

BEFORE THE
FLORIDA PUBLIC SERVICE COMMISSION

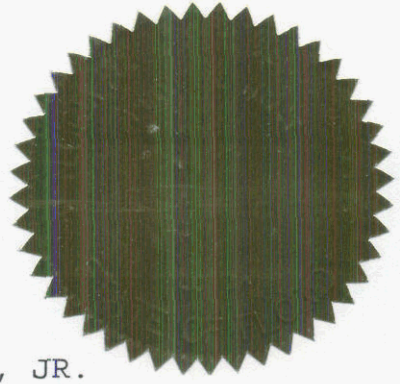
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In the Matter of : DOCKET NO. 990649-TP
:
INVESTIGATION INTO PRICING :
OF UNBUNDLED NETWORK :
ELEMENTS. :

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VOLUME 6

Pages 832 through 1,003



PROCEEDINGS: HEARING
BEFORE: CHAIRMAN J. TERRY DEASON
COMMISSIONER E. LEON JACOBS, JR.
COMMISSIONER LILA A. JABER
DATE: Monday, July 17, 2000
TIME: Commenced at 11:15 a.m.
PLACE: Betty Easley Conference Center
Room 148
4075 Esplanade Way
Tallahassee, Florida
REPORTED BY: KORETTA E. STANFORD, RPR
FPSC Official Reporter
APPEARANCES: (AS HERETOFORE NOTED.)

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24	Late-Filed "Clarification of useful lives provided by AT&T"		

25

P R O C E E D I N G S

1
2 CHAIRMAN DEASON: Call the hearing back to
3 order. You may continue with your cross.

CROSS EXAMINATION

4
5 BY MR. LAMOUREUX:

6 Q Okay. Mr. Cunningham, I don't have anymore
7 questions on that FCC order. I think our respective
8 positions are fairly clear on that.

9 You agree with me, though, that after that order
10 came out, in response to a request filed by several ILECs
11 for waiver of depreciation requirements, the FCC issued a
12 further notice of proposed rulemaking in April of this
13 year?

14 A That's my recollection, yeah.

15 Q Okay. And to the best of your recollection in
16 that order, and I'm not going to go through it, specific
17 paragraphs, but do you recall that the FCC reiterated many
18 of those same points that it made in its December order
19 about the value of continuing to maintain depreciation
20 ranges?

21 A I don't recall. I guess, I'm going to find out
22 here.

23 Q Let me hand out a copy of the April 2000,
24 further notice of proposed rulemaking.

25 MR. LAMOUREUX: I forgot to mark that first

1 document as an exhibit, and I'd like to do that and mark
2 this one as well, if I may.

3 CHAIRMAN DEASON: Well, the first document was
4 on the official recognition list.

5 MR. LAMOUREUX: Okay. Is this one as well? I
6 don't -- I don't think this one is on --

7 MS. KEATING: Didn't appear to be.

8 MR. LAMOUREUX: -- the recognition list, so I'd
9 like to go ahead and mark this as an exhibit.

10 CHAIRMAN DEASON: Okay. This will be identified
11 as Exhibit 53.

12 (Exhibit 53 was marked for identification.)

13 BY MR. LAMOUREUX:

14 Q Is this the order, Mr. Cunningham, further
15 notice of proposed rulemaking, rather, that the FCC issued
16 in April of this year?

17 A Yes.

18 Q Let me just ask you to turn to paragraph 8.

19 A Okay.

20 Q Would you agree with me, looking at that
21 paragraph, that in this April 2000 further notice of
22 proposed rulemaking, the FCC reiterated its statements
23 about continuing to require depreciation ranges for
24 possible use in UNE cost proceedings?

25 A These highlights are marked through again. I'll

1 try to suffer through them here.

2 Q I apologize. I should not use green highlighter
3 anymore.

4 A Yes, I see that. It does say that.

5 Q Are you aware of the comments filed by the
6 Florida Public Service Commission in response to that
7 further notice of proposed rulemaking?

8 A I do recall that they provided comments, yes.

9 Q And do you recall that the Florida Public
10 Service Commission agreed with the FCC's conclusions set
11 forth in its further notice of proposed rulemaking in
12 April?

13 MS. WHITE: I would object on the standpoint
14 that unless there's -- I'd like to see a copy of the
15 comments and like the witness to have a copy of the
16 comments.

17 MR. LAMOUREUX: It's coming right up.

18 CHAIRMAN DEASON: Very well.

19 MR. LAMOUREUX: This isn't on the recognition
20 list, although it's a document obviously filed by this
21 Commission. So, I guess, just to have the record clean,
22 I'd like to go ahead and have it marked as the next
23 exhibit.

24 CHAIRMAN DEASON: We can identify it as Exhibit
25 54.

1 (Exhibit 54 was marked for identification.)

2 BY MR. LAMOUREUX:

3 Q Mr. Cunningham, if you'd look with me,
4 specifically, at the bottom of page 6, would you agree
5 with me that the Florida Public Service Commission, in its
6 comments, notes that FCC oversight will provide states
7 with an additional source of information that can be
8 considered when determining prices for unbundled network
9 elements?

10 A I see that statement, yes.

11 Q Okay. And at the bottom of page 5, the earlier
12 page, would you agree that the Florida Public Service
13 Commission has told the FCC that the FCC should continue
14 to oversee the appropriateness of depreciation in cases
15 where depreciation is a significant portion of the cost?

16 A It says, if the FCC decides to no longer
17 prescribe depreciation rates for the price cap LECs, the
18 Florida Public Service Commission believes the FCC should
19 continue to oversee the appropriateness, yes.

20 Q So, even if the Florida Public Service
21 Commission comments, essentially, say that even if we, the
22 FCC, grants a waiver of depreciation requirements, the FCC
23 should continue to oversee depreciation ranges for
24 possible uses in cases where depreciation is a significant
25 portion of the cost?

1 A Yes, I see that.

2 Q You were also the sponsor of depreciation lives
3 in each of the UNE proceedings in the other various
4 BellSouth states; is that correct?

5 A Yes, sir.

6 Q And there were several of those cases; were
7 there not?

8 A Yes, sir, there sure were.

9 Q Is it your position that the states, in those
10 proceedings, adopted the lives that you recommended from
11 the BellSouth depreciation study?

12 A No, they didn't adopt all of the lives. They
13 adopt the lives that are very similar in some accounts and
14 dissimilar in others.

15 Q Would you agree with me that in many of those
16 decisions in those states what was adopted by those states
17 was, specifically, the FCC depreciation lives?

18 A They were in that range, yes.

19 Q Do you recall Tennessee adopting the FCC
20 prescription lives?

21 A I really don't have all that in my head.

22 Q Do you recall any of the states, specifically,
23 adopting the FCC prescription lives?

24 A I remember that many of the states, the lives
25 they prescribe, are within the range set out by the FCC.

1 Q Let me ask it this way. Do you recall any of
2 those states, specifically, agreeing to adopt the lives as
3 a result of your depreciation study that you sponsored in
4 those states?

5 A Not for every single account, no.

6 Q That's not what I'm asking for, not the lives --

7 A I'm not sure I understand that.

8 Q Okay. Let me ask it this way.

9 Do you recall whether any of those state
10 decisions, specifically, say that they're adopting lives,
11 specifically, as a result of the depreciation studies that
12 you filed in those states?

13 A I just don't recall.

14 Q All right. If I recall, those state decisions
15 have been made a part of the record, and I'm not going to
16 go through and ask questions about it, if that's the case.

17 MS. WHITE: They're on the official recognition
18 list.

19 MR. LAMOUREUX: Okay.

20 BY MR. LAMOUREUX:

21 Q Just give me some closure of a loop here. You
22 don't recall, specifically, any of the decisions of any of
23 those specific states, do you?

24 MS. WHITE: I'm going to object to the
25 standpoint that this question's been asked and answered on

1 several occasions now.

2 CHAIRMAN DEASON: I don't believe -- the
3 question goes to particular states, so I'll allow the
4 question.

5 MR. LAMOUREUX: This is a question that will
6 shorten up many of my questions, because if he says he
7 doesn't recall, I'm not going to ask.

8 A Would you repeat the question, please?

9 BY MR. LAMOUREUX:

10 Q Sure. You don't recall, specifically, the
11 orders from any of those specific state decisions in any
12 of those prior UNE cases, do you?

13 A I don't have them memorized. Is that what
14 you're asking?

15 Q Yeah. Do you have a specific recollection of,
16 say, North Carolina or South Carolina or Georgia or
17 Tennessee, any state in particular, what that state did?

18 A There are 30 accounts, you know, in each of
19 these studies times nine states. And, I'm sorry, I just
20 can't retain all of that data.

21 Q That's fine. Now, you did testify in the last
22 UNE case in Florida; did you not?

23 A Yes.

24 Q Okay. Do you recall that in that proceeding the
25 Florida Public Service Commission criticized the

1 substitution model as being based on several input
2 assumptions under the control of the person performing the
3 analysis?

4 A I'm sorry, I don't recall those exact words. I
5 would accept it, subject to check, but I just don't recall
6 the exact words.

7 Q Do you recall whether the Florida Public Service
8 Commission rejected your life proposals for the technology
9 accounts and adopted the FCC lives instead?

10 A That's an overstatement. No, they didn't adopt
11 the FCC lives carte blanche. I can go through each
12 account and tell you what was a UNE docket and what the
13 FCC prescribed, if that's helpful.

14 Q I think, I'll just leave it at that.

15 Let's talk about substitution analysis, for a
16 moment. As I understand it, substitution analysis was
17 used in your depreciation study in order to determine the
18 lives for the technology sensitive accounts; is that
19 correct?

20 A That was one of the tools used.

21 Q Okay. But it was not a tool used in
22 nontechnology sensitive accounts; is that correct?

23 A That is correct.

24 Q Okay. And those accounts, those
25 technology-sensitive accounts, I think, you said in your

1 testimony that they comprised more than 70% of the total
2 BellSouth plant investment; is that right?

3 A The accounts which it was used, either in whole
4 or as a part, that's correct.

5 Q And so, would you agree with me that
6 substitution analysis forms the basis for much of the
7 depreciation cost associated with the lives that you're
8 recommending?

9 A Well, I would say that that was one of the tools
10 used in determining the appropriate economic life in the
11 accounts that make up about 70% of our plant.

12 Q And as used in your depreciation study,
13 substitution analysis looks at the replacement of
14 technology in BellSouth's network with new technology. Is
15 that generally a fair statement?

16 A I would say the displacement of an old
17 technology with a new technology.

18 Q And, specifically, it looks at the displacement
19 of old technology with new technology in BellSouth's
20 network?

21 A Yes, sir.

22 Q And so, the substitution analysis, as it was
23 used in your depreciation study, essentially, uses as its
24 base line, if you will, BellSouth's existing network
25 infrastructure as it exists today and will exist in the

1 future and predicts how the technology in BellSouth's
2 network will be displaced by new technology; is that
3 correct?

4 A It looks at the various technologies that are
5 used in our plant today and will be used tomorrow.

6 Q And, specifically, used in your plant the way
7 your plant exists in BellSouth's network architecture,
8 correct?

9 A Well, it takes in consideration -- I mean, our
10 analysis takes in consideration, yes, the architecture as
11 it is today, plus how we expect the architecture to change
12 over time.

13 Q Well, I guess, what I'm trying to get at is it
14 doesn't use at its base line a hypothetical
15 forward-looking least cost, most efficient network in
16 Florida. It uses as its base line technology as it fits
17 into, specifically, BellSouth's network; is that correct?

18 A Yeah. The first part of your question is the
19 objective of the cost model, to look forward, and we're
20 providing them the economic life of the various accounts.
21 If you put a new piece of plant in today, how long would
22 it live? And then, how they apply it in their cost model
23 would be part of the cost model.

24 Q Specifically, if you put a new piece of plant in
25 BellSouth's network today, how long would it live,

1 correct?

2 A I would accept that characterization.

3 Q Would or would not?

4 A I would accept it.

5 Q Okay. Would you agree with me that,
6 essentially, substitution analysis reflects the changes in
7 values of assets as they exist in BellSouth's network?

8 A Again, substitution analysis is a tool that
9 allows us to determine how plant is going to be -- older
10 technologies will be displaced with new technologies. So,
11 if that doesn't answer your question, I guess, you'll have
12 to repeat it.

13 Q Well, one of the things that that is used to
14 predict is the changes in value of assets. I mean, that's
15 essentially what depreciation is, correct?

16 A That's a very broad way of saying it. And I'd
17 say yes, but the objective here was to determine the
18 appropriate economic life for the various categories of
19 plants to provide to the cost model folks for them to use
20 in their cost model. I mean, we're not talking about
21 depreciation of the embedded plant. We're talking about
22 what the appropriate economic life would be for a piece of
23 plant going forward.

24 Q But the underlying premise or construct, if you
25 will, that's used to use that substitution analysis is the

1 change in value of assets as those assets exist and will
2 be displaced in, specifically, BellSouth's network.

3 A Well, we're really looking at -- I mean, you
4 could get to that. We never take it that far. I mean,
5 what we're looking at the displacement, basically, of
6 circuits or access lines or in doing our substitution
7 analysis. We don't really do it on a dollar basis is
8 where I'm having a little hard time with your --

9 Q Let me take a specific example. I think you
10 said, both in your testimony and deposition, that one of
11 the things that you look at is the use of planning
12 documents to look at how technology is going to displace
13 older technology; is that correct?

14 A It gives us a feel for the direction of the
15 company, yes.

16 Q Okay. And one of the specifics, in terms of
17 technology replacement that you addressed in your
18 depreciation study, is the replacement of current
19 generation digital loop carrier with next-generation
20 digital-loop carrier; is that right?

21 A That is discussed in the study, yes.

22 Q Okay. And in particular, the way that's looked
23 at is it looks at how current generation digital-loop
24 carrier in BellSouth's network today will be replaced with
25 next-generation digital-loop carrier in BellSouth's

1 network in order to provide the services that BellSouth
2 envisions its network will provide.

3 A That is correct.

4 Q So, would you agree with me that, in a general
5 sense, the way substitution analysis works is it looks at
6 the technology in Bell's network and how that technology
7 will be displaced; again, in BellSouth's network, in order
8 to be able to provide the services that BellSouth
9 anticipates using its network to provide?

10 A Yeah. It actually takes into consideration how
11 it has been displaced, plus how -- it projects how it will
12 be further.

13 Q In the substitution model that you've used, one
14 of the inputs is the selection of a measurement to define
15 the fraction of the total usage of each technology; is
16 that right?

17 A That's correct.

18 Q Okay. And in particular, it's the time in which
19 new technology would equal 50% of the combined universe of
20 old and new technology; is that right?

21 A That is one of the inputs, yes. Actually, it's
22 calculated in our substitution analysis.

23 Q Okay. And essentially, there's two major
24 inputs; there's that one, and there's the rate at which
25 the substitution actually occurs; is that right?

1 A The rate in which the substitution progresses,
2 that is correct.

3 Q And as I understand it, BellSouth used a
4 regression analysis to come up with those two inputs; is
5 that right?

6 A Well, we used data points, historical and
7 planning data points, and put those into a regression
8 analysis to determine that, yes.

9 Q Is that what you meant a couple answers ago,
10 those inputs were calculated?

11 A Yes.

12 Q Okay. And, I think, you just said the variables
13 that were used in your regression analysis were based on
14 historical data based on the use of various technologies
15 in BellSouth's network; is that right?

16 A Yes.

17 Q Let me change gears for a moment to a different
18 subject.

19 Would you agree that if retirements that are
20 forecasted by a substitution analysis do not occur, that's
21 an indication that the projected lives were too short?

22 A I guess, if you did a substitution analysis, and
23 you project retirements, that may be true, but that's not
24 what we do. We don't project retirements in our
25 substitution analysis.

1 Q So, is it your testimony that retirement
2 analysis, retirements is not a part of substitution
3 analysis?

4 A What we depict in our substitution analysis, as
5 we talked about before, is the displacement of a new
6 technology for an old technology. And as I described
7 earlier, that doesn't necessarily -- it's not necessarily
8 associated with a book retirement on a company's books.

9 Q How long has BellSouth been using substitution
10 analysis for its depreciation studies?

11 A Well, I don't know, because I haven't been here
12 forever, but the best I can find is it probably started in
13 the very late '80s, probably '89. I can't find that, but
14 that's what people tell me.

15 Q Were you aware of the depreciation proceeding at
16 this Commission in 1992?

17 A Yes.

18 Q And was the depreciation analysis used in that
19 proceeding?

20 A Yes.

21 Q I'm sorry, I said depreciation analysis. I
22 meant substitution analysis. Substitution analysis was
23 used?

24 A Substitution analysis was used in that study,
25 that is correct.

1 Q If you don't mind, I'd like to hand out another
2 exhibit.

3 Mr. Cunningham, what I've just handed you are
4 several pages from BellSouth's depreciation study in that
5 proceeding. In particular, there are pages bates stamped
6 at the top, 270, 274, and 278. Were you involved in the
7 preparation of the study in that proceeding?

8 A I was involved in the preparation of the study.
9 I did not, personally, do the substitution analysis.
10 There was another witness in the case that presented that
11 testimony.

12 Q Okay. Who was that witness?

13 A I believe it was Steve Barecca.

14 Q Now, column C on each of these pages is titled,
15 "Retirements"; isn't that correct?

16 A That's what it says.

17 Q Can you explain to me, if retirements are not
18 used in substitution analysis, why there'd be a column for
19 that in this?

20 A I really don't know. I don't recall why that
21 column -- I have some old information out of that study,
22 and everything I have has -- I don't see anything that
23 says retirements, but I don't have those particular pages.
24 I show copper displacements on the sheets I have that are
25 depicting some of the fisher prior work done, but I'm not

1 even sure this is the fisher -- I'm not sure this is a
2 fisher prior run, actually.

3 Q Well, let me ask a couple more questions about
4 the document, if you can answer them.

5 The retirements that are listed in column C
6 there, based on this document, those are used to calculate
7 the retirement ratios in column E and the end of your
8 survivor's embedded vintages in column F. Does that
9 appear correct?

10 A Yes. And then, column F was used to calculate
11 an average remaining life.

12 Q And the embedded vintages remaining life at the
13 bottom of each page is based on the end of your survivor's
14 numbers from column F; is that right?

15 A Right. Again, my only point was I don't recall
16 this actually being the substitution analysis itself, but
17 I take it for what it says, yes.

18 Q Do you recall that the Commission accepted the
19 lives resulting from BellSouth's substitution analysis in
20 that proceeding?

21 A I don't recall, specifically, every account, but
22 I don't think they accepted all of the proposals, no.

23 Q Let me just hand you a couple pages from the
24 order from that proceeding. And I'm not going to make it
25 an exhibit.

1 If you'd turn to the last page I've got there,
2 which is Attachment A to that order.

3 A Yes.

4 Q Looking down at the cable and wire facilities
5 for aerial cable metallic, underground cable metallic, and
6 buried cable metallic --

7 A Yes.

8 Q -- looking at those and looking at the three
9 pages that I've handed out to you --

10 A Yes.

11 Q -- does it appear to you that the rates adopted
12 by the Commission reflect the bottom line embedded
13 vintages shown on those three pages that are bate stamped
14 at the top?

15 A I would agree that the average remaining lives
16 that are in this column are the same that are on these
17 calculation of product remaining life sheets you provided
18 me earlier, yes.

19 Q Okay. And, I guess, my question is, is it still
20 your testimony that retirements are not used in
21 substitution analysis performed by BellSouth?

22 A These pages are out of context of the study.
23 And I don't really believe this is the substitution
24 analysis. I think, this is the calculation of the average
25 remaining life, and it may be as a result of the

1 substitution analysis. I presume, it's involved in it in
2 some way, but I just don't recall, because I wasn't
3 involved in producing this.

4 Q Let me ask you this. Are the average remaining
5 lives in that proceeding used to determine the projected
6 lives or the economic lives?

7 A No. At this point and time, the Commission
8 really didn't talk, specifically, in terms of economic
9 life or projection life. They actually, not unlike the
10 FCC, they actually prescribed average remaining lives in
11 their dockets, not economic lives.

12 Now, you can, with the curve shape, associate
13 average remaining lives, you can back into projection
14 lives or economic lives, but the Commission didn't do that
15 at that point and time, as far as I know.

16 Q Have you read Mr. Majoros's testimony in this
17 proceeding?

18 A Yes.

19 Q Have you looked at the exhibits attached to his
20 testimony?

21 A Yes.

22 Q Have you seen Exhibit MJM-9 where he forecast
23 that the retirement forecasts from that prior proceeding
24 were overstated by about \$1.4 billion?

25 A I recall seeing that.

1 Q Do you have any reason to disagree with that
2 statement?

3 A Sure.

4 Q What's that?

5 A Well, my rebuttal testimony actually talks about
6 that.

7 First of all, the sheets that he used, from my
8 recollection -- I'm not looking at it. I don't think I
9 have it right here with me, but the sheets he used were
10 sheets that are required by the FCC to file a depreciation
11 study. And they were documents that you had to precisely
12 state -- fill in blanks that said retirements.

13 And we didn't do our substitution analysis on
14 retirements. We did it on displacements. So, we had to
15 back into those using a lot of assumptions. And we just
16 totally disagree that those backed into numbers actually
17 represent retirements.

18 Q Would it change your answer to know that
19 Mr. Majoros used the three sheets that are bate stamped at
20 the top in order to perform his analysis?

21 A I don't know, because I'm not really sure what
22 those sheets are, as I said before.

23 Q You don't recognize these sheets as sheets that
24 BellSouth would have used in that prior depreciation --

25 A Oh, it would have used them, I'm sure. It's

1 just not the substitution analysis, is my point. And
2 those numbers are called retirements, because it's
3 following an FCC script of what you have to put in
4 columns, but in our study we were using displacements.
5 So, to call them retirements is just not appropriate, in
6 my opinion.

7 Q So, is it your belief, then, that when this
8 column says retirements, those aren't really retirements,
9 those are displacements; is that what your understanding
10 is?

11 A I think, they're backed into retirement numbers,
12 that's my recollection. Unfortunately, since I didn't do
13 all that substitution analysis, I don't know, but it
14 caused such a confusion in the later study in 1995. We
15 actually explained that on page 10 of our study.

16 And it says, to satisfy the FCC's study exhibit
17 requirements, estimated displacement units are scaled to
18 dollars and included within the appropriate account
19 narratives. A unit cost is calculated by dividing
20 investment in the old technology and service at the time
21 of the study by units in the old technology.

22 The calculated unit cost is then multiplied by
23 the units of the old technology that are being displaced
24 by the new technology. This result in dollars represent
25 the equivalent value of the units displaced. They do not

1 represent the dollar value of expected retirements.

2 Q Okay.

3 CHAIRMAN DEASON: Excuse me, can you speak a
4 little bit more directly into the microphone?

5 MR. LAMOUREUX: Sure, I apologize.

6 CHAIRMAN DEASON: Thank you.

7 BY MR. LAMOUREUX:

8 Q Let me move on to another subject.

9 A Okay.

10 Q For the poles category of your depreciation
11 study, you've included a life indications plot; is that
12 correct? And, specifically, I'm looking at account 2411.

13 A Do you have a base page number there?

14 Q Unfortunately, I don't.

15 A That's all right, I'll find it. Yes, we did.

16 Q Okay. For other categories of your depreciation
17 study though, such as the digital ESS category, BellSouth
18 did not include a life indications plot; is that correct?

19 A That's right.

20 Q Why would BellSouth have included a life
21 indications plot for poles, for example, but not for other
22 categories?

23 A For the same reason I described earlier in my
24 testimony today. And that is we would expect poles to
25 have a similar life looking forward as in the past, but

1 for the technology account we would not. So, therefore,
2 it's not useful.

3 Q Okay. Let's take, as an example, the digital
4 ESS category, 2212.1, that's a category that BellSouth did
5 not include a life indications plot; is that correct?

6 A I don't think we did. There would be no reason
7 to.

8 Q All right. Let's assume you didn't. But
9 BellSouth did use regression analysis using historical
10 data in order to use its substitution analysis for that
11 category; is that correct?

12 A We used the actual data points of how the old
13 technology had been displaced with the new technology,
14 yes.

15 Q Let me hand out another document. These are
16 selections of BellSouth's response to AT&T's request for
17 production of documents, item 25?

18 A Yes.

19 MR. LAMOUREUX: We'd like to go ahead and have
20 this marked as the next exhibit, if that's okay.

21 CHAIRMAN DEASON: Exhibit 55.

22 (Exhibit 55 was marked for identification.)

23 BY MR. LAMOUREUX:

24 Q These are BellSouth's life indication plots for
25 various categories; are they not?

1 A Yes. Let me -- they're on -- life indication
2 plots are a part of this document.

3 Q Okay. The life indication plots are included in
4 the information in this document; is that right?

5 A No, the plots aren't. Where I'm confused,
6 you're saying a plot, like it's a graph, and it's not a
7 plot. The life point, the life indication point, is on --
8 there is a life indication point on these documents.

9 Q Right, okay. So, for example, for account 2212,
10 this document indicates that the life indication point for
11 digital ESS equipment is 18.7 years; is that correct?

12 A Yes, that's the backward looking approach that
13 we talked about, we don't think is appropriate for digital
14 switching, yes.

15 Q And for digital circuit equipment it shows a
16 life indication point of 23.1 years?

17 A Right. You see how ludicrous these are is why
18 we didn't use them.

19 Q So, your position is that regression analysis of
20 the actual -- I'm sorry, the life indication plots and the
21 points that result for them are ludicrous, but the
22 regression analysis, based on historical data that goes
23 into the substitution analysis, is acceptable?

24 A No. No, that's not what I'm saying at all. I'm
25 saying that in looking backward at retirements is not

1 appropriate in trying to describe how an old technology is
2 being displaced with a new technology. And the
3 substitution analysis is trying to determine that
4 appropriate displacement. It's not trying to determine
5 retirements that are shown on this sheet.

6 Q Is it acceptable to use retirements in accounts
7 such as poles?

8 A I would accept that looking at historical
9 information is helpful, and then applying your other
10 knowledge you have about the account, in terms of the
11 appropriate life.

12 Q I guess, I'm confused. Is the criticism you
13 have to the use of historical data or the use of
14 retirement information?

15 A It's backward-looking information, it's looking
16 backward in time to try to draw conclusions for the future
17 inappropriately is what I have a problem with.

18 Q Okay. And so, is it your position, then, that
19 the use of backward-looking information, such as life
20 indications would be inappropriate, but the use of
21 historical data to put into your substitution analysis is
22 appropriate?

23 A There is information data points on how
24 displacements have happened. They're important in the
25 substitution analysis, that is correct, in helping us

1 understand how the future is going to move forward.

2 And in our analysis of even the technology
3 accounts, we use a historical information to come up with
4 the appropriate, the total appropriate life of a
5 particular plant, but it's not the predominant -- it's not
6 the predominant cause of the displacement. It's, rather,
7 the technology substitution.

8 Q Who picked which accounts would be appropriate
9 to use a substitution analysis to come up with your lives
10 versus another form of analysis to come up with lives?

11 A Well, people that work for me and work under my
12 direction that are knowledgeable about what accounts are
13 being affected by technology.

14 Q So, they applied their judgment and determined
15 that one account would be an acceptable account for use of
16 substitution analysis and another account would not be; is
17 that correct?

18 A Sure, their judgment and the judgment of how
19 it's been done in the industry and how it's being done in
20 the industry and how they understand the network and how
21 it's progressing and what's impacting how that particular
22 account is changing over time or accounts are changing
23 over time.

24 Q Okay. Looking at the life indications in the
25 sheets that I've handed to you, about 8 accounts, would

1 you agree with me that those life indications indicate
2 higher lives than the lives that result from your
3 substitution analysis?

4 A Yes.

5 Q The life indications, those are
6 Florida-specific; isn't that right?

7 A Yes.

8 Q And if you were to file at the FCC for a
9 represcription, you would have to include this sort of
10 information in your filing; would you not?

11 A Yes, so that they can take that backward-looking
12 approach.

13 Q Last summer BellSouth filed with the FCC a
14 comparison of its book reserve to its theoretical reserve
15 as of January 1st, 1999, by a state; is that correct?

16 A That's another required document that the FCC
17 requires us to provide every year.

18 Q Do you recall what that document showed with
19 respect to BellSouth's reserve?

20 A I don't recall the exact number.

21 Q Okay. Mr. Cunningham, does this appear to you
22 to be the document that BellSouth or at least a part of
23 the package that BellSouth filed with the FCC?

24 A Yes, it appears to be, yes.

25 MR. LAMOUREUX: Sorry, I meant to have this

1 marked as an exhibit.

2 CHAIRMAN DEASON: It will be identified as
3 Exhibit 56.

4 (Exhibit 56 was marked for identification.)

5 BY MR. LAMOUREUX:

6 Q And you agree with me that this document shows a
7 reserve surplus for BellSouth of about \$614 million for
8 5.2% for Florida?

9 A That looks approximately correct, yes, sir,
10 based on this analysis which, of course, uses the
11 parameters that the FCC perceives as being correct.

12 Q And is that consistent with your understanding
13 of the status of BellSouth's reserve for Florida?

14 A I'm sorry, I don't understand your question.
15 Would you rephrase it, please?

16 Q Sure. Generally, is that number consistent with
17 what your --

18 A What number? I'm sorry.

19 Q \$614 million surplus, is that consistent with
20 your understanding of what the status is of BellSouth's
21 reserve for Florida?

22 I think, I can ask this easier, I'm sorry. To
23 your knowledge, has the reserve increased or decreased
24 since January 1st, 1999?

25 A I would say it's increased.

1 Q The reserve has increased?

2 A Right.

3 Q Do you have any knowledge what the current
4 number is?

5 A I don't.

6 Q Ballpark figure, how much it's increased?

7 A I don't, but I'm sure it's increased and -- I'm
8 sure it's increased the book reserve, if that's your
9 question.

10 COMMISSIONER JABER: Mr. Lamoureux, I apologize.
11 I don't see where the 16 million number is on the exhibit
12 you gave me.

13 CHAIRMAN DEASON: That may be the difference
14 between the adjusted book reserve and the theoretical
15 reserve.

16 BY MR. LAMOUREUX:

17 Q And actually, it was \$614; is that correct, that
18 it's the difference between the --

19 A It should be the difference between columns D
20 and G.

21 COMMISSIONER JABER: So, shouldn't we establish
22 what we're looking at first, and then reask your question?

23 MR. LAMOUREUX: Sure.

24 BY MR. LAMOUREUX:

25 Q Go back a little bit. Looking at this document,

1 how would I calculate what the reserve is for BellSouth
2 using the columns on this document?

3 A What the reserve is, is in column B; adjusted
4 with amortizations is in column D.

5 Q And the difference between those two would give
6 you BellSouth's -- would give you what?

7 A Actually, then, column G is the theoretical
8 reserve based on the FCC's parameters, okay? So, then by
9 subtracting G and D, you get the difference which, in this
10 case, happens to be, as you've mentioned, a surplus.

11 Q So, subtracting D from G would give you whether
12 or not there's a surplus or deficit that can tell you what
13 that amount is; is that right?

14 A Yeah, you can do the subtraction either way, as
15 long as you get your signs right, to determine whether
16 there's a surplus or a deficiency. It's an imbalance,
17 anyway.

18 Q And it's your understanding that since 1999,
19 BellSouth has continued in a surplus situation. It's
20 not --

21 A No, that's not what I said. What I said, I'm
22 sure that the reserve has grown, and if you were to do a
23 calculation using these backward-looking FCC lives again,
24 you'd come to some similar kind of result.

25 Q So, using the same sorts of calculations that we

1 would be doing looking at this exhibit, putting this in
2 the year 2000 would also tell you that BellSouth is in a
3 reserve situation and that that reserve has grown -- I'm
4 sorry, surplus.

5 A There would very likely still be a surplus
6 situation based on these FCC parameters, that is correct.

7 MR. LAMOUREUX: Let me just -- one moment.
8 That's all I have.

9 CHAIRMAN DEASON: Mr. Melson.

10 CROSS EXAMINATION

11 BY MR. MELSON:

12 Q Mr. Cunningham, Rick Melson representing MCI
13 Worldcom. I'm going to ask Ms. McNulty to hand out a copy
14 of Exhibit 34, which was MCI Worldcom's response to some
15 interrogatory answers from BellSouth.

16 This has been previously identified as a
17 confidential exhibit. We're going to hand it out for
18 purposes of asking this witness a couple questions, and
19 then at the end of his appearance on the stand we're going
20 to try to collect them back again.

21 Mr. Cunningham, I'm going to ask you to turn to
22 the next to last page of this exhibit which is the one
23 that's label confidential. And I'm going to try to ask
24 you just a couple questions in a way that neither one of
25 us blurts out any of the numbers in the years column,

1 which is what MCI regards as confidential. And for
2 comparison purposes, I'd like to turn, if you would, to
3 your exhibit number one, GDC-1.

4 Are you with me?

5 A Yes, sir.

6 Q Okay. And again, without blurting anything out,
7 I would like you mentally to compare the economic life
8 shown on your exhibit for digital ESS with the life shown
9 on the MCI Attachment 1 for switch, which is down toward
10 the bottom.

11 A Yes.

12 Q I would like you to compare circuit digital on
13 your exhibit with circuit termination equipment on the MCI
14 exhibit.

15 A Okay.

16 Q And finally, I would like you to compare your
17 six cable accounts, aerial cable, underground cable, and
18 buried cable, both metallic and fiber with the single item
19 on the MCI exhibit labeled fiber cable.

20 A Okay.

21 Q Is it fair to say that in each case of the
22 comparison the depreciable life shown on the Worldcom
23 exhibit is either the same as or longer than the
24 comparable lives shown on your Exhibit GDC-1; and again,
25 in every case equal to or longer than on the MCI exhibit?

1 A Yes. I'm trying to -- yes, that statement is
2 correct. I'm trying to make sure that they are apples to
3 apples comparisons when I look at this.

4 Q Okay.

5 A I guess, based on the information here, I would
6 have to assume that, not having other information, there
7 are other classes of a plant here that could be part of a
8 circuit account that I'm not really sure what they are,
9 based on their designation example.

10 Q I think, we can cut through this, if you'll turn
11 to the last page of the exhibit --

12 A Okay.

13 Q -- which is not confidential on which MCI
14 defines what is included in the switch cable and digital
15 circuit equipment categories.

16 A Okay. Based on that, I would agree with your
17 statement.

18 Q And would one, therefore, conclude that if the
19 Worldcom lives, rather than the BellSouth lives, were used
20 for these categories of equipment that the cost of
21 equipment charged year by year through depreciation would
22 be less using the Worldcom lives than using the -- would
23 be equal to or less using the Worldcom lives than using
24 the BellSouth lives?

25 A That would be true using a whole life approach.

1 It's not really the approach we use in BellSouth, but
2 using the kind of approach that's modeled on a cost model,
3 that would be correct. And it's, of course, very
4 surprising, since the Worldcom numbers are, without
5 quoting them, are totally out of line with the rest of the
6 industry, except for switching.

7 MR. MELSON: I've got no further questions,
8 thank you.

9 CHAIRMAN DEASON: Mr. McGlothlin.

10 MR. MCGLOTHLIN: I have no questions.

11 CHAIRMAN DEASON: Are there intervenors? Staff?

12 MS. KEATING: Staff has no questions.

13 CHAIRMAN DEASON: I'm sorry, Mr. Buechele.

14 MR. BUECHELE: Just a few questions.

15 CHAIRMAN DEASON: You need to come to a
16 microphone.

17 CROSS EXAMINATION

18 BY MR. BUECHELE:

19 Q Good afternoon. I'm sorry, could you explain to
20 me what book reserve is, very briefly?

21 A What's book reserve? That's the accumulated
22 depreciation that's on the -- for the asset accounts that
23 are on the books of the company. It's the total
24 accumulated depreciation.

25 Q And theoretical reserve is what the FCC would

1 determine should be on your books?

2 A Yeah, based on the life and salvage parameters
3 that they think are appropriate, yes, sir.

4 Q Let me ask you this. Did you testify that
5 you've seen some changing circumstances that justify lower
6 depreciation lives?

7 A Lower depreciation lives than --

8 Q Than the FCC has set forth previously?

9 A Yes, our study would indicate that.

10 Q And what is that, just the presence of
11 competition?

12 A It's the fast pace of technological change and
13 the new competitive environment that's growing every day.

14 Q Would you agree with me that BellSouth will
15 always be the only one to have wire going to most
16 residences?

17 A No, sir, I would not -- oh, wire, yes. No, no,
18 absolutely not.

19 Q Well, do you know of any case where anybody in a
20 BellSouth territory has actually strung up their own wire
21 plant?

22 A I actually have AT&T wire and BellSouth wire in
23 my house --

24 Q Okay.

25 A -- for example.

1 Q What percentage of all wire plant would you say
2 a competitor has brought in?

3 A I'm sorry, I couldn't understand you. I
4 couldn't hear you, actually.

5 Q In the last four years, what percentage of wire
6 in BellSouth territory is strung up by a different
7 competitor?

8 A Could you rephrase the question? I don't
9 understand the question.

10 Q Since 1996 --

11 A -- string BellSouth's wire, that's where I'm
12 confused.

13 Q I'm sorry, I'm sorry. The overhead wire
14 plant --

15 A Aerial plant?

16 Q The aerial plant.

17 A Okay.

18 Q Are you telling me that AT&T is stringing up
19 aerial, overhead aerial wire, in competition to BellSouth?

20 A I'm saying that based on everything I read in
21 their publications that they plan on being competitive in
22 the local -- for local telephone service with BellSouth.
23 And I happen to have AT&T cable television service in my
24 house. That's what I was referring to by the copper
25 cable.

1 Q Okay. So, you don't know of anybody who
2 actually is going to string up new wires, overhead wires,
3 to any residences in competition with BellSouth?

4 A Oh, I think they will, based on statements I
5 read in their publications and on their web sites.

6 Q Nobody's done it to date?

7 A There is facilities-based competition in
8 Florida, is my understanding. Now, whether TCG, for
9 example, subsidiary of AT&T that provides local service,
10 whether they have wires -- or I presume they do; they've
11 got switches and cable. Now, whether they have metallic
12 cable, I'm not sure, but I'm sure they have fiber cable
13 that's going to all these places where they're providing
14 service.

15 Q So, you don't see in the near future anybody --
16 strike that, I'll rephrase it.

17 There's no real incentive for anyone to string
18 up wire competition to BellSouth?

19 A I didn't say that.

20 Q Nobody's done it to date?

21 A Beg your pardon?

22 Q Nobody's done it to date, and there's no
23 competitive pressure put on BellSouth to replace its wire
24 plant?

25 A I did not say that.

1 Q Is there competitive pressure against BellSouth
2 to replace its wire plant?

3 A Competitive pressure? When you look at the
4 make-up of the networks of its competitors and see that
5 they're predominantly fiber and that if you know,
6 technically, the capability of fiber compared to metallic
7 cable, I think you'd be naive to think there wasn't a
8 competitive and economic need for BellSouth to provide
9 fiber cable to its customers as fast as it can. Matter of
10 fact, that's what we're all about trying to do.

11 Q Well, let's do it this way. If a CLEC came to
12 you to lease an unbundled loop, are you telling me that
13 that CLEC, if he doesn't like your price, is going to
14 string up a wire from their switch to the local residence?

15 A I can't tell you what a CLEC may do. I'm not a
16 CLEC, I don't know.

17 Q Okay. So, that would be a competitive pressure
18 that would require you to upgrade your wire plant,
19 wouldn't it, if that existed at all?

20 A I really can't respond to that.

21 Q Okay. Now, the electronic switches, are you
22 familiar with how they work?

23 A Not infinitely familiar, no.

24 Q Would it be a fair statement that they're
25 basically computers that are software-driven?

1 A No, they are software-driven. They have a lot
2 of computer types of equipment with them, but they are --
3 they have a lot of hardware associated with those
4 switches. You can see them, you can touch them, you can
5 -- you can walk around them, you cannot walk through them.

6 They -- if you have a computer at home, it's got
7 a lot of software in it, but it won't do a thing without
8 the hardware, and as software continues to progress --
9 actually, you know, one of the sayings I think I've heard
10 is that Intel gives us the hardware and Microsoft takes it
11 away. I mean, you can't have one without the other. And
12 the hardware is going to continue to come at faster and
13 faster technological paces, as well as the software.

14 Q Is it a fair statement that all the features
15 that customers get today are software-driven?

16 A I really can't respond to that.

17 Q Okay. And if that was the case, there'd be no
18 competitive pressure on BellSouth to update its electronic
19 switches?

20 A Well, I'm sure it's not true, so I can't agree
21 to that statement.

22 Q Okay.

23 COMMISSIONER JABER: Why are you sure it's not
24 true?

25 THE WITNESS: Because I know our switches are

1 full of hardware. I mean, just like to say that software
2 is everything, I mean, you can't -- software won't work
3 without hardware for it to work upon.

4 COMMISSIONER JABER: So, the response --
5 initially, though you said that you weren't sure that was
6 the case.

7 THE WITNESS: If I said that, I was -- I
8 misspoke in what I meant to say. I'm sorry.

9 BY MR. BUECHELE:

10 Q Have you personally done any physical studies to
11 determine future impact of competitive pressures?

12 A No, sir, I haven't.

13 Q Are you familiar with the FCC's first report and
14 order 96325?

15 A What is that? I mean, what --

16 Q Well, that's the first report and order that
17 came out after the Telecommunications Act was passed.

18 A I mean, I know, but I'm not infinitely familiar
19 with it, no.

20 Q Are you familiar with paragraph 702 that says
21 that the federal depreciation rates are a reasonable
22 starting point and that the ILEC has the burden of
23 demonstrating which specificity that business risks face
24 justify different result?

25 MS. WHITE: I'm going to object to the

1 standpoint that I would like Mr. Cunningham to be able to
2 have a copy of that paragraph to read and the context in
3 which the statement was made.

4 CHAIRMAN DEASON: Can you share that with the
5 witness?

6 MR. BUECHELE: I don't have a copy with me right
7 now.

8 CHAIRMAN DEASON: Go ahead.

9 MR. BUECHELE: Would you accept that as a fair
10 statement, subject to check?

11 CHAIRMAN DEASON: I'm sorry, the objection
12 stands, then, correct?

13 MS. WHITE: Yes, the objection stands, because
14 I'm not sure that that's what it says, and I'd like to
15 read it myself, as well as let the witness read it. So, I
16 do object.

17 CHAIRMAN DEASON: I'm going to sustain the
18 objection.

19 MR. BUECHELE: Okay.

20 BY MR. BUECHELE:

21 Q Assuming that's what paragraph 702 says, would
22 you agree with me, and it's all subject to check, that
23 it's the burden of the ILECs to prove something --

24 CHAIRMAN DEASON: Mr. Buechele, I believe, I
25 just disqualified that question. You may be rephrasing

1 it, but I think it's, essentially, the same question.

2 Can you distinguish for me what the difference
3 is between the question you're asking now and the question
4 earlier?

5 MR. BUECHELE: Yes. I'm asking him to assume
6 that I paraphrased that paragraph correctly.

7 CHAIRMAN DEASON: Well, if you can ask your
8 question without even relating to what the paragraph says,
9 but strictly a hypothetical, then, I'll allow the
10 question. But any reference to a paragraph which you're
11 not providing the witness, I'm going to disallow.

12 MR. BUECHELE: Okay.

13 BY MR. BUECHELE:

14 Q Assuming that the FCC has stated that it's an
15 ILEC's burden to prove changing circumstances, would you
16 -- strike that.

17 So, is it fair to say that you've done nothing
18 to demonstrate changing competitive circumstances in forms
19 of any studies?

20 A I, personally, haven't done any studies, but I
21 have read many documents that document the competitive
22 change. For example, I've read many parts of the Florida
23 Public Service Commission's web page that documents of how
24 competition is moving in Florida, and a lot of those
25 details as part of the studies they have done.

1 Q And none of that actually went in some sort of
2 quantification into your calculation of useful lives; is
3 that correct?

4 A It's not quantified.

5 Q Okay. So, basically, it's just nebulous,
6 something out there that you thought might be of issue,
7 but you did nothing to actually quantify it or determine
8 it?

9 MS. WHITE: I'm going to object to the
10 characterization of the witness's testimony.

11 CHAIRMAN DEASON: I'm going to allow the
12 question. If the witness disagrees with that
13 characterization, he can so indicate.

14 A Well, I do disagree with the statement.

15 Again, when you're looking at what the
16 appropriate economic life is, what we do, as we've talked
17 before, is look at the plans of the company, for one
18 thing. And those plans are driven, by a large part, by
19 the competitive world we live in.

20 And all those technological directives are
21 driven by knowing we have to meet the customer's needs.
22 And to say that the competitive world we live in isn't a
23 part of that would be naive.

24 BY MR. BUECHELE:

25 Q Right, but you did nothing to quantify that

1 future competitiveness, did you?

2 A I didn't quantify it. What I am saying is
3 through our analysis and how we're deploying our plant
4 that actually provides you the data points that are used
5 in our analysis; and that, plus, the information that are
6 in these directives allow us to actually look to be sure
7 we have the right assumptions.

8 Q Did you do any kind of quantified study wherein
9 you determined what percentage of wire plant you'd have
10 competition against or fiber plant or switch that you
11 would actually have to replace due to competitive
12 pressure, any kind of actual physical study?

13 A No. The study that I did is in the depreciation
14 study that I've provided in this case. And I didn't do a
15 separate competitive study.

16 Q And you didn't quantify competitive conditions
17 in the future at all, did you, for any of this equipment,
18 for any of the assets?

19 A The competition, as I mentioned before, is
20 considered. There's not a specific quantification of it
21 in the study.

22 Q Right. It was just your best guess estimate of
23 how to round down?

24 A No, it's not my best guess how to round; as I
25 described it before, and how competition plays in

1 providing the kinds of technologies that our customers
2 demand.

3 MR. BUECHELE: Okay. I don't have anything
4 further.

5 CHAIRMAN DEASON: Staff?

6 MS. KEATING: Staff has no questions.

7 COMMISSIONER JACOBS: Mr. Cunningham?

8 THE WITNESS: Yes, sir.

9 COMMISSIONER JACOBS: Kind of at the general
10 level, would it be fair to say that you're anticipating
11 that as technology advances you're going to be replacing
12 more stuff faster, more of your plant is going to have to
13 turn over in a faster time frame.

14 THE WITNESS: Yes, sir.

15 COMMISSIONER JACOBS: Is that a fair statement?

16 THE WITNESS: Yes, sir.

17 COMMISSIONER JACOBS: Earlier, you indicated
18 that much of your -- you use a good bit of software, but
19 you also recognize that a lot of what's going on now,
20 particularly with your switches, has to do with hardware?

21 THE WITNESS: Yes, sir.

22 COMMISSIONER JACOBS: Does that analogy apply to
23 both those components? In other words, your turnover for
24 software will be as rapid as your turnover for hardware?
25 Is that your anticipation?

1 THE WITNESS: Yes, sir, but not necessarily they
2 would be one for one. But when we study, for example, the
3 digital switch, we have a component of the digital switch
4 that we look at called the memory of the switch and the
5 main computer brain, so to speak, that's actually in the
6 digital switch.

7 And that includes both hardware and software.
8 And we realize that those new modules that come from
9 suppliers, which include both new software and the
10 associated hardware, come to us very rapidly so that we
11 have to upgrade our switches.

12 COMMISSIONER JACOBS: And with that, does that
13 translate to additional modifications outside of the
14 switch environment? In other words, as you go further out
15 into the field, are you finding that that same level of
16 frequency exists with regard to the equipment outside of
17 that switch environment?

18 THE WITNESS: Well, the same technological
19 advances are being made outside of the switch. They may
20 not be happening at the same pace as, for example, the
21 computer module. They may be at a slower pace, but they
22 are happening fast.

23 COMMISSIONER JACOBS: Thank you.

24 THE WITNESS: Yes, sir.

25 CHAIRMAN DEASON: Redirect?

1 MS. WHITE: I have no redirect.

2 CHAIRMAN DEASON: Exhibits?

3 MS. WHITE: BellSouth moves Exhibit Number 52.

4 CHAIRMAN DEASON: Without objection, Exhibit 52
5 is admitted.

6 (Exhibit 52 was admitted into evidence.)

7 CHAIRMAN DEASON: Other exhibits?

8 MR. LAMOUREUX: I lost track of the numbers, but
9 I think mine are 53 on.

10 CHAIRMAN DEASON: 53 through 56.

11 MR. LAMOUREUX: I would move for the admission
12 of those.

13 CHAIRMAN DEASON: And without objection, hearing
14 none, Exhibits 53 through 56 are admitted.

15 (Exhibits 53 through 56 were admitted into
16 evidence.)

17 CHAIRMAN DEASON: We will recess for lunch and
18 reconvene at 1:30.

19 (Recess taken)

20 CHAIRMAN DEASON: Call the hearing back to
21 order.

22 Mr. Pellegrini?

23 MR. PELLEGRINI: Charles Pellegrini appearing
24 belatedly for Covad Communications.

25 CHAIRMAN DEASON: Thank you for joining us.

1 Mr. Sovereign's direct testimony and rebuttal testimony be
2 inserted into the record as though read.

3 CHAIRMAN DEASON: Without objection, it shall be
4 so inserted.

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DIRECT TESTIMONY OF ALLEN E. SOVEREIGN

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, ADDRESS AND PRESENT POSITION.

A. My name is Allen E. Sovereign. My business address is 1420 East Rochelle Blvd., Irving, Texas 75039. I am employed by GTE Service Corporation as Group Manager-Capital Recovery.

Q. PLEASE BRIEFLY DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I received a Bachelor of Science Degree in Electrical Engineering from Michigan Technological University, Houghton, Michigan, in 1971. I received a Master of Science Degree in Business Administration from Indiana University, Bloomington, Indiana, in 1980. I have attended courses in depreciation and life analysis provided by Depreciation Programs, Inc., of Kalamazoo, Michigan. I have also attended and instructed basic and advanced GTE courses in depreciation life analysis. I am a Senior Member of the Society of Depreciation Professionals.

Q. PLEASE BRIEFLY DESCRIBE YOUR WORK EXPERIENCE WITH GTE.

A. I have worked for GTE Companies for 25 years, with 18 of those

1 years in the depreciation study area. I have held various positions in
2 Engineering and Construction, Capital Budgeting, Marketing, and
3 Product Development. I was named to my current position in
4 February 1994.

5

6 **Q. WHAT ARE THE RESPONSIBILITIES OF YOUR CURRENT**
7 **POSITION?**

8 A. I am responsible for the preparation, filing and resolution of capital
9 recovery studies and the determination of economic lives for GTE.

10

11 **Q. HAVE YOU PREVIOUSLY TESTIFIED IN FLORIDA?**

12 A. Yes.

13

14 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY OTHER**
15 **REGULATORY BODIES?**

16 A. Yes, I have also testified before state utility commissions in South
17 Carolina, Texas, New Mexico, Arkansas, California, Washington,
18 Idaho, Illinois, Indiana, Nebraska, Pennsylvania, Michigan, Virginia,
19 Kentucky, Nevada, Iowa, and Hawaii.

20

21 **Q. WHAT IS THE PURPOSE OF YOUR DIRECT TESTIMONY?**

22 A. The purpose of this testimony is to respond to Issue 7b in this
23 proceeding regarding the appropriate depreciation lives and future net
24 salvages to be used to calculate Unbundled Network Element ("UNE")
25 rates. I describe the methodology that this Commission should

1 approve for determining the depreciation parameters used to
2 calculate total service long-run incremental ("TSLRIC") costs. I also
3 recommend a set of depreciation lives and future net salvage
4 percentages to be used in the cost studies used to calculate UNE
5 rates for GTE Florida Incorporated ("GTE").

6

7 **Q. WHAT DEPRECIATION INPUTS DID GTE USE IN THE COST**
8 **STUDIES IT SUBMITTED IN THIS PROCEEDING?**

9 A. GTE used the forward-looking economic lives and future net salvages
10 recommended in this testimony. A complete list of GTE's proposed
11 depreciation lives and future net salvage percentages is attached as
12 Exhibit AES-1.

13

14 **Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.**

15 A. The Florida Public Service Commission ("FPSC") should approve the
16 economic depreciation inputs GTE used in its cost studies. Like the
17 cost study methodology prescribed for use in this proceeding, GTE's
18 depreciation inputs are forward-looking. This forward-looking
19 approach produces a more accurate estimate of assets' economic
20 lives than an outdated, historical approach.

21

22 When all local exchange companies were monopoly providers,
23 regulators could defer capital recovery without affecting the ability of
24 the regulated company to recover its investments. With the advent of
25 local competition, regulators no longer have the luxury of postponing

1 capital recovery in the rate-setting process. The changing
2 telecommunications environment must be taken into consideration
3 when determining the proper recovery period of an asset. The
4 methodology described in my testimony considers these
5 developments.

6

7 **II. ECONOMIC LIVES MUST BE USED IN FORWARD-LOOKING COST**
8 **STUDIES**

9

10 **Q. PLEASE DEFINE THE TERM “ECONOMIC LIFE” AND HOW IT**
11 **RELATES TO GTE'S COST STUDIES.**

12 A. Economic life can be defined as the period of time over which an
13 asset is used to provide economic value to GTE. GTE's proposed
14 depreciation parameters consider the decline in an asset's value from
15 all causes, including competition and technological change. They
16 reflect the principle that depreciation parameters should be consistent
17 with forward-looking economic assumptions and based on competitive
18 market asset lives.

19

20 **Q. WHAT ARE “COMMISSION-PRESCRIBED DEPRECIATION**
21 **LIVES”?**

22 A. These are the lives set by regulatory commissions for regulatory
23 accounting purposes. As I explain below, the FPSC no longer
24 prescribes depreciation lives for GTE or other price-cap regulated
25 companies.

1 **Q. IS AN ASSET'S ECONOMIC LIFE EQUAL TO THE DEPRECIATION**
2 **LIFE OF THAT ASSET AS PRESCRIBED BY STATE**
3 **COMMISSIONS OR THE FCC?**

4 A. Economic lives are generally shorter than prescribed asset lives.

5

6 **Q. WHY ARE ECONOMIC LIVES SHORTER THAN PRESCRIBED**
7 **LIVES?**

8 A. Historically, regulatory commissions prescribed asset lives under the
9 assumption that there would be little or no competition and that
10 technological innovation would continue at its traditional pace. The
11 Telecommunications Act of 1996 (Act) is intended to spur a new
12 competitive environment that invalidates that basic assumption.

13

14 As previously discussed, the economic life of an asset is the period
15 of time over which that asset is used to provide economic value. Both
16 increased competition and technological change shorten the period
17 over which an asset will provide economic value. In a world where
18 GTE was sole provider, GTE was able to keep old assets on the
19 books, even after their economic lives had expired, because
20 depreciation rates were based upon artificially long asset lives. By
21 basing depreciation rates on long asset lives, the depreciation rates
22 were lower, and the period of time over which the asset was
23 depreciated was longer. These longer depreciation lives helped state
24 commissions to keep consumer prices artificially low. Today's current
25 market environment reduces the length of time over which GTE can

1 recover its investment in an asset and renders unsustainable the use
2 of artificially long asset lives in calculating depreciation rates.

3

4 **Q. WHEN ESTIMATING ECONOMIC LIVES, IS IT POSSIBLE TO USE**
5 **TRADITIONAL LIFE ESTIMATION TECHNIQUES?**

6 A. No. Traditional life estimation techniques are used to predict an
7 asset's *physical* life, but not its *economic* life. The physical life of an
8 asset ends upon that asset's retirement. Economic lives, however,
9 can be affected when no retirements are evident. For example,
10 assume GTE has a 1,200 pair cable that has been used to provide
11 service to 1,000 customers in the pre-1996 Telecommunications Act
12 single-provider environment. Next, assume that in the post-1996 Act
13 industry, only 500 pairs of the 1,200 pair cable are being used (*i.e.*,
14 providing service to customers and economic value to GTE) as a
15 result of 500 customers leaving for competitors' networks. Retirement
16 of the 500 pairs that are no longer being used is not permitted under
17 current "Part 32" accounting guidelines. Retirement-based analysis
18 (*i.e.*, the traditional physical life estimation technique) assumes that
19 all plant in service has economic life. However, under this scenario,
20 only 50% of the originally utilized investment actually has economic
21 life. The economic life of the asset is severely affected by
22 competition, but there are no associated retirements of the asset.

23

24 **Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION FOLLOWED**
25 **THE TRADITIONAL METHOD FOR SETTING DEPRECIATION**

1 **LIVES?**

2 A. Historically, the FPSC followed the traditional method for setting
3 depreciation rates. However, since January 1996, GTE has been
4 permitted to set depreciation rates that reflect competitive and
5 technological advancements in the marketplace. GTE uses the same
6 depreciation inputs for FPSC regulatory reporting that it uses for
7 financial reporting purposes, and those are the same inputs I
8 recommend here.

9

10 **Q. WHAT DID THE FPSC RECOMMEND THE LAST TIME IT**
11 **PRESCRIBED DEPRECIATION INPUTS?**

12 A. As previously stated, the FPSC no longer prescribes depreciation
13 inputs for GTE for regulatory reporting purposes. The last time it did
14 so was in Docket 920284-TL, in 1992. The Commission did, however,
15 recommend depreciation inputs in its 1998 proceeding to determine
16 the cost of basic local service for purposes of establishing a universal
17 service fund mechanism. (Docket 980696-TP). The chart below
18 compares the FPSC-ordered depreciation lives in Docket 980696-TP
19 with the depreciation lives GTE uses in its cost studies for the major
20 technology-sensitive accounts. A complete comparison of all
21 accounts is attached as Exhibit AES-2.

22 A Comparison of FPSC-Ordered and GTE's Proposed Depreciation Lives

23		FPSC	GTE
24		<u>Ordered</u>	<u>Proposed</u>
25	Digital Switching Equipment	13	10

		<u>FPSC Ordered</u>	<u>GTE Proposed</u>
1			
2			
3	Circuit Equipment	8	8
4	Copper Cable		
5	Aerial	18	15
6	Underground	23	15
7	Buried	18	15
8	Fiber Cable		
9	Aerial	20	20
10	Underground	20	20
11	Buried	20	20

12 As the chart illustrates, the FPSC accepted GTE's lives in some of the
13 major technology-sensitive accounts, but ordered somewhat longer
14 lives in others.

15

16 Establishing the proper economic lives for these assets is critical to
17 determining economic depreciation in a forward-looking cost study.
18 Economic lives of other assets are used in GTE's cost studies, but the
19 changes in those assets' economic lives (*e.g.*, motor vehicles) as
20 compared to the prescribed lives are extremely small and have little
21 impact on the depreciation rates for those assets.

22

23 **III. COMPETITION AND TECHNOLOGICAL INNOVATION REQUIRE**

24 **THE USE OF ECONOMIC LIVES**

25

1 **Q. WHAT FACTORS SHOULD THE COMMISSION CONSIDER IN**
2 **APPROVING DEPRECIATION INPUTS FOR THE COST MODEL?**

3 A. The two most important factors that must be considered in
4 establishing the economic value of GTE's assets are: (1)
5 technological innovation and (2) impact of competition.

6
7 **Q. WHAT TECHNOLOGICAL INNOVATIONS WERE CONSIDERED IN**
8 **YOUR ESTABLISHMENT OF GTE'S ECONOMIC LIVES?**

9 A. Competitive carriers are utilizing a number of alternative technologies
10 to provide telecommunications service that completely bypass the
11 ILEC's existing wireline network. These technologies include wireless
12 local loops, cable lines, and electric lines. Prior to the passage of the
13 1996 Telecommunications Act, depreciation analysis consisted
14 primarily of mortality analysis with only slight adjustments for
15 technological change. Now, the rapid pace of advancement in
16 technological innovations must be recognized in establishing the
17 economic value of GTE's assets.

18
19 **Q. WHAT KINDS OF COMPETITIVE DEVELOPMENTS WERE**
20 **CONSIDERED IN ESTABLISHING OF GTE'S ECONOMIC LIVES?**

21 A. Florida has been and will continue to be one of the most attractive
22 markets for entry by competitive local exchange carriers. As of April
23 7, 2000, 365 companies hold statewide certificates to operate as
24 alternative local exchange companies ("ALECs"), including such well-
25 known companies as AT&T, MCI Worldcom, Time Warner,

1 Intermedia, Covad, e.spire, Teligent, and Winstar. A total of 125
2 companies have interconnection and/or resale contracts with GTE.
3 In addition, GTE has entered collocation agreements with 74 ALECs;
4 nearly all GTE exchanges have one or more collocated ALECs,
5 indicating the presence of facilities-based competitors. An additional
6 160 collocation agreements are pending. The total in-service UNE
7 loops purchased by ALECs from GTE jumped 1554% (from 52 to
8 860) in just one year, from January 1999 to January 2000. Resold
9 switched access lines increased 158% over the same period. As of
10 May 1999, 83% of all buildings in Tampa were within an 18,000 foot
11 radius of a ALEC switch. (Comments of GTE Service Corporation in
12 *Implementation of the Local Competition Provisions in the*
13 *Telecommunications Act of 1996, App. D (study by PNR &*
14 *Associates, Inc.), FCC CC Docket No. 96-98.) The FPSC's latest*
15 *Report on Competition in Telecommunications Markets in Florida,*
16 *published in December 1999, likewise noted the competitive strides*
17 *ALECs have made and continue to make. As GTE witness Jacobson*
18 *has testified, ALECs have captured a substantial number of the total*
19 *business lines in several Florida exchanges.*

20

21 These statistics clearly point to the acceleration of competitive activity
22 in GTE territory. This trend will only become more pronounced, as
23 more and more competitors enter the market. For example, Level 3
24 Communications, Inc. launched services in February 2000 in the
25 Orlando and Tampa metropolitan areas. The company is targeting

1 business customers for services such as private lines, Internet
2 access, and dark fiber. Florida Digital Networks, a facilities-based
3 ALEC headquartered in Orlando and focussing on the business
4 segment, is currently completing construction of fiber optic networks
5 in Tampa, among other areas. Most of GTE's competitors are,
6 understandably, targeting the most lucrative business customers.

7
8 The increased trend toward facilities-based competition that has been
9 evident here is consistent with developments nationwide. According
10 to the latest annual report of the national Association for Local
11 Telecommunications Services (ALTS), published in February 2000,
12 333 of the over 375 ALECs in operation across the United States own
13 or control and operate some of their own facilities. Intermedia
14 Communications, headquartered in GTE's Tampa area, has over 60%
15 of its lines on its own switches, and Allegiance and Nextlink have over
16 80%. ICG has over 50% of its lines on its own network and an
17 additional 28% on-switch. (ALTS 2000 Report at 4). ALTS President
18 John Windhausen, Jr. notes that "CLECs alone have invested \$30
19 billion in new networks since passage of the Act and are now
20 investing over \$1 billion every month in their networks." (Open Letter,
21 dated Feb. 2, 2000.)

22

23 **Q. HAVE YOU ALSO FACTORED IN THE THREAT OF BYPASS BY**
24 **EMERGING TECHNOLOGIES SUCH AS WIRELESS LOCAL LOOP**
25 **TECHNOLOGIES?**

1 A. Yes. In this regard, for instance, AT&T recently announced its
2 "Project Angel" trials of fixed wireless local loop technology was
3 underway and would soon be available nationwide. Other companies,
4 including Winstar, Teligent, and Airwire.net, are currently offering a
5 fixed wireless alternative to local landline service in the Tampa area.

6

7 **Q. HAVE THE REGIONAL BELL OPERATING COMPANIES (RBOCS)**
8 **EXPRESSED INTEREST IN COMPETING IN GTE'S OPERATING**
9 **TERRITORY?**

10 A. Yes. On June 2, 1999 the PSC granted SBC's application for
11 certification to provide local service in Florida. SBC had announced
12 that it would begin offering local service in 30 of the nation's top
13 markets, including Tampa, outside of its franchise territories within 18
14 months of consummation of its merger with Ameritech. In February
15 1999, SBC announced Miami as one of the first three "national-local"
16 markets it would enter, thus signaling its intent to compete in Florida
17 at the earliest possible moment.

18

19 Since October 1998, BellSouth has offered wireless service in the
20 Tampa Bay area. Its prices and bundled packages for wireless local
21 and long distance service, including paging and calling features,
22 represent direct competition to GTE's wireline services.

23

24 **Q. DO CELLULAR PROVIDERS ALSO POSE A THREAT TO GTE'S**
25 **WIRELINE NETWORK?**

1 A. Yes. Prices and packages for wireless plans are becoming
2 increasingly competitive with the wireline plans and are being
3 marketed as an alternative to the wireline network. A national survey
4 recently conducted by the Yankee Group indicates that the number
5 of consumers relying solely on their mobile phones is on the rise.
6 According to the survey, the number of U.S consumers who use their
7 mobile phones as their only phones account for two percent of all
8 wireless phone users, as compared to last year's unmeasurable
9 handful. Yankee Group analyst Mark Lowenstein predicts that traffic
10 on U.S. wireless networks will skyrocket from 105 billion minutes in
11 1998 to 554 billion minutes in 2004 "More Using Cell than Home
12 Phones" (USA Today, July 28, 1999 at 1A.).

13

14 **IV. GTE PROPERLY WEIGHS ALL RELEVANT FACTORS IN**
15 **DETERMINING ECONOMIC LIVES.**

16

17 **Q. WHAT METHOD DOES GTE USE TO DETERMINE THE**
18 **ECONOMIC LIFE OF AN ASSET?**

19 A. When estimating economic lives, GTE (a) evaluates the criteria that
20 are used to establish the retirement lives of assets as a guideline for
21 estimating economic lives, (b) considers industry benchmark
22 comparisons, and (c) considers the effect the evolving competitive
23 market will have on the economic lives of many of GTE's assets.

24

25 **Q. WILL YOU PLEASE EXPLAIN THE USE OF THESE FACTORS**

1 **IN MORE DETAIL?**

2 A. GTE first considers the National Association of Regulatory Utility
3 Commissioners' description of factors that cause property to be
4 retired. (Public Utility Depreciation Practices, National Association of
5 Regulatory Utility Commissioners (NARUC), 1996, at 15).

6 These include:

- 7 1. Physical Factors
- 8 a. Wear and tear
- 9 b. Decay or deterioration
- 10 c. Action of the elements and accidents
- 11
- 12 2. Functional Factors
- 13
- 14 a. Inadequacy
- 15 b. Obsolescence
- 16 c. Changes in art and technology
- 17 d. Changes in demand
- 18 e. Requirements of Public Authorities
- 19 f. Management discretion
- 20
- 21 3. Contingent Factors
- 22
- 23 a. Casualties or disasters
- 24 b. Extraordinary obsolescence

25 GTE believes these same factors can be used to help estimate an

1 asset's economic life expectancy by allocating the appropriate
2 weighting to each factor. That is, GTE uses the NARUC factors as a
3 guideline for choosing economic lives of certain assets, but only after
4 allocating proper weighting to those factors that reflect the significant
5 roles competition and technological change play in determining an
6 asset's economic life.

7
8 Specifically, the "Functional Factors" (Part 2 of the NARUC factors)
9 are sensitive to competition and technological change and are given
10 substantially greater weight when GTE considers the NARUC criteria
11 in establishing the economic lives of GTE's assets. As I explained
12 above, the effects of competition and technological change on an
13 asset's economic life must be properly considered when determining
14 competitive market asset lives. It has long been recognized in the
15 industry that traditional methods for determining lives for accounts
16 most affected by technology and competition are inadequate. Most
17 Commissions, including this one, have thus seen fit to make
18 adjustments to the physical life indications produced by historical
19 mortality analysis.

20
21 **Q. WHAT OTHER GUIDES DO YOU USE IN ESTABLISHING ASSET**
22 **LIVES?**

23 A. To help quantify our professional judgment as to the appropriate lives
24 for telephone plant, GTE also benchmarks against competitors, such
25 as AT&T, MCI Worldcom, and cable television providers, and

1 considers industry studies performed by Technology Futures Inc.
2 ("TFI").

3 **Q. PLEASE EXPLAIN WHY BENCHMARKING IS USEFUL AND**
4 **APPROPRIATE.**

5 A. We believe that benchmarking affords an excellent example of the
6 reasonableness of GTE's recommended depreciation lives. As we
7 transition to a competitive environment, we should be treated the same
8 as our competitors with respect to setting depreciation rates.
9 Competitors' depreciation rates are not reviewed or approved by any
10 regulatory body, and are a good guide to reasonable practices in a
11 competitive market.

12

13 **Q. WHAT DID YOU DETERMINE USING BENCHMARK**
14 **COMPARISONS WITH AT&T?**

15 A. Comparing the economic lives proposed by GTE to the lives AT&T
16 uses affords an excellent example of how reasonable GTE's
17 recommendations are. AT&T's 1998 annual report states that the
18 useful life of communications and network equipment ranges from 3
19 to 15 years. The useful life of other equipment ranges from 3 to 7
20 years. The useful life of buildings and improvements ranges from 10
21 to 40 years. GTE's recommended lives are not as short as AT&T's. In
22 comparison, GTE's recommendation for network equipment ranges
23 from 8 to 40 years. My testimony also recommends 5 to 10 years for
24 Other Equipment and 35 years for buildings.

25

1 **Q. WHAT WAS DETERMINED BY THE COMPARISON WITH MCI**
2 **WORLD.COM?**

3 A. MCI's 1996 annual report stated that the weighted average
4 depreciable life of the assets comprising the communications system
5 in service approximates 10 years. Furniture, fixtures and equipment
6 are depreciated over a weighted average life of 6 years. Buildings are
7 depreciated using lives of up to 35 years. In comparison, GTE's
8 recommendation for equipment that comprises the communication
9 system ranges from 8 to 40 years. My testimony recommends 5 to 10
10 years for furniture, fixtures and equipment, and 35 years for buildings.

11

12 In 1998, MCI again shortened the lives of its communications facilities
13 from approximately 10 years to 9 years, stating that the company
14 periodically reviews and adjusts the useful lives assigned to fixed
15 assets to ensure that depreciation charges provide appropriate
16 recovery of capital costs over the estimated physical and technological
17 lives of the assets. The weighted average of depreciable life of the
18 assets comprising the communications system in service approximates
19 nine years.

20

21 **Q. WHAT WAS DETERMINED BY THE COMPARISONS TO LIVES**
22 **USED BY THE CABLE TELEVISION (CATV) OPERATORS?**

23 A. GTE's lives are not as short as the lives used by CATV operators. The
24 FCC adopted a flexible range of lives to be used by CATV operators
25 seeking to justify depreciation rates in cost of service filings. The useful

1 lives adopted by the FCC for distribution facilities were from 10 to 15
2 years. This range was developed from a statistical analysis of lives
3 used by CATV operators for their own facilities. The 15-year economic
4 life for copper cable and the 20-year life for fiber cable calculated
5 selected by GTE are not as short as the lives within the FCC-allowed
6 range for CATV distribution facilities. Additionally, the lives proposed
7 by GTE for support assets such as office furniture and equipment,
8 vehicles, and buildings are reasonable when compared to the FCC-
9 allowed ranges for CATV operators. The FCC range for office furniture
10 and equipment is 9-11 years, which compares favorably to GTE's
11 proposal of 10 years for these accounts. The FCC range for vehicles
12 and equipment is 3-7 years, which is shorter than GTE's proposal of
13 8-10 years. The FCC range for buildings is 18-33 years, which
14 compares favorably with GTE's proposal of 35 years. (FCC MM Docket
15 No. 93-215, In re Implementation of Sections of the Cable Television
16 Consumer Protection and Competition Act of 1992: Rate Regulation and FCC
17 CS Docket No. 94-28, In re Adoption of a Uniform Accounting System for
18 Provision of Regulated Cable Service, Second Report and Order, First Order
19 on Reconsideration, and Further Notice of Proposed Rulemaking, released
20 January 26, 1996).

21
22 **Q. HAVE ANY OTHER COMMISSIONS DETERMINED THAT**
23 **BENCHMARKING IS A VIABLE METHOD TO ASSESS THE**
24 **REASONABLENESS OF GTE'S PROPOSED LIVES?**

25 **A. Yes.** The Missouri Public Service Commission commented on

1 benchmarking for purposes of establishing depreciation rates to be
2 utilized in GTE's TELRIC cost studies as follows:

3 Staff believes that benchmarking GTE TELRIC rates against
4 those booked for financial purposes of likely competitors and
5 other companies using similar technologies is appropriate and
6 is the best method to determine if GTE's TELRIC rates pass the
7 muster of reasonableness. (Case No. TO-97-63, Missouri
8 Public Service Commission Final Arbitration Order, July 31,
9 1997, Attachment C at 77).

10

11 The Missouri Staff chose 19 of the largest IXC, CATV, cellular, CAP,
12 and PCS companies to benchmark against and found that the
13 depreciation rates used to calculate GTE TELRIC costs were at the
14 bottom or second from the bottom of the list and were significantly
15 lower than several companies in similar industries, concluding:

16 This is the most significant factor to Staff's belief that GTE's
17 proposed depreciation rates are reasonable. (Case No. TO-97-
18 63, Missouri Public Service Commission Final Arbitration Order,
19 July 31, 1997, Attachment C at 79).

20

21 **Q. PLEASE EXPLAIN YOUR USE OF THE TFI STUDIES.**

22 A. TFI forecasts the remaining lives for certain assets when technological
23 change is driving the shortening of asset lives. To quantify this
24 technological change, TFI uses a model to analyze remaining
25 economic lives using patterns of technological substitution observed

1 in the communications industry, as well as other industries. The
 2 industry studies conducted by TFI forecast the combined effects that
 3 competition and technological change will have on an asset's
 4 remaining useful life. The studies generally project shorter lives than
 5 traditionally prescribed by most Commissions. GTE uses the TFI lives
 6 as a reasonableness benchmark comparison with the lives used by
 7 other companies, both regulated and non-regulated, with similar types
 8 of telecommunications assets.

9
 10 **Q. WHAT DO THE TFI STUDIES RECOMMEND GTE USE AS**
 11 **ECONOMIC LIVES FOR ITS ASSETS?**

12 A. GTE's recommendations here are in line with TFI's recommended
 13 economic life ranges, as shown by the following chart. (*Transforming*
 14 *the Local Exchange Network: Analyses and Forecasts of Technology*
 15 *Change*, Larry K. Vanston, Ray L. Hodges, and Adrian J. Poitras, 2d Ed.
 16 1997, Technology Futures, Inc., at 33).

17
 18 A Comparison of The TFI Ranges with GTE's Proposed Economic Lives

	TFI	GTE
	<u>Ranges</u>	<u>Economic</u>
21 Digital Switching Equipment	9-12	10
22 Circuit Equipment	6-9	8
23 Copper Cable	14-20	15
24 Fiber Cable	20	20

25

1 TFI specifically addresses the appropriate lives to be used for outside
2 plant cable, central office switching, and circuit equipment accounts,
3 as these accounts report equipment that are most affected by changes
4 in competition and technology.

5

6 **V. GTE'S ECONOMIC LIVES HAVE BEEN ENDORSED BY OTHER**

7

STATE REGULATORY COMMISSIONS

8

9 **Q. HAS ANY OTHER REGULATORY BODY APPROVED THE**
10 **ECONOMIC LIVES PRESENTED HERE?**

11 A. Yes. In 1996 the California Public Utilities Commission ("CPUC")
12 endorsed the use of the same economic lives presented here except
13 that they approved a 14 year life for copper cable, one year less than
14 requested here. The CPUC concluded that the economic lives used
15 by GTE and Pacific Bell for external financial reporting were the
16 appropriate forward-looking lives for cost studies. The CPUC rejected
17 the suggestion by AT&T and others that FCC-prescribed lives are
18 forward-looking, stating (California Public Utilities Commission
19 Decision, No. D.96-08-021, Adopted August 2, 1996, in Rule Making
20 R.93-04-003, I.93-04-002):

21 We agree with Pacific that the schedules formally adopted in
22 the represcription proceeding reflect the previous paradigm of
23 the regulated monopoly environment, and so are difficult to
24 justify in a cost study that looks forward to an environment in
25 which there is local exchange competition. We also see little

1 merit in the Coalition's original suggestion that we use FCC
2 schedules. These schedules also reflect the previous
3 paradigm; moreover, they are based on different assumptions
4 and applied in different ways than our own. It also seems to be
5 the case, however, that Pacific is now using these schedules
6 in financial reports it is required to file, and thus for purposes
7 of these cost studies, the schedules also appear consistent
8 with generally accepted accounting principles. The schedules
9 also appear realistic for a firm having to operate in a
10 competitive environment, as Pacific will soon have to do.
11 Accordingly, we will approve their use in this proceeding.

12

13 **Q. HAS THE USE OF ECONOMIC LIVES BEEN ENDORSED IN**
14 **OTHER STATE PROCEEDINGS?**

15 **A.** Yes. In 1997, the Missouri Public Service Commission adopted the
16 same economic lives proposed in this case, stating:

17 Staff's goal has been to recommend depreciation rates based
18 on parameters that GTE is likely to experience for financial
19 purposes so as to fully recover its long run capital costs in a
20 timely fashion. (Case No. TO-97-63, Missouri Public Service
21 Commission Final Arbitration Order, July 31, 1997, Attachment
22 C at 76).

23

24 The Michigan Public Service Commission also adopted its Staff's
25 recommendation to approve the use of GTE's economic lives on

1 February 25, 1998, stating:

2 GTE proposes to reduce its asset lives in accordance with
3 their economic lives ... The Staff's view is that GTE's
4 proposed asset lives are largely consistent with a forward-
5 looking approach and are reasonable The Commission
6 finds that GTE's proposal related to depreciation is
7 appropriate for TSLRIC purposes The Commission
8 further finds AT&T/MCI's proposal to be insufficiently
9 forward looking for purposes of a TSLRIC study (Michigan
10 Docket No. U-11281, Feb. 25, 1998 order, Section d).

11
12 **VI. CONCLUSION**

13
14 **Q. PLEASE SUMMARIZE YOUR DIRECT TESTIMONY.**

15 A. Traditional historical methods of establishing depreciation lives are
16 not forward-looking. The economic lives used in GTE's cost studies
17 are properly based on a forward-looking approach. GTE's proposed
18 rates are reasonable in comparison to the financial reporting lives of
19 competitive telecommunications providers such as AT&T and MCI
20 Worldcom and should be adopted by this Commission for use in
21 establishing permanent UNE rates.

22
23 **Q. DOES THIS CONCLUDE YOUR DIRECT TESTIMONY?**

24 A. Yes.

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REBUTTAL TESTIMONY OF ALLEN E. SOVEREIGN

Q. PLEASE STATE YOUR NAME, ADDRESS AND PRESENT POSITION.

A. My name is Allen E. Sovereign. My business address is 1420 East Rochelle Blvd., Irving, Texas 75039. I am employed by GTE Service Corporation as Group Manager-Capital Recovery.

Q. ARE YOU THE SAME ALLEN SOVEREIGN WHO FILED DIRECT TESTIMONY ON BEHALF OF GTE IN THIS DOCKET ON MAY 1, 2000?

A. Yes.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of this rebuttal testimony is to respond to the ALECs' direct testimony regarding the depreciation lives and future net salvages to be used to calculate Unbundled Network Element ("UNE") rates for GTE Florida Incorporated ("GTE"). Specifically, I will respond to the testimony of Michael Majoros, on behalf of AT&T Communications of the Southern States ("AT&T") and MCI Worldcom, Inc. ("MCI Worldcom"); William Barta, on behalf of the Florida Cable Television Association ("FCTA"); and Carol Bentley, on behalf of Supra Telecommunication and Information Systems, Inc. ("Supra").

Q. ARE THE DEPRECIATION INPUTS FOR GTE RECOMMENDED BY THE ALEC WITNESSES (MAJOROS, BARTA, AND BENTLEY) APPROPRIATE FOR USE IN THIS DOCKET?

1 A. No. The ALEC witnesses recommend that this Commission use the
2 projection lives and future net salvage values the FCC prescribed for GTE
3 in 1995. These prescriptions are seriously outdated. They were adopted
4 before the market-opening Telecommunications Act of 1996 ("Act") was
5 even passed. The level of competitive activity in the *local marketplace will*
6 have a direct effect on the determination of what depreciation inputs are
7 appropriate for pricing UNEs. In 1995, there were no certified ALECs in
8 GTE's territory. Today, there are over 365 companies holding statewide
9 ALEC certification; 125 of these have executed interconnection, unbundling,
10 and/or resale contracts with GTE. My Direct Testimony reviews in detail the
11 degree of competitive entry in GTE's serving area, all of which has occurred
12 since 1995. (Sovereign DT at 8-13.) The bottom line is that Florida has
13 been and will continue to be one of the *most attractive markets for entry by*
14 competitive local exchange carriers.

15
16 The ALEC witnesses would have the Commission ignore this very relevant
17 and significant fact in favor of a default to federal depreciation rates
18 developed for a marketplace that looks nothing like today's. Reviewing
19 witness Majoros' historical charts and graphs recalls the depreciation
20 analysis of a regulated monopoly franchise in the pre-Telecommunications
21 Act of 1996 environment. Mr. Majoros' *conclusions could only be credible*
22 if one assumes, contrary to facts, that GTE retains an exclusive monopoly
23 franchise and that the future will be exactly like the past. An approach based
24 on these assumptions is patently inappropriate.

25

1 **Q. HAVE AT&T AND MCI WORLDCOM THEMSELVES BECOME**
2 **LOCAL COMPETITORS?**

3 A. Yes. AT&T and MCI Worldcom are spending billions of dollars to bypass the
4 ILECs' networks. In this regard, AT&T has undertaken an approach of
5 buying cable television companies. It has publicly declared that it will offer
6 local phone service via cable TV wires, either on its own or in partnership
7 with others, and via fixed wireless technology. AT&T affiliate TCG, formerly
8 Teleport, is a *facilities-based competitor* to the ILECs in Florida. MCI
9 Worldcom is also investing in its own fixed wireless technology to bypass
10 the LEC network.

11
12 In AT&T's announcement outlining its refocused strategy, AT&T Chairman
13 C. Michael Armstrong stated in a company press release in January of
14 1998, "Local service for consumers and businesses remains a top priority
15 for AT&T, as a key part of its strategy to offer end-to-end communications
16 services." Since that announcement, AT&T has completed a merger with
17 cable giant, TCI, and stated explicitly that their intent was to bypass the
18 ILECs and control the access to customers. AT&T announced plans to
19 speed its *upgrades of TCI's cable systems to handle all-in-one packages*
20 including local phone services. (AP Headlines, January 8, 1999. AT&T
21 Speeds Local Service Effort.) Finally, in January 1999, AT&T announced
22 that it had reached agreement with five cable companies to offer advanced
23 communications services, including local telephone services.

24

25 This bypass strategy is highlighted in the following quote from a recent

1 AT&T internet website article titled "Angel Takes Flight." ["Angel Takes
2 Flight," <http://www.att.com/technology/features/0005fixedwireless.html>]. "By
3 eliminating the copper-wire connection necessary for land-line
4 communications, fixed wireless literally cuts the cord between the traditional
5 central office or switching center and a consumer's home." This same
6 article illustrates the linkage of the extensive cable network purchased over
7 the last months with the fixed wireless technology: "The goal is to bring
8 fixed wireless service everywhere AT&T Cable Services is not."

9
10 Since these companies are obviously pursuing a bypass strategy, and since
11 they cannot build facilities to supply the entire market immediately, it is
12 logical that they would only want to purchase UNEs from the ILECs on an
13 interim basis. It follows, then, that the economic life of the ILEC's facilities
14 will be seriously diminished. It is completely self-serving for AT&T and MCI
15 Worldcom to recommend outdated depreciation lives that are unreasonably
16 long. If the Commission orders unduly long lives for cost model inputs, the
17 ALECs' cost of providing service through the purchase of UNEs will be
18 considerably less. AT&T and MCI Worldcom will thus have the best of both
19 worlds, able to obtain UNEs at prices substantially below their economic
20 value, while completing their own networks to bypass the ILECs.

21

22 **Q. HAS THIS COMMISSION DEVELOPED ANY DEPRECIATION INPUTS ON**
23 **ITS OWN IN THE POST-1995 TIME PERIOD?**

24 **A.** Yes. Although this Commission no longer prescribes depreciation rates for
25 purposes of the ILECs' financial reporting, it did determine depreciation

1 inputs for use in modeling the cost of basic local service in Docket number
2 980696-TP. The decision in that docket was issued in January of 1999.
3 The ALEC witnesses completely ignore it.

4

5 In this docket, GTE recommends that the Commission use the rates in
6 Docket 980696-TP as a starting point, with appropriate adjustments. As I
7 discussed in my *Direct Testimony*, the rapid pace of competitive evolution
8 in Florida warrants further shortening of some depreciation inputs. Exhibit
9 AES-2, attached to my *Direct Testimony*, compares GTE's recommended
10 depreciation inputs in this docket with the FPSC-ordered depreciation inputs
11 in Docket No. 980696-TP. Certainly that comparison is a much more useful
12 tool for the Commission than Mr. Majoros' enumeration of FCC inputs from
13 1995, (Majoros Ex. MJM-10 at 4.)

14

15 **Q. AT&T STATES THAT ITS DEPRECIATION LIVES ARE NOT AN**
16 **APPROPRIATE BENCHMARK FOR ESTABLISHING THE ILECS'**
17 **DEPRECIATION LIVES. DO YOU AGREE?**

18 A. No. While Mr. Majoros admits that AT&T and the ILECs use the same kind
19 of plant, AT&T seems to believe that comparisons with its depreciation
20 practices are inappropriate because the plant is put to different use.
21 (Majoros DT at 17.) Mr. Majoros could possibly have had an argument,
22 albeit a weak one, prior to the passage of the Act, when AT&T and MCI
23 WorldCom were only providers of long distance service. Long distance is
24 simply the provision of a voice communication over a longer distance than
25 a local call. However, as Mr. Majoros is aware, many companies led by

1 both AT&T and MCI WorldCom are continuing to invest heavily in alternative
2 facilities, both wireless and cable, as adjuncts to existing facilities in the
3 provision of local telephone service. This heavy investing by AT&T is the
4 implementation of its stated strategy to control access to the customer for
5 a broad selection of services including local service. In order for GTE to
6 remain competitive in the expanding telecommunications market, existing
7 facilities must deliver the wide array of services offered by the competition,
8 including AT&T and MCI WorldCom.

9
10 In discovery, GTE asked AT&T for specific information regarding the
11 depreciation inputs it uses for facilities that are primarily local, such as those
12 operated by their local affiliate TCG, fixed wireless, and CATV. AT&T has
13 refused to reply, claiming that the information is irrelevant. However, on
14 AT&T's web page, in an article titled "The AT&T Worldwide Intelligent
15 Network – Facts and Figures 2000," they state that 10,000 out of 53,000
16 route miles of fiber optic cable support local telephone service. GTE
17 suggests the Commission ask AT&T and MCI Worldcom to provide the
18 depreciation lives, salvage values, and rates for each of their accounts, so
19 that it has an additional, useful data point to consider in evaluating the
20 ILECs' proposed depreciation inputs. Nevertheless, as I stated in my Direct
21 Testimony, it is possible to get a good idea of these companies' depreciation
22 practices from their annual reports. These reports reveal that the lives
23 AT&T and MCI Worldcom use are generally shorter than those used by
24 GTE.

25

1 **Q. FCC WITNESS BARTA CLAIMS THAT THE ILECS' DEPRECIATION**
2 **RESERVE LEVELS SHOW THAT THE FCC'S DEPRECIATION RATES**
3 **ARE APPROPRIATE. (Barta DT at 11.) HOW DO YOU RESPOND TO**
4 **THIS CLAIM?**

5 A. Mr. Barta states that GTE's depreciation reserve had reached 68.64% in
6 1999, thus exceeding the growth in its plant-in-service balance. Mr. Barta
7 argues that this is evidence that the FCC lives result in properly forward-
8 looking economic depreciation rates. (Barta DT at 11.)

9
10 While I disagree with Mr. Barta's conclusion about the propriety of using
11 FCC depreciation rates in this proceeding, I do concur in his apparent view
12 that the reserve for depreciable plant should be in the range of 70%.
13 Unfortunately, it is not. Witness Barta has incorrectly calculated GTE's
14 reserve. It is actually 48.9%, as calculated by Mr. Majoros from GTE's
15 ARMIS reports (Majoros DT at 12 and Ex. MJM-5 at 2.) Because Mr. Barta's
16 calculation of GTE's depreciation reserve is significantly misstated, his
17 conclusion about the reasonableness of the FCC's depreciation rates is
18 unfounded.

19
20 **Q. SUPRA WITNESS BENTLEY URGES THE COMMISSION TO SET RATES**
21 **BASED UPON "STANDARD ACCOUNTING PRACTICES AS EMBODIED**
22 **BY THE GENERALLY ACCEPTED ACCOUNTING PRINCIPLES (GAAP)."**
23 **(BENTLEY DT AT 4-5.) DO YOU AGREE?**

24 A. While I disagree with Ms. Bentley's cryptic comment that GTE is somehow
25 using "non-standard accounting methods" to derive depreciation lives that

1 do not reflect "true" useful asset lives ((Bentley DT at 4), I certainly do
2 agree that it would be appropriate to use depreciation inputs that accord with
3 GAAP. In fact, GTE is recommending the same depreciation factors in this
4 proceeding that it uses for financial reporting purposes. Reputable
5 independent accounting firms regularly audit these depreciation factors to
6 assure their compliance with GAAP.

7

8 **Q. PLEASE SUMMARIZE YOUR REBUTTAL TESTIMONY.**

9 A. The Commission should approve the economic depreciation inputs GTE has
10 recommended and used in its cost studies. Like the cost study methodology
11 prescribed for use in this proceeding, GTE's depreciation inputs are forward-
12 looking. This forward-looking approach more accurately estimates an
13 asset's economic life than the outdated, historical approach suggested by
14 the ALECs. Rather than merely adopt the FCC's 1995 depreciation factors,
15 as the ALECs recommend, the FPSC should use as a starting point its own
16 depreciation analysis performed in Docket 980696-TP in 1999. In this
17 regard, GTE urges the Commission to consider the continuing rapid pace
18 of competition and to modify certain of its depreciation factors, as GTE has
19 recommended.

20

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

22 A. Yes.

23

24

25

1 BY MS. CASWELL:

2 Q And in connection with your direct testimony,
3 Mr. Sovereign, did you have two exhibits labeled AES-1 and
4 AES-2?

5 A Yes.

6 MS. CASWELL: Mr. Chairman, I would ask that
7 those exhibits be marked for identification at this time.

8 CHAIRMAN DEASON: Composite Exhibit 57.

9 (Exhibit 57 was marked for identification.)

10 BY MS. CASWELL:

11 Q Mr. Sovereign, do you have a summary of your
12 testimony for us?

13 A Yes.

14 Q Would you give that at this time, please.

15 A Yes, thank you.

16 The purpose of my testimony is to present and
17 support the forward-looking economic depreciation cost
18 model inputs presented by GTE. GTE's inputs reflect the
19 principle that depreciation parameters should be
20 consistent with forward-looking economic assumptions and
21 based on competitive market asset lives. Since January of
22 '96, GTE has been permitted to set its own depreciation
23 parameters in Florida that reflect competitive and
24 technological advancements in the marketplace.

25 GTE uses the same depreciation inputs for FPSC

1 regulatory reporting that it uses for financial reporting
2 purposes. These are the same depreciation inputs that I
3 recommend here. These lives and inputs were not selected
4 using outdated historical comparisons, but were selected
5 considering the impact of competition and technological
6 innovation.

7 As a starting point for setting depreciation
8 input parameters in this case, the Commission should use
9 its 1999 decision in the USF docket with the appropriate
10 adjustments for technological and competitive advances.

11 In particular, the Commission should reject the
12 recommendation of AT&T, MCI Worldcom, and other ALECs that
13 the Commission should use FCC prescriptions ordered in
14 1995, rather than those ordered by the Florida PSC in the
15 USF docket.

16 The FCC parameters were ordered prior to the
17 passage of the Telecommunications Act. In contrast, the
18 Florida PSC ordered depreciation inputs in 1999 with a
19 knowledge of Florida's competitive environment.

20 ALECs, like AT&T and MCI Worldcom, continue to
21 invest heavily in telecommunications facilities in Florida
22 to provide local telephone service. These
23 facilities-based local telephone companies provide an
24 excellent group from which to benchmark to determine
25 proper depreciation cost model inputs. The results of

1 GTE's benchmarking analysis indicates that the parameters
2 recommended are very reasonable when compared to the
3 parameters used by the competitors.

4 It will be assured that all competitors are
5 treated the same as we transition to a competitive market,
6 if benchmarking is one of the inputs to the setting of the
7 depreciation parameters in this docket.

8 Thank you.

9 MS. CASWELL: Mr. Sovereign is available for
10 cross.

11 MS. WHITE: No cross examination.

12 MR. FONS: No cross examination.

13 CROSS EXAMINATION

14 BY MR. GROSS:

15 Q Good afternoon, Mr. Sovereign.

16 A Good afternoon.

17 Q In your testimony, you state that shorter
18 economic lives are necessary due to heightened
19 competition; is that correct?

20 A Yes.

21 Q Okay. Are you familiar with the report of the
22 Florida Public Service Commission dated December 1999
23 entitled, "Competition in Telecommunications Markets in
24 Florida"?

25 A Yes, I am familiar with it. I couldn't recite

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1 it, but I am familiar that it exists.

2 Q Are you aware that in their report the
3 Commission found that the ILECs control 95% of the total
4 access lines in the state of Florida?

5 A It's written. Is it written in there?

6 MS. CASWELL: I'm sorry. Mr. Gross, if you're
7 going to refer to the report, I would like you to show the
8 witness a copy, please.

9 BY MR. GROSS:

10 Q I'm going to be referring to this page and page
11 72 and page 34. I'll leave that with you.

12 A Okay.

13 Q Well, I'm not so much asking you to recite
14 what's in the report as much as I'm asking you if you have
15 familiarized yourself with these findings; and is it fair
16 to say that you have not at this point?

17 A Not in total, no.

18 Q Okay. Then, is it fair to say that you're
19 not -- also not aware that the ILECs control 98.7% of
20 total residential access lines in the state of Florida?

21 MS. CASWELL: I'm going to object. I think
22 Mr. Sovereign has already testified he's not familiar with
23 the report.

24 CHAIRMAN DEASON: He can answer the question, if
25 he knows that fact or not.

1 Q What forward-looking economic assumptions,
2 specifically, should the lives meet?

3 A Forward-looking economic assumptions would not
4 rely on historical retirement analysis, mortality
5 analysis, but rely on what the marketplace, rely on
6 estimates about what the marketplace is going to do, rely
7 on what -- trying to integrate what the competitors are
8 trying to do with their investments and integrate what
9 technological advances may influence those kinds of
10 decisions.

11 Q Now, the depreciation lives that we're talking
12 in these proceedings, those are lives that are going to be
13 used by the companies as inputs into cost models for
14 determining the price of unbundled network elements; is
15 that correct?

16 A That's my understanding.

17 Q Would you agree with me, therefore, that the
18 economic lives that we adopt in this proceeding should
19 reflect the FCC's Telric principles for forward-looking
20 economic cost inputs?

21 A They have asked me to provide what the economic
22 lives are for GTE uses as its inputs in their cost models.
23 And if -- I'd assume that when they say forward-looking
24 economic lives, that that's what would comply.

25 Q Were you asked to provide lives that complied

1 with the FCC's Telric principles?

2 A I was asked to provide forward-looking lives of
3 how long we would expect -- forward-looking economic lives
4 for -- which would mean how long we would expect our
5 equipment to provide service in the future.

6 Q I guess, my question is can you testify that the
7 lives that you are proposing are consistent with the FCC's
8 Telric principles for pricing of unbundled network
9 elements?

10 A I don't know, specifically, if they would meet
11 the compliance, as you suggest, but if they are
12 forward-looking economic lives, then I would suggest they
13 do.

14 Q Now, in your written testimony, and what you've
15 said today, I've understood as data points that you've
16 used to come up with your lives, you look at the lives
17 that the Commission approved in the USF docket, you look
18 at benchmarking, and you look at the substitution analysis
19 done by TFI; is that correct?

20 A I look at the results of the substitution
21 analysis, yes.

22 Q Okay. And my question is, I see all those three
23 things as things that GTE has looked at, but precisely how
24 did GTE come up with the specific lives of it's proposing?
25 Is it just the lives that TFI has recommended?

1 A Well, no, it wouldn't be the lives TFI
2 recommended, specifically, but if we want to choose a life
3 and we say 15, if we say 20, or if we say 14, then, you
4 know, what's the basis for choosing that life from the way
5 our analysis is presented or as opposed to the FCC picking
6 20?

7 I mean, someone has to use a judgment at some
8 point after you analyze all the data available to pick
9 some life based on -- choose some life, based on knowledge
10 of the market, knowledge of what GTE's plans are or what
11 they want to do with their investment and all sorts of
12 things. So, I think at some point you have to go from the
13 data that's available and make a judgment about what that
14 life should be, and I think we've done that.

15 Q So, would it be correct, then, that the lives
16 proposed by GTE, they're not the result of some model or
17 mathematical equation. What they are is a judgment by GTE
18 analysts looking at various data information as to what
19 the lives ought to be; is that --

20 A I submit that any life that's chosen by any
21 competitor or anyone doing business when you're looking
22 for forward-looking would be precisely that as well as GTE
23 or anyone else. I don't think that there's in existence,
24 a mathematical model, that will give you a number. At
25 some point you have to analyze the data and make a

1 judgment.

2 Q Have you looked at the lives proposed by
3 BellSouth in this proceeding?

4 A Not specifically. They -- not specifically.

5 Q Have you seen BellSouth's testimony in this
6 proceeding?

7 A I've read the testimony; haven't precisely
8 analyzed the study, but I have looked at it.

9 Q To your knowledge, has BellSouth agreed that
10 judgment is involved in the establishment of their lives
11 that they've proposed in this proceeding?

12 A I will say that at some point, no matter what
13 model you use, you have to have a judgment at some point,
14 and I would say that there is some judgment involved in
15 the analysis and the conclusion reached in any model that
16 you use.

17 Q If it all comes down to judgment, then, isn't
18 what we're really talking about in this proceeding
19 deciding whether it should be GTE's judgment versus the
20 judgment of the FCC?

21 A We have used -- we have exercised some judgment
22 in selection of our lives, but I'm suggesting that you not
23 only use GTE's judgment, but you also review the judgment
24 of the competitors that are involved in the business. You
25 also -- we're asking, like for in this case, we're asking

1 the Florida Public Service Commission to rely on -- at
2 their selection of lives, and then consider that there are
3 some advances in technology and competition that may cause
4 them to shorten the lives that they have already
5 determined were appropriate.

6 Q But the FCC has a prescribed range of lives for
7 GTE; is that correct?

8 A They have a prescribed range of lives that they
9 say it should be guidelines for, you know. In my mind,
10 that's a guideline or a data point that they might
11 recommend might be appropriate for a cost model input.
12 But then, if you look at several other commissions, they
13 have also made judgments about what their lives should be,
14 specifically, California, Missouri, Michigan, and as well
15 as Florida.

16 Q But in this proceeding, in which one party is
17 recommending FCC lives and GTE is recommending GTE lives,
18 if lives always come down to a judgment call, essentially,
19 what we've got then is should the Commission go with the
20 judgment of the FCC or should the Commission go with the
21 judgment of GTE; isn't that correct?

22 A I think the Commission should exercise their own
23 judgment.

24 Q Have you read the FCC orders that came out at
25 the end of December and the one -- further notice of the

1 proposed rulemaking that came out in April?

2 A You'd have to tell me what order, but I've read
3 several of the FCC orders.

4 Q Were you here for the cross examination of
5 Mr. Cunningham this morning?

6 A Yes, I was.

7 Q In particular, what I want to ask you about is
8 the FCC order December of 1999 that came out as a result
9 of the biannual review. Are you familiar with that?

10 A Could I have that order?

11 Q I'm not going to get into any specific
12 paragraphs, I just want to ask you a couple general
13 paragraphs about that proceeding. If you don't know, you
14 don't know.

15 A What's the docket number?

16 Q There's two docket numbers on that as a result
17 of a combination of the biannual review and the petition
18 by the USTA for forbearance. And I think, the order is
19 from the FCC dated December 31st, 1999. Have you seen
20 that order before?

21 A Yes.

22 Q Was GTE involved in that proceeding?

23 A We filed comments.

24 Q Part of the comments that GTE and other ILECs
25 submitted to the FCC in that proceeding was a depreciation

1 analysis done by FTI, wasn't it?

2 A By whom?

3 Q TFI, I'm sorry.

4 A It's generally referred to.

5 Q Let me ask you one final question on the
6 document. If you turn to page 16, I mean, paragraph 16 of
7 that document --

8 A Okay.

9 Q -- would you agree with me that in there the
10 FCC, specifically, says that the TFI study fails to
11 establish convincingly that current projection lives are
12 inadequate?

13 A That's what the final line says, but you also --
14 but there's a first line that's also very telling, given a
15 significant uncertainty that even TFI acknowledges exists
16 in forecasting plant replacement over the next 15 years.
17 I mean, we're talking about a term out here of 15 to 20
18 years out.

19 Q But bottom line, the FCC did not believe that
20 the analysis done by TFI was sufficient to cause the FCC
21 to change its depreciation lives; isn't that correct?

22 A That's what it says.

23 MR. LAMOUREUX: Okay. I have no further
24 questions.

25

CROSS EXAMINATION

1

2 BY MR. MELSON:

3 Q Mr. Sovereign, I'm Rick Melson representing MCI
4 Worldcom. I'm going to ask Ms. McNulty to pass out,
5 again, a copy of MCI Worldcom's response to a BellSouth
6 interrogatory that's previously been identified as
7 confidential Exhibit Number 32 -- excuse me, number 34.
8 And I'm going to ask you also to turn to your Exhibit
9 AES-1. And without saying any of the numbers out loud,
10 I'm going to ask you to make a couple of comparisons for
11 me.

12 I'd like you, just to yourself, to compare your
13 account 2212 digital electronic switching, your proposed
14 life with the proposed life on the Worldcom Exhibit 4
15 switch. It's toward the bottom of the Worldcom --

16 A Oh, okay.

17 Q I'd like you to compare your circuit equipment
18 2232 with Worldcom's circuit termination equipment, which
19 is about the fourth item on the list.

20 And I would like you to compare your metallic
21 and nonmetallic cable accounts to the Worldcom fiber cable
22 account. And I would point out to you that the next page
23 of this exhibit, which is nonconfidential, indicates that
24 the fiber cable shown on the MCI exhibit includes both
25 fiber and copper.

1 A Okay.

2 Q And based on that comparison, is it fair to say
3 that in every instance the GTE proposed life for those
4 accounts is either the same as the Worldcom life or is
5 shorter than the Worldcom life?

6 A The answer would have to be that your statement
7 is correct. However, I would, from what I've seen with
8 some of the other responses from the other companies,
9 these are -- the MCI Worldcom are out of line with what
10 I've seen from other companies and also out of line with
11 the annual reports I've seen from MCI in the past.

12 Q Let me ask you about the annual report. Does
13 the annual report show lives by account?

14 A No.

15 Q It shows an average life for all equipment and
16 service; is that correct?

17 A And they say 10 years shortened to 9 years,
18 right.

19 Q And there's nothing, depending on the weighting
20 of the various types of equipment in the MCI network,
21 there's nothing inconsistent between that average life in
22 the annual report and the account-specific lives shown on
23 Exhibit 34. Would you agree with that?

24 A I can't make any judgment about that.

25 COMMISSIONER JABER: Mr. Sovereign, can you

1 bring the microphone closer to you or try to speak up a
2 little.

3 MR. MELSON: That was my last question. Thank
4 you, Mr. Sovereign.

5 MR. McGLOTHLIN: No questions.

6 CHAIRMAN DEASON: Staff?

7 CROSS EXAMINATION

8 BY MR. KNIGHT:

9 Q Hello, Mr. Sovereign, good afternoon. My name
10 is Wayne Knight, Commission Staff attorney. Just a couple
11 of questions.

12 Other than judgment, what specific analysis did
13 GTE perform in determining the economic lives proposed in
14 this proceeding?

15 A There was not a specific study, as in the case
16 of BellSouth. We didn't do a study, per se, but what we
17 did do was review some of the past analysis of the past
18 and do the benchmarking analysis and come to a conclusion
19 that way, rather than do a formal study.

20 Q And what did the analysis in the past comprise
21 of?

22 A Well, the analysis in the past was very similar
23 to -- with the exception of using the substitution
24 analysis, the analysis of the past was very similar to
25 what is required in, say, an FCC study, just to get a feel

1 for what the historical data told you as a beginning
2 point.

3 And we felt that that analysis wasn't
4 sufficient, the simple historical analysis. So, we
5 elected not to do that and choose some other mode of
6 determining forward-looking lives, like the benchmarking
7 and like comparison with the TFI studies, TFI results.

8 Q At your deposition, you talked about the sources
9 of information used in your benchmarking; do you recall
10 that?

11 A Yes.

12 Q And you said that one of the sources of
13 information that GTE used was annual reports from
14 companies, such as AT&T and MCI; is that correct?

15 A Yes.

16 Q I believe, the annual report you looked at for
17 AT&T was 1998's; is that correct?

18 MS. CASWELL: I'm sorry. Mr. Sovereign, do you
19 have a copy of Exhibit 19, which includes the late-filed
20 deposition exhibits, which in turn include the AT&T and
21 MCI annual report statements?

22 THE WITNESS: I'm looking at that. I'm trying
23 to find that right now.

24 A Yes.

25 BY MR. KNIGHT:

1 Q And do you remember saying that the report gave
2 ranges for communications equipment from three to 15
3 years?

4 A Yes.

5 Q Did you look at the AT&T 2000 annual report in
6 your benchmarking process?

7 A No. I haven't reviewed the 2000 annual report.

8 Q Pardon me, I didn't --

9 A I have not reviewed the 2000 annual report.

10 Q Okay. You should have a copy of that. Staff
11 may have just given you a copy of that, at least in the
12 excerpt comment --

13 A Okay.

14 Q -- the 10k.

15 Does AT&T keep information in the same level of
16 account detail as GTE?

17 A I don't know. I don't know that.

18 Q Would you accept -- all right.

19 I'd like to refer you to page 202 of 241 on the
20 10k that was just handed out.

21 Would you accept that AT&T's 2000 annual report
22 states life ranges of 10 to 40 years for buildings and
23 improvements and three to 20 years for support equipment?

24 A Yes, that's what it says.

25 Q Do you know what's in the categories that AT&T

1 uses in their annual reports in the property and equipment
2 section?

3 A No, but when you look at the -- the 1998 report
4 says network equipment range from three to 15 years, and
5 then in the 10k that you handed me it says property
6 equipment, three to 20 years for support equipment. I
7 can't conclude from that whether support equipment
8 includes the network or not.

9 Q Okay. Do you know what's included in the
10 network equipment?

11 A Well, the network equipment would be cable,
12 whole lines and switches, and conduit and fiber cable, and
13 circuit equipment.

14 Q Would that be what GTE has in their network
15 equipment or what AT&T has in their network equipment?

16 A Well, I'm assuming that network equipment would
17 be similar equipment. Network equipment for AT&T would
18 include cables and wires and the equipment required to
19 provide communications.

20 Q But you're not sure if they're exactly the same
21 thing?

22 A Well, when you are -- when you're looking at the
23 provision of telecommunications services, it's the
24 equipment required to do that. And technology is -- my
25 belief is that whether you provide telephone, local

1 telephone, or telephone call over a coax or a wireless or
2 a twisted pair, there is some similarity, you know, like
3 there's technology that would change.

4 And so, my conclusion is that network equipment
5 would be whether it's exactly the same equipment, you
6 still have some -- it's used for the same purpose. So,
7 there is some comparison on the lives.

8 MR. KNIGHT: Thank you, Mr. Sovereign. Those
9 are all the questions we have.

10 CHAIRMAN DEASON: Redirect?

11 MS. CASWELL: I have just one question on
12 redirect.

13 REDIRECT EXAMINATION

14 BY MS. CASWELL:

15 Q Mr. Sovereign, do you have with you the
16 confidential exhibit that was distributed earlier, Exhibit
17 31, which contains AT&T's depreciation parameters? If you
18 don't, I'll give it to you.

19 A Yes.

20 Q Without disclosing any confidential information
21 in any details, can you tell if me the outside figure of
22 20 years for support assets shown in AT&T's 2000 annual
23 report, do they seem consistent with the lives for support
24 assets shown in Exhibit 31? You can take a moment to look
25 at that.

1 A I would say, generally, no.

2 Q Okay, thank you.

3 MS. CASWELL: That's all I have.

4 CHAIRMAN DEASON: Okay. Exhibits?

5 MS. CASWELL: Yes, I would like to move 57 into
6 the record, please.

7 CHAIRMAN DEASON: Without objection, Exhibit 57
8 is admitted.

9 (Exhibit 57 was admitted into evidence.)

10 CHAIRMAN DEASON: Thank you, Mr. Sovereign.

11 (witness excused.)

12 CHAIRMAN DEASON: Mr. Majoros.

13 MR. LAMOUREUX: AT&T and MCI call as their
14 witness, Michael J. Majoros.

15 DIRECT EXAMINATION

16 BY MR. LAMOUREUX:

17 Q Mr. Majoros, were you previously sworn in?

18 A Yes.

19 Q Would you please state your name and business
20 address, for the record.

21 A Yes. My name is Michael J. Majoros, Jr. My
22 business address is 1220 L Street Northwest, Washington
23 D.C.

24 Q And by whom are you employed?

25 A I'm employed by the firm of Snavelly King Majoros

1 O'Connor & Lee, Incorporated.

2 Q And on whose behalf are you appearing in this
3 proceeding?

4 A I'm appearing on behalf of AT&T of the Southern
5 States and MCI Worldcom.

6 Q Did you file direct testimony in this proceeding
7 on June 8th, 2000, consisting of 26 pages?

8 A Yes.

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

11 A Yes. Page 15, line 16, the year 1998 should be
12 changed to 1993. And on page 23, line 11, the word,
13 "million" should be "billion" with a "B."

14 Q With those changes, if I were to ask you the
15 same questions as are contained in your testimony, would
16 your responses be the same?

17 A Yes.

18 MR. LAMOUREUX: Mr. Chairman, I would move for
19 the admission, subject to cross examination of
20 Mr. Majoros's direct testimony.

21 CHAIRMAN DEASON: Without objection, the
22 testimony will be inserted into the record.

23

24

25

1 DIRECT TESTIMONY OF
2 MICHAEL J. MAJOROS, JR.
3 ON BEHALF OF
4 AT&T COMMUNICATIONS OF THE SOUTHERN STATES, INC. AND
5 MCI WORLDCOM, INC.
6 DOCKET NO: 990649-TP
7

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

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

14
15 **Q. PLEASE DESCRIBE SNAVELY KING.**

16 A. Snavely King was originally founded in 1970 to conduct research
17 on a consulting basis into the rates, revenues, costs and economic
18 performance of regulated firms and industries. The firm has a
19 professional staff of 12 economists, accountants, engineers and
20 cost analysts. Most of the firm's work involves the development,
21 preparation and presentation of expert witness testimony before
22 federal and state regulatory agencies. Over the course of the firm's
23 30-year history, its members have participated in over 500

1 proceedings before almost all of the state commissions and Federal
2 commissions that regulate the telecommunications, public utility
3 and transportation industries.

4

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

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

20

21

22

1 **Q. WHAT WAS YOUR EMPLOYMENT PRIOR TO JOINING**
2 **SNAVELY KING?**

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

6

7 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING**

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

10

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

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

17

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

19 A. AT&T and MCI WorldCom have asked me to identify the
20 appropriate plant lives to be used in Total Element Long-Run
21 Incremental Cost ("TELRIC") and Unbundled Network Element
22 ("UNE") cost studies for BellSouth and GTE. Specifically, I am to
23 provide plant lives in conformance with the FCC's requirements.¹

1 **Q. PLEASE SUMMARIZE YOUR RECOMMENDATIONS.**

2 A. For BellSouth I recommend, with the exception of the fiber cable
3 accounts, the projection lives underlying the current unbundled
4 network element ("UNE") rates. My recommended lives are, with
5 minor exceptions, consistent with the lives set forth in the FCC's
6 1995 prescription of BellSouth's depreciation rates as well as the
7 Florida Public Service Commission's ("FPSC") decision in Docket
8 Nos. 960757-TP, 960833-TP, and 960846-TP.² I have no
9 objections to BellSouth's proposed future net salvage ratios. For
10 GTE, I recommend both the projection lives and future net salvage
11 ratios set forth in the FCC's 1995 prescription of GTE's depreciation
12 rates.³

13

14 **Q. DOES THE FCC SPECIFY THE PLANT LIVES TO BE USED IN**
15 **THE PRICING OF UNBUNDLED NETWORK ELEMENTS?**

16 A. Yes, indirectly. The FCC rules require that only forward-looking
17 costs be used in the setting of interconnection prices.⁴ Forward-
18 looking costs require the use of economic depreciation rates.⁵ To
19 comply with this requirement, the plant lives used in the calculation
20 of costs must be based upon the expected economic lives of newly
21 placed plant⁶. In depreciation proceedings, such plant lives are
22 termed "projection lives," to differentiate them from "remaining lives"
23 and "average service lives" which reflect past plant placements.

1 Q. HAS THE FLORIDA PUBLIC SERVICE COMMISSION
2 IDENTIFIED THE PROJECTION LIVES IT CONSIDERS
3 APPROPRIATE FOR USE IN UNE CALCULATIONS?

4 A. Yes, the FPSC identified the lives it considers to be appropriate for
5 BellSouth UNE calculations. Those lives are shown on Table III of
6 the FPSC's April 29, 1998 Order No. PSC-98-0604-FOF-TP. With
7 the exception of the FPSC's 20-year projection life for the Aerial,
8 Underground and Buried fiber cable accounts and a few other
9 minor exceptions, the FPSC's projection lives are equivalent to the
10 FCC's prescribed lives. I am therefore recommending the FPSC's
11 projection lives except for the cited fiber accounts where I continue
12 to recommend the FCC's 25 year lives.

13

14 Q. ARE YOU FAMILIAR WITH THE DEPRECIATION ASPECTS OF
15 THE FPSC'S DECISION IN DOCKET NOS. 960757-TP/960833-
16 TP/960846-TP?

17 A. Yes, I testified on the subject of BellSouth's depreciation
18 parameters in that proceeding. The FPSC adopted several of my
19 recommendations and certain of BellSouth's proposals. The
20 primary differences between the FCC's prescribed projection lives
21 for BellSouth are in the four accounts listed below:

22

23

	<u>ACCOUNT</u>	<u>FCC</u>	<u>FPSC</u>
1			
2	Buildings	48	45
3	Aerial-Fiber	25	20
4	Underground-Fiber	25	20
5	Buried-Fiber	25	20

6 I have no objection to the FPSC's 45-year projection-life for
7 Buildings. I am, however, recommending the FCC's 25-year
8 projection lives for the fiber accounts listed above. Review of the
9 Commission's Order indicates that its decision was based on BST's
10 "projection lives of 20 years from its Florida-specific study".⁷

11 I have reviewed the Florida-specific study in question and
12 also BST's filing in this proceeding. The retirements in these three
13 accounts are negligible and recent life indications are either much
14 longer than the FCC's 25-years or are erratic. The Florida-specific
15 data indicates that if anything, the FCC's 25-year projection lives
16 should be lengthened, not shortened to BST's 20-year request.
17 Consequently, I continue to recommend the FCC's 25-year
18 projection lives.

19

20 **Q. ARE THE PROJECTION LIVES PRESCRIBED BY THE FCC**
21 **FORWARD-LOOKING?**

22 A. Yes, they are. As the FCC noted last year, in 1980, it "departed
23 from its previous practice of relying largely on historical experience

1 to project equipment lives and began to rely on analysis of
2 company plans, technological developments, and other future-
3 oriented studies."⁸

4 In 1995, the FCC reaffirmed its forward-looking orientation in
5 connection with the simplification of its depreciation represcription
6 practices. The FCC prescribed a range of projection lives which
7 could be selected by carriers for prescription on a streamlined
8 basis. The FCC stated that these ranges were based upon
9 "statistical studies of the most recently prescribed factors. These
10 statistical studies required detailed analysis of each carrier's most
11 recent retirement patterns, the carriers' plans, and current
12 technological developments and trends."⁹ Last year, the FCC
13 completed a review of these ranges and updated them as
14 appropriate.¹⁰ The FCC stated:

15 These ranges can be relied upon by federal
16 and state regulatory commissions for
17 determining the appropriate depreciation
18 factors for use in establishing high cost support
19 and interconnection and UNE prices.¹¹

20 *Indeed, the FCC further stated:*

21 In adopting a forward-looking mechanism for
22 high-cost support, we found that depreciation
23 expense calculations based on the

1 Commission's prescribed projection lives and
2 salvage factors represent the best forward-
3 looking estimates of depreciation lives and net
4 salvage percentages.¹²

5

6 **Q. DO YOU BELIEVE THE FCC STAFF FOLLOWED THE FCC'S**
7 **DIRECTIVE TO EMPHASIZE FORWARD-LOOKING ANALYSES?**

8 A. Yes. In my experience in fifteen FCC triennial rescription
9 conferences (including BellSouth rescription conferences), the
10 FCC staff always used a forward-looking approach to setting
11 depreciation rates. The FCC staff rarely relied solely on historical
12 data to set depreciation parameters. The FCC bases its parameter
13 prescriptions upon the studies and information supplied by the
14 individual companies, specific company plans, information
15 submitted by state commission staffs, consumer groups and its
16 broad industry-wide experience.

17

18 **Q. IS THERE EMPIRICAL EVIDENCE THAT THE PROJECTION**
19 **LIVES PRESCRIBED BY THE FCC HAVE BEEN FORWARD-**
20 **LOOKING?**

21 A. Yes. I would point to recent trends in the depreciation reserve
22 levels in the industry. As the FCC has recognized, "[t]he
23 depreciation reserve is an extremely important indicator of the

1 depreciation process because it is the accumulation of all past
2 depreciation accruals net of plant retirements. As such, it
3 represents the amount of a carrier's original investment that has
4 already been returned to the carrier by its customers."¹³The FCC's
5 recognition of the reserve level as an indicator of the depreciation
6 process can best be understood by examining a steady state
7 example.

8 Assume that we start with a stable environment in which the
9 average age of plant is 9 years and the expected life of plant is 27
10 years. I have assumed the addition rate, retirement rate and
11 straight-line accrual rate are all 3.7 percent (1/27), and the reserve
12 level is stable at 33 percent of plant in service (9 years/27 years).¹⁴
13 As we vary these factors, we can see the effect on the reserve
14 level. For example:

- 15 • If the addition rate were to increase above 3.7
16 percent, the reserve level would go down. This
17 should not be a cause for concern, since the
18 average age of plant would similarly represent
19 a lower percent of its expected life and the
20 reduced reserve level is anticipated in a
21 growing environment.
- 22 • If the retirement rate were to increase above
23

1 3.7 percent, the reserve level would also go
2 down. This would be a cause for concern,
3 since it would indicate that the actual life of
4 plant is shorter than previously expected. If the
5 actual life is shorter the reserve should be
6 higher, not lower than 33 percent.

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

16

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

23

1 Exhibit MJM-4 to this testimony charts reserve levels and
2 other plant rates since 1946 for all local exchange carriers ("LECs")
3 providing full financial reports to the FCC. As shown on Page 1 of
4 Exhibit MJM-4, reserve percents decreased steadily following
5 World War II due to industry growth. These declines continued
6 through the 1970's due in part to accrual rates which were too low.
7 As shown on Page 1 of Exhibit MJM-4, however, the FCC's change
8 to forward-looking depreciation practices in the 1980s resulted in a
9 dramatic rise in reserve levels after 1980. The composite reserve
10 level rose from 18.7 percent in 1980 to an historic high of 50.7
11 percent in 1998. This track record indicates that the depreciation
12 process is resulting in adequate depreciation accruals, and that the
13 FCC's projection life estimates have been forward-looking and
14 unbiased.

15 Confirmation of the forward-looking unbiased nature of
16 current FCC prescriptions can be gained by comparing the 1998
17 accrual rate of 7.0 percent (Exhibit MJM-4, Page 4, Column l) to the
18 1998 retirement rate of 3.1 percent (Exhibit MJM-4, Page 4,
19 Column k). The prescription of an accrual rate much higher than
20 the current retirement rate indicates an expectation that the
21 retirement rate will be much higher in the future. If the FCC were
22 prescribing depreciation rates based only upon historical indicators,
23 it would be prescribing depreciation rates in the range of 3 to 5

1 percent.

2 Exhibit MJM-5 confirms that these national LEC trends apply
3 also to BellSouth-Florida and GTE-Florida. The 1999 depreciation
4 reserve percents for these companies were:

	<u>1999 Reserve %</u>
5	
6	BellSouth-Florida 54.1%
7	GTE-Florida 48.9%

8

9 **Q. WHAT IS THE SOURCE OF THE LIVES PROPOSED BY**
10 **BELLSOUTH AND GTE?**

11 A. G. David Cunningham sponsors BellSouth's life proposals and
12 Allen E. Sovereign sponsors GTE's life proposals. Mr. Cunningham
13 states at page 5 of his testimony:

14 The economic lives BellSouth considers to be
15 appropriate for use in the cost studies are
16 consistent with those used to determine the
17 depreciation rates currently being booked in
18 Florida for intrastate and for external reporting
19 purposes.

20

21 Mr. Sovereign states:

22 GTE uses the same depreciation inputs for
23 FPSC regulatory reporting that it uses for

1 financial reporting purposes, and those are the
2 same inputs I recommend here.

3
4 **Q. DOES THE FACT THAT BELLSOUTH OR GTE MAY USE THEIR**
5 **PROPOSED LIVES FOR FINANCIAL REPORTING PURPOSES**
6 **NECESSARILY MAKE THEM APPROPRIATE FOR**
7 **REGULATORY COST STUDIES?**

8 **A.** No. In a 1989 Petition, AT&T asked the FCC to base its regulatory
9 depreciation on its financial books.¹⁵ The FCC flatly rejected this
10 request, stating:

11 We conclude that AT&T has not made a sufficient
12 showing that this Commission should base
13 AT&T's book rates on the depreciation rates that
14 it uses for financial reporting purpose. Initially, we
15 observe that the present depreciation procedures
16 have worked well for AT&T, in terms of ensuring
17 more rapid capital recovery. Our recent
18 depreciation orders have allowed AT&T to
19 increase substantially its depreciation reserve,
20 from 24.8% of plant as of January 1, 1984 to
21 39.1% as of January 1, 1989. AT&T does not
22 state in its petition in what specific manner this
23 Commission has been remiss in our depreciation
24 rate prescriptions of recent years. Rather, it relies

1 upon the fact that in 1988 it took a \$6 billion
2 writedown of its asset value for financial reporting
3 purposes. This event may indicate that a new
4 look at AT&T's depreciation situation is
5 warranted, notwithstanding our recent
6 depreciation rescription, and we are
7 accordingly initiating herein an inquiry into AT&T's
8 need for revised depreciation rates. However, that
9 assessment can be accomplished using current
10 procedures rather than depreciation rate
11 methodologies that go well beyond those that we
12 have traditionally employed. We have taken a
13 series of initiatives during the past decade to
14 ensure that carriers are able to adjust their
15 depreciation rates promptly to recover capital
16 investment costs as quickly as possible under the
17 federal regulatory scheme. We do not see a need
18 now to abandon one of those initiatives to
19 address what appears to be a temporary problem
20 that can be resolved with measures less drastic
21 than those suggested by AT&T.¹⁶

22
23

1 **Q. ARE FINANCIAL BOOK LIVES APPROPRIATE FOR USE IN**
2 **UNE CALCULATIONS?**

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

7

8 **Q. HAS ANY MAJOR LEC CONCEDED THE BIAS INHERENT IN**
9 **THE FINANCIAL BOOKS?**

10 A. Yes. In the FCC's Prescription Simplification proceeding, GTE
11 noted that the GAAP conservatism principle "prefers the
12 understatement (versus overstatement) of net income and net
13 assets where any potential measurement problem exist."¹⁷ Most
14 accountants would agree that the very nature of depreciation
15 makes it a challenge to measure.

16 In its October 1998 Order, the FCC agreed with GTE,
17 stating:

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

1 guided by the conservatism principle which holds,
2 for example, that, when alternative expense
3 amounts are acceptable, the alternative having
4 the least favorable effect on net income should be
5 used. Although conservatism is effective in
6 protecting the interest of investors, it may not
7 always serve the interest of ratepayers.
8 Conservatism could be used under GAAP, for
9 example, to justify additional (but, perhaps not
10 "reasonable") depreciation expense by a LEC to
11 avoid its sharing obligation. Thus, GAAP would
12 not effectively limit the opportunity for LECs to
13 merge earnings so as to avoid the sharing zone
14 as the basic factor range option. In this instance,
15 GAAP does not offer adequate protection for
16 ratepayers.¹⁸

17
18 **Q. BELLSOUTH COMPARES ITS PROPOSED LIVES TO THE**
19 **LIVES PRESCRIBED BY THE FCC FOR AT&T IN 1994. DO**
20 **AT&T's LIVES PROVIDE AN APPROPRIATE BENCHMARK?**

21 **A. No. Any comparison to lives prescribed for AT&T in 1994 is**
22 **irrelevant because in 1994 AT&T was an interexchange carrier**
23 **("IXC"). The very same FCC Order that prescribed the lives for**
24 **AT&T in 1994 also prescribed much longer lives for thirteen LECs.**

1 Clearly, the FCC recognized the difference between the appropriate
2 lives for an IXC and a LEC. The FCC explicitly noted this difference
3 in its Prescription Simplification proceeding when it stated:

4 We believe the underlying considerations that go
5 into estimating the basic factors are sufficiently
6 different for the two groups [IXC and LEC] that
7 they should be considered separately.¹⁹

8
9 The plant lives of IXCs are simply not appropriate for use in
10 calculating UNE costs. The expected productive life of plant is
11 largely dependent upon its specific use. To use an extreme, but
12 apt, analogy, the expected productive life of the copper wire
13 installed in a house is many times that of the copper wire installed
14 in an automobile. Despite surface similarity, the use of plant by
15 LECs to provide local exchange and exchange access service is
16 much different than the use of plant by IXCs to provide
17 interexchange services.

18 IXCs are much less capital intensive than LECs, and thus
19 are able to economically replace their plant much faster than LECs
20 when the occasion demands. To service all homes and businesses
21 in the nation, an IXC needs only about 150 switches and 100,000
22 sheath kilometers of cable. To gain the same ubiquity for local
23 exchange service, the LECs require over 23,000 switches and

1 6,000,000 sheath kilometers of cable. No matter how motivated the
2 LECs may be, the sheer magnitude and complexity of the
3 replacement effort ensures that replacement is a long, drawn-out
4 process. This difference also helps explain why facilities-based
5 competition came quickly to the interexchange industry and has
6 been painfully slow in the local exchange industry.

7

8 **Q. HOW DID BELL SOUTH AND GTE DEVELOP THEIR LIFE**
9 **ESTIMATES FOR THE ACCOUNTS IMPACTED BY**
10 **TECHNOLOGICAL CHANGE?**

11 **A.** They relied largely upon "substitution analysis," which attempts to
12 forecast the pattern by which new technology will replace old
13 technology. GTE relied upon substitution analyses performed by
14 Technologies Futures, Inc. ("TFI"), whose industry studies have
15 been used frequently by local exchange carriers to justify shorter
16 lives in regulatory depreciation proceedings. TFI's studies are
17 sponsored by the Telecommunications Technology Forecasting
18 Group ("TTFG"), an industry association of BellSouth, GTE, Sprint
19 and other major LECs in the United States and Canada. In prior
20 proceedings BellSouth also relied on TFI and at one point
21 convinced the Florida Public Service Commission to rely on TFI as
22 well. However, that reliance has been shown to have been
23 misplaced.

1 **Q. WHAT ASSUMPTIONS UNDERLIE THESE STUDIES?**

2 A. These studies are based upon the premise that LECs will replace
3 their narrowband telecommunications networks with broadband
4 integrated networks capable of providing both telecommunications
5 services and video services, such as cable television. According to
6 these studies, Fiber-In-The-Loop ("FITL") will bring broadband to
7 the home, displacing copper plant. This will result in the upgrading
8 of all transmission systems to Synchronous Optical Network
9 ("SONET"), replacing existing circuit equipment. TFI also predicts
10 that Asynchronous Transfer Mode ("ATM") switching equipment will
11 provide a broadband switching capability replacing today's
12 narrowband switch fabrics.

13

14 **Q. SHOULD TELRIC COST STUDIES BE BASED UPON**
15 **ASSUMPTIONS SUCH AS THOSE UNDERLYING THESE**
16 **ESTIMATES?**

17 A. No. TELRIC is based on the use of the most efficient
18 telecommunications technology currently available and the lowest
19 cost network configuration, given the existing location of the
20 incumbent LEC's wire centers. The TELRIC standard requires a
21 determination of the stand-alone cost of unbundled network
22 elements in an efficient telecommunication network. The plant lives
23 appropriate for such a calculation should not be based upon the

1 assumption that efficient telecommunications facilities will be
2 prematurely retired in order to provide broadband video services.

3

4 **Q. ARE THE LIVES RESULTING FROM THE USE OF**
5 **SUBSTITUTION ANALYSIS NECESSARILY ACCURATE?**

6 **A.** No. Substitution models merely provide a convenient method for
7 plotting by year the growth of new technology assuming the inputs
8 to the formula are correct. The output of a substitution analysis is
9 only as accurate as the inputs selected.

10 In the first place, substitution analysis is not even relevant
11 unless it is known that a new technology will replace, not
12 supplement, an older technology. It appears, for example, the
13 Asynchronous Transfer Mode ("ATM") switches will be deployed as
14 a supplemental technology to digital switches, not as a replacement
15 for them. As such, substitution analysis is of no relevance. This
16 helps to explain the low retirement rates for digital switching
17 equipment.

18 Indeed, even when a substitution has started, it does not
19 necessarily follow that it will finish according to pattern. It appeared
20 at one point, for example, that nuclear fuel would replace fossil fuel
21 in electrical generation in this country. The use of substitution
22 formulas in that case would have resulted in dramatically incorrect
23 predictions.

1 Even if a full substitution is likely, the formula requires the
2 user to predict both the rate of substitution and the point at which
3 the replacement technology will reach 50 percent of the universe.
4 In other words, the analyst must insert as an input the average
5 remaining life of the old technology, since this is essentially the 50
6 percent level of the new technology. Although substitution
7 methodology allows the preparation and presentation of impressive
8 looking charts and tables, it is merely charting the assumptions
9 made by the analyst. Its outputs at the hands of BellSouth or TFI
10 are no more credible than their inputs.

11

12 **Q. HAS SUBSTITUTION ANALYSIS PROVEN ACCURATE OVER**
13 **THE LONG RUN?**

14 A. No. Although TFI forecasts have been provided to the FCC for
15 nearly a decade, they have not been relied upon in the selection of
16 plant projection lives. Fatina K. Franklin, the Chief of the FCC's
17 Competitive Analysis Branch, made a presentation at the Annual
18 Meeting of the Society of Depreciation Professionals on the subject
19 of forecasting. The charts from her presentation are provided as
20 Exhibit MJM-6. Charts 3 and 4 deal specifically with TFI's
21 estimates. Chart 3 demonstrates that TFI's 1989 estimates for the
22 retirement of circuit equipment surviving as of the end of 1996 is
23 nearly three times as great as that predicted by its studies. Chart 4

1 demonstrates that its 1994 estimates for circuit equipment and
2 analog stored program control ("SPC") switches are already proving
3 inaccurate. Exhibit MJM-7 to this testimony provides a similar
4 analysis of TFI's fiber in the feeder estimates. Page 1 of this
5 analysis shows its predictions for the percent of fiber in the feeder
6 in 1988, 1994 and 1997, and actuals (in bold) through 1995. In
7 1988 TFI predicted a substitution of 22.55 percent by 1995; in 1994
8 its prediction dropped to 11.20 percent; and its latest study shows
9 an actual of 9.30 percent. Page 2 graphically portrays this data and
10 demonstrates how TFI's life estimates have lengthened as actuals
11 became available.

12

13 **Q. HAS BELLSOUTH'S USE OF SUBSTITUTION ANALYSIS**
14 **PRODUCED ESTIMATES MORE ACCURATE THAN TFI'S**
15 **ESTIMATES?**

16 **A.** No. Exhibit MJM-8 to this testimony reproduces the "tracking
17 reports" filed by BellSouth as part of its 1996 Depreciation Study.
18 The FCC requires these reports to shed light on the accuracy of
19 past forecasts by a LEC. Actual retirements from 1993 to 1995 as a
20 percent of retirements forecast in 1993 for the South Central Bell
21 Companies were as follows:

22

23

1	Aerial Cable Metal	32.3%
2	Underground Cable Metal	11.1%
3	Buried Cable Metal	23.6%

4 This abysmal track record may have contributed to BellSouth's
5 failure to request represcription in 1996 and 1999.

6

7 **Q. DO YOU HAVE ANY FLORIDA-SPECIFIC INFORMATION?**

8 A. Yes. Exhibit MJM-9 is a comparison of the TFI predictions upon
9 which this Commission set BellSouth's copper cable depreciation
10 rates in Docket No. 920385-TL. This table demonstrates that TFI
11 was wrong by over \$1.3 million. The remaining lives based on TFI's
12 forecast were equally as wrong.

13

14 **Q. HAVE YOU COMPARED BELLSOUTH FLORIDA'S AND GTE
15 FLORIDA'S PROPOSED LIVES TO THE FCC LIVES?**

16 A. Yes, I have. Page 1 of Exhibit MJM-10 compares BellSouth's life
17 proposals (Column e) to:

- 18 • the range of projection lives
19 prescribed by the FCC pursuant to its
20 Prescription Simplification proceeding
21 (Columns a and b);
- 22 • the most recent FCC projection life
23 prescription for BellSouth Florida

- 1 (Column c);
- 2 • the lives currently prescribed for use
- 3 in pricing BellSouth Florida UNEs
- 4 (Column d); and
- 5 • my proposal in this proceeding
- 6 (Column f).

7

8 Page 2 displays these same comparisons for future net salvage.

9 Pages 3 and 4 display these same life and future net salvage

10 comparisons for GTE.²⁰

11 Many of BellSouth's and GTE's proposed lives are much

12 shorter than the FCC/FPSC's projection lives for the major

13 technology accounts. Consequently, they are inappropriate for use

14 in UNE calculations.

15

16 **Q. HAVE YOU COMPARED BELLSOUTH FLORIDA'S AND GTE-**

17 **FLORIDA'S HISTORICAL LIVES TO THE FCC'S AND FPSC'S**

18 **LIVES ?**

19 **A.** Neither of the Companies' filings provide specific information or

20 data to make such a comparison. Nevertheless, I am quite certain

21 based on my experience that the historical lives vastly exceed the

22 FCC's and FPSC's lives for the major technology accounts.

23

1 Q. WHAT WOULD BE THE RESULT OF UNE COSTS BASED ON
2 BELLSOUTH'S AND GTE'S PROPOSED LIVES?

3 A. UNE costs would be overstated and competition would be impeded.
4

5 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

6 A. Yes, it does.

¹ 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").

² FPSC, Docket Nos. 960757-TP, 960833-TP, 960846-TP, Order No. PSC-98-0604-FOF-TP, issued April 29, 1998, ("April 29 Order") Table III.

³ FCC Parameter Report, August 11, 1998.

⁴ Rules ¶ 51.505 (a)

⁵ Rules ¶ 51.505 (b) (3).

⁶ *The economic life of an asset is its total revenue producing life. Public Utility Depreciation Practices ("Depreciation Practices")*, National Associate of Regulatory Utility Commissioners, August 1996, p. 318.

⁷ April 29 Order, p. 40.

⁸ 1998 Biennial Regulatory Review-Review of Depreciation Requirements for Incumbent Local Exchange Carriers, CC Docket 98-137, Report and Order, FCC 99-397, released December 30, 1999 ("1999 Update"), para. 5.

⁹ *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.

¹⁰ 1999 Update, para. 14.

¹¹ *Id.*, para.34.

¹² *United States Telephone Association's Petition for Forbearance from Depreciation Regulation of Price Cap Local Exchange Carriers*, ASD 98-91, Memorandum Opinion and Order, FCC 99-397, released December 30, 1999, para. 61 (emphasis added).

¹³ *Report on Telephone Industry Depreciation, Tax Capital/Expense Policy, Accounting and Audits Division*, Federal Communications Commission, April 15, 1987 ("AAD Report"), p. 3.

¹⁴ Reserve 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, 1996, p. 121.

¹⁵ *The Modification of the Commission's Depreciation Prescription Practices as Applied to AT&T and The Prescription of Revised AT&T Depreciation Rates, Petition of American Telephone and Telegraph, February 15, 1989.*

¹⁶ *Id.*, Memorandum Opinion and Order, FCC 89-325, adopted November 22, 1989 (footnote deleted).

¹⁷ *Prescription Simplification, Comments of GTE Service Corporation and its affiliated domestic telephone companies ("GTE"), March 10, 1993, p. 14.*

¹⁸ *Id.*, Report and Order, FCC 93-452, released October 20, 1993, para.46.

¹⁹ *Prescription Simplification, Notice of Proposed Rulemaking, released December 29, 1992*

²⁰ Column d is not available for GTE.

1 BY MR. LAMOUREUX:

2 Q Mr. Majoros, did you also have 10 exhibits
3 attached to your testimony marked MJM-1 through MJM-10?

4 A Yes.

5 MR. LAMOUREUX: Mr. Chairman, I'd like to have
6 those exhibits marked, I guess, as composite Exhibit 58.

7 CHAIRMAN DEASON: They will be so identified.

8 (Exhibit 58 was identified for the record.)

9 BY MR. LAMOUREUX:

10 Q Mr. Majoros, would you have a summary of your
11 testimony prepared?

12 A Yes, I do.

13 Q Would you give that now, please?

14 A Yes. The subject of my testimony is
15 depreciation. The purpose of my testimony is to recommend
16 the appropriate plant lives to be used in BellSouth's and
17 GTE's unbundled network element cost study.

18 For BellSouth, I recommend, with the exception
19 of the fiber cable accounts, the projection lives
20 underlying the current unbundled network element prices
21 being paid.

22 With minor exceptions, these lives are
23 consistent with the Florida Public Service Commission's
24 decision in docket numbers 960757 et al. That was the
25 company's last unbundled network element case. They're

1 also consistent with the Federal Communications
2 Commission's 1995 prescription of BellSouth's depreciation
3 rates.

4 I have no objection to BellSouth's future net
5 salvage ratio proposals. For GTE I recommend both the
6 lives and future net salvage ratios set forth in the
7 Federal Communications Commission's 1995 represcription.

8 In this proceeding, both BellSouth and GTE are
9 proposing much shorter lives than currently prescribed,
10 even though these lives, in certain cases, are even
11 shorter than the ranges prescribed for general use by the
12 Federal Communications Commission.

13 The federal communications allows companies to
14 go outside its ranges in special circumstances. These
15 companies' proposed shorter lives will significantly
16 increase unbundled network element prices. Therefore,
17 these companies have the burden to support the changes.

18 Unfortunately, these companies reject any
19 reference to their own empirical retirement rate data as a
20 basis to estimate lives, but rather rely on selective use
21 of alternative historical data to perform fisher pry
22 substitution analysis which has, heretofore, produced a
23 moving target answer which has demonstrated to be
24 incorrect.

25 While BellSouth's study provides an aura of

1 precise Florida-specific forecasts, the fact is that its
2 forecasts are not Florida-specific and the methodology is
3 fatally flawed.

4 Remember, that I'm making the same
5 recommendations here that I've made before, because
6 neither BellSouth nor GTE has produced anything this time
7 which demonstrates the need for a change.

8 Q Does that conclude your summary?

9 A Yes, it does.

10 MR. LAMOUREUX: Mr. Majoros is available for
11 cross examination.

12 CHAIRMAN DEASON: Mr. Gross, do you have any
13 questions?

14 MR. GROSS: No questions, thank you.

15 CHAIRMAN DEASON: Questions from any parties,
16 other than incumbent LECs? Very well, BellSouth.

17 MR. ROSS: Thank you, Mr. Chairman.

18 CROSS EXAMINATION

19 BY MR. ROSS:

20 Q Mr. Majoros, Bennett Ross on behalf of
21 BellSouth.

22 In establishing economic depreciation rates in
23 this proceeding, would you agree that the Commission must
24 determine the expected economic lives of newly-placed
25 plant?

1 A Yes.

2 Q In other words, in modeling the least cost
3 forward-looking network, the Commission must determine
4 whether a digital switch installed today is going to have
5 a useful life of 16 years, 10 years, or some other period;
6 is that correct?

7 A Yes.

8 Q Would you agree that in establishing economic
9 depreciation rates in this proceeding, there's no
10 requirement that this Commission use FCC prescribed lives?

11 A That is correct to the best of my knowledge, but
12 remember, Mr. Ross, I'm recommending with minor exceptions
13 lives prescribed or approved by this Commission and which
14 underlie current intrastate unbundled network element
15 rates.

16 Q Okay. We'll get to that in just a minute.

17 You mentioned something in your summary about
18 it's BellSouth's or the incumbent's burden to justify a
19 different rate?

20 A Yes.

21 Q I wasn't sure I understood what you meant by
22 that.

23 What burden does BellSouth have, and what do you
24 believe is the source of that burden?

25 A I believe, in particular, the FCC rules require

1 that BellSouth support any changes to current unbundled
2 network element rates and this Commission's rules. That's
3 why we're in a proceeding now.

4 Q Do you happen to know what -- do you have a
5 citation for whatever FCC rule or Florida Commission rule
6 that you believe imposes a burden on BellSouth in
7 establishing depreciation rates?

8 A No.

9 Q In your view, does this Commission have the
10 expertise to make an independent assessment of what
11 constitutes the expected economic life of newly-placed
12 plant?

13 A Yes.

14 Q But nevertheless, you recommend that the Florida
15 Commission not exercise or use that judgment; isn't that
16 correct?

17 A I'm recommending that the Commission not change
18 what it prescribed or approved the last time that it
19 studied BellSouth's unbundled network element rates.

20 Q Well, you are proposing one slight modification;
21 are you not?

22 A Which one?

23 Q Didn't the Commission, in its April 29 order --
24 1998 order in 980604, establish expected economic life of
25 fiber cables being 20 years?

1 A That's correct.

2 Q And you're advocating that the Florida
3 Commission use 25 years; is that correct?

4 A That's correct.

5 Q So, in the instance, two years ago when the
6 Commission exercised its judgment and reached a contrary
7 conclusion to what you were recommending, you're
8 advocating that the Commission not rely upon that
9 judgment, correct?

10 A I'm asking them to reconsider that decision.

11 Q Do you believe that the economic lives of
12 newly-placed plant, for purposes of a forward-looking cost
13 study, ought to be the same regardless of the purpose to
14 which that cost study may be put?

15 A Not necessarily, no.

16 Q Can you explain that answer, please.

17 A Well, I think you might be referring to the
18 lives adopted in the universal service case, which I
19 assume are going to be used generically by all
20 telecommunications providers in the state. Here, we're
21 dealing with unbundled network elements, which I believe
22 that those parameters ought to be company-specific.

23 Q All right. To your knowledge did the FCC or has
24 the FCC adopted a different Telric methodology for UNEs as
25 opposed to for unbundled network elements -- I'm sorry,

1 for universal service as opposed to unbundled network
2 elements?

3 A I don't believe that it did, but I'm not totally
4 familiar with the FCC's universal service costing
5 procedures.

6 Q Have you read the Florida Commission's January
7 1999 order in the universal service docket?

8 A Yes.

9 Q And you're not proposing that the Florida
10 Commission use the lives that they've determined to be
11 forward-looking lives in that proceeding, are you?

12 A No, no, no.

13 Q In your view, does the economic life of
14 newly-placed equipment vary, depending upon whether we're
15 talking about BellSouth or GTE?

16 A It could, given the particular use.

17 Q So, in other words, if BellSouth installs a
18 switch today, a 5-E switch, it's going to be used to
19 provide local service and GTE installs an identical switch
20 to provide local service in its territory, you believe
21 that the useful life of those two switches could vary?

22 A It could, yes. I believe, it was in the same
23 rate prescription order that in 1995 that the FCC
24 prescribed a different life for BellSouth's digital
25 switches than it did -- it may have. Let me check.

1 I stand corrected; 16 years was prescribed for
2 both.

3 Q Could I ask you to look at page 17 of your
4 direct testimony. And I'm at lines 10 through 11 where
5 you make the following statement, "The expected productive
6 life of plant is largely dependent upon a specific use."
7 Do you see that?

8 A Yes.

9 Q Do you mean to say also that the expected
10 productive life of plant is largely dependent upon its
11 specific use and who's actually using it?

12 A Well, depending on its specific use would also
13 depend on who's using it.

14 Q So, in other words, in your testimony, you did
15 not mean to suggest that the specific use you had in mind
16 was just local service as opposed to long distance?

17 A That was the distinction I had in mind when I
18 wrote this.

19 Q Were you aware of the Commission's universal
20 service order issued in January 1999 before you wrote your
21 testimony?

22 A Yes.

23 Q Prior to recommending the use of the --
24 primarily, the FCC's prescribed lives, did you prepare a
25 study of the economic lives of newly-placed plant?

1 A For BellSouth?

2 Q For BellSouth, for GTE?

3 A No.

4 Q Have you performed any studies to verify that
5 the lives -- to verify the validity of the FCC's
6 prescribed lives?

7 A No. I've relied on the FCC's lives, I've relied
8 on this Commission, and I have not performed any specific
9 studies. What I have done is requested the retirement
10 rate studies that this company has performed, and I have
11 them available. And in many cases, they get some
12 indications of what the life of newly-placed plant might
13 be.

14 Q Mr. Majoros, when were you retained by AT&T and
15 MCI in connection with this proceeding?

16 A I don't, specifically, recall. I believe -- I
17 believe, in May -- April or May. I don't recall.

18 Q Of the year 2000?

19 A Yes.

20 Q Now, when you were engaged by AT&T and MCI, were
21 you asked to conduct any studies to look at or to
22 establish the forward-looking lives of plant equipment?

23 A No. I was asked to identify the appropriate
24 plant lives to be used in Telric and UNE cost studies.
25 Specifically, I was to provide the plant lives in

1 conformance with the FCC's requirements.

2 Q So, just so I understand your response, AT&T
3 never -- and MCI never came to you and said we would like
4 you to do a study and determine what is the expected life
5 of plant being placed in Florida today; is that correct?

6 A That's correct.

7 Q Is it fair to say that what AT&T and MCI
8 Worldcom came to you and asked you to do was support the
9 use of either FCC or state Commission prescribed lives for
10 purposes of UNE cost studies?

11 A No, they never -- they never, specifically,
12 stated that.

13 What I was asked to do is shown at the bottom of
14 page three of my testimony. AT&T and MCI Worldcom asked
15 me to identify the appropriate plant lives to be used in
16 Telric and UNE cost studies for BellSouth and GTE,
17 specifically, and to provide the plant lives in
18 conformance with the FCC's requirements.

19 Q So, it was never stated by either AT&T or MCI,
20 in connection with your engagement, that they wanted you
21 to advocate use of FCC or state Commission prescribed
22 lives?

23 A No. And as an indication of that, as I
24 indicated earlier, I'm not objecting to -- the FCC also
25 prescribes future net salvage ratios. I'm not objecting

1 to BellSouth's proposed future net salvage ratios.

2 Q Since the passage of the 1996 act, Mr. Majoros,
3 how many proceedings, either unbundled network element
4 proceedings or universal service proceedings, has your
5 firm provided testimony on behalf of either AT&T or MCI
6 Worldcom on the issue of depreciation?

7 A Several.

8 Q And how many of those proceedings has your firm
9 advocated use of something other than FCC or Commission
10 prescribed lives?

11 A Probably none.

12 Q Can I get you to look at page three of your
13 direct testimony?

14 A Yes.

15 Q The question beginning on line 11 and the answer
16 beginning on line 13, where you make the note that your
17 testimony in analytical framework relies heavily upon work
18 performed by yourself and others at your firm on behalf of
19 AT&T, MCI Worldcom, and AT&T Canada; is that correct?

20 A Yes, sir.

21 Q In fact, isn't your testimony in this
22 proceeding, basically, the same proceeding you've offered
23 in all of BellSouth's states for the last three years
24 where the issue of depreciation comes up?

25 A Yes.

1 Q Since passage of the 1996 act, Mr. Majoros, have
2 you ever had occasion to look at the economic lives that
3 are used by your clients for depreciation purposes with
4 respect to the equipment that they used to provide local
5 exchange service?

6 A I recently did a study on behalf of a client in
7 New Mexico where we considered the lives of U S West's
8 plant.

9 Q Okay. I'm sorry, I should have been more
10 precise.

11 Your clients, in this proceeding, AT&T and MCI
12 Worldcom, have you ever had occasion, since passage of the
13 1996 act, to look at the economic lives that they used for
14 depreciation purposes?

15 A I had one experience, which was last Thursday.

16 Q Last Thursday.

17 And isn't it correct that only when BellSouth
18 was provided the information about the AT&T's economic
19 lives did you actually review that information for
20 yourself?

21 A Yes.

22 Q If I could ask you to look at page 16 of your
23 testimony, you are criticizing or challenging any
24 comparison of the lives that the FCC prescribed for AT&T
25 in 1994, because AT&T, at that time, was an interexchange

1 carrier; is that correct?

2 A Criticizing a comparison of local exchange
3 carrier lives to the lives prescribed by -- for AT&T in
4 1994, that's correct.

5 Q Okay. Now, today, 2000, AT&T is much more than
6 an interexchange carrier, correct?

7 A Well, what do you mean by much more?

8 Q Well, they're -- with the acquisition of
9 MediaOne, one of the largest, if not the largest cable
10 operator in the country; are they not?

11 A I believe they are, yes.

12 Q And they've acquired TCG in providing local
13 exchange service in Florida and elsewhere; have they not?

14 A That's correct.

15 Q Is it your belief that AT&T establishes
16 different lives for equipment that it uses to provide
17 local exchange service versus equipment it may use to
18 provide long-distance service?

19 A Yes.

20 Q And you base that belief on something AT&T has
21 told you or is that just your suspicion?

22 A Yes.

23 Q Which? Is it based on something AT&T has told
24 you?

25 A Yes.

1 Q Who at AT&T has told you that and what,
2 specifically, did they tell you?

3 A Mr. Lamoureux.

4 Q Mr. Lamoureux, the attorney for AT&T, has
5 advised you that AT&T uses different lives for equipment
6 used to provide local exchange service as opposed to lives
7 it uses to provide long-distance service?

8 A That is correct.

9 Q Okay. What about MCI, has MCI or have you asked
10 or inquired of MCI as to whether they use different lives?

11 A It seems to me -- I don't believe I've asked
12 that specific statement question, but I believe they use
13 the same lives.

14 Q If you had Exhibit 34 in front of you, and it's
15 a confidential exhibit, would you be surprised to know
16 that MCI states that the lives they use for switches are
17 both local and interexchange switches?

18 A I recall that, yes.

19 Q But you believe that AT&T does it differently?

20 A Yes.

21 Q Do you know, for example, with respect to
22 switches, how different the economic lives that AT&T uses
23 for its local switches as opposed to its long-distance
24 switches?

25 A No.

1 MR. ROSS: Mr. Chairman, Ms. White's going to be
2 passing out an exhibit that I'm only going to use for
3 demonstrative purposes. The exhibit is a compilation of
4 the responses to discovery that we've marked as Exhibits
5 30 and 37, which contains both proprietary and
6 nonproprietary information. I'm not going to ask this be
7 moved into evidence, but simply for ease of reference,
8 have the witness refer to it.

9 Mr. Majoros, please take a moment to review
10 this, if you will.

11 A Yes. Okay.

12 BY MR. ROSS:

13 Q Mr. Majoros, what this chart represents are the
14 responses to BellSouth's discovery by the various carriers
15 that have answered or provided the information for the
16 primary technology accounts, digital circuit equipment,
17 switching, and cable. Do you see that?

18 A Yes.

19 Q And at the top of this chart, we have
20 BellSouth's proposed lives, the most recently approved
21 Florida Public Service Commission lives, and the FCC
22 prescribed lives; do you see that?

23 A Yes.

24 Q If you look at the column marked switch, and
25 without divulging any confidential information as it

1 relates to AT&T and MCI, what is the longest life used by
2 these carriers for the useful life of a switch?

3 A Okay.

4 Q And you're advocating that this Commission --

5 A Although I -- okay. The longest life shown on
6 this page is 10.

7 Q Right. And you're advocating that this
8 Commission adopt a useful life of a switch of 16 years; is
9 that correct?

10 A That's correct.

11 Q Now, if I could get you to look over at fiber
12 cable, and let's put MCI Worldcom aside for just a minute.
13 We'll talk about that shortly. What is the longest life
14 that the carriers on this chart are using with respect to
15 the useful life for fiber cable?

16 A The longest life shown on this page, other than
17 the FCC prescribed life for fiber, is 20 years. Now, I
18 have to point out something about this page, two things.
19 You have two errors on it.

20 Q Okay.

21 A First, in my opinion, what you've shown there
22 for MCI Worldcom is incorrect. The life that you show for
23 fiber cable should be in each of the cable columns.

24 Q Each of the cable, that they use the same life
25 for copper as well as for fiber?

1 A That's my understanding, correct.

2 Q Okay.

3 A So, we should put that number in each of those
4 columns.

5 Q And what was the other error you had mentioned?

6 A The other error is this: What you show for AT&T
7 does not belong on this page, and that is because those
8 are remaining lives.

9 Q Those are remaining lives?

10 A Yeah.

11 Q Okay. So, when BellSouth asked AT&T to provide
12 the useful lives, economic lives, that AT&T uses for
13 depreciation purposes, you don't believe that's an
14 accurate -- that the information they provided was
15 accurate?

16 A I didn't say that. I said they were remaining
17 lives.

18 Q And is that different than an economic life?

19 A Well, a useful life is a useful life. What I'm
20 telling you is that what I saw indicated that those lives
21 were remaining lives. If you have any other problems with
22 that you'll have to talk with AT&T.

23 Q Mr. Majoros, with respect to the 5-E switches,
24 is it fair to assume, if AT&T is using an economic life
25 of, let's just assume, 10 years for a 5-E switch, that

1 they would replace that 5-E switch some time within the
2 last four years?

3 A I don't know.

4 Q Well, I think we can assume, can we not, that
5 AT&T didn't have many local switches in place prior to
6 passage of the Telecommunications Act?

7 A I don't think it did; however, I think, it had a
8 local switch down here in Florida. The last time I
9 testified or at least was deposed, I mean, in the
10 unbundled network element case, apparently, AT&T did have
11 a 5-E switch down here in Florida somewhere.

12 Q All right. And that was in 1998 when you last
13 testified; is that correct?

14 COMMISSIONER JABER: Counsel, would you clarify
15 for me who put this chart together? What is this?

16 MR. ROSS: Yes, ma'am. BellSouth prepared this
17 chart based upon the information that was provided by the
18 ALECs in response to discovery where they were asked,
19 specifically, to provide the economic or useful lives of
20 the -- of digital circuit equipment switches and cable
21 that they used to provide local exchange service.

22 COMMISSIONER JABER: So, you compiled this chart
23 based on interrogatory responses you received from each of
24 the carriers.

25 MR. ROSS: Yes, ma'am. And those were the

1 documents we marked as Exhibits 30 to 37.

2 COMMISSIONER JABER: Mr. Majoros, clarify for me
3 that the notation that you made with respect to AT&T, you
4 said those were the remaining lives; meaning, that some of
5 the asset was depreciated?

6 THE WITNESS: No. What I mean is that the rest
7 of these lives are what's called projection lives.
8 Earlier today, Mr. Cunningham kept focusing on that
9 concept. They're estimates of a newly-placed piece of
10 plant going forward. And what you got from AT&T were the
11 remaining lives of embedded plant.

12 COMMISSIONER JABER: All right. And --

13 THE WITNESS: And they're different. They're
14 different. And that earlier, it is inappropriate to use
15 remaining lives for forward-looking cost studies.

16 COMMISSIONER JABER: All right. And then, this
17 is -- you would agree with me that this is not a
18 comprehensive list. So, as it relates to comparing the
19 FCC prescribed life, and to some degree the PSC prescribed
20 life, we're not looking at all of the companies --

21 THE WITNESS: What I'm saying is that you should
22 -- you don't have the -- you don't have equivalent
23 information -- comparable information for AT&T. And also,
24 I think, it was incorrect to put those NAs in the line for
25 MCI Worldcom. For MCI Worldcom, that last figure should

1 be in each of the metallic cable columns.

2 BY MR. ROSS:

3 Q Mr. Majoros, do you have a copy of AT&T's
4 proprietary responses in front of you?

5 A No, I don't.

6 Q Ms. White's going to hand you a copy of what we
7 marked as, I believe, it's Exhibit 31.

8 If I could -- let's put aside the letter for
9 just a minute, which is from Mr. Lamoureux, and let's look
10 at the actual information that AT&T is providing. Where
11 is it that you see on this chart that AT&T is providing
12 remaining lives as opposed to useful or economic
13 going-forward lives?

14 MR. LAMOUREUX: I'm going to object to the
15 extent that Mr. Ross is assuming that a remaining life is
16 not a useful life or an economic life. Other than that, I
17 don't have a problem with him answering the question.

18 CHAIRMAN DEASON: I'll allow the question and
19 the witness can clarify to the extent he needs to.

20 BY MR. ROSS:

21 Q I'll ask a different way.

22 Do you see anything on this exhibit provided by
23 AT&T that says what the life that they're representing on
24 this chart actually represents?

25 A No.

1 Q So, when you're basing your testimony on --
2 first of all, when was the first time you saw this
3 information?

4 A Thursday.

5 Q Thursday.

6 A Last Thursday, yeah.

7 Q Okay. And the letter is dated July 14th, so you
8 saw it the day before it was actually provided to
9 BellSouth; is that correct?

10 A That's correct.

11 Q And in this letter from Mr. Lamoureux, he
12 represents that the lives reflected in here are AT&T's
13 1998 and 1999 depreciation lives for more than 100
14 categories that AT&T uses in development of its annual
15 report; is that correct?

16 A Yes.

17 Q Does Mr. Lamoureux's letter give any indication
18 as to whether these are remaining lives or something else?

19 A No.

20 Q Now, could you tell me, in your view, what a
21 remaining life is?

22 A What a remaining life is?

23 Q Yes, sir.

24 A Remaining life refers to embedded investment,
25 and it is the estimated -- typically, it's the estimated

1 average remaining life of embedded investment.

2 Q So, embedded investment, the longer -- assuming
3 that an investment is placed in January of 1990 and has a
4 useful life of 10 years, you would expect the remaining
5 life to decrease, correct?

6 A That's correct.

7 Q Can you explain why it is that a number of these
8 accounts have lives that actually increase between 1998
9 and 1999?

10 A I can't. I don't know why that is.

11 Q Is it fair to say that an increasing life would
12 be inconsistent with the notion of a remaining life?

13 A Not necessarily. I don't know how AT&T
14 developed these remaining lives, but it is not necessarily
15 inconsistent, because a new asset to a group of assets,
16 the newest asset has the longest remaining life.

17 Q Is it fair to say that you really have no
18 firsthand knowledge as to how any of these rates were
19 developed or what they represent?

20 A I do -- I saw these lives with some other
21 material that was supplied to Mr. Lamoureux. And these
22 lives were labeled remaining lives.

23 MR. ROSS: Mr. Chairman, I'm in a bit of a
24 disadvantage, because the witness, obviously, has seen
25 information that was provided to him but was not provided

1 to BellSouth. So, I would ask that whatever information
2 was provided to Mr. Majoros the day before AT&T responded
3 to our discovery, that we be provided with the same
4 information?

5 MR. LAMOUREUX: Mr. Chairman, what I've provided
6 to BellSouth are responses to the discovery requests they
7 asked. What Mr. Majoros has seen is other information
8 that I was provided, along with the information that's
9 responsive to their discovery request. And any
10 implication that our responses are not responsive, I don't
11 believe is true, and we've provided them what they asked
12 for.

13 CHAIRMAN DEASON: I don't believe there's an
14 implication that it's not responsive. I believe, the
15 counsel's just requesting to have that additional
16 information.

17 MR. LAMOUREUX: I don't have it with me, but I
18 don't have a problem producing it to BellSouth. But I
19 believe, it is beyond what they asked for in the discovery
20 response and that what we gave them is responsive to what
21 they asked for.

22 CHAIRMAN DEASON: Mr. Ross, are you asking for a
23 late-filed exhibit?

24 MR. ROSS: Yes, Mr. Chairman. We're going to be
25 back for a second phase of this, obviously, but to the

1 extent we can get a late-filed exhibit as to what the
2 witness has seen to help him understand what these numbers
3 mean, I think, would be appropriate.

4 MR. LAMOUREUX: That's fine.

5 CHAIRMAN DEASON: That will be identified as
6 Exhibit 59. Could you give me a title for that exhibit,
7 please?

8 (Late-filed Exhibit 59 was identified for the
9 record.)

10 MR. ROSS: Clarification of useful lives
11 provided by AT&T.

12 CHAIRMAN DEASON: Does the witness understand
13 what's being requested?

14 THE WITNESS: Yes, sir. I don't know, am I
15 supposed to supply this?

16 CHAIRMAN DEASON: Well, the attorney cannot
17 testify, and I suppose this information has got to be
18 provided -- it's got to be authenticated in some manner.
19 And if it's just going to be -- if we're going to treat
20 this as additional response to discovery, additional on a
21 response to a discovery, then, we'll just treat it in that
22 manner. It doesn't have to be sponsored by a witness,
23 then.

24 MR. LAMOUREUX: I think, that's the way it has
25 to be. Frankly, Mr. Majoros can't authenticate the

1 information, because he's not an AT&T employee and is not
2 involved in the development of the information.

3 MR. ROSS: Thanks, Mr. Chairman.

4 BY MR. ROSS:

5 Q Just a couple follow-up questions about the
6 chart. And let's talk about MCI Worldcom. And without
7 divulging the actual number that MCI Worldcom is using for
8 cable, you've indicated that that number ought to apply in
9 all the cable accounts that are listed on this chart; is
10 that correct?

11 A Yes.

12 Q Would you agree that the lives being used by MCI
13 Worldcom for cable are significantly longer than the lives
14 you believe are forward looking?

15 A Yes.

16 Q And do you know why that is?

17 A No.

18 Q Have you inquired --

19 A Although I can speculate, but I don't know why
20 MCI picked that life. I could speculate.

21 Q No, I'd rather find out what you know. Have you
22 inquired of MCI Worldcom as to why it is they're using a
23 life for cable that is well beyond the parameters that you
24 would recommend this Commission use?

25 A I have not, specifically, asked that question,

1 but again, that life is not all that unreasonable, given
2 the statistical life studies that I've seen for most
3 companies, including yours.

4 Q Well, would you agree that the number that MCI
5 Worldcom is using for the life of cable is not only
6 significantly longer than the one you're recommending,
7 it's also significantly longer than everybody else is
8 using in the industry, at least those carriers reflected
9 on this chart; is that correct?

10 A It's longer than those carriers reflected on
11 this chart. I can't say it's everybody else in the
12 industry.

13 Q And that was -- the carriers who have actually
14 answered BellSouth's discovery who are participating in
15 this docket; is that fair?

16 A That's right. And again, I say that life is --
17 could be easily supported by reference to BellSouth's
18 statistical life studies.

19 Q Well, I'm assuming that if you believe it were a
20 correct number, you'd be advocating that number be used in
21 this proceeding, correct?

22 A In the position I took in my testimony, I still
23 believe it is MCI's life and AT&T's lives are irrelevant
24 for the purposes of this proceeding.

25 Q Now, putting aside your belief that this

1 information is irrelevant, when the FCC last prescribed
2 economic lives for BellSouth, that was before passage of
3 the Telecommunications Act of '96, correct?

4 A Yes.

5 Q And since passage of the act, any number of
6 ALECs have been installing equipment here in Florida to
7 provide local exchange service, correct?

8 A To my understanding, yes.

9 Q And in setting depreciation lives, for purposes
10 of the equipment they install, these carriers have to make
11 a judgment as to the useful life of that equipment,
12 correct?

13 A Yes.

14 Q And so, the FCC lives that you're advocating
15 here were established without the benefit of the views of
16 the ALECs as to the useful life of local telephone
17 equipment, correct?

18 A I don't believe -- well, let me just say this.

19 I was at that 1995 represcription conference.
20 And you'll see, if you can look at my exhibit, that the
21 lives that BellSouth has prescribed, and I'm particularly
22 referring to outside plant, are much shorter than the
23 FCC's ranges for those categories of plant.

24 And I was at that three-way represcription
25 meeting on behalf of another client, not the Florida OCA

1 or staff, but I believe that those lives are about the
2 shortest lives I've ever seen prescribed by the FCC for
3 metallic cable accounts. And I believe that I don't know
4 everything that went into the development of that,
5 particularly the 18-year lives; and whether or not
6 consideration was given to what ALECs are using or not, I
7 don't know. There may -- very well may have been in
8 negotiations between the Florida Public Service Commission
9 and the FCC --

10 Q So, you believe --

11 A -- and the company.

12 Q I'm sorry. So, the actual answer to my question
13 is you don't know?

14 A That's correct.

15 Q But in your response, is it fair to say that you
16 believe that the FCC may have had information about the
17 useful lives being used by ALECs in 1995 before there even
18 were ALECs?

19 A I said I don't know everything that went in -- I
20 don't know everything that went into the consideration of
21 those lives.

22 MR. ROSS: Mr. Chairman, I have no further
23 questions of the witness.

24 CHAIRMAN DEASON: Ms. Caswell.

25 MS. CASWELL: I have just a few questions,

FLORIDA PUBLIC SERVICE COMMISSION

1 Mr. Majoros.

2 CROSS EXAMINATION

3 BY MS. CASWELL:

4 Q I believe, in this proceeding you've recommended
5 that the Commission adopt for GTE the lives and salvage
6 values the FCC prescribed for GTE 1995; is that correct?

7 A No, I'm recommending the lives. I'm not
8 objecting to BellSouth's future net salvage
9 recommendations.

10 Q I'm sorry, I think I misunderstood that. You
11 say you're recommending the FCC's lives for 1995, but
12 you're recommending --

13 A I'm sorry, I'm sorry. You're talking about GTE.

14 Q GTE, right. I'm sorry, I didn't introduce
15 myself.

16 A Yes, the answer is yes.

17 Q Okay. And can you please turn to your Exhibit
18 MJM-10, pages 3 and 4, and that's a recommended inputs
19 table for GTE; page 3 is lives and 4 is salvage lives.

20 A Yes.

21 Q Those tables list the FCC's prescriptions for
22 1995, along with GTE's proposed inputs and your proposed
23 inputs; is that correct?

24 A Yes.

25 Q And there's also a column, an empty column,

1 labeled GTE FPSC; is that right?

2 A Yes.

3 Q And the note, which would be note "D" down below
4 says, FPSC values not available; is that correct?

5 A Yes.

6 Q But weren't there FPSC depreciation values
7 available from this Commission's 1999 USF order where the
8 Commission did establish depreciation of parameters?

9 A Well, I don't know if they were available for
10 unbundled network elements.

11 Q I may be wrong, but I think you testified
12 earlier that -- I don't think you saw any difference
13 between inputs for UNE case as opposed to a USF case; is
14 that correct?

15 A Yes, I do.

16 Q Excuse me?

17 A The answer is yes, I do see a difference. I
18 disagree with some of the inputs developed in that USF
19 case.

20 Q But wasn't your testimony in that case
21 substantially similar to the testimony in this case with
22 regard to recommended inputs?

23 A Yes, but again, as I said earlier, in response
24 to Mr. Ross, here we're dealing with unbundled network
25 elements, which are company-specific. And it's my

1 understanding that the USF case was generic.

2 Q Mr. Majoros, I also noticed that you left off
3 docket 980696, which was the universal service proceeding
4 off of your Exhibit MJM, which is a list of your
5 appearances and depreciation proceedings. Was that a
6 deliberate exclusion?

7 A No, it was an oversight. I didn't know I had
8 left it off.

9 Q So, is it fair to say -- I'm trying to
10 understand your answer previously, is it fair to say you
11 left off the FPSC inputs from 1999 just because you
12 believe that parameters should be company-specific?

13 A Yes.

14 Q But that you don't see any inherent differences
15 between the inputs that should be used in the USF cost
16 model proceeding and a UNE cost model proceeding, aside
17 from the company-specific aspect?

18 A I believe that company-specific data should be
19 used when available --

20 Q Right, but are there any --

21 A -- unbundled network elements.

22 Q But are there any other inherent differences
23 between -- should there be any inherent differences
24 between the inputs for USF proceeding and a UNE
25 proceeding?

1 A There should be some basis for the inputs.

2 Q Right, but --

3 A Company-specific basis.

4 Q Right, okay.

5 Can you list the particular factors underlying
6 the FCC's staff analysis in 1995 that would lead you to
7 conclude that the FCC staff did a better job in that case
8 than this Commission staff did in 1998 in prescribing the
9 depreciation inputs in the USF case?

10 A Yes. The FCC, specifically, examined GTE
11 Florida's lives and net salvage values. They discussed it
12 with this Commission Staff, it discussed it with the
13 company, and whoever else was a party to those
14 negotiations.

15 And they aren't just negotiations. I mean, I've
16 been to 15 of those meetings, and there's more to it than
17 negotiating. They, specifically, considered the studies
18 filed by these companies --

19 Q But is the FCC --

20 A -- which incorporated these companies' plans.
21 And so, I think that yes, they are more founded and
22 factual GTE information than the USF inputs.

23 Q Didn't this Commission Staff also examine GTE's
24 information in 1999, the same information, perhaps, that
25 you're referring to? What did the FCC do that this

1 Commission did not do, in terms of drawing up its
2 analysis?

3 A Well, one thing it did was examine GTE-specific
4 information for GTE-specific rates.

5 Q Did this Commission examine GTE-specific
6 information?

7 A I don't know exactly what this Commission
8 examined in the USF case --

9 Q You testified in that --

10 A -- but it developed generic parameters.

11 Q But you did testify in that case; did you not?

12 A Yes, I did.

13 Q Did you read the order in that case?

14 A Yes, I did.

15 MS. CASWELL: That's all I have. Thank you,
16 Mr. Majoros.

17 CHAIRMAN DEASON: Mr. Fons.

18 MR. FONTS: Sprint has no questions of this
19 witness.

20 CHAIRMAN DEASON: Staff?

21 CROSS EXAMINATION

22 BY MS. CALDWELL:

23 Q Good afternoon, Mr. Majoros. I'm Diana
24 Caldwell. I'm representing Commission staff. I just have
25 a few questions.

1 Have you proposed lives in net salvage values
2 for Sprint?

3 A No.

4 Q And could you explain why not?

5 A Because I was not requested to review Sprint's
6 filing in this case.

7 Q All right. Thank you very much.

8 CHAIRMAN DEASON: Commissioner Jacobs.

9 COMMISSIONER JACOBS: Mr. Majoros, in your
10 testimony, I think, it was page 10, they talk about the
11 idea of declining reserves.

12 Walk me through this analysis and what you
13 allege to be the implications of this.

14 THE WITNESS: One of my very first exhibits
15 deals with depreciation reserve levels. Exhibit Number 4
16 shows the depreciation reserve levels. To be able to put
17 that analysis in perspective, I have to talk about these
18 exhibits for just a second.

19 Exhibit MJM-4 demonstrates the depreciation
20 reserve level for all reporting local exchange carriers
21 all reporting to the FCC. And what it demonstrates is
22 that starting in 1946 the depreciation reserve, and the
23 depreciation reserve, by the way, is an accumulation of
24 all past depreciation accruals.

25 That reserve ratio actually declined through

1 just about 1980 at which time the FCC, specifically,
2 adopted forward-looking approaches to depreciation. And
3 these approaches included the adoption of the equal life
4 group procedure, they included the adoption of the
5 remaining life technique, they included the adoption of
6 shorter service lives and much more negative net salvage
7 -- future net salvage ratios.

8 All of these things combined, resulting in a
9 vast and steep increase in the accumulated depreciation
10 reserve ratio through 1999, at which time it reached an
11 all-time high. Similar information is available for both
12 GTE and BellSouth of Florida.

13 Now, given that, going back to page 9, what I'm
14 trying to demonstrate here is the importance of
15 considering that ramp-up in the depreciation reserve. And
16 what I've done is develop what we call a steady-state
17 model in which we'd assume that the annual plant addition
18 rate, annual plant retirement rate, are set -- and the
19 depreciation rate are all the same; the retirement rate,
20 the addition rate, and the depreciation rate are all the
21 same. And that would imply a 27-year life and a
22 steady-state scenario.

23 COMMISSIONER JACOBS: What's the benefit of
24 that?

25 THE WITNESS: Okay. The benefit of that is to

1 show that as you adjust certain parameters, if the
2 addition rate were to increase above 3.7%, what I'm saying
3 here, the reserve level would go down. You wouldn't see
4 that increase in the reserve level, if the addition rate
5 to plant were to increase.

6 However, that wouldn't be a cause for concern,
7 because it would just mean that the average age of plant
8 would similarly represent a lower percent of the expected
9 life in a reduced reserve level as anticipated in a
10 growing environment. That's important.

11 In a growing environment we anticipate that
12 reserve levels are decreased. If the retirement rate,
13 however, were to increase above 3.7%, if the retirement
14 rate exceeded the annual depreciation rate, the reserve
15 level would go down.

16 And that would be a cause for concern, because
17 that would indicate that the actual life, the actual life
18 of the plant being experienced, is shorter than previously
19 expected, and that would be a cause for concern.

20 If the accrual rate were to increase above the
21 retirement rate and the addition rate, the reserve would
22 go up. And that's what's been happening with this company
23 and the industry, the LAC industry, in general. The
24 accrual rate, since 1978 or 1980, have pretty much vastly
25 exceeded the retirement rates, which means that the

1 companies have been, while they were under rate of return
2 regulation, recovering substantially more than they were
3 retiring and more than they were adding, in many cases.

4 So, that's the significance of that. That's --
5 what I'm getting at here is --

6 COMMISSIONER JACOBS: Now, could that be
7 explained by the fact that you're adding a lot more
8 equipment, a lot more plant, rather?

9 THE WITNESS: No, it can explain my depreciating
10 a lot more.

11 COMMISSIONER JACOBS: Okay.

12 THE WITNESS: This company still is adding a
13 substantial amount of plant, but its accruals are
14 substantially exceeding -- its depreciation accruals are
15 substantially exceeding plant activity.

16 COMMISSIONER JACOBS: I understand. Okay, thank
17 you.

18 THE WITNESS: So, what I'm trying to say there,
19 I'm trying to explain why it is relevant, notwithstanding
20 what Mr. Cunningham and Mr. Sovereign say about reserve
21 levels, it is relevant that the accumulated depreciation
22 reserve levels have skyrocketed. That's relevant.

23 COMMISSIONER JACOBS: And you would indicate
24 that that is the bottom line impact in terms of prices?

25 THE WITNESS: Pardon me?

1 COMMISSIONER JACOBS: Because those are
2 expenses, you would take that to have a bottom line impact
3 on the prices that are paid?

4 THE WITNESS: My position is that depreciation
5 lives, which translate into depreciation accruals, are a
6 very significant portion of unbundled network elements.
7 The lives in Florida for the main accounts, particularly
8 outside cable accounts, are already very, very, very
9 short.

10 I'm recommending for the metallic cable accounts
11 that those lives not be changed without a very, very
12 compelling showing that they ought to be changed. And
13 that showing has not been made.

14 COMMISSIONER JACOBS: Okay. Thank you.

15 THE WITNESS: Yes, sir.

16 CHAIRMAN DEASON: Redirect?

17 MR. LAMOUREUX: I have just a few questions.

18 REDIRECT EXAMINATION

19 BY MR. LAMOUREUX:

20 Q Mr. Majoros, does the phrase useful lives
21 necessarily imply projection lives?

22 A There are all kinds of definitions of lives in
23 the depreciation world. A useful life could apply to an
24 existing asset that has lived five years and anticipated
25 to live five more. That could be one definition. This

1 desk, I don't know, would have a remaining useful life of
2 five years or 10 years, depending on how it's constructed.
3 So, a remaining life could be a useful life.

4 Q Is it possible for a company to rely upon
5 remaining lives rather than projection lives in financial
6 reporting purposes?

7 A Yes.

8 Q Mr. Ross asked you some questions about whether
9 AT&T and MCI asked you to recommend the FCC lives in this
10 proceeding. And he asked you whether you were asked to do
11 a depreciation study.

12 If you had felt a depreciation study was
13 warranted, would you have requested permission to do that
14 as part of your charge from AT&T or MCI?

15 A Well, I -- certainly, I guess, I would have
16 requested that.

17 Q Did AT&T or MCI simply ask you in this
18 proceeding to endorse the FCC lives?

19 A No. I stated on page three what I was asked to
20 do.

21 Q Have you done any studies to verify the validity
22 of BellSouth's depreciation studies?

23 A You know, Mr. Cunningham stated this morning, "I
24 haven't done any studies. I haven't done any studies,"
25 but the studies that I would have done, the company

1 already did. It just chose not to include them in its
2 filing. And those were the statistical life studies.

3 And whether I did them or whether Bell did it,
4 it doesn't matter, we'd still get the same answer; we used
5 the same software, used the same inputs, and those are
6 what I would have done.

7 Q And what conclusions do you draw from those
8 studies?

9 A I conclude that the lives that I'm recommending
10 here are substantially shorter than what those
11 Florida-specific studies would have indicated; in fact,
12 did indicate.

13 Q Mr. Ross asked you about other proceedings --
14 other unbundled network elements cost proceedings in which
15 you recommended the FCC lives. Do you know if any of the
16 states in those proceedings adopted you or your firm's
17 recommendations to use the FCC prescribed lives?

18 A Yes, I believe several states did.

19 MR. LAMOUREUX: I have no further questions.

20 CHAIRMAN DEASON: Exhibits? Exhibit 58 is
21 prefiled. Without objection, show Exhibit 58 is admitted.

22 (Exhibit 58 was admitted into the record.)

23 CHAIRMAN DEASON: Staff have any other matters
24 to come before the Commission?

25 MS. CALDWELL: My request would be on the

1 late-filed exhibit, do you want to set a date when that
2 would be due?

3 CHAIRMAN DEASON: When can that exhibit be
4 provided?

5 MR. LAMOUREUX: What's today?

6 CHAIRMAN DEASON: Today is the 17th.

7 MR. LAMOUREUX: I can provide it by Wednesday.

8 CHAIRMAN DEASON: That would be fine. Any other
9 matters?

10 MS. KEATING: Nothing, other than I do want to
11 point out that briefs are not due after this phase of the
12 proceeding. They will be due after phase two.

13 COMMISSIONER JABER: Mr. Chairman, in that
14 regard, I was going to ask you and Staff a procedural
15 question on this docket.

16 Is it your intent that there only be one Staff
17 recommendation that will encompass the entire proceeding?
18 Bring me up to speed on that, Ms. Keating, because I don't
19 know what you all have decided.

20 MS. KEATING: That's correct. This will be
21 treated as if it were a continuation. Phase two will be
22 just a continuation of this hearing. So, there will be
23 one set of briefs, one Staff recommendation, and will go
24 to agenda one time.

25 CHAIRMAN DEASON: Parties have anything before

1 we adjourn? Hearing nothing, thank you all. This phase
2 of the hearing is adjourned.

3 (Hearing concluded at 3:05 p.m.)

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1 STATE OF FLORIDA)
: CERTIFICATE OF REPORTER
2 COUNTY OF LEON)

3
4 I, KORETTA E. STANFORD, RPR, Official
Commission Reporter,

5 DO HEREBY CERTIFY that the hearing in
6 docket 990649-TP was conducted by the Florida Public
7 Service Commission at the time and place
8 herein stated.

9 IT IS FURTHER CERTIFIED that I stenographically
10 reported the said proceedings; that the same has been
11 transcribed by me; and that this transcript, consisting
12 of 1,002 pages, constitutes a true transcription of my
13 notes of said proceedings.

14 DATED this 31st day of July, 2000.

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Official Commission Reporter
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