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Before the
Federal Communications Commission
Washington, D.C. 20554

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In the Matter of	)	
	)	
Access Charge Reform	)	CC Docket No. 96-262
	)	
Price Cap Performance Review for Local Exchange Carriers	)	CC Docket No. 94-1
	)	
Cost Review Proceeding For Residential and Single Line Business Subscriber Line Charge (SLC) Caps	)	

REPLY COMMENTS

BellSouth Telecommunications Inc. ("BellSouth") hereby submits its Reply Comments to the comments filed on January 24, 2002 regarding the cost information BellSouth submitted to the Commission in response to the *Public Notice* released on September 17, 2001[1] in the above referenced proceedings.

1. The *Public Notice* requested price cap local exchange carriers to submit cost information that would enable the Commission to review whether the current residential and single-line business subscriber line cap should be increased on July 1, 2002 to $6.00. As required, BellSouth and other price cap carriers submitted cost information to facilitate the Commission's review.

2. Several commenters argue that the LECs have not provided sufficient information for the commenters to evaluate the cost submissions. Nevertheless, a number of parties recognize that the Commission has sufficient information to determine that the SLC cap increase should

[1] *Initiation of Cost Review Proceeding for Residential and Single-Line Business Subscriber Line Charge*, CC Docket Nos. 96-262, 94-1, *Public Notice*, rel. Sept. 17, 2001.

go into effect as scheduled.[2] On the other hand, a few commenters go so far as to suggest that the Commission should not permit the SLC cap increase for residential and single-line business lines to take effect without a more thorough review of LECs' cost studies.[3]

3. At the outset, it is important to establish the purpose and the parameters of the cost review. Contrary to the apparent belief of some, it was not the Commission's intent, nor is it necessary, to commence a major cost proceeding with the attendant debate surrounding modeling. Instead, the purpose was for the Commission to use cost information submitted by the LECs in conjunction with other available information as verification that the scheduled increase in the cap on residential and single-line business subscriber line charges should go forward.

4. As WorldCom correctly notes, the standard the Commission should apply in determining whether the increase to the cap is appropriate can be found by looking to the principles and purpose of the *CALLS Order*.[4] Under the *CALLS Order*, the CMT that is used to determine the maximum SLC, PICC and CCL rates that a price cap LEC can charge is based on traditional accounting and cost allocation rules that were in place and used to develop access rates when price caps were first implemented.[5] BellSouth's CMT is $6.95. This means that

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[2] *See generally* Comments of WorldCom and Comments of Ad Hoc Telecommunications Users Committee ("Ad Hoc").

[3] *See* Comments of Florida Public Service Commission ("Florida PSC"); Comments of the People of the State of California and The California Public Utilities Commission ("California"); Comments of the National Association of State Utility Consumer Advocates ("NASUCA").

[4] *In the Matter of Access Charge Reform et. al.*, CC Docket No. 96-262 *et al.*, *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45,* 15 FCC Rcd 12962 (2000) ("*CALLS Order*").

[5] WorldCom at 3.

BellSouth recovers a considerable portion of its allowed CMT revenue through multi-line business PICCs.

5. An objective of the *CALLS Order* was to eliminate CCL and multiline PICC charges through the gradual increase in residential and single-line business SLC caps. While BellSouth has eliminated the CCL charge, its multi-line PICC remains. Without an increase in the SLC cap, the objective of the *CALLS Order* cannot be achieved. Eliminating the multi-line PICC must continue to be an important objective for the Commission since such charges reflect a subsidy that flows to residential and single-line business users. As WorldCom points out, the Commission remains obligated to eliminate such subsidies, and by increasing the SLC cap, the Commission continues its progress toward achieving this goal.[6]

6. Further, as Ad Hoc points out, the Commission is not limited to considering forward-looking cost information in making its findings here.[7] ARMIS data is another source of information upon which the Commission can rely to justify increasing the SLC cap. In this

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[6] *Id.* at 4. Ad Hoc (p. 22) urges the Commission to change the CALLS proposal that it adopted by melding the multi-line PICC into to the multi-line SLC. In the first instance, this proceeding is not for the purpose of revisiting each an every aspect of the CALLS proposal with which a commenter disagrees. Indeed, Ad Hoc's request is little more than an untimely petition for reconsideration. The sole purpose of this proceeding, as the *Public Notice* makes clear, is for the Commission to verify that the scheduled increase in the primary residential and single-line business SLC is appropriate. Substantively, Ad Hoc's idea of moving the PICC into the muti-line SLC is inappropriate. The PICC charges reflect common line charges that the Commission restructured from carrier assessed usage sensitive charges to flat-rated charges as part of its access reform efforts. The CALLS proposal through increased primary residential and single-line business SLCs is formulated to reassign responsibility for recovery of these costs to the proper user. It makes no sense to distort multi-line business SLCs by melding PICC recovery into such charges. Moreover, if Ad Hoc is unhappy with the MLB PICC rates its members are being charged by certain interexchange carriers, the proper course of action for Ad Hoc's members to follow would be to file formal complaints against those interexchange carriers with the Commission.

[7] Ad Hoc at 8.

regard, Ad Hoc submits information based on ARMIS data to show that SLC caps above $5.00 are warranted in most states.

7. While BellSouth concurs with Ad Hoc that the Commission is free to consider and should consider information other than just the forward-looking cost information, in presenting the interstate cost per line, Ad Hoc has understated line costs based on ARMIS data. By using only USF costs rather than common line costs, Ad Hoc has not taken into account significant expense amounts. The USF cost excludes expenses, such as Services Expenses (A/C 6620), Marketing Expenses (A/C 6610), General Support Facilities Expense-Depreciation (A/C 6561), Information Origination/Termination Expense (A/C 6310), Other Property Plant and Equipment Expense (A/C 6510) and Amortization Expense (A/C 6565). All of these expenses are included in ARMIS Common Line costs and should be recovered from end-users. These expenses represent approximately 25% of total BellSouth expenses. Other less significant differences between the embedded USF study methodology and Part 36 also contribute to differences in USF costs compared to ARMIS Common Line costs.

8. USF costs are also understated because USF book costs are not based on all telephone plant investments. For example, 100% of General Support Assets are excluded from USF book costs. Several other less significant investments are also excluded from the annual USF study. Part 36 of the FCC's Rules, Subpart F, provides the methodology for developing the annual embedded USF study (used in determining Hold Harmless support), which is reported on a summarized basis in ARMIS report 43-04, but is not based on total Common Line costs prescribed in Part 36.

9. Further, the USF cost is actually based on 1998 ARMIS data, not 2000 ARMIS data. As required, the USF cost per loop in the ARMIS 43-04 report reflects the cost per loop that is used to determine the year 2000 USF support, which is based on 1998 data.

10. If total common line costs per loop from the 1998 ARMIS report are used, the interstate cost per line in BellSouth's states (based on a 25 percent interstate allocation) is significantly greater than AD Hoc's estimate and above the $6.50 SLC cap:

AL	$6.88	KY	$6.78	NC	$7.06
FL	$7.07	LA	$6.56	SC	$7.18
GA	$7.42	MS	$7.65	TN	$6.76

11. As further validation that increases in the SLC cap are warranted the Commission can consider the base factor portion ("BFP") of common line costs. BellSouth's preliminary results for 2001 show the BFP to be $7.24. All of these data validate increasing the SLC Cap to $6.50.

12. Thus, applying the appropriate standard of review, *i.e.*, whether an increase in the SLC cap would further the objectives of the *CALLS Order*, it is clear that the Commission has sufficient information to determine that the increase in the SLC cap should be implemented as scheduled. Further, contrary to the opinion of the commenters, the cost information submitted by BellSouth supports and verifies the appropriateness of the SLC cap increase.

13. An often-repeated criticism is that there was insufficient information for the commenters to conduct an independent validation of the LEC cost information. As an initial matter, commenters perceive a role for themselves that is neither necessary nor contemplated by the Commission. Furthermore, it appears that commenters perceive that cost results that are based on methodologies used in other contexts, such as the USF synthesis model or UNE

TELRIC studies, are the only acceptable forward looking costs for the Commission to review.[8] The commenters are wrong.

14. The synthesis model, with its national inputs, does not measure BellSouth's cost of providing the subscriber line to primary residential and single-line business customers—which is the purpose of the cost submission. Indeed, even the Commission recognized the limited applicability of the synthesis model and cautioned about its potential misapplication and misuse.[9] Nevertheless, some commenters, like NASUCA, would have the Commission ignore its own pronouncements regarding the synthesis model and apply it without hesitation. Clearly, the Commission must reject this suggestion.

15. Likewise, to compare cost results of TELRIC UNE cost studies are equally inappropriate. Unlike UNEs, the costs that BellSouth submitted to the Commission are for a retail service. By definition, retail services include cost components, such as marketing expenses, not included in a wholesale offering such as UNEs. Even the Florida PSC concedes that there is a difference between UNE cost and retail costs.[10] It should not come as a shock that BellSouth's retail cost for primary residential and single-line business lines is greater than a UNE cost. Similarly, it should not be surprising that BellSouth's cost submission states that the results cannot be used for UNE purposes.[11]

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8 Florida PSC at 2-3, WorldCom at 7-9, NASUCA at 10.

9 See generally, In the Matter of Federal-State Joint Board on Universal Service, CC Docket No. 96-45, *Ninth Report & Order and Eighteenth Order on Reconsideration, 14 FCC Rcd 20432 (1999); In the Matter of Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs*, CC Docket Nos. 96-45 and 97-160, *Tenth Report and Order*, 14 FCC Rcd 20156 (1999).

10 Florida PSC at 3.

11 The Florida PSC suggests that shared and common costs in BellSouth's cost study, which includes a retail shared and common cost of $1.54 per line, may be too high. As explained in Attachment 1 to these Reply Comments, BellSouth believes that the Florida PSC has misused the Footnote Continued

16. BellSouth provides a detailed response to the criticisms of its cost submission in Attachment 1. In so doing, it becomes crystal clear that the methodology and inputs used by BellSouth are consistent with the derivation of a forward-looking cost study. Indeed, those who argue that the cost methodology used by BellSouth is little more than a black box have essentially ignored the material BellSouth submitted. Moreover, each of the cost models that BellSouth used and identified in its descriptive information has been thoroughly investigated in proceedings before state commissions and has been accepted by the state commissions.[12] Indeed, many of the parties to this proceeding have been participants in these state proceedings and have had access to the BellSouth models.

17. The barbs tossed at BellSouth's cost information represent last-ditch efforts to derail the objectives of the *CALLS Order*. These arguments as well as arguments that demand state deaveraging of SLCs[13] or advocate TELRIC pricing[14] obscure the real purpose of the *CALLS Order*, which to is to move to a more cost-causative and equitable recovery of permissible CMT revenues.

UNE common cost factor application and methodology. The common costs associated with UNEs exclude all retail costs in that retail costs are presumed to be avoidable in a purely wholesale environment. This is not true in a retail environment. In order to determine common costs in a retail environment, it must be recognized that wholesale common costs are not avoidable costs. They exist in both the wholesale or retail environments. To determine common costs properly, the cost study needs to capture total common costs and allocate a portion of those costs to the interstate SLC. BellSouth used such an approach in its cost submission. Further, BellSouth allocated the cost on a per line basis, which it believes is a better approach than a factor approach as advocated by the Florida PSC. Indeed, had BellSouth used a 25 percent interstate factor, its common cost allocation would have been greater than a $1.54 per line.

[12] *See, e.g., In re: Investigation into pricing of unbundled network elements,* Docket No. 990649-TP, *Final Order on Rates for Unbundled Network Elements Provided by BellSouth,* Order No. PSC-01-1181-FOF-TP, Pub. Util. Rpts. 4th, Slip Op. (Fla. Pub. Serv. Comm'n May 25, 2001).

[13] Florida PSC at 2.

[14] NASUCA at 10, 21.

18. To contend that SLC rates must be deaveraged is wrong. Deaveraging is viewed by some as a way to gain an advantage, but that advantage comes at the expense of another. Moreover, the perception that a state is low cost often overlooks the high cost areas within the state. For example, Attachment 2 shows the cost of primary residential and single line business lines for Zone 3 wire centers by state.[15] As this Attachment shows, the line costs greatly exceed the prospective SLC cap of $6.50 in all BellSouth's states. Across the region as a whole, the average Zone 3 cost is $10.68. Even Florida, which advocated deaveraging, has Zone 3 costs in excess of $10.00.

19. Similarly, advocacy of a TELRIC methodology for setting SLC rates is misplaced. TELRIC is not an appropriate rate setting methodology for retail rates. Time and again, economists have advised the Commission that a forward-looking cost is a starting point as a price floor but is not a good estimate of the correct price in the marketplace. As the noted economists Schmalensee and Taylor have explained, most economists would agree that in the face of substantial fixed costs and scale economies (*i.e.*, characteristics of the telecommunications industry), marginal cost pricing fails to recover a firm's economic cost.[16] Nothing has changed to alter this fundamental tenet.

20. The anxiety of increasing the SLC cap represents an over-reaction to the perceived impact of the change. A fact that seems to be lost is that with a $6.50 SLC cap for primary residential and single-line business lines, only one-third of such lines nationwide would reach

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[15] The Attachment also provides Zone 4 costs for Mississippi, the only state in which wire centers are assigned to Zone 4.

[16] Richard Schmalensee and William E. Taylor, "Economic Aspects of Access Reform," submitted as Attachment 1 to USTA's Comments in CC Docket No. 96-262 filed on January 29, 1997. *See also* Affidavit of J. Gregory Sidak and Daniel F. Spulber, submitted as Attachment 3 to USTA's Comments in CC Docket No. 96-262 filed on January 29, 1997.

the cap.[17] Thus, the substantial portion of lines would have SLCs that fall below the cap. Moreover, at the current $5.00 SLC cap, primary residential and single-line business lines receive a $1.2 billion subsidy that would be eliminated by raising the cap $6.50. Not only would a substantial subsidy be eliminated but also residential competition would be advanced by increasing the SLC cap.

21. The final assault on the proposed increase in SLC caps is NASUCA's litany that the Commission has failed to allocate commons costs between services included within the definition of universal service and those services excluded from universal service as required by Section 254(k) of the Act. Specifically, NASUCA argues that subscriber line costs are common costs that should be allocated between advanced services and voice services because Section 254(k) states carriers may not use services that are not competitive to subsidize services that are subject to competition. There are two flaws in NASUCA's argument.

22. The first flaw is the presumption that there is a non-competitive service. ADSL and basic local exchange services are both competitive services. In light of the multi-modal competitive alternatives to local exchange service and the variety of alternative mechanisms for alternative carriers to compete with LECs for such services (*e.g.*, UNEs, resale, facilities based competition), the Commission cannot consider basic local exchange service as non-competitive for the purposes of Section 254(k).

23. The second flaw is in NASUCA's argument is that the subscriber line cost is a common cost to be allocated among services. To the contrary, the subscriber line cost is the cost associated with connecting the subscriber's premises to a LEC location from which the LEC

[17] This figure is based on an analysis of the TRPs submitted with the 2001 Annual Access filings. Assuming an average SLC rate, it was assumed that the primary residential and single-line business SLC would be the lower of the CMT or $6.50.

provides services to the customer. The fact that the customer may use the same connection to receive multiple services, such as voice local exchange service and DSL does not mean that the cost of the subscriber line connection can be allocated. To the contrary it cannot and should not be allocated. Whether or not a customer purchases DSL, the cost of the subscriber line remains the same. To try to allocate the cost would be folly. The allocation would be the equivalent of a zero sum game in which an end user would always pay the same total line charge except that a DSL user would have its line charge divided into two components. Such an allocation is form over substance and is not mandated by Section 254(k) of the Act.

24. The Commission should not permit the comments filed here to distract it from continuing the progress toward achieving all the goals embodied in the *CALLS Order*. Achievement of these objectives facilitates the Commission fulfilling its obligations under Section 254. The next step on this road is to permit the increase in the primary residential and single-line business SLC cap. BellSouth has provided cost and other information by which the Commission can conclude that the increase is appropriate. Accordingly, the Commission should act expeditiously to affirm the scheduled increase.

Respectfully submitted,

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ATTACHMENT 1

Issue: "It is appropriate to use the forward-looking costs incorporated into state approved TELRIC rates and the FCC Synthesis Model to determine if an SLC Cap increase is warranted." (National Association of State Utility Consumer Advocates ("NASUCA"), page 10)

Response: NASUCA is wrong. The purpose of the cost studies filed by BellSouth in this proceeding was to calculate the cost BellSouth incurs in providing retail voice grade access for primary residential and single-line business customers to the public switched telephone network. These costs cannot be ascertained from either the state-approved UNE rates or from the FCC Synthesis Model.

This Commission's TELRIC methodology was specifically designed to determine costs in a wholesale environment, not retail. To equate the development of costs for UNEs to the development of costs for any retail service is overly simplistic and inaccurate. There are several significant differences that must be considered between the retail and wholesale cost results.

Regarding the calculation of UNE costs, this Commission specifically stated that the "the total element long-run incremental cost of an element should be measured based on the use of the most efficient telecommunication technology currently available and the lowest cost network configuration, given the existing location of the incumbent LEC's wire centers." (§51.505(b)(1)) In the development of retail costs, this restrictive rule does not exist. While BellSouth is an efficient provider of telecommunications services, retail service cost studies are not required to reflect the "least cost" hypothetical configuration. Instead, retail costs reflect the network configuration BellSouth anticipates using to deliver the service under study on a going forward basis. The BellSouth Telecommunications Loop Model ("BSTLM©"), however, is a proxy model that retains existing wire center locations and designs plant to efficiently serve existing customer locations. The model utilizes Minimum Spanning Road Tree ("MSRT") algorithms and thus, calculates the least cost network configuration. Port costs are derived from the SCIS/MO and Simplified Switching Tool ("SST©") models, both of which determine efficient costs based on demand.

Additionally, this Commission, in its First Report and Order, defined factors that may not be considered in the development of the forward-

looking economic cost of UNEs. Specifically, §51.505(d) excludes retail costs from UNE rates. This Commission states that: "Retail costs include the costs of marketing, billing, collection, and other costs associated with offering retail telecommunications services to subscribers who are not telecommunications carriers." On the other hand, these types of costs are charged to end users of retail services, and thus, have been appropriately considered in BellSouth's SLC cost studies.

In establishing the TELRIC methodology for UNEs, this Commission recognized that: "certain shared costs that have conventionally been treated as common costs (or overheads) shall be attributed directly to the individual elements to the greatest extent possible." (First Report and Order, ¶682) The FCC also allowed a "reasonable allocation of forward-looking common costs." (First Report and Order, §51.505(a)(2)) Thus, in the development of UNE costs, BellSouth implemented an allocation process that attributed both shared and common costs to unbundled network elements. In order to reflect the total retail costs BellSouth incurs in providing access to the public switched network, for the costs filed in this proceeding BellSouth identified shared costs and assigned common costs on a per line basis through the use of its Shared and Common Cost Application. (This is the basic allocation methodology used in the state-level generic cost proceedings.) The BellSouth Shared and Common Cost Application is a process that employs cost assignments that are fundamentally based on the cost attribution principles underlying the Cost Allocation Manual (CAM) approved by this Commission. These principles provide a structural "cost causative" basis for assigning costs to network related plant or to non-network related groupings like shared or common costs. Shared cost factors, determined in the Shared and Common Cost Application, are applied to forward-looking investments to produce forward-looking shared costs associated with the primary residential and single-line business loop and port. Examples of typical shared costs include accounts in 653X - Other Network Expenses, 211X - General Support Assets, and 612X - General Support Expenses. BellSouth also utilized its Shared and Common Cost Application in order to develop the projected common costs that span the activities of the entire (wholesale & retail) business. In order to do this, BellSouth simply replaced the wholesale/retail ratios previously used in the state generic cost proceedings for accounts 6611 (Product Management), 6612 (Sales), 6613 (Product Advertising), and 6623 (Customer Services) with factors of 100%[18]. Examples of typical common costs include accounts in 6623 –

[18] In its comments, NASUCA advocates a $.09 per month for marketing relying on the Commission's Synthesis Model input, claiming this is the appropriate input for the SLC study. First, as explained in this document, the Synthesis Model does not reflect costs BellSouth incurs on a going-forward basis. Additionally, NASUCA's argument appears to ignore the Customer Services expenses associated with primary residential and single-
Footnote Continued

Customer Services, 661X – Marketing, and 672X – General & Administrative. The resulting projected total common costs that span the activities of the entire (wholesale & retail) business were then divided by projected Average Access Lines In Service ("AALIS") for 2002, which include all types of access lines (retail, wholesale, residence, business, UNEs, resold, private line, special access, etc) to determine the total common cost per access line. The total common cost per access line was then multiplied by 15% (simple average of Total Operating Expenses ("TOE") and Total Plant In Service ("TPIS") Common-Line-to-Subject-to-Separations ratios from the most recently filed ARMIS 43-01 Report) in order to develop an interstate, common-line related common cost per access line amount.

This Commission's Synthesis Model, populated with national default values, also offers no true indication of the costs BellSouth incurs. While the Synthesis Model provides a method of comparing hypothetical costs between companies based on a set of standard national inputs for the limited purpose of determining universal service support requirements, it does not use BellSouth specific inputs and does not compute the costs BellSouth incurs to provide service in its territory.

Issue: The Florida Public Service Commission ("FPSC") compared BellSouth's SLC study for Florida to the study filed in the generic cost docket. The FPSC concluded that: "[b]y applying BellSouth's methodology from the UNE docket, but using retail costs instead of wholesale costs, a retail common cost factor of approximately 17 percent is produced." (FPSC, page 3)

Response: BellSouth wishes to first comment on the FPSC concern of the magnitude of the shared and common costs contained in BellSouth's SLC study when compared to the UNE study amount. (FPSC, page 3) As explained previously, retail costs are excluded from the development of the common costs associated with UNEs since such retail costs are presumed to be avoidable in an operational environment that is theoretically wholesale, only. Thus, the total common costs that BellSouth would incur from a Retail (SLC) perspective are significantly greater than those that it would incur from a Wholesale (UNE) perspective. For example, approximately 20% of Account 6610 (Marketing) was allocated to the Wholesale (UNE) common cost factor. From a retail perspective, however, BellSouth would incur 100% of these costs – 80% from its retail marketing efforts and 20%

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line business customers, a substantial expense. Further, BellSouth has developed a supportable process of attributing shared and common costs, as explained above, a process adopted by each of BellSouth's state commissions in the generic cost proceedings. On page 29, NASUCA also criticizes SBC for considering state regulatory fees in its loop cost estimates. These costs are not included in BellSouth's cost study.

from its theoretical wholesale provider. The same is also true for Customer Services expense (Account 6623). In the development of the Wholesale common cost factor, only 16% of these costs were considered; in the development of the retail common costs, 100% of these costs are considered[19]. As will be explained below, it appears that the FPSC did not consider all of the relevant common costs in its attempt to utilize BellSouth Shared and Common Application. The FPSC ignored a portion of the common costs that would be applicable to both a wholesale and retail environment.

In the FPSC comments, it appears that the FPSC simply replaced the wholesale ratios in the Shared and Common Cost Application with inverse ratios (100% minus the wholesale ratio). As previously described, however, BellSouth will incur 100% of these common costs. BellSouth incurs these common costs in any operating environment, i.e. in either the wholesale or in the retail condition. The appropriate approach, therefore, is to capture total common costs, divide by total access lines (including both retail and wholesale lines), and then allocate the portion that is related to the interstate common line (SLC) portion of the business, as BellSouth has done.

Finally, BellSouth believes that the development of common costs on a "per line" basis is more appropriate in determining SLC costs than the use of a common cost factor. In fact, it would have been BellSouth's preference to use a similar "per element" approach in determining common costs associated with unbundled network elements. However, the shear number of unbundled network elements, the lack of element-specific demand forecasts, and the difference in units (per loop, per minute of use, per call, etc.) made that type of methodology impossible. Further, it would have been inaccurate to allocate the same amount of common cost to an xDSL-capable loop as to a cross-connect. Thus, the factor approach was the most equitable means of identifying common costs in the unbundled network element studies. In BellSouth's SLC studies, however, the use of total projected network access lines, which includes all types of lines - retail, wholesale, residence, business, UNEs, resold, private line, special access, etc., – to allocate total common costs is an equitable means of apportioning these costs and ensures an accurate reflection of the costs BellSouth incurs.

[19] As explained previously, the total common costs developed from BellSouth Shared and Common Cost Application, are divided by projected (2002) Average Access Lines In Service and then multiplied by 15%.

Issue: NASUCA contends that the cost studies filed in this proceeding violate the Commission's forward-looking study standards, in part, because "[t]he cost submissions fail to include the actual models used to estimate costs." (NASUCA, page 13)

Response: BellSouth's cost model has undergone extensive review by state commissions in generic cost proceedings. In fact, **the cost methodology, models and inputs submitted in this proceeding are generally identical to those recently filed in Alabama, Florida, Georgia, Kentucky, Louisiana, Mississippi, and South Carolina to support cost-based rates for unbundled network elements and interconnection.** There are two major differences, however. First, while in both the UNE studies and in the SLC studies, the BSTLM configures a network to serve all customer locations, the customer locations considered in the cost development differ between the two studies. In the UNE studies, the 2-wire Analog Voice Grade Loop represents the average cost of serving all residence and business POTS, PBX, Centrex, Coin, and 2-wire analog private line locations in BellSouth's territory. In the SLC studies, the loop represents the average loop cost to serve those customer locations that pay the $5.00 SLC – that is. primary residential and single-line business locations. Second, as discussed previously, the common costs were developed on a "per line" basis rather than as a factor.

In each of BellSouth's states, the state commission accepted the models' logic and internal algorithms and underlying cost methodology. The FPSC in its order in Docket No. 990649-TP stated: "the parties are in general agreement that BellSouth's new loop model, the BSTLM, has the capability to generate realistic estimates of the amount of outside plant required to provision services." The FPSC also found that "it is more appropriate for purposes of determining BellSouth's UNE loop costs that they reflect BellSouth's current and prospective engineering principles and deployment practices. Accordingly, we find that BellSouth's modeling approach is reasonable." (FPSC Order in Docket No. 990649-TP, dated May 25, 2001) Even though the cost studies submitted in this proceeding are not for unbundled network elements, instead for a retail service, the same consideration of "BellSouth's current and prospective engineering principles and deployment practices" is still appropriate. The Kentucky Public Service Commission ("KPSC"), in Administrative Case 382, found: "The inherent design characteristics of the model and BellSouth's modeling approach using multiple scenarios and engineering assumptions pertaining to crossover points, loop length limits, range card limits, and other similar items should be accepted." (KPSC Order in Administrative Case 382, dated December 18, 2001) The Louisiana Public Service Commission ("LPSC"), in Docket No. U-24714-A, found: "[t]he parties agree to modeling assumptions which utilize BellSouth's existing wire center locations and modeling locations." When considering proposed

modifications to BellSouth's architectural assumptions in the BSTLM, the LPSC found that the party had "failed to provide reasoning or support for its proposed modifications sufficient to demonstrate that BellSouth's well-defended assumptions are inappropriate." (LPSC Order in Docket No. U-24714-A, dated September 21, 2001)

Since the BSTLM develops the loop costs (which reflect the majority of the costs associated with access to the voice grade telephone network), it has received the most scrutiny in BellSouth's generic cost proceedings. Thus, the BSTLM has undergone extensive review by intervening parties. In fact, several enhancements to the model have resulted from comments made by intervening parties. Indeed, the BSTLM has been accepted by each of the state commissions.

Port costs, derived from the SST, are directly linked to SCIS/MO outputs. The SCIS model underwent an extensive audit in the Open Network Architecture ("ONA") proceeding before this Commission. The auditing firm (Arthur Andersen & Company) concluded that SCIS "is fundamentally sound and provides reasonable estimates of switching system investment attributable to service and feature usage of the switch." The Anderson audit stated:

- "The costing principles inherent in SCIS are appropriate for estimating long run incremental investments attributable to switching system usage, and the specific methods for implementing these principles are reasonable."
- "SCIS accurately estimates the cost of actual switching systems engineered according to manufacturer engineering rules as evidenced by Bellcore's validation procedures and results."
- "Extensive software development controls and testing are used to assure SCIS models are properly implemented and installed by model users."
- "...although SCIS is a complex model requiring considerable understanding of switching systems and service costing, the model documentation, training and technical support are adequate to provide reasonable support for the model in use."

(Page 7, Arthur Andersen Independent review of SCIS/SCM Report, dated July 20, 1992) (CC Dockets 89-79 and 87-713)

The BellSouth Cost Calculator systematically calculates annual costs based on material prices. In other words, the BellSouth Cost Calculator converts material costs into installed investments, adds supporting structure investments, and converts these investments into monthly capital

costs (depreciation, cost of money, and income tax), operating costs (plant-specific costs), and shared costs. BellSouth did not receive specific criticism of the functioning of the BellSouth Cost Calculator in any of the generic cost proceedings.

Also, contrary to NASUCA's assertion, no "standard" exists as to the level of cost detail that needs to be supplied to the Commission. In fact, for some retail interstate services BellSouth provides this Commission cost information consistent with the amount of detail provided in this proceeding. Further, BellSouth fulfilled the directive established by the Commission in its procedural order. That order merely required cost "information", not "a detailed description of all algorithms, computations, and software" and "essential input values," as NASUCA contends[20]. (NASUCA, page 14)

Issue: NASUCA asserts that: "[t]he cost studies contain a number of fatal methodological flaws." (NASUCA, page 14)

Response: It is difficult to reconcile NASUCA's assertion that the cost studies filed did not contain sufficient detail to evaluate the results with the above statement. How did it arrive at its conclusion without sufficient detail? Obviously, by making generalities based on statements taken out-of-context.

NASUCA claims that the "studies are improperly designed to recover embedded costs, rather than forward-looking economic costs." (NASUCA, page 14) To support this assertion, NASUCA states that SBC's study reflects: "the mix of equipment used today." While, BellSouth cannot comment on SBC's methodology, this is not what is assumed in BellSouth's cost studies. As stated previously, the BSTLM designs the outside plant network to efficiently serve customer locations based on existing wire center locations. Furthermore, the model assumes the most efficient telecommunication technology currently available, not necessarily what BellSouth has deployed. For example, even though BellSouth still deploys Universal Digital Loop Carrier ("UDLC") systems, in this study the BSTLM places no UDLC systems to serve single-line customer locations. Additionally, the model places a greater percentage of GR303 Digital Loop Carrier systems than what BellSouth actually has in

[20] The Commission's Sixth Report and Order in CC Docket Nos. 96-262 and 94-1 states: "For this proceeding, the price cap local exchange carriers (LECs) have agreed to provide, and we will examine, forward-looking cost information associated with the provision of retail voice grade access to the public switched telephone network."

its network[21]. Port costs reflect only digital switches, even though BellSouth still has a limited number of analog switches in its network. Further, the termination of loops in the switch is consistent with the forward-looking assumptions in the BSTLM, i.e., the SCIS/MO input reflects GR303 DLC systems. Thus, NUSUCA's statement that: "Just like the other ILECs, SBC has incorrectly presented a reproduction cost study" is a gross generalization. It is obvious that BellSouth has NOT reproduced the existing network.

NASUCA also cites BellSouth's cost study to advance its "embedded" misrepresentation. NASUCA states: "BellSouth's Cost calculator applies the embedded relationship between cable and structure to determine the cost of poles, conduit, and trenching." (NASUCA, page 18, footnote 21) This is incorrect. BellSouth's loading factors reflect projected investments – pole, conduit, land, and building loading factors – based on anticipated additions. Furthermore, in developing the base year investment for these loading factors, a Current Cost to Booked Cost ("CC/BC") ratio is applied. The CC/BC ratio assures that "embedded" investments are reflected as current. More importantly, it is the application of the loading factors that must be considered. These factors develop a relationship, not an absolute value. Thus, when these factors are applied against forward-looking investments, the result projects a forward-looking investment.

Issue: This Commission should reject the submitted studies because the "cost models rely upon state specific inputs." (NASUCA, page 20)

Response: NASUCA claims that since the Commission rejected company-specific data in establishing the Universal Service Fund, it is appropriate to follow that same philosophy here. BellSouth disagrees. This Commission has

[21] NASUCA makes an erroneous assertion that a network configuration that "assume[s] more expensive materials for the provision of advanced services, such as additional fiber optic cables and universal digital loop carrier systems, that are not necessary for basic voice services" leads to an "overstatement" of cost. (NASUCA, page 25) Contrary to NASUCA's claim, the use of fiber cable and digital loop carrier systems (not necessarily universal systems) are not "more expensive" and thus, reflect an efficient means of delivering voice grade services via a narrowband network. BellSouth has conducted economic analyses of the breakpoint (12,000 feet) where it becomes more cost effective to deploy a mix of copper and fiber and digital loop carrier systems versus deploying pure copper. These assumptions are contained in the BSTLM. BellSouth also finds this statement from NASUCA in conflict with it criticism of SBC on page 31 – "IDLC is the appropriate technology for the products being studied." NASUCA then launches into a discussion of the appropriate fiber sizes – "the FCC acknowledges that an efficient solution to sizing fiber cable recognizes nine different fiber cable sizes." It is apparent that NASUCA recognizes the efficiencies obtained from the use of DLC systems and fiber cable.

repeatedly warned that the Universal Service model (i.e., the SM) "should not be relied upon to set rates for UNEs." *Kansas/Oklahoma Order*, ¶ 84. Neither should the foundation of that model be used to evaluate the SLC cap.

In fact, NASUCA contradicts itself later when it claims that: "UNE loop and port rates established by states provide reasonable forward-looking cost estimates." (NASUCA, page 23) These UNE rates are state-specific. BellSouth has already explained why it is inappropriate to use UNE rates in lieu of the submitted SLC cost study.

Issue: "Capital costs and depreciation estimates are not transparently presented in the cost studies submitted by the ILECs." (NASUCA, page 27) "Only four out of seven carriers identified the cost of capital used in their representative cost studies." (Ad Hoc, page 7)

Response: BellSouth clearly states that: "BellSouth has used 11.25% cost of money and combined federal and state income tax factors in the calculations of cost of money and income taxes." (BellSouth cost study, page 4) This is the same input submitted in each of the state-level generic cost dockets. In these dockets, BellSouth filed the expert testimony of Dr. Randall Billingsley that supported this input.

Even though BellSouth did not specifically identify the depreciation inputs, the annual cost factors, which reflect the economic lives of the equipment and the salvage values, are displayed in the cost study. The table below compares the annual depreciation factor to the economic life that generated the factor.

	Lives	Factor
2111 Land	98	0.0000
2121 Buildings	45	0.0210
2212 Digital Switching	10	0.0986
2232 Circuit Equipment	9	0.1123
2411 Poles	36	0.0439
2421 Aerial Cable-Metallic	15	0.0775
2421 Aerial Cable-Fiber	20	0.0600
2422 Underground Cable-Metallic	14	0.0786
2422 Underground Cable-Fiber	20	0.0573
2423 Buried Cable-Metallic	15	0.0719
2423 Buried Cable-Fiber	20	0.0552
2426 Intrabuilding Network Cable-Metallic	20	0.0579
2426 Intrabuilding Network Cable-Fiber	20	0.0579
2441 Conduit	55	0.0118

The depreciation lives BellSouth used reflect the forward-looking economic lives of the equipment and are consistent with the input used in the state-level generic cost proceedings. In those proceedings, BellSouth filed the supporting depreciation studies and the expert testimony of David Cunningham[22].

Issue: "Information on fill factors is not provided in the cost studies submitted by the ILECs." (NASUCA, page 31)

Response: It appears that NASUCA believes fill factors are an input into the models. This is not the case with the BSTLM. The BSTLM relies on actual customer locations, actual business line requirements, and a reasonable 2-pair per residential location assumption to determine the amount of distribution cable required to serve forward-looking demand. Additionally, the BSTLM as filed by BellSouth, only builds to ***existing BellSouth customer locations*** rather than households or housing units. BellSouth would actually place adequate cable pairs to provide service, and additional line demand, to all households – not just to existing BellSouth customer locations. This reinforces the fact that the 2 pairs per existing BellSouth residential customer location input is a conservative input. The utilization of the distribution portion of the loop is a direct result of the placement and sizing of the distribution plant. In other words, the real issue that should be debated is; "are these underlying assumptions reasonable," which they are, not whether or not the resulting fill factor is too high or too low. None of the state commissions adjusted BellSouth's 2 pair per location assumption in the state-level generic cost dockets. BellSouth's SLC studies follow the same methodology.

For feeder cables, the BSTLM uses a copper cable sizing factor that varies by density zone (from 70% to 82.5%). The model considers the number of working distribution pairs coming into the Feeder/Distribution Interface ("FDI"), divides the number of working pairs by the appropriate copper cable sizing factor, and then selects the next larger size cable for the feeder cable. For fiber feeder cables, a sizing factor of 100% is assumed. None of BellSouth's state commissions have adjusted BellSouth's feeder cable sizing factor assumption in the state-level generic cost dockets.

Issue: "Loop length is a significant driver of overall loop costs." (NASUCA, page 32)

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[22] Dr. Billingsley and Mr. Cunningham supplied experts testimony in the following recent generic cost dockets; Alabama - 27821, Florida – 990649-TP, Kentucky – Case 382, Louisiana – 24714-A, Mississippi – 00-UA-99, and South Carolina – 2001-65-C.

Response: While BellSouth agrees with NASUCA's observation, the lack of discussion by BellSouth on this point should not raise alarm. The loop length in BellSouth's studies reflect the Minimum Spanning Road Tree ("MSRT") lengths for each primary residence and single-line business location in the BellSouth region. The BSTLM builds plant to serve existing customer locations based on the MSRT algorithm. An MSRT is the shortest road path that connects a group of customer locations. Once an MSRT is determined for those customers in excess of a user-defined road-distance from the central office, branches of the tree are "broken off" to form Carrier Serving Areas ("CSAs"). A similar process for customers within the user-defined road-distance from the central office yields Allocation Areas. Appropriate components such as Digital Loop Carriers ("DLCs") and Feeder Distribution Interfaces ("FDIs") are located within each serving area. The MSRT within each serving area then becomes the distribution cable path. An MSRT for feeder plant is also determined. That MSRT links the DLCs to the Central Office (CO). It also links the FDIs in the Allocation Area to the CO.

Issue: "The RBOCs have not explained how they account for the fact that structures like conduit and poles are shared." (NASUCA, page 33)

Response: Sharing of structures, though not easily identifiable, is reflected in BellSouth's cost study. BellSouth's cost studies account for the sharing of structure costs (poles and conduit) in the development of the Plant Specific Expense factors. Rent expense paid is booked to the Plant Specific Operations Expense for the applicable accounts. These amounts are included as debits in the development of the factors. Rent revenue received from others for rental of telephone plant is booked to Rent Revenue. These amounts are included as credits in the calculation of the factors. Therefore, net rent (rent expense minus rent received) is included in the development of the Plant Specific Factor.

For buried cable, any sharing of trenching costs is captured in the buried cable in-plant factors, which account for capitalized labor. An increase in the amount of sharing reduces the buried in-plant factor, the total installed cost as a percent of non-exempt material.

On page 44, NASUCA explains how adjustments had to be made to the Synthesis Model to recognize that feeder and distribution plant can share structure. This type of adjustment is not necessary in BellSouth's studies since they utilize loading factors, which reflect a relationship between cable and structure investments, i.e., the BSTLM does not calculate the structure investment.

Issue: "The RBOCs have failed to present any information regarding how OSS transition costs are handled." (NASUCA, page 33)

Response: Since NASUCA does not provide any detailed comments on what constitutes "OSS transition costs," BellSouth cannot provide a specific response. If these "transition costs," however, refer to the investments and expenses BellSouth incurs to handle wholesale and resale orders, these costs have been directly assigned to the unbundled network element and resale service order processing costs. Thus, they are excluded from the SLC studies.

Issue: In the running of the Synthesis Model, NASUCA creates a scenario entitled "Non-Traffic-Sensitive Loop Scenario."

Response: To support this scenario run, NASUCA claims that the "loop now contains traffic sensitive components." While it is true that digital loop carrier systems are deployed with concentration ratios dependent upon the anticipated traffic load, the systems themselves are sized based upon DS0 equivalents[23]. In other words, the number of distribution pairs at the DLC site determines the size of the system and the type of equipment placed. Concentration is a merely function of the allowable contention on the feeder portion of the loop and vendor engineering guidelines. In fact, concentration is one of the reasons DLC systems are deployed; to eliminate the need for a one-to-one dedicated path from the NID to the central office for every loop. Thus, to bifurcate the loop into non-traffic sensitive and traffic sensitive components, based solely on the concentration argument, makes no sense.

NASUCA also claims that: "business customers are provided a higher quality of service than residential customers" due to the different concentration ratios. (NASUCA, page 52) This is not true. BellSouth does not allow concentration that would endanger the quality of service offer to any of its customers.

Issue: "The cost studies filed by CALLS members in this proceeding allocate 100% of loop costs to voice services even though this common facility is currently shared among voice and data services, and prospectively video programming." (NASUCA, page 60)

Response: The argument that the loop is a shared facility and thus, should be allocated among the services that utilize the loop is not new. However, it is still as inappropriate today as it was in the past.

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[23] The BSTLM also uses DS0 equivalents to size the DLC systems it places.

First, this argument directly conflicts with the fundamental principle of cost causation, a basic principle followed in the development of economic costs. The relevant question is "why have loop-related resources been expended?" In the provisioning of primary residential and single-line business service the answer is to gain access to the public switched network, not to purchase video programming. In fact, access to the network does not require that the end user purchase other services. Once the customer gains access to the network, however, other services can only be made available to that customer at an additional cost. Additionally, the cost of the loop facility arises entirely at the point it is placed in service, not in a distributed manner over time as the facility is used for different purposes. Further, any allocation process would be totally arbitrary, requiring projections of service demand, dispersion of services, and churn.

This argument was made in Florida Docket No. 98000A-SP (Determining Fair & Reasonable Rates Under Competition), where parties claimed the loop's cost should be allocated among the various services that rely on the loop. BellSouth presented the direct and reply comments of Dr. William Taylor to counter this preposterous conclusion. The FPSC ruled: "It is the Commission's position that the cost of the local loop facilities is properly attributable to the provision of basic local telecommunications service by definition." (Report on the Costs and Charges of Various Services Provided by Local Exchange Companies and Conclusions as to the Fair and reasonable Florida Residential Basic Telecommunications Service Rate, dated February 1999, page 117)

ATTACHMENT 2

BellSouth Costs

State	I. Zone 3	II. Zone 4
Alabama	$14.66	
Florida	$10.68	
Georgia	$ 8.98	
Kentucky	$12.19	
Louisiana	$17.39	
Mississippi	$10.62	$15.30
North Carolina	$10.19	
South Carolina	$10.65	
Tennessee	$ 9.40	
Total	$10.68	$15.30

CERTIFICTE OF SERVICE

I do hereby certify that I have this 14th day of February 2002 served the following parties to this action with a copy of the foregoing **REPLY COMMENTS** by electronic filing and/or by placing a copy of the same in the United States Mail, addressed to the parties listed on the attached service list.

/s/ Juanita H.Lee
Juanita H. Lee

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