BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

In the Matter of **Petition by Metropolitan Fiber Systems of Florida, Inc. for arbitration with BellSouth Telecommunications, Inc. concerning interconnection, rates, terms, and conditions, pursuant to the Federal Telecommunications Act of 1996.**	**DOCKET NO. 960757-TP**
Petition by AT&T Communications of the Southern States, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications Inc. concerning interconnection and resale under the Telecommunications Act of 1996.	**DOCKET NO. 960833-TP**
Petition by MCI Telecommunications Corporation and MCI Metro Access Transmission Services, Inc. for arbitration of certain terms and conditions of a proposed agreement with BellSouth Telecommunications, Inc. concerning interconnection and resale under the Telecommunications Act of 1996.	**DOCKET NO. 960846-TP**

FIRST DAY - MID-MORNING SESSION

VOLUME 2

Pages 155 through 241

PROCEEDINGS: **HEARING**

BEFORE: CHAIRMAN JULIA L. JOHNSON
COMMISSIONER J. TERRY DEASON
COMMISSIONER SUSAN F. CLARK
COMMISSIONER JOE GARCIA
COMMISSIONER E. LEON JACOBS, JR.

DATE: **Monday, January 26, 1998**

TIME: Commenced at 9:30 a.m.

PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida

REPORTED BY: JOY KELLY, CSR, RPR
Chief, Bureau of Reporting

APPEARANCES:

(As heretofore noted.)

WITNESSES - VOLUME 2

P R O C E E D I N G S

(Transcript follows in sequence from Volume 1.)

MR. LAMOUREUX: We're going to go ahead and go back on the record.

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ALPHONSO J. VARNER

continues his testimony under oath from Volume 1

CONTINUED CROSS EXAMINATION

BY MR. LAMOUREUX:

Q Mr. Varner, let me circle back to something for a moment, if I may.

As you understand the FCC rules, those rules define access to unbundled elements as an unbundled element as well?

A That's what I said, I was not sure. They define collocation as a means of access to unbundled network elements. But when they list the list of unbundled network elements under their rules, I didn't recall collocation being one of the ones they listed. They do define it as a means of access but I'm not clear whether they need to be a --

Q I didn't ask about collocation. What I was asking about was access to unbundled elements. As I understand the FCC rules, those define unbundled access to unbundled elements as an unbundled element; is that correct?

A I guess I'm a little bit confused by what you mean by "access." What they define as the unbundled element is the element itself; let's say, if you will, a loop. Okay. A loop on the network is an unbundled network. Obviously you have to have a way to get to that loop by itself separated from everything else in the network. If that's what you mean by access to the unbundled network element, then, yes, that's what they meant.

They also talked about ways by which you can get that loop to the other parties; collocation, for example. If that's what you mean by access to unbundled network elements, then that's the part that's not clear to me that they intended for that to be an unbundled network element.

Q Let me see if I can get at this a little more simply. I left an extra copy of your deposition transcript with you.

A Yes.

Q Could you turn to Page 26 of that for me?

A 26.

Q 26. (Witness complies.)

A Okay.

Q I'm looking at Lines 16 through 18 of that page. Now, is it correct, Mr. Varner, that in your deposition you said "As I understand it, in the FCC rules they have defined the access as an unbundled element as well."

A Yes. That's the same answer you looked at before. The answer says -- the question was "Well, do you consider collocation to be a UNE, unbundled network element?" My answer was "I believe it's been defined as one. It's really access to unbundled elements, and I believe, as I understand in the FCC rules, they define the access as an unbundled element as well." That's what I think to be the case. But, again, I'm not sure that that is the case, because of what I just explained earlier.

Q Is what you described as your understanding in your deposition still your understanding today?

A Yes, it is.

Q And we were talking about the pricing standards in the Act right before we broke. Do you have a copy of the Act with you?

A Yes, I do.

Q Okay. 252(d) is the pricing standard for interconnection and unbundled element; is that correct?

A Yes, it is.

Q Okay. And 252(d)(1) talks about establishing just and reasonable rates for network elements for purposes of (c)(3) of 251; is that right?

A I think it says (c)(2) and (c)(3) if I remember correctly. I'm still trying to find it. I believe I said (b)(5) earlier, but 252(d) too. Just a minute. Oh, I have it now. Yes, for purposes of Section (c)(2) and (c)(3).

Q Okay. So the pricing standards of 252(d) apply to 251(c)(2) and 251(c)(3), right?

A 252(d)(1) apply to those sections.

Q Okay. 251(c)(3) is the requirement to provide nondiscriminatory access to network elements, right?

A Yes, it is.

Q Okay. So the pricing standard of 252(d)(1) applies to prices for nondiscriminatory access to network elements, correct?

A Yes, just as I explained earlier. But that does not include collocation, which is 251(c)(6), which is separated from the unbundled access. They have a section in the Act called Unbundled Access 251(c)(3). Even though it says unbundled access, that's the section this applies to unbundled network elements. That's the section that requires us to make unbundled elements available.

There is another section that specifically applies to collocation separate from that, which is 251(c)(6), and the pricing standards in the Act -- those pricing standards do not apply to 251(c)(6)

Q Read me the language in the Act, Mr. Varner, that says the pricing standards in 252(d)(1) do not apply to collocation?

A Well, yes. It says on 252(d)(1) what sections it applies to and it lists them and it does not list (c)(6).

COMMISSIONER CLARK: Mr. Varner, can I ask the question a different way?

Is it appropriate to use the same pricing standards to establish the price for collocation? Shouldn't they be just and reasonable?

WITNESS VARNER: Yes. Just and reasonable does apply. That standard applies to collocation as well as the unbundled elements. The difference is the based-on cost standard. The just and reasonable standard is actually in 251(c)(3) where the unbundled elements are and in (c)(6).

COMMISSIONER CLARK: Is it your testimony that just and reasonable does not include the notion that it should be based on cost?

WITNESS VARNER: No, it's not. No, it's not. I'm simply pointing out the Act did not make that requirement.

COMMISSIONER CLARK: I'm just asking you from a commonsense point.

WITNESS VARNER: No, I do not.

COMMISSIONER CLARK: So you think just and reasonable does include that they ought to be based on cost.

WITNESS VARNER: Yes. When I say based on cost I don't mean set them equal to cost, but you ought to know what the costs are and establish your prices in relation to the cost.

COMMISSIONER CLARK: But that's your argument on all of the costs; it should be based on cost.

WITNESS VARNER: Yes.

COMMISSIONER CLARK: Okay. What I conclude from that is you would agree that the same standards for pricing collocation -- the same standards used for those specifically enumerated in the Act should also be applied to collocation.

WITNESS VARNER: Yes, if you could do it. Now, the one area where we can't do it is virtual collocation because we have the problem with the tariff being in effect.

COMMISSIONER CLARK: Well, is that an impossibility or simply a choice you all have made?

WITNESS VARNER: Again, subject to whether or not we can, in fact, have separate tariffs for each state, subject to whether that can be done or not, that would determine whether it's an impossibility or a choice. And I don't know the answer to that question.

COMMISSIONER CLARK: Okay.

Q **(By Mr. Lamoureux)** Let me see if I can sum up my questioning.

Would you agree with me, Mr. Varner, that there's nothing in the Act that specifically says that prices for collocation are exempt from the pricing standard of 252(d)(1)?

A Yes. 252(d)(1) lists the sections for which its applicable and collocation is not one of them.

Q But would be of the sections that is applicable is 251(c)(3), which is the requirement of providing access to unbundled elements?

A That's correct. But that's not the collocation section.

Q You do agree with me that collocation is means of providing access to unbundled elements, correct?

A And subject to the explanation I gave earlier, depending on how you define access, what I will typically think of as access, it is a way of getting access to unbundled network elements. But obviously the way the Act is set up, they are looking at it somewhat differently.

Q BellSouth intends to make physical collocation and virtual collocation available as a means of getting access to unbundled elements; isn't that correct?

A Yes. Again, subject to the way that I use the term.

Q You mentioned that the Florida BellSouth virtual collocation tariff was approved in 1994; is that correct?

A The FCC tariff.

Q Was that true for the Florida tariff as well?

A I don't recall for the Florida tariff what the date was.

Q Do you recall how -- within ballpark figures? Was it two, three, four years ago?

A It was around the same time. I can't

remember whether it was -- I believe it was shortly after the FCC.

Q Okay. BellSouth was rate-of-return regulated in Florida in 1994; is that correct?

A We were under an incentive sharing plan in 1994.

Q Would you agree with me that an incentive sharing plan is a form of rate based regulation?

A It has a lot of the features of rate based regulation but it departs somewhat from the norm with respect to rate base regulation, in that you have the sharing bands and so forth associated with it. It's certainly a form of rate base regulation.

Q Now, the prices that BellSouth is proposing for this proceeding are set forth in Exhibit AJV-1 to your testimony; is that right?

A Yes.

Q Could you turn to that exhibit for me for a moment? Just so I'm clear, we should be working off the revised Exhibit AJV-1 that came with your rebuttal testimony; is that right?

A Filed on December 9th. Yes.

Q Now, looking only at the loop and the port elements that are on their exhibit, BellSouth does not advocate setting prices for those loop and port elements at the TSLRIC of those elements; is that correct?

A That's correct.

Q BellSouth also does not advocate setting those prices at TSLRIC plus shared and common costs, correct?

A That's right.

Q Built into BellSouth's loop and port prices is an amount which you called this morning the residual recovery requirement?

A Yes.

Q Okay. So in the column to the right, under "proposed rates," where it says "recurring," the recurring rates for all of the loops and the ports under there include in them the residual recovery requirement?

A That's correct.

Q None of the rates proposed by BellSouth that are adopted by the Florida Commission as a result of the AT&T/BellSouth arbitration included a residual recovery component, did they?

A They could or they couldn't. You can't tell from the way that the rates were set. You mean the rate, the permanent rates? The rates other than the ones we're dealing with here?

Q That's right.

A Yes. You can't tell from that.

Q BellSouth, however, did not expressly advocate something called a residual recovery requirement during the AT&T/BellSouth arbitration in Florida, did it?

A That's correct. The way that the cost studies were done at that time, there was no way to identify and set that part out separately. We had some TSLRIC studies that were previously done on the methodology we previously used, and those were the studies that were presented.

So whatever those studies produced, those were the costs that the Commission had in front of them. And they set prices in that proceeding sometimes equal to those numbers, sometimes above those numbers, to generate a contribution.

Well, when they set a price above those numbers, that amount above a TSLRIC cost would be going towards the residual recovery requirement. We didn't expressly identify an amount for a residual recovery requirement because you couldn't, but they did set some prices about the TSLRIC.

Q Let me see if I understand that. Are you saying that any of the prices that came out of the

AT&T/BellSouth arbitration in Florida that were set higher than BellSouth's proposed TSLRIC would, by definition, include an amount for residual recovery?

A Yes, they would, to the extent that that item was applicable to that rate element. Take, for example, a loop. They set a loop price above the TSLRIC cost. That's a contribution, is what it's called. That's the amount above the cost that's called a contribution.

What the contribution does is the contribution goes to cover other costs. The first thing you cover, obviously, is common costs. Once common costs are covered, then the next thing you have to recover is you have to cover the residual recovery requirement. Now, if the price was set far enough above cost to cover all those costs, then the price would actually contain a profit. But since we did not identify how much the residual recovery requirement was -- wasn't able to -- all we know is that the price is above the incremental cost and it may very well be making a contribution towards the residual recovery requirement, but you can't tell because it wasn't separately identified.

Q Let me just work with a concrete example. If I go back to the arbitration and look at

BellSouth's TSLRIC studies for the 2-wire loop and I see that the proposed TSLRIC for the 2-wire loop was, say, $15, and the price for that loop was set at $18, you're telling me that that $3 difference would be contribution toward the residual recovery requirement?

A I'm telling you it's a contribution towards common costs, residual recovery requirement, and if, in fact, the extra $3 was sufficient to cover those costs, then it would actually also have a profit contained in it. But you can't tell how much is the common cost or how much is the residual recovery requirement using of that $3 because those items weren't separately identified. All you know is there's a $3 contribution going towards covering other costs of the firm.

Q Let me see if I can give this example. Let's say I figured out that the shared and common cost of that loop was $3. So then it would be the case that in that example there was no contribution towards the residual recovery requirement because the $3 covered only the shared and common cost?

A That's correct. But there is nothing in the proceeding that would allow you to be able to make that determination.

Q Did BellSouth propose separately, or

identify separately in that proceeding what its shared and common costs were for each of the elements?

A I don't remember.

Q Now, generally the way the residual recovery requirement works, if there was a percentage decrease for some reason in the TSLRIC for 2-wire ADSL loops, there would then be a corresponding increase in the residual recovery requirement so that BellSouth's proposed price would stay about the same. Isn't that correct?

A No.

Q Could you turn to your deposition for me. Page 94. Bottom of 93 and into 94. Looking at Lines 23, on Page 93, didn't you say if it was just a percentage type change of something, that would be generally what you could expect to happen?

A Yes, sir, I said that, and I'll go ahead and explain.

If you're just making a percentage-type change, you would expect for those to go in the same direction. And, in fact, as we've made the revisions to cost studies we've seen that happen. That as you reduce the TSLRIC, the residual recovery requirement goes up. But our experience has been is that they don't offset each other. They come reasonably close but they don't offset each other. And in some changes, such as the one we filed on December 9th, there's no relationship at all. It depends on what type of change is made in a TSLRIC study whether that -- you know, that relationship occurs or not.

Generally, that is the right -- that is the correct relationship; that when the TSLRIC goes down, the residual recovery requirements goes up. They don't off-set each other; they do move in that general direction, but there are some changes that are made wherein they don't do that.

Q Let me try and ask my question just a little bit differently then.

Generally, the way the residual recovery requirement works, there was a percentage decrease in the TSLRIC for a 2-wire ADSL loop, there would be an increase in the residual recovery requirement to account for the percentage decrease?

A Not to account for it entirely. What happens is that's the general direction in which they move.

Q And by general direction you mean as the TSLRIC were to go down, the residual recovery requirement would go up?

A Yes, generally. But as I said, we have had changes wherein there are exceptions to that, but more often than not that's the general direction that it follows.

Q And because of that, the price stays roughly the same, doesn't it?

A When that happens, that's correct. The price stays -- you know, the prices of some of those do, so if one goes down, the other goes up; the price only changes by the difference between the two.

Q So looking at your chart here, AJV-1, the TSLRIC that you have listed for the elements is pretty much irrelevant, isn't it, because the price is always going to be the same; when the TSLRIC goes down, the residual recovery requirement goes up?

A No, it's not irrelevant. What happens, as I said, for items other than the loops and the ports and virtual collocation, of course, because it's proposed at tariff rates, the prices we proposed are set equal to the TSLRIC plus an allocation of shared and common costs. So that is, in fact, a price there.

What it tells you for the loops and the ports is how much is included for the residual recovery requirement, which as you described in the previous proceeding, was something that was unknown. So now you can see how much the residual recovery requirement amount is for each of those items by knowing what the TSLRIC is.

Q But with respect to the loops and ports, BellSouth is not advocating setting prices at the TSLRIC, right?

A We're not setting -- advocating TSLRICs for any of them, loops and ports included.

Q For the loops and ports which have a residual recovery requirement, really the TSLRIC is pretty much irrelevant because all you ever look at is the price?

A No. As I said -- that's not the price, if that's what you mean by irrelevant. The price is what is shown in the recurring column. By looking at the price and comparing it to the column that says "TSLRIC plus shared and common" you can identify how much has been included for the residual recovery requirement.

For example, you look at the loop distribution, the rate is $12.57, the TSLRIC plus shared and common is $10.24, so it's about $2.30-some cents that's the residual recovery requirement.

Q BellSouth's objective in this proceeding is that all prices for unbundled network elements should be set at actual cost; is that correct?

A Yes.

Q Okay. Now, it's BellSouth's position that any kind of rule that price should equal any kind of a cost standard sets up a situation as unworkable?

A Yes.

Q Isn't that correct?

A Yes.

Q So by your own definition, BellSouth's position that all prices should be set at actual cost is unworkable, isn't it?

A No, it's not. What I was describing there is that if you establish as a policy matter that all of your prices are going to equal cost, for one thing, there's no way you can implement that in this proceeding, because we're only dealing with a few network elements.

Now, if you wanted to establish that for these items you want your prices to equal actual cost, then fine, yes, you can implement that. But establishing as a policy matter that all of my prices are going to be set equal to cost becomes unworkable for a number of reasons. One is you can't do it. Another reason is that it really doesn't make sense in a competitive marketplace to have that type of a rule because what it going to happen is the marketplace is going to help you make those decisions about what prices customers are willing to take.

So that's what I was getting at when I said establishing that as a rigid rule. If you want to establish it as as policy matter, it's going to be applied to everything; not just the few network elements that are in this proceeding.

Q Mr. Varner, wouldn't you agree with me that the objective that all prices should be set at actual cost is a cost rule or a cost standard?

A All prices?

Q Uh-huh?

A Yes, that would be a cost standard.

Q Okay.

A Or a pricing standard. It's not a cost standard; that would be a pricing standard.

Q Okay. Could you turn to Page 27 of your deposition, please. (Pause)

Q I'm looking at Line 15. Didn't you say in your definition "If you establish any kind of a rule that price is equal, should be equal, to any kind of a cost standard, if it's economic cost or any other cost standard, in all cases you set up a situation that's unworkable."

A That's right. That's exactly what I said and that's what I was explaining earlier.

Q And BellSouth's price cost standard in this case is that all prices should be set equal to actual cost?

A The pricing -- the pricing standard that we're using for the unbundled network elements -- and it's all unbundled network elements, is that the prices should be set equal to actual cost. We have not established, however, as a general pricing rule, that all of our prices should be set equal to actual costs. We know that that's impossible to do. But for these unbundled network elements, we've established that the prices should be as low as you would expect for them to be in a competitive marketplace, and as low as we could make them for -- consistent with sound business practices, and that is to set them equal to the actual cost of providing the elements. Those are the lowest prices that we could charge that would be sound business.

Q All of the prices on AJV-1 are set so as to allow BellSouth to recover its actual cost; is that correct?

A Yes. Except for the virtual collocation, of course, which is set equal to the tariff prices. And you can see the relationship to costs when you look at that. The costs are there and you can see some are higher, some are lower. As I said, the objective is to set them at equal actual cost, but virtual collocation exhibits a situation wherein trying to have that type of rule becomes unworkable.

Q Now, it's BellSouth's position that prices for unbundled elements should include the historical costs of unbundled elements with respect to the loops and ports; is that correct?

A Yes. Where historical costs, the residual recovery requirement is what I mean when I say historical costs.

Q Is there a difference of the residual recovery requirement and historic costs?

A No. I use them synonymously in my testimony.

Q The Act says nothing of recovery of historic cost specifically, does it?

A No, it doesn't. The Act doesn't specify any specific cost standard, but it clearly contemplates and mandates, I believe, the recovery of your actual costs.

Q Now, at Page 19 of your direct testimony you say that BellSouth is entitled to recover all of its actual costs of doing business.

A Yes.

Q Is that correct?
A Yes.
Q Can you point me to a decision by the Florida Public Service Commission that specifically says that BellSouth is entitled to recover its actual cost of doing business?
A Not offhand I can't.
Q Likewise, the Act says nothing specifically about recovery of the actual costs of doing business, does it?
A No, it does not. As I say, the Act does not -- doesn't talk about any specific cost standard. But what it does say is that the prices have to be just and reasonable. And it does make provisions for a profit. And you cannot have a profit until you first recover all of your actual costs. I think those two provisions of the Act clearly mandate that the prices at least cover actual cost.
Q But there's no rule, statute, decision that you're aware of that specifically says BellSouth is "entitled", as you used that word in your direct testimony, to recover its actual costs of doing business?
A Again, not that I can recall. Obviously when you were back under rate-of-return regulation

that's what the Commission was charged with doing back during that time. So I'm sure that those decisions would have that kind of language in it. But I couldn't -- couldn't point to anything specifically and say that that's what was there.

Q Now, as I understand your testimony, you believe that the phrase "based on cost" as it appears in the Act does not mean equal to cost; is that correct?

A That's correct.

Q But you do agree that incremental costs establishes a lower bound or floor which prices should not go below; is that correct?

A A form -- that's correct, a form of incremental cost; long run incremental cost would be the price floor.

Q So is it correct that under BellSouth's interpretation of the phrase "based on cost," any price that is greater than long run incremental cost is based on cost?

A Yes.

Q And did I hear you agree this morning that the prices that you have proposed for virtual collocation are also based on cost?

A Yes.

Q And some of those prices are actually below incremental cost; is that correct?

A Yes. They are below the current incremental cost. They were based on cost at the time they were filed. But obviously, over time, the cost of change for provisioning those, and the current prices, do not reflect the current cost of providing the virtual collocation. But they were based on cost at the time they were filed and approved.

Q So by BellSouth's standards any price, be it above cost or below cost, is a price based on cost; is that correct?

A No, that's not correct.

Q Now, either in your summary or in response to a question from one of the Commissioners this morning, I think I figured out that the residual recovery requirement, the RRR as we call it sometimes, is essentially an investment differential between the TSLRIC and actual cost. Would you agree with me on that?

A No, it's not an investment differential, it's a monthly cost differential. It takes the investment and converts it to a monthly cost. So it's not the investment itself, it's the depreciation expense and the return and the taxes associated with the investment.

Q But is the residual recovery requirement another way of saying that the TSLRIC price will not recover all of the investment that BellSouth has put into a particular element?

A Yes, that's the major thing, I believe, that gives rise to it, is that the TSLRIC plus shared and common, would not cover the actual costs of the equipment that we'll be using. Remember, when we do the TSLRIC studies we go out and we obviously use forward-looking technology practices and so forth. But we're actually going to be providing these services to AT&T and MCI for the next, roughly, 30 months. That's the only time period that these prices are good for; the remaining life of the agreement -- which, if I remember correctly, it was a three-year agreement, it's about six months old.

So the equipment we're actually going to be using to provision these elements to AT&T and MCI during that ensuing 30-month period may not reflect, you know -- those items, but that's the cost that we're going to incur to provision those items to you, and that's the cost that we're trying to recover.

Q All right. Let me see if I can ask a broader question. I heard you talk about residual recovery requirement and investment somewhat together in a earlier answer you gave this morning. All I want to know is what is the relationship between investment and the residual recovery requirement?

A That's the carrying charges on the difference in cost between what it would actually cost us to provision these elements to you, and the TSLRIC plus shared and common. What gives rise to that difference is investment.

Q Okay. So let's take, for example, the 2-wire ADSL loop.

A Yes.

Q By including the residual recovery requirement, are you saying there that the TSLRIC, plus the shared and common cost, if that were set as the price, that would not be sufficient to recover all of the investment that BellSouth has made in 2-wire ADSL loops?

A No. It would not be sufficient to recover the investments that we would be utilizing to provision ADSL loops to AT&T and MCI if they were to purchase them today, or, you know, the next year, couple years or so.

Q Okay. And as I understand it, the residual recovery requirement was proposed only for those elements where BellSouth had made a sufficient investment such that the TSLRIC, plus the shared and common costs, would be deficient to recover all of the costs for those elements?

A Could you repeat -- I didn't quite --

Q Sure.

A I didn't follow you all the way through that question.

Q The residual recovery requirement is not proposed for all unbundled elements?

A That's correct.

Q And it is proposed, as I understand it, only for those elements that have a sufficient investment component in the cost, such that the TSLRIC plus the shared and common costs would not be sufficient to recover all of the investment. Is that generally correct?

A That's generally the result. What we've done is we've identified those items wherein the actual cost is substantially higher than the TSLRIC plus shared and common. What makes the actual cost higher we found when we looked at that was the fact that there were large -- those items had large amounts of long-lived plant investment was what was causing the actual costs to be higher than the TSLRIC plus shared and common. So what you end up with is you end up with the residual recovery requirement being applied to those items that have substantial amounts of long plant investment in them, because that's what gives rise to the difference.

COMMISSIONER DEASON: Let me ask a question at this point, please. If that's the end result, why go through the exercise at all of doing a TSLRIC analysis?

WITNESS VARNER: A couple of reasons. One is that for items other than loops and ports, we look at -- TSLRIC seems to give you an amount that's pretty close to the actual cost. Once we determine what was causing the difference between actual cost and TSLRIC, for the remaining items we feel confident that you're getting a price based on -- if you use TSLRIC plus shared and common that allows you to recover your actual costs, or pretty close to it.

So it only became necessary to deal with this difference for those items that had that substantial difference. And we've also found that that varies by state. It's, at most, loops and ports. In some states it's only loops. So the reason for going through it is to determine where it is that you have the difference, and then to identify it so that you only apply it in the cases where it's significant.

Our objective is to really only deal with this item where it's significant; if it's not significant, it's not worth it to go through the exercise.

COMMISSIONER DEASON: But what you're telling me is you've done the analysis, and those situations where it doesn't materially differ from actual investment, you use that, you use TSLRIC, just not materially different.

WITNESS VARNER: Yes.

COMMISSIONER DEASON: In those situations where it's materially different, well, then you're going through an exercise to add an increment to add to the TSLRIC.

WITNESS VARNER: Okay.

COMMISSIONER DEASON: My question is for efficiency purposes, why not just do it actual investment, actual cost; do it and say, "This is the standard we're using."

WITNESS VARNER: Yes, I think I can answer that. I see the confusion there.

We did not do the actual cost study for every unbundled network element. We determined actual cost for -- I think the first ones we did were loops, and we had TELRIC actually was the cost that we had as the forward-looking cost. And we noticed that there was a difference. So then we started investigating why was there a difference? What's causing there to be a difference for this item. Then we determined -- that enabled us to determine that what's causing this is the investment. It's the amount of investment in the actual cost versus the forward-looking. But once we knew that then we knew that this is only going to be an issue in items that have significant amounts of investment. So it was just a matter of looking at the items and saying, "Okay, which of these have significant amounts of investment in it?" The ones that didn't, there was no need to even look at actual cost for. There were only, really, two that had significant amounts, and that was loops and ports. So those were really the only two that we looked at. We didn't go through and do them all and then decide that they were different.

COMMISSIONER JACOBS: May I ask a question? It's kind of following on Commissioner Deason's question. When you do that -- let me step back for a moment.

In the world prior to your doing this cost study for purposes of ALECs, you reached that point in your analysis, would there have been any consideration for how that loop would have been implemented? What would be the density? What would be the distribution of services on there? In other words, would there have been some kind of usage analysis done there?

WITNESS VARNER: The door closed and it cut out part of what -- the very last thing you said.

COMMISSIONER JACOBS: Would there have been any kind of a usage factor in that analysis?

WITNESS VARNER: No, not on loops. On loops -- when we develop a cost, if you will, for a loop, we're developing a cost of that pair of wires, if you will, that connects you from the wire center to the premises. And that pair of wires is used for a number of different things; a number of different types of calls and so forth. But it's still one pair of wires. And that's what we're developing the cost for. Now, what it is used for doesn't change the cost of establishing a pair of wires from that central office --

COMMISSIONER JACOBS: Because you do it --

WITNESS VARNER: -- to the premises.

COMMISSIONER JACOBS: I'm sorry, I interrupted you -- because you're doing it totally.

WITNESS VARNER: That's correct. And we're trying to recover the cost here of establishing that pair of wires, which is particularly important in unbundled network elements because that's what we're offering to an ALEC, a pair of wires. The ALEC determines how they are going to use that pair of wires. We don't have -- we can't have a different price based on them using it one way versus another way.

COMMISSIONER JACOBS: My question had more to do with the density of use more so than any particular type of use. What I'm driving at is -- I'll just leave it at that.

WITNESS VARNER: It sounds like what you're driving at is sort of the deaveraging question, am I correct on that?

COMMISSIONER JACOBS: That's why I backed away from that. I don't want that to -- come at its own time.

Q **(By Mr. Lamoureux)** Let me follow up with something you just said. You said you will offer CLECs a pair of wires and it's up to the CLECs to determine what they do with that pair of wires.

THE WITNESS: What use -- services they put over that pair of wires. For example, when you buy an unbundled loop from us, you determine what are the retail services; they go over that unbundled loop. We give you a, for example, 2-wire analog loop. That means any services that can utilize a 2-wire analog loop you would put over that 2-wire analog loop.

Q ADSL is a service, isn't it?

A Well, ADSL is a service and what we offer as an unbundled element is an unbundled loop that is capable of supporting ADSL service.

Q Fine. It's the same as a twisted pair copper wire, isn't it?

A No. It has different loop characteristics than, for example, a 2-wire analog loop. That's why it's a separate element. It's shorter in length. There's a limitation on -- and I can't remember the numbers. I think Mr. Baeza can probably tell you the exact technical parameters. But the length is shorter. You're limited about how long that loop can be. And I think it requires a larger size cable, a larger gauge cable than a regular 2-wire analog loop does.

Q Does 9,000 feet sound about the right distance?

A I can't remember whether nine was HDSL or ADSL. I think nine was HDSL, and ADSL, I believe, was 18; 16 or 18. But Mr. Baeza can tell you exactly.

Q Your testimony is that ADSL and HDSL loops are physically different than a 2-wire loop that would be used to provide plan old telephone service?

A The technical parameters for them are physically different; they have physically different technical parameters that apply to them.

Q Well, for other than the loops and ports on your exhibit, is the actual cost lower than the TSLRIC that BellSouth has calculated for those elements?

A For the ones other than those? No, we would expect it would be higher. We haven't calculated it. But we don't think it would be significantly different one way or the other. Because the thing that makes the difference is the amount of the long lived plant investment, and there isn't much of that in those other elements.

Q Now, looking at Page 2 of your exhibit there's no residual recovery requirement proposed for any features associated with the port.

A That's correct. Because there's no price proposal features.

Q Now, you have TSLRIC cost associated with each of those features?

A That's correct.

Q But you don't have a residual recovery requirement identified for any of the features?

A That's correct.

Q So I take it from your earlier explanation then that that must mean that BellSouth does not have a significant amount of investment in any of those individual features; is that correct?

A Well, we don't believe that there's a significant amount of long lived plant investment. But the reason you don't see -- there is another reason you don't see anything on here is that we're not proposing a price for features either. The only price being proposed is for the 4-wire analog port, including all of the features. And if you look at that price, what you have is the TSLRIC plus shared and common costs, which is the port with no features, plus all the features of $16.27, and a proposed rate of $17.32. So you have a residual recovery requirement of about $1 -- a little over -- about $1.15 or something like that. $1.05.

Q In order to get the price for the 4-wire analog port with all of the features, BellSouth calculated the cost for the port itself and the cost for each of the features and added them up to get a price for the port with all of the features, right?

A That's correct.

Q Okay. BellSouth calculated a residual recovery requirement for the port itself without any of the features?

A That's correct.

Q BellSouth has no residual recovery requirement associated with the features themselves?

A That's correct.

Q So I draw from that the conclusion that there is no substantial investment in the features?

A That's correct. It's principally processor time is what is included in the features.

Q Now, look at AJV-1, can you tell me what price AT&T will have to pay in order to collocate in a particular central office in Florida?

A I can't tell you in total. I can tell you the prices AT&T pays for the various piece-parts of the collocation arrangement that they may order. But the total price is going to depend on what that collocation arrangement is that AT&T orders.

Q Let me use a specific example. Let's say AT&T wants to collocate in BellSouth's central office in Tallahassee.

A You can't do that.

Q Let's try Miami. Is there a central office in downtown Miami?

A Hialeah.

Q I'm sorry, what?

A Hialeah.

Q Okay. Let's take that central office. Can you tell me, looking at AJV-1, how much AT&T will have to pay in order to collocate in that central office?

A Not without more information than that from AT&T I can't.

Q So there's no way to tell what the price would be for collocation in that central office?

A Oh, there is, but I need more information than what you just gave me.

Q What information do you need?

A Well, for example, I would need to know, first, how many square feet you wanted in the office; what type of equipment that you were planning to put into the office so I could determine whether or not there needed to be any additional heating and air conditioning work; whether we needed to extend the fire control systems in the office, or anything of that nature.

What happens is then someone would go to the Hialeah central office and determine what work needs to be done in that office in order to make whatever number square feet AT&T wanted available, and make that space suitable for containing the equipment that AT&T wanted to put in it.

For example, if AT&T came in and said "All right, I want hundred square feet in the Hialeah central office and I want a POT bay," then that's what I'm going to put in that space. Then we could send people to the Hialeah central office, they could look at what equipment is there, what space is available, and decide what work needs to be done and come back and quote AT&T a price for doing that. That's what the application fee under collocation is for; is for doing all of that work.

We would tell you that. And we'd also come back and then -- I don't know if I said this or not -- but we'd come back and tell you what it would cost to do that work.

Q Let's say I tell you, sitting here today, that AT&T wants to lease hundred square feet of that central office and wants to put in a 5ESS switch. Sitting here today, can you look at AJV-1 and tell me what the price for collocation would be in that central office?

A No. No, there's no way I can do that. That's what the application process is for. There's an application fee under physical collocation, that when you tell me that information -- which is typical of what a calculator would tell me -- then I would send somebody to that office, and say, okay, this is what AT&T wants to do. Now, what work needs to be done in that office in order to accommodate that?

They would go through that office and determine what work needs to be done. If you said it's a 5ESS switch, one of the first things they'd look at is whether or not you needed to increase the capacity of the ventilation systems, heating and air conditioning, because that would generate additional heat in the office.

Another thing they would look at, obviously, is whether the power plant in the office was sufficient to handle that additional power load. And if not, what needed to be added to the power plant. Whether the fire control systems in the office, once they determine what space -- where that space was going to be located, whether they had sprinklers or whether they needed to be extended over into that space in the event there was a fire.

So, making those determinations and identifying those specific details of what needs to be done is what is done as part of the application process. Once that is all done, then we come back and say, okay, you wanted to put this in the Hialeah office; this amount of space. This is what it would cost to make that space ready and capable of handling your request.

Q Okay. AJV-1 is BellSouth's proposed prices for this proceeding?

A That's correct.

Q Now, I want to make sure as I understand is there's no way I can look at AJV-1 and determine for any particular central office in Florida what the price AT&T would have to pay to purchase collocation in that central office?

A Well, you could if you were given enough information.

Q All right. If I gave you all of the information you just requested -- I haven't submitted an application, however.

A Okay. You have not submitted an application.

Q For our central office.

A All right.

Q I cannot look at AJV-1 and use that information to figure out what price BellSouth is going to charge me to purchase collocation in a particular central office?

A Oh, no, you can't. Because that's what the application does. Once you -- in order to determine what the cost of the collocation arrangement is, the types of things I just described, would have to be determined for the specific office that you wanted collocation in.

And the only way to determine that is that once you tell us, yes, I want -- you know -- or you could just come in and say, "I just want to know what the price is for collocation in that office." And you go through the application process. And we'll be able to tell you exactly what it is that -- what it would cost to make whatever space available and capable of handling whatever it is you wanted to do in that office. But that's what the application process is for.

Q Just so I'm clear, the beginning of your answer was you cannot determine what the price is prior to the application?

A Prior to the application, no, you can't; we can't either.

Q BellSouth has about 200 central offices in Florida; is that correct?

A Yes.

Q 197. Does that sound about right?

A That's the latest number I've heard.

Q Looking at Exhibit AJV-1, would you agree with me that if AT&T wanted or needed to purchase collocation -- I'm talking physical collocation -- in every BellSouth central office in Florida, that would cost AT&T no less than approximately $2 million?

A I don't know. I haven't done the arithmetic so I can't tell you.

Q Would you agree with me that for any particular central office, it's going to cost at least about $10,000 to get collocation in that central office, and that's just the addition of the application fee of little more than 7,000 and purchasing one cable, which is a little more than 2,000?

A That sounds about right.

Q So doing the math, about $10,000; multiplying that by about 200 central offices, if AT&T wanted or needed to buy physical collocation in every BellSouth central office, it would cost AT&T no less than $2 million to do that?

A If you wanted space in each and every central office in the state.

Q And once you add in the price of space preparation and other aspects of collocation, it frankly would be much more than that? Would you agree with me?

A Yes. If you want it in every office in the state but that's not typically what we found. People collocate in the office, they put their equipment in there and they serve, you know, customers throughout a pretty broad geographic area. We haven't had a request for every office in the state.

Q Now, these are just the up-front costs for collocation. Right? What needs to be paid before you ever even move into the space?

A When you say "up front" you're talking about the application and the space preparation?

Q Right.

A Yes. Those are the nonrecurring costs.

Q Now, in addition to those, assuming I buy a hundred square feet collocation space in each office -- again this is a hypothetical -- I'll have to pay $148 per month per central office, or nearly $30,000 for the entire state; is that right?

A 149.18 is what I have.

Q I rounded that to 150 and multiplied it by --

A Great.

Q -- 200 and got about $30,000 per month.

A Per month for the space rental, yes.

Q Now, one of the reasons you can't tell me what the price would be for collocation for any particular central office is that the BellSouth proposed price for space preparation is calculated on what's called an individual case basis; is that correct?

A No, that's not the reason I can't tell you the price. The reason I can't tell you the price is because each office that has to be looked at individually to make a determination of what work has to be done. That work is, in fact, what you pay for in the space preparation.

Space preparation is on an individual case basis because of the fact that each office, the requirements and the work that has to be done in each office has to be determined specifically for that office and for the collocator's needs. What type of equipment the collocator wants to put in that office.

Q The price listed on your price chart for space preparation as ICB?

A Yes, individual case basis.

Q So you won't know the price for space preparation until after you submit the application, after BellSouth looks at the central office and tells

AT&T, "We've looked at the central office; this is how much it's going to be for space preparation."

A Yes.

Q Okay. And AT&T wouldn't know what the price is for space preparation for a particular central office until after AT&T pays the application fee.

A That's when we quote you a firm price.

Q That's after AT&T pays the fee?

A Yes.

Q -- for the application.

A That's the only way we can determine that. The only way we can determine what it costs to actually do this is to go through the application process. I mean, the cost, that's $7,000 in cost in the application process. The reason for that is that's the cost of us going out to the office and making the determination of what all it takes in order to make that space capable and available for you to use.

If you use an analogy to a home builder, that's the cost you pay for the blueprints. You go to a contractor and you say, "Okay, I want a house." And you give him a general description of what you want and he comes back and gives you a set of blueprints. That's essentially the costs you would have paid --

analogous to the cost you would have paid the home builder to come up and put together that set of blueprints for the house.

Q So for a particular central office, let's say because BellSouth has to rip out all of the air conditioning system, move around a bunch of walls, make the space Americans With Disabilities Act compliant, a whole host of things it has to do. The space preparation, let's say it was $300,000, just as a hypothetical. AT&T wouldn't know that that's the price BellSouth wanted to charge for space preparation until after AT&T paid the more than $7,000 application fee for that space, right?

A If that's what it turned out to be. But you included some things in there that would not be in space preparation. For example, making it consistent with American -- with the ADA. We have to do that anyway. All of our buildings have to be ADA compliant anyhow. So that would not be a part of space preparation.

Q Let's clean up my example. Let's say for whatever reason the space preparation fee that BellSouth wants to charge is $300,000 for a particular central office. AT&T won't know that that's the price BellSouth intends to charge for space preparation until after AT&T pays the more than $7,000 application to fee for collocation for that central office?

A That's correct. Because BellSouth has no way of being able to tell you that until it does the work that the application fee applies for. It has to do the work that is covered by the application fee charged in order to be able to come back and tell you that that's what it's going to cost to do this. To say it on the home builder's analogy, the home builder can't tell you how much it's going to cost to build the house until he's designed it, comes up with the blueprints and knows what the house is supposed to look like. Then he can tell you what it's going to cost him to build it.

Q Going back to my hypothetical for the entire state, again if AT&T wanted or needed to physically collocate in every BellSouth central office in Florida, it would have to pay BellSouth about $1.4 million in application fees before it could ever find out what price BellSouth wants to charge for space preparation for those central offices; is that correct?

A There's 7,000 times about 200 -- if you wanted to know get a firm price on collocation for every item, for every office, then, yes, that's what you would pay. You'd get more than that. Obviously the space preparation, that would be the cost for that collocation arrangement; space preparation, cabling and everything else that went with it. But space preparation would be a part of it to the extent there was any.

Q Do you know, does BellSouth customarily charge an application fee to end-user customers to prepare an individual case basis proposal, for example, large control systems?

A For -- I'm not -- I'm not familiar with what you're talking about.

Q For an end user customer, and it wants a particular system set up by BellSouth, telecommunications system. And BellSouth is going to price that on an individual case basis, does BellSouth typically charge that end user an application fee?

A I'm going to have to search my memory because it's been a while since I dealt with that. But when we give a firm quote on something like a special assembly, for example, we do charge for a firm quote.

Q Last question, Mr. Varner. Would you agree with me that competition in the local exchange market will benefit all consumers of local exchange services?

A I hope it will.

Q Do you think it will?

A I believe it will. I think it will.

MR. LAMOUREUX: I have no further questions.

CHAIRMAN JOHNSON: We're going to take a 30-minute lunch break. We'll reconvene at 1:00.

(Lunch recess.)

CHAIRMAN JOHNSON: We are going to go back on the record. Do we have a preliminary matter?

MR. PELLEGRINI: Chairman Johnson, before resuming with Mr. Varner, I'd like to make a clarification with respect to the exhibit marked 8. That's the confidential materials. It contains documents labeled A through G and actually only documents C and D should be made a part of Exhibit 8. That is BellSouth's Stip-Con 2 and BellSouth Stip-Con 1. Only those two exhibits should be considered as part of 8. That may not have been as clear as it needed to be earlier in the day.

CHAIRMAN JOHNSON: You stated that only -- which ones?

MR. PELLEGRINI: C and D.

CHAIRMAN JOHNSON: Will be a part of this particular exhibit?

MR. PELLEGRINI: Yes. The others we'll deal with later.

CHAIRMAN JOHNSON: Okay. I'll mark that for the record. Thank you for the clarification.

Any other preliminary matters? Seeing none, Mr. Melson.

CROSS EXAMINATION

BY MR. MELSON:

Q Thank you. Mr. Varner, I'm Rick Melson representing MCI.

Let me start with a general proposition. Mr. Klick's testimony states that an appropriate cost model must be publicly available in a format that allows interested parties to review and rerun it using different input values. I believe that you agree with that statement; is that correct?

A Generally, yes.

Q Now, I want to compare for a minute the costing methodology proposed by BellSouth in this case with the costing methodology that the Commission used to set the permanent prices in the arbitration proceeding. In both cases incremental cost, or TSLRIC, is a part of that costing methodology; is that correct?

A They are both -- yes, they are TSLRIC-type studies.

Q And would you agree with me that when the Commission relied on BellSouth's study in the earlier proceedings that it did so because they approximated TSLRIC and because in the Commission's judgment they reflected BellSouth's sufficient forward-looking costs?

A I don't recall. They were TSLRIC studies and they based their prices on TSLRIC studies. That's all I really recall from it.

Q So you don't know -- you don't recall whether the order that approved the use of those studies indicated that the reason for their use was because they reflected BellSouth's, quote, "efficient forward-looking costs"?

A I don't recall that language from the order.

Q All right. And do you recall that in that order the Commission required BellSouth to file in this proceeding TSLRIC studies for the various elements for which interim rates were set in the first proceeding?

A Yes.

Q Now, beyond TSLRIC, both in the prior proceeding and in this proceeding, the prices that are proposed include some contribution to shared and common costs; is that correct?

A   If you're talking about unbundled network elements, yes.

Q   I'm talking on network elements.

A   Yes, that's correct.

Q   And in the arbitration proceeding the Commission didn't make any specific finding about a level of shared and common costs that was allocable to UNEs, did it?

A   I don't think so. I'm taking from that you mean did they determine some percentage ought to be added to the TSLRIC to reflect shared and common costs. No, they didn't do that. They established prices and recognized that to the extent that prices exceeded the TSLRIC cost, they were making a contribution towards the recovery of the shared and common cost.

Q   So essentially -- and tell me if this is a fair characterization -- that case the Commission had TSLRIC cost studies, they set prices that were somewhat above TSLRIC, and said to the extent they are above TSLRIC the prices will be making a contribution towards shared and common costs?

A   Yes.

Q   Would you agree that the level of contribution towards shared and common costs in the rates the Commission set in the first part of this proceeding is less than the percentage of shared and common costs that BellSouth allocates to the elements in this phase of the proceeding?

A I don't know. From my recollection it varied in the previous proceeding from one element to the other. In this proceeding we're proposing a constant value of 5. -- 5.3 something. Mr. Reid has that in his testimony but it's the same amount for each one.

Q Let me approach it this way: Would you agree that in the prior proceeding the Commission set a rate for 2-wire analog loops at $17?

A Yes.

Q And would you agree with me that the TSLRIC cost studies -- and I believe there were several different vintages -- but that those cost studies that supported that rate were all in the range of $15.50 or greater per loop?

A I don't remember what the cost numbers use were.

Q Assume with me hypothetically that the TSLRIC cost studies in the prior proceedings for 2-wire loop were all 15.50 or greater and the price was set at $17. If that's the case, then the price of the 2-wire loop would have been -- about 10% of that TSLRIC cost would have represented a contribution to shared and common costs?

A 15.50 and $17, about 10% of the price would be contribution towards shared and common costs.

Q Okay. And looking at AJV-1 which is your -- revised AJV-1 which is part of Exhibit 9, would you agree with me that the shared and common cost, which I guess -- let me make sure I understand this correctly. Let's look, if we might on Page 1 of AJV-1 for the 2-wire ADSL loops which is at line A.6.1.

A I have to find the exhibit.

A Okay. I have it now.

Q Are you with me now? Page 1, Line A.6.1 which is at 2-wire ADSL loop?

A I see it.

Q If I wanted to calculate the shared and common cost component, would I take the difference between the 15.69 TSLRIC cost in the first column and the 18.96 TSLRIC plus shared and common over in the fourth column?

A Yes. What you do is take 18.96 divide it by the 15.69. That would give it to you.

Q And would you agree with me that that produces a contribution shared of common costs on the order of 21 to 23%?

A I don't know. I haven't done the arithmetic.

Q Would you accept, subject to check, that 18.96 is 121% of 15.69?

A It sounds reasonable.

Q All right. And that relationship is constant for the various loops that you're pricing here; is that correct?

A I believe it is. You have to ask Mr. Reid. He actually calculated the shared and common cost amounts.

Q Let me ask this: Is it safe to say that if they are all in that range of 21%, that the contribution to shared and common costs proposed in the prices in this proceeding is greater than the contribution to shared and common costs that the Commission approved in the prior proceeding for the 2-wire analog loop?

A It's greater than it is for a 2-wire analog loop but that doesn't mean it's greater than the contribution that was proposed in the last proceeding. Some elements could have been higher than the 2-wire analog loop and some lower.

The way the Commission set them is they

established a price that the Commission felt was reasonable, and whatever the relationship was of that price to the cost became the contribution towards shared and common, as opposed to using a constant percentage applicable to all of the costs and having them all contribute the same percentage. So some of them could have been higher, so could have been lower.

Q All right. Moving away for a minute from the shared and common costs to your residual recovery requirement, or RRR, that is designed to recover historical cost rather than forward-looking costs; is that correct?

A The difference between forward-looking and actual, which, for purposes of labeling it in my testimony I call it historical, but it's the difference between the forward-looking and the actual costs that we incur to provide those items to you today.

Q Now, in terms of actual cost, I believe Chairman Johnson asked you a question this morning whether the actual costs were taken from the Company's books and records. My recollection is you said, no, because we're using forward-looking depreciation factors and forward-looking cost of capital. Am I remembering that correctly?

A Those are two items, yes. Ms. Caldwell can give you the details of exactly how it's calculated. But those were two items I know that were different between if you were looking at embedded cost and looking at the actual cost calculation that was used.

Q To the extent you're looking at actual cost, isn't it true that you are looking to the company's books and records for the investment value that you then translate into a monthly carrying charge?

A You need to ask Ms. Caldwell.

Q So you don't know then what actual -- you don't know whether the actual cost you're seeking to recover is grounded in your books and records or not?

A You say grounded in the books and records. The intent is to identify the actual cost of providing these things today. It's not embedded cost to go back and balance back historical books of the company. We're not trying to do that.

Q I think, Mr. Varner, you're asking something I'm -- you're answering a question I'm not asking. Let me try one more time, because -- are the investment figures -- do you know whether the investment figures that BellSouth used to develop its, quote, "actual cost" are investment figures that come from the books and records of the company?

A You will have to ask Caldwell exactly where she pulled those numbers from.

Q And if we wanted to see what percentage of the price -- and let's go back to this Line A.6.1 on Exhibit 9, the proposed price for that 2-wire ADSL loop is $23.28; is that correct?

A Yes.

Q If I wanted to find what percentage of that was represented by the residual recovery requirement, would I divide the $4.32 in the fifth column by the 23.28?

A Yes.

Q And would you agree with me that's for that particular item about is 19%?

A Yes. I'd say about 20.

Q In the initial arbitration proceedings BellSouth did not propose a separate residual recovery requirement, did you?

A That's correct. And I think I went through Mr. Lamoureux why it was not separately identified.

We proposed the TSLRIC cost, and to the extent prices were above those costs, they went to cover shared common and a residual recovery requirement to the extent that there was one. But we didn't separately identify an item.

Q And to the extent, though, that the shared and common cost component that you're proposing in this proceeding is higher than the shared and common cost component that was included in your rates in the prior proceeding, there wouldn't have been anything left over to apply to the residual recovery requirement?

A Would you repeat that? There were a couple of negatives in there somewhere and I'm not sure where I ended up.

Q Let me try again.

I believe you said, in essence, in the first proceeding, the difference between price and TSLRIC cost was a contribution. Is that correct?

A Yes.

Q And that contribution would go first toward covering shared and common cost, and to the extent there was anything left over, it would have been similar to this residual recovery requirement?

A It would go towards covering that residual recovery requirement.

Q And I guess my question is to the extent to about -- in the case of the loops 10% -- there was a 10% markup over TSLRIC on the first proceeding, and to the extent BellSouth is proposing roughly twice that in this proceeding, there would not have been any contribution left in the earlier rates to go toward any residual recovery requirement. You wouldn't have even covered shared and common cost?

A No, that's not necessarily the case. Because, remember, they said a number of different rates by a number of different elements. In fact, the elements that are remaining here is a relatively small number compared to the number that prices have already been set for. But when they set those prices, those prices have varying relationships to the TSLRIC. For example, they could have set prices for an item for which there really is no residual recovery requirement, and it has a contribution that goes high enough to cover the TSLRIC plus the shared and common. What happens then is the contribution remaining in that item may be going to cover the residual recovery requirement for another item.

So the prices and -- the only way you would be able to make that determination is to make this type of a comparison for all of the prices. They may not have done it for one particular item, but you could have contribution from another item wherein a price was set above cost that's providing contribution to the prices for some other item. That's typically the way rate setting works. I mean that's how you end up with residential rates as low as they are, is you have other services that make a contribution towards covering the cost of the resident's basic exchange service so the rates for that are below cost.

Q Let me ask this: I believe you said in your summary that you believe recovery of actual costs is not only permited, but, in fact, is required by the Telecommunications Act of 1996?

A Yes.

Q If that is the case, then why did BellSouth not identify and quantify this residual recovery requirement in the prior proceedings?

A Because we had to use at that time the cost studies we had available to us. The cost studies that we had were TSLRIC cost studies. We had not gone through an analysis to know what this difference was. We knew that there was probably a difference but we had no way of being able to quantify it or determine what it was or make a proposal with respect to that at that time.

Q Is it true that BellSouth has proposed a residual recovery requirement in other states in the past few months?

A You're saying proposed?

Q Yes, sir.
A Yes, we have.
Q Isn't it true that in the only two states that have reached a final commission decision, being Georgia and Lousiana, that the residual recovery requirement has been rejected by the Commission?
A I believe that's correct. The final prices did not include the residual recovery requirement. Now, whether they said they rejected it or not I just don't remember. But I do know that the final prices were below the level that would be necessary to include the residual recovery requirement.
Q Okay. Let me move away from cost methodology for a minute. I guess it's not entirely away.

BellSouth is proposing rates for loops in this proceeding that are not geographically deaveraged; is that correct?
A That's correct.
Q And I believe you would agree with me that the cost of loops does vary by density?
A Yes.
Q Let me turn, now, to the proposed prices for virtual collocation, which are shown on Page 6 of your Exhibit AJV-1. I guess actually Pages 5 and 6?

A I see it.

Q I believe you've testified those are set equal to existing tariffed rates; is that correct?

A Yes.

Q And BellSouth has not sponsored in this proceeding the cost studies that underlie those rates, have you?

A Yes, we have. The cost studies have been provided and the results of them are shown on my exhibit.

Q Okay. Let me ask the question again, because I think I may have asked a different question than you answered.

BellSouth has not sponsored in this proceeding the cost studies that were used as the basis for setting the tariffed rates; is that correct?

A That's correct. We've provided the cost studies that were recently done when we did all of the other cost studies that are provided here.

Q So, for example, let's look at Page 6, if we could, at Line H.2.8 DS-1 cross-connects. Is it fair to say that the $1.16 that appears in the fourth column is the recurring cost for a DS-1 cross-connect that is based on BellSouth's current TSLRIC studies plus shared and common costs?

A Yes, that's correct.

Q And the $7.50 in the proposed rate column is the tariffed rate that Bell is proposing to be established in this proceeding; is that correct?

A Yes. Well, not established, but utilized. The tariff rate already exists for virtual collocation. People who purchase virtual collocation can already purchase it out of the tariff, and some already have.

Q And that $7.50 rate I believe you told us this morning was supported at some time by a cost study submitted to the FCC?

A At the time it was approved. And cost studies would have been submitted to the Florida Commission. You know, they require cost studies with their tariff filings as well.

Q But BellSouth has not submitted the cost studies that supports that $7.50 as a BellSouth sponsored exhibit in this proceeding; is that correct?

A That's correct. As I said, the prices for virtual collocation vary. That one is higher under the tariff, but the floor space rental, for example, if we were to go to the current cost study, the floor space rental would be higher under the cost study than it is in the tariff. Also the application fee would be higher under the cost study than it is in the tariff. So there were some higher, some lower.

The determining factor here is what could you actually implement? Collocators have already brought collocation out of the tariff. If they were to come in now and say "I want to," I guess, "put CLEC equipment in that virtual collocation space," I don't know what they'd do.

MR. MELSON: Chairman Johnson, I'm going to object to this answer. I asked him as to whether the $7.50 was sponsored -- was supported by a BellSouth study sponsored in this proceeding. He answered the question. He's now giving us a lecture on other rate elements I've not asked about. If his counsel wants to ask him on redirect, that's fine, but that's not what I'm asking him.

MR. LACKEY: I will ask him on redirect, Madam Chairman, if that's necessary, but I think all he was doing was pointing out that there was some that were higher and some that were lower, and Mr. Melson focused on the one that was lower.

CHAIRMAN JOHNSON: Mr. Varner, I'd ask you to answer the question that's directly asked, and to the extent that the answer needs clarification, you can clarify it, but don't go off into gratuitous additional information.

Q (By Mr. Melson) Mr. Varner, focusing back again on line H.2.8 is it fair to say that the proposed rate for DS-1 cross-connect is about 6.5 times what BellSouth currently estimates the cost to be?

A The TSLRIC plus shared and common, that would be correct.

Q Would it also be correct on the next line for DS-3 cross-connects, the proposed price is about 3.8 times the sum of the TSLRIC plus the shared and common cost?

A That would be correct. But as I said there are others that go the opposite direction.

Q Let's turn for a minute to the pricing for the 4-wire analog port, which, I guess, is on Pages 2 and 3 of your Exhibit AJV-1, and let's start first on Page 2 of Line B.1.2.

A B.1.2.

Q Up toward the top of the page.

A I see it.

Q If I understand correctly, looking again at the middle columns, the $10.09 is TSLRIC plus shared and common costs, and the $1.05 is what you've called the RRR?

A That's for a port without any features, that would be correct. We're not proposing a price for a port without any features.

Q That's why the proposed rate out at the last three columns is blank?

A Yes, that's correct.

Q If I wanted to determine the price for a port I can buy that port only with all of the features?

A That's correct.

Q And to see that proposed price, I then look, I guess, at the bottom of Page 3, actually on the line that doesn't have any cost reference but it's labeled exchange port 4-wire analog with all of the available features included.

A That's correct.

Q And there I see a TSLRIC plus shared and common costs of $16.27?

A Yes.

Q How do it get to the $10.09 back on Page 2 to the $16.27 on Page 3?

A You would add in the cost of all of the features that are applicable to a 4-wire analog port. I can't remember the number. There's about 25 of them there are listed here.

Q Let's look --

A It's not all of these that are listed here. It's just the ones applicable, the 4-wire analog port.

Q If I were to look actually on the very last page, this is AJV-1, would I see indicated the particular features that are included?

A I don't think it's attached to this one.

Q Page 7. Did you have a stealth exhibit, Mr. Varner? (Laughter)

A I think I have the page you're talking about.

Q And are the items with the Xs next to them the items that are included then in the development of that $16.20 cost?

A Yes.

Q Does that assume that when a CLEC purchases 4-wire port that they are going to be providing their customer three-way calling and customer changeable speed calling and call waiting and each of the other 20-some odd items on this list?

A No. It doesn't assume anything about what the CLEC there offered its customers at all.

Q So if the CLEC purchased the port and did not activate any of these virtical features, it would still, under your proposal, pay a price of $17.32

that's based on the 16.27 cost?

A Yes. Because that's the way that the unbundled port is defined. An unbundled port is defined as including all of the features. The only way to do that, the cost -- or the actual cost of an unbundled port, 4-wire analog port including all of its features, is $17.32. Now, that means the CLEC has the capability to activate one, some, none or all of those features, depending on what the ALEC is able to sell to the end user. But you have the capacity and the capability to activate any or all of those if that's what you want to do.

Q And is there a charge to the ALEC for activating any or all of those features?

A Not initially, no. When you order the port you tell us which features you want, activate it and we activate those features. If you come along later, you know, some other -- later on you change, that customer moves out, another customer comes in; that customer wants a different set of features than the previous customer had. That's where the subsequent order charge comes in. We would charge you the subsequent order charge to change the features that have been activated.

Q Let's move back to the bottom of Page 3 for a minute because I want to be sure I understand what you've just told me.

If I look in the proposed rate out in the three far right-hand columns I see an electronic nonrecurring charge of $66.14.

A Yes.

Q That is the nonrecurring charge that is paid up front for the port and activation of any of these 24, 25 features that the ALEC directs you up front to activate; is that correct?

A That's correct.

Q And that 66.14 is developed by taking the price essentially assuming that each feature is activated?

A Yes -- no, wait a minute. No. Yes, that's correct. Each one of the features that were listed on that Page 7.

Q All right. So if the time the CLEC orders the port, it activates two of the features, it pays a no nonrecurring charge of of 66.14, correct?

A Yes.

Q If its customer comes back the following month and says, "I'd like to add toll restrict service," what charge applies at that point for the activation of that service?

A Assuming it was an electronic order it would be $5.56.

Q Which is shown a B.2.40.

A Let me clear up something. When you asked me about the 66.14, that is the charge it takes for us to set that port up and set it up such that it has the capacity for you, and capability for you to activate. Tells you what you actually want activated because you can't activate a nonrecurring cost; to set it up to enable you to do that, to activate some or all should you choose to do so.

Q Let me turn for a moment to the network interface device.

A Network interface device, did you say?

Q Yes, sir. That's one of the elements we're establishing a price --

A Separate NID.

Q Unbundled NID.

COMMISSIONER JACOBS: Can I ask a question real quick before you have leave that? On Page 7 there was some small difference in those numbers at the bottom there compared to the total numbers on the bottom of Page 3. I assume those are different calculations but meant to reflect the same totals?

WITNESS VARNER: I think the one I'm looking at, it does have the same number also on it. What happened is that when we revised the testimony on December 9th, the bottom numbers here should have been revised to reflect the actual numbers that's in the -- on page, I think, it's 6, of my exhibit.

COMMISSIONER JACOBS: I just wanted to confirm that.

MR. MELSON: Commissioner, I've got two versions of the exhibit; an original version for the nonrecurring charge we're just talking about that showed $66.40 and a revised version shows 66.14.

WITNESS VARNER: I think he may be looking at the 44. 66.14 is correct. Those numbers at the bottom should have been revised to reflect the same numbers that's on Page 3.

COMMISSIONER JACOBS: I understand. Okay.

COMMISSIONER DEASON: Before we leave that, Mr. Varner, what are those numbers just below the next line down? For example, the 65.32 which is just below the 66.14. What does that represent?

WITNESS VARNER: Okay. Those are the -- all of those numbers are the nonrecurring charges. Next to it is 106 and the 76. Those are the charges if they send the order to us manually. For example, call us or send us a fax with the order. And we have a representative actually take the order and process it and handle it manually.

COMMISSIONER DEASON: I understand that. My question is what's the difference between the 66.14 and the 65.32?

WITNESS VARNER: Okay. The 66.14 is for the first port that's on an order, and the 65.32 is for each additional port that's on the same order. It doesn't cost us quite as much to handle the additional ones on the same order.

COMMISSIONER DEASON: Thank you.

Q **(By Mr. Melson)** Mr. Varner, let's talk just for a minute about the pricing of the network interface device, or the NID.

A All right.

Q And that's the little gray box that goes on the outside of the house where the loop is connected to the inside wiring. Is that a fair description of it?

A That's close enough.

Q Okay. And when BellSouth provides a NID or installs a NID in connection with the provision of retail service to a customer, the cost of that NID is capitalized and amortized; is that correct?

A I don't know.

Q Let me tell you where I'm going. Ms. Caldwell deferred a question to you during her deposition as to the way the price applies. Let me tell you what I understood her to say with regard to some of the cost principles, and then ask you about the price?

A All right.

Q And I believe her deposition will be in the record.

My understanding was that in the situation where BellSouth installs a NID to use in providing service to its own customer, the cost of that is capitalized, amortized and ultimately recovered through a recurring charge. If you will accept that subject to check, and if you will also accept, subject to check, that when BellSouth provides a NID to an ALEC, that cost is not capitalized but instead is expensed, and, therefore, proposed to be recovered through the nonrecurring charge. Do you understand those two assumptions?

A Yes. You're talking about two different things.

When we provide a network interface device as part of basic local exchange service, we don't have a separate charge to the end user for installing that.

Because by definition their basic local exchange service includes the network interface device. That's the way their service is defined in the tariff, so there's no separate charge for that. We don't necessarily have them everywhere. We didn't go back to retrofit everybody's line when that requirement came up. We do it as we go out to premises. So if we do it, there's no separate charge for it.

The other item you were talking about, it seems to me is the case wherein we have to go out and put on a NID for an ALEC. For example, if the capacity in the BellSouth -- there's no capacity in the BellSouth NID. And we have to put a separate one out for the ALEC, and how that's treated seems to be the second item you were talking about.

Q And let's focus on that second item. Are those the -- that the situation where A.2.12 of AJV-1 applies, installation of the 2-wire/4-wire ALEC NID?

A Yes. We had to go out and put in a separate NID for the ALEC for whatever reason. Then that would be the charge.

Q And the proposed nonrecurring charge there for an electronically placed order, if I'm reading correctly is 116.68?

A Yes. And there's no recurring because the full cost of the NID is included.

Q If MCI as an ALEC orders that NID, pays the $116.68, and 18 months from now the customer elects to change his local service to AT&T, what charge is made to AT&T for the NID?

A It would be A.2.6.

Q And what is A.2.6?

A It's the NID for 2-wire analog voice grade loop. When we put the separate loop out for the -- take, for example, a BellSouth NID doesn't have any capacity in it. So you have to put in a separate NID and you have a jumper and it goes from the ALEC NID into the BellSouth network interface division. The BellSouth network interface device is there because there's where the inside wire is terminated. So you have a jumper that goes from one to the other. You put in a ALEC interface device, charging nonrecurring 16.68 for the first one of those but you pay the $1.44 a month for use of the BellSouth NID because you're still using it.

Well, if AT&T comes along, a customer moves from MCI to AT&T, we don't have to install another one for AT&T. They would use the same one that MCI has. So we wouldn't charge AT&T $116.68, we would simply charge them the cost we would incur for utilizing our own NID, which is on A.2.6.

Q And in that situation you're saying AT&T in my example would pay a then nonrecurring charge of $5.69 plus a recurring charge of $1.49?

A MCI would have paid 116.68 plus $1.44 a month. AT&T would turn around and pay the $5.59 plus the $1.44 because we don't have to install the new NID for AT&T.

Q We have been talking about a situation for MCI where a new NID was required. In the situation where there is an existing BellSouth NID and that NID can be -- has capacity, the capacity that MCI requires, in that situation does MCI pay the amount shown on line A.2.12 as a nonrecurring or do they pay the nonrecurring charge on A.2.6?

A It's not the charge on A.2.12. I know that. It would be the charge on A.2.6. The one thing I'm uncertain about is if there's any travel time involved to go out to the premises, what might be done about that? Because I don't see that. And I'm not sure whether that's already in the permanent rates that were approved earlier and just not shown here for that reason. That's the one item I'm not clear about. But it certainly -- it's not A.2.12; it would be the A.2.6. And it may be an increment for travel time that's already in the permanent rates.

MR. MELSON: Give me just a moment, please.

COMMISSIONER DEASON: While he's referring to his notes let me ask a question.

What would be an example of a situation where there's a existing NID and it has inadequate capacity when it's a change?

WITNESS VARNER: Some of the ones we have, the design of these things have changed over time. Some of the older ones don't have the four jacks that newer ones have, one or two lines that the customer has. That's it. You can't put anymore in there. If you run into the older one, you may have to put in a newer wire; you don't have capacity. If it's newer, you probably do have capacity.

COMMISSIONER DEASON: If the customer is getting the same identical service changing providers, would there be the necessity of an additional NID?

WITNESS VARNER: There may be. Let's say if he's adding lines.

COMMISSIONER DEASON: He's got one line and just changing from BellSouth to MCI.

WITNESS VARNER: I'm going to suggest you might ask Mr. Baeza what happens when we do this. Let's say it's full. What we do, you have our NID and you have theirs, and you have a jumper that goes from ours to theirs. I believe you have one spare slot in ours to put the jumper, one spare slot to go from ours to theirs. If it's full you sometimes need the new one.

MR. MELSON: That's all I've got. Thank you, Mr. Varner.

CHAIRMAN JOHNSON: Do you have follow-up questions?

MR. SELF: Yes, I have some questions.

CROSS EXAMINATION

BY MR. SELF:

Q Mr. Varner, Floyd Self on behalf of WorldCom. I have a couple of questions I'd like to ask you, please.

First, I'd like to go back to the issue I raised at the very beginning before the cross examination of you began regarding your Exhibit AJV-1 and whether, in fact, all of the costs associated with electronic and manual interfaces have, in fact, been removed.

And if I could, sir, on Page 31 of your direct testimony -- some of the language that has been stricken, you state down on Lines 21 through 23 that the nonrecurring charges on AJV-1 excluded the costs of electronic and manual interfaces; is that correct?

A Where are you?

Q Page 31, Lines 21 to 23.

A That's not describing what's on the exhibit. That's just describing how we developed what is on the exhibit.

Q Okay. Can I conclude then that, in fact, all of the electronic and manual interface costs are not included in the recurring and non -- excuse me, in the nonrecurring charges on AJV-1?

A You're talking about LENS, EDI, electronic interfaces. Yes, those costs are not included in these columns on AJV-1. The cost of those was in a single rate element which was at the end of AJV-1 like $10.99 per order. That was covering the cost of those electronic interfaces.

Q All right. Are any of the costs associated with BellSouth's LCSC included in any of the nonrecurring charges?

A Yes. To the extent that the LCSC is being utilized to do work to install these items for the CLEC.

Q Doesn't the LCSC constitute a manual or electronic interface that's been developed for the ALEC?

A LCSC is not an electronic, it's a manual interface. And it also does other work for the CLECs besides the interface function. For example, if you were to look at one of these items, let's take the first one, the loop distribution 29669 under electronic and it's 43803 under manual. The difference between those is the cost of LCSC orders taking the order manually.

Q But did not Commissioner Clark's order direct that all of the manual interface costs were to be taken out?

A No, it did not. The order said that the electronic costs were to be taken out.

MR. SELF: Chairman Johnson, can I get my copy of the order for a moment, please?

CHAIRMAN JOHNSON: (Nods head.)

Q Mr. Varner, do you have a copy of the Motion to Strike?

A No, I don't. I have the Prehearing Order.

Q For the benefit of the parties and the Commission, if we could turn to Page 3 of the Order, specifically the motion shall be granted with respect to all testimony and exhibits relating to the costs of OSS functions both manual and electronic.

A Yes.

Q End of quote.

A Yes. There's no such thing as a manual OSS function.

Q I believe you've testified that the LCSC constitutes a manual interface that is utilized by the ALECs for the purpose of order taking; is that correct?

A Yes. That's the cost of the individual taking the order. Their time spent on the phone with the CLEC taking down the information that the CLEC has requested and putting that -- you know, preparing an order and sending it through for processing. I think on the basis of this testimony BellSouth must be able to remove the cost or pro rata cost, if that's appropriate, of that interface from the rates that appear an AJV-1.

MR. LACKEY: I don't understand how Mr. Self got to that position. If the ALECs want to order 2-wire HDSL loop and they have to go through one of our employees to do it, it seems to me that the cost of that employee is clearly a cost of providing that 2-wire HDSL loop. I mean it's not free. It's there, it's necessary to do. What we took out was on Page 6, which was the $10.99 which we thought was -- the issue was in this proceeding. I don't see how the ALECs can maintain -- and if it's on an unbundled network element, I don't see how this Commission can find that the cost of our handling one of their orders and providing them with service is something that we can't recover the cost for. I mean that's -- you know, that's got to be in violation of the statute, if nothing else, since we're entitled to recover at least the cost for these things.

But it was my understanding that it was the $10.99 that was the subject of that motion which had been ruled on by Commissioner Clark. Now I perhaps misunderstood, but that's what I thought the issue was.

MR. SELF: I'd respectfully disagree with Mr. Lackey. The issue in the motion was the fact -- one of the bases for the motion was the fact that the Commission had previously determined that each company shall bear the costs of its own OSS interfaces. And I think Mr. Varner has testified now that, indeed, this part of this manual interface is included in the rates that are in here. And I think on the basis of the Commission's prior arbitration orders, as well as the order granting in part the Motion to Strike and this language on Page 3 of that order, that that cost should be removed from this exhibit.

CHAIRMAN JOHNSON: Could I see the order that you're referring to?

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(Transcript continues in sequence in Volume 3.)

Volume 2

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