

1 **4. *GTE's Cost Studies***

2

3 **Q. Please turn to the fourth section of your testimony, concerning GTE's cost model and**
4 **cost studies. What cost model has GTE used in this proceeding?**

5 A. GTE used its Integrated Cost Model (ICM) to develop costs for this proceeding. According to
6 Company witness Tucek, ICM is "an engineering process model that was developed to
7 calculate the long run forward-looking incremental costs of providing telecommunications
8 services in GTE's serving areas". [Tucek, p. 4]. ICM is comprised of six modules: Loop,
9 Switch, Interoffice Transport, SS7, Expenses, and Mapping/Reporting. According to the
10 Company, ICM is the best tool available for calculating GTE's costs, because it is GTE-
11 specific, i.e., it uses GTE's actual input prices, current engineering practices, and existing wire
12 center locations. [Id., p. 4-7].

13

14 **Q. Were you able to determine the level of loop costs used in Mr. Calnon's workpapers?**

15 A. Yes. Mr. Calnon's workpapers include cost estimates by exchange for primary residence and
16 single line business loops, and by rate group for multiline business loops. I was able to multiply
17 these costs by the number of units in each exchange or rate group, to derive the average loop
18 costs presented in the following table.

19

Table 1

Proprietary

| | Total Monthly Loop Costs | Units | Average Monthly Loop Costs |
|-------------|--------------------------|-------|----------------------------|
| Residence | | | |
| SL Business | | | |
| ML Business | | | |
| Total | | | |

These cost levels are reasonably similar to the loop costs originally filed by GTE in Cause No. 40618. For example, in that case GTE initially filed costs of ***Proprietary Proprietary *** for a 2-wire loop.

Q. Did the Commission accept GTE's cost estimates in Cause No. 40618?

A. No, it did not. The Office of Utility Consumer Counselor and other parties strongly disputed GTE's cost estimates, arguing that they were greatly overstated. The Commission subsequently ordered GTE to recalculate its costs in accordance with a series of mandated changes. These changes included the following: 1) increase fill factors to 80 percent; 2) remove "transition" costs; 3) reduce the assumed rate of return to 9.6 percent; 4) use the Commission's prescribed lives for depreciation purposes; 5) assume the deployment of integrated digital loop carrier technology; 6) for loop lengths, assume the midpoint of each distance band to determine the investment associated with each band; 7) eliminate GTD-5 switches; 8) incorporate a "productivity increase"; and, 9) remove the inflation factor used to increase the cost of GTE's embedded network deployment.

1 **Q. Did GTE file revised cost studies in Cause No. 40618, in response to the**
2 **Commission's directives?**

3 A. Yes. On July 6, 1998, GTE filed revised studies and proposed prices that it claimed "attempt to
4 reflect the findings of the Commission in its Order of May 7, 1998". [July 6, 1998 letter from
5 GTE to IURC].
6

7 **Q. How do GTE's revised studies filed on July 6, 1998 compare to the Company's original**
8 **studies filed in Cause No. 40618?**

9 A. In the revised studies, GTE's cost estimates for a 2-wire loop dropped to *****Proprietary**
10 **Proprietary** ***. This indicates that GTE's initially filed cost estimates were drastically
11 overstated. Correcting for the various problems identified by the Commission, the cost
12 estimates declined by approximately 50 percent on a statewide basis.
13

14 **Q. Did other cost estimates also decrease after GTE reran its studies in response to the**
15 **Commission's directives?**

16 A. Yes. 2-wire ports decreased by 57.85%; originating and terminating end office switching
17 decreased by 16.42% and 6.88%, respectively, common transport termination decreased by
18 12.94%, and common transport per mile decreased by 6.95%.
19

20 **Q. How do GTE's inputs used in the studies filed in this proceeding compare to the inputs**
21 **ordered by the Commission in Cause No. 40618?**

22 A. I haven't prepared an exhaustive comparison of all the inputs in these two sets of cost studies,
23 but the inputs used in this proceeding appear to be more comparable to the ones GTE originally
24 used in Cause No. 40618 than to the version which responds to the Commission's order. For
25 example, GTE uses a capital cost of 12.65% in this proceeding. This is even more overstated

1 that the 11.32% input assumption it originally used in Cause No. 40618, and it drastically
2 exceeds the 9.6% cost of capital found by the Commission. [See May 7, 1998 Order, p. 18].
3 The studies filed in this proceeding also overstate depreciation costs, based upon depreciation
4 lives that are shorter than those prescribed by the Commission. For example, GTE uses a 10
5 year life for digital switching equipment, rather than the 12 years prescribed by the Commission,
6 and 20 years for fiber cable rather than the 24-25 year lives prescribed by the Commission.
7 [Sovereign, p. 6].
8

9 **Q. Are other costs, in addition to the loop, affected by the inputs used by GTE?**

10 A. Yes. For instance, GTE's direct cost estimates include switching costs (both port costs and
11 usage sensitive costs) which result directly from GTE's choice of inputs. If these studies had
12 relied upon reasonable inputs, like those required by the Commission in Cause No. 40618, the
13 resulting cost levels would have been dramatically lower.
14

15 **Q. What about GTE's "other" common costs. Do they appear reasonable?**

16 A. It is hard to say. The Company's supporting documentation in this area is quite confusing.
17 While there are many pages of numbers, one cannot readily determine what costs are being
18 included, how these costs were developed, or what assumptions were made concerning
19 forward looking efficiencies, and the like. In fact, even the overall level of alleged common
20 costs is difficult to pin down. On Exhibit MSC-6, GTE presents "other" common costs of
21 \$190,493,623, and it shows a corresponding intrastate amount of \$143,915,196. However, on
22 Exhibit MSC-5, GTE reports its intrastate "other" common costs as \$142,686,356. A much
23 more dramatic difference occurs when one compares the "other" common costs on Exhibit
24 MSC-6 to the other common costs used in GTE's subsidy analysis. For example, on Exhibit
25 MSC-6, GTE allocates \$86,552,805 in "other" common costs to Basket 1. However, the

1 “other” common costs appearing in Basket 1 in Mr. Seaman’s Table 1 is only *****Proprietary**
2 **Proprietary*****. [See, GTE Response to OUCC IR 4.5].

3
4 **Q. Have you recalculated GTE’s analysis to illustrate the impact of using more**
5 **reasonable cost estimates?**

6 A. Yes. GTE’s bop costs declined in Cause No. 40618 by roughly 50% when it ran its studies
7 using more reasonable assumptions, as ordered by the Commission. Accordingly, I have
8 reduced GTE’s cost estimates in this proceeding by 50 percent, to demonstrate how strongly its
9 conclusions are tied to its excessive cost estimates, and to illustrate how its analysis would be
10 changed, if it were required to use more reasonable cost assumptions, like those mandated by
11 the Commission in Cause No. 40618. Accordingly, I have estimated GTE’s intrastate loop
12 costs to be \$121,247,292. Similarly, I reduced switching and other direct costs by 30 percent,
13 based upon a reasonable blend of the reductions in GTE’s port, switching and transport costs
14 after using more reasonable assumptions, as required by the Commission. Accordingly, I
15 estimate direct costs of \$37,242,223 and \$70,264,225 for Baskets 1 and 2, respectively.
16 Although requested 3 times through the discovery process, GTE has not provided its estimate
17 of the direct cost of services included in Basket 3. Accordingly, as I explain in the next section
18 of my testimony, I use an alternate method of estimating these costs.