DESCRIPTION AND JUSTIFICATION

1.0 Introduction and Description of Filing

In this tariff filing, scheduled to become effective November 30, 2002, the Bell Operating Companies (BOCs) propose changes to Tariff F.C.C. No. 1, 800 Service Management System (SMS/800) Functions (SMS/800 Tariff) to update rates and charges based on current cost and demand data. This adjustment is needed because of the continuing, unforeseen decrease in demand for toll-free numbers, and the anticipated increase in operating expenses (bad debt) for services provided to bankrupt Responsible Organizations.

2.0 Modify Rates and Charges

This tariff filing is being made by the BOCs to increase certain rates and charges in the SMS/800 Tariff. The proposed increases, reflecting the BOCs' most current estimates of demand and cost for services provided under the tariff, would increase revenue over the prospective period of November 30, 2002 through June 14, 2003 (approximately seven months) by $5.44 million.

The most significant increase, in terms of revenue impact, is the proposed increase in the Customer Record Administration (CRA) charge from $0.2219 to $0.2569. Other rates and charges are increased or unchanged. A comparison of current and proposed rates, as well as the revenue impact of the rate increases, is displayed in Table 1, (after section 5.6).

The rates covered by this transmittal will expire on June 14, 2003 unless extended or revised by a tariff filing prior to the expiration date.

3.0 Revenue Requirement Development

The prospective revenue requirement for SMS/800 consists of expenditures for ongoing operations from November 30, 2002 through June 14, 2003. Virtually all of the costs are expense items. Specific budget items for SMS/800 ongoing operations are:

1. *SMS/800 Operation and Administration* which consists of: (a) Help Desk operational support to SMS/800 users including telephone assistance related to interfacing with SMS/800 and preparation/maintenance of toll-free number records, and processing of requests for changes in Responsible Organization for toll-free numbers; (b) day-to-day management, planning and

administrative oversight provided by the SMS/800 Business Manager (DSMI), external operational support services such as billing and collections, accounting, cost analysis and website support, and other costs such as bad debt (services provided to bankrupt Responsible Organizations), and general administrative and human resources expenses related to SMS/800; and (c) the indirect cost of significant internal resources that the Bell companies expend to support management, operation and administration of the SMS/800. These resources include employees in the companies' tariff, regulatory, legal, technical, financial, taxation, procurement, accounting, network operations, systems provisioning, and operations support organizations. The estimated revenue requirement of this budget item for the period of November 30, 2002 through June 14, 2003 is $6,878,852 distributed as follows: item (a) $997,376; item (b) $5,556,476; and item (c) $325,000. Item (b) includes an estimated monthly expense of $455,000 for services provided to bankrupt Responsible Organizations (bad debt) during the prospective period of November 30, 2002 through June 14, 2003. Actual bad debt expense during the first nine months of 2002 averaged $671,500 per month.

2. *SMS/800 Data Center Operation* reflects the cost of the production and test/disaster recovery SMS/800 data centers; upgrading of the data centers to increase processing and storage capacity for the planned Cost Causer Pays modification scheduled for deployment next year; and operation of a Service Center (Help Desk) facility to handle security and access problems. The estimated revenue requirement for data center operation is $25,787,667.

3. *SMS/800 Software Support* includes the provision of software maintenance, computer site and application support, and software development for new features. The estimated revenue requirement for software support is $10,354,100.

Past year actual costs, and projected revenue requirements for future year and the approximately seven-month prospective period covered by the proposed rates are shown in Table 2.

3.1 Revenue Requirement Distributions

The projected revenue requirement for budget (cost) items was distributed to all rate elements by applying distribution factors based on cost-causation analyses. The methodology used is consistent with the methodology used for all previous SMS/800 tariff filings. The distribution factors actually applied are shown in Table 5. Resulting revenue requirement distributions are shown in Table 4 and include distribution to all SMS/800 services (including those provided to Service Control Point [SCP] Owner/Operators which are offered via contract). Cost-causation analyses were performed and applied to budget elements as follows:

1. A Task Oriented Costing (TOC) study was used to distribute SMS/800 Help Desk costs to rate elements. Each person providing Help Desk support was interviewed individually to identify the primary tasks performed, how often the tasks are performed, and the time (minimum, maximum, most likely) spent performing them. Each task was then analyzed and associated with the particular rate element it supports. The resulting distribution factors are shown in Table 5, column (a). All

other (indirect) operations and administration costs were distributed to all rate elements proportionally on the basis of the relationship of the magnitude of each element to the total. The calculation method and allocation factors developed are shown in Table 4, columns (f) and (g).

2. Data center costs consist primarily of: (a) network equipment and facilities needed to provide communications access for customers' links; (b) storage hardware (tape and disk drives) for toll-free number record data; and (c) central processor used to respond to and execute customer requests for SMS/800 services. *Network costs* are attributable almost entirely to rate elements required to access SMS/800. A unit cost analysis of each type of connection to SMS/800 was used to determine its cost and distribute the network revenue requirement on the basis of the relative, weighted (by demand) cost of each type of access. *Storage costs* are related almost exclusively to number records and were therefore assigned to the Customer Record Administration rate element. *Central Processor costs* are attributable to most rate elements. A two-step analysis was used to determine a reasonable distribution of costs. First, the quantity of lines of computer code used by each SMS/800 software application and platform function were determined and distributed to each rate element supported. Then, usage data reflecting a typical month's internal computer transactions for each software application and platform function was recorded and used to identify the relative usage of processing capacity. Since the relationship between rate elements and software applications/platforms had been established and quantified with the lines of code study, the relationship was extended to processor transactions so that they could be assigned to rate elements. The factors developed with the lines of code and transactions analyses are shown in Table 5, columns (b) and (c), respectively. The composite factors actually used to distribute total data center costs are shown in column (d).

3. The cost of software support includes software maintenance, site support and software development for new features. The software maintenance and site support dollars were distributed on the basis of the lines of code analysis described previously since there is a reasonable relationship between the magnitude of software code and the amount of support effort required to maintain it. The cost of new features was distributed by associating each new feature with the rate element it supports. The factors used to distribute software costs are shown in Table 5, column (e).

4.0 Basis of Ratemaking

The rate structure for SMS/800 consists of service elements that are used by Responsible Organizations. The proposed rate for each element is based on its projected revenue requirement and demand. This information is shown in Table 6.

5.0 Demand Forecast

The demand forecast for the prospective seven-month period is displayed in Table 3. Information and/or data considered in developing the forecast are discussed in the following sections.

5.1 Customer Record Administration (CRA)

This rate element represents the quantity of toll-free numbers for which customer records exist in the SMS/800 and is charged on a recurring (monthly) basis for each number record administered. Demand forecasts for September through December 2002, and calendar years 2003 and 2004 were developed with a modeling approach based on time series analysis of the most recent 36 months of historical monthly data.

The significant reduction in demand experienced during 2001 and the first eight months of 2002 is likely attributable to the impact of the economic recession. Key to explaining toll free number demand is whether the marked deviation from trend in early 2001 indicates a permanent or a temporary change. A fundamental consideration is that, even if the flat and then negative trend established about January 2001 proves temporary, it may take several quarters for the previous growth trend to resume. In the first three quarters of 2001, the U.S. economy was in recession, reporting negative real GDP growth. In the fourth quarter of 2001, recovery began, with real GDP growth at 2.7%, followed by 5.0% growth in the first quarter of 2002. Yet, demand for toll free numbers did not quickly resume its pre-recession pattern. In the first seven months of post-recession economic growth (October 2001 to April 2002), toll free numbers increased about 1% on an annualized basis. The next four months (May 2002 to August 2002) saw an annualized decrease of 11.8 percent. This seems to indicate that, even if the new trend in toll free number growth since January 2001 is temporary, being associated with cyclical economic factors, it will be likely to lag the growth in the economy during the immediate future.

The detailed econometric study supporting the CRA demand forecast is included as Attachment A: Forecast of Toll-Free Number Demand, 2002 – 2004.

CRA historical data for May 1993 though August 2002, and econometric estimations for September 2002 through December 2004, are displayed in Table 3A.

5.2 Change of Responsible Organization for Toll-Free Number

This element provides for changing the Responsible Organization for a toll-free number and is charged on a non-recurring (per request) basis. Actual demand since 1999 has averaged about 100,000 requests per year and is estimated at that level for 2002 and 2003.

5.3 SMS/800 Access

This service element provides for the connection of dedicated and dial-up communications links to the SMS/800 and is charged on a recurring (monthly) basis. Demand for dedicated access has been somewhat stable since 2000 and is likely to remain stable in 2002 and 2003. Demand for MGI

dedicated access is projected at 35 units per month, and demand for non-MGI access is projected at 64 units per month. Demand for dial-up access grew at a rate of about 15 units per month from 1997 through 2000, but did not grow in 2001. No growth is anticipated in 2002, but growth of 5 units per month is likely to resume in 2003 if the national economy improves. That rate of growth is reflected in the demand projected for 2003.

5.4 Service Establishment

This service element provides for various aspects of establishing service, i.e., first log-on ID, and subsequent (additional) log-on IDs. Charges for these services are applied on a non-recurring (one time) basis. Demand for first log-on IDs has averaged about 2.5 requests per month since 1997 and is forecast at about that level for 2002 and 2003. Demand for subsequent IDs averaged about 150 requests per month from 1996 to 2000, but decreased to 110 requests per month in 2001 and the first eight months of 2002. Since the downward trend in demand is expected to continue until mid-year 2003, demand is forecast at an average of about 95 requests per month.

5.5 Reports

This service element covers the provision of special reports ordered by users from the SMS/800 Help Desk and is charged on a non-recurring (per report) basis. Annual demand from 1999 to 2001 averaged about 900 reports per year, but decreased to an annual average of about 600 reports during the first eight months of 2002. The introduction of the Web-based Reporting System (WRS) feature is expected to eventually reduce demand for special reports ordered from the Help Desk to less than 200 reports per year by 2004. A gradual reduction in demand to 15 reports per month by December 2003 is reflected in the forecast for 2002 and 2003.

5.6 MGI Development and Testing

This service element covers the establishment of a mechanized interface to the SMS/800 for a Resp Org's operation system and is charged on a non-recurring (per request) basis. No requests for additional MGI interfaces are anticipated for 2002 and 2003.