BELLSOUTH TELECOMMUNICATIONS, INC.

BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 030851-TP

SUPPLEMENTAL TESTIMONY OF

DR. DEBRA J. ARON

FEBRUARY 23, 2004

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME.

A. My name is Debra J. Aron.

Q. ARE YOU THE SAME DEBRA J. ARON WHO FILED DIRECT, REBUTTAL, AND SURREBUTTAL TESTIMONY IN THIS PROCEEDING?

A. Yes, I am.

Q. WHY ARE YOU FILING SUPPLEMENTAL TESTIMONY?

A. My supplemental testimony rebuts the arguments made by Sprint's witnesses Dickerson and Londerholm filed on February 20, 2004 regarding certain inputs in the BACE model; specifically, OSS expenses and G&A assets.

Q. DID YOU PROVIDE THESE INPUTS TO THE BACE MODEL?

A. Yes, I did.

Q. DO YOU HAVE ANY PRELIMINARY COMMENTS ON SPRINT'S TESTIMONY REGARDING THESE INPUTS?

A. Yes. Sprint is incorrect in its criticisms, and I will respond to each specific criticism below. But I would like to also point out that these two inputs are very minor items in the overall model. Based on my knowledge of the model, neither of these inputs is key to the results, and either could be off by a significant factor and the results—the list of markets in which CLECs are unimpaired—would be unchanged. Sprint's testimony on these inputs strikes me as more of a diversion than substantive.

Q. PLEASE COMMENT ON MR. DICKERSON AND MS. LONDERHOLM'S CLAIM THAT THE OSS EXPENSES ARE "SEVERELY UNDERSTATED." (DICKERSON AND LONDERHOLM SUPPLEMENTAL TESTIMONY, 12.)

A. Given the parameter values for both OSS and G&A that I recommend, if anything, the BACE model over-accounts for OSS expenses. First, I have indicated in my earlier testimony, I developed the G&A expenses from a statistical evaluation of the ILEC experience. ILECs incur significant OSS costs related to loops and transport, which are already accounted for in the price of UNE-L, and for private line and special access services that the modeled CLEC does not offer, and I did not remove any of these (or any other) OSS-related expenses from the data that I used in my analysis. Accordingly, one should recognize that this alone accounts for OSS expenses, in particular, those expenses incurred on an ongoing basis to administer the OSS system. Second, we provide an up-front amount for the construction of an OSS system for the modeled CLEC.

The up-front amount was provided in an MCI *ex parte* to the FCC in the Triennial Review proceeding, which claimed that it required a $30 million one-time system-wide investment for the OSS system. The purpose of MCI's *ex parte* was to support MCI's claims of impairment in the TRO proceeding. The system was assumed to have a 7-year life. (WorldCom's January 8, 2003 *ex parte* in UNE Triennial Review CC Docket No. 01-338 Attachment A page 3.) We adopted the $30 million/7-year life assumption for use in the BACE model. However, this does not imply that the CLEC necessarily has to recover the costs of that OSS system from one market, or even from one state. MCI operates in virtually every state in

the US, and it one might reasonably assume that an efficient facilities-based CLEC might do so as well.

We assume that the CLEC that is being modeled will eventually have a national footprint, but that it does not enter every market at once. Instead, it spreads its entry over ten years to enter selected markets in all states. We implement this ten-year entry assumption by recognizing that, on average, the CLEC will enter a particular market five years after the OSS system is put into place. We do this by adding the "carrying cost" of the initial investment to the $30 million. (This means we install the OSS system in the year "-4" (or, in other words, 5 years before year 1) and then accrete this initial investment by the cost of capital for five years. In other words, after starting with MCI's $30 million estimate, we actually used a present value of approximately $50 million for the OSS system). I then computed the cost of replacing the OSS system in years 3 and 10, to reflect the 7-year life assumption. Because the BACE model does not provide for a way to model year "-4," I recomputed this particular pattern of cash flows so that, on a net present value basis, I got the same NPV from the expenditure of cash in years 1, and 7 (along with the appropriate terminal value). This total cost is then recovered proportionately from each state.

Q. SPRINT CLAIMS THAT ITS OWN OSS COSTS ARE SUBSTANTIALLY HIGHER THAN THE AMOUNTS DERIVED IN THIS MANNER.

(DICKERSON AND LONDERHOLM SUPPLEMENTAL TESTIMONY, 11.) PLEASE COMMENT.

A. Mr. Dickerson and Ms. Londerholm claim that Sprint has incurred more in software OSS costs than what MCI told the FCC would be representative of what a CLEC would incur to offer UNE-L services. However, these costs do not seem to be adjusted to remove right-to-use switching fees (which we capture elsewhere in the BACE model) and any of the information systems costs related to loop and transport, which would be captured by the UNE-L price for the switch-based CLEC in the BACE model. Mr. Dickerson and Ms. Londerholm also note that they considered the expensed software enhancements recorded in 2003. (Dickerson and Londerholm Supplemental Testimony 11.) Those expenses already are included in my G&A expenses, and are not appropriately double-counted in this portion of BACE. I would not necessarily conclude that MCI's estimate is representative of the costs that an efficient carrier could attain. However, MCI claims that they are tailored for a UNE-L provider, rather than a full facilities-based provider such as Sprint.

Q. MR. DICKERSON AND MS. LONDERHOLM ALSO CLAIM THAT THE CAPITAL EXPENDITURES RELATED TO G&A LIKEWISE ARE UNDERSTATED. (DICKERSON AND LONDERHOLM SUPPLEMENTAL

TESTIMONY 12-13.) DO YOU HAVE ANY OBSERVATIONS ON THEIR ANALYSIS?

A. Yes. Mr. Dickerson and Ms. Londerholm use Sprint - Florida as the benchmark for evaluating the Network and General support Assets for the CLEC in the BACE model. As I noted, Sprint is a facilities-based provider. As I understand that Sprint - Florida is basically the United Telephone of Florida, Central of Florida (See www.fcc.gov/wcb/armis/carrier_filing_ history/COSA_History/ucfl.htm). These companies have, and must support, outside plant (loops and transport) that the switch-based CLEC modeled in BACE would lease as UNEs. It is inappropriate to include the portion of Network and General Support Assets related to loops and transport that do not apply to a switch-based CLEC or the assets that are related to the plethora of private line and special access services that Sprint-Florida offers to its large customers, but that our CLEC does not. Mr. Dickerson and Ms. Londerholm do not say that they made any adjustment to the Sprint – Florida data to account for outside plant, and therefore there one cannot use their results to make any reasoned judgment about the Network and General Support Assets related to the efficient, switch-based CLEC.

Q. HOW DID YOU COMPUTE THIS CAPEX?

A. I computed this amount by dividing SG&A expenses (adjusted to reflect CLEC accounting practices, as I described in my Surrebuttal testimony) by total expenses, except for depreciation expense. (I included sales "S" with G&A, because sales may require some capital, as well.) This produced a ratio of 65.5 percent, based on an average of RBOCs (excluding Qwest, whose data was unavailable), as I will discuss below. I used this expense ratio to estimate the amount of capital that is related to SG&A (under the assumption that expenses generally follow investment and so the ratio of SG&A expenses to total expenses would be comparable to the ratio of SG&A-related capex to total capex). To derive the dollar amount of capital spending related to G&A, I multiplied this ratio by the amount of booked land and support plant additions for 2002 (summary account 2110, which includes accounts 2111-2114 and accounts 2121-2124) for the RBOCs (except for Qwest, which had not filed ARMIS when the computations were made). This produced a dollar amount of SG&A plant additions, which I then scaled by dividing by revenues. I obtained a ratio of 1.68 percent, which is the entry in the table.

Q. WHY IS THIS A REASONABLE APPROACH?

A. This approach is reasonable because it reflects the relative amount of capex that is made by carriers actually in the market, but it applies that ratio to the amount of total capital that would be invested by a UNE-L based CLEC. Hence, it is

consistent with the network investments appropriate to the business case being modeled.

Q. DOES THIS COMPLETE YOUR SUPPLEMENTAL TESTIMONY?

A. Yes.