

**BEFORE
THE PUBLIC UTILITIES COMMISSION OF OHIO**

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In The Matter Of The Application Of)
Cincinnati Bell Telephone Company For)
Approval Of A Retail Pricing Plan Which) Case No. 96-899-TP-ALT
May Result In Future Rate Increases)

**SUPPLEMENTAL TESTIMONY OF
DR. AUGUST ANKUM
ON BEHALF OF
MCI TELECOMMUNICATIONS CORPORATION**

January 11, 1999

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**SUPPLEMENTAL TESTIMONY OF DR. AUGUST H. ANKUM
ON BEHALF OF MCI TELECOMMUNICATIONS CORPORATION**

1 Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

2 A. My name is Dr. August H. Ankum. I am an economist and consultant, specializing in
3 telecommunications. My business address is 1350 North Wells, Suite C501, Chicago, IL
4 60610.

5 Q. ARE YOU THE SAME AUGUST H. ANKUM THAT PREVIOUSLY FILED
6 TESTIMONY IN THIS PROCEEDING?

7 A. Yes, I am.

8 Q. WHAT IS THE PURPOSE OF THIS SUPPLEMENTAL TESTIMONY?

9 A. It is my understanding that the intervenors were permitted to file supplemental testimony
10 regarding the use and development of Cincinnati Bell Telephone's (CBT's) annual charge
11 factors ("ACFs") once they were provided access to the cost model used by CBT to derive
12 the ACFs proposed for the purposes of this proceeding. As discussed below, I was able to

1 run the model at CBT's offices and now have additional testimony to present to the
2 Commission.

3 **I. THE COMMISSION SHOULD NOT APPROVE THE USE OF THE ECONCOST**
4 **MODEL FOR THE PURPOSES OF DETERMINING CBT'S ANNUAL CHARGE**
5 **FACTORS**

6 Q. WHAT MODEL DID CBT USE TO DETERMINE ITS ACFS FOR DEPRECIATION,
7 COST-OF-MONEY, AND TAXES?

8 A. CBT used the ECONCOST model. The ECONCOST model is not CBT specific, but has
9 been developed by an outside telecommunications consulting firm.

10 Q. HAVE YOU HAD AN OPPORTUNITY TO INVESTIGATE CBT'S ECONCOST
11 MODEL?

12 A. No. The ECONCOST model is a proprietary model that, to my knowledge, has not been
13 released for investigation to any of the parties in this proceeding. As of yet, therefore, the
14 ECONCOST model is unexamined.

15 Q. HAVE YOU HAD THE OPPORTUNITY TO RUN THE MODEL AT CBT'S OFFICES?

16 A. Yes. I have been at CBT's offices in Cincinnati to run the model with the assistance of CBT
17 personnel. I was not allowed, however, to examine the algorithm of which the model exists.
18 Thus, while having run the model permits me some insight into the model, I am not in a
19 position to state whether or not the ECONCOST model appropriately calculates the ACFS

1 for depreciation, cost-of-money, and taxes.

2 Q. SHOULD THE COMMISSION APPROVE THE ECONCOST model?

3 A. No. As stated, the ECONCOST model has not been examined. Thus, given that the
4 Commission has no assurance whatsoever that the model's logic is appropriate, it would be
5 inappropriate to sanction the ECONCOST model in this proceeding.

6 **II. A COMPARISON OF VARIOUS RUNS OF THE ECONCOST MODEL SHOWS**
7 **THE IMPORTANCE OF USING FORWARD-LOOKING INPUTS FOR COST OF**
8 **MONEY (COM) AND ECONOMIC LIVES**

9 Q. HAVE YOU HAD AN OPPORTUNITY TO RUN THE ECONCOST MODEL WITH
10 VARIOUS INPUT SCENARIOS?

11 A. Yes. During my visit of the CBT offices in Cincinnati, I was able, with the assistance of CBT
12 personnel, to run the ECONCOST model for various scenarios. Table 1 below reports on
13 three important scenarios.

14 The first scenario, reported under the heading *CBT's Own Base Run* are the depreciation,
15 cost-of-money, and tax components that form the basis for CBT's proposed ACF's. Under
16 the heading *Hirshleifer COM 8.43%* is found the results if the cost of money in the
17 ECONCOST model is changed to Dr. Hirshleifer's latest recommendation of 8.43%.
18 Specifically, this scenario used Dr. Hirshleifer's recommended debt-to-equity ratio, rate-of-
19 return on equity, and debt interest rate. The last column, labeled *COM 8.43% and FCC*

Lives, reports the results for running the ECONCOST model with Hirshleifer's COM of 8.43% and the FCC's recommended economic lives for CBT Ohio.

TABLE 1: ECONCOST model RESULTS FOR DEPRECIATION, COM, AND TAX COMPONENTS OF CBT'S ACFS: THREE SCENARIOS

ACCOUNT	CBT'S OWN BASE RUN	HIRSHLEIFER COM 8.43%	COM 8.43% AND FCC LIVES
OPER SYS OH 117C	0.3065	0.2831	0.2740
INTB MET OH12C	0.2578	0.2305	0.2199
AER MET OH22C	0.2333	0.2139	0.1897
DIG SW OH337C	0.2021	0.1796	0.1657
BUR MET OH45C	0.2013	0.1748	0.1607
UND CON OH4C	0.1659	0.1294	0.1294
UND MET OH5C	0.2331	0.2129	0.1847
INTB NMET OH812C	0.2144	0.1838	0.1800
AER NMET OH822C	0.2124	0.1880	0.1824
BUR NMET OH845C	0.1874	0.1581	0.1538
UND NMET OH85C	0.1848	0.1575	0.1533
LG BLDGS OH10JC	0.1566	0.1241	0.1233
POLES OH1C	0.2184	0.1947	0.1947
PUB TEL OHPTE	0.2663	0.2392	0.2392
DIG CKT OHX57C	0.2619	0.2388	0.2223
FURNITURE OH221C	0.1843	0.1567	0.1567
LAND OH22C	0.1661	0.1256	0.1256
COMPUTERS OHGPC	0.3208	0.2977	0.3063

Q. ARE THESE ALTERNATIVE SCENARIOS RELEVANT?

1 A. Yes. First, Staff itself recommends the use of the FCC's economic lives over the CBT
2 proposed economic lives. Specifically, on page 86 of the Staff Report, it states:

3 For TELRIC purposes, the Staff believes that the forward-looking lives
4 appropriate for CBT's plant would be the projection lives (and the future
5 salvage percentage) developed in CBT's triennial depreciation study. The
6 projection lives (and future net salvage percentage) were those agreed upon
7 in a meeting held in May 1997, by representatives of CBT, the FCC, and the
8 Commission.

9 Further, the Commission should have available the effect of using the forward-looking cost-
10 of-money component recommended by Dr. Hirshleifer.

11 As can be seen by comparing CBT's Base Run results with the results in the last column,
12 running the ECONCOST model with forward-looking inputs for cost-of-money and economic
13 lives drastically changes the ACFs.

14 Q. DO THE ABOVE RESULTS REPRESENT CBT'S ACFS IF THE COMMISSION WERE
15 TO ADOPT DR. HIRSHLEIFER'S FORWARD-LOOKING COM AND THE FCC'S
16 ECONOMIC LIVES?

17 A. To see the bottom-line effect on the ACF's of changing certain inputs one must also add in
18 the maintenance expense factors that were determined outside of the ECONCOST model.

19 **IV. BECAUSE THE ECONCOST MODEL HAS NOT BEEN PROVIDED TO THE**
20 **PARTIES OR THE COMMISSION FOR EVALUATION, THE COMMISSION SHOULD**
21 **ESTABLISH CBT'S ACFS USING THE INPUTS RECOMMENDED BY MCI.**

1 Q. YOU HAVE RECOMMENDED THAT THE COMMISSION NOT APPROVE THE USE
2 OF THE ECONCOST MODEL FOR THE PURPOSES OF DEVELOPING CBT'S
3 ANNUAL CHARGE FACTORS. DO YOU HAVE AN ALTERNATIVE
4 RECOMMENDATION AS TO HOW THE CBT'S ACFS SHOULD BE ESTABLISHED
5 SO THAT TELRIC PRICES CAN BE DETERMINED?

6 A. Yes. I would recommend that the ECONCOST model be used only if the inputs are adjusted
7 as recommended by MCI, including the adjustments to the maintenance expenses
8 recommended by Mr. Brad Behounek, whose testimony I have adopted..

9 Q. HAVE YOU READ CBT'S CRITICISMS OF MR. BEHOUNEK'S TESTIMONY?

10 A. Yes, I have. CBT witness Mr. Mette discusses Mr. Behounek's adjustments to CBT's
11 maintenance expenses in order to make those expenses more forward-looking and compatible
12 with the TELRIC methodology. In his testimony, Mr. Behounek used a simple regression
13 analysis that extends the trend in maintenance expenses to capture the effects of CBT's
14 deployment of more efficient technologies, *an important effect that CBT had failed to*
15 *consider.*

16 On page 2 and 3 of his supplemental testimony, Mr. Mette observes that Mr. Behounek's
17 testimony: (a) recommends "one composite reduction be applied to all maintenance expense
18 components without regard to the relative weighing of the expenses for the specific class of

1 plant"; and (b) "is inaccurate in that the historical data that serves as the basis of [the]
2 regression analysis is not comparable."

3 Q. DOES THE TESTIMONY PRESENTED BY CBT REGARDING MR. BEHOUNEK'S
4 ADJUSTMENTS TO THE ACF INPUTS CHANGE YOUR RECOMMENDATION THAT
5 THE ECONCOST MODEL BE USED ONLY WITH MCI'S ADJUSTED INPUTS?

6 A. No, it does not. Although Mr. Mette's observations are factually correct, it should be noted
7 that Mr. Behounek's adjustments to CBT's ACF's were warranted by the fact that *CBT had*
8 *failed to use forward-looking maintenance expenses*, as required under the TELRIC
9 methodology. CBT itself admits that its original ACF's failed to be forward-looking. In fact,
10 on page 1 of his testimony, Mr. Mette introduces an *alternative* method for adjusting CBT's
11 original ACFs.

12 Further, Mr. Behounek did provide the trend-analysis results for each account individually.
13 This means that, while he aggregated the results for all accounts for reporting purposes, the
14 information for each account individually is available to the Commission so that the
15 Commission can order adjustments to each expense account individually. In short, Mr.
16 Mette's criticism do not invalidate Mr. Behounek's exercise.

17 Q. DOES MR. METTE'S ALTERNATIVE METHOD FOR ADJUSTING CBT'S ORIGINAL
18 ACF'S RESULT IN THE "CORRECT" FORWARD-LOOKING ACF'S?

19 A. No. Apart from a number of other problems with CBT's ACFs, Mr. Mette's adjustments fail

1 to consider truly forward-looking maintenance expenses.

2 Following Mr. Behounek, Mr. Mette performs his own regression analysis to capture the
3 trend in CBT's maintenance expenses. The effect that Mr. Mette captures, however, is the
4 trend in CBT's *overall* maintenance expenses which are based on a *gradual phase-out* of
5 CBT's *embedded* network. As such, it can be used *only* to predict what CBT's maintenance
6 expenses may be three or four years from now, when a larger percentage of CBT's embedded
7 facilities will likely have been phased out. Mr. Mette's analysis, however, does *not* provide
8 a perfect measure for the maintenance expenses associated with a forward-looking network --
9 the objective in determining ACFs for a TELRIC study. A forward-looking network is
10 already assumed to be *devoid* of any *embedded* technologies.

11 Since embedded technologies generally require higher maintenance expenses than newer
12 technologies, Mr. Mette's adjustments are likely to overstate the forward-looking
13 maintenance expenses associated with a forward-looking network. This, in turn, means that
14 CBT is still advocating ACF's that over-recover maintenance expenses.

15 Q. WHAT IS YOUR RECOMMENDATION ON HOW TO APPROXIMATE CBT'S
16 FORWARD-LOOKING MAINTENANCE EXPENSES?

17 A. I recommend that the Commission adopt the recommendations in Mr. Behounek's testimony,
18 which I have adopted. While it is true that Mr. Behounek's adjustment do not calculate the
19 "true" forward-looking maintenance expenses, neither do Mr. Mette's adjustments. Given

1 that the burden of proof is CBT's and not MCI's, the pertinent question is not: "are MCI's
2 adjustments perfect?"; but rather: "do MCI's adjustments improve on CBT's cost studies?"
3 In my opinion, Mr. Behounek's adjustments improve on CBT's cost studies. Furthermore,
4 since Mr. Mette's adjustments will result in an over-recovery of maintenance expenses, it is
5 more appropriate to adopt Mr. Behounek's recommendations.

6 Q. CBT ALSO PROPOSED THE INCLUSION OF "NEW COSTS" IN THE
7 DEVELOPMENT OF THE ACF'S. IS THIS APPROPRIATE?

8 A. I recommend that the Commission order CBT to exclude from the ACF's the nebulous "new
9 cost" category until CBT has carefully demonstrated the magnitude and forward-looking
10 nature of these costs.

11 On page 88 of its Report, Staff noted the following: "CBT provided little support for its
12 alleged new costs. In fact, it appears that its new cost calculations are no more than estimates
13 and projections." Staff then went on to note that "it would expect CBT to provide a more
14 clear rationale and justification of new costs in its OSS TELRIC study." In view of Staff's
15 expressed concerns, it is disconcerting that CBT has not come forth with additional
16 supporting information for these alleged "new costs" in its Supplemental Testimony.

17 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

18 A. Yes, it does.

CERTIFICATE OF SERVICE

I hereby certify that a true copy of the foregoing Supplemental Testimony has been served upon the following by Federal Express or first class U.S. mail, postage prepaid, this 11th day of January 1999.


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