

1                   **BELLSOUTH TELECOMMUNICATIONS, INC.**  
2                   **DIRECT TESTIMONY OF W. BERNARD SHELL**  
3                   **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**  
4                   **DOCKET NOS. 020119-TP and 020578-TP**  
5                   **OCTOBER 23, 2002**

6  
7 **Q. PLEASE STATE YOUR NAME, ADDRESS AND OCCUPATION.**

8  
9 A. My name is W. Bernard Shell. My business address is 675 W. Peachtree St., N.E.,  
10 Atlanta, Georgia. I am a Manager in the Finance Department of BellSouth  
11 Telecommunications, Inc. ("BellSouth"). My area of responsibility is the development of  
12 economic costs.

13  
14 **Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF YOUR EDUCATIONAL**  
15 **BACKGROUND AND WORK EXPERIENCE.**

16  
17 A. I attended Clemson University, graduating with a Bachelor of Science Degree in  
18 Electrical Engineering in 1981. I received a Masters Degree in Business Administration  
19 from Georgia State University in 1997.

20  
21 My career with BellSouth spans over twenty years. My initial employment was with  
22 Southern Bell in 1981, in Columbia, South Carolina in the Network Department as an  
23 Equipment Engineer. In that capacity, I was responsible for the ordering and installation  
24 of central office equipment. In 1984, I transferred to the Rates and Tariffs group in  
25 Atlanta, Georgia where I was either directly or indirectly responsible for the rates, costs,

1 tariffs, and implementation of services. During my time in that organization, I worked  
2 with many services/offerings, such as Local Exchange Service, Service Order Charges,  
3 Operator Services, Mobile Interconnection and Inside Wire. I moved to the  
4 Interconnection Marketing Unit in 1995, where I had various responsibilities, including  
5 negotiating with Alternative Local Exchange Companies (“ALECs”), developing pricing  
6 strategies, and product managing Collocation. In December 2000, I moved to a position  
7 in the cost organization, a part of the Finance Department. My current responsibilities  
8 include cost methodology development and implementation.

9

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

11

12 A. My testimony responds to issues 2(iv) and 2(v) regarding the January and June Key  
13 Customer offerings in Florida:

14 **Issue 2(iv) Is the BellSouth Key Customer tariff filing (Tariff**  
15 **Number T-020035)<sup>1</sup> unfair, anticompetitive, or**  
16 **discriminatory under the criteria, if any, established**  
17 **pursuant to Issues 2(i), 2(ii), and 2(iii)?**

18

19 **Issue 2(v) Is the BellSouth Key Customer tariff filing**  
20 **(Tariff Number T-020595<sup>2</sup> or a subsequent tariff filing**  
21 **that extends the expiration date thereof) unfair,**  
22 **anticompetitive, or discriminatory under the criteria, if**

23

24 \_\_\_\_\_  
25 <sup>1</sup> Throughout my testimony, I will refer to this offering as the “January Key Customer  
Offering.”

<sup>2</sup> Throughout my testimony, I will refer to this offering as the “June Key Customer Offering.”

1                    **any, established pursuant to Issues 2(i), 2(ii), and**  
2                    **2(iii)?**

3

4                    The purpose of my testimony is to explain the analysis BellSouth performed to support  
5                    the prices offered in the Key Customer offerings, including the methodology used to  
6                    produce the cost component of the analysis. This analysis proves that the January and  
7                    June Key Customer offerings result in BellSouth providing services at rates that are at or  
8                    above Total Service Long Run Incremental Cost (“TSLRIC”).

9

10 **Q. WHAT TYPE OF ANALYSIS DID BELL SOUTH PERFORM TO PROVE**  
11 **THAT THE JANUARY AND JUNE KEY CUSTOMER OFFERINGS**  
12 **RESULT IN BELL SOUTH PROVIDING SERVICES AT RATES THAT ARE**  
13 **AT OR ABOVE TSLRIC?**

14

15 A. The following analysis was performed for the January Key Customer offering which  
16 provided a maximum discount of 25% off the standard tariffed rates for Key-eligible  
17 services. BellSouth first evaluated the 1FB business service line (“1FB”) to ensure that it  
18 would be above cost in all rate groups when discounted at the maximum level. No  
19 features or other services were included in this test. The subscriber line charge (“SLC”)  
20 was added to the discounted tariff rate. The SLC recovers the interstate portion of the  
21 loop costs from an end user. The costs used for this test were the statewide average  
22 Unbundled Network Element (“UNE”) rates for the loop-port combination plus usage  
23 ordered by the Florida Public Service Commission (Order No. PSC-01-2051-FOF-  
24 TP, dated October 18, 2001) in Docket No. 990649-TP. These rates were based on  
25 Total Element Long Run Incremental Cost (“TELRIC”) methodology and used as a

1 surrogate for the 1FB cost. While the appropriate cost standard is TSLRIC, the  
2 statewide average UNE rates were used as a conservative approach. Given that  
3 TELRIC typically results in higher costs than TSLRIC for business service lines, this test  
4 proved that the discounted 1FB is above TSLRIC in all rate groups. A description of  
5 how TELRIC differs from TSLRIC is provided later in this testimony.

6

7 Next, BellSouth identified the rate elements or USOCs producing 99.9% of the revenue  
8 from retail customers matching the guidelines described in the testimony of BellSouth  
9 witness Steven Bigelow. The maximum discount for the January Key Customer offering  
10 of (25%) was applied to the prices of these individual rate elements. These discounted  
11 prices were then compared to the costs of the rate elements. TSLRIC was used for all  
12 rate elements except for the ones associated with business service lines where TELRIC  
13 was used. Based on this comparison, one of the following three scenarios could occur:

14

- 15 • If the cost does not exceed the discounted price, there is no need  
16 for further tests.
- 17 • If the cost exceeded the discounted price and if the rate element  
18 was a stand-alone service, customers with that service were not  
19 eligible for the January Key Customer offering, and while  
20 customers with that service could participate in the June Key  
21 Customer offering, the revenue from that service was not used to  
22 determine the customer's qualification for the June Key Customer  
23 offering and the customer did not receive June Key Customer  
24 discounts for that service.
- 25 • If the cost exceeded the discounted price and if the rate element

1 was not a stand-alone service, a typical configuration for the  
2 target market or a minimal configuration was developed to  
3 determine if the discounted price of the service in a typical or  
4 minimal configuration was above cost. If the price/cost test of  
5 this configuration showed the costs were greater than the  
6 discounted prices, customers with that service were not eligible  
7 for the January Key Customer offering, and while customers with  
8 that service could participate in the June Key Customer offering,  
9 the revenue from that service was not used to determine the  
10 customer's qualification for the June Key Customer offering and  
11 the customer did not receive June Key Customer discounts for  
12 that service.

13  
14 The above analysis proves that the January Key Customer offering results in BellSouth  
15 providing services at rates that are at or above TSLRIC. Moreover, if the January Key  
16 Customer offering, which has a maximum discount of 25%, results in discounted rates  
17 that are at or above TSLRIC, then clearly the June Key Customer offering, which has a  
18 lower maximum discount of 20%, also results in rates that are at or above TSLRIC.

19  
20 **Q. YOU MENTIONED THAT COSTS WERE PART OF THE ANALYSIS. HOW**  
21 **WERE THESE COSTS DERIVED?**

22  
23 A. BellSouth used existing cost studies originally conducted to support tariff filings in its  
24 analysis. The methodology that provides the foundation for these costs is TSLRIC  
25 methodology, except that, as explained above, UNE rates were used as a surrogate for

1 the business service lines.

2

3 **Q. PLEASE EXPLAIN TSLRIC METHODOLOGY IN MORE DETAIL.**

4

5 A. TSLRIC uses incremental costing techniques to appropriately identify the costs  
6 associated with providing services. Incremental cost methodology is based on cost  
7 causation and thus, only considers costs directly caused by expanding production of a  
8 service, or alternatively, costs saved by reducing production levels of a service. For  
9 TSLRIC, incremental cost is calculated for the entire volume of a service. Specifically,  
10 TSLRIC methodology considers all volume sensitive and volume insensitive costs  
11 directly caused by and associated with that service. Additionally, long run incremental  
12 cost studies (such as for TSLRIC) ensure that the time period studied is sufficient to  
13 capture all forward-looking costs affected by the business decision being studied. In  
14 other words, costs developed based on the TSLRIC methodology identify the  
15 economically proper lower bound for pricing a service (and the lower bound for the  
16 revenue produced by a service, when volume insensitive costs are included). Thus, rates  
17 set at or above TSLRIC prevent cross-subsidization.

18

19 **Q. HOW DOES THE TELRIC METHODOLOGY DIFFER FROM THE TSLRIC**  
20 **METHODOLOGY REFERENCED IN THE FLORIDA STATUTES?**

21

22 A. TELRIC methodology was defined by the Federal Communications Commission  
23 (“FCC”) in its Local Competition First Report and Order (FCC Order 96-352; CC  
24 Docket No. 96-98). From a cost methodology perspective, TELRIC methodology is  
25 similar to TSLRIC methodology; however, the cost object being studied is different.

1 TSLRIC is used for services while TELRIC is used for network components or  
2 elements. Under TELRIC, costs that are shared by a service may be direct to a network  
3 element. Additionally, TELRIC methodology allows a reasonable allocation of shared  
4 and common costs; costs that are excluded from a TSLRIC study. Thus, TELRIC  
5 typically results in higher costs than TSLRIC for business service lines. Therefore, if the  
6 Key Customer Promotion results in a positive margin using TELRIC for business service  
7 lines, it would result in a positive margin using TSLRIC.

8

9 **Q. PLEASE DESCRIBE THE 1FB ANALYSIS MENTIONED ABOVE IN MORE**  
10 **DETAIL.**

11

12 A. The 1FB analysis is attached to my testimony as Exhibit WBS-1. It shows the following:

- 13 • tariff rates by rate group
- 14 • tariff rates plus the subscriber line charge/end user common line charge
- 15 • the discounted revenue (discounting only the tariff rate)
- 16 • the TELRIC-based UNE rates as ordered by the Florida Commission on October  
17 18, 2001
- 18 • the absolute margin and the percent margin after the maximum January Key  
19 Customer discount of 25% is applied [as explained earlier, the June Key Customer  
20 offering provided a lower maximum discount of 20%]

21 This test proves that the discounted 1FB rate is above cost in all rate groups.

22 Additionally, since service order charges will be waived during the promotion, this exhibit  
23 also shows a per-month service order cost that would need to be considered in the  
24 analysis. Given that the margins are significantly more than this per-month cost, it is  
25 obvious that the discounted 1FB remains above cost.

1 **Q. PLEASE DESCRIBE THE INDIVIDUAL RATE ELEMENT TEST**  
2 **CONTAINED IN EXHIBIT WBS-2.**

3

4 A. For the individual rate element test, BellSouth applied the maximum January Key  
5 Customer discount of 25% to the prices of the individual rate elements that were  
6 identified in the process discussed in the testimony of BellSouth witness Steven Bigelow.  
7 These discounted prices were then compared to the costs of the rate elements. This can  
8 be seen on the first seven pages of Exhibit WBS-2, which are labeled SBS-FL. This  
9 spreadsheet shows the following:

10

- 11 • Column 1: the individual rate elements tested
- 12 • Column 2: a description of the rate elements
- 13 • Column 3: the quantity of rate elements in service
- 14 • Column 4: the monthly revenue associated with the rate elements
- 15 • Column 5: the type of rate used (tariff or calculated using revenue divided by  
16 quantity)
- 17 • Column 6: the recurring rate for the rate element
- 18 • Column 7: the nonrecurring cost for the rate element, if applicable
- 19 • Column 8: the recurring cost for the rate element
- 20 • Column 9: the percent margin for the rate element

21

22 Based on this comparison, if the discounted rate element price exceeded the rate element  
23 cost, no further testing was done for that rate element. It should be noted that this is a  
24 very conservative test in that it includes the service provisioning nonrecurring costs,  
25 where applicable, but it shows no nonrecurring charges. In reality, however, the service



1 provisioning nonrecurring charges were not waived, and BellSouth collected more  
2 revenue than shown in this analysis. If the service provisioning nonrecurring charges  
3 were included in the analysis, the positive margin would be even greater.

4  
5 If the comparison showed that the cost exceeded the discounted price and the rate  
6 element was a stand-alone service, customers with that service were not eligible for the  
7 January Key Customer offering, and while customers with that service could participate  
8 in the June Key Customer offering, the revenue from that service was not used to  
9 determine the customer's qualification for the June Key Customer offering and the  
10 customer did not receive June Key Customer discounts for that service.

11  
12 If the comparison showed that the cost exceeded the discounted price and the rate  
13 element was not a stand-alone service, a typical configuration for the target market or a  
14 minimal configuration was developed to determine if the discounted price of the service  
15 in a typical or minimal configuration was above cost.

16

17 **Q. PLEASE DESCRIBE THE CONFIGURATION TESTS CONTAINED IN**  
18 **EXHIBIT WBS-2.**

19

20 A. The configuration tests are shown on pages eight through seventeen of Exhibit WBS-2  
21 and are further described in the testimony of Mr. Steven Bigelow. This price/cost test  
22 was done when the discounted price of a rate element is below cost.

23

24 The price/cost test determines if the configuration utilizing these rate elements produces  
25 revenues greater than costs when using the Key Customer discount. As can be seen,

1 each of the configurations tested yields a positive margin.

2

3 **Q. WHAT CONCLUSION SHOULD BE MADE AFTER REVIEWING THE**  
4 **ANALYSIS?**

5

6 A. The January and June Key Customer offering result in BellSouth providing services at  
7 rates that are at or above TSLRIC.

8

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

10

11 A. Yes.

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BellSouth Telecommunications, Inc.  
Florida Public Service Commission  
Docket Nos. 020199-TP and 020578-TP  
Exhibit WBS-1

## **Public Disclosure Document**

BellSouth Telecommunications, Inc.  
Florida Public Service Commission  
Docket Nos. 020199-TP and 020578-TP  
Exhibit WBS-2

## **Public Disclosure Document**