Exhibit No:
Issue: Cost
Witness: Rhinehart
Type of Exhibit : Testimony
Sponsoring Party: AT&T Communications of the Southwest, Inc.
Case No: TO-98-115

IN THE MATTER OF AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.'S PETITION FOR SECOND COMPULSORY ARTIBRATION PURSUANT TO SECTION 252(B) OF THE TELECOMMUNICATIONS ACT OF 1996 TO ESTABLISH AN INTERCONNECTION AGREEMENT WITH SOUTHWESTERN BELL TELEPHONE COMPANY

TESTIMONY

OF

DANIEL P. RHINEHART

Jefferson City, Missouri
August 24, 1998

Exhibit No. 2
Date 9-4-98 Case No. TO-98-115
Reporter KF

BEFORE THE PUBLIC SERVICE COMMISSION
OF THE STATE OF MISSOURI

In the Matter of AT&T Communications of the Southwest, Inc.'s Petition for Second Compulsory Arbitration Pursuant to Section 252 (b) of the Telecommunications Act of 1996 to Establish an Interconnection Agreement with Southwestern Bell Telephone Company.	)	Case No. TO-98-115

AFFIDAVIT OF Daniel P. Rhinehart

STATE OF TEXAS)

COUNTY OF TRAVIS)

Daniel P. Rhinehart, of lawful age, being first duly sworn deposes and states:

1. My name is Daniel P. Rhinehart. I am a District Manager for AT&T in its Government Affairs Organization.

2. Attached hereto and made part hereof for all purposes is my Direct Testimony.

3. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Daniel P. Rhinehart
(Name)

Subscribed and sworn to this 21st day of August, 1998

Debra H. McNeil
Notary Public

My Commission Expires: 1-18-2000

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MISSOURI CASE NO. TO-98-115

AT&T COMMUNICATIONS OF THE SOUTHWEST, INC.

DIRECT TESTIMONY OF DANIEL P. RHINEHART

I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Daniel P. Rhinehart. My business address is 919 Congress Ave., Suite 400, Austin, Texas, 78701.

Q. BY WHOM ARE YOU EMPLOYED AND WHAT IS YOUR TITLE?

A. I am employed by AT&T as District Manager - State Government Affairs.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND.

A. I have a Bachelor's degree in Education and a Masters of Business Administration degree. I have attended numerous training courses covering the topics of separations, telephone accounting, and long run incremental costs. I have completed the Brookings Institute course on Federal Government Operations and the University of Southern California Center for Telecommunications Management, Middle Management Program in Telecommunications.

Q. PLEASE DESCRIBE YOUR WORK EXPERIENCE.

A. I began my telecommunications career with Nevada Bell in 1979 and at Divestiture transferred to AT&T. Since 1980 I have had numerous assignments of increasing responsibility where I evaluated telecommunications carrier costs. In 1995, I relocated to Austin, Texas and since early 1996 I have spent the majority of my time evaluating the cost study methodologies employed by Southwestern Bell Telephone Company ("SWBT") and GTE Corp. in the provision of unbundled network elements ("UNEs") pursuant to the Telecommunications Act of 1996. ("the Act"). Prior to my relocation to Texas, I also held the position of vice chairman of the $300 million California Universal Lifeline Telephone Service Trust Fund for approximately two years.

Q. HAVE YOU PREVIOUSLY SPONSORED TESTIMONY IN OTHER REGULATORY PROCEEDINGS?

A. Yes. I have sponsored testimony in Arkansas, Kansas, Missouri, Oklahoma, Texas, and California. Schedule DPR-1 identifies the proceedings in which I have provided testimony and the topics I have addressed.

II. SUMMARY AND RECOMMENDATIONS

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will address some of the findings made by AT&T as it relates to SWBT's labor rates, maintenance and support asset factors, common cost factors, SWBT's use of utilization factors in its CCSCIS model, and a variety of lesser issues.

As a part of this testimony, I will describe some of the processes by which AT&T has replicated many of the cost studies filed by SWBT in other jurisdictions. I will then identify a number of instances where AT&T recommends corrections to the methodologies and inputs SWBT has used in developing cost factors for Missouri. These cost factors translate investments used in the provision of unbundled elements into annual, monthly, or unit costs and without these modifications, SWBT's UNE rates will be overstated.

Q. WHAT IMPORTANT CONCLUSIONS ABOUT SWBT'S COST FACTORS SHOULD THE COMMISSION DRAW FROM YOUR TESTIMONY?

A. As SWBT has been forced to reveal more of its cost development process in other jurisdictions, AT&T has been able to discern and quantify more faults with that process. In fact, AT&T has identified significant double counting of costs in various cost components, but especially between recurring and non-recurring rates and in loaded labor rates. Specifically, SWBT's cost factor development includes SWBT's cost of its own non-recurring customer-originated activities – a fact now admitted by SWBT in other jurisdictions. And, SWBT's loaded labor rate computations double count so-called support assets costs and improperly include non-forward-looking costs of a post retirement benefits accounting change. We have also found that support assets, maintenance, and other cost factors must be modified to correct a

variety of misstatements, and that SWBT's common cost factor development suffers from a number of flaws not previously recognized or considered by this Commission.

Q. WERE ALL OF THESE ISSUES PREVIOUSLY RAISED IN THE ORIGINAL AT&T ARBITRATION, CASE NO. TO-97-40?

A. No. During the first arbitration, AT&T was afforded practically no access to SWBT data for Missouri. As a result, AT&T's analysis was not so nearly well developed as it is today. Indeed, AT&T was given substantially greater access to SWBT data in the states of Texas, Oklahoma, and Kansas. As a result, over the past 18 to 20 months, AT&T has developed significant additional analysis of SWBT's methods and has found many additional corrections to SWBT's present cost studies that should be adopted by this Commission.

Q. WHY DO YOU EMPHASIZE ELIMINATING POSSIBLE DOUBLE COUNTING OF COSTS?

A. Total Element Long Run Incremental Cost ("TELRIC") studies need to focus on counting appropriate costs once and only once. SWBT's methodology persists in counting many costs in two ways and therefore raises the specter of double counted costs. For example, since SWBT's internal retail non-recurring costs are embedded in its recurring cost computations of an item, and unless SWBT's recurring cost factors are reduced, it will be inappropriate to compute and levy separate non-recurring charges. Similarly, since all the costs of general purpose computers are captured in

SWBT's studies through a recurring cost support asset factor, there should be no inclusion of computing-related costs in the development of any other cost, especially non-recurring charges that are the principal focus of this second arbitration. The Commission must endeavor to eliminate all forms of double counting from SWBT's cost studies. Otherwise, AT&T will be forced inappropriately to pay more than is appropriate for UNEs it purchases.

Q. WHAT ARE YOUR PRINCIPAL RECOMMENDATIONS IN THIS CASE?

A. SWBT must be required to restate its loaded labor rates to eliminate double counting of support asset costs and correctly state the support asset costs includable in its operator services labor rates. Labor rates must also reflect the exclusion of retail-type commissions and post-retirement benefit "TBO" costs. SWBT must be required to reduce its recurring cost maintenance factors to reflect the elimination of embedded retail non-recurring costs, just as it has agreed to do so in the recent Kansas generic cost proceeding, and it must be required to reflect a level of avoided testing expense and the exclusion of maintenance-related TBO costs. SWBT's common cost factor must be restated to a forward-looking level of less than 11.5% reflective of long-term declining unit cost trends, the benefits of the SBC/Pacific Telesis merger, the elimination of TBO costs, and the inclusion of "profit" in the denominator of its computation.. SWBT's signaling-related cost study must reflect the correct application of Commission-adopted utilization factors as SWBT has incorrectly used its CCSCIS model in other jurisdictions. Finally, separately identified computer

assets and procurement costs must be excluded from recurring and non-recurring cost studies because these costs are fully included in SWBT's support assets and maintenance factors.

III. THE AT&T COST STUDY REPLICATION PROCESS

Q. WHY HAS AT&T ATTEMPTED TO REPLICATE SWBT'S COST STUDIES IN OTHER JURISDICTIONS?

A. By going through the process of replicating SWBT's cost studies with as many of the corrections for which we had data, AT&T has been able to identify and quantify the impact of many of SWBT's errors and offer to Commissions in other jurisdictions an alternative to SWBT's cost study restatements, which have regularly failed to meet the requirements of those Commissions' orders.

Q. PLEASE BRIEFLY DISCUSS HOW YOU HAVE ATTEMPTED TO REVISE AND REPLICATE SWBT'S COST STUDIES.

A. For the 1997 cost arbitration in Texas, AT&T and MCI contracted with Coopers & Lybrand L.L.P. to develop a mechanism whereby we could replicate SWBT's ACES program and its outputs as well as quickly substitute investment inputs and factors that differ from SWBT's. AT&T also independently developed a spreadsheet-based version of SWBT's loop investment program called LPVST. AT&T used SWBT cost factor spreadsheets as the foundation to build the capability to reflect a variety of

input changes in capital costs and the development of maintenance, support asset, and common cost factors. We used SWBT-supplied PC-based programs to determine switching and signaling system investment values. In other jurisdictions, AT&T was also granted secure access to SWBT main-frame computer-based applications to develop capital cost factors and transport investments.

Q. WHAT IS ACES?

A. ACES, which stands for Automated Cost Extraction Expense System, is a program used by SWBT to convert investment values into annual, monthly, or unit costs via the use of investment factors, capital cost factors and expense factors. Because ACES takes investment values derived from other programs as inputs (e.g., Bellcore's Switch Cost Information System - SCIS), and multiple ACES outputs are frequently combined to produce a single cost study result (e.g., a loop study), ACES is the centerpiece of most of SWBT's cost studies.

Q. WHAT WAS DONE TO ENSURE THAT THE COOPERS & LYBRAND MODEL AND OTHER AT&T WORK ACCURATELY REPLICATED THE SWBT COST STUDY PROCESS?

A. State specific versions of the ACES work-alike program were developed and before any input changes were made by AT&T, we ran the program and manually compared the outputs from SWBT's program to ours. The model results were nearly identical ensuring that the logic of AT&T's ACES program matched the logic of SWBT's

ACES program. This process has been successfully followed previously in Texas, Oklahoma, and, most recently, in Kansas. Similarly, our LPVST work-alike spreadsheet was populated with SWBT data and was shown to duplicate the SWBT unadjusted results. Our cost factors spreadsheets were able to accept a variety of inputs, but when the inputs were reset to the SWBT-proposed values, the outputs replicated SWBT's results.

Q. WHAT DO YOU CONCLUDE FROM YOUR PREVIOUS STATEMENT?

A. AT&T has become intimately familiar with the cost study process generally used by SWBT in its five-state region and because there are limited variations in that process, usually the result of various Commission orders, our general knowledge about the process and the results of previous analysis are applicable to the SWBT studies presented in Missouri. While we cannot specify the exact values of many changes we now recommend, we are certain that the order of magnitude of the changes we will discuss below are correct.

IV. LABOR RATES

Q. PLEASE DESCRIBE YOUR CONCERNS WITH THE DEVELOPMENT OF LABOR RATES BY SWBT.

A. I have identified double counting of support asset costs and one computational flaw in SWBT's labor rate development. SWBT also inappropriately includes certain

historical post retirement benefit costs, called the Transitional Benefit Obligation, in its labor rate development.

Q. DO YOU HAVE ANY OBJECTIONS, IN PRINCIPLE, TO THE DEVELOPMENT OF LOADED LABOR RATES BY SWBT?

A. No. Correctly computed loaded labor rates are necessary to attribute the costs of productive and non-productive time associated with employee activities. I have never disagreed that SWBT is entitled to develop its hourly labor rates on a productive hour basis. I criticize the inputs used to create loaded labor rates on a productive time basis.

Q. WHERE HAVE YOU POSITIVELY IDENTIFIED DOUBLE COUNTING OF SUPPORT ASSET COSTS?

A. SWBT's cost studies include the same support asset costs in both the investment-related ACES support asset factors and in plant-related loaded labor rates. Significant double recoveries will occur wherever AT&T is assessed a rate based on the investment utilized (e.g., a loop, a port, or related cross connects) and is also assessed a non-recurring charge to install or maintain the same investment or to activate a feature. SWBT's recurring rates are designed to recover fully all the proportionate support assets costs and the loaded labor rates are also designed to recover those same costs. If the costs are fully assessed in the recurring rates, they should not also be assessed through the loaded labor rates.

Q. HOW DOES SWBT VIEW ITS COST FACTORS.

A. SWBT witnesses in the recent generic cost proceeding in Kansas made observations about SWBT's cost factors. Perhaps Ms. Lammert says it best:

> [B]y there very nature, the maintenance factors are based on historic costs. This does not imply that the costs identified in the cost studies are then historic costs. It simply means that recent experience as to the relationship between expenses and investment is being used as an indicator of the future level of expense."[1]

Q. WHY IS THIS SIGNIFICANT?

A. On several occasions SWBT says that a certain investment (e.g., computer support assets) included in their cost studies was not in place in 1995, the year of data on which most of its studies are based, and therefore there is no double counting of investment when the items are separately identified in SWBT's cost studies. This view is wrong. Even though a specific investment is identified in a specific study, SWBT also included the general level of all of that type of investment in, for example, support asset factors. The result is a clear double count of the specific asset or an overstatement of the generally applied factor.

Q. WHAT ARE SUPPORT ASSET FACTORS AND HOW ARE THEY DEVELOPED?

[1] Kansas Docket 97-SCCC-149-GIT, Direct Testimony of Jo Ann Lammert, page 5 and Direct Testimony of Dr. Dale Lehman, page 2.

A. Support assets are those assets not directly assigned to a specific cost object based on cost causation. Support assets in the SWBT studies generally are comprised of land and buildings, furniture and office equipment, motor vehicles, and general purpose computers. Support asset factors represent the costs associated with support assets and certain other costs not otherwise associated with specific assets. Support asset factors principally are developed by: 1) summing support asset costs, such as direct expenses like computer systems maintenance, with the capital carrying costs (i.e., depreciation, cost of money, and taxes) of the assets and, 2) dividing the total of the identified expenses by an appropriate denominator. The denominator is based on the eventual application of the factor. Support asset costs to be recovered through labor rates are divided by labor dollars. Support asset costs to be recovered through monthly recurring rates for assets used are divided by investment dollars.

Q. PLEASE DESCRIBE THE TYPES OF SUPPORT ASSET FACTORS YOU MENTIONED THAT SWBT DEVELOPS.

A. SWBT's costing methodology assigns support asset costs to rates and charges in two ways. First, SWBT attributes support asset costs to investment and combines state-specific support asset costs and Missouri-attributed general support assets. The significant state-specific support asset costs include other work equipment, house services, network administration, circuit provisioning, plant operations administration, and engineering. The Missouri-attributed general support asset costs include costs for land, headquarters buildings house services, land and building

rentals, furniture, office equipment, and the capital costs of depreciation, return and income taxes on the land, buildings, furniture and office equipment as well as amortization expense. The Missouri-attributed general support asset costs are several tens of millions of dollars. The Missouri-specific and the Missouri-attributed items are combined to form distinct ACES investment-related cost factors for switching, circuit, terminal, public telephone, and cable and wire investment types. These distinct ACES cost factors are called "Support Assets" factors in ACES and are applied to investment amounts entered into ACES.

The second way SWBT attributes support assets consists only of the expense types included in the Missouri-attributed group of costs. These costs include general support asset costs for land, headquarters buildings house services, land and building rentals, furniture, office equipment, and the capital costs of depreciation, return and income taxes on the land, buildings, furniture and office equipment as well as amortization expense, but they are considered on a SWBT-wide basis. That is, the Missouri-attributed support asset costs are a portion of the total dollars included in the labor-rate support assets factors. SWBT attributes 100% of these support asset costs in the development of loaded labor rates and the Forward Looking Common Cost factor.

Q. PLEASE DESCRIBE YOUR CONCERNS WITH SUPPORT ASSETS FACTORS DEVELOPED BY SWBT.

A. SWBT's support assets factors, if applied in the manner proposed by SWBT, would permit SWBT to recover significant amounts of support asset costs at least twice. The same SWBT support asset costs are included in an ACES support assets factor and a second time in labor rates. SWBT's support assets factors therefore overstate costs and do not conform to TELRIC principles.

Q. PLEASE DESCRIBE HOW SUPPORT ASSET COSTS ARE DOUBLE COUNTED IN SWBT'S LABOR RATES.

A. In the realm of network assets (e.g., local switches, signaling systems, and outside plant), all of SWBT's state-attributed support asset costs are included in the ACES support assets factor and all of the same support asset costs are included in the development of loaded labor rates. Therefore, where unbundled elements are purchased, a complete recovery of attributed support assets is included on the proposed monthly rate for the element. If we now base rates (particularly non-recurring rates for the installation of such elements) on labor costs that are also designed to recover, on an hourly basis, the costs of those same assets, an increment of the asset costs are recovered twice. This problem occurs in labor rates linked to network assets. A similar problem occurs in the labor rates developed for operator services personnel which I will discuss below.

Q. WHAT LABOR RATES ARE LINKED TO NETWORK ASSETS?

A. Network assets include switching (other than operator systems), signaling systems, circuit equipment, outside plant, terminal equipment, and public telephone. Therefore, labor rates associated with persons and titles assigned to construct, repair, and maintain these assets and support, supervise and direct those who do, have labor rates linked to network assets. At a minimum, this includes all personnel in the Missouri plant operations vice presidential group, with the possible exception of service representatives. All of these labor rates should be adjusted in the manner described below.

Q. WHAT PROBLEM HAVE YOU FOUND IN THE DEVELOPMENT OF LABOR RATES FOR OPERATOR SERVICE PERSONNEL?

A. SWBT's methodology computes a support asset factor for operator services personnel. The factor is based on all wages paid to operator services personnel whose wages are booked to operator services accounts. This includes not only operators but also clerical assistants and management employees. The labor support assets factor for operator services is significantly less than other labor support asset factors because costs associated with computers and motor vehicles are excluded. Unfortunately, SWBT failed to use the operator services labor rate support assets factor on all operator services wage rates, resulting in inappropriately inflated rates.

Q. CAN YOU DEMONSTRATE THE PROBLEM USING SWBT DATA?

A. Yes. In other jurisdictions, SWBT provided two independent identifications of wages and salaries attributable to operator services. The first source identifies the total of expenses booked to specific Uniform System of Accounts ("USOA") account and a breakout of those expenses into salaries and a number of other expense categories. The state-by-state amounts are summed and captured on the spreadsheet that computes support asset loading factors for salaries. The second source is SWBT's labor rate program which draws wage and expense data from another SWBT system called SATRN. The data gathered from these sources also shows a breakdown of expenses by type, but they are shown for particular vice presidential organizations. Of particular interest from these reports are groups of expenses that include wages and salaries, paid absence costs, and premium time costs. SWBT's Labor program calls the sum of these three groups of costs "Total Wages and Salaries."

Looking at one system that sums expenses by USOA account and another that sums expenses by vice presidential group would appear problematic at first, but we are fortunate in this case because we believe all operator services units report to a single vice presidential group based in Missouri. This allowed us to directly compare the wages and salaries reported in SWBT's support asset computation to those used in the labor rate development and when we do so we find that the numbers reported are virtually identical. Because SWBT used the same methodology and the same five-state data in other jurisdictions, I believe these findings are applicable to Missouri studies as well.

Q. HOW DO YOU RECOMMEND THAT THE PROBLEM OF DOUBLE COUNTED SUPPORT ASSETS IN LOADED LABOR RATES BE ADDRESSED?

A. For all network asset-related labor rates, I recommend the exclusion of the support assets loading component from the labor rate development. For all operator services personnel, including management and non-operators, I recommend the use of only the labor rate support assets factor for operator services.

Q. WHAT IS THE COMPUTATIONAL FLAW YOU IDENTIFIED IN SWBT'S LABOR RATE DEVELOPMENT?

A. SWBT's premium time component inappropriately includes commission payments.

Q. WHY DO YOU BELIEVE THAT COMMISSIONS SHOULD NOT BE INCLUDED IN THE LABOR RATE DEVELOPMENT FOR THE COST STUDIES PRESENTED BY SWBT IN THIS CASE?

A. SWBT has previously indicated that there are no incentive costs presently paid in the wholesale environment. Thus, commissions, which are effectively "incentive" costs, are not appropriately included in TELRIC studies.

Q. WHAT OTHER COSTS ARE INCLUDED AS PREMIUM COSTS?

A. SWBT indicates in its labor rate development that premium costs also include premium overtime pay, other special payments, retroactive wage adjustments, management stock plans, management team incentive compensation plan payments, cost of living adjustments, occupational employee premium payments and a couple other items.

Q. WHY DO YOU RECOMMEND THAT ONLY COMMISSIONS BE REMOVED FROM THE PREMIUM TIME LOADING FACTOR COMPUTATION?

A. Commissions were the only costs that I could unequivocally remove as not being appropriate in a TELRIC study. Even though management stock plans and team incentive compensation plan payments appear to be "incentive"-type payments, it is less readily apparent that these payments would, in fact, be identical to commissions. Therefore, I chose to be conservative and only recommend elimination of commissions from TELRIC labor rate computations.

Q. DOES IT CONCERN YOU THAT NON-MANAGEMENT LABOR RATES INCLUDE MANAGEMENT SALARY ITEMS SUCH AS STOCK PLANS AND TEAM INCENTIVE COMPENSATION?

A. Absolutely. However, SWBT has indicated that its accounting system is incapable of adequately segregating management and non-management compensation. The result is a single premium loading factor that is applicable to management and non-

management. This same issue arises across several areas of loaded labor rate development.

Q. WHAT IS THE SO-CALLED TRANSITIONAL BENEFIT OBLIGATION?

A. The "TBO" as it is called is a catch-up accounting cost that reflects SWBT's previously unaccrued liability for post-retirement benefits other than pensions that was required to be recognized for financial accounting purposes by Financial Accounting Standard 106. SWBT includes TBO costs in specific expense and capital accounts as well as in its loaded labor rate development.

Based on my personal background and knowledge of the general process that lead to the TBO, I believe that the TBO reflects the previously unaccrued liability for expenditures for post retirement benefits other than pensions for both retired and active employees of SWBT as of the date of the adoption of FAS 106. The liability would have been based on the benefits to be paid in the future, accrued as a result of past (historic) service of both current and retired employees.

Q. SHOULD THE TBO BE REFLECTED IN SWBT'S LOADED LABOR RATES?

A. No. SWBT claims that these expenses are legitimate expenses and they should remain in the calculation of labor rates (and elsewhere). SWBT wants to have its cake and eat it too. SWBT is presently recording and legitimately recovering the new

forward-looking accruals for post-retirement benefits other than pensions. The TBO represents an historic, embedded cost and by definition is not a forward-looking long run incremental cost. SWBT says it wants to include depreciation rates that purportedly match what it reports to the financial community. Yet when it comes to the TBO, which was already fully reported to the financial community years ago as a one-time instantaneous liability, SWBT wants to go back to the non-financial accounting world and collect the money from ratepayers. SWBT cannot have it both ways. The TBO should be excluded from loaded labor rate development.

Q. ARE THE THREE MODIFICATIONS TO SWBT'S LABOR RATES DIFFICULT TO IMPLEMENT?

A. Absolutely not. Support assets, commissions, and TBO costs are readily identifiable in SWBT workpapers and can be eliminated from the computational process with little effort.

Q. DO THE CHANGES YOU RECOMMEND HAVE A LARGE IMPACT ON LOADED LABOR RATES?

A. Yes. For plant-related labor rates, the elimination of the support assets allowance drops the loaded labor rates by nearly one third. For plant-related and non-plant-related labor rates, the elimination of commissions and the TBO costs are noticeable but not large.

Q. WHY ARE YOU EMPHASIZING THESE CHANGES IN LABOR RATES?

A. The majority of issues in this second arbitration center on non-recurring charges the size of which are heavily dependent on plant-related labor rates. Since SWBT will obtain its full allowance of support asset costs in recurring rates and neither commissions nor TBO expenses are appropriate in TELRIC labor rates, correctly stated labor rates are imperative to the establishment of non-recurring charges that will facilitate competitive entry.

V. MAINTENANCE FACTORS

Q. WHAT ARE MAINTENANCE FACTORS AND HOW ARE THEY DEVELOPED?

A. In SWBT's cost studies, maintenance factors represent the direct costs associated with repairing and maintaining telephone plant. Maintenance factors are computed by dividing recently booked direct repair and maintenance expenses (with certain additions for power, other terminal equipment and testing expenses) by replacement costs of the equipment maintained. Maintenance factors are developed by SWBT on a state-by-state basis except for maintenance of general purpose computers which is developed on a five-state average basis.

Q. PLEASE DESCRIBE YOUR CONCERNS WITH MAINTENANCE FACTORS DEVELOPED BY SWBT.

A. SWBT's maintenance factors, if applied in the manner proposed by SWBT, would permit SWBT to recover some of the same costs at least twice. SWBT's maintenance factors incorporate all of SWBT's costs associated with its historical embedded retail non-recurring activities and no modifications were made by SWBT to reduce maintenance factors to reflect proposed non-recurring charges. SWBT's maintenance factors therefore overstate costs and do not conform to TELRIC principles.

Q. PLEASE EXPLAIN YOUR CONCERN WITH THE INCLUSION OF SWBT'S EMBEDDED NON-RECURRING ACTIVITIES COSTS IN ITS MAINTENANCE FACTORS.

A. In developing its recurring cost studies, SWBT included the total maintenance account balance in its maintenance factor. Thus, all of the services and functions captured in the maintenance account are already included in SWBT's recurring cost studies. That account includes such non-recurring activities as telephone installations, service modifications, disconnects, etc. for SWBT's retail operations. All of the costs associated with these services are, therefore, included in SWBT's recurring cost studies.

SWBT, however, has also proposed a number of non-recurring changes which include the same services and functions which are included in the recurring rate. To permit SWBT to recover these expenses first in the recurring rate and then again in the non-recurring rate would enable SWBT to recover the same costs twice. Even though

SWBT has recently admitted in Kansas that its recurring cost studies include recurring and non-recurring costs, and would result in double recoveries for the reasons I have stated, SWBT has not yet corrected this error.

In addition to the excess recovery of non-recurring costs through overstated maintenance factors, SWBT has incorporated certain non-recurring service order processing costs in its so-called forward looking common cost factor. This will be discussed in more detail below.

Q. ARE YOU ABLE TO DETERMINE THE LEVEL OF DOUBLE COUNTING THAT IS OCCURRING?

A. Theoretically, yes. However, I would need complete access to SWBT's cost data to make the determination myself. The determination would be simple for SWBT to perform as discussed below.

SWBT accounts for repairs separately from service installation and maintenance by using several time reporting codes. Generally, SWBT designates repairs with "R" time reporting codes. Similarly, SWBT generally associates non-recurring activities with time reporting codes with an "M" or a "P" designator (collectively "M" for this testimony). Thus, when a technician does work on some aerial cable necessary to deliver dial tone to an new subscriber, that technician's time is recorded as, for example, "2M" time. When a technician repairs a service outage by switching the

pairs used by a customer because the previous pair was defective, that person's time is charged to, for example, "2R". These time reporting codes translate into specific accounting classifications which are then reported to the FCC and elsewhere. In the example, both "2M" and "2R" costs are recorded in the same Uniform Systems of Accounts ("USOA") account.

Q. ARE "M" CODE COSTS A SIGNIFICANT PORTION OF ALL MAINTENANCE COSTS?

A. Yes. My previous analysis of SWBT records have shown that a high proportion of maintenance costs are in fact "M"-type expenses. For example, the majority of SWBT's digital central office and conduit maintenance costs are charged to "M" codes. While SWBT asserts that not all "M"-coded expense is related to non-recurring activities, the problem is clear. An appropriate exclusion of portions of these costs from the recurring cost studies will have a significant impact on monthly recurring rates.

Q. HAS SWBT AGREED TO ADJUST ITS MAINTENANCE FACTORS TO ELIMINATE "M"-CODED EXPENSES IN OTHER JURISDICTIONS?

A. Yes. SWBT was ordered to make modifications to its maintenance factors in Texas and has recently volunteered to do so in the generic costing docket in Kansas.

Q. HAS SWBT PUBLICLY SPECIFIED AN AMOUNT OF THE "M"-CODED EXPENSE THAT SHOULD BE ELIMINATED FROM ITS MAINTENANCE FACTORS?

A. Yes. Ms. Jo Anne Lammert presented testimony in Kansas Docket 97-SCCC-149-GIT, which stated:

> SWBT performed a special study of outside plant service order hours which indicates that between 35% and 39% of rearrangement and change expenses are caused by provisioning in response to customer service orders. This percentage does not apply to the right-to-use (RTU) fees included in central office expense accounts. In addition, due to a reporting structure that includes Missouri and Kansas data for the Kansas City market area, it has so far been impossible to develop complete Kansas specific data. Therefore, SWBT has actually performed two adjustment calculations: one excluding the Kansas City market area -- results in a 35% adjustment, and one including all of the Kansas City market area (Kansas and Missouri data) – results in a 39% adjustment. AT&T was provided the work papers supporting the 39% estimate as an amended response to Data Request No. 2.40.

(Lammert-Direct Testimony, pp. 8-9)

Q. WHAT DO YOU CONCLUDE FROM YOUR ANALYSIS?

A. SWBT's maintenance factors must be adjusted, as SWBT has agreed to do so in Kansas, to eliminate double counted non-recurring costs. In the alternative, SWBT's maintenance factors could be accepted and no separate non-recurring charges should be assessed.

Q. DO YOU HAVE OTHER CONCERNS WITH SWBT'S MAINTENANCE FACTORS?

A. Yes. SWBT's maintenance factor development is also flawed with respect to testing expense and Transitional Benefit Obligation costs. I have additional concerns with the general purpose computer maintenance factor, but will not address them in this testimony.

Q. SHOULD MAINTENANCE FACTORS BE ADJUSTED TO REFLECT AVOIDED TESTING EXPENSE AND IF SO WHAT PORTION OF TESTING EXPENSE SHOULD BE ELIMINATED?

A. Yes. SWBT can be expected to enjoy some avoided costs as it sells UNEs. New entrants can be expected to perform many of their own testing functions. I believe that the percent of testing expense expected to be avoided as reflected in the resale discount adopted by the Texas Commission (20%) is a conservative estimate of testing expense to be avoided in the UNE environment.

Q. WHY SHOULD THE COMMISSION CONSIDER ADOPTING THE AVOIDED TESTING PERCENTAGE FROM TEXAS?

A. While SWBT continues to insist that it must insert its own test points in cross connects (and, of course charge the CLECs for the extra equipment) both this Commission and the Texas Commission rejected this position and required SWBT to offer cross connections both with and without SWBT-installed test points. Recently, in the Texas SWBT 271 docket, a discussion was held about these optional test points

and SWBT's expert, Mr. Deere, stated unequivocally that the cross connects with test points would probably never be ordered by the CLECs.

When asked "When does Southwestern Bell envision putting in SMAS points?", Mr. Deere responded: "Under the orders of this Commission, probably never, because the Commission's order was that we offer loops with and without SMAS points, and the CLECs can order with and without. So I don't expect them to order it, but there is an offering -- you know, under the Commission's ruling, we do offer them both ways."[2]

Since SWBT's expert does not believe the CLECs would order cross connections with test points for SWBT's use, it seems reasonable to conclude that the CLECs themselves will assume testing functions previously performed by SWBT. Under such circumstances, the CLECs ability to perform testing is probably greater than with resold services. Therefore, if a 20% assumption for avoided testing expense was adopted by the Texas Commission as reasonable in its computation of the applicable resale discount, a 20% avoided cost assumption for UNEs is conservative by comparison.

Q. SHOULD THE TBO BE REFLECTED IN SWBT'S MAINTENANCE FACTORS?

[2] Texas Docket 16251, Transcript of Proceedings, April 22, 1998, pp. 707-708.

A. No. As discussed earlier, the "forward-looking level" of the TBO is zero. SWBT has demonstrated in the recent Kansas cost docket that it is able to identify the TBO costs attributable to specific maintenance accounts and since TBO expenses do not belong in TELRIC studies, SWBT should be required to eliminate them from its maintenance factor development.

Q. WHAT ARE THE RESULTS OF THESE MODIFICATIONS?

A. I estimate that overall monthly recurring rates will be reduced by 3% because of the adjustments to the maintenance factors.

VI. COMMON COSTS

Q. PLEASE BRIEFLY STATE YOUR POSITION REGARDING THE FORWARD-LOOKING COMMON COST FACTOR THAT SHOULD BE ADOPTED.

A. A number of methodological flaws in the SWBT computation of a forward-looking common cost factor must be corrected. The appropriate common cost factor, and one that complies with TELRIC principles, is less than 11.5 %.

Q. WHY DO YOU RECOMMEND CHANGES IN THE COMMON COST FACTOR NOW EVEN THOUGH THE COMMISSION HAS PREVIOUSLY APPROVED THE SWBT COMMON COST FACTOR METHODOLOGY?

A. As I stated in the introduction to my testimony, significant time has passed since the first AT&T arbitration in Case No. TO-97-40. AT&T has had more access to SWBT data in other states and this has permitted a more comprehensive analysis of the common cost factor and development of its correct computation. I am not requesting any modification to rates previously approved by this Commission, but to the extent we have the opportunity to correctly state rates to be approved as a result of this second arbitration, we should take it.

Q. WHAT ARE COMMON COSTS?

A. Common costs are firm level costs that are required to produce two or more of a firm's outputs and that do not vary with the level of only one of the outputs.

Q. PLEASE PROVIDE AN OVERVIEW OF THE COMPUTATIONS YOU HAVE PERFORMED.

A. First, I identified the total expenses and related salaries on SWBT's books of account that were not captured in its TELRIC cost studies. These consisted of Executive and Planning (Accounts 6711 and 6712), General and Administrative (Accounts 6721 to 6728), Network Operations - General Supervision (Account 6534.2), Customer Operations - Marketing (Accounts 6611 to 6613), and Customer Operations - Service expenses (Accounts 6621 to 6623).

Second, I identified the percentage of each of the listed accounts that will be avoided based on the development of the Missouri adopted resale avoided cost discount for UNEs other than operator services. I determined the amount of expense that will be retained in a wholesale operation. I then attributed support assets to each set of expenses (6700, 6534, and 6610/6620 accounts) based on public data provided by SWBT. The sum of the 6700, 6534, 6610/6620 account expenses and support asset expenses represents SWBT's common costs.

Third, I adjusted common costs by a factor to recognize SWBT's long-term trend of decline in common costs and the passage of time since 1995. I based this adjustment on the percentage by which common costs are expected to decline in a forward-looking competitive marketplace, as well as a recognition of the prolonged downward trend in SWBT's common costs and the effects of the SWBT/Pacific Telesis Merger.

Q. PLEASE EXPLAIN THE FACTOR BY WHICH YOU ADJUST SWBT'S COMMON COSTS FOR MISSOURI.

A. I evaluated the compound growth rates for SWBT's revenues, access lines, call volumes, and common costs. Based on publicly available ARMIS data, I determined that annually from 1991 through 1997, Missouri revenues grew at a rate of 5.46%, the number of switched access lines grew at a rate of 3.27%, call volumes grew at a rate of 3.45%, and executive, planning, general and administrative common costs in the 6700 series USOA accounts increased by 1.86%. Thus, common costs declined by

3.60% per year per revenue dollar, by 1.41% per year per access line, and by 1.59% per call.

Based on these intertemporal trends I estimated the level of common costs for the cost study period reflected in most of SWBT's cost studies, e.g., 1997 to 1999. In particular, I extrapolated SWBT's declining costs from 1995 to the 1997 to 1999 period and averaged the levels from each of the three years. This process yielded an expected level of common costs that is 6.41% below the 1995 levels reflected in SWBT's cost studies.

I also made is a one-time adjustment to reflect the benefits of the merger of SBC and Pacific Telesis. I assume that common costs per unit across SWBT and hence attributable to Missouri will decline by only an additional 5%. I believe that this is a very conservative estimate of the savings in common costs that SWBT customers should expect because of the much greater economies of scale attained by SBC through the merger.

Indeed, as part of the merger proposal, SBC provided evidence to the California Public Utility Commission of significant savings that could be expected. SBC assumed it would be able to average an additional 3% in savings on capital purchases as a result of additional leverage in purchasing. Further, SWBT's administrative costs could shrink dramatically if the merged company locates a single administrative

headquarters in California as proposed by SBC. (See; A. 96-04-038, Decision 97-03-067, March 31, 1997, at 30) Thus, my total forward-looking adjustment to SWBT's 1995 embedded common costs is a reduction of 11.41%.

SWBT has reported to its shareholders that it expects to "add $1 billion annually to net income by 2000. This opportunity is the after-tax combination of $500 million in revenue and $1.2 billion in expense savings. In addition, more than $300 million in annual capital savings are targeted by 2000." (SBC 1997 Annual Report, page 15. See additional excerpts in Schedule DPR-2) SBC reports that initially it will experience some expense increases but it will achieve these savings levels by 2000.

Based on the AT&T common cost computation, only $7.3 million has been attributed as merger savings to Missouri. This value is based on Schedule DPR-3, line 28(C) times my proposed 5% savings value. The amount actually realized by CLECs through the purchase of UNEs will be significantly less than this amount and will depend entirely on the number and quantity of UNEs purchased for which prices are set in this case.

Q. WOULD YOU EXPECT ADDITIONAL BENEFITS TO ACCRUE TO SBC AND ALL OF ITS OPERATING UNITS AS A RESULT OF MORE RECENTLY ANNOUNCED MERGER PLANS?

A. Yes. SBC has regularly touted the benefits of the Telesis merger to shareholders and California regulators. I have no reason to doubt that the addition of SNET and Ameritech to the SBC fold will provide SBC with even more economies of scale, opportunities for shared learning, and improved purchasing power. In its May 11, 1998 news release, Ameritech stated:

> The combination will also result in significant opportunities for revenue growth, technology development, cost synergies and other benefits. "We expect to optimize costs through increased economies of scale and scope, the elimination of duplicated expenditures and the adoption of best practices in cost control," said [Ed] Whitacre [Chairman of SBC]. "We expect to grow revenues more rapidly than would have been possible independently both in our existing service areas and in new markets. These synergies can be used to integrate our two companies, improve our operations, benefit our customers and fund expansion.
>
> "The experience and knowledge we have gained from the very successful integration of Pacific Telesis makes us very confident about our ability to realize the potential financial and strategic benefits of the combination with Ameritech...." Whitacre continued.

See copy of the Ameritech News Release and a related news release about the SNET acquisition in Schedule DPR-4.

Based on 1995 Statistics of Common Carriers published by the FCC, SWBT (not SBC) had revenues of nearly $8.9 billion. For the same period, the Ameritech operating companies, Pacific Bell/Nevada Bell, and SNET had FCC-reported revenues of $10.8 billion, $7.8 billion, and nearly $1.5 billion respectively. To the extent that SBC achieves the economies it expects, proportionate improvements should be expected for Missouri. The only place this type of improvement is

reflected in AT&T's restatement of SWBT's cost studies is through the 5% reduction of common costs I have proposed.

Q. WHY DO YOU BELIEVE THAT FACTOR YOU USED TO ADJUST SWBT'S COMMON COSTS DOWNWARD IS CORRECT?

A. Public data shows that SWBT has experienced a long term downward trend in common costs relative to total revenues, access lines served, and call volumes. There is no reason to believe that the trend will cease and I believe that the acquisition of Pacific Telesis and the proposed acquisition of Ameritech will lead to further economies of scale and increase the trend over time. I also believe that the measures of decline I selected (i.e., common cost per year per revenue dollar, per year per access line, and per call) are appropriate because AT&T will be purchasing UNEs in units that are analogous to the per call and per line measures.

Q. DO YOU HAVE ANY EVIDENCE THAT SWBT IS ENJOYING INCREASING ECONOMIES OF SCALE IN ITS COMMON COSTS BECAUSE OF THE TELESIS MERGER?

A. Yes. SWBT personnel have confirmed that administrative functions once performed by Pacific Bell are being taken over by SWBT personnel. SWBT has new contracts with Pacific for common functions and states clearly in its 1997 annual report to shareholders that it expects substantial savings as a result of the merger.

SWBT points out that the SBC/Telesis merger occurred after the data year upon which the common cost allocator they computed was based. They also assert that savings have not yet been achieved and that any savings estimates are speculative. Each of these observations are or may be true, but it is important to note that the cost studies we are attempting to produce in this docket are supposed to be forward-looking and it is not unreasonable to anticipate reasonable forward-looking improvements in SWBT's unit costs.

Q. WHAT WOULD BE THE EFFECT OF NOT MAKING THIS ADJUSTMENT?

A. SWBT will recover excessive common costs that are not properly adjusted for forward-looking conditions.

Q. WHAT MODIFICATIONS TO THE COMPUTATIONAL METHOD OFFERED BY SWBT HAVE YOU MADE?

A. I adjusted SWBT's 1995 data to make it forward looking as discussed above, and I changed the computation of the denominator from one based on expenses to one based on revenues. Revenues were adjusted for avoided uncollectable revenues and avoidable testing expense.

Q. WERE THERE ANY MODIFICATIONS YOU WOULD HAVE LIKED TO MAKE BUT DID NOT?

A. Yes. Forward-looking common costs should be based on regulated operations only because unbundled elements are provided by the regulated operations of SWBT. Additionally, I do not have access to the Missouri-specific TBO costs attributable to common cost accounts. Such TBO costs should be eliminated from the common cost factor. When the adjustment was made my proposed common cost factor for Kansas, the factor declined from 10.08% by 0.22% to 9.86%.

Q. IS YOUR DEFINITION OF COMMON COSTS CONSISTENT WITH ECONOMIC PRINCIPLES?

A. Yes. One would expect that common costs should be very minimal. The ideal construct would attribute items like product management, sales expenses and advertising to the specific products supported. However, because the Commission adopted SWBT's overall TELRIC costing methodology, I am forced to call some costs "common" because they have not been included in the cost studies to this point.

Q. PLEASE EXPLAIN WHY YOU MODIFIED THE COMPUTATION OF THE DENOMINATOR OF THE FORWARD LOOKING COMMON COST FACTOR TO BE BASED ON REVENUES.

A. Revenues are equal to the sum of all total element and total service costs plus common costs. Put another way, total revenues equal all expenses including common costs, depreciation, taxes, and return on investment or profit. Profit is not shown

separately on SWBT's financial reports to the FCC but is simply the difference between total revenues and total expenses.

TELRIC includes direct expenses excluding common costs, depreciation, taxes and return on investment. So our task is to find a way to convert TELRICs (which exclude common costs) to revenues (which include common costs). The simplest approach is to multiply TELRICs by one plus a factor to yield a price. In order to do so correctly the factor must be developed consistent with the components of TELRIC. That is, since TELRIC includes a return component, the denominator of the computed factor must include return as well. Thus, in order for the common cost factor to be computed correctly, it must be based on revenues less common costs. This is how I have computed the common cost factor. Schedule DPR-5 provides an algebraic proof of my proposition.

Q. HAS ANY OTHER COMMISSION ADOPTED THIS PRINCIPLE IN ANY OTHER CASE?

A. Yes. The Texas Commission agreed with AT&T and determined that the common cost factor should be determined on the basis of revenues.

Q. IS SWBT'S ARGUMENT THAT USING REVENUES AS THE INPUT TO THE DENOMINATOR VIOLATES TELRIC PRINCIPLES CORRECT?

A. No. SWBT admits that its common cost factor denominator does not include the cost of equity. TELRIC does include the cost of equity, so SWBT is expressly proposing a mismatch between the development of the common cost factor and its application. SWBT goes on to say that revenues include all profit. The implication is that SWBT's true profit exceeds the profits included at TELRIC levels and therefore SWBT's achieved excess profitability in its revenues will cause the denominator to be overstated and the common cost factor to be understated. Interestingly, SWBT has not attempted to demonstrate its excess profit levels or the supposed potential understatement of the common cost factor.

Q. IN KANSAS, SWBT WITNESS, DR. LEHMAN ASSERTED THAT IT IS INCORRECT TO ASCRIBE REVENUES TO THE DENOMINATOR OF THE DERIVATION OF THE COMMON COST FACTOR. DO YOU AGREE?

A. No. SWBT reported 1995 revenues and expenses in Missouri of $1,475.6 million and $1,301.6 million, respectively on its ARMIS 43-03 report to the FCC. This implies a "profit," or return on equity of about $174 million in 1995. SWBT's cost studies are based on replacement cost of investments under study, and the replacement costs generally exceed, according to SWBT book-cost-to-common-cost ratios, book costs. SWBT's 1995 Missouri booked investments $4.494 billion excluding analog switching equipment. Now further assuming that SWBT's adopted common equity of 58% and adopted return on equity of 12.36% is used, then SWBT's required equity component on a book cost basis to include in its common cost computations

would be close to $322 million. Since the actual value included in my proposed common cost computation is much less than this, and therefore understates the denominator, I feel that basing my common cost factor on booked revenues is extremely reasonable.

Q. WHY HAVE YOU INCORPORATED AVOIDED COST PERCENTAGES INTO YOUR COMPUTATIONS?

A. I have simply applied the methodology proposed by SWBT, but with different computational assumptions. In its original computation, SWBT determined an amount of common costs that it claimed will be avoided because the costs are attributable to retail operations. This factor is conceptually the same as the "Indirect Factor" adopted by this Commission. SWBT's proposed method computed an indirect avoided cost factor of 13.65% based on default assumed avoided cost percentages.

Q. HAVE YOU USED THE COMMISSION ADOPTED AVOIDED COST PERCENTAGES IN EVERY CASE?

A. No. This Commission adopted 90% as the avoided cost percentage for account 6623, Customer Services. The 10% remainder represents SWBT's cost to process CLEC service orders. Since separate service order charges are assessed, I assumed that 100% of this cost is avoided in the UNE environment.

Q. WHAT FORWARD-LOOKING COMMON COST FACTOR DO YOU RECOMMEND FOR ADOPTION BY THIS COMMISSION?

A. Based on the description above and the computations as shown in Schedule DPR-3, I recommend that the Commission adopt a forward-looking common cost factor of less than 11.5%.

Q. ARE NON-RECURRING CHARGES AFFECTED IN ANY WAY BY THE FORWARD-LOOKING COMMON COST FACTOR?

A. Yes. SWBT's forward-looking common cost factor incorporates the costs associated with service order processing. These amounts are recorded in account 6623, customer services. Therefore these costs must either be eliminated from the common cost computation, or there should be no service order charges levied for UNEs.

VII. UTILIZATION FACTORS

Q. PLEASE DESCRIBE WHAT FILL OR UTILIZATION FACTORS ARE.

A. Fill and utilization are terms which capture the idea that a piece of equipment will not always be used to capacity and that the excess capacity has a cost that must be recognized as part of the cost related to the portion that is used. For example, if a cable with 100 wire pairs is engineered to have 95 pairs used to generate revenues eventually, leaving a 5-pair allowance for pairs that go bad or for administrative use, the 95 pairs would need to generate enough revenues to cover the cost of the full 100 pairs.

The concept of fill and utilization factors comes in many shapes and sizes. The most obvious fill factors are for loop cable, central office lines and processor use, and interoffice cables. However, there are fill-related issues in the areas of loop electronics, signaling system links, multiplexing, operator systems, and more.

The central theme of all fill and utilization issues is whether today's achieved actual average use or whether the engineered fill is more appropriate for use in TELRIC studies. We think the answer is obvious. Total Element Long Run Incremental Costs must look at the entire current demand and assume the long run efficient view. It is not reasonable to believe that SWBT would purchase and use equipment at 6% or 10% capacity in a competitive marketplace. A long run cost study should optimize the amount of plant investment to match the volume of output. In the long run, used and useful plant should be fully utilized at engineered levels.

In situations where large aggregates of similar units, like outside feeder plant cables, are considered, some cables will have been recently installed and be operating at a minimal utilization and others will be operating at or near full capacity. This leads to the concept of average use or achieved actual fill. In certain cases, using the average fill is appropriate, so long as efficient engineering practices have been followed and long-run assumptions are used.

Q. WHY ARE LINK UTILIZATION LEVELS A CONCERN TO YOU IN SWBT'S STUDIES?

A. SWBT claims that it has measured utilization far below engineered levels on its various SS7 links. This Commission previously recognized flaws in SWBT's proposed utilization levels for SS7 links and required higher levels to be used in the SWBT cost study restatements. SWBT has publicly stated that its links are to be engineered for 40% utilization. This engineered value reflects the so-called "mated pairing" of signaling transfer points. Each STP is designed to carry not only its own load but also the full load of its mate in the case of failure of one of the STPs. Therefore the individual links to the STPs must be able to accommodate more than twice their engineered load in the event of an STP failure.

Q. GIVEN THAT THIS COMMISSION HAS ALREADY SPECIFIED THE LINK UTILIZATION LEVELS APPROPRIATE IN THIS CASE, IS THERE ANOTHER ASPECT TO SWBT'S LINK UTILIZATION FACTORS THAT CONCERNS YOU?

A. Yes. SWBT uses a program called "CCSCIS" (Common Channel Signaling Cost Information System) to develop investment costs for its STP links. This program requires two inputs to specify the utilization on the different types of links it models. One input identifies the engineered utilization limits (i.e., the 40% level discussed above.) The other input specifies the percentage of the engineered utilization that actually occurs. So for example, if the engineered utilization is 40% and the second

entry is set at 60%, then the actual utilization of the links that CCSCIS would model is 40% times 60%. This equals only 24% utilization. Unfortunately SWBT has incorrectly used CCSCIS in other jurisdictions and input the measured utilization, 24% in our hypothetical, as the second entry into CCSCIS. The result is an absurdly low computed utilization of only 9.6% (40% times 24%). This incorrect use of CCSCIS was identified in the Texas arbitration and SWBT was required to restate its link utilization levels. SWBT should be required to make the same corrections to its Missouri studies. This means that the combination of the two utilization constraints in the CCSCIS model should be used to yield the adopted utilization levels.

VIII. COMPUTER ASSETS

Q. PLEASE DESCRIBE YOUR CONCERNS REGARDING INCLUSION OF COMPUTER ASSET COSTS IN SWBT'S STUDIES.

A. SWBT has included the costs of computer assets explicitly in many of its recurring and non-recurring cost studies. The assets come with names like LVAS, SLEUTH, Datagate, and Optiview. Some additional assets are recorded in the station equipment account instead of general purpose computers. In any event, SWBT has also included 100% of these assets and their associated costs in the support assets factors. Thus, SWBT is double counting these assets and their associated costs. I estimate that the double counting of investments and costs are in the millions of dollars.

Q. HOW SHOULD YOUR CONCERN BE ADDRESSED?

The SWBT's support assets factors should be modified to exclude costs captured in other cost studies or, in the alternative, the double-counted investments should be eliminated in the relevant cost studies.

Q. SHOULD SUPPORT ASSET FACTORS FOR INVESTMENTS BE MODIFIED IF NO ADJUSTMENT IS MADE FOR SUPPORT ASSET COSTS INCORPORATED DIRECTLY IN CERTAIN COST STUDIES?

A. As was discussed earlier, certain support assets, principally general purpose computers, are included in both the support assets factors studies and in some application-specific cost studies like LIDB/SMS, operations and support systems, and numerous non-recurring charge studies. Adjustments should be made to the investment support assets factors if the application-specific general purpose computers continue to be considered a part of the application-specific studies.

Q. SHOULD THE POWER INVESTMENT FACTOR FOR GENERAL PURPOSE COMPUTERS BE ELIMINATED?

A. Yes. SWBT developed a power investment factor for switching and circuit equipment, not general purpose computers. SWBT's accounting practices are to record the cost of power equipment in the same account as the equipment requiring the power. Thus, digital switching equipment and its associated power equipment would be recorded together in the digital switching account. SWBT's cost study

processes identify switching equipment without power equipment, so an allowance for power equipment must be made in its cost studies. However, SWBT used the entire investment booked to the general purpose computers account which, by SWBT's accounting practice, included associated power equipment in the development of various support assets factors.

SWBT also included the investment values of certain application-specific general purpose computers in certain cost studies such as LIDB/SMS and the operations and support systems study. SWBT made no effort to demonstrate that the application-specific studies included or excluded power equipment but just assumed they did not and chose to apply the central office power equipment factor as a surrogate for the power equipment factor applicable to general purpose computers.

The overall result is that since 100% of general purpose computers are included in the support assets factors, any separate identification of computer assets in application-specific studies or in non-recurring studies results in a double counting of those assets. So long as the application-specific general purpose computer investments are included in specific studies, there is no reason to exacerbate the double counting of the assets by increasing the investment value by a surrogate power factor. Therefore, AT&T recommends that the Commission set this factor to zero for purposes of TELRIC studies.

However, our first preference is that the Commission exclude general purpose computer assets and central processor unit ("CPU") costs from all recurring and non-recurring cost studies because the general purpose computer assets are fully included in the support assets factors.

IX. NON-RECURRING COST ISSUES

Q. SHOULD ANY PROCUREMENT COSTS BE INCLUDED IN NRCS?

A. No. SWBT's cost factor methodology relies on its total operations books of account for a specified period. In this instance the period is 1995. SWBT's processes are designed to ensure that most expense accounts are fully attributable to recurring cost factors such as depreciation, maintenance, services, etc. As a result, accounts like "Procurement" are identified and all of the expenses for the year under study are incorporated into recurring cost factors. The factors are then used in the development of cost studies which attribute the expenses to related items of investment. In the case of procurement expenses, the costs are recovered in recurring charges through the support assets factor or in maintenance factors. SWBT has identified 100% of its booked procurement costs as part of maintenance factors and support asset factors.

A problem arises when SWBT goes on to identify the same costs in other factors or work items. In the specific case of procurement expenses, SWBT separately identifies procurement activities in its non-recurring charge studies. While the

activities may indeed consume certain procurement activity resources, recovering an allowance for procurement in the non-recurring cost study effectively opens the door for excess cost recovery. In other words, SWBT double counts of costs. Therefore, procurement costs should be eliminated from non-recurring studies.

While space does not permit a complete rendition of SWBT's cost factor model here, SWBT's model includes two kinds of procurement costs. Those costs identified as "procurement" in account 6726 are directly and fully recovered in SWBT's computation of its common cost factor. I also consider "provisioning" costs under this issue. These costs are identified directly in accounts 6512 and 6532, and to a great extent the original booked expenses in account 6512 are cleared directly to various maintenance expense accounts. The uncleared portion of account 6512 and all of the provisioning part of account 6532 roll directly into the computation of support asset factors. These "provisioning" costs represent SWBT's circuit provisioning centers. Thus, inclusion of "circuit provisioning" separately in non-recurring cost studies represents a double count of these expenses.

X. CONCLUSION

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. SWBT must be required to restate its loaded labor rates to eliminate double counting of support asset costs and correctly state the support asset costs includable in its

operator services labor rates. Labor rates must also reflect the exclusion of retail-type commissions and post-retirement benefit "TBO" costs. SWBT must be required to reduce its recurring cost maintenance factors to reflect the elimination of embedded retail non-recurring costs, just as it has agreed to do so in the recent Kansas generic cost proceeding, and it must be required to reflect a level of avoided testing expense and the exclusion of maintenance-related TBO costs. SWBT's common cost factor must be restated to a forward-looking level of less than 11.5% reflective of long-term declining unit cost trends, the benefits of the SBC/Pacific Telesis merger, the elimination of TBO costs, and the inclusion of "profit" in the denominator of its computation.. SWBT's signaling-related cost study must reflect the correct application of Commission-adopted utilization factors as SWBT has incorrectly used its CCSCIS model in other jurisdictions. Finally, separately identified computer assets and procurement costs must be excluded from recurring and non-recurring cost studies because these costs are fully included in SWBT's support assets and maintenance factors.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

PREVIOUS TESTIMONY OF DANIEL P. RHINEHART

Date Filed	State	Proceeding Number	Subjects Addressed
6/98 7/98 8/98	Kansas	Docket 97-SCCC-149-GIT	Generic Cost Docket for SWBT. Depreciation, cost factors, fill factors.
4/98	Texas	Docket 16251	Non-cost basis of certain Arbitration rates for SWBT – TX
1/98	Oklahoma	Cause No. PUD 970000442	Permanent Rates for SWBT Services
1/98	Oklahoma	Cause No. PUD 970000213	Permanent Rates for SWBT Unbundled Network Elements
8/97	Texas	Docket No. 16226	Restatement of SWBT Arbitration Cost Studies
3/97	Kansas	Docket 97 SCCC 149-GIT	Generic Cost Proceeding for SWBT
1/97	Arkansas	Docket No. 96-395-U	Arbitration Cost Studies of SWBT – AR
1/97	Kansas	Docket 97-AT&T-290-ARB	Arbitration Cost Studies of SWBT – KS
10/96	Texas	Docket 16300	Arbitration Cost Studies of GTE – TX
10/96	Missouri	Case No. TO-97-63	Arbitration Cost Studies of GTE – MO
10/96	Oklahoma	Cause 960000242	Arbitration Cost Studies of GTE – OK
10/96	Missouri	Case No. TO-97-40	Arbitration Cost Studies of SWBT – MO
9/96	Oklahoma	Cause No. PUD 960000218	Arbitration Cost Studies of SWBT – OK
9/96	Texas	Docket 16226	Arbitration Cost Studies of SWBT – TX
6/96 7/96	Kansas	190,492-U	Universal Service Fund, Alternative Regulation, Imputation
1/96	Texas	Docket 14659	Costs of SWBT and GTE loop facilities
1/96	Texas	Docket 14658	Resale of SWBT and GTE services under PURA
9/95	California	A.95-02-011 A.95-05-018	Uniform System of Accounts Rewrite rate adjustments
6/95	Missouri	Case TR-95-241	SWBT Local Plus service offering
8/94 2/95	California	A.93-12-005 I.94-02-020	Citizens Utilities General Rate Case, Access Pricing, Price Cap, IntraLATA Equal Access, Imputation
4/93	California	A.92-05-002 A.92-05-004 I.87-11-033	First Price Cap Review, productivity factors, sharing
6/92	California	I.87-11-033	Centrex and PBX trunk Pricing
10/91	California	I.87-11-033	Competitive entry issues
1/91	California	A.85-01-034	High Cost Funding
10/90	California	I.87-11-033	Expansion of Local Calling Areas, Touch Tone

Schedule DPR-1