

1 **BELLSOUTH TELECOMMUNICATIONS, INC.**
2 **DIRECT TESTIMONY OF W. BERNARD SHELL**
3 **BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION**
4 **DOCKET NO. 040353-TP**
5 **OCTOBER 14, 2004**
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. (hereinafter referred to as "BellSouth"). My area of
12 responsibility relates to the development of 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 two 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 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 Competitive Local Exchange Carriers ("CLECs"), 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. The purpose of my testimony is to show that BellSouth recovers its direct costs in
13 offering the PreferredPack Plan service and the corresponding non-telecom promotions
14 that are at issue in this proceeding.

15
16 *Issue 2(a): Based on the criteria identified in Issue 1, does BellSouth's*
17 *PreferredPack Plan and/or its related promotional offerings (i.e., the \$100 Cash*
18 *Back, waiver of the subscriber line connection charge, and the \$25 gift card) violate*
19 *364.01(4)(g), 364.051(5)(c), or 364.08 Florida Statutes?*

20
21 **Q. DOES THE PREFERREDPACK PLAN SERVICE RECOVER ITS COST?**

22
23 A. Yes. I will show that BellSouth recovers all of its direct costs with the PreferredPack
24 Plan service. In other words, I will show that this service combined with the subject

1 non-telecom promotions produces a positive margin (revenue less cost). The margin
2 analysis can be seen in Exhibit WBS-1.

3

4 **Q. BEFORE PRESENTING THE COSTS ASSOCIATED WITH THIS SERVICE,**
5 **PLEASE DESCRIBE THE MONTHLY PRICE CHARGED TO**
6 **PREFERREDPACK PLAN SERVICE CUSTOMERS.**

7

8 A. The current monthly price charged by BellSouth for the subject service is \$26.95 (see
9 General Subscriber Service Tariff Section A3.4.6) plus the subscriber line charge
10 (“SLC”) charge of \$6.50, for a total of \$33.45 a month. BellSouth applies these
11 charges to every PreferredPack Plan service customer, including those that are eligible to
12 receive and do actually receive all or part of the non-telecommunications promotions at
13 issue in this proceeding (e.g., waiver of the line installation charge and \$100 cash back
14 coupon). Hence, the SLC is an additional part of the monthly price of PreferredPack
15 Plan service that is paid by all BellSouth customers and is received and retained as
16 revenue by BellSouth. Moreover, the Commission has accepted the use of the SLC as a
17 price paid by consumers and as revenue for BellSouth.¹

18

19 **Q. HOW WAS THE DIRECT COST OF PREFERREDPACK PLAN SERVICE**
20 **DETERMINED CONSISTENTLY WITH SECTION 364.051(C) OF THE**
21 **FLORIDA STATUTE?**

22

¹ Florida Public Service Commission, Report on the Relationship of the Costs and Charges of Various Services Provided by Local Exchange Companies and Conclusions as to the Fair and Reasonable Florida Residential Basic Local Telecommunications Service Rate, February 1999 (“FPSC Report”).

1 A. First, BellSouth identified the components of PreferredPack Plan service, which include
2 a residential flat-rate local exchange service (loop-port combination and local usage),
3 various vertical services, and Privacy Director service. The total monthly direct cost of
4 PreferredPack Plan is the sum of the direct costs of these components. In addition to
5 this monthly cost, the nonrecurring costs of the subject promotions were calculated and
6 amortized over the average duration of the service life of each winback customer.

7

8 **Q. WHAT IS BELLSOUTH'S DIRECT COST FOR THE RESIDENTIAL FLAT-**
9 **RATE LOCAL EXCHANGE SERVICE COMPONENT OF**
10 **PREFERREDPACK PLAN SERVICE?**

11

12 A. BellSouth used the statewide average residential local exchange ("1FR") rate (including
13 the SLC) as a surrogate cost for the basic service component of PreferredPack Plan
14 service because the actual 1FR rates are below costs. In other words, PreferredPack
15 Plan service combines non-basic services with a basic exchange service whose
16 standalone price is regulated and set below its direct cost. The statewide average rate
17 was determined by dividing the total 1FR revenues in Florida by the total 1FR lines in
18 Florida as of April 2003. That number is **Begin Proprietary** [REDACTED] **End**
19 **Proprietary**. The \$6.50 SLC was added to this number because every customer that
20 has basic service is charged this price. Thus, BellSouth's total direct cost for the basic
21 service component is \$16.56. Ms. Blake will provide further rationale for the use of the
22 statewide average 1FR rate as surrogate cost.

23

24

25

1 **Q. WHAT IS THE DIRECT COST USED FOR THE VERTICAL FEATURES**
2 **AND PRIVACY DIRECTOR?**

3
4 A. The total service long run incremental cost ("TSLRIC") monthly costs for the non-basic
5 vertical features and Privacy Director service of the PreferredPack Plan is **Begin**
6 **Proprietary** [REDACTED] **End Proprietary**.² This calculation presumes that all PreferredPack
7 Plan customers receive every single vertical feature available with that service and thus is
8 probably overstated.

9
10 **Q. BASED ON THE ABOVE, WHAT IS THE TOTAL DIRECT MONTHLY**
11 **COST OF THE SERVICE COMPONENTS OF PREFERREDPACK PLAN?**

12
13 A. The direct monthly cost of the service components is **Begin Proprietary** [REDACTED] **End**
14 **Proprietary**. This is the sum of **Begin Proprietary** [REDACTED] **End**
15 **Proprietary**.

16
17 **Q. WHAT ARE THE NONRECURRING COSTS OF THE PROMOTIONS?**

18
19 A. The nonrecurring costs of the promotion are the cost of the Cash Back offer (\$100) and
20 the cost of the waived line connection charge.³ The nonrecurring TSLRIC associated

² In response to Supra's 2nd Request for Production dated June 25, 2004, Item Number 15, BellSouth made a scribner error on the costs for two of the features provided via PreferredPack Plan (Message Waiting Indication and Message Waiting Indication Audio/Visual). Correcting this error reduces the direct monthly cost by \$.02 to **Begin Proprietary** [REDACTED] **End Proprietary**.

³ The Gift Card is no longer offered.

1 with the line connection charge is **Begin Proprietary** [REDACTED] **End Proprietary**. The
2 nonrecurring costs of the \$100 Cash Back and the cost of the line connection charge
3 would have to be amortized and recovered over the average duration of the service life.
4 This is because BellSouth charges its customers a levelized price for every month of
5 service, and that price covers the properly amortized average cost of promotional offers
6 that BellSouth experiences over the expected duration of the customer relationship. The
7 average duration a winback customer stays with BellSouth is **Begin Proprietary** [REDACTED]
8 **End Proprietary** months. This number of months is calculated by first determining the
9 churn for winback customers. The churn was developed using July 2003 to August
10 2004 data. The number of region-wide subscribers to winback promotions was divided
11 into the number of disconnects from the same number of subscribers. Once the churn
12 was determined, the service life was calculated by simply taking the reciprocal of the
13 churn (e.g., if the churn is 2.0%, average customer life is 50 months or 1/.02).
14 Additionally, on average, only **Begin Proprietary** [REDACTED] **End Proprietary** percent of
15 eligible customers actually redeem Cash Back offers. This percentage was calculated,
16 using regional data, by dividing the total customers redeeming cash back or coupon
17 offers by the customers who purchased qualifying products from January 2004 to April
18 2004.

19

20 **Q. WHAT IS THE TOTAL NONRECURRING COST AND THE RESULTING**
21 **AMORTIZED MONTHLY COST ASSOCIATED WITH THE COST OF THE**
22 **PROMOTION?**

23

24 A. The total nonrecurring cost of the promotion is **Begin Proprietary** [REDACTED] **End**
25 **Proprietary**. This is the sum of the line connection charge cost and **Begin Proprietary**

1 **End Proprietary** of the \$100 Cash Back offer **Begin Proprietary**
2 **End Proprietary**. As stated above, only **Begin Proprietary** **End**
3 **Proprietary** of eligible customers actually redeem Cash Back offers, therefore, the
4 appropriate nonrecurring cost to apply across all Cash Back eligible customers is **Begin**
5 **Proprietary** **End Proprietary** of \$100.

6
7 The resulting monthly amortized cost is **Begin Proprietary** **End Proprietary**.
8 This is based on a principal of **Begin Proprietary** **End Proprietary**, an
9 amortization period of **Begin Proprietary** **End Proprietary** months, and an annual
10 discount rate of 11.25%.

11

12 **Q. WHAT IS THE TOTAL DIRECT MONTHLY COST INCLUDING THE**
13 **AMORTIZED NONRECURRING COSTS?**

14

15 A. The total monthly cost including the amortized amount is the sum of the direct monthly
16 cost of the service components **Begin Proprietary** **End Proprietary** and the
17 resulting monthly amortized cost **Begin Proprietary** **End Proprietary**, which is
18 **Begin Proprietary** **End Proprietary**.

19

20 **Q. PLEASE COMPARE THE TOTAL MONTHLY COST, INCLUDING THE**
21 **AMORTIZED NONRECURRING COST, WITH THE TOTAL MONTHLY**
22 **PRICE CHARGED TO PREFERREDPACK PLAN SERVICE CUSTOMERS.**

23

24 A. The total monthly price charged to PreferredPack Plan customers is greater than the total
25 monthly cost, including the amortized nonrecurring cost. As stated above, the total

1 monthly price is \$33.45. The total monthly cost is **Begin Proprietary** [REDACTED] **End**
2 **Proprietary**. Therefore, there is a significant positive margin of **Begin Proprietary**
3 [REDACTED] **End Proprietary**. (See Exhibit WBS-1)

4
5 **Q. HOW WOULD THE TOTAL MONTHLY COST OF PREFERREDPACK**
6 **PLAN DIFFER IF IMPUTATION HAD TO BE CONSIDERED?**

7
8 A. First, BellSouth believes that the direct cost as calculated above represents the proper
9 implementation of the price floor required in Section 364.051(5)(c). However, as set
10 forth in greater detail by Dr. Taylor, if the Commission decides that imputation of certain
11 costs has to be considered under Section 364.051(5)(c), there is only one component of
12 PreferredPack Plan service that could possibly be considered a monopoly component
13 and thus should be imputed to BellSouth's direct costs. This component is the access
14 line or loop portion of the local exchange service. The other components of the
15 PreferredPack Plan service can be self-supplied or can be obtained from non-BellSouth
16 sources. Therefore, instead of using the statewide average IFR rate as a surrogate cost
17 for local exchange service, the direct cost of the loop would be the state-wide average
18 TELRIC-based UNE-P loop (Element P.1.1) price. The cost of the other components
19 of local exchange service and the cost of the other services would be based on TSLRIC
20 as required by Section 364.051(5)(c).

21
22 The Florida state-wide average UNE-P loop price is **Begin Proprietary** [REDACTED] **End**
23 **Proprietary**. The average loop price was developed using the deaveraged zone-
24 specific loop prices established by the Commission in Docket No. 990649-TP and the
25 zone-specific line counts used in the same docket. In other words, the zone 1 lines were

1 multiplied by the zone 1 loop price, the zone 2 lines were multiplied by the zone 2 loop
2 price, and the zone 3 lines were multiplied by the zone 3 loop price. Then the sum of
3 these three products were divided by the total number of lines (i.e., sum of lines in the
4 three zones) to develop the state-wide average UNE-P loop price.

5
6 The TSLRIC of the non-monopoly components of local exchange service is **Begin**
7 **Proprietary** [REDACTED] **End Proprietary**. The non-monopoly components are the switch
8 port termination and switch usage. The switch port termination TSLRIC is **Begin**
9 **Proprietary** [REDACTED] **End Proprietary** and the TSLRIC of average usage is **Begin**
10 **Proprietary** [REDACTED] **End Proprietary**. The TSLRIC of the vertical features and Privacy
11 Director is **Begin Proprietary** [REDACTED] **End Proprietary**.

12
13 **Q. WHAT IS THE TOTAL DIRECT MONTHLY COST OF THE SERVICE**
14 **COMPONENTS OF PREFERREDPACK PLAN WITH IMPUTATION OF**
15 **THE LOOP UNE PRICE?**

16
17 A. The direct monthly cost of the service components is **Begin Proprietary** [REDACTED] **End**
18 **Proprietary**. This is the sum of **Begin Proprietary** [REDACTED] **End**
19 **Proprietary**.

20
21 **Q. WHAT IS THE TOTAL MONTHLY COST WITH IMPUTATION OF THE**
22 **LOOP PRICE AND INCLUDING THE AMORTIZED NONRECURRING**
23 **COSTS?**

24
25 A. The total monthly cost including the amortized amount is the sum of the direct monthly

1 cost of the service components **Begin Proprietary** [REDACTED] **End Proprietary** and the
2 resulting monthly amortized cost **Begin Proprietary** [REDACTED] **End Proprietary**, which is
3 **Begin Proprietary** [REDACTED] **End Proprietary**.

4
5 **Q. PLEASE COMPARE THE TOTAL MONTHLY COST, WITH IMPUTATION**
6 **OF THE LOOP PRICE AND INCLUDING THE AMORTIZED**
7 **NONRECURRING COST, WITH THE TOTAL MONTHLY PRICE**
8 **CHARGED TO PREFERREDPACK PLAN SERVICE CUSTOMERS.**

9
10 A. The total monthly price charged to PreferredPack Plan customers is greater than the total
11 monthly cost. As stated above, the total monthly price is \$33.45. The total monthly cost
12 is **Begin Proprietary** [REDACTED] **End Proprietary**. Therefore, there is a significant
13 positive margin of **Begin Proprietary** [REDACTED] **End Proprietary**. (See Exhibit WBS-1)

14
15
16
17 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

18
19 A. Yes.