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1 BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
2 COMMISSION

3 WASHINGTON UTILITIES AND)
TRANSPORTATION COMMISSION,) DOCKET NO. UT-950200
4)
Complainant,) VOLUME 16
5)
vs.) Pages 1119 - 1339
6)
U S WEST COMMUNICATIONS, INC.,)
7)
Respondent.)
8 -----)

9 A hearing in the above matter was held at
10 9:24 a.m. on January 9, 1996, at 1300 South Evergreen
11 Park Drive Southwest, Olympia, Washington
12 before Chairman SHARON L. NELSON, Commissioners
13 RICHARD HEMSTAD, WILLIAM R. GILLIS and Administrative
14 Law Judge C. ROBERT WALLIS.

15

16 The parties were present as follows:

17 U S WEST COMMUNICATIONS, by EDWARD SHAW and
DOUGLAS OWENS, Attorneys at Law, 1600 Bell Plaza,
18 Seattle, Washington 98191 and JAMES VAN NOSTRAND,
Attorney at Law, 411 - 108th Avenue Northeast,
19 Bellevue, Washington 98004.

20 WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION STAFF, by STEVEN W. SMITH and GREGORY
21 TRAUTMAN, Assistant Attorneys General, 1400 South
Evergreen Park Drive Southwest, Olympia, Washington
22 98504.

23 FOR THE PUBLIC, DONALD TROTTER, Assistant
Attorney General, 900 Fourth Avenue, Suite 2000,
24 Seattle, Washington 98164.

25 Cheryl Macdonald, CSR
Court Reporter

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APPEARANCES (CONT.)

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19 AMERICAN ASSOCIATION OF RETIRED PERSONS, by
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I N D E X

2	WITNESSES:	D	C	RD	RC	EXAM
	PORTER	1122	1124	1199	1213	1186
3	WRIGHT	1223	1226			
4	EXHIBITS:	MARKED	ADMITTED			
	33-T, 153-T		1124			
5	2-T	1222	1225			
	3-5	1222				
6	154-T	1222	1225			
	155, 156	1222				
7	157	1222	1225			
	158	1222	1225			
8	159	1222	1225			
	160C	1222	1225			
9	161-T	1222	1225			
	162-163	1222				
10	2A	1223	1225			
	187	1223				
11	199	1223	1225			
	198		1225			
12	164	1240	1241			
	165	1240	1249			
13	166	1240	1257			
	167	1240	1260			
14	168	1240	1266			
	169	1240	1267			
15	170	1240	1279			
	171	1240	1281			
16	172	1240				
	173	1240	1273			
17	174	1240	1297			
	175-176	1240				
18	177	1240	1298			
	178-180	1240				
19	181	1240	1303			
	182	1240	1305			
20	183	1240	1305			
	184	1240				
21	185	1240	1310			
	186	1240	1314			
22	187	1240	1318			
	188-191	1240				
23	192-C	1240	1332			
	193	1240	1286			
24	194	1240	1285			
	195	1240				
25						

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1 P R O C E E D I N G S

2 JUDGE WALLIS: And because we're ready to
3 go let's be on the record, please, for our January 9,
4 1995 session in the matter of docket No. UT-950200
5 U S WEST Communications. This morning we're going to
6 begin with witness Dwight Porter on behalf of the
7 company; is that correct?

8 MR. SHAW: Yes. I want to confirm my
9 notes. Dr. Porter's direct is 33-T and rebuttal
10 153-T?

11 JUDGE WALLIS: Yes. I would ask the
12 reporter to insert the identification of those
13 documents at this point in the transcript.

14 MR. SHAW: Company would call Dr. Dwight
15 Porter.

16 Whereupon,

17 DR. DWIGHT PORTER,
18 having been first duly sworn, was called as a witness
19 herein and was examined and testified as follows:

20

21 DIRECT EXAMINATION

22 BY MR. SHAW:

23 Q. Would you state your name for the record?

24 A. My name is Dwight A. Porter and my address
25 is 42 Kenwood Parkway St. Paul, Minnesota.

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1 Q. What is your occupation, sir?

2 A. I'm a university professor and also a
3 president and a principal of a consulting firm Applied
4 Decision Resources.

5 Q. Are you the same Dwight Porter that caused
6 to be prefiled what is marked for identification as
7 33-T direct testimony and 153-T rebuttal testimony?

8 A. Yes, I am.

9 Q. Was this testimony prepared by you or under
10 your direction?

11 A. Yes, it was.

12 Q. Is it true and correct to the best of your
13 knowledge?

14 A. Other than a few minor corrections to my
15 rebuttal testimony.

16 Q. Would you make those corrections now,
17 please?

18 A. Yes. On my rebuttal testimony, page 7,
19 line 13, it currently reads "a specific service at."
20 After at insert A so that it should read "at a price
21 below cost."

22 On page 16, line 16, the sentence currently
23 reads, "after all," and there is a period. A comma
24 should be substituted for the period. And finally on
25 page 27, line 20, the sentence currently reads, "U S

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1 WEST should sole." It should read solve. Please
2 replace "sole" with "solve."

3 Q. With those corrections are the two exhibits
4 true and correct to the best of your knowledge and
5 belief?

6 A. Yes, they are.

7 MR. SHAW: Your Honor, I would offer
8 Exhibits 33-T and 153-T and tender the witness for
9 cross-examination.

10 JUDGE WALLIS: Is there an objection to the
11 exhibits? Let the record show that there is no
12 response and Exhibits 33-T and 153-T are received in
13 evidence.

14 (Admitted Exhibits 33-T and 153-T.)

15

16 CROSS-EXAMINATION

17 BY MR. TRAUTMAN:

18 Q. Good morning, Dr. Porter.

19 A. Good morning

20 Q. Like to start. With page 4 of your direct
21 testimony and on lines 25 to 27 you state that the
22 general purpose of your purpose is to "provide a clear
23 economic context to enable the Washington Commission
24 to make decisions regarding rates and prices for U S
25 WEST's services." Do you see that?

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1 A. Counsel, I may not see it. I may need to
2 see an official copy. It looks like I'm looking at a
3 copy that has different pagination and lines.

4 JUDGE WALLIS: Let's be off the record,
5 please.

6 (Recess.)

7 JUDGE WALLIS: Let's be on the record,
8 please. Does the witness have the appropriate
9 document now?

10 THE WITNESS: Yes, I do.

11 Q. And referring to that statement, did you
12 undertake any direct study or analysis of
13 telecommunications markets in Washington state in
14 preparing your testimony?

15 A. As I indicated in my response to the
16 information requests, I did review the testimony and
17 work of Mr. Brigham subsequently sponsored by Mr.
18 Scott and have had extensive discussions with the
19 company on the issues of competition within the state.

20 Q. But did you undertake any direct study or
21 analysis of telecommunications markets in Washington?

22 A. Well, if that doesn't feel like a direct
23 study to you then I guess the answer is no, but I did
24 make an effort to inform myself and understand the
25 issues that were ongoing in Washington.

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1 Q. Direct. And you reviewed the testimony of
2 Mr. Brigham and others?

3 A. Yes.

4 Q. Could you give us estimates of U S WEST's
5 current market share for Washington local business
6 services?

7 A. I can't give you the specific numbers, no.
8 You would have to inquire of other U S WEST witnesses
9 for those numbers.

10 Q. Could you give us an estimate of U S WEST
11 current market share for Washington local residential
12 service?

13 A. Well, my understanding is that it's a very
14 high market share. I can't give you the exact number.

15 Q. You can't be more specific than that?

16 A. No.

17 Q. Can you give us the number of competitors
18 that are operating in each of those markets today?

19 A. Not specifically, no, exactly.

20 Q. Turning to page 6, line 17 of your direct
21 testimony, you state, "today many rates are in place
22 as a result of historical circumstances that no longer
23 exist or are no longer relevant." Do you see that?

24 A. Yes, I do.

25 Q. Did you review the specific rate and cost

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1 structures of U S WEST's services in Washington in
2 preparing that testimony?

3 A. Yes, I did.

4 Q. Specifically which rates and cost
5 structures?

6 A. Well, I had, again, and we may have a
7 semantic difference here, Counsel, but I made a point
8 of trying as best as I could to understand current U S
9 WEST rates and the associated costs by discussing
10 those issues with company employees prior to my
11 testimony being prepared.

12 Q. Have you reviewed this Commission's order
13 in docket UT-93-0957 which is commonly known as the
14 term loop case?

15 A. I haven't specifically reviewed that in
16 detail, no.

17 Q. Would you accept subject to check that the
18 Commission authorized the company in that docket to
19 restructure various business service rates as the
20 Commission had requested?

21 A. I'm aware of that revision, yes.

22 Q. Turning to page 29 of your direct testimony
23 and on lines 4 through 20 you discuss flexible price
24 regulation for U S WEST. Do you see that?

25 A. Yes, I do.

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1 Q. In preparing this testimony did you conduct
2 any study or review of existing Washington statutes
3 regarding pricing flexibility for telecommunications
4 firms?

5 A. Well, I again had discussions with company
6 representatives on those issues, and I am aware at
7 least in large measure of the fact that the company
8 has permission to lower its prices. The main thrust
9 of my testimony is that that permission absent a
10 change in other prices is not a meaningful form of
11 price flexibility.

12 Q. Turning to page 39. On lines 5 and 6 you
13 state, "greater care needs to be taken in the process
14 of eliminating monopoly power to not unfairly harm U S
15 WEST as a company." How would you define harm in that
16 testimony?

17 A. Well, I think that the Commission, as I've
18 said throughout my testimony here, has a huge issue
19 which is that there is in my opinion a very large
20 probability that if this is not done properly that U S
21 WEST could be driven to a level of financial
22 performance that could approach a region insolvency
23 very, very quickly and so my view of the harm here is
24 that unless very serious and careful attention is paid
25 to the issues of the financial solvency of the company

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1 that measures which may seem to be well meaning will
2 turn out to be seriously harmful to the Washington
3 ratepayers and telecommunications customer.

4 Q. On lines 23 to 24 of the same page you
5 state that "a monopoly should have to expect to give up
6 some market share." Did you have a specific figure in
7 mind?

8 A. Well, this relates back to a very important
9 issue in my testimony which is really so important for
10 me to try to communicate to the Commission, and that
11 is it is my firm belief that relatively small amounts
12 of market share of a particular market are very, very
13 important to the ongoing profitability of the company,
14 and, therefore, it really all depends on what
15 customers are lost before one can put a percentage on
16 it. If one were going to say that one was looking at
17 market share across the entire state and equal share
18 changes were taking place in all different customer
19 types, you would get one answer, but if the answer is
20 that the competitors are allowed to cream skim the
21 marketplace and go after the relatively small portion
22 of the marketplace that provides the company's profits
23 then the point is that very, very small amounts of
24 market share can cause a great deal of harm to the
25 company and that's why one can't really put a number

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1 here until one is clear about what the rules are about
2 what kinds of market share is going to be lost and how
3 the company can compete.

4 Q. So you would not have a specific figure in
5 mind?

6 A. I would not.

7 Q. Turning to page 40 and on lines 23 to 26
8 you state that you have "reviewed U S WEST's cost study
9 methodology and approach and find it theoretically
10 correct." What material specifically did you review in
11 coming to that conclusion?

12 A. Well, that's a very complicated question
13 and answer. I've been working with the company's cost
14 crew off and on for ten years and have had numerous
15 meetings and reviewed voluminous amounts of material
16 and had long discussions with the company about their
17 cost studies, the underlying theoretical assumptions
18 and a review of the specifics in some cases. Most
19 recently I was in the Wyoming case and had occasion to
20 work very closely with the cost witnesses with respect
21 to that case for very specific elements and components
22 of their cost studies.

23 Q. In this case again what material
24 specifically did you review in coming to your
25 conclusion that U S WEST cost study methodology and

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1 approach was theoretically correct?

2 A. Well, I'm not going to be able to give you
3 a precise answer, Counsel, but I had a number of
4 meetings with U S WEST in the prior year discussing
5 cost methodology. I reviewed several documents which
6 they sent me. I had discussions with Mr. Farrow and
7 other company cost witnesses during that time frame
8 very specifically discussing their cost methodology
9 and its theoretical components.

10 Q. What part did you play in developing what's
11 known as ADSRC?

12 A. None specifically though I've had
13 discussions with the company of ADSRC and I think I
14 understand it fairly well.

15 Q. On page 41, lines 1 to 10 of your direct
16 testimony you provide your views on the economically
17 correct type of depreciation to use in U S WEST's cost
18 studies; is that correct?

19 A. Yes, it is.

20 Q. Have you conducted any studies of
21 depreciation lives used in Washington and made a
22 determination that the lives currently in use are in
23 fact not representative of the economic lives of
24 Washington?

25 A. No, I have not.

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1 Q. Have you reviewed any studies of U S WEST
2 Washington plant lives and as a result concluded that
3 depreciation lives prescribed in Washington were in
4 fact too long?

5 A. No, but the thrust of my testimony isn't
6 really to those issues. It's much more related to not
7 the issues of the physical plant life but to their
8 economic life as I specifically state in my testimony,
9 so you're asking me whether I've done things which I
10 say aren't the relevant things to be done.

11 Q. But in answer to both questions the answer
12 is no?

13 A. That's correct.

14 Q. If you could now turn to your rebuttal
15 testimony on page 4.

16 A. Counsel, I'm just going to have them give me
17 a current copy of it to make sure that pagination is
18 the same again. Page 4, did you say?

19 Q. Yes. And at lines 8 through 10 you state,
20 "the loop and its related service, residential local
21 service, clearly represents a stand alone product which
22 a consumer can easily buy independently of other
23 services." Do you see that?

24 A. Yes, I do.

25 Q. Can you define the term local loop?

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1 A. Well, there are two ways to look at this,
2 and it's I think used interchangeably when in fact
3 perhaps it shouldn't be. One way to look at it is if
4 you're performing a cost study there is an element in
5 the cost study called the local loop and that consists
6 of certain piece parts of the network that when
7 they're defined as the local loop are essentially
8 added up to create the cost of the loop. The other
9 way of thinking of the local loop is the way I think
10 most of us think of it which is the facilities or the
11 capability necessary to provide local service, and my
12 point is that the two are often used interchangeably.

13 Q. Would you agree that the local loop is
14 essentially the pair of wires that connects the
15 customer to the rest of the local exchange network?

16 A. That would be one way in defining it.

17 Q. Has U S WEST filed a tariff for an
18 unbundled local loop facility?

19 A. I'm not aware of the status of a filing on
20 that issue.

21 Q. To your knowledge, has the company filed
22 tariff revisions in this proceeding that would affect
23 the definition of local service calling areas in
24 Washington?

25 A. I think they have, yes.

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1 Q. Under the existing tariffs for flat rate
2 local exchange service customers in some U S WEST
3 exchanges have larger or smaller local calling areas
4 than other customers; is that correct?

5 A. I understand that to be the case, yes.

6 Q. Do those variations in the local calling
7 area affect the cost of the local loop provided by the
8 company in those different exchanges?

9 A. Well, again, I think we're back to the
10 question of definition. If one is going to talk about
11 the local loop in terms of the pair of wires then the
12 issue there will have to do with the location and the
13 density and the sort of mechanical or engineering
14 issues associated with the loop. If, on the other
15 hand, one is referring to the local loop as the cost
16 of providing residential service then it's very clear
17 that differences in density do impact the cost of
18 providing the service. And the whole issue of
19 geographic averaging or deaveraging comes into play.

20 Q. Would you agree that flat rate local
21 exchange service has at least two different
22 components, one a local loop providing a connection to
23 the network and also a usage component represented by
24 the local calling area?

25 A. Yes, there is. Those two components are

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1 both part of the local loop as defined by the ability
2 to obtain service.

3 Q. Would you agree that toll service as
4 furnished to an end user also consists of these two
5 components, the conveyance of the call between the
6 exchanges and the passage of the call within the
7 originating and terminating exchanges, that being
8 access?

9 A. Well, I think that that's a more complex
10 issue, and I am not prepared to say yes to that in
11 this quite a simple way. Clearly, in a very narrow
12 sense, if the call has to originate and terminate
13 someplace those are part of the call. The main point
14 is over whose facilities will it originate and
15 terminate, and the point here is that as the industry
16 becomes competitive that the origination and
17 termination of that long distance call can start to be
18 happening over different facilities, so if one sort of
19 goes to the historical circumstance one can say, well,
20 local telephone situation it had to originate over the
21 local call -- over the local loop but there's nothing
22 that says that that's the way it's going to happen in
23 the future.

24 Q. But that's the way it happens today?

25 A. No, Counsel, I don't agree with that at

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1 all.

2 Q. Would you agree that there are at least,
3 again, two components. There's the conveyance of the
4 call between exchanges and then the access component
5 being the passage of the call within the originating
6 and terminating exchanges?

7 A. Counsel, that's what I'm trying to say is I
8 can't agree to that because the point is that I might
9 well choose to carry that traffic over my cellular
10 phone in which case the transport element is there but
11 the originating and terminating piece isn't there at
12 all.

13 Q. Are there any other exceptions other than
14 cellular?

15 A. In the short-term there are I think
16 relatively few exceptions. In the very near term,
17 which is the point of my testimony, there will be so
18 many exceptions to that issue that it is essential for
19 us to begin to start to take them into consideration
20 when one does costing studies for the local loop.

21 Q. With that exception in mind, would you
22 otherwise agree that in the absence of the access
23 component at either end that a toll call would not get
24 through?

25 A. The issue of how a toll call is originated

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1 and terminated is highly dependent upon the facilities
2 one is going to use. I might choose to originate it
3 at a coin station. I might choose to terminate it at
4 a coin station. I might choose to terminate it at my
5 friend's house. I might choose to originate it in a
6 hotel room. The point is that the origination and
7 termination does require facilities. Those facilities
8 are not necessarily the local loop that the customer
9 has purchased to provide local telephone service. I do
10 the vast majority of my long distance calling over
11 facilities other than my home phone.

12 Q. Can you tell me what percentage of U S WEST
13 in state local traffic -- toll traffic -- that either
14 originates or terminates in company exchanges passes
15 through a company local loop?

16 A. You would have to ask U S WEST witness for
17 those numbers.

18 Q. Do you have any idea at all what an
19 estimate would be?

20 A. At present I'm prepared to agree that most
21 traffic currently is originating and terminating over
22 local loops of one kind or another, but as I've
23 already said, the main point of my testimony is that
24 that will no longer continue to be the case and
25 therefore cannot be relied upon as a basis for doing

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1 cost studies in a competitive environment.

2 Q. You agree, though -- you said most. Would
3 you agree that virtually all presently?

4 A. No. I think that if one were to do the
5 study one would find that a fair amount of traffic is
6 now being carried by cellular providers and that the
7 amount of cellular traffic that's being carried is
8 growing far more rapidly in percentage terms than the
9 amount of traffic being carried over the traditional
10 network.

11 Q. But you just indicated that you didn't
12 know, correct?

13 A. In the state of Washington I do not have
14 those specific numbers. I indicated that, yes,
15 Counsel.

16 Q. Isn't the local loop just as critical to
17 the completion of toll calls as it is for local calls
18 currently?

19 A. There are two ways to looking at it. One
20 is that while there is a need to complete the
21 connection and that one has to have a facility to
22 create the connection, which is true from an
23 engineering point of view, does not create an economic
24 justification for cost causality. As I think the
25 Commission is aware, a very large percentage -- Ms.

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1 Owen's testimony presents the number -- of Washington
2 ratepayers have local service and do not make long
3 distance calls. So to be allocating some portion of
4 the local loop to long distance calls is basically
5 then requiring those people who make long distance
6 calls to have to subsidize those customers who are
7 not, and it's precisely those kinds of difficulties
8 that the Commission has the opportunity to try to
9 address now before competition disrupts the
10 marketplace and makes it impossible to recover these
11 kinds of revenues based on these sorts of allocations.

12 Q. Also on page 4 of your rebuttal you present
13 your views regarding loop issues and cross subsidies.
14 Is it your position that the cost of a residential
15 loop is one of the incremental costs of providing
16 residential service?

17 A. Yes.

18 Q. Are you aware of the incremental cost
19 definitions that were used by Mr. Farrow for volume
20 sensitive and service specific fixed costs?

21 A. I am in general aware of those definitions,
22 yes.

23 Q. Is it correct that the sum of the
24 volume-sensitive and service-specific fixed costs
25 comprise what the company calls the total service

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1 incremental costs or TSIC?

2 A. I think I will have to have you repeat
3 that.

4 Q. Would it be correct that the sum of the
5 volume-sensitive and the service-specific fixed costs
6 comprise what the company calls the total service
7 incremental costs?

8 A. I believe that's correct, yes.

9 Q. With regard to the total service
10 incremental cost for residential local exchange
11 service into which of those categories would the loop
12 fall?

13 A. The loop per se is falling into the fixed
14 cost component.

15 Q. Turning to page 8 of your rebuttal and here
16 you discuss the treatment of the Yellow Pages
17 directory revenues?

18 A. Yes.

19 Q. Is it your testimony that both the White
20 and the Yellow Page directories are services that are
21 provided to customers?

22 A. I'm not sure I really follow the thrust of
23 your question, Counsel. Perhaps you could clarify it.

24 Q. Well, I think the question is fairly
25 simple. Is it your testimony -- and you could turn to

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1 lines 16 to 18 on that same page on page 8. Is it
2 your testimony that both the White and the Yellow
3 Pages directories are services that are provided to
4 customers?

5 A. I think that the answer is basically yes.
6 My concern is this. That the word service can mean
7 two things. One is it can mean literally the product
8 or service or one could be discussing the level of
9 service that are provided by the two, and I think it's
10 fair to say that in the context of this discussion my
11 answer would be yes to both of those.

12 Q. Would you agree that the company's Yellow
13 Page service -- Yellow Pages service -- was quite
14 profitable at the time it was transferred to U S WEST
15 Direct?

16 A. Yes, I would agree with that.

17 Q. Can you identify any other profit making
18 service that the company has volume material
19 transferred out of its control since divestiture?

20 A. I am not aware of any specific one, no, but
21 you might wish to ask that question of a U S WEST
22 company witness.

23 Q. If the company decided to turn over its
24 intraLATA toll business to another operator, would you
25 expect the company to demand compensation from the

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1 recipient for the profits that it would be giving up?

2 A. Well, that's an interesting question. I'm
3 not sure in this day and age I would buy U S WEST
4 intraLATA business because I'm not sure how profitable
5 it's going to be in the future, which is a specific
6 answer to your question. The more general answer to
7 your question is if one is transferring an asset with
8 a profit stream associated with it would one expect
9 compensation and the answer would be generally yes.

10 Q. On page 12 of your rebuttal testimony, on
11 lines 22 to 123 you state, "there is still plenty of
12 room for residential rates to go up." Do you see
13 that?

14 A. Yes, I do.

15 Q. Has U S WEST made any studies of the
16 potential impacts of its proposal and universal
17 service?

18 A. In the state of Washington I think those
19 questions specifically are covered in Ms. Owen's
20 testimony, and I would direct you to her for a
21 specific answer to that question. I feel very
22 strongly based on my review of the evidence both in
23 general and in other states that the impact on
24 universal service as a result of rate increases in
25 residential service are going to be very, very

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1 minimal.

2 Q. But in response to my question which is
3 whether U S WEST had made any studies of this, you
4 indicate that you do not know?

5 A. No. I believe that Ms. Owen has looked
6 that issue and I think she will be able to give you a
7 satisfactory answer. That's my understanding.

8 Q. Turning to page 14, you summarize the
9 findings of what is called the Rutgers study, a profile
10 of telecommunications access in Camden, New Jersey in
11 1995 and you speak of what you call quote a number of
12 minutes regarding universal service. Do you see that?

13 A. Yes, I do.

14 Q. Has U S WEST taken any actions or created
15 any programs to address what you stated to be the most
16 important barrier to universal service, that being
17 start up and usage-related costs?

18 A. Counsel, that question would be better
19 addressed to a U S WEST company witness.

20 Q. Has U S WEST taken any actions or created
21 any targeted programs to address the low rates of
22 penetration in the groups that the study identified,
23 namely, younger age groups especially when they are
24 members of ethnic or racial minorities?

25 A. Well, my understanding in Washington is

01144

1 that this issue has been handled fairly sensitively and
2 quite well, and I guess I would give both the company
3 and the Commission quite high marks. I think so that
4 in Washington the telephone assistance program, which I
5 understand is a partnership between the Commission and
6 Washington has resulted in above average penetration
7 rates, and I think that both the Commission and the
8 company deserve a fair amount of credit for that.

9 Q. Has U S WEST taken any actions or created
10 any programs to address the penetration problem in
11 inner cities as well as in the rural areas?

12 A. Counsel, I again would encourage you to ask
13 those questions specifically of a U S WEST company
14 witness.

15 Q. Turning to page 26 of your rebuttal
16 testimony, on lines 5 to 10 you state, "the Commission
17 should be interested in increasing the prices of
18 residential services if those increases in price move
19 price above cost because that circumstance will
20 actually produce incentives for economic entry into
21 the marketplace. That entry will be the competition
22 the Commission is seeking." Do you see that
23 testimony?

24 A. Yes, I do.

25 Q. Now, could you go back to page 10 of your

01145

1 rebuttal testimony. And on lines 17 to 20 you state,
2 "for example, to me it's self-evident that competition
3 is already present in this industry yet a variety of
4 other participants in this case assert otherwise."
5 Doesn't that mean that the current prices are
6 sufficiently high to attract competitors in the market
7 if competition is already self-evident?

8 A. Well, Counsel, this is really the heart of
9 the issue. The point is that it's so self-evident
10 that it just kind of makes me after a while almost
11 tired trying to make the point over and over again so
12 let me go one more time. It is clear that competitors
13 are coming after U S WEST in high profit margin areas.
14 It will take a relatively small amount of market share
15 loss to badly hurt U S WEST, so if U S WEST's
16 situation is that it is required to lose market share
17 in order to demonstrate that it can be competitive and
18 market share loss is going to consist of a number and
19 that number represents customers that nobody wants
20 then U S WEST will forever be forced to have a market
21 share which one can then say requires it to remain a
22 monopoly.

23 The point is that if the Commission wants
24 competition in not only the high margin areas but also
25 for local service so that there can be a reliable

01146

1 source of other companies who will provide service to
2 people around the state of Washington, then costs for
3 residential service must be recovered with adequate
4 prices.

5 Q. When you stated that a relatively market
6 share would harm U S WEST, did you have any specific
7 number in mind?

8 A. Well, Counsel, I think that that is an
9 excellent question for the Commission to engage in a
10 dialogue with U S WEST about. One of the things that
11 I think is still missing from the public policy debate
12 here is how U S WEST will be financially harmed by the
13 loss of very specific sorts and types of customers,
14 and I think it's very important for the Commission to
15 understand those numbers and to work with U S WEST
16 because if what happens is that U S WEST loses that
17 market share before the Commission is aware of it and
18 can do anything about it the result is a very bad
19 outcome, so what I'm advocating is that that number
20 should be ascertained in a cooperative effort between
21 staff and the Commission and U S WEST, but I do not
22 know a specific number today.

23 Q. You do not have a number in mind?

24 A. No, I do not.

25 MR. TRAUTMAN: Thank you. No further

01147

1 questions.

2 JUDGE WALLIS: Mr. Trotter.

3

4 CROSS-EXAMINATION

5 BY MR. TROTTER:

6 Q. Would you turn to your rebuttal testimony
7 page 4 staff asked you a question on lines 7 through
8 10. I just want to be clear. U S WEST does not have
9 currently a retail service for a customer who would
10 buy a -- a retail customer made only by a local loop;
11 is that correct?

12 A. Yes.

13 Q. And discussions about filing an unbundled
14 loop, those are generally in the context of wholesale
15 services; is that correct?

16 A. That's correct.

17 Q. You were asked some questions about using
18 the loop to complete toll calls. Isn't it correct
19 that a customer can make a local call using cell
20 services?

21 A. Yes, that's correct.

22 Q. You cited some testimony of Ms. Owen's
23 regarding customers who may not make any long distance
24 calls. Do you recall that?

25 A. Yes, I do.

01148

1 Q. And by make a long distance call you mean
2 initiate long distance calls; is that correct?

3 A. That's correct, yes.

4 Q. And so that same customer in fact may
5 receive a toll call?

6 A. That's correct.

7 Q. Competitors who begin to install their own
8 loops do so to provide a full range of services, would
9 you agree?

10 A. Yes, and I would say that right now one of
11 the primary motivation is to avoid the charges
12 associated with the long distance component of the
13 delivery of service.

14 Q. And customer -- competitors are not
15 investing large sums of money in loop facilities for
16 the sole purposes of carrying access traffic alone on
17 those facilities, are they?

18 A. Well, I am not sure I would agree. In
19 other words, I think that at least right now one of
20 the primary motivations for the long distance carrier
21 is to want to be able to bypass U S WEST is to be able
22 to avoid the access charges that they're currently
23 obligated to pay U S WEST for. I'm not sure if that
24 gets at the heart of your question.

25 Q. I think I was focusing on the alternative

01149

1 local exchange providers, not so much the IXCs?

2 A. Yeah. I think the local exchange providers
3 again, it's a little bit complicated because there's
4 so many different types, but they may be there for a
5 variety of different reasons besides the one that you
6 mentioned, yes.

7 Q. And if an alternative local exchange
8 company decided to just provide access services they
9 would recover the full loop cost from their access
10 service; is that correct?

11 A. I'm not absolutely certain. Are you saying
12 that they would choose not to participate in that
13 marketplace if they couldn't get a price that would
14 recover their costs, is that what you're saying?

15 Q. No. I'm saying if an alternative local
16 exchange carrier comes in and places loop plant and
17 decides just to provide access services it would
18 recover the cost of its facilities from access services
19 if it could; is that right?

20 A. If it could. That's my point, which is I
21 don't know whether they will or not. I don't know
22 whether they will be allowed to price at a point which
23 will cover their costs or not.

24 Q. If they place their facilities for the
25 purposes of providing access service and then later

01150

1 decided to provide local exchange service, would the
2 cost of that facility attributable to local exchange
3 service be zero, the incremental cost?

4 A. Well, you're into a pretty difficult
5 territory here with respect to understanding costs and
6 the notion that at any given moment if a capacity
7 exists and is there for another purpose and one finds
8 another way to use it, theoretically the incremental
9 cost of the alternative use is zero. But that's a
10 very, very sort of specific and technical way of
11 looking at incremental cost. To understand the sort
12 of public policy issues of the incremental cost issues
13 involved in the line of questioning as you've just
14 inquired about is a much more complex issue.

15 Q. If competitors come in and install loop
16 plant to provide access services as well as their own
17 toll services as well as local exchange services,
18 they're going to attempt to recoup their investment
19 from all of those services?

20 A. That will be what I would expect their
21 normal business behavior to be, yes.

22 Q. On page 11 at the bottom of this page you
23 indicate that much of what is going to happen is going
24 to be a shifting of costs from one service to another
25 and it is unlikely there will be significant increases

01151

1 in the overall costs of telecommunications to
2 consumers. Do you see that?

3 A. Well, I haven't actually found it on the
4 page, but.

5 Q. Bottom of page 11 over to the top of page
6 12?

7 A. That's why I hadn't found it. Yes, I'm
8 familiar with that testimony.

9 Q. And when you talk about shifting of costs
10 you're discussing costs from a consumer standpoint,
11 that is, those that would be passed through in rates?

12 A. Yes. I'm referring what to here is
13 normally known as the total bill affect.

14 Q. And the total bill affect as a result of U
15 S WEST's proposal is a net average increase for
16 residential customers?

17 A. Well, I think that's my point is that the
18 total bill is impacted by more than just U S WEST's
19 actions. It's impacted by all of the services that
20 the customer buys as part of their telecommunications
21 package of services.

22 Q. And that would include reductions in long
23 distance due to reduced access charges?

24 A. Among other things, yes, and reduced prices
25 with respect to increased competition in the

01152

1 marketplace as well.

2 Q. Were you aware that the company assumed no
3 stimulated traffic effect as a result of their lowered
4 access charge?

5 A. No, I hadn't heard that.

6 Q. Are you surprised by that?

7 A. No, I'm not. I've been involved in this
8 war so many times. One of the problems is that when a
9 company reduces its access charges it can really only
10 count on stimulation if the long distance providers
11 actually do reduce long distance prices to the
12 customer and since that's something that isn't known
13 before the fact it's fairly difficult both from a
14 technical point of view and from a philosophical or
15 practical point of view to estimate what that amount
16 of stimulation is going to be.

17 Q. Well, the company has reduced access
18 charges before haven't they?

19 A. Yes, and in some cases -- I again don't
20 have the specifics in Washington. In some cases
21 there's been pass through and other cases there hasn't
22 which is what creates some quandary.

23 Q. Is it your testimony that the interexchange
24 toll market is not effectively competitive?

25 A. No. It's my testimony that under some

01153

1 circumstances the interexchange marketplace does not
2 pass on the full amount of reductions in access
3 charges to it.

4 Q. Is it your testimony that when there is an
5 access charge reduction that it's typical or common
6 for no reductions to occur?

7 A. No, that's not what I'm saying.

8 Q. Now, U S WEST's proposal in this case is
9 for reduced toll and switched access rates and
10 increases in residential and business -- excuse me --
11 residential exchange rates. Is that correct?

12 A. I phased out on the first phrase of your
13 sentence so say it again and I will listen more
14 carefully.

15 Q. The proposal here is to reduce toll and
16 switched access rates and increase residential
17 exchange rates?

18 A. Yes, that's my understanding.

19 Q. And to the extent that customers can affect
20 their bottom line bill they can to some degree at
21 least choose to reduce their toll usage; is that
22 correct?

23 A. No. What I'm saying is that -- that's
24 certainly an option, but I think it's important to
25 understand the spirit of my testimony is that this is

01154

1 not an instantaneous issue. My testimony on these
2 pages is talking about the result over a protracted
3 period of time and that what I'm saying is that the
4 industry is engaged in a price changing period and
5 that that price changing period has over a five or six
6 or seven year period has tended to show that increases
7 in prices in one area have been offset by decreases in
8 prices in others, so I'm not saying that in any given
9 instance with any given price change that that all
10 balances out but that I am saying over time it has
11 tended to balance out and I am expecting that it will
12 continue to do so.

13 Q. So it's your testimony at the end of five
14 years if U S WEST's proposal is accepted that the
15 customer's bill will be the same?

16 A. No, I'm not saying that at all.

17 Q. So when you say offset you don't mean
18 totally offset?

19 A. Well, this comes back to a point of a
20 question by Commissioner Gillis yesterday of Mr.
21 Okamoto. I think that one of the real things we have
22 to be careful about in this discussion is that what
23 the customer buys five years from now may be so
24 different than what they're buying today that I would
25 be hard pressed to say that I know what their bill is

01155

1 going to be like five years from now. They may be
2 buying huge amounts of Internet service. They may
3 have moved to ISDN. They may have chosen to have 100
4 a month telecommunications bill five years from now,
5 but in the midst of that bill will be changes in the
6 relative prices of some of the things they're buying
7 today and then added to that will be a whole number of
8 things that they've chosen to buy in the meanwhile
9 that aren't currently available. So I'm not
10 testifying that their bill will be the same five years
11 from now. I'm saying that a customer whose chooses to
12 buy none of those other things will most likely find
13 that the increases in their residential rates will be
14 at least in some measure offset by decreases in other
15 services that they're currently buying.

16 Q. Did you review the rate impact analysis
17 that the company provided in this case on a typical
18 customer bill?

19 A. No, I don't have any knowledge.

20 Q. Would you accept subject to check that there
21 were no adjustments for Internet usage or ISDN usage or
22 any of the other items that you listed in your prior
23 answer, would you accept that subject to your check?

24 A. Certainly I would, yes.

25 MR. TROTTER: That's all I have,

01156

1 thank you.

2

3

CROSS-EXAMINATION

4 BY MR. WAGGONER:

5 Q. Morning, Dr. Porter.

6 A. Morning.

7 Q. In the effort to save some trees I've not
8 made a copy of one of your data request responses so I
9 will read portions of it and we will go through it.
10 It's a question WUT-01-126. "Is it correct that while
11 AT&T lost market share between 1982 and 1990 the toll
12 revenues of AT&T were always higher than the preceding
13 year?" And you begin your answer by saying, "In
14 general I would agree with this statement though I
15 cannot immediately verify that revenues grew each year.
16 The key point is that their share loss was offset by a
17 growing overall market for toll." And then you go on.
18 Let me ask you a question about that first part. Do
19 you believe that the overall market for toll is still
20 rapidly growing?

21 A. My understanding from the most recent
22 numbers I've looked at, and I haven't probably looked
23 at something in a few months, is that it is still a
24 rapidly growing market.

25 Q. You then go on to say, "the result of

01157

1 revenue growth is not automatic and it depends both on
2 degree of share loss and the relative rate of overall
3 market growth. It is not clear that such conditions
4 will hold for U S WEST in the markets facing
5 competitive challenge in Washington." That's the end
6 of your response. Have you made any inquiry in your
7 conversations with U S WEST about their projections
8 for growth in Washington markets?

9 A. Not specifically, no.

10 Q. So you don't know whether they're assuming
11 rapid growth, no growth or negative growth in those
12 markets?

13 A. Well, that's not quite true. I mean, I
14 think that, again, it's a question of degree. I
15 certainly have had conversations with the company
16 about its prospects in this state and about the
17 potential for growth. There was also testimony
18 offered on that subject yesterday. My point is more a
19 general point than it is a point specifically about
20 Washington, and that is that I have not expected that
21 the growth in traditional services offered to the
22 residential and business marketplace as opposed to the
23 offering of new services, that those traditional
24 services had the same opportunity for growth as the
25 toll market has had over the past ten years.

01158

1 Q. Have you reviewed the testimony of both Mr.
2 Farrow and Mr. Copeland on cost issues in this
3 proceeding?

4 A. No. I've reviewed the testimony of Mr.
5 Farrow but not of Mr. Copeland.

6 Q. So you don't have any opinion as to the
7 cost study approach described by Mr. Copeland?

8 A. Not specifically, no.

9 Q. And you've already had some inquiry about
10 your review of Mr. Farrow's cost studies. Have you
11 actually reviewed the cost studies themselves?

12 A. Well, I think that's a very difficult
13 question to answer specifically. Do you mean have I
14 looked through --

15 Q. Let me try and be very specific. There are
16 summary outputs to cost studies which have summary
17 numbers for specific services. Have you looked at
18 those?

19 A. Yes.

20 Q. Then there are lots and lots of pieces of
21 paper and lots of computer programs which produce
22 those summaries?

23 A. Right.

24 Q. Have you looked at the backup, so to speak?

25 A. And this is where I was trying to qualify

01159

1 my question -- my answer in response to your question.
2 For these specific Washington studies I have not
3 looked at that copious support material. For other
4 circumstances, other states at other times I have had
5 the opportunity to examine those kind of papers and
6 the methodology and the modeling that produced those
7 papers for U S WEST.

8 Q. Are you the person that originated all
9 these acronyms that they use?

10 A. Absolutely not.

11 Q. Good. Are you familiar with the terms
12 marginal cost and average variable cost as those are
13 used in economic literature?

14 A. Yes, I am.

15 Q. And it's correct, isn't it, that those
16 terms are more closely related to what U S WEST calls
17 ASIC than what U S WEST calls ADSRC?

18 A. Oh, no, I think we need to be a little
19 careful here. The notion of marginal cost has
20 immediately one complicating element which is is it
21 going to be a short run marginal cost or a long-run
22 marginal cost so the first point of distinction or
23 departure is that since U S WEST is advocating a
24 long-run incremental cost study approach and most of
25 economics refers to marginal cost as a short run cost

01160

1 measure one is going to get a disconnect right there.
2 Assuming one can say, no, let's talk about long-run
3 marginal cost then the intent of a long-run incremental
4 cost study is to find a measure of the long-run
5 marginal or incremental cost associated with a decision
6 that would be made. There is one other small piece to
7 the answer. Would you like it or would you rather --

8 Q. No. In your response to one of TRACER's
9 data requests 01-041 you make the statement, "ADSRC is
10 not, however, the pure incremental cost for below
11 which a cross-subsidy for an individual service would
12 be guaranteed. That would occur at ASIC." When you
13 use the term pure incremental cost floor in this
14 answer, were you referring to long-run marginal cost?

15 A. Well, the issue here, the complicating
16 issue is is that if one looks at --

17 Q. You know, this would be a lot easier if you
18 say yes or no and then give an answer?

19 A. Well, Counsel I really can't because you're
20 using terms that have specific meaning and yet I don't
21 feel like we're using them in the same way so I can
22 say yes and the record will reflect something very
23 different than what I feel and I'm under oath.

24 Q. I appreciate that. Let me see if I can
25 restate the question and if I can't get a yes or no

01161

1 answer that's my problem I guess ultimately. I'm
2 trying to find when you use the terms pure incremental
3 cost floor were you meaning long-run marginal cost or
4 something else?

5 A. And what I'm trying to say is that there are
6 two long-run marginal costs that are in question here
7 so if you give me one minute I will try and clarify.
8 If I can looking at a family of products that are all
9 part of a family that family has a long-run marginal
10 cost. If I break that family into its pieces and I
11 make the assumption that I'm already offering the
12 family so that the costs of offering the family have
13 now been taken off the table then I will have a
14 long-run marginal cost for each of the pieces which are
15 different -- which will not add up to the long-run
16 marginal cost of the family, and the whole issue here,
17 which is under discussion and which is so confusing, is
18 that if one takes this down to the level of the product
19 and you make the assumption the family is being
20 offered, you get a marginal cost. A long-run marginal
21 cost that I'm referring to in my testimony. But if one
22 says what is the long-run marginal cost of offering the
23 family you get a different answer.

24 Q. Sure. Is family as you're using it a
25 generally accepted economic term?

01162

1 A. It has become a term of art with respect to
2 telecommunications costing.

3 Q. Well, you would agree, wouldn't you, that
4 telecommunications industry often wanders off into
5 strange directions in terms of economics?

6 A. And takes a few economists along with it.

7 Q. Well, I think I will resist further inquiry
8 into this area.

9 JUDGE WALLIS: Mr. Nichols.

10 MR. WAGGONER: I just meant that area.

11 Q. Well, maybe not entirely. We've been
12 talking about long-run marginal cost. Is that a term
13 you prefer to use when talking about costing or would
14 you rather talking about average variable cost?

15 A. Well, the two are so very different from
16 each other that it depends on what you want to talk
17 about. I mean, the point here, Counsel, is that there
18 is a difference and if we don't clarify the difference
19 then we're not going to be talking about the same
20 thing.

21 Q. That's great. I just wanted to make sure
22 that you use the two terms differently. Do you have
23 any opinion as to the likely cost structures of the
24 new entrants that you believe will be competing with
25 U S WEST in the local market?

01163

1 A. Well, I think that we need to be careful.

2 Q. If you could just say yes or no and then we
3 can go from there?

4 A. I do have an opinion, yes.

5 Q. And do you have an opinion as to whether
6 their long-run marginal cost structures will be lower
7 or higher than U S WEST'S?

8 A. It all depends.

9 Q. Do you have an opinion as to whether the
10 new entrants in the local loop market will price based
11 on their long-run marginal cost?

12 A. Yes, I do.

13 Q. And what's that opinion?

14 A. My opinion is that the entrant to the
15 marketplace will seek those elements of the
16 marketplace, those customers, where they will have the
17 lowest cost, which is why my "it depends" entered your
18 previous question, they will deliberately not go after
19 that portion of the marketplace where the costs will
20 be high because the costs are not the same to serve
21 each customer type and therefore what they will do
22 from a business point of view is to go after that
23 group of customers where they can get the lowest
24 possible cost structure. They will then find what the
25 market price that they can charge is. Presumably, they

01164

1 will have done this before they start and they will
2 enter only those segments of the marketplace at least
3 initially where they can make profits or cream skim.

4 Q. So at least in some instances you believe
5 the long-run marginal cost of the new entrant will be
6 lower than U S WEST; is that correct?

7 A. I believe that the entrants to the
8 marketplace are convinced that they can go after
9 certain segment of the marketplace and by virtue of
10 making a full service offering to those customers that
11 they will be able to make significant profits off of
12 certain high volume customers within the marketplace.
13 Whether the costs specifically of providing the local
14 elements will be higher or lower is, I think, still
15 very much up in the air and depends on the
16 technologies they will choose to provide access, on
17 whether they choose to use a resale alternative and
18 that therefore it is really impossible for me to say
19 today exactly what their cost structure in the future
20 will be. I am firmly convinced that they believe that
21 they can develop a cost structure that will allow them
22 to be profitable in those high volume segments.

23 Q. At page 19 of your rebuttal testimony,
24 towards the bottom of the page, lines 19 through 25,
25 you respond to I believe it's an argument of Dr. Mayo,

01165

1 and you make the point, "it could be argued that AT&T
2 should price its long distance services at incremental
3 cost and sell them to U S WEST."

4 A. Yes.

5 Q. Is it your belief that the market power of
6 at that time in the interLATA market is the same or
7 closely similar to U S WEST's market power in the
8 local loop market in Washington state?

9 A. Well, which kind of answer do you want to
10 hear?

11 Q. Let's start with a yes or a no and then we
12 can go from there.

13 A. It depends.

14 Q. Okay, that's fine,

15 A. I'm not going to let you back me into a yes
16 or no answer when you've asked these complex questions
17 that can be entered in a variety of ways and then not
18 let you allow me to explain so I'm going to give you
19 -- when you ask these long questions I'm going to give
20 you "it depends" and then you can either ask what you
21 want me to tell you what it depends on or not.

22 Q. I didn't think that was that long a
23 question?

24 A. Do you want to ask it again?

25 Q. Sure.

01166

1 Is it your opinion that the market power of
2 AT&T in the interLATA long distance market is the same
3 or is closely similar to U S WEST's market power in the
4 local loop market?

5 A. My opinion in general is that AT&T will
6 have more market power than U S WEST does.

7 Q. Is that true today?

8 A. Yes.

9 Q. Page 19, same page we were on, you at lines
10 23 and 24 -- I'm sorry, I just have the wrong page
11 number written down. I will just pass on that one.
12 Is it possible that U S WEST could do a cost study
13 approach determining what they call ASIC for various
14 services and then determine an overall percentage
15 contribution that would need to be reached above the
16 ASIC?

17 A. Yes.

18 MR. WAGGONER: No more questions.

19 JUDGE WALLIS: Now, Mr. Nichols.

20

21 CROSS-EXAMINATION

22 BY MR. NICHOLS:

23 Q. Dr. Porter, just a couple of questions, I
24 believe. I believe you testified that new entrants
25 expected in the local exchange market would act in

01167

1 such a manner such that they would focus their efforts
2 on segments of the market where they could expect
3 higher profits; is that correct?

4 A. Some new entrants would clearly do that,
5 yes.

6 Q. Some will not?

7 A. Well, I think that the PCS/PCN entrants to
8 the marketplace will probably offer fairly aggressive
9 ubiquitous offerings whereas I think that other
10 entrants are going to be specifically targeting
11 customers who have very high total use and other
12 potential sources of profitability, so I think it will
13 depend on the nature of the entrant.

14 Q. And why would an entrant focus its efforts
15 on those areas of the market that are expected to be
16 of higher profit?

17 A. So they can make more money.

18 Q. Is that an economically rational process,
19 procedure, that a company would follow?

20 A. Yes. It's a sort of an enduring principle
21 of economics that says that when a company wishes to
22 enter or penetrate a marketplace is attracted by those
23 higher profit either customers or profit opportunities
24 and that is generally where they would spend most of
25 their time and energy early on as they're entering the

01168

1 marketplace.

2 Q. Would an economist like yourself view such
3 activity of the market entrant as both to be expected
4 and to be applauded in some sense?

5 A. Well, the expected, yes. The applauded is
6 a little more difficult. If their competitor were an
7 utterly unregulated entity that could respond by
8 defending those market segments selectively as
9 necessary then not only would I expect it but I would
10 applaud it. My lack of applause comes from the fact
11 that the entrants may be able to seek market segments
12 which once they are taken away from the current
13 provider in the marketplace, i.e. U S WEST, U S WEST
14 will find itself unable to operate effectively as a
15 carrier of last resort for the remainder of the
16 customers in the marketplace.

17 Q. So your opinion that that activity is not
18 to be applauded is because you're testifying as an
19 economist on behalf of U S WEST; is that correct?

20 A. No, absolutely not. My testimony, if you've
21 read it, shows two examples of historical misregulation
22 of pricing the result of which resulted in huge damage
23 to the customers of the prior monopoly, and my
24 testimony to the Commission which I believe to the
25 bottom of my heart, and if I could just ask for one

01169

1 thing to be heard today, it is that the Washington
2 ratepayer is the one that is going to be harmed if
3 companies are allowed to enter Washington and cream
4 skim and that U S WEST is not allowed to competitively
5 respond and is left as a limping or potentially
6 unprofitable carrier of last resort for the remainder
7 of the customers. And so my testimony as an economist
8 is it is a public policy issue and I am not simply here
9 advocating this on behalf of U S WEST.

10 Q. So you're not criticizing the activity of
11 the potential new entrant in making decisions based on
12 sound economic principles of where profit may lie; is
13 that correct?

14 A. No. In fact, Counsel careful reading of my
15 testimony, which is really the thrust of why I'm here,
16 is that I believe the Commission should cut the Gordian
17 knot as fast as it can and get U S WEST rates
18 rebalanced and then do exactly as your line of
19 questioning is encouraging, which is to encourage the
20 entrants into the marketplace to come in whatever way
21 makes economic sense for them, but simply to allow U S
22 WEST the capabilities of responding appropriately so
23 that the benefits of true competition can accrue to the
24 Washington ratepayer.

25 Q. Dr. Porter, in theory, should economic

01170

1 costing principles or principles of costing studies,
2 should they apply uniformly to all of the services
3 which a telecommunications company like U S WEST
4 provides?

5 A. Well, there are so many costing principles.

6 Q. Let's just start with the most general
7 perspective. Can you answer that in general costing
8 principles -- that is principles of the performance of
9 costing studies -- should they be applied uniformly to
10 all of U S WEST's services or not?

11 A. Counsel, this is a very difficult question,
12 and I don't want to sound obstructionist. My view of
13 costing studies is that for the most part the level of
14 detail and attention that is being focused on costing
15 studies is something that should go away from the
16 telecommunications entry as fast as possible and that
17 most of U S WEST's competitors are not either burdened
18 by or required to do the kinds of cost studies that U
19 S WEST is being forced to do.

20 Q. Dr. Porter, I'm going to interrupt you here.
21 I've asked the question whether or not costing
22 principles should be applied uniformly. I have not
23 asked your position with regard to other companies or
24 the relative comparative competitive situation with
25 regard to other companies. If you could just answer my

01171

1 question with regard to the application of costing
2 principles to U S WEST's services and then we could
3 move on.

4 JUDGE WALLIS: I am going to ask the
5 witness to listen carefully to the questions and
6 respond to the questions and if the question is
7 objectionable allow your counsel to object to it but
8 try to respond to the question.

9 THE WITNESS: Fine. Thank you, Your Honor.

10 A. Having now been admonished I still wish to
11 be very clear that the point about costing principles
12 is such a broad question that what I want to do is to
13 say that in general appropriate costing principles
14 should be applied to all U S WEST services, but that
15 is highly dependent upon what one means by costing
16 principles.

17 Q. Do you have costing principles in mind?

18 A. I do, yes, indeed.

19 Q. When you think of costing principles as
20 applied to U S WEST, in your mind, do you believe
21 theoretically you should be applying those costing
22 principles to all the services of U S WEST?

23 A. Yes.

24 Q. Thank you.

25 MR. NICHOLS: I have no further questions.

01172

1 JUDGE WALLIS: Mr. Butler.

2

3 CROSS-EXAMINATION

4 BY MR. BUTLER:

5 Q. Yes. I thought I didn't have any questions
6 but I have changed my mind. Dr. Porter, I would like
7 to direct your attention to your direct testimony,
8 page 18 beginning at line 15 where you note that in
9 your opinion competition is emerging for toll access
10 and business service and it is incumbent on U S WEST
11 to respond to date. Do you have that in mind?

12 A. Yes, I see that.

13 Q. Do you recall in your discussion with Mr.
14 Waggoner that in your opinion new entrants are likely
15 to target markets where they expect to make a profit
16 and that you are convinced that they believe they can
17 make a profit in certain -- in markets for certain
18 high volume customers? Do you have that in mind?

19 A. Yes.

20 Q. And in your discussion with Mr. Nichols you
21 stated that, again, generally entrants will target
22 high profit customers and services, and do you have
23 that in mind?

24 A. Yes.

25 Q. When you refer to a high profit customer or

01173

1 service in that context, do you have in mind basic
2 exchange service to large business customers as being
3 among those services that would be targeted by
4 competitors?

5 A. That would certainly be one possibility.

6 Q. And that is one that in your opinion U S
7 WEST should be able to respond immediately?

8 A. Yes.

9 Q. And when you say respond immediately you
10 mean reduce the price; is that correct?

11 A. No, not necessarily just reduce the price
12 but that would certainly be one of the elements.

13 Q. When you say that you believe that the
14 Commission should enable U S WEST to be able to have
15 pricing flexibility to respond to competition now
16 rather than later, are you aware that U S WEST in this
17 state has the flexibility to reduce any price that it
18 chooses without prior Commission approval?

19 MR. SHAW: Object both to the form of the
20 question and it's been asked and answered by staff's
21 cross-examination, but it's a mischaracterization of
22 the statutes in this state which has lots of
23 conditions around when U S WEST can reduce prices
24 without the ability of the Commission to suspend them.

25 Q. Let me amend it. Are you aware whether

01174

1 Washington law permits U S WEST to reduce a price for
2 any service without prior Commission approval as long
3 as it doesn't seek an offsetting increase within one
4 year?

5 A. I am aware of that provision, but as I say
6 in my testimony.

7 Q. I will get there. You're aware of that?

8 A. Thanks, Counsel.

9 Q. Are you aware and did you have in mind when
10 you prepared your testimony that Washington law
11 permits U S WEST to seek classification of a service
12 as competitive if it can demonstrate that the service
13 faces effective competition?

14 A. Yes, I am aware of that.

15 Q. And if it obtains that classification,
16 competitive classification, it would have downward
17 pricing flexibility at least?

18 A. That's my general understanding, yes.

19 Q. As well as upward pricing flexibility,
20 correct?

21 A. As I say that's my general understanding.

22 Q. And would you agree that competition would
23 require a company to decrease its price, not increase
24 its price?

25 A. I can't agree with that as stated.

01175

1 Q. Do you believe that competition for a
2 particular service would cause U S WEST to increase
3 its price for that service?

4 A. Counsel, may I be permitted a clear answer
5 to that question?

6 Q. Sure.

7 A. The problem is that people use competition
8 in sort of a fairly narrow way. Competition includes
9 improving the quality of the product, the dimensions
10 of the product and a number of other things, and so
11 very often competition can result in the redefinition
12 of what the customer buys so that when it's all said
13 and done the price has not dropped, it's gone up. If
14 in general you mean take a commoditized product that
15 is incapable of being differentiated and increase the
16 degree of competition would that in general drive
17 prices down the answer would be yes.

18 Q. The Commission does not preclude U S WEST
19 from increasing the quality of any of its products, to
20 your knowledge, does it?

21 A. Well, I think that we're into pretty
22 difficult territory here. To take a new product and to
23 bring it to the marketplace at prices that can't
24 recover the investment of the product, assuming that
25 were to happen, could lead a company to choose to not

01176

1 want to offer that product, and so I think it's a very,
2 very difficult question that you ask. I can't give you
3 a simple answer.

4 Q. You do agree, however, that business
5 exchange service is a service which you believe
6 competitors would be attracted to try to provide in
7 competition with U S WEST?

8 A. Well, yes, I do.

9 Q. Now, if I'm correct about your testimony,
10 you express two concerns. One is the ability to
11 decrease price to respond to competition for services
12 that you believe have a high margin, and the second is
13 you have some concern about whether U S WEST would be
14 able to continue to earn a reasonable return if it has
15 to decrease its prices in response to competition; is
16 that correct?

17 A. Without the opportunity for rate
18 rebalancing.

19 Q. So your primary concern then is that the
20 Commission insure that U S WEST's overall earnings
21 levels are reasonable; is that correct?

22 A. My primary concern is that rate rebalancing
23 occur today to create a reasonable rate of return as a
24 place of departure and that then after that that the
25 competitive environment be encouraged at the greatest

01177

1 and most effective and most efficient ways possible.

2 Q. Going back to page 18 of your direct
3 testimony where you say that "it is incumbent on U S
4 WEST to respond today," are you saying that it is
5 incumbent that they respond to competition today or
6 it's incumbent that they increase their earnings today?

7 A. Both.

8 Q. Is one more important than the other?

9 A. Well, as I've tried to say in my testimony,
10 these are so importantly linked together that it's one
11 of the major reasons for this rate case.

12 Q. Would you agree that if U S WEST did not
13 propose prices that responded to this competitive
14 threat which you've identified that the need to
15 continue to make adjustments in rates the rebalance
16 would continue into the future?

17 A. Well, again, it's a fairly complicated
18 question. I will try to make my answer quickly. If U
19 S WEST or any other competitor in these circumstances
20 had permission to selectively lower its prices only
21 for those customers that were being competitively
22 challenged, it's one thing. If, on the other hand, in
23 order to get its price levels down to the point where
24 it can defend the highly profitable marketplace it has
25 to lower its prices for all of its customers then the

01178

1 revenue impact on U S WEST of doing that becomes so
2 catastrophic that they are basically hindered from
3 being able to make the appropriate competitive
4 response that they should be allowed to make to those
5 new plant entrants to the marketplace.

6 Q. So the ability to contract on a customer
7 specific basis in instances of competitive necessity
8 would be the tool that you're looking for, correct?

9 A. That would be one very helpful tool.

10 MR. BUTLER: Thank you. No further
11 questions.

12 JUDGE WALLIS: Mr. Roseman, do you have
13 extensive questioning?

14 MR. ROSEMAN: Ten minutes. Well, I would
15 think short but experience proves --

16 JUDGE WALLIS: Let's take a 10 minute
17 recess.

18 (Recess.)

19 JUDGE WALLIS: Let's be back on the record,
20 please, following our morning recess. Mr. Roseman,
21 you had some questions for the witness?

22 MR. ROSEMAN: Yes, I did.

23

24 CROSS-EXAMINATION

25 BY MR. ROSEMAN:

01179

1 Q. Dr. Porter, I just want to clarify if the
2 testimony that you're giving today if this is
3 testimony that you're basing on events that exist today
4 or as the ghost in Charles Dickens Christmas Carol said
5 to Scrooge, are these events that may yet come to pass?

6 A. They're based on events today.

7 Q. So you believe that there is competition,
8 fear of -- that there is competition in the local
9 loop?

10 A. Counsel, I do and I would be delighted to
11 explain that to you if you would like me to.

12 Q. What I would like you to explain is -- I
13 will give you an opportunity to explain because I know
14 that you would like to do that. What I would like to
15 -- well, if you will allow me to read Dennis Okamoto's
16 testimony on page 11 where in his direct testimony --
17 and I would like for you to explain, give me your
18 answer in light of what he says. He says, "not a
19 single competitor seeking to do business in Washington
20 has announced plans to enter residents markets in
21 urban areas in the immediate future." Now, you could
22 answer.

23 MR. SHAW: Is there a question here
24 somewhere?

25 MR. ROSEMAN: Yes.

01180

1 Q. The question is, is there competition in
2 the residential local loop market? Dr. Porter says he
3 believes there is, and I am asking him to give me his
4 explanation in light of Dennis Okamoto's statement
5 that there is no competition at this time in that
6 market?

7 A. Well, Counsel, I appreciate the opportunity
8 to answer the question, and I will attempt to be brief
9 and then if you have additional follow-on questions,
10 please ask them. The first, in response to some of
11 your earlier questions that I got, currently the cost
12 recovery for the loop includes allocations of the loop
13 to other services. So to the extent that there is
14 bypass of the local loop of any kind whatsoever, the
15 access charges which are currently earned by local
16 residential service are lost to the company. That's
17 one form, aggressive competition. A CAP is in the
18 business of providing access. When they do that the
19 company loses the allocated revenues which the local
20 loop are supposed to provide. So that's one form of
21 meaningful lost revenue in competition.

22 The second is cellular service. I am
23 perfectly prepared to concede that cellular service is
24 not a full replacement for local service today, but it
25 is also true that the degree of use of cellular service

01181

1 has grown dramatically, continues to grow and
2 represents a form of legitimate bypass.

3 The third and most important part of my
4 answer is that recently the FCC sold a fairly
5 significant portion of the spectrum for the provision
6 of PCS services. Approximately \$8 billion was spent to
7 obtain those licenses. The FCC set a set of rules in
8 place that says that if service is not in place in
9 local residential and business markets within a certain
10 time period the licenses will be lost, so there is
11 about \$8 billion of investment which it will either be
12 lost or there will be alternative facilities provided
13 in the form of PCS within the local marketplace in a
14 very short period of time. For me that qualifies as
15 competition. My competitor is in the process of
16 spending large amounts of money to acquire the capacity
17 to provide service. Their choice is to either abandon
18 that capacity or to be a competitor, and what I've said
19 in my testimony is that I regard that as competition
20 when I see my competitor
21 spending serious dollars to enter marketplaces that I
22 am currently providing service.

23 Q. You talked about bypass. You were talking
24 about bypass for toll, weren't you?

25 A. Yes, but, Counsel, my point is that the

01182

1 residence lines' costs are recovered in part by those
2 toll revenues today so that when that bypass occurs to
3 say that there's nothing bad happening to the
4 company's residential revenue stream, the point is
5 that when the bypass occurs a local loop is lost and
6 that is a form of competition. It vanishes from site.
7 You can't say there's somebody else. It's sort of like
8 saying, well, measure the market based only on those who
9 are buying from U S WEST as opposed to saying who is
10 out there buying loop type service through an
11 alternative service provider today that is no longer
12 apparent to us because the market is no longer
13 measuring them because they bypassed.

14 Q. With the toll service a phone call must
15 originate and terminate in the residential market at
16 the local loop. That aspect is not bypassed; is that
17 correct?

18 A. No. What I'm saying is if I were a business
19 and I currently used U S WEST and I went and did
20 business --

21 Q. I asked you about the residential market.
22 That's what my questions are focusing on, not the
23 business market, the residential market and I'm asking
24 if there's competition in the local loop at the
25 residential market?

01183

1 A. Well, I will let the other two parts of my
2 answer stand.

3 Q. You use the post office example and you
4 asked us to pay great attention to that?

5 A. Yes.

6 Q. What was the result of the post office's
7 operation for year ending 1995?

8 A. The last number I have I think in my
9 testimony is '94. I haven't looked at the '95 number.
10 Are you aware of what it is?

11 Q. Would you accept subject to check that the
12 post office made a profit in 1995?

13 A. I would be anxious to know how you are
14 defining profit before I would say that I would accept
15 that.

16 Q. All I'm asking you to do is to accept it
17 subject to check. I will give you the news article in
18 the New York Times that talked about the post office
19 department making profit in 1995 and you can accept it
20 or reject that?

21 A. And my point only is, Counsel, that there
22 are two levels that the post office is measured and
23 that number may not be the relevant or appropriate
24 number, but obviously I will be happy to check it
25 after I've reviewed the article.

01184

1 Q. We might find one point of agreement
2 between us yet so I'm going to keep searching. Let's
3 take the Rutgers study. Can you tell me how many
4 customers were surveyed that led to the result of that
5 study?

6 A. I reviewed the study but I am afraid I
7 can't recall that number.

8 Q. Do you know who financed the study?

9 A. Specifically, no, I don't.

10 Q. Would you accept subject to check that it
11 was one of the -- I think one of the Bell companies on
12 the east coast?

13 MR. SHAW: I will object to asking the
14 witness to check something subject to check that he
15 thinks.

16 MR. ROSEMAN: Well, I know that it was a
17 Bell company. I don't know which one, Mr. Shaw.

18 MR. SHAW: Counsel should put his own
19 witnesses on if he wants to testify.

20 JUDGE WALLIS: Gentlemen. I will sustain
21 the objection.

22 MR. ROSEMAN: I will withdraw the question.

23 Q. You talked about the Washington telephone
24 assistance program and you commended the Commission
25 and the company for participating in that program. Do

01185

1 you recall that?

2 A. Yes, I do.

3 Q. Are you aware that that program is -- are
4 you aware of Initiative 601 that was passed by the
5 legislature?

6 A. No.

7 Q. Are you aware that the Washington telephone
8 assistance program is at its maximum taxing level
9 authority right now?

10 A. I am in general aware of that, yes.

11 Q. So if there was a large rate increase and
12 those customers needed to continue to receive the
13 benefit of that program, are you aware that then that
14 tax would have to go up?

15 A. Well, I am aware that there would have to
16 be some funding mechanism developed to fill the gap,
17 yes.

18 Q. I have one other -- I think it's a point of
19 clarification. I'm not sure that I heard your answer
20 to Mr. Trautman earlier, and I thought you said that
21 there were -- you believed a large number of
22 residential customers that did not make toll or made
23 very little toll calls, did you say?

24 A. Yes, and I believe that number is in Ms.
25 Owen's testimony or perhaps her rebuttal testimony.

01186

1 I'm not certain which.

2 Q. So when you talk about the total bill,
3 remember that concept? You talked about the total
4 telephone bill that a customer would pay?

5 A. Yes.

6 Q. For those customers that make few tolls --
7 few toll calls, if U S WEST receives their rate
8 increase of \$26 those customers' total bill would
9 substantially increase?

10 A. Yes. Their bill would be less subject to
11 an offset in reduction of toll calls.

12 Q. I knew we would find something we agreed
13 with. Thank you.

14 JUDGE WALLIS: Commissioners, Chairman
15 Nelson?

16

17 EXAMINATION

18 BY CHAIRMAN NELSON:

19 Q. Just a couple, Dr. Porter. Transportation
20 is our middle name so I would like to ask you a couple
21 of questions about the railroad analogy that you
22 outline in your testimony at pages 20 and 21. Is it
23 your testimony that misguided price regulation was
24 the sole cause of the troubles, the railroad industry
25 went through?

01187

1 A. No, but certainly one of the primary
2 causes.

3 Q. So you would concede that there were other
4 factors involved, too?

5 A. Oh, yes.

6 Q. And what is your opinion today of the
7 relative robustness of the railroad and the trucking
8 industries?

9 A. Well, I think the railroad industry
10 financially has recovered. Obviously in terms of the
11 ubiquitous nature of its service it's a very different
12 industry than it was earlier. I think the trucking
13 industry is probably in terms of ubiquitous service in
14 pretty good shape. My sense is that there's a little
15 bit more problem for the bus industry and for the
16 airline industry particularly in its service of
17 smaller towns and rural areas.

18 Q. Then I take it sort of our sense here that
19 the passenger industry as opposed to the freight
20 industry has seen the more abandonment by these
21 various firms in the rural areas?

22 A. If you mean with respect to today, yes. I
23 think if you go back to the railroad analogy there was
24 a huge abandonment of the freight component as well.

25 Q. As I understood your answer to one of the

01188

1 counsel, your concern is not so much for the --
2 although then I was confused by subsequent counsel
3 questions -- was your most sincere concern was for the
4 customers remaining -- continuing to be served by the
5 incumbent industry?

6 A. That's correct.

7 Q. I want to probe that a little bit. You do
8 discuss becoming a wireless competition. If we were
9 to see a wholesale change in customer preference
10 before wireless technology as opposed to wire line and
11 fixed kind of access, what would be the obligation of
12 public policy makers and/or regulators to U S WEST?

13 A. That's a wonderful question, and I think it
14 really depends on the starting point, and I obviously
15 am not here as a depreciation witness and I don't want
16 to get into that issue from a detailed point of view,
17 but in theory if the slate could be wiped clean and
18 the investment which U S WEST has made to date under
19 the sort of historical understanding of a monopoly
20 franchise and a rate of return regulation, if that
21 could all be sort of wiped clean, those investments
22 could be appropriately recovered because they were made
23 under a sort of a certain social contract, so assuming
24 for a moment we had done that and we're now in a going
25 forward mode where that's done, I think that U S WEST

01189

1 and every other participant in the industry will need
2 to make these investments based on its own assessment
3 of the risk and have to bear the cost of making a bad
4 investment choice just the same way anyone else should
5 have to, and this is very much to Commissioner Gillis's
6 questions yesterday.

7 I think the difficulty is in the transition
8 and that's what is creating so much problem. If we
9 could cut it clean and then go forward from there with
10 other competitors in the marketplace I think we would
11 use the normal rules of the marketplace to answer
12 those questions.

13 Q. Once again, history being what it is, not
14 being able to wipe things clean. Thank you, that's all
15 I have.

16

17 EXAMINATION

18 BY COMMISSIONER GILLIS:

19 Q. Professor Porter, do you believe that a
20 rebalancing of the business rates, decline in the
21 rates charged to businesses as proposed, would result
22 in more or less revenues for U S WEST from that
23 customer segment?

24 A. If I could give a little bit of an extended
25 answer. I have this problem all the time with my

01190

1 clients where they're sitting there saying if I lower
2 my price I'm going to lose revenue, and I say against
3 what scenario. In other words, against the scenario
4 that you have a competitor who isn't taking market
5 share from you or you have a competitor who is, and
6 the problem is that one has to compare the revenue
7 number from a business planning point of view against
8 the number that no one knows, which is what would the
9 revenue be if we did not change our price. What one
10 is trying to do is get an improvement over that
11 unknown number. So, if competition doesn't come
12 obviously a price reduction is a revenue loss.

13 If, on the other hand, one accepts the
14 hypothesis that competition is coming and is going to
15 take X amount of market share then whatever portion of
16 market share is saved as a result of U S WEST's price
17 reduction represents a revenue gain to them as a result
18 of being able to lower those prices, and that's the
19 critical number no one knows but which is the essence
20 of the business planning decision that's been proposed.

21 Q. Let me just simplify that and take away the
22 competitors and look at the market in the aggregate
23 for the moment?

24 A. Okay.

25 Q. And you said obviously there would be a

01191

1 revenue loss but I'm not sure I follow that. Isn't
2 there some assumptions there?

3 A. Yes, there were some.

4 Q. What are your assumptions?

5 A. Well, in fact I was doing sort of a very
6 static analysis assuming no stimulation and I think
7 that there's a good case to be made that in today's
8 telecommunications market that the value
9 communications is rising so much that further price
10 reductions could in certain marketplaces and with
11 certain customers actually stimulate.

12 Q. It would depend on elastic demand?

13 A. Yes, that's correct.

14 Q. And going back to what you said before then
15 a potential of U S WEST to capture it depends on how
16 successful they are in capturing the market share of
17 whatever the higher market is?

18 A. Yes, that's correct.

19 Q. On the other hand, you talk about the need
20 to increase the prices on some service which are
21 asserted to be priced below cost?

22 A. Yes.

23 Q. Do you have an opinion on whether that
24 would necessarily -- under the same logic we just
25 talked about would necessarily result in a lost

01192

1 revenue or an increase in revenue from those services?

2 A. Yes, I have a very strong opinion that it
3 would result in an increase in revenues because the
4 elasticity of demand for basic residential service is
5 so low that it's impossible really for me to imagine
6 that price increases would not substantially enhance
7 revenue.

8 Q. But just putting together the pieces that
9 you just related to me then it's possible that the
10 rebalancing could increase -- could result in an
11 increase of revenue both from a decrease of price in
12 business services and an increase in prices on the
13 residential services?

14 A. That's certainly theoretically possible,
15 and if it happened then presumably the Commission
16 would be in a position to ask the company to take
17 whatever measures were appropriate. I personally
18 don't think that that's what's going to happen on the
19 business side which is part of the reason why I'm
20 making such a strong -- taking such a strong position
21 on the --

22 Q. Let me stop you there. Why do you
23 personally not have that opinion on the business side?

24 A. Because of the competitive issues. Because
25 of the fact that even though prices -- this is the

01193

1 whole issue of market share and market size. That
2 even that the dropping of prices may well stimulate
3 the size of the marketplace but I think U S WEST will
4 lose share at a faster rate in the high profit
5 segments than the stimulation will offset.

6 Q. Why do you believe that?

7 A. Well, my sense of why that's true is that
8 at least until fairly recently the rates of growth of
9 the LEC component of telecommunications have been very
10 low and not varied significantly by differences in
11 price. In other words, so the proposition that one
12 would get a facilities-based improvement in demand by
13 lowering business services and more services would be
14 put in place versus a usage-sensitive service like
15 toll is basically what leads me -- had led me
16 historically to conclude that traditional services
17 would not see a large amount of growth as a result of
18 price reduction.

19 Q. Would you agree that's a core issue we
20 ought to be considering? When we're thinking about
21 the rebalancing of the rates should we be considering
22 whether or not there's going to be a stimulative
23 effect that U S WEST has a potential to --

24 A. On the business side.

25 Q. On the business side of lowering those

01194

1 rates?

2 A. Honestly, Mr. Commissioner, I would not
3 make it a core issue. I would make it perhaps
4 something you would look at. If you could get a
5 relatively cost-effective and easy answer to that
6 question it's probably worth going at but I wouldn't
7 make it a deal breaker on the rate rebalancing. I
8 would encourage the rate rebalancing aggressively and
9 if there were a large stimulation over the course of
10 the next couple of years then I would encourage the
11 Commission to go back and review that and make the
12 appropriate adjustments.

13 Q. I have a related question but maybe a
14 different angle on it. You talk about in your
15 rebuttal testimony some discussion of market power.
16 You make the statement that U S WEST Corporation past
17 monopoly position is not a good indication of its
18 future market power and you had a conversation I
19 believe with Mr. Waggoner suggesting that AT&T would
20 have more market power than U S WEST in your judgment.
21 How are you defining market power?

22 A. Well, I'm glad I had an opportunity to come
23 back to that question because I don't think we had an
24 opportunity to finish it. One way to look at it if I
25 could just briefly do it is to go back very quickly to

01195

1 the post office example. The post office example is
2 still a monopoly in the sense that it carries certain
3 services and has a monopoly but I think most people
4 would agree that in other services their market power
5 is very, very small. They lost the package business to
6 UPS.

7 So the question is is the post office a
8 monopoly, yes. Does it have high market power in the
9 segment of the marketplace that was most profitable and
10 the answer is no. So, my concern is that AT&T has a
11 very, very strong brand name. It has market share in
12 the 60 percent, so it has very, very strong access to
13 customers. There are many people who allege that there
14 are still the feeling that on the basis of some
15 customers that it would be nice to go back to the good
16 old days when AT&T was your only provider. If they
17 gain the intraLATA business fairly quickly with one
18 plus subscription they will have access to all the
19 customers' toll. So there are a large number of
20 reasons why I feel that AT&T's market power is
21 extremely high and quite honestly am very concerned
22 about the level of market power that U S WEST will have
23 when in fact competition enters the marketplace, so
24 I've said to them on a number of occasions that I'm
25 actually quite worried about their lack of market power

01196

1 when people have a competitive choice.

2 Q. How would you react to I guess the
3 observation that what you just described for AT&T
4 appears quite similar to what one might describe for
5 an incumbent Bell company in the local market?

6 A. Well, there are really a couple of
7 differences, and the first is that AT&T is not in a
8 situation where it's having to price a large portion
9 of its product portfolio below cost, so one way to
10 look at it is of course the LEC has market power
11 because if you accept my hypothesis for the moment
12 that price is below cost because nobody will want to
13 enter. So it's sort of a catch 22 that the incumbent
14 monopolist has prices below cost but then is going to
15 remain a monopolist because except under the exception
16 that competitors have lower cost no one will enter so
17 that's one major difference.

18 The other point which I think obviously the
19 Commission will have some great interest in is this
20 whole issue that was discussed yesterday about service
21 quality. And if in fact for whatever reasons U S WEST
22 is experiencing a service quality problem and AT&T
23 enters the marketplace, I mean, just people say, well,
24 what is my choice, this new provider who says they
25 will have no service quality problems versus this old

01197

1 one that does, so that plays a role and I think if one
2 looks in other countries like in England the level of
3 penetration of alternative LECs against British
4 Telecom has been quite dramatic. Loss of market
5 shares of 10 and 20 and 30 percent within relatively
6 short periods of time. So those are some of the
7 reasons why I think there's a difference.

8 Q. The concept of market power, again, do you
9 believe that a loss of market power, which I'm not
10 sure if you want to define in terms of loss of market
11 share or not or some other criteria. I don't know
12 what you're thinking of, but do you believe that is
13 the same thing as necessarily undermining
14 profitability of a company or is it consistent to have
15 a loss of market share and potential loss of market
16 power with a different market structure and the
17 company in fact be more profitable than it was under
18 the old structure?

19 A. Obviously under certain conditions that
20 could happen. Just very briefly to your whole
21 question of market power. If one were to take some of
22 the traditional measurements of the ability to price
23 above cost as a performance indicator of market power,
24 it's quite clear that U S WEST does not have much
25 market power in portions of the product portfolio that

01198

1 it sells, and so that's one of the reasons why I'm --
2 it's so important to distinguish the difference
3 between monopoly or the existence of monopoly and
4 market power because you don't see the performance of
5 a monopolist in terms of the pricing that its current
6 price structure. It doesn't match up with the kind of
7 price structure that a monopolist would normally have.

8 Q. I think that's about all my questions.
9 What I want to try to ask this one more time and see
10 -- just to make sure I understand your thoughts on it.
11 Again, getting back to this concept of lowering
12 business revenues and I think that you stated that at
13 least theoretically to the extent that they're
14 relatively elastic markets in the business market that
15 are usage-sensitive or service-sensitive. I'm not
16 sure how you define that, but that it's possible that
17 lower rates could stimulate more revenue for the
18 industry as a whole and whether or not U S WEST is
19 able to capture those increased revenues is going to
20 depend on their competitiveness in the market,
21 correct? I'm trying to restate things?

22 A. Yeah. Again, I don't want to draw this out
23 in deference to the Commission's time pressures, but I
24 think the only thing that you said that I would want
25 to have more of a dialogue with you on was the

01199

1 question of the degree of the elasticity of that
2 marketplace.

3 Q. Fine. Thank you.

4 A. Thank you, Mr. Commissioner.

5 JUDGE WALLIS: Mr. Shaw.

6 MR. SHAW: Thank you. I do have redirect.

7

8 REDIRECT EXAMINATION

9 BY MR. SHAW:

10 Q. Following on the same subject of the
11 general interplay of market share, market power, I
12 would like to offer you some concrete examples and
13 have you further discuss that issue. Locally here we
14 have some very large companies. For example, the
15 Boeing Company. Are you aware of the Boeing Company's
16 market share both domestically and globally?

17 A. I don't have the exact numbers but I am
18 aware it's very high, probably in the 80s or 90s.

19 Q. Does the mere fact that Boeing has market
20 share and large economies of scale and any other
21 number of indicators of monopoly power mean that it
22 should be regulated and its prices controlled by the
23 state?

24 A. No.

25 Q. Could Boeing conceivably lose that market

01200

1 share and therefore its market power to other
2 competitors?

3 A. Well, it could lose -- not only could it
4 lose market share which it's perpetually having to be
5 concerned about, but it can also lose its market in
6 the sense that it can have a large share and the
7 demand for airplanes can go down and Boeing can suffer
8 great economic distress even though it is a very high
9 market share provider.

10 Q. Would you agree that manufacturing
11 airplanes is not a mom and pop operation, that it
12 would take tremendous capital investment and size in
13 order to enter the airplane manufacturing business
14 against Boeing?

15 A. Yes, I would agree.

16 Q. Does that mere fact mean that Boeing has
17 market power that its prices should be regulated by
18 the state?

19 A. No.

20 Q. In telecommunications, is it a mom and pop
21 business where society should expect that anybody by
22 taking out a second mortgage can start a telephone
23 company?

24 A. Well, in today's day and age that's
25 increasingly difficult, though some of the resale

01201

1 opportunities that have been created by might create
2 some low barriers to entry but if it was
3 facilities-based it is certainly not a mom and pop
4 operation.

5 Q. Like manufacturing airplanes new entrants
6 will have to be large, well capitalized, knowledgeable
7 entities in order to compete?

8 A. I think in general that will be the case,
9 yes.

10 Q. You mentioned AT&T already in terms of
11 their market share. Another local company, Microsoft,
12 do you consider Microsoft to have a very large market
13 share of PC operating systems and applications?

14 A. Yes, I do.

15 Q. Do you consider that that fact of market
16 share gives them market power wherein the state should
17 regulate their prices?

18 A. No, I do not.

19 Q. Why does that market share of Microsoft not
20 convert to market power?

21 A. Well, I think that Microsoft is an example
22 of a company that is instructive in two ways. First
23 of all, even though they have a large amount of market
24 share they have really been quite aggressive in their
25 willingness to price and to -- by price, I mean to

01202

1 reduce price.

2 The second point is I think most people who
3 are students at this industry understand that
4 Microsoft's quote-unquote market share is probably a
5 temporary phenomenon in that technology is going to
6 drive much of the operating software that Microsoft
7 provides today into other places in the computing
8 topology, and the result is that much of what Microsoft
9 is selling today won't probably be sold the same way it
10 is five or ten or fifteen years from now.

11 Q. Would you consider the industry sectors that
12 Microsoft is in and the industry sector that U S WEST
13 is in as merging, that they're rapidly becoming the
14 same business?

15 A. I would say there is certainly a
16 convergence of those two industries, yes.

17 Q. U S WEST currently has an asset like Boeing
18 or Microsoft has an asset which is its ownership of
19 the -- all the copper wire out there that connects all
20 the homes. Does the mere fact of that ownership give
21 U S WEST market power different from the market power
22 that Boeing or Microsoft has?

23 A. Essentially I would say not.

24 Q. Is that because that asset is no longer
25 essential, that technology has enabled that asset to

01203

1 be replaced by other competitors?

2 A. That's exactly correct. That part of this
3 whole discussion of monopoly that we've been having is
4 -- it's important to realize that the erosion of
5 monopoly power and market share over time is generally
6 accompanied by the development of new and alternative
7 technologies which replace the monopolist or the
8 dominant share provider nonmonopolist's position in
9 the marketplace.

10 Q. There's been much discussion before this
11 Commission by members of your profession over the last
12 couple of years about whether or not U S WEST or any
13 other incumbent LEC operating in the state has a
14 natural monopoly, particularly in out state or rural
15 areas where it's not as readily apparent that somebody
16 is going to build a competing facility. What is your
17 opinion on whether U S WEST today and in the immediate
18 future the predictions of the technologies that will
19 be available has a natural monopoly that requires the
20 state to regulate its prices?

21 A. Well, that's a fairly complex question, let
22 me see if I can just touch on some of the main
23 elements. Obviously the availability of new
24 technologies which are more cost-effective than the
25 current technology that is in place would eliminate

01204

1 that natural monopoly argument in a flash, the whole
2 issue of a wire-based loop that would -- that could
3 replace a copper based loop. The other dimension of
4 the problem that is of concern to me is that if those
5 technologies do not appear and U S WEST is left as the
6 carrier of last resort for those portions of the
7 marketplace that others do not choose to provide
8 service to, whether they're a natural monopoly or
9 whether they're the only game in town by virtue of the
10 fact that everyone else is declining to serve there
11 they certainly wouldn't be a natural monopoly in the
12 economic sense of the word that they're there because
13 they're the most efficient cost alternative. They're
14 going to be there sort of hanging on their fingernails
15 trying to provide service to this residual group of
16 customers.

17 Q. Is that what you mean when you talk about
18 your concern for the consumer as opposed to concern
19 for the financial well-being of U S WEST?

20 A. Yes.

21 Q. Counsel for staff asked you some questions
22 about Yellow Pages and asked you to agree that
23 directories are services provided to customers. Do
24 you consider printed telephone directories whether
25 White Pages or advertising Yellow Pages to be

01205

1 telecommunications services?

2 A. No. I would see them as being more
3 appropriately in either the publishing business or in
4 the sort of access to information business, and I
5 don't see them specifically as telecommunications
6 services.

7 Q. Do you consider customer premise equipment
8 from a simple desk telephone to large PBXs and even
9 large central office switches to be telecommunications
10 services, the manufacturing and sale of such
11 equipment?

12 A. I think that equipment is clearly emerging
13 as a separate and related industry to the provision of
14 the telecommunications service per se.

15 Q. You were asked whether U S WEST shouldn't
16 -- the effect of it being that shouldn't there be a
17 profit charged by U S WEST if it transferred its
18 publishing business to a separate subsidiary U S WEST
19 Direct. Currently, does AT&T propose to spin off,
20 divest itself, of its equipment business?

21 A. That's my understanding, yes.

22 Q. Would you expect it to be appropriate for
23 this Commission or regulators in general to impute a
24 profit or a revenue stream from that to AT&T's toll
25 customers?

01206

1 A. No.

2 Q. Does it make any difference because it's
3 asserted that U S WEST has a local monopoly, de facto
4 monopoly, and that's a rationale for imputing Yellow
5 Pages but AT&T doesn't have a monopoly over toll and
6 therefore they shouldn't have profits from their
7 equipment business imputed to them?

8 MR. WAGGONER: Your Honor, can I object? I
9 don't recall any cross on this subject. This seems
10 well outside the scope of cross.

11 MR. SHAW: I certainly do. Staff asked
12 specific questions about profit of service such as a
13 Yellow Pages, where should that be disposed of and I
14 think that I'm entitled to examine on redirect what
15 the implications of the suggestion of the staff's
16 cross is.

17 MR. WAGGONER: I frankly don't remember any
18 such questions. Maybe staff can --

19 JUDGE WALLIS: Certainly in terms of the
20 operations of your own company, Mr. Shaw, but I'm
21 concerned about the extension of the analogy to other
22 parties.

23 MR. SHAW: Well, the witness has testified
24 in his written direct that he would not think it
25 appropriate to do such an imputation and I am asking,

01207

1 based on those analogy, whether either imputation is
2 appropriate in your view as an economist either as to
3 AT&T's equipment business or U S WEST's publishing
4 business?

5 JUDGE WALLIS: Witness may respond.

6 A. My answer would be no.

7 Q. Is it a truism of your profession that
8 competition drives prices towards cost?

9 A. That is a truism, yes.

10 Q. If current prices are below cost will
11 competition drive prices higher to cost?

12 A. In a purely unregulated environment what
13 would happen over time is that some providers would
14 exit the marketplace. There would be less service
15 provided, demand would cause costs to -- prices to
16 rise above cost, and in that sense, yes. In the sense
17 of that prices are below cost and people can't provide
18 the service in a sustainable basis, what would
19 eventually happen is they would choose not to provide
20 the service and others might step in who are not price
21 regulated and price would move up.

22 Q. Let's take a simple example of a local
23 exchange company, one that actually exists. A small
24 independent that serves one town in its immediate
25 environs, has one switched and a modest star shaped

01208

1 distribution network to a couple of thousand customers
2 that live in that little community and it provides
3 local exchange service within that community. Let's
4 assume it has no EAS for the purposes of the question.
5 If that company does not charge the full cost of
6 providing that local exchange network to its end users
7 in basic rates but meets its revenue needs by charging
8 access to toll carriers, if that company loses the
9 revenues from the access to toll carriers, will it have
10 to charge its end users adequate price to cover local
11 exchange or go out of business?

12 A. Yes.

13 Q. Is it technically possible, as far as you
14 understand, for a local exchange company to lose its
15 access revenues to alternative technology such as
16 wireless?

17 A. Yes.

18 Q. You were asked some questions by public
19 counsel about whether in fact U S WEST offers a
20 separate local loop service that a retail customer
21 could buy a local loop, and I believe you answered no.
22 Does U S WEST, to your knowledge, offer private lines
23 and often referred to as a NAC, a network access
24 channel?

25 A. Yes, they do.

01209

1 Q. Can any customer of U S WEST including a
2 residential customer buy a dedicated local loop or
3 private line or network access channel from U S WEST?

4 A. I believe they can.

5 Q. What do you understand that price to be
6 under current tariffs?

7 A. I'm not absolutely certain but I understand
8 it's in the sort of 9 or \$9 or \$10 range.

9 Q. Do CAPs in fact compete for the access
10 revenues of U S WEST by either self-providing or
11 buying NACs or private lines from U S WEST in order to
12 provide originating access to their customers?

13 A. Yes, they do.

14 Q. You were asked some questions by Mr.
15 Waggoner of AT&T about relative growth in local and in
16 toll and you talked to him about the cost structures
17 of competitors and would they have a different cost
18 structure than the incumbent. Is the cost structure
19 in your view for local exchange companies providing
20 local exchange networks a declining cost industry in
21 the same way that toll is a declining cost industry?

22 A. I think that the electronics element of
23 providing local exchange service is probably declining
24 cost, but I think that the outside plant element and
25 the equipment element is not and so it is not clear to

01210

1 me at all that this is an industry that would qualify
2 for the definition of a declining cost industry.

3 Q. In response to Mr. Nichols from MCI you
4 talked about you expect some entrant, particularly the
5 wireless entrants, to immediately offer a mass market
6 services. Would you expect the cable companies to
7 also offer mass market services?

8 A. Yes, I would.

9 Q. Are there in fact cable companies today
10 that are -- have announced their intention in specific
11 communities to offer mass market services over cable
12 facilities?

13 A. Yes.

14 Q. Including U S WEST in Atlanta, Georgia?

15 A. Yes.

16 Q. You were asked also by Mr. Nichols about
17 costing principles being applied uniformly to all
18 services and asked whether you had some costing
19 principles in mind and you said that you did. Could
20 you state briefly for the Commission what costing
21 principles you think should be applied in identifying
22 the incremental cost of U S WEST services.

23 A. Well, my basic view of costing principles
24 is that a company should invest a reasonable amount of
25 effort in determining its costs but that the level of

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1 exact precision with respect to that analysis needs to
2 be counted with the benefit and in many cases the
3 level of benefit is not sufficient to generate huge
4 additional investments.

5 The second is that normal accounting
6 systems do not provide the appropriate information,
7 cost information, therefore obtaining incremental
8 costs is an important principle.

9 The third is that the notion that a product
10 should be priced above cost is something that has
11 several different answers in terms of trying to
12 understand what cost it should be priced above. From
13 a strictly legalistic point of view to avoid predatory
14 pricing a product should not be priced below its
15 incremental cost appropriately defined.

16 Many companies may choose to set other cost
17 floors in terms of making pricing decisions, in other
18 words they may choose not to offer a product unless it
19 can recover a price substantially above its
20 incremental cost because that price floor does not
21 represent a sufficient level of profitability to
22 continue offering the product. Those would be some of
23 the costing principles that I would have had in mind.

24 Q. Is it totally appropriate to identify and
25 study as a cost object a family of services in a

01212

1 typical telecommunications company?

2 A. It's actually essential.

3 Q. And if that study identifies costs caused
4 by that family of services, is that properly in
5 economic terms an incremental cost of that family of
6 services?

7 A. It's an incremental cost of that family and
8 all of the products in the family jointly should have
9 prices sufficiently high above their individual
10 incremental costs to cover the incremental cost of the
11 family.

12 Q. Is it also a totally appropriate to
13 identify as a cost object an individual service and
14 study the cost of that?

15 A. Yes, it is.

16 Q. And in that case you're not studying the
17 family and there would be no family cost or shared
18 costs in U S WEST's parlance?

19 A. That's correct.

20 Q. Nonetheless the costs do not go away and
21 they have to be recovered somewhere in the prices of
22 the firm?

23 A. That's right, and that was my point in my
24 previous testimony on costing principles is that they
25 still need to be covered by price somewhere.

01213

1 Q. You were asked by Mr. Butler of TRACER
2 whether your testimony was the effect that you're
3 urging the Commission to assure U S WEST a reasonable
4 return. Are you concerned at all whether the
5 Commission assures U S WEST a reasonable return on its
6 investment?

7 A. Well, this comes back I think to Chairman
8 Nelson's question of me and our dialogue back then. I
9 think that the key is that to the extent that the
10 investment was required as a result of public policy
11 and law and was put in place as a result of the
12 regulatory agreement of time that that investment is
13 in effect guaranteeing a return. I think going
14 forward, as U S WEST is going to be making investments
15 in a competitive environment, that a guaranteed rate
16 of return on those investments should neither be
17 necessary nor appropriate assuming an alternative form
18 of regulation can be structured which meets both the
19 transitional needs of the Commission and U S WEST's
20 needs.

21 MR. SHAW: Thank you very much. That
22 completes my questions.

23 JUDGE WALLIS: Follow-up questions.

24

25

RECROSS-EXAMINATION

01214

1 BY MR. TRAUTMAN:

2 Q. Just one question. You talked about the
3 wireless PCN spectrum licenses being sold by the FCC
4 recently?

5 A. Yes.

6 Q. Did U S WEST successfully participate in
7 the auction for and receive any of these?

8 A. My understanding is they did, yes.

9 MR. TRAUTMAN: Thank you.

10 JUDGE WALLIS: Mr. Trotter? Other counsel.

11

12 RE-CROSS-EXAMINATION

13 BY MR. WAGGONER:

14 Q. Have you endeavored to check on the pricing
15 that's being offered for PCS service today?

16 A. Well, PCS is I think only offered on a very
17 limited basis in this country. It's offered in other
18 countries.

19 Q. Are you aware that PCS service is currently
20 being provided in Washington D. C. today?

21 A. Yes.

22 Q. Have you looked at the prices?

23 A. I don't know specifically what that pricing
24 is, no.

25 MR. WAGGONER: No further questions.

01215

1 JUDGE WALLIS: Commissioner Gillis.

2 MR. BUTLER: Could I just --

3 JUDGE WALLIS: I'm sorry. Mr. Butler.

4

5 RECROSS-EXAMINATION

6 BY MR. BUTLER:

7 Q. Dr. Porter, Mr. Shaw asked you questions
8 regarding your familiarity with private network access
9 channel and you indicated it was your understanding
10 that a NAC could be purchased today in fact or
11 purchased by competitive providers in order to provide
12 originating access to customers. Do you recall that?

13 A. Yes.

14 Q. Would you agree that under the U S WEST
15 tariffs today a network access channel cannot be
16 purchased without a channel performance element?

17 A. I am not aware of that one way or the
18 other.

19 Q. So when you say that you understand that a
20 NAC is available at a price of around \$9 that wouldn't
21 be the total price that a customer would pay if it
22 also has to buy channel performance, correct?

23 A. As I say you would have to check that with
24 some other U S WEST witness.

25 Q. Is it your understanding that a network

01216

1 access channel connects the customer's premise to U S
2 WEST central office?

3 A. Yes.

4 Q. So that a customer wanting to use a private
5 line NAC from U S WEST disregarding the channel
6 performance element in order to provide originating
7 access to its customers it would also have to purchase
8 services or pay for facilities that would provide the
9 connection from the termination of that NAC in the
10 central office of U S WEST to the competitive
11 provider's network facilities?

12 A. Yes.

13 MR. BUTLER: Thank you.

14 JUDGE WALLIS: Other questions from
15 counsel? Commissioner Gillis.

16

17 EXAMINATION

18 BY COMMISSIONER GILLIS:

19 Q. Just one more. In follow-up to Mr. Shaw's
20 question to you he asked you if you thought that
21 telecommunications is a declining cost industry and
22 you qualified that in that you thought that the
23 electronics piece of it may be so but the -- and then
24 the traditional fixed plant piece probably no.
25 Focusing on the industry not a company, do you agree

01217

1 that declining cost industry is at least partly a
2 function of technology?

3 A. Yes, absolutely.

4 Q. I want to ask you about a couple of
5 technologies, whether you would say that would be
6 consistent with declining cost anyway -- whether or
7 not it is I'm not asking you to say, but digital
8 compression technology that allows the possibility of
9 transmitting more data over an existing plant?

10 A. Well, that's clearly an improved
11 productivity in the sense that one can get more
12 information over the circuit.

13 Q. More than productivity it allows you to
14 deliver service that wouldn't otherwise be possible?

15 A. Yes, I would agree with that.

16 Q. So it would be a declining cost for
17 delivery of that particular service?

18 A. Yes.

19 Q. How about cable modems and the use of cable
20 TV to provide the cable that's used for TV currently
21 to deliver broadband capability and using the existing
22 copper plant as outflow. In other words, you're not
23 constructing new plant to do this.

24 A. I would say that obviously the use of the
25 facilities that are in place will take a cost that is

01218

1 otherwise been incurred and now find alternative uses
2 for it, and that will contribute to the reduction of
3 cost.

4 Q. It makes the existing plant more productive
5 in providing the services?

6 A. Yes.

7 Q. What about something that's more on the
8 horizon and isn't necessarily here at the moment,
9 although I really don't know enough about it, but read
10 a lot about wireless loops, and how they're potentially
11 considerably less expensive than land line loops. Is
12 that an example of a technology for the industry, not
13 necessarily the company, that would result in declining
14 industry?

15 A. That one is a little bit more complicated
16 in the sense that -- I wouldn't take long on this --
17 in the sense that there's the fixed cost and variable
18 cost component and if there's a large fixed cost to,
19 for example, setting up those loops then one has to
20 gain a sufficient level of utilization in order to
21 drive cost down to an appropriate level, but that
22 aside, I would agree with that general --

23 Q. With those qualifications. Given all that,
24 the only one that -- I guess two of them are somewhat
25 speculative at this point. The cable modem I guess

01219

1 isn't in widespread application, I guess, I'm
2 understanding it, but fairly close, and the wireless
3 loops are fairly close and the only one we have in
4 fairly wide spread application are compressed
5 technology but given those I was a little bit
6 surprised at your answer in talking about -- I guess
7 talking so assuredly about that it's not a declining
8 cost industry?

9 A. No. Commissioner I didn't say that. I
10 said that there were two dimensions. One was the
11 dimension which you very properly represented which
12 are precisely the elements of within the industry that
13 are causing cost to decline, and then there's the
14 whole issue of placing that plant in use and to the
15 extent that that involves -- or does it? This is the
16 key question. Does it involve digging trenches and
17 putting in conduit and all I'm saying is to the extent
18 that the industry moves away from those physical
19 asset-based ways of doing it and in the direction of
20 the things you've just described that would move the
21 industry toward being a cost declining industry but if
22 instead it has to still continue very large
23 investments in putting plant in place that dimension
24 could overwhelm -- not overwhelm but offset the issues
25 which you've properly identified with which I totally

01220

1 agree.

2 Q. I understand what you're saying now. I
3 interpreted you more narrowly to be talking about
4 switching and those kind of technologies exclusively.
5 Thank you.

6 JUDGE WALLIS: Anything further of the
7 witness? It appears that there's not. Dr. Porter,
8 thank you for appearing today. You're excused from
9 the stand. Let's be off the record for a moment for a
10 scheduling discussion.

11 (Discussion off the record.)

12 JUDGE WALLIS: Let's be back on the record,
13 please. Let's reconvene at 1:30 and I'm going to ask
14 if the witness could be at the witness table and ready
15 to go at 1:30 and also ask if there are typographical
16 or grammatical corrections or if there are a number of
17 relative minor corrections that we use an errata sheet
18 rather than asking her to go through those.

19 MR. SHAW: There's very few typographicals.
20 There are some changes that she wishes to make in the
21 testimony. I think it will be important to take the
22 time to identify that. They're substantive changes
23 and we'll have to supply an updated exhibit. The
24 witness is going to explain a change that she does
25 want to make in her testimony.

01221

1 JUDGE WALLIS: Would it be possible to list
2 those in a sheet so that we could follow more easily
3 and not take the time?

4 MR. SHAW: We'll try to get something over
5 the lunch hour.

6 JUDGE WALLIS: We'll make staff researchers
7 available to assist you in that. Let's be off the
8 record.

9 (Lunch recess taken at 12:08 p.m.)

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01222

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AFTERNOON SESSION

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1:30 p.m.

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JUDGE WALLIS: Let's be back on the record, please, after our noon recess. Company's next witness is Margaret J. Wright. She has stepped forward and I'm going to ask you to stand at this time and be sworn.

Whereupon,

MARGARET WRIGHT,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

JUDGE WALLIS: In conjunction with this witness a number of her exhibits have previously been identified in a pre-hearing conference and I'm going to ask that the reporter insert at this point in the transcript the identification of Exhibits Nos. 2-T through 5 and 154-T through 163.

(Marked Exhibits 2-T, 3 - 5, 154-T, 155 - 160C, 161-T, 162 and 163.)

JUDGE WALLIS: In addition there has been distributed in conjunction with the witness's appearance this afternoon three additional documents. I'm identifying as Exhibit 2A a one page document entitled errata sheet; as Exhibit 187, a multi-page

01223

1 document entitled Exhibit MJW-1 revised 1-9-96; and
2 Exhibit 199 for identification is Exhibit MJW-2
3 revised 1-9-96.

4 (Marked Exhibits 2A, 187 and 199.)

5 MR. VAN NOSTRAND: Thank you, Your Honor.

6

7 DIRECT EXAMINATION

8 BY MR. VAN NOSTRAND:

9 Q. Ms. Wright, could you state your name and
10 spell it for the record, please.

11 A. Margaret J. Wright, M A R G A R E T, Wright
12 W R I G H T.

13 Q. Do you have before you what's been marked
14 for identification as Exhibit 2-T? That would be your
15 prefiled direct testimony in this case?

16 A. Yes, I do.

17 Q. Do you recognize that document as your
18 prefiled direct testimony in this case?

19 A. Yes.

20 Q. Do you also have before you what's been
21 marked for identification as Exhibit 154-T, your
22 prefiled rebuttal testimony in this case?

23 A. Yes, I do.

24 Q. Do you recognize that document as your
25 prefiled rebuttal testimony?

01224

1 A. Yes, I do.

2 Q. And also 161-T your supplemental testimony?

3 A. Yes.

4 JUDGE WALLIS: Can I interject here for
5 just one moment and be off the record.

6 (Recess.)

7 Q. Do you have any additions or corrections to
8 make to 2-T, 154-T or 161-T other than as set forth in
9 the errata sheet which has now been marked as Exhibit
10 2A?

11 A. No.

12 Q. As corrected if I asked you the questions
13 as set forth in those exhibits would you give the
14 answers as set forth in those exhibit?

15 A. Yes.

16 Q. Do you also have before you what's been
17 marked for identification as 198 and 199?

18 A. Yes.

19 Q. And also Exhibits 157 through 160?

20 A. Yes.

21 Q. And were those exhibits prepared under your
22 direction and supervision?

23 A. Yes, they are.

24 Q. And do you have any additions or
25 corrections to make to those exhibits at this time

01225

1 other than as set forth in Exhibit 2A which is the
2 errata sheet?

3 A. No.

4 Q. Are those exhibit true and correct to the
5 best of your knowledge as corrected?

6 A. Yes.

7 MR. VAN NOSTRAND: Your Honor, move the
8 admission of Exhibits 154-T, 161-T and 2-T and
9 Exhibits 157 through 160 and 198 through 199.

10 I would also note that portions of Ms.
11 Wright's testimony refer to the depreciation and
12 capital recovery expense issue and in accordance with
13 the Commission's earlier order on that point those
14 portions are submitted as an offer of proof only.

15 JUDGE WALLIS: Very well. Is there
16 objection to the exhibits? Let the record show that
17 there is no objection and the exhibits are received.

18 MR. VAN NOSTRAND: Ms. Wright is available
19 for cross-examination.

20 (Admitted Exhibits 2A, 2-T, 154-T, 161-T,
21 157 - 160C, 161-T, 198 and 199.)

22 MR. TRAUTMAN: Just one point of
23 clarification on the MJW-1 and 2, we've admitted 162
24 and 163 but not 155 and 156?

25 MR. VAN NOSTRAND: We have not admitted 162

01226

1 and 163, no.

2 JUDGE WALLIS: Let's be off the record.

3 (Recess.)

4 JUDGE WALLIS: Let's be back on the record,
5 please. So that I'm sure that the record is accurate,
6 let me recite the exhibit numbers that have been
7 received. Those are Exhibits 2-T, Exhibit 2A, 154-T,
8 157, 158, 159, 160C, 161-T, 198 and 199. Very well,
9 Mr. Trautman, you may proceed.

10

11 CROSS-EXAMINATION

12 BY MR. TRAUTMAN:

13 Q. Good afternoon.

14 A. Good afternoon.

15 Q. Could you turn first to page 93 of your
16 rebuttal testimony. And this is the testimony that
17 concerns ratemaking adjustment No. 3 AFUDC?

18 A. Yes, I have it here.

19 Q. Is it your testimony that the capitalized
20 AFUDC is now being depreciated?

21 A. Yes.

22 Q. And does this adjustment increase book
23 depreciation for ratemaking purposes?

24 A. Yes.

25 Q. Does this adjustment make any changes to

01227

1 tax depreciation for ratemaking purposes?

2 A. It does not make a deferred tax portion of
3 this adjustment.

4 Q. Does the adjustment make any changes to tax
5 depreciation for ratemaking purposes?

6 A. Again, this adjustment purely is a
7 capitalized portion of our -- that is applied to plant
8 and it's depreciated over time according to the life of
9 our plant, and that's the extent of the adjustment.

10 Q. So it does not make an adjustment to tax
11 depreciation?

12 A. It does not make a deferred tax adjustment.

13 Q. The question was simply does it make any
14 change to tax depreciation?

15 A. The normal flow of our books is that when
16 you depreciate this capitalized portion on your books
17 there may be an income statement effect.

18 Q. Can you identify the difference between tax
19 depreciation and book depreciation?

20 A. Yes. The depreciation for tax purposes is
21 what we report to the IRS and pay according to the IRS
22 rules and our books depreciation is just a tax rate
23 that we apply to our books' results.

24 Q. So that, again, would the adjustment make
25 any change to tax depreciation for ratemaking

01228

1 purposes?

2 A. For ratemaking purposes it does not affect
3 the deferred tax portion of our rate base.

4 Q. Could you now turn to your rebuttal
5 testimony at page 56, lines 6 through 8 and is it your
6 testimony that the booking of additional depreciation
7 reduces the temporary difference and therefore reduces
8 the deferred taxes on the company's books?

9 A. That was page?

10 Q. 56, lines 6 through 8. I see that before
11 me and your question.

12 Q. Is that still your testimony?

13 A. Yes.

14 Q. Could you turn to page 53 of your rebuttal
15 testimony, and this concerns ratemaking adjustment No.
16 9, the sharing adjustment?

17 A. I have that.

18 Q. Is it your testimony on pages 53 and goes
19 through 57 that the increase in accumulated
20 depreciation expense is the result of an increase to
21 depreciation expense?

22 A. The booking associated with the sharing
23 adjustment and the rural sales settlement, which I am
24 discussing on these pages, is that when we increase
25 our depreciation reserve we book a depreciation

01229

1 expense that has an effect to increase our
2 depreciation reserve and it has the effect of
3 decreasing our deferred taxes.

4 Q. And is it also your testimony on page 56,
5 lines 1 through 8 that this increase to depreciation
6 expense reduces deferred taxes?

7 A. Yes.

8 Q. Will you accept subject to check that an
9 increase to booked depreciation expense with no
10 increase in revenues has no effect on current federal
11 income taxes or the taxes actually paid to the IRS?

12 A. I'm going to refer that question to our tax
13 expert. My understanding is that when you book
14 depreciation expense you change the timing difference.
15 You've now reduced -- you've increased your
16 depreciation reserve and you have a deferred tax
17 entry. We recorded it on our books and my
18 understanding if we did not record that on our books
19 it was a violation of our tax code and so we're
20 required to book that.

21 Q. On page 56, lines 10 through 14 you testify
22 that these adjustments increase current taxes and
23 therefore reduce cash flow. Do you see that? "I
24 should clarify that these depreciation reserve
25 adjustments increase current taxes and therefore

01230

1 reduce cash flow"?

2 A. Correct.

3 Q. What adjustments specifically are you
4 referring to by "these adjustments"?

5 A. What I'm saying is that when you reverse
6 your deferred taxes, your defer taxes become current
7 and payable to the IRS.

8 Q. Are you referring specifically to any of
9 the sharing, 1990, '91 or ordinary sharings?

10 A. What I'm specifically referring to here is
11 the entry that we made for the order to apply our 1991
12 and 1992 sharing towards the depreciation reserve.

13 Q. You define cash flow as the cash available
14 after all cash expenses are deducted from cash
15 received?

16 A. What I'm simply saying here that when you
17 reverse your deferred taxes they become part of your
18 current taxes and payable to the IRS. Very simple.

19 Q. So is that a yes?

20 A. Yes.

21 Q. Or a no?

22 A. Well, I was redefining -- would you repeat
23 the question?

24 Q. Do you define cash flow as the cash
25 available after all cash expenses are deducted from

01231

1 cash received?

2 A. Cash flow can be defined in many different
3 ways. I don't believe that I've addressed cash flow
4 per se here in an academic sense. All I'm saying is
5 that when you reverse your deferred taxes and they
6 become current taxes they're payable to the IRS and
7 they affect your cash flow meaning that you're going
8 to have to pay more cash to the IRS. It's a pretty
9 simple statement. You can get into all sorts of
10 definitions of cash flow when it comes to financial
11 statements.

12 Q. Is it true that booked depreciation expense
13 is an item that is booked as an operation expense but
14 is not paid for with cash and thus the company has
15 cash flow from the booking of depreciation expense?

16 A. We deduct deferred taxes from our rate base
17 because that's considered cash free capital to us
18 because we indeed have had a recovery of the booked
19 taxes, so, yes, the reason that deferred taxes is
20 deducted from your rate base is considered free
21 capital, but again, here, when we book this
22 depreciation expense, increased our depreciation
23 reserve, reduced our deferred taxes, that becomes part
24 of our current tax calculation and that means that --
25 in essence when you defer taxes it means you don't pay

01232

1 them but when they become current they become payable,
2 so it seems a pretty simple concept.

3 Q. I'm not sure if that was an answer to the
4 question. The question, again, was, is it true that
5 booked depreciation expense is an item that is booked
6 as an operating expense but is not paid for with cash
7 and therefore the company has cash flow from the
8 booking of the depreciation expense?

9 A. The cash free capital that we have is the
10 deferred taxes that we're allowed to deduct from the
11 rate base and the reason we're allowed to deduct them
12 for the rate base is because those are taxes we
13 haven't paid yet.

14 Q. So is that a yes or a no to the question?

15 A. I'm just trying to explain how when you're
16 talking about do you get cash free capital in your
17 rate base that's all I'm trying to explain here.

18 JUDGE WALLIS: Excuse me. I am going to
19 suggest that you really listen carefully to the
20 question and start off by answering the question if
21 you can, if it does have an answer and then begin an
22 explanation. Do you have the question in mind?

23 Q. We can repeat that. Is it true that booked
24 depreciation expense is an item that is booked as an
25 operation expense but is not paid for with cash and

01233

1 therefore the company has cash flow from the booking
2 of depreciation expense?

3 A. We do.

4 Q. Is it also true that deferred federal
5 income tax is an item that is booked as an operating
6 expense but is not paid for with cash and therefore
7 the company has cash flow from the booking of deferred
8 taxes?

9 A. That's correct, and it's deducted from our
10 rate base.

11 Q. Is it also true that if revenues are not
12 increased for an increase in deferred taxes that the
13 cash flow will not increase?

14 A. I'm not quite sure of the context of that
15 question.

16 Q. Referring now to your exhibit MJ-1 -- MJW-1,
17 and I believe it's now 198 adjustment RMA No. 9, is it
18 your testimony that this decrease to accumulated
19 deferred taxes associated with the increase to
20 accumulated depreciation expense increases the
21 company's revenue requirement?

22 A. The increase in the depreciation reserve
23 decreases the revenue requirement. The decrease in
24 the deferred tax increases the revenue requirement.

25 Q. Is it true that the increase to accumulated

01234

1 depreciation expense as approved by the Commission in
2 the AFOR sharing agreements did not increase or
3 decrease rates paid by ratepayers?

4 A. This was part of a sharing mechanism where
5 you looked at all your revenues and your expenses and
6 you determined a sharing amount. That's not in a rate
7 proceeding. This was in a sharing agreement, so I
8 don't think that applies to this.

9 Q. So is that a yes or a no?

10 A. I'm saying that that particular question
11 would not apply to this adjustment.

12 Q. So the question was did the increase in the
13 accumulated depreciation expense as approved by the
14 Commission in the AFOR sharing agreement, did that --
15 is it true that that did not increase or decrease the
16 rates paid by ratepayers?

17 A. It did not change our revenue stream.

18 Q. Is it your understanding that deferred
19 taxes are used to reduce the rate base because the
20 ratepayers have paid rates that include the deferred
21 taxes as part of the cost of operations?

22 A. That's correct.

23 Q. Is it also your understanding that the
24 opposite is true, namely, that a reduction in deferred
25 taxes is used to increase the rate base because the

01235

1 ratepayers have not paid rates since the reduced
2 amount of deferred taxes have been included in the
3 cost of service?

4 A. It depends. We booked about 27 million of
5 additional represcription depreciation expense during
6 the AFOR agreement and we did not get any rates to
7 cover that \$27 million but we reduced our deferred
8 taxes, so it depends on what -- in what context you're
9 looking at.

10 Q. Was that in conjunction with the AFOR?

11 A. It was represcription under the AFOR. We
12 had two represcriptions under the AFOR. We increased
13 our depreciation expense by 10 million and then we
14 increased our depreciation by 27 million. We received
15 no additional rates for that depreciation expense but
16 we reduced our deferred taxes.

17 Q. When did you book the deferred taxes?

18 A. At the time that the additional
19 depreciation was booked. I believe we started booking
20 the \$10 million of additional depreciation in 1991,
21 and we started booking the additional depreciation for
22 the second represcription in 1993, I believe.

23 Q. Did you report that to the Commission in
24 the work papers for the sharing agreement?

25 A. The represcription was agreed to between

01236

1 the company and the staff and the FCC. It was booked
2 on our books and it was audited by the staff. There
3 was no question on the associated deferred taxes
4 associated with that entry. Again, deferred taxes is
5 a normal entry that's always made with additional
6 depreciation.

7 Q. Is that a yes or a no to was it reported to
8 the Commission?

9 A. Well, it was reported in our A 61 on our
10 Commission basis results on a monthly basis.

11 Q. Was it reported in the work papers for the
12 AFOR?

13 A. Well, certainly, because the A 61 is part
14 of the work papers.

15 Q. Is it your testimony that the accumulated
16 deferred taxes associated with the \$32 million increase
17 in accumulated depreciation should be used to decrease
18 the accumulated deferred taxes and increase the rate
19 base?

20 A. That's correct and if we don't -- we booked
21 this on our books and if we don't include it it's my
22 understanding a violation of tax code, and if you were
23 not to reverse those deferred taxes they would stay in
24 our rate base forever. It would never go away because
25 it would be no associated depreciation with it.

01237

1 Q. So your answer was yes?

2 A. They should be.

3 Q. To your knowledge, has this Commission
4 directed the company to reduce its tariffs so that
5 ratepayers will receive the benefit of the reduction
6 of deferred taxes associated with the sharing
7 agreement to increase the accumulated depreciation?

8 A. My understanding, the only order that we
9 got for sharing that involved any tariffs was when our
10 rates were reduced by \$33 million. We received orders
11 on how to dispose of the sharing dollars, but there
12 was no tariff changes except when our rates were
13 permanently changed.

14 Q. Will you accept subject to check that the
15 sharing agreement in the AFOR allowed the company to
16 increase the accumulated depreciation as an
17 alternative to reducing revenues?

18 A. No. There was four options that the
19 Commission had. They could apply the -- they could
20 apply the sharing to depreciation. They could have
21 rate reductions. We could have credits on the
22 customer's bill and they could also invest it into
23 infrastructure so there was various options they could
24 have.

25 Q. So would you accept subject to check that

01238

1 one of the options in the sharing agreement in the
2 AFOR allowed the company to increase accumulated
3 depreciation as an alternative to reducing revenue?

4 A. Yes. That was one of the options.

5 Q. Do you agree that since the company agreed
6 to increase accumulated depreciation expense that the
7 Commission did not require U S WEST to reduce their
8 operating revenue tariffs or to refund any money back
9 to the ratepayers?

10 A. That wasn't part of that option. It was
11 just a way of disposing of part of the sharing
12 dollars.

13 Q. Again, would you agree that the Commission
14 did not require U S WEST to reduce their operating
15 revenue tariffs or to refund any money back to the
16 ratepayers?

17 A. For what sharing year?

18 Q. 1991.

19 A. I don't have the details in front of me,
20 but I think only a portion of the sharing in 1991 was
21 supplied towards depreciation, and I believe there was
22 other parts of it that were used for other purposes.

23 Q. And that the same for 1993?

24 A. For 1993 all of the sharing was applied
25 towards depreciation.

01239

1 Q. And so for 1993, is it true that the
2 Commission did not require U S WEST to reduce their
3 operating revenue tariffs or to refund any money back
4 to the ratepayers?

5 A. They had the option to do that. They had
6 the option to reduce our rates. They had the option
7 to get a pension -- excuse me, to give a credit to the
8 customers or they could apply it towards depreciation
9 or put it into infrastructure. They chose
10 depreciation.

11 Q. The question is did they require it? Did
12 they require the things that I asked and your answer
13 is?

14 A. Then it would be doubling the effect
15 because that would be doing both things. You would be
16 taking the same money, applying it towards the
17 depreciation reserve and then you would be taking the
18 same money and putting it in some kind of rate
19 reductions. That doesn't make any sense.

20 Q. Do you agree that if the company had not
21 received excess profits as defined in the AFOR that
22 the company's current federal income taxes would have
23 been less?

24 A. I would like to not characterize it as
25 excess profits. I would like you to characterize

01240

1 there was a sharing amount for and what particular
2 year are you talking about?

3 Q. 1993.

4 A. So will you repeat the question?

5 Q. Do you agree that if the company had not
6 received excess sharing dollars as defined in the AFOR
7 that the company's current federal income taxes would
8 have been less?

9 A. There are so many variables involved with
10 taxes. I'm assuming on a general sense, yes. I mean,
11 if you make less money you pay less taxes.

12 Q. Do you agree that the excess -- that the
13 excess sharing dollars did not cause any change to the
14 deferred federal income taxes?

15 A. I would rather refer that to Julie Dawson.
16 I don't know how that all works. I would rather have
17 a tax expert to address that.

18 Q. Could you now refer to what's been marked
19 as Exhibit 164.

20 JUDGE WALLIS: At this point I will ask the
21 court reporter to insert into the record the
22 identification of Exhibits 164 through 195 which had
23 been marked to be used in conjunction with the
24 Commission staff examination of the witness.

25 (Marked Exhibits 164 through 195.)

01241

1 Q. And do you recognize this exhibit as the
2 company's response to staff data request 318?

3 A. Yes, I do.

4 Q. And your name is not on the exhibit but are
5 you the witness to respond to this exhibit?

6 A. Yes.

7 Q. And is it true and correct to the best of
8 your knowledge?

9 A. Yes.

10 Q. Do you agree that the total reduction to
11 accumulated depreciation caused by the agreements in
12 the AFOR is \$50,634,616 as stated in the response to
13 this data request? And that would be the sum of the
14 last two numbers on line 9 on the attachment A.

15 A. Yes. I see that.

16 MR. TRAUTMAN: I would move to admit
17 Exhibit 164.

18 JUDGE WALLIS: Objection? Exhibit 164 is
19 received.

20 (Admitted Exhibit 164.)

21 A. Can I make one clarification about this
22 exhibit? The estimated 1993 sharing, we had not
23 received an order from the Commission when I filed my
24 testimony so the 1993 sharing both for the
25 depreciation reserve or the deferred tax impact was

01242

1 not included in my test period.

2 Q. Is the \$17,927,000 amount correct?

3 A. I don't have the exact number in front of
4 me but I know it was 17.9 million.

5 Q. Do you agree that the \$50.6 million of
6 depreciation has been received by the company as
7 sharing dollars during the AFOR?

8 A. We have been ordered by this Commission to
9 apply those dollars to our depreciation reserve.

10 Q. But you did receive them? The company did
11 receive them; is that correct?

12 A. It's according to the calculation of the
13 sharing. The sharing amount was applied towards the
14 depreciation reserve and it was both the ratepayer
15 portion and the company portion.

16 Q. Did the company receive the dollars from
17 the ratepayers?

18 A. In essence through our results of
19 operation, yes.

20 Q. Do you agree that the company paid an
21 additional approximately \$17.7 million in current
22 federal income taxes associated with the \$50.6 million
23 of sharing dollars and that would be at a rate of 35
24 percent?

25 A. I don't understand the question.

01243

1 Q. Do you agree that the company paid an
2 additional \$17.7 million in current federal income
3 taxes associated with the 50.6 million of sharing
4 dollars?

5 A. If you're looking at this document what I
6 would see here is that by booking this depreciation it
7 reversed -- looking at the end of period accumulated
8 taxes here it reversed a portion of our deferred taxes
9 that would become current. If I added them up I would
10 assume that that would be the additional current taxes
11 we had associated with this depreciation.

12 Q. Did the company receive 50.6 million in
13 sharing dollars on which they paid \$17.7 million in
14 taxes?

15 A. I will let you address that to our tax
16 expert Julie Dawson.

17 Q. Would you agree that these current taxes
18 were included as operating expenses charged in rates
19 to the ratepayers?

20 A. The 17.9 million was booked in late 1995,
21 so in my test results there certainly wouldn't be any
22 tax impact for the 17.9 million that we booked towards
23 depreciation. It wouldn't be included in my test
24 period.

25 Q. In 1993 did the company have excess sharing

01244

1 dollars of 17.9 million?

2 A. That was the agreed upon sharing amount
3 that we agreed with the staff, yes, and was ordered by
4 the Commission.

5 Q. In what year did you book the change to
6 depreciation?

7 A. We didn't get the order until late 1995. I
8 believe we booked it in November of 1995.

9 Q. So in your 1993 results of operations did
10 the company pay taxes on that 17.9 million?

11 A. It was part of our results of operation,
12 but all of the taxes and all of the adjustments to our
13 taxes I can't tell you right now the exact amount
14 of taxes that we paid in 1993.

15 Q. So would you defer that to Ms. Dawson?

16 A. Yes.

17 Q. Do you agree that if the company now books
18 depreciation expense of approximately \$50.6 million
19 that the company will be able to reduce its deferred
20 federal income tax expense by \$17.7 million?

21 A. Again, are we looking at Exhibit 164?

22 Q. Yes.

23 A. And we're taking the total of the increase
24 to the depreciation on line 9, the 32708 and the
25 17907.

01245

1 Q. Yes?

2 A. The associated deferred taxes is listed
3 right below. For the deferred taxes associated with
4 the 32708 is 13 million 404 -- excuse me. These are
5 not cumulative, so we would have to accumulate the
6 deferred taxes associated with this adjustment.

7 Q. So can you answer the question or would you
8 defer that question?

9 A. I would say now that I'm looking at this
10 this is end of period so our cumulative effect of the
11 deferred taxes associated with the 50 million
12 depreciation number you're quoting is 19,599,000.

13 Q. Is it your testimony that this \$19 million
14 change in deferred federal income taxes should flow to
15 the ratepayers?

16 A. I'm saying this was a reduction in our
17 deferred taxes and increased our rate base.

18 Q. Would you agree that this 19.9 million
19 change in deferred federal income taxes should flow to
20 the ratepayers?

21 A. No. It's part of our adjustment for the
22 depreciation reserve. It's a rate base adjustment.

23 Q. Can you tell us how the accumulated
24 deferred taxes are generated?

25 A. It's a tax timing difference. When we have

01246

1 a difference between our booked taxes and the taxes
2 that we pay to the IRS we are able to defer some of
3 our booked taxes and those deferred taxes are
4 accumulated on our balance sheet, and because they're
5 considered free use of capital to the company we
6 deduct them from our rate base.

7 Q. Are they included in the income statement?

8 A. When the deferred taxes are reversed they
9 become current taxes on our income statement.

10 if you would like some very technical
11 explanations of exactly how our taxes flow I would be
12 happy to refer that to Julie who understands all of the
13 tax laws.

14 Q. Would you agree that the ratepayers should
15 not be charged this 50.6 million increase in
16 depreciation expense because they've already paid for
17 it?

18 A. For sharing purposes we've always excluded
19 that depreciation expense from our results of
20 operation for sharing purposes, and it would be not
21 included in this -- this expense has not been included
22 in my test period as depreciation expense.

23 Q. Again, would you agree that the ratepayers
24 should not be charged this \$50.6 million increase in
25 depreciation expense because they've already paid for

01247

1 it?

2 MR. VAN NOSTRAND: Objection, Your Honor.

3 The question has already been asked and answered.

4 Q. Is that yes or no?

5 A. I'm saying it was not included for revenue
6 requirement purposes.

7 Q. So your answer is no?

8 A. Right.

9 Q. Is the total tax depreciation expense on
10 plant items equal to the total booked depreciation
11 expense on those plant items?

12 A. Again, I'm going to refer that question to
13 Julie. I don't completely understand your question.

14 Q. Would you accept subject to check that in
15 your adjustment PFA No. 7, which is rural sales, that
16 the tax depreciation and book depreciation on the rural
17 sales were not equal?

18 A. I don't have the worksheet in front of me
19 for all the entries associated with the rural sales,
20 but you're talking about the sales transaction itself?
21 The way that the company booked it?

22 A. There was both current and deferred taxes
23 associated with the entries to book the sale of our
24 properties.

25 Q. Would you accept subject to check that

01248

1 there was approximately a \$5 million difference
2 between tax depreciation and book depreciation?

3 A. Yes, subject to check.

4 Q. Could you now turn to page 16 of your
5 rebuttal testimony, and this concerns restating
6 adjustment No. 16 which is the flow through tax
7 restatement?

8 A. I have that here.

9 Q. And on page 17, beginning on line 16, you
10 state, "on September 15, 1995 the staff filed its
11 review of the company's 1994 sharing filing and
12 concluded that the 1994 AFOR sharing results are not
13 inconsistent with the staff recommendations in the
14 current rate case." Is that your testimony?

15 A. I see that, yes.

16 Q. Could you now refer to what's been marked
17 as Exhibit 165, and do you recognize this exhibit, in
18 particular the attachment, as what you were referring
19 to in your testimony?

20 A. I have that here.

21 Q. It's a cover letter which says "Enclosed
22 for filing are the original and 19 copies of the staff
23 review U S WEST sharing proposal for 1994"?

24 A. Yes.

25 Q. Is that what you were referring to in your

01249

1 testimony?

2 A. I was.

3 Q. And would you accept subject to check that
4 the actual 1994 sharing report -- and this is the last
5 paragraph -- states the following, "Finally the 1994
6 AFOR sharing results are not inconsistent with the
7 staff recommendations in the current rate case.
8 Because the stipulation and agreement in the 1990
9 earnings complaint, the limited criteria under which
10 sharing revenues were to be determined are not
11 relevant for current rate case purposes."

12 A. I see that.

13 MR. TRAUTMAN: I would move for the
14 admission of Exhibit 165.

15 JUDGE WALLIS: Exhibit 165 is received.

16 (Admitted Exhibit 165.)

17 Q. Turning to page 18 of your rebuttal
18 testimony, is it true that you state on lines 6 through
19 11 that the normalization of the tax effects on the
20 pension asset has been flowed through to the ratepayer
21 in the 1994 sharing?

22 A. I see that.

23 Q. Is it true, then, that the company
24 normalized the taxes on the pension asset previous to
25 the 1994 sharing?

01250

1 A. There was several things that happened. In
2 context of the negotiations for the 1993 sharing we
3 agreed to flow through the deferred taxes associated
4 with the 1993 year, and that increased sharing I
5 believe by about one point -- I don't have the exact
6 number but it was almost 1.9 million, and in that
7 context we also booked this in January 1995, and if
8 you read the AFOR agreement it says that if there are
9 substantial adjustments in the first quarter following
10 the sharing year you will make those adjustments
11 within the context of the previous sharing year, so by
12 booking -- flowing the rest of these deferred taxes
13 through our books in January 1995 we included it in
14 our 1994 sharing.

15 Q. So, then again, is it true that the company
16 normalized the taxes on the pension asset previous to
17 the 1994 sharing?

18 A. We actually made the entry in January of
19 1995.

20 Q. Is that when you made the entry to flow
21 through?

22 A. Yes. I will correct that. That's when we
23 flowed through the deferred taxes.

24 Q. And so then with that in mind, did the
25 company normalize the taxes on the pension asset

01251

1 previous to the 1994 sharing?

2 A. Well, we made an adjustment like I said in
3 our 1993 sharing to correct the '93 sharing to flow
4 through that portion, and it increased our sharing in
5 1993.

6 Q. So, was that a yes or no?

7 A. It wasn't actually booked on our books but
8 we made a special adjustment in our 1993 sharing to
9 show the effect of throwing it through in 1993 for the
10 1993 portion.

11 Q. Why did the company have to make that
12 adjustment?

13 A. We had just received an order from the
14 Commission stating that our interpretation of the WAC
15 that governed that was different than the company's
16 interpretation and so at that point we went ahead and
17 flowed through the deferred taxes on our books.

18 Q. So the company was not able to normalize
19 it. Would that be correct?

20 A. Well, first of all this only applies to
21 years '93 and prior. We did not have a pension credit
22 in 1994 so there was no normalization issue, but we
23 did, again per the Commission order -- and I believe
24 we didn't receive the Commission order until late
25 1994, and then we made the entry. In January of '95

01252

1 we were still in negotiations for our '93 sharing so
2 we made the correction in our '93 sharing and we made
3 the rest of the adjustment in our '94 sharing.

4 Q. Is it then true that in the 1990 through
5 1993 sharing filing that fewer dollars were available
6 for sharing because the company normalized these
7 taxes?

8 A. It depends. We did a calculation. I don't
9 have it in front of me but some years it actually went
10 out of the -- because we were sharing in different
11 ranges some of these actually would take us out of the
12 sharing range and we wouldn't have shared any of it.
13 There's one year you would actually be in a different
14 position, so it depends on how you calculate it on a
15 year by year basis. You really have to look at all of
16 the sharing amounts and what sharing range you were in.

17 Q. Is it true that if the taxes had been
18 flowed through in previous years that the ratepayers
19 would have either received additional reduced rates,
20 refunds or a larger adjustment to the accumulated
21 depreciation expense?

22 A. I just stated, in some years that was the
23 case. In some years it wasn't because we were out of
24 the sharing range where we would be sharing no
25 additional dollars. And as the case in 1994, it was

01253

1 included, but because we weren't in the sharing range
2 there was no sharing dollars to affect it.

3 Q. So is what you're saying is that by
4 including this adjustment in the 1994 sharing that the
5 ratepayers did not receive a reduction in rates?

6 A. Well, there's several things --

7 Q. A refund or additional increase to
8 accumulated depreciation expense?

9 A. It increased our results of operations for
10 1994, but there was lots of factors. In that
11 accounting order the Commission also asked us to
12 book the catch-up entry for FAS 112 which was a large
13 additional expense that we booked in our 1994 sharing.
14 Again, because there was no sharing there was no
15 impact so those entries almost offset each other.

16 Q. Could you turn to page 18 of your rebuttal
17 testimony at line 10 in and you state, "also, this is
18 an out of period transaction that would not be
19 considered for ratemaking purposes"?

20 A. I see that.

21 Q. Did you make an adjustment to the
22 accumulated deferred taxes associated with the change
23 from normalization to flow through of the tax impact
24 of the pension asset in this rate case?

25 A. Well, I want to make -- it seems to me like

01254

1 there's a misunderstanding what you do with an out of
2 period. If you have a permanent change to your
3 balance sheet that is ongoing, an out of period is an
4 adjustment to your income statement. It is either
5 expenses that apply to a previous period or some
6 adjustments to your revenues. You take that out
7 because you're trying to normalize your income
8 statement, but when you make a permanent change to
9 your balance sheet you don't then take that entry out
10 of that account. That's a permanent change to the
11 balance sheet and it should be ongoing.

12 Q. I'm not sure if that's a yes or no, so,
13 again, the question was, did you make an adjustment to
14 the accumulated deferred taxes associated with the
15 change from normalization to flow knew of the tax
16 impact of the pension asset in the rate case?

17 A. We made an adjustment to our balance sheet
18 and to our income statement. The balance sheet is an
19 ongoing decrease or a change to our deferred taxes
20 that's ongoing. That would continue. That's not an
21 out of period. That's a permanent change to the
22 balance sheet.

23 Q. On page 22 of your rebuttal testimony you
24 testified concerning the system X deferred tax
25 difference?

01255

1 A. Yes, I did.

2 Q. And does this title imply deferred tax?

3 A. I would really like to explain this
4 adjustment. I'm not sure for the Commission's
5 standpoint -- what we do on our books is we have a
6 complete set of books for, say, Washington state.

7 MR. TROTTER: Your Honor, I am going to
8 object. There was a very direct question asked. If
9 the witness saw a need to explain this adjustment it
10 should have been in her testimony to begin with.

11 THE WITNESS: It was and I will.

12 MR. TROTTER: I understand this witness's
13 need to explain but I think it's gone well beyond the
14 bounds and I will interject an objection to raise it.

15 JUDGE WALLIS: I'm going to ask that the
16 witness really concentrate on the questions and start
17 off by answering the question. I know some of them
18 are very complex and technical, and if you need to
19 have them repeated that's okay but start off by
20 answering the question and then if you have a need to
21 explain you can do that and if you want to cite to
22 your testimony you can do that, too.

23 Q. Again, referring to the testimony on system
24 X deferred tax difference. Does this title comply
25 deferred tax?

01256

1 A. It implies an adjustment for taxes for our
2 deregulated operations.

3 Q. On page 23 of your rebuttal testimony at
4 line 19 you state, "it is the staff's responsibility
5 to audit and understand the books of the company
6 including the separation process." Is that your
7 testimony?

8 A. That's correct.

9 Q. I would like you to refer now to what's
10 been marked as Exhibit 166, and do you recognize this
11 exhibit as a staff requesting an additional response
12 or a supplemental response to data request 39?

13 A. Yes, I do.

14 Q. Will you accept subject to -- will you
15 accept the data request reads as follows: "Please
16 provide additional information for DR 39 concerning
17 deferred taxes. Referring to Commission report A 61
18 for November 1993, please explain line 159, other net
19 income adjustment (excluding fixed charges) in column
20 G of \$22,097,111. This line shows an increase of
21 \$19,333,477. Also, explain line 164 system X deferred
22 tax difference. Provide the ratemaking adjustment
23 that would correct this entry on your books. Provide
24 all work papers and calculations used to make this
25 adjustment." Is that what it says?

01257

1 A. Yes, it does.

2 MR. TRAUTMAN: Move for entry of Exhibit
3 166.

4 MR. VAN NOSTRAND: No objection.

5 JUDGE WALLIS: Exhibit 166 is received.
6 (Admitted Exhibit 166.)

7 Q. Now, if you would refer to what's been
8 marked as Exhibit 167. Do you recognize this as the
9 company's response to data request 39 supplement?

10 A. Yes.

11 Q. And is it true and accurate to the best of
12 your knowledge?

13 A. Yes.

14 Q. Is it correct that your response to explain
15 the large difference on line 159 is -- and this is in
16 the fourth paragraph. Says, "the primary cause of the
17 large amount assigned to column D is the \$21,681,573
18 associated with" -- and this is an acronym --
19 "OMPOSBEN 112, part X, nonreg results, page 2. This
20 is supported by the memo from Cheryl Rudeen of August
21 23, 1995 and system X September 1993 - Washington
22 report."

23 A. That's how it's stated.

24 Q. And this memo of August 23, 1995, which is
25 referred to was written 12 days after the staff filed

01258

1 their testimony in this case; is that correct?

2 A. I don't have the date of the staff
3 testimony in front of me.

4 Q. Did you submit the August 23, 1995 memo as
5 attachment C1 to your response?

6 A. Yes, we did.

7 Q. Is it true that the second paragraph of
8 this memo states the following, "In September 1993 net
9 operating income in Washington was distorted due
10 primarily to a large depreciation booking for
11 represcription. This resulted in unusual allocations
12 of tax, adds and deducts. Tax, add, OMPOBEN 112, was
13 significantly impacted."

14 A. I see that.

15 JUDGE WALLIS: Let's be off the record for
16 just a moment.

17 (Discussion off the record.)

18 JUDGE WALLIS: Let's be back on the record.

19 Q. In looking back to the body -- main body of
20 the response to data request 39 supplement, going to
21 the last paragraph which carries over to the next
22 page, is it true the company response states, "the
23 federal income tax expense, lines 161 and 163, are the
24 results of calculations based on lines 154 through
25 160."

01259

1 A. Oh, wait. You started in the middle of
2 that?

3 Q. Starting in the middle of that paragraph.

4 MR. VAN NOSTRAND: Your Honor, if the
5 exhibit is going to be admitted can we spare having it
6 read into the record?

7 MR. TRAUTMAN: We have one line that we
8 think should be brought out.

9 Q. "In strict algorithmic sense the amounts on
10 lines 168 through 179 are independent of the amounts
11 in lines 154 through 163. Conceptually there should
12 be perfect consistency. Line 164 is the balancing
13 amount to reconcile the algorithmic independence and
14 conceptual consistency." Do you see that?

15 A. Yes, I do. Do you want me to tell you that
16 in real plain English?

17 Q. No, that's fine. And do you see further
18 that on in the next paragraph midway through the
19 response states, "The process did not anticipate the
20 distortive impact depreciation represcription entries
21 would have on line 159."

22 A. I see that.

23 MR. TRAUTMAN: I would move for admission
24 of Exhibit 167.

25 JUDGE WALLIS: Exhibit 167 is received.

01260

1 (Admitted Exhibit 167.)

2 MR. TRAUTMAN: We can take a break now if
3 you want.

4 JUDGE WALLIS: Let's take a 10-minute
5 break.

6 (Recess.)

7 JUDGE WALLIS: Let's be back on the record,
8 please, following a brief recess. Mr. Trautman?

9 Q. On page 23 of your testimony, lines 1 and 2
10 you state that Exhibit MJW-4, which is now 158 has a
11 complete explanation of the system X adjustment. Do
12 you see that statement?

13 MR. TROTTER: Is this the rebuttal
14 testimony?

15 MR. TRAUTMAN: Yes, rebuttal testimony.

16 A. Yes. I see that.

17 Q. And could you now turn to Exhibit 158 which
18 is MJW-4, and at the top it is entitled explanation of
19 system X deferred tax. It's a three-page exhibit?

20 A. Yes, I have it here.

21 Q. And could you refer to the second page of
22 paragraph 6 of that exhibit, and on the last sentence?
23 Paragraph 6 do you see the sentence what is reported
24 for November is actually based on the accounted for
25 results from September 1993. Do you see that

01261

1 sentence?

2 A. Yes, I do.

3 Q. Is September 1993 outside of the test
4 period in this rate case?

5 A. Just the quick explanation on how we do
6 part X --

7 Q. Is that yes or no?

8 A. It is. However, for November 1993 the way
9 we calculate our part X is that we don't have the
10 taxes immediately known for us so we're always two
11 months in arrears for calculating our part X taxes.
12 So our November 1993 part X taxes were calculated
13 based on September tax numbers.

14 Q. And on page 3 of the exhibit at the top do
15 you see the sentence after you explain an accounting
16 entry the sentence says, "this caused a huge distortion
17 in the estimated part 64 subordinate detail. It was
18 approximately 50 times larger than normal."

19 A. I see that.

20 Q. Would you now turn to your rebuttal
21 testimony at page 84 to 86. And this is the testimony
22 concerning restating adjustment No. 7, the federal
23 income tax adjustment.

24 A. I have that in front of me.

25 Q. Is it your testimony that you disagree with

01262

1 staff witness Mr. Twitchell in the allocation of
2 taxes?

3 A. I disagree only in the aspect of the
4 deferred taxes and how it affects the balance sheet.

5 Q. And on page 86 at lines 12 to 13 do you see
6 the -- is it your testimony that the revenues and
7 expenses associated with taxes is difficult so that
8 you have separated the taxes by component rather than
9 a composite for federal income tax?

10 A. I see that.

11 Q. Could you now turn to what's been marked as
12 Exhibit 168, and it's entitled RSA No. 7, worksheet 2.

13 A. I have that in front of me.

14 Q. This was prepared by you?

15 A. Yes.

16 Q. Is it true that column F entitled
17 intrastate factor is your allocation factor that you
18 used for the income tax expense for this work paper?

19 A. This was to allocate it to the intrastate
20 or to develop the intrastate portion.

21 Q. Is it also true that the allocation of all
22 the income tax expense items except the current
23 federal income tax or FIT, are allocated using a
24 factor greater than 70 percent?

25 A. That's correct.

01263

1 Q. And for current FIT you used an allocator
2 of .418692?

3 A. That's correct.

4 Q. Then referring to column C, and that's
5 entitled total 1993 return adjustment, and underneath
6 it has an equation C equals B divided by 12 times 2.
7 Do you see that?

8 A. Yes, I do.

9 Q. Is it true that lines 1 through 6 of this
10 exhibit can be calculated using the formula in the
11 title but that line 7 cannot be?

12 A. This is a 1993 true-up that was done in
13 November of 1994. What this adjustment does, it is a
14 two months' adjustment for 1993 expense. It didn't
15 apply to 1994 so we didn't true up 1994. We only
16 trued up November and December of '93. The line 7 is
17 an adjustment to the deferred income tax on our
18 balance sheet, and that has been adjusted correctly
19 and it should be stated as such on an ongoing basis,
20 so that's again a balance sheet item versus an income
21 statement effect.

22 Q. So would the answer to the question be yes,
23 that line 1 through 6 can be calculated using the
24 formula in the title but line 7 cannot be so
25 calculated?

01264

1 A. That's correct.

2 Q. And is it also true that line 7 in column C
3 is not the sum of lines 3 and 4 although they all
4 refer to the title deferred income tax?

5 A. Yes, that's correct.

6 Q. Is it true that line 7 in column H on the
7 other hand is the sum of lines 3 and 4?

8 A. Yes. And this is a different entry. This
9 is an off book October true-up in November. This
10 particular adjustment is a truing up, an entry that
11 was made in November of 1994 for '93, so the only
12 thing we're doing here is restating November and
13 December of '93, which is in our test period.

14 Q. And would it also be true that line 7 in
15 column D is the sum of lines 3 and 4?

16 A. That's correct, and that is again another
17 adjustment.

18 Q. Could you turn to page 88 of your rebuttal
19 testimony, and this concerns OOP -- out of period
20 adjustment No. 4 prior period income tax?

21 A. Turning specifically to page '91 of your
22 rebuttal testimony. Is it your testimony that the
23 current federal income taxes should be allocated
24 instead of calculated because the revenue and expenses
25 are not included in the test period for these taxes?

01265

1 A. This adjustment is -- was booked in
2 November of 1993, and it was a 1992 true-up, so what
3 we did here is we completely took these expenses out
4 because they have nothing to do with the test period.

5 Q. Reading the question again, is it your
6 testimony that the current federal income taxes should
7 be allocated instead of calculated because the revenue
8 and expenses are not included in the test period for
9 these taxes?

10 A. That is a correct statement. This is a
11 1992 true-up, and the revenues and expenses in our
12 test period apply to November of '93 through October
13 of '94, and so they would not include the revenues and
14 expenses associated with 1992.

15 Q. So is it correct that instead of
16 calculating taxes from allocated revenues and expenses
17 you are allocating the tax adjustment by subaccount
18 which has the effect of allocating approximately 70
19 percent to intrastate operations?

20 A. Yes.

21 Q. Could you turn to what's been marked as
22 Exhibit 169 and that's OOP worksheet No. 143.

23 MR. TRAUTMAN: And I believe I also
24 neglected to move for admission of Exhibit 168
25 which I would like to do at this time.

01266

1 JUDGE WALLIS: I don't show that 167 has
2 been admitted.

3 MR. TRAUTMAN: Oh, that was the data
4 request. I would move for admission of that data
5 request response as well.

6 MR. VAN NOSTRAND: No objection.

7 JUDGE WALLIS: There being no objection
8 Exhibits 167 and 168 are received.

9 (Admitted Exhibit 168.)

10 Q. 169 is entitled OOP worksheet No. 3. Do
11 you have that exhibit?

12 A. Yes, I do.

13 Q. In column E do you see intrastate factor?

14 A. Yes, I do.

15 Q. Is it true that you have used an allocating
16 factor greater than 70 percent for all of these taxes
17 except the current federal income taxes on line 3?

18 A. Yes.

19 Q. And again that the allocation factor for
20 current federal income tax is .418692?

21 A. For line 3 we're using .418692, yes, that's
22 correct.

23 Q. In column H of the same worksheet, is it
24 true that lines 4 and 5 of this column have an
25 adjustment to deferred federal income taxes?

01267

1 A. Yes.

2 Q. Is it true that when you record an amount
3 to deferred income taxes that you must also record the
4 same amount to accumulated deferred income taxes?

5 A. Yes, and remember this was an entry that
6 was booked in November of 1993, and it was a 1992
7 true-up, and so what it in essence is doing is it
8 would be adjusted our deferred taxes, and we use an
9 end of period deferred taxes to so the taxes were
10 trueed up in November of 1993 and they were correct on
11 an ongoing basis.

12 Q. Is it true that deferred income taxes is an
13 account included in the income statement as operating
14 taxes?

15 A. Correct.

16 Q. And is it true that accumulated deferred
17 income taxes is a balance sheet account included in
18 the rate base for regulation purposes?

19 A. Yes.

20 Q. Turning back to page --

21 MR. TRAUTMAN: Move for the admission of
22 Exhibit 169.

23 JUDGE WALLIS: Exhibit 169 is received.

24 (Admitted Exhibit 169.)

25 Q. Turning back to page 89 of your rebuttal

01268

1 testimony at lines 6 through 8, do you state that it
2 is not proper to restate the rate base for adjustment
3 to deferred income taxes?

4 A. I'm sorry, would you give me the line
5 again?

6 Q. Lines 6 through 8?

7 A. On page 89?

8 Q. Page 9. There's a question and one word
9 answer, "no." And I restated the question, "is it not
10 proper to restate the rate base for adjustment to
11 deferred income taxes?"

12 A. I would like to give an explanation rather
13 than a yes or no answer to that.

14 Q. Well, if you could first give a yes or no
15 and then I have a follow-up?

16 A. It is proper to restate the rate base, but
17 what happened is is this entry was made in November of
18 '93 to our rate base and therefore it was included in
19 our end of period deferred taxes for our test period,
20 so there was no need to make a restatement. It had
21 already -- the adjustment to the deferred taxes on our
22 balance sheet had already been made in November of '93
23 and there was no need to make a true-up.

24 Q. So are you stating that the deferred income
25 taxes should be adjusted for ratemaking purposes but

01269

1 that the accumulated deferred income taxes should not
2 be adjusted for ratemaking purposes?

3 A. I can't again give you just a yes or no
4 answer because there's two piece parts to your
5 question. One is that, again, we were referring to an
6 entry that was made in November of '93 that was truing
7 up our taxes for 1992. It was appropriate to take out
8 the '92 amounts out of our test period results because
9 they didn't belong there, but because the entry for
10 the balance sheet, the accumulated deferred taxes, was
11 made in November of '93 it was included in our
12 accumulated deferred taxes in our rate base, and there
13 was no need to make it because the entry had already
14 been made on our books and was included in the test
15 period.

16 Q. Could you turn to your rebuttal testimony
17 at page 24, and this discusses the jurisdictional
18 separations adjustment of the staff.

19 A. I have that in front of me.

20 Q. Is it your testimony that the staff has
21 made this adjustment as a mandatory FCC change?

22 A. No. I'm not stating -- as I say here, the
23 staff adjustment -- I say first it is not a
24 traditional ratemaking adjustment but apparently is
25 being offered as a mandatory FCC change.

01270

1 Q. So with that in mind is it your testimony
2 that the staff has made this adjustment as a mandatory
3 FCC change?

4 A. Yes. In the context that in previous rate
5 cases the only changes we have made to separations is
6 mandatory FCC changes.

7 Q. Can you refer me to any staff testimony
8 that states that this adjustment is being offered as a
9 mandatory FCC change?

10 A. No.

11 Q. Is it your testimony that this adjustment
12 is inappropriate because it is based on data outside
13 the test period?

14 A. Partially. Partially it was that the staff
15 used December of 1994, which was not within the test
16 period. However, the other argument is that this is a
17 basic study change. We make basic study changes
18 annually, and some of them increase the expenses
19 coming from interstate and some of them don't so in
20 previous rate cases basic studies were not introduced
21 because they went both ways and you never know from
22 year to year which direction they're going to be
23 going, whether it's going to be shifting from
24 interstate to intrastate or from intrastate to
25 interstate so in the past we have not included them.

01271

1 Q. But I believe you stated that partially
2 your answer was yes that the adjustment was
3 inappropriate in your view because it was based on
4 data outside the test period?

5 A. It was based on allocation factors, yes,
6 outside the test period.

7 Q. Would you accept subject to check that your
8 adjustments PFA No. 1, 2, 7, 9 and 11 are all
9 adjustment based on data outside of the test period?

10 A. You said PFA No. 1?

11 Q. 2, 7, 9 and 11.

12 A. I've eliminated PFA No. 9 and 11, but I
13 would agree that the PFA No. 1, 2, and 7 are proforma
14 adjustments and they are proforming the test period
15 results.

16 Q. Is it true that proforma adjustments are
17 traditional ratemaking adjustments?

18 A. Yes.

19 Q. Would you accept subject to check that for
20 your adjustments PFA 1 and 2 that you use wage and
21 salary increases that were not given during the test
22 period?

23 A. Yes. Those were increases that went into
24 effect in 1995 and would you accept subject to check
25 that for your adjustment PFA adjustment rural sales

01272

1 that the sale did not take place during the test
2 period?

3 A. Except on the rural sales, again, yes, the
4 transaction didn't take place but it was again
5 proformas are known and measurable.

6 Q. Turning to page 29 of your rebuttal
7 testimony, on line 14, is it your testimony that there
8 was a shift in the separations factors but that you
9 did not make an adjustment to that change?

10 A. And the lines you're referring to again?

11 Q. Line 14 through 17.

12 A. Yes. That's my statement. I've stated on
13 line 16 and 17, "traditionally the company has only
14 made separation adjustments based on mandatory FCC part
15 36 rule changes."

16 Q. If you could turn now to -- it's what's
17 been marked as Exhibit 173, and these are, I believe,
18 13 pages from your deposition of July 5 of 1995.
19 Specifically pages 122 to 134, and do you recognize
20 this as your deposition?

21 A. Yes, I do.

22 Q. And reviewing the pages, would you agree
23 that these contain a series of questions and answers
24 pertaining to investor-supplied working capital and
25 lead lag studies?

01273

1 A. Yes.

2 MR. TRAUTMAN: I would move for the
3 admission of Exhibit 173 primarily in the interest of
4 time to save staff from having to re-ask several of
5 the questions in this exhibit.

6 MR. VAN NOSTRAND: Your Honor, we discussed
7 this with Mr. Trautman. We didn't receive the
8 required five day notice that a portion of the
9 deposition was going to be offered but in the interest
10 of saving time and having these reread, we will waive
11 that particular objection in this instance.

12 JUDGE WALLIS: Exhibit 173 is received.

13 (Admitted Exhibit 173.)

14 Q. The next series of questions pertain to
15 your restructuring adjustment which is at pages 5 to
16 12 of your rebuttal testimony I understand you
17 withdrew the adjustment but we have questions
18 pertaining to the restructuring costs. Having the
19 restructure in mind, were the 1994 cost of
20 restructuring included in U S WEST's operating
21 expenses?

22 A. Yes, they were.

23 Q. And what about the 1993 costs? Were they
24 included?

25 A. The restructuring costs -- there was some

01274

1 restructuring costs associated in 1993 but they were
2 associated with another plan.

3 Q. Were these costs included in operating
4 expenses used to calculate U S WEST's sharing under the
5 AFOR?

6 A. They were no different than any of our
7 other operating expenses.

8 Q. So is that a yes?

9 A. Yes.

10 Q. So the restructure costs incurred in 1993
11 and 1994 have been recovered as regulated costs; is
12 that correct?

13 A. They've been part of our sharing
14 calculations.

15 Q. And that, again, is a yes?

16 A. Yes.

17 Q. Now, referring to the cost in savings from
18 previous reorganizations such as downsizing, employee
19 buyouts that you mention in your rebuttal testimony,
20 were they run through the revenue and expenses used to
21 determine the sharing under the AFOR?

22 A. Yes, they were.

23 Q. For what years?

24 A. Sharing was from 1990 through 1994.

25 Q. The 1993 reserve for this restructuring was

01275

1 recorded as a one time cost to U S WEST of
2 approximately \$880 million; is that correct?

3 A. It was recorded on our financial books for
4 SEC purposes, yes.

5 Q. And does this reserve reflect costs and
6 savings estimated through 1997?

7 THE WITNESS: Excuse me, can we take a
8 break?

9 JUDGE WALLIS: Yes.

10 (Recess.)

11 Q. Is it correct that you have withdrawn
12 proforma adjustment No. 9 based on changes in the
13 allocation of the cost to Washington?

14 A. Yes. Looking at our actual results for
15 1995 they're coming in very, very close to what was
16 embedded in our test period.

17 Q. Were there any changes to the total company
18 numbers for costs or for savings?

19 A. Looking at our SEC reports and our latest
20 reported results they will be very close. We have
21 extended some of our restructuring expenses into 1997.

22 Q. Were there changes to the total company
23 work papers provided on restructure cost in support of
24 PFA No. 9 and what has been marked as Exhibit 170?

25 A. Again, we will have to update all of our

01276

1 work papers, but again, what's buried in our test
2 period results will stay the same. We're just removing
3 the proforma.

4 Q. If you could turn to the page in Exhibit
5 170 which is marked at the bottom right-hand corner W
6 R E S T R period X L S, and this is a confidential
7 page. Do you have that page?

8 A. This is Exhibit?

9 Q. 170.

10 A. I have that in front of me.

11 Q. Did any of the numbers on this page change
12 as a result of the allocation of Washington state
13 costs?

14 A. No. These are all total U S WEST
15 Communications, and the only thing I did was look at a
16 preliminary look at the allocated cost to the state of
17 Washington for the year 1995, and the amount that we
18 had allocated from these total costs are coming in
19 closer, like I said, to what's already embedded in the
20 test period.

21 Q. Is it true that on an annual basis the
22 company projections reflect net costs in 1993, '94,
23 '95 and '96 but show savings in 1997?

24 A. Yes, they do on this document.

25 Q. And what is the pattern of the costs in

01277

1 these years in terms of increasing and decreasing?

2 A. The expenses gradually taper off and lowest
3 year is 1997.

4 Q. Is it true that the cost increased through
5 1995 and then declined in 1996 and are lower yet again
6 in 1997?

7 A. Again, that's correct, but as I was stating
8 previously what we're really experiencing is looking
9 at Washington specific and Washington specific
10 expenses do not necessarily follow this trend. Again,
11 the allocations that I'm seeing for 1995 are not
12 following this trend and, again, one of the things I'm
13 noticing as far as expense savings, we do not show,
14 and in fact an equivalent number of employees in the
15 state of Washington are actually higher now in
16 September of 1995 than they were at the beginning of
17 the test period, so we're not also experiencing the
18 savings in the state of Washington and that's due to
19 the numbers of employees and the workload in
20 Washington state. So, again, you cannot just purely
21 allocate these expenses from a total U S WEST
22 Communications basis allocate either the expenses or
23 the savings down to Washington state. That's basically
24 what we're finding out.

25 Q. Has the company performed estimate of costs

01278

1 in savings that go beyond 1997?

2 A. Yes, we have.

3 Q. And do these projections reflect net
4 savings for the years past 1997?

5 A. Just for that one particular business case,
6 but I think you need to take into context that these
7 are part of our normal operating expenses and that we
8 have increased in expenses in other areas that offset
9 these savings.

10 Q. So was the answer yes, that the projections
11 reflect net savings for the years past 1997?

12 A. At a U S WEST Communications level there's
13 no indication on how that experience will take place
14 in the state of Washington.

15 Q. Turning to your rebuttal testimony on page
16 10, you show force reductions from 1982 -- before we
17 get to that, I would move for the admission of Exhibit
18 170.

19 JUDGE WALLIS: Let me ask if the
20 information shown on the page that was discussed
21 remains confidential. It's for administrative
22 purposes. If it is we'll designate the exhibit as
23 confidential.

24 THE WITNESS: I need to conference with my
25 attorney to find out -- can I do that?

01279

1 JUDGE WALLIS: Let's be off the record for
2 a moment.

3 (Recess.)

4 JUDGE WALLIS: Let's be back on the record,
5 please. Is there an objection to Exhibit 170?

6 MR. VAN NOSTRAND: No.

7 JUDGE WALLIS: There being no objection
8 Exhibit 170 is received.

9 (Admitted Exhibit 170.)

10 Q. Again, on your rebuttal testimony on page
11 10 you show force reductions from 1982 through 1997.
12 You also state that work force additions have offset
13 these reductions. Is that correct?

14 A. To some extent and it depends on the state,
15 too. Like I said the equivalent employees in
16 Washington from November of '93 through September of
17 '95 have actually increased.

18 Q. Do you know how many of these years the
19 work force reductions shown exceed the work force
20 additions?

21 A. No.

22 Q. Is it your rebuttal testimony that the
23 restructuring costs are occurring based on recurring
24 events?

25 A. Yes. As stated, a majority of

01280

1 restructuring expenses associated with severance pay
2 and system costs and our system costs are just part of
3 our -- all of our upgrade of our systems and will
4 continue in the future, and we have had severance pay
5 for many, many years and we expect to have those
6 payments to continue in the future.

7 Q. Are you familiar with a September 17, 1993
8 news release that was issued by the company and
9 provided in response to public counsel data request
10 436 and that's marked for reference as Exhibit 171?

11 A. I have that in front of me. I haven't read
12 it in complete detail.

13 Q. And there are two news releases attached to
14 the back of that exhibit. I'm referring to the last
15 news release of September 17, 1993 and specifically
16 page 3, and do you see that at the top of the page the
17 first sentence states, "in third quarter 1993 the
18 company will record a special after tax charge of \$610
19 million for costs associated with establishing the U S
20 WEST Communications centers and completing
21 streamlining and other initiatives throughout U S
22 WEST." Do you see that?

23 A. Yes, I do now.

24 Q. And do you see at the third sentence of
25 that paragraph that this special charge to income is

01281

1 described as a, quote, one time item? Do you see
2 that?

3 A. Yes.

4 Q. Is it then your testimony that the special
5 and the one time items are synonymous with recurring
6 costs based on recurring events?

7 A. Well, I really think you have to look at
8 what the expenses associated with the restructuring
9 are. We've been changing our business and changing
10 our technology for years and years, and again, like I
11 stated previously, majority of these expenses are for
12 systems and Mary Olson stated in her testimony that
13 she believes that re-engineering and restructure will
14 continue in the future as the technology changes. I
15 cannot see that our system costs or retraining or our
16 searches pace are going to change. If anything the
17 system costs continue to increase on an annual basis.

18 MR. TRAUTMAN: I would move for the
19 admission of Exhibit 171.

20 MR. VAN NOSTRAND: No objection.

21 JUDGE WALLIS: 171 is received.

22 (Admitted Exhibit 171.)

23 Q. Turning now to page 58 of your -- I believe
24 it's rebuttal testimony. You refer to a promotional
25 advertising where you refer to the advertising

01282

1 adjustment. Do you have that page?

2 A. I'm getting close to it. Yes, I have it
3 here.

4 Q. And regarding promotional advertising, this
5 is in lines I believe 5 through 9 you refer to
6 exhibits that were examples of information that staff
7 was provided on request. Is that your testimony?

8 A. That's correct.

9 Q. And are these exhibits similar or identical
10 to the calculations provided in work papers submitted
11 by U S WEST witness Judith Hand along with her
12 rebuttal testimony?

13 A. These are examples of the type of data that
14 we provide to the staff. I did not go and compare all
15 of these samples to what was provided by Judith Hand.

16 Q. Referring you now to what's been marked as
17 Exhibit 172, and this is a multi-page response to
18 staff data request 169. Are you familiar with this
19 document?

20 A. 172?

21 Q. That's the exhibit number. And the data
22 request is staff data request 169?

23 A. For some reason I don't have 172.

24 Yes. I have that in front of me.

25 Q. And are you familiar with this company

01283

1 response?

2 A. This was response responded by our market
3 units. It's in front of me now.

4 Q. Are you the appropriate witness for this
5 exhibit?

6 A. No. Really our advertising witness should
7 be responsive to this.

8 Q. And that would be Ms. Hand?

9 A. It was Judith Hand and now it's Mary Evans.

10 Q. And so will Mary Evans be responding to all
11 questions regarding this exhibit?

12 A. Yes.

13 Q. Couple of clarifying questions. On page 4
14 of your rebuttal testimony, is it now your
15 understanding that adjustments RSA No. 9 primary toll
16 carrier and RSA 17, OOP 7, independent company, is it
17 your understanding that both of those are now
18 noncontested adjustments because they are not listed?

19 A. It was primary toll carrier and what was
20 the other one you mentioned?

21 Q. Independent company. That was RSA 17-OOP7.
22 Is it your understanding that that is a noncontested
23 adjustment?

24 A. Yes.

25 Q. And would that now also be true of PFA 11

01284

1 which is interconnection with independents?

2 A. Yes.

3 Q. Now, if you could turn to page 25 of your
4 direct testimony. This relates to the pension asset
5 line 2 and 3. On those lines you state, "for USWC
6 contributions to the fund have exceeded pension
7 approvals." Do you see that?

8 A. I'm sorry. This was in my direct
9 testimony.

10 Q. Direct testimony on page 25.

11 A. Okay, I have that now in front of me.

12 Q. And on lines 2 and 3 you state that for
13 USWC contributions to the fund have exceeded pension
14 accruals."

15 A. Yes.

16 Q. Isn't it true that since the time the
17 company adopted SFAS 87 in 1987 that the company has
18 made no cash contributions to the fund?

19 A. That's correct.

20 Q. Referring you to what the been marked as
21 Exhibit 193 and at the top it's an exhibit entered by
22 you in a previous case, Exhibit MJW-9, and it's
23 entitled U S WEST Communications pension benefit
24 obligation?

25 A. Yes. I have that.

01285

1 Q. I'm sorry. I got the wrong one first. It
2 should be 194. Exhibit 194. And 194 is identified as
3 a response to staff data request 33. Do you see that?

4 A. Yes.

5 Q. And was this -- are you familiar with this
6 exhibit?

7 A. Yes, I am.

8 Q. Was it prepared by you or under your
9 supervision?

10 A. Yes.

11 Q. And would this exhibit reflect that, again,
12 since 1987 that the company has made no cash
13 contributions to the fund?

14 A. Yes. Because we've had a pension credit or
15 a zero pension expense.

16 MR. TRAUTMAN: Move for the admission of
17 Exhibit 194.

18 MR. VAN NOSTRAND: No objection.

19 JUDGE WALLIS: Exhibit 194 is received.

20 (Admitted Exhibit 194.)

21 Q. Now, referring to Exhibit 193. And
22 referring to this exhibit, is it also true that prior
23 to 1987 that all contributions to the fund were booked
24 to expense and capital, that is, plant in service
25 accounts?

01286

1 A. Correct.

2 Q. And that's reflected in the revenue
3 requirement, \$100 number?

4 A. Yes. And again, this is a hypothetical
5 example. You know, with regulatory lag this does not
6 always work exactly this way but theoretically it
7 should work this way.

8 Q. And this exhibit was prepared by you in a
9 prior case?

10 A. Yes.

11 Q. And is it true and accurate?

12 A. Yes.

13 MR. TRAUTMAN: Move for the admission of
14 Exhibit 193.

15 MR. VAN NOSTRAND: No objection.

16 JUDGE WALLIS: 193 is received.

17 (Admitted Exhibit 193.)

18 Q. Would you also agree that these expense and
19 capitalized expenditures were included for purposes of
20 ratemaking prior to 1987?

21 A. They were if we had a rate case.

22 Q. Referring to your direct testimony at page
23 26, beginning at line 15, there you state that, "on
24 January 25, 1995 the Commission issued a final order
25 denying the company's petition." And that being a

01287

1 petition to include the pension asset in rate base.

2 Do you see that?

3 A. I see that, but I just wanted to say it
4 also goes to say the order stated the pension actually
5 should be considered as part of total investor
6 supplied working capital analysis rather than a single
7 issue and they were not disallowing as an imprudent
8 asset.

9 Q. But the Commission did deny the company's
10 petition to directly include the pension asset in the
11 rate base?

12 A. Yes.

13 Q. Referring now to the first page of your
14 Exhibit MJW-1, is it correct that you are proposing in
15 proforma adjustment No. 3 to include the pension asset
16 of approximately \$70 million directly into the rate
17 base?

18 A. That's correct but again, I want to just
19 highlight what the Commission asked us to do was to
20 include the pension asset in connection with other
21 cash working capital adjustments, and we have provided
22 PFA No. 4 and PFA No. 5 as a total cash working
23 capital adjustment.

24 Q. But again, it's true that you are proposing
25 in PFA 3 to include the pension asset directly into

01288

1 the rate base; is that correct?

2 A. Correct.

3 Q. Now, you continue on page 26 of your
4 testimony, direct testimony, at line 16 you state,
5 "the order in UT-930307 stated that the pension asset
6 should be considered as part of a total investor
7 supplied working capital analysis rather than as a
8 single issue," is that correct?

9 A. That's correct.

10 Q. Referring now to your exhibit MJW-3 which
11 is I believe Exhibit 157, and that is entitled
12 Calculation of Average Investor-Supplied Working
13 Capital?

14 A. Yes.

15 Q. And in this calculation have you addressed
16 the pension asset as directed by the Commission's
17 order in UT-930307?

18 A. This particular worksheet is not a
19 company-developed worksheet. This was developed on
20 the basis of a staff calculation in another case, so
21 this is not being presented as our cash working
22 capital adjustment.

23 Q. What case are you referring to?

24 A. It was -- I don't have it in front of me.
25 I believe it was a Puget Power case that was

01289

1 referenced in the Commission order.

2 Q. Is it your testimony that the total
3 investor-supplied working capital at line 34 of this
4 exhibit MJW-3 includes the pension asset?

5 A. This is not our presentation of cash
6 working capital. This was just based on a staff
7 worksheet. It's not being presented in this case as
8 our presentation of the cash working capital
9 adjustment.

10 Q. Is this not your exhibit that you presented
11 in the case?

12 A. This is our exhibit but this is not what we
13 presented in our revenue requirement.

14 Q. But it is your exhibit MJW-3, correct?

15 A. It is, but it's again based purely on a
16 staff previous worksheet and it only includes the
17 items that the staff had used in a previous case.

18 Q. Would you agree that since the calculation
19 in this exhibit is done on a Washington state basis
20 that the amount of pension asset included in line 34
21 is approximately \$96 million?

22 A. I will let you address that question to Don
23 Haack who is our expert in this area.

24 Q. Would you agree that the intrastate amount
25 of the pension asset, as reflected in your proforma

01290

1 adjustment No. 3, is only approximately \$70 million,
2 69.9 million?

3 A. Again, will you refer to me where you're --
4 I see the 69.9 that we've included in PFA No. 3 and
5 which other number are you referring to? Question
6 again was? What was the other number?

7 Q. 96 million. The question on that was that
8 since the calculation on the exhibit is done on a
9 Washington state basis, is the pension -- the amount
10 of pension asset included in line 34 approximately \$96
11 million if done on a Washington state basis?

12 A. I don't have that number in front of me but
13 I know that Don Haack would be able to respond to
14 that.

15 Q. I believe you indicated that in performing
16 this investor-supplied working capital calculation you
17 used a recent Puget Power case as the model for your
18 calculation of U S WEST Washington investor-supplied
19 working capital?

20 A. I have in front of me, I guess this is part
21 of your Exhibit 174, is a note on page 8 that refers
22 that the Commission has used the investor-supplied
23 working capital approach in general rate increase
24 proceedings in recent years, in the most recent
25 general rate increase case for Puget Sound Power and

01291

1 Light Company not only was this approach accepted but
2 the Commission specifically allowed certain deferred
3 assets in working capital in using this approach and
4 it was taken from that case is my understanding. I
5 did not personally prepare this. This was prepared by
6 our cash working capital expert Don Haack.

7 Q. But are you not sponsoring this exhibit?

8 A. Yes, but it was prepared by Don and Don
9 knows all of the intimate detail of the calculation.

10 Q. So could you indicate how the Puget Power
11 case example was applied to this case?

12 A. I will let Don respond to that.

13 Q. Referring back to your Exhibit MJW-3. This
14 is the investor supplied working capital calculation
15 for Washington state including interstate and
16 intrastate; is that correct?

17 A. This again is just a calculation using a
18 staff worksheet and we used total Washington
19 operations. It's not being presented in this case as
20 the number to be used in our revenue requirement.
21 It's purely to try to show that there is indeed
22 operating working capital.

23 Q. So did you use this as a test to verify
24 whether there is working capital? Would that be a
25 fair statement?

01292

1 A. It could be considered a sanity check,
2 yeah.

3 Q. Do you have balance sheets for U S WEST
4 Communications Inc. that have total company for all 14
5 states?

6 A. Yes, we do.

7 Q. And does the total company balance sheet
8 for all 14 states include amounts for temporary cash
9 investments?

10 A. Yes.

11 Q. Should temporary cash investments be
12 treated as vested capital in an investor-supplied
13 working capital calculation?

14 A. Again, I will refer that question to Don
15 Haack who is our expert.

16 Q. Does the Washington balance sheet include
17 amounts for temporary cash investments?

18 A. Cash is not kept at a state-specific level.
19 It's kept at a corporate level.

20 Q. So that's no?

21 A. Right.

22 Q. Does the Washington balance sheet include
23 amounts for investments in affiliated companies?

24 A. Again, we don't have -- the answer is no.
25 We don't have a complete balance sheet for Washington

01293

1 state and I responded to that in a data request.

2 Q. Does the total company balance sheet for
3 all 14 states include amounts for investments in
4 affiliated companies?

5 A. Yes.

6 Q. Is it correct that the questions I had
7 regarding whether temporary cash investments should be
8 treated as invested capital or otherwise in an ISWC
9 calculation that all of those questions should be
10 referred to Mr. Haack?

11 A. Yes.

12 Q. Is it your testimony that the pension asset
13 is an investment of the company?

14 A. It is my testimony that the pension asset
15 is on the Washington state balance sheet. It is
16 associated with pension credits that were booked on
17 the company's books, and the company was not allowed
18 to pull the money out of the pension fund so that the
19 shareholders should be allowed a return on that asset.

20 Q. So was that a yes, that the pension asset
21 is an investment of the company?

22 A. Yes, it's an investment of the shareholder.

23 Q. And the pension asset is equal to the
24 amount by which the pension fund is over funded?

25 A. I'm not positive of that. I would have to

01294

1 look at all of our calculations, but I do know that in
2 our annual report we do show what our current liability
3 are and what the assets are but you would have to look
4 at all of the subsidiaries of Inc. and add them all
5 together. I'm assuming this would all add back to that
6 prepaid asset.

7 Q. So you believe the answer would be yes?

8 A. But I don't have all the numbers in front
9 of me so I can't add them all up and say it's exact.

10 Q. So you would you accept that subject to
11 check?

12 A. Yes, I would.

13 Q. Turning to what's been marked as Exhibit
14 174, and these are just some relevant pages from the
15 Commission's decision in UT-930074, and in particular
16 the pages referring to the pension asset. Do you have
17 that in front of you?

18 A. Yes, I do.

19 Q. And turning to page 7 of the order, at the
20 bottom sentence which carries over on to page 8, do
21 you agree that the Commission stated, "The Commission
22 in proceedings involving gas, electric and telephone
23 companies, including cause No. U-77-87 cited by the
24 company, has refused to reflect directly in rate base
25 such assets as material and supplies and other deferred

01295

1 debits"?

2 A. I see that.

3 Q. Now, referring to your direct testimony on
4 page 31, line 8 through 11, it appears that you have
5 included materials and supplies directly in the rate
6 base; is that correct?

7 A. That's correct. In context to looking at
8 all the components of cash working capital we looked
9 at the pension asset. We looked at a lead lag study
10 and we looked at materials and supplies and we've
11 included all three in the rate base.

12 Q. Turning back to the Commission decision,
13 and you referred previously to footnote 2 on page 8.
14 Do you see that that footnote explains that the
15 Commission has used the investor-supplied working
16 capital approach in measuring working capital in
17 numerous recent general rate cases?

18 A. Well, it says the Commission has used
19 investor supplied working capital approach in most
20 general rate increase proceedings in recent years.

21 Q. In your opinion, do the adjustments PFA 3,
22 4 and 5 take the place of an investor-supplied working
23 capital calculation?

24 A. Yes.

25 Q. If the Commission were to use your

01296

1 calculation for intrastate ratemaking purposes, would
2 it not have to perform some sort of allocation from
3 your exhibit MJW-3 to arrive at an amount that
4 excluded the interstate jurisdiction and in doing so
5 wouldn't that amount be somewhat less than the \$135
6 million on that exhibit?

7 A. Well, again, that exhibit is not being
8 presented as part of our revenue requirement. The
9 amounts that we are including is the pension asset
10 worth \$69.9 million, a cash working capital amount of
11 a negative three million and material supplies of a
12 positive 4.7 million changed to the rate base and
13 that's all we're including in our revenue requirement.

14 Q. Again, the question is if the Commission
15 were to use the calculation, that calculation for
16 intrastate ratemaking purposes, would it not have to
17 perform an allocation from your -- from Exhibit MJW-3
18 to arrive at an amount that excluded the interstate
19 jurisdiction and in doing so wouldn't that amount be
20 somewhat less than \$135 million?

21 A. Yes.

22 MR. TRAUTMAN: I was going to move this for
23 an admission but I believe the company indicated
24 yesterday we could take note of the records.

25 JUDGE WALLIS: Well, yes, and I indicated

01297

1 my own belief that that's true, but again for
2 administrative convenience I find it handy to have the
3 document in the file to refer to.

4 MR. TRAUTMAN: Then I will move for
5 admission.

6 JUDGE WALLIS: Is there objection?

7 MR. VAN NOSTRAND: No.

8 JUDGE WALLIS: Exhibit 174 is received.

9 (Admitted Exhibit 174.)

10 Q. Referring you now to what's been marked as
11 Exhibit 177, and this is the company's response to
12 an AT&T data request, data request No. 12. Do you
13 have that?

14 A. Yes, I do.

15 Q. And this response was prepared by you or
16 under your supervision I should say?

17 A. Yes.

18 Q. Is it correct that AT&T in this data
19 request asked the company to provide the same
20 information that is included in Exhibit MJW-3 in the
21 same form for Washington intrastate operations?

22 A. That's correct.

23 Q. Turning to the attachment to this exhibit,
24 do you agree that if one were to divide the estimated
25 intrastate operating working capital of approximately

01298

1 \$97.3 million at line 34 on the far right column, if
2 one were to divide that number by the total Washington
3 combined amount of \$135.6 million that you would
4 arrive at an intrastate allocation factor of
5 approximately 71.79 percent subject to check?

6 A. Yes.

7 MR. TRAUTMAN: Can we take a five minute
8 break here.

9 JUDGE WALLIS: Yes. Let's take a
10 five-minute break here.

11 (Recess.)

12 JUDGE WALLIS: Let's be back on the record,
13 please.

14 MR. TRAUTMAN: Before I move on, I first
15 would move for the admission of Exhibit 177.

16 JUDGE WALLIS: Is there objection?

17 MR. VAN NOSTRAND: No.

18 JUDGE WALLIS: Exhibit 177 is received.

19 (Admitted Exhibit 177.)

20 JUDGE WALLIS: I would like to go back to
21 Exhibit 170 for a moment. That has been received.
22 There is a designation on one of the pages of
23 confidential and it's my understanding that that
24 information is no longer confidential and that the
25 designation may be stricken. Is that correct?

01300

1 moment.

2 (Discussion off the record.)

3 JUDGE WALLIS: Let's be back on the record.

4 There has been a record request for the information
5 which the witness used in her revised exhibit and it's
6 indicated that that information is available and will
7 be provided potentially tomorrow. If it goes beyond
8 that, beyond noon tomorrow, will you advise Mr.
9 Trautman and work with him, please?

10 THE WITNESS: Yes, I will.

11 Q. Ms. Wright, you filed direct testimony in
12 this rate case on February 17, 1995; is that correct?

13 A. Yes.

14 Q. And on July 28, 1995 you filed petitions to
15 update data or correct errors?

16 A. Yes.

17 Q. Did your supplemental testimony on that
18 date describe what changed in the following
19 adjustments, RSA 1 and 2 and PFA 1 and 2?

20 A. It gave -- we provided the revised
21 adjustments in the detailed work papers for those
22 adjustments, yes. In my actual testimony I do not
23 give a detail of those revisions.

24 Q. And on October 3 of 1995 you filed rebuttal
25 testimony. Does this include further revisions to RSA

01301

1 1 and 2 and PFA 1 and 2?

2 A. Yes.

3 Q. Did your original testimony -- in your
4 original testimony, did the wage and salary adjustments
5 include team and merit awards at the accrual level?

6 A. Yes.

7 Q. And does your rebuttal testimony for the
8 wage and salary adjustments include team and merit
9 awards at the expense level?

10 A. We're on an accrual basis so all of our
11 expenses are booked at an accrual level.

12 Q. Turning to page 78, lines 18 to 20 of your
13 rebuttal testimony, you there state --

14 A. This is page 78?

15 Q. Yes. Let me skip that one. In your
16 worksheet included in your work papers for RSA No. 1,
17 occupational wage increase titled summary of
18 capitalization percentages, and it's been identified
19 as Exhibit 181. Could you turn to that exhibit?

20 A. Yes. I have it in front of me.

21 Q. Looking at the total Washington salaries
22 and wages for 1994 in the amount of \$226,435,851, for
23 what months is this representative?

24 A. Well, looking at the top of the page it's
25 printed on 9-29-94, and it would have to be an

01302

1 estimated 1994 number because at that point we
2 wouldn't have all of the '94 numbers.

3 Q. But was that an estimate for the entire
4 year of 1994 or just for January through August?

5 A. This was prepared by Larry Hollenbeck so I
6 can't give you answer to that. I'm assuming it's for
7 a portion of 1994.

8 Q. This was not prepared by you and not under
9 your supervision?

10 A. It was prepared by a manager in our
11 accounting department, and it's based on -- I'm
12 assuming these are based on actual booked amounts
13 except for 1994 we would have to have estimates if it
14 was prepared on September of '94. However, I can give
15 you another number I looked at. If this doesn't give
16 you a real complete number of '94, I've looked at our
17 capitalization rate through '95 through April was at
18 10.88 and I believe the number I have for the actual
19 number for 1994 was at 10.92, so those numbers were
20 real close.

21 Q. Are you the witness who would sponsor this
22 exhibit or is there any witness that would sponsor
23 this exhibit?

24 A. No. I would sponsor this exhibit.

25 Q. Again, did you indicate you believed it was

01303

1 January through August?

2 A. I'm not positive, but if it was prepared in
3 September that's reasonable.

4 MR. TRAUTMAN: I would move for the
5 admission of Exhibit 181.

6 MR. VAN NOSTRAND: No objection.

7 JUDGE WALLIS: 181 is received.

8 (Admitted Exhibit 181.)

9 Q. Turn to Exhibit 182, and this is in your
10 work papers for the occupational proforma increase PFA
11 No. 1 worksheet 4 revised 9-27-95. Do you see that?

12 A. Yes, I do.

13 Q. Would you agree -- and again this exhibit
14 is part of your work papers; is that correct?

15 A. Yes.

16 Q. Would you agree that the total occupational
17 wages for January through August of 1994 equal
18 approximately \$118 million?

19 A. Yes, subject to check.

20 Q. Turn to your adjustment PFA 2 and this has
21 been marked as Exhibit 183. And would you agree again
22 subject to check that the total management salaries
23 for January through August of '94 equal approximately
24 \$69 million?

25 A. Yes, subject to check.

01304

1 Q. And so that the total of the two figures
2 for occupational and management salaries equals
3 approximately \$188 million?

4 A. Yes, subject to check.

5 Q. So would you agree, subject to check, that
6 the difference between the summary of capitalization
7 worksheet wages and salaries of approximately \$226
8 million from Exhibit 181 and the wages and salaries
9 from the eight months in 1994 from Exhibits 182 and
10 183, would you agree subject to check that the
11 difference between those two figures is approximately
12 \$39 million?

13 A. Yes.

14 MR. VAN NOSTRAND: Objection. There's been
15 no foundation that the periods are the same. Witness
16 has not been able to testify that Exhibit 181 is the
17 month of January through August so the comparison has
18 no validity.

19 MR. TRAUTMAN: I believe she indicated she
20 believed that was the appropriate month.

21 THE WITNESS: I don't know. I stated that
22 it was printed on top of the page that it was prepared
23 on 9-29. I don't know the exact months that were
24 included.

25 Q. So you can't explain why there's a

01305

1 difference in the numbers; is that correct?

2 A. I don't have all the data in front of me to
3 do that.

4 MR. TRAUTMAN: I would move for the
5 admission of Exhibits 182 and 183.

6 MR. VAN NOSTRAND: No objection.

7 JUDGE WALLIS: 182 and 183 are received.

8 (Admitted Exhibits 182 and 183.)

9 Q. Has the amount of overtime expense
10 increased during the test year compared to the last
11 two years?

12 A. Yes.

13 Q. And is the amount capitalized in the test
14 year less than in prior years?

15 A. Yes.

16 Q. If capitalized wages are higher in one year
17 versus a lower amount in another year due to
18 particular circumstances the higher capitalization
19 percentage used will decrease the level of expenses
20 recorded on the books; is that correct?

21 A. Yes. How much, as I stated before, in 1995
22 we're experiencing the same capitalization rate as we
23 did in 1994, so that makes me believe that just to
24 arbitrarily pick certain years with a capitalization
25 rate and use that versus what you're representing in

01306

1 your test period is not appropriate.

2 Q. If the capitalization percentage used is
3 then the expense booked is lower in a given year; is
4 that correct?

5 A. Correct.

6 Q. And the overtime increase that you referred
7 to, is that related to the restructure effort of U S
8 WEST?

9 A. I'm not drawing any correlation between our
10 overtime and our restructuring activity in my
11 testimony.

12 Q. So do you know whether the answer is yes or
13 no?

14 A. No.

15 Q. In your direct testimony, on pages 23 and
16 24 --

17 A. This is on direct?

18 Q. Direct testimony. You discuss the
19 occupational wage increase. Is that correct?

20 A. Yes, I did.

21 Q. And your testimony reads, "it is
22 appropriate to include these wage increases in the
23 test period to be more reflective of ongoing
24 conditions," is that correct?

25 A. That's correct.

01307

1 Q. In your adjustments RSA 1 and 2 and PFA 1
2 and 2 relating to wages and salaries are the team and
3 merit award expenses included in your calculation?

4 A. Yes, they are.

5 Q. Does the company pay out team awards if the
6 financial goals are met even if the service goals are
7 not met?

8 A. Depending on the component of the team
9 award and we've had different components to our team
10 award in the last few years.

11 Q. Is that what happened in the test year?

12 A. Yes. If we meet our net income we have a
13 certain payout and if we do or do not meet certain
14 service quality indicators, that's also related to a
15 payout ratio, and as in 1994 we were not given any team
16 award for CSM measurements.

17 Q. Did you pay out for quality indicator
18 measurements?

19 A. In what time frame?

20 Q. In the test year.

21 A. We had two time periods in the test year.
22 We had November and December of '93, and we had
23 January through October of '94. I do know -- I'm
24 looking to see if I have any notes on that, but in
25 1993, and this was in regard to data request WUT-359,

01308

1 in 1993 we had a payout on U S WEST C net income. We
2 had a partial payout on U S WEST C CSM and we had a
3 payout on business unit results but it did not have --
4 for 1993 we did not have the quality indicator piece.

5 Q. On page 74 of your rebuttal testimony at
6 lines 12 to 18 you state that "capitalized wages are
7 only in CWIP for a short period of time."

8 A. That's in direct?

9 Q. That's in your rebuttal?

10 A. Page 74?

11 Q. Yes. Lines 12 to 13 you state that
12 "capitalized wages are only in construction work in
13 progress, CWIP, for a short period of time."

14 A. I see that.

15 Q. Does USWC have any long-term construction
16 work in progress that includes capitalized wages?

17 A. Yes.

18 Q. Turning back to your direct testimony at
19 page 13, you address the affiliated interests billing
20 adjustment which is restating adjustment No. 5, and
21 that's at lines 8 to 18.

22 A. This is in rebuttal again, page?

23 Q. This is in your direct.

24 A. Page 13?

25 Q. Yes.

01309

1 A. Yes, I have that here.

2 Q. Now, could you refer to your what's been
3 marked as Exhibit 185, and this is RSA No. 5 worksheet
4 2, and this is your work paper?

5 A. Yes, it is. However, if you want to ask
6 any detailed questions in regard to the adjustments
7 for the U S WEST bill I would refer you to
8 Doug McDonald.

9 Q. Does the adjustment -- it indicates that
10 .1549 percent of the true-up is allocated from U S
11 WEST C total to Washington state?

12 A. Yes.

13 Q. And the schedule also shows that you
14 allocated .734001 to Washington intrastate?

15 A. That's correct.

16 Q. And lobbying expenses incurred by U S WEST
17 Inc. and USWC?

18 A. Yes, they are.

19 Q. And are those lobbying expenses booked
20 according to section 32.7370 A of the FCC?

21 A. Well, I don't have that quote right in
22 front of me, but I do know that for all of our U S
23 WEST Communications and U S WEST lobbying expenses are
24 booked below the line in a below the line account and
25 not included in our regulated results of operations.

01310

1 MR. TRAUTMAN: I would move for the
2 admission of Exhibit 185.

3 MR. VAN NOSTRAND: No objection.

4 JUDGE WALLIS: 185 is received.

5 (Admitted Exhibit 185.)

6 Q. If you could turn now to what's been marked
7 as Exhibit 186, and this has -- the cover letter is a
8 copy of a letter to Chairman Nelson and the attachment
9 is a public document regarding the FCC audit findings
10 under AAD Nos. 95-81. Do you have that exhibit?

11 A. Yes, I do.

12 Q. And would you agree that this memorandum
13 opinion and order was released on October 17, 1995?

14 A. Yes, it was. The letter was dated -- to
15 Sharon was dated October 27.

16 Q. But the opinion itself was issued October
17 17. Do you see that? It's on the first page of the
18 document?

19 A. Yes, I see that.

20 Q. And turning to -- staying on page 1 of the
21 memorandum opinion in the order and in section Roman
22 numeral II Arabic No. 3 at the bottom of that
23 paragraph, near the bottom of the paragraph, do you
24 see the sentence that says, "based on discussions with
25 Commission staff, after the initiation of the audits,

01311

1 the BOCs have changed their accounting practices for
2 lobbying costs to make them consistent with section
3 32.7370 A." Do you see that?

4 A. Yes, I do.

5 Q. Have U S WEST Inc. and U S WEST C changed
6 their accounting practices for lobbying costs to make
7 them consistent with the FCC section reference?

8 A. I'm briefly familiar with this audit. I do
9 know that we considered this a clarification of the
10 lobbying costs and how they should be recorded. I do
11 know specifically for the state of Washington ever
12 since I've been on this job that we've been very
13 strict at making sure all our lobbyists record all of
14 their time and that all of their time was recorded
15 below the line. We have special reporting for that.
16 I know that Theresa Jenson reports part of her time
17 and we've been very strict in this state and I can't
18 speak for all of the other states and all the rest of
19 U S WEST but I do know that in Washington our lobbying
20 expenses are moved below the line. As far as Inc.
21 lobbying expenses, if you look at my RSA number -- I
22 believe it was RSA No. 5B, affiliated interest billing
23 adjustment, we were alerted to some changes in circular
24 billing where lobbying costs were charged to some of
25 the affiliates of U S WEST and then indirectly they

01312

1 were booked to us or charged to us above the line and
2 we made adjustments in RSA No. 5B to adjust those
3 lobbying expenses to be moved and not part of our
4 expenses, so I do know there's been some corrections.
5 Whether all of those were corrected in our result of
6 operation, I can't absolutely give you that information
7 but I do know that we were alerted to it and that we
8 made some corrections.

9 Q. So you don't know whether all of the
10 accounting practices for lobbying costs have been made
11 consistent?

12 A. Yes, I do know that they have, and we sent
13 a letter to the FCC stating that we would, through
14 this clarification, follow this section according to
15 their interpretation.

16 Q. When was this change made at the U S WEST
17 Inc. level, the change in accounting practices?

18 A. I will have to leave that question to
19 Doug McDonald. I'm not aware.

20 Q. And do you know when this change was made
21 by U S WEST C?

22 A. I believe at the beginning of 1995 we sent
23 a letter to the FCC saying that we were going to
24 interpret this particular section according to their
25 clarification.

01313

1 Q. So would you accept subject to check that
2 neither of the changes that U S WEST Inc. or USWC were
3 made prior to the test year?

4 A. But I did make restating adjustments that
5 moved some lobbying expenses below the line in 1995
6 from some of our subsidiaries.

7 Q. Is that a yes or a no?

8 A. It's a yes in that we didn't make any
9 changes in our results of operations that were just
10 reported on our books, but I did make some restating
11 adjustments that corrected some of our expenses, and
12 those are in RSA No. 5A and 5B.

13 Q. Attached to the FCC order is a copy of
14 what's called lobbying cost audit summary of audit
15 findings. If you could turn to the third page of that
16 exhibit and there's a table on the page?

17 A. I see that.

18 Q. And of the total the label on the table is
19 classified lobbying costs-total company. In the table
20 is the annual amount shown for U S WEST equal to \$2.5
21 million for each of the years shown in the table?

22 A. I see that. Just to give a reference to
23 what 2.5 million for U S WEST means on an intrastate
24 basis if you allocate 2.5 down you would be
25 approximately about approximately \$275,000.

01314

1 Q. And the amount in the table there, you do
2 see the amount in the table?

3 A. I see the amount in the table of 2.5 but
4 that's on a total U S WEST basis and I just wanted to
5 give a perspective of what that would be on a
6 Washington intrastate basis.

7 MR. TRAUTMAN: I would move for admission
8 of Exhibit 186.

9 JUDGE WALLIS: 186 is received.

10 (Admitted Exhibit 186.)

11 Q. In your rebuttal testimony on page 65,
12 lines 18 to 19 you address the compensated absent
13 adjustment, and this is RSA 12?

14 A. I have that in front of me.

15 Q. Does your rebuttal testimony state, "a
16 liability for the estimated probable future event must
17 be accrued"?

18 A. Yes.

19 Q. Does this mean that an accrual is made
20 monthly in relation to the expense to distribute the
21 expense evenly throughout the year?

22 A. There is an accrual made on a monthly basis
23 but we also look at the liability periodically and
24 make sure that the liability on our balance sheet is
25 appropriate to cover what our current liability is, so

01315

1 you will see true-ups throughout the year to that
2 liability on our balance sheet.

3 Q. If you could refer to what's been marked as
4 Exhibit 188, and this is just a one-page excerpt from
5 your deposition of July 5, 1995. According to this
6 deposition, the accrual for USWC is \$320,000 a month.
7 That's at lines 13 to 14?

8 A. Yes, I see that.

9 Q. And is that true and accurate to the best
10 of your knowledge?

11 A. Yes. I don't have that particular document
12 in front of me right now, but that number looks
13 correct.

14 MR. TRAUTMAN: Move for admission of
15 Exhibit 188.

16 MR. VAN NOSTRAND: Your Honor, I'm not
17 quite sure how this document, the foundation has been
18 established as to what this excerpt relates to and how
19 it relates to this particular testimony. Reference to
20 an attachment A which we don't know what it is. I'm
21 not sure how just this one excerpt from the deposition
22 relates to Ms. Wright's testimony this morning.

23 JUDGE WALLIS: Is the witness's testimony
24 to this point sufficient?

25 MR. TRAUTMAN: If her testimony is that the

01316

1 monthly accrual is \$320,000 then that would be
2 sufficient.

3 JUDGE WALLIS: That was your testimony?

4 THE WITNESS: I obviously was looking at an
5 attachment A which I don't have in front of me. I do
6 know that the accrual level does change on an annual
7 basis.

8 Q. In reference to page 87 of the deposition
9 on lines 16 to 21 the question is, is this an
10 appropriate monthly accrual amount, and your answer
11 was, based on the liability that is determined through
12 certain assumptions this is the accrual that keeps our
13 liability on our balance sheet reflective of the actual
14 liability to the company. Would that be your --

15 A. Again, I don't have the rest of the
16 deposition and the one point that I made earlier is
17 that we have our accrual on a monthly basis but we
18 also have periodic true-ups to that accrual.

19 Q. So would that be your testimony today?

20 A. My testimony today is that we have an
21 average accrual we book on a monthly basis and then
22 periodically we do review the accrual level on our
23 balance sheet and adjust it accordingly.

24 Q. Could you now refer to what's been
25 identified as Exhibit 187, and this is the company

01317

1 response to staff data request 341. Do you have that?

2 A. Yes, I do.

3 Q. And although you are not listed as a
4 witness, would you be the appropriate witness for this
5 data request?

6 A. Yes.

7 Q. Does this data request refer to a
8 compensated absent true-up adjustment made in March of
9 1995 to decrease the compensated absent liability by
10 \$15,900,000?

11 A. Yes, it does.

12 Q. Does it further state -- does the response
13 further state, "the March entry was made after it was
14 determined that the reserve should be reduced as a
15 result of a change in the vacation policy for 1995.
16 In 1995 the policy is expected to revert back to the
17 regular policy." There's a sentence that I omitted in
18 the middle. Do you see that?

19 A. I do see that.

20 Q. Did you include this March of 1995 true-up
21 adjustment as a known and measurable proforma
22 adjustment?

23 A. No, I did not, and when I filed my direct
24 testimony in February that wasn't available to me, but
25 I did include true-ups in 1994 that were true-ups to

01318

1 our liability, so, again, I felt that was a
2 representative period. Again, we have true-ups every
3 year and if you go further into the year I'm sure we
4 have other true-ups in 1995 which were not included.

5 MR. TRAUTMAN: I would move for the
6 admission of Exhibit 187.

7 MR. VAN NOSTRAND: No objection to 187.

8 JUDGE WALLIS: 187 is received.

9 (Admitted Exhibit 187.)

10 Q. On page 66 lines 17 through 20 of your
11 rebuttal testimony you state, "Ms. Erdahl chose not to
12 include any true-ups that were booked during the test
13 period but rather to consider only the ongoing accrual
14 that was made monthly during the test period." Is
15 that correct?

16 A. Yes.

17 Q. If you were to refer to Ms. Erdahl's
18 testimony at page 22, lines 3 through 8, subject to
19 check, would you agree that Ms. Erdahl is aware of the
20 monthly accrual level of the December 1993 true-up,
21 the October '94 true-up and the March of '95 true-up?

22 A. Yes, she's aware of those adjustments.

23 Q. On page 6, lines 9 to 10 of your rebuttal
24 testimony you state, "I believe Ms. Erdahl attempts to
25 adjust for what she may believe is a defect in the

01319

1 booked results." Is that correct?

2 A. Yes.

3 Q. By this statement do you mean that if the
4 adjustment is made it is automatically appropriate for
5 ratemaking?

6 A. No. The statement there is that we're on
7 accrual basis and we always do true-ups to our accrual
8 every year and we're trying to look at a
9 representative period here, and I included the
10 true-ups during the test period. We could have gone
11 through all of '95 and picked true-ups throughout the
12 whole year but I do think it's appropriate to conclude
13 the true-ups to your accrual to be more representative
14 of a test period.

15 Q. Wouldn't the March of 1995 adjustment be
16 representative of ongoing conditions?

17 A. Depends on how far you want to take it.
18 I'm sure there's other true-ups in 1995 that go the
19 opposite direction. Again, I did not include all
20 true-ups that were made in 1995 in my test period.

21 Q. On page 37 of your rebuttal testimony at
22 lines 9 to 17 you describe the merit awards. Is that
23 correct?

24 A. Yes.

25 Q. And on page 36 lines 16 to 18 you're asked,

01320

1 "Does Ms. Erdahl address merit awards?" And answer
2 is, "No. Ms. Erdahl refers to merit awards when she
3 defines USWC team performance awards TPA."

4 A. Yes, I see that.

5 Q. Therefore are you stating that Ms. Erdahl
6 did not differentiate between team and merit awards?

7 A. That was my understanding.

8 Q. Would you now refer to what's been
9 identified as Exhibits 189 and 190. Are you the
10 appropriate witness for each of these exhibits?

11 A. I would refer any detailed questions on the
12 1994 management compensation plan to Paul Gobat who is
13 our witness in the compensation area.

14 Q. Do these exhibits clearly distinguish
15 between team versus merit awards?

16 A. It's hard for me to tell. It says please
17 see the responses -- on Exhibit 189 says, "Please see
18 attachment A for policy statement regarding merit
19 awards." I don't have the whole management
20 compensation plan in front of me so I don't know all
21 of the distinctions that are made in the management
22 compensation plan, but I've read this before and team
23 is very different than our plan for merit awards.

24 Q. So should I reserve any questions on these
25 exhibits for Mr. Gobat?

01321

1 A. Unless they refer to some of our booked
2 numbers but as far as distinctions between the two and
3 the reasons for our compensation plan I would refer
4 those to Paul Gobat.

5 Q. Well, so back to the question, can you
6 answer whether these exhibits clearly distinguish
7 between team versus merit awards.

8 MR. VAN NOSTRAND: Objection, asked and
9 answered. She's already indicated the attachments to
10 which the responses refer are not attached so it's
11 hard to say what this response indicates as far as a
12 distinction between team and merit awards.

13 JUDGE WALLIS: I do believe she's already
14 answered the question.

15 MR. TRAUTMAN: I just want to know through
16 whom I should move the admission of exhibit. I will
17 move now for admission of exhibit.

18 JUDGE WALLIS: I think she referred answers
19 or questions on those to Mr. Gobat. Is that correct?

20 THE WITNESS: Yes.

21 MR. TRAUTMAN: That's what I thought and
22 then she qualified it so I wasn't sure.

23 Q. On page 38 lines 19 through 21 of your
24 rebuttal testimony, you state, "Each component is
25 weighted, has a percentage of the total payout. The

01322

1 payout is based on performance and can range from zero
2 percent to over 100 percent of that component's
3 percentage." Do you see that?

4 A. Yes.

5 Q. Is it true that team performance awards are
6 not paid out unless certain financial and service
7 goals are met?

8 A. There's many components to the team award,
9 and like I mentioned earlier, the 1993 team award was
10 composed of net income, CSM and business unit results,
11 and the business unit results can have -- it varies by
12 every business unit within the company. They don't
13 have to necessarily be financial in nature or service
14 oriented. In 1994 we did have specific measurements
15 for net income CSM. We did have quality indicators and
16 again we had the business unit results, but I do not
17 have the data in front of me that details all of the
18 components of the business unit results.

19 Q. So is that a yes or a no? The question
20 was, is it true that team performance awards are not
21 paid out unless certain financial and service goals
22 are met?

23 A. I don't have enough information to answer
24 yes or no because I don't know all of the component of
25 the business unit results.

01323

1 Q. If the quality of service goals have not
2 been met, would this affect the financial situation of
3 the company?

4 A. Which quality indicators are you talking
5 about?

6 Q. The quality of service in general, not the
7 quality indicators.

8 A. Repeat the question then.

9 Q. If quality of service goals have not been
10 met, would this affect the financial situation of the
11 company?

12 MR. VAN NOSTRAND: Your Honor, I object to
13 the question as vague. I'm not sure what financial
14 situation the company --

15 MR. TRAUTMAN: I will withdraw the
16 question.

17 Q. On page 41 of the rebuttal on lines 2 and
18 3, you discuss the payout for 1994. Is this in
19 reference to team performance awards only and not merit
20 awards?

21 A. You're on the bottom of page.

22 Q. I'm on the top of page 41. I believe it's
23 the on page 41 and it would be lines 2 and 3 where you
24 refer to the actual average payout for 1994, that
25 language. Is this in reference to team performance

01324

1 awards only and not merit awards?

2 A. Yes.

3 Q. And is it your testimony that approximately
4 76 percent out of the 100 percent accrued for
5 performance awards were paid out?

6 A. No, that's not stating that, because in my
7 team and merit award the restating adjustment I made
8 that we evaluated where we thought our team awards
9 would be and where our merit awards would be and we
10 made a true-up in December of 1994 knowing that we
11 wouldn't have a full payout, and I've included that
12 adjustment in the test period.

13 Q. Is that payout based on the table shown on
14 page 40 of your rebuttal testimony?

15 A. No. Table on page 40, as I state, is
16 purely an example of one business unit. It's a
17 sample, and again, there's many business units
18 throughout the company, so I was just giving an
19 example here of one business unit and what the payout
20 for that business unit was, and that particular
21 business unit overall had a 73 percent payout.
22 However, overall the company had a 76 percent payout
23 in 1994.

24 Q. So is the entire table on page 40 that
25 carries over to page 41 one business unit?

01325

1 A. Yes.

2 Q. Including the net income piece?

3 A. I will assume that. I believe the 1994
4 performance award included 25 percent for all business
5 units on net income, but you can clarify that with
6 Paul Gobat but that's my understanding.

7 Q. Well, the table is in your rebuttal
8 testimony but you're not aware of whether --

9 A. Right -- well, the U S WEST net income is
10 part of the team award for all business units.

11 Q. Does the table indicate that the USWC
12 customer service measures target goals were short
13 under the percent achievement?

14 A. The U S WEST C CSM or the U S WEST quality
15 indicators.

16 Q. No, customer service measure, CSM?

17 A. Yes.

18 Q. And does it also show under U S WEST
19 quality indicators that the target amount relating to
20 repair and design services missed was short?

21 A. Yes.

22 Q. And does it also show under USWC quality
23 indicators that the target amount relating to install
24 and design services missed was short?

25 A. Yes. Again, this is for a particular

01326

1 market unit for their particular measurement.

2 Q. Turning to page 46 lines 20 to 21 of your
3 rebuttal testimony, do you not state that objectives
4 -- the performance objectives were not met and
5 therefore the employees were not compensated and the
6 expense was not accrued?

7 A. Can you refer me to what line on page 21?

8 Q. No. It's page 46?

9 A. Oh, I'm sorry. Lines 20 to 21. Yes. What
10 I was referring to there is that we reevaluated what
11 we thought our team award would be at the end of 1994,
12 and I made a true-up in my -- if you want to look at
13 my RSA No. 13 I trued up revenue requirement by 2.7
14 million from the test period, and that's a reduction
15 in revenue requirement for our true-ups to team and
16 merit awards in -- well, that was just, yeah, team and
17 merit awards in December '94.

18 Q. Turning to page 77 of your rebuttal
19 testimony at lines 15 to 16 and there you discuss RSA
20 14 the benefits expense adjustment?

21 A. Yes.

22 Q. And on lines 10 to 12 you state, "staff
23 witness Ms. Erdahl asserts a test year capitalization
24 of wages is lower than in the prior four years," is
25 that correct?

01327

1 A. Yes.

2 Q. And on lines 15 and 16 you state, "using a
3 different capitalization rate would not remove what
4 was actually booked." Is that correct?

5 A. That's correct.

6 Q. Do you agree that the sum of the amount
7 expensed and the amount capitalized is equal to the
8 actual cost paid?

9 A. Well, if we're accruing for benefit
10 expense, a portion of that benefit expense is
11 capitalized and the total between the capital expense
12 would be the total accruing, yes.

13 Q. And do you agree that if the amount of
14 benefit actually booked that is capitalized changes
15 that then the amount of expense will change?

16 A. Yes.

17 Q. Turning to page 62, lines 9 to 11 of your
18 rebuttal testimony there you address that staff used
19 the two-year average for overtime and a four-year
20 average for capitalization percentage. Is that
21 correct?

22 A. Yes.

23 Q. Did the company provide staff with the
24 percentages for capitalized wages over the past four
25 years?

01328

1 A. Yes, we did.

2 Q. Turning to what's been marked as Exhibit
3 192-C, it's a confidential exhibit. And this includes
4 wages and salaries for the year 1992, and it refers to
5 a response to public counsel DR No. 131 for 1993,
6 1994 and 1995; is that correct?

7 A. Well, I have -- 192 has WT 01-331, PC 01,
8 so you have two in that. Yes, it has PC 131 attached.

9 Q. Do these reports give the detail of the
10 component of wages and salaries such as overtime paid
11 absence team awards merit awards and capitalized
12 salaries?

13 A. Yes.

14 Q. From the information included in response
15 to this data request, could one calculate the
16 percentage change in overtime for the last two years?

17 A. Yes.

18 Q. Could one calculate the percentage change
19 for the last four years for overtime?

20 A. Not from these particular worksheets.

21 Q. Is the increase in overtime expense
22 incurred by USWC in part due to the restructure
23 efforts taken on by the company?

24 MR. VAN NOSTRAND: Objection, asked and
25 answered.

01329

1 A. Again, I would just like to make the
2 statement that I have looked at overtime
3 capitalization for the year 1995, and we are -- on
4 capitalization we have not changed from '94, '95 and
5 our overtime continues to be at a much higher level
6 than is used by the staff.

7 Q. I'm not sure to what question that
8 responded. Page 63, lines 14 to 16 of your testimony
9 you state that management deploys employee time where
10 they feel it will best meet the needs of the business
11 and their customers; is that correct?

12 A. Yes.

13 Q. If capitalized wages are higher in one year
14 versus lower in another year due to certain
15 circumstances, would the use of a higher
16 capitalization percentage decrease the level of
17 expenses on the books?

18 A. Yes.

19 MR. VAN NOSTRAND: Your Honor, I object. I
20 believe this question has been asked and answered as
21 well.

22 MR. TRAUTMAN: It was with respect to a
23 different calculation.

24 A. Well, again, I make the statement, if you
25 increase your capitalization rate you decrease your

01330

1 expense but, again, I want to reiterate that our
2 '95 capitalization rate is the same as our
3 capitalization rate used in the test period, so going
4 back four years I still do not think is appropriate to
5 use an average capitalization rate of a previous four
6 years.

7 Q. And the answer was yes to the question?

8 A. Yes.

9 Q. On page 97 of your testimony you address
10 the material resource group. Is that the same as the
11 marketing resource group referred to as staff
12 adjustment No. 4?

13 A. You're on what page again?

14 Q. 97 of your rebuttal testimony.

15 A. Yes.

16 Q. Would you accept subject to check that the
17 company has not filed a petition since December 1991
18 with the Commission requesting authorization to
19 implement a change in the accounting procedure
20 accounting for this adjustment?

21 A. I don't have all the dates in front of me
22 but I do know that part 32 was approved by this
23 Commission when we revised it in 1987, which included,
24 I believe, this part 32.27 D.

25 Q. Again, would you accept subject to check

01331

1 that the company has not filed a petition since
2 December 1991 with the Commission requesting
3 authorization to implement a change in the accounting
4 procedure for marketing resource group?

5 A. For the marketing resource group. Again, I
6 would refer this question to Doug McDonald because I
7 do not file the contracts between U S WEST C and MRG
8 and he would be more knowledgeable on that subject.

9 Q. On page 99 at line 16 to 18 of your
10 testimony you state, "The company should not be
11 penalized for following FCC part 32 accounting which
12 has been approved by the Commission." Is that correct?

13 A. Which lines are you referring to?

14 Q. The last three lines of page 99, lines 16
15 through 18?

16 A. I see that, yes.

17 Q. Would you agree subject to check that the
18 WAC 480-120-031 -- that's the accounting rule --
19 states that the accounting rules for book and
20 recording purposes do not dictate intrastate
21 ratemaking?

22 A. Yes. I know there's a WAC that states
23 that. I don't know the specific one but I agree with
24 you subject to check.

25 Q. Going back to two questions I asked

01332

1 previously. I'm not sure you answered. One was what
2 team and merit awards were paid out in 1994? I
3 believe you answered for 1993.

4 A. I believe that was provided to you in WUT
5 359.

6 Q. I believe I asked whether the overtime in
7 1994 was caused in part by restructuring. Would 1995
8 also be affected by restructuring?

9 A. Again, I'm not knowledgeable about the
10 relationship between overtime and restructuring.

11 JUDGE WALLIS: Mr. Trautman, I do think
12 she's answered that several times. Let's be off the
13 record for just a moment for scheduling discussion.

14 (Recess.)

15 JUDGE WALLIS: Let's be back on the record,
16 please. In a scheduling discussion it's been
17 determined that we will continue this evening until
18 Mr. Trautman finishes with his examination. Then
19 we'll break off and we'll pick up at 10:00 tomorrow
20 morning. Mr. Trautman.

21 MR. TRAUTMAN: I don't recall if I moved
22 for admission of Exhibit 192 C. If I did not I would
23 move now.

24 JUDGE WALLIS: I don't believe you have.
25 There being no objection Exhibit 192 C is received.

01333

1 (Admitted Exhibit 192 C.)

2 Q. Referring to your exhibit MJW-1, on line 5
3 you indicate that the total book revenues for the 12
4 months ending October 31, 1994 for Washington
5 intrastate is approximately \$983 million; is that
6 correct?

7 A. This is on page 2?

8 Q. I believe so. Yes, on page 2?

9 A. Yes.

10 Q. And is this intrastate revenue stated on
11 the same basis as the intrastate revenue subject to
12 the regulatory fee?

13 A. I believe some of the miscellaneous items
14 are not included in the regulatory fee.

15 Q. Are you aware of the Commission's policy
16 for setting the regulatory fee as explained in RCW
17 80.24.101?

18 A. I know it generally. I don't know right
19 now. Unless you put it in front of me I wouldn't have
20 all the details of how to do that calculation.

21 Q. If you could refer now to what's been
22 marked as Exhibit 195, and that actually has two
23 pieces. One is a worksheet showing the accrued and
24 paid regulatory fees. And the second one is a copy of
25 the notification letter sent to all regulated utility

01334

1 companies in Washington regarding RCW 80.24.101?

2 A. I have that in front of me.

3 Q. And according to the rule as explained in
4 the letter the regulatory fee is computed by taking
5 the first \$50,000 of total intrastate revenue?

6 A. Operating revenues.

7 Q. Intrastate operating revenues, multiplying
8 that by .1 percent and multiplying the remainder by .2
9 percent. Do you agree that there is the formula to be
10 used to calculate the regulatory fee?

11 A. It's my understanding that we've been
12 calculating this fee for years and years and we've
13 agreed with staff on how it should be calculated. I
14 don't think it's calculated on total operating
15 revenues. I do believe we make an adjustment to the
16 miscellaneous revenues. We include the just
17 intrastate operating revenues that are -- well, again,
18 I don't have the formula in front of me but I do
19 believe we exclude some of the miscellaneous revenues.

20 Q. If the formula were applied to the test
21 year intrastate revenues of \$983 million, which is in
22 your exhibit, would you agree that the total fee would
23 be approximately \$1.9 million for the test period?
24 Would you agree subject to check?

25 A. Yes.

01335

1 Q. And would you agree subject to check that
2 the company's test year regulatory fees showed
3 \$321,000 in November and December of 1993 and
4 approximately \$2.2 million from January to October
5 1994 for a total of approximately \$2.2 million. Would
6 you accept that subject to check?

7 A. Yes.

8 MR. VAN NOSTRAND: If I could clarify where
9 it is this would be checked.

10 MR. TRAUTMAN: It could be checked on page
11 103 of her deposition starting at line 16.

12 A. Is there an exhibit that's referred to?

13 Q. I don't have that but you would accept
14 it subject to check?

15 A. Yeah.

16 Q. And in your rebuttal testimony on page 84
17 you mention an adjustment to the 1994 fee that would
18 reduce the regulatory fee by \$100,150.

19 A. Would you refer me to the page again?

20 Q. Page 84. And it's on lines 7 and 8. There
21 you mention an adjustment to the 1994 fee that would
22 reduce the regulatory fee by \$100,150?

23 A. Yes, I see that. And again that states that
24 the company had included an entire true-up in its test
25 period results and it should have only removed

01336

1 ten-twelfths.

2 Q. Can you explain why the adjustments you
3 actually made, and this is in OOP No. 9, was only
4 approximately \$73,000?

5 A. Well, I'm going to have to look up the
6 detail. And this is out of period.

7 Q. Adjustment No. 9?

8 A. OOP No. 9. Just reviewing this we had
9 included the whole true-up in our test period, and so
10 the whole amount was buried in there, and so what I
11 did is only ten-twelfths of the true-up should have
12 been included, so the value that I am correcting, I
13 believe, is the two months value of \$73,000.

14 Q. So would it be accurate that the 12 month
15 amount would be approximately \$120,000 and that the
16 \$100,150 amount represents the 10 month portion?

17 A. Well, again just straight looking at my
18 numbers, if we're making an adjustment for \$73,000
19 that's worth -- that's a value. We're taking out two
20 months of the true-up. Those numbers don't connect
21 for me.

22 Q. Did the 73,000 come from applying the
23 intrastate percentage to the \$100,000?

24 A. The regulatory fee is based on our
25 intrastate revenues. Let me take that back. It's

01337

1 based on gross intrastate operating revenues.

2 Q. So is this appropriate when the regulatory
3 fee is only based on intrastate revenues? Wouldn't
4 the entire adjustment supply to the intrastate
5 results?

6 A. No. We had a true-up for all of 1990.
7 This was a true-up for 1993 and 1994. Let me read
8 this because I guess it's getting late here and I am
9 not focusing in. It says, "the company included the
10 entire true-up in its test period results. However,
11 ten-twelfths of the true-up should be removed as an out
12 of period adjustment," because that applies to the
13 first ten months of 1993 and we should have only
14 adjusted for two months, for November and December of
15 1993.

16 Q. Did you adjust the 1994 accruals for the
17 true-ups made in 1995?

18 A. I think this gets back to our whole
19 discussion on accrual basis accounting.

20 Q. Is it a yes or no first?

21 A. No.

22 Q. The regulatory fee that you would recommend
23 based on the numbers that you agreed to subject to
24 check I believe is \$2.2 million less the \$73,000
25 adjustment in your rebuttal testimony for a total fee

01338

1 of approximately \$2.168 million; is that correct?

2 A. I don't have the regulatory fee embedded in
3 my test period in front of me. You can probably --
4 you probably stated it earlier.

5 Q. Would you accept it subject to check?

6 A. Yes.

7 Q. And this would be the amount that you would
8 state would be used as the company's test year
9 regulatory fee for ratemaking purposes?

10 A. Those were the accruals on our books.

11 Q. So that would be yes?

12 A. Yes.

13 Q. If you were asked to calculate what
14 revenues produced the regulatory fee of approximately
15 \$2.16 million that the company is including in the
16 revenue requirement, would the answer be a higher or
17 lower revenue number than the revenues used to
18 calculate the company's revenue deficiency?

19 A. Repeat the question again.

20 Q. If you were to calculate which revenues
21 produced the regulatory fee of approximately \$2.16
22 million that the company is including in the revenue
23 requirement, would the answer be a higher or letter
24 revenue number than the revenues that are used to
25 calculate the company's revenue deficiency.

01339

1 A. I believe it would be higher revenues. And
2 again --

3 Q. In referring to the previous questions
4 about the \$100,150, do you have OOP No. 9 worksheet 3?

5 A. No, not in front of me. Is it an exhibit?

6 Q. No, it is not. I just refer to that
7 because I believed it would provide a check where you
8 could check the results of the --

9 A. Again, we're disputing a very small amount
10 of money here and I think what it gets back down to is
11 what is your representative period you're looking at.
12 I was putting into the test period results the amount
13 of the accruals that were on our books.

14 MR. TRAUTMAN: I have no further questions.

15 JUDGE WALLIS: Very well. Let's be in
16 recess until 10:00 tomorrow morning in this room.

17 (Hearing adjourned at 5:50 p.m.)

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