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

A.My name is Bill Eastlake.  My business address is 472 W. Washington, Boise, Idaho.

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

A.I am employed by the Idaho Public Utilities Commission as a Telecommunications Analyst.

Q.Have you previously submitted testimony in this proceeding?

A.Yes, I submitted pre-filed direct testimony on behalf of the Staff of the Idaho Public Utilities Commission on October 26, 1996.

Purpose

Q.What is the purpose of your testimony at this time?

A.I am responding to rebuttal testimony offered by U S WEST witnesses Owen, Wright and Wozniak in several areas: (1) transition from interim EAS regional rates to permanent rates; (2) U S WEST characterization of Staff’s direct testimony in this case; (3) the extent of local exchange competition and its impact on prices; (4) my analysis of U S WEST’s original rate proposal; (5) my stance on specific rate design issues; and (6), I will present Staff’s formal rate design proposal.

1.  Transition for interim EAS regional rates to

    permanent rates

Q.It appears that the Company’s requested revenue requirement has been reduced from $38.2 million in its direct case to $28.3 million in rebuttal testimony.  Has the revenue requirement been reduced?

A.Not entirely.  The “reduction” is misleading because the Company has embedded approximately $12 million of EAS revenue as a result of implementing the three EAS local calling regions that is only partially offset by its adjustment to reflect EAS costs.  About $10 million is attributed to the “interim” $3.62 monthly increase for residential customers located within the regional calling areas.  Another $1.8 million is attributed to consolidation of rate groups.

Q.Why do you refer to the EAS monthly increase of $3.62 as an “interim” rate?

A.In Case USW-S-96-4 the Commission authorized the creation of three EAS calling regions.  The Commission anticipated that this rate case would be completed before the EAS regions would be operational.  Realizing that the rate case would establish “permanent” rates including the cost of the new EAS, the Commission established an interim EAS rate structure.  In Order No. 26672, page 22, the Commission stated:

...because an order in the

rate case is likely to predate the

implementation of EAS service, the

customer rates proposed by the

Stipulation may never become effective.

The Stipulation’s rate and credit

provisions will be superseded by the

rates the Commission establishes in the

rate case.

The Commission affirmed this understanding on reconsideration in Order No. 26728, page 3, where it stated:

...the evidence clearly demonstrated

that the proposed rates would become

a nullity as a result of the Commission’s

review of rates in U S WEST’s pending

rate case.

The Company also acknowledged the temporary nature of the EAS rate structure.  U S WEST witness Wozniak stated that “these are interim prices” (Tr.  at page 475) and admitted that rates and the rate design from the rate case “will entirely supersede the stipulated rates proposed here for the EAS implementation.”  (Wozniak, Reb, page 12).  The $3.62 figure has no formal basis in cost and is not relevant for rate setting in this case.  The $3.62 EAS rate will be recovered from revenue sharing funds until permanent rates are issued pursuant to a final order in this case.

Subsequent testimony at page 22 below provides further details on recommended disposition of remaining revenue sharing funds.

Q.How should the costs of EAS be calculated in this case?

A.EAS costs have three elements.  First, implementation of EAS requires the Company to install new plant in the regions.  As part of the EAS case U S WEST and Staff proposed that $1.5 million in available Title 61 revenue sharing funds be used to defray the cost of the new plant.  The Company now calculates that $3.707 million in plant improvements is necessary.  Consequently the Staff and the Company propose to satisfy this additional funding requirement ($2.207 million) with available revenue sharing monies.  This plant investment should be fully depreciated on the Company’s books.  Company estimates of this cost are found in workpapers for Ms. Wright’s adjustment #28.  Since this cost is fully offset by revenue sharing funds, it is not included in Staff adjustments found at page 10 of Exhibit No. 101.

Q.What is the second component of the EAS costs?

A.Converting former toll minutes to local EAS minutes causes a shift in jurisdictional separations. The Company calculates this results in a net increase to rate base of approximately $7.45 million, subject to audit, as shown in Ms. Wright’s workpapers for adjustment #27.  Q.What is the third element of EAS cost?

A.The new plant and usage will increase operating expenses by $3.047 million.  This total adds the $183,000 maintenance expense from Ms. Wright’s adjustment #28 to the total operating expenses of $2.864 million from adjustment #27.

Q.Do you accept these later two EAS cost adjustments by the Company?

A.Staff accepts the separations impacts calculated by the Company, but the separations impacts need to be further adjusted to split intrastate amounts between Title 61 and Title 62.  The adjustments will reflect Staff allocation factors rather than the Company’s.  To accomplish this, Staff first used Company allocation factors to take plant amounts back to the intrastate level, then applied its own Title 61 allocation factors to recalculate the appropriate Title 61 amounts. These adjustments are found on page 10 of Exhibit No. 101.

Staff’s adjustments to plant cost result in a decline in EAS increment to rate base from $7.451 million to $5.292 million. Staff’s adjusted plant cost amount is entered at line 10 of Exhibit No. 101, page 1.  Similar Staff adjustments to operating expenses result in a decline from $3.047 million to $2.129 million, an amount carried to line 28 of Exhibit No. 101, page 1.

Accepting the Company’s cost estimate and the proposed separations impact on rate base allows withdrawal of my TELRIC-based cost adjustment at line 28 of Exhibit No. 101 and page 10.

2.  U S WEST’s characterization of Staff direct testimony

Q.Do you believe U S WEST witness Wozniak’s rebuttal fairly characterizes Staff’s comments from earlier earnings investigations?

A.No.  Mr. Wozniak (Reb, page 3, line 7) characterizes Staff’s revenue requirement proposal as surprisingly “extreme” based on his reading of Staff comments in recent earnings investigations that

U S WEST’s earnings appear reasonable.

Reading more than just selective quotations cited by U S WEST clearly hints of Staff uncertainty, centered around the unexamined question of cost allocation.  For instance, in the same Staff comments (in Case No. USW-S-94-3) quoted by the Company, the next line below the quote on the same page, contain a section dealing with “rate base concerns.”  A few lines down, Staff notes that “... one cannot be sure no subsidization is occurring if the rate base has not been determined to be necessary, used and useful to the basic local service ratepayer.”  On the following page, Staff goes on to say that “For the future, though, there is less security that plant investment will not be an issue.”  The fact that Staff compared and contrasted several rough allocation methods as alternatives to the current revenue-sharing plan indicated that this was also a source of concern that could develop in a future rate case.  In other words, Staff had reservations associated with the reasonableness of U S WEST earnings.

Q.Is it appropriate for U S WEST to suggest the Commission should not constrain its vision to “a Title 61 vacuum” (Wozniak, Reb, page 4, lines 14-15)?

A.Staff believes this case covers just Title 61 services.  Perhaps that justifies Mr. Wozniak’s implication that Staff’s comments limit the scope of its proposal for Commission action.  However, a major issue in this case is the allocation of costs between Title 61 and Title 62, required as a result of the Idaho Telecommunications Act of 1988.  Acceptance of a revenue sharing plan as an alternative form of allocation postponed the difficult and detailed allocation of costs between Title 61 and Title 62.  This is the first time the cost allocation issue has been formally reviewed by the Commission.

Staff posed interrogatories seeking data about both Title 61 and Title 62 costs on the assumption that one needs to be familiar with the total to understand the relationship of its parts.  Certain interrogatories were met by Company responses that such requests were about Title 62 unregulated services and thus would not lead to admissible evidence in this formal Title 61 proceeding.  Exhibit No. 149 provides examples of such responses.  In refusing to provide such information, the Company itself was attempting to operate in “a Title 61 vacuum.”

Q.U S WEST witness Wright (Reb, pages 13-14 and Exhibit 43B) offers two calculations as evidence that Staff’s allocation is unreasonable and that the basic residential rate needs to go up.  Will you comment on each?

A.First, based on her application of my rate design guidelines to Staff’s proposed revenue requirement, she calculates a 1FR rate of about $6.50 and uses it to argue that Staff’s allocation is unreasonable since it produces “unreasonable results.”  There are two responses to this charge.

I deliberately did not make such a calculation because a proper rate would include provisions for the approved EAS regions but complete data was currently unavailable.  (Staff did make a preliminary EAS adjustment for added switching costs on line 28 of Exhibit No. 101, page 1.)  It was irrelevant to make such a formal rate calculation then, and it is irrelevant to discuss such a calculation done by someone else now.

Second, determining what is a “reasonable” rate should not be prejudiced by looking at a single number.  Staff is attempting to produce a reasonable allocation of costs between Title 61 and Title 62 and from that allocation will flow an appropriate level of Title 61 rates.  Comparison to historical rates may not be the proper standard for judgment of what is reasonable in this case.

Q.Is the change in the Consumer Price Index a proper standard for escalation of the 1FR rate as Ms. Wright suggests (Reb, page 14, and Exhibit 43C)?

A.Over long periods like the 37 years since 1958, the validity of any index is clearly suspect.  A service itself often changes qualitatively and substitutes come into being so people no longer buy exactly the same product.  The mathematical calculation done by Ms. Wright is technically correct, but irrelevant.  The CPI itself is now under attack for the same reasons and the current debate suggests it overstates reality by about 1.5% per year.  Over 37 years, that overstatement is sizable.  Furthermore, lower service quality might actually deserve stable (falling in real terms) prices.

Q.Company witness Owen (Reb, page 18, lines 15-20) charges it is unreasonable to suggest U S WEST wants to subsidize Title 62 services with Title 61 revenues.  Is this characterization of your testimony accurate?

A.No.  The testimony, especially on pages

11-12, makes generic references to the way in which a split between regulated and unregulated services provides clear economic incentives to shift costs between Title 61 and Title 62.  Prior earnings investigations by Staff also note such an incentive.

Whether or not there is subsidization is utterly dependent on the way in which costs and revenues are allocated between regulated and unregulated services.  Ms. Owen seems to suggest that any allocation of loop cost to unregulated services is improper.  This case will determine the ultimate allocation and from that will flow the answers to questions of subsidy.

Q.Does Ms. Owen (Reb, page 25, lines 19-22) properly interpret your quotes from Order No. 18188 concerning the subsidy issue?

A.No.  I cited two passages from that Order at page 15 of my direct testimony.  She concentrates on the first of my quotes which she says “clearly shows” that the Commission was trying to use non-basic services to minimize the level of local exchange rates.  She ignores the next pages of that same Order, also cited in my direct testimony on page 15, in which the Commission clearly said “there is no evidence to support the Company’s contention that basic exchange service is ‘subsidized’ by toll or any other service.”

3.  Extent of competition and its impact on price

Q.What do you mean when you talk about competition in this case?

A.Competition must be limited to Title 61 regulated companies that provide residential and small business exchange service.  Counting all telecommunications service providers as competitors only serves to distract attention from the relevant group of Title 61 providers.

The distinction between Title 61 providers and Title 62 providers is crucial to this case.  The Company seems to cite the distinction when useful and gloss over it at other times.  U S WEST fails to note clearly that the only services for which there is “effective” competition in Idaho are Title 62 long distance services that are not at issue in this case.

Q.Does the “sheer number” of providers cited by Ms. Owen (Reb, page 4, lines 8-18) provide proof of the existence of competition for local services?

A.No!  A look at the Yellow Pages advertisements cited reveals that most of the firms in her cited source are not Title 61 telecommunication service providers.  Specific pages (843-49 of the December 1996 edition) referenced by the Company contain information about many sorts of telephone business, like cabling and installation, coin and cards, communications service, equipment dealers and suppliers and service, and long distance.  All of these are Title 62 services or are not regulated at all.  Of the six and one-half pages the Company cites as evidence of competition, some 20% of the space is covered by U S WEST's own ads, without counting its own number listings under several categories.  Only a dozen entries are listed as telephone companies and none are currently offering Title 61 services in competition with U S WEST.

Q.Does Exhibit 40B and its discussion (Owen, Reb, page 7) provide additional support for claims of competition for U S WEST?

A.No.  The Dime-Line (VARTEC) example is a poor one because it is clearly about competition in Title 62 services.  The advertising flyer fails to mention

U S WEST but does make reference to AT&T.  Despite the clear inference it applies to calls anywhere, the footnotes clearly say it applies to INTERstate calls.  As a matter of fact, a company like VARTEC would prefer not to make INTRAstate calls, since its rates offer little margin over U S WEST access charges.

Q.How does U S WEST choose to define competition?

A.Inconsistently, as suits the purpose at hand.  At page 34, lines 19-24, of her rebuttal testimony, Ms. Owen says resellers aren’t true competition, only companies that provide their own infrastructure (facilities-based providers) are.  But as explained above in her assertion about the “sheer number” of competitors, most of the putative competitors she cites are not facilities-based competitors but are resellers of some description, for services other than Title 61.

Q.Can Ms. Owen sustain her disagreement, at page 23-25 of her rebuttal testimony, with your assertion that new entrants face large investment requirements as an obstacle to entry?

A.No.  At page 17, lines 17-18, she expresses clear preference for facilities-based carriers, saying that competition cannot be “just a repackaging of incumbent’s services.”  Then at lines 20-23, she admits that “development of facilities-based entry is difficult.”  Given that inconsistency of definition, it is difficult to decide just what sort of entrants are under consideration.  If entry of new firms is really without serious financial obstacles, it would seem that there might be more numerous Title 61 competitors.

Q.Does your assertion concerning large investment needs require empirical validation?

A.Not really, since economic theory suggests that a high-technology, capital-intensive business like telecommunications has serious initial capital requirements that may be an obstacle to the entry of new firms.  In this case, my assertion seems clearly labeled in the testimony as a paraphrase of what customers might think, rather than a formal hypothesis.

Q.Ms. Owen at page 3 and at page 27 takes exception with your testimony that competition drives prices downward.  Is this a fair characterization of your testimony?

A.My testimony never formally expresses such a view.  On page 8 of my direct testimony, I mention specifically as “folklore” that competition will reduce costs for everyone.  Staff actually shares general agreement with the statement found in Owen’s rebuttal testimony at page 33, that competition eventually drives prices toward underlying costs.  However, that is not the point of argument between Company and Staff witnesses.  We can agree on the tendencies of competition, but we do not agree on the level of costs.

4.  Analysis of U S WEST’s original rate proposal

Q.U S WEST witness Owen, pages 28-32, finds several reasons to criticize the way you analyze the

U S WEST rate proposal outlined in its direct testimony.  She charges that your analysis doesn’t address either the phase-in of rates or the ITAP provisions.  Why did you leave them out?

A.I chose to analyze the proposed rate increase by treating the entire difference between current and proposed rates in order to show the true magnitude of the increase anticipated.  U S WEST provided adequate analysis of the three separate phases but failed to analyze the cumulative impact of all three phases.  My analysis added a useful perspective on the cumulative impact of the U S WEST rate increase.

I did examine carefully the details of the

U S WEST ITAP proposal but found no need for further comment.  The overall financial impact of the proposed ITAP changes was small and its spread to other ratepayers was at an acceptable level, as evidenced in Exhibit No. 150, the Company’s response to my question in Staff Production Request STF01-031.

Q.Did you ignore the $3.19 reduction in charges for rural zone customers?

A.No.  Page 40, lines 18-20 of my direct testimony, notes that rural zone charges are to be phased out upon implementation of EAS.  The impact of this change in rural zone charges was not formally treated in the Company’s rate spread or in my analysis of it.  It would be misleading to treat any such change, which Owen agrees is not part of this particular case, as if it creates an impact that will be separable and noticeable to customers other than the directly affected rural customers.  The new revenue requirement resulting from this case will be spread across all customers in a single rate change.  That $3.19 reduction may be offset or supplemented, in whole or in part, by other forces that result in the final rate from this case.

Q.Is it fair to charge you with not using the proper rate group consolidation (inside or outside of EAS regions) in your analysis?

A.Hardly.  I used the consolidation of Rate Groups 1 and 2 into Rate Group 3, just as the Company had in the rate spread of its original proposal supplied in response to Staff Production Request. Some customers previously in Rate Groups 1 and 2 are moved into the “in region” group as a consequence of their inclusion in an EAS.  Other customers, those remaining in former Rate Groups 1 and 2, become the “out region” group.  All residential customers now pay former Rate Group 3 rates ($12.00 instead of $10.11 or $11.01) as their base rate.

To reiterate, I did not formally model EAS for direct testimony so there was no formal consolidation into just two groups.  As Ms. Owen notes at page 31 of her rebuttal testimony, I did recommend consolidation into just two groups, one inside and one outside of the new EAS regions, and final rate design will make use of two groups.

5.  Specific rate design issues mentioned by Owen

Q.Turning first to the business-residence ratio, Ms. Owen says your direct testimony at pages 22-23 shows that residential customers do not pay their fair share of costs.  Is that an accurate characterization of your testimony?

A.No.  My references are all to revenues and are meant only to point out the major shift in revenue responsibility from business customers to residence customers in the Company’s proposal.  I neither made nor intended any reference to costs in that discussion.

Q.Ms. Owen, at page 38 of her rebuttal testimony, notes that you failed to provide any evidence that business customers have more usage than residential customers.  Do you have evidence for that assertion?

A.I avoided citation of the evidence due to its asserted confidentiality.  I made use of data on 1FR and 1FB customers from Company SLUS studies, provided in a TSLRIC Study of Residential and Business Exchange Recurring and Non-recurring Costs, 1996, from the Company’s Confidential Response to Staff Production Request STF-01-036.

Q.In arguing for a change in the business-residence price ratio and elsewhere U S WEST seems to assert this ratio is a form of social pricing based on considerations like value of service and sustainable only under regulation but not under cost-based competition.  Is this an accurate rendering of the difference between regulated and competitive markets?

A.This is a curious reversal of concepts by

U S WEST and is thus a source of likely confusion when local phone service considers moving from a regulated world to a competitive one.  A competitive market is cost-based mostly in the sense that costs provide a floor below which competition cannot drive the price on a permanent basis.  In markets, firms look first to demand and to value of service considerations.  They try to sell products and services for whatever the market will bear.  Only if and when they meet effective competition must they reduce prices toward the eventual floor set by costs.  Costs enter only through the “invisible hand” of Adam Smith, not by the conscious design of producers.  Competitors do not try to set prices at cost, but ultimately they may be forced to do so.

Regulation, on the other hand, is driven primarily by cost.  Most service is cost-plus, and the challenge is to document that whatever costs are incurred are done so in a prudent manner.  Given that premise, prices are set high enough to cover costs.  Only incidentally are real marketing considerations such as willingness-to-pay brought into the equation.

The point is that value of service considerations are not a relic of a regulated world, but a normal part of the everyday competitive world.  Certainly costs are important in competitive markets, but other considerations like value of service also have a role in setting prices.

Q.The Company’s case for not raising business rates seems based on its perception that only cost of service can be used as the basis for competitive rates.  Does the Company adhere cleanly to that position?

A.No.  If the Company believed business was so clearly cheaper to serve than residence, it might have actually proposed a reduction in business rates rather than just a freeze at current levels.  In addition, the discussion of privacy listings (Owen, Reb, page 44, lines 16-18) makes it clear that value-added services still have a place in U S WEST pricing strategy -- “...customers value that need enough to pay the current price...”

Q.Has your position on the business-residence ratio been altered as a result of reading the Company’s rebuttal testimony?

A.No.  I believe it is unfair to impose a revenue increase of the magnitude proposed by the Company only on residential customers.

Q.Ms. Owen says your position on measured service in unclear.  Can you clarify your position?

A.In direct testimony at page 28, I pointed out that the proposed increase in the monthly charge would more than offset the reduction from the 180 minute free usage allowance.  In passing, I note that the Company’s rebuttal testimony proposes for measured service customers both a lower EAS adder ($2.00 versus $3.62 for flat rate customers) and a lower measured rate than was proposed in direct testimony.  This helps overcome one of the concerns with the proposal.  Ms. Owen is correct that I accept the Company’s proposed structure for measured service with the 180 minute free allowance.  Since Ms. Owen agrees with my proposed reduction of the per minute usage charge to $.02, there are no remaining disputed issues and I agree with the Company on the newer structure combined with the lower per minute rate.

Q.Are there any remaining issues with the installation charge?

A.No.  The Company has expressed willingness to drop the proposed increase in installation charges and I accept this offer.

Q.Have you altered your position on the issue of privacy charges?

A.Yes.  Considering Ms. Owen’s points, it is not appropriate to transfer to non-subscribers of privacy listings the burden willingly shouldered by customers who perceive sufficient value of service to purchase privacy listings.  I withdraw my suggestion to reduce the charges for both types (non-listed and non-published) of privacy services.

Q.What is your position on the Company’s vacation rate proposal?

A.I am concerned because the proposed restructure provides significant benefits to a very small number of customers against the backdrop of major increases in rates for the great majority of customers.  I concede that the service is valuable to some customers and the restructure has negligible revenue impacts on those other customers.  While I cannot endorse the Company’s proposal, I will not oppose it.

6.  Staff’s rate design proposal

Q.How was your rate design proposal created?

A.Beginning with a base revenue from the test year, Staff used a spreadsheet to derive a set of rates that generated a proposed revenue such that the difference between base year revenue and the proposed revenue matched the negative amount of revenue requirement (-$26.010 million) from Exhibit No. 101.  Staff’s proposed rate design freezes current relationships between various rates to the same ratios as current, e.g. business (1FR)/residence (1FB) ratio of 2.59.  The rate design also makes use of two different rate groups, one “in region” and one “out region” of the new EAS areas.  The differential between the two new EAS rate groups amounts to $1.00 under Staff’s rate proposal.

Q.What rates does Staff recommend to achieve the recommended revenue requirement change?

A.Exhibit No. 151 details Staff’s proposal for the Title 61 residence and business rates affected.  The exhibit consolidates several specific rate classes (noted in bold type) under general types of services, based on the sharing of a common rate.  Page 1 covers residential rates, the most important being the 1FR rate that applies to flat rate residential use and generates some 94% of base revenue.  Page 2 covers business rates, the most important being the 1FB rate that applies to flat rate business use and generates some 53% of business use (83% when the AFK rate, additional flat lines, is added).

Page 3 of Exhibit No. 151 shows a comparison between Staff’s proposal and the Company’s proposal as they relate to the current base.  This exhibit is meant to highlight the major shift of revenue responsibility from business to residences that results from the

U S WEST proposal and to point out that the Staff rate proposal would preserve the business-residence proportion as it now exists.

Q.What sort of adjustment does Staff propose for the remaining revenue sharing funds?

A.Staff has prepared Exhibit No. 152 to trace the derivation of the amount still left for final distribution.  It starts with the remaining balance as noted in Order No. 26672, subtracts additional funds designated to cover the investment costs of EAS implementation, subtracts the amounts required to fund credits to offset the $3.62 EAS interim rate for the three regions, and arrives at a remaining balance for disposition of $5.28 million as of July 1.

Q.What does Staff suggest be done with that balance?

A.Staff makes note of Order No. 26672, page 22, that “both U S WEST witness Wozniak and Staff witness Cusick recommended any remaining revenue sharing funds be used as billing credits for the customer rates ultimately established in the rate case.”  Since that balance is no longer accruing interest, Staff recommends a single credit of the entire amount due each Title 61 customer.  Dividing the available $5,280,062 by the 353,426 customers in the base year gives a one-time credit amount of $14.94.

Q.Does this conclude your surrebuttal testimony in this proceeding?

A.Yes, it does.