INTRODUCTION

Qualifications

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

A.  My name is Lee L. Selwyn; I am president of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108.  Economics and Technology, Inc. (ETI) is a research and consulting firm specializing in telecommunications economics, regulation, management and public policy.

Q.  Please summarize your educational background and previous experience in the field of telecommunications regulation and policy.

A.  I have prepared a Statement of Qualifications, which is attached as Appendix 1 hereto.

Assignment

Q.  By whom were you engaged, and what was your assignment in this proceeding?

A.  Economics and Technology, Inc. has been engaged by the Staff of the Idaho Public Utilities Commission to provide expert assistance and analysis with respect to certain issues that are raised by US West's application for a rate increase.  Specifically, ETI has been asked to address the following aspects of US West's rate case proposal:

1.The relationship of this proceeding to the development of competition.

(1)Cost allocation

(2)Rate base

(3)Depreciation

(4)Quality of service

(5)Yellow Pages

My testimony addresses the relationship of this proceeding to the development of competition in Idaho, depreciation, quality of service, and yellow pages.  Ms. Baldwin's testimony describes the regulatory context for this proceeding and also addresses cost allocation and rate base issues.

Summary of testimony

Q.  Please summarize the testimony you will be presenting at this time.

A.  My testimony will address four principal issues — the extent of competition in the Idaho local exchange market, the Company's efforts to increase its depreciation rates and to recover prior "reserved deficiencies," issues relating to service quality, and the inclusion of yellow pages revenues as an offset to the Title 61 revenue requirement.

Competition:  The Commission should reject US West's exaggerated and unsupported assertions as to the presence of effective competition in southern Idaho.  Similarly, the Commission should dismiss the Company's doomsday predictions about the lack of service in rural areas that would arise in the event that the Company is not awarded the revenue increase it seeks in this proceeding.

The Telecommunications Act of 1996 (TA96) does not instantaneously transform local markets into effectively competitive ones, it only ensures that competition will be permitted as a legal matter and imposes specific requirements upon incumbent local exchange carriers (ILECs) to facilitate the development of competition as an economic matter.

When considering the advantages and disadvantages enjoyed by US West and the other incumbent LECs in Idaho vis-a-vis their potential local service competitors, one must start by recognizing the unique monopoly position under which the incumbent LECs have flourished for nearly a century.  The construction of the ILECs' networks was financed entirely by private investment capital attracted to the carriers by government commitments to protect the carriers' service monopoly from encroachment and the promise of an opportunity for full recovery of, and a "fair return" on, the investors' capital.  That having been said, it is absolutely critical to make a clear distinction between competitive activity per se and competition that has developed sufficiently to act as a constraint on the pricing practices of the incumbent carrier, in this case US West.  And when examined in this manner, it becomes evident that the southern Idaho local exchange market is a far cry from one exhibiting price-constraining competition.

Depreciation:  US West has proposed dramatic increases in depreciation rates and expenses from the levels last formally approved by the Commission in 1988.  While US West's witness contends that the lives currently prescribed by the Commission for the Company's southern Idaho plant are inadequate to reflect the pace of change in telecommunications technologies and markets, the fact remains that US West's depreciation proposals fail to take into account the differing characteristics of Title 61 and Title 62 services and, therefore, its proposed changes would force ratepayers to subsidize the Company's non-regulated, technologically intensive Title 62 services.

The depreciation lives and rates applied to Title 61 plant should therefore be deaveraged from those applied to Title 62 plant so as to reflect the stable demand and lower level of technology needed to provide adequate Title 61 services vis-a-vis that required to support the more technologically-volatile Title 62 services.  US West's attempt to apply shortened asset lives and higher depreciation rates to the plant allocated to the Title 61 category, when those parameters are based upon the Company's perception of the emerging competitive conditions for Title 62 services, is not only unfair to Idaho ratepayers, but in fact is expressly prohibited by the 1988 Telecommunications Act.  The Company's depreciation proposals are based upon speculative and generic forecasts of technology that fail to reflect Idaho's unique regulatory and technology replacement circumstances.  In the absence of any compelling evidence to the contrary, the Commission should not make any adjustments to the depreciation rates and lives that were last formally authorized for US West in 1988 for Title 61 services.  Further, the Commission should reject US West's proposal to apply the Equal Life Group methodology to Title 61 services, as well as the Company's alleged associated depreciation reserve deficiency.

Service Quality:  A key justification for investing in advanced technology, indeed, the primary justification for it from the perspective of Title 61 services, is that it enables the Company to improve the quality of service that it provides its customers.  US West itself has argued that its allocation of investment in advanced technologies is justified because it will enable it to provide "better, faster or more reliable" service to Title 61 customers.  Yet there is no hard evidence to support US West's claim and other Staff witnesses attest to declines in service quality over the past several years.  Furthermore the Company has failed to deploy ISDN in a comprehensive manner although this service could be provided at little incremental cost to the Company while bringing service quality benefits to Idaho households and businesses.

Yellow Pages:  US West's proposal that yellow pages revenues be excluded from the revenue requirement should be soundly rejected by the Commission.  Yellow Pages and other Directory revenues have long contributed maintaining affordable rates for basic local telecommunications (i.e., Title 61) services.  None of the Company's arguments in favor of departing from this long-standing practice justifies a move that effectively turns over to the Company a significant source of supracompetitive profits for a business that confronts virtually no discernable level of competition.  Unless retained as contributing to the cost of Title 61 services, Yellow pages profits will almost certainly be used by the Company either to benefit shareholders and/or to enable competitive Title 62 services to be offered below their direct incremental cost.

THE IMPACT OF THIS PROCEEDING

UPON THE DEVELOPMENT OF COMPETITION

The Company's assertions of competition are exaggerated and unsupported.

Q.  What does the Company consider to be the major issues before the Commission in this proceeding?

A.  According to US West, the fundamental issues before the Commission in this proceeding are:

(1)Pricing for residential local service that recovers costs and that permits "true, facilities-based competition;"

(2)Capital recovery to support "continued investment in a healthy public network available to all Idahoans;" and

(3)The elimination of "discriminatory, implicit subsidies which are incompatible with a multi-provider market."

(Direct Testimony of James E. Wozniak, at 20.)

Q.  Please comment on these three points.

A.  I do not disagree with the implied goals, but as my testimony, Ms. Baldwin's testimony, and Staff's testimony demonstrate, the Company's recommendations for achieving these goals are ill-conceived and self-serving.  Specifically, regarding these three goals:

●First, I support cost-based rates, although I disagree with the way in which US West proposes to allocate costs between its regulated and nonregulated services.  For the reasons discussed in my testimony and in the testimony of Ms. Baldwin and the other Staff witnesses, the Commission should reject the Company's proposed allocation of costs.  As discussed, the adoption of US West's proposed cost allocation methodology would result in prices that recover not only the cost of residential service, but also some of the cost of deploying plant to provide Title 62 services.

●Second, I certainly support the development of a "healthy public network."  However, the development of a "healthy" multi-provider telecom­muni­cations infrastructure, capable of providing the greatest benefits to Idahoans, can most efficiently evolve in Idaho if US West's competitive ventures are not cross-subsidized by basic local exchange service.

●Finally, regarding the Company's third point, I agree that implicit subsidies should be eliminated.  However, of particular concern in this proceeding are subsidies of new US West advanced digital and broadband services by basic local exchange service prices.  Such subsidies should not be permitted.

Q.  What is your understanding of US West's view of the local telecommuni­cations market?

A.  The Company would have the Commission believe that the local telecom­munications market in Idaho is competitive or will be so in the near future.  For example, according to US West, "[t]he competitive forces that US West now faces for the first time in the local exchange market make it impossible for the company to continue with business-as-usual."  (Direct Testimony of Mary S. Owen, at 13, emphasis added.)  US West further argues that "[n]ow that the 'marketplace devoid of competition' has been jettisoned in favor of a fully competitive local and interexchange market, the primary rationale for uneconomic pricing has completely fallen."  (Direct Testimony of Barbara L. Wilson, at 2, emphasis added.)

US West attempts to portray itself as hamstrung in its ability to compete effectively in the marketplace and raises the specter of disinvestment, particularly in the rural areas of its service territory, should the Commission not give in to the Company's requests for higher prices.  US West argues that "unless the current providers of local service are permitted to recover their existing investment and fund continued investment through the prices they are allowed to charge, the network in Idaho will suffer."  (Wilson at 4, emphasis added.)  US West reiterates that "[i]f US West is not permitted to increase its local residence prices, then it will suffer as a business and it will be unable to continue to invest, at least at the level that Idaho has come to expect. ...  Idaho customers will suffer if that occurs because the investment competitors will be willing to make in Idaho will be highly targeted.  The relatively uniform deployment of technology and services that Idaho has seen in the past will not continue." (Wilson at 17, emphasis added.)

The Company attempts to draw a further distinction between rural and urban markets and networks, characterizing the former as high cost markets unlikely to be served by competitive alternatives, and the latter as low cost markets with competitive alternatives.  According to US West, "[t]rue competition will generally begin where there is a concentration of high usage customers such that the anticipated revenues greatly exceed the underlying costs.  That usually means business customers in downtown areas or industrial and business parks will be targeted by new entrants. ...  True competition will not develop in those areas and for those customers whose prices do not cover their underlying service costs.  That usually means rural areas and residential customers." (Owen at 14.)  US West alleges that competition will erode its share of the high-margin markets, and unless residential prices are raised, that the Company will be unable to invest in the rural markets. (Wozniak at 8).  From yet another angle, the Company argues that cost-based pricing for residential service is necessary to allow smaller communities to attract investment so as to provide rural customers with choices among suppliers. (Wozniak at 5.)

Q.  Do you share the Company's perspective on the market in southern Idaho?

A.  No, I don't.  The Commission should dismiss the Company's doomsday predictions about the onslaught of competition in urban areas and the lack of service in rural areas as self-serving and unsubstantiated.

First, there is simply no meaningful competition in the Idaho local market (urban or rural) today, nor is there likely to be any in the near future.  Indeed, according to US West, no other provider has yet entered the local service market in Idaho (Wozniak at 3).  In response to Staff data requests, US West indicates that "[t]he Company is unable to determine the business access market percentage held by such competitors," and further that "[t]he Company is unaware of any facilities-based residential competitors currently providing local access in southern Idaho." (US West response to STF03-175.)  US West further indicates in response to Staff data requests that the Company has received only one confirmed request for virtual co-location, and that currently the Company has no plans nor deployment date to provide intraLATA presubscription, number portability, or unbundled network elements.  (US West response to STF03-189 and STF03-188, reproduced in Schedule 1 and Schedule 2, respectively of my Exhibit No. 112.)

Of course, pursuant to the Telecommunications Act of 1996 (TA96), US West is expected in the future to enter into agreements with telecommunications carriers desiring local entry regarding the provision of interconnection, unbundled access, and resale (indeed, it is my understanding that the Company has been involved in some negotiations regarding interconnection and resale arrangements).  However, for the reasons I discuss below, the enactment of the new federal legislation does not magically or instantly transform US West's local exchange service areas into effectively competitive markets.  The Act only ensures that local competition will be made possible as a legal matter and provides guidance as to how the process of opening up local markets to competition should take place.  The Act does not resolve complex implementation issues, nor does it alter the entrenched market power enjoyed by US West as the incumbent carrier.  Similarly, while the FCC's First Report and Order in CC Docket 96-98 provides further details and guidance with respect to the implementation of local competition, it too neither resolves all issues (this is particularly the case in light of the 8th Circuit Court's stay of certain provisions of the FCC's decision) nor alters the market reality facing new entrants seeking to compete against an entrenched incumbent carrier.  As is evident from the absence of competitive activity as highlighted in US West's data responses to Staff, new entrants will face an uphill battle in obtaining the terms and conditions and prices necessary for their successful entry into US West's local exchange markets in Idaho.

US West's contention that "Local Exchange Carriers like USWC will retain only about 35% of the local exchange residential market" in the "future" (Cummings at 21), is an entirely exaggerated, implausible, and unsubstantiated speculation that fails to even specify when that "future" will arrive.  (Schedule 3, which is the Company's response to STF03-184, demonstrates that US West is unable to specify the "future."  Schedule 4 in my Exhibit No. 112, which contains US West's response to STF03-183 and reproductions of an excerpt from a Morgan Stanley Report, summarizes the speculations cited by Cummings).  In sum, I believe that US West greatly overstates the current status of and future prospects for competition in southern Idaho under existing market conditions.  Without a considerable amount of direct and far-reaching intervention by the Commission to remove the many barriers to competition that currently exist in Idaho local and intraLATA services markets, competition is simply not likely to develop sufficiently fast or far to represent a serious competitive or financial threat to the Company.

Q.  US West depicts rural markets that would be denied investment in a competitive environment unless the Company can raise rates.  Should the Commission be concerned?

A.  No.  It is my understanding that as a result of the Tech Plus and Tech II programs, rural areas in southern Idaho are today served with modern, state-of-the-art equipment and facilities.  I am informed that the Commission Staff does not see any immediate need for additional upgrades to the rural parts of southern Idaho in order to provide Title 61 services in a reliable, cost-effective manner.  Should the Company determine that upgrades are necessary in order to offer Title 62 services, such initiatives should be funded by Title 62 services alone.

Q.  US West raises the concern that if it defers the capital recovery it seeks in this case, the Company's customer base will shrink and this smaller base of customers (those who lack competitive choices) will have to fund the same level of capital recovery but at a higher per capita rate (Wright (US West) at 16).  Please address this concern.

A.  As I discussed above, US West has presented no evidence to support its assertions of a rapidly shrinking customer base due to competitive inroads.  Frankly, the larger concern that should guide the Commission in this proceeding is that Title 61 customers not foot the bill for US West's strategic deployment of telecommunications plant driven by the Company's Title 62 business plans.  Any network modernization plans that US West undertakes for the alleged benefit of Title 61 services should be supported by rigorous cost-benefit analyses.  By contrast, US West's proposal would enable the incumbent carrier to acquire and to construct facilities that it intends to utilize (in whole or in part) to supply Title 62 services under the guise of a general network upgrade, and in so doing effectively cross-subsidize its competitive services with revenues derived from Title 61 customers, thus further delaying the development of competition in Idaho.

Q.  But shouldn't the Commission be concerned about US West's ability to compete with new entrants during the coming years?

A.  There is undeniably a need to establish a regulatory framework that recognizes and allows for movement toward efficient and sustainable competition in the local market.  However, at the same time, there is certainly no evidence that competition poses an imminent — or even a near-term — threat to US West's stream of revenues from residential subscribers either for Title 61 or for Title 62 services.  Furthermore, the more serious concern relating to the development of effective competition has do with (in addition to the significant matters of cost allocation and depreciation, which are under investigation in this proceeding) eliminating barriers to competition, such as establishing fair prices for interconnection and unbundled elements, and implementing number portability and other competitor and consumer safeguards.

Q.  Doesn't the Company imply that if Title 61 services are properly priced that it will be able to better price Title 62 services?

A.  Yes.  US West contends that if Title 62 services were not required to support Title 61 services it would be able to "competitively price Title 62 services to meet the customer needs and market challenges." (Wright at 16.)  It is my understanding that the Company is already able to reprice Title 62 services on 10 days' notice.  Furthermore, in response to a staff data request, the Company was unable to indicate what changes, if any, it would make to Title 62 services if "Title 62 services did not support Title 61 services" (see US West response to STF03-187).  US West's testimony implies that prices for Title 62 services would decline.  However, because the Commission no longer regulates Title 62 services, there is simply no enforceable mechanism by which the Commission can ensure that these prices will actually be reduced.  If Title 61 prices increase (allegedly to recover costs) and Title 62 prices remain unchanged, the Company will enjoy an unwarranted and substantial windfall.  There is simply no guarantee that the Company will reduce prices for Title 62 services.

Indeed, at a more fundamental level, since the prices for Title 62 services are not subject to regulation at all, one can presume that the prices presently in use are the ones that will maximize profits for US West, since the Company would have no incentive to charge less than those prices where it is not subject to regulatory constraints.  Thus, there is no economic basis to expect that US West would do anything to its Title 62 service price levels based upon any rate changes (up or down) that may be adopted by the Commission for Title 61 services.

Q.  Won't US West be required to lower rates for its Title 62 services in response to competition?

A.  Not necessarily.  The Company has failed to provide any evidence that competition will be sufficiently robust in markets such as intraLATA toll and vertical services to force the Company to lower rates for these services.  Although in the "future" such competition might exist, there is simply no evidence of such competition for the foreseeable future.  In sharp contrast with US West's proposal, in other states, rate increases for local exchange service have been explicitly offset by rate decreases for other services.  In this proceeding, however, the Commission is being offered a "trust-me" package whereby US West would be allowed to double the rates for basic residence local exchange service and would then have open-ended flexibility to price Title 62 services based upon market conditions.

Q.  Dr. Selwyn, how do you see the role of the Commission in determining the extent to which competition develops in the telecommunications markets served by US West and other incumbent LECs in Idaho?

A.  Moving forward, the Commission must determine the role that it desires competition to assume in the local telecommunications markets served by US West and other incumbent LECs, and take the steps necessary so that competition can fulfill that role.  The Commission may well have multiple policy objectives when considering the potential merits that expanded competition could bring.  For example, the Commission may believe that expanded competition will (1) stimu­late greater efficiency in the production of telecommunications services by the incumbents as well as by the new entrants; (2) encourage greater innovation in telecommunications services and applications; (3) provide lower-cost services to end users; and/or (4) result in suppliers becoming more responsive to end users' needs.  If competition will also be relied upon to substitute for economic regulation of incumbent LECs' earnings and prices, it must become sufficiently widespread and established so as to discipline LEC prices and prevent the undue exercise of market power.  In light of the formidable competitive advantages enjoyed by the incumbent LEC, to achieve that result will require a far greater degree of competition than is necessary to obtain some of the other benefits.  The policy choice between the pursuit of limited competition vs. price-constraining compe­tition for the full range of incumbent LEC services has direct impli­cations for an assessment of US West's rate rebalancing proposal.

Q.  Dr. Selwyn, in what ways does US West, as the incumbent LEC, enjoy formid­able competitive advantages relative to potential new suppliers of local telephone services?

A.  When considering the advantages and disadvantages of US West and the other incumbent LECs in Idaho vis-a-vis their potential local service competitors, one must start by recognizing the unique monopoly position that the incumbent LECs have enjoyed for nearly a century.  Historically, these carriers have prospered under a unique and protected position under the "public utility" form of regulation, with exclusive franchise rights and guaranteed opportunities to recover their investments.  The construction of the LECs' networks was financed entirely by private investment capital attracted to the carriers by government commitments to protect the carriers' service monopoly from encroachment and the promise of an opportunity for full recovery of, and a "fair return" on, the investors' capital.  (Indeed, this "fair return on investment" principle was elevated to a constitutional level as a result of several landmark US Supreme Court rulings that held that the government's failure to permit a public utility to charge rates sufficient to assure a "fair return" vio­lated the 5th Amendment protection against government expropria­tion of private property without just compensation.  See Bluefield Water Works v. West Virginia Public Service Com­mission, 262 US 679 (1923); Federal Power Commission v. Hope Natural Gas Co., 320 US 591 (1944).)  These privileges were granted to LECs in exchange for commitments to expand their networks to an essentially ubiquitous basis, to provide service to all who desired it wherever located within the defined service area, and to accept regulatory oversight of their earnings, pricing and provisioning practices.

Q.  Hasn't the incumbent LECs' monopoly position changed considerably since the initial adoption of the "public utility" model of regulation?

A.  Certainly.  In recent decades, the scope of the local telephone companies' effective monopoly in Idaho and elsewhere has been reduced by virtue of a number of affirmative steps by the courts, the FCC, and state regulatory commissions, including the opening up of the LEC monopoly on telephone sets and other customer premises equipment (CPE); the separation of local and long distance telephone operations and the growth of competition in the interexchange markets; actions by numerous states in recent years to authorize intraLATA services competition; and most recently the affirmative efforts to dismantle all remaining entry barriers as required by TA96.

While these and other important policy initiatives have been made to encour­age the development of competitive telecom­muni­cations markets, the local telephone companies' control of their core markets — that is, the markets for switched local exchange services and switched access — remain undiminished.

Q.  But hasn't the elimination of the LECs' legal monopoly on local services provision in Idaho made them vulnerable to competitive entry?

A.  No.  Even though the legal monopoly on local services no longer exists, US West and other incumbent LECs derive substantial and enduring market power from the ubiquitous, interconnected networks that were constructed under the protected monopoly model and with funds essentially guaranteed by captive ratepayers.

Large network structures, such as US West's network, are characterized by centralized control of network connectivity and large economies of scale and scope.  Hence, control of an extensive network is a source of enormous market power, since the properties of such networks create substantial externalities to both supply and demand.  The larger the number of users in the network, the lower will be the unit cost per user.  At the same time, as the number of users increases, the network becomes more valuable.  This dynamic, due to the presence of external­ities and the level of interconnection among users, allows the network owners to establish and to maintain extensive market power, even after "competition" has nominally entered into their markets.

Telecommunications network resources involve very large investments that are most efficiently recovered over the largest number of users.  Therefore, the degree to which LECs are able to exploit their network resources to accomplish an efficient scale and scope of operations will facilitate its comparative market advantage vis-à-vis smaller rivals.  A LEC's network sources of market power include, among other things, the scope and scale of interconnected network facilities; control of points of traffic aggregation (i.e. switching centers); direct access to virtually every end user within the service territory through billing and ongoing business relationship; and a starting point of virtually 100% market share in its serving territory.

These fundamental network-related advantages, in combination with the numerous, significant barriers to competition facing new entrants, mean that  unless the Commission takes aggressive steps to substantially reduce or eliminate these barriers, widespread competition is unlikely to develop.

US West's contention that competition exists in most services ignores incumbent LECs' sources of market power and entrenched monopoly positions, mischaracterizes the roles of cellular companies and other telecommunications suppliers, and is essentially devoid of evidence that price-constraining competition exists or will materialize in the near future for core local telephone services.

Q.  Dr. Selwyn, what is your response to US West's contentions that competition exists in most of its service markets?

A.  No one can dispute that there is increasing competitive activity in Idaho's telecommunications services sector, and the competition that has developed to date reflects in part the Commission's efforts to introduce diversity of supply in telecom­munications over the past decade or more.  That having been said, it is absolutely critical to make a clear distinction between competitive activity per se and competition that has developed sufficiently to act as a constraint on the pricing practices of the incumbent carrier, in this case US West.

Q.  How much of a competitive threat to US West's local telephone services is posed by the state's cable television companies?

A.  It should be recognized that while cable companies are clearly interested in telecommunications markets and are conducting trials, no cable company is currently providing generally available, switched local service in the US, and substantial development and investments (particularly in switching infrastructure) must be made before such offerings are possible.

Moreover, US West's current dominance of the public switched network infrastructure in its service territory, as described above, means that the Company is likely to be involved in the carriage of the vast majority of calls that would utilize cable company facilities.  If we consider the case of a cable television company entering the market for local telephone service, the only local calls that it could complete without transiting the Company's network are those among the cable company's own customers.  Moreover, it is reasonable to assume that the cable company's customers have no greater likelihood of making local calls to another cable company customer than to a US West customer.  In that case, even if the cable company achieves a 10% penetration of the local telephone market, that competitor would have a likelihood of only 10% x 10% = 1% of completing both ends of a local call.  Thus, even if a cable company were to overcome the barriers to entry into the local telephone service market, it would most likely be consigned to achieving only a minuscule fraction of the total market for years to come.

Q.  Is there evidence of the presence of a market for competitive access services in Idaho at this time?

A.  No.  As noted above, according to US West's response to a staff data request, the Company has received only one confirmed request for virtual collocation (US West response to STF03-189, reproduced as Exhibit No. 112, Schedule 1).  There is simply no evidence to support the view that the activities of competitive access providers (CAPs) represent a significant threat of erosion of the revenue stream that the Company currently derives from its in-state access services.  In 1994, CAPs' share of total nationwide access revenues was a mere 0.9% as compared to 99.1% for all LECs (Connecticut Research Report on Competitive Telecommunications, June 1995).

Q.  Please explain.

A.  The growth of demand for CAP services has indeed been driven in large part by the desire of high-volume business and institutional users to improve the reliability of their telecom­muni­cations services.  Consequently, those customers have made increasing use of diverse routing arrangements and "self-healing" network offerings, as well as splitting their telecommunications requirements among multiple service providers.  In that context, it is clear that, because of customer preference, US West may not be able to supply such redundant facilities.  (US West could, of course, construct redundant facilities of its own, if it determined that sufficient market demand were present and that customers insisting upon full redundancy would be willing to nevertheless take redundant facilities from the same provider.)  Even where the CAPs are truly competing with the incumbent LEC for these customers, the emphasis on facilities redundancy and fail-safe circuits means that the services provided by CAPs are not directly substituting for the incumbent LEC's traditional access services, since the LEC could not provide comparable offerings without also making new investments in redundant, route-diversified fiber rings, circuit monitoring equipment, and the like.

Furthermore, no CAP can duplicate the extensive local switching infrastructure that US West and other incumbent LECs possess.  Accordingly, the CAPs (when they enter the southern Idaho market), including those affiliated with IXCs, will continue to supply alternative special access services and begin to provide switched access local transport, but their entry into the local access switching market will likely be considerably slower and more costly.

Q.  Will IXC and cable television company joint ventures pose a serious competitive threat to US West in Idaho?

A.  No.  Such ventures must also compete against US West and the other Bell operating companies in other jurisdictions across the country.  Moreover, to the extent that such ventures are comprised of firms that rely on private risk capital, they will have strong incentives to invest selectively in those jurisdictions in which entry barriers and other impediments to competition have been reduced the most.  In contrast, regulated LECs such as US West have access to essentially risk-free capital, by virtue of their continued market power in the local telephone services market.

To make local service competition a reality, the Commission will need to take active steps to eliminate existing barriers to entry and promote the most efficient mix of facilities-based and non-facilities based-competition.

Q.  Dr. Selwyn, you have just described how the Company has exaggerated the prospects for competition and potential market share losses in its core local telephone services markets.  In your view, what additional steps must the Commission take if it intends to realize a more competitive environment for local services in Idaho?

A.  As is evidenced in response to STF03-188, which is reproduced as Schedule 2 in my Exhibit No. 112, barriers to entry have, for the most part, not yet been fully addressed by the Company.  As I observed earlier in my testimony, the Commis­sion may determine that it is in the best interests of Idaho ratepayers to continue a mix of limited competition and regulation for US West and the other incumbent LECs.  On the other hand, the Com­mis­sion may choose to pursue a fully competi­tive environment for local telephone services in Idaho — going beyond the important, but nevertheless limited competition repre­sented by resale and niche market activity (e.g., specialized services for large business users), to vigorous, largely facilities-based, and ultimately price-constraining competition in all segments of the local telephone services market, as a precondition to the eventual deregulation of US West and other incumbent LECs.  In either case, the Commis­sion will need to take decisive actions now to encourage local competition to occur.  While some degree of competition in local services will no doubt occur under Idaho's existing regulatory and market environment, the overwhelming advantages retained by the state's incumbent LECs will likely marginalize such competition unless additional proactive steps are taken by the Commission to foster growth in local competition over the next several years.

Given the existence of the incumbent LECs' ubiquitous and sizable local switched networks in the state, a first objective for the Commission should be to create a transitional environment that will promote competitive entry and make the most efficient use of that existing local telecommunications infrastructure.  In principle, the transitional environment should be designed to accomplish the following:

(1)Initially, minimize the duplication of existing LEC network infrastructure where substantial scale and scope economies exist, by requiring resale based upon appropriate demarcation of wholesale/retail functions, plus unbundled access to network functions where economically justified;

(2)Promote new entrants' efficient use of existing network infrastructure, e.g., by permitting access at points of traffic concentration (tandem switches, end offices, and remote switching units);

(3)Promote the development of new network functions and features by both the incumbent LECs and new entrants through private investments rather than through traditional ratepayer-guaranteed mechanisms, so that all competitors have more comparable degrees of financial risk and rewards from their operations and innovations;

(4)Promote a greater responsiveness by the incumbents and new entrants to the specialized needs of customers than is feasible under a single-provider model.

Q.  Assuming that competition in local services will grow as the steps you have identified are taken, should the Commission be concerned with ensuring that US West maintains a high level of service quality for all of its customers?

A.  Yes, it should.  One might surmise that competition would force all providers to improve their service quality.  However, this outcome is far from certain, as we have all seen in the case of the airline industry.  If competition has the effect of forcing the incumbent and the new entrants to shave costs in order to remain profitable, long term service quality may suffer even if the effect is not noticed immediately.  And if pockets of monopoly remain (as they have in the airline industry), incentives to improve and maintain high service quality may simply not exist.

DEPRECIATION

US West has proposed dramatic increases in depreciation rates and expenses from the levels last formally approved by the Commission in 1988.

Q.  Dr. Selwyn, can you summarize your understanding of the various changes in depreciation accounting that have occurred for US West's southern Idaho telephone plant since 1988?

A.  Yes.  Shortly before the enactment of the Idaho Telecommunications Act of 1988, (Idaho Code §§ 62-601 et. seq.) the Commission authorized new intrastate depreciation rates applying to Mountain Bell (now US West) telephone plant in southern Idaho (Case No. MTB-T-88-3, Order No. 21949, June 10, 1988).  In that decision, the Commission adopted the revised depreciation parameters (including projected lives and salvage values) agreed upon by the Company and Commission Staff in the 1988 triennial depreciation represcription meetings (Id. at 1).  Those projected lives are shown in Schedule 5 in my Exhibit No. 112.

Following the implementation of the Company's Revenue Sharing Plan in Idaho in September 1989, several events have taken place concerning depreciation rates.  First, on October 21, 1991, Staff sent a letter to US West stating that:

Because of the unique Revenue Sharing Plan under which US West is currently operating in southern Idaho, the Commission is not opposed to the Company recording Idaho intrastate depreciation using the agreed to [at the three-way meeting] salvage values and depreciation lives and the proposed ELG method without a formal order from this Commission.  This decision, however, does not signal a change in Commission policy with respect to the merits of ELG and is strictly limited to US West southern Idaho depreciation expense during the term of the revenue sharing plan (letter from Stephanie Miller, Director, Utilities Division, to Dan L. Poole, Chief Counsel-Idaho, US West, October 21, 1991).

A three-way meeting took place from May 17 through May 19, 1993.  The rates deter­mined at this meeting are those that Mr. Easton represents as the "currently recognized" depreciation lives.  (As I detail later in this testimony, such an assumption represents a potentially confusing mischaracterization of the rates last approved by the Idaho PUC.)  Following that meeting, on August 31, 1993, the Staff sent another letter to US West, indicating the following:

The Commission has agreed to allow the Company to implement for Idaho operations, the depreciation rates agreed to at the recent three-way meeting.  The Commission also agrees to your proposed rate-base neutral change in accounting for the investment associated with the completed Tech Plus Project to make it consistent with your current booking of the Tech II Project.  Finally, with respect to the Company's request to have the flexibility to increase its depreciation accruals on an optional account-specific basis above the levels agreed to at the three-way meeting, the Commission does not disapprove, but reminds the Company that depre­ciation expense, once booked, may not be recovered retroactively through rates (letter from Stephanie Miller, Utilities Division Director to James E. Wozniak, Director, Public Policy, US West, August 31, 1993).

Q.  Did either of the Staff letters that you just referenced approve revised depreciation lives and rates for ratemaking purposes in Idaho?

A.  No, I have been advised by Staff Counsel that neither of the Staff letters constituted Commission authorization, for ratemaking purposes, of revised depreciation lives and rates for US West's Idaho plant.  Counsel has advised me that the Commission allowed the Company to implement these changes for booking purposes while the Revenue Sharing Plan was in operation, but not for ratemaking purposes.  Consequently, it appears that the Commission last granted formal approval of changes to US West's depreciation lives and rates in the 1988 decision, Order 21949, discussed earlier in my testimony.

Q.  Are there other recent decisions in Idaho which must be understood in the context of a discussion of depreciation rate issues?

A.  Yes.  In particular, the capital improvements approved in the Tech Plus and Tech II plans which are being discussed by Ms. Baldwin, receive unique treatment of their associated depreciation expense.

Q.  What is your understanding of these plans?

A.  As described in further detail in Ms. Baldwin's testimony, the Commission approved US West's use of revenue sharing funds to modernize switches and outside plant in rural areas in southern Idaho.  The Commission's "Tech Plus" directives resulted in the use of regulated funds to upgrade 52 rural central office switches over a five-year period beginning in 1987, and the Commission's "Tech II" directives resulted in the use of Title 61 regulated funds to upgrade local plant in 29 rural wire centers over a three-year period beginning in 1992.

Q.  How did the Commission treat the depreciation expense that was associated with these plans?

A.  At the intrastate level, the Commission required that the capital additions directed in the "Tech Plus" and the "Tech II" decisions be expensed rather than capitalized.  Thus, in the Company's intrastate books, they show up in the plant in service line and then show up as fully depreciated in the accumulated depreciation line.  In the Depreciation Study that US West submitted to the FCC, however, the additions are capitalized.

Q.  Please summarize your understanding of US West's proposed changes to its capital recovery and depreciation expense.

A.US West contends that it is seeking an increase of approximately $18.3-million in Title 61 revenue associated with its depreciation proposal (Easton Direct at 45), which represents nearly half of its total claimed revenue increase request of $38.05-million (Wright Direct at 3).  The specific components of the Company's depreciation proposals are (1) a request to adopt shorter lives than those that were last approved by the IPUC, (2) a request to adopt the Equal Life Group (ELG) methodology, and (3) a request to amortize over three years an alleged depreciation reserve deficiency associated with the transition to ELG.

Importantly, US West portrays its depreciation proposals as starting from "currently recognized" depreciation lives (Easton Direct, at 33), which are in fact the 1993 three-way meeting lives that were accepted for interstate purposes by the FCC (see attachment to letter dated August 9, 1993, to Myrna Walters, Secretary, ID-PUC, from James E. Wozniak, Director, Public Policy, US West) but, as I indicated earlier in my testimony, were not formally approved for ratemaking purposes by this Commission.  Consequently, the amount of depreciation expense that the Company purports to recover in this case is a significant understatement of the entire increase in depreciation expense that it seeks, relative to the considerably lower 1988 depreciation rates that were last approved.  Schedule 5 in my Exhibit No. 112 compares the projection lives last formally approved by the Commission in 1988, the 1993 FCC three-way meeting lives, the 1996 three-way meeting lives, and US West's proposed lives in the instant proceeding.

The Company's depreciation proposals fail to take into account the different character­istics of Title 61 and Title 62 services, and would force ratepayers to subsidize the Company's non-regulated, technologically intensive Title 62 services.

Q.  What justification is offered by Mr. Easton for the substantial increase in depreciation expenses that US West is seeking?

A.  Mr. Easton contends that the lives currently prescribed by the Commission for US West's southern Idaho plant are inadequate to reflect the pace of change in telecommunications technologies and marketplaces.  He argues that, unlike other providers in a competitive market "who are free to determine whether, where and when to invest and price freely to cover those risks," US West does not have such choices because it continues under an obligation to serve and is subject to the Commission's pricing decisions (Direct Testimony of William R. Easton at 18).  Consequently, he argues, the Company's depreciation accruals under the prescribed rates will be insufficient (1) to recover the costs of older plant that the Company is retiring at a faster pace than originally anticipated, and (2) to fund all of the advanced technology required to compete in the emerging tele­communi­ca­tions environ­ment (Easton at 17-18).  Mr. Easton paints a bleak picture of the Company's alternatives if its depre­ciation expense request is not approved, warning of a "second rate network" in Idaho, ratepayers saddled with excess costs if the Company seeks external funding for further plant modernization, and/or allegedly confiscatory write-offs of older plant retired before the end of its anticipated useful life (Id. at 17-18).

Q.  Do you agree with Mr. Easton's claims?

A.  No, I do not.  Mr. Easton's pessimistic portrayal fails to acknowledge the fundamental impacts that US West's successful petition to segregate competitive Title 62 from basic Title 61 services has had upon the Company's ability to pursue more flexible capital recovery and plant modernization practices.

Q.  Please explain.

A.  As Ms. Baldwin demonstrates in her direct testimony, the premise of the Title 61/62 split is that the "competitive" Title 62 services are no longer subject to economic regulation, including any Commission determination of the appropriate capital recovery or rate of plant modernization for these services.  Consequently, from the time that US West elected to remove its non-basic services from Title 61 regulation, the Company has had the discretion to apply distinct capital recovery methods, including alternative depreciation lives, salvage values, and/or calculation methods (e.g. Equal Life Group) to those assets allocated to the Title 62 category, separate from those prescribed by the Commission for application to the assets remaining in the fully regulated Title 61 category.  Instead, the Company continued to apply uniform depreciation parameters and calculation methods to both Title 61 and 62 services during the years of the Revenue Sharing Plan (see US West response to ID-PUC Staff request STF02-115).  Going forward, however, neither the Company nor the Commission is under any obligation to continue to apply the same capital recovery methods to the Title 61 and 62 categories, and in fact there are compelling reasons to deaverage the depreciation lives and rates applied to regulated Title 61 plant from those applied to the competitive Title 62 category.  While the Company may apply its proposed depreciation changes to the plant allocated to the Title 62 category under the cost allocation supported by Ms. Baldwin's testimony, those changes are not at all appropriate for application to regulated Title 61 plant.

Q.  Why should the depreciation lives and rates applied to Title 61 plant be deaveraged from those applied to Title 62 plant?

A.  The fundamental reason is that the basic services remaining in the Title 61 category have significantly different characteristics from Title 62 services.  First, the overall demand for Title 61 services is significantly more stable and predictable than that for Title 62 services, and should not involve rapid or frequent plant replacements.  Schedule 2 in Ms. Baldwin's Exhibit No. 113 shows that the annual growth rate since 1991 for Title 62 business lines is 12.9%, substantially greater than that for Title 61 (residence and small business) access lines, which are growing at only a 4.3% rate.  Demand growth for Title 62 services is not only generally more rapid, but also more volatile than for Title 61 services.  While the Company designs its network to provide Title 62 services on a ready-to-serve basis, the actual take rates for most Title 62 services, including vertical features, CLASS services, and additional residence access lines, fall far short of the virtually ubiquitous penetration levels of Title 61 basic exchange services (see Ms. Baldwin's Exhibit 114, Schedule 9).  Further demand volatility is caused by the Company's provision of Centrex in competition with PBX systems (one of the few cases in which significant competition exists for the Company's local services, albeit from a non-network alternative).  For any given medium- to large-size customer, a Centrex system requires many more subscriber loops than the comparable PBX system's trunk demand, typically eight to ten times as many.  Thus, migrations (in both directions) of such customers between Centrex and PBX systems over time can create large fluctuations in loop demand for the Company's serving wire center(s).  Second, the nature of these services also requires only minimal "intelligence" in the switching and network platform; most services that would require or benefit from such technological sophistication are in the Title 62 category, including Centrex, vertical features, CLASS services such as Caller ID, and Advanced Intelligent Network (AIN) services that will be introduced in the future.  While Title 61 services may make use of digital switches and other recently-acquired resources, such use is largely the result of plant replacement decisions that were driven primarily — perhaps even exclusively — by Title 62 objectives, except where specifically mandated by the Commission in the Tech plans as discussed previously.  Consequently, for some of the most significant types of network plant, including digital electronic switching and circuit equipment, projection lives would be considerably longer and depreciation rates lower but for their shared use in the provision of the far more volatile and technologically demanding Title 62, non-regulated services.

In summary, US West is attempting to apply shortened asset lives and higher depreciation rates to the plant allocated to the Title 61 category, when those parameters are based on the Company's perception of the emerging competitive conditions for Title 62 services.  Such an outcome not only would be unfair to Idaho ratepayers, it is expressly prohibited by the 1988 Telecommunications Act, which forbids the Company from using ratepayer-generated revenues for subsidizing its competitive services (see Idaho Code § 62-613).

Q.  Is the type of deaveraging that you are proposing unworkable or impractical in any way?

A.  No, it is not.  In fact, it is already being carried out in the context of the interstate vs. intrastate jurisdictional separations process.  Many state regulatory commissions routinely prescribe depreciation lives and rates for application to jurisdictionally-intrastate plant that are different from those prescribed by the FCC for application to the same LEC's jurisdictionally-interstate plant — even plant that is, in fact, used in the joint production of intrastate and interstate services.  Clearly, any added administrative complexity introduced by this bifurcation has not prevented the use of separate intrastate and interstate depreciation practices for jointly used plant.  Indeed, the United States Supreme Court, in overturning FCC preemption of LEC depreciation rates in its Louisiana PSC decision (Louisiana Public Service Commission v. Federal Communications Commission, 106 S. Ct. 1890 (1986)), expressly concluded that the use of separate intrastate and interstate depreciation rates and accounting was entirely feasible (Id. at 373).

With respect to Idaho, in 1993 the FCC authorized US West to adopt the depreciation lives and rates agreed to at the 1993 three-way meeting, but this Commission may inde­pen­dently set whatever lives and rates it deems appropriate for the intrastate, Title 61-related plant that is within its jurisdiction (Idaho Code § 61-525).  Similarly, the Commission should choose depreciation parameters for Title 61 plant that are independent of those that US West may believe are most appropriate for the plant supporting its non-regulated, Title 62 services.

Q.  Do the Tech Plus and Tech II plans provide any justification for increasing depreciation rates and expenses for Title 61 service-related plant?

A.  No, they do not.  Mr. Easton cites the Tech Plus and Tech II plans as evidence that the Commission has encouraged investment in advanced network elements for the provision of basic service, hence justifying increasing depreciation rates (Easton Direct, at 35).  But, as I have stated previously, both plans were specifically implemented as fully-expensed and were explicitly funded with monies from the Revenue Sharing Plan.  The depreciation rates at issue in this rate case will, if approved, lead to higher rates for Title 61 services, something that did not occur with Tech Plus and Tech II.

Q.  Have the Tech Plus and Tech II plans benefitted the Company's Title 62 services even though they were paid for by funds generated from Title 61 services, i.e. funds derived from Title 61 payments made by Idaho ratepayers?

A.  Indeed they have.  The two Tech plans provided for new switches to be placed in 52 wire centers.  These wire centers with new switches funded by Title 61 service revenues plus the loop plant improvements associated with the Tech plans are also used to provide Title 62 services.  Thus, US West has received what amounts to a "free ride" to the extent that such upgrades facilitated the Company's provision of non-regulated Title 62 services.  In fact, one could argue that a portion of the Title 62 services revenues in those wire centers should be attributed to the Title 61 category, in order to fairly compensate ratepayers for the benefits that Title 62 services derived from those upgrades.  Staff is not, however, proposing a specific compensatory revenue adjustment at this time.

The Company's depreciation proposals are based upon speculative and generic forecasts of technology substitution that fail to reflect Idaho's unique regulatory and technology replacement circumstances.

Q.  Are the specific depreciation rates and lives proposed by US West appropriate for Title 61 services-related plant in Idaho?

A.  No, they are not.  The Company's proposed depreciation lives and rates are based on certain forecasts of telecommunications technology substitution trends prepared by Technology Futures, Inc. (hereinafter, "TFI").  As I shall explain in my testimony, by relying upon TFI's forecasts, the Company's depreciation proposals are inappropriate for application to US West's Title 61-related plant because the proposals:

(1)Ignore the empirical life indications traditionally relied upon to estimate

asset projection lives, and instead rely upon a non-standard methodology;

(2)Rely upon a study conducted on an industry-wide level, with no analysis

of the specific conditions confronted by US West in Idaho with respect to

competition or need for technology replacement; and

(3)Are inconsistent with US West's actual modernization plans for southern

Idaho.

Q.  Did the Company perform empirical life analyses for the major plant categories for which it is proposing significantly shorter lives?

A.  Yes, in general it did.  US West's 1996 FCC Depreciation Rate Study includes empirical life analyses for most plant accounts, including the following six major plant types:  ESS-Digital, Circuit-Digital, Circuit-Analog, Aerial Cable-Metallic, Underground Cable-Metallic, and Buried Cable-Metallic.  Schedule 6 in my Exhibit No. 112 shows the empirical average lives for the three year band 1992-1994 that US West developed for these accounts.  For the fiber cable accounts, the Company stated that it does not have sufficient empirical data to perform a mortality analysis (See US West 1996 FCC Depreciation Rate Study, Life Summary for Accounts 2421, 2422 and 2423).

Q.  Did US West rely upon these empirical life analyses to develop its proposed projection lives?

A.  No, as Schedule 6 conclusively demonstrates, the Company did not use the results of these empirical life analyses to develop its proposed projection lives.  In fact, the Company's proposed lives do not comport in any meaningful way with its actual mortality experience for its major plant accounts.  For example, the empirical average life for the buried metallic cable account is 49.8 years for the 1992-1994 period while US West claims a far shorter projection life of 20 years.  The discrepancy between actual mortality experience and the Company's proposed projec­tion life is even greater for the metallic underground cable plant category, 64.4 years versus 15 years, respectively.  Clearly, US West chose to completely disregard the results of its own empirical studies when developing its depreciation proposals for major plant accounts.

Q.  In that case, what is the source of the Company's proposed projection lives for its major plant accounts?

A.  US West's proposed projection lives are drawn from the TFI study entitled "Depreciation Lives for Telecommunications Equipment: Review and Update" which, in turn, relies upon a "technological substitution" forecast that applied Fisher-Pry substitution modelling techniques (see Direct Testimony of William R. Easton, Exhibit 20, at 10-11).  The TFI study presents recommended projection life ranges for the major plant categories (Id., at 33).  As Schedule 6 in my Exhibit No. 112 indicates, for four of the six major plant categories contained therein, US West's proposed projection lives lie within the range recommended by TFI; for a fifth category (circuit digital), US West's projection life is only one year outside of the TFI-specified range; for the remaining plant category, Buried Cable-Metallic, the Company proposes 20 years versus TFI's recommended range of 14-16 years.  While I have excluded fiber cable accounts in my Schedule 6 (because US West did not develop corresponding empirical lives for optical fiber), US West also adopted a projection life of 20 years, within TFI's recommended projection life range of 15-20 years, for these accounts (Id.).

Q.  Dr. Selwyn, can you summarize your understanding of the Fisher-Pry modelling technique that underlies the TFI-recommended projection lives incorporated into US West's proposal?

A.  Yes.  The Fisher-Pry modelling technique is a method of forecasting the replacement of one technology by another over time, by applying an S-shaped curve (the Fisher-Pry curve) using parameters determined on the basis of early observations of the rate of substitution between the two technologies.  For example, during the early 1980s, one might have attempted to forecast the substitution of compact disc (CD) players for phonographs by fitting a Fisher-Pry curve to data on the respective market shares of the two rival technologies.  J. C. Fisher described the model that bears his name as being based upon three assumptions: (1) many technological advances can be considered as competitive substi­tu­tions of one method of satisfying a need for another, (2) if a substitution has progressed as far as a few percent, it will proceed to completion, and (3) the fractional rate of fractional substitution of new for old is proportional to the remaining amount of the old left to be substituted (J.C. Fisher, "A Simple Substitution Model of Technological Change," in Technological Forecasting and Social Change, Vol. 3, 1971).

Q.  Does the Fisher-Pry forecasting technique consistently produce reliable forecasts for technology adoption?

A.  No, it does not.  While the Fisher-Pry technique may be useful in certain applications that fit the fundamental assumptions that I just described, its results are not inherently more reliable than those of any other forecasting tool.  As expressed in one guide to technology forecasting techniques, "[t]he S-shaped life cycle concept has been shown both to work and not to work in many competing technology circumstances since the original Fisher-Pry work.  While the concept is valuable, it cannot be taken too literally."  (See Stephen M. Millett and Edward J. Honton, A Manager's Guide to Technology Forecasting and Strategy Analysis Methods, Battelle Press, 1991, at 22.)

In fact, this admittedly "simple" model does not withstand analytical scrutiny when applied to many complex, real-world situations of technological evolution.  Stern, Ayres and Shapanka noted that the Fisher-Pry model assumes that the old and new technologies are direct substitutes, one for the other ("A Model for Forecasting the Substitution of One Technology for Another," in Linstone and Sahal,  Technological Substitution:  Forecasting Techniques and Applications, American Elsevier Publishing Company 1976, at 119).  Thus, the Fisher-Pry model cannot be relied upon to produce accurate forecasts when confronted by multiple new rival technologies, as is now occurring in the local loop between optical fiber and Asynchronous Digital Subscriber Line (ADSL) technology, which extends the life of copper plant and indeed may be practical only when non-carrierized copper plant running the full distance between the subscriber premises and the serving wire center is in place.  A further limitation is that the Fisher-Pry model "bypasses such questions as comparative prices or comparative utilities of the competing materials or products..." Id., at 123).

These authors conclude that the "Fisher-Pry model is inherently more adaptable to retrospective analysis than to ex ante projections." (Id.).   Of course, as US West and TFI attempt to use it, it is purely an ex ante forecasting tool.  Other analysts have emphasized that the Fisher-Pry model's results are quite sensitive to error in the data from early years of the substitution cycle.  (Alan L. Porter et al., Forecasting and Management of Technology, 1991, at 59.)  Sharif and Kabir concluded that the model was generally biased; no matter how many actual data points were available, the "Fisher-Pry model gives an overestimation of the forecast..." ("A Generalized Model for Forecasting Technological Substitution," in Linstone and Sahal, op cit. at 10).

Q.  How did TFI apply the Fisher-Pry forecasting technique to determine projection lives for telecommunications plant?

A.   TFI has developed technological substi­tution curves for major telecommunications plant categories based on assumptions regarding the substitution of the currently dominant technology by newer competing technologies, e.g. the substitution of optical fiber for metallic cable.  TFI and US West argue that more traditional depreciation methods, based upon pure historic mortality or based upon a mixture of historic data and near-term technology forecasts, do not allow sufficiently high depreciation accruals.  They contend that higher rates of depreciation are thus needed to account for the rate of technological substitution which is supposedly forecast by the Fisher-Pry technique that TFI is using to develop its "substitution curves."  Technological substitution methods, however, can be misused rather easily when telephone company managers — rather than the marketplace — are allowed to specify the substitution curve.

Q.  Should this Commission accept projection lives and depreciation rates for Title 61-related plant that is based principally on Fisher-Pry technology substitution techniques?

A.  No, certainly not.  Given the limitations of the Fisher-Pry technique that I have identified above, and the inherently speculative nature of any forecasting approach to determining projection lives, any regulator, including this Commission, should be wary of depreciation proposals, such as the Company's that rely primarily upon the Fisher-Pry model without reference to traditional empirical life indications.  Obviously, using such a method for determining part of the actual rate levels ratepayers must incur for monopoly telephone services would be even more inappropriate.

Q.  Did the TFI studies take into account the pace of competitive activity and technology replacement in southern Idaho?

A.  No, they did not.  The TFI studies on which US West has based its depreciation pro­posals are generic to the industry as a whole, without specific reference to the pace of competitive activity and technology replacement in any of US West's territory, let alone the particular conditions occurring in southern Idaho.  Thus, TFI's studies, and US West's proposed depreciation lives and rates, fail to take into account any of the following crucial characteristics of the Idaho telecommunications environment as they impact US West:

(1)The Title 61 vs. 62 split of the Company's services and plant;

(2)The effects of the Tech Plus and Tech II plant modernization programs,

including the expensing of the associated plant acquisitions;

(3)The Company's current plans for network modernization in the state.

Q.  But US West frequently cites the pressure to upgrade and modernize its plant in its depreciation study.  For example, US West cites its modernization programs to justify its proposed shorter lives for the metallic cable account.  Hasn't the Company tied its proposals to its plans for network modernization in Idaho?

A.  No, in reality it has not.  I have reviewed the Company's responses to Staff interrogatories regarding its network modernization plans in southern Idaho.  These responses clearly show that those plans are creating little pressure to prematurely retire plant, and thus raise depreciation rates, in the Company's southern Idaho service territory.  US West has initiated a multi-state infrastructure modernization plan called "Network 21" (see Easton Exhibit 19, Executive Summary, at 22).  However, there are no plans for Network 21 deployments in southern Idaho (US West response to STF03-251).  Similarly, US West has no current plans to implement any Self-Healing Loop Modern­ization Projects (SLMP) in southern Idaho (Id., Attachment A).  In fact, when Staff asked US West to identify all of the Company projects that will result in retirements of metallic cable facilities in southern Idaho, it identified only one, resulting in de minimus retirements.  Under these circumstances, it would be a particularly grievous error for the Commission to approve higher depreciation rates for Title 61 plant on the grounds that it was required to fund new technology investments, since the available evidence indicates that few of those investments would benefit any Idaho customers, and instead would be used to fund US West's modernization efforts in other states or to simply enlarge the Company's profits.

In the absence of any compelling evidence to the contrary, the Commission should not make any adjustments to the depreciation rates and lives that were last formally authorized for US West in 1988.

Q.  What do you recommend, in the alternative, to the depreciation rates that US West has proposed in this rate case?

A.  I recommend the use of the last depreciation rates authorized by the Commission in Idaho in 1988 for Title 61 services.

Q.  Why do you consider these rates to be appropriate?

A.  As I have explained earlier in my testimony, the Commission needs to determine depre­ciation lives and rates that accurately reflect the characteristics of Title 61 services only, and therefore the vast majority of the competitive influences that TFI claims are impacting plant lives are irrelevant.  As I have previously explained, the demand for Title 61 services is highly stable and predictable, and should not involve rapid or frequent plant replacements.  Indeed, the Company's own mortality experience does not comport to its requested plant lives.  To this point, the Company has not provided any compelling evidence that, for Title 61 services, there is any need to change from the existing authorized lives approved in 1988.

This case demands that rates be deaveraged as between Title 61 and Title 62 services.  Since the 1988 rates are based upon a combination of these two categories of service, they are, in fact, already higher than those that would be defined for Title 61 services in isolation.

Q.  Do you have any further evidence to support your view that there is no need to increase the depreciation rates applied to Title 61 plant from the levels currently authorized by the Commission?

A.  Yes.  In a study undertaken by ETI earlier this year, we determined that the majority of ILEC plant in service as of the end of 1995 had been acquired since the beginning of 1990, belying the "folklore" that ILEC plant was old, obsolete and in need of replacement (Selwyn, Lee L. and Patricia D. Kravtin, "Analysis of Incumbent LEC Embedded Investment: An Empirical Perspective on the 'Gap' between Historic Costs and Forward-looking TSLRIC", submitted on behalf of AT&T in CC Docket No. 96-98, Implementation of the Local Competition Provisions in the Telecommunications Act of 1996, May 30, 1996).  Moreover, the same ETI study determined that much of the pre-1990 plant still on the ILEC's books had actually appreciated in value, in that it consisted of copper distribution cables, poles, conduits and other support structure assets, and land and buildings that are still experiencing net growth and whose replacement cost today is far greater than its original acquisition cost (Id.).

Q.  Are you recommending any adjustments to the Test Year starting point plant balances or depreciation accruals for the plant allocated to the Title 61 category?

A.  No, I am not.  Consequently, the Test Year plant balances and accruals that Ms. Baldwin used to derive the Title 61 amounts shown in her testimony do not include any adjustments to reflect an application of the Commission prescribed 1988 depreciation rates during the term of the Revenue Sharing Plan.

Q.  Why should the Company's booked values be used for this purpose?

A.  Adjusting the accumulated depreciation balance would, in effect, allow the Company to recover depreciation it booked during the Revenue Sharing Plan.  US West was well aware at that time (see letter from Stephanie Miller, Utilities Division Director to James E. Wozniak, Director, Public Policy, US West, August 31, 1993) that its depreciation rates might not be accepted for ratemaking purposes and that it was at risk for any depreciation amounts it booked during that time.

The Commission should reject the Company's proposal to apply the Equal Life Group methodology to Title 61 services, as well as its alleged associated depreciation reserve deficiency.

Q.  Do you support the use of the Equal Life Group (ELG) methodology as proposed by Mr. Easton?

A.  No, I do not agree with Mr. Easton's recommendation to apply Equal Life Group methodology to Title 61 plant (Easton Direct, at 37-44).  While ELG does not create any overall increase in capital recovery over the life of an asset, it has the effect of accelerating capital recovery in the earlier years relative to the Vintage Group (VG) method, thus creating an additional burden on Idaho ratepayers in the context of the Company's rate increase request.  As I explained earlier in my testimony, the Company has not justified any increase in depreciation rates or expense for Title 61 plant beyond those that are currently authorized by the Commission.  Similarly, there is no compelling reason to accelerate the Company's rate of capital recovery for Title 61 plant by applying ELG.  Given that adoption of ELG in the instant case would have a direct upward impact on rates for Title 61 basic exchange services, I recommend that the Commission reject this aspect of the Company's depreciation proposal.

Q.  What is US West's proposal with respect to the amortization of its alleged depreciation reserve deficiency?

A.  US West proposes to amortize its alleged depreciation reserve deficiency over a three year period (Easton Direct, at 36).  This amortization is incorporated into its proposal for a rate increase.

Q.  Do you support such an amortization of this alleged reserve deficiency?

A.  No, I do not.  Consistent with my recommendation that the Commission reject the application of the ELG method to Title 61 plant, I recommend rejection of the alleged reserve deficiency that the Company calculated in association with ELG.

QUALITY OF SERVICE

The Commission should evaluate the actual level of service quality provided by US West for Title 61 products when it makes decisions as to the assignment and allocation of the Company's investments and costs.

Q.  Please describe the relationship between service quality and the assignment of investment and expense costs between regulated Title 61 and non-regulated Title 62 services.

A.  There are a number of interrelationships between service quality and the assignment of investment and expense costs between regulated and non-regulated services.  In order for the Company to meet its quality of service obligations for Title 61 customers, a certain level of investment of human and material resources is needed in the network.  If, in spite of the large expenses and investments which US West has undertaken in southern Idaho, it still fails to deliver a reasonable quality of service to its Title 61 customers, that is a strong indicator that the Company is concentrating its investment not on Title 61 services, but on Title 62.  If that is the case, it provides yet another level of justification for shifting expenses from the Title 61 side to Title 62.  The Commission has several options from which to choose in implementing a correction to US West's proposed cost allocations, in light of its service quality record.

One such possibility is an explicit reduction of US West's rate of return, to provide an incentive for the Company to improve service (the implication being that when the Company provides evidence that it has improved its quality, the Commission would correspondingly raise the rate of return).  Although the possibility of such a rate of return "penalty" could be considered to address service quality problems, another approach would be to determine whether and to what specific extent service quality considerations were driving investment and expense costs, as well as to use service quality information to inform the cost allocation process itself.  For example, if there is a shortage of available pairs in a particular exchange or cable route such that orders for regulated dialtone services are subject to excessive delay, the portion of spare outside plant capacity in that exchange that has been assigned to regulated services could be reduced.  More generally, the Company should be required, as part of its defense of any allocation of joint costs to regulated services, to satisfy the Commission that costs were incurred for the purpose of maintaining or improving service quality.

Q.  What are the basic issues regarding service quality that are being examined in this rate case?

A.  Both Wayne Hart and Carol Cooper testify to a number of Staff's concerns regarding service quality issues (see Staff Direct Testimony of Wayne Hart and Carol J. Cooper).  These include, but are not limited to, a significant increase in customer complaints regarding installation of services and held orders as well as repair delays.  Wayne Hart's Exhibit No. 120, Schedule 4, for example, shows a sharp rise in the number of consumer assistance investigations received by the Commission over the last two years and, similarly, Mr. Hart's Exhibit No. 120, Schedule 5, shows how US West compares with other major utilities in Idaho, including GTE, in relative growth of consumer assistance investigations filed with the Idaho PUC (expressed as the number of investigations per 1,000 lines or meters, depending upon the utility being examined).  Similarly, Mr. Hart's Schedule 2 of the same Exhibit No. 120 shows the large increase in the total number of PUC consumer contacts for US West over the same time period.

Q.  Have neighboring jurisdictions served by US West encountered service quality problems that are similar to those occurring in southern Idaho?

A.  Yes.  In Washington, the Washington Utilities and Transportation Commission (WUTC) found, in Docket No. UT-950200, that US West was pro­viding service that was substantially worse than that which the Company had provided only a few years earlier (WUTC, Docket No. UT-950200, Fifteenth Supplemental Order, April 11, 1996, at 11).  The Commission further found that there were major problems with the Company's ability to install service and provide repair service when needed, caused in part by lack of facilities and in part by restructuring and downsizing (Id.).

Q.  How did the WUTC in Washington State respond to these issues?

A.  The WUTC ordered US West to "provide customer service guarantee programs and reduced the Company's return on equity by 0.5% to the low end of the reasonable range, to reflect the level of service US West was providing and to provide an incentive for improvement" (Id.).  Improved reporting of service quality statistics was also required (Id.).  The Company was told that it could petition to lift these and other related requirements once it could demonstrate that adequate service was being provided (Id.).

US West's failure to deploy ISDN on a widespread basis — despite the relatively low incremental cost of such deployment — has prevented households and businesses from taking advantage of the public network's capabilities.

Q.  Please explain how service quality might relate to issues of cost allocation in the present case.

A.  The allocation of costs has emerged as perhaps the single most complex issue in this case, as the testimony of Staff Witness Ms. Baldwin makes clear.  Of particular difficulty is the allocation of investments in plant and equipment, for example, in advanced, digital switching equipment that is used to provide both basic Title 61 services and advanced Title 62 services.  A key justification for investing in such advanced technology, indeed, the primary justification for it from the perspective of Title 61 services, is that it enables the Company to improve the quality of the service that it provides its customers.  In other words, unless there are clear gains in service quality that result from investments in advanced technology, from the perspective of Title 61 services there has been no benefit derived from them beyond what would have been provided by investments in older technologies and less costly equipment.

Q.  You mentioned that improvements in quality of service are a key justification for the use of advanced technology to provide Title 61 services.  Do you know of any instances in which the Commission has directed the Company to make investments in technology for the purposes of improving its quality of service for Title 61 customers?

A.  Yes, I do.  One such case was in the Commission's order establishing the Tech II investment of Title 61 revenue sharing funds which I have discussed previously.  (Staff Witness Ms. Baldwin provides further elaboration concerning the Tech II plan impacts.)  In considering the anticipated benefits of the Tech II plan, the Commission cited US West's engineering witness' testimony that Tech II would reduce installation intervals, provide faster delivery of newer products and services, and provide better repair monitoring and diagnostic capability (Order No. 24506 at 20 citing Tr. at 195-196, 198).  In approving Tech II, the Commission stated, "Tech II will improve the quality and transmission speed for Title 61 customers without increasing rates" (Order No. 24506, at 28).  Clearly the Commission intended such investment to provide distinct and measurable quality improvements for Title 61 customers.  If the Company can not quantify these quality improvements, then it has improperly implemented the Commission's directives, and certainly should not be allowed to allocate the costs of other such investments to Title 61.

Q.  Can you provide any specific examples of how the Company has used quality of service in justifying its allocation of expenses and investment inappropriately to Title 61?

A.  Yes.  One example of this practice is the method whereby the Company proposes to justify allocating the costs of investments it has made on its own initiative (i.e., in addition to any expenditures made using revenue sharing funds under the Tech Plus and Tech II Plans) between Title 61 and Title 62.  US West has argued that its allocation of investment in advanced technologies to Title 61 is justified because it will enable it to provide improved (i.e., better, faster, or more reliable) service to Title 61 customers.  (Easton Direct, at 31.)

Q.  Has US West produced any evidence to support this claim?

A.  No, it has not.  When questioned about these claims, the Company admitted that "US West does not have any reporting mechanism that can attribute specific quality results to new technology" (Response to Staff Data Request 02-135), although it does assert that "the Company's network would be much less efficient and reliable today if continual upgrading to new technologies had not taken place." (Id.)  With no hard evidence to support its claim (indeed, based upon the testimony of Staff Witnesses Mr. Hart and Ms. Cooper, US West's service quality has remained the same or worsened over the past several years), there is little justification for the assertion that Title 61 customers derive significant benefits from the Company's investments in new technologies.

Q.  Please give an example of an offering that could be provided by US West in southern Idaho that would improve service quality at a low incremental cost.

A.  US West has only a few central offices currently capable of providing ISDN services (US West response to Staff Data Request No. STF-03-172).  The amount of investment required to introduce ISDN in the remaining central offices in Idaho is actually quite small.  The cost of a digital switch represents the vast majority of the total investment required to provide ISDN services.  By simply adding relatively inexpensive line cards and some associated software, these remaining switches could be converted to serve ISDN at a very low incremental cost.

Q.  Please explain how the Company's deployment of ISDN would represent an improvement in service quality.

A.  ISDN is a technology which has existed for many years, yet at nearly every turn the local exchange carriers have delayed in implementing it on a wide scale, or else did so but at excessively high rates.  As a digital technology, ISDN greatly expands the versatility and utility of local telephone service, providing, for example, high speed data connections and advanced voice services.  US West's massive investment in digital switches in southern Idaho had to be done to provide some service.  Making ISDN widely available at affordable prices would have represented a use of those digital switches that would have directly benefited ratepayers (even granting that it would have resulted in a shift of Title 61 customers to Title 62).  That ISDN was not widely implemented, however, suggests that those digital switches were installed merely to provide extremely expensive, advanced services to those willing to pay for them, while ordinary customers had no choice but basic analog voice services (which could have been provided equally well by analog switches).

Q.  How should the Commission take into account the fact that investments in advanced technology have not brought with them the hoped-for improvements in service quality in southern Idaho?

A.  Service quality in itself is not a complete and accurate indicator of the benefits Title 61 customers derive from investments in advanced technology.  I am not recommending that it be used explicitly to justify the allocation of plant and equipment to Title 62 in this case.  However, it does serve as a useful indicator that Title 61 ratepayers may not be deriving all the benefits they should from, for example, the digital switches and fiber that the Company is installing in southern Idaho.  In cases where there is no clear demarcation between Title 61 plant and equipment and Title 62 plant and equipment, the service quality factor can and should inform the Commission's final allocation between the two.

YELLOW PAGES

Directory Revenues have historically played a significant role the preservation of affordable rates for basic local exchange services, both in Idaho and in other jurisdictions.

Q.  Dr. Selwyn, please summarize your understanding of the issue of directory revenue allocation, as it figures into the present case.

A.  US West has proposed that it be allowed to end the long-standing practice of imputing Yellow Pages revenues in calculating its revenue requirement in southern Idaho.  The Company has excluded all of its Directory revenues from the test year.

At the time of the break-up of the former Bell System in 1984, US West and its sister Bell Operating Companies (BOCs) were permitted to retain the Yellow Pages directory business specifically because Yellow Pages revenues had been and would continue to be used to provide financial support for basic local telephone service.  If US West is allowed to stop imputing its Yellow Pages revenues, an historic and important source of financial support for universal service will end.

US West and the other RBHCs were awarded the Yellow Pages Directory business at the time of divestiture explicitly to provide a source of contribution to basic service, and the imputation of Yellow Pages profits must be considered in this context.

Q.  What is your understanding of the regulatory structure which governs US West's directory publishing operation in southern Idaho?

A.  While basic White Pages directory listings are a Title 61 service, the Company was allowed under the Idaho Telecommunications Act of 1988, and has elected, to place the balance of its directory publishing activities, including customized White Pages listings and Yellow Pages advertising, into Title 62.

Q.  If that is the case, why is it appropriate for the Commission to consider including profits from a Title 62 service in calculating the revenue requirement for Title 61?

A.  It is appropriate to do so given the important role that the Yellow Pages directory business played in the overall revenue structure of local telephone companies like US West, and the established precedent to do so in southern Idaho.

In most states, and Idaho is not an exception, Yellow Pages directory revenues have long been used as a source of financial support for the pricing of basic local exchange telephone service, principally (but not exclusively) the residential "dial tone" exchange access line.  In Idaho, like most other jurisdictions, the specific pricing of Yellow Pages listings and display advertisements is not subject to review or regulation by the Commission; US West is free to set these rates at whatever level the market will bear. However, with respect to Yellow Pages revenues and costs in the aggregate, these are included within the LEC's intrastate revenue requirement.

Q.  How long has this treatment of the Yellow Pages business been in effect?

A.  The basic structure that I have described has been in effect throughout the nation for decades, long before the break-up of the former Bell System, long before the entry of competition in the long distance and customer premises equipment markets.  US West and its predecessor, Mountain States Telephone and Telegraph, have been providing Yellow Pages service, and earning a substantial profit on it, for decades.

Q.  You stated that there was a precedent for imputing directory (and specifically Yellow Pages) revenues in southern Idaho.  Can you cite specific decisions in which the Commission ruled on the imputation of directory revenues in the past?

A.  Yes.  Under Revenue Sharing, the Commission on several occasions determined that directory revenues, including Yellow Pages revenues, should be included in the annual accumulation of company revenues and used to support Title 61 services (see, for example, Order No. 23531, January 21, 1991, at 4).  In its Order No. 25826, the Commission stated that it adhered to its "previous finding that 'the benefit of the directory revenues themselves must continue to flow to the regulated services of the telephone operations.'" (Order No. 25826 at 12, citing Order No. 22738 at 11).

Q.  How was the specific contribution-generating role of the Yellow Pages business addressed and recognized in the MFJ consent decree that broke up the Bell System?

A.  When the terms of the MFJ were initially announced on January 8, 1982, the Yellow Pages were to be assigned not to the Bell Operating Companies (BOCs), but instead to AT&T.  In the Tunney Act proceeding that followed the initial settlement agreement by AT&T and the Department of Justice, the BOCs, many state public utilities commissions and the National Association of Regulatory Utility Commissioners argued strongly for the retention of the Yellow Pages business by the BOCs expressly because of the enormous amount of revenue that was contributed by Yellow Pages to support basic exchange access services.

In response to these arguments, Judge Greene determined that the Yellow Pages should be retained by the BOCs.  In an Order adopting the MFJ issued August 24, 1982, Judge Greene concluded that the Yellow Pages "provide a significant subsidy to local telephone rates [that] would most likely continue if the [BOCs] were permitted to continue to publish the Yellow Pages."(U.S. v. AT&T, 552 F. Supp. 131, 193-194 (D.D.C. 1982)).  He went on to state:

The loss of this large subsidy would have important consequences for the rates for local telephone service.  For example, the State of California claims that a two dollar increase in the rates for monthly telephone service would be necessary to offset the loss of revenues from directory advertising.  Other states assert that increases of a similar magnitude would be required.(Id. at 194.)

Clearly, the existing inclusion of Yellow Pages contributions in the overall US West–Southern Idaho revenue requirement was the result of an affirmative judicial finding that the profits from the publication of these directories should be used to defray a portion of the cost of providing basic local telephone service.  Nothing has changed since the adoption of the MFJ as modified by Judge Greene to warrant a change in that policy, and in the current proceeding there is no reason for the Commission to alter or diminish the continuing role of Yellow Pages revenues in supporting low-priced basic telecommunications services.

The Yellow Pages business is a de facto monopoly acquired by US West solely as a result of its local telephone service franchise, and there is every reason to expect that the directory publishing business of the Company will similarly exhibit de facto monopoly characteristics.

Q.  Does US West confront any consequential competition for its current Yellow Pages directories?

A.  No, it does not.  For all practical purposes, this is a monopoly business for which the prospect of effective competition is extremely remote.

Q.  You are not suggesting, are you, that there are any legal barriers to entry by competitors into the Yellow Pages business?

A.  No, and in fact, competitive entry is allowed as a legal matter.  However, as a practical matter, this is the type of business activity that typically has only a single provider, due to the presence of formidable, perhaps even insurmountable, economic entry barriers.

Q.  Upon what facts do you base this statement?

A.  Shortly after the divestiture, there was a flurry of competitive activity in the Yellow Pages area.  For example, Southwestern Bell's directory publishing affiliate tried to compete with New York Telephone by offering its own Manhattan Yellow Pages.  Donnelley Directory, a division of the R. H. Donnelley Company, a firm that had long been in the business of publishing and marketing Yellow Pages directories under contract with Bell and non-Bell local telephone companies, attempted to enter the Yellow Pages business in several markets.  Significantly, and notwithstanding the fact that these ventures were initiated by well-financed firms with considerable experience in and knowledge of the directory publishing business, none of them has succeeded in making any consequential inroads into this market.

Q.  Why do you think this has happened?

A.  Generally, products/services of this type have a tendency to support only a single provider.  The reason for this phenomenon can best be explained by thinking of the directory product as performing a "switching" or an "exchange" function, bringing advertisers together with users and transferring information from the former to the latter.  The demand exhibited by individual advertisers and consumers for a particular Yellow Pages directory, like that for many other products and services that perform switching or exchange functions, is heavily influenced by the actions of other advertisers and consumers with respect to the product.

In economic theory, such demand is said to be influenced by "externalities;"  that is, one's demand for access to the "information exchange" function supported by a given Yellow Pages product is heavily influenced by the aggregate number of other advertisers and users who participate in the exchange.  Advertisers are more willing to advertise in, and pay higher rates for, directories with large, perhaps ubiquitous circulation; consumers are more likely to select the directory that has the largest compilation of listings and advertisements.

Moreover, each time a business decides to include its listing in the directory, it increases the value of the directory to consumers and makes it all the less likely that consumers will elect to use a competing book.  Indeed, US West and other LECs have a strong tendency to promote precisely this characteristic of their Yellow Pages directories.

Q.  How did US West come to dominate the Yellow Pages business in Idaho?

A.  US West's dominance of the Yellow Pages business arose because the Company has long dominated the local telephone business in this state.  Long before anyone spoke of competition in this or in any other sectors of the telephone industry, US West developed its Yellow Pages business as a derivative of its government-granted franchise to provide local telephone service on an exclusive, monopolistic basis.  US West did not come to dominate the directory business by its initiative, management skill, investment, or risk-taking; it did so solely because it was the sole provider of local telephone service in its service area, and as such owned the underlying customer data bases and had established business relationships with virtually all of the potential advertisers in its Yellow Pages books.

In other markets characterized by similar externalities, at the outset at least firms compete for the dominant position, take risks, and one survivor ultimately emerges.  For example, recent Congressional hearings examined alleged monopolistic practices of Ticketmaster, which apparently dominates the market for rock concert, theater, sports, and other major event tickets, causing some consumers, producers and performing artists to assert that the company engages in unlawful monopolistic practices.(See:  "Pearl Jam Musicians Testify on Ticketmaster's Prices," The New York Times, July 1, 1994, page C6.)  The validity of these claims notwithstanding, the fact remains that companies like Ticketmaster did not receive any exclusive right or franchise from any government body to provide their service; they simply developed a business from scratch and happened to win the race for what was probably inevitable dominance by a single provider.

It is simply inappropriate and factually incorrect to view the Yellow Pages business as a competitive market, which it is not, or to attribute US West's dominance of this market to the industry and investment of its shareholders and management, which clearly had nothing to do with the present dominant position that US West enjoys.

Q.  What is the importance of US West's likely continued dominance of the Yellow Pages market to the matter at issue here, i.e., the appropriateness of continuing to impute Yellow Pages revenues?

A.  Yellow Pages revenues have long been recognized as a source of monopolistic profits, and as an important source of revenue for US West.  Neither of those facts has changed in southern Idaho since the last rate case, and therefore there is no reason at this time to end the important contribution that Yellow Pages profits have made in support of basic local exchange service.

The fact that more than ten years have elapsed since the divestiture and there is still no sign of any consequential non-BOC entry into the Yellow Pages business serves to underscore and confirm the fundamentally non-competitive character of this market.  If, in the future, conditions were to change, the Commission could then reexamine the status of US West's publishing business and consider ending imputation of Yellow Pages revenues at that time.

Q.  What are your recommendations regarding the treatment of Yellow Pages revenues?

A.  The full amount of profits from directory listings, including both White Pages listings and Yellow Pages advertising, should be imputed into the revenue requirement for Title 61, resulting in lower rates for basic local exchange service than would be possible were such revenues to be excluded.  In her testimony, Staff Witness Ms. Carlock has calculated the appropriate adjustment for directory revenues; her specific recommendations for reducing US West's revenue requirement should be adopted by the Commission.

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

A.  Yes, it does.