ORIGINAL

BELLSOUTH TELECOMMUNICATIONS, INC.

REBUTTAL TESTIMONY OF WALTER S. REID

BEFORE THE

FLORIDA PUBLIC SERVICE COMMISSION

DOCKET NO. 990649-TP

(PHASE II)

AUGUST 21, 2000

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND POSITION WITH BELLSOUTH TELECOMMUNICATIONS, INC.

A. My name is Walter S. Reid and my business address is 675 West Peachtree Street N. E., Atlanta, Georgia. My position is Senior Director for the Finance Department of BellSouth Telecommunications, Inc. (hereinafter referred to as "BellSouth", or "the Company").

Q. ARE YOU THE SAME WALTER S. REID WHO FILED DIRECT AND REVISED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony in this proceeding on behalf of BellSouth on May 1, 2000 and revised direct testimony on August 18, 2000.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. The purpose of my rebuttal testimony is to respond to the comments of other parties in this proceeding regarding the appropriate amount of shared and common costs to include in the total cost of unbundled network elements ("UNEs") for BellSouth.

Q. PLEASE IDENTIFY THE WITNESSES IN THIS PROCEEDING TO WHOM YOUR REBUTTAL TESTIMONY WILL RESPOND.

A. My rebuttal testimony will respond to positions regarding the appropriate level of shared and common cost that are presented in the testimonies of AT&T and MCI WORLDCOM Witness Mr. Greg Darnell and Florida Cable Telecommunications Association Witness Mr. William J. Barta.

Q. WHAT WILL YOUR REBUTTAL TESTIMONY SHOW RELATIVE TO THESE WITNESSES' POSITIONS?

A. My rebuttal testimony will show that, except for one unique issue that has a small impact, the concerns that have been expressed by Mr. Darnell and Mr. Barta relative to BellSouth's shared and common costs are based on misunderstandings or superficial and improper analyses of BellSouth's data. BellSouth has included only a reasonable amount of shared and common cost in its UNE cost studies and a proper analysis of the data demonstrates this fact. However, my rebuttal testimony will identify one situation related to shared cost for central office equipment ("COE") that when corrected would change the shared cost factors for COE.

REBUTTAL TO MR. DARNELL'S POSITIONS

Q. WHAT OPINIONS HAS MR. DARNELL EXPRESSED RELATIVE TO BELLSOUTH'S SHARED AND COMMON COST?

A. On page 3, lines 5 through 11 of his testimony, Mr. Darnell states five opinions, four of which relate to shared and common cost. He apparently believes that BellSouth has not eliminated all retail expense from its UNE rates; that it uses too low a productivity factor in its forecast of expenses; that it may be double recovering Land, Building and Power expense; and that its common cost factor is too high.

Q. ARE HIS ASSESSMENTS OF BELLSOUTH'S COST STUDY REASONABLE?

A. No. A review of Mr. Darnell's testimony reveals that in most instances he has misunderstood and misapplied amounts and relationships in BellSouth's cost study.

Q. HOW HAS MR. DARNELL MISUNDERSTOOD THE AMOUNT OF RETAIL EXPENSE BELLSOUTH HAS ELIMINATED FROM ITS COST OF UNEs IN THIS DOCKET?

A. Mr. Darnell claims that in a previous study I determined that $1,926,591,887 of retail cost should be eliminated from UNE rates (Darnell testimony, page 4, lines 5-6). He further claims that in this proceeding BellSouth calculates that $1,426,416,105 of retail expense exists and BellSouth eliminates this lower amount from its current filing (Darnell testimony, page 3, lines 20-22). Mr. Darnell apparently believes that the difference in these amounts of avoided retail expense is in his words "contrived through differences in cost modeling assumptions" (Darnell testimony, page 4, lines 15-17). He further opines that the retail expense to be eliminated from BellSouth's UNE rates in this proceeding should be $1,649,793,034 (Darnell testimony, page 6, lines 10-12).

Mr. Darnell has obviously misunderstood BellSouth's study and has made a huge miscalculation. He is correct in his statement that I determined that the amount of retail cost to be excluded in a previous study was $1,926,591,887 and that this amount included indirectly avoided retail cost. However, Mr. Darnell has incorrectly identified the amount of retail cost that is eliminated from UNE cost in the current study. My Revised Exhibit WSR-4 filed August 18, 2000, in this proceeding clearly shows in the retail column that BellSouth has eliminated $2,188,554,658 in direct and indirect retail cost from the current study. This is $261,962,771 more than the previous study, not $500 million less as calculated by Mr. Darnell. His recommendation that $1,649,793,034 be used in the study as the retail cost to be eliminated would actually increase the cost of BellSouth UNEs in the current proceeding by over $500 million.

Q. DO YOU AGREE WITH MR. DARNELL'S VIEW THAT BELLSOUTH HAS USED TOO LOW A PRODUCTIVITY FACTOR IN ITS PROJECTION OF EXPENSES?

A. No. Mr. Darnell has not performed any studies or provided any reasonable evidence that would indicate that the 3.1% productivity factor used by BellSouth for projecting certain expenses in its study is understated. He has merely referenced a factor previously used by the FCC for adjusting prices in its interstate price cap formula and opined that the Florida Commission should require BellSouth to use a productivity factor in its expense forecasts that is no less than the FCC's 6.5% productivity factor.

He fails to mention the fact that in BellSouth's previous UNE cost study filed in Docket No. 960833-TP, BellSouth used a 2.9% productivity offset for projecting expenses and the Commission found that: "It appears to us that BellSouth has incorporated reasonable productivity offsets in developing its inflation/growth factors" (Commission Order No. PSC-98-0604-FOF-TP, at page 55). BellSouth's use of a 3.1% productivity offset in the current study is actually more ambitious on the Company's part than the previous study and results in somewhat lower projected expenses.

Mr. Darnell also fails to recognize that expense changes are only one part of overall productivity. The Commission recognized this fact and stated on the same page as the order page referenced above that: "Furthermore, because BellSouth's shared and common factors are based on the relationship between projected expenses to projected investments, and applied against forward looking investments, we find that BellSouth's factors have some inherent productivity gains".

Finally, Mr. Darnell has failed to mention that the FCC's decision that authorized the use of the 6.5% factor for interstate price cap purposes was reversed and remanded to the FCC by the United States Court of Appeals for the District of Columbia Circuit. The Court found problems with the FCC's support of its methodology for computing this factor and also questioned the fact that it included a customer dividend. The Court stayed issuance of its mandate until April 1, 2000, to allow the FCC time to conduct a proceeding regarding this factor. The FCC's decision in its CALLS proceeding subsequently established a new interstate price plan for the future and made a review of this factor moot.

Q. WHAT IS YOUR RESPONSE TO MR. DARNELL'S OPINION THAT BELLSOUTH'S STUDY MAY HAVE A PROBLEM RELATED TO DOUBLE RECOVERY OF LAND, BUILDING AND POWER EXPENSE?

A. Again, I believe Mr. Darnell's opinion is based on a misunderstanding of BellSouth's study. My testimony will clarify how land, building and power expenses are treated in the shared and common cost application and will demonstrate that, except in one unique instance that I will explain later in my testimony, there is no double recovery.

Q. HOW IS POWER EXPENSE TREATED FOR THE SHARED AND COMMON COST APPLICATION?

A. Expenses associated with network power and the cost of electrical power used to operate the telecommunications network are recorded in Account 6531, Power Expense, of the Uniform System of Accounts. The total amount in this account is assigned by the shared and common cost application to an expense bucket called "power" and is excluded from all of the shared and common cost used to determine the shared and common cost factors. The only impact these amounts would have on shared and common cost factors would come from the fact that the expense would be included in the denominator of the common cost factor, thus lowering this factor.

The cost of power produced for house services purposes is charged to Account 6121, Land and Building Expense. This account is subdivided in the shared and common cost study into cost pools for allocation of the expense. Specifically relevant to Mr. Darnell's stated concerns, it is important to note that there is a cost pool for this account that includes expenses related to space leased to others and another cost pool related to BellSouth owned central office buildings. The expense assigned to these two cost pools is excluded from recovery in the shared and common cost factors.

Because neither network power nor power related to house services for BellSouth owned central offices or for space leased to others is recovered through shared and common cost factors, it is clear that Mr. Darnell's concerns are unfounded in these instances. Mr. Darnell's opinion that revenues from leases of building space should be offset against building cost is inappropriate because costs related to leased space are not included in shared and common cost in the first place.

Q. PLEASE EXPLAIN HOW LAND AND BUILDING COSTS ARE TREATED IN THE BELLSOUTH SHARED AND COMMON COST APPLICATION.

A. The capital carrying cost associated with land investment is initially calculated and recorded in the shared and common cost application under Account 2111, Land. This amount is reclassified in the application to Account 2121, Buildings, and is allocated to the various cost pools under the building account. The application accumulates the cost of Company owned land and building investments and the associated land and building expense (Account 6121) into the cost pools specified for Account 2121.

Similar to the treatment discussed previously for power expense, the accumulated capital cost and expenses associated with Company owned land and buildings are assigned to cost pools under Account 2121 which, among other cost pools, includes "leased to others Land and Buildings" and "central office" cost pools. The amounts accumulated for these two cost pools are excluded from shared and common cost in BellSouth's application.

Because land and building costs associated with Company owned central offices and properties leased to others are excluded from the shared and common cost factors, there should be no concern about double recovery. Mr. Darnell's contention that BellSouth should be identifying projected revenues for leased properties to use as an adjustment to offset against common cost is unfounded, because the cost associated with leased space have already been excluded from shared and common cost.

Q. YOU HAVE EXPLAINED THAT MR. DARNELL'S CONCERNS HAVE NO MERIT FOR COMPANY OWNED LAND AND BUILDINGS. IS THERE A PROBLEM WITH LAND AND BUILDING COST ASSOCIATED WITH LOCATIONS WHERE THE COMPANY DOES NOT OWN THE LAND OR BUILDING, BUT RENTS EITHER FROM A THIRD PARTY?

A. Yes. In researching this area of the cost study, BellSouth has discovered that one cost pool under Account 6121 that relates to central office land and buildings rented from others has been inappropriately included in central office shared cost. The appropriate treatment for this cost pool is to exclude the cost from shared cost recovery in the same manner that similar costs are excluded for Company owned central office land and buildings.

Q. HAVE YOU DETERMINED WHAT CHANGES IN SHARED AND COMMON COST FACTORS WOULD RESULT FROM THE EXCLUSION OF THESE COST ASSOCIATED WITH RENTED FACILITIES?

A. Yes. The only factors that would be impacted are the shared cost factors for central office investment. My Rebuttal Exhibit WSR-1 provides a recalculation of these factors for the exclusion of these costs. There would be no change in the common cost factor or any other shared cost factors.

Q. IS MR. DARNELL WRONG IN HIS CONCERN ABOUT DOUBLE RECOVERY OF COSTS FOR BELLSOUTH'S CORPORATE COMMUNICATIONS NETWORK?

A. Yes. None of the direct network related costs of the BellSouth Corporate Communications Network are included in shared and common cost. To the extent there are any indirect costs associated with corporate communications included in shared and common cost, there is also an allocation of these costs to functions such as operator services.

Direct expenses associated with operator services are charged to Account 6621, Call Completion Services, and Account 6622, Number Services. The amount in these accounts is excluded from shared and common cost along with an allocation of indirect cost from other expense or investment accounts. Mr. Darnell's concerns have no substance.

Q. WHAT IS YOUR RESPONSE TO MR. DARNELL'S POSITION THAT BELLSOUTH HAS NOT DEMONSTRATED A NEED OR PROVIDED A REASON TO INCREASE THE COMMON COST FACTOR FROM 5.30% AS DETERMINED IN A PREVIOUS STUDY TO 6.24% AS DETERMINED IN THE CURRENT STUDY?

A. BellSouth explained the major reasons why its common cost factor has increased from 5.30% to 6.24% in response to Staff's 5th Set of Interrogatories, Item No. 61. Whereas, the explanation is rather technical in nature, the most significant impacts causing the increase can be boiled down to changes in cost assignment procedures for computer and software related expenses that result in more of these costs being included in common cost and less in shared cost. Another change that caused an increase in the common factor was the allocation of a portion of billing and collection costs to wholesale. The previous study had assigned 100% of billing and collection cost to retail. The current study assigns some of these costs to wholesale for activities such as carrier access billing and CLEC billing.

The change in assignment for computer and software costs results in a higher common cost factor but it has an offsetting effect due to lower shared cost factors. A review of the shared cost factors shows that the majority of these factors are lower in the current study than in the previous study.

Q. HAVE YOU MADE ANY COMPARISONS WHICH WOULD DEMONSTRATE THE OFFSETTING IMPACTS BETWEEN THE SHARED AND COMMON COSTS AND SHOW THE REASONABLENESS OF YOUR CURRENT STUDY?

A. Yes. My Rebuttal Exhibit WSR-2 shows a comparison of the overall costs by major category between the current BellSouth cost study and the previous study. I obtained the breakdown of cost by category in the previous study from Reid Deposition Late Filed Exhibit No. 7, filed January 20, 1998, in FPSC Docket No. 960833-TP. The current study breakdown comes from the revised study that BellSouth filed in this proceeding on August 16, 2000. The comparison shows that wholesale common cost did increase between the two studies by $177 million but, it also shows that wholesale shared costs decreased by $181 million. Wholesale shared and common cost in total actually decreased by $4 million between the two studies. This certainly demonstrates the reasonableness of the shared and common cost amounts in the study and shows the offsetting nature of some of the cost allocation changes.

REBUTTAL TO MR. BARTA'S POSITIONS

Q. WHAT POSITIONS DOES MR. BARTA TAKE REGARDING BELLSOUTH'S SHARED AND COMMON COST?

A. The most significant adjustment that Mr. Barta proposes to BellSouth's shared and common cost appears on pages 32 and 33 of his rebuttal testimony.

He proposes that the Commission substitute the Commission ordered wholesale percentage discount for BellSouth's calculated amount of retail cost. His calculations for this adjustment are shown on his Exhibit __WJB-2.

In addition, on page 31 of his rebuttal testimony, Mr. Barta opines that he would expect to see lower levels of operating expenses projected on a forward-looking basis assuming the network configurations of the cost proxy models embrace the most efficient, least cost technology and the engineering and operating practices of the carrier reflect productivity enhancements. He does not propose a specific adjustment regarding this issue, but he does provide an exhibit, Exhibit__WJB-1, that shows BellSouth's total operating expenses less depreciation per access line over the period 1991-1999.

Q. IS MR. BARTA'S PROPOSED ADJUSTMENT TO BELLSOUTH'S RETAIL COST REASONABLE?

A. Absolutely not. His adjustment is based on an extremely superficial approach that yields an absurd result. BellSouth conducted a detailed study of 1998 expenses in order to determine the appropriate portion of various accounts to exclude as retail related expense in its cost study. In the Company's shared and common cost application, BellSouth used relationships from its study of 1998 expenses to assign a portion of its projected expenses to direct retail cost. Indirect costs were also allocated to the retail category and excluded from the wholesale cost of UNEs. However, Mr. Barta did not address the components of BellSouth's study. He merely took the Florida residence resale discount factor and applied it to BellSouth's total company projected cost and opined that this represents the amount of retail cost to exclude as retail in BellSouth's study.

Mr. Barta's approach is not a reasonable methodology. The Florida resale discount rates, one for residence and one for business, were determined based on the individual relationships between avoided retail cost and intrastate retail revenues for Florida residence and business operations. The multiplication of Florida's residence resale discount rate times BellSouth's nine-state total forward-looking costs can only result in a meaningless number.

If Mr. Barta had just looked at the underlying data in BellSouth's study, he would have seen that his proposed adjustment was absurd. For example, in BellSouth's revised study, the total projected expenses in the accounts which the FCC has indicated most likely contain retail related costs (Accounts 6611, 6612, 6613, 6621, 6622, and 6623) totals $2,143,822,370. Of this amount, $212,620,641 is for operator services expenses that BellSouth has excluded from its shared and common costs. This leaves $1,931,201,729 of expense in these accounts to separate between wholesale and retail. BellSouth's revised study assigned $1,599,222,134 of this amount to retail. After allocating indirect costs to retail, BellSouth's total retail costs to be avoided per the revised cost study is $2,188,554,658. Mr. Barta's adjustment, which is calculated on his Exhibit__WJB-2, would have the Commission exclude $4,264,360,523 of BellSouth's cost as retail. This amount of retail cost is approximately twice the total in the expense accounts that normally include a portion related to retail. There is no justification for such a proposal.

Q. WHAT ARE YOUR COMMENTS REGARDING MR. BARTA'S STATEMENT ABOUT THE LEVEL OF PROJECTED OPERATING EXPENSES?

A. BellSouth has used a reasonable methodology to project its expenses and investments forward for purposes of its cost study. It is important to note that the purpose for projecting expense and investment is so that forward-looking factor relationships can be developed which are then applied against forward-looking investments (i.e., UNE investments which reflect efficient, least cost technology, etc.). As the Commission noted in Docket No. 960833-TP, Order No. PSC-98-0604-FOF-TP, page 55, the application of the Company's shared and common cost factors to forward-looking investments generates some inherent productivity gains. Mr. Barta apparently has not recognized this fact.

Q. WHAT INFORMATION DOES MR. BARTA'S REBUTTAL EXHIBIT__WJB-1 CONVEY?

A. His exhibit depicts a chart of BellSouth's total operating expense less depreciation per access line for each year from 1991 through 1999. The data indicates that the expenses per access line were relatively flat from 1991 until 1995 and then declined each year from 1995 through 1999. Because BellSouth was in a major reengineering effort from 1995 until approximately 1998 and because there was a major software accounting change that shifted expenses to capital in 1999, the declining trend is understandable. However, merely looking at trends such as this and making forecasts of the future is very risky. For this reason, BellSouth's projection methodology normalizes a current year for unusual events and then utilizes major expense drivers such as inflation, productivity and demand growth to project forward. This is a reasonable approach not withstanding any comment by Mr. Barta to the contrary.

Q. DOES THIS COMPLETE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

Account Number	Account Desc.	Category/Cost Pool Desc	As Reported Total Shared Cost	Average Investment	As Reported Shared Cost Factor	Revised Shared Cost	Revised Shared Cost Factor
2211	Analog Elect Sw	Analog Electronic Switching	$85,236,847.27	$1,348,225,722.07	0.0632	$ 77,261,751.02	0.0573
2212	Digital Elect Sw	Digital Electronic Switching	$184,546,141.71	$10,089,987,978.65	0.0183	$ 168,375,700.62	0.0167
2220	Operator Systems	Operator Systems	$3,679,494.67	$165,279,933.52	0.0223	$ 3,326,036.05	0.0201
2231	Radio Systems	Radio Systems	$1,548,350.12	$82,075,994.48	0.0189	$ 1,399,941.65	0.0171
2232	Circuit Equipment	Analog Circuit - Other	$8,969,452.09	$432,414,834.34	0.0207	$ 8,128,995.44	0.0188
2232	Circuit Equipment	Analog Circuit - Pair Gain	$9,727.80	$41,293.72	0.2356	$ 9,166.07	0.2220
2232	Circuit Equipment	Digital Circuit - DDS	$1,993,949.32	$97,269,967.13	0.0205	$ 1,818,253.74	0.0187
2232	Circuit Equipment	Digital Circuit - Pair Gain	$132,842,375.46	$7,092,128,655.00	0.0187	$ 121,381,954.10	0.0171
2232	Circuit Equipment	Digital Circuit - Other	$91,500,006.98	$5,115,127,863.38	0.0179	$ 83,311,600.36	0.0163

Note: "As Reported" amounts are from the Revised BellSouth Cost Study filed on August 16, 2000.

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SHARED AND COMMON COST COMPARISON

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Cost Category	Previous Study #	Current Study @	Difference
Wholesale Common Cost	842,049	1,019,148	177,099
Wholesale Shared Cost	1,529,546	1,348,603	(180,943)
Subtotal Shared and Common Cost	2,371,595	2,367,751	(3,844)
Retail Cost	1,926,592	2,188,555	261,963
Other Wholesale Cost	2,274,009	1,848,502	(425,507)
Total Costs excl'd plant specific cost	6,572,196	6,404,808	(167,388)
Plant Specific Costs	12,088,509	13,129,597	1,041,088
Total Costs in the Study	18,660,705	19,534,405	873,700

Previous Study was BellSouth Cost Study filed in FPSC Docket No. 960833-TP
@ Current Study was Revised BellSouth Cost Study filed in FPSC Docket No. 990649-TP on August 16, 2000.