

ORIGINAL

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION  
REBUTTAL TESTIMONY OF  
LEE L. SELWYN  
ON BEHALF OF  
AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.,  
AND  
MCI TELECOMMUNICATIONS CORPORATION  
AND  
MCI METRO ACCESS TRANSMISSION SERVICES, INC.

DOCKET NOs.: 960833-TP/960846-TP/971140-TP/960757-TP/960916-TP

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**Introduction:**

**Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.**

A. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), One Washington Mall, Boston, Massachusetts 02108.

**Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN THIS PROCEEDING?**

A. Yes, I submitted pre-filed direct testimony on November 13, 1997.

**Q. ON WHOSE BEHALF IS THIS REBUTTAL TESTIMONY BEING SUBMITTED?**

A. This testimony is being submitted on behalf of AT&T Communications of the Southern Region, Inc., MCI Telecommunications Corporation, and MCI Metro Access Transmission Services, Inc.

**Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY AT THIS TIME?**

1 A. My rebuttal testimony responds to the direct testimony of Mr. Alphonso Varner  
2 that supports BellSouth's recurring cost studies for unbundled network elements  
3 (UNEs) and its pricing proposals for those elements, and the testimony of Mr. Eno  
4 Landry on the processes involved in the fulfillment of service requests initiated by  
5 ALECs.

6

7 **ECONOMIC EFFICIENTCY, AS WELL AS POLICIES ADOPTED BY**  
8 **THIS COMMISSION AND THE UNITED STATES CONGRESS,**  
9 **REQUIRE THAT RECURRINGAND NONRECURRING RATES FOR**  
10 **UNBUNDLED NETWORK ELEMENTS BE SET AT THEIR TOTAL**  
11 **SERVICE LONG RUN INCREMENTAL COST**

12

13 **Q. DR. SELWYN, PLEASE EXPLAIN THE DISTINCTION BETWEEN**  
14 **"HISTORICAL" COSTS AND "ECONOMIC" COSTS IN THE**  
15 **CONTEXT OF RATE DEVELOPMENT FOR UNBUNDLED NETWORK**  
16 **ELEMENTS (UNES).**

17 A. "Historical" costs refer to the costs that have previously been incurred by a firm  
18 such as BellSouth during its operations over a given period of time, and which  
19 will be recorded in its books of account. Assuming that its accounting entries are  
20 accurate, the firm's historical costs will reflect all costs that were incurred by the  
21 firm without specific reference to the products, services, business strategies, or  
22 other factors that may have caused the Company to incur such costs, or the extent  
23 to which those costs have been inflated by systemic inefficiencies in the  
24 Company's operations. "Historic" or "embedded" costs reflect the firm's "revenue  
25 requirement" as this concept has been applied in the public utility field, and

1 includes depreciation and return on previously-incurred capital investments in  
2 plant and equipment, as well as ongoing expenses that may be incurred by the  
3 utility under existing operating practices, systems and technologies.

4  
5 In contrast, "economic costs" are defined as the costs that bear upon an economic  
6 decision, such as whether or not to produce a given service or element, and are not  
7 necessarily equivalent to the embedded accounting costs recorded on a firm's  
8 books. (See, e.g., W. Nicholson, *Microeconomic Theory*, 2nd edition, Dryden  
9 Press: 1978, at 221-222.) A defining characteristic of economic costs is that  
10 (unlike historic cost) they are assumed to be *efficiently incurred*, meaning that the  
11 resources devoted to the particular service or element could not be reallocated to  
12 some other use without reducing output. (*Id.*, at 520-521.) In other words, the  
13 production process must consume the least economic resources (capital and  
14 labor), i.e., be *least cost*, in the context of the best available technology and  
15 provisioning practices that could be used to produce the service or element from  
16 this point in time forward. Because production processes are subject to continual  
17 improvement — particularly in the supply of telecommunications services, which  
18 has been and continues to be dramatically impacted by advances in digital  
19 technology that reduce cost and increase functionality — economic costs must be  
20 evaluated from a fundamentally *forward-looking* perspective, rather than  
21 measured with reference to the firm's historical costs.

22  
23 **Q. WHAT ARE "ACTUAL COSTS" AS MR. VARNER USES THIS TERM?**

24 A. The term "actual costs" has no precise or particular economic meaning, although  
25 Mr. Varner attempts to equate "actual" cost with "historic" cost. However, on a

1 forward-looking basis, the costs that a well-managed firm will "actually" incur in  
2 efficiently furnishing a given service are best represented by the Total Service  
3 Long Run Incremental Cost (TSLRIC) of that service. The "actual" costs that the  
4 firm had incurred in the past, under technological and operating conditions that  
5 may no longer exist, are reflected in the embedded cost as recorded on the  
6 Company's books. The "actual" historic costs to which Mr. Varner refers are not  
7 relevant to a determination of forward-looking cost and are not relevant as a basis  
8 for pricing.

9  
10 **Q. IN COMPETITIVE MARKETS, WHICH OF THESE TWO COST**  
11 **LEVELS — FORWARD-LOOKING OR HISTORICAL — WILL PRICES**  
12 **TEND TO FOLLOW?**

13 **A.** Prices in competitive markets are driven toward forward-looking economic cost,  
14 not to the historical costs that may have been incurred in the past by any given  
15 firm. In a competitive industry, forward-looking economic costs are best  
16 approximated by TSLRIC.

17  
18 In a competitive industry where firms produce multiple products or services,  
19 resources (and their associated costs) may in some cases be shared among several  
20 products. In many cases, it is still possible to make direct cost attributions to  
21 specific products based upon each product's relative use of the shared resource, in  
22 which case the "shared cost" is part of the forward-looking economic cost.  
23 Certain costs, such as general corporate overhead, may not be subject to such  
24 direct attribution or assignment. Research undertaken by Economics and  
25 Technology, Inc. has demonstrated that, with respect to ILECs, such "corporate

1 overhead" costs are volume-sensitive and vary directly and proportionately with  
2 both the total output of the firm as well as with the volumes of individual products  
3 and services. Hence, an equi-proportionate share of forward-looking overhead  
4 costs should also be included in the forward-looking economic cost of each ILEC  
5 service or element. That same research also indicates that, with respect to  
6 incumbent LECs, "fixed" costs — i.e., those that do not vary with the volume of  
7 output of the firm — are minimal, indeed, statistically equivalent to zero.

8  
9 Whether or not ILECs have significant levels of shared or common costs,  
10 however, and contrary to Mr. Varner's contention (Varner Direct at 11:3-7), in the  
11 long run competitive market price levels will not permit firms to recover any  
12 historical costs that they may have incurred in excess of the economic cost level.  
13 Assuming that firms are able to freely enter into or exit from the market, prices  
14 cannot be expected to remain above economic cost for very long, because in such  
15 a situation one or more new entrants, who themselves confront the same economic  
16 cost levels as incumbent firms, will enter the market and in so doing drive prices  
17 down to the economic cost level.

18  
19 **Q. TO THE EXTENT THAT THE FORWARD-LOOKING COST IS BELOW**  
20 **THE HISTORICAL COST, HOW DO FIRMS OPERATING UNDER**  
21 **COMPETITIVE MARKET CONDITIONS RECOVER THE**  
22 **DIFFERENTIAL?**

23 **A.** They don't. If I built a factory five years ago that is capable of producing widgets  
24 at a cost of \$5 each, but you could build a factory today, using more modern  
25 equipment and technology, that can churn out the same product for \$3, there is no

1 way in which I will be able to maintain the \$5 price level. I will be forced to  
2 reduce my price in order to compete or, in the alternative, to close down my  
3 factory altogether and get out of the business. I cannot expect to be able to force  
4 customers who are confronted with a choice of suppliers to "make me whole" for  
5 my previously-incurred investments when they are able to purchase the same  
6 product at a lower cost from another source.

7  
8 Businesses that are operating in competitive industries are continually forced by  
9 the discipline of the marketplace to update their production processes to reflect the  
10 most efficient technology and practices that are currently available. As Mr. Wood  
11 has observed in his testimony (Wood Rebuttal Testimony at page 31-34), one  
12 consequence of this phenomenon is that competitive firms will often take write-  
13 offs of technologically-obsolete, inefficient plant before it has been fully  
14 depreciated, and thus charge those costs to shareholders rather than to customers  
15 of the firm. Clearly, the successful firms operating in competitive markets do not  
16 — indeed, *cannot* — act as if they are somehow "entitled" to recover all incurred  
17 costs from their customers.

18  
19 **Q. MR. VARNER CONTENDS THAT "IF THE PRICES OF THE SERVICES**  
20 **PROVIDED TO COMPETITORS DO NOT COVER [ACTUAL] COST,**  
21 **BELLSOUTH WILL BE SUBSIDIZING ITS COMPETITORS."**  
22 **(VARNER DIRECT AT 11:11-12.) DO YOU AGREE?**

23 **A.** No. A "subsidy" exists when the price is set below the *incremental* economic  
24 costs that the telephone company will incur on a forward-looking basis. That a  
25 price happens to be less than historic cost does not imply the presence of subsidy.

1           Returning to our earlier example about the widget factory, if in order to stay in  
2           business I am forced by the marketplace to offer widgets at \$3 even though (on an  
3           historic basis) my "actual" cost (as Mr. Varner would define that term) is \$5, I  
4           may experience a loss in the accounting sense because I am continuing to utilize  
5           obsolete plant, but in no way am I "subsidizing" customers who purchase the  
6           product from me at the \$3 price. If BellSouth's competitors are required to pay  
7           the Company prices for UNEs and other essential facilities that reflect historic  
8           inefficiencies or the failure of the telephone company to adopt efficient systems  
9           and production processes, then it is the *competitors* who will be forced to  
10          subsidize BellSouth's failure to adopt efficient forward-looking production  
11          processes and resources.

12  
13   **Q.    IS BELLSOUTH PROPOSING TO SET ITS RECURRING PRICES FOR**  
14   **UNEs BASED UPON FORWARD-LOOKING ECONOMIC COST?**

15   A.    No. While nominally utilizing TSLRIC as a "basis" for proposed UNE rates, Mr.  
16    Varner clearly states that BellSouth's position is that its UNE prices should not be  
17    set equal to economic cost. (Varner Direct at 12-13.) Instead, BellSouth is  
18    proposing to recover its historically incurred costs through its UNE prices.  
19    (Varner Direct at 12:24-13:1, and 18:2-21.) Specifically, BellSouth has proposed  
20    to recover the majority of the difference between its claimed economic costs (i.e.,  
21    TSLRIC plus attributed shared and common costs) and its booked, historical costs  
22    by including substantial cost additives described as "Residual Recovery  
23    Requirements" (RRRs) in its proposed rates for unbundled loops and ports.  
24    (Varner Direct at 19:17-20:20, Zarakas/Caldwell Direct at 43:19-44:10.) These  
25    additives, which are expressly designed to recover historical costs, cause

1 BellSouth's proposed rates for the affected elements – namely, 4-wire analog  
2 voice grade ports, 2-wire ADSL-compatible loops, and 4-wire HDSL-compatible  
3 loops – to be substantially higher than their reported economic cost level.  
4 (Exhibit No. P-1, Section 6, "Residual Recovery Requirement," at 000691.) In  
5 addition, Mr. Wood has described (see, e.g., Wood Rebuttal Testimony at 10-14)  
6 several mechanisms by which BellSouth has improperly included historical costs  
7 in its TSLRIC estimates for these unbundled elements.

8  
9 **Q. DID THIS COMMISSION INCLUDE THE RECOVERY OF**  
10 **BELLSOUTH'S HISTORICAL COSTS AS AN EXPLICIT COMPONENT**  
11 **OF THE PRICES FOR UNBUNDLED ELEMENTS PREVIOUSLY**  
12 **ESTABLISHED IN THIS PROCEEDING?**

13 **A.** No, it certainly did not. In the decision issued on December 31, 1996, the  
14 Commission concluded that the appropriate cost methodology to determine the  
15 prices for unbundled elements is an approximation of Total Service Long Run  
16 Incremental Cost (TSLRIC). (Order No. PSC-96-1579-FOF-TP, December 31,  
17 1996 (hereinafter, "the December 1996 Order"), at page 23.) As observed in that  
18 decision, the Commission had previously adopted the TSLRIC costing standard  
19 for unbundled elements in Docket No. 950984-TP. (Order No. PSC-96-0811-  
20 FOF-TP, issued June 24, 1996.) The Commission consequently set prices for a  
21 number of UNEs based directly upon BellSouth's proposed TSLRIC levels, with a  
22 further contribution to shared and common costs. (December 1996 Order at page  
23 33.) Given that the Commission has already made a determination on appropriate  
24 UNE pricing that did not include any "additive" to recover the Company's claimed  
25 historical costs, as a threshold matter the Commission should confirm its prior

1 conclusion barring any extraordinary showing that it must be reversed at this time.

2 As I shall now explain, I believe that the Commission's decision to adopt UNE  
3 prices based upon TSLRIC plus a portion of shared and common costs is  
4 appropriate from an economic standpoint and is the best means to implement the  
5 relevant provisions of the *Telecommunications Act of 1996*. (That having been  
6 said, I have not reviewed in detail the recurring TSLRIC studies that BellSouth  
7 has presented in this proceeding, and therefore do not offer an opinion concerning  
8 the studies' specific compliance with the Commission's TSLRIC standard.)

9  
10 **Q. FROM AN ECONOMIC PERSPECTIVE, IS BELLSOUTH'S PROPOSAL**  
11 **TO SET ITS UNE PRICES TO RECOVER HISTORICAL COSTS**  
12 **PERMISSABLE UNDER THE FEDERAL *TELECOMMUNICATIONS ACT***  
13 ***OF 1996?***

14 A. No, it is not. Section §252(d)(1)(A)(i) of the *Telecommunications Act of 1996*  
15 ("the Act") prescribes that the pricing of UNEs and interconnection arrangements  
16 must be based upon their costs "determined without reference to a rate-of-return  
17 or other rate-based proceeding..." The "Residual Recovery Requirements" to  
18 which Mr. Varner refers represent the difference between the forward-looking  
19 economic cost and the historical costs as these have been determined in a previous  
20 "rate-of-return or other rate-based proceeding." Such pricing is clearly  
21 impermissible under the Act. By expressly requiring that costs be "determined  
22 without reference to a rate-of-return or other rate-based proceeding," Congress  
23 clearly intended to require that ILECs price UNEs and interconnection arrange-  
24 ments based upon their forward-looking *economic costs*, rather than upon the  
25 *historical costs* that are the focus of a traditional rate-of-return or rate-based

1 proceeding.

2

3 **Q. WHY DO YOU REACH THIS CONCLUSION?**

4 A. Among its many consequences, the 1996 federal legislation amended the  
5 *Communications Act of 1934* to create a new Part (Sections 251-261) specifically  
6 concerned with the "Development of Competitive Markets" in  
7 telecommunications. In order to secure the benefits of competition for the nation's  
8 telecommunications consumers, this legislation established specific obligations  
9 for *incumbent* local exchange carriers (ILECs) in the areas critical to the  
10 development of a competitive local exchange marketplace. These key areas  
11 include access to unbundled network elements, interconnection to new entrants'  
12 networks, resale of services, number portability, dialing parity, and reciprocal  
13 compensation. In requiring the cooperation of incumbent LECs with the efforts of  
14 new entrants to participate in the local exchange marketplace, Congress clearly  
15 contemplated that, at least during a transition period if not over a longer time  
16 frame, new entrants would not have a sufficiently extensive base of facilities in  
17 place to enable them to compete effectively with the incumbents. Congress did  
18 not *require* new entrants to utilize the facilities of incumbents; rather, it adopted  
19 explicit measures designed to *facilitate* new entrants' ability to interconnect with  
20 and to utilize ILEC network resources as needed to fill in gaps in the new firms'  
21 own infrastructures. As Mr. Varner has himself recognized (Varner Direct at  
22 5:21-7:21), new providers will choose to construct their own facilities when this  
23 can be accomplished at a lower cost than by utilizing the incumbent's network,  
24 and will choose to utilize the incumbent's facilities when that represents a lower  
25 cost than for new construction. Indeed, that is exactly as it should be. Facilities-

1 based competition should develop only where it is efficient, and should not be  
2 expected to develop where the commitment of economic resources needed to  
3 overbuild existing ILEC plant cannot be justified. The Act recognizes both  
4 conditions, and establishes a paradigm under which a combination of facilities-  
5 based and resale competition can develop.

6  
7 Moreover, the development and growth of non-facilities-based competition at the  
8 retail level (accomplished through the resale of UNEs and bundled services) will  
9 work to encourage new entrants to invest in facilities of their own by permitting  
10 them to amass a customer and revenue base sufficient to justify the investment.  
11 Pricing of UNEs at their forward-looking economic cost sends the correct signals  
12 to prospective facilities-based competitors, whereas pricing UNEs *above*  
13 economic cost (i.e., at historic cost levels) could work to encourage inefficient  
14 construction of competing facilities.

15  
16 The only way in which the "make or buy" decision can be efficiently made by the  
17 new entrant is where the incumbent's prices are set on a forward-looking,  
18 economic cost basis. Consider the following example: Suppose that BellSouth's  
19 TSLRIC (including correctly-attributed forward-looking shared and corporate  
20 overhead costs and return on investment) for a particular UNE is \$6, and that the  
21 associated "Residual Revenue Requirement" for that same UNE is \$5. On this  
22 basis, BellSouth's price would be set at \$11. Suppose that the new entrant is able  
23 to replicate the same functionality of this UNE at a cost of \$9 by constructing its  
24 own facilities. In this case, the economically efficient decision would be to  
25 continue to utilize the ILEC's facilities (because \$6 is less than \$9). However,

1 because it is confronted with an \$11 *price* and not the \$6 forward-looking  
2 economic *cost*, the new entrant will conclude (correctly from its perspective) that  
3 it would be better off acquiring its own facilities (at the \$9 cost) than to pay the  
4 \$11 price to BellSouth. That decision is, however, *inefficient* from a societal  
5 standpoint, and the new entrant will have been misled into that incorrect decision  
6 by the inflated \$11 BellSouth price. Ironically, if the new entrant in fact does  
7 decide to pursue the "make" rather than the "buy" course of action, BellSouth will  
8 still not be able to recover its so-called "Residual Revenue Requirement" from the  
9 new entrant.

10  
11 It would make no sense for Congress to have specifically encouraged efficient  
12 competition in local telecommunications while at the same time condoning (let  
13 alone affirmatively permitting) an ILEC to overprice essential services and  
14 facilities.

15  
16 **Q. HAVE THE REGULATORY COMMISSIONS THAT HAVE**  
17 **CONSIDERED THIS ISSUE REACHED CONCLUSIONS SIMILAR TO**  
18 **YOURS — I.E., THAT THE PRICING OF UNEs MUST BE BASED UPON**  
19 **ECONOMIC COSTS RATHER THAN ON AN ILEC'S HISTORICAL**  
20 **EMBEDDED COSTS?**

21 **A.** Indeed, they have. The FCC was the first regulatory authority to comprehensively  
22 address this issue, in its *First Report and Order* in CC Docket 96-98 ("*First*  
23 *Interconnection Order*"). (*In the Matter of Implementation of the Local*  
24 *Competition Provisions in the Telecommunications Act of 1996 and*  
25 *Interconnection Between Local Exchange Carriers and Commercial Mobile*

1           *Radio Service Providers*, CC Docket Nos. 96-98 and 95-185, *First Report and*  
2           *Order*, released August 8, 1996, paras. 674-703.) In that decision, the FCC  
3           interpreted Section 252(d)(1)(A)(i) of the Act as a requirement to measure and  
4           apply the *forward-looking, long-run economic costs* of the given network  
5           function, and specifically rejected UNE pricing based upon historical costs. As  
6           expressed therein:

7  
8                   We are not persuaded by incumbent LEC arguments  
9                   that prices for interconnection and unbundled  
10                  network elements must or should include any  
11                  difference between embedded costs they have  
12                  incurred to provide those elements and their current  
13                  economic costs. ... The substantial weight of  
14                  economic commentary in the record suggests that an  
15                  "embedded cost"-based pricing methodology would  
16                  be pro-competitor -- in this case the incumbent LEC  
17                  -- rather than pro-competition. We therefore decline  
18                  to adopt embedded costs as the appropriate basis for  
19                  setting prices for interconnection and access to  
20                  unbundled elements. Rather, we reiterate that the  
21                  prices for the interconnection and network elements  
22                  critical to the development of a competitive local  
23                  exchange should be based on the pro-competition,  
24                  forward-looking, economic costs of those elements,  
25                  which may be higher or lower than historical

1 embedded costs. Such pricing policies will best  
2 ensure the efficient investment decisions and  
3 competitive entry contemplated by the 1996 Act,  
4 which should minimize the regulatory burdens and  
5 economic impact of our decisions on small entities.  
6 (Interconnection Order at para. 705 (footnotes  
7 omitted).)

8  
9 It is my understanding that the Eighth Circuit Court of Appeals decision of July  
10 18, 1997 held that the FCC lacked jurisdictional authority to prescribe those  
11 TELRIC costing and pricing rules for application to state-regulated UNEs, and  
12 thus abrogated those portions of the *First Interconnection Order* and associated  
13 rules in which such preemptive authority had been asserted. Contrary to Mr.  
14 Varner's claim, however, the Court did not find that "[m]any of the FCC's Rules  
15 conflicted with the Act" (Varner Direct at 9) on substantive grounds; the basis for  
16 vacating the specific pricing and costing rules that had been adopted by the FCC  
17 was entirely jurisdictional. Indeed, the FCC's interpretation of the Act and the  
18 pricing rules it attempted to promulgate are not substantially different from the  
19 Florida Commission's own findings and decisions with respect to the use of  
20 TSLRIC for pricing UNEs and other essential services furnished to new entrants,  
21 which I described earlier in my testimony (pages 9-10). Whether or not the FCC's  
22 ruling is ultimately binding upon this Commission, that ruling is sound on its  
23 merits and can be used by this Commission both as validation for its own prior  
24 rulings as well as providing corroboration for interpretations of the Act that may  
25 differ from those being advanced by BellSouth.

1           Moreover, several states have reached similar conclusions. The Public Utility  
2           Commission of Ohio adopted pricing guidelines that "set forth that prices for  
3           interconnection and unbundled network elements shall be set so that the LEC  
4           recovers its LRSIC ["LRSIC" (long-run service incremental cost) is another term  
5           for TSLRIC] for providing interconnection and unbundled network elements and  
6           a reasonable contribution to the joint and common costs incurred by the LEC."  
7           (Public Utility Commission of Ohio, Case No. 95-845-TP-COI, *Entry on*  
8           *Rehearing*, November 7, 1996, at 39 ("V. Pricing Standards").)

9  
10           The California PUC has not yet issued a decision that establishes the specific  
11           basis for the pricing of UNEs in the context of the Act. However, in AT&T's  
12           arbitration with GTE-California, the Arbitrator established UNE rates based on  
13           TSLRIC plus a markup to reflect forward-looking shared and corporate overhead  
14           costs, without any additive to recover historical costs. (California PUC  
15           Application 96-08-041, Arbitrator's Report, October 31, 1996, at pages 11-13.)  
16           Similarly, in the AT&T/MCI arbitration with GTE-Southwest in Texas, the  
17           Arbitrator concluded that "unbundled element prices shall be set at TELRIC plus  
18           an appropriate share of joint and common costs (determined by the application of  
19           a forward-looking cost factor)." (Texas PUC Docket No. 16300/16355,  
20           *Arbitration Award*, December 12, 1996, at page 108.)

21  
22           Even before the passage of the Act, the Connecticut Department of Public Utility  
23           Control (DPUC) had determined that UNEs should be priced at TSLRIC plus a  
24           reasonable contribution to common costs, and it has affirmed that this treatment is  
25           consistent with the Act. (See Connecticut DPUC, Docket No. 96-09-22,

1           *Decision*, April 23, 1997, at section III.C, which also cites Docket No. 94-10-04,  
2           *Decision*, August 7, 1996, at page 55.) The DPUC's recent April 1997 order also  
3           explicitly rejected the recovery of historical costs through the contribution portion  
4           of UNE prices, and adopted the principle of using a forward-looking analysis of  
5           common costs to set the contribution level applied to UNEs. (*Id.* at section V.B,  
6           "Proposed Rates")

7  
8       **Q.   MR. VARNER CONTENDS (VARNER DIRECT AT 8) THAT THE ACT'S**  
9       **ALLOWANCE FOR A "REASONABLE PROFIT" IN UNE PRICING**  
10       **UNDER SECTION 252(D)(1)(B) SUPPORTS BELLSOUTH'S**  
11       **INTERPRETATION OF THE ACT AS PERMITTING RECOVERY OF**  
12       **HISTORICAL COSTS IN UNE PRICES. DO YOU AGREE?**

13      A.   No, I do not. Section 252(d)(1)(B) of the Act *permits* the price for  
14           interconnection and unbundled elements to include a "reasonable profit." Mr.  
15           Varner's basic argument is that no profit is recovered when prices are based upon  
16           TSLRIC and thus TSLRIC-based prices are inconsistent with the Act's intentions.  
17           The statutory language "reasonable profit" must be read in the context of public  
18           utility regulation. "Reasonable profit" constitutes the "reasonable rate of return"  
19           or "cost of money" that reflects conditions that would prevail in competitive  
20           markets. For this purpose, "cost of money" is included in the TSLRIC itself,  
21           along with depreciation and ongoing expenses. If Mr. Varner intends to suggest  
22           that Congress has authorized some type of "profit" in excess of the reasonable rate  
23           of return on investment, he offers no authority for such a conclusion. Indeed, any  
24           profit in excess of the "reasonable return on investment" would *by definition*  
25           constitute *excess* monopoly profits that are, on their face, *unreasonable*.

1 Moreover, there is nothing inconsistent about the idea of earning a "profit" when  
2 prices are compared with forward-looking economic costs even if those same  
3 prices are below historic embedded cost. If the historic cost of a service is \$7 but  
4 on a forward-looking basis it costs only \$5 (exclusive of return on investment) to  
5 produce, and that service is priced at \$5.50, the company will earn a profit of 50  
6 cents for each unit it sells from this point in time forward — i.e., its aggregate  
7 earnings will be 50 cents greater for each unit it sells than it would be if the unit  
8 were not sold. The fact that in the *past* the cost of production of the same service  
9 had been \$7 has no effect upon or relevance to its profitability from this point in  
10 time forward.

11  
12 Some of the other regulatory commissions that I cited earlier in my testimony  
13 have also expressly rejected Mr. Varner's line of reasoning. The FCC was not  
14 persuaded by ILECs' contentions that UNE prices must recover embedded costs in  
15 order to ensure that they could realize a profit. (*Interconnection Order I*, at para.  
16 706.) The PUC of Ohio considered this issue and concluded that "[t]he profit  
17 level included in the LRSIC shall be the cost of capital which shall constitute  
18 'reasonable profit' for purposes of the 1996 Act." (Ohio PUC, Case No. 95-845-  
19 TP-COI, *Entry on Rehearing*, November 7, 1996, at 39.)

20  
21 **Q. MR. VARNER ALSO CONTENDS (VARNER DIRECT AT 13) THAT**  
22 **SETTING PRICES THAT DO NOT COVER "TOTAL COST" (I.E.,**  
23 **HISTORICAL COST) WILL CREATE INCENTIVES FOR ILEC**  
24 **INEFFICIENCY. DO YOU AGREE WITH THIS REASONING?**

25 **A.** Absolutely not, and it is astonishing that Mr. Varner would make such a ludicrous

1 claim. Surely Mr. Varner is aware of the fundamental shift that has occurred  
2 during the past decade away from traditional rate of return regulation of ILECs  
3 toward incentive regulation approaches such as price caps plans, which has  
4 occurred precisely because of the incentives for inefficiency that economists  
5 consider to be inherent to embedded cost-based pricing.

6  
7 Recall, for example, the FCC's findings following its review of the incentives  
8 created by rate of return regulation and their effects upon ILEC behavior in the  
9 *Further Notice of Proposed Rulemaking* (FNPR), FCC 88-172, in its price caps  
10 proceeding, CC Docket 87-313 (3 FCC Rcd 3195, 3216-3224). As stated therein:

11  
12 ... rate-of-return regulation provides regulated firms  
13 with very strong incentives to pad their rates, for  
14 essentially two reasons. First, as a profit-  
15 maximizer, the firm is led to adopt the most costly,  
16 rather than the most efficient, investment strategies  
17 because its primary means of increasing dollar  
18 earnings under rate-of-return constraints is to  
19 enlarge its rate base. This is commonly known as  
20 the Averch-Johnson effect or "A-J" effect of rate-of-  
21 return. Second, since all operating expenses are  
22 included in a firm's revenue requirement under rate  
23 of return, management has little incentive to  
24 minimize operating costs. This is commonly known  
25 as "X-inefficiency." The firm's shareholders profit

1 from the first phenomenon, and the benefits of the  
2 second redound to the firm's management. In both  
3 cases, however, consumers suffer because these  
4 distorted incentives increase the cost of doing  
5 business – and thus the rates consumers must pay  
6 for service. (3 FCC Rcd 3195, 3219, footnotes  
7 omitted)

8  
9 The FCC's review noted several studies that found these effects to have significant  
10 impacts upon regulated firms' costs, including "one showing unit cost increases on  
11 the order of 6 to 12 percent" due to A-J type distortions (3 FCC Rcd 3195, 3220)  
12 and a unit cost differential of approximately 11 percent for monopoly electric  
13 utilities subject to rate-of-return regulation relative to such utilities in situations  
14 where some competitive forces exist (3 FCC Rcd 3195, 3222). Thus, contrary to  
15 Mr. Varner's unsupported opinion, setting prices to recover total historical costs  
16 actually incents ILECs to make *inefficient* investments, in addition to creating  
17 conditions for excess costs through the "X-inefficiency" effect.

18  
19 If BellSouth is effectively *guaranteed* full recovery of its embedded investment,  
20 the Company has no incentive to assure that its capital spending initiatives are  
21 financially sound. Indeed, it is both possible and entirely likely that the apparent  
22 "gap" between embedded historic costs and forward-looking incremental costs is  
23 at least in part accounted for by inefficient investment decisions. For example, in  
24 acquiring new central office switches, the Company may have failed to recognize  
25 or give effect to the persistent downward trend in central office switch prices that

1 has characterized the switch market since the break-up of the former Bell System.

2 One reason why embedded plant may become prematurely obsolete is because  
3 the Company failed to correctly assess the pace and direction of technological  
4 improvements and price decreases that would occur in the future, and in so doing  
5 overestimated the economic lives of equipment that it was considering for  
6 purchase. If equipment prices are decreasing at the rate of, say, 5% annually but  
7 this fact is not captured in the Company's capital budgeting cash flow models, the  
8 Company could be led to replace plant prematurely rather than wait a few years  
9 until the newer models became available at perhaps significantly lower prices.  
10 Similarly, if the Company overestimates the prices of the next generation of a  
11 particular class of equipment (e.g., central office switches), it may fail to purchase  
12 them at the most cost-effective point in time. When firms in nonregulated  
13 industries, who enjoy no assurance of full recovery of their investments, make  
14 capital investment and plant replacement decisions, they must consider these  
15 factors or suffer the consequences. Full recovery insulates the telephone company  
16 from such concerns, and thus encourages inefficiency, not efficiency, in  
17 investment decisionmaking.

18  
19 **Q. MR. VARNER CLAIMS (VARNER DIRECT AT 13:14-18) THAT A**  
20 **FAILURE TO PRICE UNEs TO RECOVER TOTAL COSTS WILL ALSO**  
21 **DISCOURAGE EFFICIENT INVESTMENTS IN TECHNOLOGIES WITH**  
22 **RELATIVELY HIGH SHARED COSTS. DO YOU AGREE?**

23 **A.** No, I do not. Mr. Varner offers no economic support for this contention, which he  
24 contradicts elsewhere in his own testimony. Given that Mr. Varner correctly  
25 recognizes that economic costs include an appropriate attribution of shared and

1 common overhead costs (Varner Direct at 12:11-12), there is no reason to believe  
2 that prices based upon economic costs will create any incentives to select  
3 technologies based upon their relative shares of incremental vs. shared costs. If  
4 shared costs are correctly attributed to the various products and services that they  
5 support, technologies exhibiting relatively large shared cost components (which  
6 Mr. Varner suggests provide greater economies of scale) will exhibit lower  
7 economic costs when expressed on a per-unit basis.

8  
9 **Q. IN WHAT RESPECTS DOES YOUR NOTION OF THE TREATMENT OF**  
10 **SHARED AND CORPORATE OVERHEAD COSTS APPEAR TO DIFFER**  
11 **FROM THAT BEING ADVOCATED BY MR. VARNER?**

12 **A.** Mr. Varner appears to want the ability to allocate shared and corporate overhead  
13 costs among the various BellSouth services "based on the market, regulatory and  
14 competitive conditions that exist." (Varner Direct at 12:13-14.) One potential  
15 consequence of such allocations (which he characterizes as "contributions" toward  
16 shared and common costs) is that they will disproportionately burden those  
17 services and elements for which BellSouth faces no consequential competition.  
18 The "market conditions" to which Mr. Varner refers would permit the Company  
19 to increase prices for relatively price-inelastic noncompetitive services without  
20 significant loss of business, while at the same time potentially undercutting rivals  
21 in competitive segments of its market by effectively excluding most or all shared  
22 and common costs from the prices it sets for its competitive offerings. A correct  
23 attribution of shared costs on the basis of relative use of the shared resource by  
24 each of the various services, and an assignment of variable corporate overhead  
25 costs in proportion to each service's direct costs, overcomes this possibility.

1 Q. MR. VARNER ALSO CONTENDS (VARNER DIRECT AT 17:21-23)  
2 THAT "FOR BELL SOUTH TO STAY IN BUSINESS, REVENUES FROM  
3 ALL SERVICES MUST NOT ONLY COVER INCREMENTAL COST,  
4 BUT THEY MUST ALSO PROVIDE SUFFICIENT CONTRIBUTION TO  
5 COVER ALL OTHER COSTS OF THE FIRM." ARE BELL SOUTH'S  
6 PROPOSED PRICES FOR UNES OTHER THAN LOOPS AND PORTS  
7 CONSISTENT WITH ASSERTION?

8 A. No, they are not. Mr. Varner repeatedly declares (see also Varner Direct at 11:23-  
9 24 and 19:13-15) that BellSouth's pricing must permit the Company to recover all  
10 incurred costs, including historical, non-economic costs. Nonetheless, BellSouth  
11 proposes that only certain unbundled elements should be priced to recover their  
12 full historical costs, namely the loop and port elements that are most important to  
13 ALECs and for which there are few or no competitive alternatives. (Varner Direct  
14 at 19:17-20:20.)

15  
16 For the numerous remaining unbundled elements, including interoffice transport,  
17 vertical switching features, etc., BellSouth's proposed rates do not include an  
18 explicit "Residual Recovery Requirement" component. Relative to loops and  
19 ports, many of these elements have greater potential for earlier and more  
20 significant competitive alternatives (e.g., interoffice transport), and/or have  
21 greater price elasticity (e.g., vertical features). Apparently, BellSouth is willing to  
22 forego recovery of its historical costs for these elements that have not already  
23 been captured in TSLRIC plus the shared/common cost attributions. Thus, in  
24 these cases, BellSouth is proposing prices that will not "cover actual costs,"  
25 contrary to its avowed position that it must recover all of its "actual costs" in order

1 to survive. Clearly, if for these elements BellSouth can forego recovery of total  
2 historical costs, there is no reason to accept the Company's premise that pricing  
3 the loop and port UNEs below historical cost levels will put the Company at  
4 financial risk.

5  
6 **BELLSOUTH ENJOYS OVERWHELMING ADVANTAGES IN THE**  
7 **NEWLY-COMPETITIVE LOCAL EXCHANGE MARKETPLACE DUE**  
8 **TO ITS LONG-TERM INCUMBENCY STATUS AND FORMER**  
9 **REGULATORY PROTECTIONS, AND ITS CONTINUED "OBLIGATION**  
10 **TO SERVE" IN NO WAY ENTITLES THE COMPANY TO FULL**  
11 **RECOVERY OF ITS PAST NETWORK INVESTMENTS.**

12  
13 **Q. DO YOU AGREE WITH MR. VARNER'S ASSERTION (VARNER**  
14 **DIRECT AT 19:10-13) THAT BELLSOUTH'S PRICING MUST ALLOW**  
15 **THE OPPORTUNITY TO RECOVER ALL INVESTMENTS "MADE IN**  
16 **GOOD FAITH PURSUANT TO OBLIGATIONS UNDER A**  
17 **TRADITIONAL REGULATORY COMPACT"?**

18 **A.** No, I do not. While Mr. Varner has not spelled out the regulatory obligations he  
19 has in mind, presumably he is referring to the Florida Commission's "carrier of  
20 last resort" (COLR) requirement that BellSouth (like other regulated ILECs)  
21 provide service to all customers in its Florida serving territory upon request, and  
22 to build and maintain sufficient facilities to accommodate such service requests.  
23 While BellSouth is subject to a COLR requirement in Florida (and should  
24 continue to be, in my view), Mr. Varner is mistaken in his belief that the  
25 Company's "obligation to serve" somehow entitles it to full recovery of all

1 previously-made network investments.

2

3 **Q. PLEASE EXPLAIN WHY BELLSOUTH'S OBLIGATION TO SERVE**  
4 **DOES NOT CREATE AN ENTITLEMENT TO FULL INVESTMENT**  
5 **RECOVERY.**

6 A. There are several reasons. First, BellSouth has not demonstrated, nor could it  
7 demonstrate, that all of its network investments were efficiently incurred for the  
8 sole purpose of satisfying its obligation to serve. In reality, an ILEC's network  
9 investments are driven by multiple considerations, including not only customer  
10 demand, but also the prevailing form of regulation and strategic competitive  
11 market objectives being pursued by the ILEC's management. That embedded  
12 investment will also reflect *incorrect* and *inefficient* choices made by the  
13 Company due to, for example, misassessments of customer demand, the pace at  
14 which competition in specific market segments will develop, and/or the  
15 technological life of the equipment and facilities that were being considered for  
16 purchase, or the Company's failure to deploy modern operations support systems  
17 capable of improving overall management and utilization of network resources.  
18 While it might be possible to identify and exclude that portion of the embedded  
19 asset base that is *not* attributable to any COLR obligation to serve, no such  
20 attempt has been made or offered by the Company in the present case.

21

22 **Q. ARE THERE ADDITIONAL REASONS WHY YOU HAVE CONCLUDED**  
23 **THAT AN OBLIGATION TO SERVE DOES NOT ENGENDER AN**  
24 **ENTITLEMENT TO FULL INVESTMENT RECOVERY?**

25 A. Yes, there are. As an initial matter, the limited investments that might plausibly

1 be linked to an ILEC's obligation to serve, such as subscriber access lines in rural,  
2 relatively high-cost areas, are those least likely to be threatened by facilities-based  
3 competitive entry.

4  
5 Furthermore, an ILEC's "obligation to serve" does not exist in a vacuum, and the  
6 economic burdens, if any, arising from such an "obligation" must be considered in  
7 tandem with the enormous *and unique* economic benefits of incumbency that have  
8 been enjoyed by BellSouth and other ILECs for nearly a century. Among other  
9 things, those incumbency advantages have included virtual insulation from  
10 business risk, the ability to amass a ubiquitous distribution, switching and  
11 intraLATA transport infrastructure unmatched and unmatchable by any known  
12 competitor, the ability to acquire a near-100% share of the local exchange market  
13 without competitive challenge, and unparalleled incumbency advantages vis-a-vis  
14 actual and prospective entrants that assure the ILECs' ability to retain substantially  
15 all of their core market share — particularly in the residential segment — even as  
16 entry becomes possible.

17  
18 In addition, the Commission's regulation of BellSouth took a significant step  
19 away from the traditional rate-of-return based "regulatory compact" when  
20 incentive regulation was applied to the Company. Since 1994, BellSouth's current  
21 incentive regulation plan permits the Company to retain earnings that represent  
22 above-market returns on equity, including up to 12.5% return on equity with no  
23 earnings sharing, and up to 17.5% with sharing in 1997. (See Order No. PSC-96-  
24 1579-FOF-TP, issued December 31, 1996, at page 33, and Docket No. 920260-TL  
25 et al, Order No. PSC-94-0172-FOF-TL, at page 12.) This type of incentive

1 regulation plan is founded upon a "reward follows risk" policy in which the ILEC  
2 is afforded the *opportunity* to earn higher returns to the extent that it accepts the  
3 financial and business *risks* involved in operation under the terms of the plan. In  
4 addition, in 1995, the Florida Legislature amended Chapter 364, Florida Statutes,  
5 eliminating any vestige of rate-based rate-of-return regulation and creating a  
6 statutory price cap plan for BellSouth and other large ILECs. Under the price cap  
7 plan, BellSouth's rates for basic local exchange service are capped at 1995 levels  
8 until January 1, 2001. Notwithstanding the price caps, BellSouth can seek an  
9 increase in basic local exchange rates at any time if it can show substantially  
10 changed circumstances. Given that BellSouth is subject to an incentive regulation  
11 plan and a price cap plan that (absent any exercise of a "constitutional takings"-  
12 based return to rate-of-return regulation) eliminate any general entitlement of  
13 BellSouth to a prescribed level of return on its investments, it would be illogical  
14 and improper to adopt an entitlement to recovery of total historical costs in the  
15 context of setting UNE prices.

16  
17 **Q. IS THERE ANY MERIT TO THE IMPLICATION (VARNER DIRECT AT**  
18 **19:10-13) THAT THE COMMISSION WOULD BE BREAKING ITS**  
19 **"REGULATORY COMPACT" WITH BELLSOUTH BY REJECTING**  
20 **MAKE-WHOLE RATES FOR UNES?**

21 **A.** No. The potential for competition at the local exchange level should not have  
22 come as any great surprise to BellSouth. Competition in the US  
23 telecommunications market did not happen overnight or instantly; it has been an  
24 evolving focus of US telecommunications policy for nearly three decades. It is  
25 entirely reasonable for this Commission to expect that ILECs subject to its

1 jurisdiction will anticipate and adjust for the onset of competition in their  
2 construction plans and programs. It is reasonable for ILECs such as BellSouth to  
3 expect at least some loss of market share when competition enters the market; if a  
4 loss of local exchange market share reduces the overall demand for outside plant  
5 and other "fixed" ILEC resources, the Company should have been responsible for  
6 forecasting the changing industry climate and for adjusting its plant construction  
7 programs for its potential effects. Hence, even where some type of adverse  
8 financial impact can be directly associated with a loss of local service market  
9 share, had such a loss been correctly anticipated and forecasted by the ILEC, it  
10 could have reduced its construction program by planning to reuse plant released  
11 from service by departing customers. If the ILEC had been adjusting its  
12 construction program to account for such competitive losses, it would today be  
13 tracking long run costs rather than short run costs, and would not suffer earnings  
14 erosion.

15  
16 **THE PROCESSES EMPLOYED BY BELLSOUTH FOR THE**  
17 **PROVISIONING OF UNES REFLECT INEFFICIENT AND**  
18 **ANTIQUATED MANUAL PROCEDURES AND ARE NOT AN**  
19 **APPROPRIATE BASIS FOR SETTING FORWARD-LOOKING**  
20 **NONRECURRING CHARGES FOR SUCH WORK.**

21  
22 **Q. HAVE YOU REVIEWED THE DIRECT TESTIMONY OF MR. ENO**  
23 **LANDRY REGARDING THE PROCESSES EMPLOYED BY**  
24 **BELLSOUTH FOR THE PROVISIONING OF UNBUNDLED NETWORK**  
25 **ELEMENTS?**

1 A. Yes, I have.

2

3 **Q. ARE THE SPECIFIC TASKS AND WORK FLOWS DESCRIBED BY MR.**  
4 **LANDRY CONSISTENT WITH THE DEPLOYMENT OF THE TYPES OF**  
5 **EFFICIENT OPERATIONS SUPPORT SYSTEMS THAT YOU**  
6 **DESCRIBED IN YOUR DIRECT TESTIMONY?**

7 A. No, they are not. The various processing steps described by Mr. Landry appear to  
8 be based upon primarily manual systems and procedures rather than on the use of  
9 integrated operations support systems (OSS) and accurate, synchronized data  
10 bases. As such, they do not provide a valid basis for developing the *forward-*  
11 *looking* cost of the various nonrecurring service order processing and connection  
12 functions that would be consistent with the least cost forward-looking technology  
13 foundation for TSLRIC studies.

14

15 **Q. UPON WHAT DO YOU BASE THIS CONCLUSION?**

16 A. The various processing steps that Mr. Landry enumerates involve the manual  
17 receipt of orders from ALECs, which he asserts require manual review and error  
18 detection by BellSouth. (Landry Direct at 2-5.) He asserts that, based upon  
19 experience with access service orders received from interexchange carriers, high  
20 error rates are expected in ALEC-initiated orders for UNEs. (Landry Direct at  
21 3:23-4:2.) He also describes various manual cross-connect operations as well as  
22 manual entry of central office routing information on UNE ports provided to  
23 ALECs. (Landry Direct at 4:8-5:18.)

24

25 As I discussed in my direct testimony and in the paper attached thereto,

1 "Regulatory Treatment of ILEC Operations Support Systems Costs," the principal  
2 sources of high "fallout" rates can be attributed to the lack of electronic interfaces  
3 to ILEC OSS for ALEC entry of service orders and inquiries, as well as (more  
4 generally) to the failure of ILECs to deploy modern, integrated OSS based upon  
5 accurate and fully synchronized data bases. Mr. Landry's testimony appears to  
6 confirm my expectation that BellSouth has not deployed such systems, or at least  
7 that in developing its UNE nonrecurring charges has not assumed their existence  
8 and use. As such, Mr. Landry has assumed that a large percentage of ALEC  
9 orders will not flow through automatically, either because of ALEC-initiated  
10 errors in the service order request or the requirement for various manual cross-  
11 connect and routing operations that would be fully mechanized in OSS based  
12 upon least-cost currently available technology.

13  
14 **Q. WHY MIGHT BELLSOUTH DELAY ADOPTION AND DEPLOYMENT**  
15 **OF MODERN OPERATIONS SUPPORT SYSTEMS CAPABLE OF**  
16 **PROVIDING MAXIMUM FLOW-THROUGH AND MINIMUM**  
17 **FALLOUT?**

18 **A.** It is in BellSouth's own self-interest to set NRCs that will be imposed upon its  
19 rivals at the highest levels it can convince regulators to allow. One means for  
20 accomplishing this is to delay for as long as possible the use of systems whose  
21 deployment would significantly reduce BellSouth's nonrecurring costs.

22  
23 **Q. WHY MIGHT THE LACK OF ELECTRONIC ACCESS BY ALECs TO**  
24 **BELLSOUTH'S OSS CONTRIBUTE TO ERRORS IN ALEC-INITIATED**  
25 **MANUAL SERVICE ORDERS?**

1 A. When a retail service order is entered by a BellSouth customer service  
2 representative, that individual has full on-line access to the customer's service  
3 record as well as to the Company's Street Address Guide. An error in, for  
4 example, the designation of the street or address can in most cases be instantly  
5 detected by the system and corrected by the service representative while still in  
6 contact with the customer. If the ALEC does not have similar electronic access to  
7 the customer's service records and other ILEC data bases, it must wait for  
8 BellSouth to verify the information on the manual service order and, if that order  
9 is returned because one or more errors had been detected, correct them and  
10 resubmit the order again. Where a "changeover" order is involved (i.e., the  
11 migration of an existing BellSouth customer to the ALEC), the ALEC must also  
12 specify the various service features the customer has in place, but must rely on the  
13 customer's own recollection, rather than on direct access to the BellSouth  
14 customer record, to prepare the service request.

15  
16 It is worth reiterating the point that I discussed at length in my direct testimony  
17 that a substantial source of fallout in the processing of service orders by ILECs  
18 can be attributed to the failure of its own systems and data bases to maintain  
19 accurate and consistent records. While Mr. Landry might prefer to "blame"  
20 ALECs for all such fallout, he has not specifically shown that no such fallout  
21 occurs when the order is initiated within BellSouth itself. Indeed, if fallout rates  
22 on ILEC-initiated orders were in fact lower than for ALEC-initiated orders, the  
23 source of that differential would be attributable to the lack of an efficient  
24 electronic interface or "gateway" rather than to the malfeasance of the ALECs.

25

1 **Q. WHAT WEIGHT SHOULD BE AFFORDED THE VARIOUS ORDER**  
2 **PROCESSING DESCRIPTIONS THAT HAVE BEEN OFFERED BY MR.**  
3 **LANDRY IN SUPPORT OF BELLSOUTH'S PROPOSED**  
4 **NONRECURRING CHARGES?**

5 A. These descriptions do not reflect least-cost, forward-looking technology and are  
6 thus inconsistent with the TSLRIC standard. Accordingly, the Commission  
7 should not use these order processing descriptions as a basis for setting UNE  
8 nonrecurring charges. Instead, it should utilize and rely upon the forward-looking  
9 estimates provided by the AT&T/MCI Non-Recurring Cost Model (NRCM) as  
10 the proper basis for setting nonrecurring charges to be applied to ALEC orders.

11  
12 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

13 A. Yes, it does.

14  
15  
16  
17  
18  
19  
20  
21  
22  
23  
24  
25