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**BELLSOUTH TELECOMMUNICATIONS, INC.
DIRECT TESTIMONY OF WALTER S. REID
BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION
DOCKET NO. 990649-TP
MAY 1, 2000**

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 28 years experience dealing
7 with the financial issues of the Company.

8

9 Q. WHAT ARE YOUR CURRENT RESPONSIBILITIES?

10

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,
2 Georgia, Kentucky, Mississippi, North Carolina, South 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 Element Long Run Incremental Cost ("TELRIC") studies. The
12 inclusion of a reasonable amount of shared and common cost in the
13 economic cost of UNEs is consistent with past orders of the FCC
14 and the Florida Commission. The FCC's First Report and Order in
15 CC Docket Nos. 96-98 and 95-185, released on August 8, 1996,
16 outlined the FCC's TELRIC methodology and acknowledged that
17 prices for UNEs should include a reasonable allocation of forward-
18 looking joint and common cost (See paragraph 672 of the FCC's
19 Order). In Order No. PSC-96-1579-FOF-TP ("Order") issued
20 December 31, 1996, the Florida Public Service Commission stated,
21 "Upon consideration of the evidence in the record and based on the
22 Act, we find it appropriate to set permanent rates based on
23 BellSouth's TSLRIC cost studies. The rates are for the unbundled
24 network elements we consider to be technically feasible. The rates
25 cover BellSouth's TSLRIC cost and provide some contribution

1 toward joint and common costs." (Order at page 33). These
2 guidelines were also referred to in Order No. PSC-98-0604-FOF-TP
3 issued April 29, 1998.

4

5 BellSouth's approach for treating shared and common costs
6 consists of a study which develops appropriate shared and common
7 cost factors for use in UNE rate calculations. BellSouth's
8 methodology which is being filed in this Docket has been modified
9 from the methodology which was filed in Dockets Nos. 960757-TP,
10 960833-TP, and 960846-TP, to incorporate certain conclusions
11 reached by the Commission in Order No. PSC-98-0604-FOF-TP.

12

13 Q. PLEASE EXPLAIN THE MODIFICATIONS YOU HAVE MADE TO
14 BELL SOUTH'S METHODOLOGY SINCE IT WAS FILED IN DOCKETS
15 NOS. 960757-TP, 960833-TP AND 960846-TP.

16

17 A. The major modification which has been applied to BellSouth's
18 methodology for treating shared and common costs is the
19 recognition of the Commission's conclusion that shared costs
20 should be reflected by means of the shared cost factors and should
21 not be associated with labor rates. As noted in Order No. PSC-98-
22 0604-FOF-TP, page 63, this change in methodology merely shifts
23 the recovery of some of these costs from non-recurring rates to
24 recurring rates. This change in methodology eliminates a category
25 of factors included in BellSouth's previous study that was called the

1 "shared labor factors". The costs which previously would have
2 been assigned to non-recurring rates through these shared labor
3 factors are now included in the shared cost factors applied to
4 recurring UNEs.

5
6 In addition, other changes were made to refine the wholesale/retail
7 split of costs, to recognize certain right to use fees in the shared
8 and common cost process and, to recognize any changes in the
9 CAM or supporting information detail.

10
11 BellSouth did not change its methodology for treating costs
12 associated with its Local Carrier Service Center ("LCSC"). The
13 Company included the actual costs of its LCSC in serving CLECs in
14 the base year data included in the study and converted these into
15 forward-looking costs through its study methodology. These costs
16 are definitely wholesale in nature and should be included in a
17 TELRIC based study.

18
19 Q. HAS THE COMPANY PROVIDED ITS STUDY THAT DEVELOPS THE
20 SHARED AND COMMON COST FACTORS TO THE FLORIDA
21 PUBLIC SERVICE COMMISSION?

22
23 A. Yes. The Company provided the study that calculates the shared
24 and common cost factors as part of the data filed with its cost
25 studies on April 17, 2000. In addition, the Company filed its

1 supporting documentation on the shared and common cost study as
2 part of its cost support documentation.

3

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

7

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

20

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

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

11
12 Once all of these costs are properly categorized, cost factors for use
13 in the BellSouth cost study can be developed. For instance, the
14 relationship between wholesale common costs and the total of
15 wholesale direct and wholesale shared costs yields the common
16 cost factor. In this study, the common cost factor equals 6.24%
17 versus 5.30% in the previous study. Page 1 of WSR-1 outlines the
18 steps in the methodology used to calculate this factor. A summary
19 of the mathematical calculation is shown on WSR-4.

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

25

1 methodology and WSR-3 summarizes the calculation of the
2 individual shared cost factors for each investment category.

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

10

11 Q. PLEASE DESCRIBE IN MORE DETAIL THE MECHANICS OF
12 BELL SOUTH'S PROCEDURE TO DETERMINE A REASONABLE
13 PORTION OF ITS FORWARD-LOOKING SHARED AND COMMON
14 COSTS FOR INCLUSION IN ITS COST STUDIES.

15

16 A. The starting point in the procedure is BellSouth's 1998 regional
17 regulated expenses and regulated average investment. This data is
18 obtained at a very detailed (cost pool and cost sub-pool) level from
19 BellSouth's financial system which applies the methods and
20 procedures described in the CAM. The primary goal of the CAM is
21 a reasonable, supportable apportionment of total costs between
22 regulated services and nonregulated activities. As a general rule,
23 this methodology for shared and common costs which I am
24 addressing in this proceeding follows the same attribution
25 procedures for the various accounts and cost pools as are identified

1 in the CAM for comparable accounts and cost pools. However, the
2 treatment of shared costs has been modified in order to incorporate
3 the Commission's decision that shared costs should not be
4 associated with labor rates.

5

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

7

8 A. The next step in the methodology is to develop a projection of
9 expenses and investments for the years 1999-2002. This is
10 accomplished by normalizing the actual cost data for unusual events
11 and converting the normalized costs into forward-looking costs by
12 applying forecasted expense growth factors. In the case of
13 investment amounts, factors are applied to projected investment
14 which reflect the relationship of current cost to original book cost.
15 The application of these factors converts the historical cost data
16 into cost levels that are representative of the forward-looking
17 average costs for the future projected period.

18

19 In order to reflect the proper capital carrying costs for investment
20 accounts, *annual cost factors are applied to the forward-looking*
21 investment amounts. These annual cost factors include the cost of
22 money at 11.25%, income taxes, depreciation expense, and ad
23 valorem taxes.

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

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A. BellSouth's study recognizes that total costs can be placed into four clearly identifiable categories. First, there are the "direct wholesale costs." These are the costs which are clearly and directly assignable to the "wholesale" function. Costs of switches, for example, would fit into this category. The wholesale direct costs are further divided between those that are related to recurring investment costs and those that are related to other wholesale transactions such as non-recurring or special transactions. The direct costs of providing telecommunications services, such as the carrying cost on investment and plant specific expenses related to the investment, are segregated by each specific investment account.

Second, there are the "direct retail costs." These are the costs which are clearly and directly assignable to the "retail" function. Retail costs include marketing, billing, collection and other costs that will be avoided by the Company when it provides services at wholesale. All retail costs are excluded from the calculation of UNE costs.

Third, there are "shared costs." Shared costs are costs that are incurred in the production of two or more products or services by the same production process that do not span all activities of the business. Typical shared costs include costs for items of general

1 support equipment, procurement, engineering expenses, etc.
2 Exhibit WSR-2 to my testimony provides a more detailed list of
3 typical shared costs.

4
5 Fourth, there are "common costs." Common costs are those costs
6 that generally span the activities of the business, and the products
7 and services it produces. These costs are not directly assignable to
8 one product or service, but are necessary for the operation of the
9 business as a whole. Typical common costs are items such as
10 accounting and finance costs, executive costs, etc. A more detailed
11 list of common costs is also shown on my Exhibit WSR-2.

12
13 Clearly, all of those costs which are applicable to the wholesale
14 function (direct costs, shared costs, and common costs) must be
15 recovered by UNE rates, while all of those costs applicable to the
16 retail function should be excluded. The difficulties are: (1)
17 separating the "shared costs" and the "common costs" between the
18 "wholesale" and "retail" functions; and (2) attributing the wholesale
19 shared costs to each network investment category.

20
21 Q. HOW HAS BELLSOUTH ACCOMPLISHED THIS SEPARATION OF
22 "SHARED COSTS" AND "COMMON COSTS"?

23
24 A. The process BellSouth has followed to reach this goal has two
25 fundamental steps. First, the "shared costs" are segregated into

1 cost pools similar to those utilized in the CAM. The costs
2 accumulated in these cost pools are attributed to "wholesale" and
3 "retail" functions as I will describe below.

4

5 In the second step, the "common costs" are apportioned between
6 "wholesale" and "retail" functions based on the relative proportion
7 of the direct and shared costs that have been assigned to these
8 functions.

9

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

12

13 A. Yes. The costs which are treated as shared costs can be
14 segregated into cost pools because the historical data which was
15 obtained at the beginning of the process was collected at the cost
16 pool or cost sub-pool level. This detail was maintained as the
17 historical data was projected to forward-looking data. Therefore,
18 the forward-looking shared costs can be identified by cost pool.

19

20 Next, attribution factors, such as central office equipment ("COE")
21 investment percentages are developed. These factors are similar to
22 the attribution bases described in the CAM. BellSouth has made
23 modifications in its attribution process in order to implement the
24 Commission's conclusion that shared costs should not be
25 associated with labor rates. When the factors are applied to the

1 *respective shared costs accumulated in the various cost pools, the*
2 *result, which takes more than one iteration, is the assignment of the*
3 *shared costs to either: 1) a related "wholesale" network investment*
4 *category (pair gain equipment, buried cable, etc.); 2) the "other*
5 *wholesale" category; or 3) the "retail" category. Shared costs*
6 *which are not assignable to one of these categories after two*
7 *iterations of the attribution process are treated as common costs.*
8 Wholesale shared costs assigned to an investment category are
9 used to calculate the shared cost factor for that investment item. A
10 shared cost factor is the ratio of the shared cost assigned to a
11 particular type of investment divided by the projected average
12 investment.

13

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

16

17 A. Forward-looking common costs are proportionally split between
18 wholesale common costs and retail common costs. The wholesale
19 common cost factor is then calculated as the ratio of total
20 *wholesale common costs* divided by the total of wholesale direct
21 costs and wholesale shared costs. This wholesale common cost
22 factor is an input in the development of the UNE costs as described
23 in Ms. Caldwell's testimony.

24

25 Q. PLEASE SUMMARIZE YOUR TESTIMONY.

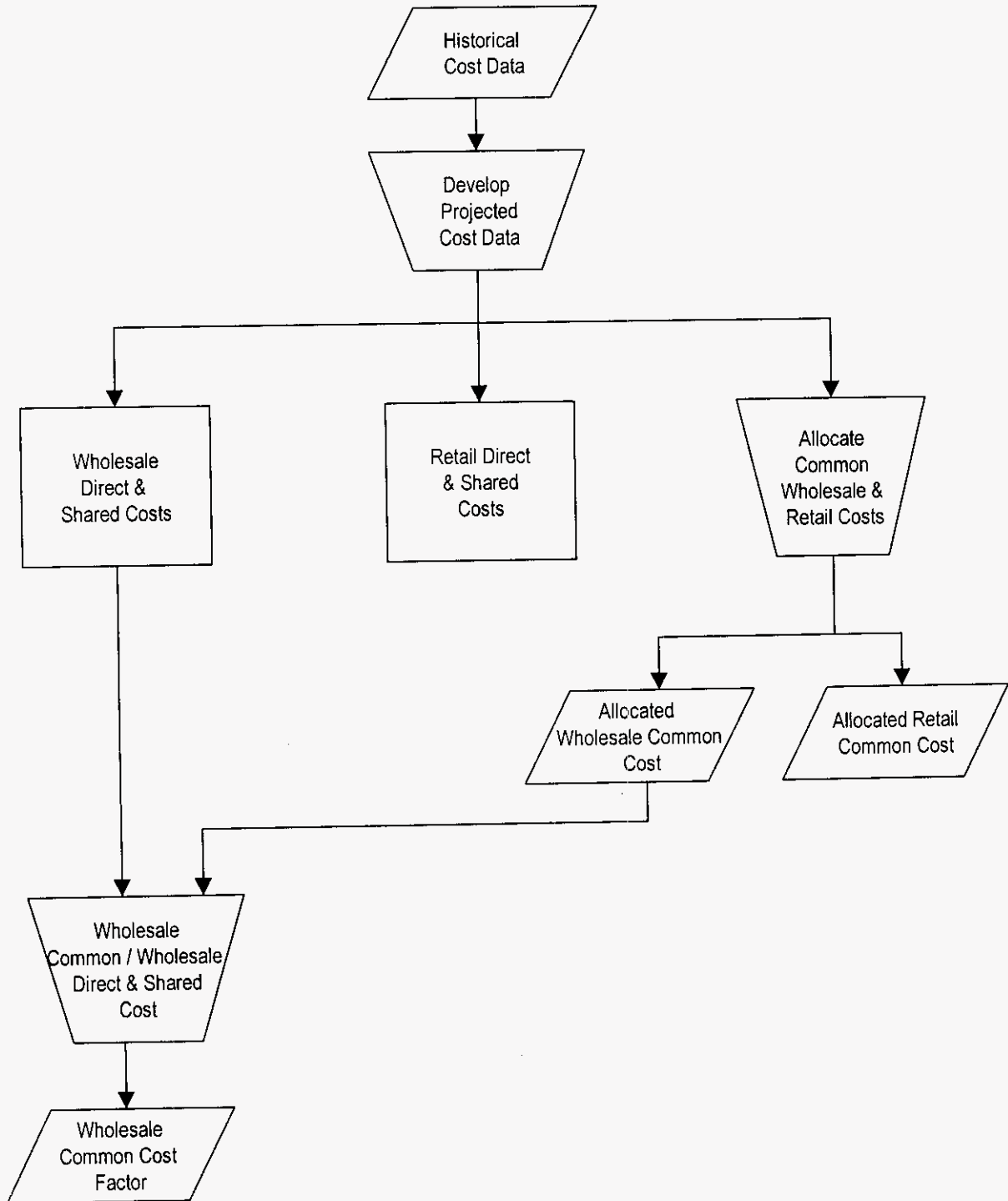
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A. My testimony provides a reasonable and supportable method for determining forward-looking shared and common costs attributable to the provision of unbundled network elements. The outputs of this methodology are a set of wholesale shared cost factors by investment category, as reported on my Exhibit WSR-3, and a wholesale common cost factor of 6.24%, as shown on Exhibit WSR-4. These factors represent the appropriate level of forward-looking shared and common costs for inclusion in BellSouth's cost studies.

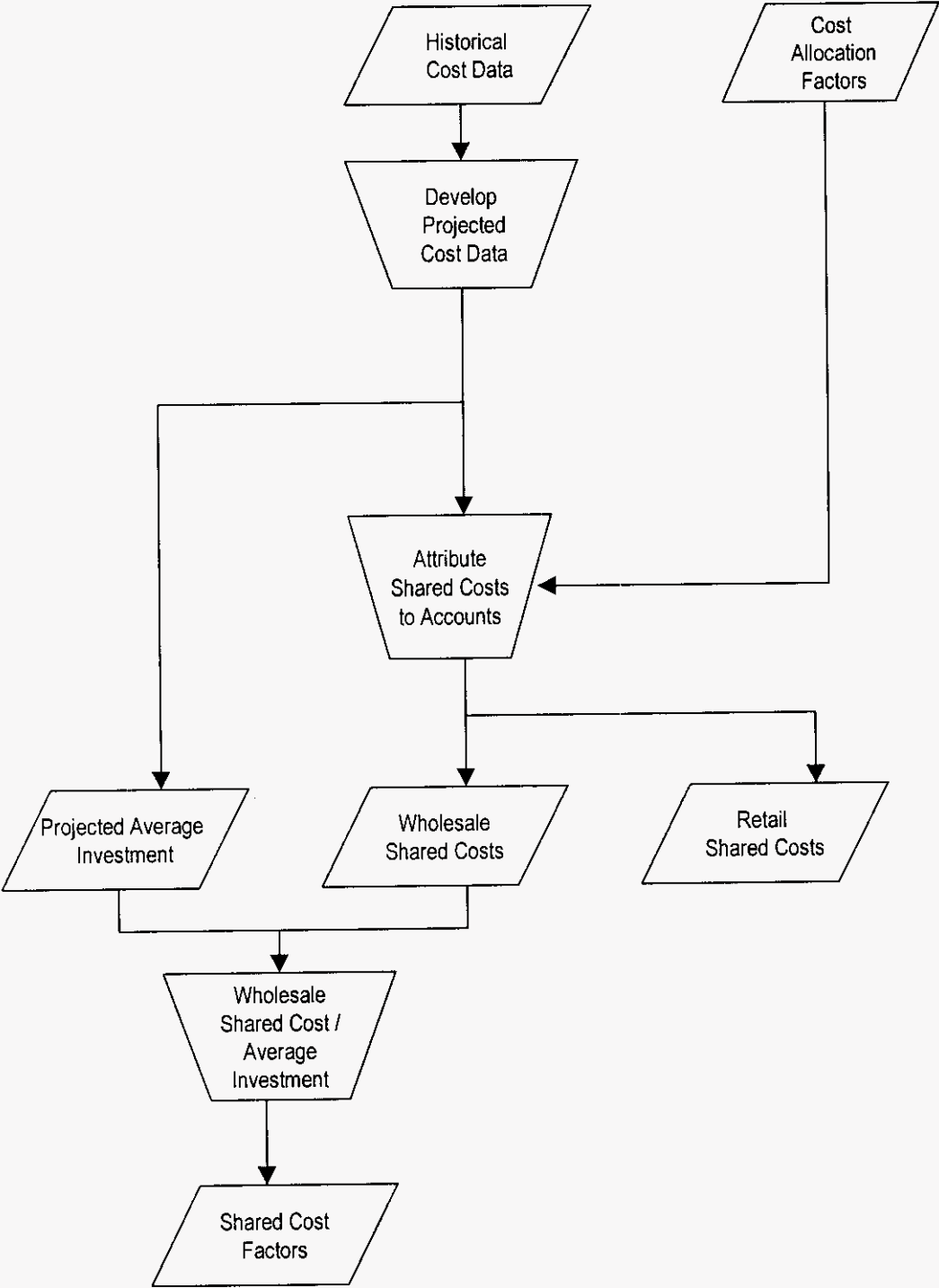
Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BST'S Methodology for Computing Common Cost Factor



BST'S Methodology for Computing Shared Cost Factor



Typical Shared Costs

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

Typical Common Costs

Other General and Admin Expenses
Accounting and Finance
External Relations
Executive (portion)
Planning
Information Management (portion)
Intangible (portion)

Shared Costs Factors

<u>Account</u>	<u>Description</u>	<u>Attributed Shared Cost</u>	<u>Projected Average Investment</u>	<u>Shared Cost Factors</u>
2121	Buildings	325,499	3,061,372,473	0.0001
2211	Analog Electronic Switching	85,611,434	1,348,225,722	0.0635
2212	Digital Electronic Switching	186,859,227	10,089,987,979	0.0185
2220	Operator Systems	3,662,964	165,279,934	0.0222
2231	Radio Systems	1,541,381	82,075,994	0.0188
2232	Circuit Equipment Analog Other	8,928,330	432,414,834	0.0206
2232	Circuit Equipment Analog Pair Gain	9,670	41,294	0.2342
2232	Circuit Equipment Digital Data Systems	1,984,374	97,269,967	0.0204
2232	Circuit Equipment Digital Pair Gain Sys	132,194,895	7,092,128,655	0.0186
2232	Circuit Equipment Digital Other	91,065,504	5,115,127,863	0.0178
2311	Station Apparatus	469,637	1,759,000	0.2670
2341	Large PBX	3,692,324	66,065,994	0.0559
2362	Other Terminal Equipment	72,979,440	390,006,924	0.1871
2411	Poles	33,342,254	2,429,174,194	0.0137
2421	Aerial Cable Metallic	216,137,690	7,820,868,107	0.0276
2421	Aerial Cable Non-Metallic	8,330,884	381,855,095	0.0218
2422	Underground Cable Metallic	72,101,236	3,782,127,112	0.0191
2422	Underground Cable Non-Metallic	10,870,512	616,675,853	0.0176
2423	Buried Cable Metallic	358,378,320	14,615,506,650	0.0245
2423	Buried Cable Non-Metallic	18,189,234	1,203,108,692	0.0151
2424	Submarine Cable Metallic	365,581	30,938,996	0.0118
2424	Submarine Cable Non-Metallic	89,971	7,504,999	0.0120
2426	Intrabuilding Cable Metallic	3,627,674	269,276,999	0.0135
2426	Intrabuilding Cable Non-Metallic	78,166	1,804,000	0.0433
2441	Conduit Systems	38,142,689	3,891,514,696	0.0098

WHOLESALE COMMON COST FACTOR CALCULATION

WHOLESALE	RETAIL	COMMON
<u>WHOLESALE (Direct and Shared Costs)</u> Directly Assigned and Attributed Costs (assigned to elements and functions) <p style="text-align: right;">16,326,981,305 A</p>		
<u>WHOLESALE (Common Costs)</u> Directly Assigned and Attributed Costs <p style="text-align: right;">327,911,922 B</p>	<u>RETAIL</u> Directly Assigned and Attributed Costs <p style="text-align: right;">2,101,175,176 G</p>	<u>COMMON (to be allocated)</u> <u>(WHOLESALE & RETAIL OPERATIONS)</u> <p style="text-align: right;">778,336,192 C</p>
<u>WHOLESALE (Common Costs)</u> Allocated Portion of Common Costs (A + B) / (A + B + G) * C <p style="text-align: right;">691,141,976 D</p>	<u>RETAIL (Common COSTS)</u> Allocated Portion of Common Costs G / (A + B + G) * C <p style="text-align: right;">87,194,216 H</p>	
<u>WHOLESALE TOTAL COMMON COSTS</u> (Direct plus Allocated Common Costs) B + D <p style="text-align: right;">1,019,053,898 E</p>	<u>RETAIL TOTAL COMMON COSTS</u> (Direct plus Allocated Common Costs) G + H <p style="text-align: right;">2,188,369,392 I</p>	
<u>WHOLESALE COMMON COSTS FACTOR</u> (Wholesale Total Common / Wholesale Direct and Shared Costs) E / A <p style="text-align: right;">6.24% F</p>		

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