miscellaneous, Private Line, Subscriber Line and Minute Driven; the Minute Driven column to Access and Interoffice categories; and the Interoffice to Local Interoffice and Toll categories.

Investment

Phase I - Functional Categorization

Net Investment serves as a basis for identifying the Phase III Rate-of-Return and FIT Gross-Up statistics. In Phase I, account specific Gross Investment data are obtained from the ARMIS 43-04 report and allocated to the Billing and Collection, Directory, Interstate Private Line (Intrastate EU Local and Intrastate IX & EU LD), Special Access, Subscriber Line, Minute Driven or Unassigned functional categories.

The various classes of investment are either assigned or distributed based on the use of the underlying investment or of related investment from a cost causative perspective or failing that are based upon a general distribution approach such as the Big Three where General Support Facilities are involved for example or such other prior distributions as are appropriate as a basis for the current distribution.

Information Originating/Terminating

The underlying investment for Information Originating/Terminating is assigned as follows:

- Subscriber Line receives LN 1440 Tot IOT Equipment less Special Access and an assignment to Intrastate EU Local PL.

Central Office Equal Access

The underlying investment for Central Office Equal Access is assigned as follows:

- Minute Driven less Special Access receives LN 30.

Central Office Operator Systems

The underlying investment for Central Office Operator Systems is assigned as follows:

- Minute Driven less Special Access receives LN 1170.

Central Office Switching

The underlying investment for Central Office Switch is assigned as follows:

- Minute driven receives Direct Message 36, LN 1201 and 1211; and Joint 36, LN 1202 and 1212; and Direct PL 36 LN 1200 and 1210 less Special Access.

Cable & Wire Facilities

The underlying investment for C&WF is assigned as follows:

- Subscriber Line receives LN 1455 Sub/Common Line.
- Intrastate EU Local receives less Special Access LN 1454 Private Line WATS, LN 1470 Nonwideband Private Line and LN 1480 Wideband Private Line.
- Minute Driven receives LN 1522 Joint Message, LN 1497 through 1500 Direct/Joint Msg and LN 1470 through 1471 Direct/Joint Message.
- Intrastate IX & EU LD receives less Special Access LN 1496 Direct Private Line.

Central Office Circuit

The underlying investment for Central Office Circuit is assigned as follows:

- Minute Driven receives LN 1231 Direct Message 36, LN 1232 Joint 36, LN 1338 Direct Message 36, LN 1338 Joint 36, LN 1391 Direct Message 36 and LN 1392 Joint 36.
- Subscriber Line receives LN 1275 Sub/Common Line.
- Intrastate EU Local receives less Special Access LN 1220 Direct PL 36, LN 1230 Direct PL 36, LN 1250 Direct PL 36 and LN 1274 PL/WATS 36.
- Intrastate IX & EU LD receives less Special Access LN 1320 Direct PL 36 and LN 1336 Direct PL 36.
- Special Access also receives LN 1280 Direct PL 36 and LN 1350 Direct PL 36.

Other investment categories are assigned to functional categories as follows:

<u>Title</u>	<u>Distributing Algorithm</u>	<u>43-04 LN</u>
General Support Facilities	Big Three	1004
Capital Leases:GSF	Big Three	2001
Capital Leases:Switch	Switching Investment	2003
Capital Leases:Operator Systems	Operator Systems Investment	2005
Capital Leases:Circuit	Circuit Investment	2007
Capital Leases:IOT	IOT Investment	2009
Capital Leases:C&WFC&WF	Investment	2011
Capital Leases:Other	Capital Lease:GSF	2013
Leasehold Improvements	Big Three Factor	2070
Intangibles	TPIS Less Intangibles	2160

Other Plant:PHFTU	Telephone Plant in Service	2190
Other Plant:TPUC Short	Telephone Plant in Service	2191
Other Plant: TPUC Long	Telephone Plant in Service	2192
Telephone Plant Adjustment	Telephone Plant in Service	2193
Inventories and so on	C&WF Investment	2221

Once the Gross Investment has been distributed, the Reserves for Accumulated Depreciation, Amortization and Deferred FIT are distributed in a similar fashion resulting in Net Investment by functional category.

Phase II - Line of Business Assignment

In Phase II the resulting Net Investment dollars are then redistributed into the five distinctive lines of business.

In Step I , the Unassigned portion is distributed based on the already distributed relative percentages of the Net Investment in Phase I. In Step 2, Minute Driven is distributed to Access and Interoffice in the same proportion as Step 2 Total Depreciation - Access and Interoffice are respectively to Step 1 Total Depreciation - Minute Driven. In Step 3, Minute Driven is distributed to Local Interoffice and Toll in the same proportion as Step 3 Total Depreciation - Local Interoffice and Toll are respectively to Step 2 Total Depreciation - Interoffice.

IDENTIFICATION AND ASSIGNMENT FACTORS

Big Three Factor: This factor is used to distribute depreciation and network expenses proportionally based on the accounts which they support. Those accounts are included in the three major expense categories: plant specific (excluding support accounts); plant non-specific and customer operations. Expenses are distributed based on the level of these "Big Three" expenses. This methodology is a commonly used apportionment method and is described in the FCC's Part 36 Separations procedures.

Customer Interest Factor: Is the interest rate multiplied against the Customer Deposits to determine the Interest Expense that will be avoided.

Hybrid Switching/Trunking Factor: The distribution of Network Operations - Power, Network Administration, Testing, Plant Administration, Engineering and Support between the Access and Interoffice functions uses the weighted sum of the Switching Minute Driven Factor for access and the Trunking Minute Driven Factor for access to determine the distribution to the Access function and the remainder is assigned to the Interoffice function. The weighting is driven by the use of Switching and Trunking Access by the portion of Network CO - Operator Systems, Network CO - Switching, Network CO - Circuit and Cable and Wire that are associated with Switching and Trunking. This hybrid weighting of minutes for both Switching and Trunking provides a reasonable means for distributing the minute driven costs of the administrative activities.

Local Conversation Minutes: A component in many of the Switching factors used throughout the model to assign costs to various Product Lines. Equal to the Local DEM divided by 2.12. This 2.12 factor accounts for the originating and terminating points and allows for breakage (ring no answer, etc.).

Local Dial Equipment Minutes (DEM): Used as an element for the development of Local Conversation Minutes and Local Interoffice Minutes. The Local DEM is created by taking the Intrastate DEM from the 43-04 multiplied by the Local State DEM Factor, defined as Local DEM divided by the Total Intrastate DEM as reported in the NECA Operating Statistics Report. This result is multiplied by a factor for Local Switched Minutes of Use from the 1989 FCC Study.

Local Interoffice Minutes: A component in the Switching and Trunking factors used throughout the model to assign costs to various functional categories. Equal to the Intrastate DEM from ARMIS 43-04 multiplied by the Local State DEM factor minus Local DEM minutes and the result is converted to conversation minutes by dividing by 2.12.

Subscriber Switching Factor: Is 19.9% which is an AT&T estimate of how much switching capacity is dedicated to the subscriber line versus costs associated with the minute driven business.

Switched Access Factor: Used to assign Intrastate Network Access revenues to Switched Access and Private Line revenues. The factor is developed by multiplying the AT&T Intrastate Access rate by the RBOC Intrastate minutes which yields an estimated Total Switched Access Revenues which is then divided by the Total State Access Revenues.

Switching Interoffice Factor: The factor developed when Local Interoffice and Toll Minutes are multiplied by weighting factors of 2.07 for Local Interoffice and 2.4 for Toll. The percentage of weighted results are appropriate for distribution Switching Interoffice expenses (i.e. Depreciation - Switching and Network CO - Switching) between the Local Interoffice and Toll functions. The weighting factors are developed by taking the number of switches used on the various type of calls weighted by the percentage of calls of that type made. Minutes are a reasonable means for distributing the costs of the switching activity.

Switching Minute Driven Factor: The factor developed when Local, Access, Local Interoffice and Toll Minutes are multiplied by weighting factors of 1 for Local, 1.4 for Access, 2.07 for Local Interoffice and 2.4 for Toll. The percentage of weighted results are appropriate for distributing Switching Minute Driven expenses (i.e. Depreciation - Switching and Network CO - Switching) between the Subscriber Line, Access and Interoffice functions. The weighting factors are developed by taking the number of switches used on the various type of calls weighted by the percentage of calls of that type made. Minutes are a reasonable means for distributing the costs of the switching activity.

Toll Minutes: Toll minutes are calculated using two methodologies. The method that yields the most reasonable answer is chosen. Reasonableness is characterized as being within a range of acceptable revenues per toll minute. Method I calculates Toll Minutes by subtracting Intrastate InterLATA minutes from Non-local Intrastate minutes. Method II calculates an average Minute per Call for Intrastate IntraLATA traffic and multiplies this average against Total IntraLATA Intrastate Calls to arrive at Toll Minutes.

Trunking Interoffice Factor: The factor developed when Local Interoffice and Toll Minutes are multiplied by weighting factors of 1.07 for Local Interoffice and 1.4 for Toll. The percentage of weighted results are appropriate for distributing Trunking Interoffice expenses (i.e. Depreciation - General Support, Depreciation - Cable & Wire, Network CO - Circuit, Network Cable & Wire, Operations - Power, Operations - Network Administration, Operations - Testing, Operations - Plant Administration, Operations - Engineering and Network Support) between the Local Interoffice and Toll functions. The weighting factors are developed by taking the number of trunks used on the various types

of calls weighted by the percentage of calls of that type made. Trunking minutes are a reasonable means for distributing minute driven costs of the trunking activity.

Trunking Minute Driven Factor: The factor developed when Access, Local Interoffice and Toll Minutes are multiplied by weighting factors of 1.4 for Access, 1.07 for Local Interoffice and 1.4 for Toll. The percentage of weighted results are appropriate for distributing Trunking Minute Driven expenses (i.e. Depreciation General Support, Depreciation - Cable & Wire, Network CO - Circuit, and Network Cable & Wire) between the Access and Interoffice functions. The weighting factors are developed by taking the number of trunks used on the various types of calls weighted by the percentage of calls of that type made. Trunking minutes are a reasonable means for distributing minute driven costs of the trunking activity.

Uncollectible Factor: Represents the rate of uncollectibles as a percent of revenue AT&T experiences in the long distance marketplace.

**SUMMARY OF AT&T AVOIDED COST STUDY
 OF BELLSOUTH 1995 FLORIDA AVOIDED RETAIL COSTS
 (\$000's)**

<u>Cost Category/Part 32 Account</u>	<u>Total Local A</u>	<u>Avoided Retail Cost Factor B</u>	<u>Avoided Retail Costs C (Col A*Col B)</u>
1 Uncollectibles - (5301)	41,943	100.0%	41,943
2 Product Management - (6611)	26,021	100.0%	26,021
3 Sales - (6612)	57,875	100.0%	57,875
4 Product Advertising - (6613)	26,585	100.0%	26,585
5 Customer Service & Billing - (6623)	174,720 (5)	100.0%	174,720
6 Operations - Testing (6533)	55,528	20.0% (4)	11,106
7 Operations - Plant Administration (6534)	64,946	20.0% (4)	12,989
8 Call Completion - (6621)	7,135	100.0%	7,135
9 Directory Assistance - (6622)	55,640	100.0%	55,640
10 Depreciation - Operator Systems - (ARMIS 43-04 Line 6040)	2,406	100.0%	2,406
11 Network - Co-Operator Systems - (6220)	1,257	100.0%	1,257
12 DIRECT COSTS (Lines 1 thru 11)	514,056		417,677
13 Network Support - (6120 & 6110)	139,306	27.5% (1)	38,276
14 Depreciation Support - (ARMIS 43-04 Line 6020)	69,977	27.5% (1)	19,227
15 General & Administrative - (6710, 6721, 6722, 6723, 6724, 6725, 6726, 6727, 6728, 7240)	468,953	27.5% (1)	128,850
16 Net Other Interest / Customer Deposits (7540)	21,426	04.2%	902 (2)
17 Return	435,243	03.3% (3)	14,254
18 Income Taxes	156,257	03.3% (3)	5,117
19 INDIRECT COSTS (Lines 13 thru 18)	1,291,162		206,627
20 TOTAL AVOIDED COSTS (Lines 12 and 19)			624,304
21 REVENUES	1,495,388		
22 DISCOUNT (Line 20 Col C / Line 21 Col A)			41.7%

Footnotes / Calculations

- Indirect Factor = Avoided Direct Costs (ln. 12C) / (Total Costs - Total Indirect Costs (ln. 19A)) = 27.5%

Total Costs =	\$2,811,304	
Total Local BU +	\$2,198,378	(Cost
Return +	\$435,243	components
Taxes +	\$156,257	from Page 2 of
Net Other Interest	\$21,426	Exhibit AL5)
- Net Other Interest = 100% of interest on Customer Deposits portion of the account. Interest calculated at 5%.
- Return & Income Taxes = (General Support Facilities Investment / Total TPIS) * (Indirect Factor) = 3.3%

Gen'l Support Facilities	\$987,477
Total Tele Plant in Service	\$8,284,534
% Gen'l Supp/Total TPIS	11.9%
- AT&T's internal customer-related testing and plant administration expense is approximately 50%. The use of the 20% factor represents a conservative estimate.
- See page 2 of Exhibit AL6.

1995 REGULATED BELL SOUTH TELECOMMUNICATIONS - Florida Financials
 Baseline version as a percent of revenues
 Total Local Business
 (\$ 000's)

	Total Local BU	Avoided Retail Cost Factor	Avoided Retail Amount	Footnotes to computations	Total Local \$per Ln/12	Avoided Retail \$per Ln/12
Revenues	\$1,495,388	41.7%	\$624,305	discount is 41.7 % of revenue	\$22.84	\$9.54
Interconnection	\$0					
Uncollectibles	\$41,943	100.0%	\$41,943	no uncollectibles with AT&T	\$0.64	\$0.64
Depreciation	\$582,211		\$21,634		\$8.89	\$0.33
Equal Access	\$0				\$0.00	\$0.00
Gen Support	\$69,977	27.5%	\$19,227	directly avoided / total - indirects	\$1.07	\$0.29
Switching	\$87,935				\$1.34	\$0.00
Oper Syst	\$2,406	100.0%	\$2,406	AT&T will use its own Ops.	\$0.04	\$0.04
Circuit	\$168,907				\$2.58	\$0.00
IOT	\$13,603				\$0.21	\$0.00
C&W	\$239,382				\$3.66	\$0.00
Other	\$0				\$0.00	\$0.00
Network	\$820,070		\$126,403		\$12.53	\$1.93
Support	\$139,306	27.5%	\$38,276	directly avoided / total - indirects	\$2.13	\$0.58
CO - Operator Systems	\$1,257	100.0%	\$1,257	AT&T will use its own Ops.	\$0.02	\$0.02
CO - Switching	\$73,395				\$1.12	\$0.00
CO - Circuit	\$37,161				\$0.57	\$0.00
Info O/T	\$43,864				\$0.67	\$0.00
Cable & Wire	\$251,107				\$3.84	\$0.00
Oper - Power	\$9,026				\$0.14	\$0.00
Oper - Ntwk Admin	\$15,891				\$0.24	\$0.00
Oper - Testing	\$55,528	20.0%	\$11,106	have our own cust. interface	\$0.85	\$0.17
Oper - Plant Admin	\$64,946	20.0%	\$12,989	have our own cust. interface	\$0.99	\$0.20
Oper - Eng	\$65,170				\$1.00	\$0.00
Equal Access	\$0				\$0.00	\$0.00
Other	\$644				\$0.01	\$0.00
Call Completion	\$7,135	100.0%	\$7,135	AT&T will use its own Ops.	\$0.11	\$0.11
DA	\$55,640	100.0%	\$55,640	AT&T will use its own Ops.	\$0.85	\$0.85
Pub Dir	\$0				\$0.00	\$0.00
Marketing, Sales & Adv	\$215,754	100.0%	\$215,754	no retail exp with wholesale operation	\$3.30	\$3.30
Product Management	\$26,021	100.0%	\$26,021		\$0.40	\$0.40
Sales	\$57,875	100.0%	\$57,875		\$0.88	\$0.88
Advertising	\$26,585	100.0%	\$26,585		\$0.41	\$0.41
Order Proc - IXC	\$0	100.0%	\$0		\$0.00	\$0.00
Order Proc - EU	\$88,804	100.0%	\$88,804		\$1.36	\$1.36
Other Cust. Operations	\$16,469	100.0%	\$16,469		\$0.25	\$0.25

1995 REGULATED BELLSOUTH TELECOMMUNICATIONS - Florida Financials
 Baseline version as a percent of revenues
 Total Local Business
 (\$ 000's)

	Total Local BU	Avoided Retail Cost Factor	Avoided Retail Amount	Footnotes to computations	Total Local \$per Lrv/12	Avoided Retail \$per Lrv/12
Billing	\$69,447	100.0%	\$69,447	no retail exp with wholesale operation	\$1.06	\$1.06
IXC - Msg Proc	\$0		\$0		\$0.00	\$0.00
IXC - Postage	\$0		\$0		\$0.00	\$0.00
IXC - Inq.	\$0		\$0		\$0.00	\$0.00
IXC - Collection	\$0		\$0		\$0.00	\$0.00
CABS	\$0		\$0		\$0.00	\$0.00
EU - Msg Proc	\$0	100.0%	\$0		\$0.00	\$0.00
EU - Postage	\$14,583	100.0%	\$14,583		\$0.22	\$0.22
EU - Inq.	\$40,592	100.0%	\$40,592		\$0.62	\$0.62
EU - Collection	\$14,272	100.0%	\$14,272		\$0.22	\$0.22
Coin Collect	\$0		\$0	\$0.00	\$0.00	
G&A	\$468,953	27.5%	\$128,851	directly avoided / total - indirects	\$7.16	\$1.97
Executive	\$10,872	27.5%	\$2,987		\$0.17	\$0.05
Finance	\$21,634	27.5%	\$5,944		\$0.33	\$0.09
Regulatory	\$18,769	27.5%	\$5,157		\$0.29	\$0.08
IMS	\$112,534	27.5%	\$30,920		\$1.72	\$0.47
Legal	\$10,784	27.5%	\$2,963		\$0.16	\$0.05
R & D	\$5,934	27.5%	\$1,631		\$0.09	\$0.02
Human Resources	\$31,322	27.5%	\$8,606		\$0.48	\$0.13
Procurement	\$6,439	27.5%	\$1,769		\$0.10	\$0.03
Other	\$108,631	27.5%	\$29,848		\$1.66	\$0.46
Tax	\$142,033	27.5%	\$39,025		\$2.17	\$0.60
Totals	\$2,198,378		\$604,032		\$33.58	\$9.23
Net operating Revenues	(\$702,990)					
Net Investment	\$3,868,826					
Return @ 11.25%	\$435,243	3.3%	\$14,254		\$6.65	\$0.22
FIT Gross Up @ 35%	\$156,257	3.3%	\$5,117		\$2.39	\$0.08
State & Lcl Income Tax	\$0	3.3%	\$0		\$0.00	\$0.00
Net Other Interest	\$21,426	4.2%	\$902	Interest on Customer Deposits	\$0.33	\$0.01
Total Discount		41.7%	\$624,305		\$42.94	\$9.54
Gross Investment						
Gen'l Support Facilities	\$987,477					
Total Tele Plant in Service	\$8,284,534					
% Gen'l Supp/Total TPIS	11.9%					

THE AT&T AVOIDED RETAIL COST MODEL

CALCULATIONS/ASSUMPTIONS

After the Avoided Retail Cost model creates the final LEC Income Statement by product line, we are able to go through the individual expense lines and determine which expenses would be "avoided" by the LEC in a wholesale business.

REVENUE/EXPENSE	PERCENT AVOIDED	REASONS
Revenues	%	The factor shown here is equal to the total avoided costs divided by the revenues. It is shown here to show the impact of the discount on revenue.
Uncollectibles	100%	The LEC will have no uncollectibles with AT&T
Depreciation		
General Support	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
Operator Systems	100%	AT&T will use its own operators
Network		
Support	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
CO-Operator Systems	100%	AT&T will use its own operators
Operation - Testing	20%	AT&T will maintain its own customer interface to deal directly with customer inquiries.
Operation - Plant Admin.	20%	AT&T will maintain its own customer interface to deal directly with customer inquiries.
Call Completion	100%	AT&T will use its own operators
Directory Assistance	100%	AT&T will use its own operators

EXPENSE	PERCENT AVOIDED	REASONS
Marketing, Sales & Advertising		
Product Management	100%	These retail expenses are not associated with wholesale operations.
Sales	100%	
Advertising	100%	
Order Proc. - IXC	100%	
Order Proc. - EU	100%	
Other Cust. Operations	100%	
Billing		
End User		AT&T will do its own billing.
Message Processing	100%	
Postage	100%	
Inquiry	100%	
Collection	100%	
General and Administrative		
Executive	Variable *	This indirect expense will follow the direct expenses; Uncollectibles, Depreciation - Operator Systems, Network - CO Operator Systems, Call Completion, Directory Assist., Marketing, Sales, Advertising and Billing
Finance	Variable *	
Regulatory	Variable *	
IMS	Variable *	
Legal	Variable *	
R & D	Variable *	
Human Resources	Variable *	
Procurement	Variable *	
Other	Variable *	
Tax	Variable *	
Return	Variable **	Reduced by an amount reflecting retail activity
Income Taxes	Variable **	Reduced by an amount reflecting retail activity
Other Interest Deductions (7540)	Variable ***	Interest on Customer Deposits not required.
		* The factor is calculated by summing the avoided costs for the direct expense categories and dividing that sum by the total local expense less the local indirect expense.
		** This factor is equal to Total General Support Assets divided by Total Plant in Service, multiplied by the avoided percent for indirect expense as identified in the factor above.
		*** The factor is calculated by dividing the amount of interest applicable to customer deposits by the total of net other interest.

State of Florida
Comparison of AT&T and BellSouth Cost Studies As Filed
1995 (Redacted Version)
(\$000's)

<u>Cost Category/Part 32 Account</u>	AT&T Avoided Costs A	BellSouth Residential Avoided Costs B	BellSouth Business Avoided Costs C	Total BellSouth Avoided Costs D = B + C
1 Uncollectibles - (5301)	41,943			
2 Product Management - (6611)	26,021			
3 Sales - (6612)	57,875			
4 Product Advertising - (6613)	26,585			
5 Customer Service & Billing - (6623) and a portion of (6722)	174,720			
6 Operations - Testing (6533)	11,106			
7 Operations - Plant Administration (6534)	12,989			
8 Call Completion - (6621)	7,135			
9 Directory Assistance - (6622)	55,640			
10 Depreciation - Operator Systems - (ARMIS 43-04 Line 6040)	2,406			
11 Network - Co-Operator Systems - (6220)	1,257			
12 DIRECTLY AVOIDED COSTS (Lines 1 thru 11)	417,677			
13 Network Support - (6120 & 6110)	38,276			
14 Depreciation Support - (ARMIS 43-04 Line 6020)	19,227			
15 General & Administrative - (6710, 6721, 6722, 6723, 6724, 6725, 6726, 6727, 6728, 7240)	128,851			
16 Return	14,254			
17 Income Taxes	5,117			
18 Net Other Interest	902			
19 INDIRECTLY AVOIDED COSTS (Lines 13 thru 18)	206,627			
20 TOTAL AVOIDED COSTS (Lines 12 and 19)	624,304			
21 REVENUES	1,495,388			
22 DISCOUNT	41.75%			

STATE OF FLORIDA
1995 (Redacted Version)
(\$000's)

<u>Cost Category/Functions</u>	AT&T Avoided Costs A (1)	BellSouth Residential Avoided Costs C	BellSouth Business Avoided Costs B
1 Order Processing EU	88,804	(2)	(8)
2 Other Customer Operations	16,469	(3)	(9)
3 EU Postage (Billing)	14,583		
4 EU Inquiry (Billing)	40,592	(4)	(10)
5 EU Collection (Collection)	14,272	(5)	(11)
6 Billing (Postage & Printing)		(6)	(12)
7 Advertising - Bill Inserts		(7)	(13)
8 TOTAL	174,720		

- Source: (1)
 (2)
 (3)
 (4)
 (5)
 (6)
 (7)

 (8)
 (9)
 (10)
 (11)
 (12)
 (13)

State of Florida
AT&T's Alternative Avoided Cost Analysis for BellSouth
(Redacted Version)

	BellSouth Revised Res. Avoided Costs A (2)	BellSouth Revised Bus. Avoided Costs B (2)	Total BellSouth Revised Avoided Costs C = A+B
(\$000's)			
Uncollectibles (1)			
Product Management			
Sales (1)			
Advertising			
Cust. Serv & Billing + Bill Inserts (1)			
Operations - Testing			
Operations - Plant Administration			
Call Completion			
Directory Assistance			
Depreciation - Operator System			
Network - Co-Operator System			
DIRECTLY AVOIDED COSTS			
Network Support			
Depreciation Support			
General & Administrative			
Return			
Income Taxes			
Net Other Interest			
INDIRECTLY AVOIDED COSTS			
TOTAL AVOIDED COSTS			
REVENUES			
DISCOUNT			
Sources: (1)			
(2)			
(3)			
(4)			
(5)			

STATE OF FLORIDA
 CALCULATION OF ALTERNATIVE AVOIDED COST ADJUSTMENTS
 (\$000's)
 (Redacted Version)

Account/Title	BellSouth Direct Retail Regulated Costs A (1)	Percentage Avoided B	Total Avoided Costs C = A x B	Res. Avoided Costs D =	Bus. Avoided Costs E =
6612 - Sales					
6611 - Product Management					
6613 - Prod. Advertising					
6623 - Customer Services & Bill Inserts					
6533 - Operations - Testing					
6534 - Operations - Plant Administration					
6621 - Call Completion					
6622 - Number Service (Directory Assistance)					
6040 - Depreciation - Operator System					
6220 - Network - Operator System					

- Source - (1)
 (2)
 (3)
 (4)