Exhibit No.: ________________
Issues: Section 392.245.9
Commenter/Type of Exhibit: Thomas M. Regan/Reply Comments
Sponsoring Party: Public Counsel
Case No.: TR-2002-251

REPLY COMMENTS

OF

THOMAS M. REGAN

Submitted on Behalf of the Office of the Public Counsel

May 28, 2004

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NOTE: ** DENOTES PROPRIETARY INFORMATION **

NOTE: ** DENOTES HIGHLY CONFIDENTIAL INFORMATION **

I. INTRODUCTION AND STATEMENT OF QUALIFICATIONS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Thomas M. Regan. My business address is 8625 Farmington Cemetery Road, Pleasant Plains, Illinois 62677.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am an economist with the firm of William Dunkel and Associates (WDA). I have been employed by William Dunkel and Associates since 1994. Since that time, I have regularly provided professional consulting services in telephone regulatory proceedings throughout the country. In addition, I have provided expert witness testimony in regulatory proceedings in several states, with respect to economic costing principles, including those relating to the proper calculation of long-run incremental costs. The proper calculation of long-run incremental costs for telecommunications services is a key issue that I discuss in these Reply Comments.

Q. HAVE YOU PREPARED AN APPENDIX THAT DESCRIBES YOUR QUALIFICATIONS?

A. Yes. My qualifications are shown on Appendix A.

Q. ON WHOSE BEHALF ARE YOU PROVIDING THESE REPLY COMMENTS?

A. I am providing these Reply Comments on behalf of the Missouri Office of the Public Counsel (OPC).

Q. WHAT IS THE PURPOSE OF THESE REPLY COMMENTS?

A. The purpose of these Reply Comments is to reply to Staff's Response to Office of the Public Counsel's Statement and Arguments ("Staff's Response to OPC") and Sprint's Response to Testimony of Barbara A. Meisenheimer ("Sprint's Response to OPC").

II. THE STAFF'S "ALLOCATED COST" ANALYSIS DOES NOT COMPLY WITH THE REQUIREMENTS.

Q. ON PAGE 2 OF ITS RESPONSE TO OPC, THE STAFF STATES "AFTER RE-ALLOCATING THE LOOP COSTS TO OTHER SERVICES, SPRINT STILL MEETS THE STATUTORY TEST FOR REBALANCING". IS AN "ALLOCATED COST" ANALYSIS THE APPROPRIATE "STATUTORY TEST" FOR REBALANCING?

A. No. Section 392.245.9 states that a Long Run Incremental Cost test, not an "allocated cost" test, should be performed to determine whether rebalancing would be allowed. Section 392.245.9 states,

> If the Commission determines that the company's monthly maximum allowable average statewide prices for basic local telecommunications service after adjustment pursuant to this subsection will be equal to or less than the long run incremental cost, as defined in

> section 386.020, RSMo, of providing basic local telecommunications services and that the company's intrastate access rates after adjustment pursuant to this subsection will exceed the **long run incremental cost**, as defined in section 386.020, RSMo, of providing intrastate access services... (emphasis added)

Q. ON PAGE 3 OF ITS RESPONSE TO OPC, SPRINT QUOTES SECTION 386.020(32) OF THE STATUTE, WHICH DEFINES LONG RUN INCREMENTAL COST. ACCORDING TO THE PORTION OF THE STATUTE SPRINT QUOTES, WHAT COSTS ARE EXCLUDED FROM THE LONG RUN INCREMENTAL COST?

A. The portion of the Statute Sprint quotes indicates that any costs that are "not brought into existence as a direct result of the increment of the output" are excluded from the long run incremental cost of the service. The portion of the Statute Sprint refers to, specifically states:

> "Long-run incremental cost", the change in total costs of the Company of producing an increment of output in the long run when the company uses least cost technology, and <u>excluding any costs that, in the long run, are not brought into existence as a direct result of the increment of output</u>.[1] (emphasis added)

Q. HOW DO YOU DETERMINE IF A COST IS "BROUGHT INTO EXISTENCE AS A DIRECT RESULT" OF A SERVICE?

A. A cost is brought into existence as a direct result by the provision of a particular service, if the cost would be avoided if that service is eliminated, while the provision of all other services remains constant. The Staff described this concept in Docket TR-2001-65, when the Staff's witness described how the TSLRIC is calculated:

[1] Missouri Revised Statutes, Chapter 386, Public Service Commission, Section 386.020(32).

> The total service long run incremental cost (TSLRIC) of a service (or group of services) is equal to the firm's total cost of producing all its services including the service (or group of services) in question, minus the firm's total cost of producing all its services <u>except</u> the service (or group of services) in question. Thus, it is a particular form of long run incremental cost (LRIC), in which the specified increment is the entire volume of output of a particular service, while all other services remain unchanged.[2]

Q. ARE THE COSTS OF FACILITIES THAT ARE USED BY MULTIPLE SERVICES, BROUGHT INTO EXISTENCE AS A DIRECT RESULT BY THE PROVISION OF ANY SINGLE PARTICULAR SERVICE THAT USES THOSE FACILITIES?

A. No. In fact, in Docket TR-2001-65, the Staff's witness specifically indicated that the cost of facilities that are used to provide multiple services "drop out of the TSLRIC". The Staff in that proceeding indicated that in the case of telecommunications services, much of the facilities that are used to provide services are used by multiple services. Therefore, the TSLRIC costs of individual telecommunications services are generally very low. The Staff's witness stated:

> In effect, TSLRIC measures the difference between producing a service and not producing it. The difference may not include certain of the firm's joint or common costs; hence, a firm that recovers in its prices only the TSLRIC of its services may find that its total revenues fall short of its total costs. In the case of telecommunications services, the magnitude of this shortfall can be substantial, because these services use many of the same network facilities. Where facilities are required if any one of several services is produced, the portion of the firm's total cost attributable to the facility in question (or, at least certain portions of that

[2] Direct Testimony of Staff witness Ben Johnson in Docket TR-2001-65, page 8, lines 15-20.

> cost) may not vary with the presence or absence of any single service. Where this phenomena exists, the cost in question drops away from the TSLRIC calculations, and thus the TSLRIC of each individual service will be quite low.[3]

Q. CAN YOU GRAPHICALLY DEMONSTRATE WHAT NETWORK FACILITIES ARE USED TO PROVIDE MULTIPLE SERVICES, AND ARE THEREFORE EXCLUDED FROM THE PROPERLY CALCULATED LRIC OF EACH OF THE SERVICES THAT USES THOSE FACILITIES?

A. Yes. Schedule WDA-1 displays the major facilities that are required to provide toll, switched access, vertical and basic local services. As this Schedule shows, a loop facility, a port facility and a NID are all required to provide all of these services, and are shared by those services. As previously discussed, the properly calculated LRIC of a service will not include any of the costs of facilities that are shared by that service and another service(s). Therefore, the loop costs, the port costs and the NID[4] costs should not be included in the properly calculated LRIC of any of the services that share those facilities.

Only those costs that are avoided when the service in question is discontinued, holding constant the production of all other services, are properly included as part of the LRIC of that service. The costs of the loop, port and NID facilities would not be avoided if a

[3] Direct Testimony of Staff witness Ben Johnson in Docket TR-2001-65, page 9, beginning at line 16.
[4] While not labeled separately, the "loop" facility shown on Schedule WDA-1 includes the feeder, distribution, drop and NID. Therefore, the NID facility is included in what is shown as "loop" on Schedule WDA-1.

service were to be discontinued from a network that continued to provide all other services that use the loop, port and NID. For example, if toll service were to be eliminated, but the company continued to provide switched access, vertical services and basic local service, the costs of the loop, port and NID facilities would not be avoided, because the loop, port and NID facilities would continue to be required to provide switched access, vertical services and basic local service. Therefore, the loop, port and NID facilities costs are not properly considered to be brought into existence as a direct result of toll services, and are therefore not included as part of the LRIC of toll services.

Similarly, if basic local service were to be eliminated, but the company continued to provide toll, switched access and vertical services, the costs of the loop, port and NID facilities would not be avoided, because the loop, port and NID facilities would continue to be required to provide toll, switched access and vertical services. Therefore, the loop, port and NID facilities costs are not properly part of the LRIC of basic local services either. The fact is that if any one of the services that share the loop, port and NID facilities are eliminated, while other services that share the loop, port and NID facilities continue to be provided, the costs of the loop, port and NID facilities will not be avoided. Therefore, the costs of the loop, port and NID facilities are not properly considered to be "brought into existence as a direct result of", or included in the LRIC of any one service that shares the loop facilities.

The loop, port and NID facility costs are caused by the whole family of services shown on Schedule WDA-1, not by just one service. The company could avoid the loop, port and NID facility costs only if they discontinued providing the whole family of services, not by discontinuing just one service.[5]

Q. IN A RECENT PROCEEDING, DID THE MISSOURI STAFF PROPERLY RECOGNIZE THAT THE LOOP FACILITY IS A SHARED COST THAT IS NOT INCLUDED IN THE TSLRIC OF BASIC LOCAL SERVICE?

A. Yes. In Case No. TR-2001-65, the Staff's witness specifically stated that the loop facility is a "common or shared cost".[6] In that same Case, the Staff cited numerous Orders from other state commissions supporting the position that the loop facility is a shared or common cost.[7] In addition, the Staff specifically cited several orders from other state commissions that specifically indicated that the cost of the loop facility is not included in the properly calculated TSLRIC of basic local service. The Staff quoted from an Order of the Washington Utilities and Transportation Commission, where the Washington Commission held:

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[5] If another company had loop, port and NID facilities in the area, a company could "rent" those facilities provided by others, but those facility cost would still exist. The cost of facility "ownership" is replaced by the facility "rental" cost.
[6] Case No. TR-2001-65, Surrebuttal Testimony of Ben Johnson, page 65, lines 22-23.
[7] Case No. TR-2001-65, Surrebuttal Testimony of Ben Johnson, beginning at page 65, line 24.

> [T]he cost of the local loop is not appropriately included in the incremental cost of local exchange service. The local loop facilities are required for nearly every service provided by the Company to a customer. Neither local service nor in-state long distance service nor interstate long distance nor vertical features can reach a customer without the local loop. Should USWC cease to provide any one of these services, its need for a local loop to provide the remaining services would remain. The cost of the local loop, therefore, is not incremental to any one service. It is a shared cost that should be recovered in the rates, but no one service is responsible for that recovery. USWC's presentation that the local loop is appropriately and necessarily an element of the cost of local exchange service, made through the testimony of witness Farrow, is not credible in light of the purposes of a long run incremental cost study and is inconsistent with accepted economic theory regarding such studies.[8]

In that same recent proceeding, the Staff also quoted from a Commission Order in the State of Colorado. The Commission in that state found:

> Loop costs are shared and common and should be covered by all the services using the loop.... The inclusion of loop costs in the TSLRIC for basic exchange service violates the definition of TSLRIC in the (Colorado) Commission's Costing and Pricing Rules.... Loop costs would not be avoided if basic exchange services were eliminated and the provision of all other services continued. The network would still be a part of USWC's costs even if basic local exchange service were discontinued.[9]

Q. ON PAGE 2 OF ITS RESPONSE, SPRINT REFERS TO THE STAFF'S POSITION IN DOCKET TR-2001-65 AS BEING "UNRELATED" TO THIS CASE. IS THE STAFF'S POSITION IN THAT DOCKET "UNRELATED" TO THIS CASE?

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[8] Commission Decision and Order Rejecting Tariff Revisions, Docket No. UT-950200, p. 78. This quote appeared on page 66 of Staff witness Dr. Johnson's Surrebuttal Testimony in Case No. TR-2001-65.

[9] Commission Order in Docket No. 96S-257T, issued January 27, 1997. This quote appeared on page 67 of Staff witness Dr. Johnson's Surrebuttal Testimony in Case No. TR-2001-65.

A. No. The definition of LRIC has not changed. As I have already discussed, in Docket TR-2001-65, the Staff specifically identified the loop cost as being a shared cost of a number of different services. In addition, in that same recent proceeding, the Staff supported the position that the cost of the loop facility is not included in the calculation of the LRIC of basic local service. The cost of Sprint's loop facilities, and how they should be treated when calculating the LRIC cost of basic local service is a key issue in this proceeding. The Staff's proposed LRIC costs in this proceeding include loop costs in the alleged "LRIC" of basic local service. Therefore, the Staff's proposed costs in this proceeding contradict the position the Staff has taken in another recent proceeding.

Q. ON EXHIBIT 4 OF APPENDIX B TO THE "STAFF'S RESPONSE TO OPC", THE STAFF SHOWS A COLUMN HEADED "SPRINT'S LRIC OF BASIC LOCAL". ARE ANY OF THE COSTS SHOWN IN THIS COLUMN THE PROPERLY CALCULATED LONG RUN INCREMENTAL COST (LRIC) OF BASIC LOCAL SERVICE?

A. No. None of the costs shown in the column headed "Sprint's LRIC of Basic Local" are the properly calculated LRIC of basic local service. Each of the costs shown in this column improperly include some allocated portion of the costs of the loop, port and NID facilities that are shared by multiple services. The properly calculated LRIC of a service completely excludes the costs of facilities that are shared by more than one service.

Therefore, every calculation of basic local service cost that the Staff has analyzed and used to determine Sprint's compliance with the Missouri Statute are not the LRIC or TSLRIC, and is therefore invalid. None of the costs that the Staff has used in its analysis comply with the Missouri Statute's requirement to use the LRIC costs of basic local service as the basis for determining whether Sprint's proposed rebalancing is appropriate.

The first cost shown under the heading "Sprint's LRIC of Basic Local" is Sprint's proposed LRIC for basic local service, which is ** ______ *. As indicated on page 4 of Appendix B of the "Staff's Response to OPC":

> Sprint's Basic Local Service Long Run Incremental Cost Studies allocate a large portion of the loop, NID, switch port and common costs to the intrastate jurisdiction.

Therefore, Sprint's proposed cost of basic local service includes a large portion of the costs of shared facilities[10] and common costs. This is not a valid LRIC cost calculation. Costs of facilities that are shared by multiple services and costs that are "common" to Sprint are clearly not reflective of costs that are brought into existence as a direct result of basic local service (LRIC). According to the Missouri Statute, the costs that are not brought into existence as a direct result of the service in question should be excluded from the LRIC of that service.

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[10] Sprint's proposed basic local service cost includes all of the "intrastate" portion of Sprint's proposed loop and port facility costs.

The other costs that the Staff shows on its Exhibit 4 under the heading "Sprint's LRIC of Basic Local" use the Sprint proposed basic local service "LRIC" as a starting point. From that starting point, the Staff makes a number of cost recalculations for the "Sprint LRIC of Basic Local" after making varying allocations of the loop, port and NID costs to intrastate access service. However, none of those allocations completely remove those shared facilities costs. Therefore, these are not valid LRIC cost calculations. The Staff has calculated an "allocated cost" of basic local service, not the LRIC of basic local service. The Staff's revised calculations still include a large portion of the costs of shared facilities and common costs. Therefore, since the Staff has calculated a form of an "allocated cost" of basic local service and not a LRIC cost, the Staff has not performed a valid test of Sprint's compliance with the "Statutory Test".

III. REGULATORS, INCLUDING THE FCC, HAVE PROPERLY FOUND THE LOOP COST IS A SHARED OR COMMON COST.

Q. ON PAGE 2 OF APPENDIX B OF "STAFF'S RESPONSE TO OPC", STAFF WITNESS MR. THOMAS STATES:

> **IT SHOULD COME AS NO SURPRISE THAT THERE IS LITTLE AGREEMENT AMONG ECONOMISTS UPON WHETHER THE LOOP IS A DIRECT COST OF LOCAL SERVICE OR A SHARED AND COMMON COST OF SPRINT'S OPERATION. THIS IS A PHILOSOPHICAL DEBATE THAT THE COMMISSION HAS NOT ADDRESSED AND IN STAFF'S OPINION DOES NOT NEED TO ADDRESS TO MAKE A FINDING THAT SPRINT'S COST STUDIES**

SUPPORT THE RATE-REBALANCING PROPOSED IN THE PRESENT TARIFF.

DO MOST REGULATORS VIEW THE LOOP AS A SHARED OR COMMON COST OF PROVIDING TELECOMMUNICATIONS SERVICES?

A. Yes. The "philosophical debate" that Mr. Thomas refers to is generally between regulatory authorities (who generally view the loop as a shared facility) and those individuals representing telephone companies (who generally allege the cost of the loop facility is a cost of basic local service). The Staff pointed out in Docket TR-2001-65, that telephone companies have been advocating treating loop costs as a direct cost of basic local service for decades, yet regulatory authorities have repeatedly rejected those proposals, and have generally properly found that the loop facility is a shared cost of providing a whole family of telephone services.[11]

That view is generally shared by regulators. For example, the National Association of Regulatory Utility Commissioners (NARUC) has stated that:

> Interexchange carriers should pay a portion of the NTS loop cost because they use the LECs loop to provide their services.[12]

[11] Case No TR-2001-65, Surrebuttal Testimony of Dr. Johnson, beginning on page 63.
[12]"NTS" means "non-traffic sensitive." Initial Comments of the National Association of Regulatory Utility Commissioners, CC Docket No. 96-262 et al., January 29, 1997, page 13.

Q. HAS THE FCC SPECIFICALLY INDICATED THAT THE LOOP FACILITIES ARE NOT CAUSED AS A DIRECT RESULT OF PROVIDING LOCAL SERVICE?

A. Yes. The FCC has specifically indicated that the loop facilities are not directly caused by any single service, because all of the loop facilities would be required even if they were only used to provide local service, or if they were used only to provide interstate switched access service. The FCC specifically stated:

> By contrast, the costs of other facilities used for both interstate and intrastate traffic do not vary with the amount of traffic carried over the facilities, *i.e.*, the costs are non-traffic-sensitive. These costs pose particularly difficult problems for the separations process: The costs of such facilities cannot be allocated on the basis of cost-causation principles because all of the facilities would be required even if they were used only to provide local service or only to provide interstate access services. A significant illustration of this problem is allocating the cost of the local loop, which is needed both to provide local telephone service as well as to originate and terminate long-distance calls.[13] (citations omitted)

In another document, the FCC stated:

> [I]nterstate access is typically provided using the same loops and line cards that are used to provide local service. The costs of these elements are, therefore, common to the provision of both local and long-distance services.[14]

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[13]¶23, First Report and Order, CC Docket No. 96-262, FCC 97-158, adopted May 7, 1997, released May 16, 1997 (hereinafter referred to as *Access Charge Reform Order*).

[14]¶ 237, Notice of Proposed Rulemaking, Third Report and Order, and Notice of Inquiry, CC Docket No. 96-262 et al., adopted December 23, 1996 and released December 24, 1996.

IV. SPRINT'S PROPOSED RATE REBALANCING FAILS TO PASS THE STATUTORY TEST. SPRINT'S CURRENT BASIC LOCAL RATES ARE ALREADY WELL IN EXCESS OF THE PROPERLY CALCULATED LRIC OF BASIC LOCAL SERVICE.

Q. ON PAGE 10 OF APPENDIX B TO THE "STAFF'S RESPONSE TO OPC", THE STAFF CLAIMS THAT SPRINT'S BASIC LOCAL SERVICE RATES ARE LESS THAN THE LRIC OF SPRINT'S BASIC LOCAL SERVICE. ARE SPRINTS BASIC LOCAL SERVICE RATES LESS THAN THE LRIC OF BASIC LOCAL SERVICE?

A. No. The Staff calculated the "allocated cost" of basic local service. The Staff did not calculated the LRIC of basic local service. If Sprint's basic local service were eliminated, while Sprint continued to provide toll, switched access and vertical services, Sprint would only avoid the costs of local usage (and possibly some small incremental costs for billing, collection, etc). Therefore, the properly calculated LRIC of Sprint's basic local service is limited to local service usage costs, and possibly some small incremental costs for billing and collection. Sprint's proposed TSLRIC Cost for local usage is ** _____ * for residence and ** _____ * for business, as shown on Schedule WDA-2. Therefore, Sprint's LRIC of basic local service is less than ** _____ * per month.

Sprint's current basic local rate is ** _____ * for residence and ** ______ * for business, as shown on Schedule WDA-3. Therefore, Sprint's current basic local service

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rates greatly exceed the LRIC of basic local service. As a result, Sprint's proposed rate rebalancing is prohibited under the Missouri Statute.

Said another way, if Sprint stopped providing basic local service, but continued to provide all other services, Sprint would avoid less than ** _____ ** per line, per month in costs, but would lose between ** ______________ * per line, per month in revenue, in the long-run. The obvious conclusion is that Sprint is better off providing basic local service than Sprint would be not providing it.

V. IN ADDITION TO THE FACT THAT STAFF HAS PERFORMED AN ALLOCATED COST ANALYSIS RATHER THAN AN LRIC COST ANALYSIS FOR BASIC LOCAL SERVICE, THE STAFF'S ALLOCATED COST ANALYSIS CONTAINS A NUMBER OF FLAWS.

Q. ON EXHIBIT 4 OF APPENDIX B TO THE "STAFF'S RESPONSE TO OPC", THE STAFF CALCULATED WHAT IT REFERS TO AS "LRIC SERVICE STUDIES" FOR LOCAL SERVICE. IN THIS ANALYSIS, THE STAFF HAS MADE ALLOCATIONS OF THE LOOP, NID AND PORT COSTS TO INTRASTATE ACCESS SERVICE. ARE THERE SERIOUS FLAWS IN THE STAFF'S ANALYSIS?

A. Yes. There are a number of serious flaws in the Staff's analysis. First of all, as I have already discussed, the Staff's analysis is calculating the "allocated cost" of basic local service, not the LRIC of basic local service. The LRIC is the cost that is relevant to the Missouri Statute, not a form of "allocated cost". The LRIC of a service does not include allocated portions of shared costs or common costs, as the Staff's proposed "allocated cost" analysis does. The properly calculated LRIC of a service excludes all shared and common costs.

In addition to the fact that an "allocated" cost is not relevant to the Statutory test at issue in this proceeding, the Staff's "allocated" cost is not a reasonable calculation of the "allocated" cost of basic local service. The Staff's analysis allocated Sprint's proposed loop and port costs. Sprint's proposed loop and port costs are grossly inflated, and should not be cost figures used in an "allocated cost" analysis.

In addition, the Staff's "allocated cost" analysis allocates 0% of the intrastate loop, NID and port costs to local vertical services. Local vertical services share the loop, NID and port and should make a contribution toward the recovery of the shared loop, NID and port costs. For example, Caller ID is a generally popular vertical service that shares the loop, NID and port facilities. Therefore, it is improper to allocate all of the "local" portion of the loop, NID and port costs to just "basic" local service, when calculating an "allocated cost" of basic local service.

Q. ON EXHIBIT 4 OF APPENDIX B TO THE "STAFF'S RESPONSE TO OPC", THE STAFF ALLOCATED SPRINT'S PROPOSED LOOP COSTS IN THE STAFF'S "ALLOCATED COST" OF BASIC LOCAL SERVICE ANALYSIS. WHAT LOOP COST IS USED IN SPRINT'S PROPOSED LOCAL SERVICE COST?

A. Sprint used an unseparated[15] residential loop cost of ** ______ ** and an unseparated business loop cost of ** ______ *. The weighted average unseparated loop cost proposed by Sprint is ** ______ *.[16]

Sprint's proposed unseparated loop costs are shown on Schedule WDA-2, which contains copies of pages from Appendix B of the "Staff Recommendation" filed on December 5, 2001 in this proceeding.

Q. WHAT UNSEPARATED LOOP COST DID THE STAFF RECENTLY CALCULATE FOR SPRINT MISSOURI IN DOCKET TR-2001-65?

A. In Case No. TR-2001-65, the Staff calculated an unseparated loop cost of ** ______ * for Sprint in Missouri.[17] The Staff workpaper that shows this loop cost is attached hereto as Schedule WDA-4.[18]

[15] For purposes of calculating its "LRIC" of Basic Local Service, Sprint allocated 25% of the unseparated loop costs to the interstate jurisdiction and the remaining 75% of the unseparated loop costs to the intrastate jurisdiction. Sprint's has allocated all of the intrastate loop costs to basic local services in its calculation of the "LRIC" of basic local service.

[16] In order to obtain the weighted average cost, I used the same weightings Staff used in this proceeding to obtain its weighted average cost for the intrastate portion of the loop, which is shown on Exhibit 2 of Appendix B of "Staff's Response to Office of the Public Counsel's Statement and Arguments." A copy of the Staff's Exhibit 2 is also attached hereto as Schedule WDA-3.

Therefore, Sprint's proposed unseparated loop cost in this proceeding is approximately ** ____ ** higher than the Staff's very recently calculated unseparated loop cost for Sprint in Missouri.[19] This casts considerable doubt on the accuracy and reliability of Sprint's proposed loop costs in this proceeding.

Q. WHAT IS SCHEDULE WDA-5?

A. Schedule WDA-5 is a graphical comparison of Sprint's proposed loop cost in this proceeding to the loop cost the Staff recently calculated for Sprint in Missouri.

Q. WHAT DO YOU CONCLUDE FROM YOUR ANALYSIS?

A. I conclude that Staff's very recently calculated cost of Sprint's loop cost demonstrates that the loop costs Sprint proposes in this proceeding is not reasonable. Sprint's proposed loop cost is approximately ** ____ * higher than the Staff's recent calculation of Sprint's loop costs. Therefore, since the Staff's "allocated cost" of basic local service allocates Sprint's proposed loop costs, the Staff's "allocated cost" of basic local service is an inflated calculation of the "allocated cost" of basic local service for Sprint in Missouri.

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[17] The Staff's loop cost calculation in that proceeding was used in the Staff's calculation of Sprint's "Common Line Loop + Port Costs per switched access minute" costs that appear on page 2 of Schedule 1 of Staff witness Dr. Ben Johnson's Direct Testimony in that proceeding.[17] I have attached this page hereto as Schedule WDA-6. The Staff's Direct Testimony in that proceeding was filed in July, 2002.
[18] Staff provided this workpaper in its response to OPC Data Request No. 2 in this proceeding.
[19] ** ______ * divided by ** ______ * = ** _____ **.

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Q. YOU HAVE JUST DEMONSTRATED THAT THE LOOP COSTS THE STAFF RELIED UPON IN ITS "ALLOCATED COST" OF BASIC LOCAL SERVICE ANALYSIS ARE INFLATED. IS THERE A SIMILAR PROBLEM FOR THE COSTS OF THE PORT USED IN THE STAFF'S "ALLOCATED COST" OF BASIC LOCAL SERVICE ANALYSIS?

A. Yes. The Staff "allocated cost" of basic local service allocates Sprint's proposed port costs. The port costs that Sprint proposes in this proceeding are inflated.

Sprint has proposed a port facility cost of ** _____ * for both business and residence ports. Sprint's proposed port costs are shown on Schedule WDA-2, which contains copies of pages from Appendix B of the "Staff Recommendation" filed on December 5, 2001 in this proceeding.

Sprint's proposed port cost is greatly in excess of the Staff's recently calculated cost of Sprint's port costs in Missouri. In Case No. TR-2001-65, the Staff calculated a port cost of ** _____ ** for Sprint in Missouri. The Staff workpaper that shows this port cost is attached hereto as Schedule WDA-4.[20] Therefore, Sprint's proposed port cost in this proceeding is more than ** ______ * the Staff's very recently calculated port cost for Sprint

[20] Staff provided this workpaper in its response to OPC Data Request No. 2 in this proceeding.

in Missouri.[21] Since the Staff's "allocated cost" of basic local service allocates Sprint's inflated port costs in its "allocated cost" analysis, the Staff's "allocated cost" of basic local service is also inflated.

<u>VI. REPLY TO SPRINT'S EXCUSES FOR INCLUDING THE COSTS OF THE LOOP FACILITY IN THE LRIC OF BASIC LOCAL SERVICE.</u>

Q. ON PAGE 3 OF "SPRINT'S RESPONSE TO OPC", SPRINT STATES:

> **[T]HE LOCAL LOOP IS A COST THAT IS BROUGHT INTO EXISTENCE AS A DIRECT RESULT OF OFFERING BASIC LOCAL SERVICE AS EACH UNIT OF BASIC LOCAL SERVICES SOLD REQUIRES A LOOP.**

IS BASIC LOCAL SERVICE THE ONLY SERVICE THAT "REQUIRES A LOOP"?

A. No. Schedule WDA-1 displays the major facilities that are required to provide toll, switched access, vertical and basic local services. As this Schedule shows, a loop facility is required to provide all of these services, and is shared by those services. Therefore, it is clear that the loop is a cost that is brought into existence to provide a whole family of services, not just any single service that requires the loop.

Q. ON PAGE 4 OF "SPRINT'S RESPONSE TO OPC", SPRINT STATES:

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[21] ** _____ * divided by ** _____ * = ** ____ *.

IF A CUSTOMER REQUESTS BASIC LOCAL SERVICE, SPRINT IS REQUIRED TO PLACE A LOOP TO THAT CUSTOMER'S HOME AND OFFER TWO-WAY SWITCHED LOCAL SERVICE WITHIN A LOCAL CALLING SCOPE. ONLY AFTER THAT CUSTOMER ESTABLISHES BASIC LOCAL SERVICE WILL INTEREXCHANGE CARRIERS WANT TO RECEIVE EXCHANGE ACCESS TO THAT CUSTOMER.

IS THIS A VALID EXCUSE?

A. No. First of all, it is highly unlikely that customers calling Sprint obtain only "basic local service". When the customer establishes telephone service, they establish the ability to place and receive local calls, as well as the ability to place and receive toll calls. In fact, when a customer calls Sprint to order telephone service, the customer is asked to select a Primary Interexchange Carrier (PIC) to be that customer's primary intraLATA toll service provider, and the customer is also asked to select a PIC to be that customer's primary interLATA toll service provider. Therefore, the customer's toll service is established at the same time that the customer's basic local service is established. In addition, the customer service representative handling the customer's order generally also asks the customer what vertical features the customer would like to receive (e.g. the customer service representative may ask if the customer would like Caller I.D. or Call Waiting, or a certain package of vertical features).

Secondly, at the time a customer decides to order telephone service, Sprint does not run out to a residential subdivision and "place a loop to that customer's home". When a customer orders telephone service, an existing spare loop is made active. For residential customers in residential subdivisions, the major loop costs are actually incurred as a result of the facilities installation at the time a developer developed the subdivision. That may have been months, years, or even decades prior to the time when a particular customer decides to subscribe to telephone service. It is not uncommon for a "new customer" who moves into a home to be provided services using a loop facility that is 10, 15, 20, or more years old.

In addition, a telephone company's decision to install loop facilities in a given area is not based just upon the potential basic local service revenues. When the loop costs are installed, the company installing those facilities considers <u>all</u> of the revenues of all of the services these loops will provide, not just residential basic local service revenues.

Q. ON PAGE 5 OF "SPRINT'S RESPONSE TO OPC", SPRINT STATES THAT THE LEGISLATION'S AUTOMATIC RATE REBALANCING OF $1.50 IS INTERNALLY INCONSISTENT WITH "ESTABLISHING A STANDARD THAT WOULD KEEP THE PRICE OF BASIC LOCAL TELECOMMUNICATIONS SERVICE BELOW THE LRIC COST OF THE SERVICE". IS THERE ANY LEGISLATIVE STANDARD TO "KEEP THE PRICE OF BASIC LOCAL TELECOMMUNICATIONS SERVICE BELOW THE LRIC COST OF THE SERVICE"?

A. No. Sprint's current basic local service rates are well above the LRIC of basic local service, as previously discussed. The legislation clearly makes "LRIC" the appropriate cost standard, not "allocated costs".

<u>VII. IF SPRINT'S ACCESS RATES ARE TOO HIGH, THEY MAY BE TOO HIGH DUE TO SPRINT'S HIGH EARNINGS.</u>

Q. ON PAGE 10 OF APPENDIX B OF THE "STAFF'S RESPONSE TO OPC", THE STAFF STATES "SPRINT'S COST FOR INTRASTATE ACCESS SERVICE IS SIGNIFICANTLY LESS THAN SPRINT'S RATE FOR INTRASTATE ACCESS RATES EVEN AFTER ALL FOUR REBALANCINGS." IF IT IS DETERMINED THAT SPRINT'S ACCESS CHARGES ARE TOO HIGH, WHAT IS A POSSIBLE EXPLANATION FOR THOSE RATES BEING TOO HIGH?

A. If Sprint's access charges are too high, a possible explanation for that is Sprint's intrastate access charges are supporting high earnings for Sprint in Missouri.

The most recent Local Exchange Carrier Annual Report to the Missouri Public Service

Commission indicates that Sprint is earning a ** ** return on equity on the stockholders' investment in telephone service in Missouri.[22]

If Sprint's high earnings were reduced, Sprint could reduce its intrastate switched access charges without raising the rates for any other service, and still enjoy reasonable earnings in Missouri.

If basic local rates are raised as a result of this proceeding, one of the actual reasons for that increase would be to support a continuation of these high earnings for Sprint in Missouri.

Q. IF SPRINT BELIEVES ITS ACCESS RATES ARE TOO HIGH, COULDN'T SPRINT REDUCE THOSE RATES WITHOUT INCREASING BASIC LOCAL SERVICE RATES TO OFFSET THOSE REDUCTIONS?

A. Yes. Sprint is "price cap" regulated. Under "price cap" regulation, Sprint is allowed to set its prices below specified caps. Therefore, if Sprint's switched access rates are excessive, that is due only to the fact that Sprint has decided to maintain those rates at an excessive level. Sprint has the authority to reduce its switched access rates whenever it

[22] Annual Report filed by Sprint May 17, 2004, for the period ending December 31, 2003. The after tax earnings on stockholder investment were ** * (Schedule 7, page 7, of Sprint's Annual Report). The interest on funded debt had already been deducted (same page 7), so this is the return on equity. This figure is divided by the Stockholders Equity of ** ** to show a return on equity of ** *. The report does not separate the earnings between interstate and intrastate jurisdictions, so that breakdown is not available from this data. This return is calculated using data directly from Sprint's Annual Report. I have made no attempt to adjust that data.

wants to under the existing price cap regulation. If Sprint's switched access rates are too high, one obvious reason is because Sprint wants to keep them high to produce high earnings for its stockholders.

Q. DOES THIS CONCLUDE YOUR REPLY COMMENTS?

A. Yes.