Q.Please state your name and business address for the record.

A.My name is Stephanie Miller.  My business address is 472 West Washington Street, Boise, Idaho.

Q.By whom are you employed and in what capacity?

A.I am employed by the Idaho Public Utilities Commission as Administrator of the Utilities Division.

Q.What is the purpose of your testimony in this proceeding?

A.I will explain why the Staff has joined with U S West to propose an alternative regulatory plan for its southern Idaho service area.  This plan would replace the current revenue sharing plan.

Q.Would you begin with a description of why the Staff and U S WEST began the negotiations that eventually led to the proposal currently before the Commission?

A.Yes.  Order No. 25147 issued in Case      No. USW-S-93-2 directed the Staff and invited other parties to examine the relative merits of the existing revenue sharing plan.  As a result, the Staff conducted an investigation into the Company's 1992 earnings and retained the National Regulatory Research Institute (NRRI) to prepare a status report on alternative forms of regulation in the U.S. telecommunications industry.

On May 19, 1994, the Commission issued a Notice of Inquiry initiating Case No. USW-S-94-3 in the Matter of the Evaluation of U S WEST Communications' Revenue Sharing Plan for the First Five Years of Operation.  The Staff filed three documents in that case:  the report of its earnings investigation, the report prepared by NRRI, and comments expressing the Staff's conclusion that the Revenue Sharing Plan had benefited basic local service customers and the Company over its life and identifying areas needing change if the Plan were to continue.

In its final order on reconsideration (Order No. 25923) in Case No. USW-S-94-3, the Commission directed the Staff to work with the Company on implementing modifications to the revenue sharing plan or developing a replacement for the sharing plan and to file a joint or individual reports.  The joint proposal in this case is the culmination of that work between the Staff and U S WEST.

Q.Would you briefly describe the joint proposal, please?

A.There are two elements to the proposal.  The first lays out the new plan that would be in operation for five years beginning January 1, 1996.  The second deals with the phase out of the existing plan.

The new plan includes the Company's acceptance of service quality standards, the establishment of service quality thresholds at which the Company would qualify for residential rate increases offset by toll decreases, and the service guarantee program that compensates certain customers whose requests for service go unfilled or for whom Company commitments are not kept.

If the existing plan is eliminated, there should be a disposition of the current level of funds available for sharing.  The proposal provides for the permanent elimination of rural zone charges and disposition of a previously agreed upon interstate source of sharing funds, as well as charges to the depreciation reserve.

Although we began negotiations with the intention of mitigating anti-competitive effects of the extended area service (EAS) compensation mechanism included in the revenue sharing plan, we were not able to reach agreement on this issue.  If the Commission grants EAS on U S West routes in the future, it will have to determine if U S WEST is entitled to compensation and, if so, the manner and amount of compensation to which the Company is entitled.

Q.How easy was it to arrive at a plan to which both parties could agree?

A.It was very difficult.  The initial positions of the parties were very far apart and many compromises had to be made.  One such compromise was the dropping of an EAS compensation mechanism.  The decision to include service quality standards, even though that was not included in our instructions from the Commission, made agreement more difficult.

Q.The Commission in Order No. 25923 established Case No. USW-S-95-2 to consider the adoption of service quality standards and monetary penalties.  Why did the Staff choose to include service quality standards in its discussions with U S WEST in this case?

A.We thought the most efficient way to effect a change in the Company's service quality would be through the willing cooperation of the Company, not through a time-consuming, fully-litigated case.  We felt that an alternative regulatory plan that addressed concerns of the Company might be the incentive required to elicit the level of cooperation we believed would be necessary.

Q.What benefits do you see from a settlement of the service quality issue?

A.The first benefit I see is that we begin fixing the problem immediately, not arguing about it.  Beverly Barker has detailed the sharp increase in service-related problems experienced by the Company's customers.

In my opinion, we cannot afford to take the time for a fully-litigated case to address this pressing problem.  As a result of the settlement with the Staff,  U S WEST has already voluntarily begun offering service guarantees to all of its customers in southern Idaho.  While that, in and of itself, does not improve service, it does provide some compensation to aggrieved customers.

The second benefit is that this will be a cooperative effort, not a protracted legal battle over what level of service is required under Idaho law.  This effort has already begun with the Company providing assistance to the three-member Staff verification team in understanding how the Company measures its performance.  As a result, the Staff is developing a much better understanding of how the Company provides service and measures its own performance.  The audit team is working with the Company to resolve in advance any questions about what is actually measured and how.

Finally, the fact that U S West has actually accepted these standards as reasonable is significant.  To my knowledge, the Company had not at the time we reached agreement willingly accepted performance standards or been willing to commit to achieving its own Basic Service Measurements (BSM) in any other jurisdiction in which it serves.

Q.Are you satisfied that the service quality standards that have been accepted by U S WEST in this case constitute outstanding service quality?

A.Frankly, I am not.  I would have preferred the standards developed by the U S WEST Regional Oversight Committee(ROC).  The ROC standards more closely represent the high quality of service the Company's customers had come to rely upon in the past.  Unfortunately, I think it is unlikely the Company would be able to attain those standards in the short term given the current level of its performance.  I expect the Company will begin the improvement process under the plan.  I hope that it will continue to improve beyond the limited term of the plan.

To be effective, performance goals must be attainable within a reasonable period of time.  I believe the targets agreed to by the Company and Staff will require a concerted effort on the part of the Company but are reasonably within reach.  They are, therefore, appropriate in this case.

Q.What happens if the Company’s performance continues to deteriorate under the plan?

A.If the Company’s performance declines instead of improving, the Company’s expense associated with the service guarantee program will increase, and it will be unable to accomplish its hoped-for adjustments in rates.  Under the proposed plan, measuring the Company’s performance will be a cooperative effort between the Company and the Staff.  This should allow the Staff to have a better understanding of why Company performance might be slipping and enable us to work more constructively with the Company in resolving problems.  However, the Staff may also recommend that the Commission consider necessary remedial measures or pursue civil penalties if the Company fails to perform at accepted levels of service quality.

Q.Please explain the provision for future residential rate increases included in the proposed plan.

A.If the Company meets a threshold level of service improvement it may raise average local residential basic service rates by $1.00.  Under provisions of the agreement, the Company may raise rates no more often than once in a twelve-month period and no more than three times during the five-year term of the plan.

Q.Why are residential rates targeted for increases and not business rates?

A.Title 61 business rates are currently over two times the residential rate.  This relationship between residential and business rates has remained fairly constant for many years.  In addition to recognizing that business customers’ average usage is higher than residential customers’ usage and occurs during peak hours, this ratio reflects a pricing policy that considered the greater value businesses receive from local service.  Although the value of service to businesses may still be higher, as usage costs decline due to technology improvements and as businesses have competitive alternatives to service by U S West, the existing ratio between business and residential rates do not seem as appropriate as they once were.

Q.Will the Company's earnings increase as a result of these residential rate increases?

A.No, the Company's overall earnings will remain the same because it has agreed to concurrently reduce toll revenues by an equal amount.  Title 61 earnings will increase, and Title 62 earnings will decrease, however.

Q.Sydney Lansing has provided testimony showing that the Company is already earning a reasonable return on its Title 61 operations.  How can a rate increase be justified?

A.Mr. Lansing has estimated what the Staff position in a revenue requirements proceeding would be.  Inherent in the financial information he has presented are a number of issues upon which U S West would disagree.  The Company would argue that its Title 61 revenues fall far short of its Title 61 revenue requirement.  While the Staff believes the Company is earning on its Title 61 operations only slightly less than its cost of capital of 9.78%, the Company calculates a loss of 2.2%, far short of its claimed cost of capital of 10%.  I would hope that in a contested proceeding, the Staff position would prevail.  Realistically, however, the Staff understands that it may not prevail on all issues.  It is more probable that decisions by this Commission would fall somewhere between the Staff and Company positions.

Mr. Lansing's analysis indicates that if the joint proposal is accepted and the Company meets the first service level threshold, everything else remaining constant, the Company's earnings would still fall within what the Staff would consider a reasonable range of the Company's cost of capital.  Title 61 earnings would still be near the bottom of the range bracketed by the Staff and Company positions.  This result is due in part to the use of an allocation method that relies heavily on revenue as an allocation factor.  As Title 61 revenues increase and Title 62 revenues decrease, costs are shifted from Title 62 to Title 61.

Q.You say there are a number of issues on which the Staff and Company disagree.  What are some of them?

A.In addition to disagreement over the Company's cost of capital, U S West believes its depreciation expense is understated by the Staff.  The Company has actually been booking increased depreciation rates for some time, but has yet to ask this Commission for formal approval of the new rates.  The rates it is currently using are based on the Equal Life Group (ELG) method.  The amounts booked are accumulating in the depreciation reserve used to calculate rate base even though the ELG method is not reflected in depreciation expense.

The Company would also argue that Staff is claiming excessive amounts of yellow pages revenue for the benefit of Title 61 customers.  It has always been this Commission's policy that yellow pages revenue be used to support the provision of local service.  This policy is supported by federal and other court decisions; however, it has never been fully litigated under Idaho law.

Finally, and probably most important, there is no agreement on how to allocate costs between Title 61 and Title 62 services.  The revenue sharing plan was based on a gross revenue allocation method.  While the Staff believed this method was reasonable when used in conjunction with revenue sharing, we have also understood its limitations.  The Company, on the other hand, uses a fairly detailed method it calls CAAS (Cost Accounting Allocation System).  While the Staff does not agree totally with the CAAS mechanics or results, we believe that the average of the results (from the current CAAS allocations and using gross revenue) provides a reasonable estimation of Title 61 and Title 62 earnings.

Q.Will Commission adoption of the proposed plan meet the criteria specified in Idaho Code § 61-622A?

A.I believe it will.  Under this section, the Commission shall "establish procedures for allocation of costs" between services provided under Title 61 and those provided under Title 62.  These procedures must "reasonably reflect" the use of joint facilities, "provide reasonable stability" for company planning and pricing, and minimize associated accounting and record keeping costs.

Idaho Code § 61-622A retains the authority of the Commission to set just and reasonable rates for fully regulated services under Title 61 and to prevent the use of Title 61 services to subsidize Title 62 services as prohibited by Idaho Code § 62-613.  Evidence submitted by Mr. Lansing in this case demonstrates that no such subsidy is occurring, and continued monitoring of earnings, as has been done in the past, will allow the Commission to continue to be confident that U S West is not reaping unreasonable monopoly profits from its Title 61 services or using Title 61 services to subsidize its competitive Title 62 services.  To the extent this can be done using an easily performed modification to the Company's own cost allocation system, accounting and record-keeping costs will be minimized and the Company will be allowed reasonable stability for planning and pricing purposes as well.

Q.Why does the plan require the Company to offset any increase in local residential rates with a decrease in toll rates?

A.The Company and Staff agreed that the Company's net earnings in Idaho should not increase as a result of the proposed change in regulatory plans.  After considering a number of alternatives, the Staff chose a reduction in toll rates to provide some benefit to   Title 61 customers who will see their local rates increase if U S West is able to meet its service quality thresholds.  Most residential customers are also Title 62 intraLATA toll customers of U S West and those in some small, rural exchanges have high intraLATA toll bills each month.  This provision should provide a significant benefit to them.

Q.Why does the joint proposal include the elimination of rural zone charges?

A.This is a position that has been advocated by the Staff for some time for a number of reasons.  Local exchange companies that have obtained financing through the Rural Electrification Administration (REA) have already been required to eliminate rural mileage or zone charges.  U S WEST is the only regulated telecommunications company in Idaho that still has mileage or zone charges, there are no such distinctions made by electric, gas, or water utilities regulated by the Commission.  Customers who request service to previously unserved premises outside a base rate area must still pay a construction charge related to the distance from their base rate area.

For customers in rural areas, this proposal should result in an approximate 20% reduction in monthly local access rates (not including the subscriber line charge).  Like the previous rural modernization projects using revenue sharing funds, the elimination of rural zone charges is yet another step in reducing the telecommunications distinctions between urban and rural areas within Idaho.  This proposal also relieves the burden of monitoring population densities of suburban areas and changing their tariff status when appropriate.  Finally, the Commission in recent years has advocated that rural zone charges be eliminated.  See Order Nos. 25733 at page 6; 24506 at page 37.

Q.Please explain the provision for increased booking of depreciation expense.

A.The increased depreciation would be in addition to the amounts the Company is currently booking, not in addition to amounts formally approved by this Commission.  It does not represent ELG depreciation which the Company is currently booking and will continue to book without formal approval of this Commission.

Q.Why did the Staff agree to allow the Company to direct some of the current level of revenue sharing dollars to depreciation expense when the revenue sharing plan is terminated?

A.This is a compromise of a number of revenue requirement issues.  It recognizes that the revenue sharing plan was voluntary on the part of U S West and that, while the Company was willing to share growth in revenue during the plan's duration, it is not willing to make a permanent rate reduction equal to the full current sharing amount.  The Staff's agreement reflects our belief that the Company could legitimately claim a number of known and measurable adjustments not necessarily related to depreciation that were not included in the Staff's earnings analysis.

An increase in depreciation expense was chosen because the Company claims a significant depreciation reserve deficiency from its regulated operations in Idaho.  The Staff agreed to a depreciation expense adjustment not because we necessarily agree there is a reserve deficiency but because this method allows the Company to retain the funds without an increase in earnings.  More importantly, because it is booked to accumulated depreciation, it will be reflected as a reduction in rate base in future earnings investigations.

Q.Please explain why you believe the proposed plan is in the public interest and should be approved to replace the existing revenue sharing plan.

A.I believe the proposed plan addresses the

goals identified by the Commission in Case             No. USW-S-94-3.  These goals are:  promoting universal service, enhancing effective competition, ensuring quality of service, and setting fair rates for Title 61 customers.

By reducing the cost of access to the system for approximately 65,000 rural customers, the elimination of rural zone charges will improve universal service.  Dropping the automatic compensation to U S West for toll revenue lost because of future extensions of local service through EAS will put U S West on a more even footing with other toll providers in the state and should, therefore, eliminate at least some competitive concerns.  Acceptance by U S West of service quality targets addresses the Commission's concerns about the need for improvement of service quality and the prospect of future rate adjustments provides the Company with an incentive to improve service.  Finally, evidence presented in this case should assure the Commission that Title 61 rates as a whole are reasonable, do not provide the Company with unreasonable monopoly profits, and are not being used to subsidize Title 62 services.

Q.Were you entirely satisfied with all the terms of the proposed plan?

A.No, but any settlement must be taken as a whole, and that is certainly the case with this proposal.  The revenue sharing plan was an effective regulatory tool that has become, in its current form, no longer workable for a variety of reasons.  If approved, I believe the proposed plan will do the same.  It will serve for a period of time and then become obsolete.

The pace of change in the telecommunications industry is fairly rapid and no one knows exactly what will happen with respect to legislation and regulation during the next five years.  The joint proposal gives the Commission the opportunity to change the regulatory plan for U S West without lengthy litigation.  It allows the efforts of the Staff to be focused on the quality of service experienced by customers subscribing to the Company’s 389,000 Title 61 and Title 62 access lines in Idaho, not on a cost allocation procedure of questionable lasting value.  The Commission gives up no authority under this plan, and will retain all of its options to review the Company's earnings and, should it decided to do so, open a cost allocation case in the future.

Q.Does this complete your testimony in this proceeding?

A.Yes, it does.