

BEFORE THE ILLINOIS COMMERCE COMMISSION

Docket No. 02-0864

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

SBC Illinois Exhibit 15.1

March 5, 2004

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

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1 **SURREBUTTAL 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. ARE YOU THE SAME DONALD G. PALMER JR. WHO SUBMITTED**
10 **REBUTTAL TESTIMONY IN THIS PROCEEDING?**

11 A2. Yes.¹

12 **Q3. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**

13 A3. The purpose of my surrebuttal testimony is to respond to specific portions of the rebuttal
14 testimony of AT&T witnesses, Messrs. Brian F. Pitkin and Steven E. Turner,² as well as
15 the surrebuttal testimony of WorldCom/MCI witnesses, et al, (hereafter “Joint CLECs”)
16 Messrs. Michael Starkey and John Balke.³ My testimony relates solely to the Alcatel
17 contract Digital Loop Carrier (DLC) equipment costs that SBC Illinois used as inputs in
18 its UNE loop studies and modeled in SBC Illinois’ LoopCAT cost model.

¹ See Rebuttal Testimony of Donald G. Palmer, Jr. on behalf of SBC Illinois, SBC Exhibit 15.0, January 20, 2004 (hereafter “Palmer Rebuttal”).

² See Rebuttal Testimony of Brian F. Pitkin and Steven E. Turner on Behalf of AT&T Communications of Illinois, Inc., AT&T Ex. 2.1P, February 20, 2004 (hereafter “Pitkin-Turner Rebuttal”).

³ See Surrebuttal Testimony of Michael Starkey and John Balke on Behalf of WorldCom, Inc., et al., Joint CLEC Exhibit 2.1, February 20, 2004 (hereafter “Starkey-Balke Surrebuttal”).

19 **Q4. CAN YOU BRIEFLY OUTLINE THE SPECIFIC ISSUES THAT YOU WILL**
20 **ADDRESS IN YOUR TESTIMONY?**

21 A4. Yes. First, Messrs. Pitkin and Turner continue to assert that SBC Illinois' LoopCAT
22 model fails to reflect an additional Alcatel contract discount that they claim "there is no
23 question" that SBC has either already received from Alcatel, or in the alternative, that
24 SBC has received some other unspecified benefit that is at least equivalent to the subject
25 discount and that this alleged benefit should be factored into SBC Illinois' forward-
26 looking DLC equipment costs.⁴ As I made clear in my rebuttal testimony and will briefly
27 address again here, SBC has never received any such discount from Alcatel, or any other
28 equivalent benefit, that would reduce the current cost of the DLC equipment modeled in
29 LoopCAT. Messrs. Pitkin and Turner's restatement of LoopCAT to account for this
30 alleged discount must therefore be rejected.

31
32 Second, Messrs. Pitkin and Turner, as well as Messrs. Starkey and Balke, both contend
33 that SBC Illinois has overstated its DLC equipment investments by using installation
34 factors that are not specific to the Alcatel DLC equipment used by SBC Illinois,
35 contending that the language in SBC's Alcatel contract and the prices therein already
36 includes a "majority" of the total cost to actually place and install this equipment in the
37 field.⁵ Again, contrary to these assertions, the Alcatel contract does not include any of the
38 costs incurred by SBC Illinois to physically install this equipment at its remote terminal
39 sites and in its central offices, as explained in detail in my rebuttal testimony.

⁴ Pitkin-Turner Rebuttal, pp. 63-64.

⁵ Pitkin-Turner Rebuttal, pp. 65-66; Starkey-Balke Surrebuttal, pp. 39-42.

40
41 Finally, Mr. Balke specifically questions my discussion of facts related to the recent
42 Wisconsin UNE cost proceeding, cited and relied upon by Joint CLECs in their respective
43 direct testimonies, in which the same Alcatel contracts were at issue as they are in this
44 case with respect to SBC's installation factors.⁶ I will again address this issue and
45 attempt to clarify information presented by Joint CLECs to ensure the Commission has an
46 accurate perspective on the Wisconsin case in its consideration of the appropriateness of
47 SBC Illinois' installation factors as they relate to the Alcatel contracts.

48 **II. ALCATEL CONTRACT DISCOUNTS**

49
50 **Q5. WHAT IS THE BASIS FOR MESSRS. PITKIN AND TURNER'S CLAIM THAT**
51 **SBC ILLINOIS HAS IN FACT RECEIVED AN ADDITIONAL CONTRACT**
52 **DISCOUNT, OR SOME EQUIVALENT BENEFIT, THAT SBC HAS FAILED TO**
53 **ACCOUNT FOR IN ITS UNE LOOP STUDY?**

54 A5. Messrs. Pitkin and Turner's only support for their contention is mere speculation about a
55 specific clause in the Alcatel contract and misplaced reliance on a recent ruling in the
56 Indiana UNE cost proceeding that I will address in a moment. In their rebuttal testimony,
57 Messrs. Pitkin and Turner simply refer back to their direct testimony and thus rely solely
58 on the language in the cited provision of Amendment No. 3 to the Alcatel Purchasing
59 Agreement to support their position that SBC has received the benefit of a ***
60 **CONFIDENTIAL *****END CONFIDENTIAL ***** discount from Alcatel.⁷

⁶ Starkey-Balke Surrebuttal, pp. 42-46. See generally, Starkey-Balke Direct, pp. 58-59, 61-62; Pitkin-Turner Direct, pp. 83-84.

⁷ Pitkin-Turner Rebuttal, p. 63.

61 Recognizing that they have no factual basis to support their claim, Messrs. Pitkin and
62 Turner then speculate that “there is no question that SBC has either already received this
63 discount, or in the alternative, has negotiated with Alcatel and received additional
64 benefits at least commensurate with” the subject discount.⁸ Messrs. Pitkin’s and Turner’s
65 primary support for their conclusion is simply a comparison of SBC Illinois’ cost study
66 worksheets for Alcatel DLC equipment, the original prepared in 2002 and the more
67 recent study revised in January 2004.⁹ Since the contract price inputs in these study
68 worksheets were the same, and the alleged discount under Amendment No. 3 was
69 scheduled to take effect during the intervening period in September 2003, Messrs. Pitkin
70 and Turner simply conclude that SBC either failed to incorporate the discount that it
71 actually received, or if it did not receive one, then SBC must have received something of
72 an equivalent nature, observing that “SBC would not simply give this [discount] away.”¹⁰

73 **Q6. HAS SBC ILLINOIS IN FACT RECEIVED EITHER THE DISCOUNT OR AN**
74 **EQUIVALENT BENEFIT FROM ALCATEL THAT WOULD EFFECTIVELY**
75 **REDUCE THE DLC EQUIPMENT PRICES MODELED IN LOOPCAT?**

76 A6. No. Messrs. Pitkin and Turner are certainly correct in their observation that SBC did not
77 simply give this discount away, as I fully explained in my rebuttal testimony.¹¹ Again, as
78 explained in my rebuttal testimony, SBC has been in negotiations with Alcatel for many
79 months discussing a variety of issues that cover several different products and several
80 different contracts, not just the Alcatel Litespan equipment at issue here. SBC’s

⁸ Id.

⁹ Id.

¹⁰ Id., pp. 63-64.

¹¹ Palmer Rebuttal, pp. 24-25.

81 negotiations with Alcatel have in fact avoided substantial additional costs that would
82 have otherwise increased the current cost of Alcatel's DLC equipment. SBC's
83 negotiations with Alcatel resulted in the mutual cancellation of the subject discount in
84 exchange for other concessions from Alcatel that did not affect the current contract price
85 of the equipment modeled in LoopCAT.

86 **Q7. WHAT EVIDENCE HAS SBC ILLINOIS PRESENTED IN THIS CASE TO**
87 **SUPPORT THE FACT THAT NEITHER THE DISCOUNT NOR ITS**
88 **EQUIVALENT BENEFIT HAS BEEN RECEIVED FROM ALCATEL?**

89 A7. In addition to the above, and the information cited in my rebuttal testimony, SBC Illinois
90 has produced in this case three separate copies of its Alcatel contract price list, the first
91 dated July 15, 2002,¹² the second dated February 2003,¹³ and a third dated August 2003,
92 provided as an attachment to my rebuttal testimony as Confidential Schedule DGP-R2. I
93 have included as an additional Confidential Schedule¹⁴ to my surrebuttal testimony
94 copies of the first page of each of these price lists to demonstrate two facts: First, that the
95 current contract discount is ***** CONFIDENTIAL****END CONFIDENTIAL ***** as
96 noted on the February 2003 price list (which actually went into effect and is reflected in
97 the July 15, 2002 prices). This fact is acknowledged by Messrs. Pitkin and Turner.¹⁵
98 Second, because of the then pending nature of the on-going negotiations with Alcatel,
99 and reflecting the mutual cancellation of the Amendment No. 3 discounts, Alcatel issued
100 its updated August 2003 price list, reflecting the same level of discount as in the prior

¹² See Staff Data Request No. PL 1.09(b) and Joint CLEC Data Request No. 1.95(a).

¹³ See AT&T Data Request No. BFP-114.

¹⁴ Reference Confidential Schedule DGP-S1, attached.

¹⁵ Pitkin-Turner Rebuttal, p. 132.

101 February price list, but with revised effective dates for the period “2003-2006.” These
102 prices remain in effect today and are the basis of SBC’s current forward-looking DLC
103 equipment prices that are modeled in LoopCAT.

104 **Q8. MESSRS. PITKIN AND TURNER ALSO CITE THE RECENT INDIANA**
105 **DECISION IN SUPPORT OF THEIR POSITION THAT THE ADDITIONAL**
106 **DISCOUNT SHOULD BE APPLIED TO SBC ILLINOIS’ LOOP STUDY. CAN**
107 **YOU PLEASE ADDRESS THE DECISION IN THE INDIANA CASE?**

108 A8. Yes. Messrs. Pitkin and Turner quote a portion of the Indiana Order as additional support
109 for their position that an additional discount should be applied in this case.¹⁶ However, as
110 the language of that portion of the order plainly states - which is one of the bases for SBC
111 Indiana’s pending request for rehearing of that decision: “... *the evidence establishes that*
112 *SBC Indiana has not realized any of the discounts at issue....*” (Emphasis added). SBC
113 Indiana believes that the Indiana decision to apply the discount in developing loop costs
114 was simply wrong and contrary to the Indiana Commission’s own finding regarding the
115 evidence presented in that case. Similarly, there is absolutely no evidence in the record
116 of this case that establishes as a fact the position that Messrs. Pitkin and Turner advocate.
117 SBC Illinois has presented both documentary and testimonial evidence that demonstrates
118 that the subject discount has neither been received by SBC, nor any other equivalent
119 benefit that would apply to the Alcatel equipment modeled in LoopCAT. Messrs. Pitkin
120 and Turner’s restatement of LoopCAT to take into consideration this additional discount
121 should be rejected.

¹⁶ Pitkin-Turner Rebuttal, p. 64.

122 **III. ALCATEL CONTRACT INSTALLATION**

123

124 **Q9. MESSRS. PITKIN AND TURNER CONTINUE TO ASSERT IN THEIR**
125 **REBUTTAL TESTIMONY THAT SBC ILLINOIS' DLC EQUIPMENT COSTS**
126 **ARE OVERSTATED, PRIMARILY DUE TO THEIR CONTENTION THAT THE**
127 **ALCATEL CONTRACT PRICES ALREADY INCLUDE A "MAJORITY" OF**
128 **THE COST TO INSTALL THIS EQUIPMENT. CAN YOU PLEASE RESPOND**
129 **TO THE ADDITIONAL POINTS THEY RAISE ON THIS ISSUE?**

130 A9. Messrs. Pitkin and Turner actually provide very little, if any, new information in their
131 rebuttal arguments to support their position that the Alcatel contract prices include a
132 majority of the cost to install this equipment. The only statement they make is that the
133 Commission should consider "one distinct fact" in reaching a decision to reject SBC
134 Illinois' use of installation factors for the Alcatel equipment and then encourages the
135 Commission to "read the contracts for themselves."¹⁷ Indeed, I too encourage the
136 Commission to review the Alcatel contracts. In my rebuttal testimony, I have explained
137 exactly what the terms of these contracts mean in regard to the type of installation
138 services that Alcatel performs for SBC Illinois (assembly only), and the installation
139 services they do not perform (field installation).¹⁸ The Commission only needs to read
140 these agreements in their proper context, consider Alcatel's own confirmation of this fact,
141 and consider the evidence presented by SBC Illinois' witnesses, Messrs. White and
142 Smallwood, to conclude that Messrs. Pitkin and Turner are wrong on this issue. The real
143 issue that the Commission should carefully consider in this context is whether SBC

¹⁷ Pitkin-Turner, p. 65.

144 Illinois' revised installation factors accurately account for SBC's actual forward-looking
145 costs to install the Alcatel DLC equipment in the field after the equipment has been
146 delivered to SBC. Said another way, do Messrs. Pitkin's and Turner's estimate of a mere
147 *** CONFIDENTIAL*****END CONFIDENTIAL *** per RT and COT
148 installation cover it, or do SBC Illinois' installation factors provide a more
149 comprehensive and realistic accounting of the actual forward-looking cost to install this
150 equipment? That is the key issue.

151 **Q10. MESSRS. STARKEY AND BALKE ALSO ADDRESS THIS ISSUE IN A LITTLE**
152 **MORE DETAIL IN THEIR SURREBUTTAL TESTIMONY. CAN YOU PLEASE**
153 **ADDRESS THEIR CRITICISMS AS WELL?**

154 A10. Certainly. Messrs. Starkey and Balke spend a considerable amount of time discussing the
155 fact – for which we both agree - that Alcatel pre-assembles some of the DLC equipment
156 with the required electronics prior to delivery to SBC.¹⁹ Where we disagree is the extent
157 of the impact of Alcatel's assembly on the subsequent engineering and installation costs
158 that SBC Illinois' incurs, again, after the equipment is delivered to SBC. Messrs. Starkey
159 and Balke contend that "Alcatel is essentially performing many of the engineering and
160 installation functions previously undertaken by SBC for 257c equipment that had not
161 been pre-assembled" and then concludes that "a much lower installation factor is required
162 to estimate the Telco related installation costs."²⁰ It is not clear to me why Messrs.
163 Starkey and Balke place so much weight on the fact that Alcatel pre-assembles some of
164 this equipment. Alcatel has been performing this service for years, both under the terms

¹⁸ Palmer Rebuttal, pp. 7-23.

¹⁹ Starkey-Balke Surrebuttal, pp. 40-42.

165 of SBC’s current contract, which has applied to SBC Illinois since late 2000, as well as
166 the former Ameritech-specific contract going back to the early 1990s. SBC Illinois’
167 installation factors were derived using recent actual cost data for the period 2000 to 2002
168 and accurately capture all of the non-Alcatel related costs that SBC Illinois incurs after
169 the equipment is delivered to SBC. Alcatel’s pre-assembly has not taken the place of the
170 functions that SBC Illinois - or its third-party contracted installation vendors – must
171 perform to fully engineer and install this equipment.

172 **Q11. MR. BALKE CONTENDS THAT YOU HAVE ERRED IN YOUR**
173 **EXPLANATION OF THE FACTS RELATED TO THE RECENT WISCONSIN**
174 **UNE COST PROCEEDING. CAN YOU PLEASE RESPOND TO MR. BALKE’S**
175 **COMMENTS?**

176 A11. Yes, but first I would like to provide the Commission with some context. Messrs.
177 Starkey and Balke, as well as Messrs. Pitkin and Turner, each cited to the Wisconsin case
178 in their respective direct testimony to support the proposition, as Messrs. Starkey and
179 Balke put it, that SBC Illinois’ use of a hardwire installation factor for DLC equipment in
180 this case represents “a full reversal of its [SBC’s] former acknowledgement [in
181 Wisconsin] that the use of the entire hardwire in-plant factor was inappropriate for use in
182 estimating Alcatel DLC costs.”²¹ First of all, that is not an accurate statement, as I will
183 explain in a moment. This attempt at comparing the hardwire factor presently used in
184 Illinois with the lower plug-in factor that was ultimately used in Wisconsin is central to
185 their claim that SBC Illinois’ DLC costs are substantially overstated, supported primarily

²⁰ Id., p. 40.

²¹ Starkey-Balke Direct, p. 59, pp. 58-62 generally. See also Pitkin-Turner Direct, pp. 82-83.

186 by their contention that the Alcatel contract prices includes the cost of installation. In
187 Wisconsin, Joint CLECs argued, based solely on their interpretation of isolated language
188 in the contracts, that the contract prices included the total cost of the complete installation
189 and that the installation was performed by Alcatel.²² Of course, as is evident in this case,
190 Joint CLECs have backed away from this position and have instead focused solely on
191 their “pre-assembly” argument. This background is essential to a full understanding of
192 the distinctions involved between these two cases.

193 First, as I noted above, Messrs. Starkey and Balke cite a portion of SBC Wisconsin’s brief
194 to suggest that SBC Wisconsin acknowledged or admitted that it was inappropriate to
195 apply the hardwire installation factor to the Alcatel DLC equipment. Nowhere in the
196 cited portion of that brief, or anywhere else that I am aware of, has SBC ever taken that
197 position. Indeed, in the five most recent UNE cost cases that I have personally
198 participated in (Texas, California, Indiana, Michigan, Illinois), SBC has in fact applied a
199 hardwire factor to the very same Alcatel equipment at issue here.

200 Second, an example of the very “mistake” that I assert in my rebuttal testimony that was
201 made in the Wisconsin case and to which Mr. Balke finds fault, is found in the very
202 excerpt of SBC Wisconsin’s brief that Mr. Balke cites in his testimony:

203 The hardwire in-plant factor for 257C equipment in Wisconsin is 2.4194. Tr.
204 Conf. Vol. 3 at 566. However, as Mr. [William] Palmer explained, Ameritech
205 Wisconsin’s cost studies did not apply the hardwire in-plant factor to Alcatel
206 Litespan DLC equipment. Tr. Conf. Vol. 3 at 566, 567. ***Instead, after obtaining the***
207 ***vendor EF&I price (which included the engineering and installation services***
208 ***provided by Alcatel)***, Ameritech Wisconsin applied smaller factors for the

²² Joint CLECs’ position is clearly stated in the excerpt of the Wisconsin Commission’s Final Decision that I quote at p. 17 of my rebuttal testimony.

209 engineering and installation factors specific to this equipment. Tr. Conf. Vol. 3 at
210 566. These factors account for the direct labor costs and overhead loadings for
211 facilities, network services, and engineering employees associated with the
212 construction activity. These factors are not included in the vendor EF&I prices, and
213 are relatively small (Telco engineering was only 4.63% and Telco installation was
214 only 3.61%). Tr. Conf. Vol. 3 at 566-67. (Emphasis added).²³
215
216

217 The italicized text in the above quote reflects an example of the misunderstanding that I
218 referred to in my rebuttal testimony. In fact, the “vendor EF&I prices” that were
219 developed in the Wisconsin case did not include engineering and installation services
220 “provided by Alcatel,” but rather, as Mr. Balke correctly states in his direct and
221 surrebuttal testimony:

222 SBC separately identified the costs for vendor installation and included those
223 installation costs as a separate line entry in the development of the DLC
224 investments prior to their entry into LFAM. Since the major and minor equipment,
225 and the vendor installation costs were already identified, a much smaller
226 installation factor was required – one that accounted for the Telco engineering and
227 installation.... (Emphasis added).²⁴
228
229

230 In the above quote, the “vendor installation” refers to separate non-Alcatel vendor labor
231 that is contracted for by SBC Wisconsin (and SBC Illinois) to perform the actual
232 installation of Alcatel COT equipment, including some RT and CEV equipment as well.
233 The reference to “major” equipment refers to the Alcatel equipment itself and the “minor”
234 equipment is a reference to the separate miscellaneous materials that both SBC’s
235 installation vendors and SBC’s own technicians use in the process of actually installing
236 the Alcatel equipment. The mistake by SBC Wisconsin that I refer to in my rebuttal
237 testimony is the assumption that was made in that case that the language in the new
238 Alcatel contract should be construed to mean that the prices included the cost of

²³ Starkey-Balke Direct, p. 59.

239 additional installation services to be provided by Alcatel, which was not correct. That
240 assumption, in part, is what lead SBC Wisconsin to assume that its use of a lower plug-in
241 factor was appropriate.

242 **Q12. DO YOU BELIEVE THAT SBC ILLINOIS' USE OF THE HARDWARE FACTOR**
243 **IN THIS CASE IS A BETTER ESTIMATE OF THE FORWARD-LOOKING**
244 **COST TO INSTALL THE ALCATEL EQUIPMENT?**

245 A12. Yes I do. While this is an area that is more specifically addressed in the testimony of Mr.
246 Smallwood, I believe the approach used by SBC Illinois more accurately accounts for the
247 actual costs expected to be incurred by SBC Illinois for the purchase and installation of
248 its Alcatel DLC equipment. SBC Illinois' use of its revised hardware factor captures the
249 complete expected cost of both its own engineering and installation labor, as well as the
250 actual cost of the labor provided by the third-party installation vendors. The approach
251 used in Wisconsin relied upon an estimate of the installation vendor cost and then added
252 the lower plug-in factor to account for the additional engineering and installation work
253 provided by SBC Wisconsin's technicians. I do not believe that the approach in
254 Wisconsin accurately accounted for the full cost of the labor required to install the
255 Alcatel equipment.

256 **IV. CONCLUSION**

257

²⁴ Starkey-Balke Direct, p. 61; Starkey-Balke Surrebuttal, pp. 43-44.

258 **Q13. DO YOU HAVE ANYTHING ELSE TO ADD?**

259 A13. Again, as I stated in my rebuttal testimony and have further emphasized here, SBC
260 Illinois has accurately accounted for all currently applicable Alcatel contract discounts in
261 the equipment prices that it has modeled in LoopCAT. Additionally, SBC's contract with
262 Alcatel does not include the cost of installing the Alcatel equipment in the field and the
263 additional revised factor-based estimates that SBC Illinois has added to the cost of the
264 equipment itself accurately accounts for the additional costs incurred by SBC Illinois that
265 are necessary to place this equipment in the field ready for service. Joint CLECs
266 positions on these issues are incorrect and should be disregarded.

267 **Q14. DOES THIS CONCLUDE YOUR TESTIMONY?**

268 A14. Yes it does.