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

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

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

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

Q.Please describe your educational background and work experience.

A.I received an H.A.B. (Honors Bachelor of Arts) with emphasis in classics and economics from Xavier University in 1965 and completed graduate course work and general examinations for the Ph.D. program in economics at Ohio State University in 1969.

I taught undergraduate economics at Boise State University from 1969 through 1976, with two years on leave as a Fulbright Exchange Professor at Cuttington College in Liberia.  I have also taught various economics courses part-time at Boise State University, College of Idaho, and Ohio State University.

In 1978, I took a position with the Idaho Office of Energy as an energy economist, with responsibility for energy conservation planning and for economic feasibility analysis of geothermal and other alternative energy proposals.  When the office became a division of the Idaho Department of Water Resources in 1981, I became responsible for the Idaho Water Resource Board's financial programs, loans and grants as well as industrial revenue bonds for water projects.  With the demise of the bond program in 1983, I assumed responsibility for the design and implementation of a statewide energy conservation loan program.  In addition, I provided economic analysis in support of policy decisions concerning water rights, water planning, and agricultural water uses.  I was Staff Economist at the Idaho Public Utilities Commission (IPUC; Staff) from 1989 through mid-1994, performing support services as an economist for the telecommunications, audit and engineering sections.  I have appeared as a Staff witness specializing in conservation and resource planning in cases involving electric, gas and water utilities.  Between September 1994 and August 1995 I served as an energy policy analyst with the Idaho office of the Northwest Power Planning Council and with the Washington State Energy Office.

I.  INTRODUCTION

Q.What is the purpose of your testimony?

A.My testimony will cover several areas.  First, it will provide another perspective on the claims made by U S WEST Communications, Inc. (Company; USW) as background to its rate proposal.  Second, it will provide commentary and analysis of specific parts of USW’s rate proposal.  Third, it will provide suggestions on a rate design to achieve the Staff’s recommended revenue requirement, with a recommendation that specific rates be set only after the revenue requirement and general principles for a proposed design have been set by the Commission.

a.  General background

Q.Do you have some introductory comments about the broad issues in this case?

A.Putting all technicalities aside, I believe this case represents USW’s attempt to remain whole in the face of ensuing competition.  USW sees itself as the only entity capable of sustaining Idaho’s telecommunications infrastructure.  Idaho’s infrastructure is sound and was assembled largely by USW, but pro-competitive legislation at the national level will not assure incumbent monopolies of their current position.

Things are not now, nor are they likely to ever become, quite as bad as USW’s doomsday predictions for its own fate:

 ...any vestige of the local exchange

telephone monopoly has been eradicated

by a stroke of the Congressional pen...  USW response to the petition

of MFS Communications Company, Inc.,

for arbitration of interconnection

rates, terms, and conditions,

Washington Utilities and Transportation Commission, Docket UT-960323, page 1.

If USW can effectively compete, and I believe it can, it will continue to be a player.  But it will not be the only player and, indeed, may not continue to be the dominant player.  Neither this Commission nor the State of Idaho can or needs to ensure that USW remains predominant.  That decision will be made by markets.

Q.What are the two main issues in this case?

A.First is cost recovery, especially depreciation.  Second is which customers bear that burden.

This case is about the rectitude of giving USW recovery of all the costs it might have recovered under continued monopoly regulation.  USW argues that it needs to depreciate its investments faster to keep up with the practices of its present competitors and that it needs to recover the resulting depreciation reserve deficiency in three years, lest those costs be stranded by competitive forces.

What USW takes for granted, that all its stranded costs should be recovered, amounts to asking for “a disposition that violates the way the American people believe their economic system should work.”  Charles M. Studness, “Stranded-cost Recovery: It’s Un-American,” Public Utilities Fortnightly, July 15, 1996, p. 43.  According to Mr. Studness, investments “stranded” by competition often carry a questionable pedigree and form part of “the residue of a system that allowed utilities to earn healthy returns despite widespread inefficiencies and abysmal technological progress.”  Studness, p. 44.

What USW also takes for granted is that money to invest in its system to meet new competition should come from captive customers in non-competitive market sectors (Title 61).  Such a stance is predictable and was the subject of a caution by former Colorado PUC Chairwoman Edythe Miller a few years ago:

Telcos raise issues of technological advance and obsolescence to support

their case forincreasing the rate and

speed of recovery of depreciation of

current plant.  They have been largely successful in this matter before regu-

latory bodies, thereby increasing cash

flow.  It is a matter of some concern

that modernization of the telecommunica-

tions plant not become an instrument of cross subsidization, which would be the case given construction of a platform primarily for the benefit of the user of premier services, underwritten by captive core consumers whose need for and use of these services will be minimal or nonexistent.  Edythe Miller, “Some Market Structure and Regulatory Implications of the Brave New World of Telecommunications”, Journal of

Economic Issues, Vol. XXVII,No. 1, March 1993, page 21 (italics added).

Q.What is the Company attempting to do in this case?

A.The Company is making business decisions to protect what it sees as its own best interest in the face of potential competition.  It is, in the words of Company-cited experts Harris and Yao, acting thus:

Further, when competing in an emerg-

ing market, or when public policies

have radically changed the rules of

the game, firms try to shape the compe-

titive battleground to favor their particular assets.  From Exhibit A toComments of U S WEST, Inc. to the Federal Communications Commission in CC Docket

96-98, dated May 16, 1996.

The Company’s stance tries to capture the best of two worlds.  U S WEST wants to recover all its costs from the old regulated monopoly world at the same time it wants freedom to earn all it can in the new competitive environment.  The Company is not approaching the current reform of the telecommunication market offering some sort of quid pro quo, indicating a willingness to give up some small portion of its return on regulated services as the price of entry into the competitive markets it has always sought to enter.

Perhaps the same effort that is now being engaged in exacting every possible return from the regulated customer for past investments could be more profitably spent on forward-looking strategies for ensuring that USW remains the predominant telecommunications provider to customers who for the first time will have some real choice in the matter.  Q.What is your reaction to the Company's claim that it is somehow disadvantaged relative to its potential competitors, by having to cover both embedded costs from past investments and forward-looking costs from new investments?

A.I believe this concern is misplaced.  There is no real sense in which USW is forced to cover more costs than its competitors.  Especially for the provision of Title 61 services to its regulated customers, USW is in the enviable position of being able to provide necessary services from an existing and partially depreciated rate base. The ability to serve customers at low cost from an existing rate base rather than to face the necessity of making expensive new investments is what every competitor seeks.

Q.What is the biggest flaw in USW's rate proposal?

A.It fails what some pundits call the “front page” test (e.g., it sounds preposterous), as evidenced by a variety of comment letters received at the Commission.  Customers can hardly believe that USW has been willingly selling them basic local exchange service at half of its real cost, since it always had the means to pass on to customers its prudent and necessary expenses.  Customers can hardly believe that USW, the incumbent monopolist with an ubiquitous network, is in serious jeopardy from potential competitors, who face enormous start-up costs to seek new customers.  Customers find perplexing the assertion that USW needs to raise rates to prepare for competition---they have been brought up on the folklore that competition will lower costs for everyone.

An ordinary customer summarizes these concerns well in a July 31, 1996, FAX to Commissioner Nelson, commenting on the upcoming telephone rate increase for business service by U S WEST:

I see U.S. West asking us business

customers to subsidize their investments/expenses because of in-

creased competition due to theTelecommunications Act of 1996.

Q.Do you have a final observation concerning the public image raised by this USW filing?

A.I fear the USW proposal provides for customers and the general public a sober preview of what ordinary Title 61 ratepayers may expect from the competitive era.  Ordinary customers’ sense of hopefulness on the arrival of competition may be chilled.

b.  Specific economic issues

Q.The Company refers often to the “subsidy” inherent in local exchange rates?  Is there a unique meaning to the word subsidy?

A.In economic theory, it usually refers to the payment needed to cover losses incurred by a declining cost natural monopoly when it produces output at the socially optimal level of production.  In more general terms it means a grant or gift to assist an enterprise deemed advantageous.  In even looser terms, there is a subsidy whenever one person’s loss is another’s gain, regardless of actual cost coverage.

Everyone seems to define subsidy differently.  Merely defining a service as subsidized if it fails to recover all its direct costs, as USW seems to do with basic local exchange service, really ignores the basic question, that is, whether the sharing of joint and common costs is essentially fair.  A caution from    James C. Bonbright is in order:

But in any attempt to develop sound principles of ratemaking, the undesir-ability of subsidized services can not properly be taken for granted as the starting point for the theory of utility rates.  Instead, the merits or demerits of a subsidy should be subject to careful analysis.  James C. Bonbright, “Principles of Public Utility Rates”, Columbia

University Press, New York, 1961,

page 51 (italics added).

Q.What does economic theory say about subsidies and the likely direction in which they will flow?

A.All the incentives are to overprice non-competitive services, as noted in an introductory piece on competitive services by Ben Johnson Associates on its homepage:

(http://www.microeconomics.com/essay/compserv.html,   page 2).  One would naturally attempt to charge more than cost to those customers without alternatives, Title 61 customers, and use the excess to subsidize customers in unregulated markets for Title 62 services.

Q.Is there more concrete support for this theoretical concern over the flow of subsidies from regulated to unregulated services?

A.Idaho Code § 62-613 expressly forbids a subsidy that flows in this direction, to wit:

“a telephone corporation may not subsidize telecommuni-cations services which are subject to this chapter” by those services subject to Title 61.  In Washington, another U S WEST state, there is similar concern expressed in WA RCW 80.36.300 as formal policy:      “(4). Ensure that rates for non-competitive telecommunication services do not subsidize the competitive ventures of regulated telecommunications companies.”

Q.Has concern over subsidies been noted by Staff in recent cases involving USW?

A.Yes, in several places.  At page 22 of Staff Comments in Case No. USW-S-94-3, Staff noted the need for review of the Company's rate base since “a potential exists for subsidization of Title 62 services with Title 61 revenues.”  In the Report of Earnings Investigation Test Year 1992, dated May 25, 1994, at page 18, Staff notes an incentive to allocate a disproportionate amount of common costs to Title 61 and notes that “if Title 62 services were completely competitive, this incentive would be even greater.”

Q.Why is it likely that in Idaho such subsidization does occur?

A.The distinction between Title 61 and Title 62 services created by the Idaho Telecommunications Act of 1988 made it nearly inevitable.  Every company producing Title 62 services has a chance to earn whatever the market will bear on provision of such services.  Absent effective competition, there is little reason for a company to provide services for the minimum price required to cover cost.

In addition, there is every incentive for a firm anticipating competition in Title 62 services to begin to cut its cost of providing such services wherever possible by shifting some of those costs to Title 61 services.  Costs judged to be necessary for provision of Title 61 services can be covered fully by regulated rates, leaving Title 62 costs lower and thus giving Title 62 more flexibility to cut prices should that be demanded for competitive reasons.

Q.How are the Company’s claims at odds with theory on the direction of subsidy flows?

A.The Company claims Title 62 earnings subsidize Title 61 services.  Yet all incentives seem to go in the opposite direction.  One wonders why the Company would allow profits from its competitive businesses, where it can earn what the market will bear, to be diverted to support local exchange services, where regulation provides a legal right to coverage of prudently-incurred costs.

Q.Is USW unilaterally against all forms of subsidy in the pricing of telecommunication services?

A.Evidently not.  An August 1, 1996, News Release for attribution to Sol Trujillo, President and CEO of U S WEST Communications, Inc. about the newly released FCC order on competitive rules seems to make it apparent that though USW, in cases like this, rails mightily against subsidies, the Company only dislikes certain kinds of subsidies:

The FCC’s decision not to allow

sudden reductions in access charges

is prudent.  These access charges

contribute $800 million a year

toward keeping basic service afford-

able in our fourteen states and

customers would feel the impact

of their loss (italics added).

Many believe that access charges are above costs, so there is “subsidy” involved.  This subsidy is evidently OK, because it enhances USW revenues.

Q.If there is no clear meaning for subsidy and the direction of subsidy claimed by the Company is counter to what one would expect on theoretical grounds, shouldn't the Company bear a strong burden of proof?

A.When the Company so obviously finds it fruitful to raise rates to its non-competitive customers so that it can compete effectively in its competitive markets, it must conclusively prove that it is doing something other than simple profit-maximization, charging more to those whose demand is inelastic because of the lack of substitutes.

Q.What about the Company's claim that it wants to reprice local service in order to move in the direction of more correct economic pricing, as will be required in future competitive markets?

A.The Company claims it is trying to bring local rates into compliance with the economic pricing rule that price should be set to cover costs.  However, the costs it chooses to use for reference here are not economic opportunity costs, the forward-looking marginal costs of economic theory.  The costs the Company prefers for a benchmark are its historical embedded costs.  In economic theory, if not in the future competitive world, those costs are nearly irrelevant and are certainly not the proper reference point for future pricing decisions.

This is a logical flaw in the Company's case.

Q.Why is Staff using embedded costs in its case?

A.In the interest of providing the Commission with testimony that is properly comparable, Staff has chosen to restrict itself to the embedded cost proposal that was filed.  Otherwise, the Commission’s task in weighing evidence would be like comparing apples and oranges.

Staff realizes that future decisions in the wake of the Telecommunications Act of 1996 (e.g., on interconnection) will be based on some variant of forward-looking costs.  Staff feels that this is not the appropriate venue to argue different cost models.

c.  General policy considerations

Q.Are the issues in this case new ones?

A.No.  They are virtually identical to ones discussed the last time USW had a major rate case.  In July 1983, in Case No. U-1000-63, USW (then Mountain Bell) asked for authority to earn an additional $34 million dollars, mostly from increases in basic exchange rates based on dramatic changes “that will shortly be occurring in the telecommunications industry” (Order    No. 18188, page 2).

  Q.Why did the Company ask for large increases in basic exchange rates?

A.The Company asserted that basic exchange service was priced below cost, which the Commission interpreted to be the result of the Company’s “insisting that basic exchange customers should bear the entire cost of the telephone system’s backbone plant while other services ... are provided a ‘free ride’ when using this plant” (Order No. 18188, page 13).  Staff countered with a different view of cost allocation and the Commission concurred with the Staff conclusion that “there is no evidence to support the Company’s contention that basic exchange service is ‘subsidized’ by toll or any other service” (Order No. 18188, page 16) and that “it is appropriate for non-basic services...to be priced at levels that generate the maximum reasonable contribution to joint and common costs in order to minimize local exchange rates” (Order No. 18188, page 24).

Q.Why was the Company asking for such a large increase to its overall revenue requirement?

A.The Company foresaw major changes as a result of settlement of the antitrust suit against Western Electric and AT&T and in decisions of the FCC.  New competition would require alteration to the old regulated way of life.  Yet in Order No. 18188 (Case   No. U-1000-63), the Commission found that estimates and predictions being discussed were too speculative for ratemaking purposes, and chose to “decide the revenue requirement and allocation in this case based on the present circumstances of the Company” (Order No. 18188, page 2).

Q.Do you see any differences between that prior case and the current one?

A.The most significant one is that technological change has brought all sorts of new products into the telecommunications world.  However, as a result of a choice available under the Idaho Telecommunications Act to all telephone companies but chosen by USW alone, most of those products belong to unregulated Title 62 services and are outside the scope of this case.  Passage of the federal Telecommunications Act of 1996 would seem to herald a more definite step in the direction of competition than was the case in the early 1980's with the breakup of AT&T, but USW is currently involved in appeals of the very Act it claims will require the sorts of new competitive responses outlined in its current rate proposal.  In short, the eventual outcome and market responses required of USW are still quite unpredictable.

II.  ANALYSIS OF USW RATE PROPOSALS

 Q.How would you characterize USW’s rate proposal?

A.USW claims this proposal is about simplification, that the new rate structure would be simpler for both Company and regulators to administer and that it would be easier for customers to understand.

Beyond all the rhetoric, the USW proposal calls for a monumental rate increase.  USW wants to raise rates for two reasons:  1) to position USW advantageously for the new competitive world by allowing it to recover quickly its past costs and 2) to hinder competition by making resale more expensive for potential competitors.  USW wants to recover its previous investments while it still has captive regulated ratepayers to assure recovery.  USW wants to put the burden of that recovery on local exchange customers by removing from local exchange rates the putative “subsidy”, e.g., by nearly doubling rates for most customers.

Q.Why have you done further analysis of the characteristics and impacts of USW rate proposals contained in this case?

A.Because I thought it important to look beyond USW pronouncements about enhancing customer choice and preparing for competition to the impact on specific classes of customers.  Ms. Owen’s testimony, at page 3, provides an overview of the proposed changes.  In it, she mentions “simplifying” residence and business local measured service, “simplifying” residency non-recurring charges, consolidation of rate groups, and “restructure” of vacation rates.  At page 4, she mentions how it is easier for the customer to understand a single $.03 per minute charge and notes that the customer no longer has to determine whether the call is within their exchange or to some other exchange.  She even notes her “belief that the proposal outlined above accomplishes the simplification that customers want.”

Beyond the favorable surface impression created by words like “simplify” and “enhance” lies  stark reality.  This proposal represents a huge rate increase for most residential customers, roughly a doubling (100% increase) for the monthly flat rate, with a range for other residential rates of 41% to 445%.      A column of Exhibit No. 131, page 2, calculates the specific percentage increase for each individual residential and business rate.  The only rate increases for business are relatively small, 6% to 20%, and apply to customers being moved from Rate Groups 1 and 2 to Rate Group 3.  The analysis that follows takes a harder look at USW rate changes to point out what would really happen to Title 61 ratepayers as a result of U S WEST’s proposed rate changes.

Q.What sort of analysis have you done here?

A.I have simply taken the USW numbers provided and rearranged them to highlight the incremental impact of individual pieces of the proposed rate increase.  For its part, USW did not attempt to portray either the magnitude of its proposed increases or the conceptually separable impacts of many of the parts of the rate proposal.  The Company also separated its analysis of rate elements, thereby making it more difficult to assemble an accurate picture of the net result.  For example, Company witness Owen discusses the decrease in residential revenues associated with the proposed change in per-minute-price of measured service on page 5, yet refers to someplace “later in the testimony” for the impact of the increase to the basic monthly charge.

Q.What was the primary tool of analysis for examining the separate impacts?

A.I used the Company’s response to Staff Production Request No. STF01-029, showing the spread proposed for the $38.2 million revenue requirement requested by the Company.  Staff workpapers are spreadsheets that mirror the Company’s Confidential Exhibits B and C of that response and, for purposes of this analysis, use exactly the same number of access lines claimed by the Company.  The revenue impacts noted below are provided for comparative purposes only.

Access line counts used here are those provided in Company spreadsheets in response to Staff Production Request STF01-029, showing derivation of the rate spread.  These line counts are lower (by some 10,000 residential and business lines combined) than the counts provided in the revenue sharing cases and ordinarily used for ratemaking.  This results in U S WEST’s proposed rate spread generating about $1 million more than the revenue requirement of $38.2 million.  Staff will utilize the larger number of access lines from revenue sharing for its own rate design comments later in the testimony.

a.  Consolidation of rate groups

Q.Turning to the Company’s proposal to consolidate rate groups for all Title 61 residence and business customers, what does your analysis show?

A.Using current rates and moving Rate Groups 1 and 2 to the current Rate Group 3 would, in addition to the change noted above for measured service, move the basic monthly residential charge from $10.11 (Rate Group 1) or $11.01 (Rate Group 2) to $12.00 (Rate Group 3), a 19% increase for former Rate Group 1 customers or a 9% increase for former Rate Group 2 customers.  The percentage increases vary with the class of service, reaching as high as 57% for the limited ITAP plan.  Taking into account all residential service, rate group consolidation will cost residential customers $1,288,002.  That results in an annual increase of $13.70 per residential access line in rate groups 1 and 2 only.  The revenue impacts of rate group consolidation are detailed as part of Exhibit No. 129.

For business customers, rate group consolidation increases individual rates from 9% to 20% depending on class of service and on rate group.  For all business classes, rate group consolidation will cost about $752,421.  That amounts to an annual increase of $35.39 per business access line in rate groups 1 and 2.  The derivation of these amounts is also detailed in Exhibit No. 129.

b.  Overall revenue impact

Q.What is the net impact of the proposed rate increase on all business and residential customers?

A.USW’s proposed rate design generates its desired revenue requirement target of $38.2 million by raising $37.4 million (97.9%) from residential customers and $.795 million (2.1%) from business customers.  Exhibit No. 129 shows the way in which that increase is distributed between residential customers and business customers.  Though most rate classes are affected, about 94% of the increased revenue from residential customers comes from those using the flat monthly rate (1FR).  Among business customers, 53% of the much smaller increased burden is concentrated on the flat monthly rate (1FB).

It should be pointed out that the overall revenue impact noted in Exhibit No. 129 includes the separable impacts outlined in the previous questions relating to measured service and to rate group consolidation.

c.  Business/residence rates

Q.How has the balance between business and residence contributions to Title 61 revenue been altered by the Company’s proposal?

A.Even with the higher rates for business, residential customers pay through their current rates about 64% of revenues, with business customers contributing some 36%.  With the rates proposed by the Company, the residential share rises to 77% and the business share falls to 23%.  That shift in percentage contributions means that residences would pay $12.8 million more, and businesses $12.8 million less, than if their relative contributions stayed the same as at present (See Exhibit No. 130).

Q.Company witness Owen, at page 10, points out that there is a “significant pricing disparity” between residential and business service that should be reduced.  Do you agree with this characterization?

A.No.  First, as to the disparity in prices, the current ratio of the basic monthly business rate (1FB) to the basic residential rate (1FR) is 2.59.  USW proposes to reduce that ratio to 1.38 by raising the monthly residential rate and leaving the business rate the same, along with consolidating all classes of customers into the same rate group.  The ratio of the various business rates to the basic residence rate will fall by approximately the same percentage, about 46%.  Exhibit No. 131, page 1, shows the percentage increase in rates for 1FR and 1FB customers proposed by the Company. In addition, Exhibit No. 131, page 2, shows current and proposed ratios of all relevant residential and business rates to the 1FR rate.

The current ratio, with business rates roughly twice residential rates, has been around for a long time and its existence has not been a bone of serious contention in previous cases.  This disparity applies similarly across different companies and different states.  This Commission has ruled various times on the reasonableness of such a disparity, see for example GTE Case No. U-1002-62 (Order No. 22464) or USW Case No. U-1000-63 (Order No. 18188).  Order No. 18188, at page 31, reads:

“The Commission finds that it is

generally appropriate to impose

higher rates for business exchange

service than residential.  Business

service has different usage patterns

and typically has a higher cost and

value than residential service.”

Q.Do you agree with witness Owen’s claim that business and residence are “essentially the same service”?

A.Not really.  Given uncertainty about appropriate cost allocation procedures, Staff does not believe that the Company has made a clear showing that the differing business and residence investment costs cited to show that a business line might be cheaper than a residence line make use of costs solely associated with  Title 61 business.  More importantly, there are many additional and relevant dimensions to the question of “sameness”, none of which Owen has chosen to discuss.  Without any discussion of these items, Staff does not believe it is, as Owen claims at page 10,“logical to assume these prices should be brought closer together.”

Q.What are some of these other dimensions and how might they temper the discussion of what is “logical” about the relationship between residence and business rates?

A.Usage patterns are likely of importance.  Business customers make more calls than residential customers and they make them during what are most likely peak usage periods during the day.  Value of service considerations deserve some mention.  Businesses have to have a phone, vital to their existence for contact with customers and vice versa.  One would expect that FAX transmissions have added further to business usage recently.  Couple that with the fact that basic phone service is an insignificant portion of any businesses’ total costs and you have clear evidence of inelastic demand.

Q.Are business customers receiving a rate decrease?

A.No.  Their rates are staying the same except for consolidation of Rate Groups 1 and 2 into 3.  The only decline involved is a relative decline in the relationship of business to residential rates, brought on by a drastic increase in residential rates.

Q.Do you agree with witness Owen’s observations on page 12 that arbitrage opportunities are a problem that needs correcting?

A.No.  For small businesses of the type that are under consideration here, there has always been some  difficulty in distinguishing businesses from residences and in preventing the use of residential accounts for business purposes.  That situation will be no worse than before, since there is no proposal to increase the rate disparity.  Raising prices for residential customers as a way to reduce the relative rate disparity and dissuade arbitrage is hardly a fair way to treat the majority of honest customers as the Company attempts to deal with those customers who try to take advantage and slip a business in under residential rates.

Q.Is cutting the business-residence rate ratio a step that is required by new competitive forces?

A.Hardly.  First, as Staff witness Selwyn points out in his testimony, the Company has not made a compelling showing that there is viable and effective competition at present, or even in the very near future.  Second, while it is a truism that competitors will attempt to “cherry pick” customers from the incumbent local exchange companies, they will go after big, high-volume business customers.  Title 61 business customers, with less than five lines, are hardly going to be the targets of serious competitive inroads.  In that sense, business customers are really very much like residential customers.  They are small users, with relatively small bills, probably unlikely and unable to do much shopping around.  They are not the sorts of customers a business would feel pressured to court in order to keep their trade.

Q.What is Staff’s recommendation concerning the business-residence price ratio?

A.That it remain as it currently stands.  The Company’s desire to extract maximum revenues from its regulated service customers to prepare for future competition is self-serving but understandable.  What is not understandable is why it should choose to except small business customers from the fate it hopes to visit on residential customers.  There are simply no good theoretical reasons to begin treating Title 61 business customers differently at this time.  If rates need to go up, business rates need to go up along with residence rates.

d.  Measured service

Q.What are the various parts of the proposed “simplification” of measured service and their relative impacts?

A.There are three elements:  usage, rate group consolidation, and flat monthly charge.  The first is elimination of the difference in usage charges between inter- and intra-exchange calls.  This increases the price of all measured intra-exchange usage from $.02 to $.03 per minute.  Though it includes a 3-hour free call allowance, it also eliminates time of day discounts.  According to Company estimates, only 33% of residential measured service customers will exceed the free allowance and pay for minutes of usage.  But even for the two-thirds of residential customers whose usage falls within the 3-hour free allowance, the increase in the flat monthly charge is at least $9.37 (from the current $6.13 to the proposed $15.50).  That increase in the monthly charge would have purchased between 312 minutes ($9.37 divided by $.03) and 468 minutes ($9.37 divided by $.02), far more than the 180 minutes covered by the allowance, even without accounting for time of day discount.  There are about 7400 residential measured service customers and 2400 business measured service customers.  Savings to the two-thirds of residential customers is estimated at about $108,632.  For business customers, to whom the 3-hour call allowance does not apply, the impact is estimated to be about an $59,747 increase.  With the addition of public access lines, this impact becomes about $80,000.

Q.What is the second element of the measured service rate change?

A.Second is the consolidation of Rate Groups 1 and 2 into Rate Group 3.  Current rates for Rate Groups 1, 2 and 3 are $5.19, $5.64, and $6.13, respectively.  Moving all measured service customers to Rate Group 3 at current rates would cost residential measured service customers an additional $15,532.  The rate groups for measured service business customers pay $13.15, $14.38, and $15.69.  Moving all to Rate Group 3 at current rates would cost business measured service customers an additional $12,842.

Q.What is the third element of the measured service rate proposal?

A.Finally, the third part is the change in the monthly flat charge.  This increases from $6.13 to $15.50 for residential customers and from $15.69 to $17.00 for business customers.

The revenue increase due to the flat rate usage element is $833,377 for residential customers and $37,922 for business customers.

Combining the three separable rate elements of measured service generates an annual revenue increase  of about $740,277 (or $100 per access line) for residential measured service customers.  For business customers, the revenue increase is about $130,764      (or $54 per access line).  Exhibit No. 132 outlines both these impacts.

e.  Reduction of non-recurring charges for installation

Q.Company witness Owen, at pages 23-24 of her Direct Testimony, proposes to “simplify” the structure and raise the price of non-recurring installation charges, making it “easier to understand” and thereby “meeting customer needs.”  Do you agree with her characterization of these changes?

A.No.  The price rise of $1 appears slight (3.3%) when compared to the current charge of $30.  However, the $31 proposed charge covers not one but two lines, effectively lowering the cost of two lines by 48% or the cost per second line by 96%.

Q.Why is this important?

A.Because I believe the Company’s explanation of this proposed price change is somewhat misleading.  The Company estimates that this “increase” will result in a decline of $140,822 in revenues from recurring charges, due to an 8% decline in the number of such charges incurred. Put another way, it expects 8% less new installations as customers put in a second line for the mere $1 charge, rather than the $30 it cost them before.

Staff suspects, with no way of proof, that the demand for second lines is sufficiently responsive to create a much larger demand.  Staff witness Baldwin comments on the already striking growth in second lines over the last five years and quantifies it in Exhibit 113, Table 2.  In other words, many more people might accept the Company’s offer of putting in a second line simultaneous with the first line for only an additional $1.  This would result in an estimated reduction greater than 8%, thusmaking the Company’s estimate of revenue loss understated.  One reason the Company seems unconcerned with the estimated “loss” may be that the additional recurring revenue from stimulation of second line growth will at least offset the revenue decline from installation charges.  The Company has chosen not to estimate the revenue gain that would spring from this growth.  Logically, no estimate of revenue gain should be provided, since the Company claims it does not even cover the costs of providing a local exchange access line.

Q.What are Staff concerns with this particular pricing proposal?

A. Staff is concerned that this pricing proposal is in fact a sort of promotional discount that could lengthen the installation interval and create a shortage of facilities and further non-recovery of costs.  Somewhat similar concerns were aired in Case          Nos. MTB-T-89-4 and again in USW-T-91-8.

To Staff’s expressed concern in those cases that the number of held orders might rise as a result of such promotions, the Company “insisted that it would not propose promotional offerings if such offerings were likely to affect its level of service.”  (Order        No. 24034, page 3).  In light of the Company’s service quality problems outlined in the testimony of Staff witness Hart, Staff wishes to reiterate its concern about this subject.

Staff believes that reducing the charge for the second line will actually raise revenue for the Company and may impede efforts to improve service quality.  Consequently Staff recommends rejection of the Company’s proposal to reduce non-recurring installation charges for the second line.

f.  Rates for privacy listings

Q.The Company makes no mention of this issue.  Why has Staff chosen to address it?

A.The Commission incorporated Case No.     USW-S-96-2 (the Hoffman complaint) into this general rate case.  In that case, Mr. Hoffman objected to the monthly fee, or recurring charge, associated with privacy listings.  His primary objection was based on USW’s taped admission to him that there was little or no Company activity on a monthly basis to justify a regular monthly charge.  In response to the formal petition that initiated the case, USW claimed that the recurring charge had been in place at least 25 years and that the same structure was in use by Bell Operating Companies in all 50 states.  The Company admitted the charge was not based on cost of service on an individual basis, but was part of an overall rate design that allowed the Company to earn its revenue requirement.

Q.What concerns has the Commission voiced concerning this issue in previous cases?

A.In Order No. 22839 the Commission noted that “not publishing or listing telephone numbers...creates burdens on other customers...” p. 3.  In Order No. 19956 (Case No. U-1000-82) at page 4, the Commission declared that the cost of maintaining privacy should be borne by the person who desires it.  The old arguments that extra directory assistance (DA) calls merited the monthly charge no longer hold because DA calls are individually billed at $0.60 per call and classified as a Title 62 service.

Q.Has the Company made any attempt to provide cost justification for these charges in response to the Hoffman complaint?

A.No.  Staff has found, in a TSLRIC study submitted in response to Staff Production

Request STF01-037 concerning another issue, a recurring cost study for privacy listings that contains almost miniscule costs.  That study mentions seven different categories of expenses included in the costs, but there is no mention of a cost impact on directory assistance.

Q.Will you comment on the overall revenue impact of recurring charges for privacy listings and also on the level of such charges in other states?

A.The Company currently receives about $1.4 million annually from recurring charges for non-listed and non-published numbers, with the great majority coming from residential rather than small business customers.  For the fourteen states in which USW serves, the average recurring charges for non-listed and non-published services are $1.47 and $2.45 per month respectively (see Exhibit No. 133).  Current USW Idaho monthly charges are $2.50 for non-listed and $4.00 for non-published.  A Bellcore response supplied to Staff by USW found a range of from $.15 to $3.95 and from $.30 to $4.00 respectively across all states.

Q.Does Staff have a recommendation for the level of recurring charges for privacy listings?

A.Because there is no specific cost that needs to be covered by recurring charges, and because USW’s current charges are high relative to other states and other USW service areas, Staff recommends cutting the recurring charge significantly, to the monthly charges of $1.50 for non-listed and $2.50 for non-published.  These rates are roughly the average USW charges for its fourteen states.  Using year-end 1995 numbers for residences and businesses subscribing to privacy services, this would generate revenues of approximately $962,000, or $524,649 less than is collected under the current rates.

Q.Is there any way to offset the revenue decline by readjusting other privacy charges?

A.No.  Upward adjustments could theoretically be made to the non-recurring initial charge for privacy listings to help offset the decline in recurring charges and keep the Company roughly revenue neutral.  This might avoid adding new burden to the rates of the Title 61 customers who do not subscribe to privacy listings.  Given the small number of privacy listings, however, there is no real potential to offset the substantial decline in recurring revenues ($524,000) with an increase in the non-recurring fee.

The burden to be passed on to other customers would range from about $.12 to $.35 per month per customer, depending on whether the recurring charges were cut to $1.50 and $2.50 or eliminated entirely.

g.  Vacation rates

Q.Has Staff done a customer-focused analysis of the proposed changes to vacation rates?

A.Yes.  The proposed changes to vacation rates call for a flat monthly charge of $10 instead of using 50% of the flat rate and a cut in the nonrecurring suspend-restore charges from $40 to $15.  These changes are made to “greatly simplify the price” and make it easier to understand.  The revenue losses from the change are a combined $23,000 annually from both residences and businesses, an insignificant amount which would be spread to the rest of Company customers.  Since the revenue impact is very small, there seems no objection based on the burden to other customers.

However, Staff has done analysis that indicates this change to the structure of vacation rates leads to a relatively large reduction in a hypothetical individual customer’s bill.  That reduction appears particularly unwarranted in a rate proposal where nearly all other rate changes lead to substantial increases in customer bills.

Exhibit No. 134 details a comparison of bills for a residential customer under three possible rate options:  flat rate, measured rate, and vacation rate.  Staff used the assumption that the vacation rate was suspended for seven months and in active use for five months.  Staff also used an option in which the customer  chose a measured rate alternative for the entire year, that is, the customer would pay for additional measured usage during five months but would pay only the flat monthly charge for seven months when the premises were not in active use.  In addition, for calculation of this measured rate alternative Staff assumed that customers use 320 minutes per month.

Q.What were the results of Staff’s analysis?

A.Using these assumptions, with the existing rate structure a customer choosing the vacation rate saves 1.4% over flat rate bill.  Choosing measured rate service using the same assumptions, this customer could save 15.6%.  Customers apparently choose the vacation rate over measured service so that phone service is disconnected during their absence, avoiding the possibility of unauthorized use of their phone.  Using measured service, customers would not be in jeopardy of actually losing their access line during the suspend and restore process, as has happened in isolated circumstances to vacation rate customers.

Under the Company’s new rate proposal, the vacation rate results in a 26.9% saving over flat rates.  Again, measured service would provide an even larger savings than vacation rates, but the margin of difference is now quite small.  Testing the new proposed structure of vacation rates with the old basic rates also leads to large savings of about 22%.  The major cause for the substantial percentage decline is the decline in the suspend-restore charge from $40 to $15.

While the proposed change appears very favorable to vacation rate customers, measured rates still appear to offer bigger savings and they do not create any additional costs (however small) to be allocated to other customers.  Vacation rates affect only some 65 or so residence customers per month, plus less than 10 business customers.

Q.What is Staff’s recommendation on vacation rates?

A.Staff recommends that vacation rates be abolished and their function be served through the use of measured rates.  This will require the Company to provide better information as to the advantages and availability of a measured service option.  For those who worry about their phone line still being “in service” while they are absent, the Company should suggest they simply unplug their phone and store it out of harm’s way.  The Staff recommendation is very much in line with the Company’s desire to simplify the rate structure---dropping a service option entirely is the ultimate step toward simplification.

Q.Do you have an alternative recommendation?

A.If the Commission wishes to preserve the vacation rate, it should retain the current structure.  The proposed vacation rate creates an uncalled for windfall, when most other residential customers face large proposed increases, to a very small group of customers.

III.  EXPENSE ADJUSTMENT

a.  Changes to reflect newly-approved local calling areas

Q.What adjustments were necessitated by the recent Commission order approving three new local calling areas?

A.The addition of the local calling areas approved in Case No. USW-S-96-4, Order No. 26672, introduces two necessary Staff adjustments to the Company’s proposal in this case.  Order No. 26672 already allotted $1.5 million of revenue sharing funds to help offset the capital costs associated with implementation of EAS.  To the extent the Company incurs costs above that amount, they are to be included in the Company’s rate base.

Second, the costs associated with the change in calling from toll to local, and the resulting call stimulation, must be shifted to local expenses so the Company can be compensated for these costs. Using the Company’s actual local switching cost results in switching expenses of $1.8 million, as estimated by Staff in Confidential Exhibit No. 101, page 10.

Q. Has the Staff shifted any plant or other expenses as a result of the EAS order?

A.No, the expenses calculated by Staff are based on the Company’s own TELRIC study with the Company’s calculation of joint and common costs included and should fully compensate them for this shift in calling.

b.  Elimination of the rural zone credit

Q.What does Staff recommend with respect to the elimination of the rural zone credit?

A.By the terms of the recent EAS Order, rural zone credits are to be phased out upon implementation of local calling areas.

c.  Disposition of remaining revenue-sharing funds

Q.What should be done with the remaining 1995 revenue sharing funds?

A.The recent EAS case allocated monies for a variety of specific purposes, leaving a balance of approximately $10 million.  That money should be returned directly to customers in the form of a per access line credit over a four-month period.  The balance of the funds for the last payment will not be known until the Company completes implementation of the EAS regions and the payment of rural zone credits ends.  When that amount is calculated, the final payment can be made.

IV.  PROPOSED RATE DESIGN

Q.What is the result of Staff's investigation of the revenue requirement proposal submitted by U S WEST in this case?

A.Staff's investigation of the Company’s earnings and expenses has resulted in a recommended reduction of $32 million in revenue requirement.

Q.Does Staff have a specific rate design proposal for reducing revenue requirement by $32 million?

A.It makes a big difference to rate design that the Company's proposal calls for a large revenue requirement increase, as opposed to Staff's call for an equally large decrease.  It makes no sense to treat the dollars identically, as if the minus sign is only a convention of mathematics.  A large proposed rate increase may require a set of very important considerations to make sure that increased burdens are equitably shared.  A large proposed rate decrease entails perhaps an entirely different set of criteria.  In fact, such a major decrease in revenue requirement almost avoids the usual need to concern oneself with tradeoffs of one group’s welfare for that of another.  With so large a proposed decrease, every customer can benefit substantially.

Any change in revenue requirement in this case should be handled as simply as possible, without radical redesign of the rate structure or drastic alteration of the terms and conditions of various service offerings.

Q.Does Staff have any general proposals to offer for guidance in this filing?

A.Staff suggests two general principles for application in any rate design that implements Staff’s proposed reduction.  One is that existing rate ratios within the various residential rates and within the various business rates be preserved, for instance, preserve the existing ratio ($6.13/$12.00=.51) that relates the residential measured service rate to the basic 1FR rate.  The ratio of 1FB to 1FR should remain at 2.5:1 and the ratio of trunks to 1FB should be targeted at 1.5:1.  Staff would support this position.  Second, Staff suggests in light of its proposal that a revenue reduction is appropriate, that the Company proposal to consolidate the per-minute charge for measured service be accepted.  However, Staff recommends that the single rate applicable to measured service be $.02, the lower of the two current  applicable rates, rather than $.03, the rate suggested by the Company.

Third, Staff recommends that some sort of differential be preserved to distinguish in-region from out-of-region calls, pursuant to the Commission’s recent EAS Order.

The major point is that it is speculative at this juncture to try to design a specific rate structure capable of reducing revenues by $32 million.  Staff’s primary purpose is to set guidelines to use when a revenue requirement is decided and actual rates must be calculated.

Q.Does this conclude your direct testimony?

A.Yes, it does.