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BELLSOUTH TELECOMMUNICATIONS, INC.
DIRECT TESTIMONY OF WALTER S. REID
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 990649-TP
AUGUST 11, 1999

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

A. My name is Walter S. Reid and my business address is 675 West Peachtree Street N. E., Atlanta, Georgia. My position is Senior Director for the Finance Department of BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth", or "the Company").

Q. BRIEFLY OUTLINE YOUR EDUCATIONAL BACKGROUND AND BUSINESS EXPERIENCE IN THE TELECOMMUNICATIONS INDUSTRY.

A. I received bachelor and master of science degrees in industrial engineering in 1969 and 1971, respectively, from the Georgia Institute of Technology. I am a Certified Public Accountant (CPA) licensed in the state of Georgia, and am a member of the American Institute of CPAs. I was employed by BellSouth in November,

1 1971, as a management trainee in the Comptrollers Department in
2 Jacksonville, Florida. Since that time, I have held various positions
3 of increasing responsibility in the areas of budget and forecast
4 preparation, cost accounting, separations, and regulatory matters. I
5 was transferred to my current position at Company Headquarters in
6 October, 1987. Overall, I have over 27 years experience dealing
7 with the financial issues of the Company.

8

9 Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

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11 A. I am responsible for the preparation and analysis of the Company's
12 financial results, the provision of accounting and cost information
13 requested in proceedings before state and federal regulatory
14 commissions and the coordination of other regulatory activities
15 related to accounting and finance.

16

17 Q. HAVE YOU TESTIFIED PREVIOUSLY REGARDING FINANCIAL
18 ISSUES IN STATE REGULATORY PROCEEDINGS?

19

20 A. Yes. I have testified in Florida proceedings for many years.
21 Included among the dockets in which I have testified, are Dockets
22 Nos. 960757-TP, 960833-TP, and 960846-TP which dealt with the
23 appropriate unbundled network element (UNE) rates for BellSouth in
24 Florida. My testimony in these dockets related to the proper
25 amount of shared and common cost to include in UNE rates. I have

1 also testified in numerous regulatory proceedings in Alabama, South
2 Carolina, Georgia, Kentucky, Mississippi, North Carolina and
3 Tennessee.

4

5 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS
6 PROCEEDING?

7

8 A. The purpose of my testimony in this proceeding is to address the
9 appropriate methodology for including a reasonable amount of
10 forward-looking shared and common costs in BellSouth's Total
11 Service Long-Run Incremental Cost ("TSLRIC") plus Shared and
12 Common cost studies (BellSouth Cost Studies). In Order No.
13 PSC-96-1579-FOF-TP ("Order") issued December 31, 1996, the
14 Florida Public Service Commission stated, "Upon consideration of
15 the evidence in the record and based on the Act, we find it
16 appropriate to set permanent rates based on BellSouth's TSLRIC
17 cost studies. The rates are for the unbundled network elements we
18 consider to be technically feasible. The rates cover BellSouth's
19 TSLRIC cost and provide some contribution toward joint and
20 common costs." (Order at page 33). These guidelines were also
21 referred to in Order No. PSC-98-0604-FOF-TP issued April 29,
22 1998.

23

24 BellSouth's approach for treating shared and common costs consist
25 of a study which develops appropriate shared and common cost

1 factors for use in UNE rate calculations. BellSouth's methodology
2 which is being filed in this Docket has been modified from the
3 methodology which was filed in Dockets Nos. 960757-TP, 960833-
4 TP, and 960846-TP, to incorporate certain conclusions reached by
5 the Commission in Order No. PSC-98-0604-FOF-TP.

6

7 Q. PLEASE EXPLAIN THE MODIFICATIONS YOU HAVE MADE TO
8 BELLSOUTH'S METHODOLOGY SINCE IT WAS FILED IN DOCKETS
9 NOS. 960757-TP, 960833-TP AND 960846-TP.

10

11 A. The major modification which has been applied to BellSouth's
12 methodology for treating shared and common costs is the
13 recognition of the Commission's conclusion that shared costs
14 should be reflected by means of the shared cost factors and should
15 not be associated with labor rates. As noted in Order No. PSC-98-
16 0604-FOF-TP, page 63, this change in methodology merely shifts
17 the recovery of some of these costs from non-recurring rates to
18 recurring rates.

19

20 In addition to this change, BellSouth has identified the cost
21 associated with its Local Carrier Service Center (LCSC) and its
22 incremental Operational Support Systems which serve CLECs and
23 has excluded these amounts from its shared and common cost. Per
24 Order No. PSC-98-0604-FOF-TP, (Page 60), these costs should not
25 be included in UNE prices at this time. BellSouth believes that it

1 should be compensated for these costs and its decision to remove
2 them at this point in the methodology is based on the understanding
3 that recovery of these costs will be addressed in other proceedings.

4
5 Q. FROM A HIGH LEVEL PERSPECTIVE, CAN YOU BRIEFLY DESCRIBE
6 BELLSOUTH'S APPROACH FOR TREATING SHARED AND
7 COMMON COSTS AS A COMPONENT OF UNE RATES?

8
9 A. Yes. The ultimate objective of BellSouth's methodology, which I
10 have depicted on Exhibit WSR-1, pages 1 through 2, is to split the
11 Company's total forward-looking cost of business between its
12 wholesale and retail functions and to specifically identify three major
13 categories of wholesale costs: 1) wholesale direct costs; 2) the
14 portion of shared costs attributed to wholesale; and 3) a reasonable
15 portion of common costs applicable to wholesale operations. It is
16 further necessary to split category (1) above between those
17 wholesale costs that are related to recurring investment related
18 transactions (UNE related) and those that are related to "other
19 wholesale" transactions, such as non-recurring (e.g., service order
20 activities) or special purpose transactions (e.g., operator services).

21
22 Because the Uniform System of Accounts ("USOA") does not
23 uniquely identify these desired cost categories, a study was required
24 to determine the appropriate amounts to include in each category.
25 Fortunately, the BellSouth Cost Allocation Manual ("CAM") and the

1 reporting procedures which the Company follows to separate its
2 costs on a cost causative basis between regulated and non-
3 regulated costs provided a good model on which to base this study.
4 Therefore, the Company utilized the basic attribution principles of its
5 CAM, (with certain modifications to implement the Commission's
6 prior order), and the underlying cost pools and sub-pools which it
7 maintains for cost attribution purposes as the underlying
8 methodology for determining the desired breakdown of wholesale
9 costs into categories. The wholesale costs identified through this
10 process are the appropriate costs to apply to a cost methodology
11 that defines the cost for UNEs.

12
13 Once all of these costs are properly categorized, cost factors for use
14 in the BellSouth cost study can be developed. For instance, the
15 relationship between wholesale common costs and the total of
16 wholesale direct and wholesale shared costs yields the common
17 cost factor.

18
19 A second set of factors is derived by determining the relationship,
20 by investment type, between wholesale shared costs related to
21 investment accounts and the associated network investment.
22 These are the shared cost factors. Page 2 of WSR-1 illustrates this
23 calculation.

24
25

1 These two types of factors are used as inputs to the BellSouth cost
2 study development methodology described in BellSouth Witness
3 Daonne Caldwell's testimony. Application of these factors in the
4 cost development process allows BellSouth to associate a
5 reasonable amount of forward-looking shared and common costs
6 with each UNE.

7
8 Q. PLEASE DESCRIBE IN MORE DETAIL THE MECHANICS OF
9 BELLSOUTH'S PROCEDURE TO DETERMINE A REASONABLE
10 PORTION OF ITS FORWARD-LOOKING SHARED AND COMMON
11 COSTS FOR INCLUSION IN ITS COST STUDIES.

12
13 A. The starting point in the procedure is BellSouth's regional regulated
14 expenses and regulated average investment. This data is obtained
15 at a very detailed (cost pool and cost sub-pool) level from
16 BellSouth's financial system which applies the methods and
17 procedures described in the CAM. The primary goal of the CAM is
18 a reasonable, supportable apportionment of total costs between
19 regulated services and nonregulated activities. As a general rule,
20 this methodology for shared and common costs which I am
21 addressing in this proceeding follows the same attribution
22 procedures for the various accounts and cost pools as are identified
23 in the CAM for comparable accounts and cost pools. However, the
24 treatment of shared costs has been modified in order to incorporate

25

1 the Commission's decision that shared costs should not be
2 associated with labor rates.

3

4 Q. WHAT IS THE NEXT STEP IN BELLSOUTH'S METHODOLOGY?

5

6 A. The next step in the methodology is to develop a projection of
7 expenses and investments for three years into the future. This is
8 accomplished by normalizing the actual cost data for unusual events
9 and converting the normalized costs into forward-looking costs by
10 applying forecasted growth factors and, in the case of investment
11 accounts, factors which reflect the relationship of current cost to
12 original book cost. The application of these factors converts the
13 historical cost data into cost levels that are representative of the
14 forward-looking average costs for the future projected period.

15

16 In order to reflect the proper capital carrying costs for investment
17 accounts, annual cost factors are applied to the forward-looking
18 investment amounts. These annual cost factors include the cost of
19 money, income taxes, depreciation expense, and ad valorem taxes.

20

21 Q. HOW IS THE FORWARD-LOOKING FINANCIAL DATA ANALYZED?

22

23 A. BellSouth's study recognizes that total costs can be placed into four
24 clearly identifiable categories. First, there are the "direct wholesale
25 costs." These are the costs which are clearly and directly

1 assignable to the "wholesale" function. Costs of switches, for
2 example, would fit into this category. The wholesale direct costs
3 are further divided between those that are related to recurring
4 investment costs and those that are related to other wholesale
5 transactions such as non-recurring or special transactions. The
6 direct costs of providing telecommunications services, such as the
7 carrying cost on investment and plant specific expenses related to
8 the investment, are segregated by each specific investment
9 account.

10
11 Second, there are the "direct retail costs." These are the costs
12 which are clearly and directly assignable to the "retail" function. All
13 retail costs are excluded from the calculation of UNE costs.

14
15 Third, there are "shared costs." Shared costs are costs that are
16 incurred in the production of two or more products or services by
17 the same production process that do not span all activities of the
18 business. Typical shared costs include costs for items of general
19 support equipment, procurement, engineering expenses, etc.

20 Exhibit WSR-2 to my testimony provides a more detailed list of
21 typical shared costs.

22
23 Fourth, there are "common costs." Common costs are those costs
24 that generally span the activities of the business, and the products
25 and services it produces. These costs are not directly assignable to

1 one product or service, but are necessary for the operation of the
2 business as a whole. Typical common costs are items such as
3 accounting and finance costs, executive costs, etc. A more detailed
4 list of common costs is also shown on my Exhibit WSR-2.

5
6 Clearly, all of those costs which are applicable to the wholesale
7 function (direct costs, shared costs, and common costs) must be
8 recovered by UNE rates, while all of those costs applicable to the
9 retail function should be excluded. The difficulties are: (1)
10 separating the "shared costs" and the "common costs" between the
11 "wholesale" and "retail" functions; and (2) attributing the wholesale
12 shared costs to each network investment category.

13
14 Q. HOW HAS BELLSOUTH ACCOMPLISHED THIS SEPARATION OF
15 "SHARED COSTS" AND "COMMON COSTS"?

16
17 A. The process BellSouth has followed to reach this goal has two
18 fundamental steps. First, the "shared costs" are segregated into
19 cost pools similar to those utilized in the CAM. The costs
20 accumulated in these cost pools are attributed to "wholesale" and
21 "retail" functions as I will describe below.

22
23 In the second step, the "common costs" are apportioned between
24 "wholesale" and "retail" functions based on the relative proportion

25

1 of the direct and shared costs that have been assigned to these
2 functions.

3

4 Q. CAN YOU PROVIDE A MORE DETAILED EXPLANATION OF THE
5 FIRST FUNDAMENTAL STEP YOU MENTIONED ABOVE?

6

7 A. Yes. The costs which are treated as shared costs can be
8 segregated into cost pools because the historical data which was
9 obtained at the beginning of the process was collected at the cost
10 pool or cost sub-pool level. This detail was maintained as the
11 historical data was projected to forward-looking data. Therefore,
12 the forward-looking shared costs can be identified by cost pool.

13

14 Next, attribution factors, such as central office equipment ("COE")
15 investment percentages are developed. These factors are similar to
16 the attribution bases described in the CAM. BellSouth has made
17 modifications in its attribution process in order to implement the
18 Commission's conclusion that shared costs should not be
19 associated with labor rates. When the factors are applied to the
20 respective shared costs accumulated in the various cost pools, the
21 result, which takes more than one iteration, is the assignment of the
22 shared costs to either: 1) a related "wholesale" network investment
23 category (pair gain equipment, buried cable, etc.); 2) the "other
24 wholesale" category; or 3) the "retail" category. Shared costs
25 which are not assignable to one of these categories after two

1 iterations of the attribution process are treated as common costs.
2 Wholesale shared costs assigned to an investment category are
3 used to calculate the shared cost factor for that investment item. A
4 shared cost factor is the ratio of the shared cost assigned to a
5 particular type of investment divided by the projected average
6 investment.

7

8 Q. HOW ARE FORWARD-LOOKING COMMON COSTS TREATED IN
9 BELLSOUTH'S METHODOLOGY?

10

11 A. Forward-looking common costs are proportionally split between
12 wholesale common costs and retail common costs. The wholesale
13 common cost factor is then calculated as the ratio of total
14 wholesale common costs divided by the total of wholesale direct
15 costs and wholesale shared costs. This wholesale common cost
16 factor is an input in the development of the UNE costs as described
17 in Ms. Caldwell's testimony.

18

19 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

20

21 A. My testimony provides a reasonable and supportable method for
22 determining forward-looking shared and common costs attributable
23 to the provision of unbundled network elements. The outputs of
24 this methodology are a set of wholesale shared cost factors by
25 investment category and a common cost factor. These factors

1 represent the appropriate level of forward-looking shared and
2 common costs for inclusion in BellSouth's cost studies.

3

4 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

5

6 A. Yes.

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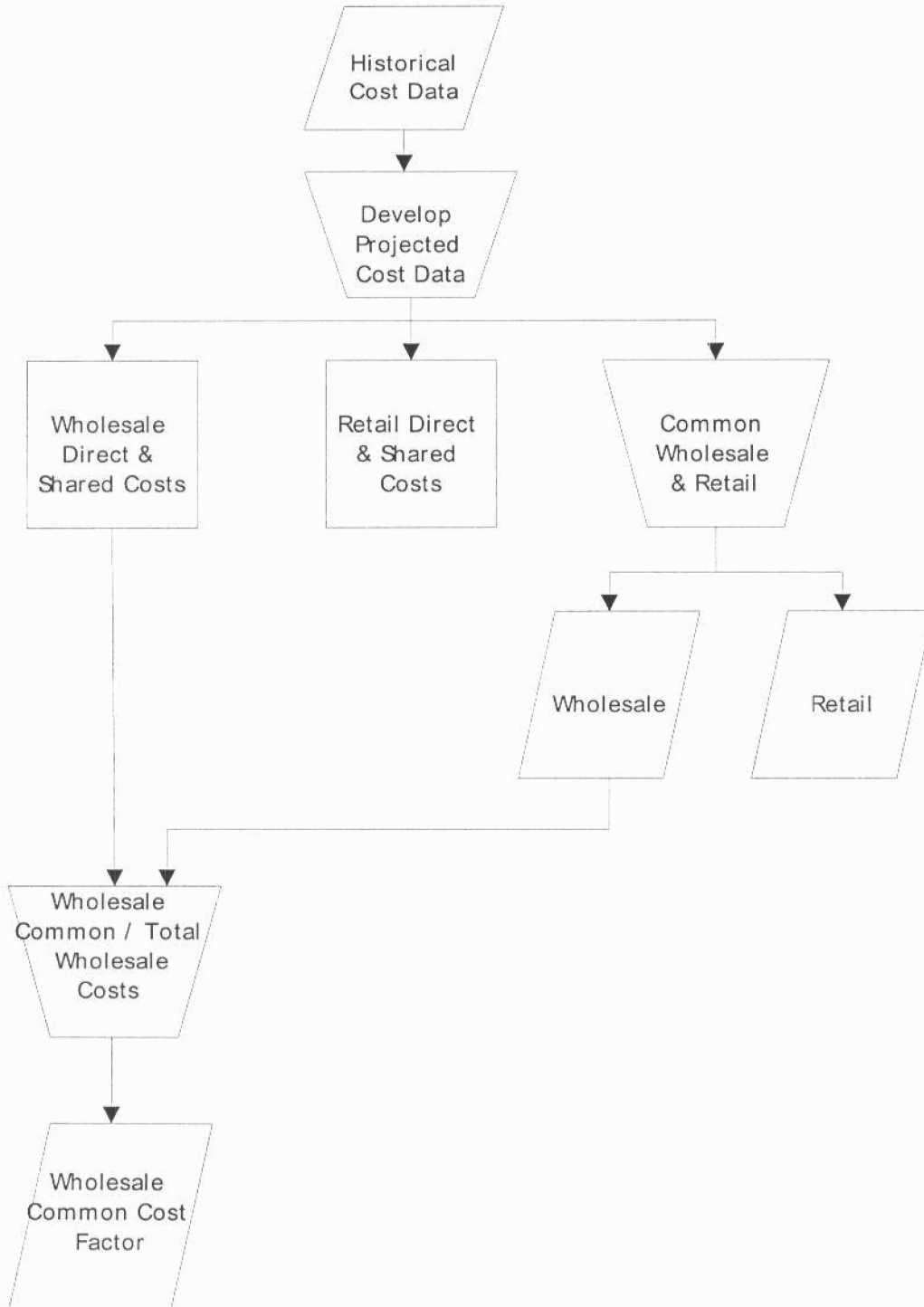
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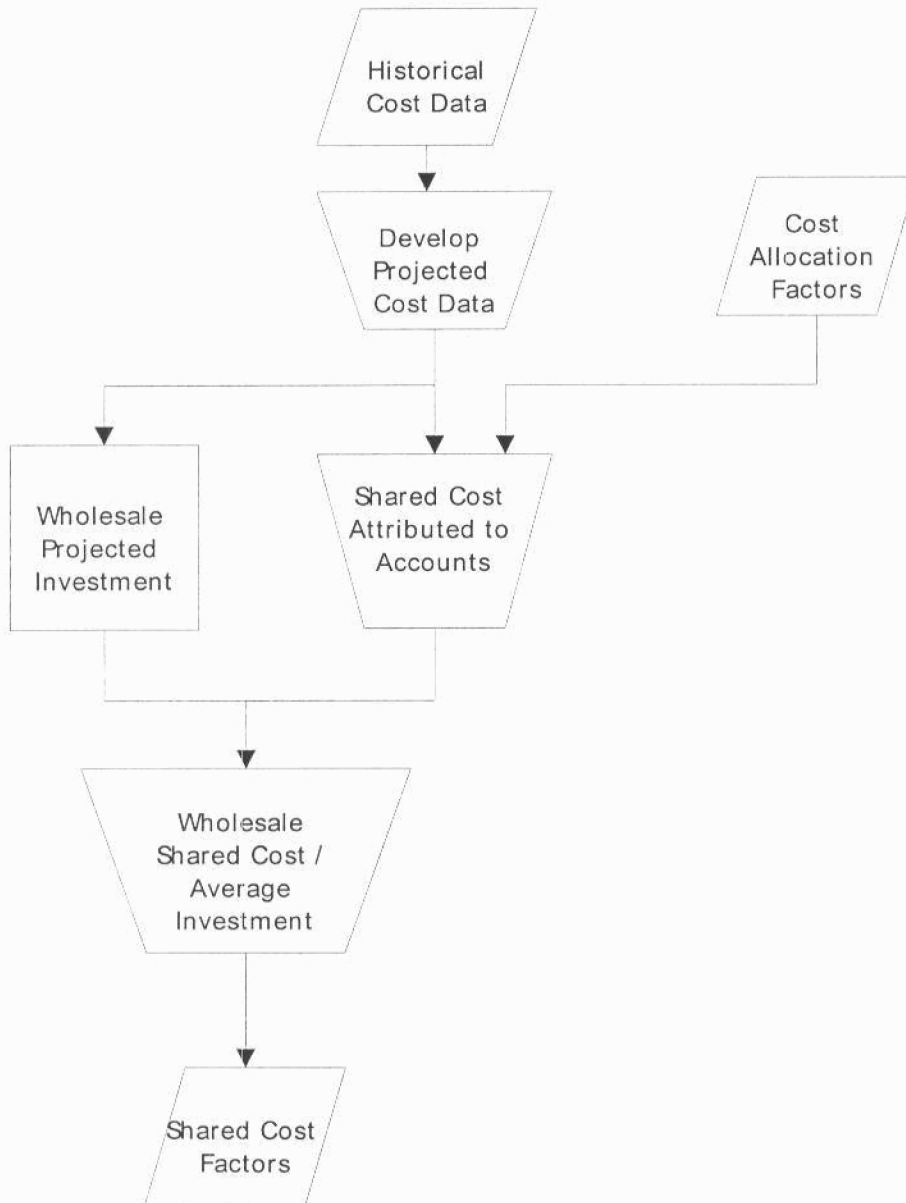
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BST's Methodology for Computing Common Cost Factor



BST's Methodology for Computing Shared Cost Factors



Typical Shared Costs

General Purpose Computers
Information Management
Plant Opns Admin Expenses
Engineering Expense
Land and Buildings (non COE)
Procurement
Network Administration Expenses
Inventories
Human Resources
Motor Vehicles
Office Equipment

Typical Common Costs

Other General and Admin Expenses
Accounting and Finance
External Relations
Executive (portion)
Planning
Plant Under Construction
Intangibles