

BELLSOUTH

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Director-Federal Regulatory

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March 18, 1993

Mr. Gregory J. Vogt
Chief, Tariff Division
Federal Communications Commission
1919 M Street, NW, Room 518
Washington, DC 20554

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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

RE: CC Docket No. 92-24

Dear Mr. Vogt:

Use of ARMIS data to calculate direct cost ratios and overhead ratios for application to BellSouth's forward looking incremental investments is inappropriate. First, use of ARMIS data for developing direct cost ratios (i.e., annual cost factors) does not recognize differences in the mix of plant account specific investments among different services. Second, ARMIS data is based on embedded investments and expenses. Applying ratios developed from this embedded data directly to BellSouth's forward looking investments without making adjustments for the differences in embedded versus forward looking investments leads to an inappropriate overhead ratio. BellSouth will demonstrate that, if the appropriate adjustments are made to place the embedded ARMIS costs and the forward looking BellSouth LIDB costs filed with the Commission in CC Docket No. 92-24 on an equal basis, the overhead ratios resulting from the process using ARMIS data are very close to those used by BellSouth in its filing.

The methodology BellSouth uses to calculate a price ceiling for new services first develops the incremental cost, i.e., the price floor, for the new service by identifying the incremental investment and the incremental noninvestment related annual costs. The total incremental costs are the investments times the appropriate annual cost factors, plus the noninvestment related annual costs. Next, BellSouth develops the price ceiling ratio by dividing the total revenue for the category in which the new service will reside (e.g. Local Transport) by the total incremental costs for the category. The price ceiling is calculated by multiplying the ratio (total revenues to incremental costs) times the incremental costs of the new service. This methodology sets the appropriate ceiling relative to incremental costs. As information, LIDB rates were set below the ceiling.

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AB C D E

A direct cost ratio based on ARMIS direct cost and investment for the Traffic Sensitive Switched Access Basket applied to BellSouth's incremental investment developed in its LIDB cost studies results in a false presumption that the mix of plant account specific investments associated with each of the elements of LIDB is the same as that for the Traffic Sensitive Switched Access Basket. It also does not account for the occurrence of varying levels of noninvestment related direct costs such as service specific software right-to-use fees. There are even significant differences in levels of noninvestment related direct costs among the LIDB rate elements. For example, the LIDB Access Line rate element has \$607.63 of investment related unit costs and zero noninvestment related unit costs with a ratio of total unit annual costs to total unit investment of .2601. The LIDB Access Port has \$3709.80 of investment related unit costs and \$3100.00 of software noninvestment related unit costs which produces a .5044 ratio of total unit annual costs to total unit investment. The noninvestment related costs are a direct result of providing the LIDB service and are appropriately reflected in the incremental costs developed for LIDB. The use of ARMIS data results in a direct cost ratio that is inappropriate for application to BellSouth's incremental investment for LIDB.

ARMIS data is a reflection of embedded investments, costs and expenses. This information covers broad service categories and is not necessarily representative of a specific service, i.e. LIDB. ARMIS also represents historic data, and is inappropriate for making pricing decisions for future services. In a rapidly changing telecommunications industry, the use of historical data is not appropriate to determine future costs. Forward looking incremental costs are appropriate to determine the costs of providing a service. Incremental costs provide the price floor to test market prices. Incremental costs reflect the costs that are a direct result of provisioning a service, and they do not include costs that do not change with the provisioning of the service. Incremental cost development is based upon proposed (forward looking) facility and equipment provisioning strategies since it is future costs that are affected by a decision. In other words, the only expenditures which can possibly be saved are future incremental costs. Therefore, incremental costs

In the Attachment, BellSouth demonstrates that, when the appropriate adjustments are made to account for the mismatch of embedded ARMIS costs and incremental LIDB costs, using ARMIS based methodology results in an overhead ratio that is very close to what is used in the BellSouth LIDB tariff filing. The Attachment displays BellSouth ARMIS data on line numbers 1 through 31. Lines 32 through 36 indicate the steps necessary to develop the appropriate overhead ratio. Using the ARMIS methodology, the ARMIS Direct Cost Ratio (line 32) for Transport is .2651, and the ARMIS Overhead Ratio (line 33) for Transport is 1.7306. The BellSouth Incremental Cost for Transport (line 34) is developed by multiplying the forecasted demand for Transport by the unit incremental cost for Transport and is equal to \$129,033 (expressed in thousands as is the ARMIS data). The ratio (2.1505) of ARMIS Direct Cost (line 25) to BellSouth Incremental Transport Cost (line 34) is developed on line 35. On line 36, this ratio is then multiplied by the ARMIS Overhead Ratio (line 33) to produce the Adjusted ARMIS Overhead Ratio for Transport (3.7217). The Adjusted ARMIS Overhead Ratio can be applied directly to the incremental LIDB costs. The Adjusted ARMIS Overhead Ratio of 3.7217 for Transport (line 36) is close to the Overhead Ratio of 3.65 used in BellSouth's LIDB tariff

Attachment

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BELLSOUTH
ARMIS BASED OVERHEAD LOADING
1991 DATA (000)

	Transport
<u>INVESTMENT</u>	
1 Investment - COE+IOT+CWF	1,208,771
2 Investment - GSF	274,717
3 Total (Ln1+Ln2)	1,483,488
4 COE+IOT+CWF Factor (Ln1/Ln3)	0.8148
5 GSF Factor (Ln2/Ln3)	0.1852
<u>NET INVESTMENT</u>	
6 Net Investment - COE+IOT+CWF	601,539