

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

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In the Matter of  
Determination of the cost of  
basic local telecommunications  
service, pursuant to  
Section 364.025,  
Florida Statutes.  
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DOCKET NO. 980696-TP



VOLUME 1  
Pages 1 through 143

PROCEEDINGS: HEARING

BEFORE: CHAIRMAN JULIA L. JOHNSON  
COMMISSIONER J. TERRY DEASON  
COMMISSIONER SUSAN F. CLARK  
COMMISSIONER JOE GARCIA  
COMMISSIONER E. LEON JACOBS, JR.

DATE: Monday, October 12, 1998

TIME: Commenced at 9:40 a.m.

PLACE: Betty Easley Conference Center  
Room 148  
4075 Esplanade Way  
Tallahassee, Florida

REPORTED BY: H. RUTHE POTAMI, CSR, RPR  
Official Commission Reporter

DOCUMENT NUMBER-DATE  
11334 OCT1298

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5 behalf of Florida Cable Telecommunications  
6 Association.

7 **TRACY HATCH**, AT&T Communications of the  
8 Southern States, Inc., 101 North Monroe Street, Suite  
9 700, Tallahassee, Florida 32301-1549, and **JIM**  
10 **LAMOUREUX** and **GENE COKER**, 1200 Peachtree Street N.E,  
11 Room 8150, Atlanta, Georgia 30309, and **STEPHEN RUSCUS**,  
12 McKenna & Cuneo, 1900 K Street, Washington, D.C.  
13 20006, appearing on behalf of AT&T Communications.

14 **PHILIP CARVER**, **MARY KEYER** and **NANCY WHITE**,  
15 c/o Nancy Sims, 150 South Monroe Street, Suite 400,  
16 Tallahassee, Florida 32301, appearing on behalf of  
17 BellSouth Telecommunications, Inc.

18 **WILLIAM H. HOLLIMAN**, **JOHN P. FONS** and **JEFFRY**  
19 **WAHLEN**, Ausley & McMullen, Post Office Box 391,  
20 Tallahassee, Florida 32302, appearing on behalf of  
21 **ALLTEL**, Northeast Florida Telephone Company,  
22 **Sprint-Florida**, Incorporated, and **Vista-United**  
23 **Telecommunications**.

24

25

1     **APPEARANCES CONTINUED:**

2                     **CHARLES J. BECK**, Deputy Public Counsel,  
3     Office of Public Counsel, 111 West Madison Street,  
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5     on behalf of the Citizens of the State of Florida.

6                     **CHARLES REHWINKEL**, P.O. Box 2214,  
7     Tallahassee, Florida, appearing on behalf of Sprint.

8                     **NORMAN H. HORTON, JR.**, Messer, Caparello, &  
9     Self, 215 South Monroe Street, Post Office Box 1876,  
10    Tallahassee, Florida 32302, appearing on behalf of  
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16    Florida 32301, appearing on behalf of Florida  
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18                    **DAVID B. ERWIN**, 127 Riversink Road,  
19    Crawfordville, Florida 32327, appearing on behalf of  
20    **Frontier Communications International, Inc.; GTC,**  
21    **Inc.; ITS Telecommunications Systems, Inc.; and TDS**  
22    **Telecom - Quincy Telephone Company.**

23  
24  
25

**APPEARANCES CONTINUED:**

**KIMBERLY CASWELL**, One Tampa City Center,  
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**RICHARD D. MELSON** and **MICHAEL J. HENRY**,  
Hopping Green Sams and Smith, Post Office Box 6526,  
Tallahassee, Florida 32314, appearing on behalf of **MCI**  
**Telecommunications Corporation** and **MCImetro Access**  
**Transmission Services, Inc.** (collectively, **MCI**).

**MICHAEL A. GROSS**, Assistant Attorney  
General, Office of the Attorney General, PL-01 The  
Capitol, Tallahassee, Florida 32399-1050, appearing on  
behalf of the **Office of the Attorney General**.

**BARBARA AUGER**, Pennington, Moore, Wilkinson,  
Bell & Dunbar, P.A., Post Office Box 10095,  
Tallahassee, Florida 32302-2095, appearing on behalf  
of **Time-Warner Axs of Florida, L.P.**

**FLOYD R. SELF**, Messer, Caparello, & Self,  
215 South Monroe Street, Suite 701, Post Office Box  
1876, Tallahassee, Florida 32302-1876, appearing on  
behalf of **Worldcom, Inc.**

1   **APPEARANCES CONTINUED:**

2                   **WILLIAM COX, Florida Public Service**  
3   **Commission, Division of Legal Services, 2540 Shumard**  
4   **Oak Boulevard, Tallahassee, Florida 32399-0870,**  
5   **appearing on behalf of the Commission Staff.**

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**EXHIBITS**

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**P R O C E E D I N G S**

(Hearing convened at 9:45 a.m.)

**CHAIRMAN JOHNSON:** If everyone could settle in, we're going to go ahead and begin the hearing. Counsel, could you read the notice?

**MR. COX:** Pursuant to notice filed September 15, 1998, this time and place have been set for a hearing in Docket No. 980696-TP, determination of the cost of basic local telecommunications service, pursuant to Section 364.025, Florida Statutes.

**CHAIRMAN JOHNSON:** Take appearances, just starting here.

**MR. CARVER:** Thank you. Phillip Carver on behalf of BellSouth, 675 West Peachtree Street, Atlanta, Georgia 30375. Also appearing on behalf of BellSouth will be Mary Keyer and Nancy White.

**MR. FONS:** My name is John Fons with the Ausley law firm, Post Office Box 391, Tallahassee, Florida 32302, appearing on behalf of Sprint-Florida. Also appearing with me is Charles Rehwinkel, 1313 Blair Stone Road, Tallahassee, Florida 32301.

**MS. CASWELL:** Kill Caswell for GTE Florida, P.O. Box 110, Tampa City Center, Tampa, Florida 33601, and appearing with me is Lewis Powell. Lewis is a member of the firm of Hunton & Williams in Richmond,



1 Virginia. Lewis has been a member of the Virginia bar  
2 since 1978, and he has practiced before numerous state  
3 utilities commissions.

4 **MR. WAHLEN:** Good morning. I'm Jeff Wahlen  
5 of the Ausley & McMullen law firm P.O. Box 391,  
6 Tallahassee, Florida 32302, appearing on behalf of  
7 ALLTEL Florida Inc., Northeast Florida Telephone  
8 Company, and Vista-United Telecommunications.

9 Also appearing with me will be William H.  
10 Holliman of the same law firm and same address.

11 **COMMISSIONER CLARK:** What was the name?

12 **CHAIRMAN JOHNSON:** William A. Oliver?

13 **COMMISSIONER CLARK:** Mr. Wahlen, who is  
14 appearing with you?

15 **MR. WAHLEN:** Bill Holliman.

16 **MR. ERWIN:** My name is David B. Erwin, 127  
17 Riversink Road Crawfordville, Florida. I'm appearing  
18 on behalf of Frontier Communications of the South,  
19 Inc., GTC, Inc., Indiantown -- ITS Telecommunications  
20 Systems, Inc., and TDS Telecom-Quincy Telephone.

21 **MR. HATCH:** Tracy Hatch, 101 North Monroe  
22 Street, Suite 700, Tallahassee, Florida 32301,  
23 appearing on behalf of AT&T Communications of the  
24 Southern States, Inc.

25 Also appearing with me will be Gene Coker,

1 also of AT&T, and James Lamoureux, also of AT&T.  
2 Their address is 121 Peachtree Street, Atlanta,  
3 Georgia 30309. In addition, appearing with me will be  
4 Steven Ruscus of the law firm McKenna & Cuneo, 1900 K  
5 Street, Washington D.C. 20006.

6 **CHAIRMAN JOHNSON:** That was Russell?

7 **MR. HATCH:** Ruscus, R-U-S-C-U-S.

8 **MR. MELSON:** Rick Melson of the law firm  
9 Hopping Green Sams and Smith, P.O. Box 6526,  
10 Tallahassee, appearing on behalf of MCI  
11 Telecommunications Corporation and MCI Metro Access  
12 Transmission Services, Inc.

13 Also appearing with me will be  
14 Michael J. Henry, 700 Johnson Ferry Road, Atlanta,  
15 Georgia.

16 **MR. SELF:** Floyd Self of the law firm  
17 Messer, Caparello & Self, P.A., 215 South Monroe  
18 Street, Suite 701, Tallahassee, Florida. I'm  
19 appearing on behalf of WorldCom Technologies, Inc.

20 **MR. MCGLOTHLIN:** Joe McGlothlin, 117 South  
21 Gadsden Street, Tallahassee, for the Florida  
22 Competitive Carriers Association.

23 **MR. HORTON:** Norman H. Horton, Jr., Messer  
24 Caparello & Self, 215 South Monroe, Suite 701,  
25 appearing on behalf of e.spire Communications.

1           **MR. BECK:** Charlie Beck, Office of the  
2 Public Counsel, 111 west Madison Street, Room 812,  
3 Tallahassee, Florida appearing on behalf of Florida  
4 citizens.

5           **MS. AUGER:** Barbara Auger with the law firm  
6 of Pennington, Moore, Wilkinson, Bell & Dunbar, 215  
7 South Monroe Street, Tallahassee, Florida. I'm  
8 appearing on behalf of Time-Warner.

9           **MR. GROSS:** Michael Gross, Office of the  
10 Attorney General, The Capitol, Tallahassee, Florida.

11           **MS. GALLAGHER:** Laura Gallagher appearing on  
12 behalf of Florida Cable Telecommunications  
13 Association, 310 North Monroe Street, Tallahassee,  
14 Florida 32301.

15           **MR. COX:** William Cox on behalf of the  
16 Florida Public Service Commission Staff. Also  
17 assisting me will be Catherine Bedell, Martha Brown,  
18 Beth Keating, June McKinney Clintina Watts.

19           **CHAIRMAN JOHNSON:** Thank you. Any  
20 preliminary matters?

21           **MR. COX:** Yes, Madam Chairman, there are  
22 several preliminary matters.

23           The first, I would like the parties to  
24 present at this time the stipulation of various  
25 witness testimony. I believe we have the

1 stipulations. The first is on the witness for the  
2 FCTA.

3 MS. GALLAGHER: Yes, Madam Chairman. We  
4 reached a stipulation that the prefiled direct  
5 testimony and rebuttal testimony of William Barta  
6 would be inserted into the record.

7 CHAIRMAN JOHNSON: Do we do that now?

8 MR. COX: Yes. I would request that we do  
9 that now.

10 MS. GALLAGHER: There is also an exhibit  
11 attached to Mr. Barta's direct testimony, which was  
12 his resume. It's WJB-1.

13 CHAIRMAN JOHNSON: Show Mr. Barta's direct  
14 and rebuttal inserted into the record as though read,  
15 and the exhibit WJB-1 should be identified, then, as  
16 Exhibit 1 and admitted into the record without  
17 objection.

18 (Exhibit 1 marked for identification and  
19 received in evidence.)  
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1                                   **DIRECT TESTIMONY OF WILLIAM J. BARTA**

2                                   **DOCKET NO. 980696-TP**

3                                   **BEFORE THE**  
4                                   **FLORIDA PUBLIC SERVICE COMMISSION**

5                                   **I. QUALIFICATIONS**

6           **Q.     Please state your name and business address.**

7           **A.     My name is William Barta, and my business address is 1140 Liberty Grove**  
8                                   **Road, Alpharetta, Georgia 30004.**

9  
10          **Q.     What is your occupation?**

11          **A.     I am the founder of Henderson Ridge Consulting, Inc., a regulatory**  
12                                   **consulting firm. The firm's practice focuses on the technical and policy**  
13                                   **issues confronting the telecommunications and electric utility industries.**

14  
15          **Q.     Please provide a summary of your education and professional experience.**

16          **A.     From 1975 through 1978, I attended The Lindenwood Colleges where I**  
17                                   **received a Bachelor of Arts degree, cum laude, with a study emphasis in**  
18                                   **accounting. Upon graduation, I held accounting staff positions with a**  
19                                   **privately-held corporation and with a division of a large, public corporation.**  
20                                   **The primary responsibilities of these positions were to perform financial**  
21                                   **ratio analysis, cost accounting functions, and to supervise the monthly**  
22                                   **book close and preparation of the financial statements. In 1980, I enrolled**  
23                                   **in the graduate business program at Emory University and received my**  
24                                   **Masters of Business Administration with concentrations in finance and**  
25                                   **marketing.**

1 After graduating from Emory University in 1982, I joined the Bell System as  
2 an Account Executive where I was responsible for the sale/lease of  
3 regulated products and services to large business customers. In late 1983,  
4 I transferred to AT&T Communications where I provided a broad range of  
5 accounting regulatory support functions to the nine state Southern Region.

6  
7 From 1986 through 1988, I held various positions in the regulatory  
8 departments of Contel Corporation, an independent local exchange carrier.  
9 My responsibilities ranged from tariff support to ratemaking and rate design  
10 issues to line of business feasibility studies.

11  
12 In April 1988, I joined the firm of J. Kennedy and Associates, Inc., a  
13 regulatory and economic consulting firm. As a Manager at Kennedy and  
14 Associates, I directed or supported the ratemaking investigations of major  
15 telecommunications and electric utilities. My work covered rate design,  
16 revenue requirements analysis, and the determination of the appropriate  
17 cost of capital and other issues associated with traditional rate base/rate of  
18 return regulation.

19  
20 I have conducted management and compliance audits of regulated  
21 telecommunications and electric utilities. I have examined utilities' filings  
22 regarding other matters such as merger proposals, alternative regulation  
23 requests, affiliate relationships, network modernization proposals, and  
24 emerging competition.

25

1 Q. Do you hold any professional certifications?

2 A. Yes, I am a Certified Fraud Examiner and a Certified Public Accountant with  
3 an active license to practice in the State of Georgia.

4

5 Q. Please provide a brief overview of your experience that is germane to this  
6 proceedings.

7 A. I have been involved and/or testified in State regulatory proceedings that  
8 have been initiated to examine local competition and universal service in  
9 response to the Federal Telecommunications Act of 1996 ("1996 Act").  
10 With respect to local competition rulemakings, I have participated and  
11 testified in dockets to establish the appropriate wholesale percentage  
12 discount for resale purposes and to establish permanent prices for local  
13 interconnection and unbundled network elements. In these engagements,  
14 I have addressed policy and technical issues, including the analysis of the  
15 forward-looking economic cost ("FLEC") models which support the Total  
16 Service Long Run Incremental Cost ("TSLRIC") studies and Total Element  
17 Long Run Incremental Cost ("TELRIC") studies submitted by the incumbent  
18 local exchange carriers and interexchange carriers.

19

20 I have directed and/or testified in numerous traditional rate base/rate of  
21 return proceedings that investigated the earnings levels and operations of  
22 local exchange carriers. Many of these engagements examined the impact  
23 of basic local exchange rates due to changes in rates or rate restructurings  
24 of other service offerings. My firm is currently developing policies,  
25 procedures, and internal controls to govern the administration and oversight

1 of a State universal access fund.

2

3 I have been retained as an expert witness in universal service proceedings  
4 in other jurisdictions in response to the requirements of the 1996 Act.  
5 These dockets required analysis of very similar issues and cost proxy  
6 models that will be deliberated in the instant proceeding. In addition, I have  
7 been retained to participate and testify in upcoming access charge reform  
8 proceedings when a procedural schedule has been adopted.

9

10 Additional detail with respect to my qualifications can be found in Exhibit  
11 (WJB-1).

12

13 **Q. On whose behalf are you testifying in this proceeding?**

14 **A.** I am testifying on behalf of the Florida Cable Telecommunications  
15 Association ("FCTA").

16

17 **Q. What is the purpose of your testimony?**

18 **A.** I have been requested by the FCTA to review the cost models and related  
19 cost studies filed by the incumbent local exchange carriers ("ILECs") and  
20 AT&T/MCI in support of the estimated cost to provide the supported  
21 universal services when those studies and cost support become available.  
22 Furthermore, I have been requested to evaluate whether it is appropriate to  
23 establish a State Universal Service Fund at this time based upon the overall  
24 profitability of serving the residential subscriber in Florida.

25



1           **ii. THE ANALYSIS OF THE COST PROXY MODEL RESULTS**

2           **Q.    What types of analyses should be conducted to determine the appropriate**  
3           **cost study?**

4           **A.    If the analyses of the parties' cost studies are to be meaningful to the**  
5           **Commission, the level of their compliance with legislative and regulatory**  
6           **requirements should be evaluated. The costing methodology used by each**  
7           **model sponsor should be examined to determine whether it is consistent**  
8           **with the approach that is most appropriate for the purpose of providing the**  
9           **supported universal services as defined by the Commission. In addition, the**  
10          **analysis of the cost studies should include an examination of how the**  
11          **underlying components of the costs proposed by the parties' were**  
12          **developed.**

13  
14          **Q.    What specific analyses of the cost studies will you undertake when such**  
15          **information becomes available?**

16          **A.    My analysis of the cost studies will evaluate whether they are consistent**  
17          **with the standards and requirements established by the**  
18          **Telecommunications Act of 1996. The cost studies should be consistent**  
19          **with forward-looking economic costing principles and not reflect a blend of**  
20          **costing approaches (i.e. embedded and TSLRIC approaches). Clearly, one**  
21          **would not expect the cost proxy models to incorporate less efficient**  
22          **technology than is currently available, work processes that are more labor**  
23          **intensive than existing automated procedures, or any types of past**  
24          **inefficiencies.**

25

1 My analysis of the cost studies will examine how the capital costs and  
2 operating expenses were developed and whether the level of such costs,  
3 on a forward-looking basis, are reasonable. For instance, the proposed fill  
4 factors, average drop lengths and other loop characteristics will be  
5 reviewed to determine how these inputs affect the level of the forward-  
6 looking network investment that underlies the projected capital costs. An  
7 analysis of the components of the estimated operating expenses (e.g.  
8 reasonableness of labor rates and installation times, assumptions regarding  
9 forward-looking efficiencies, etc.) will be undertaken.

10  
11 I will also attempt to evaluate the non-rural ILECs' overall profitability in  
12 serving the residential subscriber based upon a forward-looking cost  
13 estimate and a revenue analysis specific to each carrier.

14  
15 **Q. Does this conclude your direct testimony?**

16 **A. Yes.**

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**BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION**

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**I. PURPOSE OF REBUTTAL TESTIMONY**

10 **Q. Please state your name and business address.**

11 **A. My name is William Barta, and my business address is 1140 Liberty Grove Road,  
12 Alpharetta, Georgia, 30004.**

13 **Q. Have you previously submitted testimony in this proceeding?**

14 **A. Yes. I submitted direct testimony in this proceeding on August 3, 1998.**

15 **Q. What is the purpose of your rebuttal testimony?**

16 **A. My testimony comments upon the cost proxy models that have been submitted by  
17 the large incumbent local exchange carriers (i.e. BellSouth, GTE, and Sprint) and  
18 jointly by AT&T/MCI to estimate the cost of providing basic local  
19 telecommunications service. The testimony discusses the modifications that should  
20 be made to the model inputs in order to develop more reliable forward-looking cost  
21 estimates. In addition, my testimony rebuts ILEC claims concerning the need to  
22 establish an intrastate universal service fund at this time.**

23 **Q. Please summarize your testimony.**

24 **A. The Florida Legislature has directed the Florida Public Service Commission ("the  
25 Commission" or "the FPSC") to determine and report the total forward-looking  
economic costs ("FLEC") of providing basic local telecommunications service in**

1 Florida. The FLEC models submitted for the Commission's consideration produce  
2 sharply divergent results with respect to universal service support requirements.  
3 Indeed, the Benchmark Cost Proxy Model, Version 3.1 ("BCPM 3.1") submitted by  
4 the non-rural local exchange carriers ("LECs") generate high estimates of required  
5 universal service support relative to those calculated under the Hatfield Model,  
6 Version 5.0a ("HM 5.0a"). My testimony addresses the model inputs that are most  
7 likely to influence the cost estimates of each model. Assuming that the Florida  
8 Legislature wishes to obtain this cost information in order to evaluate whether to  
9 establish a permanent universal service fund for Florida, it is important to  
10 distinguish between the estimated cost of service versus the need for and size of  
11 any fund.

12  
13 This docket focuses on the determination of the forward-looking costs to provide  
14 basic local telecommunications service in Florida. The proceeding has not been  
15 initiated to quantify the level of universal service support. Indeed, it has not been  
16 established that any funding is necessary at this time. The Commission should note  
17 that competition, especially for basic local exchange service, will not be realized for  
18 many years. The incumbent local exchange carriers will be the primary  
19 beneficiaries of any universal service support established by the Legislature  
20 throughout the transition to a fully competitive market. An oversized universal  
21 service support system will create an unnecessary windfall for the ILECs that poses  
22 a barrier to entry for would-be competitors. Thus, while the FCTA proposes certain  
23 adjustments to the cost estimates in this proceeding, the FCTA opposes the  
24 establishment of a permanent universal service fund at this time.

25

1 In assessing the need for a universal service support mechanism, a number of other  
2 factors deserve equal consideration in addition to carrier-provided cost information.  
3 The need for a universal service fund should be first considered in terms of the  
4 incumbent carrier's overall profitability in serving the residential subscriber  
5 throughout the State of Florida. The degree of competition, both on a current and  
6 prospective basis, also influences the urgency for the establishment of a State fund.  
7 Other issues that will likely be addressed in a separate proceeding by the  
8 Commission include the revenue benchmark, the appropriate affordability threshold,  
9 and the opportunities for rate rebalancing. These areas are further measures that  
10 can be used to offset the need for an intrastate universal service fund.

## 11 12 13 II. THE PROCEDURAL BACKGROUND 14

15 **Q. What are the events that have led to the initiation of this proceeding?**

16 **A.** On the federal level, a trilogy of regulatory initiatives is underway focusing on  
17 achieving the pro-competitive objectives of the Telecommunications Act of 1996.  
18 Universal service reform is one of the areas specifically addressed by the 1996 Act.  
19 The other two components of the trilogy include local competition (i.e.  
20 interconnection and unbundled network element rates) and access charge reform  
21 rulemakings.

22  
23 On May 8, 1997, the Federal Communications Commission released its Universal  
24 Service Order (CC Docket 96-45) implementing the universal service reform  
25 requirements outlined in the 1996 Act. Although the FCC's Universal Service Order

1 provides guidance to State regulatory authorities, each jurisdiction can elect to  
2 conduct its own study to determine the costs of providing universal service. In that  
3 vein, pursuant to Chapter 364.025, Florida Statutes, the Legislature has directed  
4 the Commission to conduct a study and report on the forward-looking cost of  
5 providing basic local telecommunications services by February 15, 1999.

6  
7 On June 19, 1998, the FPSC issued Order No. PSC-98-0813-PCO-TP establishing  
8 a procedure to determine the cost of basic local telecommunications service  
9 pursuant to Chapter 364.025, Florida Statutes. The Commission will report back  
10 its findings to the Legislature by February 15, 1998.

11  
12  
13 **III. AN OVERALL ASSESSMENT OF THE COST MODELS**

14  
15 **Q. What forward-looking economic cost models have been submitted in this proceeding**  
16 **to estimate the costs of providing universal service?**

17 **A.** There are two forward-looking economic cost models that have been submitted to  
18 estimate the cost of providing universal service in Florida. The models under  
19 consideration include the Benchmark Cost Proxy Model, Version 3.1 and the  
20 Hatfield Model, Version 5.0a. Cost studies that are based upon the BCPM 3.1 have  
21 been submitted by BellSouth Telecommunications, Inc., Sprint, and, GTE. The joint  
22 sponsors of the Hatfield Model 5.0a are AT&T and MCI.

23  
24 **Q. What analysis of the BCPM 3.1 and the Hatfield Model 5.0a have you performed?**

25

1 A. I have reviewed the documentation submitted by the sponsors in support of the  
2 forward-looking economic cost models and attended workshops sponsored by  
3 regulatory authorities where the design and operation of the BCPM and the Hatfield  
4 Model were presented. I have also reviewed ex parte filings submitted by a number  
5 of industry participants to the FCC in the matter of developing a forward-looking  
6 economic cost model to estimate the cost of providing universal service.  
7

8 Q. What general observations do you have regarding the BCPM and the Hatfield  
9 Model?

10 A. The respective FLEC models are sponsored by industry members with very  
11 divergent views and agendas regarding the cost to provide universal service. The  
12 Commission would do well to keep in mind that the majority of universal service  
13 support, at least in the foreseeable future, will flow to the incumbent local  
14 exchange carriers. Thus, in developing a FLEC model, the sponsors of the BCPM  
15 are incented towards a higher cost estimate of providing universal service. On the  
16 other hand, a lower cost estimate that minimizes the size of the USF is consistent  
17 with the desires of the joint sponsors of the Hatfield Model who are likely to be  
18 large contributors to any universal service support system.  
19

20 Q. What are the critical components that a cost proxy model must address in the  
21 design of a telecommunications network?

22 A. The design of the cost proxy model must be consistent with the policy that every  
23 customer who desires service is connected to a local central office switch. The  
24 critical components in achieving ubiquitous connectivity include accurately locating  
25

1 customers and then designing the least-cost, most efficient feeder and distribution  
2 network to serve the customers.

3

4 Q. To what extent have you examined the processes performed within the BCPM 3.1  
5 and the HM 5.0a to locate customers and configure the feeder and distribution  
6 network?

7 A. In addition to the explanations of the customer location methodology and network  
8 configuration presented by the model sponsors at workshops, I have reviewed the  
9 documentation provided in support of the carriers' prefiled testimony. Each cost  
10 proxy model engages in a series of complex algorithms and iterations based upon  
11 Census Block data (i.e. road and household data), wire center information obtained  
12 from Business Location Research, and business line data acquired from PNR and  
13 Associates. The cost proxy models process this data in an effort to accurately  
14 locate customers. Indeed, each model further refines the data through clustering  
15 algorithms in an attempt to identify clusters of customers in recognition that  
16 subscribers are not uniformly dispersed throughout a carrier's service territory. The  
17 end result of these sophisticated mathematical processes is to locate, or assign,  
18 customers at a very discrete level (i.e. the microgrid level) and design a network  
19 within the engineering constraints of a Carrier Serving Area.

20

21 The customer location methodology and the configuration of serving areas represent  
22 model platforms that are not readily subject to revision as user inputs. Although  
23 the approaches in which the BCPM 3.1 and HM 5.0a process the customer  
24 information data and configure the network to serve the customers differ, it is

25



1           difficult to isolate the impact of these differences in each model's final cost  
2           estimate to provide universal service.

3  
4                                   **IV. A DISCUSSION OF THE MODEL INPUTS**

5  
6   **Q.    Did you review any other areas or features of the cost proxy models in addition to**  
7   **the customer location and network configuration methodologies?**

8   **A.    Yes. I reviewed each model's inputs documentation provided in support of the**  
9   **BCPM and the Hatfield Model. The flexibility of both models is evident from the**  
10   **volume of inputs the user can change. In my analysis of the differences that exist**  
11   **between specific user inputs, I have focused on those inputs that I believe most**  
12   **materially effect the output of the models, i.e. the final cost estimates.**

13  
14    My review considered the input parameters effecting the level of investment  
15    required to provide universal service, the related capital costs, and the operating  
16    expenses necessary to maintain and operate the network. The discussion of these  
17    issues is intended to result in revisions that more appropriately reflect the forward-  
18    looking conditions that the incumbent local exchange carriers are likely to encounter  
19    during the study period. Other parties to the proceeding may raise valid concerns  
20    over the values of additional model inputs.

21  
22   **Q.    What overall cost of capital has been assumed by each of the carriers in the cost**  
23   **proxy models?**

24   **A.    In submitting its cost study based upon the BCPM 3.1, BellSouth assumes that the**  
25   **cost of debt will be 6.5% and the cost of equity will be 14.4% on a forward-**

1 looking basis. The Company also assumes a debt ratio of 40% which results in an  
2 overall cost of capital of 11.24%. The projected overall cost of capital is intended  
3 to mirror the current interstate rate of return of 11.25% authorized by the FCC.  
4

5 The 12.63% overall cost of capital projected by GTE for use in the BCPM 3.1 is  
6 based upon a cost of debt of 6.9% and a cost of equity of 14.3%. The  
7 capitalization ratios are assumed to be a debt ratio of 22.5% and an equity ratio of  
8 77.5%.

9  
10 Sprint forecasts an overall cost of capital of 11.23% for use in BCPM 3.1. The  
11 11.23% overall rate of return is comprised of a cost of debt of 7.0% and a cost of  
12 equity of 14.1%. A capital structure consisting of 40.4% debt and 59.6% equity  
13 is assumed. Sprint, like BellSouth, believes that the FCC authorized rate of return  
14 of 11.25% should be used in the cost proxy model.  
15

16 The weighted average cost of capital used in the Hatfield Model, Version 5.0a for  
17 all incumbent local exchange carriers is 10.01%. The cost of capital is based upon  
18 a cost of debt of 7.7% and a cost of equity of 11.90%. The capitalization ratios  
19 include 45% debt and 55% equity.  
20

21 **Q. What cost of capital do you recommend be used in the cost proxy models?**

22 **A.** The authorized intrastate cost of capital for a regulated utility is typically decided  
23 by the Commission after hearing testimony from the parties participating in the  
24 proceeding. Until the Commission reaches a decision regarding the appropriate  
25 forward-looking cost of capital in the instant proceeding, the rate of return

1 estimated by the HM 5.0a sponsors appears to be more representative of the ILECs'  
2 forward-looking cost of capital. The HM 5.0a cost of capital more appropriately  
3 recognizes the lower business risk attributed to the inherent efficiencies derived  
4 from the incumbent local exchange carriers' network economies of scale and scope.  
5 In addition, the HM 5.0a cost of capital more closely reflects the fact that there is  
6 no meaningful competition for basic local service at this time.

7  
8 **Q. What is a fill factor?**

9 **A.** A fill factor represents the percentage of the network facility that is being used.  
10 Neither regulated or nonregulated firms anticipate or desire to be at full, or 100  
11 percent, utilization of capacity. Thus, the network facilities of telecommunications  
12 common carriers are engineered with an appropriate amount of spare capacity in  
13 mind. The spare capacity can take the form of administrative spare, spare capacity  
14 attributed to modularity, and demand related spare.

15  
16 **Q. How do the fill factors adopted for feeder and distribution facilities effect the cost  
17 estimates developed by the models?**

18 **A.** The fill factors used in the BCPM 3.1 and the Hatfield Model 5.0a effect the level  
19 of investment required to provide services to customers. Lower than necessary  
20 utilization rates increase total loop investment because the increase in capacity  
21 associated with lower fill factors increases the amount of loop plant used to deliver  
22 telecommunications services. Optimistically robust fill factors may jeopardize the  
23 quality of service. The feeder and distribution fill factors used in the Hatfield Model  
24 are higher than those used in the BCPM.

25

1       The appropriate fill factor used in the cost proxy models should balance current and  
2       expected demand levels for the supported universal services as well as  
3       accommodate the requirements for administrative and modular related spare  
4       capacity over the economic life of the feeder and distribution facilities.

5  
6   **Q.    What is meant by the sharing of support structures?**

7   **A.    Structure sharing refers to the practice of sharing investments in poles, trenches,  
8       and conduits with other utilities and/or carriers.**

9  
10 **Q.    What do each of the models assume with respect to the sharing of support  
11       structures?**

12 **A.    The level of sharing of support structures projected in the Hatfield Model is  
13       significantly greater than in the BCPM. In both models, the amount of structure  
14       sharing depends upon the type of structure and the density zone.**

15  
16       The Hatfield Model sponsors believe that the increased level of sharing of support  
17       structures on a forward-looking basis is attributed to the strong economic and  
18       financial incentives that will prevail on a forward-looking basis:

19  
20       **"First, because utilities are now more likely to either face  
21       competition or to be regulated on the basis of their prices  
22       (e.g. price caps) rather than their costs (e.g. ratebase), a  
23       LEC's own economic incentive is to share use of its  
24       investment in outside plant structure. Such arrangements  
25       permit the LEC to save substantially on its outside plant costs**

1           **by spreading these costs across other utilities or users.**  
2           **Second, many localities now strongly encourage joint pole**  
3           **usage or trenching operations for conduit and buried facilities**  
4           **as a means of minimizing the unsightliness and/or right-of-**  
5           **way congestion occasioned by multiple poles, or disruptions**  
6           **associated with multiple trenching activities.**

7  
8           **Because of these economic and legal incentives, not only has**  
9           **structure sharing recently become more common, but its**  
10          **incidence is likely to accelerate in the future -- especially**  
11          **given the Federal Telecommunications Act's requirements for**  
12          **nondiscriminatory access to structure at economic prices"**  
13          **(Hatfield Model Version 5.0a, Inputs Portfolio, Appendix B,**  
14          **page 151).**

15  
16          The sponsors of the BCPM rely upon past and current experience with the sharing  
17          of structures within the state. The model documentation states that structure  
18          sharing is based upon **"BellSouth Florida-specific structure sharing percentages to**  
19          **reflect values representative of BellSouth's costs in Florida"** (BCPM 3.1  
20          documentation, Section 4, Proposed BCPM 3.1 Inputs). Witnesses testifying on  
21          behalf of the BCPM in other jurisdictions have concluded that the sharing of  
22          trenches and conduit among utilities and other users is negligible. These  
23          conclusions were reached based upon inquiries of state contractors regarding the  
24          degree of sharing of trenching in distribution and feeder routes and current  
25          experience with sharing of underground facilities (Rebuttal Testimony of Jamshed

1 K. Madan, Michael D. Dirmier, and David C. Newton on behalf of BellSouth  
2 Telecommunications, Inc., Tennessee Regulatory Authority Docket No. 97-01262).

3  
4 **Q. How should the FPSC address the percentage of structure sharing in the cost proxy  
5 model used for universal service support?**

6 **A. Clearly, the model sponsors have differing views on the level of structure sharing  
7 that is likely to occur on a forward-looking basis. The issues raised by the Hatfield  
8 Model sponsors have merit -- the percentage of structure sharing among utilities  
9 and other users should increase in the future as more parties require space on a  
10 limited number of facilities and right-of-ways. But it is doubtful whether the degree  
11 of structure sharing envisioned by the Hatfield Model sponsors will materialize  
12 immediately or even in the near future.**

13  
14 **The model inputs for structure sharing should be revised, by density zone, in order  
15 to reflect a more realistic sharing arrangement. The structure sharing percentage  
16 should recognize that there will be more carriers seeking the economic benefits of  
17 structure sharing but the opportunities for such sharing may be constrained for a  
18 number of reasons, including engineering limitations.**

19  
20 **Q. What depreciation rates are used in the cost proxy models?**

21 **A. The Hatfield Model adopts the average projection lives adjusted for net salvage  
22 value as determined in the three-way meetings held between the FCC, the State  
23 regulatory authority, and the utility for 76 LEC study areas. As explained in the  
24 Hatfield Model Version 5.0a documentation on page 67:**

1            "[T]he model assumes straight-line depreciation and calculates  
2            return on investment, tax gross-up and depreciation expenses  
3            annually on the mid-year value of the investment. Because  
4            capital carrying costs are levelized, substitution of nonlinear  
5            or accelerated depreciation schedules for straight-line  
6            depreciation would have almost no net effect on calculated  
7            annual capital carrying costs (aside from favorable tax  
8            effects)."

9  
10           The incumbent local exchange carriers adopt a different approach to populate the  
11           depreciation-related model inputs than the one used in HM 5.0a. BellSouth presents  
12           the rates developed by its Depreciation Organization, GTE asserts that its 1996  
13           financial reporting rates are representative of forward-looking conditions, and Sprint  
14           relies upon an outside study conducted by Technology Futures, Inc.

15  
16    **Q.**    What depreciation rates should be adopted by the Commission for use in the cost  
17           proxy model?

18    **A.**    The Commission should adopt the economic lives and net salvage values prescribed  
19           for the Florida operations of BellSouth and GTE by the FCC. The forward-looking  
20           depreciation lives and future net salvage estimates prescribed by the FCC are  
21           grounded in a comprehensive examination and offer an objective assessment of  
22           capital recovery rates. The FCC has not prescribed rates in the case of the Sprint  
23           operating companies. In lieu of FCC specific rates, the default rates of the HM 5.0a  
24           serve as a suitable proxy.

25

1 Q. What other model inputs should the Commission examine closely?

2 A. The other input values that would appear to have the greatest effect on each  
3 model's cost estimates include the copper/fiber crossover point, the purchase price  
4 for outside plant and switching facilities, the labor rates and installation times to  
5 install facilities, the projected operating expenses, and the level at which universal  
6 service support is aggregated.

7

8 Q. How is the copper/fiber crossover point treated in each model?

9 A. The copper/fiber crossover point refers to the threshold where fiber facilities are  
10 used in lieu of copper facilities. The BCPM 3.1 is designed to limit copper loop  
11 lengths to 12,000 feet:

12

13 **"Tends to limit average copper loop lengths from the DLC to**  
14 **the customer by generally limiting the maximum ultimate grid**  
15 **size to 12,000 feet by 14,000 feet, latitude and longitude.**  
16 **If copper loop lengths from the DLC to the customer exceed**  
17 **12,000 feet, the cable gauge is reduced to 24 gauge cable**  
18 **and extended range plug-ins are installed on loops extending**  
19 **beyond 13,600 feet. The ultimate grids are designed such**  
20 **that copper loop lengths from the DLC to the customer are**  
21 **unlikely to exceed 18,000 feet"** (BCPM 3.1 Model  
22 Methodology documentation, Appendix C, page 125).

23

24 The Hatfield Model, in turn, assumes longer copper loop lengths in the design of the  
25 forward-looking network: "[t]he model selects fiber feeder if any of following five



1       **criteria are met: b) the total copper loop length, including feeder and distribution**  
2       **cable, for customer locations within a main cluster, exceeds a user-adjustable**  
3       **maximum analog copper distance whose default value is 18,000 feet" (HM 5.0a**  
4       **documentation, Model Description, page 20).**

5  
6       The Commission should determine, based upon sound engineering practices, the  
7       appropriate economic crossover point to be used in the cost proxy models.

8  
9       **Q. How do each of the models estimate the acquisition costs of switching and outside**  
10       **plant facilities?**

11       **A. The Hatfield Model sponsors admit that the proprietary claims of switching**  
12       **manufacturers and vendors of outside plant facilities increase the difficulty of**  
13       **estimating the acquisition costs for such network facilities as central office**  
14       **switches, and copper and fiber optic cable:**

15  
16       **"Prices of telecommunications equipment and materials are**  
17       **notoriously difficult to obtain from manufacturers and large**  
18       **sales organizations. Although salespeople will occasionally**  
19       **provide 'ballpark' prices, they will do so only informally and**  
20       **with the caveat that they may not be quoted and the**  
21       **company identity must be concealed. It is very nearly**  
22       **impossible to obtain written, and hence 'citable,' price**  
23       **quotations, even for 'list' prices, from vendors of equipment,**  
24       **cable and wire, and other items that are used in the**  
25       **telecommunications infrastructure. Part of the reason for this**

1 is that the vendors have long-standing relationships with the  
2 principal users of such equipment, the incumbent local  
3 exchange carriers ('ILECs'), and they apparently believe that  
4 public disclosure of any prices, list or discounted, might  
5 jeopardize these relationships. Further, they may fear  
6 retaliation by the ILECs if they were to provide pricing  
7 explicitly for use in cost models such as HM 5.0a. The HM  
8 5.0a developers thus have often been forced to rely on  
9 informal discussions with vendor representatives and personal  
10 experience in purchasing or recommending equipment and  
11 materials. Nevertheless, a great deal of experience and  
12 expertise in the industry underlies the estimates, where they  
13 were necessary to augment with explicit, publicly-available  
14 information" (Hatfield Model Version 5.0a documentation,  
15 Inputs Portfolio, page 10).

16  
17 The BCPM sponsors draw upon the opinions of engineers to compliment the use of  
18 state specific data regarding the costs to engineer, furnish, and install network  
19 facilities. The vendor price\_ for the facilities are deemed proprietary by the BCPM  
20 sponsors.

21  
22 **Q. How can the Commission be assured that the prices for switching and outside plant  
23 network facilities used in the cost proxy models reflect forward-looking conditions?**

24 **A. Since the BCPM sponsors are critical of the prices for network facilities used in the  
25 Hatfield Model, it seems reasonable for the FPSC to require additional support for the**

1 BCPM input values. The Commission should seek more reliable data from the BCPM  
2 sponsors -- under proprietary protection -- in order to determine whether the values  
3 input into the model are supported by actual vendor information. The supporting  
4 documentation may include vendor invoices that can be verified with individual  
5 construction work order summaries that capture vendor material costs, contractor  
6 labor costs, and company labor costs.

7  
8 **Q. How do the models differ with respect to projected installation times and labor rates  
9 to deploy network facilities?**

10 **A. Not surprisingly, the model sponsors have different opinions with respect to the time  
11 required and the labor charges to install facilities. The Hatfield Model installation  
12 times and labor rates are based upon "the opinion of a team of outside plant experts"  
13 (Hatfield Model Version 5.0a documentation, Inputs Portfolio, page 11). The Hatfield  
14 Model also incorporates a Regional Labor Adjustment Factor to recognize that  
15 "[D]ifferent areas of the country are known to experience variations in wages paid  
16 to technicians, depending on availability of trained labor, union contracts, and cost  
17 of living factors. The adjustment applies only to that portion of installed costs  
18 pertaining to salaries" (Hatfield Model Version 5.0a documentation, Inputs Portfolio,  
19 page 140).**

20  
21 The BCPM input is based upon the company-specific, regional loaded labor rate and  
22 the state-specific time associated with the installation of the facilities. Therefore,  
23 the BCPM sponsors do not make an adjustment for regional labor cost variances.  
24  
25

1 The installation times and the fully-loaded labor rates assumed in the Hatfield Model  
2 are lower than those used in the BCPM. The FPSC should determine whether the  
3 BCPM inputs reflect historical experience (i.e. embedded costs) or are indicative of  
4 the forward-looking operations that an efficient carrier would be likely to incur in a  
5 competitive market.

6  
7 **Q. How significantly do the assumptions regarding operating expenses effect the**  
8 **results of the models?**

9 **A.** The level of operating expenses greatly effect the cost estimates developed by the  
10 models to provide universal service. In past versions of the BCPM, it was estimated  
11 that an average of 40% to 50% of the cost of universal service was attributed to  
12 the operating expenses of the carrier.

13  
14 **Q. How do each of the models estimate forward-looking operating expenses?**

15 **A.** In the BCPM 3.1, operating expenses are input as expenses per access line or as  
16 a percentage of investment. BellSouth used the same plant-specific expense  
17 factors developed for the Company's TSLRIC cost studies submitted July 31, 1998  
18 in FPSC Docket No. 980000A-SP. The operating expenses included in the BCPM  
19 3.1-based cost study submitted by Sprint were derived from the actual operating  
20 expenses incurred by the Company in Florida during 1997. GTE, like Sprint, uses  
21 1997 actual operating expenses as the basis for its BCPM 3.1 input values. GTE,  
22 however, makes a series of adjustments (i.e. out-of-period normalizations, going-  
23 forward adjustments, and yellow pages revenues adjustments) in order to recast the  
24 actual 1997 expenses as forward-looking.

25

1 The Hatfield Model sponsors acknowledge the difficulty in developing forward-  
2 looking cost estimates for the operations of the incumbent local exchange  
3 providers:

4  
5 **"Estimating LEC operating costs is more difficult than**  
6 **estimating capital costs. Few publicly available forward-**  
7 **looking cost studies are available from the ILECs.**  
8 **Consequently, many of the operating cost estimates**  
9 **developed here must rely on relationships to and within**  
10 **historical ILEC cost information as a point of departure for**  
11 **estimating forward-looking operating costs. While certain of**  
12 **these costs are closely linked to the number of lines provided**  
13 **by the ILEC, other categories of operating expenses are**  
14 **related more closely to the levels of their related investments.**  
15 **For this reason, the Expense Module develops factors for**  
16 **numerous expense categories and applies these factors both**  
17 **against investment levels and demand quantities (as**  
18 **appropriate) generated by previous modules"** (Hatfield Model  
19 Version 5.0a documentation, page 68).

20  
21 A more complete discussion of the method and assumptions supporting the level  
22 of operating expenses projected by the Hatfield Model can be found in Appendix D  
23 of the HM 5.0a Inputs Portfolio documentation.  
24  
25

1 Q. In what way can the Commission be assured that the operating expenses included  
2 in the cost proxy models reflect the costs of a competitive carrier on a forward-  
3 looking basis?

4 A. The estimate of operating expenses developed by each of the models lacks  
5 adequate support and does not provide the FPSC reasonable assurance that the  
6 levels are representative of an efficient carrier operating in a competitive market.  
7 For instance, the Forward-Looking Network Operations Factor input of the Hatfield  
8 Model assumes that the incumbent local exchange carrier will reduce this type of  
9 expense by 50% from the current levels reported in ARMIS. The assumption is  
10 supported by the statement that "ARMIS-based network operations expenses are --  
11 by definition -- a function of telephone company embedded costs. As reported,  
12 these costs are artificially high because they reflect antiquated systems and  
13 practices that are more costly than the modern equipment and practices that the  
14 HAI Model assumes will be installed on a forward-looking basis" (Hatfield Model  
15 Version 5.0a documentation, Inputs Portfolio, page 120). The relevancy and  
16 accuracy of the documentation used to support other operating expense inputs to  
17 the model is also questionable.

18  
19 The documentation supporting the incumbent local exchange carriers' view of  
20 forward-looking operating expenses is flawed in a different sense. These parties  
21 simply assert that the operating expenses included in the model are forward-looking.  
22 GTE adjusts its actual 1997 expenses in an attempt to make them representative  
23 of forward-looking conditions. Although the adjustments may appropriately exclude  
24 specific expenses on a forward-looking basis, the Commission simply does not have  
25 sufficient information to judge the appropriateness of the adjustments without more

1 detailed filings. It is not at all clear whether the operating expenses allegedly  
2 required to support universal service include categories of expenses that are  
3 incurred to provide competitive and/or discretionary services.  
4

5 **Q. How can the Commission obtain greater assurance that the level of operating**  
6 **expenses estimated by the models is reasonable?**

7 **A. The Commission should require that the incumbent local exchange carriers (i.e.**  
8 **BellSouth, GTE, and Sprint) provide detailed documentation supporting either the**  
9 **adjustments they have made to recast embedded cost activity as forward-looking**  
10 **expenses or, in the case of BellSouth, provide the detail that is relied upon from**  
11 **other cost studies prepared by the Company.**  
12

13 **Q. Are there other inputs that can substantially impact the degree of subsidy**  
14 **calculated in support of universal service?**

15 **A. Yes. The Commission's decision concerning the aggregation of costs will be an**  
16 **important determinant in the ultimate size of the Florida universal service fund.**  
17 **Each cost proxy model can disaggregate the costs to provide universal service at**  
18 **a very discrete level. In developing cost estimates, data is disaggregated at the**  
19 **wire center level, Census Block Groups ("CBGs"), Census Blocks ("CRs"), and even**  
20 **at the grid and microgrid level.**  
21

22 **Although each successive level of disaggregation can be helpful in locating**  
23 **customers and configuring a network to serve those customers, the geographic area**  
24 **that is ultimately defined for universal service support consideration is especially**  
25 **important in determining the magnitude of the support. As the geographic serving**

1 areas being modeled become increasingly granular, it should be recognized that the  
2 alleged precision of the cost estimates do not fully take into account the economies  
3 of scale and scope engineered into the incumbent local exchange carrier's network.  
4 Taking the level of granularity to its extreme, the costs necessary to provision  
5 universal service for one customer may result in high cost support but the facilities  
6 to serve an adjacent subscriber may be below the cost threshold.

7  
8 The wire center appears to be the most suitable level at which to aggregate the  
9 costs to calculate universal service support requirements. Indeed, BellSouth  
10 witness Peter Martin recommends in his prefiled direct testimony that:

11  
12 "Initially, the forward-looking cost of basic  
13 telecommunications should be calculated at the wire center  
14 level. Current telecommunications providers capture data at  
15 this level of aggregation on a standardized basis. Therefore,  
16 a wire center basis for cost calculation would be less  
17 burdensome initially than going to a more targeted area of  
18 measure like a census block group (CBG)" (Direct Testimony  
19 of Peter Martin, page 12, lines 20 through 24).

20  
21  
22 **V. THE CURRENT NEED FOR A UNIVERSAL SERVICE FUND**

23  
24 **Q. In what way will the cost estimates to provide universal service determined in this**  
25 **proceeding effect the "appropriate" level of required support?**



1 A. The issues in this proceeding are framed in such a way that it is clear the FPSC is  
2 looking for the cost information in the context of what is appropriate for  
3 establishing a permanent universal service mechanism. The final cost estimates  
4 merely represent the starting point on which to determine whether a universal  
5 service mechanism is necessary. It is equally important to evaluate the estimated  
6 costs to provide universal service within other contexts.

7

8 Q. In what context should the Commission evaluate the estimated costs to provide  
9 universal service in order to calculate the carrier-specific levels of support?

10 A. It is important for the Commission to keep in mind that the ILECs' assertion that  
11 there is a present need for a universal service fund has not been demonstrated and  
12 can be legitimately challenged. For instance, the level of profitability to serve the  
13 residential subscriber on a statewide basis, the opportunities for rate rebalancing,  
14 and the establishment of the appropriate revenue benchmark and affordability  
15 threshold can nullify the need for a massive universal service subsidy.

16

17 Q. Why is it important to consider the overall profitability of serving the residential  
18 subscriber as part of the determination of universal service support?

19 A. The explicit universal service subsidy that will flow to the incumbent local exchange  
20 carriers stems from the concern over competitive threats. The ILECs claim that  
21 their traditional pricing policies have been designed to promote universal service but  
22 these policies will be upset as a result of the targeted entry of new competitors.  
23 Before accepting the ILECs' position, the overall profitability of serving the  
24 residential subscriber on a statewide basis and the degree of competition within the  
25 State of Florida should be examined.

1 As a first step in determining the need for a universal service fund, the cost and  
2 revenue profile of serving the residential subscriber should be examined. The  
3 estimated costs to provide universal service as determined in the instant proceeding  
4 should be compared to the revenues received from the residential subscriber,  
5 including basic local exchange revenue as well as optional and discretionary  
6 services.

7  
8 **Q. Is the concern over the threat of competition eroding the ability of the incumbent  
9 local exchange carriers to sustain their traditional pricing policies serious?**

10 **A. No, at least not in the foreseeable future. A case of robust competitive activity  
11 disrupting the pricing policies of the incumbent local exchange carriers in the State  
12 of Florida -- and thereby, the policy of universal service -- can hardly be made.  
13 Indeed, the December 1997 publication of The Florida Public Service Commission's  
14 Division of Communications underscores what little inroads competitors have made  
15 into the markets of the incumbent carriers.**

16  
17 **\*The total number of business access lines served by all entrants combined  
18 is 42,303 and the total number of residential access lines is 13,857. By  
19 way of comparison, the three large LECs (BellSouth, GTE Florida, and Sprint-  
20 Florida) have approximately 2.9 million business access lines and 7.8 million  
21 residential access lines, which account for approximately 98.5% of the total  
22 access lines in the state (the remaining 1.5% of the total access lines belong  
23 to the remaining seven incumbent LECs). Based on information received as  
24 of September 1997, the competitors account for 0.5% overall of the total  
25 access lines served, 1.4% of the business access lines, and 0.2% of the**

1           **residential access lines**" (Competition In Telecommunications Markets In  
2           Florida, page 8).

3  
4           Based upon the independent assessment of the FPSC Division of Communications,  
5           it does not appear that these incumbent local exchange carriers require any  
6           protection from the threat of competition, much less being the primary beneficiaries  
7           of a significant, explicit subsidy that their competitors, ironically, are required to  
8           fund.

9  
10   **Q.   How do the opportunities for rate rebalancing as well as the establishment of a**  
11   **revenue benchmark and affordability threshold impact the size of the universal**  
12   **service fund?**

13   **A.   Rate rebalancing, the appropriate revenue benchmark, and an affordability threshold**  
14   **are expected to serve as offsets to the total costs to provide universal service and,**  
15   **consequently, reduce the size of the universal service support that flows to the**  
16   **incumbent carriers. The real issue is to what extent these measures reduce the**  
17   **degree of subsidy if appropriately crafted or whether they even need be examined**  
18   **based upon the statewide profitability of serving the residential subscriber. The**  
19   **merits of these issues and others related to universal service support should be**  
20   **thoroughly examined before any intrastate universal service fund is established.**

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

22   **A.   Yes.**

23

24

25

1           **MR. COX:** The next stipulation is regarding  
2 the depreciation witnesses found on Page 8 of the  
3 prehearing order, and the first is AT&T witness --  
4 AT&T/MCI witness.

5           **MR. HATCH:** AT&T's witness was Michael  
6 Majoros. He filed both direct and rebuttal  
7 testimonies. He had direct exhibits of MJM-1  
8 through 6 and rebuttal exhibits, MJM-7 through 12, as  
9 well as he also had a deposition and several  
10 late-filed deposition exhibits. If we could request  
11 that Mr. Majoros' direct and rebuttal testimony be  
12 inserted into the record as though read.

13           **CHAIRMAN JOHNSON:** The direct and rebuttal  
14 will be inserted into the record as though read.

15           **MR. HATCH:** And could we have his direct and  
16 rebuttal exhibits identified, please?

17           **CHAIRMAN JOHNSON:** I'll identify those as a  
18 Composite Exhibit, MJM-1 through 6 slash -- or 7  
19 through 12.

20           **MR. HATCH:** And that would be Exhibit 1?

21           **CHAIRMAN JOHNSON:** Exhibit 2. I'm sorry.

22           (Exhibit 2 marked for identification.)  
23  
24  
25

1 Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS  
2 ADDRESS.

3 A. My name is Michael J. Majoros, Jr. I am Vice President of the  
4 economic consulting firm of Snavely King Majoros O'Connor & Lee,  
5 Inc. ("Snavely King"). My business address is 1220 L Street, N.W.,  
6 Suite 410, Washington, D.C. 20005.

7 Q. ARE YOU THE SAME MICHAEL J. MAJOROS, JR. WHO  
8 SUBMITTED DIRECT TESTIMONY IN THIS PROCEEDING ON  
9 AUGUST 3, 1998?

10 A. Yes, I am.

11 Q. DID YOUR DIRECT TESTIMONY CONTAIN A DESCRIPTION OF  
12 YOUR BACKGROUND AND EXPERIENCE?

13 A. Yes, it did.

14 Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR  
15 DIRECT SUPERVISION?

16 A. Yes it was. I should note, however, that this testimony and its  
17 analytical framework draws heavily upon work performed by myself  
18 and others at Snavely King on behalf of AT&T, MCI and AT&T  
19 Canada LDS for use in other proceedings.

20 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

21 A. In this testimony, I respond to the proposals of BellSouth, GTE and  
22 Sprint on the subject of the appropriate economic lives and future  
23 net salvage percents to be used in calculating depreciation

1 pursuant to the Universal Service Order of the Federal  
2 Communications Commission ("FCC").<sup>1</sup>

3 **Q. PLEASE SUMMARIZE YOUR FINDINGS.**

4 **A.** In my direct testimony, I explained that the FCC requires that Total  
5 Element Long-Run Incremental Cost ("TELRIC") methodology be  
6 used to estimate the cost of universal service.<sup>2</sup> I also found that the  
7 projection lives and future net salvage percents prescribed by the  
8 FCC are consistent with the FCC's Universal Service Order and  
9 appropriate for use in calculating depreciation. I recommended  
10 projection lives and future net salvage percents prescribed in 1995  
11 by the FCC for BellSouth-Florida and GTE-Florida. I also  
12 recommended lives and future net salvage percents for Sprint from  
13 the low end of the FCC ranges.<sup>3 4</sup> Since several of the lives  
14 proposed by BellSouth, GTE and Sprint are much shorter than  
15 those prescribed by the FCC in most major accounts, I conclude  
16 that they are too short to be used in universal service cost studies.  
17 The use of unrealistically short lives would overstate the cost of  
18 universal service and the subsidies necessary for its preservation.

19 **Q. HAVE YOU COMPARED THE LIVES AND FUTURE NET  
20 SALVAGE VALUES PROPOSED BY BELL SOUTH, GTE AND  
21 SPRINT TO THOSE CONSISTENT WITH THE FCC'S RULES AS  
22 REFLECTED IN YOUR RECOMMENDATIONS?**

23 **A.** Yes, I have. On Attachment MJM-7, I compare the proposals of

1 BellSouth, GTE and Sprint (Column d) to my recommendations

2 The life proposals of BellSouth, GTE and Sprint (Column d)  
3 for digital switching, digital circuit and the outside plant accounts  
4 are generally much shorter than the latest FCC prescribed  
5 projection lives (Column c).

6 **Q. HOW DID BELLSOUTH, GTE AND SPRINT DEVELOP THEIR**  
7 **LIFE ESTIMATES?**

8 A. They relied largely upon "substitution analysis," which attempts to  
9 forecast the pattern by which new technology will replace old  
10 technology.<sup>5</sup> GTE and Sprint relied upon substitution analyses  
11 performed by Technologies Futures, Inc. ("TFI"), whose industry  
12 studies have been used frequently by local exchange carriers  
13 ("LECs") to justify shorter lives in regulatory depreciation  
14 proceedings.<sup>6</sup> TFI's studies are sponsored by the  
15 Telecommunications Technology Forecasting Group ("TTFG"), an  
16 industry association of BellSouth, GTE, Sprint and other major  
17 LECs in the United States and Canada. BellSouth also used to rely  
18 on TFI and at one point convinced this Commission to rely on TFI  
19 as well. However, that reliance has been shown to have been  
20 misplaced.

21 **Q. WHAT ASSUMPTIONS UNDERLIE THESE STUDIES?**

22 A. These studies are based upon the premise that LECs will replace  
23 their narrowband telecommunications networks with broadband

1 integrated networks capable of providing both telecommunications  
2 services and video services, such as cable television. According to  
3 these studies, Fiber-In-The-Loop ("FITL") will bring broadband to  
4 the home, displacing copper plant. This will result in the upgrading  
5 of all transmission systems to Synchronous Optical Network  
6 ("SONET"), replacing existing circuit equipment. TFI also predicts  
7 that Asynchronous Transfer Mode ("ATM") switching equipment will  
8 provide a broadband switching capability replacing today's  
9 narrowband switch fabrics.

10 **Q. SHOULD TELRIC COST STUDIES BE BASED UPON**  
11 **ASSUMPTIONS SUCH AS THOSE UNDERLYING THESE**  
12 **ESTIMATES?**

13 **A. No. TELRIC is based on the use of the most efficient**  
14 **telecommunications technology currently available and the lowest**  
15 **cost network configuration, given the existing location of the**  
16 **incumbent LEC's wire centers. The TELRIC standard requires a**  
17 **determination of the stand-alone cost of unbundled network**  
18 **elements in an efficient telecommunications network.<sup>7</sup> The plant**  
19 **lives appropriate for such a calculation should not be based upon**  
20 **the assumption that efficient telecommunications facilities will be**  
21 **prematurely retired in order to provide broadband video services.**  
22 **The FCC has specifically ruled that the costs of premature**  
23 **retirements will not be charged to ratepayers. The FCC states:**



1 Facilities upgrades and accelerated replacement of  
2 older facilities might also be undertaken primarily for  
3 the benefit of unregulated service offerings. The  
4 principles adopted in the Order dictates that such  
5 costs be excluded from the regulated accounts.<sup>8</sup>

6 The use of plant lives based upon the assumption that an  
7 integrated telecommunications/video network will replace the  
8 telecommunications network would effectively cause the costs of  
9 premature retirements to be charged to telephone ratepayers.

10 **Q. IS THIS DISTINCTION BETWEEN TELECOMMUNICATIONS**  
11 **AND VIDEO SERVICES UNIQUE TO THE FCC?**

12 **A.** No. The Canadian Radio-Television and Telecommunications  
13 Commission ("CRTC") draws the very same distinction. The CRTC  
14 divides cost between the Competitive (non-regulated) and Utility  
15 (regulated) segments, and states:

16 The Commission finds that, in general, the most  
17 appropriate regulatory treatment for broadband  
18 initiatives is to require the telephone companies to  
19 assign to the Competitive segment all new  
20 investments and related expenses associated with  
21 the deployment of fiber, coaxial cable, optoelectrical  
22 equipment, asynchronous transfer mode (ATM)  
23 switches, and video servers.<sup>9</sup>

...

1  
2           The Commission does not foresee any instances  
3           where it would be appropriate to have fiber or coaxial  
4           cables in the distribution portion of the loop assigned  
5           to the Utility segment.<sup>10</sup>

6   **Q.   ARE THE LIVES RESULTING FROM THE USE OF**  
7   **SUBSTITUTION ANALYSIS NECESSARILY ACCURATE?**

8   **A.   No.** Substitution models merely provide a convenient method for  
9   plotting by year the growth of a new technology assuming the  
10   inputs to the formula are correct. The output of a substitution  
11   analysis is only as accurate as the inputs selected.

12           In the first place, substitution analysis is not even relevant  
13   unless it is known that a new technology will replace, not  
14   supplement an older technology. It appears, for example, that  
15   Asynchronous Transfer Mode ("ATM") switches will be deployed as  
16   a supplemental technology to digital switches, not as a  
17   replacement for them. As such, substitution analysis is of no  
18   relevance. This helps to explain low retirement rates for digital  
19   switching equipment.

20           Indeed, even when a substitution has started, it does not  
21   necessarily follow that it will finish according to pattern. It appeared  
22   at one point, for example, that nuclear fuel would replace fossil fuel  
23   in electrical generation in this country. The use of substitution

1 formulas in that case would have resulted in dramatically incorrect  
2 predictions.

3 Even if a full substitution is likely, the formula requires the  
4 user to predict both the rate of substitution and the point at which  
5 the replacement technology will reach 50 percent of the universe."'  
6 In other words, the analyst must insert as an input the average  
7 remaining life of the old technology, since this is essentially the 50  
8 percent level of the new technology. Although substitution  
9 methodology allows the preparation and presentation of impressive  
10 looking charts and tables, it is merely charting the assumptions  
11 made by the analyst. Its outputs at the hands of BellSouth or TFI  
12 are no more credible than their inputs.

13 **Q. HAS SUBSTITUTION ANALYSIS PROVEN ACCURATE OVER**  
14 **THE LONG RUN?**

15 **A.** No. Although TFI forecasts have been provided to the FCC for  
16 nearly a decade, they have not been relied upon in the selection of  
17 plant projection lives. Fatima K. Franklin, the Chief of the FCC's  
18 Competitive Analysis Branch, recently made a presentation at the  
19 Annual Meeting of the Society of Depreciation Professionals on the  
20 subject of forecasting. The charts from her presentation are  
21 provided as Attachment MJM-8. Charts 3 and 4 deal specifically  
22 with TFI's estimates. Chart 3 demonstrates that TFI's 1989  
23 estimates for the retirement of circuit equipment have proven

1 grossly inaccurate. The percent of 1987 circuit equipment  
2 surviving as of the end of 1996 is nearly three times as great as  
3 that predicted by its studies. Chart 4 demonstrates that its 1994  
4 estimates for circuit equipment and analog stored program control  
5 ("SPC") switches are already proving inaccurate.

6 Attachment MJM-9 provides a similar analysis of TFI's fiber  
7 in the feeder estimates. Page 1 of this analysis shows its  
8 predictions for the percent of fiber in the feeder in 1988, 1994 and  
9 1997, and actuals (in bold) through 1995. In 1988 TFI predicted a  
10 substitution of 22.55 percent by 1995; in 1994 its prediction  
11 dropped to 11.20 percent; and its latest study shows an actual of  
12 9.30 percent. Page 2 graphically portrays this data and  
13 demonstrates how TFI's life estimates have lengthened as actuals  
14 became available.

15 **Q. HAS BELLSOUTH'S USE OF SUBSTITUTION ANALYSIS**  
16 **PRODUCED ESTIMATES MORE ACCURATE THAN TFI'S**  
17 **ESTIMATES?**

18 **A.** No. Attachment MJM-10 to this testimony reproduces the "tracking  
19 reports" filed by BellSouth as part of its most recent 1996  
20 Depreciation Study. The FCC requires these reports to shed light  
21 on the accuracy of past forecasts by a LEC. Actual retirements  
22 from 1993 to 1995 as a percent of retirements forecast in 1993 for  
23 the South Central Bell Companies were as follows:

1	Aerial Cable Metal	32.3%
2	Underground Cable Metal	11.1%
3	Buried Cable Metal	23.6%

4 This abysmal track record may have contributed to BellSouth's  
5 failure to request represcription in 1996.

6 **Q. DO YOU HAVE ANY FLORIDA-SPECIFIC INFORMATION?**

7 A. Yes. Attachment MJM-11 is a comparison of the TFI predictions  
8 upon which this Commission set BellSouth's copper cable  
9 depreciation rates in Docket No. 920385-TL. The table  
10 demonstrates that TFI was wrong by over \$900 million. The  
11 remaining lives based on TFI's forecast were equally as wrong.

12 **Q. ARE THE LIVES PROPOSED BY BELLSOUTH, GTE AND**  
13 **SPRINT CONSISTENT WITH THE LIVES THEY USE FOR**  
14 **PUBLIC REPORTING PURPOSES?**

15 A. Yes. Apparently they are at least for BellSouth and GTE.

16 **Q. DOES THE FACT THAT BELLSOUTH, GTE OR SPRINT MAY**  
17 **USE THESE LIVES FOR FINANCIAL REPORTING PURPOSES**  
18 **MAKE THEM APPROPRIATE FOR TELRIC PROCEEDINGS?**

19 A. No. Florida-specific FCC prescribed lives are available and should  
20 be used in TELRIC calculations. In a 1989 Petition, AT&T asked  
21 the FCC to base its regulatory depreciation on its financial books.<sup>12</sup>  
22 The FCC flatly rejected this request, stating:

23 We conclude that AT&T has not made a

1 sufficient showing that this Commission should base  
2 AT&T's book rates on the depreciation rates that it  
3 uses for financial reporting purposes. Initially, we  
4 observe that the present depreciation procedures  
5 have worked well for AT&T, in terms of ensuring more  
6 rapid capital recovery. Our recent depreciation orders  
7 have allowed AT&T to increase substantially its  
8 depreciation reserve, from 24.8% of plant as of  
9 January 1, 1984 to 39.1% as of January 1, 1989.  
10 AT&T does not state in its petition in what specific  
11 manner this Commission has been remiss in our  
12 depreciation rate prescriptions of recent years.  
13 Rather, it relies upon the fact that in 1988 it took a \$6  
14 billion writedown of its asset value for financial  
15 reporting purposes. This event may indicate that a  
16 new look at AT&T's depreciation situation is  
17 warranted, notwithstanding our recent depreciation  
18 prescription, and we are accordingly initiating herein  
19 an inquiry into AT&T's need for revised depreciation  
20 rates. However, that assessment can be  
21 accomplished using current procedures rather than  
22 depreciation rate methodologies that go well beyond  
23 those that we have traditionally employed. We have

1 taken a series of initiatives during the past decade to  
2 ensure that carriers are able to adjust their  
3 depreciation rates promptly to recover capital  
4 investment costs as quickly as possible under the  
5 federal regulatory scheme. We do not see a need  
6 now to abandon one of those initiatives to address  
7 what appears to be a temporary problem that can be  
8 resolved with measures less drastic than those  
9 suggested by AT&T.<sup>13</sup>

10 **Q. HAS ANY MAJOR LEC CONCEDED THE BIAS INHERENT IN**  
11 **THE FINANCIAL BOOKS?**

12 **A.** Yes. The lives used for financial accounting purposes are  
13 governed by the Generally Accepted Accounting Principle  
14 ("GAAP") of "conservatism." In the FCC's Prescription  
15 Simplification proceeding, GTE noted that the GAAP conservatism  
16 principle "prefers the understatement (versus overstatement) of net  
17 income and net assets where any potential measurement problems  
18 exist."<sup>14</sup> Most accountants would agree that the very nature of  
19 depreciation makes it a challenge to measure. GAAP, independent  
20 auditors and the Security and Exchange Commission, therefore,  
21 might well prevent the LECs from understating depreciation, since  
22 this would overstate net income and net assets. It is highly  
23 unlikely, however, that GAAP, or any financial auditor, would find

1           that a LEC (or any company, for that matter) had overstated its  
2           depreciation, since this would result in a conservative view of net  
3           income and net assets.

4           In its October 1993 Order, the FCC agreed with GTE,  
5           stating:

6           One of the primary purposes of GAAP is to ensure  
7           that a company does not present a misleading picture  
8           of its financial condition and operating results by, for  
9           example, overstating its asset values or overstating  
10          its earnings, which would mislead current and  
11          potential investors. GAAP is guided by the  
12          conservatism principle which holds, for example, that,  
13          when alternative expense amounts are acceptable,  
14          the alternative having the least favorable effect on net  
15          income should be used. Although conservatism is  
16          effective in protecting the interest of investors, it may  
17          not always serve the interest of ratepayers.  
18          Conservatism could be used under GAAP, for  
19          example, to justify additional (but, perhaps not  
20          "reasonable") depreciation expense by a LEC to avoid  
21          its sharing obligation. Thus, GAAP would not  
22          effectively limit the opportunity for LECs to manage  
23          earnings so as to avoid the sharing zone as the basic



1 factor range option. In this instance, GAAP does not  
2 offer adequate protection for ratepayers.<sup>15</sup>

3 **Q. IN AN EARLIER CASE BELLSOUTH CLAIMED THAT IT HAS A**  
4 **RESERVE DEFICIENCY ON AN FCC BASIS. IS THIS AN**  
5 **ACCURATE STATEMENT?**

6 A. No. BellSouth claims a reserve deficiency calculated on the basis  
7 of its financial book lives. On an FCC basis, using FCC prescribed  
8 lives, BellSouth has a reserve surplus of \$2.0 billion as of January  
9 1, 1997.<sup>16</sup> BellSouth reported a \$450 million surplus for Florida  
10 alone.

11 **Q. BELLSOUTH COMPARES ITS PROPOSED LIVES TO THE**  
12 **LIVES PRESCRIBED BY THE FCC FOR AT&T IN 1994.<sup>17</sup> DO**  
13 **AT&T LIVES PROVIDE AN APPROPRIATE BENCHMARK?**

14 A. No. Any comparison to lives prescribed for AT&T in 1994 is  
15 irrelevant because in 1994 AT&T was an interexchange carrier  
16 ("IXC"). The very same FCC Order that prescribed the lives for  
17 AT&T in 1994 also prescribed much longer lives for thirteen LECs.  
18 Clearly, the FCC recognized the difference between the  
19 appropriate lives for an IXC and a LEC. The FCC explicitly noted  
20 this difference in its Prescription Simplification proceeding when it  
21 stated:

22 We believe the underlying considerations that go into  
23 estimating the basic factors are sufficiently different

1           for the two groups [IXC and LEC] that they should be  
2           considered separately.<sup>18</sup>

3           The plant lives of IXCs are simply not appropriate for use in  
4           calculating TELRIC for local service. The expected productive life  
5           of plant is largely dependent upon its specific use. To use an  
6           extreme, but apt, analogy, the expected productive life of the  
7           copper wire installed in a house is many times that of the copper  
8           wire installed in an automobile. Despite surface similarity, the use  
9           of plant by LECs to provide local exchange and exchange access  
10          service is much different than the use of plant by IXCs to provide  
11          interexchange services.

12          IXCs are much less capital intensive than LECs, and thus  
13          are able to economically replace their plant much faster than LECs  
14          when the occasion demands. To service all homes and  
15          businesses in the Nation, an IXC needs only about 150 switches  
16          and 100,000 sheath kilometers of cable.<sup>19</sup> To gain the same  
17          ubiquity for local exchange service, the LECs require over 23,000  
18          switches and 6,000,000 sheath kilometers of cable.<sup>20</sup> No matter  
19          how motivated the LECs may be, the sheer magnitude and  
20          complexity of the replacement effort ensures that replacement is a  
21          long, drawn-out process. This difference also helps explain why  
22          facilities-based competition came quickly to the interexchange  
23          industry and has been painfully slow in the local exchange industry.

1           The key investments in TELRIC proceedings are local loops  
2           and end office switches. The IXCs have neither local loops or end  
3           office switches in the plant they currently depreciate. If and when  
4           they establish end office switches and local loops, it would be  
5           reasonable for the IXCs to look to FCC prescribed lives for LEC  
6           end office switches and local loop plant as benchmarks. Similarly,  
7           it would be reasonable for BellSouth to look to IXC lives for its  
8           interexchange plant. It is not, however, reasonable to use IXC lives  
9           for local plant, or vice versa.

10   **Q.   WHAT EFFECT WOULD THE USE IN TELRIC CALCULATIONS**  
11           **OF PLANT LIVES WHICH ARE UNREALISTICALLY SHORT**  
12           **HAVE ON UNIVERSAL SERVICE?**

13   A.   The use of unrealistically short lives would overstate the cost of  
14           universal service and the subsidies necessary for its preservation.

15   **Q.   BASED ON THE DIRECT TESTIMONY FILED BY THE ILECS IN**  
16           **THIS CASE, DO YOU BELIEVE ANY ADJUSTMENT IS**  
17           **WARRANTED IN THE RECOMMENDATION YOU GAVE IN**  
18           **YOUR DIRECT TESTIMONY?**

19   A.   No. I still believe the depreciation rates I recommended in my  
20           direct testimony, are the most appropriate rates to use in this  
21           proceeding.

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

23   A.   Yes, it does.

---

<sup>1</sup> Federal-State Joint Board on Universal Service, CC Docket No. 96-45, Report and Order, FCC 97-157, released May 8, 1997 ("Universal Service Order").

<sup>2</sup> Majoros Direct, pp. 4.

<sup>3</sup> *Id.*, p. 11.

<sup>4</sup> Simplification of the Depreciation Prescription Process, CC Docket No. 92-296 ("Prescription Simplification").

<sup>5</sup> Direct Testimony of G. David Cunningham, page 5.

<sup>6</sup> Testimony of Allen E. Sovereign, page 16, and Testimony of Kent W. Dickerson, page 8

<sup>7</sup> FCC, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, first Report and Order, FCC 96-325, released August 8, 1996 (August 8 Order), Appendix B ("Rules"), ¶ 51.505 (c)(2)(A).

<sup>8</sup> Separation of costs of regulated telephone service from costs of non-regulated activities, CC Docket No. 86-111, Report and Order, FCC 86-564, released February 6, 1987, paragraph 115.

<sup>9</sup> CRTC, Implementation of Regulatory Framework - Splitting of the Rate Base and Related Issues, Telecom Decision CRTC 95-21, 31 October 1995, pp. 34-35.

<sup>10</sup> *Id.*, p.35.

<sup>11</sup> The Modification of the Commission's Depreciation Prescription Practices as Applied to AT&T and The Prescription of Revised AT&T Depreciation Rates, Petition of American Telephone and Telegraph, February 15, 1989.

<sup>12</sup> *Id.*, Memorandum Opinion and Order, FCC 89-325, adopted November 22, 1989 (footnote deleted).

<sup>13</sup> Prescription Simplification, Comments of GTE Service Corporation and its affiliated domestic telephone operations companies ("GTE"), March 10, 1993, p. 14.

<sup>14</sup> Prescription Simplification, Report and Order, FCC 93-452,

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released October 20, 1993, para. 46.

<sup>15</sup> Attachment MJM-12 to this testimony summarizes the Statement C Reports filed by BellSouth with the FCC last year.

<sup>16</sup> Cunningham Testimony, page 9.

<sup>17</sup> Prescription Simplification, Notice of Proposed Rulemaking, FCC 92-296, released December 29, 1992.

<sup>18</sup> 1994 FCC Statistics of Common Carriers, p. 159.

<sup>19</sup> Id.

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DIRECT TESTIMONY OF

MICHAEL J. MAJOROS, JR.

ON BEHALF OF

AT&T OF THE SOUTHERN STATES, INC.

AND

MCI TELECOMMUNICATIONS COMPANY

DOCKET NO. 980696-TP

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

**A. My name is Michael J. Majoros, Jr. I am Vice President of the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.**

**Q. PLEASE DESCRIBE SNAVELY KING.**

**A. Snavely King was originally founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. The firm has a professional staff of 16 economists, accountants, engineers and cost analysts. Most of the firm's work involves the development,**

1 preparation and presentation of expert witness testimony before  
2 Federal and State regulatory agencies. Over the course of the firm's  
3 28-year history, its members have participated in over 500  
4 proceedings before almost all of the state commissions and Federal  
5 commissions that regulate telecommunications companies, utilities,  
6 and transportation industries.

7

8 **Q. PLEASE DESCRIBE THE TYPE OF WORK YOU HAVE**  
9 **PERFORMED WHILE AT SNAVELY KING.**

10

11 **A.** I have provided consultation specializing in accounting, financial and  
12 management issues. I have testified in over 80 regulatory  
13 proceedings. A significant number of these appearances have related  
14 to the subject of telecommunications and public utility depreciation.  
15 Attachment MJM-1 to this testimony summarizes my appearances  
16 relating to depreciation. I have also negotiated and/or represented  
17 various user groups in fifteen of the Federal Communications  
18 Commission's ("FCC's") three-way triennial depreciation represcription  
19 conferences. Page 1 of Attachment MJM-2 identifies those  
20 conferences. I have also participated in several regulatory  
21 proceedings in which depreciation was an issue that was ultimately  
22 settled. Page 2 of Attachment MJM-2 summarizes these  
23 proceedings.

1

2 **Q. WHAT WAS YOUR EMPLOYMENT PRIOR TO JOINING SNAVELY**  
3 **KING?**

4

5 **A.** I joined Snavely King in 1981 and have been with the firm since that  
6 time. My prior employment and educational background is  
7 summarized in Attachment MJM-3 to this testimony.

8

9 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**

10

11 **A.** I am appearing on behalf of MCI Telecommunications Corporation  
12 ("MCI") and AT&T Communications of the Southern States, Inc.  
13 ("AT&T").

14

15 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR**  
16 **DIRECT SUPERVISION?**

17

18 **A.** Yes, it was. I should note, however, that this testimony and its  
19 analytical framework draws heavily upon work performed by myself  
20 and others at Snavely King on behalf of AT&T, MCI, and AT&T  
21 Canada LDS for use in other proceedings.

22

23 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**



1

2 A. In general, I address the depreciation life and future net salvage  
3 percent inputs appropriate for use in universal service cost model  
4 calculations. Specifically, I provide lives and future net salvage values  
5 appropriate for universal service cost calculations pursuant to the  
6 FCC's Universal Service Order.<sup>1</sup>

7

8 Q. PLEASE SUMMARIZE YOUR FINDINGS.

9

10 A. I conclude that the lives and future net salvage percents I have  
11 recommended for use in the HAI Model are appropriate for use in  
12 universal service calculations since they are consistent with the FCC's  
13 Universal Service Order.

14

15 Q. WHAT ARE THE RELEVANT REQUIREMENTS OF THE FCC'S  
16 UNIVERSAL SERVICE ORDER?

17

18 A. The FCC requires that Total Element Long-Run Incremental Cost  
19 ("TELRIC") methodology be utilized to estimate the cost of universal  
20 service.<sup>2</sup> The FCC's Universal Service Order states:

21

22 Economic lives and future net salvage  
23 percentages used in calculating

1                   depreciation expense must be within the  
2                   FCC-authorized range.<sup>3</sup>

3

4   **Q.    DOES THE FCC SPECIFY THE SPECIFIC PLANT LIVES TO BE**  
5   **USED IN THE CALCULATION OF TELRIC?**

6

7   **A.    No. However, the FCC's rules require that only forward-looking costs**  
8   **be used.<sup>4</sup> This requires the use of economic depreciation rates.<sup>5</sup> To**  
9   **comply with this guideline, the plant lives used must be based upon**  
10   **the expected economic lives of newly placed plant.<sup>6</sup> In depreciation**  
11   **proceedings, such plant lives are termed "projection lives" to**  
12   **differentiate them from "remaining lives" and "average service lives"**  
13   **which reflect past plant placements.**

14   **Q.    ARE THERE ANY REALISTIC ESTIMATES OF SPECIFIC PLANT**  
15   **PROJECTION LIVES?**

16

17   **A.    I believe the projection lives prescribed by the FCC to be realistic**  
18   **estimates of specific plant projection lives. Pursuant to statutory**  
19   **responsibility, the FCC has been prescribing depreciation rates for**  
20   **telephone companies for over 50 years.<sup>7</sup> It usually reviews full studies**  
21   **submitted by the largest companies on a triennial basis.<sup>8</sup> The FCC**  
22   **bases its projection life prescriptions on its analysis of the studies filed**  
23   **by the carriers and in consultation with the various state commission**

1           staffs. Since its staff has the responsibility, and the opportunity, to  
2           review periodically the plans of every large telephone company, I  
3           consider its estimates to be realistic.

4

5   **Q.    ARE THE PROJECTION LIVES PRESCRIBED BY THE FCC**  
6   **FORWARD-LOOKING?**

7

8   **A.    Yes, they are. Over a decade ago the FCC directed its staff to put**  
9           less emphasis on historic data in estimating productive lives, and to  
10          pay "closer attention to company plans, technological developments  
11          and other future-oriented analyses."<sup>9</sup>

12                 Recently, the FCC reaffirmed its forward-looking orientation in  
13                 connection with the simplification of its depreciation prescription  
14                 practices. The FCC prescribed a range of projection lives which could  
15                 be selected by carriers for prescription on a streamlined basis. The  
16                 FCC stated that these ranges were based upon "statistical studies of  
17                 the most recently prescribed factors. These statistical studies  
18                 required detailed analysis of each carrier's most recent retirement  
19                 patterns, the carriers' plans, and the current technological  
20                 developments and trends."<sup>10</sup>

21

22   **Q.    DO YOU BELIEVE THE FCC STAFF HAS FOLLOWED THE FCC'S**  
23   **DIRECTIVE TO EMPHASIZE FORWARD-LOOKING ANALYSES?**

1

2 A. Yes. In my experience in fifteen FCC triennial represetion  
3 conferences (including BellSouth represetion conferences), the  
4 FCC staff always used a forward-looking approach to setting  
5 depreciation rates.

6 The FCC staff rarely relied solely on historical data to set  
7 depreciation parameters. The FCC bases its parameter prescriptions  
8 upon the studies and information supplied by the individual  
9 companies, specific company plans, information submitted by state  
10 commission staffs, consumer groups and its broad industry-wide  
11 experience.

12

13 **Q. IS THERE EMPIRICAL EVIDENCE THAT THE PROJECTION LIVES**  
14 **PRESCRIBED BY THE FCC HAVE BEEN FORWARD-LOOKING?**

15

16 A. Yes. I would point to recent trends in the depreciation reserve levels  
17 in the industry, generally, and BellSouth and GTE-Florida specifically.  
18 As the FCC has recognized, "[t]he depreciation reserve is an  
19 extremely important indicator of the depreciation process because it is  
20 the accumulation of all past depreciation accruals net of plant  
21 retirements. As such, it represents the amount of a carrier's original  
22 investment that has already been returned to the carrier by its  
23 customers."<sup>11</sup>

1           The FCC's recognition of the reserve level as an indicator of  
2 the depreciation process can best be understood by examining a  
3 steady state example. Assume that we start with a stable  
4 environment in which the average age of plant is 9 years and the  
5 expected life of plant is 27 years. In this case, the add rate,  
6 retirement rate and straight-line accrual rate are all 3.7 percent, and  
7 the reserve level is stable at 33 percent of plant in service (9 years/27  
8 years).<sup>12</sup> As we vary these factors, we can see the effect on the  
9 reserve level. For example:

- 10
- 11           • If the add rate were to increase above 3.7  
12           percent, the reserve level would go down.  
13           This would not be a cause for concern,  
14           since the average age of plant would  
15           similarly represent a lower percent of its  
16           expected life.
  
  - 17
  - 18           • If the retirement rate were to increase  
19           above 3.7 percent, the reserve level would  
20           go down. This would be a cause for  
21           concern, since it would indicate that the  
22           expected life of plant is shorter than  
23           previously expected. If the expected life is

1 shorter, the average age of plant would  
2 represent a higher percent of its expected  
3 life, and the reserve should be higher, not  
4 lower than 33 percent.

5

- 6 • If the accrual rate were to increase above  
7 3.7 percent, the reserve level would go up.  
8 This would not be appropriate absent a  
9 reduction in the expected life of the plant,  
10 since it would indicate that the age of plant  
11 is higher than 33 percent of its expected  
12 life.

13

14 In summary, a declining reserve percent would be a reason for  
15 concern absent indications that it is merely the result of growth in  
16 plant. On the other hand, a rising reserve percent is generally a  
17 positive sign that the depreciation process is working well. Indeed,  
18 absent indications that the expected life of plant is decreasing, it might  
19 be a sign that accrual rates are too high.

20

21 Attachment MJM-4 to this testimony displays reserve levels  
22 and other plant rates since 1946 for all local exchange carriers  
23 ("LECs") providing full financial reports to the FCC. As shown on  
Page 1 of Attachment MJM-4, reserve percents decreased steadily

1 following World War II due to industry growth. These declines  
2 continued through the 1970's due in part to accrual rates which were  
3 too low.<sup>13</sup> As shown on Page 2 of Attachment MJM-4, however, the  
4 FCC's change to forward-looking depreciation practices in the early  
5 1980s resulted in a dramatic rise in reserve levels after 1980. The  
6 composite reserve level rose from 18.7 percent in 1980 to an historic  
7 high of 48.8 percent in 1997. This track record indicates that the  
8 depreciation process is resulting in adequate depreciation accruals,  
9 and that the FCC's projection life estimates have been forward-  
10 looking and unbiased.

11 Confirmation of the forward-looking nature of current FCC  
12 prescriptions can be gained by comparing the 1997 accrual rate of 7.1  
13 percent (Attachment MJM-4, Page 3, Column l) to the 1997 retirement  
14 rate of 4.0 percent (Attachment MJM-4, Page 3, Column k). The  
15 prescription of an accrual rate much higher than the current retirement  
16 rate indicates an expectation that the retirement rate will be much  
17 higher in the future. If the FCC were prescribing depreciation rates  
18 based upon historical indicators, it would be prescribing depreciation  
19 rates in the range of 3 to 5 percent.

20 Attachment MJM-5 demonstrates that these national trends  
21 apply also to BellSouth and GTE-Florida. The 1997 depreciation  
22 reserve percents for these companies were:

23 1997 Reserve %

1	Bell South	51.2
2		
3	GTE-Florida	43.5
4		

5 **Q. WHAT IS THE SOURCE OF THE LIVES USED IN THE HAI**  
6 **MODEL?**

7

8 **A. The lives used in the HAI Model are derived from the projection lives**  
9 **and future net salvage percents prescribed by the FCC for BellSouth-**  
10 **Florida<sup>14</sup> and GTE-Florida in 1995. The lives and future net salvage**  
11 **percents for United (Sprint) and Centel are from the low end of the**  
12 **FCC ranges. These lives and future net salvage percents are shown**  
13 **in Columns c, d, e and f of Attachment MJM-6 on pages 1 and 2**  
14 **respectively. Attachment MJM-6 also shows the range of projection**  
15 **lives and future net salvage percents prescribed by the FCC pursuant**  
16 **to its recent Prescription Simplification Proceeding (Columns a and b).**

17

18 **Q. ARE YOU FAMILIAR WITH THE DEPRECIATION ASPECTS OF**  
19 **THE FPSC'S DECISION IN DOCKET NOS. 960833-TP/960847-TP?**

20

21 **A. Yes, I testified on the subject of Bell South's depreciation parameters**  
22 **in that proceeding. Staff recommended the adoption of several of my**



1 recommendations and certain of Bell South's proposals. The FPSC  
 2 adopted staff's recommendation. The primary differences between  
 3 staff's overall projection life recommendations and the FCC's  
 4 prescribed projection lives for Bell South are in the four accounts  
 5 listed below:

6	<u>FCC</u>	<u>STAFF</u>		
7		Buildings	48	45
8		Aerial-Fiber	25	20
9		Underground-Fiber	25	20
10		Buried-Fiber	25	20

11 I have no objection to staff's 45-year projection-life for  
 12 Buildings. I am, however, recommending the FCC's 25-year  
 13 projection lives for the fiber accounts listed above. Review of the  
 14 Commission's Order indicates that staff's recommendation was based  
 15 on "BST's projection lives of 20-years from its Florida-specific study".

16 <sup>15</sup>

17 I have reviewed the Florida-specific study in question and  
 18 discovered that the retirements in these three accounts are negligible  
 19 and recent life indications are either much longer than the FCC's 25-  
 20 years or are erratic. The Florida-specific data indicates that if  
 21 anything, the FCC's 25-years should in my opinion, be lengthened,

1 not shortened to BST's 20-year request. Consequently, I continue to  
2 recommend the FCC's 25-year projection life.

3

4 **Q. SHOULD THE FCC PRESCRIBED PROJECTION LIFE FOR AN**  
5 **ACCOUNT BE USED EVEN IF IT IS SLIGHTLY ABOVE OR BELOW**  
6 **THE FCC'S NATIONAL RANGE?**

7

8 **A.** Yes. State-specific FCC prescriptions are consistent with the intent of  
9 the FCC's Universal Service Order. For example, the FCC has  
10 proposed that it use a weighted average of state-specific projection  
11 lives as an input to its forward-looking cost calculations.<sup>16</sup>

12

13 **Q. HAVE ANY STATE COMMISSIONS ISSUED ORDERS WHICH**  
14 **ADOPTED FCC PRESCRIBED PROJECTION LIVES, OR SIMILAR**  
15 **STATE PRESCRIBED LIVES, FOR USE IN TELRIC**  
16 **CALCULATIONS?**

17

18 **A.** Yes, indeed. Prescribed projection lives have already been adopted  
19 for use in TELRIC calculations by Louisiana,<sup>17</sup> Georgia,<sup>18</sup> Texas,<sup>19</sup>  
20 Massachusetts,<sup>20</sup> New York,<sup>21</sup> West Virginia,<sup>22</sup> Wyoming,<sup>23</sup> Delaware,<sup>24</sup>

1 Ohio,<sup>25</sup> Colorado,<sup>26</sup> Maryland,<sup>27</sup> and Illinois.<sup>28</sup> In many other states,  
2 TELRIC proceedings are in progress.

3

4 **Q. DOES THIS SURPRISE YOU?**

5

6 **A.** Not at all. In its recent Price Cap decision, the FCC adopted the use  
7 of its prescribed lives for use in Total Factor Productivity calculations.

8 The FCC noted that:

9 We can think of no reason why incumbent LECs should be  
10 permitted to use different depreciation rates for different  
11 regulatory purposes.<sup>29</sup>

12

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

14

15 **A.** Yes, it does.

---

<sup>1</sup> Federal-State Joint Board on Universal Service. CC Docket No. 96-45, Report and Order, FCC 97-157, released May 8, 1997 ("Universal Service Order").

<sup>2</sup> Id., para. 250.

<sup>3</sup> Id. at (5).

<sup>4</sup> FCC, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, first Report and

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Order, FCC 96-325, released August 8, 1996, ("August 8 Order"), Appendix B ("Rules"), ¶ 51.505(a).

<sup>5</sup> Rules, ¶ 51.505 (b) (3).

<sup>6</sup> The economic life of an asset is its total revenue producing life. Public Utility Depreciation Practices ("Depreciation Practices"), National Association of Regulatory Utility Commissioners, August 1996, p. 318.

<sup>7</sup> 47 U.S.C. ¶ 220 (b).

<sup>8</sup> Interim updates are also performed.

<sup>9</sup> Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, Federal Communications Commission, April 15, 1987 ("AAD Report"), p. 3.

<sup>10</sup> FCC, Simplification of the Depreciation Prescription Process, CC docket No. 92-296 ("Prescription Simplification" proceeding) Third Report and Order, FCC 95-181, released May 4, 1995, p. 6.

<sup>11</sup> AAD Report, pp. 5-6.

<sup>12</sup> Reserve will stabilize at 33 percent assuming a triangular (straight-line) mortality curve. See Notes for Engineering Economics Courses, American Telephone and Telegraph Company, Engineering Department, 1966, p. 121.

<sup>13</sup> AAD Report, p. 7.

<sup>14</sup> With the exception of the 45 years for BellSouth's Buildings account which is the Florida PSC's recommendation.

<sup>15</sup> Order No. PSC-98-0604-FOF-TP in Dkt. Nos. 960833-TP/96084-TP/page 39.

<sup>16</sup> Federal-State Joint Board on Universal Service, and Forward-Looking Mechanisms for High Cost Support for Non-Rural LEC's CC Docket Nos. 96-54 and 97-160, Further Notice of Proposed Rulemaking ("FNPRM"), FCC 97-256, released July 18, 1997, para. 149-151.

<sup>17</sup> Docket U-22022/22093, October 22, 1997.

<sup>18</sup> Docket 7061-U, December 16, 1997.

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<sup>19</sup> Docket 16189, et al., November 8, 1996.

<sup>20</sup> Docket DPU 96-73/74, 96-75, 96-80/81, 96-83, 96-84-Phase 4, December 4, 1996.

<sup>21</sup> Docket 95-C-0657, 94-C-0095, 91-C-1174, April 1, 1997.

<sup>22</sup> Docket 96-1516-T-PC, April 21, 1997.

<sup>23</sup> Docket 7000-TF-96-319, 72000-TF-96-95, April 23, 1997.

<sup>24</sup> Docket 96-324, April 29, 1997.

<sup>25</sup> Docket 96-222-TP-UNC, June 19, 1997.

<sup>26</sup> Docket 96S-331T, July 28, 1997.

<sup>27</sup> Docket No. 87C-1, Phase II, September 22, 1997.

<sup>28</sup> Docket 96-0486, 96-0569, February 17, 1998.

<sup>29</sup> Docket 94-1, 96-262, May 21, 1997, footnote 122.

1           **MR. COX:** Madam Chairman, Staff would note  
2 that we are going to mark and move the deposition  
3 transcript later in the order here.

4           **CHAIRMAN JOHNSON:** Okay. Mr. Hatch, would  
5 you have anything else, then?

6           **MR. HATCH:** If they're doing the deposition  
7 transcripts and late-fileds then, that's fine.

8           **CHAIRMAN JOHNSON:** Okay.

9           **MR. COX:** The next witness is BellSouth,  
10 David Cunningham.

11           **MR. CARVER:** Yes. David Cunningham has both  
12 direct and rebuttal testimony, and he has with his  
13 prefiled testimony four exhibits, as well, that are  
14 marked GDC-1 through 4. We would like to have those  
15 inserted into the record and exhibits marked for  
16 identification and admitted also.

17           **CHAIRMAN JOHNSON:** We'll insert his direct  
18 and rebuttal into the record as though read. We'll  
19 mark his Exhibits GDC-1 through 4 as Exhibit 3 and  
20 show them admitted without objection.

21           **MR. CARVER:** Thank you.

22           (Exhibit 3 marked for identification and  
23 received in evidence.)  
24  
25

1                   **BELLSOUTH TELECOMMUNICATIONS, INC.**  
2                   **DIRECT TESTIMONY OF G. DAVID CUNNINGHAM**  
3                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**  
4                   **DOCKET NO. 980696-TP**  
5                   **AUGUST 3, 1998**

6  
7 Q.    **PLEASE STATE YOUR NAME, ADDRESS AND POSITION WITH**  
8        **BELLSOUTH TELECOMMUNICATIONS, INC. (HEREINAFTER**  
9        **REFERRED TO AS "BELLSOUTH" OR "THE COMPANY").**

10  
11 A.    **My name is G. David Cunningham and my business address is 3535**  
12        **Colonnade Parkway, Birmingham, Alabama 35243. My position is**  
13        **Director in the Finance Department of BellSouth.**

14  
15 Q.    **PLEASE GIVE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL**  
16        **BACKGROUND AND BUSINESS EXPERIENCE IN THE**  
17        **TELECOMMUNICATIONS INDUSTRY.**

18  
19 A.    **I graduated from Morehead State University, Morehead, Kentucky in**  
20        **1971 with a Bachelor of Arts Degree in Economics. I was employed by**  
21        **South Central Bell in 1972 and held various staff and line assignments**  
22        **in the Kentucky Network Operations Department until mid-1983. In**  
23        **July of 1983, I moved to Birmingham, Alabama with BellSouth**  
24        **Services, Inc., holding positions in the Corporate Affairs Department**  
25        **and later in the Regulatory Department. My current assignment**

1 includes responsibility for Regulatory and Depreciation concerns within  
2 the Finance organization.

3

4 Q. WHAT ARE YOUR CURRENT JOB DUTIES AND  
5 RESPONSIBILITIES?

6

7 A. I am responsible for the preparation of depreciation studies for the nine  
8 states comprising BellSouth to determine appropriate depreciation  
9 parameters and depreciation rates for booking purposes and to meet  
10 regulatory requirements as necessary.

11

12 Q. HAVE YOU PREVIOUSLY APPEARED IN REGULATORY  
13 PROCEEDINGS REGARDING DEPRECIATION ISSUES?

14

15 A. Yes. I have testified and also participated in workshops before various  
16 state commissions regarding depreciation. I have served as  
17 BellSouth's chief representative on several occasions in negotiations  
18 with the Federal Communications Commission (FCC) and the various  
19 state commissions in depreciation prescription meetings.

20

21 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

22

23 A. The purpose of my testimony in this proceeding is to present the  
24 economic lives used in BellSouth's calculation of universal service  
25 costs and to provide information in response to Issue 4 (a). My



1 testimony will demonstrate the appropriateness of the forward-looking  
2 economic lives developed by BellSouth's Depreciation organization and  
3 provided for use in BellSouth's first study using the BCPM 3.1 Model  
4 (hereinafter referred to as "BellSouth's BCPM Study"), as described by  
5 Ms. Caldwell in her testimony in this proceeding.

6

7 Q. WHAT LIVES DOES BELLSOUTH CONSIDER TO BE APPROPRIATE  
8 FOR USE IN UNIVERSAL SERVICE COSTS CALCULATIONS?

9

10 A. The asset lives that were developed and provided for use in  
11 BellSouth's BCPM Study are included in Exhibit GDC-1. These are  
12 BellSouth's expected economic lives for newly placed plant.

13

14 Q. WHAT IS THE SOURCE OF THE LIVES USED IN BELLSOUTH'S  
15 BCPM STUDY?

16

17 A. The source of the lives provided for use in BellSouth's BCPM Study is  
18 the 1998 BellSouth Florida Depreciation Study, attached to this  
19 testimony as Exhibit GDC-2. Projection (economic) lives are defined as  
20 the average life expectancy of new additions to plant. The depreciation  
21 study also describes average remaining lives and depreciation rates to  
22 be used for depreciation booking purposes. These parameters,  
23 however, relate to embedded investment and are not used in  
24 BellSouth's BCPM Study.

25

1           Although this is not a depreciation proceeding, the depreciation study  
2           included as Exhibit GDC-2 is being provided to demonstrate the  
3           appropriateness of the data.

4

5           BellSouth prepared the detailed depreciation study in this exhibit,  
6           analyzing the various asset accounts to determine appropriate  
7           depreciation parameters for each account. The depreciation study  
8           provides explanations of methodology, data and analysis that support  
9           the asset lives and other depreciation parameters for asset accounts,  
10          including those accounts that are used in BellSouth's BCPM Study.

11

12 Q.       PLEASE SUMMARIZE BELLSOUTH'S APPROACH IN DETERMINING  
13       THE ASSET LIVES USED IN BELLSOUTH'S BCPM STUDY.

14

15 A.       As demonstrated in the attached depreciation study, numerous  
16       methods are utilized to determine the appropriate economic lives of the  
17       different asset accounts. One factor used in determining the  
18       appropriate lives of all accounts is an analysis of Company planning  
19       data. This data is useful in assessing the near term portion of the life  
20       cycles of most assets, and is particularly useful when the technology is  
21       near the end of its life cycle.

22

23       A second factor used in assessing the life of an account is normal  
24       mortality, i.e., wear and tear with usage, deterioration with age and  
25       accidental removal, breakage, or damage. The technique used to

1 assess normal mortality is called Historical Mortality Analysis. For  
2 some accounts, like poles, Company planning data and normal  
3 mortality alone are the major considerations in determining the life. In  
4 these cases, the Company does not expect that the future  
5 characteristics of this type of plant will differ significantly from the past.

6  
7 In cases where a newer technology is substituting for an established  
8 embedded technology, use of Company planning data and the  
9 Historical Mortality Analysis alone to assess the life will generally result  
10 in an inappropriately long life. Over the long term, the substitution of a  
11 new technology for the old is the primary force driving the displacement  
12 of the old technology. Therefore, after initial deployment of the new  
13 technology, life analysis techniques that take into account technological  
14 substitution must also be used. These technology-sensitive accounts  
15 (that is, Digital Electronic Switching, Digital Circuit, Aerial Metallic  
16 Cable, Underground Metallic Cable, Buried Metallic Cable) comprise  
17 approximately 70% of BellSouth's total plant investment.

18  
19 Q. HAS THE FCC PRESCRIBED LIVES TO BE USED IN FLORIDA TO  
20 DETERMINE DEPRECIATION RATES ON AN INTERSTATE BASIS?

21  
22 A. Yes. Lives were last prescribed by the FCC in 1995 for booking  
23 depreciation expense on an interstate basis in Florida.

24  
25

1 Q. DO YOU BELIEVE THAT LIVES PRESCRIBED BY THE FCC ARE  
2 APPROPRIATE FOR THIS APPLICATION?

3

4 A. No, I do not.

5

6 Q. WHY ARE THE LIVES PRESCRIBED BY THE FCC FOR  
7 INTERSTATE DEPRECIATION PURPOSES NOT APPROPRIATE  
8 FOR USE IN UNIVERSAL SERVICE COST CALCULATIONS?

9

10 A. Lives were last prescribed by the FCC in Florida in 1995. These lives,  
11 particularly for the technology-sensitive accounts, are much too long.  
12 They are based on the old regulatory paradigm in which plant lives  
13 were artificially lengthened beyond their true economic lives so that the  
14 investment in that plant would be recovered in smaller year-to-year  
15 increments over longer periods of time. The assumption under this  
16 paradigm was always that BellSouth was entitled to and would recover  
17 all of its investments, but over a longer period of time, thus reducing the  
18 amount the customer paid in the short term.

19

20 In today's competitive environment, however, the marketplace is not  
21 likely to allow BellSouth to recover investment based on lives that are  
22 inappropriately long. The rapid changes in technology, which  
23 BellSouth must embrace in order to stay competitive, shorten asset  
24 lives significantly beyond what the FCC has prescribed. BellSouth has  
25 emphasized to the FCC that substantially more progress is needed in

1 moving to lives that adequately reflect the current pace of technology  
2 and competitive changes.

3

4 With implementation of Price Regulation, BellSouth was given authority  
5 to establish its own depreciation rates in Florida beginning January  
6 1998 for intrastate purposes. As a result, BellSouth uses the lives that  
7 are supported by the Depreciation Study to determine depreciation  
8 rates booked in Florida for intrastate purposes and for external  
9 reporting purposes. These lives are significantly shorter than those  
10 prescribed by the FCC, particularly for the technology-sensitive  
11 accounts.

12

13 Q. HAS THE FCC GIVEN ANY INDICATION THAT CHANGES MAY  
14 NEED TO BE MADE TO ITS PRACTICES CONCERNING  
15 DETERMINATION OF PLANT LIVES?

16

17 A. Yes. The FCC has acknowledged the need to examine its depreciation  
18 practices in today's environment. On several occasions, the FCC has  
19 stated that it has plans to initiate a separate proceeding to undertake a  
20 comprehensive review of its depreciation rules. A February 5, 1998,  
21 FCC news report listing proposed 1998 review proceedings included  
22 the following item: "Depreciation. Consider streamlining or eliminating  
23 Commission's methods for prescribing depreciation rates."

24

25

1 In addition, attached to the January 30, 1998, Memorandum Opinion  
2 and Order (FCC 98-11) revising depreciation rates for those companies  
3 that filed for represcription in 1997, was a separate statement of FCC  
4 Commissioner Harold Furchtgott-Roth. His statement included the  
5 following: "The Commission's authority to prescribe depreciation rates  
6 is merely a vestige of outdated rate-of-return regulation....In today's  
7 increasingly competitive environment, there should be no need for the  
8 Commission to continue to dictate, even through revised streamlined  
9 procedures, depreciation rates or the factors that may be used to  
10 compute such rates."

11

12 Q. WHAT OTHER OBSERVATIONS DO YOU HAVE AS TO THE  
13 INAPPROPRIATENESS OF USING LIVES PRESCRIBED BY THE  
14 FCC IN BELLSOUTH'S UNIVERSAL SERVICE COSTS  
15 CALCULATIONS?

16

17 A. The FCC has emphasized historical data when prescribing BellSouth's  
18 depreciation lives. BellSouth does not believe that simply looking at  
19 the past can possibly indicate what will happen in the future with  
20 equipment that is sensitive to rapid changes in technology. This rear-  
21 view mirror approach is clearly not appropriate for projecting the future  
22 of this equipment. Emphasis on historical retirement patterns is an  
23 indication that one does not expect the future to vary significantly for  
24 the past. Even a casual observation of the telecommunications

25

1 industry today leaves no doubt that there is an evolution taking place  
2 that cannot help but have a major effect on telecommunications assets.

3  
4 It is clear that forward-looking lives should be used for depreciation  
5 purposes and for universal service cost calculations. However,  
6 BellSouth believes that the FCC has not properly assessed the impact  
7 of technological evolution and increasing competition to determine  
8 appropriate forward-looking lives. BellSouth's depreciation study, as  
9 demonstrated in Exhibit GDC-2, provides detailed analysis to support  
10 forward-looking lives significantly below those prescribed by the FCC,  
11 particularly for the technology-sensitive accounts.

12  
13 Q. ARE THE LIVES USED IN BELLSOUTH'S BCPM STUDY  
14 REASONABLE WHEN COMPARED TO LIVES PROPOSED BY  
15 OTHER TELECOMMUNICATIONS COMPANIES?

16  
17 A. Yes. One comparison of lives can be found in Exhibit GDC-3, which  
18 lists the lives used in BellSouth's BCPM Study for the major  
19 technology-sensitive accounts and the lives that the FCC prescribed in  
20 1994 for AT&T. As shown in this comparison, AT&T's depreciation life  
21 for Digital Electronic Switching is 9.7 years. The life that BellSouth  
22 uses in its BCPM Study for this account is 10 years. The life prescribed  
23 by the FCC in 1995 for BellSouth in Florida was an unrealistically long  
24 17 years. The comparison in this exhibit demonstrates that, for all the  
25 major technology-sensitive accounts, the lives used in BellSouth's

1 BCPM Study are comparable or conservative when compared to the  
2 lives last prescribed by the FCC for AT&T as shown in Exhibit GDC-3.

3

4 Q. IN THE FLORIDA COST PROCEEDINGS, REFERENCE WAS MADE  
5 TO A STREAMLINED DEPRECIATION RATE-SETTING PROCESS  
6 DEVELOPED BY THE FCC. PLEASE DESCRIBE THIS PROCESS.

7

8 A. As part of CC Docket No. 92-296, the FCC issued a Notice of Proposed  
9 Rulemaking in which it stated that it was continuing its "efforts to reduce  
10 unnecessary regulatory burdens and their associated costs by  
11 undertaking simplification of our depreciation prescription process."  
12 The FCC's approach to simplification was to set up ranges of projection  
13 life and future net salvage estimates for most of the asset accounts.  
14 Under this procedure, if a company is meeting certain predetermined  
15 prerequisites and proposes to use projection lives or future net salvage  
16 estimates from within these ranges, the company need not submit the  
17 voluminous, detailed supporting data otherwise required.

18

19 Q. DOES BELLSOUTH BELIEVE THAT THE LIVES SPECIFIED IN THE  
20 FCC'S RANGES ARE FORWARD-LOOKING AND APPROPRIATE TO  
21 BE USED IN BELLSOUTH'S BCPM STUDY?

22

23 A. No. As stated above, the main purpose of this simplification effort was  
24 merely to lessen paperwork and the cost of unnecessary regulation.  
25 Simplification was not designed to assure forward-looking lives. In fact,



1 the FCC has prescribed lives lower than these ranges in Alabama,  
2 Florida, Georgia, Louisiana, Mississippi, North Carolina and South  
3 Carolina for some of the major accounts. In Florida, this includes the  
4 Aerial Metallic Cable, Underground Metallic Cable, Buried Metallic  
5 Cable and Circuit Digital accounts.

6

7 Q. WHAT WAS THE BASIS FOR THE PROJECTION LIVES AND  
8 FUTURE NET SALVAGE PERCENTAGES THAT WERE USED TO  
9 ESTABLISH THESE FCC RANGES?

10

11 A. The FCC's ranges were generally developed by nothing more than  
12 taking one standard deviation around the mean of the lives and salvage  
13 values that the FCC had prescribed most recently for the various  
14 accounts for the local exchange carriers. For the first set of accounts  
15 for which the FCC ordered ranges, the ranges were based on 1990-  
16 1992 represcriptions, and have not been updated since. Lives  
17 prescribed in 1990-1992 could hardly be considered forward-looking  
18 today.

19

20 Q. HOW DO THE ECONOMIC LIVES USED IN BELLSOUTH'S BCPM  
21 STUDY COMPARE TO THE LIVES USED TO DETERMINE THE  
22 DEPRECIATION RATES BOOKED BY BELLSOUTH 'N FLORIDA?

23

24

25

1 A. The economic lives used in BellSouth's BCPM Study are consistent  
2 with those used to determine the depreciation rates currently being  
3 booked in Florida for intrastate and for external reporting purposes.  
4

5 Q. IS THERE ANY MERIT TO A CONCERN RAISED IN OTHER  
6 JURISDICTIONS THAT LIVES USED FOR EXTERNAL REPORTING  
7 PURPOSES ARE INAPPROPRIATE FOR USE IN THESE STUDIES  
8 DUE TO THE "CONSERVATISM" PRINCIPLE OF GAAP?  
9

10 A. No. The "conservatism" principle of GAAP does not determine  
11 BellSouth's lives. BellSouth's economic lives, used for intrastate and  
12 external reporting purposes and in BellSouth's BCPM Study, were  
13 determined by the approaches described in this testimony and detailed  
14 in Exhibit GDC-2. These lives are used to determine depreciation rates  
15 that appropriately allocate the cost of BellSouth's assets over their  
16 estimated useful lives in a systematic and rational manner.  
17

18 Q. SOME CONCERN HAS BEEN EXPRESSED IN OTHER  
19 JURISDICTIONS AS TO THE APPROPRIATENESS OF THE LIVES  
20 USED IN STUDIES FOR A NARROWBAND NETWORK. DO YOU  
21 HAVE COMMENTS REGARDING THESE CONCERNS?  
22

23 A. Yes. The lives used in BellSouth's BCPM Study are based on the  
24 economics of providing traditional telecommunications services, and  
25 would be appropriate even if the only services BellSouth ever provided

1 in the future were narrowband, traditional telephony services. Our  
2 existing network can be described as narrowband, and fiber  
3 deployment in the feeder is already at a significant penetration level.  
4 This is due to the advantages of fiber's high capacity, low maintenance  
5 and reliability. Deployment of fiber in the distribution will also be driven  
6 by these advantages. Fiber deployment in the feeder is greater than  
7 that in the distribution because traffic in the feeder can be aggregated  
8 and carried more efficiently in larger "pipes". Increasingly, the  
9 economics of fiber deployment make it desirable further and further out  
10 in the network (closer and closer to the customer premises).

11

12 It should be pointed out that many customers use modems that operate  
13 at 28,800 bits per second (bps) and greater over our narrowband, voice  
14 grade network. Data transmission at these rates meet the current  
15 needs of most residential customers. However, customer needs are  
16 expanding, and BellSouth is designing today's network to meet  
17 customers' growing needs. Today's customers are requesting services  
18 that require higher bandwidth, but this is a long way from broadband,  
19 cable TV capability. Replacement of today's network will occur due to  
20 normal mortality and technological obsolescence, that is, when the  
21 current technology is not the most efficient means of providing  
22 narrowband service in the future.

23

24 Two other characteristics of fiber which are closely related are reliability  
25 and maintainability. Customer needs for reliability, which are

1 increasing, can be met through the use of fiber in our network.  
2 Maintenance expense, which the Company is always seeking ways to  
3 reduce, can also be improved through the use of fiber. Both factors  
4 add to the economic attractiveness of fiber for a narrowband, voice  
5 grade network.

6  
7 As stated above, the lives used in BellSouth's BCPM Study are based  
8 on the economics of providing traditional telecommunications services.  
9 They do not include future demands for emerging digital and  
10 multimedia services, nor do they include the impact of a paradigm shift  
11 to a totally competitive marketplace. Including these impacts would  
12 likely result in a reduction of lives below the Company's current  
13 recommendations.

14  
15 Q. OTHER PARTIES IN FLORIDA'S COST PROCEEDINGS POINTED  
16 TO AN INCREASE IN THE DEPRECIATION RESERVE OVER TIME  
17 AS EVIDENCE THAT FCC-PRESCRIBED LIVES HAVE BEEN  
18 FORWARD-LOOKING. HOW DO YOU RESPOND?

19  
20 A. The fact that the reserve has grown over time is not an indication that  
21 the reserve is at the appropriate level. The depreciation reserve is the  
22 accumulation of all past depreciation accruals, reduced by plant  
23 retirements. In an environment in which one technology is rapidly  
24 displacing another technology, it is obvious that the depreciation  
25 reserve must be built up by appropriate accruals to a level high enough

1 to handle the inevitable asset retirements. Today, we have two  
2 situations in which a major technology displacement is occurring;  
3 specifically, digital is replacing analog, and fiber is replacing copper.  
4 Never in the history of this industry has technology displacement been  
5 so pronounced. Huge retirements of these old technologies are  
6 expected in bulk at the end of the technologies' life span. Depreciation  
7 accruals over the years have not been high enough, due to  
8 inappropriately long prescribed lives for copper and analog related  
9 assets, to position the depreciation reserve for the avalanche of  
10 retirements that will soon come.

11

12 The critical issue here is not just that the reserve has increased over  
13 the past few decades. The issue is that the reserve has not increased  
14 enough to handle retirements caused by the dramatic paradigm shift  
15 that has occurred in the telecommunications industry.

16

17 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

18

19 A. BellSouth's Depreciation organization has provided economic lives for  
20 use in BellSouth's BCPM Study that were developed by performing  
21 detailed analyses of each asset account. The 1998 BellSouth Florida  
22 Depreciation Study, which documents this analysis, is attached to this  
23 testimony as Exhibit GDC-2. These lives are appropriate for use in  
24 BellSouth's BCPM Study. The lives prescribed by the FCC for

25

1           depreciation purposes are inappropriately long, particularly for the  
2           technology-sensitive accounts.

3

4 Q.    DOES THIS CONCLUDE YOUR TESTIMONY?

5

6 A.    Yes, it does.

7

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1                   **BELLSOUTH TELECOMMUNICATIONS, INC.**  
2                   **REBUTTAL TESTIMONY OF G. DAVID CUNNINGHAM**  
3                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**  
4                   **DOCKET NO. 980696-TP**  
5                   **SEPTEMBER 2, 1998**

6  
7 Q.   **PLEASE STATE YOUR NAME, ADDRESS AND POSITION WITH**  
8       **BELLSOUTH TELECOMMUNICATIONS, INC. (HEREINAFTER**  
9       **REFERRED TO AS "BELLSOUTH" OR "THE COMPANY").**

10

11 A.   **My name is G. David Cunningham and my business address is 3535**  
12       **Colonnade Parkway, Birmingham, Alabama 35243. My position is**  
13       **Director in the Finance Department of BellSouth.**

14

15 Q.   **ARE YOU THE SAME G. DAVID CUNNINGHAM WHO FILED DIRECT**  
16       **TESTIMONY IN THIS DOCKET?**

17

18 A.   **Yes.**

19

20 Q.   **WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

21

22 A.   **The purpose of my testimony in this proceeding is to respond to the**  
23       **direct testimony of Michael J. Majoros, representing AT&T and MCI,**  
24       **regarding the economic lives used in BellSouth's calculation of**  
25       **universal service costs.**

1

2 Q. PLEASE REVIEW THE LIVES THAT BELL SOUTH USED IN ITS  
3 UNIVERSAL SERVICE COSTS CALCULATIONS.

4

5 A. The asset lives used in BellSouth's universal service costs calculations  
6 were provided in Exhibit GDC-1 of my direct testimony. These lives are  
7 supported by BellSouth's 1998 Florida Depreciation Study, which was  
8 attached to my direct testimony as Exhibit GDC-2. These forward-  
9 looking lives appropriately reflect the impact of rapid technological  
10 changes taking place in the telecommunications industry.

11

12 Q. WHAT IS THE BASIS OF THE LIVES THAT MR. MAJOROS  
13 RECOMMENDS FOR UNIVERSAL SERVICE COSTS  
14 CALCULATIONS?

15

16 A. In general, Mr. Majoros recommends that the projection lives  
17 prescribed by the FCC in 1995 for booking depreciation expense on an  
18 interstate basis be used in universal service costs calculations.

19

20 Q. DO YOU AGREE THAT LIVES PRESCRIBED BY THE FCC ARE  
21 APPROPRIATE FOR THIS APPLICATION?

22

23 A. No, I do not. As I stated in my direct testimony in this proceeding, the  
24 lives currently prescribed by the FCC, particularly for the technology-  
25 sensitive accounts, are much too long. Mr. Majoros states in his



1 testimony that the projection lives prescribed by the FCC are forward-  
2 looking. BellSouth believes that the FCC has not properly assessed  
3 the impact of technological evolution and increasing competition to  
4 determine appropriate forward-looking lives.

5  
6 As I stated in my direct testimony, BellSouth currently establishes its  
7 own depreciation rates for intrastate purposes in Florida, under  
8 authority granted by Price Regulation implementation. However, when  
9 the Florida PSC did establish intrastate depreciation rates for  
10 BellSouth, they were considerably more progressive than the FCC in  
11 determination of appropriate asset lives for depreciation purposes. The  
12 Florida PSC historically prescribed Average Remaining Lives, not  
13 "Projection", economic lives as used in BellSouth's BCPM study.  
14 However, projection lives corresponding to the Average Remaining  
15 Lives last prescribed by the Florida PSC for intrastate depreciation  
16 purposes can be determined, and are shown in Exhibit GDC-4.

17  
18 BellSouth's Depreciation Study, provided as Exhibit GDC-2 in my direct  
19 testimony, provides detailed analysis to support forward-looking lives  
20 significantly lower than those prescribed by the FCC, particularly for the  
21 technology-sensitive accounts.

22  
23 Q. ON PAGE 6 OF HIS TESTIMONY, MR. MAJOROS REFERENCES A  
24 STREAMLINED, SIMPLIFIED DEPRECIATION RATE-SETTING  
25 PROCESS DEVELOPED BY THE FCC. HE GOES ON TO SAY

1           **THAT, WITH THE SIMPLIFIED APPROACH, "THE FCC REAFFIRMED**  
2           **ITS FORWARD-LOOKING ORIENTATION". WHAT COMMENTS DO**  
3           **YOU HAVE?**

4  
5   **A.    As described in my direct testimony, the streamlined process that the**  
6           **FCC set up as part of CC Docket No. 92-296 was intended to reduce**  
7           **unnecessary regulatory burdens and their associated costs.**  
8           **Simplification was not designed to assure forward-looking lives.**

9  
10   **Q.    MR. MAJOROS POINTS TO AN INCREASE IN THE DEPRECIATION**  
11           **RESERVE OVER TIME AS EVIDENCE THAT FCC-PRESCRIBED**  
12           **LIVES HAVE BEEN FORWARD-LOOKING. HE STATES ON PAGE 9**  
13           **OF HIS TESTIMONY THAT "A RISING RESERVE PERCENT IS**  
14           **GENERALLY A POSITIVE SIGN THAT THE DEPRECIATION**  
15           **PROCESS IS WORKING WELL". HOW DO YOU RESPOND TO HIS**  
16           **STATEMENTS?**

17  
18   **A.    As stated in my direct testimony in this proceeding, the fact that the**  
19           **reserve has grown over time is not an indication that the reserve is at**  
20           **the appropriate level. The critical issue here is not just that the reserve**  
21           **has increased over the past few decades. The issue is whether the**  
22           **reserve has increased enough to handle retirements that will occur**  
23           **because of the dramatic paradigm shift in the telecommunications**  
24           **industry.**

25

1 Q. MR. MAJOROS PRESENTS HISTORICAL RETIREMENT RATES TO  
2 OFFER "CONFIRMATION OF THE FORWARD-LOOKING NATURE  
3 OF CURRENT FCC PRESCRIPTIONS". HOW DO YOU RESPOND?  
4

5 A. Mr. Majoros focuses on historical data, just as the FCC has done in  
6 prescribing BellSouth's depreciation lives. As stated in my direct  
7 testimony, BellSouth does not believe that simply looking at the past  
8 can possibly indicate what will happen in the future with equipment that  
9 is sensitive to rapid changes in technology.  
10

11 Q. MR. MAJOROS REFERENCES STATE COMMISSION ORDERS IN  
12 HIS TESTIMONY WHICH HAVE ADOPTED THE FCC'S  
13 PRESCRIBED LIVES FOR USE IN TELRIC CALCULATIONS. WHAT  
14 COMMENTS DO YOU HAVE REGARDING HIS STATEMENTS?  
15

16 A. While some state commissions have ordered that FCC-prescribed lives  
17 be used, state commissions such as Missouri, California, and Michigan  
18 have endorsed the use of economic lives similar to those used in  
19 BellSouth's BCPM study.  
20

21 In January 1998 the Michigan PSC, in Docket U11280, modified its  
22 earlier decision to approve FCC prescribed lives for use in TELRIC  
23 calculations. The Commission stated, "On reconsideration of this  
24 issue, the Commission is persuaded that the asset lives proposed by  
25 Ameritech Michigan are more forward-looking than those that the

1 Commission initially adopted in the July 14, 1997 order. As such, the  
2 Commission concludes that they are more reasonable than the FCC  
3 prescription lives, which more closely resemble cost-based regulation  
4 than TSLRIC principles. The Commission agrees with Ameritech  
5 Michigan and the Staff that, in a more competitive environment, the  
6 development of new technologies and a greater sensitivity to  
7 customers' need can be expected to stimulate new investment and  
8 hasten the obsolescence of existing equipment."

9  
10 Q. MR. MAJOROS ATTEMPTS TO SUPPORT HIS RECOMMENDATION  
11 OF FCC-PRESCRIBED LIVES BY NOTING ON PAGE 14 OF HIS  
12 TESTIMONY THE FOLLOWING QUOTE FROM THE FCC  
13 REGARDING TOTAL FACTOR PRODUCTIVITY CALCULATIONS:

14 "WE CAN THINK OF NO REASON WHY INCUMBENT LECs  
15 SHOULD BE PERMITTED TO USE DIFFERENT  
16 DEPRECIATION RATES FOR DIFFERENT REGULATORY  
17 PURPOSES."

18 WHAT OBSERVATIONS DO YOU HAVE AS TO THIS STATEMENT?

19  
20 A. Mr. Majoros seems to be confused. BellSouth does not propose to use  
21 something different here than for other regulatory purposes. The lives  
22 used in BellSouth's BCPM Study are consistent with those used to  
23 determine the depreciation rates currently being booked in Florida for  
24 intrastate and for external reporting purposes.

25

1 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

2

3 A. Mr. Majoros recommends that lives prescribed by the FCC in 1995 for  
4 interstate depreciation purposes in Florida be used in BellSouth's  
5 BCPM Study. These lives are inappropriately long, particularly for the  
6 technology-sensitive accounts. The lives provided in my direct  
7 testimony in this proceeding in Exhibit GDC-1 were developed by  
8 performing detailed analyses of each asset account. These lives are  
9 appropriate for use in BellSouth's calculation of universal service costs.

10

11 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

12

13 A. Yes, it does.

14

15

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25

1           **MR. COX:** The next witness is Allen  
2 Sovereign for GTE Florida.

3           **MS. CASWELL:** Mr. Sovereign has both direct  
4 and rebuttal testimony, and his exhibits are AES-1  
5 through AES-7. We would like those marked for  
6 identification and inserted into the record, please.

7           **CHAIRMAN JOHNSON:** His direct and rebuttal  
8 will be inserted into the record as though read.  
9 AES-1 through 7 will be identified as Exhibit 4 and  
10 admitted without objection.

11           (Exhibit 4 marked for identification and  
12 received in evidence.)

13           **MS. CASWELL:** Thank you.  
14  
15  
16  
17  
18  
19  
20  
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24  
25

## GTE FLORIDA INCORPORATED

DOCKET 980696-TP

## DIRECT TESTIMONY OF ALLEN E. SOVEREIGN

I. INTRODUCTION

1  
2  
3  
4  
5  
6  
7  
8 **Q. PLEASE STATE YOUR NAME, ADDRESS AND PRESENT**  
9 **POSITION.**

10 A. My name is Allen E. Sovereign. My business address is 1420 E.  
11 Rochelle Dr., Irving, Texas 75038. I am employed by GTE as  
12 Manager-Capital Recovery.

13  
14 **Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL**  
15 **BACKGROUND.**

16 A. I received a Bachelor of Science Degree in Electrical Engineering  
17 from Michigan Technological University, Houghton, Michigan, in  
18 1971. I received a Master of Science Degree in Business  
19 Administration from Indiana University, Bloomington, Indiana, in 1980.  
20 I have attended courses in depreciation and life analysis provided by  
21 Depreciation Programs, Inc., of Kalamazoo, Michigan. I have also  
22 attended and instructed basic and advanced GTE courses in  
23 depreciation life analysis. I am a Senior Member of the Society of  
24 Depreciation Professionals.

25

1 Q. BRIEFLY DESCRIBE YOUR WORK EXPERIENCE WITH GTE.

2 A. I have worked with GTE Companies for 24 years, with 17 of those  
3 years in the Depreciation study area. I have held various positions  
4 in Engineering and Construction, Capital Budgeting, Marketing, and  
5 Product Development. I was named Manager of Capital Recovery in  
6 February 1994.

7

8 Q. WHAT ARE THE RESPONSIBILITIES OF YOUR CURRENT  
9 POSITION?

10 A. I am responsible for the preparation, filing, and resolution of capital  
11 recovery studies for GTE Telephone Operations and the  
12 determination of economic lives for GTE.

13

14 Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY  
15 REGULATORY BODIES?

16 A. Yes, I have testified before the Texas, New Mexico, Arkansas,  
17 California, Washington, Oregon, Idaho, Illinois, Pennsylvania,  
18 Michigan, Indiana, South Carolina, Virginia, Kentucky, Nevada, Iowa,  
19 Nebraska, and Hawaii State Utility Commissions.

20

21 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

22 A. My testimony addresses Issue 4(a)--the depreciation rates that  
23 should be input into the cost model chosen to determine the cost of  
24 providing basic local service. I will first describe the appropriate  
25 methodology for determining the depreciation lives used in universal



1 service cost studies, then recommend a set of lives to be used in  
2 those cost studies for GTE Florida Incorporated.  
3

4 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

5 **A.** The economic lives GTE has been booking on a financial reporting  
6 basis since 1996 should be used in the cost models to calculate the  
7 cost of providing basic local service. These economic lives are  
8 properly based on a forward-looking approach. The economic  
9 depreciation methodology underlying GTE's recommended  
10 depreciation parameters measures the decline in an asset's value  
11 from all causes, placing appropriate emphasis on competition and  
12 technological change. GTE believes that this Commission has for  
13 some time considered the changing telecommunications environment  
14 when determining the proper recovery period of an asset. Indeed,  
15 many of the lives GTE proposes in this proceeding are the same as  
16 or similar to those approved by the Commission for GTE as early as  
17 1992. Reliance on a historical methodology would be a step  
18 backward for this Commission and inconsistent with the legislative  
19 directive to determine forward-looking costs.  
20

21 **II. ECONOMIC LIVES MUST BE USED IN FORWARD-LOOKING COST**  
22 **STUDIES**

23 **Q. PLEASE DEFINE THE TERMS "ECONOMIC LIFE" AND**  
24 **"ECONOMIC DEPRECIATION" AND EXPLAIN HOW THEY**  
25 **RELATE TO THE COST STUDIES IN THIS PROCEEDING.**

1 A. "Economic life" is the period of time over which an asset is used to  
2 provide economic value to GTE. "Economic depreciation" is the per  
3 annum rate at which the cost of an asset can be recovered during the  
4 asset's economic life. Economic depreciation can be expressed  
5 mathematically in its simplest terms as the amount of the original  
6 asset investment divided by its economic life. This quotient  
7 represents an asset's economic depreciation expense that must be  
8 recovered each year for the duration of that asset's economic life.

9  
10 **Q. IS THERE ANY REASON TO DEPART FROM ECONOMIC**  
11 **DEPRECIATION METHODOLOGY IN THIS DOCKET?**

12 A. No. Historically, regulatory commissions prescribed asset lives based  
13 on the assumptions that there would be little or no competition, and  
14 that technological innovation would continue at a constant pace. The  
15 opening of the local exchange market invalidated those basic  
16 assumptions. As noted above, the economic life of an asset is the  
17 period of time over which that asset is used to provide economic  
18 value. Both increased competition and technological change shorten  
19 the period over which an asset will provide economic value. In a  
20 world where GTE was the sole provider, it was able to keep old  
21 assets on the books, even after their economic life had expired,  
22 because depreciation rates were based upon artificially long asset  
23 lives. Basing depreciation rates on long asset lives yielded lower  
24 depreciation rates and a longer period of time over which the asset  
25 was depreciated. These longer depreciation lives helped state

1 commissions to keep consumer prices low. Today's market  
2 environment--which will reduce the length of time over which GTE  
3 must recover its investment in an asset--renders the use of artificially  
4 long asset lives in calculating depreciation expense unsustainable.  
5 GTE urges this Commission to reject any suggestion that Florida  
6 should use an outdated, historical-based depreciation approach--  
7 especially when rates the Commission prescribed for GTE as early as  
8 1992 demonstrated more progressive thinking.

9  
10 **Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION ("FPSC")**  
11 **STRICTLY FOLLOWED THE "TRADITIONAL" METHOD FOR**  
12 **SETTING DEPRECIATION LIVES IN FLORIDA?**

13 **A.** No. The Florida Commission has for some time taken a more  
14 forward-looking and innovative approach, in conjunction with  
15 traditional methods, in setting depreciation lives. Indeed, the FPSC  
16 historically has not followed, but has been "in-front" of the FCC in  
17 their analysis of appropriate depreciation parameters. Approval of  
18 GTE's depreciation inputs in this case would further the FPSC's past  
19 thinking.

20  
21 **Q. HAS THE FPSC ALREADY APPROVED DEPRECIATION**  
22 **PARAMETERS FOR GTE THAT ARE SIMILAR TO THOSE GTE**  
23 **PROPOSES IN THIS CASE?**

24 **A.** Yes. As observed in the attached Exhibit AES-1, many key lives  
25 approved for GTE by the FPSC are nearly the same as requested for

1 cost model input. In the 1992 FPSC prescription for GTE, the  
 2 FPSC approved a 10 year projection life for Digital Switching, a 7.9 -  
 3 8 year life for Circuit Equipment, 16.4 - 19.8 for Copper Cable and  
 4 19.5 - 20.8 for Fiber Cable, based on GTE's Florida-specific study  
 5 data.

6  
 7 In GTE's 1995 Florida-specific study, GTE requested retention of the  
 8 10 year life for Digital Switching, the 8 year life for Circuit Equipment,  
 9 and 20 year lives for the Fiber Cable accounts. GTE requested a  
 10 shortening of the Copper Cable Accounts to 15 - 16 years in the  
 11 1995 study. Before that study was resolved, GTE began to use  
 12 economic depreciation parameters for calculating intrastate  
 13 depreciation expense, as permitted by the 1995 legislative revisions.  
 14 The cost study in this docket uses the 10 year life for Digital  
 15 Switching, 8 year life for Circuit Equipment, and 20 year lives for the  
 16 Fiber Cable accounts approved by the FPSC in Docket No. 92084-  
 17 TL. One important difference, however, is that GTE uses a 15 year  
 18 life for the Copper Cable accounts, as requested in GTE's 1995  
 19 Florida-specific depreciation study.  
 20

21 **Q. WHAT DEPRECIATION PARAMETERS DOES GTE CURRENTLY**  
 22 **USE FOR INTRASTATE DEPRECIATION REPORTING**  
 23 **PURPOSES?**

- 24 A. Since 1996, GTE has been booking depreciation rates based on the  
 25 same economic depreciation parameters as requested in this docket,

1 and shown in Exhibit AES-2, attached. GTE also uses these  
 2 depreciation parameters for financial reporting purposes.  
 3

4 **III. THE INTRODUCTION OF COMPETITION REQUIRES THE USE OF**  
 5 **ECONOMIC LIVES**

6  
 7 **Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER IN**  
 8 **APPROVING DEPRECIATION INPUTS FOR THE COST MODEL?**

- 9 A. The Commission should keep in mind that it has already approved  
 10 depreciation lives that are, in many instances, the same as or similar  
 11 to the lives GTE proposes here. There is no plausible rationale for  
 12 reverting to a less progressive, strictly historical approach, which  
 13 would be primarily a mortality analysis with slight adjustments for  
 14 technological change. Rather, competitive impacts must be  
 15 recognized in establishing the economic value of GTE's assets. To  
 16 this end, some 240 companies hold statewide certificates to operate  
 17 as alternative local exchange carriers (ALECs), including such  
 18 companies as AT&T, Bell South, MCI, Time Warner, WinStar  
 19 Wireless, Biz-Tel, Ameritech, Metropolitan Fiber, Intermedia, Cable  
 20 & Wireless, TCG, Teligent, and WorldCom. Full facilities bypass is  
 21 becoming more of a reality, not only through emerging technological  
 22 developments like wireless local loops and transmission through  
 23 electric lines, but also through mega-competitors like AT&T-TCI, and  
 24 SBC-Ameritech. Competitors will use not only copper twisted wire  
 25 pairs, but also local wireless, coaxial cable, and the electrical wires

1 into the home. The depreciation inputs approved in this case must  
2 reflect these competitive considerations. Indeed, economic  
3 depreciation based on competitive market asset lives is the only  
4 approach consistent with the use of the forward-looking costing  
5 principle the Florida Legislature has dictated.  
6

7 **Q. ARE THERE SPECIAL CONSIDERATIONS THAT SUBJECT GTE**  
8 **FLORIDA TO PARTICULARLY SEVERE COMPETITIVE LOSSES?**

9 A. Yes. GTE's facilities in Florida are concentrated largely in the Tampa  
10 Bay Area, which has been a prime entry target for numerous  
11 competitors. This geographic concentration increases competitive  
12 risk, making GTE's Florida's operations particularly susceptible to  
13 devastating competitive losses.  
14

15 **Q. HOW SERIOUS IS THE COMPETITIVE THREAT IN GTE'S LOCAL**  
16 **MARKETS?**

17 A. Very serious. The Telecommunications Act of 1996 has substantially  
18 eased entry into local markets for competitors of all sizes. GTE has  
19 already executed 59 interconnection and/or resale contracts with  
20 other firms. Resale is a particularly quick and easy way for even  
21 smaller entities to offer service. More importantly, many of GTE's  
22 competitors will be large, well financed and well established  
23 telecommunications companies--some of which may bypass GTE's  
24 network completely. For example, AT&T Chairman C. Michael  
25 Armstrong has emphasized that local service is a key aspect of

1 AT&T's refocused strategy:

2 "Local service for consumers and businesses remains a top  
3 priority for AT&T, as a key part of its strategy to offer end-to-  
4 end communications services.

5  
6 AT&T is actively pursuing alternative technologies for  
7 providing local service, including mobile spectrum, fixed  
8 wireless, broadband cable and power transmission."

9 (AT&T Company Press Release, January 26, 1998.)

10  
11 On June 24, 1998, AT&T took a giant leap toward implementing this  
12 strategy with the announcement that it would buy the giant TCI.  
13 The significance of the deal was immediately apparent to analysts  
14 and the industry. A CBS MarketWatch report noted that:

15 "Since the passage of the telecommunications reform act in  
16 1996, the company [AT&T] has been seeking a way to enter  
17 the local phone market and bypass the regional Bells. TCI,  
18 whose cable lines pass into one-third of American homes,  
19 gives AT&T that missing link into the so-called last mile--the  
20 phone wiring into American homes and businesses almost  
21 entirely controlled by the Baby Bells. "We can deliver all of  
22 the telecommunications services over one line from one  
23 company" said AT&T Chairman C. Michael Armstrong during  
24 a conference call with analysts. "We must control the  
25 Architecture" Armstrong said on CNBC. "We must control

1 access to our customers and we must control costs. This  
2 investment with TCI is really the beginning of a consumer-  
3 based facilities service." "

4 (CBS MarketWatch Media Report, June 24, 1998, "AT&T Buys TCI  
5 in \$48 Billion Deal.")

6  
7 Since TCI operates in GTE's Tampa territory, the AT&T/TCI merger  
8 underscores the need for this Commission to affirm the use of  
9 economic depreciation principles that will continue to permit GTE to  
10 recover capital investments in accordance with market realities.

11

12 **Q. DOES GTE FACE BYPASS FROM OTHER SOURCES?**

13 **A.** Yes. GTE competes with facilities-based providers—including ICI,  
14 MFS/WorldCom, MCI, WinStar, AT&T/TCG, Time Warner, e.spire,  
15 and the City of Lakeland—even today. Bypass options will become  
16 increasingly more common through emerging technologies such as  
17 wireless local loop options. WinStar, for instance is a "wireless fiber"  
18 company already operating in GTE's market. As noted in a recent  
19 Wall Street Journal article:

20 "WinStar and other wireless service companies could offer the  
21 giant Bell companies and GTE Corp. their most meaningful  
22 competition in luring away phone customers to alternative local  
23 services on a massive scale."

24 (Wall Street Journal, Nov. 10, 1997, page B6.)

25

1 On May 7, 1998, WinStar announced that services were launched  
2 during the first four months of 1998 in seven markets, including  
3 Tampa. (WinStar press release, May 7, 1998, "WinStar Adds 7 New  
4 ALEC Markets.")

5  
6 Teligent Inc. offers another example of the competitive threat of  
7 emerging technologies. Alex J. Mandl, former AT&T President and  
8 now Chairman and CEO of Teligent Inc. recently stated:

9 "It is no accident that the company AT&T decided to buy to  
10 jump-start its entry into local markets was Teleport  
11 Communications Group, one of the largest of the new facilities-  
12 based local competitors.

13  
14 Companies like Teligent, WinStar, and BizTel (now owned by  
15 Teleport) today are delivering new broad-band services with  
16 technology that was not available even a year or two ago.  
17 Real competition is coming to the local telephone market."

18 (Wall Street Journal, Jan. 28, 1998, page A18 [emphasis added].)

19  
20 On January 28, 1998, Teligent announced the first ten cities,  
21 including Tampa and Orlando, for full commercial launch of facilities-  
22 based commercial service over its own digital wireless networks in  
23 1998. At the same time, Teligent announced that it had ordered its  
24 first ten DMS-500 switches. (Teligent press release, January 28,  
25 1998, "Teligent Announces First Ten Cities for Commercial Launch



1 in 1998.") In the company's report of 1997 financial results,  
2 Chairman Mandl emphasized Teligent's local market strategy:

3 We are building the necessary foundation to support our  
4 aggressive build out schedule. We're deploying the most  
5 advanced digital, local communications networks in the  
6 country to bring real competition to the local marketplace.

7 (Teligent press release, March 11, 1998, "Teligent Reports 1997  
8 Financial Results, Setting the Stage for 1998 Market Entry.")

9  
10 Teligent's local market assault prompted Fortune magazine to name  
11 Teligent one of America's 12 "coolest" companies. The July 6, 1998  
12 issue states: "Wall Street and industry pundits are gushing about this  
13 fledgling telecom company, which is building a nationwide wireless  
14 network to provide local phone service." (Fortune Magazine, July 6,  
15 1998, "Cool Companies 1998.")

16  
17 Chairman Mandl responded: "To be recognized as the only cool  
18 telecom services company at a time when competition in the  
19 telecommunications industry is exploding is exciting for us. We've  
20 always known that Teligent is bringing leading edge technology to the  
21 marketplace. But it's nice to be cool, too." (Teligent Press Release,  
22 June 17, 1998, "Fortune Magazine Names Teligent One of America's  
23 "Coolest" Companies.")

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Q. HAVE THE BELL OPERATING COMPANIES EXPRESSED INTEREST IN COMPETING IN GTE'S OPERATING TERRITORY?

A. Yes. Bell South and Ameritech have been granted ALEC status in Florida. Mega-mergers, such as the recently announced SBC - Ameritech merger, pose a particular threat to GTE as an SBCg2 press release makes clear:

"The merger of SBC Communications Inc. and Ameritech Corp. will create a new company that will deliver full competition to 30 markets around the country while spurring additional competition in SBC and Ameritech's respective regions. "This merger will jump start competition in local markets nationally like nothing else has to date" said SBC chairman and chief executive officer Edward E. Whitacre Jr. "This merger will add a new competitor to the industry that is capable of-and committed to-providing the full range of services, including local and long distance, to business and residential customers. This will fulfill the spirit of the Telecommunications Act of 1996, which envisioned broad competition across the country. No other telecommunications company has committed to competing on this scale," he said."  
(SBC press release, May 12, 1998, "Full Competition at the Heart of SBC-Ameritech Merger" [emphasis added].)

SBC has committed to entering 30 new markets under its "National-

1 Local" strategy." Among the new markets listed is GTE's Tampa - St.  
2 Petersburg market.

3

4 **Q. COULD YOU PROVIDE SOME EXAMPLES OF HOW A CUSTOMER**  
5 **COULD LEAVE GTE'S LOCAL WIRELINE NETWORK FOR A**  
6 **COMPETITOR'S LOCAL WIRELESS NETWORK?**

7 **A.** Yes. In February 1997, well before the merger announcement, AT&T  
8 touted its "Project Angel," a revolutionary fixed wireless technology  
9 to carry high-speed digital communications to most households  
10 across the country at many times the capacity of traditional copper  
11 wire. This technology will give AT&T a new way to provide local  
12 service over its own facilities. This option would completely bypass  
13 the ILEC's existing network, including the copper cable distribution  
14 network. Even though AT&T is still in the trial phase of this project,  
15 other providers are building and implementing local wireless  
16 technology on a national scale.

17

18 Wireless providers, such as WinStar and Teligent, are building a full-  
19 service national local switched telephone network that can bring fiber  
20 quality service to fixed wireless connections for high speed, digital  
21 voice and data transmissions. These reliable wireless circuits take  
22 the place of existing fiber optic and copper communications lines.  
23 This fixed wireless technology, in conjunction with a provider's own  
24 switch, could completely bypass the ILEC's existing network.

25

1 Q. ARE THERE COMPETITIVE THREATS FROM FIRMS OTHER  
2 THAN TELECOMMUNICATIONS COMPANIES?

3 A. Yes. Evolving technologies will expand competition in ways that may  
4 not be immediately obvious. For instance, Britain's Norweb  
5 Communications has invented a "Digital PowerLine" technology that  
6 allows telephone calls to travel over electric lines. Ten utilities in  
7 Europe and Asia, with a combined reach of 35 million homes, are  
8 already testing the system. Northern Telecom, the big Canadian  
9 manufacturer of telephone equipment, has joined Norweb as a  
10 partner. Some American power providers are considering their own  
11 tests. "We are certainly familiar with the technology and are  
12 evaluating it," confirmed a spokesman for FPL Group Inc.'s Florida  
13 Power & Light. Of the 1500 inquiries Norweb has received about the  
14 system, one third were from U.S. companies. (Wall Street Journal,  
15 July 2, 1998, "Garage Tinkering Yields an Electrifying Breakthrough.")  
16 Again, competitive threats from all of these sources—both familiar and  
17 emerging—illustrate the need for the Commission to adopt GTE's  
18 recommended economic lives for use in determining basic service  
19 costs in this case.  
20

21 **IV. PROPER WEIGHT IS GIVEN TO ALL FACTORS CONSIDERED IN**  
22 **THE DETERMINATION OF AN ECONOMIC LIFE**

23  
24 Q. WHAT FACTORS SHOULD BE CONSIDERED WHEN ESTIMATING  
25 THE ECONOMIC LIFE OF AN ASSET?

1 A. GTE's process for estimating economic lives properly balances  
2 traditional criteria with objective benchmarks and market realities.  
3 Specifically, GTE (a) evaluates the criteria used to establish the  
4 retirement lives of assets, (b) benchmarks GTE's selected lives with  
5 the lives used by other telecommunications providers, the lives  
6 prescribed by the FCC, and pertinent studies conducted by  
7 Technology Futures, Inc. ("TFI"), and (c) considers the effect that the  
8 evolving competitive market will have on the economic lives of many  
9 of GTE's assets.

10

11 **Q. WHAT ECONOMIC LIVES DOES THIS PROCESS YIELD?**

12 A. The economic lives that GTE has estimated for various key assets  
13 are 10 years for Digital Switching, 8 years for Circuit Equipment, 25  
14 years for Poles, 15 years for Copper Cable, and 20 years for Fiber  
15 Cable. The economic lives of these assets are most subject to  
16 change in a competitive and technologically evolving environment.  
17 Establishing the proper economic lives for these assets is critical to  
18 determining economic depreciation in a forward-looking cost study.  
19 A complete list of GTE's recommended economic lives is attached as  
20 Exhibit AES-2.

21

22 **Q. WILL YOU PLEASE DESCRIBE THE ROLE OF TRADITIONAL**  
23 **RETIREMENT FACTORS IN ESTABLISHING ECONOMIC LIVES?**

24 A. GTE first considers the National Association of Regulatory Utility  
25 Commissioners ("NARUC") description of factors that cause property

1 to be retired. (Public Utility Depreciation Practices, National  
2 Association of Regulatory Utility Commissioners, 1996, p. 15.) These  
3 include:

4 1. Physical Factors

- 5 a. Wear and tear
- 6 b. Decay or deterioration
- 7 c. Action of the elements and accidents

8 2. Functional Factors

- 9 a. Inadequacy
- 10 b. Obsolescence
- 11 c. Changes in art and technology
- 12 d. Changes in demand
- 13 e. Requirements of public authorities
- 14 f. Management discretion

15 3. Contingent Factors

- 16 a. Casualties or disasters
- 17 b. Extraordinary obsolescence

18  
19 The NARUC factors, which have traditionally been used to establish  
20 the retirement or physical life expectancy of assets in the  
21 telecommunications industry, can provide some guidance in  
22 estimating an asset's economic life, but only if they are properly  
23 weighted to reflect the significant roles competition and technological  
24 change play in determining an asset's economic life. Specifically, the  
25 "Functional Factors" (Part 2 of the NARUC factors) are sensitive to

1 competition and technological change and are given substantially  
2 greater weight in establishing the economic lives of GTE's assets.  
3 The weighting process is reasonable considering the longstanding  
4 industry recognition that traditional methods for determining lives for  
5 accounts affected by technology and competition were not adequate.  
6 Most commissions, including this one, made adjustments to the  
7 physical life indications produced by historical mortality analysis. It  
8 would be a serious mistake to underestimate the effect that  
9 competition and technological change will have on an asset's  
10 economic life .

11  
12 **Q. DOES GTE USE EXTERNAL SOURCES TO CONFIRM ITS LIFE**  
13 **ESTIMATION JUDGEMENTS?**

14 **A.** Yes. Having recognized that traditional methods were not adequate,  
15 GTE attempted to develop an economic life model as early as the  
16 mid-1980's. However, it was soon evident that in a competitive  
17 environment, GTE could not operate in a vacuum. To help quantify  
18 our professional judgment as to the appropriate lives for telephone  
19 plant, GTE reviews industry studies performed by TFI, including a  
20 GTE-specific analysis, entitled "Technology Forecasts For GTE  
21 Telephone Operations." We then use these lives as a  
22 "reasonableness" benchmark comparison with the lives used by other  
23 companies, both regulated and non-regulated, with similar types of  
24 telecommunications assets.

25

1 Q. WHAT DO THE TFI STUDIES RECOMMEND AS THE ECONOMIC  
2 LIVES FOR GTE'S ASSETS?

3 A. The chart on Exhibit AES-3, attached, compares TFI's recommended  
4 economic life ranges with the economic lives GTE uses in its cost  
5 studies. TFI specifically addresses the appropriate lives to be used  
6 for outside plant cable, central office switching, and circuit equipment  
7 accounts, as these are the accounts that are most affected by  
8 changes in competition and technology. As the chart points out, the  
9 lives used by GTE for financial reporting, for intrastate reporting, and  
10 for cost study inputs fall within the ranges recommended by TFI.

11

12 VI. GTE'S RECOMMENDED LIVES ARE REASONABLE WHEN  
13 BENCHMARKED WITH OTHER TELECOMMUNICATIONS PROVIDERS

14

15 Q. DID YOU DO ANY BENCHMARK COMPARISONS OTHER THAN  
16 TFI RANGES?

17 A. Yes. We also benchmarked against the lives used by AT&T, MCI,  
18 and CATV operators, as well as the Regional Bell Operating  
19 Companies ("RBOCs").

20

21 Q. WHAT DID YOU DETERMINE USING BENCHMARK  
22 COMPARISONS WITH AT&T?

23 A. Comparing GTE's proposed economic lives to the lives AT&T uses  
24 affords an excellent example of the reasonableness of GTE's  
25 economic lives. In fact, GTE's lives are not as short as lives used by



1 AT&T. (FCC Docket No. 95-32, In the Matter of the Prescription of  
2 Revised Percentages of Depreciation, Memorandum Opinion and  
3 Order, January 31, 1995.) The attached Exhibit AES-4 compares  
4 AT&T's lives with those recommended by GTE for the key accounts.  
5 AT&T uses 9.7 years for Digital Switching compared to 10 years  
6 recommended by GTE. AT&T uses 7.2 years for Circuit equipment  
7 compared to 8 years recommended by GTE. AT&T uses 3.4 to 15  
8 years for Copper Cable compared to the 15 years recommended by  
9 GTE. Finally, both AT&T and GTE use 20 years for Fiber Cable.

10  
11 Likewise, the lives AT&T uses for support asset accounts such as  
12 motor vehicles, furniture, office and work equipment are shorter than  
13 the lives GTE proposes. AT&T uses 6.6 years for motor vehicles,  
14 GTE proposes 8 years. AT&T uses 6.7 - 8.2 years for work  
15 equipment, GTE proposes 10 years. AT&T uses 4.7 - 9.3 years for  
16 office equipment, GTE proposes 10 years. AT&T uses 5.6 years for  
17 furniture, GTE proposes 10 years.

18  
19 **Q. WHAT WAS DETERMINED BY THE COMPARISON WITH MCI?**

20 **A.** GTE's lives are longer than lives MCI uses. Page 16 of MCI's 1996  
21 annual report stated:

22 "The weighted average depreciable life of the assets  
23 comprising the communications system in service  
24 approximates 10 years. Furniture, fixtures and equipment are  
25 depreciated over a weighted average life of 6 years ...

1 Buildings are depreciated using lives of up to 35 years."  
2 (MCI 1996 Annual Report, page 16.)

3  
4 Earlier this year, MCI made the following statement:

5 "The company periodically reviews and adjusts the useful lives  
6 assigned to fixed assets to ensure that depreciation charges  
7 provide appropriate recovery of capital costs over the  
8 estimated physical and technological lives of the assets. The  
9 weighted average of depreciable life of the assets comprising  
10 the communications system in service approximates nine  
11 years."

12 (MCI Communications Corporation Annual Report, SEC form 10-K,  
13 dated April 15, 1998.)

14  
15 MCI has shortened the lives of its communications facilities from  
16 approximately 10 years to 9 years, while not changing the lives for  
17 furniture, fixtures and buildings.

18  
19 GTE's proposed lives are longer or similar to the lives used by MCI.  
20 GTE proposes 10 years for switching and 15-20 years for cable  
21 compared to MCI's 9 years. GTE proposes 10 years for support  
22 assets such as furniture and equipment compared to MCI's 6 years.  
23 GTE proposes 30 years for buildings compared to MCI's up to 35  
24 years.

25

1 Q. WHAT WAS DETERMINED BY THE COMPARISONS TO LIVES  
2 USED BY THE CABLE TV OPERATORS ?

3 A. GTE's lives are not as short as the lives used by Cable TV operators.  
4 The FCC adopted a flexible range of lives to be used by Cable TV  
5 operators seeking to justify depreciation rates in cost of service  
6 filings. (FCC MM Docket No. 93-215, In re Implementation of  
7 Sections of the Cable Television Consumer Protection and  
8 Competition Act of 1992: Rate Regulation and FCC CS Docket No.  
9 94-28, In re Adoption of a Uniform Accounting System for Provision  
10 of Regulated Cable Service, Second Report and Order, First Order  
11 on Reconsideration, and Further Notice of Proposed Rule Making,  
12 January 26, 1996.) The useful lives adopted for distribution facilities  
13 was 10 to 15 years. This range was developed from a statistical  
14 analysis of lives Cable TV operators use for their own facilities. The  
15 15 year economic life for copper cable and the 20 year life for fiber  
16 cable selected by GTE are not as short as the lives within the FCC  
17 allowed range for Cable TV distribution facilities. Additionally, the  
18 lives GTE proposes for support assets such as office furniture and  
19 equipment, vehicles, and buildings are reasonable when compared  
20 to the FCC allowed ranges for Cable TV operators. The FCC range  
21 for office furniture and equipment is 9-11 years, which compares  
22 favorably to GTE's proposal of 10 years for these accounts. The FCC  
23 range for vehicles and equipment is 3-7 years, which is shorter than  
24 GTE's proposed 8-10 years. The FCC range for buildings is 18-33  
25 years, which compares favorably with GTE's proposal of 30 years.

1 Q. ARE GTE'S ECONOMIC LIVES SIMILAR TO THE ECONOMIC  
2 LIVES IDENTIFIED BY THE RBOCs?

3 A. Yes. The RBOCs' economic lives are, like GTE's, within the ranges  
4 identified by TFI. The attached Exhibit AES-5 compares the lives the  
5 RBOCs published in their FAS-71 announcements with the lives GTE  
6 proposes. The lives used by the RBOCs for financial reporting  
7 purposes are of particular interest because they will most likely be the  
8 lives they use for depreciating out-of-franchise investments made in  
9 the Tampa Bay area. SBC-Ameritech, for example, plans to provide  
10 "full residential and business services" in the Tampa Market. (Tampa  
11 Tribune, May 14, 1998, "Phone Deal Could Jangle Local Market.")  
12 BellSouth has declared its intent to offer local phone service in the  
13 Tampa Bay area. (Tampa Tribune, October 15, 1997, "BellSouth  
14 Seeks Share of Region.") It would be obviously unreasonable to use  
15 depreciation inputs for GTE that are longer than those used by GTE's  
16 competitors.

17  
18 Q. HAVE ANY OTHER COMMISSIONS DETERMINED THAT  
19 BENCHMARKING IS A VIABLE METHOD TO ASSESS THE  
20 REASONABLENESS OF GTE'S PROPOSED LIVES?

21 A. Yes. The Missouri Public Service Commission recently commented  
22 on benchmarking for purposes of establishing depreciation rates to  
23 be utilized in GTE's TELRIC cost studies stating: "Staff believes that  
24 benchmarking GTE TELRIC rates against those booked for financial  
25 purposes of likely competitors and other companies using similar

1 technologies is appropriate and is the best method to determine if  
2 GTE's TELRIC rates pass the muster of reasonableness." The  
3 Missouri Staff chose 19 of the largest IXC, Cable TV, Cellular, CAP,  
4 and PCS companies to benchmark against and found that the  
5 depreciation rates used to calculate GTE's TELRIC rates were at the  
6 bottom or second from the bottom of the list and were significantly  
7 lower than several companies in similar industries. The Missouri  
8 Order noted: "This is the most significant factor to Staff's belief that  
9 GTE's proposed depreciation rates are reasonable." (Case No. TO-  
10 97-63, Missouri Public Service Commission Final Arbitration Order,  
11 July 31, 1997, Attachment C at p. 77-79)).

12  
13 **VII. OTHER STATE REGULATORY COMMISSIONS HAVE ENDORSED**  
14 **GTE'S ECONOMIC LIVES**

15  
16 **Q. HAS ANY OTHER REGULATORY BODY APPROVED THE**  
17 **ECONOMIC LIVES PRESENTED HERE?**

18 **A.** Yes. The California Public Utility Commission ("CPUC") endorsed the  
19 use of the same economic lives presented here, except that the life  
20 approved for copper cable is one year less than requested. These  
21 lives were ordered to be used in a recent cost study ruling.  
22 (California Public Utilities Commission Decision No. D.96-08-021,  
23 August 2, 1996, in Rule Making R.93-04-003, I.93-04-002.) The  
24 CPUC concluded that the economic lives used by GTE and Pacific  
25 Bell for external financial reporting were the appropriate forward-

1 looking lives for cost studies. The CPUC rejected the suggestion by  
2 AT&T and others that FCC-prescribed lives are forward-looking.

3

4 **Q. WHAT DID THE CPUC SAY ON THIS ISSUE IN THAT**  
5 **PROCEEDING?**

6 **A.** In its decision, the CPUC commented as follows:

7 "We agree with Pacific that the schedules formally adopted in  
8 the represcription proceeding reflect the previous paradigm of  
9 the regulated monopoly environment, and so are difficult to  
10 justify in a cost study that looks forward to an environment in  
11 which there is local exchange competition. We also see little  
12 merit in the Coalition's original suggestion that we use FCC  
13 schedules. These schedules also reflect "the previous  
14 paradigm". Moreover, they are based on different  
15 assumptions and applied in different ways than our own. It  
16 also seems to be the case, however, that Pacific is now using  
17 these schedules in financial reports it is required to file, and  
18 thus for purposes of these cost studies, the schedules also  
19 appear consistent with generally accepted accounting  
20 principles. The schedules also appear realistic for a firm  
21 having to operate in a competitive environment, as Pacific will  
22 soon have to do. Accordingly, we will approve their use in this  
23 proceeding."

24 (Id. at page 52. (The Coalition referred to includes AT&T, MCI,  
25 California Cable Television Association, and the California

1 Association of Long Distance Carriers, among others.))

2

3 **Q. DOES GTE USE ECONOMIC LIVES IN ITS CALIFORNIA COST**  
4 **STUDIES?**

5 **A. Yes. The CPUC ordered GTE to use economic lives as well, stating:**

6 "We find GTEC's arguments to be persuasive, and will  
7 therefore order GTEC to modify the depreciation rates  
8 used in the cost studies it has submitted only to the  
9 extent of the eight technology accounts...."

10 (Id. at 75.)

11

12 **Q. HAVE OTHER STATE COMMISSIONS ENDORSED THE USE OF**  
13 **ECONOMIC LIVES?**

14 **A. Yes. Both the Michigan and Missouri Public Service Commissions**  
15 **have adopted GTE's recommended economic depreciation**  
16 **parameters. In adopting the economic lives presented here in**  
17 **Florida, the Missouri Commission stated:**

18 "Staff's goal has been to recommend depreciation rates based  
19 on parameters that GTE is likely to experience for financial  
20 purposes so as to fully recover its long-run capital costs in a  
21 timely fashion. "

22 (Case No. TO-97-63, Missouri Public Service Commission Final  
23 Arbitration Order, issued July 31, 1997, Attachment C at 76.)

24

25

1 The Michigan Commission likewise approved the use of GTE's  
2 economic lives in a February 25, 1998 order explicitly rejecting  
3 AT&T and MCI proposals:

4 "GTE proposes to reduce its asset lives in  
5 accordance with their economic lives....The  
6 Staff's view is that GTE's proposed asset lives  
7 are largely consistent with a forward-looking  
8 approach and are reasonable....The Commission  
9 finds that GTE's proposal related to depreciation  
10 is appropriate for TSLRIC purposes....The  
11 Commission further finds AT&T/MCI's proposal  
12 to be insufficiently forward looking for purposes  
13 of a TSLRIC study."

14 (Michigan Docket No. U-11281, February 15, 1998, Order,  
15 Section d.)

16  
17 **VIII. FCC DEPRECIATION RANGES ARE OUTDATED**

18  
19 **Q. SHOULD THE FCC'S AUTHORIZED DEPRECIATION PARAMETER**  
20 **RANGES CONTROL THIS COMMISSION'S DECISION?**

21 **A.** Certainly not. This Commission did not follow FCC parameters in  
22 GTE's 1992 depreciation decision. The rationale for rejecting FCC  
23 ranges has, since then, become only stronger. GTE discusses the  
24 FCC's parameters here only because it expects that AT&T, MCI, and  
25 perhaps others, may recommend FCC ranges to this Commission.



1

2 **Q. ARE THE FCC DEPRECIATION RANGES FORWARD-LOOKING?**

3 A. No. Particularly in the wake of the Act, the FCC's prescribed lives  
4 are outdated, in need of revision, and cannot be considered forward-  
5 looking or reasonable in today's telecommunication's environment.  
6 Even the Federal-State Joint Board (which is to assist the FCC in  
7 developing forward-looking cost calculations) has recommended  
8 depreciation lives significantly shorter than the outdated FCC ranges.  
9 The FCC itself has listed depreciation as an item for possible  
10 elimination in the 1998 biennial review. FCC Commissioner  
11 Furchgott-Roth has referred to the FCC depreciation procedures as  
12 relics and outdated, and has urged the Commission to eliminate its  
13 rules and regulations regarding depreciation.

14

15 **Q. WHEN WERE THE FCC DEPRECIATION RANGES DEVELOPED?**

16 A. The FCC ranges were developed from a statistical sampling of lives  
17 prescribed in the 1990 - 1994 timeframe, prior to the adoption of the  
18 Telecommunications Act of 1996. Thus, they can hardly be construed  
19 as forward-looking in 1998.

20

21 **Q. DOES THE FCC RECOGNIZE THAT ITS DEPRECIATION  
22 PROCEDURES NEED REVISION?**

23 A. Yes. The FCC recognizes that its depreciation rules need to be re-  
24 examined to reflect the post-Act telecommunications market  
25 environment, and intends to issue a notice of proposed rule making

1 to further examine the Commission's depreciation rules. (FCC Order  
2 97-157, Federal-State Joint Board on Universal Service, adopted May  
3 7, 1997, page 140.) In the Access Charge Reform Proceeding, the  
4 FCC acknowledged that the ongoing evolution of the  
5 telecommunications industry may well require the FCC to revise its  
6 prescription methods, or possibly discontinue depreciation rate  
7 prescriptions altogether. (FCC Order 96-262, Access Charge  
8 Reform, adopted May 21, 1997.)  
9

10 **Q. HAS THE FCC, IN FACT, IDENTIFIED DEPRECIATION AS AN ITEM**  
11 **FOR POSSIBLE ELIMINATION?**

12 **A.** Yes. The FCC Staff has released a list of proposed proceedings to  
13 be initiated as part of the 1998 biennial review. The review is aimed  
14 at eliminating or modifying regulations that are overly burdensome or  
15 no longer serve the public interest. Depreciation has been identified  
16 as an item that the Commission will consider for elimination in this  
17 review. (FCC Report No. GN 98-1, Feb. 5, 1998.)  
18

19 At least one Commissioner has already cast his vote to eliminate FCC  
20 depreciation prescriptions. In a statement issued on January 30,  
21 1998, FCC Commissioner Harold Furchtgott-Roth commented:

22 "In today's increasingly competitive environment, there should  
23 be no need for the Commission to continue to dictate, even  
24 through revised streamlined procedures, depreciation rates or  
25 the factors that may be used to compute such rates....I urge,

1 and specifically encourage parties to request, that the  
2 Commission use this year's biennial review to eliminate its  
3 rules and regulations regarding depreciation expenses."

4 (FCC Order 98-11, Jan. 30, 1998, separate statement by  
5 Commissioner Furchtgott-Roth.)  
6

7 **IX. CONCLUSION**

8  
9 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

10 **A.** Traditional historical methods of establishing depreciation lives are  
11 not forward-looking, and thus are inappropriate for use in forward-  
12 looking cost models. The lives GTE proposes are based on a  
13 forward-looking approach. They properly consider evolving  
14 technological and competitive factors likely to affect GTE Florida's  
15 operations. GTE's proposed lives are reasonable in comparison to  
16 the financial reporting lives of GTE's actual and potential competitors,  
17 which include Cable TV operators and telecommunications providers  
18 like SBC, Bell South, AT&T, TCI, and MCI.  
19

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

21 **A.** Yes.  
22  
23  
24  
25



1            assertions, existing FCC depreciation parameters are not forward-  
2            looking and are not appropriate for input in forward-looking analyses.

3

4            **Q. DO YOU AGREE WITH MR. MAJOROS THAT THE LIVES USED IN**  
5            **COST STUDIES SHOULD BE FORWARD LOOKING?**

6            A. Definitely, yes. As Mr. Majoros points out, the FCC clearly states the  
7            proper lives to be used are forward looking, economic lives.

8

9            **Q. DO YOU CONCUR IN MR. MAJOROS' CLAIM THAT THE LIFE**  
10            **RANGES ESTABLISHED BY THE FCC ARE FORWARD**  
11            **LOOKING?**

12            A. No, absolutely not. There are a number of reasons why we believe  
13            that the FCC ranges are not forward-looking. The most telling reason  
14            is that a number of forward-looking commissions have prescribed  
15            lives much shorter than the FCC ranges, including the FPSC. As  
16            stated in my direct testimony, California, Michigan, and Missouri  
17            concluded that the lives presented by GTE were reasonable, forward  
18            looking, and subsequently ordered their use in cost studies. As I  
19            explain later in this testimony, the FCC itself described the ranges Mr.  
20            Majoros uses only as a means to simplify the depreciation process;  
21            they were, therefore, developed using a sampling of historical  
22            depreciation represcriptions. Forward-looking analysis was beyond  
23            the scope of that development, and therefore was not considered.

24

25

1           Particularly in the wake of the Act, the FCC's prescribed lives are  
2           outdated, in need of revision, and cannot be considered forward-  
3           looking or reasonable in today's telecommunication's environment.  
4           The FCC itself has slated depreciation prescriptions as an item for  
5           possible elimination in the 1998 biennial review. FCC Commissioner  
6           Furchgott-Roth has referred to the FCC depreciation procedures as  
7           relics and outdated, and has urged the Commission to eliminate its  
8           rules and regulations regarding depreciation.

9  
10          **Q.    HAS THE FLORIDA PUBLIC SERVICE COMMISSION FOLLOWED**  
11          **THE FCC FOR SETTING DEPRECIATION LIVES IN FLORIDA?**

12          **A.    No.** As I discussed in my direct testimony, the Florida Commission  
13          has long taken a much more forward-looking and innovative approach  
14          in setting depreciation lives. Indeed, the FPSC historically has been  
15          "in-front" of the FCC in its analysis of appropriate depreciation  
16          parameters.

17  
18          **Q.    HAS THE FPSC ALREADY APPROVED DEPRECIATION**  
19          **PARAMETERS FOR GTE WHICH ARE SIMILAR TO THOSE GTE**  
20          **PROPOSES IN THIS CASE?**

21          **A.    Yes.** Again, as I discussed in my direct testimony, and as observed  
22          in Exhibit AES-6 (which is an update of Exhibit AES-1, attached to my  
23          direct testimony), many key lives approved for GTE by the FPSC  
24          years ago are nearly the same as requested for cost model input.  
25          GTE has been permitted, by statute, to use economic depreciation

1 since it became a price-cap carrier in 1996. Even so, in GTE's last  
2 depreciation prescription, in 1992, the FPSC approved projection life  
3 parameters for GTE that were shorter than the FCC's. It is my belief  
4 that the FPSC did not consider the FCC life parameters forward-  
5 looking in 1992 (Docket No. 920284-TL). Yet Mr. Majoros is  
6 recommending the FPSC take a step backward and use certain FCC  
7 parameters that are even longer than the FPSC parameters in the  
8 1992 case. For example, Mr. Majoros recommends the FCC's 1995  
9 Digital Switching projection life of 16 years, compared to the 10 year  
10 projection life prescribed for GTE in 1992 by the FPSC.

11

12 **Q. DOES GTE USE THE SAME DEPRECIATION PARAMETERS**  
13 **RECOMMENDED IN THIS DOCKET FOR BOTH REGULATORY**  
14 **INTRASTATE DEPRECIATION REPORTING AND FINANCIAL**  
15 **REPORTING PURPOSES?**

16 Yes. As I discussed in my direct testimony, GTE has, since 1996,  
17 been booking depreciation rates based on the same economic  
18 depreciation parameters as utilized in the cost study, and shown in  
19 Exhibit AES-2 to my direct testimony. GTE uses these same  
20 depreciation parameters for financial reporting purposes.

21

22 **Q. MR MAJOROS CLAIMS THAT A GROWING DEPRECIATION**  
23 **RESERVE SIGNIFIES ADEQUATE DEPRECIATION LIVES. DO**  
24 **YOU AGREE?**

25 **A. No. In fact, Mr. Majoros claims that because the reserve is growing,**

1 depreciation lives might even be too short (Majoros Direct Testimony,  
2 page 9). It is bewildering that someone with Mr. Majoros' experience  
3 would make a naive statement normally attributed to a novice in  
4 depreciation analysis. The 1968 NARUC manual characterized the  
5 reserve ratio "test" as inadequate even then, stating that it was  
6 popular at a time when there was no plant growth and unchanging  
7 total plant dollars in service. The 1968 manual further states that the  
8 reserve ratio test has limited applicability and is not an adequate test  
9 of historical or forward looking depreciation rates. (Public Utility  
10 Depreciation Practices, National Association of Regulatory Utility  
11 Commissioners, 1968, p. 202.) There is no mention of the reserve  
12 ratio test in the current edition (1996) of the NARUC manual. As Mr.  
13 Cunningham of BellSouth explains, (Cunningham Direct Testimony,  
14 page 14) no conclusions about the adequacy of depreciation lives can  
15 be drawn from the growth of the depreciation reserve. To conclude  
16 that the lives are adequate or should be shortened is potentially  
17 dangerous. In fact, the depreciation reserve may not be growing fast  
18 enough in the technology sensitive accounts to compensate for the  
19 avalanche of retirements that will occur as a result of technological  
20 change.

21  
22 **Q. DO YOU HAVE AN EXAMPLE OF AN ACCOUNT FOR WHICH THE**  
23 **RESERVE WAS GROWING BUT NOT FAST ENOUGH?**

24 **A. Yes, the Florida Analog Switching Equipment Account is a good**  
25 **example. As can be seen on Exhibit AES-7, the Florida FCC**



1 depreciation reserve for this account grew from 22% in 1981 to more  
2 than 50% in 1988. Using the Majoros logic, one could mistakenly  
3 conclude that the lives were too short due to the growing reserve. In  
4 retrospect, the reserve should have been about 80% in 1988 to  
5 prepare for the substantial retirements about to occur.

6

7 **Q. WHAT IS THE IMPACT OF THE FAILURE TO ANTICIPATE**  
8 **TECHNOLOGICAL CHANGE?**

9 A. The avalanche of retirements in analog switching equipment caused  
10 a large depreciation reserve deficit. The FCC attempted to  
11 compensate by substantially increasing the depreciation rate, but  
12 even a three-fold increase was not enough to prevent the large  
13 reserve deficit. Today, there is sufficient evidence that this scenario  
14 may reoccur in the copper cable and other technology sensitive  
15 accounts. So the pivotal question becomes whether the reserve is  
16 growing fast enough to reflect the wave of retirements that will occur  
17 due to a changing technology.

18

19 **Q. SHOULD THE FCC'S AUTHORIZED DEPRECIATION PARAMETER**  
20 **RANGES CONTROL THIS COMMISSION'S DECISION?**

21 A. No. Mr. Majoros' testimony focusses principally on the FCC's  
22 depreciation policies and practices, thus giving short shrift to this  
23 Commission's thinking in this area. GTE believes this focus should be  
24 reversed, with the emphasis on what has been and should be done in  
25 Florida. There is no reason, and nothing in any FCC Orders, that

1 requires this Commission to reverse the forward-looking path it has  
2 established in the depreciation area. As I have noted, this  
3 Commission did not follow FCC parameters even in GTE's 1992  
4 depreciation decision. The FCC prescribed parameters for AT&T in  
5 1995 that were nearly the same as the FPSC prescribed for GTE in  
6 1992. The rationale for rejecting FCC ranges just continues to  
7 become stronger.

8  
9 **Q. WHEN WERE THE FCC DEPRECIATION RANGES DEVELOPED?**

10 **A.** The FCC ranges were developed from a statistical sampling of lives  
11 prescribed in the 1990-1994 time frame, prior to the adoption of the  
12 Act. Thus, they can hardly be construed as forward-looking in 1998.

13  
14 **Q. WHY WERE THE FCC RANGES ESTABLISHED?**

15 **A.** The FCC ranges were established simply to streamline the FCC  
16 depreciation prescription process and promote paperwork reduction.  
17 The FCC objective was not to develop economic depreciation rates for  
18 forward-looking cost studies. The FCC stated:

19 Our objective was not to change depreciation rates, but to  
20 streamline the process used by the Commission to prescribe  
21 those rates.

22 (CC Docket No. 92-296, Second Report and Order, Simplification of  
23 the Depreciation Prescription Process, released June 24, 1994, para.  
24 24.)

1 Q. WAS THE INTENT OF THE FCC RANGES TO ESTABLISH  
2 FORWARD-LOOKING DEPRECIATION PARAMETERS?

3 A. No. The FCC further emphasized that the FCC ranges were simply  
4 a compilation of historical represcriptions, stating:

5 In discussing the ranges, many of the commenters recommend  
6 that we consider other methodologies, criteria and data in  
7 establishing the ranges. For example, the LECs state that we  
8 should consider forward-looking data rather than historical  
9 data....these issues are beyond the scope of this [Order].

10 (CC Docket No. 92-296, Third Report and Order, released May 4,  
11 1995, page 6.)

12

13 Q. HAS THE FCC SINCE THEN RECOGNIZED THE NEED FOR  
14 SUBSTANTIVE REFORM OF ITS DEPRECIATION POLICIES AND  
15 PRACTICES?

16 A. Yes. The FCC Commission Staff has released a list of 31 proposed  
17 proceedings to be initiated as part of the 1998 biennial review. The  
18 review is aimed at eliminating or modifying regulations that are overly  
19 burdensome or no longer serve the public interest. Depreciation has  
20 been identified as an item that the Commission will consider for  
21 elimination in this review. (FCC Report No. GN 98-1, released  
22 February 5, 1998.)

23

24 The FCC recently reported progress on the 1998 biennial regulatory  
25 review. In an August 6 report, one of the items for action was

1 "elimination or streamlining various rules prescribing depreciation  
2 rates for common carriers." (1998 Biennial Regulatory Review -  
3 Review of Depreciation Requirements for Incumbent Local Exchange  
4 Carriers, CC Dkt. No. 98-137, NPRM, FCC 98-170 adopted July 22,  
5 1998, FCC Report No. GN 98-11, August 6, 1998, FCC announces  
6 significant progress on 1998 biennial regulatory review.) Although the  
7 FCC's Notice of Proposed Rulemaking has been internally adopted,  
8 it had yet to be publicly released at the time this testimony was filed.

9  
10 **Q. HAS THE FCC GIVEN ANY FURTHER INDICATIONS OF ITS**  
11 **COMMITMENT TO REFORMING ITS OUTDATED DEPRECIATION**  
12 **POLICIES?**

13 **A.** Yes, as I noted in my direct testimony, at least one Commissioner  
14 has already cast his vote to eliminate FCC depreciation  
15 reprecisions. Back in January, FCC Commissioner Harold  
16 Furchtgott-Roth stated:

17 In today's increasingly competitive environment, there should  
18 be no need for the Commission to continue to dictate, even  
19 through revised streamlined procedures, depreciation rates or  
20 the factors that may be used to compute such rates .... I urge,  
21 and specifically encourage parties to request, that the  
22 Commission use this year's biennial review to eliminate its  
23 rules and regulations regarding depreciation expenses ...

24 (FCC Order 98-11, adopted January 30, 1998, Commissioner  
25 Furchtgott-Roth issuing a separate statement.)

1 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

2 A. FCC depreciation lives are not forward-looking and must be rejected  
3 by this Commission. The FPSC has historically led the FCC in  
4 prescribing depreciation lives, and should not now accept Mr. Majoros'  
5 suggestion to follow outdated parameters that the FCC itself will likely  
6 disavow. The lives presented by GTE are reasonable, and agree  
7 with the forward-looking philosophy of this Commission and the  
8 Legislature's directive to determine forward-looking costs.

9  
10 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

11 A. Yes.

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1 (Transcript follows in sequence in  
2 Volume 2.)  
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