INTRODUCTION

Qualifications

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

A.  My name is Susan M. Baldwin; I am a vice president of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108.  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 the application of US West ("US West" or "Company") for a rate increase.  Specifically, ETI has been asked to address the following aspects of US West's rate case proposal:

1.Cost allocation.

2.Rate base.

3.Depreciation.

4.Quality of service.

5.Yellow Pages.

6.The relationship of this proceeding to the development of competition in the local market in Idaho.

My testimony discusses the regulatory framework for US West's operations in southern Idaho and the relationship of that framework to the issues listed above, and also addresses cost allocation and rate base.  Dr. Selwyn's testimony addresses depreciation, quality of service, yellow pages, and the impact of this proceeding upon the development of competition in the local market in southern Idaho.

Summary of testimony

Q.  Please summarize your testimony.

A.  In this proceeding, for the first time since US West elected the Title 61/Title 62 regulatory framework, the Commission must determine a proper and fair way — other than the "revenue sharing plan" — to allocate between regulated (Title 61) and partially regulated (Title 62) products the extensive amount of common plant and resources that support the Company's southern Idaho operations.

US West's proposed allocation methodology, which relies upon a complex accounting system, should be rejected because it would enable the Company to improperly cross-subsidize its Title 62 operations with revenues from its regulated Title 61 operations.  This cross-subsidy would, in turn, have two adverse impacts:  First, it would cause customers of regulated services to pay excessive rates, and second, it would chill the development of competition in southern Idaho.

The Commission should adopt a methodology for allocating common plant costs that best reflects the underlying motivation for the Company's capital investments.  Local exchange plant that supports existing demand should be assigned based upon the relative numbers of lines in service.  Plant that has been deployed to support future (and often highly variable) demand should be assigned based upon the relative growth rates in Title 61 and Title 62 access lines.  Furthermore, the Commission should allocate 5% of local loop costs to custom calling and CLASS services to reflect the fact that the Company derives a substantial revenue stream from these Title 62 services.  In sharp contrast, under the Company's proposal ,these optional services would not bear any of the cost of the Company's substantial local loop investment.

In its determination of the proper allocation of the substantial amount of plant in the central office equipment account (which includes, in addition to investment in analog and digital switches, significant investment in transmission facilities such as digital subscriber loop carrier (DLC) equipment), the Commission should con­sider carefully the service delivery objectives underlying the plant acquisition decision.  Digital switches and digital subscriber loop carrier equipment are generally essential for many reasons that have nothing whatsoever to do with the provision of Title 61 services.  For example, such facilities are needed in order to offer advanced services such as CLASS, to attract and retain digital Centrex customers (who might otherwise migrate to PBXs), and to support any future broadband initiatives the Company may choose to pursue.  Although certain deployment decisions may be economically efficient when the Company considers its combined business operations, it does not necessarily follow that such investments are economically efficient for Title 61 services on a stand-alone basis — even where the Title 61 service is required to carry only a portion of the total cost of the resource.

The Commission should directly assign to Title 61 the investment in digital switches associated with the Tech Plus directives.  Furthermore, in its evaluation of the proper allocation of central office equipment (COE), the Commission should also recognize that Title 62 services have benefitted (and will continue to benefit) from the plant that was upgraded in the rural areas and that was acquired using Title 61 revenue sharing funds, such that it is reasonable that the investment associated with the digital switches that the Company has deployed on its own initiative during the revenue sharing years (i.e., in urban areas) should be assigned directly to Title 62.  Similarly, other additions to digital COE since 1989 (other than the DLC equipment deployed directly pursuant to the Commission's Tech II directives) should be assigned directly to Title 62.

Expenses should be assigned, to the greatest extent possible, on a direct basis, which will likely require the Company to implement more detailed systems for capturing these costs as they are incurred.  Consistent with the Commission's directives regarding the expensing of the Tech Plus and the Tech II investments, the entire accumulated depreciation associated with these directives should be assigned directly to Title 61.  Those portions of the accumulated depreciation and depreciation expense that remain after the direct assignments (i.e., the "common pool") should be allocated in direct proportion to the corrected plant in service.

REGULATORY FRAMEWORK

US West's operations in southern Idaho are subject to a unique regulatory framework, whereby a substantial portion of its operations are no longer directly regulated by the Commission.

Q.  Please describe your understanding of the current system under which tele­com­mu­ni­ca­tions services are regulated in southern Idaho.

A.  Under the Idaho Tele­com­muni­ca­tions Act of 1988, tele­com­muni­ca­tions providers in Idaho are allowed to exclude all services, except for certain basic local exchange services, from the provisions of Title 61 of the Idaho Code, which provides for economic regulation of public utility services (Idaho Code, §§ 62-601 through 62-622, as added by 1988, ch. 195, § 1, p. 358).  As stated in Section 62-602, the Tele­com­muni­ca­tions Act of 1988 was intended to foster the development of a competitive market for tele­com­muni­ca­tions services in Idaho, while ensuring the continued provision of "high-quality universal tele­com­muni­ca­tions at just and reasonable rates for all classes of customers" in the state (Idaho Code, § 62-602, as added by 1988, ch. 195, § 1, at p. 358).

Q.  Is US West subject to this system of regulation?

A.  Yes.  In March 1989, US West elected to remove its non-basic local tele­com­muni­ca­tions services in southern Idaho from the Commission's rate setting authority (Case No. MTB-T-88-13, Order No. 22738).  Idaho Code § 61-622A requires the Commission to establish procedures for allocating costs between regulated (Title 61) and partially regulated (Title 62) services.  Basic local exchange service is defined in the Idaho Code as the provision of access lines to residential and small business customers with five or fewer lines for the transmission of two-way interactive switched voice communication within a local exchange area.  Idaho Code §§ 62-603(1), (5), and (8).  The first revenue sharing plan was adopted by the Commission in 1989 as an alternative to traditional cost allocation procedures.  In its decision approving the Company's application for adoption of US West's revenue-sharing plan, the Commission stated that, in implementing the directives of the Idaho Code, it "may adopt procedures based on gross allocation factors derived from relative changes in total intrastate tele­com­muni­ca­tions service revenues or expenses or other measures of relative change" (Order No. 22738, September 20, 1989, at 8-9).

Q.  You referred to US West's southern Idaho operations.  Please explain.

A.  US West has two service territories in Idaho.  Southern Idaho serves Boise, Nampa, Caldwell, the Magic Valley, and eastern Idaho including Pocatello and Idaho Falls.  The other service area was historically served by Pacific Northwest Bell (a predecessor to US West) and consists of only eight exchanges between Grangeville and Lewiston.  This second area continues to be subject to traditional rate of return regulation (i.e., US West has not elected Title 61/62 regulation of its northern Idaho operations).

Q.  In southern Idaho, which US West services are currently regulated under Title 61, and which services are "nonregulated" (that is, are regulated under Title 62)?

A.  US West provides basic residential local exchange service, business local exchange service for businesses with five lines or fewer, PBX services for businesses with five lines or fewer, public telephones, certain operator services — basic intercept message (i.e., number-no-longer-in-service) and new number message, and white pages directory primary listings under Title 61.  All other services provided to southern Idaho customers are classified as Title 62.

Q.  What are the ramifications of this split between Title 61 and Title 62?

A.  Idaho has created a unique regulatory environment for local exchange carriers.  In essence, the state has given providers free rein to offer any service they want, at any price the market will bear, and to handle accounting, cost allocation, and other matters as the provider sees fit except in the case of the few services which remain under Title 61.  Title 61 services are fully subject to Commission regulations, and legally and economically they must be jurisdictionally separated from any services the company might be offering simultaneously under Title 62.  In practice, of course, Title 61 and Title 62 services are furnished out of a common network infrastructure, a common set of corporate and operational resources, and a common corporate financial structure.  As a consequence, both groups of services make extensive use of shared resources and involve extensive amounts of shared and joint costs.

One of the key aspects of the implementation of the jurisdictional split between Title 61 and Title 62 involves the allocation of costs between the two categories.

Q.  Are any principles established by Idaho State Law regarding the allocation of costs between Title 61 and Title 62 services?

A.  Yes.  Chapter 600 of Title 62 of the Idaho Code, which covers tele­com­muni­ca­tions services not subject to economic regulation by the Commission, holds that "[a] telephone corporation may not subsidize telecommunication services which are subject to this chapter by those telecommunication services which are subject to regulation pursuant to Title 61, Idaho Code.  Provided, payments to the universal service fund ... shall not be considered to be a violation of this section" (Idaho Code, § 62-613, as added by 1988, ch. 195, § 1, p. 358).  A telephone company may not, therefore, allocate costs incurred in the provision of Title 62 services to Title 61.

Q.  How has this jurisdictional divide been applied in practice to US West's operations in southern Idaho, until now?

A.  Until the present rate case, the division between Title 61 and Title 62 services has not required the Commission to review the actual underlying costs that the Company assigns and allocates to each category of service it offers.  When the Tele­com­muni­ca­tions Act of 1988 was first implemented, the Commission adopted a "revenue sharing" plan, which served as an alternative to the explicit allocation of costs between US West's Title 61 and Title 62 services.

Q.Please describe your understanding of Idaho's revenue sharing plans.

A.In September 1989, the Commission approved the implementation of a three-year revenue sharing plan, in Order No. 22738, as an alternative to traditional cost allocation procedures.  Under this plan, "[t]he portion of growth or deficit revenues assigned to Title 61 or Title 62 is determined by the ratio of the actual revenues generated by the regulated and deregulated services for the year being calculated" (Order No. 23441 at 3).

The revenue sharing plan for 1989 resulted in a one-time, per-line credit of $5.49 for Title 61 customers (Order No. 23441, November 30, 1990, at 19), and for 1990, it resulted in one-time, per-line credit of $7.98 (Order No. 24506, November 2, 1992, at 5).  In Order No. 23531, dated January 19, 1991, the Commission extended the Sharing Plan, although it declined to do so for a specified time period.

Traditional rate of return regulation is now replacing seven years of revenue sharing as the regulatory regime for Title 61 services.  The revenue sharing arrangement was officially ended by the Commission in its Order in Case No. USW-S-96-4, establishing extended area service (EAS) territories (Case No. USW-S-96-4, Order No. 26672).  Staff advises me that the termination of revenue sharing produces approximately $11-million in Title 61 funds available for the Company's disposition in this case.  Staff witness Eastlake discusses this disposition.

Q.  In what way does this proceeding depart from the status quo of the revenue sharing plans adopted for southern Idaho?

A.  In this proceeding, the Commission is required for the first time to determine the appropriate allocation of costs between Title 61 and Title 62 services.  The vast majority of the costs are associated with US West's investment in and maintenance of its plant in service.  According to the Company, before its proposed adjustments, approximately $548-million of plant in service is booked for intrastate southern Idaho, and approximately $234-million is booked for accumulated depreciation.  Thus, according to US West, after considering other accounts, the rate base — prior to the Title 61/62 split — is approximately $267-million (see Exhibit 101 of Lansing testimony).  The challenge facing the Commission is how to allocate the significant amount of common plant that supports both Title 61 and Title 62 services.

Q.  Has the Commission provided any cost allocation guidelines in the past?

A.  Yes.  In a 1994 decision, the Commission set forth criteria to be followed in an allocation method:

1.Title 62 services must not be subsidized by Title 61 services.

2."Title 62 services must be assigned a reasonable portion of the common and joint network costs as well as general overhead costs.  In particular, all services using the local loop should be included in the allocation of the loop costs."

3."Direct cost assignment must be used when facilities or other operating expenses are clearly necessary for only Title 61 or Title 62 services, when the level of costs is escalated beyond what is necessary for Title 61 services alone, the additional cost should be directly allocated to Title 62" (Order No. 25826, at 11, Case No. USW-S-94-3).

The Commission also addressed one of the many challenges of cost allocation, namely the disaggregation of common plant to reflect the purpose for which the plant was originally deployed:

Conversely, telephone providers have the technological ability to deliver video and data services.  Thus, regulation has the addi­tional challenge to assign cost recovery of facilities installed for the purpose of providing non-telephone services or unregulated services to those services or to the companies' stockholders (Order No. 25826, at 7).

In the same decision, the Commission stated that it would not at that time specify the cost allocation method to use in assigning a fair share of the costs of operating US West's network to Title 61 services (Order No. 25826, at 10).

Certain improvements in rural areas were undertaken pursuant to Commission directive and were entirely funded with Title 61 monies.

Q.  What is your general understanding of the Commission's directives with respect to network modernization during the last decade?

A.  The Commission approved US West's use of Title 61 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 regulated Title 61 funds to upgrade local plant in 29 rural wire centers over a three-year period beginning in 1992.

Q.  Please summarize your understanding of the modernization of central office switches in southern Idaho.

A. In its Order No. 20981 dated January 9, 1987, the Commission authorized a network modernization plan referred to as "Tech Plus" under which many rural electro­mechanical central offices in southern Idaho were to be replaced with digital switches.  The Commission found that the upgrade project would "provide these customers with a greater array of services and allow these 52 rural communities' telephone service to compete on an equal footing with the larger communities of Idaho" (Order No. 20981 at 11).

The Commission directed Mountain Bell (the predecessor of US West Communi­cations) to expense rather than to capitalize the intrastate expenditures for the five-year project, and by the end of 1988 to expense on an intrastate basis a minimum of $19.429-million (Order No. 20891 at 13).  Also, the Commission directed Mountain Bell to depreciate the existing central office equipment ($14.8-million) that was being replaced over the same five years.  It indicated that the intrastate amount to be amortized should be $3.805-million in 1987 and $2.894-million in 1988 (Order No. 20981 at 14).

Tech Plus expenditures for 1989 were $9.810-million (Order No. 23441).  The Tech Plus expenses for 1990 and 1991 were capped at the levels suggested by Commission Staff, i.e., $6.89-million for 1990 and $3.184-million for 1991 (Order No. 23531 at 5-6).  Tech Plus was initiated when US West was entirely subject to the Commission's Title 61 authority.

Q.  Please summarize your understanding of the directives regarding local plant in southern Idaho (i.e., Tech II).

A.  In its Order No. 24506, dated November 2, 1992, the Commission approved a three-year construction schedule, beginning in 1992, by which the Company would use Title 61 revenue sharing funds in the amount of approximately $13.5-million to upgrade local plant in 29 wire centers.  US West was to use its own funds in the amount of approximately $24.7-million to upgrade local plant in 16 urban wire centers (Order No. 24506, Appendix A).  Furthermore, the Company indicated that it would provide all of the $12.776-million investment necessary to construct an alternate fiber optic toll route (Order No. 24506 at 9).  The Commission specifically stated:  "However, Title 61 revenue sharing funds will not be used to construct the alternate toll fiber route.  US West will fund the entire investment necessary to  construct this alternate route from unregulated revenue sources" and also stated that "[b]ecause US West is supplying all of the funding for the alternate toll route, the disposition of Title 61 funds does not hinder competition in the toll market" (Order No. 24506, at 32).

In that proceeding, the Commission's Staff observed that the Company has 58 digital switches and 20 electronic analog switches, serving 33% and 67%, respectively, of all access lines.  The Staff observed that, in general "US West customers are currently provided with adequate tele­com­muni­ca­tions services" (Order No. 24506, at 10).  In planning the Tech upgrades, Staff opposed the use of Title 61 revenue sharing funds to upgrade interoffice facilities, which are used to provide Title 62 toll services, and also "noted that the 20 older electronic analog switches ... provide most if not all features otherwise provided by US West's newer digital switches" (Order No. 24506).  Staff also estimated that it would cost more than $110-million to replace these older switches (Order No. 24506, at 11).  However, because it would directly benefit Title 61 customers, Staff supported the modernization of the local loop and the reduction of rural zone charges to approximately 65,000 customers (Order No. 26434, at 1).

The Commission stated that:

Our task in this case is to determine the appropriate disposition of Title 61 sharing funds.  Consequently, review of the Tech II proposal is limited to that portion of the project funded by Title 61 sharing funds; we make no judgment on the alternate toll route funded by US West (Order No. 24506, at 19).

The Commission stated that "[t]he goal of Tech II is to make the 9600 bps transmission speed available to a minimum of 60% of customers residing in the targeted wire centers" (Order No. 24506, at 20).  With respect to quality of service, 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).

When the Commission approved Tech II, it concluded that "Tech II will improve the quality and transmission speed for Title 61 customers without increasing rates" (Order No. 24506, at 28).

The Commission also distinguished between rural and urban communities:

Rural communities do not possess the critical mass or population density to demand enhanced services through normal market forces that generally deploy enhanced technology to the more densely populated areas.  Tech II ensures that Idaho's smallest and most rural communities have the same attributes and capabilities as customers in our major metropolitan areas(Order No. 24506, at 29).

Q.  Are you aware of any other Commission guidance with respect to network modernization in southern Idaho?

A.  Yes.  In a 1994 decision, the Commission determined that "[t]he existing tele­com­muni­ca­tions network in southern Idaho is capable of providing excellent service to Title 61 customers.  Therefore, further upgrades or replacement of basic service facilities must be carefully reviewed to ensure they are necessary and beneficial for Title 61 services" (Order No. 25826, December 19, 1994, at 6).

COST ALLOCATION/RATE BASE

The Company's proposed cost allocation methodology would subsidize future Title 62 services with revenues from Title 61 services.

Q.  Have you examined the Company's proposed allocation of costs between Title 61 and Title 62?

A.  Yes, I have.  Schedule 1 in Exhibit 113 to my testimony summarizes the Company's aggregate intrastate costs and the Company's proposed allocation of costs between Title 61 and Title 62 for 40 different line items (including revenues and expenses).  (I have not examined the Company's allocation of costs between the interstate jurisdiction and the Idaho PUC's jurisdiction, but it is my understanding that Staff has reviewed this jurisdictional split.)  The results of our analysis of the Company's proposed depreciation is discussed in detail in Dr. Selwyn's testimony.

Q.  Other than the data shown in Schedule 1 in Exhibit 113, have you identified any other tables prepared by the Company that provide more disaggregated information about the Company's proposed allocation of line 34, i.e., plant in service?

A.  Yes.  Schedule 1 in Exhibit 114 to my testimony provides a partial disaggregation of the plant in service as the Company proposes to allocate the investment between Title 61 and Title 62.  Also, Schedule 2 in Exhibit 114 to my testimony shows the Company's proposed allocation of those same plant and equipment costs to the various Title 61 and Title 62 products.

Q.  What information (in addition to its testimony) has US West make available to assist your understanding of the Company's proposed cost allocation methodology?

A.  The Company provided Staff with printed copies of its "Cost Accounting Segregation Manual" and the "USWC Cost Accounting Allocation System Documentation Guide" and responses to numerous data requests on the cost allocation methodology.  US West also provided us with copies of the Cost Accounting Allocation System ("CAAS") and the Cost Accounting Reporting System ("CARS") input and output files on diskette.  These files include southern Idaho-specific data and results.  (Because these files contain allegedly proprietary data, I have included relevant portions of these data and my analyses that rely explicitly on these data in the proprietary version of Exhibit 114 to my testimony.)  Finally, I accompanied a member of the Commission's Staff in a special meeting in Denver in order to hear US West's explanation of its CAAS and CARS.  That this meeting was necessary underscores the complexity of the cost allocation system and the difficulty of undertaking a comprehensive review of the complete system.

Q.  Was the information provided by US West sufficient to enable a detailed analysis and understanding of the CAAS?

A.  No, it was not.  Among other things, the CAAS relies upon several "Special Studies" to complete the allocation of costs among products, and between Title 61 and Title 62.  Although we requested copies of these Special Studies they were not readily provided to us by US West (STF03-169).  To date, we have received the Special Studies that allocate revenues, and apparently the Special Study for Residence and Business Lines that is referenced in Section VI of the CAAS Manual.  In responding to a request for the Special Studies regarding lines, the Company referred us to its response to Staff's Data Request 51, which consisted of total numbers of business and residence access lines.  The Company failed to clarify whether that was the entire content of its Line Special Studies, and indeed there is reason to doubt that this is the case.  For example, the data in the Company's response to this staff data request does not shed any light on the relative numbers of Title 61 and Title 62 PBX lines.

Section III of the CAAS Manual refers to numerous other special studies used by US West to assign and allocate costs to product categories. It is extremely unwieldy and virtually impossible to verify the validity of the logic of each of these numerous special studies.

Moreover, the Company in several instances failed to provide additional details when requested.  Several questions submitted during discovery regarding more details about the cost allocation methodology received responses that referred back to the data files that contained only excerpted CAAS and CARS output files (see, for example, responses to Staff Data Requests 01-033 and 01-036).

Q.  How did the Company generate the estimates for per-line loop investment that are discussed on page 19 of Mr. Elder's testimony?

A.  I presume that US West relied in part upon its proprietary Cost Accounting Allocation System (CAAS), which I mentioned previously.  CAAS is the name given to the entire process whereby revenues, expenses, taxes and investments (all of which are referred to as "costs") are assigned to product categories and ultimately to Title 61 and Title 62 services.  Although the term CAAS is used to refer to the entire process of cost allocation, CAAS actually represents one of four models that together provide for the allocation of costs among product families and then between regulated and nonregulated services.  The first two models are called "ALFI" and "Revenues."  The ALFI model allocates primary invest­ments, which consist of Central Office Equipment (COE) and Outside Plant (OSP), and the Revenues model allocates billed revenues.  The output from these two models serves as the input to the CAAS itself, which is a mainframe processing model for US West's embedded cost accounting results.  The output of CAAS serves as input for the final model which is called the Cost Accounting Reporting System (CARS), also a mainframe application.  Whereas US West has achieved cost allocation indirectly through the Revenue Sharing Plan since 1989, the Company now proposes to use its CAAS system for this purpose.

Q.  US West indicates that CAAS as well as US West's Accounting Segregation Plan manual have been accepted in other states and that although "the Idaho Commission has not had a formal hearing on the acceptance of CAAS, US West has shared the results for Title 61 and Title 62 operations during the past several years with the 'Commission Staff'" (Elder (US West) at 2).  Please comment.

A.  Although US West may have "shared the results" of CAAS with Idaho Commission Staff in the past, this is the first proceeding in which the use of CAAS to allocate costs is being investigated by the Idaho Commission.  I am not aware of any approval to date by the Idaho Commission of the use of CAAS to allocate costs between Title 61 and Title 62.

Q.  What is your understanding of the methodologies used by CAAS to assign costs to product families and then as between regulated and nonregulated services?

A.  US West witness Dallas R. Elder provides a general overview of these methodologies in his testimony.  According to Mr. Elder, CAAS assigns costs in accordance with "causal" or "beneficial" relationships espoused by the Cost Accounting Standards Board (CASB) (Elder (US West) at 4).  In principle, this assignment of costs requires several steps.  First, costs are directly assigned to specific products or services whenever possible.  Second, costs which cannot be directly assigned to specific products or services are allocated on the basis of some other logical assignment method, such as a direct measurement of usage, or through "surrogate measures" that have an observable or logical correlation with some other function or investment.  Finally, CAAS employs a "general allocator" to allocate general overheads among Title 61 and Title 62 product categories.

Q.  Does Mr. Elder provide further information on the specific methodologies utilized by CAAS to perform the allocation of costs outlined above?

A.  Yes, he does.  Mr. Elder's testimony provides a general overview of the allocation of revenues, investment and expenses among Title 61 and Title 62. According to Mr. Elder's testimony, revenues are assigned to Title 61 and Title 62 service categories after having first been assigned either directly or indirectly to one of several product families.  For product families that contain both Title 61 and Title 62 services, revenues are allocated among both types of services, such that the amounts assigned to Title 61 and Title 62 product categories correspond to the revenue sharing amounts generated by the Revenue Sharing Plan.

Investment amounts are also assigned to product families for allocation among Title 61 and Title 62 services.  First, investments are categorized as being either "primary" or "support."  As stated earlier, primary investments consist of Central Office Equipment and Outside Plant Facilities while support (or "secondary") investments include such categories as Land and Buildings, Vehicles and Office Equipment, and Materials and Supplies.  The COE and OSP investments, for example, are assigned to product families through a process that utilizes input from several sources including the corporate books (ledger data and in-service statistics), jurisdictional separations, special studies and usage studies.  Secondary investments are allocated to Title 61 and Title 62 services on the basis of the primary investment that they support.

Finally, expenses are assigned to product families and then allocated between Title 61 and Title 62 primarily on the basis of US West's Functional Accounting database.  Where direct assignment of expenses is not possible, US West uses special studies, secondary relationships and general allocators to complete the assignment between Title 61 and Title 62 services.  (Elder (US West) at 9).

Q.  How does US West allocate central office equipment (COE) between Title 61 and Title 62 categories?

A.  After making the jurisdictional separation for central office equipment, US West classifies its COE by use: local switching, interoffice switching, and circuit COE.  Then any specific investment that is dedicated to a product or service (as determined by a specific separations category or through special studies) is assigned to the applicable product family.  US West assigns the remaining COE investment to product families using Jurisdictional Separations data and Subscriber Line Usage Studies (SLUS).  Finally, the traffic-sensitive portion of the central office is allocated among Title 61 and Title 62 on the basis of usage statistics.

Q.  How does the Company allocate outside plant investments to Title 61 and Title 62?

A.  Outside plant investments are also assigned to product families on the basis of Jurisdictional Separations categories and usage studies.  The local loop portion of the outside plant is assigned to product categories based on the corporate books and on special studies that identify the average loop length by customer type and the in-service quantities of residence and business local loops (Elder (US West) at 8).  Interoffice outside plant that is used for local service is assigned to product families on the basis of usage data (Elder (US West) at 8).

Q.  What Idaho-specific cost allocation methodologies does the Company use in order to allocate gross investment between Title 61 and Title 62?

A.  US West currently allocates 25% of the local loop to the interstate jurisdiction, 15% of the local loop to the toll/switched access category and the remaining 60% to the local service products.  Products, such as business local exchange service, that include Title 61 and Title 62 are allocated to Title 61 and to Title 62 "using access lines, and secondary allocation procedures" (Elder (US West) at 11).

The most significant part of the CAAS for the Commission to evaluate is Section III which, when applied to US West's costs and expenses, results in the overallocation of costs to Title 61 and the resulting cross-subsidization of Title 62 services.

Q.  Were an interested party to attempt to unravel the workings of the CAAS in order to evaluate the exact manner in which the Company proposes to allocate costs between Title 61 and Title 62 services, where would you recommend that such an examination be focussed?

A.  Although the specific methodology for allocating costs between Title 61 and Title 62 is described in Section VI of the Cost Manual, the most significant allocation between these two categories actually takes place implicitly in a step previous to that described in Section VI.  Indeed, it seems that the vast majority of the Title 61/62 split occurs via the methodology described in Section III of the Cost Manual, specifically the system for allo­cating costs to products and product groups.  Because most product categories are typically classified as either Title 61 or Title 62, it is US West's proposed allocation of costs to those products that merits the most scrutiny.  (Of course, allocation of costs within the Title 61 category also merits attention.  For example, business lines likely require additional spare capacity relative to primary residential lines, and as Schedule 2 in Exhibit 113 to my testimony shows, the approximate 27% compound annual growth in additional residential lines (in comparison with 3.4% for primary residence lines) suggests that the cost of second lines is likely to be significantly above that for initial lines.)

Q.  Please describe in general terms, the magnitude of the outside plant investment.

A.US West's "ALFI" process distinguishes among five categories of outside plant: CWF1 (local loop), CWF2 (exchange), CWF2a (wideband), CWF3 (interexchange) and CWF4 (host remote).  As Schedule 3 in Exhibit 114 to my testimony shows, US West's categorization of the unseparated investment dollars for cable and wire investment results in the vast majority being allocated to the local loop, with only a relatively small percentage of the entire cable and wire facility category, to interexchange plant.

Q.  Please explain why Schedule 3 in Exhibit 114 includes unseparated dollars.

A.  US West's proposed allocation of investment occurs in the "ALFI" part of the cost allocation system, which is based upon unseparated dollars.  I believe that the "origin" of the dollar amounts themselves are based upon data from the Company's Part 36 process and show up in numerous separate rows in a sheet entitled ISAACs in the ALFI file.  In mapping investment to categories (e.g., to  local loop or to interoffice plant), the Company apparently relied in part on the categorization used in the Part 36 process.

Q.  Please elaborate on how the Company mapped the amounts in the ISAACs file to the categories that are ultimately used in the allocation of plant?

A.  Mechanically, one can trace the mapping using the audit function in Microsoft Excel, but because the entries in the ISAACs sheet are laced with cryptic identifiers, it is not possible to determine which network components these elements represent.

Q.  Please explain the significance of CARS.

A.  CARS translates unseparated dollars into intrastate ones, reports the results of the entire cost allocation system, and reconciles the intrastate dollars with the USOA accounts shown in Ms. Wright's papers (and reproduced in Schedule 1 of Exhibit 113).  Among the various CARS files are reports that show the results of the allocation of the interstate portion of the local loop (Report B); the allocation of the 15% of the loop to toll/access as required by the Commission directive (Report C); applying a ratio to reconcile the data with the Part 36 results (Report D); and splitting the business exchange between Title 61 and Title 62 (Report E).  Report F summarizes the final results, i.e., the Company's proposed allocation of costs among the Title 61 and Title 62 products (see Schedule 1 of Exhibit 113).

Q.  Are there any areas of potential problems with this general approach to allocating gross investment to consider as the Commission examines the Company's specific recommendations regarding the allocation of plant?

A.  Yes.  Assume for a moment that the distribution plant for US West has a low fill factor (i.e., substantial excess capacity) and suppose further that the excess capacity exists primarily to allow US West to respond to requests for Centrex service and to offer new, unregulated services.  The result of allocating the sum of the utilized and the unutilized outside plant to products based on existing lines in service is to cross-subsidize the Company's provision of future Centrex and other Title 62 services with revenues derived from the Company's present Title 61 services.  Primary residence lines account for the vast majority of the total lines in service of the Company.  Any deployment of investment for which the costs are allocated in part or in whole based upon the relative number of lines in service, therefore, will be borne by residential customers, even if the reason for adding the new plant was to attract or retain customers for Title 62 services.

Q.  How does the Company allocate spare capacity?

A.  It allocates spare outside plant or switch capacity to Title 61 and Title 62 "using the same allocation methodology for outside plant or switch investment in use" (see Schedule 3 in Exhibit 113, which is the Company's response to STF03-170).

Q.  Is this a reasonable approach?

A.  No.  The Company has invested in excess capacity far beyond what would be needed to meet a reasonable business projection of growth in demand for new lines.  It is inappropriate that any of the expenses related to that overinvestment be allocated to Title 61.  Legal precedent in Idaho holds that a public utility is under duty "to find a market for consumption of its commodity and where a public utility provides capacity without proper regard to the present and the prospective future demands, value of excess capacity should not be included in rate base." (In re Boston & Idaho Gold Dredging Co., PUCI Case F435, Order 804, P.U.R. 1921E, 843, at 850-51 cited in Idaho Public Utilities Laws, Idaho PUC, 1995, at 94).  This argues strongly that US West's overinvestment should be allocated entirely onto Title 62; the Company is certainly entitled to make whatever investments it deems necessary, as long as Title 61 ratepayers are not forced to shoulder the burden for investments which are not essential for Title 61 services.

Q.  You have described in general terms the way in which the Company makes the Title 61/Title 62 split.  What is your understanding of the specific methods and procedures proposed by US West for allocating costs between Title 61 and Title 62 services?

A.  US West's allocation of costs between Title 61 and Title 62 services technically occurs at the final stage in its cost allocation process, as described in the Company's Cost Manual.  However, in reality the most important step in the allocation process occurs prior to this, during the Company's allocation of costs to products.  US West bases its Title 61/Title 62 allocation on its Idaho south intrastate results, segregated by product category.  The Company allocates costs to Title 61 or Title 62 at the income statement line-item level for each product or service category that has a Title 61 component (that is, residential and business local, PBX, public telephones, operator services, and listings) (US West Corporation, CAAS Manual, Section VI, at 1).  Within each of these product categories, the Company uses a pre-determined procedure to allocate revenues and costs between Title 61 and Title 62.

Q.  Please describe the procedures used in the Title 61/Title 62 allocation process.

A.  US West bases most of its allocation of costs between Title 61 and Title 62 upon what it refers to as Special Studies that it has prepared for each product category.  Special Studies exist for both revenues and lines; apparently it is the latter that form the basis of many of the Company's cost allocations.  For example, within the Business product category, the Engineering, Network Operations, Network Administration, Access and Other costs, as well as Property and Other Operating Taxes, Depreciation and Amortization, Interest Expense, and, additionally, the Investment categories of Plant in Service, Plant Under Construction, Plant Held for Future Use, Material and Supplies, Depreciation Reserve and Accumulated Deferred Income Tax, are all allocated based upon the "Business Lines Special Study" (US West Corporation, CAAS Manual, Section VI.1, at 9-10.   The allocation method for these and other revenue and expense items are summarized in Schedule 4 of Exhibit 114 to my testimony.

Q.  What are the ramifications of the Company's decision to perform its cost allocation between Title 61 and Title 62 services in this manner?

A.  US West has stated that it derives the separation between Title 61 and Title 62 investment in plant and equipment only at the income statement level, and that as a result "the back-up data to the Title 61/Title 62 model does not contain detail" at the level of individual ARMIS accounts (Response to Staff Data Request 02-136).  In other words, the Company is incapable of showing how it allocates individual expenses or investments between Title 61 and Title 62, because that level of detail is lost during the CAAS process.  It is impossible, then, for the Company to meaningfully answer questions regarding its allocation of invest­ments in specific type of equipment, i.e., digital switches, digital circuits, analog circuits, and copper and fiber cable between Title 61 and Title 62 because it does not perform its allocation at that level of detail.  Instead, that allocation only takes place at the aggregate level of categories such as "central office equipment" and "outside plant" (Response to Staff Data Request 02-136).

Q.  What is the significance of this lack of detail in US West's allocation process?

A.  This is an extremely serious flaw in the Company's methodology.  It means that the Company necessarily includes a portion of all investment in central office equipment and outside plant in the costs it attributes to Title 61 services, including those investments that are clearly and unambiguously undertaken for the purpose of pro­viding advanced and competitive Title 62 services.

Q.  Is this problem confined only to the Company's investment in plant and equipment?

A.  No, it is not.  Beginning with data at an "income statement" level of disaggregation raises fundamental questions about US West's allocation of all other expenditures as well.  The Company has admitted that it cannot provide Title 61 and Title 62 allocations for a number of specific accounts for which the distinction is extremely important.  For example, Title 61 customers fund a portion of the total US West corporate investment in research and development (Response to Staff Data Request 03-200).  The same holds true for all US West expenses.

Q.  Can you cite any other specific examples?

A.  Yes, I can.  US West has stated that its legal expenses "incurred on behalf of the whole corporation" are allocated to all US West serving territories via a "headquarters prorate" (Response to Staff Data Request 03-196).  This means that not only do Title 61 customers potentially pay a portion of the legal expenses that the Company incurs in the context of providing Title 62 services, they also pay a portion of the legal expenses the Company incurs in other states.  The same holds for other corporate expenses, including, but not limited to, information management expense (Response to Staff Data Request 03-201), external relations expense (Response to Staff Data Request 03-202), and customer services expense (Response to Staff Data Request 03-203).  Staff witness Madonna Faunce discusses these affiliate expenses in greater detail in her testimony.

Q.  How has US West justified basing its Title 61 cost allocations on such aggregate data, instead of examining specific expenditures required for the provision of regulated service in southern Idaho?

A.  In response to a number of data requests seeking specific information about expenses directly relevant to the provision of Title 61 services, the Company has claimed that developing such information would be "burdensome, and would require a great deal of analysis and investigation" (see, e.g., Response to Staff Data Request 03-200).  Mr. Elder explains that details of the specific methodologies employed by CAAS must be gleaned from US West's Cost Accounting Segregation Manual (Elder (US West) at 6).

Based on our analysis of that manual, US West has failed to demonstrate that the CAAS properly allocates costs to Title 61 services.  The response to a Staff data request underscores the complexity of tracking the allocation of costs to Title 61 services:

There is no data field in USWC's accounting data base which corresponds to Title 61 products.  An existing product allocation system (CAAS) had been modified to provide factors to allocate costs and revenues to Idaho Title 61.  This system obtains certain cost and revenue data from the accounting system and allocates amounts to numerous products common to USWC's 14 states.  The amounts related to these products are then either directly assigned to Title 61 and Title 62, or are further allocated between Title 61 and Title 62 based on studies and analyses.  A separate step insures that the combined Title 61 and Title 62 amount agrees with the reported Idaho intrastate amount.  Allocated amounts are at an "income statement" level of detail, and do not include information such as responsibility codes, EXTC's, etc.  Where a Title 61 amount is needed for a specific adjustment, it is approximated by applying factors based on the results of the allocation process (Response to STF03-209, nonproprietary portion).

Q.  Does this methodology satisfy the statutory requirement you discussed previously with respect to a proper allocation of costs between Title 61 and Title 62?

A.  No.  The Company's cost allocation methodology allows costs incurred at the level of the company as a whole, costs which often have nothing to do with the provision of Title 61 services, to flow through to Title 61 services.  The Company has failed to keep its end of the bargain it entered into when the Idaho legislature in 1988 allowed it to exempt services from economic regulation.  Idaho state law says very clearly that the Company can charge what it wishes, and allocate costs as it deems best, for any Title 62 service it offers.  However, based upon my understanding of the statutory framework, Title 61 services cannot be treated in the same way.  The state of Idaho's separation between Title 61 and Title 62 is unique, and it imposes a unique obligation upon US West.  The Company's single, company-wide cost allocation procedures do not, and indeed cannot, properly distinguish between costs incurred solely in the process of providing Title 61 services.  That, however, is precisely what the Company must do in order to establish the appropriate allocation of cost between Title 61 and Title 62.  US West's cost allocation methodology is inappropriate, and unacceptable.

Q.  Why has this cost allocation methodology not been a problem in the past?

A.  US West's inappropriate cost allocation method has not up to now been a problem in southern Idaho because of the revenue sharing arrangement which was in place up until this year.  Under revenue sharing, it was not necessary to calculate costs separately for Title 61 and Title 62 services, because the allocation of revenues acted as a surrogate to allocating cost.  Although the Company itself requested an end to the revenue sharing arrange­ment, it clearly is not adequately prepared to undertake the studies needed to properly allocate its costs as required by the Idaho Code.

Q.  What is your proposal with regard to cost allocation?

A.  I discuss specific alternative recommendations below.

A fair cost allocation system would recognize that much of the TPIS, while not critical for Title 61 services, is essential for Title 62 services.

Q.  Ms. Baldwin, you have identified various examples of flaws in the US West cost allocation scheme.  Do you have any affirmative recommendations as to how the Commission can reasonably allocate US West's vast amount of common plant between Title 61 and Title 62 in a fair and administratively straightforward manner?

A.  Yes, I do.  Before I discuss specific alternative methodologies, however, I will first address the overarching issues relating to a fair and economically efficient apportionment of US West's integrated asset base of switching, transport and distribution plant between regulated and non-regulated services.  Such an appor­tionment can be accomplished by first determining the "stand-alone" cost of each of the two service categories (regulated and non-regulated) separately, from which the overall "economy of scope" as between these two categories can be identified as the difference between the sum of the two separate stand-alone costs and the cost of the jointly-used asset base.

While incumbent local exchange carriers have long focused their attention upon the allocation of joint and common costs, a more appropriate approach, particularly in light of the unique Idaho regulatory system, is to focus instead upon the allocation of the "economy of scope" that arises when regulated and non-regulated services are jointly provided.  In general, the benefits of such scope should flow to regulated services, because (a) the ILEC's infrastructure was funded primarily (and, before 1989, entirely) by ratepayer support (shareholders were entitled to a "fair return" on their investment and were thus not themselves exposed to any significant financial or business risk), and (b) because the requirement that ILECs base prices for their competitive, non-regulated services on the stand-alone costs of these services helps to assure fair and efficient competition in the non-regulated market segments.

For example, the need for extensive spare capacity is driven primarily by discretionary and competitive services rather than by essential, monopoly services that enjoy stable, near-100% penetration rates.  Advanced digital electronic switches are primarily required by US West in order to support the Title 62 discre­tion­ary and competitive services, and the acquisition costs of such equipment should generally not be included in a stand-alone cost analysis of those services that are subject to (Title 61) rate regulation in Idaho.  Significant amounts of ILEC human resources and operating costs are also driven by discretionary and compe­titive services, and not by basic dialtone.

Q.  Is there an economically efficient way to allocate joint costs between Title 61 and Title 62 services?

A.  Yes.  The economically efficient way is to assign the stand-alone cost to the competitive services because:

●It facilitates the development of competition because it does not advantage the incumbent's competitive entry vis-a-vis non-ILEC rivals by virtue of the incumbent's huge base of common plant; and

●It flows the benefits of the economies of scale and scope resulting from the joint provision of Title 61 and Title 62 services to the monopoly ratepayers who are the ones that have through their purchase of regulated monopoly services, borne the cost of the development of the ILEC's extensive common network and resource base.

Q.  Have you then computed the stand-alone costs for Title 62 services in order to determine the costs that should be assigned to Title 61?

A.  No, and for that reason, my results likely underallocate costs to Title 62.  It is my understanding that the Commission must allocate common plant between Title 61 and Title 62 service, and for that reason, I have developed mechanisms that generally follow the principle I have discussed above and that are consistent with the statutory directive to make specific allocations.

I have developed solutions that comply with the Act's directive to allocate costs and that ensure that competitive services are assigned "at least" a fair share of the joint cost.  If anything, however, my proposals likely err on the side of under-allocating costs to Title 62.

I have several suggestions, some of which can be implemented concurrently and others that are various alternatives to accomplish the same end.

Q.  Please describe your recommendations for allocating the Company's investment in plant to support the local loop.

A.  As is shown in Schedule 3 in Exhibit 114 to my testimony, the local loop, as quantified by the Company, represents the vast majority in investment of the outside plant, and a significant portion of the total plant in service (see the ALFI files).

Schedule 5 in Exhibit 114 to my testimony summarizes ETI's proposed preliminary allocation of the local loop plant (CWF1) which reflects the cost-causative nature of services that require relatively greater spare capacity.  This methodology can be summarized as follows:

1.First, 15% of the loop is assigned directly to Title 62 products to reflect the Commission's directive that some of the local loop costs be recovered from toll and switched access.

2.Second, using the actual fill factor for the Company (see response to Staff Data Request 049), the plant that supports the lines actually in service is isolated.  This amount can then be allocated based upon lines in service.  Schedule 6 in Exhibit 114 — which reflects data from the CAAS file — shows ETI's estimate of the percentage of lines in service that are classified as Title 61.  Line 6 in Schedule 5 in Exhibit 114 shows the corresponding allocation of the plant to Title 61.  (We asked the Company for all Special Line Studies in Staff Data Request 169.  However, the Company did not provide us with its PBX Special Line Studies, and therefore I assigned PBX lines to Title 61 and Title 62 based upon the relative share of PBX revenues; see Schedule 7 in Exhibit 114.)

3.The remaining amount of the plant (see Line 8) reflects capacity necessary to accommodate growth over some reasonable planning horizon and administrative capacity.  Schedule 2 in Exhibit 113 shows that over the last five years, Title 62 local exchange lines have been growing at three times the rate as Title 61 local exchange lines.  This ratio actually underrepresents overall growth in demand for Title 62 services because, in fact, many Title 62 services are not measured in term of lines (e.g., call waiting, caller identification, etc.).  Although these optional features are not measured in terms of lines, they clearly depend upon the existence of lines and thus should bear some of the costs associated with the outside plant.  US West's allocation fails to assign any outside plant to these services, thus giving them a "free ride."

Furthermore, this ratio does not capture the costly volatility associated with meeting Title 62 demand.  Five-year job growth in Boise has been 34%, among the cities with the highest job growth rates in the country, according to a recent article ("It's the cost, stupid," Forbes, October 21, 1996, at 252-258).  This extraordinary growth in the business sector creates corresponding demand for telecom­munications services.  As Schedule 2 in Exhibit 113 demonstrates, Title 62 growth is far more volatile than Title 61 growth, thereby creating a greater need for spare capacity in order for the Company to maintain a "readiness to serve" position.  Thus, Schedule 5 in my Exhibit under­states the costs that should be allocated to Title 62.  Using the 3:1 ratio, I assigned 25% of the investment associated with the spare capacity to the remaining plant (Line 8), yielding the amount shown on Line 10 for investment to support spare capacity for Title 61 lines.  This is conservative because the three-to-one ratio is based upon an analysis of data for residence and business basic exchange only.  Competitive services, such as Centrex, likely exhibit significantly greater churn, and frequently create nonreusable plant when an existing customer discontinues the service.

4.The resulting allocation of the local loop to Title 61 is shown in Schedule 5 of Exhibit 114 and can be compared to the Company's proposed allocation, which is indicated in the same table.

This result is conservative for several reasons in addition to those I have already mentioned.

Q.  Why is the result "conservative"?

A.  The result is conservative (meaning that it errs on the side of over-allocating costs to Title 61), first, because some portion of the approximate $13.5-million of Title 61 funds that the Commission directed be invested by the Company in order to upgrade the local plant for rural areas (Tech II) likely was used for the deployment of fiber, which would be included in the cable and wire category.  Title 62 should make some type of compensation to Title 61 because this modernization project — which was funded entirely with Title 61 monies — is inextricably linked to the provision of Title 62 services, yet absolutely no Title 62 funds were used for this modernization program.

This method is also conservative because it assumes that all modernization of the local loop that the Company has undertaken was economically efficient for the continuing provision of reliable basic local exchange service.  To the extent that the outside plant includes the deployment of fiber in excess of that which was economically efficient for Title 61 service, the method reflected in Schedule 5 over-allocates cost to Title 61 because it multiplies the fill factor by an investment that itself is excessive.

A third reason that the method over-allocates costs to Title 61 is that outside plant includes both feeder and distribution plant, yet the fill factor that is reflected in the computations in Schedule 5 of Exhibit 114 is the Company's fill factor for feeder only.  Distribution fill is significantly lower than that for feeder plant, and if the lower distribution fill was also factored in, more of the investment would be considered spare capacity.  (See Schedule 8 in Exhibit 114 to my testimony for the Company's actual fill factors for feeder and distribution plant.)

Q.  Earlier you referred to this as a preliminary allocation of local loop costs.  Is there an additional allocation that should be made?

A.  Yes.  In addition to the allocation described above and shown in Schedule 5 of Exhibit 114, the Commission should allocate local plant to services such as custom calling and CLASS services, consistent with the Commission's long-standing policy of assigning 15% of the local loop to toll and switched access.  At that time, when the Commission determined that it was appropriate for switched services to recover some of the local loop costs, demand for custom calling services (call waiting, three-way calling, etc.) was minimal and demand for CLASS services was non-existent.  Whatever rationale applies for assigning a portion of loop plant to toll also applies with respect to custom calling and CLASS services.

The Company's responses to Staff data requests, which are included as Schedule 9 in Exhibit 114, show that demand for these optional services is growing, and in some instances the demand at a considerable rate.  These services could not be offered absent the existence of the subscriber loop, and thus it is appropriate that a portion of the local loop costs be assigned to these products.  Although typically an arbitrary allocator is not the preferred basis for assigning costs, in this proceeding where certain unique conditions exist (i.e., rates are to be based upon fully allocated costs rather than upon incremental costs, there is a substantial amount of common plant that must be allocated between regulated and nonregulated services, and the revenues associated with these largely noncompetitive services are not considered in the revenue requirement for the regulated services), such a method of allocating a fair share of the local loop costs to Title 62 services is appropriate.  This allocation is proper because the revenues for these services – which face little if any competition — are classified as falling under Title 62, and so it is all the more important that the services bear their fair share of joint and common costs.

Furthermore, this method of allocation is entirely consistent with the Commission's directives that "Title 62 services must be assigned a reasonable portion of the common and joint network costs as well as general overhead costs.  In particular, all services using the local loop should be included in the allocation of the loop costs."  (Order No. 25826, at 11.)

Q.  What is your specific recommendation that would implement this principle?

A.  Schedule 10 in Exhibit 114 shows this additional allocation of the local loop plant, which is computed as follows:

An allocation of 5% of the local plant is assigned directly to Title 62 services, consistent with the Commission's previous directive that the Company must recover some of the local loop costs from toll and switched access services.  The rest of Schedule 10 simply continues the analysis that was described above and that is reflected in Schedule 5 of Exhibit 114.

Q.  How did you determine the allocator of 5%?

A.  This is explained in the notes to Schedule 10 of Exhibit 114, which in turn relies upon an analysis of the data in Columns X and AC in Schedule 7 of Exhibit 114.

Q.  You have provided the Commission with a two-step methodology for allocating the local plant in a way that more fairly recognizes the purpose for which the plant is deployed.   Do you have any other recommendations regarding the assignment and allocation of outside plant?

Yes.  According to the Company, it currently has installed 123,280 km of fiber in cable (Response to Staff Audit Request 18, Attachment A).  However, of that massive investment, only 12,766 km is 'lit', i.e., is presently in use (id.).  Approximately 90% of the installed cable, therefore, provides no benefit whatsoever to Title 61 ratepayers, and, consistent with the recommendation of Mr. Lansing, it is therefore inappropriate to assign any of the costs of that unused investment to Title 61.

Q.Have you developed any methodologies for allocating the plant that is categorized by US West as central office equipment?

A.  Yes, I have.

Q.  Before you discuss your specific recommendations, please describe in general terms the major categories of central office equipment.

A.  The central office equipment (COE) category, like Cable and Wire, is comprised of several classifications of plant.  Of the total unseparated investment for COE, Schedule 11 in Exhibit 114 shows that Transmission Equipment constitutes the largest single category.  Investments in digital and analog switches are two other major categories of the Company's COE.

Q.  Please discuss the general approach you recommend for allocating COE between Title 61 and Title 62 services.

A.  First, the component of the Company's plant in service that represents the switch upgrades in the 52 rural wire centers that occurred directly as a conse­quence of the Commission-mandated Tech Plus plans and the entirely offsetting accumulated depreciation should be considered to have been deployed for the benefit of the basic exchange services subject to Title 61.  All other additions to the digital switch accounts that have occurred since 1989 should be assigned to Title 62.  It is important to recognize that Title 62 services are essentially getting a "free ride" by virtue of the modernization of the rural switches with 100% Title 61 revenues, and thus it is entirely fair that Title 62 services bear the costs of the upgrades in the Company's other wire centers — particularly since there may be little if any specific requirement that any Title 61 service imposes that would justify such upgrades.

Furthermore, as I understand the directives in the past Commission decisions, by contrast with the mandates for modernizing certain rural plant, there was simply no mandate for upgrading other plant.  Regarding future upgrades, "[t]he Staff generally observed that US West customers are currently provided with adequate tele­com­muni­ca­tions services."  (Order No. 24506, at 10.)  Staff opposed the use of Title 61 revenue sharing funds to upgrade interoffice facilities, which are used to provide Title 62 toll services, and also "noted that the 20 older electronic analog switches ... provide most if not all features otherwise provided by US West's newer digital switches."  Since the Title 61 services derive little if any direct benefit from the Company-funded CO upgrades, whereas the Title 62 services do benefit from the ratepayer-funded rural upgrade, it seems entirely reasonable that there should be no explicit allocation of other additions to the COE accounts to Title 61.

Q.  Please be more specific about the treatment of the Tech Plus investments.

A.  The 1989 revenue sharing expenditures for switch modernization was $9.810-million (Order No. 23441 at 16).  This entire amount should be allocated to Title 61 average plant in service, as should a corresponding $9.810-million in accumulated depreciation.  The Tech Plus expenses for 1990 and 1991 were capped at the levels suggested by Commission Staff, i.e., $6.89-million for 1990 and $3.184-million for 1991 (Order No. 23531 at 5-6).  These amounts should be treated in a similar manner.  Finally, based upon Order No. 20981, $19.429-million for the years 1987 and 1988 should be similarly treated.

Q.  Your proposal would have the Commission allocate all digital switches except the ones upgraded through the Tech Plus directive to Title 62.  Shouldn't there be some type of allocation of theoretical analog switches to Title 61 to correspond with the digital switches that have been entirely allocated to Title 62?

A.  No.  As I discussed earlier, Title 62 services are getting a "free ride" in the rural areas, and it is, therefore, both reasonable and appropriate that Title 61 services receive a quid pro quo in the urban areas.

Q.  Please describe in more detail ETI's recommended allocation of central office equipment, including not only the digital switches you have just described, but also the other components of the COE category.

A.  ETI's recommended allocation can be found in Schedule 12 of Exhibit 114.  The ETI analysis bases its allocation of central office equipment (COE) upon the breakdown of those investments found in US West's ALFI spreadsheets.  As I have described previously, the ALFI is the part of the US West cost allocation system that allocates unseparated investment in plant and equipment to broad categories and among various product groups.  A section of the ALFI spreadsheets, called the Ledger Analysis Worksheet, includes subcategories for COE that include Operator Systems; Analog, Digital, Packet, SXS, and XBAR switches; Radio Systems; and Transmission Equipment.

Since ALFI data represents total southern Idaho investment in plant and equipment, ETI utilized US West's CARS separation factor for total investment in central office equipment to estimate intrastate investments on each sub-category of COE listed above.  For each of those sub-categories, ETI then developed a factor to separate investment between Title 61 and Title 62.

Q.  Why did you go back to ALFI to perform this analysis, when US West uses its CARS system to allocate COE?

A.  As I have discussed previously, the CARS system presents accounting data in a very aggregate, "rolled-up" manner.  As a result, a great deal of detail as to the specifics of investments and expenditures is lost in the transition from the CAAS and ALFI portions of the system to the CARS.  Without that detail, any allocation between Title 61 and Title 62 will be hopelessly arbitrary, since there is no way to examine and allocate separately specific types of central office equipment.  Starting with ALFI data was the only way to recapture that lost level of detail.

Q.  Please describe the factors that ETI used to develop that Title 61/Title 62 allocation.

A.  Operator Systems, Analog, SXS, XBAR, and Radio Systems all legiti­mately support both Title 61 and Title 62 services.  As a general, rough allocator, we decided to employ US West's own allocation between Title 61 and Title 62 for central office equipment.

Because Title 61 services do not involve packet switching, all investment in the Packet category was directly allocated to Title 62.

As I discussed previously, the allocation of digital switches was based upon southern Idaho's Tech Plus plan.  Tech Plus required US West to use revenue sharing funds to upgrade certain rural switches, replacing them with digital.  As those investments were made using Title 61 funds at the Commission's behest, they are assigned to Title 61 (with the corresponding and fully offsetting accumulated depreciation) even though such digital switches can clearly be used (and indeed are necessary) for the provision of advanced, Title 62 services.  However, all other investment that the Company has made in digital switches was allocated to Title 62.  Such investment, not mandated by the Commission, was necessary for the purposes of providing competitive, Title 62 services.

Finally, the majority of investment in COE was charged to the category that US West labels "Transmission Equipment."  Because this category involves a substantial portion of the total COE, ETI used the ALFI spreadsheets to derive the drivers that comprised it, which are shown in Schedule 12 in Exhibit 114.  These specific transmission investments were then examined in greater detail.

Q.  Please describe ETI's analysis of those Transmission investments.

A.  As a conservative allocation, total transmission investment was divided into two broad categories — digital and non-digital.  Non-digital equipment investment was allocated between Title 61 and Title 62 using the general COE allocator developed from US West's proposed allocation.  Digital transmission equipment consists primarily of Digital Loop Carrier (DLC) and a category entitled "other digital equipment."  The Tech II Plan that I discussed earlier mandated, in part, investment in DLC on the part of the Company.  It is not readily distinguishable what particular component of the total $13.5-million local plant upgrade is reflected in the outside plant category (e.g., fiber) and what component that is reflected in the COE account (e.g., digital loop carrier equipment).  We assumed that 50% of the Tech II investment would be reflected in the transmission investment (and the balance in the cable and wire category).

Following the same reasoning as was used in allocating Tech Plus investment, the 50% of the Tech II-related investment that is assumed to be in the transmission category was assigned to Title 61 (as should the corresponding amount in accumu­lated depreciation).  All non-Tech II investment in digital transmission equipment during and after 1989 was assigned directly to Title 62, based upon the Company's response to a Staff Data Request 02-153 (see Schedule 4 of Exhibit 113 to my testimony).  Finally, all investment in digital transmission equipment not directly assigned was divided between Title 61 and Title 62 using US West's already-established general COE allocator.  The final recommended split between Title 61 and Title 62 appears in the bottom row of Schedule 12 in Exhibit 114.

Q.  You indicated that your proposed allocation of the transmission plant was "conservative."  Please explain.

A.  The method I have described above over-allocates plant to Title 61 because it focuses only upon additions to the transmission account in the direct assignment of digital transmission plant, and thus it reflects an unsubstantiated assumption that all plant that was placed in service before January 1, 1989 in this account was economically efficient for the provision of Title 61 service.

Q.  Isn't it more likely that the DLC supports residential (i.e., Title 61) customers than business customers because DLC is often used for feeder distances of longer lengths?

A.  While homes may be more likely to be located at greater distances from the central office than businesses, the use of DLC is dictated by factors other than distance, including the Company's strategic interest in deploying fiber, and the capacity being served (all else being equal, the Company may deploy DLC for short distances where the capacity is large, e.g., in commercial locations).  The Company may be deploying DLC because it is economically efficient for its provision of combined Title 61/Title 62 services but the deployment may not necessarily be efficient for the provision of Title 61 services.  My proposed allocation addresses this concern.

Q.  Did you ask for evidence regarding whether the deployment of digital circuit equipment technology was cost-effective for Title 61 services?

A.  Yes.  US West indicated that CUCRIT studies were not done on digital circuit equipment technology deployment plans but rather that "USWC has already adopted a fiber strategy for interoffice applications based on fiber's increased bandwidth and increased reliability" (see Schedule 5 in Exhibit 113, the Company's response to Staff Data Request 232).

Q.  Have you developed any alternative methodologies for assigning COE costs?

A.  Yes.  Rather than assigning all Tech Plus digital switches to Title 61 and all other digital switches to Title 62, the Commission could allocate the entire group of digital switches consistent with the Company's proposal.  Schedule 13 in Exhibit 114 summarizes this analysis, which, also reflects the treatment of digital transmission equipment that is reflected in Schedule 12 in Exhibit 114.  Should the Commission adopt this approach, I would nonetheless continue to recommend that the entire accumulated depreciation associated with Tech Plus be assigned to Title 61.

Q.  What is the disadvantage of this approach?

A.  The disadvantage of the analysis in Schedule 13 is that it essentially gives Title 62 services a free ride with respect to the modernization of the rural switches that occurred with Title 61 funds.

Q.  Ms. Baldwin, have you prepared a table that summarizes your recommend­ations regarding the appropriate allocation of the Company's plant?

A.  Yes.  Schedule 14 in Exhibit 114 summarizes the allocation of Telephone Plant In Service (TPIS) that I recommend the Commission adopt.  This table reflects the analysis that is provided in Schedule 10 and Schedule 12 in Exhibit 114 of my testimony and also reflects the allocation of secondary investment (such as buildings, land, computers, etc.).  This table can be compared with Schedule 1 in Exhibit 114, which summarizes the Company's proposed allocation of TPIS between Title 61 and Title 62, disaggregated among plant categories.

Q.  How did you allocate secondary investment?

A.  Separately for each secondary investment, I retained the same ratio of the item (e.g., buildings) to the total primary investment that is reflected in the Company's proposal (see Schedule 1 in Exhibit 114).

Q.  Does this table reflect all of the corrections to TPIS that have been identified by Mr. Lansing?

A.  Yes.  This table reflects Mr. Lansing's direct assignment of approximately $9-million to Title 62 to reflect the unlit fiber (see Line 12).  (Line 13 allocates the remaining investment in CWF2, CWF2A, CWF3, and CWF4 consistent with US West's proposed allocator; see Schedule 1 of Exhibit 114.)

Line 18 reflects the other corrections to TPIS that have been identified by Mr. Lansing.  These corrections total approximately $40.1-million (consisting of (a) $20.227-million to correct for the fact that the detailed records for the Company are less than the General Ledger by this amount; (b) $10.304-million to correct for the results of Mr. Lansing's audit of the Company's plant in service inventory; and (c) and $9.568-million for direct assignment relating to voice messaging and other services.

Q.  Please elaborate on the computations in Line 18.

A.  The purpose of Line 18 is to remove from Title 61 that portion of the approximate $40.099-million that is incorporated in the various components of the Company's Title 61 plant in service.  The overall distribution shown in Line 17 is 49%/51%, and for that reason we have shifted 49% times $40.099-million (i.e., $19.649-million) to the Title 62 column.

Q.  What is the final allocation of plant to Title 61?

A.  As Schedule 14 in Exhibit 114 shows (at Line 19), I recommend that $248.096-million of the Company's TPIS be allocated to Title 61.  Comparing this table to Schedule 1 in Exhibit 114 (which summarizes the Company's proposed allocation of plant) shows that the implementation of this recommendation would, relative to the Company's proposal, shift $103.7-million to Title 62 or to non-Title 61.

Q.  What do you mean when you refer to non-Title 61?

A.  Some of the corrections that have been identified (e.g., the General Ledger correction) do not really concern the allocation between Title 61 and Title 62, but rather reflect corrections of a different nature.

Q.  Please explain your proposed treatment of accumulated depreciation.

A.  Column (d) of Exhibit 101 to Mr. Lansing's testimony shows a direct assignment of $40.083-million for accumulated depreciation to correspond with the total investment associated with the Tech Plus and Tech II plans, and consistent with the Commission's directives that the Company fully expense these invest­ments.  The balance remaining to be allocated after making this assignment and the one appearing in column (e) (see Lansing) is $178.831-million.  The allo­cation between Title 61 and Title 62 that appears in Exhibit 101 in Mr. Lansing's testimony simply assigns this amount using the ratio shown in Schedule 14 of Exhibit 114, which summarizes ETI's proposed allocation of TPIS.

Q.  Please explain your proposed allocation of depreciation expenses.

A.  Depreciation expenses appear on line 30 of Exhibit 101 to Mr. Lansing's testimony.  Mr. Lansing has directly assigned $23.853-million consistent with his testimony and that of Dr. Selwyn, leaving $27.579-million to be allocated.  The amounts shown in columns (g) and (h) allocate the depreciation expenses consistent with ETI's proposed allocation of the Title 61 and Title 62 plant.

Q.  Column (f) of Mr. Lansing's Exhibit 101 includes other "common pools" of those expenses that have not been directly assigned by Staff.  You have provided a recommended allocation of the accumulated depreciation and of the depreciation expenses.  Please provide your recommendation as to how the Company should allocate the other items shown.

A.  I assigned the following items based upon plant in service (consistent with the corrected numbers shown in Schedule 14 in Exhibit 114): Materials and Supplies (Line 2), Cash Working Capital (Line 3), Accumulated Depreciation (Line 5), Maintenance (line 15), Engineering Expense (Line 16); Network Operations (line 17); and Property and Other Taxes (Line 25) and Depreciation (Line 30).

I allocated access entirely to Title 62.

Q.  What is your recommendation regarding the proper allocation of corporate operations (Line 24)?

A.  As Staff witness Faunce testifies, the Company should improve its reporting system so that a greater percentage of these expenses can be directly assigned.  The Company's proposal would allocate 50% of corporate operations to Title 61.  In its CAAS Manual, the Company indicates that it assigns these expense either based upon employee wages and salaries, or based on total expenses (CAAS Manual, Section III.O, at 13-14).   Corporate Operations includes expenses for items such as legal, human resources, executive, planning, financial services, procurement, research and development, planning, financial services, external relations, and it is likely that such activities are disproportionately associated with the marketing and pursuit of competitive and advanced services.  Absent a better tracking system that would record these expenses separately for Title 61 and Title 62 services at the time the expenses were incurred (e.g., through time management and reporting systems), it is virtually impossible to determine a fair allocation.  The Commission could disallow all of the expenses until such time as the Company provides better justifi­cation for the expenses that it proposes to allocate to Title 61.  Alternatively, the Commission could allocate these corporate operations expenses based upon revenues, which at least reflects in part the incentives that exist for the Company regarding corporate expenses.

Q.  In which instances did you rely upon US West's proposed allocation of expenses?

A.  I relied upon the Company's proposed allocation for Network Administration (Line 18), Customer Operations (Line 23), Uncollectibles (Line 26), and Other Operating (Line 29).

Q.  How did you allocate the Pension account to the Title 61 and Title 62 services?

A.  The Pension account is assigned on the same basis as Customer Operations.

Q.  How did you allocate EAS costs?

A.  The expansion of local calling areas affects Title 61 and Title 62 customers.  Based upon the data shown in Schedule 6 in Exhibit 113, I computed a ratio of Title 61 lines and Title 62 lines (excluding lines that are not appropriately included, such as WATS, RCC, private lines, and PBX inward trunks), and I used this ratio to allocate the EAS costs.  An improvement on this method would be to implement a usage-based allocator, i.e., to determine the ratio of (1) usage (that has been reclassified from toll to local) that is associated with Title 62 lines to the (2) relevant usage associated with Title 61 lines.  The Commission could direct the Company to provide these data and, based upon these data, the EAS costs could be allocated.  In the absence of such data, I recommend that the Commission adopt the allocation shown in Exhibit 101 to Mr. Lansing's testimony, which is based upon relative numbers of switched lines in service.

Q.  Did you examine the Company's allocation of revenues?

A.  No, I did not, but both Dr. Selwyn and Staff Witness Carlock discuss the proper allocation of directory revenues.

Q.  Ms. Baldwin, do you have any other recommendations regarding the allocation of the Company's costs?

A.  Yes.  The Company should be directed, in its compliance filing, to provide comprehensive workpapers and documentation relating to the implementation of the recommendations made by and on behalf of Staff.

The level of complexity of a cost allocation system does not in and of itself render the results reliable for rate setting purposes.

Q.  The Company's proposed cost allocation system seems complex, sophisticated, and able to process vast quantities of data concerning expenses, investment and revenues.  Your proposal would have the Commission ignore the results of this detailed cost accounting, allocation and reporting system and adopt a simple approach to assigning costs between Title 61 and Title 62 services.  Aren't you concerned that your proposal will be less accurate in its results by virtue of its apparent simplicity?

A.  No.  The Commission should not be misled into equating complexity with accuracy.  The Company takes approximately a half-billion dollars in plant in service and, relying on its CAAS (including numerous special studies) ends up with a proposed allocation of only 36% of plant in service to Title 62 products (see Schedule 1 of Exhibit 113).  While all the individual numbers may tally up and reconcile with the ledger, that is not the proper criterion for evaluating the validity of the results.  The fact that there are 136 files (including text and Excel files and spreadsheets) may offer the appearance of accuracy, but it would be a serious mistake for the Commission to conclude that the sheer volume of data processing that occurs in the CAAS renders the results reliable.

One proper criterion that the CAAS fails to reflect adequately is whether the costs are truly being allocated on a cost-causation basis.  The Company defines cost causative in its glossary as follows:  "A product is considered cost causative of a cost pool if the product is the sole reason for the cost to be incurred, or if the amount of costs incurred are affected by the provisioning of the product" (CAAS, Section VII, at 2, emphasis added).  This is an overly narrow definition of cost causation.  The replacement of analog electronic central offices with digital switches is largely caused by a business need to provide custom calling services, to attract and retain customers for digital Centrex who might otherwise migrate to competing PBX services, and to offer unregulated new services such as Frame Relay, etc., none of which are subject to Title 61 regulation.  The Company's proposed cost allocation system related existing plant (and other costs) to existing services, thereby excluding from consideration of cost causation any costs whose incurrence was driven by future needs and business goals.

As other Staff witnesses discuss in their testimony, the Company has made negligible effort to directly assign costs and expenses but rather lumps them in common pools to be allocated in a manner that benefits Title 62 services and harms Title 61 customers.

US West's proposed cost allocation methodology would burden Title 61 with the costs of competitive Title 62 services.

Q.  The Company contends that because residence accounts for 83% of Title 61 access lines, that it follows that the basic residence services represent the majority of the Title 61 costs.  Do you agree?

A.  Although the Company contends that the relative percentage of access lines indicates the appropriate distribution of costs (Elder (US West) at 17), the issue is significantly more complicated than the Company would have the Commission believe.  First, before addressing the split within the Title 61 category, it is necessary to consider the split between the Title 61 and Title 62 categories.  Basing allocation on lines in service does not necessarily reflect cost causation, particularly in a market that may face competition.  If the Company, for example, maintains a low utilization factor for its outside plant (i.e., low fill factor) in order to be able to rapidly respond to demand for Centrex and other Title 62 services, allocating investment based upon lines currently in service will disproportionately burden Title 61 customers with the cost of that excess capacity, capacity that would not be necessary but for the Company's interest in serving a competitive market.  Such an allocation would thus expressly violate the statutory prohibition against cross-subsidization of Title 62 services by Title 61 customers (Idaho Code §62-613).

Turning to the split within the Title 61 category, the Company endeavors to show that its cost of providing basic residence exchange services is far greater than its cost of providing business service, thus justifying its proposal to recover practically the entire amount of its desired revenue increase from its captive Title 61 residential customers.  US West presents a table in which it develops the argument that due to longer loop lengths for Title 61 residence customers, there is a proportionately higher loop investment required per residential access line, as compared with Title 61 business customers.  By the Company's calculation, loop costs per residential access line are 42% more than loop costs per title 61 business access line (Elder (US West), at 19).  The Company then compares COE usage investment for Title 61 business and residence customers.  Based on its evidence, Title 61 business usage investment per access line is 21% more than residence (Id., at 19).  The Company then combines loop and COE investment per access line, and finds that residence costs per access line are approximately 1.24 times those of title 61 business customers (Id., at 19).  It uses this finding to justify its argument that residential customers should bear the brunt of the proposed rate increase.

Within the Title 61 category, the Company conducted studies that purport to show that the loop investment per residence line is $802 while, according to the Company, the corresponding amount for business lines is only $565.  (Elder (US West) at 19.  These amounts represent the loop embedded gross investment after the interstate allocation and after the intrastate 15% assignment to toll and switched access.)  The Company also contends that the central office usage (COE) investment per residence and business line, respectively, is $199 and $240 (Elder (US West) at 19).  Thus, according to the Company, the total loop and COE for the residence and business line, respectively, are $1001 and $805 (Elder (US West) at 19.)

Q.  Do you concur with the Company's findings?

A.  No.  First, as Schedule 2 in Exhibit 113 shows, during the period beginning 1991 through 1995, the compound annual growth rate in secondary residence lines was almost eight times as high as the corresponding growth in primary residence lines.  Therefore, within the residence customer class, it is additional lines, not first lines that are largely creating the need for spare capacity.  Should the Commission ever contemplate adjustments to rates for residential service, the increases should be for rates charged for additional lines, and not rates for initial lines.

The Company has raised concern about high-cost customers, but failed to provide any data that indicates that the total revenue stream associated with serving these customers fails to cover the cost.  If offering Title 61 customers is such a losing proposition, there is absolutely no reason that the Company should be marketing second lines.  Instead, the likely business proposition is that even if the line is a "loss leader" (though the Company has failed to demonstrate this to be the case) connecting a customer to US West's network enables it to derive substantial Title 62 revenues.

Furthermore, as US West implements plans to pursue competitive markets such as broadband, interactive video, and other nonregulated services, it will deploy plant now in anticipation of some later date when it will introduce and provide services that will generate a revenue stream for the Company.  Therefore, as I stated previously, an allocator that is based upon today's demand will result in an overassignment of common costs to Title 61 basic local exchange service.

The allocation of cost should track the purpose for which the cost was incurred.

Q.  Should the Company conduct a business case before it invests in new plant in its southern Idaho network?

A.  It depends.   Ultimately, costs should be assigned based upon a cost causation principle.  There are three general categories of investment that one can consider that reflect different rationales for capital investment projects.  First, although I would expect US West to prepare some type of net present value analysis of any proposed capital construction plans, those investments that the Company undertakes solely to support existing or new Title 62 services or that it has undertaken entirely using Title 62 funds are outside the purview of the Commission.  Thus the investments that the Company undertook during the years of revenue sharing with funds not derived from Title 61 services and any other investments for which the costs are entirely allocated to Title 62 are irrelevant to this and future Commission proceedings.

A second category of investment corresponds with Commission-mandated construction plans, such as the Tech Plus and Tech II plans that were undertaken consistent with Commission directive and using Title 61 revenue sharing funds.  The Commission did not require a business case in these instances.  However, because these investments were fully expensed, the cost allocation of these investments is straightforward — the plant in service associated with these investments should be allocated to Title 61 as should the completely offsetting accumulated depreciation.

Q.  You referred to three categories of investment.  What is the third group?

A.  The third, and most complicated investment category corresponds with construction that supports both Title 61 and Title 62 services, i.e., common plant.  For these projects, there needs to be some type of linkage between a cost-benefit analysis for capital construction projects for which any portion of the costs are to be allocated to Title 61 services.  It is inadequate for the Company to simply undertake additions and replacements to plant willy-nilly and then at a later date seek recovery from Title 61 customers simply because they inevitably "use" the plant.

Q.  You have discussed the role of business case analyses related to network modernization initiatives.  What is your understanding of when the Company actually conducts such analyses?

A.  Staff questioned US West in several contexts regarding business case analyses.  In several instances, where questions were asked about specific technologies or services, the Company responded that it had not, in fact, performed business case analyses for the introduction of a new product or service in southern Idaho.  However, in response to a more general Staff Data Request regarding any business case analyses performed by the Company, the response made reference to "Business Case Guidelines/Outlines - 1997 Program Funding/1996 interim funding" (Response to Staff Data Request 02-061).  The Company claims that this guide is highly proprietary, and has made a copy available at US West's offices in Boise.

Q.  Does the Company always undertake cost-benefit analyses before investing in its network?

A.  Apparently not.  US West indicated that CUCRIT studies were not done on digital circuit equipment technology deployment plans: "USWC has already adopted a fiber strategy for interoffice applications based on fiber's increased bandwidth and increased reliability" (see Schedule 5 of Exhibit 113, which is the Company's response to STF03-232).

The Commission should adopt a cost allocation methodology that ensures that Title 61 is not cross-subsidizing Title 62, or indeed non-southern Idaho services.

Q.  Please summarize your recommendations.

A.  The Commission should adopt the following approach to allocating costs between Title 61 and Title 62.

1.To the extent possible, costs should be directly assigned based upon cost causation principles (e.g., expenses associated with Bellcore projects that support Title 62 services should be directly assigned to Title 62).  The implementation of this principle will likely require the Company to develop improved reporting and accounting systems, such as time management systems for its corporate and customer service operations.

2.Any network modernization programs undertaken at the Company's initiative should be allocated to Title 62, and any network modernization undertaken with revenue sharing funds should be allocated to Title 61 (along with the corresponding offset in the Accumulated Depreciation account).  As I discuss in my testimony, the Company should compensate Title 61 for the use of common plant that has been modernized entirely with Title 61 funds.

3.Allocating investment based upon present quantities of demand (e.g., lines in service, or minutes of use) is inappropriate because Title 61 customers would then bear an inappropriate share of the costs of excess capacity, and of investment undertaken for speculative purposes, for example, where the Company undertakes a construction project with an expectation of future unregulated revenues.

Cost-based pricing is an acceptable, and economically sound goal for local service; however, the costs upon which local service rates are based need to be determined in a manner that is justified on both economic and legal grounds.

Q.  US West contends that prices for residence local exchange service must move toward costs.  Do you agree?

A.  I certainly am not opposed to moving rates toward cost — as the Company contends is necessary in a competitive environment (Wozniak (US West) at 6) — but it is critically important that the "costs" that are to be reflected in rates for Title 61 services include only those items that are legitimately associated with the efficient provision of basic local exchange service.

The Company is focusing upon the costs that it proposes to allocate to Title 61 services and the revenues that these services yield.  This is an incomplete picture.  In order to fully understand the Company's position in southern Idaho, the Commission must look on the other side of the wall - at the revenues and costs associated with Title 62 services.  It is misleading to consider merely the revenues associated with basic local exchange service.  The bifurcated regulatory structure in Idaho presents US West with both the economic incentive and (through rate case filings such as the present one) the opportunity to "game" the regulatory system by shifting costs to the Title 61 services while shifting revenues to Title 62.  Absent affirmative regulatory intervention with respect to both costs and revenues, the goals of the 1988 legislation can be easily frustrated by the Company.

When a household is connected to the public switched network, it purchases a variety of Title 61 and Title 62 services, which in total, yield revenues in excess of the revenue associated with basic local exchange service.  If, in anticipation of competitive inroads into toll, vertical offerings, and other Title 62 services, the Company is proposing to raise local exchange rates, then presumably, it should be simultaneously proposing to lower rates for Title 62 services.  If US West is not proposing to lower these rates, that suggests that these services do not yet face meaningful competition and the Company will benefit from a windfall until such time as effective competition "arrives."  Alternatively, if competition occurs earlier in urban areas than in rural areas, rural customers without competitive alternatives will pay more for residential local exchange service without benefitting from lower rates for Title 62 services.

Q.  What are some of the possible problems of relying on US West's proposed fully allocated cost study as Idaho enters a period of progress toward competition in the tele­com­muni­ca­tions market?

A.  The fully allocated cost methodology ensures that US West recovers all of the embedded costs associated with its existing Title 61 and Title 62 services.  However, it is inevitable that US West will (1) deploy new services and (2) increase the demand for existing Title 62 services, and as my testimony demonstrates demand for Title 62 services (which includes services such as custom calling and CLASS that are not measured in lines but other units) are growing at a faster pace than that Title 62 services.  Because the excess capacity in today's network in Idaho will enable US West to offer new services and to meet additional demand for other existing Title 62 services at negligible incremental cost, these services will essentially get a "free ride" in the future.

Q.  What would be the implication of the Company failing to assign and to allocate adequate costs to all of the Title 62 products?

A.  Aside from the serious issue I discussed above with regard to the allocation of costs to future new services, even within the framework of the Company's CAAS, the failure to allocate to costs to all Title 62 services results in an over-allocation of common plant to Title 61 services.

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