

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION

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

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VOLUME 24

Pages 2684 through 2736

PROCEEDINGS: HEARING

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

DATE: Friday, October 16, 1998

TIME: Commenced at 9:05 a.m.

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

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

APPEARANCES:  
  
(As heretofore noted.)

DOCUMENT NUMBER - DATE

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**WITNESSES - VOLUME 24**

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90	Sprint/Lucent contract	2687	
91	ALR-1 through ALR-3	2690	

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

(Hearing reconvened at 9:05 a.m.)

(Transcript follows in sequence from  
Volume 23.)

CHAIRMAN JOHNSON: We're going to go back on  
the record this morning. Any preliminary matters?

MR. COX: Chairman Johnson, I believe at  
least one party has a preliminary matter they'd like  
to bring up.

MR. REHWINKEL: Yes. Madam Chairman --

CHAIRMAN JOHNSON: You again? (Laughter)

MR. REHWINKEL: One last time. Yesterday  
during the cross-examination of Mr. Dickerson there  
was some discussion about the availability of a Lucent  
contract, and after doing some more investigation, we  
have determined that there is one.

And I've discussed the matter with counsel  
for AT&T, and what I would like to do is offer to file  
that as a late-filed exhibit, have it given a number.  
Parties with access to the -- it's a highly  
confidential document, but parties with access to it  
through a nondisclosure agreement would be able to  
access the document and use it in the brief as part of  
the record, if that would be acceptable.

CHAIRMAN JOHNSON: Okay. I guess we'll

1 identify it as Late-filed 90, and the short title,  
2 Mr. Rehwinkel?

3 MR. REHWINKEL: "Sprint/Lucent contract."

4 CHAIRMAN JOHNSON: Thank you.

5 (Exhibit 90 marked for identification.)

6 MR. WAHLEN: I have a preliminary matter.

7 Mr. Dennis Curry of ALLTEL has been sitting in the  
8 back waiting patiently all week and is scheduled last,  
9 but he has a 1:45 plane flight.

10 I know we're all hoping to be done before  
11 then, but if it looks like we're kind of getting  
12 behind schedule, I wonder if it would be possible to  
13 take him out of order sometime. I don't know that we  
14 necessarily need to decide now, but I just wanted to  
15 put people on notice that we've got a problem.

16 He'd be glad to stay this weekend, except  
17 it's homecoming weekend and there are no hotel rooms.

18 CHAIRMAN JOHNSON: Well, let us know if  
19 there's a need.

20 MR. WAHLEN: Okay. Thank you.

21 MS. KEYER: I was just going to say that I  
22 believe our witnesses also have a 1:45 flight out.

23 CHAIRMAN JOHNSON: So you all should be  
24 sufficiently motivated. (Laughter)

25 Okay. AT&T?

1                   MR. HATCH: Madam Chairman, AT&T calls Art  
2 Lerma to the stand.

3   - - - - -

4   ART LERMA  
5 was called as a witness on behalf of AT&T  
6 Communications of the Southern States, Inc. and,  
7 having been duly sworn retroactively, testified as  
8 follows:

9   DIRECT EXAMINATION

10 BY MR. HATCH:

11           Q     Mr. Lerma, could you state your name and  
12 address for the record, please?

13           A     Yes. My name is Art Lerma, and my business  
14 address is 1200 Peachtree Street, Atlanta, Georgia.

15           Q     By whom are you employed and in what  
16 capacity?

17           A     I'm employed by AT&T as regional regulatory  
18 CFO.

19           Q     Did you prepare and cause to be filed  
20 rebuttal testimony consisting of, I believe, 12 pages?

21           A     Yes, I did. And by the way, I haven't been  
22 sworn in yet. (Witness duly sworn.)

23           Q     Do you have any changes or corrections to  
24 your rebuttal testimony?

25           A     Just a couple. On the very first page of

1 the testimony the room number shown there on Line 9  
2 should be "8080" instead of "5082". And then Lines 10  
3 and 11, there's two duplicate sentences there that  
4 begins with "I am employed". Either one of those --  
5 one of those needs to be lined out. Lining out the  
6 second one would be fine with me.

7 I don't have any other changes.

8 Q If I were to ask you the same questions as  
9 are in your direct -- or your rebuttal testimony,  
10 would your answers be the same?

11 A Yes, they would.

12 MR. HATCH: Madam Chairman, I would request  
13 that Mr. Lerma's rebuttal testimony be inserted into  
14 the record as though read.

15 CHAIRMAN JOHNSON: It will be so inserted.

16 Q (By Mr. Hatch) Did you also prepare and  
17 cause to be filed with your rebuttal testimony three  
18 exhibits identified as ALR-1 through ALR-3?

19 A That's correct.

20 Q Were those exhibits prepared by you or under  
21 your supervision?

22 A Yes, they were.

23 Q Do you have any corrections or changes to  
24 any of your exhibits?

25 A No, I do not.

1                   MR. HATCH: Madam Chairman, could we get  
2 Mr. Lerma's exhibits marked for identification?

3                   CHAIRMAN JOHNSON: They will be marked as  
4 91, composite exhibit. What were the initials again?

5                   MR. HATCH: It would be ALR-1 through ALR-3.

6                   CHAIRMAN JOHNSON: That will be the short  
7 title.

8                   (Exhibit 91 marked for identification.)  
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1                                **REBUTTAL TESTIMONY OF**2                                    **ART LERMA**3                                    **ON BEHALF OF AT&T COMMUNICATIONS**4                                    **OF THE SOUTHERN STATES, INC**5                                    **DOCKET NO. 980696-TP**

6

7    **Q.    PLEASE IDENTIFY YOURSELF, YOUR CURRENT POSITION AND**  
8    **THE SCOPE OF YOUR RESPONSIBILITIES.**

9    A.    I am Art Lerma. My address is Promenade I, Room <sup>8080</sup>~~6082~~, 1200 Peachtree Street,  
10          Atlanta, Georgia. I am employed by AT&T as Regional Regulatory Chief  
11          Financial Officer for the Southern States region. ~~I am employed by AT&T as~~  
12          Regional Regulatory Chief Financial Officer for the Southern States region. In  
13          my current position, I am responsible for AT&T's financial regulatory matters and  
14          for certain local exchange carrier ("LEC") cost analysis functions in nine southern  
15          states including Florida.

16

17   **Q.    PLEASE DESCRIBE YOUR EXPERIENCE.**

18   A.    I have 24 years experience in the telecommunications industry. I began my career  
19          in 1974 with Southwestern Bell Telephone Company ("SWBT") as a supervisor  
20          in Accounting Operations with responsibility for accounts receivable processing  
21          and revenue journalization. For the next nine years, I held various line and staff  
22          positions at SWBT Accounting Centers, where I was responsible for data  
23          processing operations, toll operations, customer billing and collection, payrolls,  
24          accounts payable, and the production of corporate books and records. In July of  
25          1983, I transferred to AT&T and accepted the position of Manager- Accounting



1 Regulatory Support with responsibility for AT&T financial regulatory matters in  
2 Texas. Since 1983, I have been responsible for AT&T financial regulatory  
3 matters and have been involved in the review of LEC cost information filed  
4 before public utility regulatory agencies in the southern or southwestern portions  
5 of the country.

6  
7 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

8 A. I have a Bachelor of Arts degree in Mathematics from Trinity University in San  
9 Antonio, Texas and Master of Business Administration from St. Edwards  
10 University in Austin, Texas. I have also completed a Telecommunications  
11 Management Program from the Graduate School of Management at the University  
12 of Dallas and an Advanced Management Program in Telecommunications from  
13 the Marshall School of Business at the University of Southern California.

14  
15 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE ANY REGULATORY  
16 COMMISSION ?**

17 A. Yes. I have testified previously before the Florida Public Service Commission  
18 ("FLPSC") and in numerous proceedings involving cost issues before public  
19 regulatory commissions in Alabama, Arkansas, Georgia, Kentucky, Louisiana,  
20 Mississippi, North Carolina, South Carolina, Tennessee, and Texas.

21  
22 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY IN THIS  
23 PROCEEDING?**

24 A. The purpose of my testimony is to evaluate the calculation of BellSouth  
25 Telecommunications Inc.'s ("BST"), GTE Florida Inc.'s ("GTE"), and Sprint-

1 Florida Inc.'s ("Sprint") operating expense inputs to the Benchmark Cost Proxy  
2 Model 3.1 ("BCPM3.1") Operating expenses result from activities such as  
3 marketing, operator services, general administrative, and network operations.  
4 Attached to my testimony as Exhibit ALR-1 is a table that itemizes the total  
5 universal service cost per line proposed by BST, GTE, and Sprint. In this table, I  
6 have highlighted in bold print the operating expenses that are the focus of my  
7 analysis. The cost model adopted by the FLPSC should reflect the total forward-  
8 looking costs that an efficient provider of telecommunications services incurs in a  
9 competitive environment. Based on my analysis, the BCPM3.1 operating expense  
10 inputs submitted by BST, GTE and Sprint do not meet this criteria.

11  
12 **Q. ARE YOU FAMILIAR WITH THE OPERATING EXPENSE INPUTS**  
13 **ASSOCIATED WITH THE BCPM COST MODEL?**

14 **A.** Yes. In addition to evaluating inputs to the BCPM3.1 model filed here in Florida,  
15 I have also evaluated inputs to the BCPM models filed by BST in Alabama,  
16 Louisiana, Kentucky, Mississippi, North Carolina, South Carolina, and  
17 Tennessee. BST has routinely populated the operating expense modules of the  
18 BCPM model with cost data that was developed in the shared and common cost  
19 module of BST's Unbundled Network Element ("UNE") Total Element Long Run  
20 Incremental Cost ("TELRIC") cost model. I have previously filed testimony  
21 addressing BST's shared and common cost development in the UNE cost  
22 proceeding here in Florida in conjunction with Docket Nos. 960833-TP/960846-  
23 TP/971140-TP/960757-TP/960916-TP. I have also reviewed GTE's and Sprint's  
24 operating expense inputs to the BCPM model in various other states including  
25 Alabama, Kentucky, North Carolina, South Carolina, and Tennessee.

1 Q. SHOULD THE FLPSC ACCEPT THE METHOD IN WHICH  
2 OPERATING EXPENSES, RESULTING FROM THE PROVISION OF  
3 BASIC LOCAL SERVICE, HAVE BEEN CALCULATED BY BST, GTE,  
4 AND SPRINT AS INPUTS TO THE BCPM3.1 MODEL? IF NOT, WHY  
5 NOT?

6  
7 A. No. The FLPSC cannot rely on the method in which BST, GTE, and Sprint have  
8 calculated universal service operating expenses because:

- 9 1. the accuracy of the BST, GTE, and Sprint operating expense inputs  
10 and calculations cannot be confirmed; and
- 11 2. the operating expense inputs for BST, GTE, and Sprint are based  
12 largely on historical costs and include other inappropriate costs that are  
13 not reflective of forward-looking, competitive costs.

14  
15 Q. WHAT ARE BST'S, GTE'S, AND SPRINT'S RECOMMENDED  
16 OPERATING EXPENSES PER LINE RESULTING FROM THE  
17 PROVISION OF BASIC UNIVERSAL SERVICE IN FLORIDA?

18 A. Exhibit ALR-1, line 4, provides a summary of the total operating expenses  
19 proposed by BST, GTE, and Sprint for use in this proceeding as inputs to the  
20 BCPM3.1 model. Exhibit ALR-2 provides an account summary for certain BST  
21 operating expenses that are identified as basic local service costs. Neither GTE  
22 nor Sprint provided sufficient operating expense detail in its filings for the  
23 development of a comparable exhibit.

24

1 Q. HAVE BELLSOUTH, GTE, OR SPRINT PROVIDED THIS  
2 COMMISSION ADEQUATE SUPPORTING DOCUMENTATION WITH  
3 WHICH TO VERIFY THE ACCURACY OF THE OPERATING EXPENSE  
4 INPUTS TO THE BCPM3.1 MODEL? PLEASE EXPLAIN.

5 A. No. On page 16, lines 6-7, of the testimony of BellSouth witness Daonne  
6 Caldwell, she states that operating expense inputs to the BCPM3.1 model were  
7 based on " BellSouth-specific expenses using 1998-2000 period total regulated  
8 expenses." These are the expenses reflected in column B of Exhibit ALR-2 to my  
9 testimony. Nowhere in the testimony or the BCPM study data that was filed, has  
10 BellSouth provided any calculations or supporting documentation that affords this  
11 Commission, or any party to this case, the means with which to verify the  
12 appropriateness of these operating expenses.

13 With respect to the determination of GTE operating expenses, witness Michael R.  
14 Norris states on page 4, lines 19-22, that " the starting point for assigning expense  
15 and investment to cost pools is state-specific, 1997 USOA ARMIS data. The  
16 ARMIS account data, at a budget center level of detail, is then assigned to work  
17 centers, which are, in turn, assigned to cost pools." GTE relies upon this cost pool  
18 data to develop its local service costs. However, nowhere in their filing has GTE  
19 provided calculations, mappings of costs between centers and cost pools, and the  
20 necessary supporting documentation that would allow this Commission to verify  
21 the appropriateness of the resulting operating expense inputs. In addition, a  
22 footnote to Exhibit MRN-3 page 1 of 2 of the testimony of witness Michael R.  
23 Norris states " adjusted expenses were developed based on the ICM 3.0 model".  
24 Nowhere in their filing has GTE provided supporting documentation for this

1 model nor does it indicate whether other inputs to the BCPM3.1 were also  
2 developed using data from the ICM model.

3 With respect to Sprint's operating expenses, witness Kent W. Dickerson states on  
4 page 16, lines 10-17, of his testimony that " estimates were derived from the  
5 actual operating expenses Sprint experienced in Florida during 1997." Here too,  
6 Sprint has provided no calculations or supporting documentation to allow for the  
7 verification of operating expenses.

8  
9 **Q. DOES THE METHOD IN WHICH BST, GTE, AND SPRINT DETERMINE**  
10 **OPERATING EXPENSE INPUTS FOR THE BCPM3.1 MODEL**  
11 **PRODUCE APPROPRIATE FORWARD-LOOKING RESULTS? PLEASE**  
12 **EXPLAIN.**

13 **A.** No. For BST, I concluded this when I evaluated the same operating expense data  
14 derived from the shared and common cost component of the UNE TELRIC cost  
15 model filed by BST here in Florida in conjunction with Docket Nos. 960833-  
16 TP/960846-TP/971140-TP/960757-TP/960916-TP. I determined that the  
17 projected operating expense levels are based largely on historical costs instead of  
18 the forward-looking costs that an efficient company can achieve today in a  
19 competitive environment. BellSouth did not fully consider the role that  
20 competition, technology, and productivity play in reducing operating expenses  
21 below historical costs.

22 Based on the insufficient and or lack of calculations and information filed by GTE  
23 and Sprint in support of their operating expense inputs, it is abundantly clear that  
24 this Commission does not have the means to determine whether these expense



1 inputs are reflective of the forward-looking costs that an efficient provider of  
2 telecommunications services incurs in a competitive environment.

3  
4 **Q. HOW DO COMPETITION, TECHNOLOGY, AND PRODUCTIVITY**  
5 **PLAY A ROLE IN PRODUCING LOWER OPERATING EXPENSE UNIT**  
6 **COSTS THAN THE HISTORICAL COSTS OF A REGULATED**  
7 **MONOPOLY?**

8 A. Competition, technology, and improved productivity produce lower operating unit  
9 costs for a number of reasons. First, competition provides a powerful incentive  
10 for a regulated monopoly to reduce its overhead expenses and to increase its  
11 productivity. Otherwise, it would find itself unable to compete against its "leaner  
12 and meaner" competition. Although the onset of competition has impacts on  
13 operating expenses across-the-board, it has a particularly significant impact on  
14 General and Administrative ("G&A") costs. These are overhead or common costs  
15 like executive salaries or accounting and finance costs. In a competitive  
16 environment, G&A expenses per line are considerably less than those reflected by  
17 BST, GTE, and Sprint in their BCPM3.1 inputs.

18 Second, the increased use of more modern, least cost technology produces lower  
19 network operating expenses in a competitive environment. In a least-cost,  
20 forward-looking environment, an efficient carrier starting in business today would  
21 utilize the most modern network equipment available. Because current trends  
22 show network operations expenses per line declining, they can be expected to be  
23 less than the historical levels reflected in BST's, GTE's, and Sprint's operating  
24 expense inputs and by necessity, be more in line with those of a least cost, most  
25 efficient carrier.

1 Q. HAVE BST AND GTE INCLUDED NON-RECURRING COSTS IN ITS  
2 CALCULATION OF THE OPERATING EXPENSE PORTION OF BASIC  
3 UNIVERSAL SERVICE COSTS? IF SO, PLEASE EXPLAIN WHY THIS  
4 IS INAPPROPRIATE.

5 A. Yes. Based on an analysis of the calculation of operating expenses in the UNE  
6 model filed here in Florida in conjunction with Docket Nos. 960833-TP/960846-  
7 TP/971140-TP/960757-TP/960916-TP, BST has included non-recurring operating  
8 expenses such as those resulting from service order related activities, in its  
9 calculation of basic universal service costs. This is inappropriate because service  
10 order related activities are one-time cost based activities that only benefit the  
11 customers requesting the service. Non-recurring costs of this nature should be  
12 separately identified and considered in non-recurring cost studies.

13 BST's treatment of non-recurring costs is also contrary to the action taken by GTE  
14 to remove non-recurring costs from its calculation of basic local service costs. On  
15 page 3, lines 14-16, of the testimony of witness Michael R. Norris, he states  
16 "these costs are recovered through non-recurring charges associated with service  
17 order activity and as such must be removed so as not to recover the same expense  
18 twice".

19 I cannot determine what Sprint has done with non-recurring costs. In other states  
20 when sufficient supporting data was provided, Sprint included non-recurring  
21 costs in its determination of the costs of recurring local service.

22  
23 Q. HAVE YOU CALCULATED AN ADJUSTMENT TO REMOVE THE  
24 NON-RECURRING COSTS THAT BST AND SPRINT HAVE INCLUDED  
25 AS INPUTS TO THE BCPM MODEL?



1 A. No. I did not have the required information with which to make this adjustment  
2 at this time. Neither BST nor Sprint filed any supporting documentation that  
3 allows any party to this proceeding to calculate such an adjustment. This  
4 Commission must make certain that both BST and Sprint identify their non-  
5 recurring costs and exclude them from their calculation of basic local service  
6 operating expenses.

7

8 **Q. IN CALCULATING BST'S, GTE'S, AND SPRINT'S BASIC SERVICE**  
9 **OPERATING EXPENSES, IS IT APPROPRIATE TO INCLUDE ALL**  
10 **MARKETING EXPENSES AS A NECESSARY COST OF RESIDENTIAL**  
11 **BASIC SERVICE COSTS? IF NOT, WHY NOT?**

12

13 A. No. BST, GTE, and Sprint do not advertise basic local service. Consequently, it  
14 is inappropriate to include any advertising expense in the calculation of basic  
15 local universal service costs. On Exhibit ALR-3, I have reflected an adjustment  
16 that removes any advertising expenses included in the Marketing expense  
17 category for BST. Although I did not have sufficient detail by account with  
18 which to make a similar adjustment to GTE's and Sprint's calculations, advertising  
19 expense should be removed from their calculations as well.

20

21 **Q. DO YOU AGREE WITH THE WAY THAT THE BST HAS**  
22 **CALCULATED THE PORTION OF REGULATED OPERATING**  
23 **EXPENSES ATTRIBUTABLE TO UNIVERSAL BASIC LOCAL**  
24 **SERVICE?**

1 A. No. As shown on Exhibit ALR-2, BST has utilized factors labeled "%  
2 Attributable to Basic Service" to derive the portion of total regulated expenses per  
3 line that BST presumes are attributable to basic service. In documentation  
4 supporting the BCPM3.0 and previous versions of BCPM that BST has filed in  
5 other states including, Kentucky, South Carolina and North Carolina, a uniform  
6 basic local factor was applied to all expense categories instead of the multiple  
7 factors now proposed. That factor represented basic local revenues as a percent of  
8 total revenues throughout the BST nine state region. BST has not explained why  
9 it has departed from their previous methodology nor provided evidence to support  
10 why either the single factor or the new multiple factors are appropriate cost  
11 drivers for determining the forward-looking operating expenses necessary for  
12 providing basic universal service. Without such a justification or verification, the  
13 Commission should not blindly rely on BST's data.

14  
15 **Q. DO THE BASIC SERVICE FACTORS APPEARING ON EXHIBIT ALR-2**  
16 **REPRESENT REASONABLE PERCENTAGES FOR DERIVING COSTS**  
17 **THAT MAY BE ATTRIBUTABLE TO BASIC LOCAL SERVICE?**

18 A. No. This is illustrated by the factor being used to determine the portion of  
19 marketing expenses that are attributed to basic local service. As shown on Exhibit  
20 AL-2, B<sub>1</sub> assumes that 86.25% of all marketing expense per line is attributable  
21 to basic local service. If one keeps in mind that marketing expense includes sub-  
22 categories of expense such as product advertising, which is approximately 24% of  
23 marketing expense, this factor is particularly unreasonable because BST does not  
24 advertise its basic local service. Consumers should not have to pay for marketing  
25 expenses that BST does not incur.

1 Q. IN SUMMARY, WHAT IS THE IMPACT OF YOUR RECOMMENDED  
2 ADJUSTMENTS TO THE OPERATING EXPENSE INPUTS PROPOSED  
3 BY BST, GTE, AND SPRINT?

4 A. If this Commission adopts the BCPM3.1 model and the proposed inputs, Exhibit  
5 ALR-3 includes adjustments that must at minimum be made to reduce BST's  
6 overhead expenses by 15% and to reduce network operating expenses by 30%.  
7 These are the same adjustments recommended by the FLPSC Staff and adopted  
8 by this Commission in the Final Order for the UNE proceeding in conjunction  
9 with Docket Nos. 960833-TP/960846-TP/971140-TP/960757-TP/960916 ( See  
10 Order No. PSC-98-0604-FOF-TP). In addition, Exhibit ALR-3 also includes  
11 adjustments to remove advertising expenses from the Marketing expense line. I  
12 have also substituted the proposed BST basic service factors shown in Exhibit  
13 ALR-2 with a single factor of 40.85% as discussed previously. If applied to the  
14 data that BST has used to populate the BCPM3.1 model, the impact of those  
15 adjustments is to reduce the operating expenses per line related to plant non-  
16 specific expenses proposed by BST from \$9.14 to \$5.40. (see Exhibits ALR-2 and  
17 ALR-3)

18 Because GTE and Sprint have provided insufficient support for this Commission  
19 to verify the appropriateness of the operating expense inputs, the 15% reduction  
20 to overheads and 30% reduction to network operating expenses are reasonable  
21 adjustments that should be made. In addition, this Commission should obtain the  
22 necessary data to remove advertising expenses from the calculation of Marketing  
23 Expenses for GTE and Sprint and apply a single basic local service factor that  
24 represents basic local service revenues as a percent of total revenues.

25

1 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

2 A. Yes it does.

3

4

5

6

7

1           Q        (By Mr. Hatch) Do you have a summary of  
2 your testimony?

3           A        Yes, I do.

4           Q        Could you please give that?

5           A        Yes, I will. Good morning, Commissioners.  
6 My name is Art Lerma, and I have 24 years' experience  
7 in the telecommunications industry.

8                    The last 14 years my duties have included  
9 analyzing cost studies prepared by local exchange  
10 companies in different proceedings. The focus of this  
11 testimony is to critique the operating expense inputs  
12 into the BCPM model.

13                   A large percentage of the operating expenses  
14 result from activities like marketing, operator  
15 services, finance, accounting, and network operations.  
16 These are all noncapital related expenses.

17                   The operating expense inputs used by  
18 BellSouth, GTE, and Sprint to calculate monthly basic  
19 local service costs are highlighted on my exhibit ALR-1.  
20 That exhibit provides not only the operating expenses  
21 that I will be discussing in my testimony, but also  
22 the other components that lead to the total basic  
23 local service cost per line for each of the three  
24 companies.

25                   Based on my current analysis, adoption of

1 the BCPM operating expense inputs proposed by the  
2 three companies will overstate basic universal service  
3 costs, which must then be reflected in higher consumer  
4 prices.

5           Now, the methods by which BellSouth, GTE,  
6 and Sprint have calculated their operating expense  
7 inputs are not reflective of forward-looking,  
8 competitive costs, because, first, they're based  
9 largely on historical costs, when in fact they should  
10 represent costs for an efficient carrier in a  
11 forward-looking environment; and, number two, they  
12 include other inappropriate costs. Advertising,  
13 nonrecurring costs are two examples of these  
14 inappropriate costs.

15           How are BellSouth, GTE, and Sprint's  
16 operating expenses not reflective of competitive  
17 costs? Because they relied largely on historical  
18 operating expenses.

19           In the case of BellSouth, I learned this  
20 from an analysis of their inputs presented in this  
21 case and from previous analyses of the shared and  
22 common cos inputs to their TELRIC model, which was  
23 filed here in Florida in conjunction with Dockets  
24 960757, 960833, and 960846, and in various other  
25 states where they have put forward their UNE model.

1           The BellSouth BCPM operating expense inputs  
2 for USP purposes are calculated using methodology  
3 similar to the method in which UNE shared and common  
4 costs were calculated right here in Florida. These  
5 historically based operating inputs do not reflect the  
6 impact that competition has in reducing operating  
7 expenses to levels incurred by an efficient provider  
8 of telecommunications services in a competitive  
9 environment.

10           In a competitive environment there is  
11 perpetual pressure to reduce operating expenses as  
12 evidenced by declining cost trends. Reductions to  
13 general administrative and network operating unit  
14 costs are occurring. Therefore, reliance on inputs  
15 based on historical expenses results in overstated  
16 costs. My analysis of GTE and Sprint's operating  
17 expense inputs confirms that they, too, are reflective  
18 of historical operating expenses.

19           What are some examples of inappropriate  
20 costs that are reflected in the BCPM operating expense  
21 inputs for each of the companies?

22           The first, BellSouth, GTE, and Sprint have  
23 inappropriately included advertising expenses in  
24 marketing expense per line, even though there's  
25 virtually no advertising for basic local service.



1           Second, the companies have not removed --  
2 particularly BellSouth and Sprint -- have not removed  
3 nonrecurring expenses associated with service order  
4 activity from the development of recurring operating  
5 expenses. This can result in double recovery of  
6 nonrecurring costs because they would be recovered by  
7 nonrecurring charges, and possibly through the USF  
8 fund as well.

9           If this Commission adopts the BCPM model and  
10 the inputs proposed to determine basic universal  
11 service costs, I recommend that at minimum the  
12 following adjustments to BellSouth, GTE, and Sprint's  
13 operating expense inputs be considered, as referenced  
14 in my testimony: A 15% reduction to general  
15 administrative expenses, a 30% reduction to network  
16 operating expenses, and a reduction in marketing  
17 expenses to remove BellSouth's advertising expenses.  
18 And that's reflected on my Exhibit ALR-3 that is  
19 already attached to my testimony.

20           Now, I didn't have a similar calculation for  
21 GTE and Sprint. I was able to obtain some additional  
22 information data requests. If the Commission is  
23 looking for a number to remove for advertising for GTE  
24 based on that information, it was \$10.7 million in  
25 advertising expenses for GTE, and \$5.9 million for

1 Sprint.

2 I do have a calculation of the GTE  
3 adjustments that I calculated. It's available to the  
4 Staff if they would like that.

5 As stated in my testimony, an adjustment to  
6 remove nonrecurring expenses related to service order  
7 activity for BellSouth and Sprint is also necessary.  
8 However, BellSouth has indicated in interrogatory  
9 responses that these amounts are not separately  
10 identifiable, while Sprint has now provided a  
11 calculation in an interrogatory response to AT&T's  
12 third set, No.46c.

13 Adoption of the BCPM operating expense  
14 inputs proposed by BellSouth, GTE, and Sprint without  
15 the adjustments recommended in my testimony will  
16 result in higher costs which must be reflected in  
17 higher consumer prices. This concludes my summary.

18 MR. HATCH: Tender the witness for cross.

19 CROSS EXAMINATION

20 BY MS. WHITE:

21 Q Good morning, Mr. Lerma.

22 A Good morning.

23 Q My name is Nancy White. I represent  
24 BellSouth Telecommunications.

25 Now, in your testimony you assert that

1 BellSouth's overhead expenses should be reduced by  
2 15%; is that correct?

3 A That's correct.

4 Q And you assert that BellSouth's network  
5 operating expenses should be reduced by 30%; is that  
6 correct?

7 A That's correct.

8 Q Now, is the 30% reduction in network  
9 operating expense assumed to occur over the three-year  
10 study period of 1998 to 2000?

11 A No. It's not assumed to occur over any  
12 particular time because, in fact, what we're here to  
13 do is to establish what operating expenses should be  
14 in a forward-looking, competitive environment and not  
15 over any one particular period of time.

16 Q So what you're telling me is that you  
17 believe BellSouth can reduce 30% of its network  
18 operating expenses over some unknown period of time in  
19 the future; is that correct?

20 A Yes. And let me elaborate on that a little  
21 bit, because, number one, there are trends that I have  
22 looked at with regard to network operating expenses  
23 using publicly available ARMIS data.

24 If you look at the expenses in Accounts 6530  
25 to 35 and 6512, over a period from 1989 to 1996 those

1 expense levels have been going down approximately 7% a  
2 year. If we were -- if those trends continue, for  
3 example, you'd be talking about four years before you  
4 get near the 30%, but we're not talking about doing it  
5 over a specific time period.

6 That looks at what the trends have been and  
7 is driven by things like access line growth, because  
8 access line growth is part of that determinant as to  
9 what the unit costs will be. Even if BellSouth's  
10 network operating expenses didn't change over time and  
11 the access lines grew, the unit costs trend downward,  
12 and so that's backed up by -- specifically by the  
13 trends that I have observed.

14 Q And you're using historical data to  
15 determine those trends; correct?

16 A That's correct; and that's the same  
17 information that I provided in the UNE proceeding  
18 earlier this year here in Florida and that 30% is the  
19 same 30% that was recommended by this Commission.

20 Q Now, you list three factors that support  
21 your conclusion that BellSouth can, in fact, achieve a  
22 30% reduction, and those factors are productivity  
23 technology, and competition; is that right?

24 A That's correct.

25 Q Now, would you agree that although your

1 testimony discusses the technology --

2 COMMISSIONER DEASON: Excuse me. Let me ask  
3 a question. You mentioned 7% reduction. That's a  
4 historical reduction in network operations expense?

5 WITNESS LERMA: Yes, sir. The --

6 COMMISSIONER DEASON: Let me ask you, is  
7 that in terms of total dollars, or 7% in terms of  
8 expenses per access line?

9 WITNESS LERMA: The latter; expenses per  
10 access line. The unit costs have been trending  
11 downward about 7% a year.

12 COMMISSIONER DEASON: And is your  
13 recommended 30% adjustment in terms of total dollars,  
14 or in terms of cost per unit, i.e., cost per access  
15 line?

16 WITNESS LERMA: It's in -- the adjustment is  
17 calculated off of the total dollars and then expressed  
18 in terms of access, yes.

19 COMMISSIONER DEASON: So if it's done in  
20 terms of total dollars, that equates to a higher  
21 percentage of reduction, does it not, in per access  
22 line, if you assume there's growth in access lines.

23 WITNESS LERMA: You could do it both ways.  
24 I think the calculations would be close.

25 Q (By Ms. White) Your testimony discusses

1 the technology and the competition factors, but I  
2 didn't see anything in there about productivity  
3 specifically. Is that a fair characterization?

4 A Yes. And let me elaborate on that, too,  
5 because one of the things --

6 MS. WHITE: I just asked him if he discussed  
7 productivity in his testimony. That's pretty much a  
8 yes or no question.

9 MR. HATCH: He answered the question yes.  
10 May he be allowed to explain?

11 CHAIRMAN JOHNSON: No. That yes is  
12 sufficient.

13 Q (By Ms. White) Would you agree that a  
14 very simple definition of productivity is doing more  
15 with less?

16 A That would be one definition, yes.

17 Q And would you agree that part of your  
18 productivity assumption would be concerned with the  
19 person<sup>nel</sup> level at a company or with whether  
20 downsizing is going to occur?

21 A Not necessarily, because as -- when you  
22 asked me earlier if that was -- if that's a definition  
23 of productivity, productivity can be accomplished in a  
24 variety of different ways.

25 One is just flat out reducing the amount of



1 employees. Another is reengineering processes so that  
2 the work functions can be done smarter; coming up with  
3 computer systems that employees use that allow them to  
4 do more over shorter periods of time. So it's not  
5 dependent solely on personnel.

6 Q Okay. Well, let's talk about the personnel  
7 angle of productivity a little bit. You would agree  
8 that personnel expenses are a considerable portion of  
9 BellSouth's network operating expenses each year;  
10 correct?

11 A Yes.

12 Q And are you aware that BellSouth has  
13 undergone a work force reduction in recent years?

14 A Yes.

15 Q Were you present when Ms. Caldwell was on  
16 the stand?

17 A No, I was not.

18 Q Would you accept, subject to check, that she  
19 testified that BellSouth decreased its work force by  
20 over 11,000 employees in recent years?

21 A Yes. I'm aware of that.

22 Q And would you also accept, subject to check,  
23 that BellSouth's access lines have increased in recent  
24 years?

25 A Yes, their access lines have increased.



1           Q     Now, do you have any personal knowledge of  
2 BellSouth's work force needs in Florida over the next  
3 few years?

4           A     No, I do not. But if I could elaborate on  
5 that specifically, I think where we're headed here  
6 again is that the costs are primarily driven here by  
7 personnel costs, and that's not necessarily true.

8                     Reengineering plays a big part in this. And  
9 one of the things that really concerns me -- getting  
10 back to productivity that we were -- which was the  
11 theme of your questions earlier -- is that BellSouth  
12 has understated their productivity in this proceeding.

13                     In each of its expenses, including the  
14 network operating expenses that you spoke about  
15 earlier, there's a 3.1% productivity factor that  
16 BellSouth has included. And I found that at the FCC  
17 in its latest price cap filings, they've been filing  
18 6.5% productivity. So that by itself there  
19 understates the productivity in all expense accounts,  
20 including network operating expenses, and isn't  
21 necessarily driven by additional work force  
22 reductions.

23           Q     Do you remember what my question was? All I  
24 asked was whether you had any personal knowledge of  
25 BellSouth's work force needs in Florida over the next

1 few years. And your answer to that is no; is that  
2 right?

3 A That's correct.

4 Q Now, would you accept, subject to check,  
5 since you weren't here when Ms. Caldwell was  
6 testifying, that BellSouth is hiring more technicians  
7 in the state of Florida?

8 A Yes, I would expect that. I would expect  
9 that while they're hiring more, in some places they're  
10 letting other people go.

11 One of the things that's important to  
12 recognize here is that the costs that we're looking at  
13 are not specific to Florida for -- in this proceeding  
14 as presented to BellSouth. They're region dollars, so  
15 what's happening in Florida in and of itself is not  
16 what drives the costs.

17 This is a study that was put together for  
18 nine states, and that same study is what's being used  
19 in every other proceedings that BellSouth files both  
20 its US and its UNE costs.

21 MS. WHITE: And I appreciate the fact that  
22 Mr. Lerma needs to get his points across, but I'm  
23 asking pretty simple yes or no questions, and I know  
24 that we want to move this along.

25 Q (By Ms. White) Are you aware that

1 BellSouth has service quality commitments in the state  
2 of Florida that are set by this Commission?

3 A I would expect that they do. I've not read  
4 what those are.

5 Q Now, do you believe it is reasonable for  
6 this Commission to allow BellSouth to ignore those  
7 service commitments in order to achieve your 30%  
8 reduction?

9 A No. And I'm not -- and, again, the reason  
10 I'm having to elaborate on my questions is because the  
11 direction of your questions indicate that the only way  
12 to achieve the reductions that I recommend are by  
13 reducing the amount of personnel; and as I've stated  
14 before, we're talking about unit cost reductions.

15 You can reduce costs through greater  
16 efficiencies, through reengineering, and the fact that  
17 your access lines are growing, even if you maintain  
18 the costs where they are today, does not necessarily  
19 mean that the unit costs are not going to go down. In  
20 fact, that's why the costs are going down at 7% per  
21 year.

22 Q But you agreed with me earlier that  
23 personnel expense is one piece of the productivity  
24 issue; correct?

25 A That's correct.

1           Q     Now, let's talk about the technology for a  
2 while. Have you conducted any review of the  
3 technology that BellSouth uses in Florida to determine  
4 whether expenses would change?

5           A     No. That was not the decider for how I  
6 determined the percentage reduction.

7           Q     Do you have any experience in outside plant  
8 engineering?

9           A     No.

10          Q     Have you ever purchased technology equipment  
11 for a telecommunications company?

12          A     No.

13          Q     Now, the third leg of your factors that  
14 support your 30% reduction is the issue of  
15 competition. And I believe it's your position that  
16 competition will drive operating expenses down; is  
17 that right?

18          A     Yes.

19          Q     Would you agree that the long distance  
20 industry is competitive?

21          A     Yes, I would.

22          Q     And can you tell me any interexchange  
23 carriers that have achieved a 30% reduction in four  
24 years?

25          A     I've done no analyses in this proceeding of

1 interexchange carriers.

2 Q Have you looked at the level of operating  
3 expenses in AT&T?

4 A No, I have not.

5 Q I'd like to ask you who is going to provide  
6 the competition in Florida that will drive part of  
7 that 30% reduction?

8 A Well, I know that there are many  
9 interconnection agreements that have been entered into  
10 by both BellSouth and GTE. I don't know the numbers  
11 for BellSouth. I did see in a data request that GTE  
12 indicated that they have interconnection agreements  
13 with approximately 68 companies at this time. I would  
14 expect BellSouth's number is in that vicinity.

15 Q Do you know to what degree AT&T will be  
16 competing in the state of Florida in the local market  
17 in the next few years?

18 A No, I do not.

19 Q Now, with regard to advertising, you state  
20 that advertising expense should be removed from basic  
21 service costs; correct?

22 A That's correct.

23 Q Now, you base this on the statement that  
24 BellSouth and GTE and Sprint do not advertise for  
25 local service, or advertise local service. Is that a

1 fair characterization?

2 A Yes, it is.

3 Q If you're wrong, if you're wrong and  
4 BellSouth, GTE and Sprint do advertise local service,  
5 should that expense be included?

6 A Yes. And, in fact, if BellSouth had put  
7 forward some studies or provided some information  
8 about specifically where that local advertising was  
9 actually occurring, that could have been considered;  
10 but instead just the entire amount of product  
11 advertising was included.

12 Q You don't live in the state of Florida, do  
13 you, Mr. Lerma?

14 A No, I do not.

15 MS. WHITE: Thank you. I have nothing  
16 further.

17 COMMISSIONER CLARK: Mr. Lerma, why should  
18 advertising for basic local service be included?

19 WITNESS LERMA: I'm sorry?

20 COMMISSIONER CLARK: Why should it be  
21 included, even if they do advertise for basic local  
22 exchange service only?

23 WITNESS LERMA: Well, you know, what we're  
24 trying to accomplish here is coming up with the  
25 specific costs that are incurred in providing a



1 service. So as counsel for BellSouth mentioned a  
2 while ago, if there was a campaign to do that, then it  
3 might need to be considered.

4 Now, if that is a sustained campaign or if  
5 it's a nonrecurring thing, then you'd have to look at  
6 that. Was it a one-time thing? Was it more in line  
7 with customer instructions? Was it more in line with  
8 corporate advertising? Because on that issue  
9 yesterday I heard a couple of witnesses -- I believe  
10 it was Mr. Norris for GTE and Mr. Dickerson for  
11 Sprint -- mention that there were other types of  
12 advertising that should be allowed.

13 I heard image advertising mentioned by  
14 Mr. Dickerson, for example. That's not in the account  
15 that I removed. That's product advertising. Image  
16 advertising is in Account 6722, and I didn't make any  
17 adjustments to remove that.

18 Customer instructions, instructions provided  
19 to customers for --

20 COMMISSIONER GARCIA: But I think, though,  
21 the Commissioner's question is more precise, if I'm  
22 not mistaken. She asked, why at all allow it. And I  
23 assume that the concept is if we're going to allow  
24 competition in local service, why should that be  
25 recovered at all from --

1           **COMMISSIONER CLARK:** Universal service.

2           **COMMISSIONER GARCIA:** Exactly.

3           **WITNESS LERMA:** I believe that only specific  
4 advertising related to basic local could be allowed if  
5 it was determined that it existed, but I -- but they  
6 haven't been able to make that -- they haven't been  
7 able to identify what part of advertising and local -  
8 I don't disagree that local advertising would be  
9 allowed, because it is a -- if there is any, and if it  
10 could be identified --

11           **COMMISSIONER GARCIA:** You still haven't  
12 answered the question. It's a philosophical question.  
13 Why allow it? If we are -- why should universal  
14 service pay for basic advertising if we want to  
15 promote competition? In other words, why should your  
16 company be paying for BellSouth's advertising its  
17 local loop?

18           **WITNESS LERMA:** Well, because from a --

19           **COMMISSIONER GARCIA:** I know you said you  
20 didn't find it. It's a philosophical question. Why  
21 should i be allowed at all since you're a competitor?

22           **WITNESS LERMA:** Consistency purposes. From  
23 my perspective, and what I've done here, you look at  
24 all costs, and if a cost is being incurred to provide  
25 that service and if there is a rational study that's

1 been prepared that shows that those costs, you know,  
2 were incurred to provide that service, then they could  
3 be considered. It doesn't necessarily mean they have  
4 to be accepted, but they would -- they would be  
5 considered just like anything else.

6 My point goes back to the fact that it  
7 hasn't been done, and that the advertising costs --  
8 and that I am not familiar with any local advertising.  
9 And, again, it's a regional thing. The reference here  
10 about a campaign in Florida doesn't indicate that  
11 there are significant comparable types of advertising  
12 across the region, which is the basis for these  
13 advertising costs.

14 COMMISSIONER CLARK: Let me ask the  
15 question. You mentioned image advertising which you  
16 said is in a separate account?

17 WITNESS LERMA: That's correct.

18 COMMISSIONER CLARK: Has that, to your  
19 knowledge, been included as a cost in determining  
20 basic local exchange service?

21 WITNESS LERMA: Yes, it is, because it's  
22 included in Account 6722. It's one of the corporate  
23 operations accounts, and that is one of the expense  
24 per-line categories that's part of the overall  
25 operating expenses that are used to calculate the

1 basic local service costs.

2 COMMISSIONER CLARK: I don't recall that  
3 we've ever allowed image advertising to be recovered  
4 in rates. Do you know whether that's true?

5 WITNESS LERMA: I don't know that for  
6 Florida. I know, having been involved in a lot of the  
7 other states, that in rate of return regulation when  
8 cases were put together, image advertising was one of  
9 the typical disallowed categories.

10 COMMISSIONER CLARK: If it was typically  
11 disallowed, why would we include it now?

12 WITNESS LERMA: Well, that's a good  
13 question. I guess we're -- we're trying to come up  
14 with long-run economic costs here, and we're in areas  
15 that are different in some respects to what was done  
16 in rate of return regulation.

17 One of the things that could be considered  
18 here is that a lot of the costs that are part of the  
19 operating expenses per line that have been calculated  
20 here, they're primarily booked expenses. So  
21 categories of expenses that in the past you might have  
22 disallowed are all included there. And certainly in  
23 the Staff's review if there were disallowances in the  
24 past, were done before and it's felt like they should  
25 still be disallowed because it shouldn't be part of

1 the universal service and that's -- very definitely  
2 something that could be done. It's not an adjustment  
3 that has been made by any of the companies.

4 COMMISSIONER CLARK: Thank you.

5 COMMISSIONER DEASON: Let me ask a follow-up  
6 question. You mentioned there had been disallowances  
7 in the past. Do you know why there had been  
8 disallowances when there was rate of return  
9 regulation?

10 WITNESS LERMA: Yes. And traditionally the  
11 concept was that you were attempting to come up with  
12 the cost, the reasonable cost, of providing service.  
13 If a cost was --

14 COMMISSIONER DEASON: And it wasn't  
15 reasonable, was it, to have image enhancement  
16 advertising when the customer didn't have a choice?

17 WITNESS LERMA: That's correct.

18 COMMISSIONER DEASON: But in a competition,  
19 the customer will have a choice; isn't that correct?

20 WITNESS LERMA: Yes.

21 COMMISSIONER DEASON: It seems to me -- and  
22 I'll ask you if you agree -- that there's much more  
23 advertising now in the long distance market than there  
24 was, say, in 1975.

25 WITNESS LERMA: There's probably more

1 advertising, yes.

2 COMMISSIONER DEASON: And that's because the  
3 market is competitive now.

4 WITNESS LERMA: I'm sure competition has a  
5 lot to do with that.

6 COMMISSIONER DEASON: And if you compete in  
7 the local market and you win over customers that are  
8 in a high cost area, you would benefit, too, from  
9 having advertising included as a cost, because that's  
10 the subsidy you would get for serving those customers,  
11 would you not?

12 WITNESS LERMA: I'm sorry. Are you  
13 referring to the image advertising we were talking  
14 about?

15 COMMISSIONER DEASON: Yes. Would AT&T  
16 engage in advertising to win customers over if you  
17 were to enter a wire center and try to recruit  
18 customers?

19 WITNESS LERMA: I don't know how AT&T would  
20 do that. I know that AT&T does do image advertising,  
21 and there's probably some benefits that come from  
22 that.

23 COMMISSIONER DEASON: Is it your opinion  
24 that advertising is a natural cost of doing business  
25 in a competitive market?



1           **WITNESS LERMA:** Yes.

2           **COMMISSIONER GARCIA:** Following up  
3 Commissioner Deason's point, isn't there a benefit if  
4 we use -- well, let's use the GTE example, that, you  
5 know, we created this huge universal service fund, and  
6 by your estimates and by your numbers you guys believe  
7 you could do it for much less.

8           So don't we promote competition much more  
9 aggressively by creating this huge universal service  
10 fund so that you can access those dollars to provide  
11 service to BellSouth customers or GTE customers?

12           **WITNESS LERMA:** Would you repeat the  
13 question again?

14           **COMMISSIONER GARCIA:** Let me put it into  
15 context. You believe that what should be allowed for  
16 is the recovery of the loop and the service cost to  
17 that local loop based on long-term, most efficient  
18 system. Then you disagree with BellSouth's using  
19 numbers that it has derived from its records from past  
20 dealings.

21           But if this Commission went with BellSouth's  
22 numbers, would that not give an opportunity for you as  
23 a competitor to say, well, the Commission is allowing  
24 this much recovery on this, or there's this much money  
25 put away in universal service, therefore, if I know,

1 as you seem to know, that we can do it for much less,  
2 won't this Commission be promoting more aggressive  
3 competition by you getting into the market, since the  
4 margins that BellSouth listed are way above cost and,  
5 thereby will make customers more attractive to you as  
6 a local service provider?

7           **WITNESS LERMA:** I don't necessarily agree  
8 that that's what would occur. What I think it does,  
9 it sets more of a level platform in terms of everyone  
10 being able to benefit from the subsidies, but if the  
11 subsidies themselves are higher than they ought to be,  
12 then prices for consumers are going to be higher; and  
13 so I'm not sure that consumers are better off.

14           **COMMISSIONER GARCIA:** Well, while I'm sure  
15 that deep down you're concerned about consumers, I'm  
16 asking more philosophically about your company. And I  
17 think one of the witnesses stated, you know, if we  
18 have this money out there, we're going to get more  
19 competition more aggressively.

20           Now, on your numbers and BellSouth's numbers  
21 in certain areas there are tremendous discrepancies,  
22 and I say this because you seem to have found  
23 efficiencies that BellSouth has not found, or GTE or  
24 Sprint.

25           And so if we were to use their model which,

1 according to your numbers, provides too much money for  
2 these issues, doesn't that give you a greater margin  
3 to enter the market? And I understand that somebody  
4 is going to pay for it, and it may be you, or it may  
5 be customers. That said, you can -- let's discuss  
6 you. Let's leave the customers out of it. Doesn't it  
7 allow you or give you an opportunity there?

8           **WITNESS LERMA:** I think what it does is that  
9 in wire centers where a subsidy is needed to get into  
10 that geographical area, where other competitors might  
11 not have considered going into that wire center, they  
12 might now consider it and might compete there; but it  
13 isn't necessarily -- provide a benefit in all the wire  
14 centers.

15           So it -- potentially in a rural area where  
16 competitors might not have previously considered going  
17 into, yes, that could happen.

18                           **CROSS EXAMINATION**

19 **BY MR. REHWINKEL:**

20           **Q**     Good morning, Mr. Lerma. My name is Charles  
21 Rehwinkel with Sprint.

22           **A**     Good morning.

23           **Q**     Just to follow up on this advertising issue,  
24 you do agree with Commissioner Deason that -- let me  
25 strike that. Let me start over again.

1           You refer to a leaner, meaner competitor on  
2 Page 7 in your testimony, do you not?

3           A     Words to that effect.

4           Q     Yes. Now, that leaner, meaner competitor  
5 would include advertising costs in their campaign,  
6 would they not?

7           A     Yes.

8           Q     And there's nothing wrong with that, is  
9 there?

10          A     No.

11          Q     In fact, you know who the Lucky Dog Phone  
12 Company is, don't you?

13          A     Yes, I do.

14          Q     Are they incurring advertising expenses to  
15 enter a new market?

16          A     Yes.

17          Q     Are these advertising expenses higher than  
18 maybe an existing competitor's, per customer?

19          A     I don't know. I'm not privy to what's being  
20 spent on advertising. But I think the point is -- and  
21 I mentioned earlier -- that the issue here was not  
22 should there be any advertising at all.

23                 I removed advertising because neither of the  
24 companies was able to indicate what portion of that  
25 was truly being incurred today to provide local

1 advertising, and there was no effort to put together  
2 any studies to show what that level of advertising  
3 might be in the future.

4           What we're being asked to accept is that the  
5 level of advertising that's being incurred today is  
6 what it's going to be in the future for local.

7           Q     Okay. Let me take you back to your summary.  
8 I believe you've mentioned a big problem you found  
9 with the ILECs' numbers is that they were largely  
10 based on historical costs and not on a forward-looking  
11 competitive basis; is that correct?

12           A     Yes.

13           Q     Okay. So if there's something wrong with  
14 historical costs in any sense, why is it that the  
15 historical or current status of no local -- basic  
16 local service advertising is a problem?

17           A     Because of the way the companies have -- let  
18 me back up a minute. Because the companies first  
19 start with their operating expenses in total and then  
20 come up with factors to determine what piece of that  
21 should be included in local. And the factors that are  
22 being used are not -- do not indicate in any way  
23 whatsoever that they're related to what competition  
24 will drive.

25                     For example, you're with Sprint, and I can

1 tell you that based on the data request that Sprint  
2 filed, they developed a factor, and it says, let's  
3 say, 80% of marketing expenses should go to local, and  
4 they're based off of factors built off of what had  
5 historically been provided to the interstate for  
6 common line expenses.

7 In the past the FCC wanted to perpetuate  
8 subsidies that -- to local service, and so larger  
9 amounts of advertising were allocated to the FCC to  
10 the interstate jurisdiction and should have been; and  
11 they're using those same relationships to determine  
12 what part should go to local in the future.

13 There is no study, nothing has been put  
14 forward to indicate what level of the total expenses  
15 that are being incurred today would be reasonable as a  
16 portion of local advertising in the future. And my  
17 contention is that until that is done, then it  
18 shouldn't be considered at all.

19 Q Is it your policy that somehow -- well, let  
20 me step back for a second. Are you generally aware of  
21 the statute that gave rise to this proceeding?

22 A Yes.

23 Q The direction from the Legislature that the  
24 Commission determine the cost of basic local service  
25 and choose a cost model to do so?



1           A     Yes.

2           Q     Is it your contention that somehow that  
3 statute allocated a burden of proof to one proponent  
4 or the other?

5           MR. HATCH: I object. He's asking him for a  
6 legal conclusion regarding burden of proof.

7           MR. REHWINKEL: Well, if I might respond to  
8 that, Commissioner, Mr. Lerma's testimony urges a  
9 conclusory 30% network operating expense, 15% other  
10 common, or overhead adjustment based on the lack of --  
11 or his characterization of the lack of filings on  
12 behalf of the three companies, which seems to me to  
13 argue that there's a burden of proof that's not been  
14 met here, and I'm just trying to get to the underlying  
15 nature of his testimony and why he's suggesting that  
16 there ought to be such a disallowance.

17           COMMISSIONER DEASON: Objection is  
18 overruled. The witness may answer the question  
19 realizing he's not an attorney, but in the context of  
20 his testimony how the bill -- he considered the bill  
21 when he formulated his testimony.

22           WITNESS LERMA: When I considered my  
23 testimony, I do it primarily from the definition for  
24 basic local service. And the definition for basic  
25 local service included providing dial tone, 911, some

1 operator services, those types of services.

2 In that respect, as I stated previously,  
3 since you don't hear advertising for those types of  
4 services and there wasn't any studies presented  
5 indicating what costs were being incurred for those  
6 types of services, that was the basis for my  
7 conclusion.

8 Q (By Mr. Rehwinkel) So would an answer to  
9 my question, a more succinct one, be that there is no  
10 burden of proof allocated?

11 A I don't know the laws well enough to tell  
12 you whether there is any or not in there.

13 Q Fair enough. Let's talk about your  
14 definition of basic local service. You have stated --  
15 in fact, you use the term "basic local service" and  
16 "basic local universal service" in your testimony, do  
17 you not?

18 A Yes.

19 Q Is there any distinction between those two  
20 terms?

21 A I .

22 Q I'm looking on Page 9, Lines 13 through 15.

23 A Yes.

24 Q Do you equate basic local service with the  
25 service that would be supported by a universal service

1 mechanism?

2 A Yes.

3 Q So does your basic local service definition  
4 include or exclude vertical services?

5 A It excludes it. It's the definition that in  
6 the Florida statute says basic telecommunications  
7 service means voice grade, flat rate residential and  
8 flat rate, single-line, business local exchange  
9 services which provide dial tone, local usage  
10 necessary to place unlimited calls with local exchange  
11 area, multi-frequency dialing, and access to emergency  
12 911 directory assistance operator services.

13 Q Okay. And just one last question in this  
14 advertising area. I think you said in your summary  
15 that there's virtually no advertising expense for  
16 basic local service. Is it virtually none, or none?

17 A I said virtually.

18 Q So there may be some?

19 A Yes.

20 Q Okay. Ms. White asked you questions about  
21 what you are familiar with -- had you done any  
22 studies or analyses of productivity within BellSouth.  
23 Do you recall those questions?

24 A Yes.

25 Q Have you done any such with regard to

1 Sprint?

2 A No.

3 Q How about any technology improvements or  
4 advances with respect to Sprint? Have you done any?

5 A No. But if I may, one of the -- I wanted to  
6 do all those things. I asked a very extensive data  
7 request to Sprint for documentation backing up any  
8 possible adjustment that should be considered for  
9 things like productivity, natural storms, anything at  
10 all that should be adjusted or things that should be  
11 considered on a going-forward basis.

12 That information was not provided. I asked  
13 for it on August 11th and didn't receive it until  
14 October the 8th, way long after the 20 days that were  
15 allotted. I have very little with which to work with  
16 with Sprint.

17 Q Well, what you received, did you do an  
18 analysis of that?

19 A With respect to productivity, I did an  
20 analysis and, in fact, I provided that analysis in a  
21 data request to the Staff with regard to general  
22 administrative expenses.

23 I provided a trend of general administrative  
24 expenses for the five-year period from 1992 to 1997  
25 using ARMIS data that I used from publicly available

1 information, and it showed a consistent downward trend  
2 in unit costs for general administrative costs.

3 Q And you would agree, as Mr. Dickerson's  
4 testimony reflects, that there is a downward trend  
5 relative to the ARMIS data included in his  
6 forward-looking BCPM results?

7 A No, I do not.

8 Q You don't agree that there's a lower  
9 number -- amount of expense in his ARMIS data relative  
10 to the ARMIS --

11 A Yes. And I'm very glad that you brought  
12 that up, because that was very misleadingly presented  
13 yesterday. The numbers that he started with were the  
14 total ARMIS numbers that include costs for local,  
15 toll, and access. And he came up with his amount for  
16 total local costs using a percentage allocator which,  
17 as I said on October the 8th, we got information on  
18 how that allocator was determined.

19 That allocator was nothing more than the  
20 percentage allocator that's being used to determine  
21 the local piece of the total to the interstate today.  
22 There were no adjustments made to reduce -- in other  
23 words, he didn't start with local costs and reduce  
24 those costs, because he said going forward they're  
25 going to be lower. He started with total costs and

1 came up with local, and it's nothing more than coming  
2 up with the percentage that he believes is local.

3 He made no adjustments to reduce today's  
4 level of expenses based on downward trends,  
5 productivity, reengineering. That was very  
6 misleadingly presented.

7 Q Your standard that a leaner, meaner  
8 competitor would come in and provide the standard  
9 against which to base forward-looking costs, where is  
10 that competitor today?

11 A Where is that competitor today?

12 Q What is your example that you would have the  
13 Commission look at to determine that the appropriate  
14 costs are the ones that AT&T supports?

15 A I'm sorry. Rephrase that question again.

16 Q I'll withdraw the question.

17 MR. REHWINKEL: I have no further questions.

18 - - - - -

19 (Transcript continues in sequence in

20 Volume 25.)

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Page 2684

BEFORE THE  
FLORIDA PUBLIC SERVICE COMMISSION1  
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In the Matter of : DOCKET NO. 980686-TV  
Determination of the cost of :  
basic local telecommunications :  
service, pursuant to :  
Section 364.023, :  
Florida Statutes. :  
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VOLUME 24  
Pages 2684 through 2736

PROCEEDINGS: HEARING

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

DATE: Friday, October 16, 1998

TIME: Commenced at 9:05 a.m.

PLACE: Betty Easley Conference Center  
Room 148  
4075 Esplanade Way  
Tallahassee, FloridaREPORTED BY: H. RUTHIE POTAMI, CSR, RPR  
Official Commission Reporter

APPEARANCES:

(As heretofore noted.)

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