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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 19
5)
vs.) Pages 1538 - 1771
6)
U S WEST COMMUNICATIONS, INC.,)
7)
Respondent.)
8 -----)

9 A hearing in the above matter was held at
10 9:23 a.m. on January 11, 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
and SHERILYN PETERSON, Attorneys at Law, 411 - 108th
19 Avenue Northeast, 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, and JAMES CUNNINGHAM, Special
24 Assistant Attorney General, 900 Fourth Avenue, Suite
2000, Seattle, Washington 98164.
25 Cheryl Macdonald, Court Reporter

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1

I N D E X

2	WITNESSES:	D	C	RD	RC	EXAM
	KOEHLER-CHRISTENSEN		1548	1601	1612	1575
3	BARRINGTON	1622	1626	1666		
	McDONALD	1672	1675	1722	1737	1737
4	CUMMINGS	1741	1744			

5	EXHIBITS:	MARKED	ADMITTED
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	30-T		1545
6	280-T		1545
	281		1545
7	283 - 285		1545
	228		1550
8	229		1557
	230 - 232		1567
9	235T, 236-239		1625
	240		1651
10	241		1666
	21T, 245T,		
11	22-29, 249-252		1674
	265, 266, 267C,		
12	268, 269C		1683
	270		1694
13	271		1697
	272-273		1700
14	274		1703
	261		1711
15	262 (WITHDRAWN)		1711
	234		1740
16	6T, 7-20,		
	290T, 291-306		1744
17	307		1750
	308		1751
18	313	1766	1771

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

2 JUDGE WALLIS: Let's be on the record,
3 please, for our January 11, 1996 session in the matter
4 of UT-950200 U S WEST Communications. When we broke
5 last night we were in the mid of the cross-examination
6 of Ms. Koehler-Christensen. At the present time we
7 want to handle some procedural matters regarding the
8 evidence of Lawrence K. Vanston and William R. Easton.

9 MS. PETERSON: Your Honor, we have an offer
10 of proof on Mr. Vanston and also on Mr. Easton. Did
11 you want to take up first what of Mr. Easton's
12 testimony comes in because if we do it that way then I
13 can simplify the offer of proof by putting them
14 together.

15 JUDGE WALLIS: Very well. We have already
16 marked the exhibits, so go right ahead.

17 MS. PETERSON: I think there's no
18 disagreement as to Exhibit 280T, 281 and 283. I think
19 we're in agreement that those will come in. We are in
20 agreement that U S WEST will do an offer of proof on
21 Exhibits 31, 32 and 282. The only one that I believe
22 is at issue is portions of Exhibit 30-T Mr. Easton's
23 direct testimony in this case.

24 We agree that the introductory section,
25 pages 1, line 1 through page 2, line 5 which has Mr.

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1 Easton's qualifications and background will come in.
2 We disagree on pages 26, line 1, through 46, line 1.
3 The company wishes to admit those and staff has not
4 agreed to that. The balance of that direct testimony
5 will be submitted as an offer of proof so we're only
6 arguing about those 20 pages.

7 We believe that the testimony should come
8 in for a number of reasons. First, the depreciation
9 rate study, Exhibit 281, well all the testimony at
10 issue directly relates to that. Basically it simply
11 describes how the company applied Mr. Vanston's
12 studies that were discussed yesterday to its own plant
13 and it basically takes Exhibit 281, which there's no
14 argument over and explains category by category,
15 account by account, how the company reached the
16 numbers it reached in the depreciation rate study, so
17 that's why the company thinks it should come in.

18 MR. SMITH: Thank you, Your Honor. Staff
19 has not objected to certain portions of Dr. Vanston's
20 and Easton's testimony for the limited purposes of a
21 factor in a cost study rather than for purposes of
22 capital recovery. Our position is that the rebuttal
23 testimony of both witnesses, to the extent it
24 incorporates the prior testimony, is fully covered by
25 the Commission's ruling, and also that would apply to

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1 Exhibit 30-T including the 20 pages in dispute. That
2 is the identical testimony that was filed in the prior
3 depreciation case, and our position is that is
4 testimony going to capital recovery. There is no
5 mention of cost studies in that testimony, and it
6 should be subject to the prior ruling. It would be
7 anomalous if the Commission were to rule that the
8 company could not relitigate issues raised in that
9 prior proceeding but that they could put in all the
10 testimony from that prior proceeding and that's the
11 basis of our objection to that portion of the
12 testimony. I would also point out that yesterday on
13 the stand in whatever phase of the testimony it was,
14 Dr. Vanston went into great detail about the lives that
15 the company is recommending for its cost studies, so,
16 therefore, the company has had the opportunity to
17 put that in in connection with the cost study, and I
18 did not object to that. I do object to Exhibit 30-T
19 for the reasons I've stated.

20 MS. PETERSON: May I respond?

21 JUDGE WALLIS: Let me ask if any other
22 party wishes to comment.

23 MR. TROTTER: We support the staff
24 position, public counsel.

25 MS. PETERSON: Your Honor, the testimony

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1 that was admitted yesterday and the exhibits, staff
2 said they were offering -- they were allowing them
3 without objection to go to the cost study issues in
4 this case, and they weren't waiving any objection on
5 depreciation, and I would see no difference by
6 admitting these pages of the testimony. I would say
7 it's anomalous to offer -- allow in the rate study but
8 then not allow in the testimony that describes it and
9 explains it. All you have is a bunch of numbers
10 otherwise. Mr. Easton's testimony fully explains it
11 and it is not the testimony per se from the prior
12 docket. It was put in in this case and it would
13 certainly support the depreciation life and other
14 issues that have been excluded but it also fully
15 supports the cost studies and the use of lives in the
16 cost studies.

17 JUDGE WALLIS: And you're talking about the
18 portion of Exhibit 30-T?

19 MS. PETERSON: Correct. Pages 26 through
20 46.

21 MR. SMITH: I would just repeat. I have not
22 dissected the pure rebuttal testimony to see which
23 parts of my -- would be subject to a prior ruling. I
24 have given a lot of leeway on that. Where I have drawn
25 the line and where my argument rests is on the

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1 wholesale importation of verbatim testimony from the
2 prior proceeding upon which the bench has ruled cannot
3 be relitigated.

4 JUDGE WALLIS: And pages 26 through 46
5 include that in corps.

6 MR. SMITH: Yes, and I believe and I
7 haven't done it recently but I believe it is word for
8 word the identical testimony. If it is not word for
9 word it is in all substantial respects the same
10 testimony.

11 MS. PETERSON: But, Your Honor, it goes to
12 two separate issues, it goes to both the issue in that
13 docket and the issue that remains here.

14 JUDGE WALLIS: Very well. We have the
15 arguments of counsel now in mind and we will take the
16 arguments under advisement.

17 MS. PETERSON: Thank you, Your Honor.

18 JUDGE WALLIS: At this time, let me see if
19 my notes accurately reflect the uncontested portions of
20 the documents. Exhibit 30-T excluding pages 26 through
21 46, 280T, 281, 283, 284 and 285 may be received without
22 objection; is that correct?

23 MR. SMITH: Yes, for the limited purposes I
24 mentioned earlier.

25 JUDGE WALLIS: Yes. And those documents

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1 are received.

2 (Admitted Exhibits 30-T, 280-T, 281, 283,
3 284, 285.)

4 JUDGE WALLIS: The ruling on pages 26
5 through 46 of Exhibit 30-T, Exhibit 31, 32 and 282 for
6 identification is reserved.

7 MS. PETERSON: Do you want the offer of
8 proof now?

9 JUDGE WALLIS: Yes, please.

10 MR. SHAW: Thank you, Your Honor. In
11 response to the Commission's 11th supplemental order
12 of January 3 granting the staff's motion to dismiss
13 the company's request in this case to authorize
14 certain shorter depreciation lives and to implement
15 equal life proof methodology effective for assets in
16 service as of 1982 to '83, the company believes as
17 we've argued previously that the issues preclude by
18 the 11th supplemental order are an integral part of
19 this rate case. I won't reargue that here but I would
20 point out that we strongly believe that we should be
21 able to present current evidence on depreciation and
22 argue for treatment of depreciation in the present rate
23 case and specifically I would refer the Commission to
24 the Pacific Telephone case 19 Washington 2nd 200.

25 MR. TROTTER: Your Honor, I will object.

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1 She is rearguing the issues. The offer of proof as I
2 understood it in prior conversations with counsel, was
3 just putting in -- taking notice of the testimony
4 that's been excluded and that's the proof. Now we're
5 getting into relitigating past issues again and I'm
6 going to object right now so it's on the record.

7 MR. SMITH: Your Honor, while we've
8 interrupted I will voice my objection at the same
9 time. There has been an offer of proof in the October
10 oral argument where a specific argument was made as to
11 the admissibility of this evidence. I have no
12 objection to putting it in as the offer of proof. The
13 Commission is aware of what that testimony is. It's
14 from a prior proceeding and it was the very basis of
15 the Commission' ruling so I think any further argument
16 on that point is unnecessary.

17 JUDGE WALLIS: Yes. I agree with counsel
18 and believe that further argument would be
19 inappropriate at this time.

20 MS. PETERSON: Thank you, Your Honor. I
21 was simply attempting to state the reasoning. The
22 exhibits that we will submit the offer of proof on for
23 Mr. Vanston are Exhibits 267 in its entirety which is
24 the testimony from docket UT-940641 and all of the
25 exhibits to that testimony that were offered, and that

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1 I believe is Exhibit 267-T, and we would also include
2 in the offer of proof the exhibits that were admitted
3 Exhibit 265-T, Exhibit 266 and Exhibit 268 to the
4 extent that they were admitted for limited purposes we
5 would obviously offer them for all purposes.

6 For Mr. Easton we submit an offer of proof
7 for Exhibits 31, 32, 282 and all portions of Exhibit
8 30-T that are not admitted, and I can't state for
9 certain what that will be since we don't yet have a
10 ruling. Thank you, Your Honor.

11 JUDGE WALLIS: Very well. Consistent with
12 the Commission's earlier ruling the offer of proof is
13 noted, and the exhibits are rejected subject to of
14 course the Commission's ruling on Mr. Easton's
15 testimony.

16 MS. PETERSON: Thank you.

17 JUDGE WALLIS: Is there anything further on
18 the Vanston/Easton documents? It appears not. Let's
19 proceed to resume the examination of Ms.
20 Koehler-Christensen.

21 Merely remind the witness that she's
22 previously been sworn in this proceeding and remain
23 under oath. Have a chair, get yourself some water and
24 make yourself comfortable.

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1 CROSS-EXAMINATION

2 BY MR. SMITH:

3 Q. Morning.

4 A. Good morning.

5 Q. Like to start by turning to page 15 of your
6 rebuttal testimony. And am I correct that the data
7 that you present there is for all Washington
8 communities not just those served by U S WEST?

9 A. Yes, that's correct.

10 Q. And do you have copies of the exhibit that
11 have been premarked?

12 A. Yes, I do.

13 Q. If I can direct your attention to Exhibit
14 228 which is company's response to public counsel
15 request 01-151 and on attachment A under 1985, the
16 portion for all Washington communities, that's the
17 same information that appears in your table 1 on page
18 15?

19 A. Under 1995?

20 Q. Yes.

21 A. Yes, it is the same.

22 Q. And turning to the section below that, that
23 shows the number of directories available in U S WEST
24 Communication communities; is that correct?

25 A. Yes, that is correct.

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1 Q. And your data show that U S WEST
2 directories face no competing directories at all in 30
3 percent of U S WEST communities; is that correct?

4 A. That is correct.

5 Q. And in 49 percent of the U S WEST
6 communities they face competition from a single other
7 directory; is that correct?

8 A. Yes. That means that in that community
9 there are a choice of two directories publishing the
10 listings from that community, one by U S WEST Direct
11 and one by another publisher.

12 Q. So that U S WEST directories face no more
13 than one competing directory in 79 percent of the
14 company's communities; is that correct?

15 A. I'm sorry, I don't understand the
16 percentage. No more than one in 79.

17 Q. Yes. If you add the 30 percent where
18 there's no competition and 49 percent where there's a
19 single other directory provider, there are 79 percent
20 of the communities have at most one other directory
21 option?

22 A. Yes, that's correct.

23 MR. SMITH: Your Honor, move for admission
24 of Exhibit 228.

25 MR. OWENS: No objection.

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1 JUDGE WALLIS: Exhibit 228 is received.

2 (Admitted Exhibit 228.)

3 Q. Do the directories published by U S WEST
4 Direct for U S WEST Communications' service territory
5 display the U S WEST logo?

6 A. There is no U S WEST logo. They have the
7 name U S WEST Direct on them. They do not have the
8 name U S WEST Communications.

9 Q. I'm sorry, but do they bear the Bell symbol
10 we are familiar with for U S WEST?

11 A. Yes, they do bear the Bell logo which is
12 used by U S WEST and a number of other companies.

13 Q. And by other companies, which companies are
14 you referring to?

15 A. Other regional Bell operating companies and
16 other companies that other than telephone companies
17 the Bell was allowed to the holding companies not to
18 the telephone companies so that Bell is available to
19 other companies within U S WEST and outside of U S
20 WEST as well.

21 Q. Outside of U S WEST but that were at one
22 time part of AT&T before divestiture?

23 A. Yes.

24 Q. And that Bell symbol appears on U S WEST
25 Communications' local service bills in Washington,

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1 does it not?

2 A. I actually would assume so, but I do not
3 have my service from U S WEST Communications so I do
4 not know that for a fact.

5 Q. Well, prior to asking that question I
6 checked my own bill and I'm a U S WEST Communications
7 customer so if you will accept that subject to your
8 check?

9 A. I will.

10 Q. Now, is it your position that U S WEST
11 Communications has no involvement in the publication
12 of Yellow Pages directories in this state?

13 A. U S WEST Communications has an obligation in
14 the state of Washington to assure that White Pages
15 directories are published for all of the area that is
16 served by U S WEST Communications and that directories,
17 White Pages directories, are provided to all of the
18 customers of U S WEST Communications. U S WEST
19 Communications assures that that obligation is met
20 through a contract between U S WEST Communications and
21 U S WEST Direct and in this contract U S WEST Direct
22 agrees to publish directories for each of U S WEST
23 Communications exchanges and deliver those directories
24 free of charge. U S WEST Communications does not pay U
25 S WEST Direct for the expenses that are associated with

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1 publishing the White Pages nor does U S WEST
2 Communications pay U S WEST Direct for the expense
3 associated with delivering the directories to the
4 customers of U S WEST Communications. On the other
5 hand, U S WEST Direct does pay U S WEST Communications
6 for the listings just like other directory publishers
7 in the state of Washington pay U S WEST Communications
8 for the listings they receive from U S WEST
9 Communications.

10 Q. As I understood your response you were
11 talking about White Pages. Is it your position that
12 U S WEST C has no involvement in the publication of
13 Yellow Pages in this state?

14 A. Yes, that is correct.

15 Q. Given that can you explain, and I will
16 refer you back to 228, why U S WEST Communications
17 undertook the study of markets in which it does not
18 participate?

19 A. U S WEST Communications undertook that
20 study because of the issue of the Yellow Pages
21 imputation in the state of Washington. I personally
22 undertook that study, and it was because of the
23 imputation issue, and it was actually because of the
24 testimony of Dr. Selwyn who stated that U S WEST
25 Direct was a virtual monopoly and had no competition,

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1 and my study clearly indicated that that was not the
2 fact.

3 Q. How were the costs of this study recorded,
4 if you know?

5 A. The same way the rest of my salary was
6 recorded.

7 Q. I want to ask you something about your
8 testimony on page 14 and on page 17 where you state
9 that Yellow Pages are only 6.5 percent of the total
10 business advertising expenditures in the United
11 States. Are you familiar with that part of your
12 testimony?

13 A. Yes, I am.

14 Q. Would you agree that one of the functions
15 of business advertising is to give consumers
16 information regarding product prices?

17 A. I am not an expert in advertising and I
18 really -- I couldn't say that or not say that.

19 Q. You can't say whether one of the functions
20 of business advertising is to give consumers
21 information about prices.

22 MR. OWENS: Objection, asked and answered.

23 JUDGE WALLIS: Sustained.

24 Q. In your experience do commercials on radio
25 and television often mention specific prices for

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1 things they're trying to sell?

2 A. Frankly, no. I don't think of prices
3 associated with a lot of the advertising I hear.
4 Occasionally, yes, buy something for 14.95 or 29.95 on
5 TV.

6 Q. But times they advertise things on sale,
7 does that happen?

8 A. I guess I can't say that I personally view
9 the prices I hear as very significant to me.

10 Q. Well, would you agree that advertisements
11 on radio and television do refer to price, discount
12 and sales and things of that nature? Isn't that just
13 a large part of it or some part of it?

14 A. I would say that it is sometimes some part
15 of it. That's really all I can say.

16 Q. Would that be also true for newspaper
17 advertising?

18 A. Again, I think there's a wide range of
19 advertising, and different purposes for advertising.
20 Some of it is price.

21 Q. Would you agree that product advertisers do
22 not typically advertise prices in the Yellow Pages?

23 A. Yes, that is true.

24 Q. If you would refer to what's been marked as
25 Exhibit 229?

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1 A. Yes.

2 Q. Ask you if you're generally familiar with
3 that or that type of document?

4 A. I received a copy of this yesterday and I
5 have looked at it.

6 Q. I will represent to you that that's from
7 the current 1996 Seattle Yellow Pages for U S WEST
8 Direct.

9 A. Okay.

10 Q. And if I can direct your attention to the
11 upper left-hand corner of the document, it refers to U
12 S WEST Direct Yellow Pages as the final link between
13 seller and buyer. Do you see that?

14 A. Yes, I do.

15 Q. And at the bottom of the circle Yellow
16 Pages or the final link is shown as the link at the
17 bottom. Do you see that?

18 A. Yes, I do.

19 Q. Up on top appears to be all or most other
20 forms of business advertising as a separate link. Do
21 you see that?

22 A. Yes.

23 Q. And below that circle of links in paragraph
24 2 it refers to Yellow Pages as directional
25 advertising. Do you see that?

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1 A. No. Number two?

2 Q. Right?

3 A. Yes.

4 Q. Just below that No. 3 it states that "U S
5 WEST Direct Yellow Pages complements all other
6 advertising." Do you see that?

7 A. Yes, I do. I think it needs to be
8 recognized that this is a marketing tool used by U S
9 WEST Direct to sell its advertising. I'm also aware
10 that other forms of advertising use similar marketing
11 tools to try to convince potential advertisers that it
12 is not necessary for them to spend their advertising
13 dollars with Yellow Pages, that they should in fact
14 spent their advertising dollars for direct mail or for
15 newspaper advertising.

16 Q. If I could direct your attention to the
17 upper right-hand corner of the document. Says, "Five
18 ways that U S WEST Direct Yellow Pages provides
19 advertising value." And the first it states that "U S
20 WEST Direct distributes directories to nearly every
21 home and business in the area." Do you see that?

22 A. Yes, I do.

23 Q. Under No. 4 it states that "more than 80
24 percent of the population uses the Yellow Pages
25 regularly." Do you see that?

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1 A. Yes, I do: I might point out that when you
2 read that No. 4 it's certainly on a national basis.
3 It's not on a Washington basis since they say more
4 than 112 million people.

5 MR. SMITH: Your Honor, I will move for
6 admission of Exhibit 229.

7 MR. OWENS: No objection.

8 JUDGE WALLIS: 229 is received.

9 (Admitted Exhibit 229.)

10 Q. Is it U S WEST's Direct practice to
11 distribute its White and Yellow Page directories to
12 every home and business within the U S WEST service
13 territory in Washington?

14 A. U S WEST Direct by contract with U S WEST
15 Communications is required to deliver the directories
16 to every home that is served by U S WEST
17 Communications telephone service.

18 Q. So you would agree that Yellow Pages
19 directories have essentially 100 percent penetration
20 in your service territory?

21 A. Assuming that -- they're required to deliver
22 the White Pages. Now, that White Pages and Yellow
23 Pages by U S WEST Direct are cobound for most of the
24 directories in the state of Washington. They are not
25 required to deliver Yellow Pages in the directories

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1 that are separately bound, however. It's in U S WEST's
2 Direct's best interests to deliver those directories
3 not in U S WEST Communications' best interests to
4 deliver the directories to every home.

5 Q. So based on those best interests, is it
6 your understanding when they are not cobound when a
7 White Pages directory is delivered a Yellow Pages
8 directory is delivered as well?

9 A. Yes, but that is not a requirement of the
10 contract between U S WEST Communications and U S WEST
11 Direct.

12 Q. Can you identify any other form of
13 advertising that has nearly a 100 percent penetration
14 level in the company's service territory?

15 A. Not specifically, no: Actually television
16 I would assume. Television, I am aware that television
17 penetration is higher than telephone penetration in
18 the United States, and I would assume that perhaps
19 Washington is no exception to that.

20 Q. What do you base that statement that
21 television penetration is greater than
22 telecommunications -- or telephone penetration in the
23 state of Washington? I should say Yellow Pages
24 penetration.

25 A. No. What I'm saying is I have seen

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1 studies, I cannot name the source right now, that
2 indicate that television penetration is higher than
3 telephone penetration. I'm not talking about
4 directory penetration here. I'm talking about the
5 number of homes in the United States that have
6 televisions in the home, the number of homes in the
7 United States that have telephones in the home and the
8 percentage that I have seen in the studies is that
9 there are televisions in more homes in the United
10 States than there are telephones.

11 Q. How often does U S WEST Direct issue new
12 Yellow Pages directories?

13 A. Approximately once every 12 months.

14 Q. Would you agree then that typical U S WEST
15 telephone subscriber has access to the advertising and
16 listings in a particular issue of U S WEST Direct's
17 Yellow Pages for about one year?

18 A. Yes.

19 Q. Can you identify any other sources of
20 advertising typically found in the home or business
21 that are retained and consulted for a time span of up
22 to a year?

23 A. Other than other White and Yellow Pages
24 directories, no, I cannot, but certainly other
25 directory publishers publish directories with White

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1 Pages listings and with Yellow Pages listings. Many of
2 them are scoped almost identically with U S WEST
3 Direct, and in fact appear quite similar to U S WEST
4 Direct directories. I have here an example of the
5 Olympia directory published by U S WEST Direct.

6 Q. Can you just hang on to those until you're
7 redirected by your counsel?

8 MR. OWENS: The witness is entitled to
9 answer. She's sworn to tell the whole truth and it
10 seems to me that that answer is directly responsive to
11 the question of what other forms of advertising
12 besides U S WEST directories are retained and
13 consulted for as long as a year.

14 MR. SMITH: She's answered that other
15 directories are?

16 A. Yes. I was simply giving an example.
17 Here is another directory published in Olympia by
18 regional telephone directory. It has a similar scope
19 and a similar time frame, and I would very much assume
20 that it was retained in the home a similar period of
21 time. In fact I obtained this one from someone's home
22 living here in Olympia.

23 Q. Have you done any studies as to how many
24 homes in Olympia retain more than one Yellow Page
25 directory?

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1 A. No, I have not.

2 Q. Have you been to the public library in
3 Olympia where they maintain telephone Yellow Page
4 books or directory for the state of Washington?

5 A. No, I have not.

6 Q. Is it typical for public libraries to have
7 as reference materials U S WEST Direct's Yellow Pages?

8 A. It is my understanding it is typical and
9 that U S WEST Direct provides directories to public
10 libraries at no cost to the libraries. I'm not
11 familiar about the policy of other directory
12 publishers.

13 Q. Let's assume that you live in the Seattle
14 metropolitan area and you've been considering
15 purchasing a new stereo system for a few weeks and you
16 decided to go ahead and purchase one. How many stereo
17 vendors would you expect there to be in the Seattle
18 metropolitan area?

19 A. Many.

20 Q. Now, if you turn to your daily newspaper
21 would you expect to find information on all of those
22 vendors who might sell you a stereo?

23 A. No.

24 Q. And you mentioned earlier TV as an example
25 of comparable penetration rates to telephones and

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1 telephone directories?

2 A. Yes, I did.

3 Q. Would you turn on your TV and wait for an
4 advertisement for a store that was selling stereos?

5 A. No, I don't believe that I would.

6 Q. But you could turn to the U S WEST Direct
7 Yellow Pages that that's already in your home and find
8 a comprehensive list of virtually every seller of
9 stereo equipment in the Seattle metropolitan area?

10 A. Yes, I could. On the other hand it doesn't
11 mean that that's what I would do. I personally bought
12 a television in the month of December and I did not go
13 to the Yellow Pages. I went to a newspaper
14 advertising and that's how I found the store that I
15 went to and purchased a television.

16 Q. In a staff interrogatory data request No.
17 164 you were asked as part of that to define the
18 market in which Yellow Pages are competing, "The scope
19 of the market, total annual revenues for the market
20 and number of alternative suppliers," part C of that
21 request, and in response the company referred to its
22 responses to public counsel 151, 139 and 236; is that
23 correct?

24 A. Actually, I can't find -- 164 was the one
25 you were referring to?

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1 Q. 364 was the staff's request in part C?

2 A. Yes. I referred to public counsel 151, 139
3 and 236.

4 Q. Can you identify any other forms of
5 business advertising other than twelve directories
6 that you referred to in those responses?

7 A. In response to 139 the question was to
8 provide a list of Yellow Pages competitors so, no, I
9 referred to no other form of advertisers. In response
10 to public counsel request No. 151 I was asked to
11 provide available studies of competition in the Yellow
12 Pages markets so, no, I referred to no other form of
13 advertising. And in response to public counsel
14 request No. 236 I was asked to provide a listing of the
15 White and Yellow Pages directory markets in the state
16 of Washington, so, no, I referred to no other form of
17 advertising.

18 Q. Now, you've identified 14 Yellow Pages
19 publishers in Washington in addition to U S WEST
20 Direct; is that correct?

21 A. Actually, I made a correction. There are
22 14 directory publishers in the state of Washington
23 including U S WEST Direct that publish -- that are
24 members of the Yellow Pages Publishers Association.

25 Q. With that correction, are any of those

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1 publishers affiliated with companies that provide
2 local exchange service in U S WEST's service territory
3 in Washington?

4 A. I am aware that at least -- that one of
5 them is affiliated, one other is affiliated, with a
6 telephone company in the state of Washington and that
7 is GTE directories is affiliated with General
8 Telephone.

9 MR. SMITH: Those are all my questions.
10 Thank you.

11 JUDGE WALLIS: Mr. Trotter.

12

13 CROSS-EXAMINATION

14 BY MR. TROTTER:

15 Q. Does U S WEST Direct provide complimentary
16 Yellow Pages listings to business within the scope of
17 a particular directory regardless of which
18 telecommunications company provides their basic
19 telephone service?

20 A. Could you repeat the question, please.

21 Q. Do you provide Yellow Pages listings for
22 customers, business customers, of competitive access
23 providers?

24 A. U S WEST Direct, if they have the
25 subscriber listing of a business that is served by

01565

1 another telephone provider will provide and does
2 provide a complimentary Yellow Page listing
3 irrespective -- as long as that business is located
4 within the scope of their directory. In other words,
5 within the scope of a U S WEST Direct directory as
6 long as U S WEST Direct has the listing of that
7 business they will not charge them for one
8 complimentary Yellow Page listing whether that
9 business receives their telephone service from U S
10 WEST Communications, from General Telephone, from some
11 other independent telephone company or from another
12 alternative exchange carrier.

13 Q. How do you get the listing?

14 A. Now, when you say how do you, I work for U
15 S WEST Communications. I do not work for U S WEST
16 Direct.

17 Q. How does U S WEST Direct get the listing?

18 A. U S WEST Direct gets the listings in
19 various ways. U S WEST Direct certainly gets the
20 listings from U S WEST Communications. They sometimes
21 get the listings from the other telephone provider.
22 If U S WEST Communications has the listing of the
23 other telephone provider and the other telephone
24 provider chooses to sign an agreement with U S WEST
25 Direct so that U S WEST Communications will provide

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1 that listing, then U S WEST Communications does
2 provide that listing. Now, in addition there is a new
3 order, the interconnection order, that was just issued
4 that actually requires U S WEST Communications to take
5 the listings of alternative exchange carriers and
6 assure that those listings are provided to U S WEST
7 Direct at no charge to the alternative exchange
8 carrier.

9 Q. And so those customers will get a Yellow
10 Pages listing as well?

11 A. Yes, they will.

12 Q. Turn to Exhibit 226, your qualifications
13 statement. And there you list several dockets in
14 which you've testified?

15 A. Yes.

16 Q. Were all of those dockets related to Yellow
17 Pages imputation?

18 A. Yes, they were.

19 Q. Has your position been adopted by any of
20 those commissions in the dockets you mentioned?

21 A. In Montana and New Mexico my position that
22 I advocated in those cases were adopted by those
23 states.

24 Q. And then the other dockets it was rejected?

25 A. Yes, that is true. In Utah there was one

01567

1 dissenting opinion of a commissioner who supported my
2 position.

3 Q. And referring to Exhibits 230, 231 and 232
4 for identification, do you recognize those as your
5 responses to public counsel data request related to
6 the Yellow Pages imputation issue?

7 A. Yes, I do.

8 Q. Are they true and correct?

9 A. As far as I know, yes, they are.

10 MR. TROTTER: Move for the admission of
11 Exhibits 230 through 232.

12 MR. OWENS: No objection.

13 JUDGE WALLIS: 230, 231 and 232 are
14 received.

15 (Admitted Exhibits 230, 231 and 232.)

16 Q. Turn to page 4 of your testimony and staff
17 asked you some questions about this but on line 20 you
18 indicate "The current Yellow Pages imputation embedded
19 in rates is 39.9 million." Do you see that?

20 A. Yes, I do.

21 Q. And we asked you in response to public
22 counsel request 987 to explain and provide copies of
23 supporting documentation for that figure; is that
24 right? Do you have that response?

25 A. I will have to find that response.

01568

1 Q. Maybe I can just hand it to you, but am I
2 correct that the response reads, "Please see
3 attachment A for a copy of the Washington settlement
4 agreement" and then the Washington settlement agreement
5 in the AFOR is attached; is that correct?

6 A. Yes, that is correct.

7 Q. And where does the 39.9 million figure
8 appear in that document?

9 A. The 39.9 million figure itself does not
10 appear in the document. The question said, "Please
11 explain and provide copies of supporting
12 documentation, and methodology for calculating the
13 39.9 million is in the attached settlement agreement,"
14 and that is the calculation that was used to arrive at
15 the directory imputation that was included in the
16 revenue requirement. Now --

17 Q. So what you're saying is that --

18 MR. OWENS: Excuse me, had you finished
19 your answer?

20 A. I was going to say yesterday I really
21 referred to that as a rate case and that was
22 incorrect. It was a settlement agreement that was
23 agreed to in conjunction with the implementation of
24 the sharing plan so it was a revenue requirement and
25 the 39.9 million was concluded in the revenue

01569

1 requirement that adjusted rates at that time, but it
2 was not a rate case.

3 Q. It arose upon complaint by the Commission,
4 did it not?

5 A. I do not know that.

6 Q. Now, the \$39.9 million figure then would be
7 included in an exhibit in which the revenue surplus
8 that was settled upon was derived; is that correct?

9 A. Yes.

10 Q. And that is not what you attached in
11 response to that exhibit, is it?

12 A. No. I attached what I believed was
13 supporting documentation for the \$39.9 million, which
14 is the formula that was used to arrive at the \$39.9
15 million.

16 Q. So are you telling me that in the documents
17 in the record in that docket there is a Yellow Pages
18 adjustment and that adjustment is calculated by the
19 staff accounting witness based on the formula in the
20 AFOR, is that your testimony or your understanding?

21 A. I can't say that specifically, no. It is
22 my understanding that 39.9 million was calculated was
23 using the formula in this and that \$39.9 million was
24 used in the \$65 million rate adjustment that went into
25 effect.

01570

1 Q. Isn't it true that the staff exhibit in
2 that docket showed revenue surplus in excess of that
3 65 million?

4 A. I do not know.

5 Q. There was a rate change in January of '94
6 in which the Commission using sharing dollars reduced
7 the company's revenues by approximately \$33.3 million
8 a year; is that correct?

9 A. That's my understanding.

10 Q. And the directory imputation calculation
11 under the AFOR that gave rise to sharing declaration
12 in that phase was \$75.8 million; is that correct?

13 A. Subject to check, yes.

14 Q. Turn to page 5 of your rebuttal and you
15 refer to Yellow Pages imputation as being over one
16 half billion dollars since divestiture. Do you see
17 that?

18 A. Yes, I do.

19 Q. Would you please tell us what the total
20 revenues received by U S WEST from Washington
21 ratepayers over that same period was?

22 A. I don't understand the question.

23 Q. Well, you indicate what ratepayers have
24 received from the Yellow Pages imputation. How much
25 have ratepayers paid U S WEST in revenues over that

01571

1 same time period?

2 A. How much have U S WEST Communication
3 ratepayers paid?

4 Q. Paid U S WEST in rates over that same time
5 period.

6 A. I have no idea. What I am saying here is
7 that U S WEST --

8 MR. TROTTER: Your Honor, this isn't
9 responsive to the question. I asked specifically how
10 many revenues U S WEST received so I could make a
11 comparison and she doesn't have the data?

12 THE WITNESS: I know how much --

13 JUDGE WALLIS: I'm going to ask the witness
14 not to respond. I do believe that counsel is correct,
15 that there was no question pending.

16 Q. If your proposal is accepted and Yellow
17 Pages revenues are no longer imputed, would it be true
18 that U S WEST could use those revenues for any
19 corporate purpose?

20 A. Well, frankly, U S WEST Communications has
21 no access to those revenues.

22 Q. Excuse me. I will restate it. U S WEST
23 Inc.

24 A. They can today. They can -- it's
25 irrespective of the outcome of this. They have the

01572

1 use of those revenues.

2 Q. And so they could use it to assist in the
3 roll out of new services over its cable system in
4 Atlanta or its PCS service or video dial tone?

5 A. Like I said, irrespective of the outcome of
6 this case they can use it, the revenues earned by
7 U S WEST Direct, for whatever purpose is appropriate
8 within -- actually within U S WEST's media group, is my
9 understanding.

10 Q. And that could involve the Atlanta
11 operation?

12 A. It could.

13 Q. U S WEST Direct is a division of the
14 Marketing Resources Group MRG; is that right?

15 A. Yes, that's right.

16 Q. And it shares in the costs of MRG
17 management; is that right?

18 A. Yes.

19 Q. And U S WEST Inc. charges an allocation of
20 its costs for executive management, treasury services,
21 accounting, strategic planning, and other similar
22 costs to MRG in U S WEST Direct just like its other
23 subsidiaries; is that right?

24 A. Yes. I don't have a detail of what all is
25 included in the allocation, but, yes, they do charge a

01573

1 portion of their costs to Marketing Resources Group
2 and a portion of that is allocated to U S WEST Direct.

3 Q. And that's in return for service rendered?

4 A. Yes.

5 Q. On page 10 of your testimony you talk about
6 the billing and collecting, and you indicate that U S
7 WEST does not offer billing and collecting to
8 competing directory publishers; is that right?

9 A. That is correct.

10 Q. You indicate that the same page, line 16
11 through 19, that none of the other publishers in the
12 state have asked for that service; is that right?

13 A. Yes, and I do see another correction that
14 ought to be made on page 17. It should be none of the
15 other 13 other rather than 14. And to my knowledge
16 none of them have requested that U S WEST
17 Communications provide billing and collection services
18 for them.

19 Q. Would you consider that they may have a
20 concern that U S WEST would have access to customer
21 lists and amount of directory advertising that your
22 customers buy?

23 MR. OWENS: I'm going to object. This
24 calls for the witness to speculate on the mental state
25 of these publishers.

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1 JUDGE WALLIS: The question asks the
2 witness to respond if she knows and I will allow the
3 witness to indicate whether she knows or not.

4 A. I do not know why they are not interested
5 in U S WEST Communications providing billing and
6 collection services for them. I am aware that some of
7 them have been queried as to whether they were
8 interested prior to U S WEST Communications
9 establishing the policy that U S WEST Direct was the
10 only one that we would provide these services to, and
11 they simply responded that they were not interested.

12 Q. Well, but you have the policy, don't you,
13 as stated on --

14 A. Yes. The policy was put in place because
15 of lack of interest from other directory publishers,
16 and the modifications that would be required in order
17 to be able to provide this service to multiple
18 publishers, since we received no interest from other
19 directory publishers the policy was put in place that
20 the modifications would not be made, the expense would
21 not be incurred and therefore the policy is that we do
22 not offer this to other publishers.

23 MR. TROTTER: Those are all my questions.
24 Thank you.

25 JUDGE WALLIS: Questions from the

01575

1 commissioners.

2

3

EXAMINATION

4 BY COMMISSIONER HEMSTAD:

5 Q. Good morning.

6 A. Good morning.

7 Q. The white page listings I take it is an
8 asset of U S WEST Communications. Isn't that true?

9 A. The white page listings, I suppose one
10 could look at it as an asset. The white page listings
11 of our customers are something that we have access to
12 and we do make these listings available to all
13 directory publishers and they charge them -- we charge
14 them for the use of the use of the listings.

15 Q. I take it it's not listed on the balance
16 sheet of U S WEST Communications as an asset with a
17 value?

18 A. To my knowledge, no, it is not.

19 Q. Are the white page listings offered at an
20 equivalent price to all Yellow Page providers?

21 A. To all directory publishers, yes. As a
22 matter of fact, in the state of Washington of the 14
23 directory publishers that I talked about those
24 listings are made available to each of those
25 publishers including U S WEST Direct at the same price

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1 and under the same terms and conditions. Now, of the
2 14 publishers 13 of the publishers, including U S WEST
3 Direct, include U S WEST Communications listings in
4 one or more of their directories, and of those 13
5 directory publishers, one of which is U S WEST Direct,
6 the other 12 of those, nine of them actually pay U S
7 WEST Communications for our listings and three of them
8 -- of these publishers obtain the listings in some
9 other manner. That's using the test year time period
10 of which publishers purchase listings from U S WEST
11 Communications.

12 Q. How do those other three obtain the
13 listings?

14 A. Well, I don't specifically know how they
15 obtain them. I do know that some publishers scan
16 listings so they would take a U S WEST Direct
17 directory, for example, and scan the directory into
18 their system and use the listings in that way. I do
19 know that one publisher who publishes in the state of
20 Washington and in a number of other states, I believe,
21 but in the state of Oregon this publisher stated that
22 they received the listings by purchasing a CD ROM that
23 is available through software stores. You pay \$99
24 and receive all of the listings of the residences and
25 businesses in the state basically or you pay \$139 or

01577

1 there's various prices, but all of these listings are
2 readily available.

3 Q. Is the price that U S WEST Communications
4 charges for access to its White Pages, is that public
5 information?

6 A. Yes, it is.

7 Q. What is that price?

8 A. Well, it depends on the product that is
9 purchased. I provided that information in response to
10 staff data request No. 361, and there was an
11 attachment A. There are various products, expanded
12 use subscriber list, expanded use updates, delivery
13 lists, basic subscriber lists. Each of these has a
14 different price, and this is the price that U S WEST
15 direct pays U S WEST Communications and it's the price
16 that other publishers who purchase from U S WEST
17 Communications pay us.

18 Q. And what is the total amount that U S WEST
19 Communications receives from U S WEST Direct for
20 Washington listings per year?

21 A. What I have here -- let me see if I can
22 find what time period I provided this number. For the
23 test period used in this case U S WEST Direct paid U S
24 WEST Communications \$1,153 -- no, \$1,153,483 to
25 account 5230 above the line and \$802,034 to account

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1 7360 below the line for various publishers products.

2 Q. Is it something approximating \$2 million?

3 A. So something approximating \$2 million, yes.

4 Q. Do you have any information as to the costs
5 that are incurred by U S WEST Direct in publishing the
6 Yellow Pages for Washington?

7 A. Total costs I provided the allocation model
8 that I referred to yesterday for -- I think I provided
9 it for 1993 and 1994 but specifically I know I
10 provided it for 1994, and on a Washington basis what I
11 have -- and this is an allocated income statement --

12 MR. OWENS: Excuse me, Ms.

13 Koehler-Christensen, is this a confidential number
14 that you're going to be stating?

15 THE WITNESS: Yes, it is. Thank you.

16 MR. OWENS: Perhaps we could prepare an
17 exhibit and supply it after the noon recess that would
18 give you the answer to your question, Commissioner
19 Hemstad.

20 COMMISSIONER HEMSTAD: That's fine.

21 JUDGE WALLIS: We'll reserve Exhibit No.
22 233 for that document.

23 Q. It's fair to say, I think from the general
24 testimony and the evidence that the Yellow Page
25 activities of U S WEST Direct is a quite profitable

01579

1 operation. Isn't that a fair statement?

2 A. Yes, that's a fair statement.

3 Q. Do you have any estimates of the percentage
4 of the total Yellow Page market in terms of total
5 revenues that are U S WEST Direct's percentage?

6 A. I don't have any estimates of that. Most
7 of the publishers, Yellow Pages publishers, are part of
8 a corporation so that it is not possible to get at
9 their financials specifically that relate to their
10 publishing operations let alone much less the
11 publishing operations in the state of Washington. U S
12 WEST Direct has at times in the past, but it's my
13 understanding that they have not done this recently,
14 attempted to make estimates of that, and the way that
15 they do it is a very manual process, and they simply
16 take their own Yellow Pages advertising and they know
17 what the display advertising is that is paid for
18 because, of course, part of the volume here includes
19 the complimentary Yellow Page listings and they state
20 or they know their own revenues from the Yellow Pages,
21 and then they take the Yellow Pages of competitive
22 directories and they look at the size of the Yellow
23 Pages as it compared to their own Yellow Pages and they
24 go through and they look at the advertising and the
25 prices in the Yellow Pages Publishers Association, and

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1 certainly there are publishers that publish in the
2 state of Washington that are not members of the Yellow
3 Pages Publishers
4 Association. That just happens to be the largest
5 publishers publishing association and one that a
6 majority of the larger publishers belong to, and that
7 association publishes a list of the prices that are
8 charged by each of the publishers that are its
9 members, so U S WEST Direct has at times gone through
10 and made an estimate. They have not done that
11 recently, and so I really can't say what percentage,
12 but I can say comparing in Olympia, for example, that
13 regional telephone directories, Yellow Pages are in
14 thickness slightly thicker than U S WEST Direct's.

15 And I have an example here of south King
16 County where there are three, and U S WEST Direct's is
17 -- they're comparable to regional telephone directory
18 and then there is general telephone also publishes in
19 there and there's Yellow Pages there. In some cities
20 there are five publishers that publish in the same
21 city so it would involve manually going through and
22 making an estimate. There is no place to go and just
23 say well, these are the revenues for each of the
24 publishers in the state of Washington.

25 Q. Well, taking the greater Olympia regional

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1 competing directory that covers a substantially larger
2 area than the Olympia Yellow Pages?

3 A. Well, in looking at it -- they both cover
4 Olympia, Lacey, Tumwater, McKenna, Rainier, Yelm and
5 Tenino and regional telephone directory includes
6 Shelton, includes Port Union, Oakville and Rochester,
7 so that's the differences that they do include that
8 additional area.

9 Q. Are you prepared to make any -- let me give
10 you an example. Do you think that the U S WEST Direct
11 portion of the general -- of the over all Yellow Page
12 market in Washington exceeds 90 percent of total
13 revenues?

14 A. I really could not make an estimate at all.
15 I would suspect that it would not be 90 percent based
16 on the number of other publishers in this state.

17 Q. Has either U S WEST Communications or U S
18 WEST Direct done any studies of to what extent its
19 customers use the Yellow Pages of other Yellow Page
20 providers?

21 A. I don't have any such studies. I know that
22 some studies in the past have been done whether it's
23 been done in the state of Washington I don't know and
24 I don't have the results of those studies.

25 Q. Now, historically, Yellow Page revenues

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1 have always been part of the general revenues of the
2 regional -- well, first of AT&T before it was broken
3 up into smaller parts. Is that an accurate historical
4 statement?

5 A. Yes. Historically directories were
6 published to encourage the use of the telephone
7 network, and telephone companies wanted to make the
8 network usable by their subscribers. They wanted
9 people to have telephone service. Of course when
10 telephone service began it was not something that was
11 in most households, so in order to make it valuable it
12 was necessary to have listings of people who had
13 telephones and what their telephone numbers are, so
14 telephone directories were developed that way. And as
15 a development of history, the way the industry
16 developed White Pages and then White Pages and Yellow
17 Pages together were published by the telephone
18 companies and those revenues and profits were used to
19 support local rates.

20 Now, that was in a historical setting where
21 the telephone service was provided as a regulated
22 monopoly, and really what my testimony addresses here
23 is not dependent on the fact that U S WEST Direct has
24 competition in Yellow Pages, which it certainly does,
25 but the real significance of my testimony is that U S

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1 WEST Communications really is no longer operating in
2 the same environment as it was prior to divestiture
3 when Judge Green as has been quoted made his comments
4 that recognized that Yellow Pages provided a
5 significant subsidy to local telephone rates nor do we
6 operate in the same environment when this Commission
7 made its decision to impute Yellow Page revenues
8 either. Since that time the supreme court in the state
9 has ruled that U S WEST Communications does not have a
10 monopoly franchise and a number of decisions have been
11 made to at least support if not promote the development
12 of competition in local exchange services, and as a
13 result of that continuing to use the revenues of U S
14 WEST Direct to subsidize U S WEST Communications' local
15 rates when that subsidy is not available to the
16 emerging competitors is the reason that continuing the
17 imputation of Yellow Pages is no longer appropriate.

18 Q. Let me give you an analogy. Take a typical
19 local newspaper. I suppose we can say the revenues of
20 that publisher include on the one hand the price that
21 the customer pays, typically 35 or 50 cents for the
22 paper, and the advertising that the publisher includes
23 in the newspaper. Now, assuming that the publisher
24 brings in very substantial revenues from the
25 advertising and with that revenue source the price of

01584

1 the per copy that the customer pays to the paper is
2 less. Isn't that true?

3 A. Yes, that's true.

4 Q. And that if the publisher of the newspaper
5 put revenues received from advertising into a separate
6 subsidiary that the price for the paper would have to
7 go up substantially that a customer would pay?

8 A. Whether they put it in a separate
9 subsidiary, I guess what you're saying is if the price
10 charged for the newspaper was not supported by the
11 advertising then the price would go up charged to the
12 customer, yes.

13 Q. Now, the newspaper industry is a relatively
14 competitive industry, isn't it?

15 A. Yes, I believe so.

16 Q. So how is the U S WEST Communications
17 situation different from that?

18 A. I think the difference is that again, it's
19 probably based on a historical accident, but what we
20 have today is a number of directory publishers that
21 publish in the same area that publish White and Yellow
22 Pages directories. They have access to the same White
23 Pages listings from U S WEST Communications and the
24 advertising from the Yellow Pages sold by U S WEST
25 Direct has been used to support the local rates of U S

01585

1 WEST Communications. The advertising sold by the
2 publishers of competing directory operations have not
3 been used to support the rates of U S WEST
4 Communications or of other telephone companies.

5 Also, I think the difference is that with
6 the development of competition in local service the
7 emerging competitors would be expected, if one were to
8 say, well, they can simply publish their own
9 directories they would be expected to or they would
10 have to start not only a local telephone business,
11 which I believe Dr. Porter testified is not simply a
12 mom and pop operation. It takes a lot of capital to
13 start it, it takes a lot of knowledge. It takes a
14 large investment in order to provide telephone service.

15 Now, if emerging competitors were each
16 expected to produce a directory as well then they would
17 have to have another business which is really not
18 operationally related to the provision of telephone
19 service. They have their own customer lists which is
20 really the only input to publishing directories that
21 relates it to the telephone, provision of telephone
22 service. Otherwise, the equipment that they use, the
23 expertise of their force, all of that has really
24 nothing to do with the provision of telephone service.
25 So, to expect all emerging competitors to provide their

01586

1 own competing directories that would provide an
2 equivalent subsidy is, I don't believe, realistic.

3 Now, they may choose to do this at some
4 point in time and they certainly have the ability to
5 choose to go into that line of business, but I believe
6 in the order where this Commission required U S WEST
7 Communications to take their listings and include them
8 in -- assure that they're included in U S WEST
9 Direct's directory really recognizes the fact that at
10 this point in time it's not reasonable to expect the
11 alternative exchange carriers to publish their own
12 directories and receive revenues and profit from those
13 directories that would subsidize their local exchange
14 service in an equivalent manner.

15 Q. What other activities are included in U S
16 WEST Marketing Resources Group?

17 A. I know that they provide various marketing
18 lists, and frankly, at the moment I know that that is
19 not all that they do, but they basically provide
20 various marketing tools.

21 Q. Well, you list your principal duties as
22 being responsible for the analysis of information in
23 contractual agreements concerning USWC's affiliated
24 relationship with U S WEST Marketing Resources Group
25 Inc., I take it then that your responsibilities are

01587

1 primarily if not exclusively Yellow Pages?

2 A. No. What I meant there was the contractual
3 relationship that U S WEST Communications has with
4 Marketing Resources Group, which is really the goods
5 and service that we provide to Marketing Resources
6 Group or that they provide to us, there is primarily
7 the businesses that the -- other lines of business
8 that Marketing Resources Group participates in has
9 nothing to do with U S WEST Communications so there is
10 no contractual relationship related to those so
11 therefore I don't need to be so familiar with those
12 operations of Marketing Resources Group.

13 COMMISSIONER HEMSTAD: That's all I have
14 for now.

15

16 EXAMINATION

17 BY COMMISSIONER GILLIS:

18 Q. Ms. Christensen, do your responsibilities
19 in U S WEST Inc. include any involvement in preparing
20 promotions to business of Yellow Page advertisements?

21 A. In preparing promotions? None at all.

22 Q. Are you familiar with them to answer a
23 question on it for me?

24 A. Well, ask and I can tell you whether I
25 can answer it.

01588

1 Q. If it doesn't make sense then don't. What
2 I need some help with is a conflict in messages that I
3 get as a customer listening to the promotions and
4 then from your testimony, and let me just explain that
5 and one of the messages I'm probably hearing wrong,
6 but the message I get from the promotions is that as a
7 business person I'm essentially wasting my money
8 buying somebody else's Yellow Pages because -- sound
9 bite this is the one people use or something along
10 those lines. And then -- which I guess suggests that
11 there isn't any real competition in the promotion.
12 But then in your testimony there is a strong
13 suggestion that there is competition. Which message
14 am I hearing wrong?

15 A. Well, I guess what I can say is we have to
16 take into consideration is that the message that you
17 get from U S WEST Direct when they're trying to sell
18 advertising is a promotional message, and so they say
19 that their book is the one that is used. Regional
20 telephone directory says this is the area's most
21 complete White and Yellow Pages. I don't know who is
22 right. Truth in advertising? I can't address that
23 specifically. What I did address was that really the
24 choices that were available to advertisers and to
25 telephone users as far as directories and what I found

01589

1 was that there is choice out there.

2 Q. So it may be just kind of marketing hype is
3 what you're saying?

4 A. That's my interpretation without seeing the
5 numbers, yes.

6 Q. I have a little different question, and I
7 should know this. I apologize but I don't. Now, U S
8 WEST Direct is a subsidiary of U S WEST Inc.; is that
9 correct?

10 A. Well, it's changed over the years so it's
11 not easy to keep track of how it is. U S WEST Direct
12 is an operating division today of U S WEST Marketing
13 Resources Group. U S WEST Marketing Resources Group
14 is a subsidiary of U S WEST Inc. Now, we have a
15 further complication in that now we have two pieces of
16 U S WEST Inc. with separate stock. One is U S WEST
17 Media Group and U S WEST Marketing Resources Group is a
18 part of the U S WEST --

19 Q. I think I will stop you there. What I
20 would like to have, though, if it's not in our
21 materials though, maybe it is, is an organizational
22 chart for U S WEST?

23 A. I believe it's in there. We'll get it for
24 you.

25 Q. Point it out to me. I guess the basic

01590

1 question I was really getting at are the shareholders
2 that own U S WEST Direct different than the
3 shareholders that own U S WEST Communications?

4 A. Today they are.

5 Q. They are different?

6 A. Yes. Today they are different.

7 Q. I need to understand this. If we were to
8 accept your suggestion of removing imputed Yellow Page
9 revenues from U S WEST Communications then that
10 becomes a gain for U S WEST Direct compared to the
11 past; is that right?

12 A. Well, I guess what I was trying to explain
13 is that in my opinion U S WEST Direct isn't affected
14 by this decision nor is the -- nor are the
15 shareholders.

16 Q. Wait a minute. I don't know that much
17 about accounting so I need to just be real simple with
18 it. I know when you remove the imputed revenues from
19 U S WEST Communications then that has to be somewhere
20 within the corporation, within this organizational
21 chart, there's an increase because we're taking
22 revenue away from one -- from U S WEST Communications
23 by removing the imputation so those revenues that were
24 previously imputed to U S WEST Communications are
25 going somewhere, and they have to go to U S WEST

01591

1 Direct, Inc.; is that right?

2 A. No, I don't see it that way. The revenues
3 that have been imputed, especially with today where we
4 have the two sets of stock, the media group and the
5 communications, prior to the split there was just one
6 shareholder so you could say that the revenues that
7 were imputed simply made -- it was all within U S WEST
8 Inc. But today with two separate stock and two
9 separate sets of shareholders in fact the impact of no
10 longer having the imputation simply means that the
11 revenues are available -- that U S WEST Communications
12 can earn more revenues. U S WEST Direct isn't affected
13 at all, and if any stockholder is affected it would
14 simply be the U S WEST Communications stockholder not
15 anything to do with the U S WEST media group.

16 Q. I'm still having trouble with this and I
17 may have to ask our policy advisor to help me if you
18 can't, but maybe this is simplistic but if we're
19 taking revenue away from one hand, which has been
20 imputed in the past, that revenue can just disappear,
21 it has to go somewhere in the balance sheet somewhere
22 in the corporation as a positive because we have a
23 decrease in one account, we have an increase somewhere
24 else. Right?

25 A. Right, but there is no common balance sheet

01592

1 that includes the business of U S WEST Communications
2 in U S WEST Direct, so taking away the imputation or
3 having the imputation affects the income stream of U S
4 WEST Communications group but it doesn't affect the
5 other.

6 Now, before we had the two separate stock
7 really what we had was if U S WEST Communications --
8 let me start and say if U S WEST Direct earned the
9 profits that they earned then the policy was to
10 dividend their profits to U S WEST Inc., which they
11 did, and if U S WEST Communications was allowed to earn
12 fewer revenues because of the imputation that meant
13 their profits were lower so they had less to dividend
14 to U S WEST Inc. and it all went to the same point in
15 the long run once the dividends were declared.

16 Now that we have two separate sets of stock
17 what U S WEST Direct earns and what goes to -- into
18 their final results is not affected by the imputation.
19 What happens today is simply U S WEST Communications if
20 they're allowed to earn more or less it affects the
21 profits within U S WEST Communications group and the
22 amount --

23 Q. I understand how it affects the profits
24 within U S WEST Communications group. I'm not having
25 a problem with that. But I am having, I guess, a

01593

1 problem of understanding why it doesn't positively
2 impact profits in some other segment of the
3 corporation that is under current rules, I guess to
4 use the term in quotes, subsidizing U S WEST
5 Communications because it would no longer -- if we
6 remove the imputation it would no longer be
7 subsidizing U S WEST Communications. That revenue
8 stream is going somewhere.

9 A. The revenue stream is either -- the revenue
10 stream to U S WEST Direct is the same. The revenue
11 stream is either available to U S WEST Communications
12 through revenues received from customers or it's not
13 available to U S WEST Communications.

14 Q. Let me take this, and I apologize because
15 I'm not as conversant in the accounting things as I
16 should be?

17 A. I'm not either.

18 Q. But the nature of it is that regardless of
19 what we do with imputation there will be the same
20 amount of revenues generated by U S WEST Direct?

21 A. Yes.

22 Q. Okay. And under current agreements a
23 portion of those revenues are imputed to U S WEST
24 Communications as in quotes again subsidy to
25 residential ratepayers?

01594

1 A. Yes, but they're imputed -- there is no
2 cash flow. I guess that's the difference. U S WEST
3 Direct doesn't make a payment to U S WEST
4 Communications for the imputation piece.

5 Q. But there is a balance sheet transaction
6 isn't there?

7 A. No, there is no balance sheet transaction.

8 Q. I'm going to have to work on this with our
9 policy advisor. I'm lost on it.

10 A. I'm sorry, I wish I could explain it more
11 clearly.

12 Q. Well, I will sort it out. Thank you.

13 JUDGE WALLIS: Chairman Nelson.

14

15 EXAMINATION

16 BY CHAIRMAN NELSON:

17 Q. Couple of questions. In answer to
18 Commissioner Hemstad, I think, about the three
19 competing publishers who get their listings some other
20 way, I think I heard you say that one of them scans
21 U S WEST Direct's book; is that right?

22 A. No. I said scanning is one way they can
23 obtain it. I didn't say that one did. What I did say
24 was that one of the publishers in at least one of our
25 other states have said that they purchased a CD ROM

01595

1 listing, and I don't know that they did that for the
2 state of Washington. I would only jump to the
3 conclusion that if they purchased this CD ROM that
4 included all of the listings in the United States and
5 they used it in Oregon, they probably used it in
6 Washington as well, but I know that scanning is one
7 way that other directory publishers get their listings
8 without paying for them. I don't know if any of these
9 three use that method.

10 Q. Well, isn't scanning stealing?

11 A. Actually, no, it's not, and I don't have
12 with me today but there have been several court cases
13 that have addressed this issue, and it is not illegal
14 for -- it has been determined that White Pages are not
15 copyrightable.

16 Q. I recall that now, thank you. In your
17 experience, been in this position since '88 I see, have
18 any competing publishers entered the market who have
19 then exited the market? Do you have any evidence of
20 that?

21 A. Yes. Some directory publishers have
22 entered the market, in fact, probably throughout our
23 14-state territory there's been a number of them who
24 have entered the market and exited. What I see is --

25 Q. Can you give me a ballpark number when you

01596

1 say a number of them?

2 A. I can't give you a ballpark number but what
3 I can say is that what I've noticed over the last
4 five, six years is almost a consolidation there, too,
5 where one publisher may publish in Olympia. They sell
6 their operations to a different publisher so there's a
7 lot of changing hands and actually consolidation where
8 there may be fewer competitive publishers today than
9 there were five or six years ago, but the publishers
10 that exist today have published more directories in
11 more areas, so in effect it's kind of through
12 acquisitions and sales I think the current competitive
13 publishers have a stronger hold in the market.

14 Q. One last kind of off-the-wall question. Are
15 you aware of any publisher that does a large type
16 directory that would be marketed toward the elderly?

17 A. Toward the elderly? You mean large print?

18 Q. Yes.

19 A. You know, I have heard from time to time of
20 something like that but I have not seen one, and I am
21 not aware of one in the state of Washington so I am
22 not --

23 CHAIRMAN NELSON: Thank you.

24 JUDGE WALLIS: Commissioner Hemstad.

25

EXAMINATION

1

2 BY COMMISSIONER HEMSTAD:

3 Q. I would like to ask, going back to the type
4 of question I was asking earlier, if U S WEST
5 Communications, say, were spun off totally and were a
6 freestanding company and didn't have this unique
7 relationship with U S WEST Direct or this connected
8 relationship, wouldn't a rational choice of that
9 freestanding company be to itself again publish Yellow
10 Pages as part of this white page listings and capture
11 the profits of that operation for that U S WEST
12 Communications Incorporated?

13 A. You know, that's an excellent question and
14 I have to admit that it's one that I've pondered many
15 times, and it's not something easy to determine what
16 we would or should do under those circumstances. The
17 situation we have today is that U S WEST
18 Communications makes the listings available to any
19 directory publisher who wishes to purchase the
20 listings from us, and those directory publishers have
21 access to our listings and can and do publish
22 directories that include our listings with no
23 obligation to U S WEST Communications whatsoever.
24 Today U S WEST Direct publishes directories. They
25 make the same payments for the listings that the other

01598

1 publishers do but they have an obligation through our
2 contractual relationship to assure that all of our
3 customers are included in directories and receive
4 directories. Now, if we were to start -- I'm sorry.

5 Q. Well, I wanted to try to cut through that,
6 but the freestanding company, that would be U S WEST
7 Communications Inc., would surely be better off,
8 wouldn't it, in terms of itself profitability if it
9 were able to capture at least the current profits that
10 are included in U S WEST Direct?

11 A. Yes. I guess what you're saying is what we
12 would do is come to the assumption that if U S WEST
13 Communications began publishing a directory that it
14 would be a profitable endeavor, and I was asked that
15 question yesterday, and actually, in thinking about my
16 answer, I interpreted the question to mean had U S
17 WEST Communications retained the Yellow Pages
18 operation and continue to publish the directories
19 would I assume that it would continue to be profitable
20 and, yes, under that scenario I would make that
21 assumption.

22 On the other hand, for U S WEST
23 Communications to begin publishing directories today
24 would I assume that U S WEST Communications would be
25 profitable in that endeavor then I guess you have to

01599

1 look at what other assumptions are in the market --
2 excuse me -- are in the scenario. I would assume that
3 U S WEST Direct would probably continue to publish
4 directories as would the other directory publishers in
5 the state of Washington, and with that set of
6 assumptions I would assume that it would take U S WEST
7 Communications a number of years in order to become
8 profitable, and I don't have a specific number of
9 years, but I would think it would be far in excess of
10 five years before U S WEST Communications would have
11 the opportunity of becoming profitable and whether or
12 not they would be able to in that amount of time I
13 really don't know.

14 Q. Is it overall -- attempting to capture the
15 essence of your testimony it would be that in order to
16 be fair to competitors the price that U S WEST
17 Communications customers pay for local service has to
18 rise measurably by excluding the revenues of the
19 Yellow Pages?

20 A. I really think to be fair to everyone,
21 competitors and U S WEST Communications, as
22 competition develops what we need to do is to make
23 sure that prices at least approach cost, and if we
24 have one service subsidizing another service and
25 keeping the price of that service particularly below

01600

1 cost then it doesn't allow for economically efficient
2 competition to develop. Even if prices were not set
3 below cost but one service was making a considerable
4 contribution to indirect costs and overheads that
5 wasn't available to the competitors, again, that
6 doesn't provide for an environment that promotes
7 healthy competition.

8 Q. Well, is it your view that in the short run
9 U S WEST residential ratepayer will be worse off but
10 in the long run he or she will be better off? Is it a
11 price that would have to be paid in the long run in
12 order to be in a better situation?

13 A. I believe that if you equate worse off with
14 paying what it costs to provide the service, yes.

15 Q. No. In a certain sense the customer
16 doesn't -- that doesn't enter the customer's mind.
17 The customer looks at what the price for the service
18 is not what it costs is to the provider, but the price
19 to the customer will rise measurably, but I assume you
20 have to argue that in the long run in terms of better
21 services or differentiated services or the like that
22 residential customer will, will be better off but in
23 the short-term will not be?

24 A. Yes, if you interpret that they will not be
25 better off because they will pay a higher price

01601

1 definitely that is true.

2 COMMISSIONER HEMSTAD: That's all I have.

3 JUDGE WALLIS: Anything further? Let's be
4 off the record for a scheduling discussion.

5 (Recess.)

6 JUDGE WALLIS: Let's be back on record,
7 please, following a morning recess. Redirect.

8 MR. OWENS: Yes, thank you.

9

10 REDIRECT EXAMINATION

11 BY MR. OWENS:

12 Q. Ms. Koehler-Christensen, Commissioner
13 Hemstad asked you a question about whether if
14 hypothetically U S WEST Communications were spun off
15 would it be a rational choice for that company to
16 engage in the publishing of Yellow Page directories to
17 capture profits. Do you have any information on
18 whether or not the fact that it would be U S WEST
19 Communications that would be engaging in that
20 enterprise would give it any kind of marketing
21 advantage over the other entities that are in the
22 marketplace including U S WEST Direct?

23 A. Well, what I do have is a study that was
24 completed in June of 1994 regarding brand awareness,
25 and this was brand awareness of telecommunications

01602

1 services and U S WEST actually faired pretty poorly
2 compared to AT&T, MCI, Sprint as brand or name
3 recognition as far as providing telephone service.
4 Therefore, I would assume that putting U S WEST's name
5 on a directory would not tie it strongly to the
6 telephone company. It would not provide a special
7 advantage in that regard.

8 Q. The chairman asked you about whether you
9 were aware of a specific directory aimed at the
10 elderly customers that employed the use of large type,
11 and you indicated you weren't aware of that but do you
12 have any other information on the issue of how
13 competition affects the type size in the directory
14 publishing industry?

15 A. Yes. I am aware that over the past ten
16 years, let's say, that the type size of directories
17 has increased, and I am also aware in speaking with U
18 S WEST Direct that they have increased the size of
19 their type in direct response to increase type size of
20 competitive directories, so their reason for
21 increasing the type size was in competitive response.

22 Q. Chairman also asked you if you were aware
23 of any competitors in Washington that had both entered
24 and exited the market over the last few years. Are
25 you aware of whether that phenomenon, that is, both

01603

1 entering and exiting the market, is typical of
2 competitive markets generally?

3 A. Yes. I would say that both the entering
4 and exiting of competitors is very typical of a
5 competitive market.

6 Q. Also in response to a question from the
7 chairman you mentioned that of the ways in which
8 competitors can gain use of U S WEST's
9 Communications's listings for their purpose in
10 producing their directories is the existence of
11 commercial CD ROM listing products that you can buy at
12 a software store. If a competitive directory publish
13 that is competitive to U S WEST Direct uses that
14 source of listings, is there any means by which U S
15 WEST Communications receives compensation for the
16 value of the listings of its subscribers?

17 A. No. U S WEST Communications doesn't
18 receive any compensation in respect to the purchase of
19 those C D ROMs.

20 Q. Have you been able during the recess to
21 find any kind of organizational chart to respond to --

22 A. I have not found that. I will hopefully,
23 because I believe it was provided, find it over the
24 lunch hour or we will make sure that one is provided.

25 Q. Commissioner Gillis asked you a number of

01604

1 questions about the effect of imputation on the
2 different subsidiaries and perhaps we could go through
3 a little bit more discussion about that. Are you
4 familiar generally with the elements that go into the
5 regulatory setting of rates?

6 A. Yes, I am.

7 Q. And do you know whether or not, for
8 example, operating expenses of the company are
9 included in that?

10 A. Yes. Operating expenses plus a return
11 which would be a return on rate base together are what
12 are used to come up with the revenue requirement.

13 Q. And then normally do you know whether or
14 not the next step involves the setting of tariff
15 charges which, based on anticipated consumption units,
16 would equal that revenue requirement?

17 A. Yes. The next step is to take the
18 anticipated number of units times the tariff prices
19 and to have that come out to the revenue requirement
20 that is set.

21 Q. Now, when directory revenues are computed
22 to U S WEST Communications how does that affect that
23 process?

24 A. The way that process is affected is simply
25 by lowering the revenue requirement, so in turn the

01605

1 number of units that are anticipated times the price,
2 the price must be lower in order to have it equal the
3 revenue requirement that is set, which is lower than
4 it would be without the imputation.

5 Q. So, for example, hypothetically speaking,
6 of course, if the Commission were for some reason to
7 determine to impute the profits of an unrelated
8 company like Boeing to U S WEST Communications, would
9 that affect the actual profits of the Boeing Company?

10 A. No, it would not. If the Commission
11 decided to impute a portion of Boeing's profits it
12 would have absolutely no impact on Boeing. The impact
13 it would have would simply be of lowering U S WEST
14 Communications's revenue requirement and therefore
15 lowering the price that U S WEST Communications can
16 charge for its services.

17 Q. Commissioner Hemstad asked you about the
18 prices of the listing products that U S WEST
19 Communications makes available on a nondiscriminatory
20 basis to Yellow Page publishers and I think perhaps
21 your answer wasn't quite complete because you
22 described that there are a number of those products
23 but I don't think you gave any examples of the prices.
24 Would you do that at this time, please.

25 A. Yes. A basic subscriber list is 40 cents

01606

1 per listing. Delivery lists are sold initial lists
2 for 15 cents per listing. Expanded use listing, which
3 is basically a subscriber list in a database format,
4 are sold for 21 cents per listing. Now, this is
5 December '94 price list. If it's been changed since
6 then I don't have the update with me. And expanded
7 use updates are 60 cents per listing, for example.

8 MR. TROTTER: Counsel, those are monthly or
9 could you just clarify that, please. Pardon me for
10 interrupting.

11 Q. Would you clarify?

12 A. Yes. This is per listing, and the way this
13 works is that a directory publisher contacts U S WEST
14 Communications and gives a time frame and says I would
15 like your listings as of a particular date and then U
16 S WEST Communications takes the most current
17 subscriber lists as of that date requested by the
18 publisher, provides the listings and charges these
19 rates. Now, that's with the exception of the expanded
20 use updates and in those updates U S WEST
21 Communications has an agreement with the publisher
22 whereby we send them changes to our listings that
23 occur, new subscriber listings, for example, or
24 changed telephone numbers, and it is agreed upon that
25 that will be sent daily or weekly or monthly and then

01607

1 each change is charged. So it's each time they
2 receive a listing that's the price for each listing.

3 Q. Commissioner Hemstad also asked you a
4 question about an analogy to a newspaper publisher and
5 the fact that if the advertising revenue from the
6 newspaper were put into a separate subsidiary then the
7 price of the newspaper would have to increase. Are
8 you aware of whether there are any newspapers sold in
9 Washington or actually distributed in Washington at no
10 charge to the reader?

11 A. Yes. There are in fact I believe fairly
12 recently Seattle Weekly which used to charge for the
13 paper now distributes those -- the paper without
14 charge with, I suppose, the assumption or the hope
15 that the readers will also read the ads that are
16 included in the newspaper.

17 Q. And that generally the motivation for the
18 low price for newspapers that are sold as opposed to
19 being given away, that is, to induce the reading of
20 the printed advertising?

21 A. I would assume so, that in effect the news
22 is included so that from the advertiser's perspective
23 then the hope is and the reason in the advertising is
24 that the consumer will read the ads. In the case of
25 directories U S WEST Direct certainly distributes the

01608

1 directories with the hope that the users will read the
2 ads in the Yellow Pages. U S WEST Communications, on
3 the other hand, doesn't provide telephone service with
4 the hopes that the subscribers will read the
5 advertising, so the analogy isn't exactly equivalent in
6 my opinion.

7 Q. And historically, did AT&T or the Bell
8 system provide the telephone service in order to sell
9 the advertising?

10 A. No, they didn't provide that. They
11 provided the directory in order to encourage and
12 enable the use of telephone service.

13 Q. Counsel for the Commission staff asked you
14 whether or not you could think of an advertising
15 medium in which the consumer would retain and consult
16 that medium for a period as long as a year, and at
17 that point you couldn't remember any. Have you,
18 during the break, found any facts that would cause you
19 to amend that answer?

20 A. Yes. I would say that perhaps catalogs
21 would be an example of something that a user or a
22 consumer would retain in their household, the catalogs
23 such as perhaps a J. C. Penney catalog. I would say
24 Sears although we know that Sears no longer produces
25 their catalogs. However, I have to confess that the

01609

1 Wish Book is so popular in our household that we still
2 have the last Wish Book in order to refer to it.

3 Q. Yesterday counsel for the Commission staff
4 asked you with regard to the opinion of the
5 divestiture court that approved the modification of
6 final judgment of how you could say that that opinion
7 supported your view that directories were at that time
8 considered to be at least a potentially competitive
9 enterprise. Do you have any other reference in that
10 opinion that you rely on for that belief?

11 A. Yes. Really in the same paragraph where
12 the super competitive profits were referred to Judge
13 Green goes on and says -- I will read this -- that
14 "There is no warrant therefore for proceeding on the
15 premise that the advertising prices charged by the
16 operating companies are artificially low as a result of
17 a subsidy.

18 Similarly, there is no possibility of
19 improper discrimination by the operating companies
20 against competing directory manufacturers since access
21 to local exchange network is not required for
22 production of the printed directory."

23 He goes on and discusses competition
24 further that I think I referred to previously but he
25 at least assumed that there was competing directory

01610

1 manufacturers in the market.

2 Q. And actually at the beginning of counsel's
3 examination yesterday for the staff he asked you
4 whether U S WEST Direct is the U S WEST subsidiary
5 which produces White and Yellow Pages directories in
6 the 14-state U S WEST region, and I think you answered
7 yes. My question to you is, does U S WEST Direct
8 publish exclusively within the U S WEST Communications
9 service territory in that 14-state region?

10 A. No. U S WEST Direct publishes directories
11 in.

12 And specifically one directory that I am
13 aware of in the state of Washington that does not
14 include any U S WEST Communications listings. It is
15 totally outside of the -- while it is in our 14-state
16 area and it is in the state of Washington it does not
17 include any service provided by U S WEST
18 Communications.

19 Q. And are the profits of the production of
20 that and sale of the advertising in that directory
21 included in U S WEST Direct's profits?

22 A. Yes, they are.

23 Q. And would they be included in any profits
24 imputed by the Commission to U S WEST Communications's
25 regulated operations for provision of

01611

1 telecommunications service if the proposals of the
2 staff and public counsel are accepted?

3 A. Yes, they would be.

4 Q. And so would there be in that situation, at
5 least for that directory, any possibility that there
6 would be any advantage accruing to U S WEST Direct
7 from being associated with the official local exchange
8 telephone company that provides local service?

9 A. There would be no benefit that I could see
10 since they would be providing any totally competitive
11 directory and would not be the provider of local
12 telephone service in that area.

13 Q. And finally you were asked whether it was
14 your belief that U S WEST Communications should be
15 compensated by U S WEST Direct for the latter's
16 publishing of the Yellow Pages and you said no. Why
17 is that?

18 A. Well, I guess this comes back to what I
19 discussed previously and basically U S WEST Direct
20 compensates U S WEST Communications in the same manner
21 as other publishers compensate U S WEST Communications,
22 and to expect that U S WEST Direct would compensate U S
23 WEST Communications for the obligation to publish and
24 provide directories in all of the areas served by U S
25 WEST Communications and to deliver free of charge

01612

1 without compensation from U S WEST Communications for
2 the costs of manufacturing and delivering the
3 directories to U S WEST Communications customers,
4 that's an obligation that they incur that other
5 publishers don't have, so therefore, I don't see a
6 rationale, actually, for U S WEST Direct paying U S
7 WEST Communications an additional amount of money in
8 order to meet an additional obligation when they don't
9 receive any additional -- how would you say it --
10 privileges that other directory publishers don't have.

11 MR. OWENS: Thank you. That's all that I
12 have on redirect.

13 JUDGE WALLIS: Mr. Smith.

14

15 RE-CROSS-EXAMINATION

16 BY MR. SMITH:

17 Q. You were just asked some questions
18 following up on Commissioner Hemstad's about if U S
19 WEST Communications were spun off as a stand-alone
20 company, and as a stand-alone corporation it would look
21 after the best interests of its shareholders. Isn't
22 that fair to say?

23 A. Yes.

24 Q. Mr. Owens asked you about a or you
25 testified about a June '94 study on brand awareness?

01613

1 A. Yes.

2 Q. And I haven't seen that, but can you tell
3 me what that study was studying?

4 A. It was studying brand awareness of
5 telephone service providers.

6 MR. OWENS: I have a copy if you would like
7 to see it.

8 Q. Let me just follow up and I will decide
9 then. What geographic area was that covering?

10 A. I believe it was covering the U S WEST
11 territory.

12 Q. And that as I understand it was not a study
13 based on brand awareness of Yellow Page publishers?

14 A. No, it was not.

15 Q. You also indicated that you thought of one
16 example of a form of advertisement you would likely
17 keep around a year in addition to the Yellow Pages and
18 that was the catalogs; is that correct?

19 A. Yes.

20 Q. And catalogs are typically issued several
21 times a year; isn't that correct?

22 A. Well, I think some of them are, yes. On
23 the other hand, the Wish Book I gave as an example
24 came out once a year.

25 Q. And catalogs are issued by individual

01614

1 vendors; is that correct?

2 A. Yes.

3 Q. And is it also correct that they contain
4 information regarding sales and product availability
5 that may soon become outdated?

6 A. Yes. They certainly may become outdated.
7 Again, as I said I still refer to the Wish Book that
8 is several years old.

9 MR. SMITH: Your Honor, that's all I have
10 although may I look at that study.

11 MR. OWENS: Certainly.

12 JUDGE WALLIS: Mr. Trotter.

13

14 RE-CROSS-EXAMINATION

15 BY MR. TROTTER:

16 Q. So where in Washington is the coverage of
17 the directory that has no U S WEST listings?

18 A. Snohomish County.

19 Q. And how much of the U S WEST Direct
20 revenues in the test period are attributable to that
21 directory?

22 A. I do not know.

23 MR. TROTTER: Thank you.

24 JUDGE WALLIS: Commissioner Hemstad.

25

01615

1

EXAMINATION

2 BY COMMISSIONER HEMSTAD:

3 Q. If U S WEST Communications had been a stand-
4 alone company at the time that U S WEST Direct was
5 created, I assume to make the transfer of that occur
6 the stand-alone company would have established the
7 market value of the Yellow Pages and demanded a market
8 price for that Yellow Page business as a going
9 business. Isn't that true?

10 A. Are you saying if the Yellow Pages -- if
11 U S WEST Communications had sold the Yellow Pages
12 to --

13 Q. To U S WEST --

14 A. -- an unaffiliated company?

15 Q. Yes.

16 A. Yes. If the sale had been made I would
17 assume that there would be some market value that
18 would be negotiated.

19 Q. Well, some market value. It would have a
20 very substantial market value would it not have had?

21 A. Yes, I believe it would.

22 Q. Because it was a highly profitable
23 operation?

24 A. Yes.

25 Q. Was any contribution made within the rate

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1 base at the time that the transfer was made?

2 A. Well, certainly there was an asset
3 therefore that was approved by this Commission at that
4 time. Additionally, there was a publishing fee that
5 U S WEST Direct paid to U S WEST Communications and the
6 publishing fees between 1984 and 1988 on a Washington
7 basis amounted to just slightly over 140 million
8 dollars and then additionally the imputation that has
9 been embedded in rates was another additional almost
10 \$240 million, so in adding the two together I would
11 come up with a \$379.5 million and that is not including
12 any additional imputation in the sharing calculations
13 and that is by adding that additional \$130 million in
14 -- between 1990 and 1994 I come up with somewhat over a
15 half a billion dollars that U S WEST Communications
16 customers have benefited from U S WEST Direct
17 operation.

18 Q. Pursuing the question, line of questions
19 from Mr. Owens, does a business customer of U S WEST
20 Communications have a choice as to whether it would be
21 listed in the Yellow Pages?

22 A. Yes, they do. You mean if they choose not
23 to be listed, can they not be listed?

24 Q. Yes.

25 A. Definitely.

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1 Q. Do they get a price reduction in price for
2 their business line if they choose not to be listed?

3 A. No. In my opinion the complimentary
4 listing is provided by U S WEST Direct. It is not
5 provided by U S WEST Communications and it is a
6 complimentary listing that is provided not only to U S
7 WEST Communications's business customers but also to
8 other customers of other telephone providers.

9 Additionally, it's an industry standard
10 whereby I could not find any Yellow Page publisher in
11 the state of Washington who charged a business
12 customer for an initial complimentary -- or an initial
13 listing. They were all complimentary.

14 Q. Why should U S WEST Communications care or
15 does it not care whether a business customer is listed
16 in its Yellow Pages?

17 A. U S WEST Communications doesn't consider
18 Yellow Pages part of our business, part of the
19 business of providing telephone service or part of the
20 business of providing a directory. That's White Pages
21 listings. U S WEST Communications makes sure that
22 every customer who wishes to be included -- of course
23 that is not including those customers who request not
24 to have their listings included in the directory -- are
25 included in our White Pages. And many years ago I

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1 believe the White Pages were generally interfiled
2 between residence and business.

3 Today it is far more common for there to be
4 two sections in the White Pages, one section that
5 includes residence listings alphabetically and a second
6 section some people refer to as the gray pages because
7 they commonly have a gray strip, in U S WEST Direct
8 directories anyway and many others, that is an
9 alphabetical listing of business customers, but U S WEST
10 Communications is not involved in the preparation of
11 the Yellow Pages in any way. In fact, the headings
12 that exist in the Yellow Pages customers, business
13 customers, receive from U S WEST Direct and other
14 Yellow Pages publishers have a listing under the
15 heading of their choice.

16 U S WEST Communications is not involved in
17 the selection or the transmission of a customer's
18 choice regarding what Yellow Page heading they appear
19 under. That is all negotiated between the Yellow Page
20 publisher and the business.

21 Q. But the presence essentially of all or
22 substantially all businesses in the Yellow Pages
23 enhances the value of the Yellow Page directory, I
24 assume?

25 A. Yes. I agree it enhances the value to U S

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1 WEST Direct and to other Yellow Page publishers to
2 include those and that's why they do.

3 Q. And should any of that enhanced value
4 ultimately be able to be attributed to the business
5 customer himself?

6 A. I don't know how one would put or should go
7 about doing that. For example, I mean, the
8 advertising, certainly there's no obligation of any
9 business to advertise and pay for any advertising in
10 the Yellow Pages.

11 Q. I wasn't referencing that.

12 COMMISSIONER HEMSTAD: That's all I have.

13 MR. OWENS: One brief follow-up question to
14 Commissioner Hemstad's question.

15

16 REDIRECT EXAMINATION

17 BY MR. OWENS:

18 Q. At the time of the asset transfer that
19 Commissioner Hemstad asked you about immediately
20 following divestiture did the same shareholders own
21 the same assets before the transfer as after the
22 transfer or was there a change in that regard?

23 A. No. It was the same shareholders.

24 MR. OWENS: Thank you. That's all.

25 JUDGE WALLIS: Anything further of the

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1 witness? It appears that there's not. Thank you for
2 your appearance today and yesterday and you're excused
3 at this time. Let's be off the record for a
4 scheduling discussion.

5 (Discussion off the record.)

6 JUDGE WALLIS: Looking at the witness list
7 we do have a lot of ground to cover and a limited time
8 to do it in. Let's be back here at 1:00 and resume
9 with Ms. Barrington.

10 MR. OWENS: I thought we were going to take
11 Mr. Easton out of order because there was expected to
12 be a little for him or is there any cross for him.

13 MR. TROTTER: Easton is done as far as I'm
14 concerned.

15 JUDGE WALLIS: I understood that there was
16 nothing for the witness and the documents.

17 MR. OWENS: So we can just offer the
18 documents.

19 JUDGE WALLIS: Documents have been, my
20 recollection is that they have been received.

21 MR. TROTTER: Only thing outstanding was
22 the controversial parts.

23 MS. PETERSON: I don't think they've been
24 formally offered. We had anticipated putting him on
25 the stand just to say what most of the documents were.

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1 JUDGE WALLIS: Off the record.

2 (Discussion off the record.)

3 JUDGE WALLIS: Let's be back on the record
4 for a moment. It appears that the exhibits for Mr.
5 Easton have been received and have been offered
6 subject to Commission ruling, and it also appears that
7 Exhibit 284 offered by public counsel and received
8 does have confidential information appended to it and
9 that there should be designated 284C and I have done
10 so on the official document.

11 Anything further of an administrative
12 nature? It appears that there is not. Thanks very
13 much. We're in recess until 1:00.

14 (Lunch recess taken at 12:00 p.m.)

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1 AFTERNOON SESSION

2 1:10 p.m.

3 JUDGE WALLIS: Let's be back on the record,
4 please, following our noon recess. We're picking up
5 at this point with U S WEST's witness Margaret A.
6 Barrington. Ms. Barrington is on the stand.
7 Whereupon,

8 MARGARET BARRINGTON,
9 having been first duly sworn, was called as a
10 witness herein and was examined and testified as follows:

11 JUDGE WALLIS: The exhibits for this
12 witness have previously been identified. Mr. Owens.

13 MR. OWENS: Thank you, Your Honor.

14

15 DIRECT EXAMINATION

16 BY MR. OWENS:

17 Q. Good afternoon, would you please state your
18 name and address for the record and spell your last
19 name.

20 A. My name is Margaret Barrington. My
21 business address is 4001 Discovery Drive in Boulder,
22 Colorado, 80303, and my last name is spelled B A R R I
23 N G T O N.

24 Q. Are you the same Margaret A. Barrington who
25 has cause to be prefiled in this case a document

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1 entitled rebuttal testimony of Margaret A. Barrington
2 and associated exhibits MAB-1 through 4?

3 A. Yes, I am.

4 Q. And is what's been marked as Exhibit 235T
5 your prefiled rebuttal testimony in this case?

6 A. Yes.

7 Q. Was it prepared by you or under your
8 direction and supervision?

9 A. It was.

10 Q. Do you have any additions, changes or
11 corrections to make to your testimony at this time?

12 A. I have two corrections to make to the
13 testimony.

14 Q. Please state what they are.

15 A. On page 5, line 6 the number 19 percent
16 needs to be changed to 22 percent. I had misread a
17 number on a fax that I received, and the other
18 correction is on page 17. There's a table at the top
19 of the page and the format got messed up and the
20 translation got -- it should read, revenues
21 \$1,739,241; technology exchanges, 9; and number of
22 cases 85.

23 Q. As corrected if I were to ask you the
24 questions printed in Exhibit 235T would your answers
25 be as set forth therein?

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1 A. They would.

2 Q. And are Exhibits MAB-1 MAB-2 MAB-3 and
3 MAB-4 which have been marked as 236 through 239
4 consecutively the exhibits to which you make reference
5 in your testimony?

6 A. Yes, they are.

7 Q. Were they exhibits prepared by you or under
8 your direction and supervision?

9 A. They were.

10 Q. Are they true and correct to the best of
11 your knowledge and belief?

12 A. They are. Excuse me. I have a correction
13 to make on Exhibit MAB-1.

14 Q. Please state what that is.

15 A. There are several places where the letters
16 are wrong, the numbers of the projects are correct but
17 the letters following the five numbers are wrong.
18 Since this doesn't have line numbers that's going to
19 be difficult but the second section where it says
20 systems and operations centers of excellence, project
21 10878 should be followed by BC rather than TP.
22 Project 10879 should be followed by BC rather than TP.
23 Under corporate R and D, the last section, project 2347
24 should be followed by BC rather than CC. Project 2809
25 should be followed with a CC rather than BC, and 2353

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1 should be a CC rather than BC.

2 MR. TROTTER: Your Honor, can I recommend
3 the company substitute a page? I got all mixed up.

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

6 (Discussion off the record.)

7 JUDGE WALLIS: Let's be back on the record.
8 It's been determined that the company will provide a
9 revision to Exhibit 236 for identification.

10 Q. Other than the revisions that will
11 be submitted, Ms. Barrington, to Exhibit 236, are
12 Exhibits 236 through 239 true and correct to the best
13 of your knowledge?

14 A. Yes, they are.

15 MR. OWENS: We would offer Exhibit 235T
16 and Exhibit 236 subject to substitution of a revised
17 page and 237 through 239.

18 JUDGE WALLIS: Is there objection? Let the
19 record show that there is no objection and the doubt
20 are received.

21 (Admitted Exhibits 235T and 236 - 239.)

22 MR. OWENS: Ms. Barrington is available for
23 cross-examination and examination by the Commission.

24

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01626

1 CROSS-EXAMINATION

2 BY MR. TRAUTMAN:

3 Q. Good afternoon.

4 A. Hello.

5 Q. Could you turn first to page 26 of your
6 rebuttal testimony, and on lines 8 and 9 you state,
7 "some projects benefit multiple USWC market units, for
8 example, home and personal services, small business
9 services and business and government services." Do
10 you see that?

11 A. Yes, I do.

12 Q. Do these market units sell only regulated
13 products or do they sell both regulated and
14 unregulated products?

15 A. These market units sell both regulated and
16 unregulated products.

17 Q. In research and development or R and D
18 projects where funds are allocated entirely to USWC as
19 you state on line 11 of that page, the funds would
20 still have to be reallocated again between USWC
21 regulated and USWC unregulated; is that correct?

22 A. That's correct.

23 Q. And how is this split or percentage split
24 between USWC regulated and USWC unregulated
25 determined?

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1 A. I don't know the details of the split, but
2 it's done by the accounting department at U S WEST
3 Communications, and it's done according to FCC
4 accounting rules and Doug McDonald can provide some
5 additional detail on the U S WEST Communications
6 accounting side.

7 Q. Turning back to page 5 of your rebuttal
8 testimony on lines 14 to 17. Is it correct that you
9 state that USWC and other entities are billed based on
10 the expected benefit?

11 A. That's correct for corporate projects,
12 they're allocated based on expected benefit.

13 Q. Referring back to page 26 beginning on line
14 11 going through line 16, you speak about ISDN and
15 having the Commission's decision with ISDN in mind, is
16 it still true, is it not, that the amounts for
17 research and development for ISDN are in the company's
18 revenue requirement?

19 A. That's my understanding, yes.

20 Q. On that page you refer to ISDN growth and
21 you state that "it is appropriate for USWC to fully
22 fund ISDN growth." Do you see that?

23 A. Yes. I say that it's appropriate for U S
24 WEST Communications to fully fund the project which is
25 named ISDN growth.

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1 Q. Would it be appropriate to split the
2 funding between USWC regulated and USWC unregulated
3 accounts for ISDN growth?

4 A. I don't think it would be because my
5 understanding is that ISDN is regulated in Washington
6 and no part of ISDN is unregulated.

7 Q. When was ISDN technology developed?

8 A. I don't know the exact year. It was before
9 my time, Advanced Technologies. I think it was late
10 1980s.

11 Q. Do you know how long ISDN technology has
12 been discussed in the telephony press even though it
13 may not have been necessarily available?

14 A. I don't know the exact numbers of years. I
15 know I've read about it for many years.

16 Q. It would be fair to say then that ISDN
17 technology has been well known to telephone companies
18 for sometime since the late '80s?

19 A. That would be fair to state, and the
20 technology and language may be available. However,
21 having it implemented and providing customer service
22 may not be a routine matter. In fact, there is still
23 a lot of variety of vendor switches and varieties of
24 consumer equipment, business equipment that you need
25 to worry about the compatibility of those things so

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1 that they can work together within a network, and so
2 the expertise of Advanced Technologies has been brought
3 in to help to pull it all together for a customer.

4 Q. Is it also true that the basic
5 infrastructure changes needed to offer ISDN have also
6 been known for sometime, for example, ISDN switching
7 capable or nonloaded loops?

8 A. It's true that vendors have been making
9 ISDN switches. There is some variable to understand
10 between the characteristics of some of the switches so
11 there is still some technical expertise required in
12 making the services work.

13 Q. So in answer to the question whether the
14 basic infrastructure changes needed to offer ISDN has
15 been known for sometime, was your answer yes?

16 A. I think there's a little bit of a gray area
17 here because when you talk about basic infrastructure,
18 there are articles, books, technical reports on it,
19 but when it comes down to putting the service within
20 U S WEST Communications' network and making it work
21 within the existing infrastructure of U S WEST
22 Communication network that is a relatively new area.

23 Q. Is it true that ISDN service is now
24 available in a number of areas although it is not
25 universally available?

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1 A. It's true.

2 Q. Is the future growth of ISDN highly
3 dependent on CPE, customer premise equipment, and
4 applications?

5 A. I expect those would be two of the factors
6 that its growth would depend on. I'm not sure about
7 highly dependent. I don't have access to the market
8 research.

9 Q. Is CPE unregulated?

10 A. It is.

11 Q. Are applications unregulated?

12 A. As far as I understand it, the ISDN
13 applications that U S WEST Communications sells are
14 the network transport and that is a regulated product,
15 and in fact the reason for doing any research on CPE
16 is so that U S WEST Communications, in this case
17 business and government services market unit, can give
18 their sales people a list of approved products and
19 those sales people when they talk to customers to sell
20 the U S WEST Communications ISDN lines can say these
21 are the types of equipment you can use with it and
22 don't use other types of equipment with it because it
23 won't work with the type of network that U S WEST
24 Communications handles.

25 Q. Would most applications require additional

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1 software or hardware or both?

2 A. In addition to what? I'm not sure I
3 understand your question.

4 Q. In addition to what is in the U S WEST
5 network? For example, desktop video?

6 A. It does require some changes in programming
7 on the network side and that's what the Advanced
8 Technologies technicians do.

9 Q. Is service delivery another critical ISDN
10 component?

11 A. What do you mean by service delivery?

12 Q. Compatibility with the existing network.

13 A. Compatibility I understand is an issue with
14 ISDN.

15 Q. And so if that were also phrased as service
16 delivery you would agree that is --

17 A. Yes.

18 Q. Is that regulated or unregulated?

19 MR. OWENS: Is what?

20 Q. Service delivery.

21 A. If ISDN is regulated the delivery of that
22 service, the way I understand regulation and
23 nonregulation, a particular product would be regulated
24 if it's included in calculations of rate of return,
25 and we're talking about ISDN network connections, we

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1 are talking about regulated and the service delivery
2 of a regulated service I would have to say is
3 regulated.

4 Q. Turning back to page 5 of your rebuttal
5 testimony, and on lines 10 and 11 you state that radio
6 communications are not regulated in Washington. Could
7 you please identify what differences there are between
8 radio communications and wireless services and
9 wireless services are shown in your table at the top
10 of page 2.

11 A. You could use the words synonymously, I
12 suppose. When I use the word radio communications
13 here I'm referring to legislation that has been passed
14 in Washington saying that radio communications
15 services would be deregulated under certain
16 circumstances. When we use the term within U S WEST
17 of wireless communications that's a term that we're
18 using to describe a program of work that has to do
19 with radio services, so it could be related to radio
20 services but may not be the radio service itself. For
21 example, it could be the network infrastructure that's
22 required and the changes that are required in the
23 network infrastructure in order to be able to
24 interconnect to other radio common carriers or
25 wireless service providers personal communication

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1 service providers, but it's not the wireless service
2 itself. It's something that's associated with
3 offering wireless service.

4 Q. What percent of the wireless service
5 charged to USWC is currently unregulated?

6 A. I don't believe any wireless service is
7 offered yet by U S WEST Communications because the FCC
8 is in the process of bidding and allocating spectrum.

9 Q. What percent of the wireless services are
10 PCS or personal communication services?

11 A. There are no services offered today,
12 wireless services offered today. The spectrum hasn't
13 been allocated yet. If you want to know about the
14 research, the research itself, how much of that is
15 personal communication services of it?

16 Q. Yes.

17 A. A large portion is. There is also a
18 portion -- I don't know the exact numbers. A portion
19 of it would have to do with interconnection. The
20 Federal Communications Commission will be having bids
21 for seven PCS licenses in each metropolitan area so
22 there will be seven providers in each metropolitan
23 area and U S WEST Communications would be required to
24 provide the network infrastructure for that.

25 Q. You said a large portion. Can you be any

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1 more specific numerically?

2 A. I think I do have -- in 1994 I have some
3 bill data for Advanced Technologies. We did work
4 for about \$7.8 million in the wireless program. In
5 this case what we're asking to recover for the network
6 interconnection piece is \$125,000 so network
7 infrastructure and network interconnection is -- I
8 think that comes to about 3 percent of the total.
9 Another project, I don't have the exact numbers but
10 there's another project called fixed wireless loop
11 which I expect would be regulated because what fixed
12 wireless loop technology would be is the replacement
13 of a copper pair with two microwave antennas so one of
14 a microwave transmitter, microwave receiver instead of
15 a pair of copper, but it could be the only form of
16 basic exchange that's provided in some areas where
17 it's economical to do so. So that would be another
18 small piece, and then the larger portion of the work
19 is PCS regulated, could be unregulated, and is not
20 included in this rate case.

21 Q. Turning to page 12 of your rebuttal
22 testimony at the top of that page you refer to the
23 voice dial product and you state that the speech
24 recognition terminology --

25 A. Speech recognition technology?

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1 Q. "Speech recognition technology has
2 benefited USWC 100 percent while USWC has provided
3 only 80 percent of the funding"?

4 A. That's right.

5 Q. Does this imply that USWC has under funded
6 the project?

7 A. It does not at this point because in my
8 discussions with the technical staff who we consult on
9 the allocation of these projects the technical
10 knowledge is in a relatively early stage of
11 development. They still intend that it will be used
12 for other, many other, applications because it is
13 still early in development and those other
14 applications could benefit the unregulated companies.
15 For example, this year we're working on a customer
16 service application where customers could call in and
17 rather than having to wait for a service rep or push
18 buttons they could actually be talking to a machine
19 and the computer could understand what they're saying
20 and an unregulated company could use that as well to
21 serve its customers, and so because the technology is
22 early in its development it may be expected to go on
23 and benefit other companies. It's still appropriate to
24 allocate those costs to unregulated companies.

25 Q. Does this product have an application in

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1 the cellular or the PCS markets, the voice dial
2 product?

3 A. It does. The application that is being
4 considered for those markets is on a noise reduction.
5 They've developed some algorithms for a filter that
6 can tell the difference between background noise and
7 person's words and by using that technology in PCS or
8 other network based services you can reduce the amount
9 of equipment that's needed to get good quality voice
10 service, and the costs of this project are allocated
11 partially to unregulated.

12 Q. Are cellular and the PCS markets both
13 nonUSWC entities?

14 A. Cellular is nonU S WEST. It's New
15 Vector's market.

16 Q. And PCS?

17 A. PCS looks like it will be U S WEST
18 Communications market as well as an out of region
19 market.

20 Q. Are either of these markets regulated?

21 A. New Vector's is not regulated. The PCS, the
22 retail end of the PCS market, I understand is
23 unregulated by legislation in Washington. However, the
24 interconnection piece of that market would be I expect
25 to be regulated.

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1 Q. Do you believe that the benefit to the
2 cellular PCS markets for the voice dial product that
3 we've referred to will eventually exceed the 20
4 percent that was not funded?

5 A. Cellular markets are not using the voice
6 dial product at this time, and I don't know if they
7 will.

8 Q. Are you aware --

9 MR. OWENS: Had you finished your answer?

10 THE WITNESS: I had finished.

11 Q. Are you aware that a competitor, AT&T
12 Wireless, is advertising a similar product locally for
13 cellular users?

14 A. I am not aware of it, no.

15 Q. Turning to your Exhibit MAB-3, which is I
16 believe Exhibit 238, on page 1, lines 2 through 16,
17 and there you refer to the C O I N or community of
18 interest network?

19 A. That's right.

20 Q. How many Washington customers have seen
21 this demonstration?

22 A. I don't know. I didn't get a count.

23 Q. Are any Washington customers currently
24 benefiting from COIN?

25 A. I would say that Washington customers are

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1 benefiting from having U S WEST Communications ready to
2 provide the service in Washington. Whether they're
3 actually using some of the products that the service
4 helped to identify such as commercial video service or
5 frame relay service, I do know that Washington
6 customers are using frame relay service and what this
7 community of interest project is trying to do was to
8 work with the market units to determine an architecture
9 for if you've got groups of companies in multiple
10 locations who have some kind of common interest how do
11 you make it so they can communicate with each other
12 rapidly, exchange data, those kind of things. So the
13 types of services that you would sell and the types of
14 services that this project looked into would be frame
15 relay service which is a high speed service and
16 commercial video. Washington booked about a million
17 dollars in 1994 for frame relay service.

18 Q. How many Washington customers are currently
19 using that service?

20 A. I don't have count. I don't know how many.

21 Q. You don't know?

22 A. Million dollars worth in 1994.

23 Q. On the same page of MAB-3, starting at line
24 17 you refer to cell relay services. Is cell relay
25 service currently available in Washington?

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1 A. U S WEST Communications is able to provide
2 this service in Washington. However, until there is a
3 customer that asks to use it it won't be tariffed
4 here, and I understand it is not tariffed here yet.
5 It is up and running in Los Angeles.

6 Q. Is it currently being provided in
7 Washington?

8 A. There are no customers using it in
9 Washington that I know of.

10 Q. Is CPE a critical element in the provision
11 of cell relay service?

12 A. I don't know about critical but certain CPE
13 would be required for using that service.

14 Q. What would be the difference between
15 critical and required?

16 A. I think if you did some market research on
17 what are the most critical factors determining if a
18 customer uses this or not, I don't know that CPE would
19 be on the top of the list.

20 Q. To use your term, is it a required element
21 in the provision of cell relay service?

22 A. Yes. You have to have CPE to use the
23 network.

24 Q. Turning to page 2 of MAB-3, on line 25,
25 what is the phase gate development process?

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1 A. Phase gate is U S WEST Communications' term
2 for its new product development process. It originated
3 from a process called stage gate which was developed
4 out of academia, which tried to get at what are the
5 best ways to go about new product development so you
6 can get a lot of ideas to meet customer needs into kind
7 of like into the chute and then how do you quickly
8 narrow down those ideas so that you get rid of the ones
9 that are not feasible, not good ideas, and then just
10 speed through the ideas that are good and that will
11 really serve customers' needs, can do it at a good
12 cost, provide good value, so on and so forth, and
13 Advanced Technologies participates with U S WEST
14 Communications in that new development process.

15 Q. On page 3 of MAB-3 on line 17 through 19
16 you refer to U S WEST's held order problem and the use
17 of wireless local loops and PCS. Which division of
18 U S WEST will be providing PCS service?

19 A. I'm not sure if it's been determined yet
20 where they will fit yet organizationally but there is
21 a PCS organization within U S WEST Communications.
22 That is not the same organization that would provide
23 fixed wireless loop, however. So PCS is in the next
24 statement after I talk about the paragraph on wireless
25 local loops. PCS is a different topic.

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1 Q. Does U S WEST have PCS licenses?

2 MR. OWENS: U S WEST Communications? U S
3 WEST Inc.? Could you be more specific with your
4 question?

5 Q. Both.

6 A. The Air Touch venture for out of region did
7 get licenses early on because the 30 megahertz
8 licenses were auctioned off first. I don't have a
9 status update on the 10 megahertz. However, U S WEST
10 was planning to bid on 10 megahertz spectrum for the
11 U S WEST Communications territory and I don't know if
12 that's happened yet.

13 Q. My question was broadly worded because I
14 believe you indicated you did not know which division
15 of U S WEST provided PCS service, so again, the
16 question was do you know whether -- do you know
17 whether any division of U S WEST has PCS licenses?

18 A. Yes. I know that the out of region
19 organization U S WEST Air Touch joint venture has
20 licenses for out of region and I don't have the latest
21 update for in region within the 14-state territory.
22 That spectrum was supposed to be launched I think in
23 December and January and I haven't seen results yet.

24 Q. Do you know whether there are any U S WEST
25 PCS licenses in Washington?

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1 A. There will be seven licenses auctioned off.
2 Either will be or have been in December/January. I
3 don't have the update. The FCC will auction seven
4 licenses in each metropolitan area so there will be
5 seven licenses in Seattle. There may be seven licenses
6 in other metropolitan areas and U S WEST will bid for
7 one of those licenses.

8 Q. What is U S WEST C's relationship to PCS
9 Prime Co?

10 A. There is none as far as I know.

11 Q. Has there been?

12 A. U S WEST Communications is on the
13 communications group side of the company and PCS Prime
14 Co is on the media group side of the company.

15 Q. Does any U S WEST division have a
16 relationship to PCS Prime Co?

17 A. I don't know if it has a name but there are
18 U S WEST employees in PCS Prime Co.

19 Q. What does PCS Prime Co?

20 A. Let me see if I have a chart on -- PCS
21 Prime Co is a joint venture between Air Touch, U S
22 WEST, Bell Atlantic and NYNEX, and it's the company
23 that's going to be bidding for PCS spectrum outside of
24 the U S WEST region. Does that explain --

25 Q. Is PCS Prime Co regulated?

01643

1 A. No, it is not.

2 Q. Do you know whether PCS Prime Co recently
3 spent \$1.1 billion for 11 PCS licenses?

4 A. I don't have that fact with me. I would
5 accept it subject to check.

6 Q. On page 2 of your Exhibit MAB-4 on lines 18
7 to 22, you state that "fixed wireless loop project,
8 that that project will benefit customers in
9 mountainous and remote areas." Do you see that?

10 A. Yes.

11 Q. Is it true that U S WEST recently sold most
12 of its exchanges in mountainous and remote areas to
13 PTI?

14 A. I don't know that.

15 Q. On page 4 of MAB-4 on lines 10 to 23 you
16 discuss the customer premises equipment, the CPE
17 consumer lab. Does USWC sell CPE?

18 A. It does not. In this case, this project
19 resulted in Northern Telecom selling some CPE that
20 helps to stimulate U S WEST Communications custom
21 calling features. These features are complex for
22 customers to use. You have to remember star 71 for
23 this star 72 for this and so the use of a screen phone
24 makes it very much easier for customers to use those
25 custom calling services. And so the stimulation in

01644

1 the revenues that U S WEST Communications gets are
2 from the custom calling services.

3 Q. You stated USWC does not sell CPE?

4 A. That's correct.

5 Q. Does any other U S WEST entity sell CPE?

6 A. Yes. The communications services affiliate
7 does.

8 Q. On line 15 of page 4 on MAB-4 you refer to
9 a telephone with a small screen. Which entity will be
10 selling this?

11 A. It's sold by Northern Telecom and all the
12 revenues go to Northern Telecom.

13 Q. Is it sold --

14 A. What U S WEST Communications sells is the
15 home receptionist product which is the controls and
16 the software that make it so that that CPE can access
17 a customer's service profile and know which types of
18 custom calling features and other services that the
19 customer purchases from U S WEST so the screen phone
20 can work with U S WEST Communications services.

21 MR. TRAUTMAN: That's all I have.

22 JUDGE WALLIS: Mr. Trotter.

23

24 CROSS-EXAMINATION

25 BY MR. TROTTER:

01645

1 Q. Turn to page 1 of your testimony. You
2 identify yourself as a regulatory manager. Do you see
3 that?

4 A. That's correct.

5 Q. And at the bottom of the page you refer to
6 your duties relating to regulatory inquiries and
7 requirements. Is that true?

8 A. That's true.

9 Q. Is it fair to say your primary role is to
10 explain and defend U S WEST's payments for R and D
11 services to AT before regulators?

12 A. That's fair to say. It's also to make sure
13 that regulatory processes are understood and put in
14 place at Advanced Technologies.

15 Q. You indicate that you have a bachelor's
16 degree in environmental health science. Could you
17 give us a very brief explanation of what that is?

18 A. It's a bachelor's degree so basically it's
19 an early four year degree. I took a lot of general
20 science classes and math classes, calculus classes,
21 physics, chemistry.

22 Q. What's the field?

23 A. Protecting the environment, air pollution,
24 water pollution, helping solve those problems.

25 Q. You have no degrees in electrical

01646

1 engineering?

2 A. That's true, I don't.

3 Q. Or any physical sciences or do you consider
4 your degree in physical sciences?

5 A. I wouldn't consider my degree in statistics
6 as physical science.

7 Q. Do you conduct any technical research in
8 your job?

9 A. I don't.

10 Q. On the top of page 2 you indicate you're
11 the chair of the allocations team?

12 A. That's correct.

13 Q. And am I correct that the allocations team
14 is primarily composed of individuals with business
15 accounting and regulatory backgrounds?

16 A. Just look through the list of members.

17 Q. 206 we asked a request of that nature?

18 A. That's true. It's regulatory and
19 accounting expertise. We get the technical expertise
20 from talking with the project managers and the program
21 managers at Advanced Technologies. It is also
22 included for allocations.

23 Q. And you do apply a benefit test to
24 determine allocation of AT billings; is that correct?

25 A. That's correct.

01647

1 Q. On page 7, line 10, you make a distinction
2 between projects that produce specific and immediate
3 work product for a particular business unit, and
4 projects that have broader benefits to multiple
5 entities. Is that a fair statement?

6 A. That's right, the first being our direct
7 client funded projects, the second being corporate R
8 and D.

9 Q. Is the corporate R and D what the
10 allocations team is primarily concerned about?

11 A. It's exclusively what the allocations team
12 is concerned with.

13 Q. And on page 8 of your testimony you talk
14 about the allocation process and on line 7 the first
15 step is for the chairperson of the allocation team to
16 get project description and consulting managers, et
17 cetera. Do you see that?

18 A. Yes, I do.

19 Q. Are you the chairperson?

20 A. I am.

21 Q. You indicate on line 10 that your team has
22 experts in part 64 and part 32 accounting?

23 A. Yes.

24 Q. Those rules do not specifically address
25 intellectual property transfers between U S WEST

01648

1 affiliates?

2 A. That's correct, they don't. They do
3 address the services being provided so in this case
4 since Advanced Technologies is providing a service to
5 U S WEST Communications as well as other affiliates it
6 would come under the service provision rules of FCC
7 part 32 and part 64.

8 Q. So do you disagree or agree that the work
9 product from U S WEST Advanced Technologies primarily
10 consists of intellectual property, new software,
11 network and operating systems or simply technical
12 know-how?

13 A. There's a service provided by Advanced
14 Technologies -- could you ask the question again.

15 Q. Let me ask it this way. If U S WEST
16 Advanced Technologies provides new software to a
17 division, does that constitute intellectual property
18 transfer?

19 A. No, it does not constitute an intellectual
20 property transfer because that division that's
21 receiving the software would be the funding party and
22 would fund its development so that division would be
23 an owner of that software. There would be no transfer
24 of intellectual property involved. The funding party
25 would be essentially the beneficial owner of that --

01649

1 have what you call irrevocable rights to use that
2 technology for any legitimate purpose so we don't have
3 the transfer. They own it.

4 Q. In your testimony you describe various
5 meetings involved in your allocation process. Would
6 it be correct that the members of your team do not
7 always agree and sometimes compromise to reach
8 consensus?

9 A. We occasionally have some discussion over
10 how a project should be allocated. It's not a very
11 difficult process. Basically what we're doing is
12 looking at the technology area that the research is
13 being done in. For example, we talked about wireless
14 and PCS today and then we look at which U S WEST
15 entities are in a business that uses that technology
16 and those are the entities to which we would allocate
17 it, so it's very rare that there are questions about
18 it. Usually it's pretty clear which entities need to
19 be allocated.

20 Q. On page 9, line 19, you state that if any
21 billing changes are necessary they're made retroactive
22 to January of that year?

23 A. That's correct, and this is in -- we're
24 talking about the year end review process.

25 Q. Fine. By billing changes does that mean

01650

1 that the allocation that was initially set was changed
2 at some point during the year?

3 A. That's right, and so the billing was changed
4 retroactive to January to match the new allocation
5 that has been determined to be the most appropriate
6 one because we have the most current knowledge.

7 MR. TROTTER: Your Honor, we've had marked
8 for identification our data request 997 which has
9 Exhibit 240.

10 JUDGE WALLIS: Yes, it is.

11 Q. Do you recognize Exhibit 240 as response to
12 our data request asking for complete copies of all
13 documents associated with the projects disallowed by
14 public counsel witness Brosch and associated with your
15 testimony on page 9, line 5 through page 10, line 12?

16 A. Yes.

17 MR. TROTTER: Move the admission of Exhibit
18 240.

19 MR. OWENS: With only the caveat that the
20 description of what's asked for speaks for itself. I
21 think there's a phrase omitted there but that is the
22 "associated consideration of benefits process." We
23 have no objection.

24 MR. TROTTER: That's fine. Also I take it
25 it should be designated confidential.

01651

1 THE WITNESS: I looked through this
2 yesterday and there was one document in there that was
3 stamped confidential but it was stamped 1993 but I
4 would say at this time that knowledge wouldn't need to
5 be protected any longer.

6 MR. OWENS: Then the witness with knowledge
7 and responsibility has indicated that we no longer
8 need to claim confidentiality for this document.

9 JUDGE WALLIS: Very well. The document is
10 received as Exhibit 240.

11 (Admitted Exhibit 240.)

12 Q. Is it correct that some of U S WEST
13 affiliates are not telephone companies and and do not
14 use part 32 accounting?

15 A. First part of that question is correct that
16 some affiliates are not telecommunications companies.
17 I don't know about the second part.

18 Q. Do you know whether part 64 accounting for
19 nonregulated activities of FCC regulated telephone
20 companies applies to or does not apply to several
21 entities owned by U S WEST Inc.?

22 A. Would you repeat that question, please.

23 Q. Isn't it true that part 64 accounting
24 prescribed by the FCC does not apply to several
25 entities own by U S WEST Inc.?

01652

1 A. I don't know. I'm not an expert on those
2 rules.

3 Q. Do the experts on your allocation team
4 understand that when R and D costs are charged to U S
5 WEST C they are eligible for ratemaking recovery
6 proceedings such as this?

7 A. Yes. I believe they all understand that.

8 Q. Do they understand how costs may be
9 recovered in nonregulated businesses of U S WEST Inc.?

10 A. Yes. I believe they understand that.

11 Q. You were asked some questions earlier about
12 the speech feasibility and useability work. That was
13 on page 10?

14 A. Page 10 of testimony?

15 Q. Yeah. Beginning on line 5, and you say
16 that --

17 A. I don't see it on page 10, line 5.

18 Q. Well, it says "for instance speech
19 feasibility and useability were"?

20 A. Okay.

21 Q. -- "is allocated to all entities because
22 there are potential benefits." Do you see that?

23 A. Yes.

24 Q. How do you determine which portion of the
25 cost goes through all entities?

01653

1 A. We allocate on a project level so the
2 entire speech feasibility and useability project would
3 be allocated to all entities.

4 Q. How do you determine -- say there's \$100
5 involved, how do you determine that 90 goes to U S
6 WEST C and two dollars goes somewhere else and one
7 dollar goes somewhere else?

8 A. In the case of the speech feasibility and
9 useability we've said this technology is young and
10 early in development. When we talk to the technical
11 managers, the project managers, program managers, they
12 say there are many, many potential applications of
13 this technology, both in offering external products
14 and in providing internal systems, customer systems,
15 employee-based systems, there are many applications and
16 so we expect that the benefits would be proportional
17 to the size of the entities. So this project is
18 allocated to entities based on their relative expenses
19 and our billing person at Advanced Technologies gets
20 factors quarterly from U S WEST Inc. of the total
21 operating expense of each U S WEST entity and that's
22 how the project was allocated.

23 Q. Would you agree that you could not tell us
24 today exactly how that technology will benefit each
25 U S WEST affiliate over the next five years?

01654

1 A. That's correct.

2 Q. And would you agree that because it is
3 extremely difficult to accurately quantify potential
4 benefits from a new technology that is why you used
5 the total entity expense factor?

6 A. We used total entity because it's a
7 reasonable and fair factor that is available. It's
8 consistently available from time to time, consistently
9 defined, so that as yearly and quarterly we get that
10 data it's a reasonable source of data. Reasonable
11 allocator. It's accepted by the FCC accounting rules
12 and it's been audited, found to be reasonable.

13 Q. If you knew how the benefits would be -- if
14 you could quantify the potential benefits for each you
15 would, wouldn't you, and use that formula?

16 A. I don't know if we would. The reason I say
17 that is that if we could it might take a tremendous
18 amount of resources, 100 person years to go do this
19 for each and every project so it may be more
20 reasonable to take a factor like entity expense and
21 use it in lieu of expending unnecessary resources to
22 come up with what would likely be a very similar
23 allocation.

24 Q. On what basis do you assume it would likely
25 have a similar allocation?

01655

1 A. My experience from working with these
2 projects what I've seen in the past several years
3 speech recognition, for example, we've got many more
4 product managers, many more products at Advanced
5 Technology -- excuse me, at U S WEST Communications --
6 than we have at other entities. Speech recognition
7 isn't itself a stand alone product. It's another
8 interface to various other products, and so it makes
9 sense and what we've seen happen is that U S WEST
10 Communications has more potential applications for the
11 technology than do the other entities and so they would
12 have a higher allocation to them.

13 Q. But you don't know whether the extent to
14 which they will actually use those technologies will
15 be consistent with the potential use of those
16 technologies?

17 A. It's true we don't know that. I think
18 we're talking about the precision of the percentages
19 that are assigned and we don't have the precision of
20 rocket science but if you look at the process it's a
21 fair process. It's very reasonable, well documented,
22 the documentation has been provided. It's been
23 audited both by the part 64, part 32 attestation
24 auditors. It's been audited internally. It was
25 audited by Shumacher and Company in the regulatory

01656

1 impact review and it's been found to be reasonable.

2 Q. Didn't the Shumacher audit report indicate
3 that U S WEST AT had not met its burden of proof to
4 regulators and had not developed sufficient
5 documentary evidence of the reasonableness and
6 appropriateness of U S WEST AT R and D?

7 A. I'm not familiar with that. What I
8 referred to is a section of the RIR on page 73 that
9 says, "the policies, procedures and practices followed
10 by the U S WEST AT allocation team reasonably allow
11 U S WEST Communications to monitor how entities are
12 charged by U S WEST AT." And that's the RIR comment on
13 the allocation process.

14 Q. Would you accept subject to your check on
15 page 118 of that regulatory impact review the auditor
16 reported that state regulatory commissions need to
17 closely monitor and review how costs are booked to
18 regulated and deregulated accounts and the impact
19 which those bookings -- apparently have a non sequitur
20 here. Did you read Mr. Brosch's direct testimony in
21 this case?

22 A. I did.

23 Q. And he referred to that RIR report; is that
24 correct?

25 A. I don't recall. It was a long time ago

01657

1 when I read it.

2 Q. On page --

3 A. I'm not sure what that section of the RIR
4 is referring to, but the section that refers to the
5 allocation team is a section that I just quoted.

6 MR. TROTTER: Your Honor, I need to secure
7 a document. Can I have a couple of minutes.

8 JUDGE WALLIS: Yes. Let's take a brief
9 recess.

10 (Recess.)

11 JUDGE WALLIS: Let's be back on the record,
12 please, following a brief break.

13 Q. You refer on page 14, line 8 to audits
14 being performed by Shumacher and Company in the RIR;
15 is that right?

16 A. That is right.

17 Q. You were asked the question were any
18 deficiencies indicated in these reviews?

19 A. Regarding the allocation basis, allocation
20 methodology and accounting procedures.

21 Q. And so your answer to the question on line
22 10 is in that context?

23 A. That's correct.

24 Q. Now, I earlier showed you page 97 from Mr.
25 Brosch's direct testimony in this case which is yet to

01658

1 be marked and there is a quote from the RIR in that
2 testimony; is that right?

3 A. That's correct.

4 Q. And would you accept that it is an accurate
5 quote?

6 A. Subject to check. I have nothing to check
7 it against.

8 Q. And that dealt with there was a deficiency
9 indicated in that text but it was not in the subject
10 areas that your question deals with on line 1 of page
11 14?

12 A. Yes.

13 Q. Now, going back to Exhibit 240, one of the
14 projects which Mr. Brosch recommends for disallowance
15 is 2809 CC; is that right?

16 A. That's correct.

17 Q. And you refer to that project on page 11 of
18 your testimony relating to PCS infrastructure?

19 A. Yes.

20 Q. Could you, referring to Exhibit 240, could
21 you identify what part of this exhibit relates to
22 that --

23 A. There's a memo dated September 22, 1993 and
24 the subject is corporate R and D allocations for the
25 wireless program. That cover memo refers to project

01659

1 2909 CC.

2 Q. And it also relates to other projects, does
3 it not?

4 A. That's correct. This is all of the
5 documentation from our allocation process. Mr. Brosch
6 asked for all documents associated with that part of
7 the testimony.

8 Q. And the next page of that exhibit is a
9 program office project information related
10 specifically to that project; is that correct?

11 A. That's correct. This is the documentation
12 we have on the nature of the work and its benefits.

13 Q. And what is it in that document that tells
14 you that this project is exclusively or -- let me
15 start over. Were the costs of this project allocated
16 80 percent to regulated or what portion?

17 A. In the cover memo it says that the costs
18 would be allocated 90 percent to regulated and that's
19 a change from the original allocation which is
20 exclusively to U S WEST Communications. If you look
21 at the date on this project, September 1993, at that
22 time the only network company at U S WEST was U S WEST
23 Communications and so when a project referred to
24 having a PCS capable network it's talking about U S
25 WEST Communications network.

01660

1 Q. So is it your testimony that this project
2 related only to infrastructure that would allow U S
3 WEST to interface with wireless communications
4 companies?

5 A. Yes. The focus of this project is on
6 network infrastructure and that's necessary -- company
7 is obligated to have the infrastructure in place and
8 unbundled so that we could provide access to other
9 service.

10 Q. A PCS provider needs infrastructure, too,
11 doesn't it?

12 A. Yes, it does.

13 Q. What is it about this program office
14 project information docket that tells you that this is
15 U S WEST regulated infrastructure not a PCS
16 unregulated infrastructure?

17 A. When this project was started there was no
18 unregulated PCS organization at U S WEST. By year end
19 1993 where you have this cover memo that talks about
20 Inc. having an interest -- they had an interest in
21 seeing reports out of the project. Although they were
22 focused on working on U S WEST Communications
23 infrastructure this other entity was interested in
24 seeing some of the results and that was the
25 unregulated out of region entity that was trying to

01661

1 get an understanding of technology for competitive
2 reasons. And that was information that we had from
3 the project manager at the time.

4 Q. On page 16 you talk about the fair -- what
5 you call the compare compensation policy?

6 A. Yes.

7 Q. On line 20 you indicate U S WEST C has
8 received about \$1.7 million in lieu of revenue from
9 nine technology exchanges; is that right?

10 A. Excuse me.

11 MR. TROTTER: I didn't mean to misquote it.

12 Q. Let's start over. The \$1.79 million is
13 what?

14 A. Revenues received by U S WEST
15 Communications for fair compensation.

16 Q. And how much total U S WEST AT funding has
17 U S WEST C provided from 1989 through 1994 in relation
18 to that \$1.7 million?

19 A. I remember answering this in response to a
20 data request. I don't think I have the -- I don't
21 know if I have the number with me, but when you talk
22 about in relation there is really no relation between
23 research that's being done exclusively for U S WEST
24 Communications and custom tailored for U S WEST
25 Communications versus some technology that might

01662

1 exchange hands sometime after the funding and the work
2 is done. There is not a relationship between those
3 two.

4 Q. But you don't have the figure of U S WEST
5 AT funding from '89 through '94?

6 A. I may have it. I don't have that number
7 specifically. I could calculate it.

8 Q. Now, beginning on page 21 of your testimony
9 you say you reviewed the proposed disallowances that
10 staff and public counsel submitted; is that right?

11 A. Yes.

12 Q. And you agree with some of them and
13 disagree with others. Is that a fair statement?

14 A. That's correct.

15 Q. And the company provided the cost to the
16 affiliate for each of the projects at issue; is that
17 right?

18 A. Could you repeat that question.

19 Q. U S WEST in this case provided the cost to
20 the affiliate for each of those projects, did it not?

21 A. U S WEST provided cost data by project,
22 yes.

23 Q. And you are not -- you are not agreeing
24 that these expenditures were imprudent, are you?

25 A. I am not.

01663

1 Q. They're just inappropriate for recovery
2 from rates in this proceeding and you're agreeing to
3 that to a limited extent?

4 A. I'm agreeing to that to a limited extent
5 based on radio communications being unregulated in
6 Washington.

7 Q. And Mr. Brosch identified 11 projects and
8 you have agreed with the ones that he identified as
9 projects 3, 4, 6, 8 and 9; is that right?

10 A. That's correct.

11 Q. And on page 26 you describe certain
12 corporate R and D projects. None of these were part
13 of the public counsel/TRACER adjustment; is that
14 right?

15 A. It appears that that's right. Well, could
16 you repeat that question?

17 Q. None of the projects you discuss on page 26
18 were disallowed by the public counsel/TRACER
19 adjustment?

20 A. Projects I mention on page 26 are the two
21 ISDN. I see one project mentioned there, an ISDN
22 project. That was not recommended for disallowance by
23 the public counsel/TRACER.

24 Q. You talked about the PCS Prime Co group and
25 they are now in the media side of the business; is

01664

1 that right?

2 A. That's correct.

3 Q. Like to give you a quote from an SEC form
4 S4 filed by U S WEST on May 12 of 1995 related to the
5 recapitalization proposal. "The recapitalization
6 proposal retain for the company the advantages of doing
7 business as a single corporation. As part of a single
8 entity each group would be in a position to benefit
9 from synergies with the other including synergies that
10 may result from the eventual convergence of the
11 telecommunications with cable and wireless industry as
12 well as synergies between access providers and
13 information and content suppliers. In addition by
14 remaining a single entity the company will continue to
15 enjoy certain strategic financial and operational
16 benefits that would not be available if the
17 communications group and media group were separate
18 legal entities." Would you accept that that's an
19 accurate quote from page 37 from that registration,
20 subject to your check?

21 A. Subject to check I would accept it. I
22 haven't seen it.

23 Q. Is U S WEST AT one of the synergies that
24 the media group and communications group benefit from?

25 A. I really can't say what -- Mr. McCormack

01665

1 wrote that statement. I can't say what he meant by
2 it.

3 MR. TROTTER: Nothing further. Thank you.
4 Move the admission of Exhibit 240.

5 JUDGE WALLIS: Exhibit 241?

6 MR. OWENS: I don't think the witness was
7 asked any questions about 241.

8 JUDGE WALLIS: I believe Exhibit 240 has
9 been admitted.

10 MR. TROTTER: I'm sorry. I forget about
11 241.

12 Q. Would you turn your attention to Exhibit
13 241?

14 A. Yes.

15 Q. And this was a public counsel data request
16 which asked what the relationship between the fair
17 compensation policy and the accounting part 32 and 64
18 regarding the transfer of intellectual properties
19 between affiliates and is U S WEST's answer shown on
20 this page and supported by the following page?

21 A. Yes, it is.

22 MR. TROTTER: Move the admission of Exhibit
23 241.

24 MR. OWENS: No objection.

25 JUDGE WALLIS: Exhibit 241 is received.

01666

1 (Admitted Exhibit 241.)

2 MR. TROTTER: All I have. Thank you.

3 JUDGE WALLIS: Commissioners, questions.

4 COMMISSIONER HEMSTAD: No, I have none.

5 COMMISSIONER GILLIS: None.

6 JUDGE WALLIS: Redirect.

7 MR. OWENS: Thank you, Your Honor.

8

9 REDIRECT EXAMINATION

10 BY MR. OWENS:

11 Q. Just a few questions. You were asked a
12 question about a project that you discuss at page 5 of
13 your rebuttal testimony for wireless services, and you
14 were asked what -- this was by staff counsel -- what
15 percent of that research was PCS and you said that it
16 was large. And I wondered if you could elaborate on
17 the significance of the term wireless services and the
18 fact that a large percent of the research under that
19 category would be earmarked or related to PCS and the
20 context of whether or not that activity relates to the
21 regulated service provided by U S WEST Communications?

22 A. I will try. I had mentioned that 7.8
23 million was spent at Advanced Technologies on wireless
24 services and a large percentage of that was PCS. A
25 huge portion of that was billed to the unregulated

01667

1 companies. They also pay Advanced Technologies to do
2 research, and to the extent that corporate R and D
3 project is shared amongst entities U S WEST
4 Communications would benefit from some economies of
5 scale by having the research done once and shared both
6 with U S WEST Communications and the unregulated
7 company. For example, on project 2809 that we
8 discussed earlier, the project was initiated because
9 of needs that were expressed by U S WEST
10 Communications to build their network infrastructure,
11 and then later on as the unregulated planning was
12 going on it was found that that information could be
13 shared and so the cost to U S WEST Communications were
14 reduced from sharing that information. So a
15 substantial portion of the costs were billed to
16 unregulated entities, a portion of the corporate R and
17 D costs were shared and the unregulated companies paid
18 for them, and then there were costs that were billed
19 to U S WEST Communications but they were excluded from
20 this rate case because they were an unregulated retail
21 service and that's how we result with asking for
22 \$125,000 of cost recovery out of the total \$7.8
23 million that was spent on research. Did that answer
24 your question?

25 Q. Yes. In doing the work that you've

01668

1 described as infrastructure related to PCS, do you know
2 whether or not U S WEST Technologies is helping
3 U S WEST Communications act as a public utility to
4 meet demand for new services?

5 A. I do know that we're doing the work to
6 support U S WEST Communications, and the key clients
7 for that work are the network organization at U S WEST
8 Communications. Their motivation for having us do
9 that work I'm not clear on.

10 Q. You're aware of the auctions of certain PCS
11 spectrum that's already occurred; is that correct?

12 A. Yes.

13 Q. And do you know whether or not the winners
14 of those auctions will be in a position at some point
15 in time, based on those licenses, to tender traffic
16 from their customers to U S WEST for termination on U
17 S WEST Communications's network?

18 A. I expect it will be absolutely necessary
19 for each of those PCS providers to do so. Otherwise
20 they wouldn't be able to complete calls that are
21 originated from a PCS phone to a land line phone or
22 vice versa. We would be able to terminate calls.

23 Q. And is this something that U S WEST
24 Communications can simply accommodate by turning a
25 switch or is it something that requires the kind of

01669

1 work that U S WEST Technologies is doing in order to
2 accommodate that traffic?

3 A. It does require the work that Advanced
4 Technologies is doing to both accommodate that traffic
5 and to be able to provide the necessary features and
6 functions that this new technology will bring about,
7 so there are changes to switch. There's more
8 intelligence required in the network and it has to be
9 developed and we have to determine where in the
10 network it will go. There will be a new set of
11 standards for how are a traffic is handed off from one
12 person to the another. How the administrative things
13 are handled, how billing information is handed off and
14 those standard all have to be developed. They have to
15 be developed from U S WEST Communications perspective
16 considering what equipment Communications has in
17 place. If they're not, if communications did not
18 participate in the standards bodies and another
19 organization had a very heavy hand in setting
20 standards it could be very expensive for U S WEST
21 Communications to build to those standards which it is
22 obligated to do by the FCC because of open network
23 architecture. We have to be able to connect to the
24 other providers so it's absolutely essential that U S
25 WEST Communications participate in standards work,

01670

1 that it develop the architecture that's necessary and
2 things of those sort.

3 Q. Now, are any of the projects described in
4 Exhibit 240 that are proposed for disallowance by
5 public counsel related to this topic?

6 A. Yes. Project 2345 BC is the wireless
7 standards project and project 2809 CC is the
8 infrastructure project PCS infrastructure.

9 Q. And as far as you understand it, has public
10 counsel proposing a complete disallowance of all
11 monies that U S WEST Communications paid U S WEST
12 Technologies for this work?

13 A. Yes, they are.

14 Q. And would U S WEST Communications be in a
15 position to accommodate the demands of the new PCS
16 providers as they tender this traffic if this work
17 were not done?

18 A. No, they would not.

19 Q. Counsel for the staff asked you about
20 whether CPE was required for cell relay service and
21 you answered yes, CPE is required to use the network.
22 Is this different from any other kind of network
23 service that U S WEST provides?

24 A. No, it isn't. Well, it might be different
25 equipment than you need to connect to it for voice but

01671

1 you need equipment to connect to the network.

2 MR. OWENS: Thank you. That's all I have
3 on redirect.

4 JUDGE WALLIS: Mr. Trautman, Mr. Trotter?
5 Commissioners? It appears that there's nothing
6 further for Ms. Barrington. Ms. Barrington, you are
7 excused from the stand. Let's be off the record for a
8 moment.

9 (Recess.)

10 Whereupon,

11 LAWRENCE MCDONALD,
12 having been first duly sworn, was called as a witness
13 herein and was examined and testified as follows:

14 JUDGE WALLIS: I will note for the record
15 that the direct and rebuttal testimony and exhibits
16 and exhibits presented by public counsel and
17 Commission staff for introduction during this
18 witness's testimony have been premarked, and counsel
19 for staff has just distributed a single page document
20 containing an awful lot of numbers that belongs in
21 Exhibit 269C, and it is to be the page immediately
22 after appendix B, labor cost capitalizations. 269C
23 was distributed and marked this morning.

24 MR. TRAUTMAN: Your Honor, I've just been
25 informed this page should be a replacement page for

01672

1 the page that immediately follows it in 269C. The
2 replacement page in the upper left-hand corner,
3 there's an SVC-20 and the page that was previously
4 in started with SVC-21 so this one should replace
5 it.

6 JUDGE WALLIS: So it is a replacement for
7 the text in appendix B; is that correct?

8 MR. TRAUTMAN: Yes.

9

10 DIRECT EXAMINATION

11 BY MR. OWENS:

12 Q. Good afternoon, will you please state your
13 name and address for the record and spell your last?

14 A. My name is Lawrence McDonald. My address
15 is 1600 Seventh Avenue, Seattle, Washington 98191. My
16 last name is spelled M C D O N A L D.

17 Q. Are you the same Lawrence T. McDonald who
18 has caused to be predistributed direct testimony
19 that's been marked Exhibit 21T and rebuttal testimony
20 that's been marked 245T?

21 A. Yes, it is.

22 Q. Are you further the same person who is
23 sponsoring Exhibits 22 through 29 and 246 through 251
24 and 252?

25 A. Yes, I am.

01673

1 Q. Do you have any additions, changes or
2 corrections to make to the two testimony exhibits, 21T
3 and 245T?

4 A. Yes, I do.

5 Q. Will you please state what they are?

6 A. Yes. In my direct testimony --

7 Q. Other than typographical errors?

8 A. In my direct testimony, turning to page 21,
9 line 24, change 400 to 300, and in my rebuttal
10 testimony, page 27, line 16, change 1994 to 1984, and
11 on page 51, line 26, change 100 percent to 50 percent,
12 and on page 54, line 19, change rate of return to rate
13 base. And then turn to rebuttal testimony page 47,
14 there's a calculation on this page that runs for
15 several lines. In light of Mr. Wallis's suggestion
16 that we submit an errata page the company will do that
17 or a completely new page. The important change is
18 that the company accept staff's bench response to
19 response No. 10 and the amount at issue is \$1,875,981,
20 and I will correct the rest of that page.

21 Q. What was that page?

22 MR. TROTTER: What was that page?

23 THE WITNESS: 47.

24 JUDGE WALLIS: What is the number again?

25 THE WITNESS: The new number at issue is

01674

1 1,875,981.

2 JUDGE WALLIS: Thank you.

3 A. That's all the changes I have.

4 Q. As corrected if I were to ask you the
5 questions printed in Exhibits 21T and 245T would
6 your answers be as set forth therein?

7 A. Yes, they would.

8 Q. And were Exhibits 22 through 29 and 249
9 through 251 and 252 prepared by you or under your
10 direction and supervision?

11 A. Yes, they were.

12 Q. Are those exhibits true and correct to the
13 best of your knowledge?

14 A. Yes, they are.

15 MR. OWENS: Your Honor, U S WEST offers
16 21T, 245T and 22 through 29 and 249 through 252 for
17 admission into evidence.

18 JUDGE WALLIS: Let the record show that
19 there is no objection and the exhibits are received.

20 (Admitted Exhibits 21T, 245T, 22 - 29 and
21 249 - 252.)

22 MR. OWENS: Thank you. Mr. McDonald is
23 available for cross-examination and examination by the
24 Commission.

25

01675

1 CROSS-EXAMINATION

2 BY MR. TRAUTMAN:

3 Q. Good afternoon. Could you turn first to
4 pages 55 and 57 of your direct testimony and here you
5 discuss the 1988 value study and the 1990 updated
6 value study performed by Coopers and Lybrand?

7 A. I see that.

8 MR. OWENS: Excuse me. I neglected to ask
9 one further question if I could interrupt briefly.
10 Mr. McDonald, were you in the hearing room when Mrs.
11 Wright described the allocation process for corporate
12 image advertising coordinated or sponsored by U S WEST
13 Inc.?

14 THE WITNESS: Yes, I was.

15 MR. OWENS: And do you have any correction
16 to the statement she made about the basis on which
17 that is allocated?

18 THE WITNESS: Yes, I do.

19 MR. OWENS: Would you indicate what that
20 is, please.

21 THE WITNESS: The issue was the
22 identification in Exhibit 197 with respect to benefits
23 received and the criterion that identified the
24 beneficiary associated with that. Ms. Wright, I
25 believe, said that image advertising was allocated by

01676

1 U S WEST Inc. on the basis of gross operating expense.
2 I had provided that information to her, and I was one
3 line off on the material I was looking at, and the
4 correct allocation for Inc. image advertising is by
5 external revenue.

6 The other information that I have about
7 this exhibit is that it was a college textbook and not
8 a titled, quote, Cost Accounting, A Managerial
9 Emphasis, sixth edition. The authors being Charles
10 Horngren, H O R N G R E N, and George Foster, and it
11 was not provided by the company as a U S WEST
12 accounting manual process or procedure.

13 MR. OWENS: Thank you. I apologize for the
14 interruption.

15 Q. Are you on pages 55 and 57 of your direct
16 testimony?

17 A. Yes, I am.

18 Q. And again here you discuss both the 1988
19 value study and the 1990 updated value study performed
20 by Coopers and Lybrand?

21 A. That's correct.

22 Q. And referring now to Exhibits 265 and 266,
23 do you recognize 265, although it is not dated on the
24 cover, as the 1988 value study to which you refer?

25 A. The document is the executive summary of

01677

1 that study.

2 Q. And Exhibit 266, cover sheet of which is a
3 response to staff data request 423, do you recognize
4 this as revision to the 1988 value study?

5 A. I do.

6 Q. Now, is it correct that the 1988 study
7 compared loaded labor rates for BRI, Business Resources
8 Inc., to loaded labor rates for potential alternative
9 providers of some BRI services?

10 A. Yes. Loadings were applied to both company
11 -- both the group of companies that were the external
12 providers and the BRI.

13 Q. Is it correct that that 1988 study was
14 later revised to reflect a downward adjustment to the
15 BRI loaded labor rates?

16 A. That's correct.

17 Q. Referring to Exhibit 265 and turning to
18 page 10 and paragraph 3, is it correct that the
19 unloaded labor rates that were used in the study
20 included payroll tax and insurance bonuses and other
21 benefits?

22 A. Yes.

23 Q. And on the same page, is it correct,
24 looking at paragraph 4 and the last sentence, is it
25 correct that the 1988 study stated that the fully

01678

1 loaded labor rates used for BRI were equivalent to the
2 market labor rates provided by the eight companies
3 used as pricing comparisons in the 1988 value study?

4 A. Yes.

5 Q. Turning to page 11 and also if needed for
6 cross reference turning to on Exhibit 266 looking at
7 it will be revision one on table 3. Would you accept
8 that the overheads that were added to the unloaded BRI
9 labor rates totaled approximately \$1.95 million as
10 shown in the revised 1988 study?

11 A. What is your calculation, please.

12 Q. Approximately \$1.95 million. The number is
13 \$1,950,984.

14 A. I don't follow seeing that here.

15 Q. That's on revision 1, table 3 of Exhibit
16 266. These are the revisions to the 1988 study.

17 A. I see that, yes.

18 Q. And turning back to Exhibit 265 on page 11,
19 the top paragraph, the last sentence, is it correct
20 that the overhead items that were mentioned include
21 items such as finance accounting, human resources,
22 buildings, and office equipment?

23 A. Yes, that's what it says.

24 Q. Now, if you could refer now to Exhibit 268.
25 Do you recognize this as the 1990 value study to which

01679

1 you refer on page 57 of your direct testimony?

2 A. Yes, it is. Again, it's the executive
3 summary part of that study.

4 Q. And turning to page 2 of Exhibit 268, is it
5 correct that this 1990 update -- I should back you up.
6 Looking at page 2, it's in the second paragraph, the
7 second to the last sentence, is it correct to state
8 that this update compared the 1990 BRI labor rates to
9 the labor rates for two of the comparison firms from
10 the 1988 study and that it adjusted them for regional
11 labor rate differences and for inflation?

12 A. That's what it says.

13 Q. Is that correct?

14 A. That's correct.

15 Q. Now, referring to Exhibits 267C and 269C,
16 do you recognize these as appendices to the 1988 value
17 study in the case of 267C and the appendix to the
18 1990 U S WEST value study in the case of Exhibit 269C.

19 A. Yes, I do.

20 Q. Now, for the comparison firms in these
21 studies, is it true that the loaded labor rates from
22 the 1988 study were adjusted for regional and
23 inflation changes and used in the 1990 study?

24 A. That's correct.

25 Q. Is it correct that the 1990 update started

01680

1 with unloaded BRI labor costs and then added overheads
2 as whole dollar amounts instead of increasing the
3 labor rates for overheads?

4 A. The 1988 study used a composite labor rate,
5 composite overhead loading. The method completely
6 changed when we went to 1990 to simplify that and so
7 rather than load the 1990 costs with overhead the
8 costs were replicated exactly for all companies, BRI
9 and the alternative providers, equally by the costs
10 associated with BRI so that they were on a comparable
11 basis.

12 Q. The question was, is it correct that the
13 1990 update started with unloaded BRI labor costs and
14 then added as whole dollar amounts -- and then added
15 overheads as whole dollar amounts instead of
16 increasing the labor rates for overheads; is that
17 correct?

18 A. I'm having a little trouble with the first
19 part of that. The 1988 --

20 Q. No. The 1990 update, did that start with
21 unloaded BRI labor costs for the BRI costs and then
22 add overheads as whole dollar amounts instead of
23 increasing the labor rates for overheads?

24 A. The 1990 study started with the 1988 data
25 and then to apply the overheads appropriate for 1990

01681

1 used the BRI 1990 actual cost across the board for
2 those activities that would be continued to be
3 performed by BRI in a new contractor environment.

4 Q. So is your answer yes or no to the
5 question?

6 A. Well, what we have here is two different
7 methodologies and two different studies. We came to a
8 conclusion in 1988 that BRI as about at midpoint. We
9 used a methodology that isolated the overheads into a
10 general factor. That general factor was applied to
11 BRI -- to the alternative providers equally. Of
12 course the overhead was embedded in the 1988 BRI costs
13 to begin with. In 1990 we simply took the '88 costs
14 and brought them forward two years and the rates that
15 were brought forward were unloaded.

16 Q. Is it correct that for BRI the 1990 study
17 used March 1990 actuals and then added overheads?

18 A. It used 1988 actuals and updated that for
19 inflation to 1990.

20 Q. Then going back to the original question
21 again, yes or no, is it correct that the 1990 updates
22 started with unloaded BRI labor costs and then added
23 overheads as whole dollar amounts instead of
24 increasing the labor rates for overheads?

25 A. I'm going to have to see where the 1988

01682

1 rates were unloaded. I don't know if that document is
2 before me.

3 Q. So is your answer that you don't know?

4 A. Until I see that data the answer is I don't
5 know.

6 Q. Is it correct that the labor rates for the
7 comparison firms were loaded with overhead dollar
8 amounts equal to those that were added to BRI's
9 unloaded labor costs?

10 A. BRI's 1988 rates were loaded going forward
11 with overhead and then in 1990 an equal amount of
12 overhead was applied to all of the -- to the three
13 alternative providers studied and that same overhead
14 was applicable to BRI because we used BRI's actual
15 costs.

16 Q. Is it correct that the 1990 study compared
17 unloaded labor costs for BRI with loaded labor costs
18 for the comparison firms and then loaded each of the
19 comparison firm's labor costs for BRI overhead rather
20 than loading each of all of the firms labor costs for
21 BRI overheads?

22 MR. OWENS: Would you read that question
23 back, please.

24 (Record read as requested.)

25 MR. TRAUTMAN: Let me rephrase the

01683

1 question.

2 A. Thank you.

3 Q. Is it correct that the 1990 study compared
4 unloaded labor costs for BRI with loaded labor costs
5 for the comparison firms and then loaded both the BRI
6 and comparison firm's labor costs for BRI overheads?

7 A. The 1988 BRI costs were loaded with 1988
8 cost data for BRI. That data was brought forward to
9 1990 using inflation rates to recognize the change in
10 the cost structure for that two-year period. It's
11 just as simple as that.

12 Q. Has U S WEST performed any value studies
13 since the 1990 update?

14 A. And we're speaking of BRI only here?

15 Q. Yes.

16 A. No, we have not.

17 Q. I would move for admission of Exhibits 265,
18 266, 267C, 268 and 269C.

19 MR. OWENS: No objection.

20 JUDGE WALLIS: Exhibits are received.

21 (Admitted Exhibits 265, 266, 267C, 268 and
22 269C.)

23 Q. In your direct testimony on page 54 you
24 state on lines 8 through 9 that "BRI is able to provide
25 USWC with the highest quality goods at the lowest

01684

1 prices." Do you see that?

2 A. Yes, I do.

3 Q. What comparison studies has the company
4 performed that demonstrate that quality is the highest
5 and prices are the lowest compared to other firms?

6 A. U S WEST BRI engages in competitive bidding
7 for all the materials and supplies that they buy for
8 U S WEST. The evidence is the marketplace with respect
9 to the supplier that BRI chooses, based on the design
10 of the equipment that the network and engineering
11 people tell BRI to buy. It's compatible with the
12 network and the equipment and the computer activity
13 associated with the operation of our company.

14 Q. Has U S WEST done any comparison studies
15 since the 1988 and 1990 value studies?

16 A. With other subsidiaries or with BRI? I've
17 already answered that we have not done any with BRI.

18 Q. When was the last time that U S WEST issued
19 requests for proposals or requested bids for
20 performing services that are now provided by BRI?

21 A. Are you speaking of U S WEST
22 Communications?

23 Q. Yes, U S WEST C.

24 A. Bear in mind, this study was a hypothetical
25 bid. It was not a bid for replacing BRI. It was to

01685

1 obtain data to evaluate that situation, and to meet a
2 regulatory need in another jurisdiction and U S WEST
3 Communications has not gone out for an RFP or an RFQ
4 looking at the BRI services for alternative
5 replacement. However, as I point out, and I believe
6 it's in some data requests that you have as an exhibit
7 here that BRI itself has inspected the marketplace from
8 time to time looking for alternative suppliers of
9 certain services that BRI provides to us, U S WEST
10 Communications.

11 Q. Again, the question was when was the last
12 time that USWC has issued RFPs or requested bids for
13 performing services now provided by BRI?

14 A. I don't know.

15 Q. On pages 50 to 55 of your direct testimony
16 you discuss test year savings resulting from BRI
17 service to USWC; is that correct?

18 A. Page 50 to 55, yes, I do.

19 Q. And turning to the table that's on pages 54
20 to 55 of the testimony, can you tell us which of these
21 items are services that are included in the value
22 studies?

23 A. The first item, "reduced cost per line item
24 shipped," definitely is in the value study. It
25 incorporates most of the warehousing cost that BRI

01686

1 incurs. Costs per dollar procured is included in the
2 value study. It includes both the purchasing and
3 contracting functions performed by BRI.
4 Transportation was another major category in the
5 study. That was category 3 and that was also
6 included. Reduced overheads due to external sales,
7 the overheads were included in the studies. For the
8 service associated with the services included in those
9 first three categories, warehousing, procurement,
10 transportation. Information resource management was
11 not in the study. Inventory savings as stated here,
12 which is the physical inventory that BRI purchases and
13 U S WEST C takes title of, was not in the study but
14 the management inventory expenses was in the study.
15 Copper exchange cable contract is just simply product
16 and not in the study and airline contracts were not in
17 the contract or in the study either.

18 Q. Now, for the first two items in the table
19 on page 54 you present another table on page 49 that
20 shows the decreases in unit costs from 1990 through
21 1994. Do you see that?

22 A. Yes, I do.

23 Q. Did you determine whether any of the
24 alternative vendors to BRI experienced savings of this
25 type between 1990 and 1994?

01687

1 A. No.

2 Q. On page 50 you state that BRI has been
3 using over 600 carriers to transport material and
4 supplies and reduced this number to 400 realizing
5 savings?

6 A. That's correct.

7 Q. And on page 51 you state that the savings
8 realized through inventories -- you mentioned savings
9 that are realized through reductions in inventories in
10 Washington. Do you see that?

11 A. Yes, I do.

12 Q. Is it your testimony that these are actions
13 that only BRI could accomplish and that an alternative
14 firm would not have been capable of making this kind
15 of change?

16 A. If the alternative firm contracted for a
17 price to undertake the function of inventory
18 management the performance requirements in the
19 contract would probably spell out that it would be the
20 expectation of U S WEST C that the contracting company
21 improve the inventory levels and and internal of the
22 inventory as good management practice.

23 Q. Is it your testimony that USWC's management
24 would not possess the expertise to perceive the need
25 for these kind of changes?

01688

1 MR. OWENS: Under what conditions? This
2 question appears to assume some basis of comparison
3 that isn't stated in the question. Is the question
4 assuming that USWC rather than BRI would perform all
5 procurement operations?

6 MR. TRAUTMAN: Yes.

7 A. Please restate it.

8 Q. Is it your testimony that USWC's management
9 would not possess the expertise to perceive the need
10 for a these kinds of changes?

11 A. Would not?

12 Q. Yes.

13 A. I believe they would.

14 Q. Is it your experience that large firms are
15 able to negotiate larger purchase discounts with
16 vendors than smaller firms?

17 A. I have no personal knowledge but I think
18 that's fairly common intelligence that the aggregation
19 of purchasing power results in lower unit prices, and
20 I think that's what BRI accomplishes by aggregating
21 volumes of business in order to gain that advantage.

22 Q. Does USWC receive discounts on services and
23 goods purchased even when BRI is not involved in the
24 negotiating or purchasing process?

25 A. Certainly.

01689

1 Q. On page 60 to 61 of your direct testimony
2 you describe several factors to be considered in
3 determining what firm should provide services to USWC.
4 Do you see that?

5 A. I am at page 60 and is this of my direct
6 testimony?

7 Q. Your direct testimony, 60 and 61.

8 A. What I'm showing on page 60 and 61 are
9 factors to be considered in purchasing services other
10 than price. In other words, my point is price alone
11 is not a correct way to evaluate a buy decision
12 between alternatives.

13 Q. Can you assign an amount of monetary
14 premium to each of the benefits that you list that you
15 believe exist in a contract with BRI versus one with
16 an outside vendor?

17 A. No. It would be very difficult to do, and
18 let me give you an example. You look at labor
19 relations, and this is on the assumption that U S WEST
20 C would replace BRI employees with contract employees
21 externally, and these contract employees would come in
22 to the company's premises and in the 1992 study or
23 1988 study that was approximately 232 people. In the
24 1990 study the hours equated to 775 people. You can
25 imagine the displacement, the morale problems, the

01690

1 potential lack of productivity, the other aspects
2 associated with this change in the labor situation. It
3 probably would also require a considerable discussion
4 and negotiation with the Communication Workers of
5 America union with whom we have a good relationship,
6 and there would be probably an intangible cost, if you
7 will of that, so these are very difficult to evaluate
8 and to quantify but I think they're certainly prevalent
9 and realistic to consider in a buy decision.

10 Q. But your answer is that you have not
11 quantified it?

12 A. No.

13 Q. Does BRI provide services to nonaffiliates?

14 A. Yes.

15 Q. Could you describe these types of services?

16 A. They are the same services that U S WEST C
17 would buy, is relatively small amount. For example,
18 in an unregulated company wished to warehouse material
19 or have a contract with them, BRI would provide that
20 type of a service and they would be charged rates
21 similar to those charged U S WEST Communications.

22 Q. What portion of BRI's revenues are derived
23 from contracts with nonaffiliates?

24 A. I don't find the information right offhand.
25 I do know that the major two services that are

01691

1 provided to nonaffiliates are fleet services
2 management which, in 1994, was \$85,000 revenue and the
3 rest of it had to do with real estate services, that
4 BRI's real estate commercial property management group
5 provides to nonaffiliated companies in the management
6 of real estate properties.

7 Q. Would you accept subject to check that less
8 than 1 percent of BRI's revenues are derived from
9 contracts with nonaffiliates?

10 A. Could you help me identify what I would
11 check offhand that you're looking at?

12 Q. I believe it's the response to staff data
13 request 468, the third page subparagraph C.

14 A. Thank you. Yes, I would.

15 Q. Does BRI provide these services in a
16 professional manner at the lowest possible cost?

17 MR. OWENS: Excuse me, for clarification
18 are you talking about the services to nonaffiliates or
19 just all of its --

20 MR. TRAUTMAN: Service to nonaffiliates.

21 A. I believe they are.

22 Q. And does using BRI have a negative affect
23 on the nonaffiliated customer's labor force and on the
24 morale of their employees?

25 A. I don't know.

01692

1 Q. Does the use of BRI increase its
2 nonaffiliated customer's risk of sensitive information
3 being passed outside the company?

4 A. Potentially.

5 Q. Does using BRI cause unnecessary costs to
6 its nonaffiliated customers because of its
7 inflexibility?

8 A. I didn't hear the first part of that.

9 Q. Does using BRI cause unnecessary costs to
10 its nonaffiliated customers because of its
11 inflexibility?

12 MR. OWENS: Objection, assumes a fact not
13 in evidence namely that BRI is inflexible. The witness
14 hasn't been asked that question.

15 JUDGE WALLIS: The question is permissible.
16 You may answer the question.

17 A. I apologize. I'm going to have to hear
18 that again. It's a fairly complex question to me.

19 Q. Does using BRI cause unnecessary costs to
20 its nonaffiliated customers because of BRI's
21 inflexibility?

22 A. I don't believe so.

23 Q. Does BRI as a contractor to nonaffiliates
24 optimize its own operation without considering the
25 impact on its customers?

01693

1 A. Potentially.

2 Q. Turning to your rebuttal testimony, and
3 specifically pages 7 through 9 you cite three cases in
4 which the Commission held that affiliate charges --
5 affiliated charges should be accounted for as costs
6 plus fair return?

7 A. Reported on the orders that the Commission
8 had in these three cases and the principle that they
9 applied in evaluating affiliated transactions.

10 Q. And you refer specifically on pages 7 and 8
11 to cause No. U-82-45 in the second supplemental order;
12 is that correct?

13 A. Yes.

14 Q. And on the top of -- on the bottom of page
15 7 you state that "the Commission staff therefore uses
16 the cost plus fair return theory to calculate
17 adjustments to transactions with GTE Directories
18 Corporation and GTE Automatic Electric Inc." Correct?

19 A. Correct.

20 Q. On the top of page 8 you state, "the
21 Commission went on to accept staff's proposed
22 adjustments based on the cost plus fair return
23 theory," is that correct?

24 A. That's what it says, yes.

25 Q. Could you refer now to what's been

01694

1 identified as Exhibit 270, and these are the relevant
2 pages from the Commission order, and if you could turn
3 to page 25 of that order at the top, the first
4 complete sentence, would you agree that that sentence
5 states, "while not necessarily endorsing the cost plus
6 fair return theory used by Commission staff in
7 evaluating transactions between GTNW and GTE-AE the
8 Commission has concluded that the prices paid by GTNW
9 to GTE-AE may be unreasonably high."

10 A. That's what it says.

11 MR. TRAUTMAN: Move for admission of
12 Exhibit 270.

13 MR. OWENS: No objection.

14 JUDGE WALLIS: 270 is received.

15 (Admitted Exhibit 270.)

16 Q. Are you aware of any cases in which the
17 Commission has used the lower of costs or market as a
18 criteria in determining the allowable prices for
19 services from affiliates?

20 A. No. Cases I have reviewed the Commission
21 principally and exclusively relied upon cost plus fair
22 return. It's not to say that I have reviewed all
23 orders by the Commission.

24 Q. If you could turn back to Exhibit 271, and
25 this was again the company's response to staff data

01695

1 request 01468, and is it correct that in this request
2 the staff asked the company to provide for each of the
3 cases that you cite on page 7 and 8 of your rebuttal
4 testimony the approach advocated by each party to the
5 case and the relative cost results of those methods?

6 A. That's what the request was for.

7 Q. And turning to pages 7 and 8 of your
8 rebuttal testimony, the cases you cite on those pages
9 are U-82-45 and 48, U-82-41 and U-75-50; is that
10 correct?

11 A. Yes.

12 Q. And is it correct that in your response to
13 the data request the cases for which you included
14 information requested on the data requests were
15 U-75-50, U-81-61 and U-82-41?

16 A. U-82-41 was part of the combined second
17 supplemental order in U-82-45. Excuse me. I'm on the
18 wrong line. Yes, that's correct.

19 Q. So the data request response did not
20 include the information for all of the dockets
21 referred to in your testimony; is that correct?

22 A. No. And the information that was requested
23 is evident in my testimony, other than all parties. I
24 didn't look at intervenors or others. I just simply
25 looked at the order, what the Commission ordered, what

01696

1 the staff and company proposed.

2 Q. Turning to -- staying with Exhibit 271 and
3 turning to attachment C to that exhibit, this document
4 is the job description for USWC's contract manager
5 positions that deal with affiliated contracts; is that
6 correct?

7 A. Yes, it is.

8 Q. And is it correct that the purpose
9 statement at the top of the first page of attachment C
10 states, "to manage the contractual relationship
11 between USWC and its affiliated companies in a way
12 that minimizes risk to USWC, satisfy each party's
13 needs and supports regulatory strategies to maximize
14 recovery of affiliated interest expenses."

15 A. That's what it says.

16 Q. And turning to item 4 on page 3, paragraph
17 1 subsection 2, is it correct that --

18 A. You're going to have to slow down a bit.
19 Where are we now?

20 Q. Page 3 of attachment C, and we're at Roman
21 numeral IV, paragraph 1 subsection 2 and it states,
22 "regulatory requests/interrogatories. Regulatory
23 and/or legal due dates met 100 percent of the time
24 responses will support regulatory strategies as
25 identified by the AI/state manager," is that correct?

01697

1 A. That's correct. And the purpose of that --

2 Q. Is that what is stated?

3 A. That's what is stated.

4 MR. TRAUTMAN: I would move for admission
5 of Exhibit 271.

6 MR. OWENS: No objection.

7 JUDGE WALLIS: 271 is received.

8 (Admitted Exhibit 271.)

9 Q. Turning back to your rebuttal testimony at
10 page 17. I believe you stated earlier that in the
11 1990 value study that USWC used BRI's 1988 cost and
12 then update them?

13 A. That's correct.

14 Q. Now, on lines --

15 A. I'm sorry. We used 1990 BRI actual costs
16 and updated the alternative provider's costs.

17 Q. If you could turn now to your rebuttal
18 testimony at page 60. On lines 13 to 17. Actually on
19 lines 8 through 17 you address the whole firm approach
20 to management; is that correct?

21 A. Yes.

22 Q. And you state here at line 13 that "in
23 addition significant cost savings can be realized in
24 the form of decreased executive and management costs,"
25 is that correct?

01698

1 A. Yes, it is.

2 Q. Have you identified this significant cost
3 savings during the test year?

4 A. During the test year not specifically, but
5 I can identify and support that statement by this
6 approach in other -- at other times that flowed
7 through to the test period.

8 Q. But you have not identified the significant
9 cost savings for the test year?

10 A. For the test year that's correct.

11 Q. If you could turn to what's been identified
12 as Exhibits 272 and 273 and these are the company's
13 response to public counsel data request 214 and 215.
14 Do you recognize these?

15 A. Yes, I do.

16 Q. The response to data request 214 includes
17 descriptions for the duties of U S WEST Inc.'s
18 chairman, president and CEO, chief financial and chief
19 planning officers.

20 MR. OWENS: Are you discussing 272 or 273?

21 MR. TRAUTMAN: 272.

22 MR. OWENS: You asked about U S WEST Inc.
23 and I believe that's U S WEST Communications Inc.

24 MR. TRAUTMAN: I'm sorry, I stand
25 corrected.

01699

1 Q. U S WEST Communications Inc.

2 A. I may be able to help out here. When the
3 company responded to these two data requests from a
4 typographical perspective the names got switched, so
5 if you go to 214 we should correct the request and
6 cross out U S WEST Communications and put in U S WEST
7 Inc., and the converse is true on 215. So the
8 attachments to 214 describe the position descriptions
9 of the U S WEST Inc. officer group in Communications.

10 Q. And 215 describes U S WEST Communications?

11 A. Yes.

12 Q. And according to these descriptions in 214
13 the president and the CEO of U S WEST Inc. is
14 responsible for overall accountability for the
15 strategic leadership of U S WEST, the diversified
16 global company that provides communications,
17 information, marketing and financial service; is that
18 correct?

19 A. I see that.

20 Q. And according to the descriptions for the
21 president and CEO of USWC on 215 --

22 JUDGE WALLIS: Could we use the exhibit --

23 MR. TRAUTMAN: Exhibit 273.

24 Q. The president and CEO of USWC is
25 responsible for overall strategic leadership of the

01700

1 telecommunications subsidiary of U S WEST; is that
2 correct?

3 A. Yes. That's what it says.

4 MR. TRAUTMAN: Move for admission of
5 Exhibits 272 and 273.

6 MR. OWENS: No objection.

7 JUDGE WALLIS: 272 and 273 are received.

8 (Admitted Exhibits 272 and 273.)

9 JUDGE WALLIS: Let me ask counsel if the
10 first pages are the only portions of that document
11 that you wish the Commission to consider of those
12 documents.

13 MR. TRAUTMAN: Yes. We need the title page
14 and the first attachment page.

15 JUDGE WALLIS: So the rest of the pages are
16 not necessary.

17 MR. TRAUTMAN: Not for our purposes.

18 JUDGE WALLIS: May we dispense with those
19 so we don't have them in the record.

20 MR. TRAUTMAN: Yes.

21 MR. OWENS: Well, with all respect I think
22 on redirect we'll be talking about the underlying
23 pages and under the whole document rule we prefer that
24 they stay in.

25 JUDGE WALLIS: Very well.

01701

1 MR. OWENS: Thank you.

2 Q. Turning to page 64, lines 11 to 16 of your
3 rebuttal testimony. You state that with the exception
4 of the golf tournament, the sponsorship fee, the
5 corporate brand advertising and the state support
6 advertising that the list of public relations accounts
7 do not relate to image enhancement; is that correct?

8 A. Yes, it does.

9 Q. Did you remove the expenses of the golf
10 tournament corporate brand advertising and state
11 support advertising?

12 A. No, I did not.

13 Q. Would you agree, subject to check, that Ms.
14 Wright in her previous testimony allocated 15.49
15 percent of the true-up adjustment for U S WEST Inc.'s
16 bill to USWC Washington?

17 A. 15.49 I believe is the correct allocation
18 factor, yes.

19 Q. And would you agree also subject to check
20 that of this amount she then allocated 73.4 percent to
21 Washington intrastate?

22 A. Yes.

23 Q. Referring you now to Exhibit 252 and this
24 was, I believe, a revision to your Exhibit LDM-1. Do
25 you have that?

01702

1 A. Yes, I do.

2 Q. And looking at the figure in the first
3 column or second column under November '93 to October
4 '94 USWC, the figure for U S WEST Inc. of
5 \$120,675,632?

6 A. I see it.

7 Q. Should this figure equal the U S WEST
8 Inc.'s invoice amount that is charged to USWC which is
9 reflected in Exhibit 274? And that is the company
10 response to staff data request 01302.

11 A. I don't believe there will be a match
12 between my exhibit or Exhibit 252 and the responsive
13 data request 302, which is Exhibit 274. And the
14 reason being is the response on 274 or the dollars
15 that are billed from U S WEST Inc. through their cost
16 assignment policy, these are commonly referred to as
17 headquarters costs. Additional costs come in three
18 ways beyond that from U S WEST Inc. The first way is
19 for the MIS or management information systems that
20 is not billed through the centralized billing
21 arrangement because that organization has a separate
22 general ledger and they charge computer services based
23 on usage and is treated like a separate subsidiary.
24 The second piece that is not billed through the
25 headquarters allocation process is the strategic

01703

1 marketing group for the same reason as MIS is not
2 billed. And the third group that's not billed are the
3 lease arrangements where U S WEST Inc. is the master --
4 holds the master lease agreement with an outside party
5 and those charges are passed on to C, so there's not
6 going to be a reconciliation between these two
7 documents.

8 Q. Do you recognize Exhibit 274 as the
9 company's response to staff data request 01-302?

10 A. Yes, I do.

11 MR. TRAUTMAN: Move for admission of
12 Exhibit 274.

13 MR. OWENS: No objection.

14 JUDGE WALLIS: 274 is received.

15 (Admitted Exhibit 274.)

16 Q. If you could now refer to Exhibits 275 and
17 276, and these are the U S WEST responses to public
18 counsel data request 128 and 243. Do these responses
19 include advertising by U S WEST Inc. of which a
20 portion is allocated to U S WEST C Washington
21 intrastate?

22 A. Yes, they do.

23 Q. And do these responses include advertising
24 relating to video conferencing services, voice
25 messaging, cellular services and fax services?

01704

1 A. The package that I'm looking at contains
2 several pages and the advertisements on these pages
3 reflect a desire by U S WEST to talk about the
4 dependability of the telephone company or U S WEST in
5 total, and while there are those services you speak of
6 for example, on the third page or I should say the
7 second page of attachment A I also see things like call
8 waiting services, which is a tariff service.

9 Q. Do they include the services that I --

10 A. Does include that but it includes more than
11 that that you handed me.

12 Q. Are the services to which I referred
13 regulated in Washington state?

14 A. No.

15 Q. Are lobbying expenses incurred by U S WEST
16 Inc.?

17 A. Yes.

18 Q. And referring back to a question that was
19 referred to you by Ms. Wright, if you could turn to
20 Exhibit 186 previously admitted the cover sheet of
21 which was a letter to Chairman Nelson and attached was
22 an order of the FCC.

23 Again, turning to page 1 of the order,
24 section 2, Roman numeral II Arabic numeral 3?

25 A. Slow down.

01705

1 Q. Page 1 of the order, section Roman numeral
2 II, Arabic numeral 3 about two thirds of the way of
3 that paragraph, do you see where it states based on
4 discussions with Commission staff after the initiation
5 of the audits the BOCS have changed their accounting
6 practices for lobbying costs to make them consistent
7 with section 32.7370 subsection A?

8 A. Yes, I see that.

9 Q. Has U S WEST Inc. changed their accounting
10 practices for lobbying costs to make them consistent
11 with this action?

12 A. It's my understanding that they have
13 addressed that, yes.

14 Q. When was this change made?

15 A. I don't know.

16 Q. Can you say whether during the test year
17 that U S WEST Inc. lobbying expenses were allocated in
18 accordance with this FCC order?

19 A. Well, this information came to the company
20 in late 1995, so I don't know if there was other
21 discussions or reaction to the audit which took place
22 for the years 1988 to 1991 or not. I have no
23 knowledge of that.

24 Q. And one additional question Ms. Wright
25 referred to you addressed the market resource group

01706

1 that she addressed at page 97 of her testimony. Will
2 you accept subject to check that the company has not
3 filed a petition with this Commission requesting
4 authorization to implement a change in accounting
5 procedure for the revenues of the marketing resource
6 group?

7 MR. OWENS: May I interject here? I
8 believe that was her testimony on the first day of her
9 testimony but I think second session of her testimony
10 she corrected that by indicating she now understood
11 what the question was directed to and I believe she
12 did answer it.

13 MR. TRAUTMAN: I don't recall whether she
14 did or not.

15 Q. Do you know the answer to the question?

16 A. I'm sorry, I don't.

17 Q. Of the following U S WEST services, CPE,
18 voice messaging and wireless, which of these would you
19 classify as regulated in Washington state?

20 A. CPE is certainly not regulated, retail
21 radio services have been deregulated by the
22 legislature, and what was the third one?

23 Q. Wireless. Voice messaging, I'm sorry.

24 A. My understanding is that is not regulated.

25 Q. On page 30, lines 5 and 6 of your rebuttal

01707

1 testimony, you state that "Bellcore work is not
2 available to any unregulated U S WEST entity." Do you
3 see that?

4 A. Yes.

5 Q. Does that mean that all Bellcore funding is
6 provided through USWC?

7 A. Yes.

8 Q. Did any other U S WEST entities contribute
9 to Bellcore through the fair compensation process
10 during the test year?

11 A. Ms. Barrington would have had that
12 information. I don't have the fair comp information.
13 My understanding is that very little Bellcore
14 technology is transferred to unregulated companies
15 simply because they have no need for it.

16 Q. If you could turn to your Exhibit LDM-10,
17 and is it correct that the allowed percent of Bellcore
18 rate case results in the far right-hand column ranged
19 from 85 percent to 100 percent within the region?

20 A. Yes.

21 Q. And would you agree subject to check that
22 Commission staff's recommendation for allowance is 86
23 percent for Bellcore and 89 percent for both Bellcore
24 and Advanced Technologies?

25 A. Is this presented, if I may ask for

01708

1 clarification for checking purposes, in bench request
2 No. 10?

3 Q. Yes.

4 A. I will accept subject to check.

5 MR. TRAUTMAN: I have no further questions.

6 JUDGE WALLIS: Let's take a 10 minute
7 recess at this time.

8 (Recess.)

9 JUDGE WALLIS: Let's be back on the record,
10 please, following an afternoon recess. Counsel for
11 Commission staff has asked the admission of Exhibits
12 274, 5 and 6 for identification and the company has
13 indicated no objection. Consequently those documents
14 are received in evidence. Mr. Trotter.

15 (Admitted Exhibits 274 - 276.)

16

17 CROSS-EXAMINATION

18 BY MR. TROTTER:

19 Q. Mr. McDonald, do you have your deposition
20 testimony before you, Exhibit 261? Let's do it this
21 way. Would you accept that Exhibit 261 for
22 identification is your deposition?

23 A. I will accept that. I don't have it in
24 front of me.

25 MR. TROTTER: Move for the admission of

01709

1 Exhibit 261.

2 MR. OWENS: Your Honor, we do object to
3 this. I think this presents kind of a nice question
4 of an equal of the Commission as opposed to a court.
5 We certainly can see that under the rules of evidence
6 and rules of discovery a deposition of a party
7 opponent may be used for any purpose. However, there
8 are this Commission's own rules on the use of
9 depositions which provide that a portion or portions
10 of the deposition may be offered at a hearing and we
11 would submit that the wholesale incorporation of the
12 entire deposition doesn't purport with the spirit of
13 that rule.

14 And we would also point out that the
15 potential for this is somewhat troubling where the APA
16 indicates that if the presiding officer hasn't in
17 essence presided at the hearing there needs to be a
18 proposed order, and this kind of process has the
19 potential for transforming this into a situation where
20 there might be material parts of the hearing where the
21 commissioners haven't actually sat and in fact nobody
22 in a presiding capacity has set and the potential is
23 that the requirement of issuing rules to order may
24 exist by virtue of this.

25 Also, on a more substantive note this

01710

1 process really deprives us, the company, of the
2 opportunity to have the commissioners view the demeanor
3 of our witnesses when they're undergoing what amounts
4 to cross-examination, and we think that's an important
5 part of the role of the commissioners as finders of
6 fact in evaluating credibility of witnesses. The APA
7 requires that any finding on a credibility issue be
8 specifically stated and you really would have no basis
9 for making that finding under this kind of a procedure.
10 We don't have any objection if portions are offered for
11 purposes of impeachment or something of that nature,
12 but we do feel that a line ought to be drawn and really
13 exists on the wholesale incorporation of a deposition.

14 JUDGE WALLIS: Mr. Trotter.

15 MR. TROTTER: This treatment is fully
16 consistent with the Commission rule first of all. It
17 will substantially reduce my examination. I would be
18 happy to limit the exhibit to my examination of Mr.
19 McDonald if that would satisfy the company's demands.
20 This was a discovery deposition, and in essence it's a
21 series of data requests that are now in writing, but
22 we participated in this process pursuant to the
23 Commission rules and the deposition was noted pursuant
24 to the Commission rule and is applicable and there was
25 no objection at that time that the rule was in any

01711

1 way deficient or deprived it of some substantive right,
2 so we believe it's fully appropriate.

3 JUDGE WALLIS: Does staff wish to comment?

4 MR. TRAUTMAN: Staff would also believe it
5 is consistent with the Commission rule.

6 JUDGE WALLIS: Mr. Owens, would Mr.
7 Trotter's offer to limit the portions of the
8 deposition offered to his examination satisfy your
9 concerns?

10 MR. OWENS: We'll accept it. Thank you.

11 JUDGE WALLIS: Very well. Would that be
12 acceptable to staff as well?

13 MR. TRAUTMAN: Yes.

14 JUDGE WALLIS: Very well. The document as
15 thus limited will be received.

16 (Admitted Exhibit 261.)

17 MR. TROTTER: Also, Your Honor, we are
18 withdrawing Exhibit 262. The company provided us with
19 a supplement and so 262 is no longer apparently
20 accurate so we will withdraw it from consideration.

21 JUDGE WALLIS: Thank you.

22 (Withdrawn Exhibit 262.)

23 Q. Mr. McDonald, I'd like to start with your
24 cost plus fair return principle testimony on page 7 of
25 your rebuttal Exhibit 245T, and am I correct that it

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1 is not your position that an affiliate can charge the
2 regulated telephone company for any service or product
3 it wants as long as the charge is based upon incurred
4 cost plus return for the affiliate?

5 A. I believe that the and have been advised by
6 counsel that RCW 80.13 -- 16.020 requires the company
7 to demonstrate and prove the cost of that affiliate
8 relationship, and through the cases heard by this
9 Commission for at least a couple of decades of orders
10 that I looked at supported that that was a standard
11 that the Commission applied. I also believe that
12 there are other measures that one can look at, but my
13 position and my point in my testimony is that the RCW
14 controls the process. It controls the standard by
15 which an evaluation of these charges will be made.

16 Q. So whether the particular service or
17 product that's provided by the affiliate, assuming
18 it's not even needed by the regulated company, you can
19 recover it as long as you provide the fact that you
20 paid -- that the charges for services or product were
21 cost plus fair return?

22 A. I think another principle that the
23 Commission has applied is one of prudence, and I
24 believe embodied in that concept is the idea that the
25 telephone company or the telecommunications industry

01713

1 certainly would not be asking for recovery of expenses
2 that are outside the operation and delivery of
3 regulated telephone services, so I think the second
4 principle addresses your concern or your question.

5 Q. And let's assume that there was a proof of
6 cost plus fair return and proof that the particular
7 expenditure was prudent, and that, just to take a
8 hypothetical situation, that U S WEST in this case is
9 proposing to allocate 70 percent of that cost to
10 regulated operations. Do you have that hypothetical
11 in mind?

12 A. Uh-huh.

13 Q. And assume that the Commission decides,
14 again based on the record, that the allocation should
15 be 60 percent. It's not your testimony that the
16 Commission is barred in any way from undertaking such
17 an analysis and making such a decision if the evidence
18 supports it?

19 A. Not at all. I think the Commission has the
20 authority if not the obligation to consider all the
21 facts, and if a fact were presented in an unrefutable
22 manner that a different allocation was appropriate I
23 think they would certainly react to that and so order.
24 I would also think that in terms of the principles
25 applied that the company has a reasonable opportunity

01714

1 to expect a consistent treatment of its affiliated
2 charges in this respect and rely upon the past
3 decisions and orders that the Commission has so
4 ordered.

5 Q. When did you first review the GTE cases and
6 the other cases?

7 A. Prior to -- in this particular case prior to
8 submitting this testimony. In other areas I had
9 reviewed the old PNB cases. I was aware of the cost
10 plus fair return. The company felt that --

11 MR. TROTTER: Your Honor, the question was
12 when did he review these cases which he cited in his
13 testimony and he answered it and now he's way beyond
14 it. I will object to any further response as
15 nonresponsive to the question.

16 JUDGE WALLIS: Sustained.

17 Q. Do you agree with the principle that an
18 affiliate should not engage in transactions with the
19 regulated entity that results in an excessive return
20 to the affiliate?

21 A. I believe the company should follow the FCC
22 accounting requirements in part 32 and 64 which simply
23 say that the unregulated company can set a price at
24 any level it wishes, but the only expense that can be
25 recorded on the company's regulated results of

01715

1 operations are those expenses that are expressed in
2 the unregulated company's fully distributed cost for
3 that service. It does not restrict the unregulated
4 company from setting any price.

5 Q. Do you agree with the principle that an
6 affiliate should not engage in transactions with the
7 regulated entity that results in an excessive return
8 to the affiliate?

9 MR. OWENS: Asked and answered.

10 MR. TROTTER: It was asked, I agree with
11 that part of it. It was not answered.

12 Q. Was your answer yes or was your answer no?

13 A. They can set the price whatever they wish
14 to set the price and that results in an excessive
15 return. That's not prohibited. What is prohibited is
16 for the regulated company to recognize a cost level
17 higher than fully distributed cost.

18 Q. So it's okay for the affiliate to engage in
19 such transactions but it's not okay for the regulated
20 utility to pay at that excessive level?

21 A. I guess you could say okay. It could be a
22 practice.

23 Q. On page 26 of your testimony you start your
24 prudence standard discussion. Could you identify,
25 particularly related to R and D expenses, what actions

01716

1 of management would create a situation of imprudence
2 in your mind?

3 A. First of all, if the company were to propose
4 that expenses that were not -- that were incurred for
5 services, for example, that were not relevant to the
6 provision of the telephone service and the company
7 would be proposing acceptance of that, I don't think
8 that's a prudent management decision. I think the
9 company should review its relationship as we do in our
10 contractual business with unregulated companies to
11 assess those as being necessary for the provision of
12 telephone service, regulated telephone service.

13 Q. Does that complete your answer?

14 A. Yes.

15 Q. And I take it that based on your Exhibit
16 252 you found no Bellcore projects other than \$40,000
17 worth that were not recoverable under the standards
18 that you're applying?

19 A. The \$40,000 in that exhibit is part of an
20 adjustment. It's not the only one. It's the one that
21 I made dated revised 10-3-95 for certain Bellcore
22 projects associated with the redefinition of Bellcore
23 which, simply stated, is preparation for the sale of
24 Bellcore. Prior to that the company has removed the
25 deregulated portion of many if not virtually all

01717

1 projects depending on the magnitude of the dollars of
2 the project itself because it boils down to a
3 percentage in line with part 32 and 64 accounting.

4 Q. But other than those types of adjustments
5 you did not remove any Bellcore project based on
6 prudence or imprudence?

7 A. I did not.

8 Q. And is the same true for U S WEST AT, the
9 \$373,000 shown on the AT line?

10 A. I think the 373 is -- I wouldn't say those
11 were removed because of imprudence. These are the
12 projects that were included in Ms. Barrington's
13 testimony. They are related to PCS. The projects
14 were a combination of infrastructure and
15 retail-related activities. To the extent the company
16 did not separate out the difference between the two to
17 comport with the legislative law or the law house bill
18 2525 that was passed a few years back, the company
19 removed those charges not because they were imprudent
20 but because to comply with the legal situation here in
21 Washington. I believe those expenditures were
22 prudent.

23 Q. You refer to a decision on page 27 of your
24 testimony involving Puget Power. That decision did
25 not deal with R and D costs, did it?

01718

1 A. There may be R and D costs from EPRI, E P R
2 I, embedded in that case. I think it had more to do
3 with the decisions made by Puget Power at that time in
4 investing in power generation.

5 Q. So that the quote relates here to a nuclear
6 power plant or a power plant of some variety and the
7 prudence of that; is that correct?

8 A. Yes.

9 Q. Do you believe that U S WEST has an
10 obligation to demonstrate the appropriateness of U S
11 WEST A T expenditures on a cost benefit basis to its
12 regulators?

13 A. I believe that the prudency notion requires
14 that the regulated company assess benefit. I think
15 that benefit can be qualitative, it can be
16 quantitative. It can be current. It can be future,
17 and this is what A T and Bellcore have done is look at
18 each of these projects and assess that -- those
19 parameters. We've heard earlier today in discussions
20 with Ms. Barrington that it is at times difficult to
21 quantitatively measure the benefit of R and D by the
22 very nature of R and D and therefore a cost benefit
23 analysis in that sense wouldn't be appropriate because
24 it wouldn't be feasible to do.

25 Q. So from your point of view the cost benefit

01719

1 analysis is a part of the prudence thing?

2 A. Qualitative and quantitative, current and
3 future, yes.

4 Q. You were talking about regulatory treatment
5 of R and D. You did not conduct a national survey of
6 R and D treatment by commissions in 50 states, did
7 you?

8 A. No.

9 Q. On page 50 of your rebuttal testimony you
10 refer to a benefit analysis that you have undertaken.
11 Do you see that testimony?

12 A. Yes.

13 Q. And that analysis is summarized in Exhibit
14 250; is that right?

15 A. Yes.

16 Q. Do you consider this analysis -- first of
17 all, was it conducted by you?

18 A. Yes.

19 Q. When did you do that?

20 A. Prior to the -- my activity -- this is a
21 summary of the benefit analysis. So I did the summary
22 work associated with this. When projects are
23 brought --

24 Q. Just let me be precise with my question.
25 You did a benefit analysis and can you give me an

01720

1 indication of when you did it? Give me a month and a
2 year or if that's not possible explain.

3 A. I did the summary prior to -- just prior to
4 or within a month or two prior to submission of this
5 testimony. The information I relied upon to do it was
6 done principally at the time that the project was
7 purchased that the decision was made to buy, so my
8 work was summarizing it. My work also was in
9 evaluating and discussing with managers within the
10 technical departments of U S WEST C what appropriate
11 categories of benefit would express the outcome in the
12 deliverables from those projects, so to say that I did
13 this full analysis myself in a very short period of
14 time is disingenuous with respect to what really took
15 place.

16 Q. Do you consider this analysis to be an
17 independent study like the value studies that you
18 contracted for and have described in your direct
19 testimony?

20 A. I describe this as a prudent ongoing
21 business operation to evaluate U S WEST C's
22 participation in Bellcore R and D projects.

23 Q. And your analysis revealed no Bellcore
24 projects were not properly charged to ratepayers?

25 A. Other than my adjustments for the purposes

01721

1 of the revenue requirement in this state, the answer
2 is no.

3 Q. Bottom of page 74 of your rebuttal you
4 indicate that Mr. Brosch -- at the bottom of the page,
5 "Mr. Brosch, the public counsel witness, refers to U S
6 WEST Inc. as simply a passive equity investor." Do
7 you see that?

8 A. Yes, I do.

9 Q. Isn't it correct on page 37 of Mr. Brosch's
10 direct testimony, line 15, he said, "The duality of
11 purpose comes into play where U S WEST Inc. acts as
12 more than a passive equity investor in U S WEST
13 Communications." Do you recall that testimony?

14 A. I don't specifically.

15 Q. And what specific page and line of Mr.
16 Brosch's testimony are you relying on for the
17 proposition that he refers to USWI as simply a passive
18 equity investor?

19 A. I would have to look at his testimony.

20 Q. You don't have that in your notes?

21 A. No, I don't.

22 Q. MR. TROTTER: Those are all my questions.

23 Thank you.

24 JUDGE WALLIS: Commissioners.

25 CHAIRMAN NELSON: No.

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1 COMMISSIONER HEMSTAD: None.

2 COMMISSIONER GILLIS: No.

3 JUDGE WALLIS: Redirect.

4 MR. OWENS: Thank you, Your Honor.

5

6 REDIRECT EXAMINATION

7 BY MR. OWENS:

8 Q. Mr. McDonald, you were asked some questions
9 by counsel for the staff about the savings that you
10 describe I believe at page 50 to 55.

11 MR. OWENS: May I have a moment?

12 JUDGE WALLIS: Yes.

13 MR. OWENS: Thanks for your indulgence.

14 Q. I was referring to page 60 of the direct
15 testimony which would be Exhibit 21T. Counsel for the
16 staff asked you whether you could assign a monetary
17 value or premium to these factors, and I believe you
18 indicated you couldn't because, for example, it would
19 be difficult to put a value on the issue of having to
20 replace BRI employees with the employees of a
21 contractor. Do you recall that discussion generally?

22 A. Yes, I do.

23 Q. And I believe you indicated that part of
24 that would involve possible discussions with the
25 Communications Workers of America. Do you recall

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1 saying that?

2 A. I do.

3 Q. Do you have any knowledge as to whether
4 either or both of the companies that the staff is
5 proposing to be used as the benchmarks for cost for
6 U S WEST procurement activities are nonunion
7 companies?

8 A. Yes, I do. In the management of that
9 project that I was personally involved in that the Day
10 Zimmerman company is a nonunion firm with labor rates
11 less than union company, represented companies and my
12 opinion of that when I became aware of that that that
13 would have an adverse affect on our relationship with
14 the CWA.

15 Q. And that would manifest itself in these
16 discussions that you had mentioned that you would have
17 in the event that U S WEST chose to replace union
18 workers at BRI with nonunion contractor workers; is
19 that correct?

20 A. Yes, and the disruption that that would
21 cause with potentially at least impact negatively
22 productivity, for example.

23 Q. Would that have an effect on employee
24 morale in your view?

25 A. Certainly it does.

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1 Q. You were asked some questions that BRI does
2 with nonaffiliated companies and there was a series of
3 questions whether the use by the nonaffiliated
4 customers of BRI for the functions it provides for
5 those customers in your view adversely affects the
6 customer's labor force and the morale of their
7 workers. Do you recall that?

8 A. Yes.

9 Q. If the customers are union companies would
10 there be any reason to think there would be a harmful
11 effect of using BRI?

12 A. As represented by labor certainly not but
13 if otherwise that's certainly a potential.

14 Q. You were also asked whether the use by
15 these customers, nonaffiliated customers of BRI,
16 causes them unnecessary costs because of alleged
17 inflexibility of BRI. In your view is BRI inflexible
18 or flexible?

19 A. BRI is very flexible in the provision of
20 its services, and provides services on demand for U S
21 WEST C to meet emergencies due to weather or other
22 catastrophes or activities that would be hard to
23 replicate in a contractual environment, not that it
24 wouldn't be but it would be difficult.

25 Q. Is there any difference between BRI's

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1 quality in this regard, that is, the flexibility, and
2 any of the comparison companies that the staff wants
3 to use in its adjustment?

4 A. Yes. In its report Coopers and Lybrand
5 recognized that the higher cost companies were much
6 more flexible in the provision of services, and what I
7 mean by flexible is that you can write a contract to
8 describe a performance requirement, and then a
9 contingency exists. For example, you run out of
10 supply of a crew in Eastern Washington and you don't
11 want to have a crew standing around with nothing to
12 do. If it's not in the contract to do a contingency
13 fallback position is required which BRI performs
14 without going through negotiation or discussion but
15 recognizes that that needs to be met. And that's an
16 example of what I was talking about.

17 Q. You were asked some questions by counsel
18 for the staff about Exhibit 271, which is the response
19 to WUT 01-468, and specifically about some wording on
20 the attachment C. Do you recall those questions?

21 A. Yes, I do.

22 Q. And let's take on the third page of that
23 attachment you are asked whether the document as it
24 reads and then you attempted to explain the purpose
25 and you weren't given an opportunity to state that.

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1 Would you now finish that statement, please.

2 A. Yes, I will. The company has insisted, the
3 U S WEST Communications company, has insisted that a
4 regulatory support clause be entered into the
5 contracts with affiliates. The sole purpose of that
6 clause is to obtain information for regulatory
7 proceedings such as this and so that that information
8 will be readily available.

9 In addition, we meet and I meet personally
10 with representatives of unregulated companies to set
11 up processes to anticipate the need for information
12 that staff or other counsel may need in the evaluation
13 of unregulated affiliates' charges to U S WEST C. So
14 this whole support process is geared towards the need
15 to comply with and support proceedings such as this.

16 Q. Thank you. Now referring to the purpose
17 statement that you were asked to read, would you state
18 what your understanding of the meaning of the phrase
19 "supports regulatory strategies to maximize recovery
20 of affiliated interests expenses" means in this
21 context?

22 A. The idea embodied in this purpose statement
23 is related to what I've already said, and I won't
24 repeat it. The second aspect of this, the maximize
25 recovery, has to do with the appropriate accounting,

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1 the appropriate reporting from those accounting
2 systems so that we don't get into situations with
3 regulators where we're unable to demonstrate the proof
4 of cost, that we're unable to demonstrate the proof
5 that we're following appropriate accounting processes
6 and procedures. So the maximize recovery is simply
7 that we feel these arrangements are prudent, they're
8 relative and necessary for the ongoing operation of
9 the business, and mine and our expectation is that we
10 will be able to demonstrate that, and that's the
11 underlying fundamental process and concept that's
12 embodied in this purpose statement.

13 Q. Put another way, do you have a view as to
14 whether this activity is intended to avoid properly
15 incurred affiliate expenses from failure of recovery
16 because of a simple failure of proof or gathering of
17 information?

18 A. Absolutely not. It's the exact opposite of
19 that.

20 Q. You mean --

21 A. Do you want to ask me again? Maybe I
22 misunderstood.

23 Q. I just asked you do you have a view as to
24 whether the intent of this is to prevent legitimate
25 affiliate expenses from failure of recovery through

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1 a simple failure of gathering of proper information?

2 A. It is not intended to prevent that.

3 Q. You were asked some questions about the
4 testimony at page 60 of your rebuttal testimony,
5 Exhibit 245T about the whole firm approach, and you
6 were asked whether you had identified during the test
7 year any savings from this whole firm approach, and
8 you attempted to indicate that you had identified such
9 savings in other periods which I believe you said
10 would flow through into the test period but you were
11 not given an opportunity to finish that statement.
12 Would you do so at this time, please.

13 A. Yes, I have two examples that I would like
14 to give. The first is that in 1990 U S WEST
15 incorporated the tax research and tax function from
16 the three telephone operating companies into U S WEST
17 Inc. The savings decreased to U S WEST C on a total
18 three-company basis of \$3.9 million. And that was an
19 example that I think illustrates that this common
20 management and the whole firm approach, as the auditors
21 and the RIR called it, demonstrates that savings.

22 The more significant one was the whole firm
23 approach taken to the legal department in U S WEST
24 where the legal function was transferred to U S WEST
25 Inc. The savings in that case was \$5.4 million to

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1 U S WEST C as a result of doing that. That business
2 case was filed in an affiliated interest application
3 with this Commission on April 2, 1993 as support of a
4 change in the contractual relationship.

5 Q. Now, those developments are embedded in the
6 allocated expenses that appear in U S WEST's test year
7 cost of service in this case. Is that true or untrue?

8 A. That is true.

9 Q. So when you indicated that you couldn't
10 identify test year savings, did it have anything to do
11 with the fact that you have had to project forward
12 some estimate of how things would have been but for
13 those changes?

14 A. No. They were evident in the results of
15 operations.

16 Q. I mean in terms of establishing a dollar
17 savings, would you have to have known what the costs
18 would have been if those consolidations hadn't
19 occurred?

20 A. Yes.

21 Q. You were asked, in reference to your
22 testimony or these Exhibits 272 and 273, to read the
23 description of the president and CEO of the two
24 companies, U S WEST Inc. and U S WEST Communications.
25 Do you know, does U S WEST Inc. have a board of

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1 directors?

2 A. Yes, it does.

3 Q. And does U S WEST Communications have a
4 board of directors?

5 A. Not an external board. They have an
6 internal board that meets informally and infrequently,
7 but in no way does it replicate any activity
8 associated with the external board of directors, so
9 it's entirely different function.

10 Q. Is one of the duties of the chairman,
11 president and the CEO of U S WEST Inc. interacting
12 with and executing the wishes of the board, the
13 external board?

14 A. Yes.

15 Q. And so is any comparable function performed
16 at the USWC level?

17 A. Not at all.

18 Q. Now, with regard to positions below the
19 chairman, president and CEO of U S WEST Inc. and the
20 president and CEO of USWC that appear in Exhibits 273
21 and 272 respectively, can you state whether there is
22 any duplication of those functions?

23 A. There is not duplication of those
24 functions, and I can give a couple of examples of
25 that. Mr. McCormack at the U S WEST Inc. level also

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1 supervises his direct staff. His direct staff
2 consists of a vice-president human relations. U S
3 WEST C has no such position. Mr. McCormack supervises
4 the function of the chief legal officer. U S WEST has
5 no such function and therefore does not perform that
6 activity and so those are examples of the difference
7 of the relationship and the idea that if U S WEST C
8 doesn't have the function at all how can you duplicate
9 it? Well, you can't.

10 Q. Does not U S WEST C have need of the
11 functions of a human relations organization?

12 A. Yes, they do.

13 Q. And so who performs those functions for
14 USWC?

15 A. Inc. performs a substantial amount of those
16 functions. U S WEST C also has some human resources
17 people directly associated with departmental
18 operations that have to do with payroll changes and
19 things of that nature, but the majority of the human
20 resources function is performed at U S WEST Inc.

21 Q. You were asked with regard to your
22 testimony in your rebuttal at page 64 whether or not
23 you removed from your proposed expenses for affiliate
24 transactions the items for the international golf
25 tournament and sponsorship fee and corporate brand

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1 advertising and state support advertising and you
2 indicated no. Why not?

3 A. My opinion is that the image advertising as
4 represented by some of the ads submitted in the
5 exhibits offered by staff counsel that this advertising
6 promotes the sale of U S WEST products, of U S WEST
7 communication products. It encourages the public to
8 recognize U S WEST C and to view other U S WEST
9 entities as dependable as providing services of value
10 to enhance one's lifestyle like saving time and that
11 type of thing.

12 Also, there were examples in this
13 advertising text that specifically related to tariff
14 services and so in my opinion while it is designated
15 and the company isn't quarrelling that it's image
16 advertising, the whole idea of brand or image
17 advertising is simply to enhance the position of the
18 company with the stake holders and the public who are
19 customers as well as others, but certainly it is to
20 influence and improve the sales position of the
21 company.

22 Q. By influencing and improving the sales
23 position of the company, do you have in mind whether
24 this would tend to grow the regulated business of the
25 company?

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1 A. Yes. That's the intent, to grow the
2 regulated portion as well as the unregulated portion.

3 Q. You were asked a question by counsel for
4 the staff with regard to certain specific ads in
5 Exhibits 275 and 276 as to whether specific services
6 were unregulated in Washington, and I believe you
7 stated that video conferencing and fax service were
8 unregulated. Do you want to amend that answer at all?

9 A. Yes, I wish to correct that. Those
10 services are not unregulated in the state of
11 Washington.

12 Q. You were asked a question about your
13 Exhibit 247 which is the Bellcore rate case results
14 and asked to compare the staff recommendation with the
15 low range in North Dakota of 85 percent and the high
16 range of 100 percent. Is there anything significant
17 about the North Dakota 85 percent number?

18 A. Yes. The 85 percent number was generated
19 from a 1983 case. The essence of that disallowance at
20 that time of considerable change within the
21 telecommunications industry, of course, was
22 divestiture, and the North Dakota Commission made that
23 disallowance on the basis that was project work that
24 was not well defined. There was a startup
25 organization that was known as the central offices

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1 organization, Bellcore had yet to be formed, and it
2 became an unknown and unmeasurable charge as compared
3 to the environment we're in today where we're looking
4 at specific project work and the output from that work
5 that's associated with regulated telephone operations.
6 So it's an aged case. North Dakota hasn't had a rate
7 case since 1983 and so that's why that information is
8 in there.

9 Q. Now, with respect to the exhibit that was
10 admitted consisting of your deposition, Exhibit 261 I
11 believe it is, at page 72 of that exhibit you were
12 asked whether or not you knew if NARUC's auditors
13 recommended that broadband network development costs
14 at Bellcore not be charged to ratepayers as an expense
15 but instead should be capitalized and you indicated
16 you accept that, that you weren't aware of it. Are
17 you aware of whether there's been any reaction to that
18 recommendation in the regulated utility industry?

19 A. I don't know if I can speak for the
20 regulated utility industry but I can reflect on
21 actions within the U S WEST states, and that is the
22 NARUC report was I think important and interesting
23 information, but it was expressed to the state
24 commissions as a concern, as something to look out for.
25 I'm not even sure it was a recommendation, but it was

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1 an area that the NARUC organization felt was sensitive
2 apparently and wished the state commissioners to take
3 recognition of that. As far as those kind of services
4 in the U S WEST territory I am not aware of
5 disallowances associated with broadband activities and
6 deliverables associated with projects of that nature.

7 Q. Similarly, on the following page of the
8 same exhibit you were asked the same question about a
9 challenge or concern in the same audit report about
10 cost recovery from ratepayers of the advanced
11 intelligent network and you again agreed to accept
12 that subject to check. Similarly, are you aware of
13 any reaction as you previously described to this
14 recommendation?

15 A. I am not. I would want to review the
16 results in the last Arizona case before I firmly
17 confirm that, and look at the -- at some of the
18 projects in that case, but to my recollection there are
19 none.

20 Q. You were asked at page 82 of the same
21 exhibit whether you would be concerned if you were
22 required to fund a major research project but did not
23 own the rights to any intellectual properties that
24 might result, and you indicated no. In the context of
25 the question pertaining to advanced technologies why

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1 is that?

2 A. The intellectual property developed as a
3 result of project funding is owned by U S WEST
4 Advanced Technologies. There is no transfer of that
5 intellectual property. There is, however, an
6 agreement, a beneficiary agreement, that U S WEST C
7 can use the output of the work they fund on an ongoing
8 basis -- on an ongoing basis.

9 Q. You were asked a question at page 90 of the
10 same Exhibit 261 whether or not after the common stock
11 is restructured -- this is speaking from the
12 standpoint of July of 1995 -- USWC will take over
13 shareholder services for the Communications stock, you
14 indicated you didn't know. Do you have any more recent
15 information on that question?

16 A. Yes. U S WEST Communications will have its
17 own shareholder services organization as a result of
18 the targeted stock environment.

19 Q. Finally, at page 104 of the same exhibit,
20 you were asked whether you were aware that the
21 National Regulatory Research Institute had just
22 launched a review of the fairness of the treatment of
23 regulated business by the fair compensation review
24 committee and you indicated you were.

25 MR. TROTTER: Your Honor, I will object.

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1 That evidence is not in the record. That was excluded
2 according to counsel's own request.

3 MR. OWENS: I beg your pardon. I went past
4 the part that was admitted. Thank you for correcting
5 me. I have no further redirect.

6 JUDGE WALLIS: Mr. Trautman.

7

8 RECROSS-EXAMINATION

9 BY MR. TRAUTMAN:

10 Q. Is Pan Am a union company?

11 A. I don't know if it is or not. I just simply
12 don't know.

13 Q. And you referred to the studies by Coopers
14 and Lybrand. Did Coopers and Lybrand quantify the
15 additional costs that a less flexible contractor might
16 charge when it needs to make modifications to its
17 normal methods of operation?

18 A. No.

19 MR. TRAUTMAN: All I have. Wait a second.
20 I do have one more.

21 That's all I have.

22 JUDGE WALLIS: Commissioner Gillis.

23

24 EXAMINATION

25 BY COMMISSIONER GILLIS:

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1 Q. Mr. Owens, in discussion with you on the
2 corporate structure, reminded me of one other question.
3 Is it your testimony that the investment decisions by
4 U S WEST C are completely unrelated to any input or
5 decisions from U S WEST Inc.?

6 A. I think that there is input by U S WEST
7 Inc. I believe it's at a very high level. This is a
8 function that takes place within the strategic
9 planning department and the capital resource
10 allocation between the companies is addressed in that
11 activity, and at a high level the total amount of
12 capital expense level of employees is addressed, but
13 U S WEST C certainly is in the position and given the
14 autonomy to invest once that level is set throughout
15 the 14 states and for what activities and services it
16 sees fit.

17 Q. So is the amount of capital of the whole
18 pie, the amount of capital that goes to U S WEST C
19 that's the big lump money, that capital that goes to
20 U S WEST C is a decision by U S WEST Inc.?

21 A. It's a decision by both parties. The
22 president of U S WEST C certainly has a very, very
23 large input and influence to acquire the capital that
24 is needed to run the U S WEST Communications business,
25 so it's a dual role. Inc. certainly is involved but

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1 each of the presidents and each of the subsidiaries
2 have a responsibility to identify their needs and then
3 present that information to the senior team which is
4 chaired by Mr. McCormack.

5 Q. Do you have an opinion -- see, U S WEST is
6 a diversified company. You have regulated divisions,
7 unregulated divisions, global, the big U S WEST Inc.
8 Do you have an opinion whether the decisions that are
9 made by U S WEST Inc. are influenced by that? Is it a
10 portfolio decision is what I'm thinking? The amount
11 of capital that U S WEST C would devote to its
12 operations as a stand-alone company, would the same
13 decision be made by a parent company that has a more
14 diversified portfolio?

15 A. I don't know.

16 Q. We haven't found the organizational chart
17 yet, have we.

18 MR. OWENS: We have it right here. I was
19 waiting for an appropriate break to distribute it.

20 No further redirect.

21 JUDGE WALLIS: Is there anything further of
22 the witness? It appears that there's none. Thank you
23 very much for appearing, Mr. McDonald. You're excused
24 from the stand.

25 (Recess.)

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1 JUDGE WALLIS: The company has distributed
2 a document previously identified as Exhibit 234 for
3 identification consisting of an organizational chart
4 in response to questions by I believe Commissioner
5 Gillis and it has distributed a revised page 1 of 1,
6 Exhibit 236, reflecting changes offered by Mr.
7 Barrington to her exhibit, and those documents are
8 received in evidence. Peter Cummings has been called
9 to the stand by U S WEST.

10 (Admitted Exhibit 234.)

11 Whereupon,

12 PETER CUMMINGS,
13 having been first duly sworn, was called as a witness
14 herein and was examined and testified as follows:

15 MR. CUNNINGHAM: One preliminary matter. I
16 don't believe I have entered a formal appearance. I
17 know Mr. Trotter has entered an appearance for me from
18 time to time but I think I would like to enter an
19 appearance at this time. My names is James F.
20 Cunningham. I'm a special assistant attorney general.
21 My business address will be the same address as Mr.
22 Trotter and I'm saying that because I don't know what
23 it is. And I'm appearing here for public counsel.

24 JUDGE WALLIS: Welcome back, Mr.
25 Cunningham. I will ask you to pull the microphone

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1 over to you so everyone in the room can hear
2 everything that you say.

3 MR. CUNNINGHAM: You're too kind.

4 JUDGE WALLIS: The exhibits for witness
5 Cummings have previously been identified for record
6 purposes.

7 MR. SMITH: Your Honor, I have one more
8 exhibit that I had not predistributed earlier. Should
9 not be controversial but I can do it now.

10 JUDGE WALLIS: Let's wait.

11 JUDGE WALLIS: Mr. Van Nostrand.

12

13 DIRECT EXAMINATION

14 BY MR. VAN NOSTRAND:

15 Q. Mr. Cummings, could you state and spell
16 your last name for the record?

17 A. My name is Peter Cummings, C U M M I N G S.

18 Q. Do you have before you what's been marked
19 for identification as Exhibit 6T in this proceeding?

20 A. Yes.

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

23 A. Yes.

24 Q. Do you have any additions or corrections to
25 make to Exhibit 6T at this time?

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1 A. No, I don't.

2 Q. Do you also have before you what's been
3 marked for identification as 290T?

4 A. Yes.

5 Q. Do you recognize that document as your
6 prefiled rebuttal in this case?

7 A. Yes.

8 Q. And do you have any additions or
9 corrections to make to Exhibit 290 at this time?

10 A. Yes, I do have several. The first is on
11 page 18, line 20. I would like to change Exhibit KMF-3
12 to Exhibit KMF-1. The second change is on page 56 line
13 30, the word give should be changed to "given."

14 Page 57 line 26, the last two words on that
15 line are "my that." And I would like to change those
16 to "that my." Reverse the order of those two words.

17 And then on page 47, line 26 through page
18 50, line 18, I wish to delete that entire section. I
19 have some additional corrections that are associated
20 with --

21 MR. CUNNINGHAM: Excuse me. Through --

22 JUDGE WALLIS: Let's be off the record,
23 please.

24 (Discussion off the record.)

25 MR. CUNNINGHAM: Can I further inquire of

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1 the witness where are you finished up on page 50?

2 THE WITNESS: Line 18.

3 JUDGE WALLIS: I'm going to request that
4 the company and other sponsors of witnesses, if you do
5 have changes of this kind that are in essence
6 housekeeping changes, an errata sheet would be very
7 helpful.

8 A. The deletions in connection with the
9 deletion of the testimony of AT&T witness Toomey in
10 the Roman III page of the last three lines on that
11 page through the middle of page Roman numeral IV, the
12 summary of my testimony should be deleted.

13 Page 1 of my rebuttal testimony, line 19 I
14 would like to delete the phrase "and AT&T witness
15 Diane P. Toomey." And then the substantive portion of
16 that deletion begins on page 66 line 5 through page
17 78, line 16.

18 Q. And as so corrected, Mr. Cummings, if I
19 asked you the questions set forth in Exhibit 6T and
20 290T today would you give the answers set forth in
21 those exhibits?

22 A. Yes, I would.

23 Q. Do you also have before you what's been
24 marked for identification as Exhibits 7 through 20 and
25 291 through 306?

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1 A. Those are the prefiled exhibits to that
2 testimony?

3 Q. Yes.

4 A. Yes.

5 Q. Were those exhibits prepared under your
6 supervision or direction?

7 A. Yes.

8 Q. Are they true to the best of your
9 knowledge?

10 A. Yes.

11 MR. VAN NOSTRAND: Move the admission of 6T
12 and 7 through 20 and 290T and 291 through 306.

13 JUDGE WALLIS: Is there an objection? Let
14 the record show that there is no objection and those
15 documents are received.

16 (Admitted Exhibits 6T, 7 - 20, 290T and
17 291 - 306.)

18 MR. VAN NOSTRAND: Mr. Cummings is
19 available for cross-examination.

20

21 CROSS-EXAMINATION

22 BY MR. SMITH:

23 Q. Good evening, Mr. Cummings.

24 A. Good evening.

25 Q. Purpose of your testimony is to offer a

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1 current estimate of U S WEST C's cost of capital; is
2 that correct?

3 A. Yes. The purpose of my testimony is to
4 estimate the cost of capital for use in this rate
5 proceeding.

6 Q. And U S WEST Inc. owns all the common
7 equity of U S WEST C; is that correct?

8 A. I'm hesitating because of the recent
9 targeted stock issue. There are two classes of stock
10 which are now owned by shareholders. There's one
11 company but there are two classes of stock and the
12 ownership of the U S WEST Communications stock is now
13 much more diverse than it was at the time I prepared
14 this testimony.

15 Q. But at the time you prepared this testimony
16 and during the test year U S WEST Inc. was the sole
17 shareholder of U S WEST Communications; is that
18 correct?

19 A. That's correct.

20 Q. And U S WEST Communications has its own
21 debt; is that correct?

22 A. That's correct.

23 Q. And the parent company, holding company at
24 the time you filed your testimony also had its own
25 debt in its own name; is that correct?

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1 A. U S WEST parent company has a very small
2 amount of debt in its own name. The primary financing
3 vehicles for the operations for U S WEST as a whole
4 are primarily U S WEST Communications which we're
5 talking about here and U S WEST Capital Funding which
6 provides financing both short and long-term for U S
7 WEST's other operations.

8 Q. Nevertheless, U S WEST Inc. does issue debt
9 in its own name, as I understood your testimony?

10 A. Yes.

11 Q. And in your discounted cash flow or DCF
12 analysis you formed three proxy groups of companies
13 that you believe are comparable in risk to U S WEST
14 Communications; is that correct?

15 A. That's correct.

16 Q. And one of the proxy groups consists of
17 five independent operating companies, telephone
18 operating companies?

19 A. Yes. They're five independent telephone
20 companies.

21 Q. And are any of those independent operating
22 companies subsidiaries of a holding company?

23 A. Actually the companies that are in that
24 proxy group can be considered holding companies in
25 their own right. They have telephone operating

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1 companies subsidiaries similar to the arrangement that
2 U S WEST has and other regional holding companies
3 have.

4 Q. And the other regional holding companies
5 you referred to are your second proxy group; is that
6 correct?

7 A. Yes.

8 Q. Turning for a moment to your DCF analysis.
9 In using the DCF model a rate of return analyst
10 requires an estimate of the rate of growth of
11 dividends; is that correct?

12 A. That's correct.

13 Q. And would you agree that any information
14 that investors can get that may be relevant to their
15 investment decisions is captured in the prices they
16 are willing to pay for various firm's common stock?

17 A. If we assume that stock markets are
18 efficient and the use of these financial models is
19 generally predicated upon that assumption we can
20 safely assume that investors have all publicly
21 available information. It would not be correct, I
22 don't believe, to assume that they have nonpublic
23 information at their disposal or private information.

24 Q. And do you believe that investors must
25 receive a higher return as an inducement to make a

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1 riskier investment?

2 A. Yes.

3 Q. Mr. Cummings, are you familiar with a Smith
4 Barney report on large telephone companies entitled
5 Favorable Growth Prospects in a Competitive
6 Environment which has been marked for identification
7 as Exhibit 307 in this proceeding?

8 A. Yes, I have looked at it or I've looked at
9 the portion that was distributed earlier today, which
10 is two pages.

11 Q. That's correct, and the full report is
12 available if that's necessary. If I could just direct
13 your attention to the bottom of the second page of the
14 exhibit, which is page 75 on the top of the document,
15 where it talks about U S WEST Communications group
16 telephone operations, and I will just give you a
17 chance to read that?

18 A. Yes.

19 Q. Would you agree that the analysts state
20 that U S WEST telecommunications operation's operating
21 environment is slightly above average and the company
22 has below average vulnerability to competition?

23 A. That's what's stated on this page by the
24 two analysts from Smith Barney.

25 Q. And is this the kind of document investors

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1 rely on in making investment decisions?

2 A. This is one of quite a number of analyst's
3 reports that investors would typically be aware of.
4 There are somewhere in the range of 18 to 20 analysts
5 that actively follow the major companies in the
6 telecommunications industry, the local
7 telecommunications, and Smith Barney is one of those.

8 MR. SMITH: Your Honor, move for admission
9 of Exhibit 307.

10 MR. VAN NOSTRAND: I would object, Your
11 Honor. This witness has already indicated he's only
12 familiar with this document to the extent he's been
13 able to review the two pages that were distributed
14 this morning. This document is it not cited anywhere
15 in Mr. Cummings's testimony and has not been relied
16 upon by this witness. If staff wishes to make those
17 points staff can sponsor this document in its own
18 testimony.

19 MR. SMITH: Well, Your Honor, the witness
20 indicated that this is the type of document that
21 investors in the investment community rely on in making
22 investment decisions and of course the relative risk of
23 a company is directly related to the return investors
24 expect, as Mr. Cummings indicated earlier. It's
25 certainly relevant to show the relative risk of

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1 U S WEST Communications.

2 JUDGE WALLIS: There is a difference
3 between admissibility, I think, and credibility or
4 weight, and I believe the document is sufficiently
5 authenticated that it may be admitted so the objection
6 is overruled.

7 (Admitted Exhibit 307.)

8 Q. Mr. Cummings, do you also have before you
9 what's been marked as Exhibit 308 which is another
10 Smith Barney publication?

11 A. Yes, I do.

12 Q. And that's entitled Large Telco's
13 Competitive Vulnerability Analysis. Are you familiar
14 with that document?

15 A. Again, I read this document earlier today.
16 I had not seen it before today.

17 Q. And in reading that document, do you see
18 that page 6 of the report -- there is one more page to
19 the report is all that's deleted here, page 7, can be
20 made available. Page 6 OF that report shows that U S
21 WEST has the lowest competitive vulnerability of all
22 the regional holding companies and GTE?

23 A. On the basis of a weighted average score to
24 the exposure in the four factors that were analyzed
25 what you say is true.

01751

1 MR. SMITH: Your Honor, move for admission
2 of Exhibit 308.

3 MR. VAN NOSTRAND: Same objection as stated
4 earlier.

5 JUDGE WALLIS: Objection is overruled. 308
6 is received.

7 (Admitted Exhibit 308.)

8 Q. Mr. Cummings, in performing your DCF
9 analyses, you used three groups of proxy companies
10 comparable to U S WEST Communications; is that
11 correct?

12 A. Yes.

13 Q. And in essence the proxy groups are
14 intended to be comparable -- strike that. For the
15 comparison to be appropriate the risk of the proxy
16 companies must be comparable to that of U S WEST
17 Communications; is that correct?

18 A. That's what we're hoping to do in using a
19 number of companies and groups of companies for the
20 analysis. Two of the company groups have operating
21 companies in the same industry and the third group was
22 selected on the basis of risk parameters specific to
23 U S WEST Communications.

24 Q. Would that be the comparable industrials?

25 A. The industrials' nomenclature might not be

01752

1 appropriate. That group includes a mix of what I
2 would term as industrial companies and also there are
3 some utility-type companies in there. They weren't
4 selected on the basis of being industrial or utility.

5 Q. Now, in selecting your comparable companies
6 in that third group, the nontelecommunications group,
7 in your testimony, your direct testimony -- and I
8 don't think you need to refer to it but it's page 71
9 -- you state that you screened the entire S and P
10 Compustat databases of over 9,000 companies to identify
11 comparable risk companies?

12 A. That's correct.

13 Q. And according to your work papers you
14 applied seven screens to the 9,000 company data set?

15 A. I think it was seven screens. The first
16 screen was to see if they actually had data available.
17 There were a couple of other screens that related to
18 data availability, yes, but the two -- it ultimately
19 gets down to two factors, the cash flow variability
20 and their Standard and Poor's bond rating.

21 Q. If I could direct you to your rebuttal
22 exhibit, it's PCC-20. I apologize. I'm not working
23 from my own set so I don't have that number.

24 MR. VAN NOSTRAND: 296?

25 THE WITNESS: You and I are working off the

01753

1 same numbering schemes.

2 JUDGE WALLIS: 296.

3 MR. SMITH: Thank you, Your Honor.

4 Q. Now, in Exhibit 296 the IBES -- that's
5 institutional brokers estimate service -- estimated
6 growth rate for Cincinnati Bell is 12.5 percent. Do
7 you see that?

8 A. Yes.

9 Q. And for Frontier Corporation it's 15
10 percent; is that correct?

11 A. Yes.

12 Q. And referring then to Exhibit 297, which
13 would be PCC--21, the IBES estimated growth rate for
14 Auto Data Processing is 14 percent?

15 A. Yes.

16 Q. And for McDonald's is also 14 percent; is
17 that correct?

18 A. Yes.

19 Q. In the DCF model the assumption is that
20 these growth rates are sustainable forever; is that
21 correct?

22 A. Yes. One of the simplifying assumptions
23 that the model goes on for a very long period of time.
24 It's one of the reasons why I used groups of companies
25 and why I used more than one methodology so what

01754

1 appears to be a high growth rate figure in one company
2 or several companies is taken into account when you're
3 looking at a group of companies.

4 Q. In the figures shown in Exhibit 297 and 296
5 and 295 were based on five-year projections of IBES.
6 Am I correct about that?

7 A. That's correct. Those are the longest, the
8 furthest out, growth rates that we have from the
9 analysts. If there were longer ones I will use them.

10 Q. Do you know how many of the companies in
11 the Compustat database of 9,000 companies are
12 regulated utility companies?

13 A. No, I don't.

14 Q. In your group of 20 companies on Exhibit
15 297, PCC-21, do you know how many are regulated
16 utilities in that list?

17 A. You asked me this question on the
18 deposition and I will see if I can get the answer
19 right. I think there's about a half a dozen. As I go
20 down the list, British Telecom is a bit of a question
21 mark to me. I'm not sure about that one. Lincoln
22 Telecom I would consider regulated. Oklahoma Gas and
23 Electric, Southern Indiana Gas and Electric,
24 Southwestern Public Service, Techo Energy and WPS
25 Resources I would consider in the category of a

01755

1 regulated company.

2 Q. And what appear to me at least to be the
3 only two telecommunications companies, British Telecomm
4 and Lincoln?

5 A. That's right. Actually there were a couple
6 of others that made the initial part of the screen.
7 One was Bell South but I already had Bell South in
8 another group, and other one was Citizens Utilities,
9 but I didn't include that because it doesn't pay a
10 dividend and it makes it difficult to apply the DCF
11 model which I wished to apply to this. Most of the
12 other RHC companies would be in this group except for
13 the bond rating, the bond ratings of the RHC holding
14 companies and in a sense the cash flow variabilities
15 are different than the operating company
16 characteristics of U S WEST Communications that I was
17 screening. If those parameters are little bit
18 different we would get more of the RHCs in this group.

19 Q. Directing your attention to Exhibit 292.
20 Do you have the numbers now? I can give you your
21 designation.

22 A. Would you, please.

23 Q. PCC-16 and PCC-17 which is Exhibit 293.

24 A. Right.

25 Q. And there you show selected capitalization

01756

1 statistics for the regional telephone operating
2 companies and independent telephone operating
3 companies; is that correct?

4 A. That's correct.

5 Q. And are these statistics indicators of the
6 financial risks faced by these companies?

7 A. Yes, they are.

8 Q. Is it fair to say that there's considerable
9 variation in these statistics as reported for each of
10 the operating companies?

11 A. Are you talking about in any given year or
12 over the span of years here?

13 Q. Well, let's just take 1994 as the most
14 recent information.

15 A. There's a fair range there. I've got the
16 statistics there. The averages for the RHC operating
17 companies is 41.1 percent. The maximum is 48.3 and
18 the minimum is 29.0. Standard deviation is 4.4 which
19 indicates to me that if you look at a one standard
20 deviation range around the average, most of the
21 companies, probably two thirds of the companies, are
22 falling between roughly 36 percent debt and 44, 45
23 percent debt. So for this size group of companies I
24 don't consider that a wide distribution.

25 Q. Did you directly compare the debt ratios of

01757

1 your proxy groups of companies with U S WEST
2 Communications' debt ratio?

3 A. No, I didn't. It's very difficult to do
4 that because of the accounting conventions that are
5 used in the telecommunications industry. That's why I
6 have these two exhibits here. These two exhibits show
7 the local telecommunications industry capitalization
8 on a monthly report or FCC authorized basis. If we
9 look at the financial reports the companies have
10 varied widely in their adoption of accounting changes
11 which produce wildly different debt ratios for those
12 companies.

13 Q. If I may interrupt, you've answered my
14 question.

15 A. Thank you.

16 Q. You started off by answering some questions
17 I had about U S WEST Incorporated and you referred to
18 the recent stock split and how that might have changed
19 things. Does the market data for the two classes of
20 stock, the new stock, have any impact on your analysis
21 here?

22 A. I have not included the market data on this
23 analysis because the split in the two target stocks
24 took place on November 1, so we really have fairly
25 limited data to go on at this point. I've got some

01758

1 preliminary looks by the investment analysts on what
2 they're looking at for growth, and betas which are
3 required for the capital asset pricing model input is
4 also a bit of a problem. I have been collecting daily
5 data to estimate betas and while I don't have enough
6 confidence in that data yet because it's only been a
7 couple of months what I'm seeing is that my
8 preliminary results are showing a beta of about .9 for
9 U S WEST Communications. And in the preliminary
10 analyst's reports --

11 Q. Was that U S WEST Communications group?

12 A. Yes. And the preliminary reports that I
13 have from the analysts are showing growth in the 6 to
14 8 percent range. I think the picture from the
15 analysts is going to be much better after the 1994
16 annual financial results are published. That's their
17 next event to really look at the two companies. If I
18 were to be here in another six months, say, testifying
19 in a rate case, I would certainly be including the
20 market data for the U S WEST Communications group
21 stock.

22 Q. Do investors bond rating agencies,
23 brokerage firms and other members of the public use
24 company annual reports as a source of information on a
25 particular company?

01759

1 A. Yes, they do.

2 Q. Page 17 of your rebuttal testimony, in
3 response to -- just go back one step, our discussion
4 about the effect of the stock split, you said I
5 believe you indicated that you thought the financial
6 reports of analysts would go up when the '94 results
7 came in. Did you mean '95 results?

8 A. Yes, I did, I'm sorry. I didn't mean to
9 say that they would go up. I said I think we will
10 have more information available from the analysts and
11 I did misspeak. I did mean '95.

12 Q. Page 17 of your rebuttal testimony
13 beginning on line 4 you state that the comparisons
14 shown in Ms. Folsom's exhibit KMF-3 is distorted by
15 accounting difference between the companies related to
16 their adoptions of accounting standards FAS 106 and
17 SFAS 71. Can you tell me which of the 12
18 telecommunications companies in that exhibit actually
19 show distortions due to SFAS 106 and 71 in the 1994
20 reported results?

21 A. In Ms. Folsom's exhibit?

22 Q. Yes. KMF --

23 A. Without looking at it I can tell you that
24 they were all impacted by SFAS 106.

25 Q. In 1994?

01760

1 A. Prior to that. Most companies adopted in
2 '93. Some companies adopted in 1992. Here are some
3 of the differences.

4 Q. You can explain later but all of the
5 distortions were prior to the 1994 reported results.
6 Is that what I heard you say?

7 A. For FAS 106. For FAS 71 I would have to
8 check on that because all of the RHCs have now gone
9 off of FAS 71 accounting and a number of the major
10 independent companies have as well, and it's the exact
11 timing of when they did that I don't have right at my
12 fingertips. Some of those independents may still be
13 using FAS 71 accounting. Alltel has gone off of it
14 and so has GTE and I'm not sure about the others.

15 Can I get back to the distinction in FAS
16 106?

17 Q. Let me ask you another question.

18 A. You said I could come back to that.

19 Ask your other question.

20 Q. During the test period or prior to the
21 stock split did U S WEST Inc. issue preferred stock?

22 A. Yes, prior to the stock split. I'm not
23 sure about in the test period. U S WEST Inc. did. U S
24 WEST Communications does not.

25 Q. Are you aware of a \$600 million preferred

01761

1 stock issuance by U S WEST Inc. in September of 1995?

2 A. Yes.

3 Q. Are you aware of preferred stock issuances
4 by GTE Delaware over the last year and a half totaling
5 \$875 million?

6 A. No, I'm not aware of that one specifically.
7 One of Ms. Folsom's exhibits she did show the
8 percentage of preferred stock and the capital
9 structures of the companies, and my recollection was
10 that that wasn't very great.

11 Q. Would you accept subject to your check that
12 Corporate Financing Week of January 23 of 1995 showed
13 an issuance for GTE Delaware of \$425 million in
14 preferred shares and the same Corporate Financing Week
15 of April 17, 1995 showed a preferred issuance of \$450
16 million?

17 A. Sure. But the exhibit that I was referring
18 to KMF-3 shows that as of 1994 GTE corporation, all of
19 GTE, had .49 percent preferred stock in their
20 capitalization. Seems to me that's about a tenth of
21 what she recommended for U S WEST Communications.

22 Q. Isn't it true all other things being equal
23 that a business or industry cannot sustain a growth
24 rate higher than the economy in the very long-term?

25 A. I'm not sure that that's true. It seems

01762

1 plausible to me that a company can sustain a growth
2 rate that's lower than the overall growth rate of the
3 economy in the long-term and maybe some of those
4 companies eventually go out of business and die. It's
5 probably mathematically correct that no company could
6 exceed the growth rate of an entire economy
7 infinitely, but I think it's possible that a company
8 could have a superior growth rate for a long period of
9 time, and there are companies that have demonstrated
10 growth, very superior growth over a long period of time
11 and Warren Buffet's company comes to mind. McDonald's
12 has grown and the jury is probably still out on
13 Microsoft but certainly there are companies out there
14 that have grown at high rates for a long period of
15 time.

16 Q. What do you mean by long period of time? I
17 believe you said mathematically it can't happen
18 forever.

19 A. I don't think it probably can happen
20 forever because if you define something that's within
21 the total set as growing larger than the total set to
22 infinite I don't think that that can happen, but
23 there's two issues here. One is --

24 Q. Well, my question is what are you
25 determining as a long time that this high level of

01763

1 growth can be sustained?

2 A. It would be more than the five years that
3 the analysts have forecasted the growth rates for my
4 DCF analysis. It would be more than the ten years
5 which Ms. Folsom used for economic forecasts in which
6 she got her estimated long-term growth for the
7 economy. Maybe as long as some of some of our bond
8 issues are going to be outstanding. We have 40 year
9 bond issues and 50 year bond issues outstanding.

10 Q. Do you have Ms. Folsom's exhibit KMF-5?

11 A. Yes, I do.

12 Q. If you can turn to that, please. Let me
13 ask you where on that exhibit -- looking at that
14 exhibit what is Ms. Folsom's true cost of equity for
15 investors?

16 A. It doesn't say on this exhibit, but as I
17 recall in her testimony she defines or assumes the
18 true cost of equity as 12 percent.

19 Q. Look under assumptions on KMF-5 that's the
20 quarterly DCF model cost of equity. Do you see that?

21 A. I see that. I would characterize that as
22 an estimate of the cost of equity. We don't know the
23 true cost of equity. We estimate it. In the
24 narrative of her testimony she made the assumption
25 that it was the true cost of equity.

01764

1 Q. But in the hypothetical set forth on KMF-5
2 the investor's earned rate of return is 12.13 percent
3 -- do you see that -- exceeding the true cost of
4 equity?

5 A. What is the question? Do I see the line
6 that says return on equity equals 12.13 percent?

7 Q. That's correct. That's the investors'
8 earned rate of return in this hypothetical. Do you
9 understand that?

10 A. I understand that this is the conclusion
11 presented by Ms. Folsom in this exhibit.

12 Q. And are you disputing any of the
13 calculations in that exhibit, let me ask you that?

14 A. No, I wouldn't dispute the mathematical
15 calculations in the exhibit. I would dispute the
16 assumptions that go into the exhibit. It is a
17 hypothetical mathematical example.

18 Q. And do you understand that Ms. Folsom
19 utilized her capital asset pricing model or CAPM
20 results only as a broad check of reasonableness?

21 A. Probably a better question for her. Do you
22 want me to go back to her testimony and see what she
23 says about that?

24 Q. I'm just asking your understanding of it.

25 A. She spends a lot of time in her testimony

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1 talking about the CAPM pricing model, but it's my
2 understanding that she does not give weight to the
3 results of her analysis in estimating the cost of
4 equity for U S WEST Communications.

5 Q. Page 28 of your rebuttal testimony, lines
6 18 to 26 you indicate that research on CAPM continues
7 to find it a valid model.

8 A. Yes.

9 Q. Would you agree with me -- I don't think we
10 need to prolong this but that there are a number of
11 articles in the field that indicate that there is
12 still considerable debate about the validity of beta?
13 Have you seen any such articles?

14 A. I think I've responded in data requests
15 that the CAPM was probably one of the most researched
16 financial concepts there is, and there is pro and con.
17 I have in my briefcase six or eight articles which have
18 come out since the Fama French article which are taking
19 issue with the Fama French conclusion, and even Fama
20 and French themselves in subsequent articles have
21 backed away a little bit from their conclusion. I
22 would say the issue is -- still has controversy
23 associated with it.

24 MR. SMITH: Your Honor, I have to add one
25 exhibit that was not predistributed and I simply need

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1 to confirm a couple of numbers on it. I think it
2 should go fairly quickly.

3 JUDGE WALLIS: I'm marking as Exhibit 313
4 for identification a document designated EOP Capital
5 Structure 10-31-94 Actuals Dollars.

6 (Marked Exhibit 313.)

7 Q. Mr. Cummings, if I could first direct you
8 to your direct testimony at page 40, line 10. The
9 capital structure that you are recommending prior to
10 your rebuttal is reflected in Exhibit PCC-4. Do you
11 see that?

12 A. Yes.

13 Q. And PCC-4 is now been identified as Exhibit
14 10 in this proceeding. Am I correct in saying that in
15 Exhibit 10 you've reflected the amounts of capital
16 that have been allocated to Washington from U S WEST
17 Communications for the purpose of determining
18 Washington's capital structure October 31, 1994?

19 A. Yes.

20 Q. Now I would like to refer you to what's
21 been premarked as Exhibit 313 and ask you whether you
22 recognize that as some of the pages from the work
23 papers which support the summary shown on Exhibit 10?

24 A. Right. It's part of that work paper.

25 Q. Just to be clear, where it says page 1 of

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1 4, 2 of 4, 3 of 4 and 4 of 4, that was added by us and
2 not you?

3 A. Yes.

4 Q. And those work papers were prefiled with
5 your direct testimony and exhibits?

6 A. That's right.

7 Q. And they were used by you to prepare
8 Exhibit 10?

9 A. Yes.

10 Q. Referring to page 3 of 4 of the exhibit and
11 the column entitled total just about halfway across
12 the page. Do you see that?

13 A. Yes.

14 Q. And under that column the October 31, 1994
15 amounts listed there are the source for your Exhibit
16 10; is that correct?

17 A. I think so. Yes.

18 Q. And just to make sure we're on the same
19 column, you agreed the amount listed on the line
20 titled total shareholders equity MR is \$1,300,298,000?

21 A. Yes.

22 Q. And those were the amounts that were
23 allocated and/or directly assigned from the amounts
24 listed on page 1 of this exhibit entitled U S WEST
25 Communications total?

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1 A. I think the total was actually the sum of
2 all of them. Maybe I'm not understanding your
3 question correctly. I was with you on page 3 or 4 as
4 those are the inputs that go into my Exhibit 10.

5 Q. And I'm trying to clarify. I'm trying to
6 clarify. If you turn to page 1 of the exhibit, under
7 total shareholders equity MR, that line under total,
8 there is a number of 7,938 million. Do you see that?

9 A. Yes.

10 Q. And was that then allocated down to
11 Washington's portion of that that is shown on page 3
12 of the exhibit of 1 point approximately 3 billion?

13 A. Actually, the way the products worked is
14 we've taken the pre-merger capital, which is assigned
15 to Washington, and the post-merger capital, which is
16 allocated or assigned to Washington, and totaled it up
17 for Washington. We didn't get to the U S WEST
18 Communication number and then take X percent of it to
19 get to Washington. It was more complicated than that.

20 Q. So there would be, if I understand you, one
21 additional step where you accounted for the pre-merger
22 debt -- attributable to Washington state?

23 A. Yes.

24 Q. With that adjustment --

25 A. The process is that, as I described it, we

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1 took the pre-merger capital for each of the states. In
2 the case of Washington -- I should back up. The reason
3 we did this, Commissioners, is because there was a
4 significant difference in the embedded cost of debt for
5 the three companies that we merged, and the Pacific
6 Northwest company of which Washington was the largest
7 share has the lowest embedded cost of debt, and so
8 rather than average the embedded cost of debt among all
9 of our states, as a condition of the merger we agreed
10 to allocate pre-merger debt and equity and any
11 post-merger financing.

12 And of course over time as all of the
13 pre-merger debt issues are replaced it would eventually
14 all become U S WEST Communications, so where we
15 started was allocating to Washington a portion of the
16 Pacific Northwest Bell pre-merger debt and equity based
17 on Washington's percentage of the company at that
18 time, and then any post-merger transactions were
19 allocated on Washington's share of the net plant in
20 service of the whole company. So that's the way that
21 this was constructed.

22 Q. Try this one more time and then move on.

23 On page --

24 JUDGE WALLIS: Excuse me, Mr. Smith. By

25 move on how much --

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1 MR. SMITH: I'm done. That's what I mean
2 by move on. It's a much better response, I'm sure.

3 Q. Mr. Cummings, on page 1 of Exhibit 313 in
4 the total column again where we get to total
5 shareholders' equity MR, the \$7.9 billion is the
6 total --

7 A. 7.9 -- 7.938 is the total shareholders
8 equity for U S WEST Communications, is that the
9 question?

10 Q. Yes.

11 A. Yes.

12 Q. And if you haven't already, could you
13 explain how that number relates to total shareholders
14 equity MR on page 3 of the exhibit?

15 A. You're talking about the 1 billion 300
16 million dollars?

17 Q. Yes.

18 A. The 1 billion 300 million is the Washington
19 portion of the equity of the 7.938.

20 MR. SMITH: Thank you. That's all I have.
21 Move for admission of Exhibit 313 if I didn't
22 previously.

23 MR. VAN NOSTRAND: No objection.

24 JUDGE WALLIS: 313 is received and we will
25 take our evening recess at this time and we'll be back

01771

1 at about 9:00 tomorrow morning. I would like counsel
2 to come in -- let's go off the record for a scheduling
3 discussion.

4 (Admitted Exhibit 313.)

5 (Recess.)

6 JUDGE WALLIS: Let's be back on the record
7 for a moment. We will take up at 8:30 tomorrow
8 morning to identify exhibits, and the hearing session
9 for tomorrow will begin at 9:00. We will take the
10 remainder of the examination of Mr. Cummings and then
11 witnesses Farrow, Copeland, Emmerson and Purkey, and
12 the company has indicated that it will be in touch
13 with Mr. Harlow whose interest is in Mr. Lanksbury.

14 Let's also tomorrow talk about scheduling
15 for the next witnesses. There are a number of
16 witnesses who are only available on Monday or Monday
17 and Tuesday. Thank you all very much. See you in the
18 morning.

19 (Hearing adjourned at 5:45 p.m.)

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