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SUPPLEMENTAL TESTIMONY OF

ART LERMA

ON BEHALF OF AT&T COMMUNICATIONS OF

THE SOUTHERN STATES, INC.

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

Docket No. 88-033-11

Filed: August 23, 1996

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

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

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by AT&T as Area Controller-Regional Controller Organization.

Q. DID YOU FILE TESTIMONY PREVIOUSLY IN THIS DOCKET?

A. Yes. I addressed the determination of wholesale prices for BellSouth services subject to resale through the presentation of an avoided cost study.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

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1 A. The purpose of this testimony is to provide the AT&T simplified avoided cost
2 (“ASAC”) study. This study complies with the regulations regarding wholesale
3 prices for services subject to resale as set forth in the FCC’s Order released August 8,
4 1996. The ASAC study results in a recommended permanent percentage reduction of
5 39.99% which would apply to all Florida retail local, toll, and private line BellSouth
6 services rates.

7
8 **Q. WHAT IS THE CRITERIA SET FORTH BY THE FCC FOR USE IN**
9 **DETERMINING THE WHOLESALE PRICE FOR SERVICES SUBJECT**
10 **TO RESALE?**

11
12 A. Generally, the FCC states that wholesale prices equal retail rates less avoided retail
13 costs. The FCC requires that avoided costs be established by a cost study that
14 considers the following pertinent criteria:

- 15
16 1. The FCC Order provides that “‘the portion [of the retail rate] . . .
17 attributable to costs that will be avoided’ includes all of the costs that the
18 LEC incurs in maintaining a retail, as opposed to a wholesale, business.”
19 FCC Order, ¶ 911, at 455.
- 20
21 2. The FCC Order also provides that “‘an avoided cost study must include
22 indirect, or shared, costs as well as direct costs.” FCC Order, ¶ 912, at 455.
- 23
24 3. Further, the FCC states that “[a] portion of contribution, profits, or
25 markup may also be considered ‘attributable to costs that will be avoided’

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when services are sold wholesale.” FCC Order, ¶ 913, at 456.

4. Under the FCC criteria, “[a]n avoided cost study may not calculate avoided costs based on non-cost factors or policy arguments.” FCC Order, ¶ 914, at 456.

5. The FCC Order also provides that the Act “precludes use of a ‘bottom up’ TSLRIC study to establish wholesale rates that are not related to the rates for the underlying retail services.” FCC Order, ¶ 915, at 456.

6. The FCC notes in its Order that “[w]e neither prohibit nor require use of a single, uniform discount for all of an incumbent LEC’s services.” FCC Order, ¶ 916, at 456.

7. According to the FCC Order, the direct costs in the following Uniform System of Accounts (“USOA”) accounts are presumed avoidable:

- 6611-product management
- 6612-sales
- 6613-product advertising
- 6621-call completion services
- 6622-number services (also referred to as directory assistance)
- 6623-customer services (includes billing and collection)

A LEC may rebut the presumption of avoidance by showing costs will be incurred for wholesale activities or the costs are not in the retail price. FCC Order ¶ 917, at 457.

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8. Under the FCC Order, indirect expenses in the following USOA accounts are presumed to be avoided in proportion to the avoided direct expenses:

6121 to 6124-general support expenses

6711, 6712, and 6721 to 6728-corporate operations expenses

5301-telecommunications uncollectibles

FCC Order, ¶ 918, at 457.

9. The FCC Order also provides that “[p]lant-specific and plant non-specific expenses (other than general support expenses) are presumptively not avoidable.” FCC Order, ¶ 919, at 457. The new entrant may rebut the presumption by showing that any of those costs can be reasonably avoided.

10. Further, the FCC Order states that “based on the record before us, we establish a range of default discounts of 17-25 percent that is to be used in the absence of an avoided cost study that meets the criteria set forth above.” FCC Order, ¶ 932, at 462.

Q. ARE THERE COSTS THAT THE FCC ORDER AND REGULATIONS SUPPORT AS AVOIDABLE BUT ARE NOT SPECIFICALLY CAPTURED IN A USOA ACCOUNT?

A. Yes. The FCC states that “[i]n AT&T’s model, the portion of return on investment (profits) that was attributable to assets used in avoided retail activities was treated as an avoided cost.” FCC Order, ¶ 913, at 456. The FCC found that this approach was

1 consistent with the Act. The ASAC study also includes this same calculation of
2 avoided return and the corresponding income taxes.

3

4 **Q. HAVE YOU PERFORMED A STUDY THAT COMPLIES WITH THE FCC**
5 **REGULATIONS FOR DETERMINING AVOIDED COSTS?**

6

7 **A.** Yes. It is attached to this testimony as Exhibit ALS-1.

8

9 **Q. BRIEFLY EXPLAIN WHAT APPEARS ON EXHIBIT ALS-1.**

10

11 **A.** Exhibit ALS-1 is the ASAC study and includes all USOA accounts that are presumed
12 avoidable in the FCC's Order in paragraphs 917 and 918. It also includes an amount
13 of avoided costs pertaining to return and related income taxes as supported in
14 paragraph 913 of the FCC Order. In addition, costs are reflected in the ASAC study
15 that are not presumed avoidable in the FCC's rules. These costs are discussed later in
16 this testimony. AT&T believes that all or portions of these other costs can be
17 reasonably avoided. Exhibit ALS-1 also provides a calculation of the revenues
18 subject to resale which in essence include all local, toll, and private line revenues.
19 Lastly, Exhibit ALS-1 provides a calculation of the 39.99 avoided cost percentage
20 reduction, or discount factor, that applies to Florida local, toll and private line retail
21 services.

22

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

24

25 **A.** Local services include basic area message services such as flat rate local services,

1 measured local services, "vertical" features such as call waiting and forwarding and
2 expanded area calling plans.

3

4 **Q. WHAT ARE TOLL SERVICES?**

5

6 A. Toll services include message services which utilize the public long distance network
7 and are placed over basic subscriber access lines, along with long distance calls
8 placed from mobile and public telephones.

9

10 **Q. WHAT ARE PRIVATE LINE SERVICES?**

11

12 A. Private line services include dedicated circuits and private switching services.

13

14 **Q. HAVE YOU PROVIDED WORKPAPERS IN SUPPORT OF THE LINE**
15 **ITEMS APPEARING ON EXHIBIT ALS-1?**

16

17 A. Yes. Exhibit ALS-2 is a copy of the supporting workpapers for the ASAC study.
18 The cost and revenues are primarily obtained from the Automated Report
19 Management Information Systems ("ARMIS") 43-03 reports as noted in the
20 workpapers.

21

22 **Q. WHY ARE ACCESS AND MISCELLANEOUS REVENUES AND COSTS**
23 **EXCLUDED FROM THE CALCULATION OF THE AVOIDED COSTS**
24 **DISCOUNT FACTOR?**

25

1 A. According to the FCC regulations, “[a]n incumbent LEC shall offer to any requesting
2 telecommunications carrier any telecommunications service that the incumbent LEC
3 offers on a retail basis to subscribers that are not telecommunications carriers for
4 resale at wholesale rates that are at the election of the state commission.” 47 C.F.R.
5 § 51.605(a). Access services (see 47 C.F.R. § 51.607(b)) and miscellaneous services
6 are not generally offered to “subscribers that are not telecommunications carriers”
7 and are excluded from the ASAC study. The methodology to accomplish the
8 identification of access and miscellaneous costs is provided on page 3 of Exhibit
9 ALS-2. Because access and miscellaneous costs are excluded from the calculation,
10 access and miscellaneous revenues are not reflected on the calculation of the revenues
11 subject to resale.

12
13 **Q. WHAT COSTS ARE INCLUDED IN THE ASAC STUDY THAT ARE NOT**
14 **SPECIFICALLY PRESUMED AVOIDABLE IN THE FCC ORDER AND**
15 **REGULATIONS AND EXPLAIN WHY THEY ARE INCLUDED IN THE**
16 **COST STUDY?**

17
18 A. AT&T has included costs for accounts 6220 (operator systems), 6533 (operations
19 testing), 6534 (operations plant administration), and 6560 (the portions of
20 depreciation expense pertaining to operator systems and general support assets).
21 AT&T’s study reflects those costs based on direction provided in 47 C.F.R.
22 § 51.609(d). That regulation states that “[c]osts included in accounts 6110-6116 and
23 6210-6565 . . . may be treated as avoided retail costs and excluded from wholesale
24 rates, only to the extent that a party proves to a state commission that specific costs in
25 these accounts can reasonably be avoided when an incumbent LEC provides a

1 telecommunications service for resale to a requesting carrier.” Id.

2

3 **Q. WHY DOES AT&T’S STUDY CONSIDER AS AVOIDABLE THE COSTS**
4 **OF OPERATOR SYSTEMS (ACCOUNT 6220) AND A PORTION OF**
5 **DEPRECIATION EXPENSE PERTAINING TO OPERATOR SYSTEMS**
6 **(INCLUDED IN ACCOUNT 6560)?**

7

8 **A.** This calculation is necessary and consistent with two other categories of costs that are
9 presumed avoided in the FCC Order and regulations. Specifically, those costs that
10 are captured in accounts 6621 (call completion services) and 6622 (number services)
11 are costs that are avoided because these are operator service-related. Paragraph 917
12 of the FCC’s Order states that these costs are avoided “because resellers have stated
13 they will either provide these services themselves or contract for them separately from
14 the LEC or from third parties.” FCC Order, ¶ 917, at 457. Given that resellers will
15 perform their own operator services, the LEC’s wholesale business would not require
16 the use of any operator systems and likewise would incur no operator systems
17 equipment costs (which is the definition of account 6220 per the FCC’s USOA rules)
18 in the provision of its wholesale business. Likewise, there is a component of
19 *depreciation expense pertaining to operator systems assets included in account 6560.*
20 *Because this depreciation expense is related to operator systems, it too can reasonably*
21 *be avoided for BellSouth’s wholesale business.*

22

23 **Q. WHY DOES AT&T’S STUDY CONSIDER COSTS OF TESTING**
24 **(ACCOUNT 6533) AND PLANT ADMINISTRATION (6534) AVOIDABLE**
25 **COSTS?**

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A. According to Part 32 of the FCC's USOA rules, account 6533 (testing expense) includes "costs incurred in testing telecommunications facilities from a testing facility (test desk or other testing system) to determine the condition of plant on either a routine basis or prior to assignment of the facilities; receiving, recording and analyzing trouble reports; testing to determine the nature and location of reported trouble condition; and dispatching repair persons or otherwise initiating corrective action." Account 6534 (plant administration) includes "costs incurred in the general administration of plant operations. This includes supervising plant operations; planning, coordinating, and monitoring plant operations; and performing staff work." AT&T has requested an electronic interface with BellSouth's service trouble reporting database. This will allow AT&T to perform both immediate and high quality initial trouble analysis (including receiving, recording and when a customer reports trouble on his line). Based on AT&T's experience, about 50% of its own testing and plant administration costs involve end user customers. Based on this experience, AT&T conservatively estimates that approximately 20% of BellSouth's customer related testing costs can reasonably be avoided. In addition, all plant administration costs incurred in support of the customer interface portion of testing functions are impacted, so that 20% of these costs can also reasonably be avoided.

Q. WHY DOES AT&T'S STUDY CONSIDER DEPRECIATION EXPENSES PERTAINING TO GENERAL SUPPORT ASSETS (INCLUDED IN ACCOUNT 6560) AS AVOIDABLE COSTS?

A. Depreciable general support assets are the assets reflected in accounts 2112 through

1 2124. These accounts include costs for motor vehicles, aircraft, special purpose
2 vehicles, garage work equipment, other work equipment, buildings, furniture, office
3 equipment, and general purpose computers respectively. Those assets that were
4 previously used to support the retail business are not required in their entirety for the
5 provision of BellSouth's wholesale business. Consequently, a portion of the
6 depreciation expense in account 6560 pertaining to these general support assets can
7 reasonably be avoided. The portion of this depreciation cost that is avoided is
8 calculated using the same ratio that is used to calculate other indirect costs previously
9 mentioned.

10

11 **Q. IS AT&T'S TREATMENT OF UNCOLLECTIBLES DIFFERENT FROM**
12 **THAT REFLECTED IN THE FCC ORDER AND REGULATIONS? IF SO,**
13 **WHY?**

14

15 **A. Yes. The FCC's Order and regulations categorize costs from account**
16 **5301 (telecommunications uncollectibles) as an indirect avoided cost. The rules**
17 **specify that only a portion of indirect costs shall be determined as avoided. AT&T's**
18 **study assumes that 100% of these costs are avoided because in a resale environment,**
19 **the liability for end user uncollectibles transfers in total to the reseller. In fact, in the**
20 **states where BellSouth has previously filed their avoided cost studies before**
21 **Commissions (including Georgia and Tennessee), they too have calculated**
22 **uncollectibles as 100% avoided.**

23

24 **Q. HOW HAS AT&T CALCULATED THE PORTION OF INDIRECT**
25 **EXPENSES , OTHER THAN UNCOLLECTIBLES, THAT ARE**

1 **PRESUMED AVOIDABLE IN THE FCC'S ORDER AND REGULATIONS?**

2 **PLEASE EXPLAIN.**

3

4 A. AT&T has calculated a ratio of directly avoided costs to total direct costs which is
5 then applied to indirect costs. This ratio is developed by taking directly avoided costs
6 totaling \$519,025,000 for BellSouth in Florida, divided by total direct costs of
7 \$1,851,059,000. The ratio that results is 28%. The ratio that is applied to avoided
8 return and income taxes is 3.65%. That calculation is provided on page 4 of Exhibit
9 ALS-2.

10

11 **Q. IS THE ASAC STUDY APPROPRIATE FOR THIS COMMISSION TO SET**
12 **PERMANENT WHOLESALE RATES?**

13

14 A. Yes. The recommended permanent percentage reduction of 39.99% was calculated
15 consistent with the FCC's criteria for avoided cost studies necessary for setting
16 permanent rates. For that reason, the ASAC study does not rely on the FCC's
17 methodology to produce interim default rates.

18

19 **Q. DOES THE ASAC STUDY YIELD A DIFFERENT AVOIDED RETAIL**
20 **COST PERCENTAGE THAN THE PERCENTAGE FILED WITH YOUR**
21 **INITIAL DIRECT TESTIMONY?**

22

23 A. Yes. The percentage in my initial direct testing was 41.7% and the recommended
24 permanent percentage in this testimony is 39.99%. The difference exists primarily
25 because AT&T reclassified certain costs to comply with the FCC's order and

1 calculated a retail cost percentage for all services, rather than just local services, to
2 simplify the study.

3

4 **Q. SHOULD THIS COMMISSION ORDER BELLSOUTH TO PRODUCE A**
5 **STUDY CONSISTENT WITH THE FCC REGULATIONS?**

6

7 **A.***No. I believe AT&T's study is fully compliant with the FCC's regulations.*

8

9 **Q. WHY DOES THE COST STUDY PROVIDED IN EXHIBIT ALS-1 COMPLY**
10 **WITH THE FCC'S CRITERIA AND REGULATIONS FOR IDENTIFYING**
11 **AVOIDED COSTS?**

12

13 **A.**First, AT&T's cost study is a top-down study based on embedded costs as reflected
14 on BellSouth's publicly available ARMIS reports. Second, all of the USOA cost
15 categories that are presumed avoidable in the FCC regulations, are considered
16 avoided in the AT&T study. Third, to the extent that costs are included in the study
17 that are not presumed avoidable in the FCC regulations, AT&T provides supporting
18 rationale that demonstrates why these costs should be reflected as avoided costs.
19 Finally, AT&T properly identifies costs subject to proration between retail and
20 wholesale.

21

22 **Q. IF THE COMMISSION WERE TO DISAGREE WITH YOUR**
23 **CONCLUSION THAT AT&T'S STUDY IS COMPLIANT WITH FCC**
24 **REGULATIONS, WHAT DO YOU RECOMMEND THE COMMISSION**
25 **DO?**

1

2 A. First, available cost data in all AT&T avoided cost studies supports a retail cost
3 reduction above the maximum default rate of 25%. Thus, the Commission should
4 order an interim retail cost reduction at the highest end of the default range of 17-
5 25%; specifically it should order a 25% interim cost reduction. Second, the
6 Commission should order BellSouth to produce a detailed study and all supporting
7 information that would allow testing and validation in a regulatory proceeding.

8

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

10

11 A. Yes.