

BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 02-0864

**Rebuttal Testimony of Donald G. Palmer, Jr.
On Behalf of SBC Illinois**

SBC Illinois Exhibit 15.0

January 20, 2000

***** PUBLIC VERSION *****

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1 **REBUTTAL TESTIMONY OF DONALD G. PALMER, JR.**

2 **ON BEHALF OF SBC ILLINOIS**

3
4 **I. INTRODUCTION AND PURPOSE OF TESTIMONY**

5
6 **Q1. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

7 A1. My name is Donald G. Palmer, Jr., Senior Manager, Procurement Regulatory and Legal
8 Support. My business address is 2600 Camino Ramon, San Ramon, CA 94583.

9 **Q2. PLEASE STATE THE NAME OF YOUR EMPLOYER AND DESCRIBE YOUR**
10 **RESPONSIBILITIES.**

11 A2. I am employed by SBC Services, Inc., a wholly owned subsidiary of SBC
12 Communications Inc. (“SBC”). My business address is 2600 Camino Ramon, San
13 Ramon, California, 94583. I have been employed by SBC for eight years, four years in
14 my present capacity. My current responsibilities are to represent SBC’s Procurement
15 organization and provide support on regulatory and legal matters that relate to the
16 Procurement organization and SBC’s business relationships with its suppliers. These
17 activities include coordinating responses to regulatory and legal requests for information
18 and the production of documents, as well as providing testimony and witness support on
19 specific Procurement issues.

20 **Q3. PLEASE DESCRIBE YOUR PREVIOUS WORK EXPERIENCE AND**
21 **EDUCATIONAL BACKGROUND.**

22 A3. Prior to joining SBC, I held a variety of procurement-related management positions over
23 a twenty-year period with various companies in the medical device and commercial
24 electronics manufacturing industries. My responsibilities have included extensive
25 contract negotiations, administration of high value purchase agreements covering a wide
26 variety of goods and services, and management of procurement operations in general. I
27 received an M.B.A. from the University of Phoenix in June 2000 and a J.D. from John F.
28 Kennedy University School of Law in 1994. I earned a B.S. in Business Administration
29 in 1988, also from John F. Kennedy University. I have additionally completed executive
30 management programs in Contract Management (UC Berkeley, 1997) and Management
31 of Technology Organizations (Carnegie Mellon, 1997), and have attended numerous other
32 management, technology, and legal education seminars throughout my career. I am also
33 an active member of the California State Bar.

34 **Q4. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?**

35 A4. No.

36 **Q5. HAVE YOU FILED TESTIMONY IN ANY OTHER PROCEEDING THAT**
37 **RELATES TO THE SUBJECT OF YOUR TESTIMONY IN THIS CASE?**

38 A5. Yes. I have provided written and/or oral testimony relating to the subjects that I address
39 in this proceeding in similar UNE cost related proceedings in Texas, California,
40 Wisconsin, and Indiana.¹

¹ See Public Utility Commission of Texas, Proceeding on Cost Issues Severed From P.U.C. Docket No 24542, Docket 25834 (“Texas UNE Case”) (rebuttal and deposition testimony, February and March 2003, respectively); Public Utility Commission of Texas, Arbitration of Phase I Costing Issues for Successor Interconnection

41 **Q6. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

42 A6. The purpose of my testimony is to provide the Commission with some clarification
43 regarding two specific issues, both of which relate to SBC Illinois' ("SBC") contract
44 costs for Alcatel Digital Loop Carrier ("DLC") equipment that SBC models in its
45 Unbundled Recurring UNE Loop Cost Study.² The Alcatel contract issues have been
46 raised in the Direct Testimony of AT&T witnesses, Messrs. Brian F. Pitkin and Steven E.
47 Turner,³ as well as in the Direct Testimony of Messrs. Michael Starkey and John Balke,
48 on behalf of WorldCom, et al. (collectively "Joint CLECs").⁴

49 **Q7. WHAT ARE THE SPECIFIC ALCATEL CONTRACT ISSUES?**

50 A7. First, Joint CLECs contend that certain language in SBC's contracts with Alcatel should
51 be interpreted to mean that the DLC equipment prices modeled in LoopCAT already
52 includes a majority of the cost associated with the actual field installation of the
53 equipment and, therefore, SBC's application of an additional installation, or "linear
54 loading factor," results in an overstatement of SBC's DLC equipment investments.⁵ This
55 contract language issue is intimately associated with the separate but related issue of

Agreements to the Texas 271 Agreement, Docket 28600 ("Texas Arbitration Case") (rebuttal testimony, January 2004); Before the Public Utilities Commission of the State of California, Joint Application of AT&T Communications of California, Inc. and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching [and Unbundled Loops] in its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050, Applications 01-02-024, 01-02-035 ("California UNE Case") (rebuttal and hearing testimony, March and April 2003, respectively); Before the Public Service Commission of Wisconsin, Investigation Into Ameritech Wisconsin's Unbundled Network Elements, Docket No. 6720-TI-161 ("Wisconsin UNE Case") (Affidavit, April 2003); State of Indiana, Indiana Regulatory Utility Commission, In the Matter of the Commission Investigation and Generic Proceeding of Rates and Unbundled Network Elements and Collocation for Indiana Bell Telephone Company, Inc., d/b/a SBC Indiana Pursuant to the Telecommunications Act of 1996 and Related Indiana Statutes ("Indiana UNE Case") (reply and hearing testimony, September 2003).

² SBC Illinois' Loop Cost Analysis Tool ("LoopCAT") is used to model SBC's total investments for various types of UNE loops which include equipment investments for Alcatel DLC equipment.

³ See Direct Testimony of Brian F. Pitkin and Steven E. Turner on Behalf of AT&T Communications of Illinois, Inc., May 6, 2003 (hereafter "Pitkin-Turner Direct").

⁴ See Direct Testimony of Michael Starkey and John Balke on Behalf of WorldCom, Inc., et al., May 6, 2003 (hereafter "Starkey-Balke Direct").

56 SBC's use of installation factors that account for all the additional costs that SBC incurs
57 to actually install this equipment in the field, but that are not included in the contract
58 prices for the equipment itself. SBC's use of installation factors is fully discussed in the
59 Rebuttal Testimony of SBC witness, Mr. James R. Smallwood. My testimony will focus
60 strictly on the language in SBC's contracts with Alcatel and how that language should
61 correctly be interpreted. Additionally, Messrs. Pitkin and Turner separately argue that
62 SBC has failed to account for certain contract discounts that they contend will go into
63 effect by the time an order is issued in this case and thus SBC has further overstated its
64 DLC-related loop investments.⁶ However, contrary to these allegations, it is the purpose
65 of my testimony to show that:

- 66
67 **1. The Alcatel contract prices modeled in LoopCAT do not**
68 **include any duplicate installation costs, and**
69
70 **2. SBC Illinois' Alcatel DLC equipment costs, as modeled in**
71 **LoopCAT, reflect all applicable contract discounts.**
72

73 **Q8. HAVE THE ALCATEL CONTRACTS BEEN PRODUCED IN RESPONSE TO**
74 **DISCOVERY IN THIS CASE?**

75 A8. Yes. Following is a list of the specific Alcatel contracts that SBC Illinois has produced in
76 discovery and the corresponding data request. I reference portions of these agreements in
77 detail throughout my testimony.

78 Joint CLEC Data Request No. 1.95(a), Staff Data Request No. PL 1.09(b):

- 79 ○ Alcatel Master Agreement No. 99007655
80 ○ Alcatel Litespan Purchasing Agreement No. 99007255 (Amendments 1 to 7)
81 ○ Alcatel Litespan Price List ("Exhibit B" dated July 15, 2002)

⁵ Pitkin-Turner Direct, pp. 26, 61-87; Starkey-Balke Direct, pp. 57-62.

82 AT&T Data Request No. BFP-114:

83 o Alcatel Litespan Price List (“Exhibit B” dated February 20, 2003)

84 **Q9. HAVE THERE BEEN ANY SUBSEQUENT AMENDMENTS TO THESE**
85 **AGREEMENTS?**

86 A9. Yes. Amendment No. 8 to the Litespan Purchasing Agreement (No. 99007255) was
87 executed in April 2003, and a revised “Exhibit B” equipment price list went into effect in
88 August 2003. Both of these documents are attached as Schedules to my testimony.⁷
89 Neither Amendment No. 8 nor the revised price list has materially affected the DLC
90 equipment prices that SBC Illinois has modeled in LoopCAT.

91 **Q10. PLEASE SUMMARIZE SBC ILLINOIS’ POSITION ON THESE ISSUES.**

92 A10. With regard to the contract installation issue, my testimony demonstrates that the prices
93 in SBC’s contracts with Alcatel are equipment only prices and that none of the actual
94 costs incurred by SBC Illinois to physically place and install this equipment in the field
95 are accounted for in the contract prices. It is of critical importance to understand what is
96 actually meant by the term “installation,” not only as used in the Alcatel contracts, but
97 also as that term is applied in LoopCAT, as well as how it is used in the testimony of
98 Joint CLECs’ witnesses. The general use of the term “installation” seems to have led to
99 this protracted debate about what is and is not included in the contract unit prices and to
100 what extent SBC’s actual “installation costs” are accounted for by SBC’s installation
101 factors. To help provide some clarity on this issue, I think it is important at the outset to
102 explain that there are two kinds of “installation” at issue in this case. One is the type of

⁶ Pitkin-Turner Direct, pp. 131-136.

103 “installation” performed by Alcatel under the terms and for the prices stated in the
104 contracts. This type of installation does not relate to the physical placement of Alcatel’s
105 DLC equipment in SBC’s field locations, but only relates to Alcatel’s factory assembly or
106 “integration”⁸ of various hardware and electronic components that are built into the
107 remote terminal (“RT”) cabinets and various central office terminal (“COT”) equipment
108 configurations that SBC purchases from Alcatel. The other type of “installation” that is
109 debated in this case relates to all of the necessary activities that are performed by SBC
110 (and/or its contractors) after the equipment (pre-assembled or not) has been received from
111 Alcatel. All of these additional activities (and costs) are fully described in the Rebuttal
112 Testimony of SBC’s witness, Mr. Randall S. White. As I explain in detail later in my
113 testimony, it is the costs associated with these latter “installation” activities that are not
114 included in the Alcatel contract prices within the meaning of the terms of the contracts.

115
116 Finally, with regard to the contract discount issue, my testimony will show that all of the
117 applicable contract discounts that SBC Illinois is entitled to from Alcatel have in fact
118 been appropriately accounted for in the equipment prices modeled in LoopCAT.
119 AT&T’s contention that there are other discounts that SBC expects to receive in the
120 future that should have also been accounted for in LoopCAT is simply not correct.
121 Therefore, Joint CLECs’ restated costs for the Alcatel DLC equipment should be
122 rejected.

123

⁷ Amendment No. 8 to the Litespan Purchasing Agreement is attached marked as Confidential Schedule DGP-R1. The August 2003 version of the Exhibit B price list is also attached marked as Confidential Schedule DGP-R2.

⁸ Pitkin-Turner, p. 67.

124 **II. ALCATEL CONTRACT INSTALLATION**

125 *The Alcatel contract prices modeled in LoopCAT do not include any*
126 *duplicate installation costs.*
127

128 **Q11. WHAT IS THE BASIS FOR JOINT CLECS' ASSERTION THAT SBC ILLINOIS'**
129 **CONTRACTS WITH ALCATEL INCLUDES A MAJORITY OF THE COST OF**
130 **INSTALLING THIS EQUIPMENT IN THE FIELD?**

131 A11. Messrs. Pitkin and Turner state in their direct testimony that the Alcatel contract prices
132 “include all of the material costs and the vast majority of installation costs associated
133 with DLC equipment.” (Emphasis added).⁹ Messrs. Pitkin and Turner base their position
134 primarily on an erroneous interpretation of two isolated provisions of SBC’s contracts
135 with Alcatel. Their incorrect interpretation, coupled with other isolated and incomplete
136 sources of information, ultimately leads them to the following conclusion:

137 Fundamentally, the problem with SBC’s approach in developing its DLC
138 investments is that the material costs for Litespan 2000 systems in
139 LoopCAT already include much of the installation costs for these systems.
140 Only modest additional installation cost is therefore required. SBC’s
141 approach ultimately double counts costs because such costs are already
142 included in SBC’s contract price for Alcatel’s DLC equipment.¹⁰
143

144 As I have previously stated, Alcatel does not “install” this equipment in the field for SBC
145 and thus the prices reflected in the contract do not include the cost of this installation.
146 Alcatel DLC equipment is installed by SBC’s own technicians and third-party
147 contractors, and at significant additional cost beyond the cost of the equipment itself.
148 Furthermore, these installations require the use of additional materials that are not

⁹ Pitkin-Turner Direct, p. 61. Messrs. Starkey and Balke similarly claim that “the contract between SBC Illinois and Alcatel requires Alcatel to undertake many of the engineering and installation functions previously undertaken by SBC....” See Starkey-Balke Direct, p.58.

¹⁰ Pitkin-Turner Direct, pp. 85-86.

149 provided by Alcatel. Messrs. Pitkin and Turner are simply wrong to assert that “all”
150 material is provided by Alcatel.¹¹ The bottom-line is that Joint CLECs have simply
151 misinterpreted the language in SBC’s contracts with Alcatel and they lack an
152 understanding of how *Alcatel and SBC* actually apply and administer the terms of their
153 own contracts. This fundamental misinterpretation of the contracts has, in part, lead Joint
154 CLECs to the erroneous cost recommendations that they make in this case.

155 **Q12. ASIDE FROM THE CONTRACTS, WHAT OTHER BASES DO THE JOINT**
156 **CLECS CITE IN SUPPORT OF THEIR POSITION REGARDING DLC**
157 **INSTALLATION COSTS?**

158 Messrs. Pitkin and Turner also cite to a number of other SBC documents, the testimony of
159 other SBC witnesses, and citations to other UNE-related cost proceedings to support their
160 contention that the installation factors used in LoopCAT duplicate the installation costs,
161 the majority of which they contend are already included as part of the Alcatel contract
162 prices.¹² Most of their cited support is addressed in the Rebuttal Testimony of SBC’s
163 witnesses, Mr. Smallwood and Mr. White. However, they do include a cite to my own
164 rebuttal testimony in a recent Texas UNE case and use it to suggest that I have actually
165 “admitted” that a majority of the DLC installation costs are already included in the
166 contract prices.¹³ Their characterization of my testimony is false and taken entirely out of
167 context. Messrs. Pitkin and Turner selectively quote only the italicized portion of my
168 complete statement, excerpted below, and without reference to the context of the question
169 that I was addressing. They conveniently exclude the rest of my statement that shows the

¹¹ SBC Illinois’ witness, Mr. Randall S. White, discusses these additional installation and material costs in his rebuttal testimony.

¹² Pitkin-Turner Direct, 61.

170 consistency of SBC's position on this issue. Following is my complete statement, in
171 context:

172

173 **Q. IS MR. TURNER CORRECT IN HIS ASSERTION THAT THE ALCATEL**
174 **CONTRACT PRICES ALSO INCLUDE THE COST OF INSTALLING**
175 **THAT EQUIPMENT IN SWBT'S CENTRAL OFFICES AND REMOTE**
176 **TERMINAL LOCATIONS?**

177

178 A. Absolutely not. The Alcatel contract prices do not include the
179 installation costs that SWBT [SBC Texas] incurs to install this
180 equipment in SWBT's central offices and remote terminal locations
181 and never have. This fact has been confirmed with Alcatel as
182 pointed out in the rebuttal testimony of SWBT witness, Mr. Trott.
183 *The prices contained in the Exhibit B price list reflect only the net*
184 *price of the equipment itself plus, where applicable, any pre-*
185 *delivery labor and miscellaneous materials associated with specific*
186 *pre-assembled Litespan configurations that Alcatel is responsible*
187 *for prior to delivery or shipment to SBC.* These prices have never
188 reflected the added costs associated with SWBT's engineers and
189 technicians and third-party contractors who [are] actually placing
190 and installing this equipment in SWBT's central offices and remote
191 terminal sites once the equipment has been received from Alcatel.
192 These additional activities are described in more detail in the
193 respective rebuttal testimony of SWBT witnesses Mr. Trott (remote
194 terminals) and Mr. Ellis (central office terminals). (Emphasis
195 added).¹⁴

196

197 Messrs. Pitkin and Turner also suggest that I made a similar admission in the California

198 UNE proceeding, without citation, which again is false. Following is an excerpt of my

199 California testimony which is representative of the numerous, consistent statements that I

200 made in that case regarding this issue:

¹³ Id. at pp. 66-67.

¹⁴ See Texas UNE Case, Rebuttal Testimony of Donald G. Palmer, Jr. on Behalf of Southwestern Bell Telephone, L.P., D/B/A Southwestern Bell Telephone Company (Feb. 14, 2003), pp. 14-15. A copy of this portion of my prior testimony is attached hereto marked as Schedule DGP-R3.

201 CROSS EXAMINATION BY MR. MILLER (AT&T):

202 Q. So it is your position then that there are some labor or assembly costs
203 that are included in the contract price and there are other costs that are
204 not included within the contract price; is that correct?

205 WITNESS PALMER:

206 A. That's correct. The assemblies that are assembled in the Alcatel
207 factory include their labor to assemble particular configuration types.
208 And then there are costs to actually replace [sic] in the field that are
209 not included in those costs that are reflected in LoopCAT.¹⁵

210 As these excerpts of my Texas and California testimony clearly show, and as I have
211 stated previously, the Alcatel contract prices only include Alcatel's factory assembly
212 labor costs. They do not include any of the substantial additional costs that SBC Illinois'
213 incurs to actually plan, engineer, physically install, and test this equipment prior to being
214 made ready for service. Joint CLECs' primary argument basically boils down to their
215 contention, born of their misinterpretation of the contracts, that the "majority" of the total
216 cost to SBC for the actual installation and turn-up of the Alcatel RT and COT equipment
217 is that associated with Alcatel's factory assembly, or its "integration" work. In other
218 words, as Messrs. Starkey and Balke put it, "*the contract between SBC Illinois and*
219 *Alcatel requires Alcatel to undertake many of the engineering and installation functions*
220 *previously undertaken by SBC...*" (Emphasis added).¹⁶ This fundamental error in their
221 interpretation of the Alcatel contracts leads them to negate virtually all of SBC's
222 additional costs associated with its own engineering, construction, contractor work, and
223 additional materials that are actually required to make these systems ready for service.
224 Alcatel's factory assembly of some of this equipment merely displaced a portion of the

¹⁵ See California UNE Case, Hearing Transcript, Apr. 15, 2003, pp. 16-18. An excerpt of a more complete portion of the transcript is attached to my testimony marked as Schedule DGP-R4.

225 work previously performed by SBC Illinois, but it did not have an impact on the
226 substantial amount of additional work that must performed after this equipment is
227 delivered to SBC.

228 **Q13. EARLIER YOU SUGGESTED THAT SBC AND ALCATEL WERE IN**
229 **AGREEMENT IN THEIR INTERPRETATION OF THE CONTRACT**
230 **LANGUAGE. DO YOU HAVE ANY EVIDENCE THAT CONFIRMS**
231 **ALCATEL'S AGREEMENT?**

232 A13. Yes. I have attached to my testimony Schedule DGP-R5 which is a copy of a letter from
233 Alcatel, dated March 5, 2003, that acknowledges SBC's interpretation of the contracts
234 and confirms that the contract prices from Alcatel do not include any on-site installation
235 costs. The letter states as follows:

236 ***** CONFIDENTIAL**

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238 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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¹⁶ Starkey-Balke Direct, p. 58.

257 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
258 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX¹⁷

259
260 **END CONFIDENTIAL *****

261
262 As Alcatel’s letter plainly states, the unit prices contained in the Alcatel contract price list
263 (“Exhibit B”) reflects only the cost of the equipment itself and, where applicable, the
264 factory installed components and associated labor for specific pre-assembled Litespan
265 DLC equipment configurations that Alcatel is responsible for assembling prior to delivery
266 to SBC.
267

268 **Q14. CAN YOU EXPLAIN HOW THE ALCATEL CONTRACT LANGUAGE CITED**
269 **BY JOINT CLECS IS CONSISTENT WITH THE INTERPRETAION THAT**
270 **ALCATEL CONFIRMS IN ITS LETTER?**

271 A14. Certainly. First, as I pointed out earlier in my testimony, Messrs. Pitkin and Turner rely
272 on two isolated and unrelated provisions of the Alcatel contracts, one from the Master
273 Agreement (No. 99006755), and the other from the Litespan Purchasing Agreement (No.
274 99007255).¹⁸ Both of these clauses are restated below with accompanying explanations.
275 Following is Section 10.14 (“Installation Services”) of the Master Agreement:

276 ***** CONFIDENTIAL**

277 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
278 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
279 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
280 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
281 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX¹⁹

282 **END CONFIDENTIAL *****

¹⁷ Alcatel’s letter is attached to my testimony marked as Confidential Schedule DGP-R5.

¹⁸ Pitkin-Turner Direct, pp. 64-65.

¹⁹ A copy of Section 10.14 of the Master Agreement, 99006755, is attached to my testimony marked as Confidential Schedule DGP-R6.

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In interpreting this clause and the Master Agreement generally, it is important to recognize that there are no prices in the Master Agreement for the Litespan DLC equipment. In fact, Section 8.1 (“Prices”) of the Master Agreement specifically states:

***** CONFIDENTIAL**
XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX²⁰

END CONFIDENTIAL ***

There have never been any price “Schedules” for either “Products” or “Services” included or attached to the Master Agreement which is essentially boilerplate language that applies in the absence of more specific controlling terms. In fact, this Master Agreement applies generally to a broad range of Alcatel “Products” and not just the Litespan DLC equipment at issue here, such as modems, routers, and various other types of high-speed transport and switching equipment products, all of which are actually purchased pursuant to the terms of more specific subordinate purchase agreements that do include the actual price terms. Similarly, the Alcatel DLC equipment at issue in this case is actually purchased under the terms and pricing contained in the subordinate “Litespan Purchasing Agreement” and the specific pricing terms of Section 7.1 that I will explain in a moment. So in essence, although Joint CLECs place great emphasis on Section 10.14, it really does not even apply to SBC Illinois’ purchase of Alcatel’s DLC equipment.

306 Another important point is that the capitalized terms are defined terms in the contract and
307 it is important in the interpretation of these clauses to fully understand what these terms
308 mean.²¹ For example, referencing Section 8.1, above, the term “Products” is plainly
309 defined in the contract as the physical equipment itself. Whereas, “Services” are defined
310 as the labor provided by Alcatel, if requested by SBC, and includes engineering and
311 “Installation” services. “Installation,” “Installation Date,” and “Installation Site” are all
312 further defined in the Master Agreement and relate to the “mounting, placing,
313 modification, assembly, cabling, wiring, and testing” by Alcatel in accordance with
314 SBC’s specifications at locations specified by SBC.²² All of these terms must be taken
315 into consideration when interpreting the language and the intent of these clauses in order
316 to have an accurate understanding of the contract. Furthermore, certain clauses, like
317 Section 10.14, are actually subsections of broader topics, like “Performance” (Section 10)
318 which generally relates to Alcatel’s performance obligations under the contract, one of
319 which would be Alcatel’s “Installation Services” under Section 10.14, if SBC were to
320 request it, which it has not. So, all that this clause means is that if SBC had actually
321 negotiated for “Installation Services” (as opposed to just “Products”) and had established
322 prices for those “Services” (which has never been done), only then would this clause
323 arguably have the kind of meaning that Joint CLECs contend.

324

²⁰ A copy of Section 8.1 of the Master Agreement, 99006755, is attached to my testimony marked as Confidential Schedule DGP-R7.

²¹ Copies of the contract “Definitions” sections of both agreements are attached to my testimony for reference marked as Confidential Schedule DGP-R8.

²² See pp. 5-6 of the Alcatel Master Agreement, 99006755, included in Confidential Schedule DGP-R8.

325 Furthermore, Messrs. Pitkin and Turner altogether ignore Section 10.15 of the Master
326 Agreement which provides SBC with the right to select an alternate vendor to install
327 Alcatel equipment. Section 10.15 (“Installation Performance”) reads in relevant part:

328 ***** CONFIDENTIAL**

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330 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
331 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
332 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
333 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX²³

334 **END CONFIDENTIAL *****

336 Importantly, this clause provides SBC the right to have a vendor other than Alcatel install
337 any products that SBC purchases from Alcatel under this contract. There would
338 obviously be no such reservation of rights if the cost to install the equipment had already
339 been included in the “Product” price. Further, SBC exercised this right from the time it
340 entered into the agreement in 1999 and has continued to do so to the present. SBC
341 Illinois uses the services of contract “cluster vendors” (contract installers assigned to
342 specific geographic regions approved to install Alcatel equipment) to physically install
343 much of the Alcatel COT equipment. These costs are separate and apart from the DLC
344 equipment cost itself. SBC Illinois’ use of cluster vendors is also explained in more detail
345 by Mr. White.

346 **Q15. BEFORE CONTINUING, PLEASE EXPLAIN THE JOINT CLEC WITNESSES’**
347 **REFERENCES TO THE WISCONSIN PROCEEDING AND THEIR**

²³ A copy of Section 10.15 of the Master Agreement, 99006755, is attached to my testimony marked as Confidential Schedule DGP-R9.

348 **ALLEGATION THAT SBC-AMERITECH HAD ACKNOWLEDGED THAT THE**
349 **ALCATEL CONTRACT PRICES INCLUDED THE INSTALLATION COST.**²⁴

350 A15. Certainly. First of all, the issue before the Wisconsin Commission was not whether or
351 not the Alcatel contract prices included the cost of installation, but whether Ameritech's
352 use of installation factors for both plug-in and hardwired DLC equipment improperly
353 overstated Ameritech's DLC installation costs. Messrs. Pitkin and Turner's references to
354 the Wisconsin case and their suggestion that the Wisconsin Commission relied on Section
355 10.14 is misleading.²⁵ Following is a complete portion of the Wisconsin Commission's
356 Final Decision in that case to which Messrs. Pitkin and Turner refer:

357 Installation Factor. The subject at issue is commonly referred to
358 in the record as the "in-plant" factors and the issue is what factors to
359 use. In general, the factors include the application of engineering at 4.63
360 percent and installation at 3.61 percent, for a total of 8.24 percent as the
361 in-plant factor for the placement of equipment in Ameritech's loop
362 architecture. These two components are part of the composite in-plant
363 factor of 13.75 percent.

364 Ameritech stated that it applied in-plant factors on its DLC units
365 because Alcatel will not bear all costs associated with providing service
366 on those units. Ameritech pointed out that even under the current
367 SBC/Alcatel contract, Ameritech is still required to bear the costs of
368 turning up service on Alcatel DLC units so use of installation factors in
369 the cost study to recover these costs is necessary.

370 Ameritech states it applied an in-plant factor to account for taxes,
371 transportation, and other material handling costs incurred by Ameritech,
372 but not included in the vendor prices, such as for the Litespan plug-in
373 cards used in providing basic service.

374 Ameritech went on to show that it did not apply its higher
375 "hardwire" factor (2.4194 times material cost) for installation costs.
376 Instead, it claims to have only applied much smaller factors to account
377 for the engineering and installation costs it actually incurs. Further,
378 Ameritech claimed those smaller in-plant factors are based on a 3-year
379 average of costs actually incurred for similar vendor-installed
380 equipment. These costs include direct labor and overhead loading for its

²⁴ Pitkin-Turner Direct, pp. 82-83; Starkey-Balke Direct, p. 59.

²⁵ Pitkin-Turner, p. 83.

381 facilities, network services, and engineering personnel associated with
382 the construction activity.

383 ***The CLECs believe Ameritech improperly includes “in plant”***
384 ***factors which result in a double recovery of the costs of installation of***
385 ***the DLC equipment. In defense of their position, the CLECs cite the***
386 ***contract Ameritech uses to purchase DLC equipment, which contains***
387 ***the following provision:***

388 Seller agrees to install, at the prices set forth herein the products
389 ordered hereunder, including all necessary cabling, connection
390 with buyer supplied power, utility and communication services,
391 and in all other respects make the equipment ready for its
392 intended use.

393 The CLECs argued that Ameritech’s cost study applies a markup
394 of 8.24 percent for “telco engineering” and “telco installation” to each
395 piece of equipment purchased by Ameritech under this contract. ***The***
396 ***CLECs contend that the contract for the loop electronics already***
397 ***includes 100 percent of the cost of installation.*** They also state that
398 Ameritech admits that it adds maintenance costs to “in plant” factors.
399 Application of each of these factors, they believe, results in a double
400 recovery of costs since Ameritech also applies a separate maintenance
401 factor to cover maintenance costs.

402 Ameritech did not apply the full set of “in-plant” factors for
403 installation of the Alcatel DLC equipment under this contract, but only
404 the factors it deemed applicable. The Commission does not believe that
405 the record evidence the CLECs provided, which attempts to refute
406 Ameritech’s use of installation factors for Alcatel DLC equipment, is
407 persuasive. Therefore, Ameritech’s use of installation factors to make
408 Alcatel DLC units ready for service is adopted for cost study purposes.
409 The Commission finds these factors are reasonable and appropriately
410 permit Ameritech to recover the costs it actually incurs and do not result
411 in double recovery (Emphasis added).²⁶

412 This complete portion of the Wisconsin Decision shows that the Commission was not
413 making a finding in support of its Decision with respect to the meaning of Section 10.14,
414 as suggested by Messrs. Pitkin and Turner, but was merely reciting their argument
415 regarding the meaning of Section 10.14. Joint CLECs do correctly point out, however,
416 that there was testimony by Ameritech that formed the basis for the Commission’s finding

417 that Ameritech's use of a lower installation factor for its hardwire DLC equipment was
418 reasonable. But this result was solely due to a mistake by Ameritech in the interpretation
419 of the contract because at the time, Ameritech's cost witness²⁷ was not completely
420 familiar with the terms of the new SBC contracts that started to apply to Ameritech's
421 purchases in November 2000, which was during the course of the Wisconsin
422 proceedings.²⁸ In the recent California hearings I addressed this issue during cross-
423 examination by counsel for AT&T:

424 Q Okay. Then I want to ask you a question or two about statements
425 made by Joint Applicants' witness Mr. Donovan or Turner in
426 their joint declaration that they filed on February 7th. I don't
427 know if you will need to look at a copy. But generally, they are
428 arguing that installation cost was included with the contract.
429 Then they also attack the EF&I loading factors and say that they
430 are so much different than in other states such as Wisconsin
431 where a similar UNE costing proceeding recently took place. In
432 fact, these are some of the points you are rebutting directly in
433 your later filing. So it is I think -- I think they make the
434 statement that the same contract, the same Alcatel contract that
435 you are testifying about, is used throughout the SBC territory to
436 purchase this equipment; is that right?

437 A That's correct. Effective November of 2000 it became a 13-state
438 contract.

439 Q So the material prices for Wisconsin would be the same as for
440 California?

441 A That is correct, for the equipment, material itself.

442 Q So then Joint Applicants' point is that the EF&I factors used in
443 Wisconsin were drastically lower than in California used in the

²⁶ See Wisconsin UNE Case, Final Decision, Mar. 22, 2002, pp. 146-147. A copy of this portion of the Wisconsin Commission's decision is attached marked as Schedule DGP-R10.

²⁷ Ameritech's cost witness at the time was Mr. William ("Bill") Palmer (no relation) who is also a witness in this case on behalf of SBC Illinois.

²⁸ Amendment No. 2 of the Litespan Purchasing Agreement replaced Ameritech's former contract with Alcatel, effective November 17, 2000. A copy of Amendment No. 2 is attached to my testimony marked as Confidential Schedule DGP-R11.

446 LoopCAT model. Either one of you, I guess. This is a question
447 for why is there such a large difference between the EF&I
448 factors used to install equipment purchased out of the same
449 contract in one state versus another?

450 A Let me answer that first, and then I can maybe defer part of that
451 to Cheryl [Bash]. But the Alcatel contract just came into being in
452 November of 2000. And that was during the pendency of the
453 Wisconsin proceedings. And in researching that and looking into
454 it further, it was clear that there was a misinterpretation of the
455 new Alcatel agreement by the Ameritech witnesses in that case
456 where they had construed, incorrectly stated or thought the
457 Alcatel contract included installation, field installation, and it
458 does not. So that was a mistake. And ultimately that EF&I
459 factor, their original EF&I factor was reduced owing to that
460 mistake.

461 Q It was reduced?

462 A I think in the Ameritech and Wisconsin case the original factor
463 was 2X. I don't remember what the number, exact number was.
464 But that apparently was reduced to 1.0824, I think it is.

465 Q Right. That is the number?

466 A Part of the reduction was because they had mistakenly assumed
467 that the prices in the Alcatel contract, that they were not familiar
468 with at that time because it had just become applicable to
469 Ameritech, included installation. And it did not.

470 Q I see. So they had initially taken a position of 2.4 I think in
471 Wisconsin and then lowered it to 1.08. You are saying that is
472 because they thought installation was included?

473 A That's correct.

474 Q And they were mistaken?

475 A That's correct.²⁹

476

²⁹ See California UNE Case, Hearing Transcript, April 15, 2003, pp. 57-59. An excerpt of the transcript is attached to my testimony marked as Schedule DGP-R12.

477 Messrs. Starkey and Balke also place a great deal of reliance on the Wisconsin case and
478 remark that SBC Illinois' cost study in this case, with reference to installation factors,
479 represents an inexplicable "full reversal" of SBC Illinois' acknowledgement in that case
480 (citing to SBC's post-hearing briefs) that the use of a higher hardwire installation factor
481 for Alcatel's DLC equipment was inappropriate.³⁰ As I've explained above, the outcome
482 in Wisconsin was simply the result of an error and should not be repeated here in Illinois.

483 **Q16. RETURNING AGAIN TO THE CONTRACTS, PLEASE EXPLAIN THE**
484 **MEANING OF SECTION 7.1(A) OF THE ALCATEL PURCHASING**
485 **AGREEMENT THAT MESSRS. PITKIN AND TURNER ALSO CITE IN**
486 **SUPPORT OF THEIR POSITION?**

487 A16. Section 7.1(a) of the Litespan Purchasing Agreement reads in relevant part:

488 ***** CONFIDENTIAL**

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490 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
491 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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500 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
501 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX³¹

502 **END CONFIDENTIAL *****

503

³⁰ Starkey-Balke Direct, p. 59.

³¹ A copy of Section 7.1(a) of the Litsepan Purchasing Agreement is attached to my testimony marked as Confidential Schedule DGP-R13.

528 clause does not mean that the prices in Exhibit B also includes the cost of any optional
529 “Installation Services” that are necessary to physically install the equipment in SBC
530 Illinois’ central offices and remote terminal sites. Messrs. Pitkin and Turner are simply
531 incorrect in their interpretation.

532 **Q17. MESSRS. PITKIN AND TURNER ALSO CITE TO ANOTHER SECTION OF**
533 **THE CONTRACT THAT RELATES TO INSTALLATION. CAN YOU**
534 **ADDRESS THAT CLAUSE AS WELL?**

535 A17. Yes. Messrs. Pitkin and Turner make a passing reference to Section 9.4 of the Alcatel
536 Purchasing Agreement that relates to Alcatel’s provision of “Support Personnel.” By
537 combining this Section with section 7.1(a) and Section 10.14 of the Master Agreement,
538 Messrs. Pitkin and Turner conclude that “*in short, SBC’s purchase of DLC equipment out*
539 *of the Alcatel contract is basically a turnkey job, leaving SBC with only a minimal*
540 *additional cost.*” (Emphasis added).³³ Again, Messrs. Pitkin and Turner neglect the
541 context within the contract where this provision is located and then speculate as to its
542 actual meaning. Following is a complete quote of Section 9.4 (“Support Personnel”) that
543 reads as follows:

544 ***** CONFIDENTIAL**

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546 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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³³ Pitkin-Turner Direct Testimony, p. 66.

554 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
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560 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX
561 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX³⁴

562
563 **END CONFIDENTIAL *****

564
565 Alcatel does provide technical consultants to SBC on an as needed basis at no charge
566 pursuant to the terms of this clause. But this clause neither states nor does it support the
567 assertion made by Messrs. Pitkin and Turner that Alcatel includes on-site installation costs
568 in its contract prices for DLC equipment. The resources at issue in Section 9.4 are
569 Alcatel-employed consultants who provide technical “support” to SBC’s own technicians
570 and engineers, and its installation contractors who do the actual installation of Alcatel’s
571 equipment. Based on its plain language, read in context, Section 9.4 simply does not have
572 the meaning that Messrs. Pitkin and Turner attempt to superimpose.

573
574 In summary, the Alcatel contract prices modeled in LoopCAT do not include the cost to
575 actually physically place and “install” this equipment in the field and, therefore, Joint
576 CLECs suggestions to the contrary should be rejected.

577 **III. ALCATEL CONTRACT DISCOUNTS**

578
579 ***SBC Illinois’ Alcatel DLC equipment costs, as modeled in LoopCAT,***
580 ***reflect all applicable contract discounts.***
581

³⁴ A copy of Section 9.4 of the Litespan Purchasing Agreement is attached to my testimony marked as Confidential Schedule DGP-R14. “Exhibit I” is simply a job description for a “Program Manager.”

582 **Q18. MESSRS. PITKIN AND TURNER ALSO CONTEND THAT THE ALCATEL**
583 **EQUIPMENT PRICES USED IN SBC ILLINOIS' LOOP STUDY DO NOT**
584 **REFLECT ADDITIONAL CONTRACT DISCOUNTS THAT SHOULD HAVE**
585 **BEEN INCLUDED. CAN YOU PLEASE ADDRESS THIS ISSUE?**

586 A18. Certainly. Messrs. Pitkin and Turner first cite to Amendment No. 3 of the Litespan
587 Purchasing Agreement (99007255), executed in October 2001, which did provide for two
588 potential *** **CONFIDENTIAL XX END CONFIDENTIAL** *** discounts, one was to
589 be effective September 1, 2003 and the other on September 1, 2004.³⁵ However, since
590 the time of the execution of Amendment No. 3, and well before the first of those
591 discounts were to go into effect, SBC had entered into negotiations with Alcatel to
592 address a variety of issues that covered not only the DLC equipment at issue here, but
593 also several other contracts and products that SBC purchases from Alcatel. Those
594 negotiations effectively resulted in the mutual cancellation of these two particular
595 discounts. While the current contract has not yet been modified to reflect this fact, a
596 formal amendment will eventually be executed when these negotiations are completed.
597 The current August 2003 price list remains in effect and the prices therein represent SBC
598 Illinois' current forward-looking costs for the DLC equipment modeled in LoopCAT.
599 Although Messrs. Pitkin and Turner contend that the first of those discounts should be
600 factored into SBC Illinois' cost study, and have themselves included that discount in their
601 recommended restatement, the fact is that SBC Illinois' has not received the benefit of
602 those discounts, nor any equivalent benefit, that would apply to the DLC equipment that

³⁵ Pitkin-Turner Direct, pp. 132-33. A copy of Amendment No. 3 to the Litespan Purchasing Agreement is attached to my testimony marked as Confidential Schedule DGP-R15.

603 SBC Illinois has modeled in its study. Accordingly, there is no basis for applying the
604 discount that Messrs. Pitkin and Turner recommend.

605 **Q19. WHAT LEVEL OF CONTRACT DISCOUNT IS REFLECTED IN THE**
606 **ALCATEL DLC EQUIPMENT PRICES CURRENTLY MODELED IN**
607 **LOOPCAT?**

608 A19. The contract discount reflected in the equipment prices modeled in LoopCAT is ***
609 **CONFIDENTIAL XX END CONFIDENTIAL *****. This discount has been in effect
610 since July 2002 and is the deepest discount currently available to SBC under the terms of
611 the Alcatel contracts. Specifically, this discount reflects SBC's realization of the deepest
612 volume discount level possible under the terms of Exhibit B-1 of the Litespan Purchasing
613 Agreement.³⁶ The Alcatel equipment prices modeled in LoopCAT were derived from the
614 July 2002 version of the Exhibit B price list which incorporated this discount.

615 **Q20. ARE THERE ANY OTHER CONTRACT DISCOUNTS OR SIMILAR PRICING**
616 **BENEFITS THAT MESSRS. PITKIN AND TURNER CONTEND THAT SBC**
617 **ILLINOIS HAS FAILED TO REFLECT IN ITS COST STUDY?**

618 A20. Yes. Messrs. Pitkin and Turner do cite additional provisions of the Alcatel Purchasing
619 Agreement that they characterize as reflecting "discounts," however, none of those cited
620 provisions actually involves discounts of the kind that would properly be included in a
621 forward-looking cost study. Indeed, Messrs. Pitkin and Turner stop short of making that

³⁶ A copy of Exhibit B-1 of the Litespan Purchasing Agreement is attached to my testimony marked as Confidential Schedule DGP-R16. SBC Illinois' responses to AT&T Data Request Nos. BFP-115 and BFP-381, and Staff Data Request No. RK-1.18(c) all address the question of SBC's current discounts under the Alcatel contracts. These Data Request responses are also attached as Confidential Schedule DGP-R17.

642 **Q21. DO YOU HAVE ANYTHING ELSE TO ADD?**

643 A21. Yes. I would just like to summarize by saying that SBC's contract with Alcatel does not
644 include the cost of installing the Alcatel DLC equipment in the field and therefore to that
645 extent those costs are not duplicated in LoopCAT. Furthermore, SBC Illinois has
646 accurately accounted for all currently applicable Alcatel contract discounts in the
647 equipment prices that it has modeled in LoopCAT and, therefore, Messrs. Pitkin and
648 Turner's recommendation to incorporate any additional discounts should be rejected for
649 the reasons I have stated.

650 **Q22. DOES THIS CONCLUDE YOUR TESTIMONY?**

651 A22. Yes it does.