

1           BEFORE THE FLORIDA PUBLIC SERVICE COMMISSION

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3

4           In Re: Petition by Metropolitan            )  
 5           Fiber Systems of Florida, Inc. for        ) DOCKET NO. 960757-TP  
 6           arbitration with BellSouth             )  
 7           Telecommunications, Inc. concerning     )  
           interconnection rates, terms, and        )  
           conditions, pursuant to the Federal     )  
           Telecommunications Act of 1996.         )

8           In Re: Petition by AT&T Communications) DOCKET NO. 960833-TP  
 9           of the Southern States, Inc. for         )  
 10          arbitration of certain terms and        )  
 11          conditions of a proposed agreement     )  
 12          with BellSouth Telecommunications,     )  
 13          Inc. concerning interconnection and     )  
 14          resale under the Telecommunications     )  
 15          Act of 1996.                             )

16          In Re: Petition by MCI                   ) DOCKET NO. 960846-TP  
 17          Telecommunications Corporation and MCI) DOCKET NO. 960846-TP  
 18          Metro Access Transmission Services,     )  
 19          Inc. for arbitration of certain terms     )  
 20          and conditions of a proposed agreement   )  
 21          with BellSouth Telecommunications,     )  
 22          Inc. concerning interconnection and     )  
 23          resale under the Telecommunications     )  
 24          Act of 1996.                             )

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20                           THIRD DAY - MORNING SESSION

21   VOLUME X

22   PAGE 1498 through 1655

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PROCEEDINGS: HEARING

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

DATE: Wednesday, January 28, 1998

TIME: Commenced at 9:00 a.m.

PLACE: Betty Easley Conference Center  
Room 151  
4075 Esplandade Way  
Tallahassee, Florida

REPORTED BY: NANCY S. METZKE, RPR, CCR

APPEARANCES:

(As heretofore noted.)

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I N D E X

WITNESSES

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1                                    P R O C E E D I N G S

2                                    (Transcript continued in sequence from Volume IX)

3                                    MR. HATCH: And I would also request that his  
4 direct and rebuttal exhibits be marked for identification.

5                                    COMMISSIONER DEASON: They will be marked as a  
6 composite exhibit, exhibit number 51.

7                                    MR. HATCH: And we would ask that those be  
8 inserted into the record.

9                                    COMMISSIONER DEASON: Without objection, they  
10 will be inserted into the record.

11                                   MR. PELLEGRINI: Commissioner Deason.

12                                   COMMISSIONER DEASON: Yes.

13                                   MR. PELLEGRINI: The packets identified as BC-12,  
14 staff would ask that it be marked for identification  
15 purposes at this time. It consists of Doctor Cornell's  
16 January 13, 1998 deposition transcript, deposition and  
17 late-filed deposition exhibits numbers 1 through 2, and an  
18 update to exhibit -- an update to exhibit BC-3.

19                                   COMMISSIONER DEASON: All right. That will be  
20 identified as exhibit 52. Do you move it at this time?

21                                   MR. PELLEGRINI: And staff would move it at this  
22 time, yes.

23                                   COMMISSIONER DEASON: Without objection exhibit  
24 52 is admitted.

25                                   MS. KEATING: Commissioner Deason.

1           COMMISSIONER DEASON: Yes.

2           MS. KEATING: Staff also has an exhibit for  
3 Michael Majoros. We'd ask that it be marked for the record  
4 at this time.

5           COMMISSIONER DEASON: Let's get his testimony  
6 admitted first.

7           MR. HATCH: Yes, with respect to Mr. Majoros, he  
8 filed both direct and rebuttal testimony. We'd request  
9 that that testimony be inserted into the record as though  
10 read.

11           COMMISSIONER DEASON: Without objection the  
12 testimony of Michael Majoros will be inserted into the  
13 record.

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DIRECT TESTIMONY OF  
MICHAEL J. MAJOROS, JR.

ON BEHALF OF

AT&T OF THE SOUTHERN STATES, INC. AND  
MCI TELECOMMUNICATIONS COMPANY AND  
MCI METRO ACCESS TRANSMISSION SERVICES, INC.

DOCKET NOs: 960833-TP/960846-TP/971140-TP

**Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

A. My name is Michael J. Majoros, Jr. I am Vice President of the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

**Q. PLEASE DESCRIBE SNAVELY KING.**

A. Snavely King was originally founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. The firm has a professional staff of 16 economists, accountants, engineers and cost analysts. Most of the firm's work involves the development, preparation and presentation of expert witness testimony before Federal and State

1 regulatory agencies. Over the course of the firm's 26-year history, its  
2 members have participated in over 500 proceedings before almost all of  
3 the state commissions and Federal commissions that regulate  
4 telecommunications companies, utilities, and transportation industries.

5

6 **Q. PLEASE DESCRIBE THE TYPE OF WORK YOU HAVE PERFORMED**  
7 **WHILE AT SNAVELY KING.**

8

9 A. I have provided consultation specializing in accounting, financial and  
10 management issues. I have testified in over 80 regulatory proceedings. A  
11 significant number of these appearances have related to the subject of  
12 telecommunications and public utility depreciation. Exhibit MJM-1 to this  
13 testimony summarizes my appearances relating to depreciation. I have  
14 also negotiated and/or represented various user groups in fifteen of the  
15 Federal Communications Commission's ("FCC's") three-way triennial  
16 depreciation represetion conferences. Page 1 of MJM-2 identifies  
17 those conferences. I have also participated in several regulatory  
18 proceedings in which depreciation was an issue that was ultimately  
19 settled. Page 2 of MJM-2 summarizes these proceedings.

20

21 **Q. WHAT WAS YOUR EMPLOYMENT PRIOR TO JOINING SNAVELY**  
22 **KING?**

1 A. I joined Snavely King in 1981 and have been with the firm since that time.  
2 My prior employment and educational background is summarized in  
3 Exhibit MJM-3 to this testimony.

4

5 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**

6

7 A. I am appearing on behalf of MCI Telecommunications Corporation ("MCI")  
8 and AT&T Communications of the Southern States, Inc. ("AT&T").

9

10 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR  
11 DIRECT SUPERVISION?**

12

13 A. Yes, it was. I should note, however, that this testimony and its analytical  
14 framework draws heavily upon work performed by myself and others at  
15 Snavely King on behalf of AT&T, MCI, and AT&T Canada LDS for use in  
16 other proceedings.

17

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

19

20 A. AT&T and MCI have asked me to identify the appropriate plant lives to be  
21 used in Total Element Long Run Cost ("TELRIC") and other incremental  
22 cost studies. Specifically, I am to provide plant lives in conformance with  
23 the FCC's requirements.<sup>1</sup>

1 Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.

2

3 A. I recommend that the projection lives and future net salvage values  
4 underlying the depreciation rates prescribed by the FCC for BellSouth in  
5 Florida as set forth in the FCC's 1995 prescription of BellSouth's  
6 depreciation rates be used for the determination of cost based rates in this  
7 proceeding.<sup>2</sup> A majority of this testimony addresses lives.

8

9 Q. DOES THE FCC SPECIFY THE PLANT LIVES TO BE USED IN THE  
10 PRICING OF UNBUNDLED NETWORK ELEMENTS?

11

12 A. Yes, indirectly. The FCC rules require that only forward-looking costs be  
13 used in the setting of interconnection prices.<sup>3</sup> The Florida Public Service  
14 Commission's adoption of TSLRIC reflects a consistent conceptual  
15 requirement. Forward-looking costs require the use of economic  
16 depreciation rates.<sup>4</sup> To comply with this requirement, the plant lives used  
17 in the calculation of costs must be based upon the expected economic  
18 lives of newly placed plant.<sup>5</sup> In depreciation proceedings, such plant lives  
19 are termed "projection lives," to differentiate them from "remaining lives"  
20 and "average service lives" which reflect past plant placements.

21

22 Q. ARE BELLSOUTH'S CURRENT INTRASTATE DEPRECIATION RATES  
23 BASED ON PROJECTION LIVES?

1 A. No. BellSouth's current intrastate depreciation rates are based on  
2 estimated remaining lives, and embedded plant and reserve balances as  
3 of December 31, 1991. They are inappropriate for forward-looking cost  
4 studies.

5  
6 **Q. ARE THE FCC'S PROJECTION LIVES FORWARD-LOOKING?**

7  
8 A. Yes. Over a decade ago the FCC directed its staff to put less emphasis  
9 on historic data in estimating productive lives, and to pay "closer attention  
10 to company plans, technological developments and other future-oriented  
11 analyses."<sup>6</sup>

12  
13 Recently, the FCC reaffirmed its forward-looking orientation in connection  
14 with the simplification of its depreciation prescription practices. The  
15 FCC prescribed a range of projection lives which could be selected by  
16 carriers for prescription on a streamlined basis. The ranges were based  
17 upon "statistical studies of the most recently prescribed factors. These  
18 statistical studies required detailed analysis of each carrier's most recent  
19 retirement patterns, the carriers' plans, and the current technological  
20 developments and trends."<sup>7</sup> As such, this streamlined prescription  
21 practice assures the development of projection lives that allow forward-  
22 looking capital recovery.

1 Q. DO YOU BELIEVE THE FCC STAFF HAS FOLLOWED THE FCC'S  
2 DIRECTIVE TO EMPHASIZE FORWARD-LOOKING ANALYSES?

3

4 A. Yes. In my experience in fifteen FCC triennial rescription conferences  
5 (including BellSouth rescription conferences), the FCC staff always  
6 used a forward-looking approach to setting depreciation rates.

7

8 The FCC staff rarely relied solely on historical data to set depreciation  
9 parameters. The FCC bases its parameter prescriptions upon the studies  
10 and information supplied by the individual companies, specific company  
11 plans, information submitted by state commission staffs, consumer groups  
12 and its broad industry-wide experience.

13

14 Q. IS THERE EMPIRICAL EVIDENCE THAT THE PROJECTION LIVES  
15 PRESCRIBED BY THE FCC HAVE BEEN FORWARD-LOOKING?

16

17 A. Yes. I would point to recent trends in the depreciation reserve levels in  
18 the industry, generally, and BellSouth specifically. As the FCC has  
19 recognized, "[t]he depreciation reserve is an extremely important indicator  
20 of the depreciation process because it is the accumulation of all past  
21 depreciation accruals net of plant retirements. As such, it represents the  
22 amount of a carrier's original investment that has already been returned to  
23 the carrier by its customers."<sup>8</sup> The FCC's recognition of the reserve level



1 as an indicator of the depreciation process can best be understood by  
2 examining a steady state example.

3

4 Assume that we start with a stable environment in which the average age  
5 of plant is 9 years and the expected life of plant is 27 years. I have  
6 assumed the addition rate, retirement rate and straight-line accrual rate  
7 are all 3.7 percent (1/27), and the reserve level is stable at 33 percent of  
8 plant in service (9 years/27 years).<sup>9</sup>

9

10 As we vary these factors, we can see the effect on the reserve level. For  
11 example:

12

13 • If the addition rate were to increase above 3.7  
14 percent, the reserve level would go down. This  
15 should not be a cause for concern, since the average  
16 age of plant would similarly represent a lower percent  
17 of its expected life and the reduced reserve level is  
18 anticipated in a growing environment.

19

20 • If the retirement rate were to increase above 3.7  
21 percent, the reserve level would also go down. This  
22 would be a cause for concern, since it would indicate  
23 that the actual life of plant is shorter than previously

1 expected. If the actual life is shorter the reserve  
2 should be higher, not lower than 33 percent.

3

4 • If the accrual rate were to increase above 3.7  
5 percent, the reserve level would go up. This would  
6 not be appropriate absent a reduction in the actual life  
7 of the plant, since it would indicate that the age of  
8 plant is higher than 33 percent of its expected life  
9 when, in fact, it is not, without a reduction to the  
10 actual service life of plant.

11

12 In summary, a declining reserve percent would be a reason for concern  
13 absent indications that it is merely the result of growth in plant. On the  
14 other hand, a rising reserve percent is generally a sign that accrual rates  
15 anticipate increasing retirement levels. Indeed, absent indications that the  
16 expected life of plant is decreasing, it might be a sign that accrual rates  
17 are too high.

18

19 Exhibit MJM-4 to this testimony charts reserve levels and other plant rates  
20 since 1944 for all local exchange carriers ("LEC's") providing full financial  
21 reports to the FCC. As shown on Page 1 of Exhibit MJM-4, reserve  
22 percents decreased steadily following World War II due to industry growth.  
23 These declines continued through the 1970's due in part to accrual rates

1 which were too low.<sup>10</sup> As shown on Page 1 of Exhibit MJM-4, however, the  
2 FCC's change to forward-looking depreciation practices in the 1980s  
3 resulted in a dramatic rise in reserve levels after 1980. The composite  
4 reserve level rose from 18.7 percent in 1980 to an historic high of 47.1  
5 percent in 1996. This track record indicates that the depreciation process  
6 is resulting in adequate depreciation accruals, and that the FCC's  
7 projection life estimates have been forward-looking and unbiased.

8 **Confirmation of the forward-looking unbiased nature of current FCC**  
9 **prescriptions can be gained by comparing the 1996 accrual rate of**  
10 **7.2 percent (Exhibit MJM-4, Page 4, Column l) to the 1996 retirement**  
11 **rate of 3.7 percent (Exhibit MJM-4, Page 4, Column k). The**  
12 **prescription of an accrual rate much higher than the current retirement**  
13 **rate indicates an expectation that the retirement rate will be much higher**  
14 **in the future. If the FCC were prescribing depreciation rates based only**  
15 **upon historical indicators, it would be prescribing depreciation rates in the**  
16 **range of 3 to 5 percent.**

17  
18 Exhibit MJM-5 confirms that these national LEC trends apply also to  
19 BellSouth. The depreciation reserve level for BellSouth has grown from  
20 35.3 percent in 1990 to 48.9 percent in 1996. BellSouth depreciation  
21 rates have averaged 7.3 percent over the last seven years, while its  
22 retirement rates have averaged only 3.6 percent.

1 Q. HAVE YOU COMPARED BELLSOUTH FLORIDA'S HISTORICAL LIVES  
 2 AND RETIREMENT PATTERNS TO THE FCC'S PRESCRIBED LIVES  
 3 AND RETIREMENT PATTERNS?  
 4

5 A. Yes. Exhibit MJM-6 compares BellSouth Florida's historical lives and  
 6 retirement patterns to the FCC prescribed lives and retirement patterns for  
 7 the major accounts. Page 1 of Exhibit MJM-6 is replicated below:  
 8

9 Comparison of Recent Life Indications  
 10 to FCC-Prescribed Lives

11 BellSouth Florida

12

13	<u>Account Name</u>	<u>Recent Life Indications</u>	<u>FCC</u>
14	<u>Prescribed</u>		
15	Digital Switch	23.0	16.0
16	Digital Circuit	11.0	10.5
17	Aerial Cable-Metallic	25.0	18.0
18	Underground-Metallic	32.0	23.0
19	Buried Metallic	27.0	18.0

20

21 The FCC's prescribed projection lives are much shorter than the recent  
 22 historical indications. Also, as shown on pages 2 to 6 of Exhibit MJM-6,  
 23 the FCC's prescribed retirement patterns are much more accelerated than

1 indicated by recent historical experience. In my opinion, on this basis  
2 alone, it is reasonable to conclude that the FCC's prescribed lives  
3 and retirement patterns as set forth in the FCC's most recent  
4 prescription of BellSouth Florida's depreciation rates are forward-  
5 looking.

6

7 **Q. HAVE YOU SUMMARIZED THE FCC'S PRESCRIBED LIVES AND NET**  
8 **SALVAGE VALUES FOR BELL SOUTH FLORIDA?**

9

10 A. Yes. The FCC's most recently prescribed lives for BellSouth Florida are  
11 summarized in on Exhibit MJM-7, which compares the FCC's range of  
12 lives and future net salvage values in Columns (a) and (b) to its most  
13 recent state-specific parameters for Florida in Column ( c ).

14

15 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

16

17 A. Yes, it does at this time.

18

19

20

21

22

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<sup>1</sup> FCC, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, CC Docket No. 96-98, first Report and Order, FCC 96-325, released August 8, 1996 ("August 8 Order"), Appendix B ("Rules"). While the court has ruled that state commissions are not required to follow the FCC's rules, the detailed guidelines described by the FCC for the calculation of depreciation of unbundled network elements continue to represent sound economic costing principles and should be applied in the context of this proceeding.

<sup>2</sup> FCC Docket No. 95-1635.

<sup>3</sup> Rules, 47 CFR § 51.505 (a).

<sup>4</sup> Rules, 47 CFR § 51.505 (b) (3).

<sup>5</sup> The economic life of an asset is its total revenue producing life. Public Utility Depreciation Practices, National Association of Regulatory Utility Commissioners, August 1996, p. 318.

<sup>6</sup> Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, Federal Communications Commission, April 15, 1987 ("AAD Report"), p. 8.

<sup>7</sup> FCC, Simplification of the Depreciation Prescription Process, CC Docket No. 92-296 ("Prescription Simplification" proceeding) Third Report and Order, FCC 95-181, released May 4, 1995, p. 6.

<sup>8</sup> AAD Report, pp. 5-6.

<sup>9</sup> Reserves will stabilize at 33 percent assuming a triangular (straight-line) mortality curve. See Notes for Engineering Economics Courses, American Telephone and Telegraph Company, Engineering Department - 1966, p. 121.

<sup>10</sup> AAD Report, p. 7.

1 REBUTTAL TESTIMONY OF  
2 MICHAEL J. MAJOROS, JR.  
3 ON BEHALF OF  
4 AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC., AND  
5 MCI TELECOMMUNICATIONS CORPORATION, AND  
6 MCI METRO ACCESS TRANSMISSION SERVICES, INC.  
7 DOCKET NOs.: 960833-TP, 960846-TP, 971140-TP, 960757-TP, 960916-TP  
8

9 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

10 A. My name is Michael J. Majoros, Jr. I am Vice President of the economic  
11 consulting firm of Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly  
12 King"). My business address is 1220 L Street, N.W., Suite 410,  
13 Washington, D.C. 20005.

14

15 **Q. HAVE YOU SUBMITTED TESTIMONY PREVIOUSLY IN THIS**  
16 **PROCEEDING?**

17 A. Yes, I submitted Direct Testimony on November 13, 1997.

18

19 **Q. DID YOUR DIRECT TESTIMONY CONTAIN A DESCRIPTION OF YOUR**  
20 **BACKGROUND, EXPERIENCE AND QUALIFICATIONS?**

21 A. Yes, it did.

22

23 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

24 A. I have been asked to compare the lives proposed by BellSouth for use in  
25 Unbundled Network Element (UNE) cost study calculations to the

1 projection lives I recommended in my Direct Testimony. I am also to  
2 comment on the propriety of BellSouth's proposed lives.

3

4 **Q. WOULD YOU BRIEFLY SUMMARIZE THE PROJECTION LIVES THAT**  
5 **YOU RECOMMEND BE USED IN BST'S COST STUDIES?**

6 A. Yes. I recommend the projection lives underlying the FCC's 1995  
7 prescription of BellSouth-Florida's depreciation rates.<sup>1</sup> My Direct  
8 Testimony explains the projection life concept and demonstrates why  
9 those lives are appropriate for forward-looking cost studies.

10

11 **Q. HAVE YOU COMPARED THE LIVES USED BY BELL SOUTH IN ITS**  
12 **COST STUDIES TO THE PROJECTION LIVES UNDERLYING THE**  
13 **FCC'S RATES?**

14 A. Yes, I have. Rebuttal Exhibit MJM-1 Page 1 of Attachment 1 compares  
15 the lives proposed by BellSouth (Column e) to:

- 16 ● the range of projection lives prescribed by  
17 the FCC pursuant to its recent Prescription  
18 Simplification proceeding (Columns a and  
19 b); and
- 20 ● the projection lives underlying the FCC's  
21 1995 prescription for BS-FL (Column c).

22 The lives used by BellSouth (Column e) are much shorter than the  
23 projection lives underlying the FCC's 1995 prescription (Column c),  
24 consequently they are inappropriate for use in UNE calculations.

25



1 **Q. WHAT IS THE SOURCE OF THE LIVES PROPOSED BY BELLSOUTH**  
2 **FOR FLORIDA?**

3 A. BellSouth notes that "Regional economic lives were used in all states."<sup>2</sup>  
4 BellSouth's witnesses stated:

5 BellSouth used projected depreciation lives  
6 generally consistent with the depreciation lives  
7 we use for public reporting purposes in  
8 Florida.<sup>3</sup>

9

10 **Q. ARE "REGIONAL" LIVES APPROPRIATE FOR USE IN FLORIDA?**

11 A. No. The FCC lives specific to Florida are available and should be used  
12 for UNE calculations.

13

14 **Q. ARE FINANCIAL BOOK LIVES APPROPRIATE FOR USE IN UNE**  
15 **CALCULATIONS?**

16 A. No. The lives used for financial accounting purposes are governed by the  
17 Generally Accepted Accounting Principle ("GAAP") of "conservatism" As  
18 the FCC has found, GAAP is investor-focused, and may not always serve  
19 the interest of ratepayers. The FCC states:

20 One of the primary purposes of GAAP is to  
21 ensure that a company does not present a  
22 misleading picture of its financial condition and  
23 operating results by, for example, overstating  
24 its asset values or overstating its earnings,  
25 which would mislead current and potential

1 investors. GAAP is guided by the  
2 conservatism principle which holds, for  
3 example, that, when alternative expense  
4 amounts are acceptable, the alternative having  
5 the least favorable effect on net income should  
6 be used. Although conservatism is effective in  
7 protecting the interest of investors, it may not  
8 always serve the interest of ratepayers.  
9 Conservatism could be used under GAAP, for  
10 example, to justify additional (but, perhaps not  
11 "reasonable") depreciation expense by a LEC  
12 to avoid its sharing obligation. Thus, GAAP  
13 would not effectively limit the opportunity for  
14 LECs to manage earnings so as to avoid the  
15 sharing zone as the basic factor range option.  
16 In this instance, GAAP does not offer adequate  
17 protection for ratepayers.<sup>4</sup>

18

19 **Q. IS THE CONSERVATIVE BIAS INHERENT IN FINANCIAL BOOK LIVES**  
20 **THE ONLY REASON WHY SUCH LIVES SHOULD NOT BE USED IN**  
21 **UNE CALCULATIONS?**

22 A. No. BellSouth's financial book lives assume the replacement of  
23 telecommunications plant to provide non-regulated video services. The  
24 lives appropriate for UNE calculation should be forward-looking and reflect  
25 the expected economic lives of newly placed plant. However, the plant

1 lives appropriate for such a calculation should not be based upon the  
2 assumption that efficient telecommunications facilities will be prematurely  
3 retired in order to provide non-regulated services. The FCC has  
4 specifically ruled that the costs of premature retirements will not be  
5 charged to ratepayers. The FCC states:

6 Facilities upgrades and accelerated re-  
7 placement of older facilities might also be  
8 undertaken primarily for the benefit of  
9 unregulated service offerings. The principles  
10 adopted in the Order dictates that such costs  
11 be excluded from the regulated accounts.<sup>5</sup>

12  
13 The use of plant lives based upon the assumption that the  
14 telecommunications network will be replaced by an integrated  
15 telecommunications/video network would effectively cause the costs of  
16 premature retirements to be charged to telephone ratepayers.

17  
18 **Q. IS THIS DISTINCTION BETWEEN TELECOMMUNICATIONS AND**  
19 **VIDEO SERVICES UNIQUE TO THE FCC?**

20 **A.** No. The Canadian Radio-Television and Telecommunications  
21 Commission ("CRTC") draws the very same distinction. The CRTC  
22 divides cost between the Competitive (non-regulated) and Utility  
23 (regulated) segments, and states:

24 The Commission finds that, in general, the  
25 most appropriate regulatory treatment for

1 broadband initiatives is to require the  
2 telephone companies to assign to the  
3 Competitive segment all new investments and  
4 related expenses associated with the  
5 deployment of fiber, coaxial cable,  
6 optoelectrical equipment, asynchrocus transfer  
7 mode (ATM) switches, and video servers.<sup>6</sup>

8  
9 \* \* \*

10 The Commission does not foresee any  
11 instances where it would be appropriate to  
12 have fiber or coaxial cables in the distribution  
13 portion of the loop assigned to the Utility  
14 segment.<sup>7</sup>

15  
16 **Q. DOES BELLSOUTH PLAN TO DEPLOY SUCH A NETWORK IN**  
17 **FLORIDA?**

18 **A.** Apparently not. My Rebuttal Exhibit MJM-1 Attachment No. 2 contains  
19 the company's responses to several AT&T Data Requests which indicate  
20 that the company does not, in fact, have plans to deploy the video  
21 network.

22  
23 **Q. HAVE ANY STATE COMMISSIONS ISSUED ORDERS WHICH**  
24 **ADOPTED FCC PRESCRIBED PROJECTION LIVES, OR SIMILAR**  
25 **STATE PRESCRIBED LIVES, FOR USE IN UNE CALCULATIONS?**

1 A. Yes. Prescribed projection lives have already been adopted for use in  
2 TELRIC calculations by Massachusetts,<sup>8</sup> New York,<sup>9</sup> West Virginia,<sup>10</sup>  
3 Wyoming,<sup>11</sup> Delaware,<sup>12</sup> Ohio,<sup>13</sup> Michigan,<sup>14</sup> and Colorado.<sup>15</sup> In many other  
4 states, TELRIC proceedings are in progress. For example, the Hearing  
5 Examiner in Illinois recently proposed the use of prescribed lives.<sup>16</sup>

6

7 This is not surprising. In its recent Price Cap decision, the FCC adopted  
8 the use of its prescribed lives for use in Total Factor Productivity  
9 calculations. The FCC noted that:

10 We can think of no reason why  
11 incumbent LECs should be permitted to  
12 use different depreciation rates for  
13 different regulatory purposes.<sup>17</sup>

14

15 **SUMMARY**

16

17 **Q. WHAT EFFECT WOULD THE USE OF PLANT LIVES WHICH ARE**  
18 **UNREALISTICALLY SHORT HAVE ON COMPLETION?**

19 A. The use of unrealistically short lives would cause unbundled network  
20 elements to be priced above TELRIC. Such pricing would be contrary to  
21 the FCC's guidelines and impede the development of competition based  
22 upon the purchase of unbundled network elements in the local market.

23

24 **Q. WHAT EFFECT WOULD THE USE OF PLANT LIVES WHICH ARE**  
25 **UNREALISTICALLY SHORT HAVE ON TELEPHONE RATEPAYERS?**

1 A. Effectively, telephone ratepayers would be required inappropriately to  
2 provide capital contributions to the ILEC. I will demonstrate this with  
3 simple illustration. Assume a plant asset costs \$1000 and will have a  
4 productive life of 20 years. Depreciation expense should be \$50 per year  
5 for 20 years. Assume further that regulatory authorities allow the ILEC to  
6 depreciate this asset using a 10-year period at a 10 percent rate and then  
7 freeze prices at the resulting \$100 level. There are at least two erroneous  
8 consequences. First, the depreciation reserve would build to an  
9 excessive level. The Supreme Court has ruled that excessive  
10 depreciation results in an unwarranted capital contribution by telephone  
11 ratepayers.<sup>18</sup> Second, the ratepayers would pay for this asset at \$100 per  
12 year in perpetuity even though they should be paying \$50 per year for 20  
13 years.

14

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

16 A. Yes, it does.

17

18

19

20

21

22

23

24

25

1 Endnotes:

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- 1 FCC Docket No. 95-1635.
- 2 BellSouth Economic Life Input for Capital Cost Runs Used in Development of 1996 Cost Factors.
- 3 Direct Panel Testimony of William P. Zarakas and D. Daonne Caldwell, p. 13.
- 4 Prescription Simplification, Report and Order, FCC 93-452, released October 20, 1993, para. 46.
- 5 Separation of costs of regulated telephone service from costs of non-regulated activities, CC Docket No. 86-111, Report and Order, FCC 86-564, released February 6, 1987, para. 115.
- 6 CRTC, Implementation of Regulatory Framework – splitting of the Rate Base and Related Issues, Telecom Decision CRTC 95-21, 31 October 1995, pp. 34-35.
- 7 Id., p. 35.
- 8 Docket DPU 96-73/74, 96-75, 96-80/81, 96-83, 96-84-Phase 4, December 4, 1996.
- 9 Docket 95-C-0657, 94-C-0095, 91-C-1174, April 1, 1997 (“NY Order”).
- 10 Docket 96-1516-T-PC, April 21, 1997.
- 11 Docket 70000-TF-96-319, 72000-TF-96-95, April 23, 1997.
- 12 Docket 96-324, April 29, 1997.
- 13 Docket 96-922-TP-UNC, June 19, 1997.
- 14 Docket U11280, July 14, 1997.
- 15 Docket 96S-331T, July 28, 1997.
- 16 Docket 96-0486, 96-0569, August 8, 1997.
- 17 Docket 94-1, 96-262, May 21, 1997, footnote 122.

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<sup>18</sup> Lindheimer v. Illinois Bell Telephone Co., 292 U.S. 151, 78 L.ed. 1182, 54 S.Ct. 658 (1934).



1 MR. HATCH: And with respect to Mr. Majoros, we  
2 would request that his direct and rebuttal exhibits be  
3 marked for identification.

4 COMMISSIONER DEASON: They will be identified as  
5 composite exhibit 53. And staff's -- I'm sorry?

6 MR. HATCH: I was going to request that they be  
7 admitted into the record.

8 COMMISSIONER DEASON: Okay. Exhibit 53 without  
9 objection will be admitted, and staff's exhibit identified  
10 as MJM-3 will be identified as exhibit 54. Staff moves 54?

11 MS. KEATING: Staff moves exhibit 54.

12 COMMISSIONER DEASON: Without objection exhibit  
13 54 is also admitted.

14 MR. HATCH: We have already done Mr. Wells. AT&T  
15 would call Mr. Art Lerma.

16 COMMISSIONER DEASON: Okay. Before Mr. Lerma  
17 takes the stand, we are going to take a recess. We will  
18 reconvene at 10:45.

19 (BRIEF RECESS)

20 COMMISSIONER DEASON: Call the hearing back to  
21 order. Mr. Hatch.

22 MR. HATCH: AT&T would call Art Lerma to the  
23 stand.

24 COMMISSIONER DEASON: Has Mr. Lerma been sworn?

25 MR. HATCH: I don't believe so.

1 Have you been sworn, Mr. Lerma?

2 WITNESS LERMA: I'm sorry?

3 MR. HATCH: Have you been sworn, Mr. Lerma?

4 WITNESS LERMA: No.

5 COMMISSIONER DEASON: Please stand and raise your  
6 right hand.

7 (Whereupon, Witness Lerma was duly sworn by  
8 Commissioner Deason)

9

10

11

\* \* \* \*

12 Whereupon,

13

ART LERMA

14 was called as a witness on behalf of AT&T and, after being  
15 first duly sworn, testified as follows:

16

DIRECT EXAMINATION

17 BY MR. HATCH:

18

Q Could you state your name and address for the  
19 record please?

20

A Yes. My name is Art Lerma and my address is  
21 Promenade I, 1200 Peachtree Street, Atlanta, Georgia.

22

Q By who are you employed and in what capacity?

23

A I'm employed by AT&T as regional regulatory CFO  
24 for the Southern States region.

25

Q Did you prepare and cause to be filed in this

1 proceeding rebuttal testimony?

2 A Yes, I did.

3 Q Do you have any changes or corrections to that  
4 testimony?

5 A No, I do not.

6 Q Did you also prepare and cause to be filed  
7 attached to your rebuttal testimony several exhibits, ALR-1  
8 through ALR-11?

9 A Yes, I did.

10 Q Were those exhibits prepared by you or under your  
11 supervision?

12 A Yes, they were.

13 Q Do you have any changes or corrections to your  
14 exhibits?

15 A No, I do not.

16 MR. HATCH: Mr. Chairman, I would request that  
17 the direct -- or the rebuttal of Mr. Lerma be inserted in  
18 the record as though read.

19 COMMISSIONER DEASON: Without objection it shall  
20 be so inserted.

21

22

23

24

25

**BEFORE THE**  
**FLORIDA PUBLIC SERVICE COMMISSION**

**REBUTTAL TESTIMONY OF**

**ART LERMA**

**ON BEHALF OF**

**AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC.**

**Docket Nos. 960833-TP/960846-TP/971140-TP/960757-TP/960916-TP**

**Filed: December 9, 1997**

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1 processing operations, toll operations, customer billing and collection, payrolls,  
2 accounts payable, and the production of corporate books and records. In July of  
3 1983, I transferred to AT&T and accepted the position of Manager - Accounting  
4 Regulatory Support with responsibility for AT&T financial regulatory matters in  
5 Texas. Since 1983, I have been responsible for AT&T financial regulatory  
6 matters and have been involved in the review of LEC cost information filed  
7 before public utility regulatory agencies in the southern and southwestern portions  
8 of the country.

9  
10 **Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.**

11 **A.** I have a Bachelor of Arts degree in Mathematics from Trinity University in San  
12 Antonio, Texas. I have also received a Master of Business Administration from  
13 St. Edwards University in Austin, Texas with a concentration in General Business  
14 and Telecommunications Management.

15  
16 **Q. HAVE YOU TESTIFIED PREVIOUSLY BEFORE ANY OTHER  
17 REGULATORY COMMISSION OR AUTHORITY?**

18 **A.** Yes. In addition to testifying before the Florida Public Service Commission  
19 ("FPSC), I have also testified in numerous proceedings involving cost issues  
20 before public regulatory commissions in Alabama, Arkansas, Georgia, Kentucky,  
21 Louisiana, Mississippi, North Carolina, South Carolina, Tennessee, and Texas.

22  
23 **II. PURPOSE:**

24

25

1 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS**  
2 **PROCEEDING?**

3 **A.** The purpose of my testimony is to evaluate certain cost factors and labor rates  
4 applied in the calculation of Total Element Long Run Incremental Costs  
5 (“TELRIC”) rates in the BellSouth Telecommunications, Inc. (“BST”) TELRIC  
6 cost study. I provide an assessment and, where possible, I recommend  
7 adjustments consistent with my findings.

8

9 Specifically, I have reviewed the following calculations in the BST cost study:  
10 the common cost, shared cost, and shared labor rate factors produced in the  
11 shared and common cost model; TELRIC labor rates; and other loading factors.

12

13 Based on my analysis, I make a recommendation on the use of BST's proposed  
14 cost factors and labor rates. I also rebut certain statements reflected in the direct  
15 testimony of BST witness Walter S. Reid.

16

17 **III. RECOMMENDATIONS:**

18

19 **Q. SHOULD THE FLORIDA PUBLIC SERVICE COMMISSION (“FPSC”)**  
20 **ACCEPT BST's SHARED AND COMMON COST MODEL?**

21 **A.** No. The FPSC should not rely on BST's shared and common cost model to  
22 calculate the shared costs, common costs, or labor rates for use in developing  
23 UNE prices. The reason that the FPSC should not rely on BST's shared and  
24 common cost model is that the model is not forward looking, the accuracy of the

1 outputs cannot be confirmed, and the model contains numerous methodological  
2 errors.

3

4 **Q. DOES YOUR TESTIMONY CONTAIN ANY RECOMMENDED**  
5 **UNBUNDLED NETWORK ELEMENTS (“UNE”) RATES FOR**  
6 **CONSIDERATION BY THE FPSC?**

7 **A.** No. The FPSC should establish rates based upon the recommendations of  
8 AT&T/MCI witness Wayne Ellison who has incorporated my adjustments and  
9 those proposed by other AT&T and MCI witnesses. Due to the lack of available  
10 data, I have not been able to calculate and propose adjustments to address all of  
11 the deficiencies in the Florida BST UNE Cost Study that I have noted in my  
12 testimony. My testimony provides only limited adjustments which are reflected  
13 on Rebuttal Exhibits ALR-1 through ALR-6.

14

15 **ANALYSIS OF SHARED AND COMMON COST MODEL**

16

17 **Q. IS BST’S SHARED AND COMMON COST MODEL AN ACCEPTABLE**  
18 **MEANS FOR CALCULATING THE SHARED COSTS, THE COMMON**  
19 **COSTS, OR THE SHARED LABOR RATES FOR USE IN DEVELOPING**  
20 **PRICES FOR BST’S UNES? IF NOT, WHY NOT?**

21 **A.** No. BST’s shared and common cost model is an unreliable and unacceptable  
22 means for calculating the shared costs, the common costs, or the shared labor rates  
23 that are used to establish prices for BST’s unbundled network elements for the  
24 following reasons:

25



- 1 (1) BST's shared and common cost model is inadequate to determine the  
2 long-run shared and common costs of an efficient, forward-looking, least-  
3 cost network because the shared and common cost model is based largely  
4 upon the embedded historical costs of BST's existing network;  
5
- 6 (2) The accuracy of the outputs of BST's shared and common cost model  
7 cannot be confirmed because: (a) many inputs to the model are based upon  
8 untested and unwarranted data extrapolations; (b) many other model inputs  
9 lack an adequate evidentiary basis; and (c) BST's shared and common cost  
10 model is so unduly complex and so insufficiently integrated that it is  
11 neither auditable nor readily understandable by persons familiar with the  
12 industry and its costs; and  
13
- 14 (3) BST's model contains numerous methodological errors. Examples include  
15 the following: BST's model (a) improperly treats recurring costs as non-  
16 recurring in its shared labor factors; (b) uses improper attribution bases for  
17 attributing shared and common costs; and (c) includes unsupported costs  
18 for a local carrier service center ("LCSC") that should not be recovered in  
19 UNE prices. I will explain each of these deficiencies in more detail below.  
20

21 **Q. IS BST'S SHARED AND COMMON COST MODEL ADEQUATE FOR**  
22 **DETERMINING THE LONG-RUN SHARED AND COMMON COSTS OF**  
23 **AN EFFICIENT, FORWARD-LOOKING, LEAST-COST NETWORK?"**

24 **A.** No. BST's shared and common cost model does not yield the long-run shared and  
25 common costs of an efficient, forward-looking, least-cost network. The model is

1 not based upon a "bottoms-up" assessment of the costs that would be incurred by  
2 BST in a competitive environment using industry best practices and least-cost  
3 methods. Instead, BST's shared and common cost model is based upon BST's  
4 embedded or historic costs and largely projects the costs that would be incurred if  
5 BST simply did "business as usual" in 1997, 1998, and 1999.

6  
7 **Q. PLEASE PROVIDE EXAMPLES OF HOW THE SHARED AND**  
8 **COMMON COST MODEL IS NOT FORWARD-LOOKING.**

9 **A.** I will provide two examples. The first example relates to BST's estimate of  
10 expenses for the years 1997, 1998, and 1999 in Account Nos. 6110 (Network  
11 Support), 6120 (General Support), 6510 (Other Property, Plant and Equivalent),  
12 6540 (Access), 6610 (Marketing), 6620 (Services), and 67xx (General and  
13 Administrative, excluding 6727), in which it applied an inflation factor that did  
14 not account for any productivity improvements. The second example relates to  
15 BST's estimate of expenses for the years 1997, 1998, and 1999, in Account Nos.  
16 62xx (Central Office), 6310 (Information Origination / Termination), 6410 (Cable  
17 and Wire Facilities), 6530 (Network Operations), and 6727 (Research and  
18 Development), in which BST applied a growth rate that purportedly accounted for  
19 certain productivity improvements.

20  
21 **Q. PLEASE EXPLAIN THE FIRST EXAMPLE IN WHICH BST**  
22 **ESTIMATED EXPENSES FOR THE YEARS 1997, 1998, AND 1999 IN**  
23 **ACCOUNT NOS. 6110, 6120, 6510, 6540, 6610, 6620, AND 67xx**  
24 **(EXCLUDING 6727).**

25

1     **A.**     BST estimated expenses in these accounts by: (1) taking the expenses incurred by  
2             BST during the first ten months of 1996; (2) extrapolating 1996 expenses from the  
3             ten months of historical expenses; (3) normalizing the extrapolated 1996 data to  
4             adjust for non-regulated business, the impact of the Olympics and Hurricane Fran,  
5             for the effects of a projected 11,300 employee workforce reduction, and for the  
6             effects of a compensated absence issue; (4) inflating the normalized and  
7             extrapolated 1996 data by a 3.4% inflation factor to measure 1997 expenses; (5)  
8             normalizing the inflated 1997 expenses to adjust for the effects of the projected  
9             11,300 employee workforce reduction; (6) inflating the inflated and normalized  
10            1997 expenses by a 3.5% inflation factor to measure 1998 expenses; (7)  
11            normalizing the inflated 1998 expenses to adjust for the effects of the projected  
12            11,300 employee workforce reduction; and (8) inflating the normalized and  
13            inflated 1998 expenses by a 3.5% inflation factor to measure 1999 expenses.

14  
15     **Q.**     **DOES BST's USE OF "INFLATION" AND NORMALIZATION**  
16             **ADJUSTMENTS FOR THESE ACCOUNTS RENDER BST's COST**  
17             **STUDY FORWARD LOOKING?**

18     **A.**     No. Contrary to the conclusion of BST witness Walter S. Reid (Reid direct  
19             testimony, p.7, lines 16-18) that the application of these factors converts the data  
20             to forward-looking costs, the study is not forward-looking because it is not  
21             representative of an efficient least cost network based on current technology.  
22             Except for the effects of Hurricane Fran, the Olympics, a single announced  
23             ongoing downsizing initiative, and the compensated absences issue, BST's shared  
24             and common cost model assumes that BST will incur the same expenses in 1997,  
25             1998, and 1999 that it incurred during the first ten months of 1996 and that the

1 amount of those expenses will increase with inflation at a rate of approximately  
 2 3.5% per year. BST's shared and common cost study for Account Nos. 6110,  
 3 6120, 6510, 6540, 6610, 6620, and 67xx (excluding 6727), simply ignores the fact  
 4 that competition, technology, and improved productivity will result in further  
 5 reductions in BST's shared and common costs beyond the levels experienced in  
 6 1996.

7  
 8 Indeed, the BST cost study states that the inflation rates used for those accounts --  
 9 called "Telephone Plant Indexes" ("TPIs") -- "are not intended to be forecasts of  
 10 technology changes or productivity improvements. ...Use of these inflation rates  
 11 implicitly makes the assumption that history will more or less repeat itself."  
 12 (BST's Florida cost study, Vol.1, Sec.4, p. 34).

13  
 14 **Q. AT A MINIMUM, WHAT CHARACTERISTICS MUST BE MET FOR**  
 15 **THE BST SHARED AND COMMON COST MODEL TO BE PROPERLY**  
 16 **FORWARD-LOOKING FOR USE IN SETTING TELRIC RATES?**

17 **A.** BST's shared and common cost model cannot simply assume that normalized and  
 18 annualized 1996 expense levels will increase with inflation. To the contrary, a  
 19 forward-looking model must consider all reduced expense levels and productivity  
 20 improvements: (1) that inevitably result when a member of a regulated,  
 21 monopoly industry becomes subject to competition; (2) that would result from the  
 22 application of current, least-cost technology across BST's entire network; (3) that  
 23 would result from BST's adoption of industry best practices; and (4) that would  
 24 result from additional workforce reduction, outsourcing, and reengineering  
 25 initiatives that will occur as BST encounters competition. BST's shared and

1 common cost model completely ignores these factors with respect to Account  
2 Nos. 6110, 6120, 6510, 6540, 6610, 6620, and 67xx (excluding 6727).

3

4 **Q. YOU REFERRED EARLIER TO A SECOND EXAMPLE IN WHICH BST**  
5 **ESTIMATED EXPENSES FOR THE YEARS 1997, 1998, AND 1999, IN**  
6 **ACCOUNT NOS. 62xx, 6310, 6410, 6530, AND 6727. IS THIS ESTIMATE**  
7 **OF EXPENSES FORWARD-LOOKING?**

8 **A.** No, it is not. BST's shared and common cost study is not adequately forward  
9 looking even though BST's estimate for these accounts purports to consider  
10 certain productivity improvements. This is so because the study fails to fully  
11 consider the amount of cost reduction that should be expected in a competitive  
12 environment. Indeed, the model even fails to consider all of the cost reduction  
13 initiatives identified by BST. For these accounts, BST's shared and common cost  
14 model estimated 1997, 1998, and 1999 expenses in the manner previously  
15 described on pages 7 and 8 of my testimony, except that the "growth rate" used  
16 for each year purportedly considered the impact of changes in demand (called  
17 "load changes"), service enhancements (called "service initiatives"), and  
18 "productivity changes," as well as the effects of inflation. Based upon these  
19 factors, BST's shared and common cost study used growth rates of 5.1% for 1997,  
20 4.5% for 1998, and 4.2% for 1999, for Account Nos. 62xx, 6310, 6410, 6530, and  
21 6727. However, the supporting documentation for BST's shared and common  
22 cost study indicates that additional "re-engineering initiatives," "organizational  
23 alignment initiatives," and "productivity changes" not considered in the  
24 development of the growth rates would result in cost reductions of 4.4% in 1997,  
25 4.3% in 1998, and 2.8% in 1999. (See BST's response to AT&T's First Set of

1 Data Requests, SCPSC Docket No. 97-374-C, Item No. 281, page 9 of Rebuttal  
2 Exhibit ALR-11. This BST response to an AT&T data request in South Carolina  
3 is being used throughout this testimony because a Florida equivalent response was  
4 not available at the time this testimony was prepared. This information is of a  
5 regional nature and is the same information used by BST in all states that BST has  
6 filed its TELRIC UNE cost model.) Had BST considered those cost reductions,  
7 their "growth rates" would be .7% in 1997, .2% in 1998, and 1.4% in 1999. These  
8 growth rates would have been even lower if BST had fully considered the effects  
9 of competition.  
10

11 **Q. YOU STATED EARLIER THAT "COMPETITION, TECHNOLOGY,  
12 AND PRODUCTIVITY WILL REDUCE BST'S SHARED AND COMMON  
13 COSTS." PLEASE EXPLAIN WHY THAT IS SO.**

14 **A.** Competition, technology, and improved productivity will reduce BST's shared  
15 and common expenses below normalized 1996 levels for a number of reasons.  
16 First, the onset of competition is a powerful incentive for a formerly regulated  
17 monopoly such as BST to reduce its overhead expenses and increase its  
18 productivity. Otherwise, BST would find itself unable to compete against its  
19 "leaner and meaner" competition. Although the onset of competition should  
20 impact shared and common expenses across-the-board at BST, it should have a  
21 particularly significant impact on BST's general and administrative ("G&A")  
22 costs, such as those recorded in Account Nos. 6711, 6712, and 6721-28.  
23 Automated Results Mechanized Information System ("ARMIS") results for the  
24 Bell Operating Companies indicate that G&A expenses per line have been  
25 trending downward anywhere from 22% to about 54% depending on the

1 individual BOC. (See Rebuttal Exhibit ALR-9). In contrast, BST's shared and  
2 common cost study pretends that competition will not impact BST's G&A  
3 expenses at all.

4  
5 Second, network operating expenses, such as those recorded in Account Nos.  
6 6512, and 6530-6535, will also be reduced by the use of modern, least-cost  
7 technology across BST's network. In a least-cost, forward-looking environment,  
8 modern network equipment will replace antiquated systems that are more costly to  
9 operate and more susceptible to breakdown. The antiquated systems that are  
10 reflected in BST's historical costs require extensive staffing at end offices for  
11 repair, maintenance, upgrade, and supervisory work. With modern equipment,  
12 however, network surveillance can be executed from a central facility. New  
13 technologies will allow for substantial savings from new management network  
14 standards, intranets, and the like. Also, in a wholesale environment, some of the  
15 repair service functions resulting from customer trouble reports and related plant  
16 administration work will be performed by competing local exchange companies  
17 like AT&T. In addition, current trends show network operations expenses  
18 declining. They can be expected to decline even more. For these reasons, network  
19 operations expenses can be expected to be reduced by approximately 50%.  
20 Rebuttal Exhibit ALR-1 to my testimony reflects a 50% reduction to the 1996  
21 normalized level of expenses in the shared and common cost model for Account  
22 Nos. 6512, 6531, 6532, 6533, 6534, and 6535. Rebuttal Exhibit ALR-8 provides  
23 supporting documentation for the 50% reduction in network operations expenses.

24  
25

1 **Q. YOU EARLIER TESTIFIED THAT BST'S SHARED AND COMMON**  
2 **COST MODEL IS NOT AN ACCEPTABLE MEANS OF CALCULATING**  
3 **THE SHARED COSTS, THE COMMON COSTS, AND THE SHARED**  
4 **LABOR RATES TO BE USED IN PRICING BST'S UNES BECAUSE THE**  
5 **ACCURACY OF THE MODEL'S OUTPUTS CANNOT BE CONFIRMED.**  
6 **PLEASE EXPLAIN THE BASIS FOR THIS TESTIMONY.**

7 **A.** Although BST has constructed a complex and elaborate shared and common cost  
8 model, the outputs of that model are only as credible as the data inputs,  
9 assumptions, and extrapolations upon which the model are based. The FPSC  
10 should not accept BST's shared and common cost model as a basis for  
11 determining the shared costs, the common costs, and the shared labor rates to be  
12 used in pricing BST's UNES because: (a) many inputs to the model are based  
13 upon untested and unwarranted data extrapolations; (b) many other inputs to the  
14 model are unsupported by any data that would permit a verification of the  
15 accuracy and reasonableness of the inputs; and (c) the model is so complex and  
16 poorly integrated that it cannot be adequately tested. Simply put, BST has not  
17 provided the FPSC with sufficient data to assess the data inputs, assumptions, and  
18 extrapolations upon which the shared and common cost model is based. In such  
19 circumstances, the model's outputs cannot be accepted as reliable, reasonable, or  
20 appropriate. The elegance of a model is irrelevant if the data inputs,  
21 extrapolations, and assumptions underlying the model are unsupported or  
22 incorrect.

23

24 Perhaps an analogy will help drive home the skepticism with which BST's shared  
25 and common cost model should be viewed. That model is like an elaborate



1 mansion built upon a foundation of dubious structural strength. Although the  
2 mansion's facade will be impressive to a first-time visitor, no one should purchase  
3 the mansion for use as a home before being given adequate proof of the soundness  
4 of the foundation.

5

6 **Q. YOU EARLIER TESTIFIED THAT BST'S SHARED AND COMMON**  
7 **COST MODEL IS UNACCEPTABLE IN PART BECAUSE IT RELIES**  
8 **UPON UNTESTED AND UNWARRANTED DATA EXTRAPOLATIONS.**  
9 **PLEASE EXPLAIN WHAT YOU MEAN BY "DATA**  
10 **EXTRAPOLATIONS."**

11 **A.** By "data extrapolations," I mean those instances where BST has gathered data  
12 relating to a relatively brief period of time or a relatively few examples of a cost  
13 incurrence, and used that data to project what the costs would be for a longer  
14 period of time or for a greater universe of cost incurrences.

15

16 **Q. PLEASE EXPLAIN THE IMPACT THAT UNTESTED AND**  
17 **UNWARRANTED DATA EXTRAPOLATIONS CAN HAVE ON A COST**  
18 **STUDY.**

19 **A.** Untested and unwarranted data extrapolations can lead to erroneous conclusions  
20 about the level of costs that will be incurred. The cost study filed by BST in  
21 Florida demonstrates that the use of "data extrapolations" can lead to incorrect  
22 conclusions about the amount of costs that will be incurred, even when the period  
23 upon which the extrapolation is based is very close in time to the period to which  
24 the extrapolation is being applied. For example, Rebuttal Exhibit ALR-7 to my  
25 testimony is a copy of page 240 of Appendix H to BST's Revised Exhibit P-1 in

1 Daonne Caldwell's Direct Testimony filed in Georgia Docket No. 7061-U. It  
2 refers to a forecast of "pole rental" income based on "actuals through June, 1996."  
3 The cost study indicates, however, that "[a]ctual activity increased significantly in  
4 August. Therefore, we should overrun the forecast."

5  
6 In this example, BST's extrapolated forecast failed to correctly predict future  
7 "pole rental" income because it failed to account for the increase in "pole rental"  
8 income. Similarly, the extrapolations in BST's shared and common cost study  
9 lead to incorrect cost projections because they fail to account for the expense  
10 reductions and productivity increases that will result from competition.

11  
12 **Q. DOES THE SERVICE ORDER STUDY USED IN THE SHARED AND**  
13 **COMMON COST MODEL INCLUDE EXAMPLES OF UNTESTED AND**  
14 **UNWARRANTED DATA EXTRAPOLATIONS? PLEASE EXPLAIN.**

15 **A.** Yes. BST's service order study relies on untested and unwarranted data  
16 extrapolations. That study, used to identify the amount of non-recurring costs to  
17 be excluded from attribution as shared and common costs, is separated into two  
18 parts, both of which rely heavily on untested and unwarranted data extrapolations.  
19 The first part estimates the amount of service order related costs for the years  
20 1997-1999. The second part estimates the central office non-recurring costs for  
21 these years.

1 **Q. PLEASE EXPLAIN HOW THE USE OF THE SERVICE ORDER STUDY**  
2 **TO ESTIMATE SERVICE ORDER-RELATED COSTS FOR OUTSIDE**  
3 **PLANT NON-RECURRING COSTS IS BASED ON DATA**  
4 **EXTRAPOLATIONS WHOSE REASONABLENESS AND**  
5 **APPROPRIATENESS HAVE NOT BEEN DEMONSTRATED BY BST.**

6 **A.** With respect to outside plant non-recurring costs, BST estimated the non-  
7 recurring costs that would be incurred region-wide from 1997 through 1999 by  
8 BST's outside plant workforce by extrapolating from a study of the work  
9 performed by a small portion of the applicable workforce during a single month in  
10 1996. For example, the Florida portion of the POTS I & M (Plain Old Telephone  
11 Service Installation and Maintenance) service order study for outside plant forces  
12 was based on the activities during only one month of just 1.2% of the appropriate  
13 workforce (30 technicians of a universe of 2530), while, across the BST region,  
14 less than 4% of the applicable workforce was included in the sample. BST's cost  
15 study provides no information that would permit the FPSC to assess whether the  
16 workforce sample in BST's study was statistically representative or whether the  
17 one-month sampling period was representative of the outside plant service order  
18 activities in 1996, let alone in 1997 through 1999. (Florida BST Cost Study, CD-  
19 ROM version 1.2, blstric.fl\ Appendix E \svcord.xls). Absent such information,  
20 BST has failed to demonstrate that its extrapolation is a reasonable or reliable  
21 basis for estimating non-recurring outside plant costs.

22

23

24

1 **Q. PLEASE EXPLAIN HOW THE USE OF THE SERVICE ORDER STUDY**  
2 **TO ESTIMATE NON-RECURRING CENTRAL OFFICE COSTS IS ALSO**  
3 **BASED UPON UNTESTED AND UNWARRANTED EXTRAPOLATIONS**  
4 **FROM NONREPRESENTATIVE DATA.**

5 **A.** BST estimated its non-recurring central office costs by extrapolating from a study  
6 of the non-recurring costs incurred by central office employees during a two-  
7 month period in 1996. Moreover, BST excluded all Florida data from its  
8 supposedly "region-wide" study because of unexplained problems with the  
9 Florida data, despite the fact that Florida accounts for more of BST's business  
10 than any other state. No effort was made to identify the problem with the Florida  
11 data, or to perform a study that was free of the problem. BST's cost study  
12 provides no information that would permit the FPSC to assess whether the two-  
13 month sampling period was representative of the central office service order  
14 activities in 1996, let alone in 1997 through 1999, or whether a sample that  
15 excludes Florida can be representative of region-wide activity. Absent such  
16 information, BST has failed to demonstrate that its extrapolation is a reasonable or  
17 reliable basis for estimating non-recurring outside plant costs.

18

19 **Q. PLEASE PROVIDE OTHER EXAMPLES OF UNTESTED AND**  
20 **UNWARRANTED DATA EXTRAPOLATIONS FROM BST'S SHARED**  
21 **AND COMMON COST MODEL.**

22 **A.** First, BST used an unsupported extrapolation to estimate the amounts of salaries  
23 and wages that would be capitalized in various accounts in 1997 through 1999.  
24 This data is needed to develop salary and wage ratios for apportioning attributable  
25 costs among specified investment or expense accounts and for accumulating

1 salary and wage cost pool data used in developing shared labor cost factors .  
2 BST's extrapolation is based upon data from only a three-month period in 1996.  
3 BST's cost study provides no information that would permit the FPSC to assess  
4 whether the data from the three-month period is representative of salary and wage  
5 capitalization in 1996, let alone the salary and wage capitalization that should be  
6 expected in 1997 through 1999.

7  
8 Second, as I mentioned earlier in my testimony, BST utilized the costs incurred in  
9 various accounts during the first ten months of 1996 as the starting point for its  
10 calculation of the costs expected to be incurred in 1997-99 in those accounts. It  
11 then extrapolated those ten-month amounts to full-year 1996 costs by multiplying  
12 the ten-month costs by a factor of 1.2. BST provides no rationale for its use of  
13 this "annualized" data, rather than using actual full-year data for 1996 (which was  
14 available well prior to the filing of the Florida BST TELRIC cost study), and it  
15 provides no information that would permit the FPSC to determine whether the  
16 "annualized" 1996 costs are in fact representative of the actual costs incurred in  
17 1996.

18  
19 **Q. YOU TESTIFIED EARLIER THAT BST'S SHARED AND COMMON**  
20 **COST STUDY IS UNACCEPTABLE BECAUSE MANY OF THE DATA**  
21 **INPUTS TO THE MODEL ARE UNSUPPORTED AND THEREFORE**  
22 **NOT VERIFIABLE. PLEASE PROVIDE EXAMPLES.**

23 **A.** There are numerous examples where BST's data inputs are not supported by  
24 documentation that would permit the FPSC to assess their accuracy and

1           reasonableness. In effect, BST is asking the FPSC to accept its data inputs  
2           without establishing their appropriateness or accuracy.

3

4           To demonstrate just how pervasive unsupported data inputs are in BST's shared  
5           and common cost study, I'd like to discuss just one part of that study: the  
6           calculation by BST of the amount of expenses that it estimates will be incurred in  
7           various accounts in 1997, 1998, and 1999. These costs are used to calculate the  
8           Expense/Salary & Wage Development Factors that are extensively used in BST's  
9           shared and common cost model. I discussed the eight-step process earlier in my  
10          testimony on page 7. The documentation relevant to this process is set forth in  
11          BST's response to AT&T's First Set of Data Requests, SCPSC Docket No. 97-  
12          374-C, Item No. 281, pages 12-14 of Rebuttal Exhibit ALR-11.

13

14          BST has failed to provide adequate supporting data for each element of its  
15          calculation of the costs estimated to be incurred in 1997 through 1999 that it used  
16          in developing the Expense/Salary & Wage Development Factors. First, as I  
17          explained in response to an earlier question, BST supplied no data justifying its  
18          extrapolation of the full-year 1996 costs from the ten months of data. Second, it  
19          failed to support the "normalizing" adjustments that it made to the annualized  
20          1996 data and made, to a limited extent, to the estimated 1997-99 costs. Finally,  
21          it failed to provide adequate support for the inflation factors/growth rates that it  
22          utilized in estimating the costs to be incurred from 1997-99.

23

24

25

1    **Q.    PLEASE EXPLAIN HOW THE INFLATION RATES AND GROWTH**  
2    **FACTORS THAT ARE PART OF THE EXPENSE/SALARY AND WAGE**  
3    **DEVELOALENT FACTORS ARE UNSUPPORTED.**

4    **A.**    The inflation rates and growth factors that are part of the expense/salary and wage  
5    development factors are the most significant examples of unsupported data inputs  
6    in BST's development of costs. For Account Nos. 6110, 6120, 6510, 6540, 6560,  
7    6610, 6620, and 67xx (excluding 6727), the inflation rates/growth factors used  
8    were 3.4% in 1997, 3.5% in 1998, and 3.5% in 1999. BST's response to AT&T's  
9    First Set of Data Requests, SCPSC Docket No. 97-374-C, Item No. 281, page 8 of  
10   Rebuttal Exhibit ALR-11 identifies the source of these rates/factors as the  
11   "BellSouth Regional Telephone Plant Index, RL95-10-015BT, attachment C,  
12   Union Wages." This reference raises several concerns. First, the referenced  
13   document does not appear in the Florida BST cost study. Indeed, there appears to  
14   be no support for the 3.4%, 3.5%, and 3.5% rates in that section even though  
15   various inflation forecasts for labor costs appear there. Second, BST's cost study  
16   never explains the manner in which the inflation factors/growth rates were  
17   derived, and fails to provide or identify the source of the data inputs or  
18   assumptions (if any) that underlie the forecasts. Third, BST never explains, and it  
19   is not immediately apparent, why an inflation forecast relating to "Union Wages"  
20   is appropriate for use with the expenses in Account Nos. 6110, 6120, 6510, 6540,  
21   6560, 6610, 6620, and 67xx (excluding 6727). Fourth, as noted earlier in my  
22   testimony, the inflation rates/growth factors utilized by BST for these accounts do  
23   not reflect the cost reductions that should be expected from the onset of  
24   competition.

25

1 Similarly, BST failed to supply adequate supporting documentation for the  
2 inflation rates/growth factors used to determine estimates of 1997-99 expenses for  
3 Account Nos. 62xx, 6310, 6410, 6530, and 6727. For these accounts, BST used  
4 inflation rates/growth factors of 5.1% in 1997, 4.5% in 1998, and 4.2% in 1999.  
5 BST's response to AT&T's First Set of Data Requests, SCPSC Docket No. 97-  
6 374-C, Item No. 281, page 8 of Rebuttal Exhibit ALR-11 is the sole supporting  
7 documentation for those rates/factors, which were calculated by summing the  
8 estimated percentage impact on costs in each year of: (a) load changes (primarily  
9 increases in average access lines in service ("AALIS")); (b) the cost of a service-  
10 improvement initiative; (c) the impact of salary and wage increases for non-  
11 management employees; and (d) the impact of productivity changes related to  
12 "network operations."

13  
14 The use of the rates/factors to inflate the expenses in Account Nos. 62xx, 6310,  
15 6410, 6530, and 6727 is unacceptable for several reasons. First, BST supplied no  
16 supporting data whatsoever for any of the subfactors identified in the previous  
17 paragraph, that were used to derive the inflation rates/growth factors for 1996  
18 through 1997 for those accounts. Second, there is no support in the section of the  
19 Florida BST cost study (CD-ROM version 1.2, blstric.fl\ Appendix E\  
20 flfactors.xls, TPI-A, TPI-B, TPI-C) for the non-management salary and wage  
21 subfactor. BST has simply failed to demonstrate the reasonableness or  
22 appropriateness of the inflation rates/growth factors used for Account Nos. 62xx,  
23 6310, 6410, 6530, and 6727.



1 Q. DOES BST's SHARED AND COMMON COST MODEL RELY ON  
2 UNSUPPORTED DATA INPUTS FOR OTHER ELEMENTS OF ITS  
3 CALCULATION OF THE COSTS EXPECTED TO BE INCURRED FROM  
4 1997-99? IF SO, PLEASE PROVIDE EXAMPLES.

5 A. Yes. BST also failed to provide adequate supporting data for the adjustments that  
6 were used to "normalize" the annualized 1996 costs prior to their being inflated to  
7 1997, 1998, and 1999 costs. For example, BST provided the FPSC with no data  
8 supporting its estimates of the impact of the Olympics and Hurricane Fran on the  
9 amount of costs incurred in 1996 in various accounts, and provided no  
10 explanation of the methodology or assumptions (if any) used in deriving those  
11 estimates. Similarly, BST has neither provided nor explained the basis for its  
12 estimates of the impact of a 11,300-employee workforce reduction on costs  
13 incurred in 1996, and to be incurred in 1997 through 1998. Moreover, BST failed  
14 to explain the basis on which it selected these "normalizing" adjustments, and  
15 offered no justification for its failure to make other adjustments. I find it  
16 particularly likely, for example, that BST will be engaging in additional  
17 workforce reductions prior to the year 2000, which will result in additional cost  
18 reductions not considered by BST in the shared and common cost model. I  
19 understand from an article in the August 7, 1997, edition of the Atlanta Journal-  
20 Constitution, that BST is in the process of finalizing an outsourcing arrangement  
21 with EDS and Andersen Consulting. ("BellSouth Job Shift Riles Union,  
22 Multibillion-Dollar Outsourcing Deal Will Touch 2,000 workers," Atlanta  
23 Journal-Constitution, August 7, 1997, p. E1). Although a BST spokesman claims  
24 that this action will not result in job cuts, it is evident that some of BST's workers  
25 may be hired by the consultants, while others may not. Consequently, the charges

1 from EDS and Andersen Consulting will be contract expenses instead of payroll  
2 expenses. So, in addition to the fact that the contract expenses could result in cost  
3 savings to BST, contract expenses could be booked in different account categories  
4 from the accounts in which the current payroll expenses are reflected in BST's  
5 embedded costs.

6  
7 Similarly, BST has failed to provide any auditable data supporting the \$15 million  
8 in costs that BST expects to incur for the operation of a Local Carrier Service  
9 Center ("LCSC"). Putting aside the question of whether such costs should be  
10 included in the shared and common cost study, BST has provided the FPSC with  
11 no data with which to support its estimate of the amount of LCSC expenses that  
12 may be incurred in the future.

13  
14 **Q. ARE OTHER ELEMENTS OF BST'S SHARED AND COMMON COST**  
15 **MODEL ALSO UNDERMINED BY THE LACK OF SUPPORTING**  
16 **DATA?**

17 **A.** Yes. This same lack of adequate support pervades BST's calculation of the  
18 Investment Development Factors which are used to adjust booked investment to a  
19 projected level of investment based on current cost. In the shared and common  
20 cost model, the wholesale portion of this projected investment is reflected in the  
21 denominator of the common cost and shared cost factors. It is also the same  
22 projected investment that is used to calculate the carrying charges (cost of money,  
23 depreciation, income taxes and ad valorem taxes) that are reflected in the model.  
24 These factors are determined in part using projections of the net additions to  
25 investment that will be made in various BST accounts from 1997 through 1999

1 (BST's Florida Cost Study, Appendix E, pp. 1430-1432). However, the  
2 methodology utilized to derive the projections used in calculating investment  
3 development factors is inadequately explained in BST's cost study. BST relied  
4 upon "out-years" budgets for these projections. Again, however, BST's own cost  
5 study provides a basis for being skeptical about BST's budget projections. For  
6 example, in the memorandum that appears on page 5 of Rebuttal Exhibit ALR-11  
7 to Item No. 281 of BST's response to AT&T's First Set of Data Requests, SCPSC  
8 Docket No. 97-374-C, a BST official explains that BST did not use its 1997-99  
9 budgets to derive the Expense/Salary & Wage Development Factors "due to the  
10 ever-present problem of inadequate out-years' budgets."  
11

12 **Q. YOU TESTIFIED EARLIER THAT BST'S SHARED AND COMMON**  
13 **COST APPLICATION IS UNACCEPTABLE IN PART BECAUSE IT IS**  
14 **SO UNDULY COMPLEX AND SO INSUFFICIENTLY INTEGRATED**  
15 **THAT IT IS NEITHER AUDITABLE NOR READILY**  
16 **UNDERSTANDABLE BY PERSONS FAMILIAR WITH THE INDUSTRY**  
17 **AND ITS COSTS. PLEASE EXPLAIN THE BASIS FOR THIS**  
18 **TESTIMONY.**

19 **A.** In describing the standards that should be applied to a cost study, BST witness  
20 Mr. William P. Zarakas has testified that "development of economic costs are  
21 understandable and auditable." (Zarakas testimony, p. 12, line 5). BST's shared  
22 and common cost model, however, is so complex and poorly integrated that it  
23 cannot be independently tested. The simplest way to demonstrate the difficulty  
24 one would have in testing BST's model is by providing some concrete examples.  
25

1 Q. PLEASE PROVIDE SOME CONCRETE EXAMPLES OF THE  
2 DIFFICULTIES OF TESTING BST'S SHARED AND COMMON COST  
3 MODEL.

4 A. One very important example of the difficulty of testing BST's shared and  
5 common cost model involves BST's decision to calculate non-recurring costs  
6 disparately in different parts of their TELRIC cost model. On the shared and  
7 common cost side of the model, BST has attempted to remove non-recurring  
8 costs, based on embedded costs, for limited number of cost pools in a combination  
9 of ways including the application of service order factors and direct assignment.  
10 BST attempted to remove non-recurring costs from the shared and common cost  
11 model because it intends to recover them in proposed non-recurring prices derived  
12 from separate non-recurring cost studies also filed in this proceeding. However,  
13 BST has not provided any data with which to compare and test the reasonableness  
14 of the non-recurring costs removed from the shared and common cost model  
15 versus the projected non-recurring costs resulting from BST's separate non-  
16 recurring cost studies. BST did not use the non-recurring costs identified in the  
17 shared and common cost side to calculate its proposed non-recurring prices.  
18 Instead, BST calculated the non-recurring costs anew by taking actual data and  
19 multiplying those numbers by a labor rate to calculate the projected non-recurring  
20 costs.

21  
22 This decision causes two serious problems. First, due to BST's inconsistent  
23 methodologies for calculating the non-recurring costs, there exists the danger that  
24 BST could be removing a lesser number on the shared and common side than the  
25 numbers that it calculates in its non-recurring cost calculation. Simply put, this

1 raises the specter of double recovery of non-recurring costs. The second problem  
2 is that there is no way to determine whether the first problem occurred. BST's  
3 choice to use two different methodologies makes the model unusable for the  
4 purpose of verifying BST's non-recurring cost calculations. BST's model may  
5 double count some of the non-recurring costs. Furthermore, any adjustments  
6 made to one set of the calculations would not translate to the other set, creating  
7 another hurdle to a thorough testing of the data.

8  
9 The next example of the difficulty of testing BST's shared and common cost  
10 model concerns the process of attributing shared costs to various investment  
11 accounts, which is at the heart of the model. An appropriate way to test BST's  
12 attributions is to track the amounts from each shared cost account all the way  
13 through BST's reclassification and attribution process to ensure that each dollar of  
14 shared cost is attributed only once and consistent with the attribution basis chosen  
15 by BST. Complicating this desired test is the fact that it needs to be performed at  
16 the individual cost pool or sub-pool basis. Unfortunately, BST has structured its  
17 shared and common cost application in a way that makes this verification  
18 extremely difficult. During his deposition, BST expert Charles B. Lee even  
19 admitted, "I don't know that I could do it sitting here with you." (Reid and Lee  
20 Deposition Transcript, Georgia Docket No. 7061-U, p. 112, see Rebuttal Exhibit  
21 ALR-10).

22  
23 Much of the problem with the BST model is that many cells are populated without  
24 formulas, and instead are simply numbers calculated off-line and then hard input  
25 into the model. During their panel deposition in the Georgia Cost Docket, BST

1 employees Walter S. Reid and Charles B. Lee, Jr., unwittingly demonstrated the  
2 complexity of testing the shared and common cost model. Despite the fact that  
3 both men described their knowledge of the study as comprehensive, neither could  
4 initially explain the source of the calculation of certain cells; rather, they blamed  
5 the errors in their calculations as mathematical "rounding errors." (It took until the  
6 second day of the deposition for BST's experts, Messrs. Reid and Lee, to  
7 understand the source of the BST's own calculations in their own model.) When  
8 Messrs. Reid and Lee attempted to demonstrate how to track one of the cost pools  
9 through the shared and common cost study, they arrived at a calculation that  
10 would disaggregate the value of one of the account pools into three subpools. The  
11 proportion of that pool that was disaggregated, however, to each subpool was not  
12 apparent from simply looking at the model. In the cell of the computer model  
13 where there should have been a formula that would permit the Commission to  
14 verify the attribution to the subpools, BST failed to provide a formula; rather,  
15 BST inserted the result of a calculation performed outside the shared and common  
16 cost model. The frequent use of hard inputs such as this makes it extremely  
17 difficult to verify the results of BST's model. Lee admitted, "I'm just not sure we  
18 have a mathematical representation of how we get from there to there." (Reid and  
19 Lee Deposition Transcript, Georgia Docket No. 7061-U, p. 151, see Rebuttal  
20 Exhibit ALR-10). Messrs. Reid's and Lee's failure occurred because the formulas  
21 that they needed to replicate the calculations in the model were inaccessible to  
22 them, just as they are to the Commission. Only through a time intensive manual  
23 process by an individual very familiar with the model can the simple exercise of  
24 tracking the initial dollar values of the accounts through the primary and  
25 secondary attributions be achieved. Even then, BST admits the process is very

1 difficult and can only be done by backtracking the values from the attributed cost  
2 pools back through the front of the study where the dollars started in the accounts  
3 initially. BST expert Lee admitted that this process is “very tedious work.” (Reid  
4 and Lee Deposition Transcript, Georgia Docket No. 7061-U, p. 113, see Rebuttal  
5 Exhibit ALR-10).

6  
7 **Q. YOU EARLIER TESTIFIED THAT BST’S MODEL CONTAINS**  
8 **NUMEROUS METHODOLOGICAL ERRORS. PLEASE PROVIDE AN**  
9 **EXAMPLE OF A METHODOLOGICAL ERROR.**

10 **A.** BST erred in the method it used to calculate its shared labor factors. BST’s model  
11 included recovery of recurring costs. Therefore, the shared and common cost  
12 model must be modified to produce shared labor factors that exclude recurring  
13 costs. BST’s shared labor factors are used to determine a portion of shared costs  
14 that BST believes should be recovered via the TELRIC labor rates used to price  
15 out non-recurring costs. However, costs generally are non-recurring if they are  
16 transactional in nature, such as those resulting from transactions involving the  
17 installation of a new customer line. BST improperly assumed that recurring  
18 wholesale expenses in account/cost pools that are attributed based on salary and  
19 wages should be recovered via the shared labor rate factors and subsequently, the  
20 labor rates applied to calculate non-recurring prices.

21  
22 **Q. DOES BST’S COST ATTRIBUTION APPROACH RESULT IN**  
23 **RECURRING COSTS BEING IMPROPERLY TREATED AS NON-**  
24 **RECURRING COSTS? PLEASE EXPLAIN.**

25

1 A. Yes. BST has relied on a cost attribution approach that results in wholesale  
2 expenses for specified account/cost pools being recovered through shared labor  
3 factors as non-recurring costs without any showing that recurring expenses have  
4 been excluded. Although some of the costs in the specified cost pools may in  
5 fact include some increment of non-recurring costs, BST has provided no way to  
6 determine that increment. As stated in Walter S. Reid's direct testimony, the  
7 shared and common cost model relies primarily on the use of the cost attribution  
8 principles as specified in the Cost Allocation Manual ("CAM") filed with the FCC  
9 (Reid testimony, p.5, lines 8 - 11 ). Some accounts/cost pools in the CAM are  
10 attributed to other expense or investment accounts based on salary and wages.  
11 BST's assumption that costs attributed based on salary and wages should be  
12 recovered in labor rates used to calculate non-recurring costs is unwarranted and  
13 unsupported.

14  
15 **Q. PLEASE PROVIDE AN EXAMPLE OF AN ACCOUNT/COST POOL**  
16 **THAT INCLUDES RECURRING COSTS THAT ARE IMPROPERLY**  
17 **RECOVERED IN THE SHARED LABOR RATE FACTORS.**

18 A. Account 2112 (Motor Vehicles) is a good example. Investment-related costs  
19 resulting from Account 2112 are recurring costs that should not be recovered in  
20 non-recurring rates. In the shared and common cost model, the wholesale  
21 expenses for all cost pools in Account 2112 are attributed based on salary and  
22 wages. In the shared and common cost model, as stated previously, attribution  
23 based on salary and wages signifies that the amounts in Account 2112 are to be  
24 recovered in the shared labor rate factors that produce the shared cost labor



1 portion of BST's TELRIC labor rates. These labor rates are subsequently used to  
2 calculate non-recurring costs.

3

4 **Q. HOW SHOULD SHARED COSTS IN ACCOUNT 2112 (MOTOR**  
5 **VEHICLES) BE RECOVERD?**

6 **A.** Due to the fact that the amounts in Account 2112 are recurring costs, they should  
7 be recovered in recurring rates. In BST's shared and common cost model, each of  
8 the cost pools in Account 2112 should be attributed on some cost causative basis  
9 other than salary and wages. This results in recovery of the costs in Account 2112  
10 via the shared cost factor, which in BST's model, recovers recurring shared costs.

11

12 **Q. HAS BST TREATED OTHER ACCOUNTS/COST POOLS THAT**  
13 **INCLUDE RECURRING COSTS IN A FASHION SIMILAR TO THE**  
14 **MOTOR VEHICLES EXAMPLE?**

15 **A.** Yes. In fact, the amounts in numerous cost pools for various accounts are  
16 attributed based on salaries and wages without any showing that the costs in these  
17 accounts are non-recurring in nature. Those accounts include 6121 (land and  
18 buildings), 6124 (general purpose computers), 6512 (provisioning), 6534 (plant  
19 administration), 6535 (engineering), 6711 (executive), 6723 (Human Resources),  
20 6724 (information management), 6726 (procurement), 1120 (materials and  
21 supplies), 2116 (other work equipment), 2121 (Buildings), 2122 (furniture), 2123  
22 (office equipment), 2681 (Capital leases), and 2682 (leasehold improvements).  
23 Nowhere in the shared and common cost model or in supporting documentation is  
24 a determination made that some of the amounts in these cost pools are recurring

1 and should be excluded from the calculation of shared labor factors used to  
2 calculate non-recurring costs.

3

4 **Q. HAVE YOU CALCULATED AN ADJUSTMENT TO THE SHARED**  
5 **LABOR RATE FACTORS IN THE BST MODEL THAT CORRECTS THE**  
6 **PROBLEM THAT YOU HAVE NOTED?**

7 **A.** Yes. That information is provided on Rebuttal Exhibit ALR-2. This adjustment  
8 reflects alternative attribution bases for those cost pools attributed using salary  
9 and wages. This adjustment has the effect of reducing the shared labor factors to  
10 zero.

11

12 **Q. IS BST PREVENTED FROM RECOVERING ANY OF THE COSTS FOR**  
13 **THOSE ACCOUNTS/COST POOLS APPEARING ON REBUTTAL**  
14 **EXHIBIT ALR-2?**

15 **A.** No. The changed attribution basis shifts recovery from the shared labor rate  
16 factors to the shared cost factors used to calculate recurring TELRIC rates. Should  
17 BST be able to provide the FPSC with a reliable and auditable method with which  
18 to identify those non-recurring costs that are legitimate for recovery through the  
19 shared labor rate factors, then the shared labor factors could be adjusted  
20 accordingly. The data supplied to date by BST to the FPSC is insufficient to  
21 permit a determination of the amount, if any, of non-recurring costs in those  
22 accounts.

23

24

25

1 **Q. IN ADDITION TO THE EMBEDDED COSTS REFLECTED IN THE BST**  
2 **SHARED AND COMMON COST MODEL, ARE THERE OTHER COSTS**  
3 **THAT ARE INAPPROPRIATE FOR RECOVERY IN THE COMMON**  
4 **COST, SHARED COST, AND SHARED LABOR FACTORS? PLEASE**  
5 **EXPLAIN.**

6 **A.** Yes. BST has included recovery of new forecasted costs for what it calls the  
7 Local Carrier Service Center ("LCSC") costs that should not be recovered in the  
8 shared cost or common cost factor. BST has included \$15,536,528 in new  
9 expenses for which it has arbitrarily assumed that 25% are recurring in nature and  
10 75% are non-recurring in nature. Based on the testimony of Mr. Thomas Hyde,  
11 none of the expenses of this new center should be reflected in the UNE prices that  
12 are being established in this proceeding. In addition, BST has not provided  
13 sufficient information to allow for validation of any of these costs. For these  
14 reasons, I recommend that the costs be removed from consideration in the shared  
15 and common cost model.

16  
17 **Q. DOES THE METHOD BY WHICH DEREGULATED PUBLIC COIN**  
18 **COSTS ARE REMOVED ALSO UNDERMINE BST'S SHARED AND**  
19 **COMMON COST MODEL?**

20 **A.** Yes. BST's adjustment to remove deregulated public coin costs is another  
21 example of a methodological error. A review of this adjustment indicates that  
22 BST failed to remove any increment of G&A expenses in account series 67xx  
23 (BST's Florida Cost Study, Appendix E, pp. 1427-1428). The public coin data  
24 inputs filed in this proceeding differ from the inputs included in the Florida  
25 Payphone Subsidy Study dated February 20, 1997. Florida Payphone Subsidy

1 Study identified a portion of corporate operations expense in Account 67xx that  
2 represented a burden on BST's payphone business and then removed it from the  
3 regulated costs. The requirements of Section 276 of the Telecommunications Act  
4 of 1996 made it necessary for BST to complete these payphone subsidy studies  
5 for multiple jurisdictions. Because of Section 276, BST had already developed  
6 the methodology and the ability to determine these costs on a regional basis.  
7 Therefore, BST has no excuse for its failure to remove from the shared and  
8 common cost model the same level of corporate expenses in accounts 67xx as  
9 were identified in the payphone subsidy study. The development of a new  
10 methodology for the payphone adjustment in this proceeding is obviously self-  
11 serving. Further, not only is it different from the previous payphone subsidy  
12 study provided to the FPSC, but it is also not supported by that study.

13

14 **Q. PLEASE DESCRIBE THE ADJUSTMENTS THAT YOU HAVE MADE**  
15 **TO THE BST SHARED AND COMMON COST MODEL.**

16 **A.** The adjustments that I have made do not address all of the deficiencies in BST's  
17 shared and common cost model which are explained in my testimony. I was able  
18 to propose adjustments only in those instances where BST provided the FPSC  
19 with sufficient data. The adjustments and supporting documentation for those  
20 issues that could be quantified are as follows:

21

22 Rebuttal Exhibit ALR-1 provides revised expense development factors and  
23 supporting calculations that remove growth from inflation, reduce G&A expenses  
24 by 27%, and reduce network operating expenses by 50% (Rebuttal Exhibit ALR-8

1 provides supporting documentation for the 50% reduction; Rebuttal Exhibit ALR-  
2 9 provides supporting documentation for the 27% reduction);

3  
4 Rebuttal Exhibit ALR-2 describes the alternative attribution bases used to shift  
5 recovery of costs from the shared labor cost factors which recover non-recurring  
6 costs, to the shared cost factors that recover recurring costs;

7  
8 Rebuttal Exhibit ALR-3 describes the removal of the LCSC costs; and

9  
10 Rebuttal Exhibit ALR-4 provides a comparison of the original and revised shared  
11 cost, common cost and shared labor rate factors. The revised factors also reflect  
12 AT&T's recommended change in carrying costs that results when the cost of  
13 money and depreciation rates are adjusted.

14

15 **V. ANALYSIS OF LABOR RATES:**

16

17 **Q. HAS BST DEVELOPED LABOR RATES REFLECTIVE OF A**  
18 **FORWARD-LOOKING COMPETITIVE ENVIRONMENT?**

19 **A.** No. As with the rest of the shared and common cost model, BST once again  
20 assumes that embedded wage and salary expense is the appropriate starting point  
21 for determining labor rates that will be applicable in a forward looking  
22 environment. In this case, BST's labor rates are calculated from 1995 salaries and  
23 wages and the actual hours worked.

24

25

1 **Q. WHY IS IT IMPROPER TO USE 1995 EMBEDDED SALARIES, WAGES,**  
2 **AND HOURS TO CALCULATE THE LABOR RATES TO BE USED IN**  
3 **CALCULATING TELRIC RATES?**

4 **A.** A couple of examples will help illustrate why the use of 1995 salary and wage  
5 information is improper for setting TELRIC labor rates. First, BST is currently  
6 involved in implementing an announced downsizing initiative whereby 11,300  
7 employees will be off the payroll by the end of 1997. Some of the downsizing is  
8 made possible because of a trend in the outsourcing of work exemplified by  
9 BST's negotiations regarding an outsourcing agreement with EDS and Andersen  
10 Consulting involving 2000 employees. Further, outsourcing can be expected in an  
11 environment in which BST will be needing to trim costs to allow it to compete  
12 more aggressively with new competitors. To the extent that employees who are  
13 downsized have been replaced by outsourcing expenses in 1996 or later, the 1995  
14 salary and wage expense is no longer representative of forward-looking salary and  
15 wage expenses in a competitive environment.

16  
17 Second, reengineering initiatives that have occurred in 1995 and 1996, or later,  
18 have resulted in productivity improvements that can result in both changes to the  
19 number of people required to do a job, the salary grade of the individual  
20 performing the job in cases where skillset requirements have been reduced, and  
21 the amount of time that it takes to complete the job. It is evident from this  
22 example that use of 1995 salaries and wages and the corresponding hours are not  
23 representative of forward-looking environment and should not be the basis for  
24 determining forward-looking labor rates.

25

1 **Q. IS IT IMPROPER FOR BST TO APPLY INFLATION FACTORS TO ITS**  
2 **CALCULATION OF LABOR RATES?**

3 **A.** Yes. The application of inflation factors to booked salary and wages for 1995  
4 assumes business as usual in a monopoly environment instead of the competitive  
5 environment in which BST will be operating. In a competitive environment, BST  
6 will have continued pressure to hold payroll costs down. The application of  
7 inflation factors to historical salaries is not representative of the forward-looking  
8 labor rates that should be calculated for use in developing TELRIC rates.

9  
10 **Q. ARE THERE ANY CATEGORIES OF COSTS THAT BST HAS**  
11 **INCLUDED IN ITS DIRECTLY ASSIGNED LABOR RATES THAT ARE**  
12 **INAPPROPRIATE? PLEASE EXPLAIN.**

13 **A.** Yes. BST's calculation of directly assigned labor rates includes commissions and  
14 incentive awards paid to employees for the sale of retail services. These  
15 Commissions are not a wholesale cost that should be reflected in labor rates.  
16 Unfortunately, BST has not included supporting documentation that allows for a  
17 removal of these payments.

18  
19 **Q. WHAT ADJUSTMENTS HAVE YOU MADE TO THE CALCULATION**  
20 **OF THE TELRIC LABOR RATES?**

21 **A.** For the reasons previously stated, I have eliminated the inflation factors from the  
22 calculation of directly assigned labor rates. In addition, as explained earlier in my  
23 testimony, adjustments that I calculated for the shared and common cost model  
24 produced revised shared labor rate factors. Due to the lack of available data, I  
25 have not been able to calculate and propose adjustments to address all the

1 deficiencies in the BST calculation of labor rates. Rebuttal Exhibit ALR-5  
2 reflects calculations that I have been able to quantify.

3  
4 **Q. ARE THESE THE TELRIC LABOR RATES RECOMMENDED BY AT&T**  
5 **IN THIS PROCEEDING?**

6 **A.** No. Due to the lack of available data, I have not been able to calculate and  
7 propose adjustments to address all the deficiencies in the BST calculation of labor  
8 rates. There are issues that could not be quantified or adequately addressed.  
9 While the resulting labor rates are an improvement over the TELRIC labor rates  
10 proposed by BST, the labor rates reflected in the AT&T NonRecurring Cost  
11 ("NRC") model, as presented by AT&T witness John P. Lynott, are the labor rates  
12 that should be approved by the Commission.

13  
14 **VI. ANALYSIS OF PLANT SPECIFIC EXPENSE FACTORS:**

15  
16 **Q. DID BST BASE THE CALCULATION OF THE PLANT SPECIFIC**  
17 **EXPENSE FACTORS ON EMBEDDED COSTS? PLEASE EXPLAIN.**

18 **A.** Yes. In a fashion similar to the development of the shared and common cost  
19 factors, the inputs are based on partial year 1996 data which purportedly is  
20 normalized for the same events as the shared and common cost factors, including  
21 the effects of Hurricane Fran, the Olympics, and a compensated absence issue.  
22 As in the case of the shared and common cost model, growth factors are also  
23 applied. Here too, data extrapolations are utilized which are untested. For  
24 example, the factors are calculated at the field reporting code ("FRC") or  
25 subaccount level based on a 1995 study. Data from that study is used to



1 determine what percentage each FRC is of the total account, but does not show  
2 that these relationships can be expected to be unchanged in 1996 or the future.

3

4 **Q. DO YOU AGREE WITH THE METHOD BY WHICH BST HAS**  
5 **CALCULATED ITS PLANT SPECIFIC EXPENSE FACTOR THAT**  
6 **INCLUDES THE COST OF MATERIAL USED AND DIRECT LABOR**  
7 **FOR MAINTENANCE AND REARRANGEMENT EXPENSE?**

8 **A.** No. As in the case of the inputs to the shared and common cost model, the inputs  
9 should be based on forward-looking expenses based on least cost technology.  
10 Instead, BST has once again assumed a business-as-usual environment and  
11 applied growth factors to the embedded cost data to calculate what it considers to  
12 be forward-looking factors.

13

14 **Q. IS IT APPROPRIATE FOR BST TO FURTHER APPLY INFLATION**  
15 **GROWTH FACTORS TO THE EMBEDDED EXPENSES FROM WHICH**  
16 **THE PLANT SPECIFIC FACTORS ARE CALCULATED?**

17 **A.** No. Similar to the rationale previously explained in my testimony regarding  
18 network operating expenses in the shared and common cost model, network  
19 operating expenses will be reduced in a competitive forward-looking  
20 environment. The series of accounts that is included in the calculation of the plant  
21 specific factor (Account Nos. 6121-6441 and 6531) should experience negative  
22 growth instead of inflation because expense levels are tied to older plant  
23 equipment included in embedded costs. Competition should drive these expenses  
24 downward as new technology is deployed.

25

1 **Q. HAVE YOU ADJUSTED THE CALCULATION OF THE PLANT**  
2 **SPECIFIC FACTOR?**

3 **A.** Yes. I adjusted the BST calculation of the 1997-99 amounts to remove the  
4 inflation/growth factors, shown on Rebuttal Exhibit ALR-6. Although these  
5 accounts will experience negative growth, I did not have sufficient data to  
6 estimate the amount of that negative growth. Therefore, to be conservative, the  
7 adjustments that I propose merely remove BST's inflation factors.

8

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

10 **A.** Yes it does.

11

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1           MR. HATCH: I would also request that Mr. Lerma's  
2 exhibits to his rebuttal testimony be marked for  
3 identification.

4           COMMISSIONER DEASON: It will be identified as  
5 composite exhibit 55.

6 BY MR. HATCH:

7           Q     Mr. Lerma, if I asked you the same questions  
8 today, would your answers be the same?

9           A     Yes, they would.

10          Q     Do you have a summary of your testimony,  
11 Mr. Lerma?

12          A     Yes, I do.

13          Q     Would you please give that?

14          A     Yes. Good morning, Commissioners. My name is  
15 Art Lerma. And my duties the last 13 years have included  
16 the review of local exchange company cost studies. In this  
17 proceeding, I have evaluated the development of BellSouth's  
18 shared factors, common cost factors and plant specific  
19 factors that are used to determine expenses applicable to  
20 each unbundled network element. I've also evaluated the  
21 calculation of BellSouth's labor rates. These labor rates  
22 are the basis for the development of nonrecurring costs and  
23 prices in BellSouth's UNE cost studies.

24                 Now as a result of my review, I've concluded that  
25 these BellSouth factors and labor rates aren't acceptable

1 for several reasons. First, they are not based on  
2 competitive costs. Second, the accuracy of the shared and  
3 common cost model inputs cannot be confirmed. And third,  
4 the shared and common cost model treats some recurring  
5 costs as nonrecurring costs. For these reasons, acceptance  
6 of these BellSouth factors and labor rates will be  
7 detrimental to consumers because UNE recurring and  
8 nonrecurring rates will be set too high and result in  
9 barriers to entry for competing local exchange companies.

10 First, before I go on, some explanations about  
11 the BellSouth factors and labor rates are in order.  
12 Recurring costs related to the UNE investments are  
13 calculated by applying factors. The common cost factor  
14 assigns wholesale overhead costs like executive salaries or  
15 accounting and finance costs to each of the unbundled  
16 network elements. Shared cost factors recover recurring  
17 wholesale costs that apply to two or more elements.  
18 BellSouth's engineering expenses, for example, are examples  
19 of costs shared by multiple unbundled network elements.

20 Shared labor factors are a third set of factors,  
21 and these identify shared costs that BellSouth seeks to  
22 recover in labor rates that are used to price out  
23 nonrecurring cost. Now this is important because TELRIC  
24 labor rates include two different components. One of those  
25 are the direct labor rates that reflect your actual

1 salaries and wages and benefit loadings, and then they also  
2 include a shared cost component, and this is the shared  
3 labor factor that I refer to that in some cases amounts to  
4 about 50% of the direct labor rate.

5           Should BellSouth's factors and labor rates be  
6 accepted? No, they should not. And why not? The factors  
7 and labor rates do not reflect competitive costs. Why?  
8 First, because they don't reflect long-run productivity  
9 improvements. In a competitive environment, there will be  
10 more pressure to reduce costs than in a monopoly  
11 environment. They are also not reflective of a least cost  
12 environment in which new technology is being used.  
13 Instead, the factors and labor rates are based largely on  
14 historical or embedded costs. For example, overhead  
15 expenses, like executive planning and finance costs, are  
16 costs that are reduced in a competitive environment.  
17 BellSouth has overstated the forward-looking level of these  
18 overhead expenses. In a competitive environment,  
19 BellSouth's overhead expenses are likely to be considerably  
20 lower than they are in a monopoly environment.

21           Another reason that BellSouth's factors and labor  
22 rates should not be accepted is that the accuracy of the  
23 shared and common cost model inputs cannot be confirmed and  
24 it's difficult to test the model. Many of the model's  
25 inputs were calculated off line, and there was significant

1 reliance on data extrapolations. And when I say data  
2 extrapolations, what I'm referring to there is using data  
3 that was based on short periods of time, a month, two  
4 months, and using it to project costs for a longer period  
5 of time, in this case, for three years or forward.

6           Wherever BellSouth has used these data  
7 extrapolations, it provides no evidence that these  
8 extrapolations produce reasonable results and have been  
9 tested. Another reason that this Commission should reject  
10 the BellSouth shared and common cost factors and labor  
11 rates is that the shared and common cost model treats  
12 recurring costs as nonrecurring costs. How does this  
13 occur? As I stated earlier, TELRIC labor rates are key in  
14 the development of these nonrecurring rates, and a  
15 significant portion of these BellSouth TELRIC labor rates  
16 is the shared cost component, which I stated earlier that  
17 in some cases increases the labor rate by almost 50  
18 percent. This component is generated by shared labor  
19 factors that are calculated in the shared and common cost  
20 model.

21           The shared labor factors as calculated by  
22 BellSouth should be rejected. Why? Well, using motor  
23 vehicle costs as an example, BellSouth's cost attribution  
24 process causes recurring expenses to be recovered in  
25 nonrecurring rates. Motor vehicle costs are recovered in

1 recurring rates through recovery of recurring costs like  
2 depreciation and ad valorem taxes. Recovery of recurring  
3 costs in nonrecurring rates creates barriers to entry for  
4 the competing local exchange companies. In attachment  
5 ALR-4, page 3 of my testimony, reflects my recommended  
6 adjustment in which I zeroed out the shared labor factors  
7 and instead shifted recovery of those costs to the shared  
8 cost factors.

9           Aside from this adjustment, the attachments to my  
10 testimony reflect only those adjustments that I could  
11 quantify. For the shared and common cost model they  
12 include removal of projected inflation for expenses because  
13 they trend downward in the competitive environment. My  
14 adjustments also recognize reduced network operating  
15 expenses and overhead. I have also adjusted labor rates  
16 and plant specific factors to remove inflation.

17           There are other problems with the BellSouth  
18 factors and labor rates that can't be fixed with the data  
19 that BellSouth has made available to this Commission, and  
20 consequently, this Commission should not accept them. If  
21 the Commission adopts these factors and labor rates without  
22 considering these adjustments, it will hurt consumers  
23 because they will pay higher rates and recover higher  
24 costs. This concludes my summary.

25           MR. HATCH: We tender the witness for cross.

1 MS. KEATING: Commissioner Deason.

2 COMMISSIONER DEASON: Yes.

3 MS. KEATING: Staff would ask that its exhibit  
4 for this witness be marked at this time. Staff has one  
5 exhibit, it's ALR-12, and it contains the deposition  
6 transcript and the deposition exhibits and late-filed  
7 deposition exhibits from Mr. Lerma's deposition.

8 COMMISSIONER DEASON: It will be identified as  
9 exhibit 56.

10 MS. KEATING: Thank you.

11 MR. TWOMEY: What was that number, Commissioner  
12 Deason?

13 COMMISSIONER DEASON: 56.

14 MR. TWOMEY: At this time, BellSouth -- and I  
15 have already talked to Mr. Hatch about this. One of the  
16 deposition late-filed exhibits was the testimony of  
17 Kimberly Dismukes that was filed in Louisiana. The copy of  
18 that testimony that was submitted by Mr. Lerma did not  
19 include the exhibits to that testimony because the exhibits  
20 were proprietary. I'd just like to make the exhibits to  
21 that testimony part of the exhibit 56 as well, and I have  
22 copies here, but we would propose submitting them with a  
23 notice of intent no later than Friday, if that's acceptable  
24 to everybody.

25 COMMISSIONER DEASON: Any objection?



1 MR. HATCH: That's fine with us, Commissioner  
2 Deason.

3 MR. MELSON: Commissioner Deason, if we could  
4 just have that marked as a separate exhibit to aid in  
5 keeping track of it.

6 MR. TWOMEY: We have no objection to that.  
7 That's fine.

8 COMMISSIONER DEASON: Very well. That will be  
9 exhibit 57, and it will be the confidential exhibits  
10 attached to the testimony of Witness Dismukes which  
11 testimony is part of exhibit 56; is that correct?

12 MR. TWOMEY: Just for the record to be perfectly  
13 clear, there are exhibits that are not confidential, but  
14 there are some that are, and we are going to submit them  
15 altogether as a package; and there were also certain  
16 revisions made by Ms. Dismukes two days after she submitted  
17 her testimony. We've included those as well because those  
18 are revised exhibits.

19 COMMISSIONER DEASON: Very well.

20 MR. TWOMEY: Thank you, Commissioner Deason.

21 MR. TWOMEY: Good morning, Mr. Lerma.

22 WITNESS LERMA: Good morning.

23 COMMISSIONER DEASON: Mr. Melson, did you have  
24 any questions?

25 MR. MELSON: No.

1 MR. TWOMEY: Thank you.

2 CROSS EXAMINATION

3 BY MR. TWOMEY:

4 Q Mr. Lerma, this is not the first cost proceeding  
5 that you have testified in, is it?

6 A No, that's correct.

7 Q You've testified on behalf of AT&T in a number of  
8 the cost dockets, around the BellSouth region at least,  
9 since mid 1997, correct?

10 A Yes.

11 Q In the states other than Florida, AT&T has  
12 advocated the use of a 10.4% common cost factor derived  
13 from 1994 AT&T data, correct?

14 A If you are referring to the Hatfield model and  
15 the common cost factor that is included in that, that's the  
16 factor, and that is part of the testimony of Mr. Don Wood.

17 Q And just so the record is clear, is the answer to  
18 my question yes?

19 A Yes.

20 Q Thank you.

21 Now you describe that as a common cost factor,  
22 correct?

23 A Yes.

24 Q Would you please define common cost for me?

25 A Generally speaking, common costs are costs that

1 apply to all facets of the business. In this case it would  
2 be those costs that apply to all of the unbundled network  
3 elements and not just to a smaller group.

4 Q Is common cost the same thing as shared cost?

5 A Shared costs normally apply to two or more  
6 elements, and if the shared costs applied to all the  
7 elements, then they would be the same. But in most cases,  
8 shared costs would apply to a smaller group of unbundled  
9 network elements.

10 COMMISSIONER CLARK: The answer is no?

11 WITNESS LERMA: No.

12 Q Is common cost the same thing as overhead cost?

13 A Yes, generally speaking.

14 Q So if I were to use the term common cost or  
15 overhead cost, as far as you're concerned, those two things  
16 mean the same thing?

17 A As far as I'm concerned, but with respect to how,  
18 say, BellSouth calculated its common cost factor within its  
19 own model, it went through an extensive attribution process  
20 where it attempted to attribute costs -- shared costs to  
21 individual investment categories; and to the extent that  
22 they weren't able to do that, there were sometimes some  
23 costs that they included in the common cost factor that  
24 aren't traditionally considered as general and  
25 administrative costs, like executive and planning. So in

1 the case of BellSouth, there may be some costs in there  
2 that aren't normally considered as common costs.

3 Q All right. Well, let's just talk about the AT&T  
4 common cost factor that we have previously identified. You  
5 would use the phrase common cost factor and overhead cost  
6 factor synonymously with respect to the AT&T number,  
7 correct?

8 A Not necessarily. Your question earlier was what  
9 I considered common costs to be, and I said that they --  
10 you know, overheads are what comes to mind for me. I was  
11 not involved in the development of the Hatfield model. I  
12 understand that there is a common cost factor that is  
13 applied within the Hatfield model, but I can't tell you  
14 specifically what it's intended to do. That would be  
15 better left probably for Mr. Wood to answer.

16 Q Well, without regard to what it is intended to  
17 do, you have defined common cost for us as being synonymous  
18 with overhead cost, correct?

19 A Yes, generally speaking.

20 Q Now Mr. Lerma, in your testimony you have  
21 criticized BellSouth's shared and common cost model for,  
22 among other things, your opinion that BellSouth is not  
23 using the least cost, most efficient technology, correct?

24 A Yes.

25 Q You have concluded that BellSouth is not using

1 the least cost, most efficient technology, correct?

2 A Yes, it would appear so.

3 Q What technology is BellSouth currently using to  
4 provide services in Florida?

5 A I'm sorry, that's a fairly broad question. I'm  
6 not sure I understand what you're asking.

7 Q Well, you've concluded, I think you've just  
8 agreed with me, that BellSouth is not using the least cost,  
9 most efficient technology. My question to you is what  
10 technology is BellSouth using in Florida in your opinion?

11 A Let me explain when I answered that what exactly  
12 I meant, and that's that when I reviewed the shared and  
13 common cost model the numbers that are used specifically in  
14 the shared and common cost model to come up with the shared  
15 and common cost factors are primarily the current costs of  
16 the company with some adjustments for reengineering. So  
17 with respect to that, that would reflect that it's based on  
18 the current technology and that there hasn't been any  
19 adjustments for any newer, modern technology that might be  
20 expected in the future.

21 Now that's different from, say, how BellSouth  
22 might have developed its investment in the TELRIC  
23 calculator which those factors are applied to. Within that  
24 building up of investment, they may have considered other  
25 technology. I did not review that. What I reviewed is

1 that within the shared and common cost model they used  
2 primarily historical costs that did not reflect any kind of  
3 adjustments to suggest that there was newer, current  
4 technology being considered.

5 Q Okay. So when you did your analysis of the  
6 shared and common cost factor, you took into consideration  
7 that BellSouth's technology -- you took into consideration  
8 BellSouth's technology choices, correct?

9 A I'm sorry, ask the question again.

10 Q When you did your analysis of the shared and  
11 common cost model, you took into consideration BellSouth's  
12 technology choices, correct?

13 A Yes. As I explained, the fact that there had not  
14 been any factoring in of the types of expense reductions  
15 that we would see from newer, more modern technology being  
16 brought in, that was evidence to me that it had not been  
17 adjusted for newer, forward-looking technology.

18 Q Now what is the current technology that BellSouth  
19 is using as reflected in the shared and common cost model?

20 A Generally speaking, it is the embedded historical  
21 network that is in place at this time.

22 Q Okay. And what analysis did you do personally to  
23 conclude that that current technology is not the least  
24 cost, most efficient technology?

25 A I did no separate analysis of my own. The fact

1 that that cost is based on historical embedded costs is  
2 enough for me to know that it's not based on any  
3 forward-looking technology that would involve least-cost  
4 economic costs.

5 Q Mr. Lerma, do you have any expertise in outside  
6 plant engineering?

7 A No, I do not.

8 Q Have you ever purchased technology for a  
9 telecommunications company?

10 A No.

11 Q So you're not able to offer us any opinion on  
12 whether BellSouth's existing technology can actually  
13 provide the least cost, most efficient service, can you?

14 A No, I cannot.

15 MR. TWOMEY: I have no further questions.

16 COMMISSIONER DEASON: Staff.

17 MS. KEATING: Staff has no questions for this  
18 witness.

19 COMMISSIONER DEASON: Commissioners.

20 COMMISSIONER CLARK: I do have a question for  
21 you, Mr. Lerma, and I guess it may engender more, I guess,  
22 redirect or maybe recross.

23 Could somebody give to Mr. Lerma Mr. Reid's  
24 rebuttal testimony?

25 WITNESS LERMA: I should have a copy of that

1 here.

2           COMMISSIONER CLARK: Okay. And I gather from  
3 what he says in his exhibit 6 -- well, and specifically his  
4 conclusion on page 8 that their analysis of the common cost  
5 factor calculated using the Hatfield model and BellSouth's  
6 forward-looking projections of expense produces a factor of  
7 6.4 which is better than the factor that you all have  
8 indicated is appropriate which is 10.4. What I gather from  
9 Mr. Reid's rebuttal is sort of doing a sanity check of what  
10 they've proposed. Using your model, they come out pretty  
11 good, and it gives credence to their model. Do you  
12 disagree with that?

13           WITNESS LERMA: Yes, let me answer that in two  
14 parts. First off, and that's that there is a difference  
15 between -- and I think I mentioned earlier when we were  
16 trying to discuss what a common cost factor includes, and I  
17 said generally it includes overheads. As BellSouth  
18 calculated its cost factor, it didn't necessarily include  
19 just overheads. A lot of the costs that are traditionally  
20 included as common costs they moved into shared cost  
21 factors, so you would have to, you would -- Going through  
22 the model in the detailed cells of the model, you can find  
23 accounts that were attributed to investments that  
24 traditionally are included in the common cost factor. Had  
25 they not done that attribution, the common cost factor



1 would have been higher.

2           The point is, that because of that different  
3 approach, it's also an apples and oranges comparison to use  
4 one factor to apply to the other. To give you an example,  
5 AT&T didn't calculate -- my understanding, and when  
6 Mr. Wood is up here, he'd be a better person to talk to  
7 about the Hatfield model, but there are no comparable  
8 shared cost factors in the Hatfield model. So the common  
9 cost factor is intended to recover, you know, all common  
10 costs. So there is not -- you can't compare the two, and I  
11 think when they say that if you replace their numbers with  
12 -- if you replace the Hatfield calculation with their  
13 numbers, it creates, based on Mr. Reid's information, it  
14 creates a lower factor. Based on that information, I think  
15 it shows the conservativeness of the Hatfield model with  
16 respect to that factor. I think that factor could be  
17 significantly lower if you were to calculate it based on  
18 the way that BellSouth has calculated its cost factor. For  
19 example, I wouldn't have -- Bell's cost factor is 5.30%,  
20 the common cost factor. I wouldn't have any problems with  
21 that being substituted in the Hatfield model if that's what  
22 the Commission decided to do; however, Mr. Wood has  
23 conducted analysis that suggests to him that for the  
24 purposes of the Hatfield model the 10.4% was the best  
25 available information he had concerning what a

1 forward-looking common cost factor ought to be.

2 COMMISSIONER CLARK: Well, let me ask maybe a  
3 different question. In the rebuttal testimony it says the  
4 comparison -- I'm on page 7 -- the comparison of  
5 BellSouth's proposed shared and common cost factors to  
6 historical based factors shows that the forward-looking  
7 costs that they are advocating average 32% lower than the  
8 historical levels. First of all, do you agree or disagree?

9 WITNESS LERMA: I disagree, and let me explain to  
10 you. I'm glad you asked that question because one of the  
11 things that has occurred in the analysis that BellSouth has  
12 put forward is they are comparing these changes to 1995  
13 costs as if 1995 is the starting point, and if you look at  
14 how they built their cost study, they took '95 costs and  
15 then they normalized them or brought them to 1996 levels,  
16 and so what you ought to be looking at is after you've made  
17 all of your adjustments at the end of 1996, then you look  
18 and say, what is happening going forward? Instead, because  
19 they chose to initially populate the data with '95, they  
20 have now gone back and said, look what's happened since  
21 1995. And so some of the reductions that they are  
22 reflecting there include costs all the way back to 1995.  
23 And how far back would be appropriate? You know, if they  
24 had populated them with 1994 costs and then normalized them  
25 to '96, they would be comparing it to '94. So I think it

1 was inappropriate that they look at those cost reductions  
2 based on 1995 as the starting point.

3 COMMISSIONER CLARK: Well, let me relate back to  
4 you what I think you said and tell me if I'm correct. What  
5 you're saying is by using 1995 historical costs it's really  
6 too far back to conclude that a 32% decline in terms of  
7 what they've developed for a forward-looking cost is really  
8 not significant?

9 WITNESS LERMA: That's correct.

10 COMMISSIONER CLARK: Because it starts too far  
11 back?

12 WITNESS LERMA: That's correct.

13 COMMISSIONER CLARK: It would be more appropriate  
14 to use 1996 actual costs?

15 WITNESS LERMA: Yes, ma'am.

16 COMMISSIONER CLARK: Normalize them for '97 and  
17 then look at what the lower level -- what results when  
18 compared to what they estimate for the forward-looking  
19 cost?

20 WITNESS LERMA: Absolutely. I would agree with  
21 that.

22 COMMISSIONER CLARK: Okay. I just say though, I  
23 can't say that I followed your explanation of why you can't  
24 compare the six point -- their 6.4% using the Hatfield  
25 model. I gather that what you might be saying is it's

1 because they've shifted some costs to shared or they've  
2 shifted some costs to common is the reason why you get a  
3 different fatcor.

4 WITNESS LERMA: Yes. That's part of it, yes,  
5 absolutely.

6 COMMISSIONER CLARK: Okay.

7 COMMISSIONER DEASON: Redirect.

8 MR. HATCH: No redirect.

9 MR. TWOMEY: Commissioner Clark, would it be  
10 appropriate for me to ask a follow-up question on that  
11 question you just asked Mr. Lerma?

12 COMMISSIONER DEASON: Are you asking for further  
13 cross as a result of Commissioner Clark's questions?

14 MR. TWOMEY: Yes.

15 COMMISSIONER DEASON: You may be permitted.

16 MR. TWOMEY: Thank you

17 FURTHER CROSS EXAMINATION

18 BY MR. TWOMEY:

19 Q Mr. Lerma, did someone provide you with a copy of  
20 Mr. Reid's rebuttal testimony?

21 A I have a copy of his.

22 Q Okay. Would you turn to rebuttal exhibit WSR-6,  
23 page 4 of 4?

24 A Yes.

25 Q And I believe this is the exhibit that contains

1 the numbers that Commissioner Clark was asking you about?

2 A Yes, it does.

3 Q Okay. Now there are actually three columns here,  
4 or three entries, a Hatfield model, BST historical data and  
5 then BST data, correct?

6 A Yes.

7 Q Now under the entry BS -- excuse me, Hatfield  
8 model, AT&T 1994 gross revenues were used. AT&T 1994  
9 corporate operation expenses and then revenue less  
10 corporate operation expenses we used to derive a common  
11 cost factor of 10.4%, correct?

12 A That's correct.

13 Q And that's the 10.4% number that we were talking  
14 about during my cross examination, correct?

15 A Yes.

16 Q Now the entry immediately below that contains BST  
17 1994 gross revenue. Do you see that?

18 A Yes.

19 Q And you would agree with me that corresponds  
20 directly with the AT&T 1994 gross revenue, correct?

21 A That's what it says there. I have not verified  
22 those numbers, but it says it's 1994 gross revenues.

23 Q Assuming BST hasn't misrepresented the numbers,  
24 the categories correspond, correct?

25 A Yes.

1 Q Okay. And the entry below that is BST 1994  
2 actual corporate operations expense; do you see that?

3 A Yes.

4 Q Does that correspond directly with the AT&T 1994  
5 corporate operations expense?

6 A It's the same description of expenses, yes.

7 Q Okay. And the last column is the revenue less  
8 corporate operations expense. Does that correspond  
9 directly with the revenue less corporate operation expenses?

10 A Yes, that's the description.

11 Q And what's the percentage number that is derived  
12 as a common cost factor when BST historical revenue and  
13 expenses are used rather than AT&T operations expenses and  
14 revenue are used?

15 A It says 9.7%.

16 Q Okay. Would you describe AT&T as being in a  
17 competitive industry in 1994?

18 A Yes.

19 Q Okay. Now the entry below that is BST projected  
20 data, and do you understand how those numbers were put  
21 together?

22 A Yes, I do. It appears here that the  
23 relationships are BellSouth's total cost of service as a  
24 percentage of the projected expenses.

25 Q And you understand that BellSouth replaced the

1 historical cost -- instead of using historical cost, we  
2 used what we projected would be our expenses, correct?

3 A Yes.

4 Q And that made the number drive down to 6.4%,  
5 correct?

6 A That's correct.

7 MR. TWOMEY: Thank you, Commissioner Deason. I  
8 have no further questions.

9 COMMISSIONER DEASON: Redirect.

10 MR. HATCH: No redirect.

11 COMMISSIONER DEASON: Exhibits.

12 MR. HATCH: Move 55.

13 COMMISSIONER DEASON: Without objection, exhibit  
14 55 is admitted.

15 MS. KEATING: Staff moves 56.

16 COMMISSIONER DEASON: Without objection, exhibit  
17 56 is admitted.

18 MS. WHITE: And I guess we would move exhibit 57  
19 subject to the notice of intent that will be filed on  
20 Friday.

21 COMMISSIONER DEASON: Without objection, exhibit  
22 57 is admitted.

23 Thank you, Mr. Lerma, you are excused.

24 WITNESS LERMA: Thank you.

25 MR. HATCH: AT&T would call Catherine Petzinger.

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\* \* \* \*

Whereupon,

CATHERINE E. PETZINGER

was called as a witness on behalf of AT&T and, after being  
duly sworn, testified as follows:

DIRECT EXAMINATION

BY MR HATCH:

Q Ms. Petzinger, could you please state your name  
and address for the record?

A Yeah, my name is Catherine Petzinger. I'm at 279  
North Maple Avenue, Basking Ridge, New Jersey.

Q By who are you employed and in what capacity?

A I'm a district manager at AT&T.

Q Did you prepare and cause to be filed in this  
proceeding rebuttal testimony?

A Yes, I did.

Q Do you have any changes or corrections to that  
testimony?

A Yes, I have a couple of minor corrections.

Q Could you give them, please?

A Certainly. On page 9, line 12, in the title 1996  
is inadvertently there. It should be deleted.

COMMISSIONER CLARK: Would you repeat that?



1           WITNESS PETZINGER: Certainly. On page -- Well,  
2 hopefully I've got the same pagination. It's the question  
3 that says, "Does Southwestern Bell's switched price per  
4 line 1996 support BellSouth's pricing."

5           COMMISSIONER CLARK: And what is the change?

6           WITNESS PETZINGER: 1996 should be removed

7           A     And on page 11, in the center of the table it  
8 says "Raley testimony, dash, BellSouth." BellSouth should  
9 be replaced with Southwestern Bell. That's the only  
10 changes.

11 BY MR. HATCH:

12           Q     There were no exhibits attached to your  
13 testimony; is that correct?

14           A     That's correct.

15           Q     If I asked you the same questions as were in your  
16 prefiled testimony today, would your answers be the same?

17           A     Yes, they would.

18           COMMISSIONER DEASON: Let me confirm, has  
19 Ms. Petzinger been sworn?

20           Q     Have you been previously sworn?

21           A     No.

22           COMMISSIONER DEASON: Okay. Let's go ahead and  
23 do that right now. If you'll please stand and raise your  
24 right hand.

25                     (Whereupon, Witness Petzinger was duly sworn by

1 Commissioner Deason)

2 MR. HATCH: AT&T would request that the prefiled  
3 rebuttal testimony of Ms. Petzinger be inserted in the  
4 record as though read.

5 COMMISSIONER DEASON: Without objection it shall  
6 be so inserted.

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## 1 REBUTTAL TESTIMONY OF

2 CATHERINE E. PETZINGER

3 ON BEHALF OF

4 AT&amp;T COMMUNICATIONS OF THE SOUTHERN STATES, INC.

5 DOCKET NOS: 960833-TP/960846-TP/971140-TP/960757-TP/960916-TP

6

7 **1.0 INTRODUCTION**8 **Q. PLEASE STATE YOUR NAME, PRESENT POSITION AND BUSINESS**  
9 **ADDRESS**10 **A.** My name is Catherine E. Petzinger. I am a District Manager with AT&T Corp. in  
11 Regulatory and Legislative Affairs, 295 North Maple Avenue, Basking Ridge,  
12 New Jersey.

13

14 **Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE AND EDUCATIONAL**  
15 **BACKGROUND**16 **A.** I have an MBA from Rutgers University, New Jersey, and have thirteen years of  
17 experience in the telecommunication industry building, and subsequently leading,  
18 a group that developed switching cost models, including the Switching Costs  
19 Information System ("SCIS"). My experience includes extensive consultation on  
20 the use of cost models in various cost studies in the United States and abroad.

21

22 At Bellcore for 13 years, I was one of three individuals who designed the  
23 SCIS/IN<sup>1</sup> model and implemented new incremental costing methodology into the  
24 program. I also was the lead subject matter expert on feature costing in general as  
25 well as a subject matter expert on 1ESS, 1A ESS and 5ESS switches. When I was

1 promoted to lead the SCIS group of approximately 20 people, I had responsibility  
2 for the technical development, production, documentation, customer care and cost  
3 study consultation on the SCIS family of models. I also had responsibility for  
4 marketing the Bellcore cost models in Europe and Asia/Pacific.  
5

6 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN REGARD TO LEC COST**  
7 **MODELS IN GENERAL, AND THE SWITCHING COST INFORMATION**  
8 **(SCIS) IN PARTICULAR?**

9 A. Yes, I have presented expert testimony in numerous State proceedings dealing  
10 with local switching unbundled element cost studies.  
11

12 **2.0 PURPOSE AND SUMMARY OF TESTIMONY**

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

14 A. The purpose of my testimony is to report my findings regarding BellSouth's  
15 switching investment studies<sup>2</sup> and recommend new switching investments that  
16 serve as the foundation for the 4-wire port switching unbundled element rate  
17 sponsored by Mr. Ellison.  
18

19 **Q. PLEASE SUMMARIZE THE MAIN POINTS OF YOUR TESTIMONY**

20 A. BellSouth's costs for a 4-wire port is flawed in the following major respects:

- 21 1. BellSouth began its entire switching cost process with incorrect switching  
22 prices. BellSouth entered the wrong discount to customize the SCIS/MO<sup>3</sup>  
23 switching vendor list prices to reflect the "actual prices" paid by  
24 BellSouth. This incorrect discount causes all of BellSouth's switching  
25 elements to be significantly overstated. In addition to comparing

1 BellSouth/vendor contracts to the switch prices used by BellSouth in this  
2 study, I present publicly available information regarding switching prices  
3 paid by Southwestern Bell, Pacific Bell, and U.S. West that provide  
4 comparative price points. This publicly available information  
5 demonstrates that BellSouth's SCIS switch price estimates are  
6 substantially inflated.

7 2. The costs that BellSouth has identified for the limited numbers of features  
8 that were included are overstated because of double counting, input errors,  
9 and inappropriate costing methodology.

10

11 When BellSouth's switching cost study for the 4-wire port is corrected, using  
12 BellSouth's own cost models, to reflect switch prices in BellSouth's vendor  
13 contracts and remove double counting of feature investments, the resulting 4-wire  
14 port investment *with* features is *less* than BellSouth's port *without* features.

15

### 16 **3.0 BELLSOUTH'S SWITCHING COST STUDY OVERVIEW**

#### 17 **Q. WHAT ARE THE SCIS MODELS?**

18 **A.** The SCIS programs were originally developed by Bellcore to identify the  
19 investments associated with features and services provided from central office  
20 switching machines. The SCIS/MO program determines the investments for  
21 various functions that a switch performs and the SCIS/TN model calculates the  
22 investments for vertical features.

23

24

25

1    **Q.    HOW DID BELLSOUTH USE THE SCIS MODELS?**

2    **A.**BellSouth used the SCIS/MO program from Bellcore to calculate investments for  
3           the 4-wire analog port. Specifically, they used a subset of the output called  
4           Minimum Investment per Line. The Minimum Investment per Line is a melded  
5           average of standard analog lines and lines served on integrated digital loop carrier.  
6           BellSouth used a special report in SCIS to identify only those costs associated  
7           with an analog line.

8

9           The SCIS/TN model utilizes the Unit Investment results from the SCIS/MO  
10          program to develop the investment for services and features. BellSouth  
11          apparently did not actually use the SCIS/TN program, but copied SCIS/TN  
12          algorithms and program data inputs into multiple SCIS/TN-like spreadsheets to  
13          calculate investments for the features. Thus, whatever reported integrity between  
14          SCIS/MO and SCIS/TN is supposed to exist cannot be assured in the BellSouth  
15          study.

16

17          Switching investments were then processed in BellSouth's TELRIC models to  
18          include additional loadings, such as land and building; convert the investment to  
19          an annual cash flow; and add expenses to generate the costs of switching  
20          unbundled elements.

21

22    **4.0    BELLSOUTH'S ACTUAL SWITCH PRICES ARE LOWER THAN THE**  
23           **PRICES USED IN THE COST STUDY**

24    **Q.    DOES THE SCIS/MO CALCULATE THE ACTUAL PRICES PAID BY**  
25           **BELLSOUTH FOR SWITCHES?**

1 A. No. The SCIS/MO model contains vendor list prices and requires the user to  
2 enter a discount to customize the switching investments to reflect the "actual  
3 prices" paid by the local telephone company, according to locally negotiated  
4 contracts and/or agreements.

5  
6 The discount factors utilized for each switch type are of critical importance in the  
7 evaluation of any SCIS study since these discounts affect every SCIS output (*i.e.*,  
8 a discount factor of 50% generates SCIS outputs that are half the values produced  
9 using the list price). Therefore, if the discount factors do not reflect the actual  
10 price in BellSouth's negotiated agreements with switching vendors, the results  
11 produced by SCIS will misstate all of BellSouth's switching investments,  
12 including those used as the basis for the 4-wire port.

13  
14 **Q. WHAT ARE THE SWITCH PRICES PER LINE IN BELLSOUTH'S**  
15 **VENDOR SWITCHING CONTRACTS?**

16 A. BellSouth recently made its switch vendor contracts available to AT&T in  
17 response to a data request. The accessibility to these contracts was limited,  
18 because BellSouth would not allow copies to be made and AT&T had to review  
19 these voluminous contracts on BellSouth's premises. The Nortel contract  
20 indicated that BellSouth receives a \_\_\_\_\_ discount plus up to a \_\_\_\_\_  
21 \_\_\_\_\_ discount<sup>4</sup>. The contract also references the existence of additional  
22 discounts, but these were not specified.

23  
24 The Lucent 5E switches are covered via three contracts - one general contract  
25 crafted in 1992;<sup>5</sup> an additional agreement that is more current,<sup>6</sup> providing prices

1 for specific switch replacements throughout the BellSouth States, and a separate  
 2 agreement just for switch purchases in Tennessee.<sup>7</sup> The two recent contracts  
 3 indicate that BellSouth pays \_\_\_\_\_ per line<sup>8</sup> for SE switches. It is important to  
 4 note that these prices per \_\_\_\_\_  
 5 \_\_\_\_\_  
 6 \_\_\_\_\_.

8 It is also interesting to note that BellSouth has an existing contract (1992-1999)  
 9 and a subsequent Letter of Authorization<sup>9</sup> with Siemens Stromberg-Carlson for  
 10 switches with prices even lower than the \_\_\_\_\_ switches,<sup>10</sup> but these  
 11 switches have been excluded from BellSouth's studies.

13 **Q. WHAT IS THE DIFFERENCE ON A PER LINE BASIS BETWEEN THE**  
 14 **NORTEL AND LUCENT CONTRACTS?**

15 **A.** The Nortel contract discounts were used by BellSouth as direct inputs to  
 16 SCIS/MO, which generates a DMS price per line of \$210<sup>11</sup> and the Lucent  
 17 contract explicitly states the price per line is \_\_\_\_\_ (including significant  
 18 amounts of additional equipment for features).

20 **Q. WHAT EXPLANATIONS COULD THERE BE FOR THIS DISPARITY**  
 21 **BETWEEN THE VENDORS?**

22 **A.** The fact that BellSouth has included Nortel prices that are more than \_\_\_\_\_  
 23 \_\_\_\_\_ than Lucent prices may indicate that:

- 24 • The Nortel contract could be a "baseline" contract, equivalent to the older  
 25 Lucent contract which is also still in effect.



- 1           ●     There may be additional Nortel agreements that were not provided, that  
2                     could specify prices competitive with Lucent.
- 3           ●     BellSouth simply may not have plans to place Nortel switches in the near  
4                     future and has not initiated aggressive negotiations for \_\_\_\_\_ switching  
5                     prices as they have done with Lucent.

6

7   **Q.    HOW SHOULD THIS DISPARITY BE TREATED IN THE COST**  
8   **STUDIES?**

9   **A.**   The cost studies should use switch prices per line for both technologies that are  
10           comparable and reflect forward-looking, least-cost technology. Lucent and Nortel  
11           are aggressively competing in all areas of the switching market, as evidenced by  
12           the recent Nortel/US WEST contract described below, these prices should be  
13           comparable to the prices in the Lucent/BellSouth contract. It would likewise be  
14           anticipated that in any head to head competition for BellSouth's business, bids  
15           among the various switch providers would be similarly competitive. AT&T's  
16           restated switching element investments for the 4-wire port assume that the  
17           average Lucent price per line for switching also applies to the Nortel switches.  
18           Corroborating statements made by Southwestern Bell and Pacific Bell indicate  
19           that the same price is paid for switching regardless of vendor.<sup>12</sup> If BellSouth is  
20           going to place Nortel switches, then it should be expected that BellSouth would  
21           negotiate prices that are competitive with Lucent.

22

23   **5.0    HOW DO THE PRICES IN BELLSOUTH'S COST STUDY COMPARE**  
24   **TO SWITCHING PRICES IN THE INDUSTRY?**

1 Q. WHAT ARE THE AVERAGE SWITCH PRICES PER LINE IN THE  
2 INDUSTRY?

3 A. The Northern Business Information (NBI) study, "U. S. Central Office Equipment  
4 Market", states that the average price for RBOC digital switches per line shipped  
5 in 1995 was \$102, and \$99 in 1996. The study also indicates that per line prices  
6 are expected to continue to decline slightly through the remainder of the decade.

7 Both Lucent and Nortel have referenced this document's marketing data  
8 estimates, which lends credibility to NBI's expertise in the central office  
9 equipment market.<sup>13</sup>

10

11 Q. DO THE SWITCH PRICES REPORTED FOR PACIFIC BELL SUPPORT  
12 BELLSOUTH'S PRICING?

13 A. No. Four years ago, Pacific Bell negotiated a major contract for approximately  
14 \$110 per line.<sup>14</sup> According to the NBI study, the price per line for switching has  
15 been declining and is expected to continue to decline. The four-year old data for  
16 Pacific Bell, when brought down to current switch prices with a .97 factor per  
17 year<sup>15</sup> would result in \$97 per line.<sup>16</sup> There were no separate prices quoted for  
18 different size switches, so the deflated \$97 per line either applies to all line size  
19 switches or is an average; and the \$97 per line provides a comparative price point  
20 to evaluate the BellSouth switching prices.

21

22 Q. DO THE SWITCH PRICES REPORTED BY SPRINT SUPPORT  
23 BELLSOUTH'S PRICING?

24 A. No. The January, 1997, BCPM<sup>17</sup> proxy model contained switching prices using a  
25 fixed cost of \$261,871 and variable per line amount of \$225<sup>18</sup> that were the results

1 of a survey, based on telephone company inputs to SCIS. Sprint later retracted  
 2 these switching prices, stating that "there exists a fundamental disagreement  
 3 concerning the costs of switching."<sup>19</sup> Sprint submitted new BCPM inputs for  
 4 switching prices of \$150,000 fixed/startup and \$110 per line.<sup>20</sup> Sprint said "the  
 5 current BCPM values [the new lower values] more closely approximate Sprint's  
 6 current costs of switching . . ."<sup>21</sup> For a 15,000-line switch, allocating the  
 7 \$150,000 fixed cost to the lines would result in an overall average price of  
 8 switching of \$120 per line. While AT&T does not propose that this is the correct  
 9 price, it provides a comparative price point to evaluate the BellSouth switching  
 10 prices.

11

12 **Q. DOES SOUTHWESTERN BELL'S SWITCH PRICE PER LINE ~~1996~~**  
 13 **SUPPORT BELLSOUTH'S PRICING?**

14 **A.** No. Mr. Hugh Raley stated in 1996 testimony that for Southwestern Bell  
 15 Telephone, "the Engineered, Furnished and Installed"(EF&I) price was  
 16 \$85/line"<sup>22</sup> for switching. Mr. Raley stated that \$85 includes "everything that is  
 17 required to make the switch work," . . . "the trunks, the fabric, the processors - the  
 18 total price from a vendor standpoint divided by the number of lines on the  
 19 switch." He also indicated that this figure represents recent bids both from Lucent  
 20 and Nortel and that this price was the average *and not the lowest bid price*. Mr.  
 21 Raley included in his testimony an Attachment<sup>23</sup>, which revealed the following:

22

	1-15,000 lines	15-40,000 lines	40-80,000 lines
EF&I Inv. Per Line	\$140	\$115	\$85

23

1 Q. DOES BELLSOUTH'S MODEL TAKE INTO ACCOUNT THE MOST  
2 CURRENT INFORMATION REGARDING THE PRICE OF SWITCHES?

3 A. No. The most current information comes from Nortel's Internet web page<sup>24</sup>  
4 announcing that a contract has been signed with US WEST "in excess of \$US 100  
5 million" for 2.2 million DMS-100 lines. This implies switch prices as low as \$45  
6 per line. Even allowing for the *in excess* to be an incredible additional 50% of the  
7 contract, for a total of \$150 million, \$150 million divided by 2.2 million lines  
8 would yield a price per line of only \$68.<sup>25</sup> Nortel also indicated that this upgrade  
9 of US WEST's network will provide advanced digital features, such as ISDN,  
10 network business services and advanced display services. In addition, Nortel  
11 stated that "Nortel will keep US WEST's network ready for new services, such as  
12 Local Number Portability and for Advanced Intelligent Network AIN features...."

13

14 These prices are similar to the \_\_\_\_\_ contract prices for BellSouth.

15

16 Q. WHAT SWITCH PRICES HAS BELLSOUTH USED AND WHY ARE  
17 THEY INCORRECT?

18 A. BellSouth's average price per line for 5E switches is \_\_\_\_\_ and \_\_\_\_\_ for  
19 the DMS-100,<sup>26</sup> resulting in a melded price of \_\_\_\_\_ per line. In addition to  
20 BellSouth not accurately reflecting their own switch vendor contract prices, a  
21 comparison of the prices from other RBOCs with BellSouth's prices demonstrates  
22 that BellSouth's prices are significantly overstated by all accounts.

23

24

25

Source	Price Per Line
NBI	~\$100
Pacific Bell	\$110
Sprint Inputs to BCPM	~\$120
Raley Testimony- <del>SOUTHWESTERN BELL</del> <del>BellSouth</del>	\$85/115/140
Nortel/US West	~\$68
BellSouth Lucent Contract	_____
<i>BellSouth UNE Cost Study</i>	_____

1

2 Q. WHAT SCIS/MO DISCOUNT INPUTS DOES AT&T PROPOSE AND  
3 HOW DID YOU ARRIVE AT THESE DISCOUNTS?

4 A. Using BellSouth's Lucent contract, AT&T has calculated a SCIS/MO discount of  
5 \_\_\_\_\_ . As stated above, SCIS begins with  
6 vendor list prices in its investments tables and requires the local telephone  
7 company to enter a discount in order to reflect actual prices paid by that company.  
8 Each vendor begins with different list price levels and therefore the discounts that  
9 the vendors offer will be different to generate approximately the same total switch  
10 prices.<sup>27</sup>

11

12 In order to determine the correct discount that BellSouth should enter into  
13 SCIS/MO, the discount necessary for each switch technology to approximately  
14 equal the actual contract price of \_\_\_\_\_ per line was calculated using SCIS  
15 results. BellSouth accumulated all of the switches for a given technology into a

1 "study" in SCIS/MO. We used the two studies with BellSouth's input data, but  
 2 varied the discount input. The program was run iteratively until we matched the  
 3 total switching investments calculated from the contract.

4  
 5 **Q. WHAT IMPACT WOULD THIS DISCOUNT INPUT CHANGE HAVE ON**  
 6 **OUTPUTS?**

7 **A.** I have rerun the port investment study using BellSouth's models with BellSouth's  
 8 data, but substituted the discounts shown above. These revised investments are  
 9 compared to BellSouth's original values below:

10

	BellSouth <sup>28</sup> 5E Inv.	Revised 5E Inv.	BellSouth DMS Inv.	Revised DMS Inv.
4-wire Port				

11  
 12 Note that this is just the switching port investment. Additional investments for  
 13 converting the 4-wire to 2-wire signaling is added subsequently and is reflected in  
 14 the prices proposed by Mr. Ellison.

15  
 16 **6.0 DESIGNATING SEPARATE COSTS FOR INDIVIDUAL FEATURES IS**  
 17 **INAPPROPRIATE**

18 **Q. SHOULD FEATURES AVAILABLE IN THE SWITCH BE COSTED**  
 19 **SEPARATELY?**

20 **A.** No, this is inappropriate for several reasons. While BellSouth has costed a small  
 21 subset of vertical features as if they are each a unique separate element, vertical  
 22 services and features are an integral part of the switch. This becomes clearer if

1 you think of BellSouth's switch as a personal computer that is delivered by the  
2 manufacturer with a suite of software applications.<sup>29</sup> Now, whether the owner of  
3 the computer utilizes a word processing or spreadsheet program daily or only once  
4 a year, the owner does not incur a cost each time he utilizes the program. Instead,  
5 these costs are incurred at the outset as a part of the acquisition of the computer.  
6

7 In contrast, BellSouth's switching studies are based on the incorrect assumption  
8 that each time a feature is used, there is a corresponding cost in the switch. This  
9 incorrect assumption that features are usage sensitive has been based on logic  
10 contained in the SCIS models.  
11

12 **Q. WHY DOES SCIS MAKE THIS ASSUMPTION?**

13 **A.** SCIS assumes that the processing capacity of a switch is the ultimate limiting  
14 factor for a switch and that every call or feature that uses this processing capacity  
15 should pay its "fair share". In the past, as reviewed in Mr. Garfield's direct  
16 testimony, switch vendors struggled to keep processing capacities on par with the  
17 demand for new services and features. It was appropriate under those  
18 circumstances to determine how much of the switch's capacity specific features  
19 and calls were using and assign an allocated portion of the cost to those features  
20 and calls.  
21

22 **Q. WHY IS THIS ASSUMPTION INCORRECT?**

23 **A.** It is simply no longer true that switches, in general, are limited by processing  
24 capacity; instead, they are primarily limited by the numbers of lines and trunks  
25 that can be served.<sup>30</sup> This is validated by BellSouth's own inputs to the SCIS

1 model that indicate they are currently utilizing only 27% of the processing  
2 capacities in switches in Florida. Today's switches provide call processing  
3 capacities that far exceed the traffic that is expected over the entire lifetime of  
4 these switches, especially given that much of the intelligence of call processing is  
5 being moved from the end office switches to the Advanced Intelligent Network.<sup>31</sup>  
6 Indeed, the newer, marginal version of SCIS identifies these costs as a fixed up-  
7 front investment, depending on the processor utilization inputs, rather than always  
8 assuming these costs are sensitive to the processing capacity.

9  
10 **Q. WHAT OTHER PROBLEMS EXIST WITH BELLSOUTH'S FEATURE**  
11 **COSTING METHODOLOGY?**

12 **A.** BellSouth's complicated methodology of determining individual investments for  
13 each feature requires large numbers of inputs and assumptions, many of which are  
14 not "measurable" and amount to nothing more than unsubstantiated "estimates"  
15 by BellSouth. SCIS was developed at a time when overestimating the costs of  
16 features to be sold to subscribers carried no penalty; but that is not the case here.  
17 By misallocating costs on a feature-usage basis coupled with the requirement that  
18 the feature usage may be mis-estimated by BellSouth, new entrants are seeing  
19 excessive costs for features that are entirely inappropriate in a unbundled switch  
20 element environment.

21  
22 **7.0 BELLSOUTH HAS INAPPROPRIATELY ASSIGNED ALL OF THE**  
23 **GETTING STARTED INVESTMENTS TO TRAFFIC SENSITIVE**  
24 **SWITCHING UNBUNDLED ELEMENTS**

25



1 **Q. WHAT IS THE SCIS/MO GETTING STARTED INVESTMENT?**

2 **A.** SCIS computes a Getting Started Investment for each switch that includes the  
3 initial investment for:

- 4 ● Central processor and related equipment;
- 5 ● Maintenance and test equipment;
- 6 ● Spare components;
- 7 ● Miscellaneous equipment; and
- 8 ● Investment for underutilized equipment, termed "Breakage".

9  
10 **Q. HOW ARE THESE GETTING STARTED INVESTMENTS RECOVERED**  
11 **IN SCIS?**

12 **A.** SCIS automatically assigns these getting started investments to a traffic sensitive  
13 category, called Getting Started Investment per Millisecond, when SCIS/MO is  
14 run in "average" mode (which is the way BellSouth ran the model for its cost  
15 studies) based on the assumption that switch replacement occurs due to processor  
16 exhaust, as discussed above. SCIS/MO inputs ask for processor utilization at  
17 three time periods: (1) at initial installation of the switch, (2) at year 5, and (3) at  
18 switch replacement. BellSouth's inputs indicate that utilization at time of switch  
19 replacement is projected to be 28%. As correctly modeled in the SCIS/MO  
20 marginal mode, the processor investments in BellSouth's study should not be  
21 considered traffic sensitive if they are never expected to exhaust. It is simply a  
22 fixed cost required to make the switch operational over its life.

23

24 In addition to the processor, there are numerous other items in the SCIS/MO  
25 Getting Started Investment, which are one-time fixed investments incurred as a

1 first cost. BellSouth, however, has assumed that the entire Getting Started  
 2 Investment for every switch is traffic sensitive. This is inappropriate because it  
 3 does not follow the basic TELRIC principle of reflecting costs based on causation.  
 4 The non-traffic sensitive getting started investment should be assigned to the non-  
 5 traffic sensitive port elements.

6  
 7 **Q. HOW DOES ALLOCATING THE GETTING STARTED INVESTMENT**  
 8 **TO THE PORT INVESTMENT CHANGE THE PORT INVESTMENTS?**

9 **A.** Allocating the entire Getting Started investment from SCIS/MO over the total  
 10 lines increases the port investment. This Getting Started allocation was added to  
 11 the investments that AT&T calculated using the corrected discounts to arrive at  
 12 new 2-wire analog port investments as shown below:

13

	Line Inv. Per line	GS Additive	Port Investment
5ESS	_____	_____	\$45.39
DMS	_____	_____	\$50.70
Weighted			\$47.03

14  
 15 **8.0 GETTING STARTED INVESTMENT TREATMENT FUNDAMENTALLY**  
 16 **AFFECTS BELL SOUTH'S ENTIRE COST METHODOLOGY**

17 **Q. WHAT IS THE RELATIONSHIP BETWEEN GETTING STARTED**  
 18 **INVESTMENT AND FEATURE INVESTMENT?**

19 **A.** The Bellcore switching models were originally designed to distinguish  
 20 investments for vertical features and services from POTS. Most feature

1 functionality is provided through the computer processor in the switch. The SCIS  
 2 models, therefore, distinguish among various features and call types primarily by  
 3 the amount of processor milliseconds that are used by each feature.<sup>32</sup> BellSouth,  
 4 using SCIS/MO, has allocated the Getting Started Investment over the number of  
 5 milliseconds available for call processing (and then inflated it by utilization  
 6 factors averaging 27%<sup>33</sup>).

7  
 8 **Q. HOW DOES AT&T'S REVISED TREATMENT OF GETTING STARTED**  
 9 **INVESTMENT AFFECT FEATURE COSTING?**

10 **A.** As stated previously, in the vast majority of features, the only investments  
 11 assigned to features is the allocated<sup>34</sup> Getting Started Investment. AT&T proposes  
 12 that the entire Getting Started Investment be allocated to, and recovered by, the  
 13 ports as a non-traffic sensitive investment. In this approach, there are no Getting  
 14 Started Investments that can be assigned to features without double counting and,  
 15 therefore, the complicated task of separately identifying feature investments  
 16 through detailed processor millisecond calculations is not necessary. As shown  
 17 below, when BellSouth's cost study is corrected for the incorrect discounts, the  
 18 inclusion of features (via allocating the entire Getting Started Investment to the  
 19 ports) results in a port investment that is still lower than BellSouth's port  
 20 investment *without* features.

21

	<b>BellSouth Port <i>without</i> Features</b>	<b>Corrected BellSouth Port <i>with</i> Features</b>
<b>Port Investment</b>	<b>\$57.37</b>	<b>\$47.03</b>

22

1 **Q. WHAT INPUTS AND ASSUMPTIONS ARE CRITICAL TO**  
2 **BELLSOUTH'S TREATMENT OF FEATURE INVESTMENTS?**

3 **A.** BellSouth's SCIS/TN-like spreadsheets require busy hour feature utilization inputs  
4 in order to calculate feature investments. These inputs usually have a one-to-one  
5 relationship with the output. If the busy hour utilization input is estimated at  
6 double the actual usage, the feature investment will also be double. Many of these  
7 inputs are difficult to obtain because they must be explicitly measured in a special  
8 study and many more simply are not measurable at all. Marketing/Product  
9 managers are often asked to provide this data, but it is very difficult to estimate  
10 how often subscribers use a particular feature. It is even more difficult to express  
11 this estimate in terms of busy hour usage.

12

13 In addition, these estimates must average subscribers who frequently use features  
14 with subscribers who purchase features, but seldom use them. This difficulty is  
15 especially acute when features are bundled or packaged, as in ESSX offerings or  
16 residential custom calling packages.

17

18 **Q. HOW SHOULD BELLSOUTH RECOVER THE COSTS FOR FEATURES**  
19 **THAT REQUIRE SPECIAL HARDWARE?**

20 **A.** A very small number of features use special hardware; the bulk of this equipment  
21 is conference circuits. The Lucent contract includes conference circuits, as well  
22 as some voice messaging equipment in the \_\_\_\_\_; and are therefore  
23 included in the port and other basic switching investments. BellSouth's study,  
24 however, also adds these conference circuits into the cost of the features; thereby  
25 double counting these investments.

1 **Q. DOES FEATURE USAGE CAUSE BELLSOUTH TO INCUR**  
2 **ADDITIONAL SWITCH HARDWARE INVESTMENTS?**

3 **A.** No. BellSouth does not incur any additional investment per feature because the  
4 special hardware, such as conference circuits, is already included in the basic  
5 switching price. As described previously, features do not cause exhaust of  
6 processing capacity of the switch, so there should be no processing capacity  
7 allocations (in the form of Getting Started Investment per Millisecond costs)  
8 based on feature usage.<sup>35</sup> BellSouth's feature cost methodology, however,  
9 includes processing capacity costs based on feature usage and additives for the  
10 already included special hardware.

11

12 **Q. WHAT CORRECTIONS TO THE FEATURE COSTING**  
13 **METHODOLOGY DOES AT&T RECOMMEND?**

14 **A.** First, the investments for separate features must be eliminated to:

- 15 • Eliminate the double counting of special feature hardware, such as the  
16 conference circuits.
- 17 • Eliminate double counting the Getting Started Investment, or first cost, of the  
18 switch.
- 19 • Eliminate double counting feature software right to use fees.

20

21 Second, the BellSouth SCIS input discounts must be revised to accurately reflect  
22 the actual forward-looking prices BellSouth pays for switching as stated in the  
23 vendor contracts.

24

25

1 AT&T's restatement of BellSouth's cost study shows that the corrected port  
2 investment that includes features (via the assignment of the Getting Started  
3 Investment to the ports) is less than BellSouth's port without features. This  
4 proves that BellSouth's feature additives are incorrect, include double counting,  
5 and result in highly inflated port rates.

6

7 **9.0 SUMMARY AND CONCLUSION**

8 **Q. PLEASE SUMMARIZE YOUR TESTIMONY**

9 **A.** BellSouth's methodology, inputs and assumptions are not appropriate for  
10 developing the cost of the 4-wire port unbundled network element. The problems  
11 include:

- 12 1. Incorrect switching prices
- 13 2. Double counting the costing of vertical features
- 14 3. Various incorrect or inappropriate input data
- 15 4.

16 **Q. WHAT ARE YOUR CONCLUSIONS?**

17 For the reasons stated above, the Commission should reject BellSouth's cost  
18 studies and resulting rates for the 4-wire analog port and adopt the rate proposed  
19 by Mr. Ellison.

20

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

22 **A.** Yes.

23

24

25

1 Endnotes:

---

- 1 SCIS/IN is the feature costing model in the SCIS family of models.
- 2 There is a technical distinction between "cost" and "investment." In my testimony, investment refers solely to the capital expenditure for the switch. To determine cost, additional capital expenditures for land, building, power, and local telephone company installation are added to the investment. This total is annualized via cost factors into a capital-related cash flow requirement and then expenses are added to determine "cost." I will use the term price to refer to the prices paid by telephone companies to switch vendors.
- 3 As explained more fully below, the SCIS/MO program calculates the investment for various functions performed by a switch.
- 4 Nortel Agreement PR-6900-A. BellSouth used a \_\_\_\_\_ iscount, implying it used a volume discount of \_\_\_\_\_. The maximum volume discount of \_\_\_\_\_ would generate an overall discount of \_\_\_\_\_.
- 5 Lucent Agreement PR-6700-B.
- 6 1/95-12/06.
- 7 Special Tennessee Agreement - "Special Order" 12/1/93-12/31/99
- 8 Id; the price drops from \_\_\_\_\_ when \_\_\_\_\_ lines are purchased. Note that the term "price per line" is equivalent to total switching price divided by total number of lines. The price per line is *not* the same as the port investment.
- 9 The Letter of Authorization was crafted to apply only to Tennessee switch purchases, but it is safe to assume that BellSouth could negotiate similar agreements in other states.
- 10 Letter of Authorization 5/31/95: "Siemens offers \_\_\_\_\_ (EF&I) per equipped line . . ."
- 11 Calculated from total DMS switching investment divided by total DMS lines.
- 12 This is substantiated by Mr. R. Scholl and Mr. J. Caling in Deposition of R. Scholl p. 46, ls 1-5, and Deposition of J. Caling, p. 93, ls 13-18, dated February 12, 1997.

- 
- <sup>13</sup> Lucent and Nortel October 15, 1996, filings in response to FCC Supplemental Request for Information from Lucent and Nortel, respectively. Cited in FCC 97-125, page 24.
- <sup>14</sup> Quoted in GTE's Responses to proxy cost model questions in CC Docket 96-45, Federal-State Joint Board on Universal Service Proxy Cost Models, January 7, 1997.
- <sup>15</sup> Extrapolated from the NBI yearly prices.
- <sup>16</sup> This data substantiates the prices used in Hatfield. The average switch size for Pacific Bell is 27,200 lines. The average switching price on the Hatfield cost curve for a 27,200 line switch is \$90.
- <sup>17</sup> The Benchmark Cost Proxy Model ("BCPM") was, until recently, jointly sponsored as a proxy model by Sprint, US WEST and Pacific Bell. Pacific Bell has withdrawn and has been replaced by BellSouth.
- <sup>18</sup> BCPM Methodology (no date), Page 20.
- <sup>19</sup> Ex Parte Letter, 3/24/97, from Mr. Warren D. Hannah, Sprint to Mr. William F. Caton, FCC, Attachment A, page 5.
- <sup>20</sup> Id., Attachment BCPM National Results Using Sprint Input Values, Page 3.
- <sup>21</sup> Id., Attachment A, Page 3. The remainder of the quote dealt with a recommendation to use the higher rates for USF purposes.
- <sup>22</sup> Direct Testimony of Hugh W. Raley, 9/6/96, Docket Nos. 16189,16196,16226,16285,16290; p. 7, lines 9-10 and Deposition of Hugh Raley, 9/13/96.
- <sup>23</sup> Note, however, that there are other equipment costs added to Mr. Raley's \$85/line such as taxes. AT&T agrees that these need to be added, but the relevant cost in this analysis is the actual price paid to the vendor which Mr. Raley calls EF&I. This compares to the prices used in the Hatfield Model switch curve that also are switch prices paid to the vendor. The Hatfield Model includes costs for the other components shown on Mr. Raley's chart in subsequent calculations. Mr. Raley was claiming that Southwestern Bell Telephone's \$85 per line was significantly higher than the Hatfield Model's \$59 per line for an 80,000 line switch. This comparison was flawed for two reasons: [1] Mr. Raley stated that the \$85.00 per line was based on an average switch size of 53,653 lines; therefore, Mr. Raley's comparison to the Hatfield Model 80,000 line switch is inappropriate; and [2] the



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Hatfield Model's \$59 per line is the price without trunk ports and when these are added back in, the actual price the Hatfield Model calculates for a 53,653 line switch is approximately \$80 per line. Mr. Raley's \$85.00 per line is, in actuality, very close to the \$80 per line that the Hatfield Model calculates.

24 [www.nortel.com/home/press/1997b/6\\_16\\_9797219\\_US\\_West.html](http://www.nortel.com/home/press/1997b/6_16_9797219_US_West.html)

25 Thus substantiating that the large switch price of \$75 per line used in Hatfield is conservative. All switch prices are quoted as prices paid to the vendor just for vendor EF&I switch equipment and do not include taxes, telephone company installation, etc.

26 Calculated from BellSouth's SCIS/MO study outputs by taking total switching investment and dividing by total lines.

27 It is interesting to note that vendors have been consistently raising their list prices over many years, but actual switching prices per line are declining. This phenomenon has two causes - capacities are increasing and vendor discounts have been increasing.

28 These investments, as well as the DMS investments, were taken from the Input Workpapers for Port Elements in BellSouth's Cost Study

29 As noted earlier, BellSouth's switching contracts \_\_\_\_\_ as part of the base price of the switch, and these costs are already included in the port investments.

30 This was confirmed by a statement by Mr. Scholl, of Pacific Bell, in his February, 1997, deposition that Pacific's switches are overwhelmingly line capacity constrained.

31 It is expected that vendors' efforts to further increase processing capacities are due to expectations of broadband traffic to provide services such as video, which is not relevant in this proceeding.

32 There is a tiny subset of features that have special hardware to make them operational. This issue will be addressed in a subsequent section.

33 This utilization is the average computed by SCIS/MO over the life of the switches, based on BellSouth inputs.. Note that the previous discussion on processor utilization inputs by BellSouth were the utilizations at the end of the switches' lives.

1 BY MR. HATCH:

2 Q Ms. Petzinger, do you have a summary of your  
3 testimony?

4 A Yes, I do.

5 Q Could you please give that?

6 A Certainly.

7 Good morning. I'm Cathy Petzinger, and I'm here  
8 to talk about the switching unbundled element cost that  
9 used to support the 4-wire port element and the separate  
10 feature costs proposed by BellSouth. BellSouth used the  
11 BellCore SCIS model as the foundation for their switching  
12 cost studies, and before I discuss that, I would like to  
13 share with you a little of my background. Before coming to  
14 AT&T, I worked for 13 years at BellCore, and before I left  
15 I led the team that builds the SCIS model. I'm an expert  
16 in switching and in switching cost studies.

17 The BellCore SCIS model starts with list prices  
18 that the user must determine and enter a discount input to  
19 modify the list prices to reflect the prices that will be  
20 paid for switches in this case by BellSouth. The discount  
21 input is absolutely critical because it affects every  
22 switching unbundled element. In my review I found that  
23 BellSouth has used an incorrect discount input to SCIS that  
24 generates a switch price per line that is two and a half  
25 times the prices that we reviewed in their switching

1 contracts with their vendor. I determined the correct  
2 discount by running BellSouth's SCIS program loaded with  
3 all of BellSouth's data but modifying the discount input  
4 until the outputs from the SCIS model matched the number in  
5 their contract.

6           This correction cut the proposed BellSouth port  
7 investment, not including the features, by approximately  
8 50%. BellSouth is also fundamentally -- made a  
9 fundamentally incorrect assumption in their cost studies  
10 regarding the first cost of a switch. The first cost is  
11 called the getting-started investment in the SCIS model,  
12 and it is the cost of the equipment that is purchased to  
13 get a switch up and running regardless of the amount of  
14 traffic or the number of lines or size of the switch. It  
15 is truly a non-traffic sensitive cost. However, BellSouth  
16 has inappropriately allocated it to usage sensitive  
17 elements.

18           BellSouth has also developed separate feature  
19 cost studies that are incorrect. For example, some  
20 features have special hardware, such as three-way  
21 conference circuits to enable three-way calling, and these  
22 have been double counted. The double count occurs because  
23 the switching contract includes some of this equipment, and  
24 it was included in the base switching price per line that  
25 was used to generate the port element. However, they then

1 went in and ran the model in the feature mode and added  
2 additional costs for the same conference circuits as a part  
3 of, for example, the three-way calling feature. This  
4 similar construct occurred in software right-to-use fees  
5 in the software that also is included in the basic  
6 switching price per line in their contract; therefore, to  
7 include it in a separate feature cost is a double count.

8 A good analogy is a computer that comes from the  
9 store loaded with software programs, you pay for the price  
10 for the computer up-front with the software. You don't  
11 incur costs every time you use the spread sheet or every  
12 time you bring up the word processor. It is an up-front  
13 cost and already paid for and should be recovered in a  
14 manner appropriately.

15 In summary, BellSouth does not actually incur  
16 additional switching investment when they provide features  
17 to their users. It's already included in the basic  
18 switching price per line in their contracts; therefore, it  
19 is inappropriate to charge additional costs for features to  
20 the new entrants in the form of unbundled elements. I have  
21 restated the BellSouth investments to account for these  
22 errors, and these restated investments form the foundation  
23 of the new rates sponsored by Mr. Ellison. That concludes  
24 my summary.

25 MR. HATCH: We tender the witness for cross.

1 COMMISSIONER DEASON: Okay. Mr. Self.

2 MR. SELF: No questions.

3 MR. PELLEGRINI: Commissioner Deason.

4 COMMISSIONER DEASON: Just a second.

5 MR. MELSON: No questions.

6 COMMISSIONER DEASON: Okay.

7 MR. PELLEGRINI: Staff would ask that the packet  
8 identified as CEP-1 be marked at this time. it consists of  
9 Ms. Petzinger's January 12th, 1998 deposition transcript  
10 and deposition and late-filed deposition exhibit number 1.

11 COMMISSIONER DEASON: It will be identified as  
12 exhibit 58.

13 Before we begin cross, I have a clarifying  
14 question. You gave the analogy of the computer and the  
15 software and if you buy a computer and software is already  
16 included that is part of the -- I think your point is it's  
17 basically part of the cost of the computer; is that  
18 correct? I guess what is the point you are trying to make  
19 in terms of utilization of software that comes with the  
20 computer, so to speak?

21 WITNESS PETZINGER: The point I was trying to  
22 make was that when you purchase a computer, you purchase  
23 the ability to use the software programs, such as word  
24 processing or spread sheet programs as a function of the  
25 purchase price when you initially purchased the computer.

1 You don't actually incur a cost every time you use the  
2 spread sheet.

3           Now if you loan your computer out, you would  
4 probably charge a general amount for the computer. You  
5 would not charge someone each time they brought up a spread  
6 sheet program because your cost was not incurred in that  
7 way. Similarly, with switching systems, if you think of  
8 them as very large computers with a lot of extra equipment  
9 as well, the equipment that I'm talking about here that is  
10 pre-loaded when BellSouth purchased it was the ability to  
11 process three-way calls, for example, and other features.  
12 They paid for that up front. They included it in the  
13 switching unbundled elements as part of the general pricing  
14 structure associated with the port elements and the minute  
15 of use elements and all those basic switching unbundled  
16 elements, and then added again and charged separately each  
17 time a new entrant wants to buy a feature is not only a  
18 double count, but it also doesn't -- has no cost causation  
19 linkage.

20           COMMISSIONER DEASON: So would you propose those  
21 costs being recovered through a depreciation on the  
22 computer itself as its used as a -- or how would those  
23 costs -- Obviously there is a cost associated with the  
24 software which is part of the computer. How should those  
25 costs be recovered?

1           WITNESS PETZINGER: Yeah, for any investment that  
2 would be capitalized then, yes, the appropriate way to  
3 recover it would be in the recurring rates for the general  
4 switching in this case because it was included in the base  
5 price of the switching equipment they purchased.

6           COMMISSIONER DEASON: BellSouth.

7           COMMISSIONER CLARK: Mr. Deason, can I follow  
8 up? Are you presuming it was included in the base price,  
9 or do you know it was included in the base price?

10          WITNESS PETZINGER: I've reviewed the contracts,  
11 and it was included.

12          COMMISSIONER CLARK: Okay. While I am asking you  
13 questions, and maybe I should ask you, Mr. Hatch, is it  
14 your intention that the end note should be considered as  
15 testimony?

16          MR. HATCH: Good question. Technically, yes.  
17 The problem is that their end notes goofs up the line  
18 numbers and that sort of thing.

19          COMMISSIONER CLARK: It sure does.

20          MR. HATCH: We could mark it as a separate  
21 exhibit if you wish. We probably ought to go back and  
22 make -- for the record, if that's the point and the  
23 problem, there are numerous witnesses that have that same  
24 phenomena.

25          COMMISSIONER CLARK: There are?

1 MR. HATCH: Yes, for example Mr. Selwyn has lots  
2 of end notes in his testimony.

3 COMMISSIONER CLARK: I don't remember seeing  
4 that. I thought it was just --

5 MR. HATCH: As do several other witnesses.

6 COMMISSIONER CLARK: Okay. Let me ask --

7 MR. HATCH: If you would like to mark them or  
8 mark it as a separate exhibit or note for the record that  
9 they are included as part of --

10 COMMISSIONER CLARK: They are testimony?

11 MR. HATCH: Yes.

12 COMMISSIONER CLARK: Okay. Let me just ask one  
13 question. On page 7 you indicate -- you have a title, "How  
14 do the prices in BellSouth's cost study compare to  
15 switching prices in the industry?" And I take it from the  
16 answers they do not compare favorably, BellSouth's prices  
17 are higher based on the answers to the individual  
18 questions.

19 WITNESS PETZINGER: Yes, that was what I found,  
20 and in the table -- it's summarized in the table on page  
21 11.

22 COMMISSIONER CLARK: Okay. Thanks.

23 WITNESS PETZINGER: Thank you.

24 COMMISSIONER DEASON: Mr. Ross.

25 MR. ROSS: Thank you, Commissioner Deason.



## 1 CROSS EXAMINATION

2 BY MR. ROSS:

3 Q Good morning, Ms. Petzinger.

4 A Good morning.

5 Q I'd like to talk a little bit just generally  
6 about BellSouth's cost studies and how it treated  
7 switching. You would agree that BellSouth's cost studies  
8 assumed one hundred percent digital switches, correct?

9 A Yes, that's correct.

10 Q And it assumed a combination of Nortel DSM-100s  
11 and Lucent 5E switches; is that correct?

12 A Yes, that's correct.

13 Q And you would agree that those switches are  
14 forward-looking, represent forward-looking technology?15 A Yes, I would with the caveat that some of those  
16 are remotes, and the decision to place remotes historically  
17 might be different if it were reviewed today; and the  
18 reason for that is that the capacities of remotes have  
19 increased. So where in the past BellSouth may have decided  
20 to place a full-size Nortel or Lucent switch, today they  
21 might be able to efficiently place a remote.22 Q Okay. Now BellSouth has an existing contract  
23 with Nortel that governs the purchase of DMS-100 switches;  
24 isn't that correct?

25 A I did review a Nortel contract.

1 Q Is the answer to that yes?

2 A Yes.

3 Q BellSouth also has three existing contracts with  
4 Lucent; isn't that correct?

5 A I believe there were actually more, but I was  
6 looking at three of them, yes.

7 Q All right. Well, on page 5 you identify -- you  
8 state specifically Lucent 5E switches are covered via three  
9 contracts, lines 24 and 25.

10 A Yeah, these were the three contracts that I  
11 reviewed that seemed to cover the hardware for the switch  
12 identified, and this also was the contracts I reviewed on  
13 BellSouth's premises; so if there were some that weren't  
14 provided, I don't know about it.

15 Q To your knowledge, did BellSouth not provide any  
16 contracts that you've requested?

17 A I do not know that.

18 Q All right. Of the three contracts you listed,  
19 one is a general contract that was entered into beginning  
20 in 1992; is that correct?

21 A That's correct.

22 Q To your knowledge, is that contract still in  
23 effect with Lucent?

24 A Yes, it is. The dates of it are still in effect,  
25 yes.

1           Q     To your knowledge, has that contract been  
2 terminated or superseded?

3           A     I would say it is probably no longer used by  
4 BellSouth because of the newer contract that is in place --

5           Q     Do you know that, or you just --

6           A     -- coincidentally with that.

7           Q     I'm sorry, excuse me. Do you know that for a  
8 fact, or are you just guessing?

9           A     Well, the second contract that I refer to  
10 specifically, it has a later date, it is more current, and  
11 that is also still in effect. It has much lower prices, so  
12 I assume that you would like to buy out of that contract as  
13 opposed to the higher price, older contract.

14          Q     The second contract that you are referring to,  
15 and you describe it specifically as for specific switch  
16 replacements throughout the BellSouth states; is that  
17 correct?

18          A     That's correct.

19          Q     And did you sit down to try to compare the switch  
20 replacement contract with the master contract that  
21 BellSouth has with Lucent to see any differences between  
22 the two?

23          A     I conducted the review because we were not  
24 allowed to get copies of the contracts, so my review -- I  
25 can't say that I remember everything that I saw in detail

1 that would compare the two contracts.

2 Q And the other contract that you mentioned with  
3 Lucent is a Tennessee specific contract; is that correct?

4 A Yes, that was correct.

5 Q Now to your knowledge, which contracts did  
6 BellSouth use or rely upon in developing its switching  
7 investment for purpose of its cost studies?

8 A It appears that they used the older, higher  
9 priced contract.

10 Q That would be the Lucent 1992 contract?

11 A Yes, that's correct. There was also some other  
12 things that were done that would also explain the price  
13 differences in the way they interpreted the contract and  
14 entered the discount input into SCIS.

15 Q Are you also aware that BellSouth used its  
16 existing contract with Nortel to establish the price for  
17 the DMS-100 switches?

18 A Yes.

19 Q Have you attempted to verify whether the  
20 discounts used by BellSouth in the SCIS model using the  
21 existing contracts, or accurately reflect the existing  
22 contracts with Nortel and the master contract with Lucent  
23 entered into in 1992?

24 A I'm sorry, could you repeat that question?

25 Q Yes, I'm sorry, it was probably an inartful

1 question. Have you attempted to verify whether the  
2 discounts used by BellSouth in its cost model accurately  
3 reflect the discounts in the Nortel contract and the Lucent  
4 1992 master contract?

5 A Yes, I have looked at that. In the Nortel  
6 contract, it appears that -- an assumption had to be made  
7 about the volume of lines that were purchased by BellSouth  
8 in order to determine which discount in the Nortel contract  
9 to use. It appeared reasonable to me based on the Nortel  
10 contract.

11 The Lucent contract, however, there were two  
12 things. It appeared that the older, higher priced contract  
13 was used. It also appeared to me that that contract has  
14 one price for the placement of new switches and one price  
15 for when you add equipment to an existing switch. Now in  
16 the standard ongoing daily business, if you are adding  
17 switches -- excuse me, adding equipment to an existing  
18 switch, pretty much the only equipment you are adding is  
19 line and maybe trunk kind of peripheral equipment. You are  
20 not going to be adding much else.

21 In the BellSouth analysis, however, what they did  
22 was they took the older, higher priced cost of a new switch  
23 and used it only for one small category of equipment in the  
24 SCIS run. They discounted that piece of equipment  
25 separately, called just the getting started costs. All the

1 other equipment for every line ever installed in all of  
2 BellSouth territory they assumed it was always priced at  
3 the higher growth price in the older contract, so it was a  
4 double whammy there.

5           The last item too is, as I mentioned in my  
6 testimony, although the Nortel numbers were used out of the  
7 contract, my interpretation is that Nortel contract at this  
8 time is not competitive with the Lucent contract. So I  
9 would assume that in a competitive environment where the  
10 switch suppliers are competing for BellSouth's business,  
11 that you would be able to obtain in a competitive bid  
12 situation prices that are comparable no matter what vendor  
13 you go to.

14           Q     Putting aside our differences about what numbers  
15 to use and what are the appropriate numbers to use, can you  
16 verify that the discounts used by BellSouth in the SCIS  
17 model do, in fact, come from the existing Nortel contract  
18 and the existing Lucent 1992 master contract, yes or no?

19           A     I could verify it absolutely in the Nortel  
20 because it was a fairly easy calculation. As I mentioned,  
21 in the Lucent contract there were multiple calculations  
22 done between new pricing and growth pricing, and in the  
23 application in SCIS I was not able to validate that exactly  
24 to the numbers in the contract, in the older contract  
25 assuming that was the one that was being done. It

1 definitely did not validate to the newer, lower priced  
2 switching contract.

3 Q Let's talk a little bit about switching purchases  
4 generally. Your testimony refers to a study by Northern  
5 Business Information entitled U.S. Central Office Equipment  
6 Market; is that correct?

7 A That's correct.

8 Q And I believe you acknowledge that Northern  
9 Business Information has expertise in the area of  
10 switching, and their publications are relied upon in the  
11 industry; is that correct?

12 A For their marketing data, yes, that's correct.

13 MR. ROSS: Mr. Chairman, at this time I would  
14 like to approach the witness and have an exhibit marked for  
15 identification purposes.

16 COMMISSIONER DEASON: Very well.

17 BY MR. ROSS:

18 Q Ms. Petzinger, you have been handed a copy, an  
19 excerpt from the Northern Business Information study which  
20 is referenced in your testimony; is that correct?

21 A Yes, it does appear to be.

22 Q I'd like to direct your attention to the third  
23 page of this, I believe the third page of this exhibit,  
24 which is section 3.5, line and trunk prices, 1994 to 1999.

25 A Yes.

1 Q There are three bullet points under the heading  
2 "Supplier Strategies." Do you see that?

3 A Yes.

4 Q Could you read the first bullet point under that  
5 heading please?

6 A "Cut price on sale of initials, paren, new  
7 switches, to grow installed base and guarantee high margin  
8 sales of add-on hardware and software."

9 Q Can you turn to the next page of that exhibit?  
10 And there is a paragraph, the second paragraph on that page  
11 begins, "Once a switch supplier."

12 A "Once switch supplier sells a new system, it has  
13 a nearly captive customer. A tel. co. can only grow a  
14 switch by buying add-on lines from the manufacturer of that  
15 switch; therefore, add-on lines are priced higher than the  
16 lines on new systems and represent higher margin sales.  
17 The price of add-on lines will remain higher than the price  
18 of new lines throughout the forecast period." Exhibit 3-37  
19 shows line and trunk prices from 1994 to 1999.

20 Q Thank you.

21 MR. ROSS: Commissioner Deason, we'd like to have  
22 that marked as the next exhibit which I believe is 59.

23 COMMISSIONER DEASON: Yes, exhibit 59.

24 MR. ROSS: Thank you.

25 BY MR. ROSS:



1           Q     Now if I understand this correctly, what Northern  
2 Business Information says happens is that switching  
3 manufacturers like Lucent and Nortel try to have a low  
4 initial placement price to encourage the telephone company  
5 to buy the switch, and then when it has to add growth lines  
6 it's going to pay higher prices down the road; is that  
7 correct?

8           A     I have seen that frequently in the contracts but  
9 not always.

10          Q     Let's talk about the approach you've used to  
11 establishing BellSouth switching investments. First of  
12 all, in looking at the price that BellSouth would pay on a  
13 going-forward basis for DMS-100 switches, you ignored the  
14 existing contract that BellSouth has with Nortel; isn't  
15 that correct?

16          A     Yes. As I said, I made the assumption that since  
17 the document that I was looking at indicated that  
18 consistently the Nortel switches were much more costly than  
19 in an actual competitive situation you would be able to get  
20 competitive bids that would be equivalent to the lower  
21 priced prices in the other vendors' contracts.

22          Q     To your knowledge, does BellSouth presently have  
23 a contract which allows it to get DMS-100 switches for the  
24 price you've assumed it can get?

25          A     No, I have not. I have no knowledge of that.

1 Q Now in looking at the price that BellSouth would  
2 pay for Lucent 5E switches, you've disregarded the master  
3 contract that BellSouth has that was entered into in 1992;  
4 isn't that correct?

5 A Yes, I used the older contract.

6 Q Instead, you relied upon the switch replacement  
7 contract that BellSouth entered into with Lucent I believe  
8 in 1996; is that correct?

9 A That's correct.

10 Q Now would you agree that the switch replacement  
11 contract with Lucent covers existing analog switches that  
12 BellSouth intends to replace with digital switches in its  
13 network?

14 A I did not see those words. It did have specific  
15 switch replacements. It did not say what the existing  
16 switches were that I remember.

17 Q Well, is a 1A switch an analog switch?

18 A Yes, it is.

19 Q All right. But I think you would agree that the  
20 switch replacement contract specifically identified the  
21 central offices that were covered by the switch replacement  
22 contract; is that right?

23 A Yes, there were large lists of offices that I  
24 guess BellSouth was negotiating for replacement.

25 Q And how many central offices do you recall were

1 identified as being in Florida for which the switch  
2 replacement contract applied?

3 A I don't have that information. I do know that  
4 BellSouth-wide there were a couple of pages. I couldn't  
5 write down all the data. As I said, you know, we were  
6 reviewing this on your premises.

7 Q It was a couple of pages throughout the region;  
8 is that correct?

9 A Yes.

10 Q Would you agree that the switch replacement  
11 contract is not a general contract that BellSouth can elect  
12 to purchase under for any central office in its region?

13 A I would not necessarily characterize it that  
14 way. I would say that although it identifies specific  
15 switch replacements, my assumption is -- and I think, you  
16 know, a legitimate one -- forward-looking is that BellSouth  
17 would be able to negotiate similar prices for any new  
18 switches they elected to purchase, even if it may not be on  
19 that contract.

20 Q Well, I --

21 A It didn't say that it excluded -- I didn't read  
22 language that said this was only available for these and,  
23 you know, that it affirmatively excluded anything else. It  
24 just was laying out what it was including at that point.

25 Q Putting aside the question of whether or not

1 BellSouth could go back and renegotiate a different deal,  
2 I'm asking about the terms of the existing contract. To  
3 your knowledge, does the existing replacement switch  
4 contract with Lucent govern the central offices  
5 specifically identified in the contract where BellSouth  
6 would be purchasing switches?

7 A Yes.

8 Q And would you agree that the price per line that  
9 is quoted in the switch replacement contract is only for  
10 initial placement and does not cover the price for growth  
11 of the switch?

12 A That was correct, and I believe that's the  
13 correct number to use in a long-run study because the rule  
14 here, the fundamental principle is that you must assume  
15 that all costs are -- the time period is long enough that  
16 all the investment is avoidable or variable so, therefore,  
17 an entire -- you know, if you are assuming a ten-year  
18 depreciation like, for example, of switching, then the  
19 appropriate period would be at least ten years where you  
20 actually have to put in new switches.

21 Q All right. Just so we are clear here, when you  
22 were looking at the switching investment that you believed  
23 should be included in the model, you looked only at initial  
24 placement and ignored any expenses associated with growth;  
25 is that correct?

1           A     That's correct. The other reason I did that was  
2 because if I were faced with the decision BellSouth has  
3 which says I have, can buy prices -- or excuse me,  
4 switching equipment at one price per line today but that it  
5 goes up next year and stays higher to add equipment to that  
6 switch for the next few years, then obviously I'm going to  
7 do an analysis and figure out how many lines should I buy  
8 today at a lower price because I want to minimize my cost  
9 for investing in a switch. And if I, you know, know that  
10 I'm going to be growing 3%, 5%, whatever is appropriate for  
11 the local area being studied, I would make sure that I get  
12 the lowest price; and if that means buying more lines today  
13 at the new switch placement price, I would buy them today.  
14 Now of course those lines will be paid for in the future by  
15 future customers, so those costs should not be included in  
16 today's analysis. If you're going to do that, if you're  
17 going to include the cost of growth, then you absolutely  
18 must include the revenues that you expect to receive to  
19 offset those costs in the future, and you also must include  
20 things such as the growth of that switch in other areas of  
21 the study. When you take a cost study, and let's simplify  
22 it, and you take the total investment and divide it by the  
23 total minutes of use to come up with a minute of use cost,  
24 if you include the cost of new switch equipment at a higher  
25 price but don't grow the number of minutes you expect over

1 that same time period, you've got apples and oranges. You  
2 can't include growth in one place and not in another.

3 Q I just want to get this straight here. You are  
4 looking out at a snapshot in time and you are going to size  
5 the network including switches for the demand that exists  
6 at that point in time even though you know a month from  
7 then, two months later you are going to have additional  
8 growth or additional capacity demands for the network;  
9 isn't that correct?

10 A Yeah, the model that BellSouth used, the SCIS  
11 model, is what they call a snapshot model. It has no  
12 capability to do life cycle costs. It is looking at the  
13 cost of the network if you replaced it in one snapshot in  
14 time today. It includes the equipment, vintages and, you  
15 know, all of the underlying assumptions. It's basically a  
16 snapshot model, which is fairly consistent with the way  
17 cost studies have been done for many years.

18 Q Well, SCIS also allows you to include assumptions  
19 about growth and purchasing switch -- growth lines as  
20 demand increases, doesn't it?

21 A No, it doesn't. You can only put in one number  
22 for the number of lines.

23 Q Well, and that number of lines could include a  
24 growth number as opposed to just the initial placement of  
25 the switch?

1           A     What you can do is run the model multiple times  
2 should you want to perform this kind of analysis and change  
3 the number of lines each year as you increase your  
4 investment. It is not something that is inherent in the  
5 model. It would be controlled by user inputs.

6           Q     Now the Hatfield model -- your approach to just  
7 looking at a snapshot in time and ignoring future demand is  
8 the approach taken in the Hatfield model; isn't that  
9 correct?

10          A     Yeah, I believe so. I'm not an expert in all of  
11 the Hatfield model; however, the assumption there is that  
12 future revenues, future customers will take care of future  
13 demand costs.

14          Q     I just want to make sure I understand what you've  
15 assumed will happen in the future. You believe that  
16 BellSouth can go to Lucent and/or Nortel and say we need to  
17 buy switching to cover our entire network, and by the way,  
18 we don't want to pay any high margin growth lines later on,  
19 we only want to pay for initial placement and we want  
20 everything included, right-to-use fees, all the necessary  
21 hardware, and you think we can get that for the price that  
22 is in the replacement switch contract?

23          A     No, I don't agree with that.

24          Q     Okay. You don't agree that is what is going on  
25 here or what you're assuming?

1           A     No, I don't.

2           Q     Okay.

3           A     I would say that what I'm assuming is that as a  
4 rational consumer, BellSouth would try to minimize their  
5 investment. If that means buying more lines today at the  
6 cheaper replacement price, they would do that, and only  
7 when, only -- let's say, take an example, in year five when  
8 you present value that cost back to today's dollars, only  
9 then would you decide to start purchasing at the higher  
10 growth price. So it's not that I've ignored the concept,  
11 I just feel it does not impact the decision on what is the  
12 correct price for switching in a long-run cost study. And  
13 I have also not taken the assumption that you are going to  
14 go to the vendor and say, I'm going to change out every one  
15 of my switches, give me a price. Obviously, that kind of a  
16 contract, you could argue over whether or not it would be a  
17 lot cheaper or a lot more expensive. We have not taken  
18 that extreme approach. All we have taken is what is the  
19 price for -- that BellSouth incurs today at its current  
20 level, if you will, of switching replacement, not the  
21 extreme of I'm going to go buy every new switch right now.

22           Q     Well, but don't you understand that's what we are  
23 doing in a forward-looking environment, we are trying to  
24 determine what cost BellSouth would incur if it were to  
25 rebuild its network today using forward-looking, least-cost



1 technology; isn't that correct?

2 A It's correct; however, the way you apply it is  
3 not as simplified as what you're saying. If that were  
4 true, then the correct price of switching would be what can  
5 I go to Nortel and Lucent and whatever other vendors that  
6 are out there, and I want to buy literally hundreds and  
7 hundreds and hundreds of switches for all of BellSouth.  
8 Obviously you are going to get a much better price than any  
9 of the numbers I used in my analysis. I think --

10 Q Well, and you are going to get -- I'm sorry.

11 A You know, to take your study assumptions to that  
12 extreme, I think is illogical.

13 Q Well, you are going to get a better price because  
14 they, the vendors have you locked in. Once you put the  
15 price in -- once you put the switch in, you are stuck with  
16 that switch; and when you actually grow it, you are  
17 committed to purchasing additional lines from the switch  
18 vendor; isn't that correct?

19 A That is correct. However, it is not a situation  
20 where you go and build a contract and say, I'm only going  
21 to negotiate today the price of a new switch. Tomorrow  
22 I'll worry about the cost of the growth. Obviously they  
23 have the capability, under those circumstances, to take  
24 advantage of that situation. When you go to structure a  
25 contract with the vendors, you are going to take into

1 account up front how many switches am I purchasing and what  
2 is going to be my growth additional cost of switching; but  
3 again, you are going to make the decision how much  
4 equipment to buy based on an economic analysis of should I  
5 buy more equipment today at the cheaper price versus paying  
6 more later.

7 Q Let me ask it this way, the price that you have  
8 assumed BellSouth can get would apply in your estimation  
9 for replacing the entire network; isn't that correct?

10 A I would say that the limited number of  
11 switches -- I mean it was a substantial number of switches,  
12 but still not the entire network, that that was a  
13 reasonable price to assume on a going-forward basis that  
14 BellSouth will incur to purchase switching.

15 Q All right. And that is irrespective of any  
16 additional margins that switch vendors can obtain from  
17 BellSouth for growth of that switch, correct?

18 A No. Let me try this again. I did take into  
19 account the concept that a higher growth price exists. The  
20 reality is it isn't relevant, and the reason it's not  
21 relevant is because you have an option to buy today at a  
22 lower price and then you can pay a higher price tomorrow  
23 and next year and the year after that. At some point in  
24 the life cycle of that switch, it will be cheaper in  
25 today's dollars to buy at the higher growth price. The

1 reality is, that insures that the maximum price you will  
2 ever actually pay is the new switch number. You're only  
3 going to go and buy out of the higher growth price number  
4 when it's actually cheaper to do so in today's dollars.

5 Q And the reality is you've ignored any expense  
6 that BellSouth will incur when it has to pay to grow the  
7 switch?

8 A No, I don't think so. I think I just answered  
9 that question.

10 Q The number that you've included for the price per  
11 line, I think you've already acknowledged, only includes  
12 the initial placement of the switch, correct?

13 A That's correct.

14 Q So that X-dollars per line does not include any  
15 expenses associated with growth, correct?

16 MR. HATCH: Objection, asked and answered. We  
17 have been over this and over this.

18 COMMISSIONER CLARK: Commissioner Deason, you can  
19 probably ask this a different way. What I understand you  
20 to be saying is that to make the most economic decision you  
21 may purchase growth in, say, year six but you would have  
22 done an analysis that says on a net present value, for  
23 instance, that's going to cost you 150 dollars, a hundred  
24 dollars for the current -- Let me take that back.

25 On a net present value, it's going to cost you a

1 hundred dollars, whereas, if -- when you are looking at  
2 that, your offer to price for the new switch of being 149,  
3 and that covers, say, to year seven, you're going to choose  
4 the current thing because on a net present value it is  
5 less?

6 WITNESS PETZINGER: Yeah, that's basically  
7 exactly right. I would go year by year and say, you know,  
8 what is my cost per line if I buy out of the replacement  
9 when I first buy the switch? What is my cost in year one  
10 per line? What happens if I buy it today out of those  
11 extra lines today versus buying it in year one and net  
12 present value that back to today's dollars? Always the  
13 comparison would be today's dollars. And you wouldn't  
14 start purchasing at the growth price until it is equal to  
15 or less than in today's dollars, net present valued back to  
16 the actual replacement price you have initially available  
17 to you.

18 BY MR. ROSS:

19 Q Let me ask you, the chart that you've identified  
20 on page 11 comparing the price per line --

21 A I'm sorry, are you in my testimony now?

22 Q Yes, page 11 of your testimony. Do you see that?

23 A Yes, I do.

24 Q Those prices you've identified for NBA, for  
25 Pacific Bell, for Southwestern Bell, for Nortel/U.S. West

1 and for BellSouth/Lucent contract is the price on initial  
2 placement of switch, correct?

3 A Yes, that's correct. It's unclear about the  
4 Sprint numbers. They may have been a meld of new and  
5 growth pricing.

6 Q And the number that --

7 A But the other numbers I understand to be new  
8 switch placement prices.

9 Q And the numbers that you have --

10 A Which is considerably lower than anything that  
11 we're using.

12 Q I'm sorry, I don't mean to interrupt.

13 The number that you've reflected as the element  
14 used in the BellSouth cost study, that is also a melded  
15 number of growth and initial placement; isn't that correct?

16 A Are you talking about the last line?

17 Q Yes, ma'am.

18 A Okay, I'm also avoiding numbers because they are  
19 proprietary.

20 Q I'm just asking if that is a melded growth and  
21 initial placement number.

22 A That number comes directly out of BellSouth's  
23 study and would and does reflect the average price for a  
24 Nortel and Lucent and whatever weightings BellSouth gave to  
25 new and growth, that's correct.

1 Q All right. So that is -- you are comparing  
2 apples and oranges here in your chart on page 11, aren't  
3 you?

4 A What I was trying to do is show what is the  
5 average price per line that BellSouth is using in their  
6 cost study, and I was comparing it to other switching  
7 prices per line. In this case we are talking total switch  
8 investment divided by total lines. And I would say that  
9 the relevant comparison is what is the number out of the  
10 BellSouth study compared to other numbers we know represent  
11 cost of switching. I would not say that they are apples  
12 and oranges.

13 Q So you would say --

14 A If they are, you've chosen to use the wrong  
15 numbers.

16 Q Okay. So you would say comparing a melded  
17 growth, an initial placement number against just strictly  
18 initial placement number is not an apples to oranges  
19 comparison?

20 A I see what you're asking me. I would say that,  
21 yes, it's an apples to orange comparison, but it is the  
22 only comparison we could make because you use the melded  
23 growth and new numbers. If we substituted the new number  
24 into -- just the new placement number in there, that would  
25 be a totally irrelevant comparison because BellSouth didn't

1 use that number.

2 Q Going back to vertical features for just a  
3 minute.

4 COMMISSIONER DEASON: Are you leaving to a  
5 different subject?

6 MR. ROSS: Yes, sir.

7 COMMISSIONER DEASON: Okay. Let me ask a  
8 question. You just indicated in your answer to a previous  
9 question that if it was BellSouth's choice to use a melded  
10 number and that perhaps that was incorrect and that  
11 obviously you feel that the per-line cost for a totally new  
12 installation at the time is the more relevant price; is  
13 that -- I'm sorry, cost; is that correct?

14 WITNESS PETZINGER: Yes, that's right.

15 COMMISSIONER DEASON: All right. But it seems to  
16 me -- and you in answer to a previous question, you also  
17 indicated that there needs to be an analysis of the  
18 relevant cost of adding lines at a later time comparing  
19 that to the cost of having it installed with the initial  
20 installation, correct?

21 WITNESS PETZINGER: Right. Right.

22 COMMISSIONER DEASON: There needs to be some type  
23 of a present analysis value of that.

24 WITNESS PETZINGER: Right.

25 COMMISSIONER DEASON: So that if you make the

1 decision that on a present analysis value it's cheaper to  
2 get some additional growth with the initial installation,  
3 that that perhaps is the economic decision.

4 WITNESS PETZINGER: Right. Now be aware though  
5 that those additional lines you are purchasing are the  
6 lines that would be purchased at the lower new switch price  
7 because you are buying it co-incidentally with the  
8 placement switch.

9 CHAIRMAN DEASON: But isn't there a carrying cost  
10 of putting that up-front, making that up-front investment  
11 so that there is an additional cost of having made that  
12 up-front investment and that that economic cost is more  
13 than what you have listed for the other contracts?

14 WITNESS PETZINGER: That's a good question. To  
15 do a total life cycle cost is an extremely complicated  
16 analysis which is why none of these cost studies are based  
17 on true life cycle costing. That is why they are snapshot  
18 in time cost studies. The life cycle cost that you are  
19 talking about, if you were going to do that, you would  
20 definitely identify, what is the additional carrying cost I  
21 am carrying today? Let's say you buy two years worth of  
22 lines that are sitting idle in anticipation of future  
23 revenues. Now what you have to do is do a forecasted  
24 revenue projection, bring back the revenues to today's  
25 dollars, compare that to the cost and see if there is a



1 differential. It's an extremely complicated analysis when  
2 you start getting into forecasted demand and revenues, and  
3 in most cases I have not seen that kind of a cost study in  
4 any of these proceedings.

5 COMMISSIONER DEASON: It is complicated, and  
6 there are certain risks involved, are there not?

7 WITNESS PETZINGER: Yes.

8 COMMISSIONER DEASON: If your forecasts do not  
9 bear out and you anticipate a more rapid growth and you get  
10 the additional lines up front, and then you have to carry  
11 that for a longer period of time without the forecasted  
12 growth, there is a certain risk associated with that  
13 possibility, isn't there?

14 WITNESS PETZINGER: Yes, I agree with that. Yes.

15 BY MR. ROSS:

16 Q Just to go back to the issue about the vendors.  
17 If BellSouth were to go to Lucent and say I want the buy  
18 one switch and I don't want to ever grow this switch, just  
19 talking about initial placement, do you believe that Lucent  
20 would give the price that you have quoted on the table on  
21 page 11 as being the price under BellSouth's Lucent  
22 contract?

23 A It's a very illogical hypothetical.

24 Q Well, just bear with me.

25 A Could you repeat it again?

1 Q Yes. If BellSouth were to go to Lucent and say I  
2 want to buy a switch and I'm not interested in ever growing  
3 this switch, is it your testimony that BellSouth could get  
4 that switch for the price you have identified on page 11?

5 A Yeah, I do, unless they are breaking the law and  
6 selling under cost because they have the option to provide  
7 you that switch or give their business to the competitor,  
8 whether it's growth or not.

9 Q Okay. So you do not believe that initial  
10 placement costs or prices are lost leaders for switch  
11 vendors as suggested by the Northern Business Information  
12 Systems?

13 A No, I don't think they are necessarily saying  
14 it's a total lost leader. Let me relook at that, that  
15 phrase.

16 (WITNESS REVIEWED DOCUMENT)

17 A It doesn't say anything about being a lost  
18 leader. It just says that they sell the new switch  
19 placement cheaper than growth.

20 Q Okay. But putting aside the phraseology "lost  
21 leader," you do not believe that initial placement prices  
22 are a mechanism by which to entice the company to buy the  
23 switch so that they can make higher margin sales on growth?

24 A We are getting into areas now where you are  
25 asking me to contemplate how vendors structure their

1 pricing, and the only thing I can tell you is I have seen  
2 situations where the contracts do not include separate  
3 prices for new and growth, they are the same price.

4 Q So the answer is you don't know?

5 A The answer is I don't know what a vendor would  
6 do.

7 Q Turning to vertical features. You accused  
8 BellSouth of double counting specific feature hardware; is  
9 that correct?

10 A Yes, that's correct.

11 Q Are special feature hardware included in the  
12 price per line reflected in the Nortel contract?

13 A I did not see any reference to that, nor did I  
14 use the Nortel contract in my analysis.

15 Q To your knowledge, are special feature hardware  
16 included in the general contract with Lucent?

17 A I don't remember seeing anything in there, but  
18 again, I didn't use that contract in my analysis. I used  
19 the newer contract that did include the feature hardware.

20 Q So if the Commission were to decide that the  
21 Nortel contract and the general contract with Lucent are  
22 the appropriate contracts to use in calculating switching  
23 investment, you know of no reason to think there is any  
24 double counting going on, do you?

25 A Yeah, we were through this in the deposition, and

1 I will agree with you that you would not classify it as a  
2 double count in that particular instance; however,  
3 obviously it would be highly inflated because you are using  
4 an older, more expensive contract for switching.

5 Q With respect to right-to-use fees, to your  
6 knowledge are right-to-use fees included in the price per  
7 line reflected in the Nortel contract?

8 A I don't know that. Again, I didn't use the  
9 Nortel contract in the analysis. I don't remember what it  
10 said in that.

11 Q To your knowledge, were right-to-use fees  
12 included in the price per line in the Lucent general  
13 contract?

14 A I believe there were some. I don't remember what  
15 exactly.

16 Q If the Commission were, again, to decide that the  
17 Nortel contract and the Lucent general contract were the  
18 appropriate contracts to use in BellSouth's cost studies,  
19 would you have any reason to believe there is any double  
20 counting of right-to-use fees going on?

21 A Technically speaking, no, but obviously the costs  
22 would be included using an older contract and then added  
23 again separately in the feature cost that would highly  
24 overstate the actual cost that BellSouth would be expecting  
25 to pay.

1 Q Going back to your analogy to a computer, is it  
2 your testimony that whenever an incumbent or any telephone  
3 exchange company buys a switch that all the right-to-use  
4 fees are included in that?

5 A No, contracts vary significantly.

6 Q So it may very well be the case that even though  
7 BellSouth buys a computer, that when, in fact, software is  
8 used that BellSouth has to pay a right-to-use fee  
9 associated with that software?

10 A I was referring to other contracts. In this  
11 particular one it appeared to me that the features were  
12 included up front.

13 Q This would be the Lucent replacement contract?

14 A That's right.

15 MR. ROSS: No further questions, Commissioner  
16 Deason.

17 COMMISSIONER DEASON: Staff.

18 CROSS EXAMINATION

19 BY MR. PELLEGRINI:

20 Q Good afternoon, Ms. Petzinger. I'm Charlie  
21 Pellegrini on behalf of the staff.

22 A Good afternoon.

23 Q I think you've addressed most of our concerns in  
24 responses to Mr. Ross and to Commissioners Deason and  
25 Clark, but I just have one or two questions I think to be

1 absolutely sure we understand the basis for your  
2 recommended per line switching investment.

3 Now I think I understood you to state that  
4 essentially switches are priced on the basis of new  
5 switches and on the basis of growth switches; is that  
6 correct?

7 A Are you referring to my testimony or --

8 Q Yes, and --

9 A I mean my restatement?

10 Q Well, I'm referring to your testimony and to your  
11 responses here today.

12 A Okay. What I said was we incorporated the idea  
13 of whether or not BellSouth should be paying higher growth  
14 prices. We said that if you take the net present value,  
15 that -- of the growth prices in future years, that the  
16 highest cost that you would ever pay would be the price  
17 that is identified at the initial switch placement price  
18 because you would simply buy additional lines at that  
19 time. So I said I included the concept but the actual  
20 price I used from the contract was the new switch placement  
21 price.

22 Q All right. That's one point that I wanted to  
23 establish, and I thank you for that, but what I was asking  
24 with my initial question is this, vendors typically offer  
25 switches under new switch terms and under growth terms;

1 would you agree with that?

2 A Yes, quite often they do.

3 Q And did you say that the new, the prices under  
4 the new switch terms are typically less than the terms  
5 under -- the prices under the growth terms?

6 A That's typically true, yes.

7 Q But it's not always true I think you said?

8 A Well, it's not always true that you see two  
9 different prices. Sometimes they are the same.

10 Q All right. And you disagree with BellSouth's  
11 choice of using melded new and growth prices in  
12 establishing this investment, correct?

13 A Yes, I objected for two reasons.

14 Q Briefly recount those reasons, briefly.

15 A Sure. One was my analysis of the net present  
16 value, that an efficient provider would minimize their cost  
17 if they know they are placing a switch today at a new  
18 switch price, that they would buy enough lines at the new  
19 switch price and not begin to pay the growth price until  
20 the net present value of that growth price was equal to or  
21 less than the new switch price. So I feel that the maximum  
22 price they would ever actually pay in today's dollars, or  
23 what they should pay anyway, would be the new switch  
24 price.

25 The second item I objected to in their analysis

1 was the melding itself. They assumed that only the  
2 getting-started cost of a switch was priced at a new switch  
3 price, and even the first line on that switch they priced  
4 at the higher growth rate. That's incorrect, absolutely,  
5 you know, without a doubt. There are definitely lines and  
6 trunks that were purchased the same time as that switch  
7 that definitely should have received a new switch price.  
8 You can see that in the discount table. They use what they  
9 call the custom discount table in SCIS.

10 Q Just to be certain, again, of another point, on  
11 page 5, you -- or actually I think it was page 6, you  
12 identified the contract, the Lucent contract which you  
13 reviewed as a replacement contract?

14 A Yes.

15 Q Does that contain what we are presently calling  
16 new prices?

17 A Yes.

18 Q New switch prices?

19 A That's right.

20 Q Just a final question. I think you  
21 acknowledged -- you acknowledged to Mr. Ross that you  
22 reviewed -- the replacement contracts which you reviewed  
23 were specific to certain central offices?

24 A It was one contract that laid out all the new  
25 switch purchases that BellSouth was buying over all of its



1 territory.

2 Q Was it apparent why those contracts were specific  
3 or why that contract was specific to certain central  
4 offices?

5 A I simply assumed that it was because they were  
6 buying a fairly good size number of switches at one time in  
7 their planning period, that they could go to the vendor and  
8 negotiate a better deal than the older, you know, sort of  
9 off the shelf type contract.

10 Q And I think you said that in your view at least  
11 those prices should be generally applicable?

12 A I would say that given a ten-year depreciation  
13 life for switching, as the rate of replacement switching  
14 continues, that they should be able to continue those kinds  
15 of prices.

16 MR. PELLEGRINI: Thank you, Ms. Petzinger, that's  
17 all the questions we have for you.

18 COMMISSIONER DEASON: Commissioners.

19 (NO RESPONSE)

20 COMMISSIONER DEASON: Redirect.

21 MR. HATCH: Just a small portion.

22 REDIRECT EXAMINATION

23 BY MR. HATCH:

24 Q Ms. Petzinger, I expect you recall numerous  
25 questions regarding the contents of the switch vendor

1 contracts that you have reviewed at BellSouth's  
2 headquarters. Do you recall those?

3 A Yes.

4 Q Do you know whether those contracts were filed  
5 before this Commission in this proceeding?

6 A No, they weren't. We had to go to BellSouth's  
7 offices to review them.

8 Q If BellSouth had submitted those contracts, would  
9 it be easier for the Commission to assess the validity of  
10 your assertions regarding those contracts?

11 A Oh, absolutely.

12 MR. HATCH: No further redirect.

13 COMMISSIONER DEASON: Okay. Exhibits.

14 MR. ROSS: BellSouth would like to move exhibit  
15 59 into the record.

16 COMMISSIONER DEASON: Without objection, exhibit  
17 59 is admitted.

18 MR. PELLEGRINI: Staff moves exhibit 58.

19 COMMISSIONER DEASON: And without objection,  
20 exhibit 58 is admitted.

21 MR. HATCH: May Ms. Petzinger be excused?

22 COMMISSIONER DEASON: Yes.

23 WITNESS PETZINGER: Thank you.

24 COMMISSIONER DEASON: We are going to take a  
25 lunch break, and we will reconvene at one o'clock.

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