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

A.My name is Terri Carlock.  My business address is 472 West Washington Street, Boise, Idaho.

Q.Are you the same Terri Carlock that has previously filed testimony in this case?

A.Yes, I am.

Q.Please summarize the issues you address in this surrebuttal testimony.

A.I discuss the continued reasonableness of the directory revenue adjustment of $8,645,032 in this proceeding.  I explain why the cost of capital range and capital structure that results in the recommended overall rate of return of 8.66%-9.04% as presented in my direct testimony continues to be reasonable despite the rebuttal testimony of Company witness Cummings and changes I have made.  I also discuss impacts on cash flow.

U S WEST DIRECTORY (DIRECTORY) ADVERTISING

Q.Has U S WEST Direct changed its name since filing your direct testimony?

A.Yes.  U S WEST Direct was organized under

U S WEST Marketing Resources Group as part of U S WEST Media Group.  Since December 1996, U S WEST Marketing Resources Group has transitioned to the current name of

U S WEST Dex, Inc (Dex).  Dex remains part of U S WEST Media Group.

Q.USWC transferred the Directory business to a separate affiliate, U S WEST Dex, and USWC states that no imputation of Directory revenues should be made by this Commission in this case.  Is it appropriate for revenue producing businesses and assets associated with Directory to be transferred from the regulated entity to a separate non-regulated entity without payment?

A.No.  It was and still is inappropriate to transfer revenue producing business lines and assets or the revenues associated with those assets to another entity without payment.  The payment should be made based on the level of revenues to be produced.  This payment could be a one time payoff or a series of payments over time.  In the case of the directory advertising, the revenue imputation should be continued until a payoff has been established.

Q.Is it true that the provision of white pages and directory exclusions (non-published/non-listed) are required Title 61 services?

A.Yes.  U S WEST is required to provide white pages directory listings under Title 61 basic services.  In addition directory exclusions are and have been Title 61 services.  See Order No. 22416.

Q.How is the directory advertising linked to the white pages directory listings?

A.Directory advertising, commonly referred to as yellow pages, is directly linked to the white pages listings because the advertisers rely on use of the directory by customers, primarily Title 61 local service customers, to provide advertising benefits.

Advertising revenues are used to offset the costs of providing the essential product, in this case the white pages listings.  This is consistent with advertising sources used for other products, i.e., television programs are produced, and magazines and newspapers are printed and sold at a lower price than would otherwise be possible due to advertising revenues.

Q.Please expand on the relationship between basic telephone service and yellow pages directory advertising.

A.The relationship between telephone service and directory advertising is mutually beneficial.  The directory advertising in the yellow pages would be of no value if the telephone network did not exist.  The publication and distribution of telephone directories has been part of the local telephone company's service obligation as a basic local exchange service (i.e., Title 61), and the revenues from the directory publishing advertising have been used to defray the Company's revenue requirement and maintain affordable telephone rates.  The presence of local service telephone customers and the use of U S WEST's name and logo in directories increases the value of the directory advertising.  The value of the directories is connected directly to the Title 61 regulated operations of U S WEST.

Q.Is the recognition of goodwill associated with the name and logo precluded from Title 61 regulation?

A.No.  Any goodwill associated with the name and logo is not precluded from an assignment to Title 61 services.

Q.Have you made a specific adjustment to recognize goodwill associated with the name and logo of

U S WEST?

A.I have not made a specific adjustment in this case.  I simply recognize the goodwill associated with the name and logo as one reason why a one-time payment or continued revenue imputation associated with directory advertising should be made in this case.

Q.Company witness Koehler-Christensen on page 16 of her rebuttal testimony indicates that if the directory operations remained with USWC the expenses of publishing, printing and distributing the directories would have remained on the USWC books.  Is this a valid reason to deny the directory revenue imputation?

A.No.  As shown on Proprietary Exhibit No. 127 (direct testimony) the revenues were reduced by the expenses in my adjustment.  The reduction for expenses, including expenses for publishing, printing and distributing the directories, were included in the calculation to determine the directory adjustment.  The validity of these expenses was not questioned for this adjustment.  I simply accepted the expenses as booked and deducted them from the revenues as booked.

Q.Have you considered payments for the white pages listings and billing and collection in your analysis?

A.Yes.  The Idaho white pages listings revenue of $188,068 (Response to Production Request No. 266) along with billing and collection revenues of $205,386 for southern Idaho (Response to Production Request No. 267) were included in revenues for this case.  The expenses related to the white pages listings along with the payments for billing and collection are included as an expense on the books of U S WEST Direct, now U S WEST Dex, and reflected as a reduction in the directory advertising adjustment I recommend.

Q.On page 19, lines 10 - 13 of USWC witness Koehler-Christensen’s rebuttal testimony she states:

“An important factor in considering this market share data, is that Dex’s yellow pages are advertised in and used by other than USWC customers, so the revenues earned by Dex are not entirely from customers of USWC.”  Do you consider the source of advertising revenues to be the important point here?

A.It is important only in the sense that the source of revenue is derived from the purpose of the directory advertising.  The revenues come from the advertisers and the advertisers continue to advertise in the directory due to the draw and response from local service customers using the directory.

Q.Do you agree with USWC witness Koehler-Christensen (page 22, line 18 through page 23, line 2) that it is no longer appropriate to use the profits of the competitive yellow pages advertising business to subsidize rates and deter the development of economically efficient competition in the basic local exchange market in Idaho.

A.As previously discussed, I believe it continues to be appropriate to impute revenues or in the alternative, to impute a one-time payment for the business lines and assets transferred out of the regulated entity to an affiliated entity.  The payment should be based on business expectations or market price.  I do not agree that the level of competition for local exchange services is at a point that imputation of directory advertising will deter the development of competition in the basic local exchange markets.  The reason I don’t agree with this statement is that the current level of planned competition revolves around resale facilities as stated in my direct testimony and the testimony of Staff witness Selwyn.  When facilities-based competition is present, the imputation of directory revenues will need to be revisited to determine if it is still appropriate and, if competition is present, how directory revenues should be allocated to the end customer.  A transfer payment could resolve this issue now.

Q.Do you agree that the directory publishing business in southern Idaho is competitive?

A.Not entirely.  The directory publishing services are available from many sources in southern Idaho.  The penetration rates for directories other than U S WEST Dex are minimal.  U S WEST directories continue to exist at customer locations even if another directory is also utilized.  The areas where the market share for

U S WEST Dex is smaller are in the areas where the community of interest draws the users of the directory to other exchanges.  These exchanges are consistent with the areas where this Commission recently ordered EAS including Blackfoot, Pocatello, Boise, Nampa/Caldwell and Twin Falls.  Currently alternative directories in these areas cover a larger service area but still retain a minority market share.  It would be reasonable to expect the market share for U S WEST Dex to remain stable or increase in these areas as EAS is implemented and the directories reflect the EAS service area.  This expansion of EAS in the three large regions will enhance the value of the directory advertising.  I have not made an adjustment for this enhanced value in my recommended directory adjustment.

Q.Do the market share ratios at U S WEST Dex reflect competition in the directory advertising business?

A.Although there is limited competition in the directory advertising business in Idaho, U S WEST Dex continues to maintain market dominance.  This market dominance is primarily due to the historical nature of directory advertising and the direct tie to the local service.  Title 61 requires that each customer (except exclusion services) receive a white page listing and that each customer receive a telephone directory as part of basic service.

Q.Does imputation of the directory revenue adjustment that Staff has reflected in local rates and ultimately in the resale rates for local competitors provide a competitive advantage to any local service provider?

A.No.  The inclusion of the directory revenue adjustment does not provide an advantage to one supplier over another.  The end user customer will receive the benefit no matter which entity provides the local service.  This is reasonable at least for the period of time that local service providers utilize resale options.

Q.Will local service competition decrease the benefits seen by directory advertisers of advertising in the U S WEST Dex directory?

A.Local service competition will probably not impact the benefit received by advertising in the

U S WEST Dex directory.  The value of the directory will continue to be high since the circulation of the U S WEST Dex directory remains directly related to the number of telephone subscribers in the coverage area.  The number of subscribers in the area will not diminish because some subscribers take local service from competing carriers.  These customers still would have access to and could utilize the U S WEST directory.

Q.Should directory advertising be compared with other forms of advertising?

A.No.  Directory advertising is a unique service provided to advertisers in the sense that it is a directory book that is available for a continuous period of time, usually a year, and users often refer to it to determine availability of services and locate the phone number or place of business associated with that service.  Other forms of advertising are often limited in duration, focus on price advertising as well as availability of products and/or services.  Staff witness Selwyn also discusses this issue.

Q.Referring to Exhibit No. 33A, USWC witness Koehler-Christensen focuses on the market share decline for yellow pages from 7.2% in 1991 to 6.3% in 1995.  Is this the most relevant data on this exhibit?

A.I do not believe so.  It is more relevant to note that other media also experienced a decrease in market share; such as for newspaper, broadcast TV and the other category.  It is also important to note that the actual advertising revenues for yellow pages continues to increase each year.  The advertising rates in Idaho (Response to Production Request No. 263) over the past ten years have increased each and every year.  The rate of increase is greater than inflation in every year except 1987 and 1988.  I believe these items are more important than the overall advertising market share for yellow pages compared to other advertising media.

Q.Do directory revenues continue to be imputed in other jurisdictions?

A.Yes.  Other jurisdictions continue to impute directory advertising as support for local service revenues, although U S WEST Communications has challenged this policy.

Q.Should a transfer price be implemented if it is determined that all of the directory services, including the advertising revenues be removed totally from Title 61 rates?

A.Yes.  If the directory advertising is removed totally from Title 61 rates and the revenue imputation is no longer allowed, a one time transfer price or a phase in of the transfer price would be appropriate.

COST OF CAPITAL

Q.USWC witness Cummings addresses several errors in your testimony.  Do you agree that these are errors?

A.Exhibit No. 128, Schedule 12, page 2 of 2 reflects an error in the historical growth figures.  These errors are corrected and updates are included for January 10, 1997 growth estimates as reflected on Revised Exhibit No. 128, Schedule 12, page 2 of 2.  These updates do not change my ultimate growth and return on equity recommendations.  The other “errors” identified by Mr. Cummings are actually differences of opinion rather than errors.

Q.Is it reasonable to analyze historical returns along with expected returns?

A.Yes.  Investors utilize both historical returns and expected returns when analyzing the projected stock performance for an individual stock.  They are very seldom used in isolation.

Q.Company witness Cummings describes comparable risk on page 3, lines 8-13 of his rebuttal testimony.  Do you agree with this description of  comparable risk?

A.Yes.

Q.Do you agree with his statement on lines 13-17 that you have confused comparable earnings with comparable risk and that comparable earnings is a meaningless construct for investors?

A.No, I do not agree with these statements.  Investors evaluate the risk of an investment.  They also evaluate the returns earned by companies of comparable risk.  Hence the phrase “investors expect comparable earnings for comparable risk.”  The different use of terminology has no impact on the analysis or ultimate recommendation.

Q.On page 4, lines 11-16, USWC witness Cummings provides definitions for return on common equity and investor total return.  Do you agree with these definitions?

A.I agree with the definitions but I do not agree with the characterization that return on common equity is not the proper measure for analysis by regulators.  Regulated utilities do not have dividends set by the regulators, this is a board of directors/upper management decision.  Stock appreciation is determined in the market for each individual stock and ultimately for the market in total.  These items reflect returns in the marketplace but can not be set by regulators.  A conversion from market to book must be made since regulators make decisions based on book data.  Return on common equity is the correct book accounting measure for regulators to consider.

Q.USWC witness Cummings (page 8, lines 12-28) quotes several of your statements related to the risk of USWC.  He then states there is no evidence to support the generalities that U S WEST is less risky than other telephone service providers.  Is risk analysis an exact science?

A.No, risk analysis is not an exact science where each factor can be precisely quantified.  Risk analysis includes a review of relationships in the broad sense that often contains generalities.  Just as there are no direct facts reflecting these risk areas, there is no evidence to prove they are not important and relevant considerations in general.  The Beta for U S WEST of .75 that I utilize in my recommendation reflects less risk than the either telephone group average cited by USWC witness Cummings of .79 (page 10, line 6) or .82 (page 10, line 13).

Q.USWC witness Cummings states on page 9, lines 9-11 that “the staff position in this proceeding would deny USWC the recovery of a significant portion of its cost expenditures.”  Do you agree with this statement?

A.No.  The Staff position in this case does not deny USWC recovery of its cost expenditures, Staff is simply assigning these costs to the appropriate business lines/services.  USWC is free to recover these costs from those non-Title 61 services.

Q.USWC witness Cummings contends “For the quarterly dividend compounding adjustment to the DCF model, Ms. Carlock mistakenly adjusts the growth rate.”  Is this a mistake?

A.It is not a mistake but is different than the traditional quarterly dividend compounding adjustment referred to by Mr. Cummings.  When the quarterly dividend compounding adjustment was accepted by this Commission, adjusting the growth component was the methodology that was adopted.  Rather than arguing the reasonableness of either method at this time, I note that making this change does not change the ultimate return on equity range of 11% - 12% that I have recommended.

Q.USWC witness Cummings (page 12) criticizes the growth rate estimate of 3.5% - 4% that you have utilized in your DCF calculation.  What growth rate do you believe is reasonable in light of Mr. Cummings’ remarks?

A.After updating and correcting growth factors for USWC I still believe a growth rate in the range of 3.5% - 4% is reasonable in this proceeding.  My revised Exhibit No. 128, Schedule 12, page 2 of 2 reflects updated and corrected growth factors for USWC, both historical and projected.

Investors realize growth in dividends and stock appreciation.  The projected growth in dividends can be individually reviewed.  The stock appreciation must focus on other factors.  Growth in book value impacts changes in revenues and ultimately the growth in earnings.  Growth in earnings then impacts the potential dividend growth.  Therefore all three of these factors are important to analyze when projecting the expected growth rate to use in the DCF analysis.

The historic two-year growth factors in 1996 show negative growth in earnings per share, zero growth in dividends and 7.34% growth in book value per share.  The three-year growth factors for 1997 reflect current growth in earnings per share of 1.09%, zero growth in dividends, and growth in book value per share of 6.6%.  The projected growth rates, estimated to 1999-2001, reflect 5% growth in earnings per share, zero growth in dividends, and 6% growth in book value.

Q.Mr. Cummings uses a growth factor of 6% based on IBES projections.  What growth rate does IBES currently project for USWC?

A.Response to Production Request No. 327 states “The most recent IBES consensus forecast for long term growth for U S WEST Communications is 5.0%.”

Q.How does this relate to your recommended growth factors?

A.The historical growth rates for USWC are restated for 1994 forward because U S WEST, Inc. divided its stock into U S WEST Communications Group and U S WEST Media Group on November 1,1995.  Although this is a short time frame for historical results, it is still important to look at the actual results for the individual stock of U S WEST Communications Group rather than only a comparable group as utilized by Mr. Cummings.

The average growth rates shown on Revised Exhibit No. 128, Schedule 12, page 2 of 2 are consistent with the IBES growth rate over the corresponding time periods.  The average historical two-year growth rate is 2.17%, the average current three-year growth rate is 2.56%, the average projected growth rate to 1999 - 2001 is 3.67% and the IBES long term growth rate is 5%.  The averages show the continued growth expectations for longer periods of time.

Q.You updated the growth factors.  Have you also updated the stock price in the dividend yield to remain consistent?

A.The current stock price on February 25, 1997 of $36.625 falls within the 52-week price range.  Because the current price of $36.625 is less than one dollar below the 52-week high of $37.50 and the numbers are within the ranges shown, I have not revised Exhibit No. 128, Schedule 12, page 1 of 2.

Q.What would the results of the DCF method be if this Commission accepted the quarterly dividend compounding adjustment as proposed by USWC witness Cummings but utilized the 3.5% -4% growth range you propose?

A.The range under the DCF method would be 9.52% - 12.36% as shown on the top half of USWC Rebuttal Exhibit No. 32A.  This range compares to my recommended  return on equity range of 11% -12%.  My rate recommendations remain reasonable.

Q.Is it true that your cost of equity range recommendation is based primarily on the DCF method?

A.Yes.

Q.Is the DCF method market based?

A.Yes.

Q.Do you still believe the capital structure utilized by investors and market analysts for ratings is reasonable to use for ratemaking purposes?

A.Yes.  If USWC were a smaller company, the capital structures for financial and ratemaking purposes would be the same.  It is primarily because of the size of USWC and its allocation process that the regulatory reporting capital structure and the actual financial structure differ.

Q.Does the regulatory capital structure actually track the combination of debt and equity used to finance assets?

A.No.  These sources of funds can not actually be traced unless it is a project financing for a single project.  The regulatory capital structure is calculated by USWC matching the financings outstanding with the assets using an allocation process developed for this purpose.  Although workpapers were provided, this is the first time this Commission has formally reviewed the method of allocation used by USWC since the merger of Mountain States Telephone & Telegraph, Pacific Northwest Bell and Northwestern Bell.  There is insufficient evidence to show this allocation is reasonable.

Q.Does the rate base match the capital structure?

A.No.  The rate base does not match the capital structure due to capital supplied by other sources, (i.e., customers, tax advantages, etc.)  and all net income or retained earnings adjustments.

Q.Should the separation of funding continue?

A.No.  USWC is a merged entity operating in a competitive environment for all services except local exchange services.  Even these services are expected to enter the competitive arena in the future.  The funding requirements are driven by reasons other than Title 61 services.  Debt issued by USWC since the merger comprises more than 85% of the existing outstanding debt.  The remaining 15% consists of low cost debt and debt issued in anticipation of the merger by the three operating companies.  The low cost debt remaining from Mountain States Telephone and Telegraph (the predecessor of the Idaho operations) is less than 4% of the total funded debt outstanding.  The remaining Mountain States Telephone and Telegraph issues (approximately 2.7% of the total funded debt outstanding) was issued in May and June of 1990.  It can be argued that these issuances, along with similar issuances by Pacific Northwest Bell and Northwestern Bell, provided funding for the merger.  These should be considered requirements for USWC and not attributed to the individual operating company.

It is reasonable to look at the total USWC funded debt to determine the cost of debt for the following reasons:

1.  The level of funding remaining from the Mountain States Telephone and Telegraph operating company is only an approximate 4%.  This is not a significant percentage to continue the allocation of funds.

2.  The funding requirements are being driven by reasons other than providing Title 61 services.  Since the allocation is based on the old operating companies and does not reflect the type of service being funded, this process only adds expense without adding benefit for Title 61 customers.

3.  Expansion of competition will continue to move the focus of funding requirements away from Title 61 services.

Without this allocation of funding requirements, the capital structure and cost of debt will reflect total operations, as is the case for all but USWC, and can be more easily verified.

Q.USWC witness Cummings (rebuttal testimony, page 22, lines 15-19) states your cost of debt calculation of 7.23% is flawed because it “does not include other long term debt and capital leases.”  Do you agree that the other long term debt and capital leases are properly included in the capital structure?

A.No.  Although it is appropriate to include some types of other long term debt in the capital structure, that is not true in this case.  The other long term debt in this case includes contracts with IBM and Nebraska affordable housing fund partners.  These items are not appropriate types of long term debt to include in the capital structure.

Capital leases are not appropriately included in the capital structure because the cost of the lease, including interest, is included in the results of operation as an expense to calculate the revenue requirement.  The cost of debt calculation reflects interest costs that are not already included in the revenue requirement.

Q.USWC witness Cummings also states your recommended cost of debt rate of 7.23% is flawed because you have not properly reflected discount, premium and issuance expenses (rebuttal testimony, page 23, lines 1-4).  Do you agree with his statement?

A.No.  I have adjusted the stated cost of debt for discounts, premiums and issuance expense in a manner consistent with prior Commission orders.  The interest expense calculated on stated rates is divided by the outstanding debt balance adjusted for the unamortized premiums, discounts and issuance costs to determine the “effective” cost of debt.  The most recent determination of the cost of debt using this methodology was approved in Case No. IPC-E-94-5, Order No. 25880.

USWC witness Cummings adjusted the interest expense for the amortization of premiums, discounts and issuance expenses.  Either method is appropriate but not both.

Q.On pages 25-26 of rebuttal testimony, USWC witness Cummings claims it is inappropriate to adjust the return on equity by a service quality adjustment.  Do you agree?

A.No.  As stated in my prefiled direct testimony an adjustment for management decisions such as service quality are within the Commission’s discretion when setting the allowed return on equity.  Staff witness Hart addresses the service quality issue problems.  The adjustment I have recommended of 50 basis points has precedent in prior Commission orders as identified in my direct testimony.  This adjustment results in an allowed return on equity that is within the reasonable return on equity of 11% - 12% that I recommend.

Q.USWC witness Cummings states in rebuttal testimony page 26, lines 19-21 “Ms. Carlock’s recommendation denies USWC the opportunity for a fair return because of the hypothetical capital structure incorporated into her recommended overall return.”  Do you agree?

A.No.  The capital structure I recommend is not hypothetical as previously discussed, it is the actual financial structure.  It will not provide an unreasonable return on investor supplied capital as a result of the capital structure.  The converse of Mr. Cummings’ argument could also be made, if the allowed return on equity is based on the allocated regulatory structure developed by USWC, an excessive return on equity would be allowed.

Q.What is your recommendation to the Commission?

A.My recommendation remains the same as shown on Exhibit No. 128, Schedule 14.  I recommend an allowed return on equity range of 11% - 12% with an overall rate of return range of 8.66% - 9.04%.  The point recommendation remains an 11% return of equity with and overall rate of return of 8.66%.

CASH FLOW

Q.In her rebuttal testimony, pages 14-17,

U S WEST witness Wright claims that the Staff-proposed revenue requirement in this case would seriously degrade the Company’s Idaho intrastate cash flow.  Did you review her cash flow presentation?

A.Yes, I did and found several problems with it.  First, she performed her analysis at the Idaho intrastate level and did not distinguish between Title 61 and Title 62 cash flows.  By so doing, she ignores the fact that Title 62 services currently account for approximately 60% of intrastate revenues.  Consequently, she is making an unequal comparison between the total of Title 61 and Title 62 together and Title 61 by itself.  Second, she does not take into consideration that the Staff case is predicated on an different allocation of costs between Title 61 and 62 services.  Although the Staff has not developed an revenue requirement for Title 62 services, it is possible that the Company may need to raise its Title 62 prices to cover its true Title 62 costs.  In using total intrastate construction expenditure requirements, she does not segregate the use of funds necessary to provide Title 61 services from investments the Company chooses to make for Title 62 services.  Staff witness Baldwin addresses the allocation of new investment in her testimony.

Third, Ms. Wright does not adjust her calculation to take into account the fact that Idaho customers have provided significant funding amounts to cover the costs of Company investment over the past 10 years (e.g., Tech Plus and Tech II).  The $45.606 million provided by ratepayers for Tech Plus and Tech II investments represents 49.6% of the total Staff recommended rate base for Title 61.  Customers have provided cash flow up front in return for reduced cash requirements over the life of the plant they financed.  For this reason, one would expect cash flow to be lower than might otherwise be expected.

Finally, Ms. Wright utilizes the total amount of interest and dividends reflected for Idaho Intrastate purposes.  In addition to the concerns addressed above in the first concern, the level of dividends are also a concern.  When the stock was divided November 1, 1995 into U S WEST Communications Group and  U S WEST Media Group, the level of dividends did not change.  It could be argued that the dividend level for  U S WEST Communications Group would be less than the dividend level for U S WEST Media Group.  Additionally, a distinction between Title 61 and Title 62 is not made.  Therefore, the dividend amount shown in Ms. Wright’s cash flow Exhibit 43D and 43E are probably not the correct amounts to utilize.

For all these reasons, Ms. Wright’s arguments with respect to cash flow should be dismissed.

Q.Does this conclude your surrebuttal testimony?

A.Yes, it does.