Q.Please state your name and business address.

A.My name is Kent Schneider.  My business address is 472 West Washington Street, Boise, Idaho.

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

A.I am employed by the Idaho Public Utilities Commission.  My title is Auditor.

Q.Please describe your educational background and professional experience.

A.I graduated with honors from the University of Missouri in May 1972, with a B.S.B.A. Degree in Accounting.  I am a Certified Public Accountant, a Certified Internal Auditor, and a Certified Bank Auditor.  I have attended the annual regulatory studies program sponsored by the National Association of Regulatory Utilities Commissioners (NARUC) at Michigan State University in August 1996.  I worked for Arthur Andersen & Co. from 1972 until 1981, performing external audits and consulting projects for a wide variety of companies and government entities while based in St. Louis, Missouri, Salt Lake City, Utah, and Boise, Idaho.  From 1981 until 1996 I was the Director of Internal Control for West One Bancorp.  In July 1996 I joined the Idaho Public Utilities Commission (IPUC).

Q.What is the purpose of your testimony in this proceeding?

A.The purpose of my testimony is to address the following issues:

1) Employee Benefits

a. Pension Accounting

b. Post-Retirement Benefits

c. Compensated Absences Accounting

2) The Restructuring Plan and its Effect on Employee Related Expenses

3) Reasonableness of Lease Expense

Adjustments proposed based on my   testimony are:

Pension Asset Reduction of

   Rate Base$27,670,000

Transition Benefit Obligation

   Expense Reduction$   396,541

Curtailment Loss Amortization

   Expense Reduction$ 1,139,399

Compensated Absences Amortization

   of Expense$   203,179

Amortization of Restructuring &

   (re-engineering) Expense

    included in test period$ 4,486,150

Employee Layoff Expense Reduction

   (less: amortization of expected

    future restructuring costs$ 5,977,500

Excessive Lease Charges to be

   Removed$  172,857

 Total Expenses$12,375,626

Q.Will you use abbreviations in your testimony?

A.Yes.  I will use the following abbreviations in my testimony:

USWC - U S WEST Communications, Inc.

SFAS - Statement of Financial Accounting     Standards

PBOP - Post-Retirement Benefits Other than     Pensions

TBO  - Transition Benefit Obligation

Also, for the purpose of this testimony, “The Restructuring Plan” used by USWC is a re-engineering effort.  Therefore, the terms restructuring and re-engineering are interchangeable.

Q.Are you sponsoring any exhibits to accompany your testimony?

A.Yes, I am sponsoring Exhibit Nos. 107-111 which display my adjustments to the rate base and revenue requirements for the test year 1995.  I would like to note that all of my adjustments reflect southern Idaho intrastate amounts before allocation to Title 61 (regulated) or Title 62 (unregulated) services.  A summary of my adjustments are reflected on Staff witness Lansing’s Exhibit No. 101, p. 12.

PENSION RATE BASE ADJUSTMENT

Q.What issue do you have concerning pension accounting?

A.In Company witness Margaret Wright’s Adjustment 21, a Pension Asset of $13,835,000 is added to the southern Idaho rate base.  In her testimony on page 31, item 3.21: Pension Asset, Ms. Wright states that    “U S WEST booked a pension expense equal to the company's cash contribution to its pension fund....  For U S WEST, contributions to the fund have exceeded pension expense accruals, therefore an asset has been created.”  Since the expenses for the contributions to the pension fund were included in rates paid by the customers, and since the fund assets have performed well, as most investments have during the last decade, the customers have been responsible for the creation of this asset.  In the last full rate case in 1984, Case No. U-1000-63, pension expense was included as an undisputed expense as part of the revenue requirement.  The Revenue Sharing Plan did not reflect any expense credits in the revenue sharing calculations for pensions.  Therefore, I propose that this asset be a reduction to the rate base on the basis that this asset is a ratepayer-contributed asset.

Q.Should this Pension Asset be attributed to customers?

A.Since customers have historically funded pension expenses through rates, and particularly since no expense relief was provided to customers under the Revenue Sharing Plan the asset should be considered as a customer-provided asset (See Exhibit No. 107).  If considered as a customer-provided asset in rate base, the rate base would be reduced by this customer contribution.

POST-RETIREMENT BENEFITS

Q.Of the issues concerning employee benefits, would you explain and summarize post-retirement benefits?

A.In years prior to the release of SFAS 106 - “Employers' Accounting for Post-Retirement Benefits Other than Pensions” by the Financial Accounting Standards Board, most companies including USWC, recognized the costs of providing post-retirement medical, life insurance and other miscellaneous benefits when they were paid.  This was known as the pay-as-you-go method.  In 1990, SFAS 106 was released, requiring these PBOPs to be recognized on the accrual basis the same way as pensions are.  It was effective on January 1, 1992.

To aid in the transition to the accrual method, SFAS 106 allowed the accumulated PBOP expense and liability that would be created at the start of the accounting change, which is called the Transition Benefit Obligation (TBO), to be amortized over a period of up to twenty years.  Starting January 1, 1992, USWC has been, for regulatory purposes, amortizing its TBO over 17.3 years, due to actuarial studies done at that time.  USWC's 1995 results of operations include both current PBOP expenses and the TBO amortization.

Q.Are there other SFAS 106 adjustments?

A.Yes.  SFAS 106 also provides for accounting for curtailments.  Curtailments involve events that either (1) significantly reduce the expected years of future service of active plan participants or (2) eliminate the accrual of defined benefits for some or all of the future services of a significant number of active plan participants.  In 1995, USWC recorded a curtailment loss of $1,210,611 due to the number of employees who had been terminated.

a.  TBO Amortization

Q.Please explain your adjustments proposed for post-retirement benefits other than pensions.

A.For calculation of the PBOP-TBO amortization, the Company used 17.3 years as the estimated average service lives remaining of its active employees in 1992 when the amortization of the TBO was started.  In 1993 a special “re-engineering” charge of $880 million was taken by USWC to reflect its plan to eliminate 10,000 employees by December 31, 1997.  The elimination of this many employees would create doubt about the continued accuracy of the actuarial assumptions.  Therefore, I propose that 20 years rather than 17.3 years be used for the amortization of the TBO for ratemaking purposes.  This is allowed by SFAS 106 and is recommended when a more accurate amortization period cannot be determined.  The effect of the elimination of 10,000 employees on the amortization period cannot be determined.  Therefore a more conservative 20-year amortization period would be best, in my opinion.  The effect of this change of amortization periods in the 1995 test year would be a $396,541 reduction in TBO amortization expense.

b.  Curtailment Loss Amortization

Q.Do you agree with USWC's SFAS 106 curtailment loss adjustment?

A.No.  Rather than record a rare if not unique event in the test year, I propose two possible alternative treatments.  First, because this could be considered as a one-time non-recurring expense, the entire amount could be removed from the test year.  Alternatively, because USWC is not quite half finished with its re-engineering efforts another adjustment may be required in 1997 or 1998, when the Restructuring Plan is complete and its effects are known and measurable.

Therefore I propose that the amount incurred in 1995 be amortized over the remaining 17 years the TBO is to be amortized.  The first option would eliminate $1,210,611 from 1995 expenses for ratemaking purposes.  The second option would allow one-seventeenth of the curtailment loss to be recorded in 1995, or $71,212, reducing expenses by $1,139,399.  Staff suggests that the second option be accepted since it would also provide the amortization mechanism if future curtailment losses are incurred and would have little impact on the test year.

COMPENSATED ABSENCES

    Q.Please explain Compensated Absences Accounting and what your concern is with U S WEST's method of accounting.

A.Compensated absences represent any “time” the employee has earned that the employee will be away from work and still be paid as if the employee was at work.  Examples of compensated absences include vacation, sick leave and personal leave.  To qualify for accrual accounting, the compensated absence earned would have to be owed to the employee even if the employee terminated employment.  According to SFAS 43 - Accounting for Compensated Absences, compensated absences are to be expensed as earned rather than when paid.  There was a catch-up entry required at the time of the accounting change for all past earned compensated absences that had not been paid and had not been recorded as a liability.

The FCC adopted a ten-year phase-in period for the catch-up entry where USWC can phase in the expense impact over ten years.

Effective January 1, 1988, a deferred charge was established by USWC for the compensated absence catch-up expense, along with a deferred credit related to the liability.  These amounts are being amortized to expense on a straight-line basis over the ten-year period from January 1, 1988 to December 31, 1997.

I agree completely with this accounting treatment and the ten-year amortization period is fair and reasonable.  However, this amortization of the catch-up entry is a one-time event, the effect of this amortization is known and measurable, and the amortization of the catch-up amount will be nearly complete when this rate case will become final.  Therefore, to properly reflect the 1995 test year for setting rates on a proforma basis the catch-up amortization expense of $203,179 should not be included in 1995 expenses for ratemaking purposes.

THE RESTRUCTURING PLAN

Q.Please explain the USWC Restructuring Plan.

A.There have actually been two re-engineering plans in the last five years, one started in 1991 and another, called the “Restructuring Plan,” started in 1993.  These two plans overlap.  In the 1993 USWC Financial Statements, Footnote 4: Restructuring Charges, the following comment was made:

The Company's 1991 restructuring

plan was established to partially

offset the effects of future wage,

salary and benefit increases.  The

plan will result in a work-force

reduction of approximately 6,000

employees, of which approximately

5,000 employees have left the

Company as of December 31, 1993.

The 1991 restructuring charge was

$240 [million], of which

$56 [million] is unused at

December 31, 1993.

In the 1995 USWC Financial Statements, in Footnote 4:  Restructuring Charge, the following comments were made:

The Communications Group's 1993

results reflected an $880 [million] restructuring charge (pretax).

The related restructuring plan (the

“Restructuring Plan”) is designed to provide faster, more responsive

customer services while reducing the

costs of providing these services.

As part of the Restructuring Plan,

the Communications Group is

developing new systems and enhanced

system functionality that will enable

it to monitor networks to reduce the

risk of service interruptions, activate

telephone service on demand, rapidly

design and engineer new products and

services for customers, and centralize

its service centers.  The Communications

Group has consolidated its 560 customer

service centers into 26 centers in 10

cities and plans on reducing its work

force by approximately 10,000 employees.

In the 1995 USWC Management's Discussion and Analysis of Financial Condition and Results of Operations on page C-6, the following comments were made:

The Restructuring Plan is expected to be

substantially completed by the end of

1997.  Implementation of the Restructuring

Plan has been impacted by growth in the

business and related service issues,

new business opportunities, revisions

to system delivery schedules and

productivity issues caused by the

major rearrangement of resources

due to restructuring.  These

issues will continue to affect the

timing of employee separations.

Therefore, with 52,864\* employees as of December 31, 1990, the Company developed two consecutive restructuring plans to reduce the workforce by 15,000 or 28.4% by enhancing systems and consolidating operations.  (\*Source:  1990 U S WEST Fact Book and Statistical Summary, page 7.)

As of December 31, 1995, $349 million remains in the restructuring reserve of the original $1,120 million allocated (31.2%), and of the original 15,000 employees planned to be laid off, 5,495 (36.6%)  are planned to be laid off in 1996 and 1997.

Q.Please explain your concerns and your proposed adjustment to expenses incurred in 1995 to implement the restructuring plans.

A.In the July 29, 1996 Telephony article

titled “MCI complaint blasts U S WEST credibility”    Lynn Hilderbrand, Vice President of service delivery

at U S WEST said,

U S WEST admits that a problem

exists, which it blames on

enormous growth in its service

area coupled with its failed re-engineering efforts during the

last two years.  The telco threw

itself into a comprehensive system

overhaul in 1994 and 1995 but put

its plans on hold indefinitely when

it began running into serious ser-

vice glitches.  Things we thought

we could automate and streamline

turned out to be much more compli-

cated and expensive than we thought.

Service quality issues have been raised in recent rate cases in Arizona, Utah, Washington and Oregon as well as in this rate case.  Service quality in this rate case is addressed by Staff witnesses Hart and Cooper.  Idaho already addressed one aspect of service quality in Case No. USW-S-95-8.

Employee related costs from C-17 of         U S WEST Communications Group Combined Statement of Operations for 1995 and C-16 for 1993 are as follows:

Table I

%Increase

  from

1991 $2,729previous yr.

1992 $2,862    4.9%

1993 $3,068    7.2%

1994 $3,215    4.8%

1995 $3,314    3.9%

Therefore, with the continuing system complications and inadequacies, and the continuing

employee-related cost increases, the planned benefits of the Restructuring Plan of reduced costs and improved customer service have not been realized as of     December 31, 1995.  Because the Restructuring Plan expenses of $4,866,356 allocated to Idaho have not resulted in benefits in the test year but will be realized over a number of years once the Restructuring Plan is complete, these expenses should be amortized over a period of at least fifteen years to more closely relate the expenses to the benefits to be received (See Exhibit No. 108).  Since this rate case will be settled in 1997 and the Restructuring Plan is to be completed in 1997, an amortization starting in the test year would seem reasonable.  Therefore, using a fifteen-year amortization of $380,205 (See Exhibit No. 108) would result in an adjustment in the test year of $4,486,150 ($4,866,356 - $380,205).

An alternative would be to simply disallow the entire $4,866,356 Restructuring Plan expenses in the test year since they are not beneficial to the southern Idaho intrastate customers.  The amount I propose does not reflect any re-engineering expenses provided by the other affiliates:  BRI, Bellcore, or Advanced Technologies since these expenses will be addressed in Staff witness Faunce's testimony.

Q.What is the issue regarding the re-engineering effect on Employee Related Expenses?

A.As noted above, in 1993 USWC recorded an $880 million restructuring charge to reflect a restructuring plan that was intended to enable the Company to operate more effectively and efficiently.   The Restructuring Plan is expected to be complete by the end of 1997.

As of December 31, 1995, 5,495 employees were yet to be laid off.  In its estimate of future savings in 1993, USWC estimated employee related expenses of $50,000 for each employee would be saved.  By using USWC published financial information from its 1993 and 1995 financial reports to shareholders, I determined that savings for the average employee had increased to slightly more than $65,000 by December 31, 1995 (See Exhibit No. 109).

Since the remaining employees to be laid off will be gone by year-end 1997, the year in which the rate case will be finally resolved, I believe that this significant subsequent event should be included in the test year to best reflect the rates on a proforma basis.  This is a known and measurable effect that is conservative since it doesn’t include other aspects such as lease expense reductions and other less measurable

intangibles related to employee reductions.

Using my recommended estimate of savings for each employee laid off, the total southern Idaho intrastate employee-related expense reduction for the test year would be $6,390,944.  Using USWC's more conservative estimate of savings for each employee, the total expense reduction in the test year would be $4,888,734.

Q.Wouldn't there be additional expenses to be incurred to enable these savings to be realized?

A.Yes.  As of December 31, 1995, the balance in the restructure reserve account was $348,537,927.  The southern Idaho intrastate amount of expense yet to be incurred could be calculated as follows:

$348,537,927 x 2.51% x 70.89% = $6,201,671

This would be a one-time expense (in 1996 and 1997) that should result in the permanent projected annual savings of $6,390,944 once the Restructuring Plan is complete.

Q.As we have seen in Table I on page 11 of your testimony, employee-related expenses have continued to increase from 1993 through 1995 even though restructuring expenses have been incurred and nearly two-thirds of the employees planned to be laid off have been laid off.  Why should we anticipate an annual expense savings once the Restructuring Plan is complete?  Also,

why should the expenses yet to be incurred be given any consideration?

A.Once the Restructuring Plan is complete the enhanced systems and the consolidation of operations called for in the plan will be operating effectively and the Restructuring Plan goal of improved service should be achieved.  This would enable the savings planned from the layoffs in 1996 and 1997 to be achieved.  As noted in Exhibit No. 109, the savings from the 1996 and 1997 layoffs are known and measurable.  Since USWC will reap these benefits so soon after the conclusion of the rate case, I believe they should be included.  However, I realize that further expenditures must be incurred to receive the benefits expected.  Therefore, I propose that the expenses be amortized over a period of at least fifteen years.  The resultant benefit in the test year would be:  $6,390,944 - ($6,201,671 ÷ 15) = $5,977,500

LEASE EXPENSE

Q.What is your issue concerning reasonableness of lease rates?

A.In 1984, U S WEST Communications, Inc. (USWC) leased approximately 600,000 square feet of the building located at 1801 California in Denver, Colorado.  The net lease for this space was $12.50/sq ft per year on average for ten years.

In 1986, U S WEST, Inc. decided to enter the real estate market.  Through a separate subsidiary, Beta West, many properties were purchased and then leased, including the building at 1801 California.  At this time USWC's lease did not change.  In 1991, U S WEST, Inc. decided to get out of the real estate market and sold, through sale and lease-back arrangements, several properties, including the building at 1801 California.  By this time USWC was leasing 905,475 square feet of the building or approximately three-fourths of the available rentable space.

Upon the sale to an out-of-state corporation, not affiliated with any U S WEST company, the original lease for the building at 1801 California was voided and a new lease was established requiring an average net lease cost of $18.24/sq ft per year on average for 20.5 years.  Therefore, the financial venture of U S WEST, Inc. into and then out of the real estate business had a significantly negative impact on USWC and ultimately its customers.

In September 1996, I verified that leasable space in the building at 1801 California and at a comparable prime “A” class building across the street from 1801 California, First Interstate Tower North, were available for $18.00/sq ft gross, including $6.40 of

operating costs per square foot.  Therefore the net lease rate for these properties would be $11.60/sq ft.  The net lease rate of $11.60/sq ft is less than the comparable net lease rate of $12.50/sq ft in 1984.  This comparison was made to verify that the information shown on   Exhibit No. 110 accurately shows that lease rates required in 1994 and 1995, when the original lease   would have had to be renewed, would still be about the same as the original net lease rate of $12.50/sq ft.  Exhibit No. 110 reflects the “gross” lease rates for class “A” property in the Central Business Core.  The difference between a gross rate and a net rate on a lease is that their gross rate includes:  property taxes; utilities; and maintenance, management and operating expenses.  The net lease rate excludes these costs.  The gross lease rates shown on Proprietary Exhibit No. 111 for class “A” property would have to be reduced by the costs noted above, which as of January 1, 1992 were $6.27/sq ft for 1801 California, but could range from $4.00 to $7.00/sq ft depending on the property.  Proprietary Exhibit No. 111 provides an extract of a lease for a floor at 1801 California starting in January 1992 and lasting until January 2002.  The average net lease rate for this floor is $12.40/sq ft.

Therefore, due to actions of other U S WEST affiliates in unregulated activities, Idaho customers were harmed since USWC was charged additional expenses of $5,197,427 [($18.24 - $12.50) x 905,475 sq. ft.] for each year since 1991 when the new lease was signed including 1995 through 2011.

Idaho's Intrastate portion would be $172,857, (5,197,427 x .0251 x .7547).

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

A.Yes, it does.