SURREBUTTAL TESTIMONY

Introduction

Q.  Please state your name, position and business address.

A.  My name is Susan M. Baldwin; I am a vice president of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108.

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 November 26, 1996.

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

A.  I am responding to those portions of the rebuttal testimony offered by US West witnesses Elder, Owen, Plummer, Ilett, Wozniak, and Wright that address cost allocation principles, methodology, and recommendations.  For the most part, Staff witnesses Selwyn and Eastlake rebut the various US West witnesses that address the relationship of this proceeding to competition, although, clearly, the Commission's final determination as to how to assign and allocate rate base costs and operating expenses between Title 61 and Title 62 services will bear directly and materially on the actual prospects for competition in Idaho's market for local telephone service.

Q.  How is your testimony organized?

A.  I have organized my surrebuttal testimony along the following topics:

1.  The first part of my testimony addresses Mr. Elder's erroneous assertion that Staff has not applied any cost allocation principles in its allocation of costs between Title 61 and Title 62, and also addresses Mr. Wozniak's unfounded concerns about the impact of Staff's proposal on investment in Idaho's telecommunications infrastructure.  See pages 3 through 21.

2.In the next part of my testimony I rebut the unconvincing arguments of several US West witnesses regarding Staff's proposed assignment and allocation of the local loop portion of the Company's Telephone Plant In Service (TPIS).  See pages 21 through 37.

3.I then address US West's opposition to Staff's proposal to rely on the Commission's findings in the Tech Plus and Tech II decisions as a way to assign and allocate the Company's TPIS.  I demonstrate that under the guise of a "partnership" US West seeks to shift costs to Title 61 while retaining substantial Title 62 revenues.  See pages 37 through 47.

4.Although the Company's rebuttal testimony does not alter the fundamental cost allocation approach proposed by Staff, US West has provided data that has allowed Staff to fine-tune its calculations, and therefore I summarize the refinements to Staff's recommendations regarding the assignment and allocation of US West's TPIS, made possible by this new information, in Schedule 1 of Exhibit 158.

5.  In certain instances other Staff witnesses have modified their specific corrections to the Company's proposal, which, in turn, has altered the amounts of common expenses available for allocation.  These changes have not altered the way in which I propose to allocate these common expenses, but have changed the results of the allocation of expenses such as advertising, maintenance, and the other plant-related and non-plant-related expenses.  These changes appear in the revised Exhibit 101 to Mr. Lansing's surrebuttal testimony.

6.I demonstrate that contrary to the unfounded assertions of US West, it is entirely feasible to adopt and implement Staff's recommendations for assigning and allocating costs.  See pages 47 through 51.

Q.Have you prepared any additional schedules either to supplement or replace the ones that you had included with your direct testimony?

A.  Yes, I have.  My surrebuttal testimony includes two exhibits:  Exhibit 158 only includes schedules that contain information that the Company does not consider to be proprietary, and Exhibit 159 includes schedules with information that is allegedly proprietary.  Four of the schedules in Exhibit 159 reflect various approaches for assigning and allocating the Company's telephone plant in service (TPIS): Schedule 1 reflects Staff's proposal; Schedule 2 and Schedule 3 reflect two alternatives; and Schedule 4 summarizes the three approaches.

Judgment as to the appropriate manner in which to assign and allocate costs should be guided by the cause of the costs being incurred.

Q.  Please describe generally the challenge the Commission faces as it determines how to assign and allocate US West's extensive plant in service that jointly supports the provision of both Title 61 services (subject to full price regulation by the Commission) and Title 62 services (exempted from direct economic regulation).

A.  The production of telecommunications services necessarily involves an extensive base of common facilities whose costs are largely fixed over a broad range of services and service quantities.  The manner in which US West assigns and allocates these largely fixed costs among its numerous services has a direct bearing upon whether the Company complies with the statutory prohibition against the cross-subsidization of Title 62 services with Title 61 monies.  (Chapter 600 of Title 62 of the Idaho Code, which covers tele­com­muni­ca­tions services not subject to economic regulation by the Commission, holds that "[a] telephone corporation may not subsidize telecommunication services which are subject to this chapter by those telecommunication services which are subject to regulation pursuant to Title 61, Idaho Code.  Provided, payments to the universal service fund ... shall not be considered to be a violation of this section" (Idaho Code, § 62-613).)  US West may not, therefore, allocate costs that it has incurred for purposes of providing Title 62 services to Title 61.

Q.  Is the fact that the Company's non-basic local services are not directly subject to the Commission's regulation the result of a Commission directive or the Company's own election?

A.  The Idaho Telecommunications Act of 1988 gives a local exchange carrier the choice between receiving an exclusive franchise for all of its services (i.e., including those that would otherwise be subject to Title 62) at rates that the Commission sets pursuant to the traditional ratesetting authority contained in Title 61, or electing to remove its non-basic local services from the direct regulation of the Commission.  US West exercised this option in March 1989.  (See Order No. 26355, at 1).  Eight years ago, US West chose to remove most of its services from the Commission's direct regulation, and thus was permitted virtually unlimited discretion in the way that it priced and offered those Title 62 services.

Q.Mr. Elder has asserted that you used no cost allocation principles in preparing your assignment and allocation of plant and equipment in this case (Elder Rebuttal, at 38).  Do you agree with his assertion?

A.I disagree entirely with Mr. Elder.  In preparing Staff's proposal, Staff has firmly adhered to several key principles.  These principles include:

(1)Cost causation;

(2)Clarity and ease of implementation; and

(3)Consistency with sound economic principles and the statutory mandate against cross-subsidization of Title 62 services by Title 61 services.

Q.Please describe these principles in greater detail.

A.Certainly.

(1)Cost causation means that the products and services that cause costs to be incurred should bear those costs, and in those instances where the deployment of a particular network improvement is justified disproportionately by certain products, those products should bear a corresponding share of the costs.  Given the vast amounts of common plant that are involved, it is critical to ensure that the cost allocation methodology that the Commission adopts does not permit the Company to cross-subsidize new ventures with revenues from existing monopoly services.  By way of example, allocating costs primarily on the basis of existing usage (e.g., lines in service), would unfairly burden Title 61 customers during the Company's "ramp-up" period — i.e., the period during which US West has just begun to offer new services or has not yet even begun to offer them.

This improper shift of costs to Title 61 customers could occur for at least three reasons: (i) the plant in service may have excess capacity that is necessary to meet the demand for a disproportionate amount of growth in Title 62 services; (ii) decisions made prior to or during the test year to upgrade plant may have been motivated by the Company's interest in offering new (Title 62) services in the future.  Once the plant is deployed, however, the actual use of the plant during the test year could well result in the vast majority of the shared costs being allocated to Title 61, since the Title 62 services will either be newly introduced, or perhaps not even in existence.  Finally, (iii) any new services that are still on the Company's drawing board and that do not currently utilize any resources in common with Title 61 services will necessarily escape the test-year cost allocation process altogether.

(2)Clarity and ease of implementation — the allocation should be based upon information that is readily available to US West, either through its existing accounting system or through other studies routinely prepared by the Company.  The allocation process should not require hundreds of pages of documentation, or thousands of spreadsheet lines to be implemented or understood by the Commission.  The actual allocation itself should be readily understandable, and as straightforward as possible.

(3)Consistency with sound economic principles and the statutory mandate against cross-subsidization of Title 62 services by Title 61 services — where investments are made that are neither necessary nor economic­ally efficient for the current or likely future provision of Title 61 services, such investments must not be allocated to Title 61.  Such an allocation by the Company will thwart entry by potential competitors, and cause basic rates to be set unnecessarily and inappropriately high.

Q.  Does the Company's CAAS comport with these economic principles?

A.  No.  As a general matter, because the Company's cost allocation system fails to recognize the costs that are caused by its ventures into competitive areas and by its provision of Title 62 services, the methodology espoused by the Company would result in the cross-subsidization of Title 62 services with Title 61 revenues, a consequence that would be inconsistent with Idaho's statutory framework and with sound economic principles.  For example, US West has indicated that it allocates the cost of excess capacity (also referred to as spare, unused, growth and/or reserved capacity) in the same proportion as in-service capacity.  (See the Company's response to Staff Audit Request STF03-170, which has been reproduced as Schedule 3 in Exhibit 113 of my direct testimony.)  This approach ignores entirely the undisputed fact that different products have differing needs for future capacity.  The demand characteristics of Title 62 services are significantly different from those of Title 61 services.  For example, the demand for residential basic exchange is highly predictable because the number of housing units along a given distri­bution cable route can be known or predicted with relative certainty.  By contrast, large business customers' demand is far more variable and thus less predictable, particularly at the granular level of individual distribution routes:  If a 5,000 line centrex system is replaced by a customer premises PBX that requires only 500 PBX trunks, 4,500 loop pairs will have been made idle.  There will thus be a substantial increase in spare capacity that is directly attributable to the more volatile demand of the Title 62 service.  If those 500 Title 62 PBX trunks are supplied by a competitive access provider (CAP) or other non-US West local carrier, the entire 5,000-pair facility will be idled.  Because all business services in excess of five exchange access lines are subject to Title 62, there will be grossly disproportionate amount of Title 62 plant in facilities that serve business locations than in areas predominated by residential (Title 61) subscribers.  Not only does the Company's proposed allocation scheme fail to recognize the very different growth and demand characteristics between Title 62 and Title 61 services, it would actually work to shift costs from Title 62 to Title 61 effectively insulating the Company from the volatility and competition that exist in the Title 62 arena.

Q.  How could that type of cost shift happen?

A.  I can best answer that by way of a simple numerical example.  Suppose that there is a 6,000-pair subscriber loop cable that presently serves 500 Title 61 access lines and 4,500 Title 62 access lines.  Suppose that the annual revenue requirement (cost) associated with this particular facility is $600,000.  Under a strict in-service usage-based allocation (i.e., based upon 500 Title 61 and 4,500 Title 62 working lines), 10% of those costs (i.e., $60,000) would be assigned to Title 61, and the remainder ($540,000) would be assigned to Title 62.  Now, suppose that 3,000 out of the 4,500 Title 62 lines were associated with a large centrex customer who not only discontinued the US West centrex service, but chose to take its PBX trunk service from a competing local carrier.  As a result, only 2,000 of the total 6,000 lines of capacity will remain in use, but the Title 61 share of those in-service lines will have increased to 25% (i.e., 500/2,000).  Despite the fact that there will have been no change whatsoever in the quantity of or demand for Title 61 services, the costs assigned to Title 61 under US West's allocation scheme will have increased from the original $60,000 to $150,000.  Put another way, by this device US West will have been able to shift $90,000 in annual costs back to Title 61 services that are subject to cost-based regulation, at least partially offsetting the Title 62 revenue loss it will have sustained with respect to its competitive centrex and PBX trunk offerings.

The point of this example is that the $90,000 of costs that would shift to Title 61 is in no way caused by any Title 61 service.  The 6,000 lines of capacity could not remotely be justified as necessary for the 500 Title 61 lines that are served by that cable.  US West's allocation rules would have the effect of shifting the effects of demand variability and uncertainty that are present in competitively-impacted Title 62 services over to noncompetitive Title 61 services.  By any economic definition, that shift would constitute a cross-subsidy of Title 62 by Title 61, and would be prohibited by Idaho law.

Q.  What overall effect does the Company's proposed method of assigning and allocating spare capacity have on the Title 61 revenue requirement?

A.  By assigning the costs of "spare" joint plant (that is, spare capacity) in precisely the same manner as "in-service" joint plant, US West's proposal effectively shifts costs to monopoly services when new (and often highly underutilized) plant is acquired for the purposes of responding to competitive pressures.  All else being equal, and absent the presence of competitively-driven plant additions, if plant utilization rates would be higher, any differential in utilization between the pure monopoly case and the hybrid monopoly/competitive joint production scenario should be assigned in its entirety to the competitive category.  As was aptly stated by Idaho Citizens Coalition witness Thomas Power, "the investment in new facilities is caused by the telecommunications company in anticipation of profits associated with future markets that it hopes to develop."  Powers (Idaho Citizens Coalition) at 22.  I concur with Dr. Power's assertion that "[b]asic service should not be asked to support business activities that are primarily focused on USWC's competitive ventures" (Power at 23).

 Q.  Are there other relevant facts relating to the regulatory paradigm that governs US West's operations in southern Idaho?

A.  Yes.  It is important to recognize that Title 62 products are defined by exclusion.  In other words, the legislation explicitly defines a very narrow set of services as belonging to the Title 61 category, and all other services are then implicitly covered by Title 62.  Thus, the specific products that the Company offered during the test year (which comprise the universe of products to which common and joint costs are being proposed to be allocated in this proceeding) do not fully account for the Company's future offerings that will make use of its extensive common plant.  In other words, future products will be getting a "free ride" because they can be offered using the Company's common network and yet will not be required to bear a share of the cost of the substantial common plant.  All of the revenues that are derived from these new services will flow to the Title 62 "side" and yet none of the vast amount of common capital costs will shift away from the Title 61 services.  When the Commission takes into account the relative growth and volatility in Title 62 services, it is important to recognize that there is not only the growth and volatility in those Title 62 services that US West currently offers, but also the growth of entirely new Title 62 services that US West will offer in the future.

Q.  Can you give an example of such a service that US West might offer?

A.  Yes.  Broadband data services represent what is likely to be the most significant new service offered by the ILECs in the near future.  The most promising current technology for offering such services is asymmetrical digital subscriber line (ADSL), which operates over the existing copper distribution plant (i.e., the local loop) to deliver extremely high bandwidth digital services.  Under the Idaho regulatory regime, this will likely be a Title 62 service.

The allocation of the local loop between Title 61 and Title 62 is being set in this rate case.  When ADSL is deployed, it is very likely that some Title 61 customers will switch from their analog service to ADSL.  Others will obtain entirely new ADSL lines dedicated to data communications.  However, without a new rate case, there will be no shifting of the underlying loop and other joint and common costs from Title 61 to Title 62.  Thus, Title 61 customers will end up subsidizing a Title 62 service.

Q.  Do you have a recommendation as to how the Commission should quan­tify the differential in the growth and volatility characteristics of Title 61 and Title 62 products?

A.  Yes.  I describe such a computation in my direct testimony at pages 37 through 41, and discuss the matter of spare capacity further in this surrebuttal testimony.

Under the guise of a "partnership" US West seeks to shift costs from Title 62 to Title 61.

Q.  Mr. Wozniak characterizes your recommendation as precluding all digital technology from the rate base and as "changing the agreements to add a new and onerous condition for the use of Title 61 funds" (Wozniak Rebuttal, at 23).  Please comment.

A.  First, Mr. Wozniak has misconstrued my recommendation.  As is discussed in more detail below, I recommend that all of those digital investments that were undertaken with Title 61 funds be directly assigned to Title 61 (with the fully offsetting accumulated depreciation).  I also recommend that all other digital switches be assigned to Title 62 as well as all additions to the digital subscriber pair gain account since January 1, 1989.  Finally, I recommend that all other digital plant be allocated between Title 61 and Title 62.  As Mr. Wozniak recognizes, "the Company was to use shareholder matching funds to build facilities upgrades in the larger communities served by US West" (Wozniak Rebuttal, at 22, emphasis added).  Just as there were excess revenues associated with the Company's Title 61 operations, so too were there excess revenues associated with the Company's Title 62 operations during the same time period.  The consequences of the fact that the Company did not expense its part of the "agreement," but instead chose to capitalize these urban investments should not now be used to impose a cost burden to Title 61 customers.  It is hard to imagine that the Commission intended such a lopsided "partnership."

Q.  Mr. Wozniak is concerned that Staff's proposal would "encourage disparate investment across the state" (Wozniak Rebuttal, at 23).  Please comment.

A.  It is my understanding that, as a result of the Commission's directives to use revenue sharing funds, the vast majority if not all of the rural areas of southern Idaho are now served by modern telecommunications plant that is more than adequate to offer Title 61 services, and that is required for many Title 62 services.  It is hard to imagine — other than routine maintenance — a compelling need in the near future for any further substantial new investment in US West's network in rural areas.  Mr. Wozniak's concern about disparate treatment is therefore unconvincing.  (Of course, in statements filed recently by the United States Telephone Association (USTA) on behalf of its member ILECs (including US West) in the FCC's Access Charge Reform proceeding (CC Docket 96-262), Dr. Vanston and other USTA experts there contend that the very same types of digital electronic switching systems that US West has just completed deploying in southern Idaho are already "obsolete" and in need of replacement.  (See, for example, Jeffrey H. Rohlfs, Charles L. Jackson, and Ross M. Richardson, "The Depreciation Shortfall," Comments of USTA to the FCC, CC Docket NO. 96-262, January 29, 1997, Attachment 15.)  To the extent that such assessments deserve any credence — which I seriously doubt — the prudence of US West's deployment of plant that was at the end of its technological life should also be subject to question.)  Any future decisions to deploy substantial new plant, where the costs to be borne by Title 61 services would not be offset by any savings and/or new revenues associated with these services (i.e., any modernization that is being undertaken for the specific benefit of Title 61 customers and that would not pass a cash-flow analysis) — should be pursued only upon an affirmative Commission mandate.

Q.  Please elaborate.

A.  The critical challenge facing the Commission is to distinguish between those investments that are necessary for Title 61 services from those that are necessary for Title 62 services.  In the Tech II proceeding, the Commission's Staff observed that the Company has 58 digital switches and 20 electronic analog switches, serving 33% and 67%, respectively, of all access lines.  The Staff observed that in general "US West customers are currently provided with adequate tele­com­muni­ca­tions services" (Order No. 24506, dated November 2, 1992, at 10).  That being the case, there will be no reason for any major network investment unless and until technological advances result in a substantive change in the way basic local exchange services (i.e., Title 61 services) are provided.

Q.  Mr. Wozniak refers to a later Commission decision issued in March 1996 in which "the Commission disagreed with Staff's assessment that the Jerome, Burley and Declo 2BESS switches were 'perfectly adequate' to provide Title 61 services."  Doesn't this contradict your earlier statement?

A.  No.  The Commission supported US West's proposal to use $1.25-million in 1994 revenue sharing funds "to be matched equally with funds from US West" to purchase the three new switches.  Order No. 26355, issued March 6, 1996, at 14.  While I cannot speak to the Commission's specific intent, it seems implausible that the Commission contemplated a "partnership" whereby the Company "matches" Title 61 funds with yet more Title 61 funds.

Q.  Mr. Wozniak believes that Staff's recommendation will have a "chilling effect on new investment."  Do you agree?

A.  No, not as long as the new investment is economically sound to begin with.  If US West decides to forego new investment where, under a fair apportionment of costs as between Title 61 and Title 62 services, that investment would be uneconomic, then in fact the investment should not be made in the first place.  If US West is permitted to shift costs of new plant whose acquisition is motivated by strategic and competitive pursuits to Title 61 services, it will be almost impossible for any new entrant — one that does not possess such an opportunity for cost shifting — to compete with US West.  This undermines the underlying premise of the Title 61/Title 62 distinction — that Title 62 services can and should be provided under competitive market conditions.  Ironically, then, while the Staff's proposal will not have a "chilling effect on [economically prudent] new investment" made by US West, failure to adopt Staff's recommendations will certainly chill new entrants' interest in investing in Idaho.

Note that I have no fundamental objection to the Company's continuing deployment of digital investment in its network.  However, it is critical that the costs of such plant be assigned to the cost causers, namely Title 62 services.  As is illustrated by the example provided by Dr. Selwyn in his surrebuttal testimony, only if the Company can demonstrate cost savings or other offsetting economic benefits for Title 61 customers that result from the deployment of digital investment should that investment be allocated in part to Title 61.  As I have explained, investment by potential entrants will be hindered if US West is given an unfair advantage through an inadequate allocation of costs to Title 62.

Q.  Mr. Wozniak contends that "positive action by the Commission in this case will encourage sustained investment by US West and also encourage competing firms to invest in Idaho," which he states will "in turn, provide jobs and a larger tax base to the state and continue to bring innovative new service and choices to consumers in Idaho."  Wozniak Rebuttal, at 11.  Wouldn't such a consequence be desirable?

A.  Presumably by "positive action" US West means approval of its request to increase rates by more than $30-million.  While this represents a "positive" development for US West's shareholders, the consequence would not be nearly as beneficial for the Company's customers and competitors.  I fully support economically efficient investment in the telecommunications infrastructure of Idaho.  Were the Commission to approve US West's cost allocation proposal, however, competing firms would have minimal incentive to invest in Idaho, because US West would be able to cross-subsidize its provision of competitive services as a result of the under-allocation of costs to Title 62.  Innovation, low prices, and high quality service are desirable outcomes of a market that becomes more competitive, but the Company's proposal is incompatible with the development of such competition.

Q.  US West's arguments seem to suggest that the Company's capital acquisi­tions improve the basic platform for Title 61 customers throughout the state, in urban and rural areas, i.e., that Title 61 customers benefit by virtue of having access to advanced telecommunications services.  Isn't this a reasonable objective?

A.  Mr. Elder contends that US West deploys investment that "makes economic sense to all services" and that it is therefore inappropriate for Staff to assert that this "joint" investment is motivated by the Company's objective of selling Title 62 services.  Elder Rebuttal, at 18.  I would certainly agree that an appropriately advanced platform accessible to all households, businesses, and new entrants may indeed be highly desirable.  However, Mr. Elder's notion of a "platform" whose costs should be borne primarily by Title 61 services fails to correspond with either the statutory scope of such services or the specific manner in which the so-called "platform" services are offered to customers and competitors.

Q.  In what respect does the "platform" envisioned by Mr. Elder fail to correspond with the statutory scope of Title 61 services and the manner in which access to the platform is to be provided?

A.  The term "platform" has come to imply a base set of functions and capabilities upon which other products and services can be constructed.  A computer operating system, such as Microsoft Windows 95, along with the personal computer on which it runs, is a "platform" for which various software applications (products like word processors, spreadsheets, graphics packages, and countless others) are created.  Although Windows 95 is proprietary to Microsoft Corporation and the Pentium processor that supports it is proprietary to Intel, all of the various interfaces that are required in order to develop software applications for that platform are publicly available for use by developers not affiliated with either of these two firms.  Indeed, allegations that Microsoft had somehow managed to lock competitors out of its Windows 95 platform aroused the attention of the Antitrust Division of the United States Department of Justice.

To serve as a "platform" of the type described by Mr. Elder — and to justify assigning most or all of the costs thereof to monopoly Title 61 services, US West's switching and transport infrastructure must be similarly open and available to any nonaffiliated competitor capable of satisfying the technical interface requirements.  For this to be so, (1) there can be no bundling, literal or de facto, of any Title 61 and any Title 62 service, and (2) all services and functionalities that constitute the "platform" must be regulated under Title 61.  US West fails to satisfy either of these conditions.

Q.  Please explain.

A.  With respect to the first requirement, there is in fact extensive bundling of Title 61 and Title 62 services.  For example, call waiting is a Title 62 service that cannot be purchased apart from the underlying Title 61 dial tone line.  Centrex lines are Title 62 services that bundle competitive features with monopoly exchange access.  Interexchange carrier switched access is a Title 62 service that is furnished to customers whose dial tone lines are subject to Title 61 regulation, and which could not be provided unless the end user subscribed to the Title 61 dial tone line.

In short, if there is to be a "platform" whose costs will be borne broadly by all Title 61 subscribers, then all services and functions encompassed within that platform must be regulated under Title 61 and must be available on a nondiscriminatory basis to any nonaffiliated provider who desires to compete in providing any US West Title 62 service.

This condition does not, however, exist under the current Idaho regulatory and legislative scheme.  There is no "bright line" separating Title 61 and Title 62 services whereby all "platform" elements are subject to Title 61 regulation.  In the instant case, although US West commits Title 61 monies to build this "platform," the principal and, in many instances, the sole benefit inures to US West through its provision of Title 62 services.  For these services, US West may earn unlimited profits without incurring any significant costs for the use of the "platform," even though absent that "platform" such advanced Title 62 services could not exist in the first place.

Q.  US West witness Wozniak also asserts that the "prices for what we call 'Title 62 services' will continue to decrease."  Wozniak Rebuttal, at 5.  How should this prediction of the Company influence the Commission's findings as to cost allocation?

A.  This forecast should be afforded no weight.  The Company's speculation has negligible basis and, in any case, cannot be enforced because Title 62 services are not regulated.  Mere assurances that the Company will reduce prices for Title 62 services cannot be used to justify the certainty of rate increases to Title 61 services.  Moreover, if the Company is able to sustain such rate reductions via its ability to cross-subsidize Title 62 services by shifting costs onto Title 61 services, the rate reductions will be anticompetitive, and thus, in the long run, will actually be contrary to the consumer's interest.

Because of the unusual regulatory paradigm that governs the Company's operations, and because custom calling and CLASS services are inextricably linked to the basic dial tone, the Commission should require US West to assign at least 5% of the local loop investment to these services.

Q.  Please describe your understanding of the Company's analysis of Staff's recommendation to directly assign 5% of the local loop investment to custom calling and CLASS services.

A.  Mr. Elder faults Staff's proposed allocation of 5% of the costs of the local loop to Title 62 for CLASS and Custom Calling services because it "does not follow historical cost allocation principles."  Elder Rebuttal (US West) at 21.  Mr. Elder has either forgotten the relevant history, or is simply engaging in revisionism here.  In fact, historically (i.e., prior to the bifurcation of the Company's services as between Title 61 and Title 62), Custom Calling services were priced so as to generate substantial contribution toward the cost of the local loop.  (As is shown in Schedule 5 in Exhibit 159, CLASS services were not offered in 1989.)  Moreover, the Commission has previously adopted the use of cost allocation precisely for the purpose of replacing the contribution that certain services now subject to Title 62 had previously produced.  For example, the Commission ordered that 15% of the local loop cost be assigned to toll and access services in 1988, when the Commission adjusted that assignment from 19% to 15%.  In the intervening years, although the costs directly attributable to these services has been negligible, the revenues have grown substantially.  The Company's response to Staff Production Request STF05-308, which has been reproduced as Schedule 5 in Exhibit 159 of my surrebuttal testimony shows the dramatic increase in revenues derived from custom calling and CLASS services, as measured both in absolute dollars and as a percentage of the Company's entire intrastate revenues.  If it were not for US West's provision of Title 61 lines and the vast amount of common plant in its network, the Company would not be able to derive this revenue stream.

Q.  Please describe and respond to your understanding of some of the other concerns raised in the Company's rebuttal testimony.

A.  Several US West witnesses raise overlapping arguments which mainly consist of allegations that either US West or US West's competitors will be disadvantaged by Staff's proposal.  Ms. Owen (Rebuttal, at 17) erroneously contends that Staff's proposal will disadvantage facilities-based providers.  I understand this argument to be as follows:  US West's local exchange rate will be lower than it would be absent the assignment of 5% of the costs of the local loop to custom calling and CLASS services and thus new entrants must compete against a relatively lower price umbrella than they would absent such a Commission requirement.  But the very same entrants that seek to provide dial tone will also seek to sell the same lucrative custom calling/CLASS services that US West sells, because new entrants are not competing against a bare-bones dial tone but against a package of services.  Thus Ms. Owen's apparent concern for the competitive impact for facilities-based providers is spurious.  The price umbrella that a new entrant likely considers is that of a customer purchasing an average mix of basic local exchange and optional services.

Ms. Owen also implies that US West would not be able to compete in its provision of custom calling and CLASS services if the Staff's proposal to allocate loop costs to these services were adopted.  First, it is important to recognize that it is highly unlikely that someone (whether it is an end user or a new entrant) will purchase custom calling and CLASS from US West without purchasing dial tone from the Company as well.  Indeed, I do not believe that it is physically possible for call waiting service — the most popular of the custom calling features — to be provided by an entity other than the one that provides dial tone.  In order to accept the premise that the Company is seriously concerned about such competitive inroads, it is necessary first to accept the premise that the Company believes it faces competition in its provision of custom calling/CLASS services.

If the Company were truly concerned about competition, it could file a Title 61 tariff modification with the Commission that would bundle all custom calling and CLASS services into the dial tone (as the Company did with touch tone as part of the rate reduction accompanying the implementation of revenue sharing in September 1989, Case No. MTB-T-88-13) and raise the dial tone rate to recover the foregone revenue.  According to Mr. Wozniak (at 20), the Company presently generates some $15-million in annual custom calling revenues, of which $5.7-million is associated with residence lines.  See US West Response to STF06-470, which is reproduced as Schedule 2 in Exhibit 158.  However, because these services are separately marketed and sold, the Company also incurs numerous advertising, marketing, transaction and other costs that would cease to exist if these services were bundled into the basic dial tone line rate.  For purposes of this discussion, I will assume that those avoidable costs for residential customers amount to roughly $2-million annually.  Thus, if these services were to be bundled with the basic dial tone line, US West could raise rates for all residential local exchange lines by only about $1.00 per month and make all of these vertical features available to all of its residential subscribers at no additional charge.  Such a policy would eliminate the deadweight economic losses associated with the transaction costs and would have the added benefit of providing Idahoans with tangible benefits of the advanced "platform" that US West has deployed.  The fact that the Company has never proposed such a package to the Commission suggests that it is really not very concerned about competitive inroads in this market or, for that matter, about actually furnishing the advanced services and capabilities that its "platform" can support to its Title 61 customers.  (Such bundling is not without precedent.  It is my understanding that as the local telephone company in Israel installed digital central offices to replace older electromechanical switches, it began including call waiting, three-way calling, and call forwarding in its basic local exchange dial tone service offering at no additional charge, thereby making the advanced features of the new equipment immediately available to and usable by all of its customers.)  US West is simply seeking to have it both ways:  High residential rates and high custom calling/CLASS revenues.

Q.  But Mr. Wozniak argues that US West is recommending a 23% wholesale discount on its central office features for new entrants which, he claims, will jeopardize the Company's revenue stream.  Please comment.

A.  Mr. Wozniak's argument is misleading.  The federal Telecommunications Act requires that the wholesale discount be set equal to the retailing costs that the Company will avoid when the retailing functions are assumed by a reseller.  47 U.S.C. § 251(c)(4), Joint Explanatory Statement of the Committee of Conference.  Thus, assuming the discount is properly set, the Company should be indifferent as between selling its custom calling and CLASS services (or any other services, for that matter) on a wholesale or on a retail basis.  In either event, the Company will continue to sell the features, and the fact that the price could be 77% of today's prices simply reflects the fact that there will be a corresponding reduction in retailing costs. From a net revenue perspective there is simply no loss to the Company.

Q.  Please describe and address the other concerns of Mr. Wozniak as you understand them.

A.  Mr. Wozniak's concern about the pricing of the unbundled loop is unfounded (Rebuttal, at 15).  There is simply no evidence in this case to suggest that the Company's vertical service revenues are on the decline and indeed, the evidence suggests just the opposite trend.  Mr. Wozniak attempts to depict an implausible scenario whereby new entrants will only purchase "bare loops" from US West, thus depriving the Company of all other sources of revenue.  More importantly, the vertical service revenue sources to which Mr. Wozniak refers are subject to Title 62 treatment and under the Company's proposal would make no contribution toward the cost of the local loop.  Under Mr. Wozniak's theory, its (Title 61) customers should pay the entire cost of their Title 61 services, and then pay additionally for vertical features, interexchange carrier access, and long distance toll calls that generate substantial profits all of which should be flowed solely to the Company's shareholders without providing any contribution whatsoever toward the cost of basic service.  Interestingly, Mr. Wozniak seems to have some memory of the history that Mr. Elder has forgotten but, like Mr. Elder, now appears to support a policy of "what's mine is mine and what's yours is mine" for US West.

Q.  Is there any other approach besides the 5% loop cost assignment that the Commission could consider for dealing with custom calling services?

A.  Yes.  As I have previously noted, custom calling services are built upon, and could not be provided without, the basic (Title 61) dial tone line.  An alternative to an allocation of a portion of the dial tone line (loop) costs to these services would be to require that US West "pay" an "access charge" for the use of the Title 61 dial tone line by Title 62 custom calling services.  Such an access charge would be entirely analogous to the access charges that are imposed upon long distance carriers for their use of local dial tone lines to originate and terminate toll calls.  As with the case of IXC access charges, the application of access charges to Title 62 services would capture a portion of the contribution that had previously flowed to the local access line from the discretionary end user service.  That is, prior to the introduction of long distance competition, revenues from intrastate and interstate toll services were used to offset a portion of the costs of the basic dial tone line.  When the former Bell System was broken up and competition was introduced into the long distance market, that implicit contribution was replaced by explicit access charges.  An analogous policy would be appropriate here, where the Title 62 service that formerly made a contribution toward basic access line costs and that utilizes the basic access line (in much the same way as long distance calling) would be required to pay an explicit access charge for such use.

Q.Doesn't US West witness Elder suggest that Staff's proposal would be unfair because vendors of CPE which incorporates speed dial capabilities would not have to bear any costs of the local loop, thus competitively disadvantaging US West? (Elder Rebuttal, at 43.)

A.  Yes, that is my understanding of his concern.  Unlike call waiting, call forwarding, caller ID, and other services that must be furnished out of the same switch that provides dial tone, the Speed Dial function can be supplied by CPE.  (Incidentally, although I have not studied the demand for Speed Dial specifically in Idaho, I would note that this particular custom calling service generally exhibits an extremely low penetration rate, perhaps because it can be provided by CPE at a substantially lower cost to the consumer.)  I would not object to limiting the cost allocation (or custom calling access charge, if the Commission pursues that route instead) to those services that can only be provided from the same switch that provides the customer's dial tone.   Other than Speed Dial I am not aware of any other custom calling or CLASS service that would be excluded on this basis.

Q.  After reviewing the Company's analysis of Staff's proposal to assign 5% of the local loop to custom calling/CLASS services, do you have any modifications to your proposal?

A.  I do not have any suggested modifications to my fundamental proposal; however, the Commission may find it appropriate to increase the assignment above 5% based upon an examination of the relationship of the revenue stream from these services to the Company's total revenue stream.  (See Schedule 7 of Exhibit 114 of my direct testimony for these data.  Also see Schedule 5 in Exhibit 159 of my surrebuttal testimony which demonstrates that custom calling and CLASS service revenues are increasing dramatically not only in absolute dollars but also as a percentage of the Company's total revenue.)

In addition, in his rebuttal testimony Mr. Elder pointed out that, although technically central office equipment, digital and analog subscriber pair gain equipment are for jurisdictional purposes treated as part of the local loop.  (Elder Rebuttal, at 33.)  It is therefore appropriate to apply the 5% assignment to those investments as well, which I have done in Schedules 1 through 3 in Exhibit 159.

Q.  Please summarize your recommendations regarding the proper treatment of costs and revenues pertaining to custom calling and CLASS services.

A.  Staff's proposal to assign 5% of the local loop to custom calling and CLASS services, contrary to the unfounded arguments made by US West, would be fair and proper.  This specific proposal continues to be incorporated in my schedules and those of Mr. Lansing.  Alternatively, US West could be directed to pay access fees for the use of the dial tone when it offers these Title 62 services over a Title 61 line.  Or, as yet another alternative, custom calling and CLASS features should be bundled with basic local exchange service, with a small increase in local rates to recover the foregone revenue and the slight shift of the existing allocation of TPIS from these products to other products.

The allocation of plant in service associated with spare capacity should reflect the fundamentally different growth and volatility characteristics of Title 61 and Title 62 services.

Q.  Please summarize briefly the recommendation in your direct testimony regarding the assignment and allocation of the Company's investment in local loop outside plant.

A.  As I discussed earlier in my section on cost allocation principles, I recommend that the Commission approve a cost allocation methodology whereby the costs of spare capacity are not allocated in direct proportion to lines in service.  Staff's specific proposal allocates spare capacity to mirror the ratio of the relative growth rates of Title 61 and Title 62 lines.  (This methodology should be adopted in addition to the recommendation described above regarding the direct assignment of at least 5% of the local loop to custom calling and CLASS services.)

Q.  Please summarize the Company's criticisms of Staff's proposal regarding the allocation of spare capacity.

A.These appear to be the Company's major criticisms of my proposal:

●  Spare capacity is less costly than capacity for lines in service, and by treating all TPIS equally, ETI overstates the cost of plant for spare capacity.  Elder Rebuttal, at 4, and Plummer Rebuttal, at 15.

●  Instead of using the ratio of Title 62 to Title 61 growth rates (i.e., a ratio of 3:1 which reflects the 12.9% annual growth rate in Title 62 to the 4.3% annual growth rate in Title 61 lines), Mr. Elder contends that we should use relative percentages of absolute line growth (12:82, which reflects the historical, five-year growth of 15,634 Title 62 lines and 70,865 Title 61 lines).  Elder Rebuttal, at 44.

●  Mr. Plummer refers to an analysis of outside plant utilization that was conducted by the Company in November 1996, and which purportedly demon­strates that there is not much spare outside plant.  Plummer Rebuttal, at 22-23.

●  Mr. Elder contends that Staff has failed to recognize the difference of the costs for residence and business loops.  Elder Rebuttal, at 20.

Q.  Please address these purported flaws in Staff's analysis.

A.  US West contends that spare capacity is less costly than capacity for lines in service, and claims that by treating all TPIS equally, ETI overstates the cost of plant for spare capacity.  While this may be true when examined across all plant that has been placed "in the ground," it is not necessarily correct — and indeed it is likely incorrect — with respect to the utilization of plant by individual services.  When US West places outside plant in a residential area sufficient for precisely one access line per household (plus a small amount of "maintenance spare"), it has a reasonable expectation that virtually all of that plant will be placed in revenue-producing service virtually all of the time.  When US West places large capacity cables in a business district with the hope that some or all of its customers will order Centrex, it cannot have a similar expectation with respect to overall utilization.  Even if the demand for dial tone lines and PBX trunks is relatively stable (which it might not be, if competitive local carriers are also present in the same area), it is certainly anything but stable or predictable with respect to Centrex.  Thus, on a per-loop basis, the cost of plant earmarked for Centrex demand, when adjusted for average utilization, may well be greater than the corresponding cost of a monopoly residential access line.

As to the matter of the incremental cost of spare vis-a-vis the cost of working lines, the fact that the former is smaller than the latter does not justify affording the competitive Title 62 services the ability to benefit disproportionately from the less expensive spare.  The only reason that US West has the ability to deploy less expensive (on a per-pair basis) spare is because it enjoys monopoly control of the primary access line demand.  No competitor possesses a similar advantage — not even a cable television operator, since the cost of adapting video coaxial cables for telephony has turned out to be quite high.  If anything, the Title 62 services should be responsible for recovering the stand-alone cost of the spare capacity that they will utilize, and not just the incremental cost of deploying that spare capacity relative to the primary demand.

Q.  Does the Company concede that there is no single "correct" way to allocate the costs of common plant?

A.  Yes.  As US West witness Mr. Ilett acknowledges, there is no "theoretically correct" way to allocate joint costs, making it therefore "at best a matter of judgment."  Ilett Rebuttal, at 9.  Thus it is critical that the Commission apply its informed judgment to the cost allocation process in order to ensure that the results are fair.

Q.  Please address Mr. Elder's criticism of Staff's proposal.

A.  Mr. Elder's approach to the cost allocation process is backward-looking, since his analysis of Staff's proposal affords undue weight to historical data.  Over a ten-year period, the growth in Title 61 lines will be 52%, whereas the growth in Title 62 lines will be 236%.  Furthermore, Mr. Elder's analysis overlooks the costly "churn" associated with serving Title 62 products.  For the purposes of outside plant utilization, "churn" means the physical discontinuation of service at one location and the installation of a like amount of service at a different location.  The transfer of service from one occupant of a residential dwelling unit to a subsequent occupant of the same unit is not "churn" in the economic sense of this term, since the associated plant remains in revenue-producing service irrespective of which particular individual happens to pay the bill.  Staff requested detailed data on several relevant measures of churn in the Company's Title 61 and 62 products (specifically, by product, the inward movement (lines added to service) and the outward movement (lines removed form service) for each of the past five years).

Staff also requested data as to the subset of the lines that were removed from service that were subsequently re-installed within a 30-day period.  See Staff Requests 5-313 through 5-315.  The Company was unable to provide these data.  Common sense suggests that churn is likely to occur with far greater frequency in the multiline business and Centrex markets than in the Title 61 market.

Furthermore, the Company's analysis ignores the fact that construction undertaken today has a life of at least 20 years, if not much longer than that, and will support new demand (largely coming from Title 62 services) and new (Title 62) services well into the twenty-first century.  The Company's cost allocation (whereby the cost of spare capacity is allocated in the same manner as the cost of capacity serving lines in service) means that today's Title 61 customers are subsidizing the customers of tomorrow's Title 62 services, a result that clearly violates the statutory prohibition on cross-subsidization.

Q.  Assuming arguendo that Mr. Elder's approach of measuring growth by examining absolute growth rather than percentage growth is appropriate, how would you correct his analysis?

A.  First, it is critical to consider separately the fill factors associated with meeting Title 61 and Title 62 demand.  ETI conducted a study on behalf of the Staff of the Washington Utilities and Transportation Commission (completed in 1989) that analyzed US West's outside plant in Washington.  ETI determined that the fill rate had been 70% for many years until the mid-1970s.  At that time, the BOCs began a strategy to migrate customers to Centrex, and the fill factor dropped accordingly so that the BOCs would have the capacity in place to readily attract and retain Centrex customers.  Schedule 7 in Exhibit 159 summarizes my corrections to Mr. Elder's analysis which reflects this and other factors.  As is shown in this schedule, setting aside the merits of Elder's approach, but at least correcting some of its glaring oversights yields very different results from those in his rebuttal testimony.  I have corrected his approach to reflect the differing growth rates for Title 61 and Title 62 products, to adjust for the differing fill factors for Title 61 and Title 62 services, and to look forward rather than backward.  Disaggregating the fill factors for Title 61 and Title 62 (which, again, recognizes the differing growth and volatility associated with serving these products) and looking forward five years (rather than backward), the ratio of the absolute growth of Title 61 lines to Title 62 lines is 125,325/112,807, or, put differently, Title 62 lines account for 47% of the absolute growth in lines during the next five years.  Furthermore, even this calculation probably understates of the number of future Title 62 lines, because the analysis does not include Centrex lines.  See Schedule 6, Exhibit 114 of Baldwin Direct.

Q.  Does Mr. Plummer's discussion of the November 1996 outside plant utilization study alter your recommended cost allocation methodology?

A.  No. In response to a staff data request, he confirmed that our use of the fill factors reproduced in Schedule 8 of Exhibit 114 of my direct testimony continue to be accurate.  See US West Response to STF06-456, Attachment A, which has been reproduced as Schedule 6 in Exhibit 159.   US West surprisingly was unable to provide data that would allow a comparison of the utilization factors with the types of products being served.  See US West Response to STF06-459, which has been reproduced as Schedule 8 in Exhibit 159.

Q.  Why do you find it surprising that the Company could not provide the requested data?

A.  The Company apparently has results of its outside plant utilization at the wire center level (US West Response to Staff Audit Request STF06-455, which I have not included because of its voluminous nature) and the Company also has information at the wire center level about demand for its products (see US West Response to Staff Audit Request STF03-172, which I have reproduced, in part, as Schedule 9 in Exhibit 159.  Therefore it would seem that US West could provide the requested data which would indicate whether there is a relatively greater number of multiline business and Centrex lines in the areas designated by the Company as "high" or "saturated."  The Company's apparent inability to separately identify Title 61 business lines from Title 62 business lines, if true, is an unfortunate shortcoming of its CAAS.

Q.  Please respond to US West's assertion that Staff's methodology does not reflect the difference in the cost of providing residence and business loops?

A.  The Company has identified one cost driver (loop length) that is in its CAAS system that our analysis does not reflect, but has failed to address an offsetting cost driver that our analysis also does not address, namely that Staff does not deaverage the fill factors for Title 61 and Title 62 services.  For example, in Schedule 1a of Exhibit 159, by allocating plant for existing demand based upon an average fill factor, Staff has overallocated plant to Title 61.  This means that Title 61 customers are bearing an inappropriately high share of the cost of excess capacity, which is caused disproportionately by Title 62 services.  While the Company has identified one aspect of our analysis that results in a relative under-allocation of costs to Title 61, it has not identified an offsetting aspect of our analysis that results in the relative over-allocation of loop costs to Title 61.

The assignment and allocation of the Company's TPIS should be guided by the Commission's findings and directives in the Tech Plus and Tech II decisions.

Q.  US West faults Staff for its proposed manner of relying on the Commission's prior findings and directives in the Tech Plus and Tech II decisions to guide cost allocation decisions in this proceeding.  Please address this topic.

A.  Contrary to the assertions of US West witnesses Elder and Wozniak (see, e.g., Elder Rebuttal, at 37 and Wozniak Rebuttal, at 22-24), the Company's capital acquisition programs (or additions to telephone plant in service — TPIS) in the COE category can be generally categorized as follows: (1) network modernization resulting directly from the Commission's Tech Plus and Tech II programs in rural areas; (2) investments in digital plant in addition to those accounted for in the previous category (typically this involves investment in urban areas); and (3) all other additions to plant.  The vast majority of the Tech Plus and the Tech II programs involved network modernization in the following plant categories:  digital switches (which are within what the Company refers to as the central office equipment category); digital subscriber loop equipment (which is within the Company's COE category but is actually treated as local loop for separations purposes); and other improvements to the local loop (e.g., fiber in the local loop).

Q.  Based upon your review of US West's rebuttal testimony, have you prepared any additional alternatives for the Commission?

A.  Yes, in addition to the two different approaches reflected in Schedule 10 and Schedule 12 of Exhibit 114 of my direct testimony, I have prepared a third alternative.  Also, I have prepared revised schedules for the first two approaches.

Q.  Please describe your general approach to allocating the Company's TPIS.

A.  In addition to the specific recommendations regarding the local loop that I describe above, I have prepared schedules that correspond with three different options for assigning and allocating TPIS.  The three options entail differing treatments of the two largest portions of the Company's TPIS, the so-called "primary investment" which includes two categories of plant: (1) Cable and Wire Facilities and (2) Central Office Equipment.  The Commission should adopt our "Proposed Allocation and Assignment," methodology, which is as follows:  the direct assignment to Title 61 of $45,606,038 in TPIS that corresponds with the Company's investments in compliance with the Commission's network modern­iza­tion directives for the Tech Plus ($36.092-million) and the Tech II programs ($9.514-million).  This plant includes 52 digital switches deployed in rural areas, and improvements to the loop plant in 29 wire centers.  A component of my proposal that is inextricably linked to this direct assignment is the corresponding direct assignment of $45.6-million in accumulated depreciation to Title 61.  As Mr. Elder has indicated (at 36-37 of his rebuttal), mathematically this recommendation is no different from allocating the Tech Plus and Tech II invest­ments and allocating the corresponding accumulated depreciation between Title 61 and Title 62.  The first reason for approaching the assignment in this manner, however, is simply to recognize the cause of the investment (i.e., Commission directive) and the source of the funds for the investment (funds that would have otherwise flowed into the pockets of Title 61 customers).  A second reason for this approach is to be consistent with my companion recommendation that all other digital switches and all additions to the digital subscriber loop equipment account since January 1, 1989 be directly assigned to Title 62.  And finally, for the reasons I describe below, I disagree with Mr. Elder's implication that the $45.606-million in accumulated depreciation should be allocated between Title 61 and Title 62.

Q.  What do the Company's schedules show regarding the treatment of this accumulated depreciation?

A.  Apparently, the Company is proposing to allocate only $19.98-million consisting of $14.086-million for Tech Plus and $5.893-million for Tech II (i.e., approximately 44% of the total amount) to Title 61.  See Wright Rebuttal, Exhibit 43A, at 13.

Q.Please summarize your understanding of Mr. Elder's position regarding Staff's assignment of the depreciation reserve amount associated with the Tech Plus and Tech II plans directly to Title 61.

A.Mr. Elder disputes the Staff's position that all depreciation reserve associated with Tech Plus, as well as Tech Plus investment itself, be assigned to Title 61 (Elder Rebuttal, at 35).  He contends that as long as the associated depre­ciation is allocated in precisely the same manner as the Tech Plus investments them­selves, the net impact on the Company's books, and on the rate base, will be zero.  In his words, "[b]y simply keeping the depreciation reserve tied to the assets depreciated, ratepayers are protected from paying in rates for investment they 'paid for' under Tech Plus" (Elder Rebuttal, at 37).

Q.  Do you agree with him?

A.  No.  The use of revenue sharing funds that would otherwise have been refunded to Title 61 ratepayers to fund Commission-mandated investment in plant and equipment is not identical to investments undertaken independently by US West on its own, and cannot be treated as such in this case.  In essence, in the Tech Plus and Tech II Plans, the people of Southern Idaho gave US West a large amount of digital plant and equipment, purchased without the use of any shareholder or creditor funds.  As part of the deal under which US West received this gift from the people of Idaho, it agreed to fully expense its investment; that is, to arrange its accounting in such a way that the investments did not appear in the rate base, and so had no impact on the rates paid for telephone service.  Had this accounting treatment not been utilized, US West would have been allowed to capture for itself a return on other people's money (i.e., Idaho ratepayers).

Regardless of the methodology adopted for assigning or allocating the primary investment between Title 61 and Title 62 services, if the depreciation reserve is allocated in any other way, Title 61 ratepayers will effectively be forced to pay for the Tech Plus investments twice, since some of the depreciation reserve that cancels out that investment will no longer be in Title 61.  Indeed, any allocation of the depreciation reserve associated with Tech Plus or Tech II to Title 62 will give Title 62 customers a free ride, at the expense of Title 61.

Q.  Why should all other digital switch additions and digital subscriber loop equipment be directly assigned to Title 62 services — don't they benefit Title 61 customers as well?

A.  The major reason for deploying digital switches in urban areas is to be able to offer custom calling and CLASS services, and to be able to attract and to retain Centrex customers.  Basic local exchange service can be offered from analog electronic switches, and it is unlikely that any operational savings associated with the deployment of digital switches would offset the substantial capital investment that was involved in their acquisition.  Instead, it is likely that the expectation of new sources of revenues from Title 62 services provided the business case justification for the deployment of urban switches.  Furthermore, it is my understanding that the Commission did not direct the Company to deploy the urban digital switches, but that the Company did so on its own.  Finally, just as there were revenue sharing funds that were required to be used for Title 61 purposes, there were also excess revenues available for the Company either to use for Title 62 purposes or to flow back to shareholders.  US West elected to invest in urban digital switches, and to capitalize those switches.  For these reasons, it is fair and appropriate that the Company's investment in digital switches in urban areas be assigned directly to Title 62.  At most, only that portion of the investment in urban switches that can be demonstrated to make the provision of Title 61 services more economical should be allocated to Title 61.

Q.  How are your recommendations that correspond with this first option reflected in Staff's schedules?

A.  In Schedule 1a of Exhibit 159, after assigning 15% to toll consistent with existing Commission directives and after assigning 5% to custom calling/CLASS services — I directly assign $4.757-million of local loop rate base to Title 61 — again, this should not occur unless the fully offsetting accumulated depreciation is also assigned to Title 61.  This amount is an approximation of that portion of the $9.514-million that pertains to CWF1 (the balance of the Tech II program invest­ments are assumed to be included in the COE category).  In Schedule 1b of Exhibit 159 I directly assign $39.092-million in digital switches to Title 61 and directly assign $4.757-million in other digital categories to Title 61.  Line 6 of Mr. Lansing's revised Exhibit 101, shows the direct assign­ment of $45,606,038 of accumulated depreciation (the portion that reflects the amount the Commission directed the Company to expense) to Title 61.

Q.  Does Schedule 1a reflect any recommendations other than those related to the Tech Plus and Tech II programs?

A.  Yes.  As I discussed in more detail previously, Schedule 1a also reflects Staff's recommendations regarding (1) the assignment of 5% of the local loop to custom calling and CLASS services, and (2) the allocation of spare capacity to reflect the differing costs of meeting growth in Title 61 and Title 62 services.

Q.  Please describe your alternative approaches.

A.  Title 62 services are benefitting from the fact that the Company modern­ized its network in rural areas using exclusively Title 61 funds.  Therefore, it may be fair to allocate the Tech Plus and Tech II improvements between Title 61 and Title 62 services while continuing to assign the accumulated depreciation solely and directly to Title 61.  Under this second approach, all other new digital switches (digital switch deployment that the Company undertook on its own), and all other digital subscriber loop equipment added since January 1, 1989, would be directly assigned to Title 62.  Schedules 2a, 2b, and 2c of Exhibit 159 correspond with this option.

Q.  You mentioned a third option.  Please explain.

A.  If the Commission, contrary to my recommendation, decides to treat all plant (regardless of whether it was purchased with revenue sharing funds, and regardless of whether it occurred in urban or rural areas) as common plant whose costs are to be allocated, it should nonetheless be guided by its Tech Plus and Tech II directives as the Commission determines how to assign and allocate the associated accumulated depreciation.  Thus, under this third option, the Tech Plus and Tech II TPIS as well as the urban switches and all additions to the digital subscriber loop are allocated consistent with the Company's proposed allocation, but the $45-million in accumulated depreciation is directly assigned to Title 61.

Q.  Please elaborate.

A.  As I observed previously in this testimony, the $45-million represents monies that — were it not for the Company's network modernization program — would have flowed directly and solely to Title 61 customers.  Therefore, it is fair and appropriate that this amount (which reflects the accumulated depreciation that occurred because the Company expensed the plant) be assigned directly to Title 61.  This alternative is reflected in Schedules 3a, 3b, and 3c of Exhibit 159.

Q.   Does this third approach to assigning and allocating plant comport with the cost allocation principles you described at the outset of this testimony?

A.  No.  This approach fails to reflect the cause of the costs being incurred for urban network modernization.  That cause is the Company's strategic interest in offering Title 62 services whose provision requires a digital switch.  In fact, there are at this time no Title 61 services being offered by US West in southern Idaho whose provision requires digital switching.  Applying the principle of cost causation would result in a direct assignment of digital switches in urban areas directly to Title 62.  The purpose of presenting this option is simply to reinforce the point that regardless of the way in which the TPIS is allocated and assigned, the accumulated depreciation that is associated with Title 61 revenue sharing funds be directly assigned to Title 61.

Q.  Are there any common elements to the three options you have described for assigning and allocating the Company's TPIS?

A.  Yes.  All the options share three main common features.  First, for the reasons described above, regardless of how the Tech Plus and Tech II plant is allocated, the Commission should directly assign the entire $45-million of accumulated depreciation that corresponds with the Tech Plus and Tech II programs to Title 61 customers because these represent Title 61 dollars, i.e., they are monies that were it not for the network modernization, would have flowed to Title 61 customers.  Second, 5% of the local loop should be assigned to custom calling/CLASS services consistent with the Commission's earlier decision to assign 15% of the local loop to toll/access services.  Finally, the investment in the local loop that corresponds with spare capacity should be allocated in a manner that reflects the differential cost characteristics of meeting the more volatile and faster growing Title 62 demand.

Q.Have you refined Staff's analysis of the proper assignment and allocation of TPIS in light of US West's rebuttal?

A.Yes, I have.  Although none of the changes alter Staff's fundamental approach, in selected instances I have revised calculations based upon my review of the Company's rebuttal testimony.  Schedule 1 in Exhibit 158 summarizes these changes.

Q.  Mr. Wozniak (Rebuttal, at 30) contends that Staff's testimony is inconsistent because Dr. Selwyn faults the Company for failing to deploy ISDN, although you argue that such investment should be excluded from the rate base.  Please address this alleged inconsistency.

A.  ISDN is a Title 62 service; US West and I are in agreement on that.  However, ISDN is also one of the very few Title 62 services the wide deployment of which would (1) require very little additional investment beyond the digital switches already in place, and (2) if widely deployed and priced in accord with the cost of provision, provide greater choice and better quality of service to the residential and small business, as well as large business, customers.  The Company — allowed to make unilateral decisions about network investment for Title 62 services — has failed to deploy ISDN at affordable prices throughout the state even though much of the infrastructure required to provision it is in place.   See Schedule 9 of Exhibit 159.  That the required infrastructure was paid for by revenue sharing funds provides clear evidence that the Company is building a platform neither for the benefit of its customers nor its competitors but rather its own strategic interest.  Therefore, contrary to Mr. Wozniak's assertion, the ISDN discussion in Dr. Selwyn's testimony is consistent with the concerns raised in my direct testimony.

Staff's proposal is feasible, fair, and consistent with the Idaho statute.

Q.  Ms. Baldwin, Ms. Wright faults Staff because, she claims, Staff "has not developed a comprehensive cost allocation system according to any cost accounting system that I am aware of in my years of study."  She states further that "[i]n comparison CAAS has been in existence for 10 years at USWC to deter­mine costs on a fully embedded basis at a product specific level.  CAAS was developed at a cost of over $15 million and has been thoroughly reviewed by external auditors."  (Wright Rebuttal, at 13.)  Do these specific criticisms have merit?

A.  No, they do not.  The CAAS system clearly has the ability to capture, record, and tally up figures.  Unfortunately, the specific manner in which it performs these functions does not come even close to accurately reflecting cost causation and the CAAS is fundamentally incapable of addressing the cost allocation and cross-subsidization demands of the Idaho Telecommunications Act.  For example, as is shown in USWC's response to a Staff data request (see Schedule 3 in Exhibit 113 of Baldwin direct), the Company indicates that CAAS allocates spare capacity in the same proportion as plant meeting existing demand.  While simple to administer from an accounting standpoint, this procedure produces demonstrably incorrect results for the numerous reasons that I have been described both here and in my direct testimony.  The fact that the CAAS may somehow "account" for all dollars spent by the Company in some fashion in no sense "proves" that CAAS satisfies the specific statutory requirements.

Q.  Have you asked the Company to perform an alternate CAAS run reflecting any of the specific revisions that you have recommended?

A.  Yes, I have.  In STF05-306 (which has been reproduced as Schedule 3 in Exhibit 158 to my surrebuttal testimony), Staff requested that the Company run the CAAS to reflect the assignment of 5% of the local loop to Title 62.  The Company indicated that its does not have the capabilities to assign a portion of the local loop to these products and that it would take as long as two weeks of programming plus an additional three or four days for processing to provide the results.  Quite frankly, I am surprised that so simple and straightforward a modification to the allocation rules that are apparently "hard-wired" into the CAAS would require such effort.  Nevertheless, the fact remains that, by the Company's own concession, such a revision is capable of being made, and its absence from the CAAS in its present form is not a sufficient basis for rejection of this recommendation.  Indeed, more generally, the Commission should not permit the Company to hide behind alleged limitations of the CAAS as a rationale for preserving allocation rules and practices that are both economically invalid and that frustrate the requirements of the applicable statute.  Indeed, with respect to the specific 5% loop allocation that was requested, the effect of this change on Title 61 can be readily calculated by some simple "back-of-the-envelope" arithmetic which, in fact, Staff has already done in preparing its schedules in this case.  See, e.g., Schedules 1a and 1b in Exhibit 159, both of which assign 5% for custom calling and CLASS.

Moreover, upon learning that US West would be unable to re-run the CAAS under the 5% scenario, Staff itself created a series of spreadsheets that duplicate the relevant steps of the CARS cost allocation process, and used them to generate an approximate allocation of Title 61 TPIS.  This approximation yielded a result that was in fact very close to that produced by Staff's own analysis.  (See Schedule 10 of Exhibit 159.)

Q.Have you examined the implication of the Commission's EAS decision on the Company's proposed allocation of costs?

A.  Not in detail.  It is my understanding that the Commission approved an interim rate structure for the EAS until the Commission establishes permanent rates in this case.  (See Order No. 26672, at 22, 24.)  EAS issues are discussed in greater detail by Staff witness Eastlake.

Staff's methodological approach applies economic principles, fairly allocates costs between regulated and nonregulated products, and minimizes the opportunities for cross-subsidization of Title 62 services with revenues derived from Title 61 products.

Q.  Please summarize your surrebuttal testimony.

A.  Contrary to the erroneous assertions of US West witnesses, Staff has applied economic principles in its allocation of the costs of telephone plant in service (TPIS).  Because the Company has not identified any legitimate concerns with the Staff's proposed cost allocation methodology, the Commission should direct the Company to:

(1)  Assign at least 5% of the local loop costs to custom calling and CLASS services.

(2)  Allocate spare capacity in the local loop outside plant between Title 61 and Title 62 in such a manner as to reflect the substantially different demand characteristics of these services.

(3)  Apply the Commission's directives in its Orders regarding the Tech Plus and Tech II programs to guide the way in which the costs of the related additions to plant in rural and urban areas are assigned, consistent with the approach described in my direct and surrebuttal testimony.

(4)  Assign the accumulated depreciation that corresponds specifically to the Commission's directive to expense certain rural improvements in its entirety to Title 61.  The reason for this assignment is that Title 61 customers caused the creation of this accumulated depreciation because it was as a result of excess regulated revenues that the Company was able to expense its Tech Plus and Tech II programs.

Q.  Does this conclude your surrebuttal testimony at this time?

A.  Yes, it does.f the costs of telephone plant in service (TPIS).  Because the Company has not identified any legitimate concerns with the Staff's proposed cost allocation methodology, the Commission should direct the Company to:

(1)  Assign at least 5% of the local loop costs to custom calling and CLASS services.

(2)  Allocate spare capacity in the local loop outside plant between Title 61 and Title 62 in such a manner as to reflect the substantially different demand characteristics of these services.

(3)  Apply the Commission's directives in its Orders regarding the Tech Plus and Tech II programs to guide the way in which the costs of the related additions to plant in rural and urban areas are assigned, consistent with the approach described in my direct and rebuttal testimony.

(4)  Assign the accumulated depreciation that corresponds specifically to the Commission's directive to expense certain rural improvements in its entirety to Title 61.  The reason for this assignment is that Title 61 customers caused the creation of this accumulated depreciation because it was as a result of excess regulated revenues that the Company was able to expense its Tech Plus and Tech II programs.

Q.  Does this conclude your rebuttal testimony at this time?

A.  Yes, it does.