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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 20
5)
vs.) Pages 1772 - 2019
6)
U S WEST COMMUNICATIONS, INC.,)
7)
Respondent.)
8 -----)

9 A hearing in the above matter was held at
10 8:45 a.m. on January 12, 1996, at 1300 South Evergreen
11 Park Drive Southwest, Olympia, Washington
12 before Chairman SHARON L. NELSON, Commissioners
13 RICHARD HEMSTAD, WILLIAM R. GILLIS and Administrative
14 Law Judge C. ROBERT WALLIS.

15

16 The parties were present as follows:

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

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

23 FOR THE PUBLIC, DONALD TROTTER, Assistant
Attorney General, and JAMES CUNNINGHAM, Special
24 Assistant Attorney General, 900 Fourth Avenue, Suite
2000, Seattle, Washington 98164.
25 Cheryl Macdonald, Court Reporter

1 APPEARANCES (CONT.)

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1 I N D E X

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3	WITNESSES:	D	C	RD	RC	EXAM
3	CUMMINGS		1786	1814	1818	
4	FARROW	1823	1835	1975	1986	1957
5	EMMERSON	1990	2014			

6

7	EXHIBITS:	MARKED	ADMITTED	
7	54T, 55 - 58,	1786		
	59C, 60C, 61 - 64	1786		
8	65C, 66	1786		
	83T		1786	1824
9	84 - 90C	1786		
	315 - 324	1786	1786	
10	330T, 331C, 332C	1786		
	333T	1786	1824	
11	335, 336C, 337C,	1786		
	338T	1786	1824	
12	339, 340, 341C,	1786		
	342C, 343, 344C, 345	1786		
13	346, 347C	1786	1896	
	348, 349C	1786	1946	
14	350 - 352	1786	1957	
	355T, 356T, 357, 358,	1786		
15	360T, 361	1786	1990	
	362, 365T	1786		
16	366 - 370, 371C, 372 -	1786		
	374, 375C, 376C	1786		

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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. By way of preliminary matters, I want to
4 indicate that I have asked counsel to let me know of
5 any changes in the estimated time on
6 cross-examination. I have distributed a sheet showing
7 all parties' estimates that I have as of this morning,
8 and if there are any changes to that, if you have not
9 already mentioned it to me, if you would do so during
10 the day then I could update this. It's a big help for
11 scheduling witnesses for all concerned.

12 MR. BUTLER: Yes. I have one change for
13 Mr. Farrow, with a mention to Mr. Shaw, if we can
14 stipulate to the admission of the two exhibits which
15 I've distributed for him we would not have any
16 questions for him.

17 MR. SHAW: I have not had a chance to
18 review those yet but we will look at it with that in
19 mind.

20 MR. SMITH: Staff's estimate is probably
21 going to be closer to an hour than the 45 minutes.

22 JUDGE WALLIS: On Mr. Farrow?

23 MR. SMITH: Yes.

24 MR. TROTTER: Our estimate of Mr. Emmerson
25 will probably be shorter.

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1 MR. WAGGONER: Your Honor, there's a
2 correction. AT&T somehow did not end up with an
3 estimate for Wilcox and that would be half an hour.

4 MR. SMITH: On Copeland and Emmerson --

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

6 (Discussion off the record.)

7 JUDGE WALLIS: Let's be back on record,
8 please. We are asking that any changes to testimony
9 of changes in prefiled testimony be done by an errata
10 sheet or addendum in writing, and we'll designate
11 those as exhibits and handle them that way. And if
12 oral surrebuttal is planned for any witness we're
13 asking that opposing counsel be advised and any
14 scheduling difficulties be worked out with opposing
15 counsel.

16 I would like to move to the bench requests
17 and mark for identification the bench requests that we
18 have received to date. U S WEST has distributed this
19 morning copies of their response to bench request No.
20 12, and consequently I believe we have all of the
21 documents. I'm designating the response to bench
22 request 1 as Exhibit 315 for identification; response
23 to bench request 2 is 316; response to bench request 3
24 as 317; response to bench request 4 as 318; response
25 to bench request 5 as 319; response to bench request

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1 6 as 320; the responses to bench requests 7 through 10
2 collectively as 321; the response to 11 as 322; the
3 response to 12 as 323; and the response to the bench
4 request of Ms. Wright, which has been provided, is
5 marked as Exhibit 324 for identification. We will
6 designate that as bench request 13.

7 Is there any other matter regarding bench
8 requests? My understanding based on earlier comments
9 of counsel, at least relating to documents that had
10 been received as of Monday, was that there would be no
11 objection to receiving these documents. Is that
12 correct? Let the record show that that is correct.
13 Is there any reason to reserve ruling on bench request
14 responses 12 and 13? Let the record show that there
15 is no affirmative response. Is there any objection to
16 12 or 13? Let the record show that there is no
17 response, and consequently Exhibits 315 through 324
18 inclusive are received.

19 JUDGE WALLIS: Let's move on to witness
20 Farrow. Note that the direct testimony is designated
21 Exhibit 83T. BEF-1 model descriptions is Exhibit 84
22 for identification. BEF-2 cost model, 85 for
23 identification. BEF-3 transport model, 86 for
24 identification. BEF-4 usage model is 87 for
25 identification. BEF-5 regional loop cost model is 88

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1 for identification. BEF-6 SS7 model is 89 for
2 identification. And BEF-7 WIN PC 3 is designated
3 Exhibit 90C for identification.

4 The supplemental testimony is marked as
5 330T for identification. BEF-C1 ISDN cost study is
6 marked as 321C for identification.

7 MR. BUTLER: Excuse me, Your Honor, would
8 that one be going in --

9 JUDGE WALLIS: 331. Did I say otherwise?
10 BEF-C1 ISDN cost study is marked as Exhibit 331.

11 MR. BUTLER: I had a question whether that
12 would be going in as an exhibit given the Commission's
13 ruling with ISDN?

14 MR. SHAW: We would not plan to offer that
15 one, Your Honor. The supplemental testimony of Mr.
16 Farrow that this is referring to was simply to
17 introduce the ISDN cost study after the Commission had
18 merged the ISDN docket with this. Of course that's
19 been changed now. So the supplemental testimony
20 that just simply introduces the attached cost study is
21 no longer relevant in this case, I guess.

22 JUDGE WALLIS: I think my preference would
23 be to assign numbers and then if the company wishes to
24 withdraw the exhibits that would certainly be
25 appropriate, so BEF-8 standby line cross study would

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1 be 332C for identification. Does the rebuttal
2 testimony also deal with that issue?

3 MR. SHAW: If I can have a moment to get
4 the testimony and make sure --

5 JUDGE WALLIS: That's not something that
6 you need to commit to right now. We can go on and
7 designate the rebuttal testimony as 333. BEF-1 model
8 service components as 334, and BEF-2 pricing decision
9 process as 335, and you can advise us when Mr. Farrow
10 comes forward what your intentions are with regard to
11 those documents.

12 MR. SHAW: Yes, Your Honor, there's some
13 confusion. We don't have on your preprinted
14 description, and I apologize for not tumbling to it
15 sooner. There's another set of testimony designated
16 Farrow supplemental testimony which is the
17 supplemental testimony required by the Commission to
18 be filed by the company relating to costs, if you
19 recall that last round, and you don't have it on your
20 lists so we will need to add that.

21 JUDGE WALLIS: Very well. Could you go
22 through that? We'll call the supplemental testimony
23 336T for identification.

24 MR. SHAW: Could we go off the record for a
25 moment?

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1 JUDGE WALLIS: Yes.

2 (Discussion off the record.)

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

4 A document designated BEF-3 Washington private line
5 attached to the rebuttal testimony of Mr. Farrow is
6 designated as 336 and BEF-4 current residential rates
7 is designated as 337.

8 MR. FINNIGAN: Are those confidential
9 exhibits?

10 MR. SHAW: Yes.

11 JUDGE WALLIS: And those are each
12 designated as 336C and 337C respectively. The
13 December 15 supplemental testimony is designated 338T
14 for identification.

15 MR. SHAW: There's an exhibit BEF-1 which
16 is a proposed stipulation regarding costing
17 principles.

18 JUDGE WALLIS: Was that designated BEF-1?
19 That would be 339 proposed stipulation.

20 MR. SHAW: That has attachments A, B and C
21 to it. There's a BEF-2 a lengthy exhibit entitled
22 Cost Manual.

23 JUDGE WALLIS: That would be 340 for
24 identification.

25 MR. NICHOLS: Is that the cost manual

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1 that's 340?

2 JUDGE WALLIS: Yes.

3 MR. SHAW: There's a BEF-3 confidential
4 exhibit, 17 pages, first page saying "results summary
5 Washington."

6 JUDGE WALLIS: That's 341C for
7 identification.

8 MR. SHAW: Finally a confidential exhibit
9 BEF-4 seven page document consisting of spreadsheets.

10 JUDGE WALLIS: That's 342C. And I'm marking
11 as 343 a single page document designated "changes to
12 Brian Farrow testimony."

13 Let's move to Commission staff.

14 MR. SMITH: Your Honor, we have two
15 exhibits. The first one is designated confidential.
16 It's a two-page exhibit. Cover sheet is entitled
17 Executive Summary Washington 976 Information Delivery
18 Service Cost Study.

19 JUDGE WALLIS: That is designated 344C for
20 identification. And a multi-page document designated
21 Deposition Upon Oral Examination of Brian E. Farrow
22 June 5, 1995 is marked as 345 for identification.

23 MR. TROTTER: We have two exhibits. The
24 first is "response to public counsel data request 941."

25 JUDGE WALLIS: Marking as 346 for

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1 identification a document designated PC 01-941.

2 MR. TROTTER: And the second is response to
3 public counsel data request 614.

4 JUDGE WALLIS: That's marked as 347 for
5 identification. Is it TRACER and DIS that had
6 additional exhibits?

7 MR. BUTLER: TRACER, the first is a
8 response to TRACER 01-099, and the second is a
9 two-sided document that was a portion of an attachment
10 to the response to TRACER 01-064.

11 JUDGE WALLIS: Those are designated 348 and
12 349 respectively.

13 MR. BUTLER: I think the second one should
14 be designated confidential.

15 MR. SHAW: That is correct.

16 JUDGE WALLIS: The document designated
17 TRA 01-064 attachment B is designated as 349C for
18 identification.

19 MS. MARCUS: DIS has three exhibits. The
20 first is company's response to TRACER data request
21 01-094.

22 JUDGE WALLIS: That's marked as 350 for
23 identification.

24 MS. MARCUS: Next is company's response to
25 TRACER's data request 01-097.

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1 JUDGE WALLIS: That's 351 for
2 identification.

3 MS. MARCUS: Last is company's response to
4 TRACER's data request 01-098.

5 JUDGE WALLIS: And that's 352 for
6 identification.

7 Off record.

8 (Recess.)

9 JUDGE WALLIS: Let's mark the rebuttal
10 testimony of Peter B. Copeland as 355T, the
11 supplemental testimony as 356T, and document
12 designated PBC 1 the benchmark cost model as 357 for
13 identification. Now Mr. Emmerson's.

14 MR. WAGGONER: Your Honor, just checking,
15 but it struck me that there was an exhibit to Mr.
16 Copeland's rebuttal testimony or denominated work
17 papers and I wasn't clear.

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

19 (Discussion off the record.)

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

21 There is marked as 358 for identification a document
22 and, Mr. Shaw, what is the description of that
23 document?

24 MR. SHAW: It is a multi-page white paper
25 entitled Loop Dreams, The Price of Connection for

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1 Local Service Competition.

2 JUDGE WALLIS: Designated 358 for
3 identification. Anything further for Mr. Copeland?
4 Now Mr. Emmerson. Is Mr. Emmerson's name spelled with
5 one M or two?

6 MR. SHAW: Two M's I believe.

7 JUDGE WALLIS: Marking as 360T for
8 identification the rebuttal testimony of Richard D.
9 Emmerson and as 361 a document designated RDE-1. Are
10 there any documents to come in through the cross of
11 Mr. Emmerson?

12 MR. SMITH: Staff has one. It's a
13 three-page document. The cover sheet says Super
14 Fairness Applications and Theory.

15 JUDGE WALLIS: It's designated as 362 for
16 identification. Anything else for Mr. Emmerson?
17 Moving on to Mr. Purkey. His direct is designated as
18 54T for identification. Attachments as follows: DP-1
19 is 55, DP-2 is 56, DP-3 is 57, DP-4 is 58, and DP-5 is
20 59C for identification. DP-6 is 60C. DP-7 is 61.
21 DP-8 is 62. DP-9 is 63. DP-10 is 64, and DP-11 is 65C
22 for identification. DP-12 is 66.

23 His rebuttal testimony is designated 365T
24 for identification. DP-13 is 366. DP-14 is 367.
25 DP-15 is 368. DP-16 is 369. DP-17 is 370. DP-18 is

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1 371C. DP-19 is 372. And DP-20 is 373 for
2 identification.

3 Are there documents for Dan Purkey's
4 cross-examination?

5 MR. SMITH: Staff just has the deposition
6 taken of Mr. Purkey July 6.

7 JUDGE WALLIS: Multi-page document
8 designated Deposition Upon Oral Examination of Dan
9 Purkey, July 6, 1995 is marked as 374 for
10 identification.

11 MR. WAGGONER: AT&T has two exhibits for
12 Mr. Purkey. The first would be AT&T data request
13 01-076, and the second would be staff data request WUT
14 01-284.

15 JUDGE WALLIS: Those are marked 375 and 376
16 for identification. Off record, please.

17 (Recess.)

18 JUDGE WALLIS: Let's be back on the record
19 to conclude this session. The documents designated
20 as 375 and 376 appeared to be confidential and should
21 be designated 375C and 376C respectively. It appears
22 that we've concluded with the preliminary matters and
23 we'll be off the record momentarily before we resume
24 the hearing.

25 (Marked Exhibits 83T, 84 through 90C,

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1 315 through 324, 330T, 331C, 332C, 333T through 335,
2 336C, 337C, 338T, 339, 340, 341C, 342C, 343, 344C, 345
3 through 348, 349C, 350, 351, 352, 355T, 356T, 357,
4 358, 360T, 361, 362, 365T, 366 through 370, 371C, 372
5 through 374, 375C, 376C, and 54T, 55 through 58, 59C,
6 60C, 61 through 64, 65C, 66.)

7 (Admitted Exhibits 315 - 324.)

8 (Recess.)

9 JUDGE WALLIS: Good morning, let's be on
10 the record, please, for our January 12, 1996 session
11 in docket UT-950200 U S WEST Communications. At the
12 conclusion of yesterday's session Commission staff had
13 completed its cross-examination of witness Peter
14 Cummings and public counsel was about to begin.

15 Mr. Cummings, welcome again today. We
16 merely note for the record that you have previously
17 been sworn in this matter and you may resume the stand
18 at this time.

19 THE WITNESS: Thank you.

20 JUDGE WALLIS: Mr. Cunningham.

21

22 CROSS-EXAMINATION

23 BY MR. CUNNINGHAM:

24 Q. Morning, Mr. Cummings. See if we can get
25 through this with happy dispatch. Like to take you

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1 briefly through the differences between the costs of
2 capital as portrayed in your original testimony and
3 exhibits and your rebuttal testimony and exhibits.

4 First of all, do I understand correctly that
5 you changed the capital structure recommendation from
6 59.3 percent equity and 47 percent debt to 56.6 percent
7 equity and 43.4 percent debt?

8 A. That's correct.

9 Q. That was to reflect, was it not, the
10 existence of less equity and more debt in the booked
11 capital structure of the company?

12 A. Yes. It reflects the change in the capital
13 structure from the time that my direct testimony was
14 prepared until the time that my rebuttal testimony was
15 prepared.

16 Q. So there was additional infusions of debt
17 in effect into the capital structure?

18 A. That's correct.

19 Q. In your original testimony do I understand
20 correctly that your recommendation for cost of equity
21 was a range from 13.3 percent to 14.0 with a midpoint
22 of 12.5 -- 13.65?

23 A. Yes, that's correct.

24 Q. And this was based on your market data that
25 was available to you as of October 1994?

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1 A. Yes.

2 Q. In the rebuttal testimony, and this is
3 based on market data available to you in June of 1995,
4 your estimated equity ranged from 12.1 percent to 12.9
5 percent and the midpoint was 12.5; is that correct?

6 A. That's correct.

7 Q. That would reflect, would it not, a change,
8 a reduction, of 715 basis points between the market
9 data indicated in October of 1994 and June of 1995?

10 A. Yes.

11 Q. We can conclude from that I gather that
12 capital costs were reduced markedly during that eight
13 month period?

14 A. Yes.

15 Q. You also made a capital asset pricing model
16 analysis, and in that analysis the risk free rate that
17 you used long-term was 30-year treasuries, was it not?

18 A. I used both a long-term based on 30-year
19 treasuries and also an intermediate term which is
20 three-year, five-year and ten-year treasury bonds.

21 Q. Confining your attention to the 30-year
22 treasuries your original testimony indicated that the
23 yield on those treasuries was 7.88 percent?

24 A. Yes, I think that's correct.

25 Q. And in your rebuttal testimony the yield

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1 was 6.56 percent?

2 A. Yes.

3 Q. As a rate of return analyst, Mr. Cummings,
4 do you stay on top of the yields on long-term
5 treasuries?

6 A. Yes, I do.

7 Q. Would you agree or would you accept subject
8 to check that recently, at least in the end of
9 December and continuing into January, 30-year
10 treasuries have produced a yield at or about 6 to
11 6.1 percent?

12 A. That's true. In fact at one point they
13 dropped below 6 percent and they're currently at about
14 6.15 percent.

15 Q. Do you have before you what's been marked
16 for identification as Exhibit 310?

17 A. Yes, I do.

18 Q. Obviously you did not construct this though
19 basically what I'm going to ask you to do is accept
20 the third column figure subject to check. There have
21 been -- let me explain to you how this was
22 constructed. As a preliminary, let me ask you whether
23 it is true that Bell South had a two for one stock
24 split between now and the time that your rebuttal
25 testimony was prepared?

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1 A. That's true.

2 Q. And it's also true, is it not, I think we
3 talked about this in your deposition that there was
4 some thought within U S WEST that the media group
5 would be spun out of the company, correct?

6 A. When we were doing the deposition it had
7 already been announced that U S WEST had a plan to
8 create two classes of targeted stock, one for the
9 communications group and one for the media group and
10 that event did take place on the first of November of
11 this year -- of last year, excuse me.

12 Q. So to go on with the construction of this
13 identification, the original market price in the first
14 column -- and these are all for the Bell holding
15 companies -- was extracted from your testimony of
16 October 1994, but adjusted for these two for one split
17 in Bell South. On the updated market price of June
18 1995 that would be reflected in Exhibit 295, one of
19 your rebuttal exhibits, and I will ask you to accept
20 subject to check that the current market price as
21 indicated in the right-hand column for each of these
22 Bell companies would be the market price of those
23 particular stocks during the period -- the average of
24 the price during the period 12-18-95 to 12-2-95?

25 A. I will accept that subject to check.

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1 Q. This indicates, does it not, that the
2 market price of these Bell stocks have shown an
3 increase of almost 25 percent from June to December of
4 1995?

5 A. It's not clear to me in this exhibit which
6 you've given me whether the increase that's almost 25
7 percent is from June of '95 or is it from October of
8 '94?

9 Q. I think if you do the mathematics you would
10 find that the increase of 9.91 percent reflects the
11 change from the average in 1994 to 1995 and the other
12 increment is from 1995, June of '95 to December of
13 '95.

14 A. Just eyeballing it an average of 41 going
15 to 51 looks to be like an increase of about 20
16 percent.

17 Q. Well, we can figure it out. In any event,
18 let me also point out that the top column or the top
19 set of figures reflects U S WEST and its combination
20 of the media group end in U S WEST and that is
21 excluded from the bottom portion simply so that any
22 distortion that may possibly have been created by this
23 separate body of common stock would be eliminated.

24 JUDGE WALLIS: Did the witness make a
25 positive response?

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1 THE WITNESS: I'm not sure if that was a
2 question, Your Honor.

3 JUDGE WALLIS: I saw your head nodding and
4 I wasn't sure whether you were saying yes?

5 THE WITNESS: I was trying to follow the
6 conversation.

7 Q. You would accept that's the way the two
8 sections are constructed?

9 A. Yes. The second section excludes U S WEST
10 and the first one includes U S WEST.

11 Q. These figures on the changes in market
12 price over the last six months would tend to suggest
13 that the cost of equity has diminished even since June
14 of 1995, would it not?

15 A. Other factors being equal that's true. If
16 you're just looking here at the stock price there may
17 have been changes in dividend levels or changes in
18 growth rates for these companies as well.

19 Q. Have you made any analysis of changes in
20 dividends or growth rates?

21 A. As part of a total analysis. I did make an
22 analysis of a current cost as of the first week in
23 January using the same methods that I used in both my
24 direct testimony and my rebuttal testimony, and what I
25 found was that since my rebuttal testimony I would

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1 conclude that the cost of capital has declined but
2 that my recommendation would still be within the range
3 that I presented in the rebuttal testimony.

4 Q. And that range would be the 12.1 to 12.9?

5 A. That's correct, yes.

6 Q. In any event you would agree that capital
7 costs have continued to fall in the six and a half
8 months since June of 1995 to the present date?

9 A. Yeah. They've fluctuated and if you look
10 at two points in time I would say, yes, capital costs
11 are slightly less now than they were at that time.

12 Q. In response to public counsel request
13 01-976 you indicated that it is more important to
14 determine the most current cost of capital than it is
15 to match any time period in which another witness may
16 have conducted the study. Do you adhere to the idea
17 that it is important to determine current cost of
18 capital?

19 A. Yes, I would.

20 Q. In making your change in capital structure
21 and adding in effect debt to the capital structure and
22 lowering the equity ratio, does that affect, in your
23 opinion, an increase in financial risk inherent in
24 your recommended capital structure?

25 A. Yes. I think it would portend an increase

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1 in the financial risk.

2 Q. In estimating your cost of equity capital
3 did you do anything different to reflect that
4 perceived increase in financial risk?

5 A. No. I made no explicit adjustment, but I
6 did look at the capital structure statement, I looked
7 at the market data to estimate the cost of capital in
8 my update presented in the rebuttal testimony.

9 Q. Beginning at page 35 of your rebuttal
10 testimony you seem to be taking issue with Mr. Hill's
11 operating risk analysis, and at page 36 you point out
12 that the R squared, which results from his analysis of
13 the independent telephone industry, is higher than the
14 R squared he determined through analysis of U S WEST
15 Corporation's historical data, and you state at lines
16 15 through 19 that "the result contradicts his
17 position that independent telephone companies are
18 riskier than the regional Bell holding companies."
19 Correct?

20 A. I believe that his statement was that the
21 independent telephone companies were riskier than U S
22 WEST Communications, and my purpose in this section
23 was to point out that looking at his earnings before
24 interest and taxes, his EBIT analysis, he comes up
25 with a very high R squared .98 versus the .61 for U S

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1 WEST Communications. That data would tend to indicate
2 that the independent group is much less risky than U S
3 WEST Communications.

4 Q. You would agree, would you not, that it is
5 not unusual for times series analysis of earnings for
6 an industry aggregate to have a higher aggregate than
7 a time series analysis for an individual company?

8 A. I would agree with that.

9 Q. In your rebuttal exhibits, those would be
10 PCC-22 and 23. That would be 298 and 299.

11 A. These are the capital asset pricing model
12 estimates of the independent companies?

13 Q. Yes. You show, do you not, that the RBOC's
14 average beta coefficient is 0.77? That would be
15 on Exhibit 298.

16 A. Yes.

17 Q. And on Exhibit 299 you show an independent
18 telephone company sample as having a beta coefficient
19 of 0.8?

20 A. Yes.

21 Q. And according to that beta risk measure
22 which group would have the higher risk?

23 A. Numerically the independents come out
24 higher. I'm not sure that that's a significant
25 difference. In fact, I would say that given the

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1 nature of beta estimates I would say that's not a
2 significant difference.

3 Q. As I understand it one of the problems that
4 you seem to have with Mr. Hill's operating risk
5 analysis is that in the 1994 Arizona rate proceeding
6 which involved U S WEST Mr. Hill utilized EBIT,
7 earnings before interest and taxes, rather than the
8 EBITDA, earnings before interest taxes depreciation
9 and amortization, would that be correct?

10 A. That's correct.

11 Q. You do acknowledge, do you not, that at
12 page 36 of his testimony in this proceeding Mr. Hill
13 noted that changes in the U S WEST Communications
14 depreciation expense made an analysis of operating
15 risk which included that noncash expense unreliable?

16 A. He made that statement and I've been
17 puzzled by that statement because I don't know what
18 kind of fluctuations in depreciation he's talking
19 about. Our depreciation levels have been pretty
20 constant.

21 Q. Do you recall your response to public
22 counsel request 01-978?

23 A. 978? Maybe you could help me with that
24 one.

25 Q. This had to do with Mr. Hill's testimony

01797

1 before the Arizona Corporation Commission, and it
2 basically dealt with the question of increases in U S
3 WEST depreciation rates as being a primary factor in
4 the instability of the EBIT and I believe you
5 responded, if I can continue, that Mr. Hill did
6 indicate that "it appears that increased depreciation
7 expenses have caused volatility in EBIT since
8 divestiture"?

9 A. That was his statement.

10 Q. Let me ask you, Mr. Cummings, whether your
11 testimony is precisely the same as it was before the
12 Arizona Corporation's Commission?

13 A. Of course not.

14 Q. I'm not just talking about the result but
15 talking about the theory, the theories in and support
16 for the theories you were advancing in that case?

17 A. I would say that my testimony in this
18 proceeding is very similar to what I did in the
19 Arizona proceeding. There hasn't been any change in
20 financial theory that underlies the models that I've
21 used.

22 Q. There has been a change in the financial
23 theory of the people that you use to support your
24 testimony in the two cases, correct? I'm referring to
25 the Merton Miller and Franco Modigliani study which in

01798

1 Arizona purportedly supported your view that capital
2 structure does not affect who the value of the firm?

3 A. I believe that I quoted Modigliani and
4 Miller in rebuttal testimony in Arizona and I did not
5 in testimony in this proceeding.

6 Q. Is that because Miller and Modigliani have
7 changed their view with respect to the subjects that
8 you were addressing?

9 A. I don't think so. Their original studies
10 were published in 1958 and they were updated in 1963
11 and they had more work in 1977, and there was a Nobel
12 prize in 1990, and they haven't done much since.

13 Q. In this proceeding you use a treatise by
14 one Robert Higgins to support the notion that capital
15 structure is not a relevant consideration in cost of
16 capital?

17 A. I did utilize a quote by professor Higgins
18 who is on the faculty at the University of Washington,
19 but it would be incorrect to say that capital
20 structure is not a factor. What Higgins said is that
21 it would be naive to conclude that you could reduce a
22 company's weighted average cost of capital by using
23 more of the cheap source of financing debt and less of
24 the expensive source equity. He went on to explain
25 that further but that was his basic premise.

01799

1 Q. Isn't that also the principle advanced by
2 Miller and Modigliani that supported your position or
3 allegedly supported your position in the Arizona case?

4 A. It's very similar, yes.

5 Q. Are you familiar with Peter L. Bernstein
6 and the works of Peter L. Bernstein?

7 A. Yes, I am. Peter Bernstein has been editor
8 of the journal portfolio management for a long time.
9 He's probably achieved curmudgeon status. He's been
10 around a long time and he makes comments on what's
11 going around in finance. He's written a book or two.

12 Q. As a matter of fact you cite his book, do
13 you not?

14 A. I cite his book Capital Ideas in one of the
15 appendices in my testimony.

16 Q. I assume from that that you assume Mr.
17 Bernstein to be somewhat of a guru or certainly worthy
18 of attention with respect to capital finance matters?

19 A. I would, yes.

20 Q. Do you have before you what's been marked
21 for identification as Exhibit 311?

22 A. Yes.

23 Q. Do you recognize that, sir, as an excerpt
24 from the very book that you cite, Capital Ideas by
25 Peter L. Bernstein in which he's discussing the Miller

01800

1 Modigliani perspective with respect to capital
2 structure?

3 A. Yes. This exhibit has a couple of pages
4 out of his book.

5 Q. And those are the two pages that are
6 devoted to his evaluation of an update and Miller and
7 Modigliani, correct?

8 A. It's certainly a portion of it. It's been
9 a while since I read Bernstein's book and it seems to
10 me he had more to say on the subject, but this is
11 certainly a part of it.

12 Q. Is it fair to conclude that Mr. Bernstein,
13 anyway, who is presumably an expert in finance, in his
14 evaluation of Miller and Modigliani has indicated that
15 capital structure does in fact matter in the
16 determination of capital costs?

17 A. It's Miller that's being quoted in this
18 book and Miller is pointing out that the original
19 hypothesis envisioned a perfect capital market, if you
20 will, without the imperfection of taxes and
21 transaction costs and such, and their later studies
22 did indicate that when you looked at the tax advantage
23 of debt that it would be possible for firms to lower
24 their overall costs of capital by employing debt. The
25 article that Miller wrote which is cited in his book,

01801

1 however, went on to say that there are other costs
2 that offset the debt benefit, and chief among those
3 other costs was the cost of financial distress or
4 bankruptcy and the transactions costs which were
5 ignored in the perfect capital markets assumption, and
6 there were additional costs, agency costs, associated
7 with differences between management and bondholders,
8 shareholders and information costs as well. It's
9 pretty clear that the financial distress or bankruptcy
10 costs and transactions costs are in the opposite
11 direction to the benefit associated with tax
12 deductibility of debt.

13 In a regulated setting such as we're
14 operating here it's not clear to me that there is a
15 tax advantage to debt financing in the Modigliani
16 Miller context because the benefit of tax deductible
17 of debt financing is really passed on to the
18 ratepayers through this revenue requirement process
19 and it doesn't go to the shareholders so it to me that
20 brings us back to the original proposition that you
21 can't increase the value of the firm by the way that
22 you finance it.

23 Q. Are you taking the position, sir, that
24 leveraging cannot lower the cost of capital?

25 A. Well, I tried to explain to you in a little

01802

1 bit more detail that it can because of the tax
2 advantage, but if you don't get that tax advantage, if
3 it doesn't flow through to the shareholders then it's
4 questionable to me whether it in fact does. Even if
5 you take it out of the regulated setting what
6 Modigliani and Miller found was that contrary to the
7 expectation of the tax benefit which would lead you to
8 conclude that firms would be almost entirely debt
9 financed because it was so cheap, what they found was
10 that firms aren't entirely debt financed that there
11 are 0 offsetting costs and that the risk of financial
12 distress and bankruptcy causes firms not to employ
13 nearly 100 percent of debt financing but some lesser
14 percentage which tends to vary by industry, and this
15 is probably the same reason why the bond rating
16 agencies have different leverage criteria for their
17 different bond ratings.

18 Q. Do you detect any suggestion in Mr. Hill's
19 or anybody else's testimony in this proceeding that
20 the company should go to 100 percent debt financing?

21 A. No. Mr. Hill did not recommend 100 percent
22 debt financing. He recommended 48 percent debt
23 financing.

24 Q. That taxes on that debt would be
25 deductible, would it not?

01803

1 A. They are, but as I pointed out the
2 advantages of that tax deductibility gets factored
3 into the revenue requirement and it doesn't flow
4 through to the shareholders.

5 Q. Have you reviewed orders of this Commission
6 with respect to capital structure?

7 A. Yes, I have.

8 Q. And do you recall that in many instances
9 including cases involving telecommunications companies
10 the Commission has used a capital structure which is
11 more highly leveraged and contains more debt than the
12 actual capital structure of the company?

13 A. Yes.

14 Q. Would that be characterized, Mr. Cummings,
15 as simply determination for ratemaking purposes that
16 an appropriate capital structure rather than the
17 actual capital structure is to be used for ratemaking
18 purposes only?

19 A. Well, certainly what this Commission orders
20 is for ratemaking purposes. It does not bind the
21 company to actually finance in that manner.

22 Q. Now, in his operating risk analysis Mr.
23 Hill uses the EBITDA, correct?

24 A. He does in his analysis of U S WEST
25 Communications. He does not do that for the

01804

1 independent telephone company group.

2 Q. Do you have a copy before you of your
3 response to public counsel request 01-977?

4 A. Can you tell me what the subject of that
5 one was?

6 Q. It had to do with -- well, it was a
7 multi-page --

8 A. Yes, I do have it.

9 Q. Let me ask you this. Do you agree that in
10 the 1995 SEC form S4, which described the company
11 split into two stocks, U S WEST stated that
12 "Communications group considers EBITDA an important
13 indicator of the operational strength of its
14 business"?

15 A. Yes. That statement is in there.

16 Q. So would we understand correctly from that,
17 then, that U S WEST tells stockholders that EBITDA is
18 an important indicator of operational strength but is
19 not proper in assessing operating risk?

20 A. I think that's an overbroad statement. My
21 issue with Mr. Hill's analysis was that he concluded
22 on the basis of his operating risk analysis which
23 included the depreciation and amortization and that
24 was a huge increase over a previous analysis that he
25 had done, but his conclusion was that that U S WEST

01805

1 Communications could safely take on a debt level of
2 \$35 billion. Not million. \$35 billion. That's an
3 astronomical figure.

4 Q. That's also a hypothetical figure, is it
5 not?

6 A. I hope so, because there's no way we could
7 take on that level of debt.

8 Q. You've read Mr. Hill's testimony haven't
9 you and you've read his exhibits?

10 A. Yes.

11 Q. What is his recommendation with respect to
12 the debt level for his purposes?

13 A. His recommendation for the debt level is a
14 38 percent debt ratio.

15 Q. And what's the amount? Would you accept 1
16 billion 52 million?

17 A. I would accept that subject to check.

18 Q. Not 35.5 billion?

19 A. The 35 billion is the conclusion of his
20 operating risk analysis. That's --

21 Q. And all he's saying is that given these
22 factors conceivably the company could support that
23 level of debt. Isn't that all he's saying?

24 A. That's what he's saying and I'm saying
25 that's ridiculous.

01806

1 Q. But he's not suggesting in any fashion and
2 you're not suggesting to the Commission that he is
3 suggesting a debt at that level?

4 A. What I'm saying is that based on his
5 testimony and his operating risk analysis he said that
6 the company could safely undertake 35 billion in debt
7 and I said that's ridiculous. As you pointed out
8 that's not his ultimate recommendation but that is
9 part of his testimony.

10 Q. Wouldn't you agree that basically what Mr.
11 Hill is saying is that the company can support more
12 than the 1.052 billion that he has concluded is
13 appropriate?

14 A. That's not what I would say. What I would
15 say is what's in Mr. Hill's testimony, and that's what
16 I was taking issue with.

17 Q. Let me give you one hypothetical. With an
18 EBITDA of \$4,000 and the assumption that temporarily
19 cash flow from depreciation were available to be
20 applied to debt expense, could the firm meet a debt
21 cost obligation of \$3500?

22 A. Yes.

23 Q. 3750?

24 A. 3500 and 3750?

25 Q. 3,750, that's the next part of the

01807

1 question.

2 A. Let me make sure I understand the question
3 because I think we're missing some zeros here.

4 Q. Well, the zeros don't really matter. We're
5 starting with 4,000 --

6 A. With an EBITDA of.

7 Q. 4,000 and the assumption that temporarily
8 cash flow from depreciation would be available to
9 apply to debt expense. Could a firm meet a debt cost
10 obligation of \$3500 under these circumstances?

11 A. I'm sorry. I would like to correct my
12 previous answer. I was thinking in terms of 4 billion
13 of depreciation.

14 Q. Take 4 billion just add some zeros?

15 A. In your example I would say no, that the
16 debt level of depreciation and amortization would not
17 support a debt level. To use your example of a \$4,000
18 level depreciation and amortization does not suggest
19 to me that a company could support a borrowing level
20 of \$3500 or 3750.

21 Q. You would agree that income taxes are not
22 fixed in that situation, correct?

23 A. That the income taxes on the borrowing are
24 not fixed?

25 Q. That they would vary with the amount of

01808

1 operating income available after depreciation interest
2 expense?

3 A. That's true but I think for all practical
4 purposes you find that the corporations are paying
5 taxes at the marginal rate and so I doubt that it
6 would vary, very much if at all.

7 Q. Mr. Smith asked you yesterday of your
8 understanding of Ms. Folsom's use of CAPM, and let me
9 ask you about your use of the CAPM. Do you treat it
10 as a coequal analysis along with your DCF?

11 A. Yes, I do. I find that there are two
12 financial models in common use today to estimate the
13 cost of capital, that is the discounted cash flow and
14 capital asset pricing models.

15 Q. So you give CAPM exactly the same weight as
16 DCF?

17 A. I use those two methodologies applied to
18 three groups of companies and then apply some judgment
19 to the range of results that that produces.

20 Q. Are you aware of any regulatory body that
21 gives coequal weight to CAPM and DCF?

22 A. I'm not sure about the definition of
23 coequal. If you mean 50/50 I'm not sure about this,
24 but I know that the Oregon Commission places a heavy
25 reliance on the capital asset pricing model. So does

01809

1 the South Carolina Commission. The Illinois and
2 Wisconsin commissions have also used it. This was
3 some time ago but before Nebraska essentially
4 eliminated rate of return regulation the Nebraska
5 staff recommendation in the last case before
6 deregulation had the capital asset pricing model used,
7 so there are some.

8 Q. Have you examined the Commission orders in
9 this Commission with respect to its acceptance of the
10 DCF versus capital asset pricing model?

11 A. Not in any great detail but my impression
12 is that this Commission favors the discounted cash
13 flow methods.

14 Q. Would you turn to your Exhibit PCC-27 which
15 is Exhibit 303.

16 A. Yes, I have it.

17 Q. In the middle of the page you refer to ex-
18 post Ibbotson data for the market risk premium as
19 determined by the difference in the return on the
20 market and the returns on long-term and intermediate
21 term government securities. The long-term market risk
22 premium reports to be 7.1 and the intermediate market
23 risk premium reports to be 7.5, correct?

24 A. Yes.

25 Q. Do you have your work papers?

01810

1 A. Yes, I do.

2 Q. Refer you to page 118 from Ibbotson's 1995
3 year book. And I believe you cite that as the source
4 of the numbers that appear on this exhibit.

5 A. Yes, I have that.

6 Q. Where did the 7.1 and 7.5 figures that
7 appear on your exhibit come from?

8 A. The 7.1 -- actually they both start with
9 total returns on large company stocks. That's the
10 first line in that table and the second column is 12.2
11 percent and for the long-term government bonds we
12 subtract the income return for the long-term
13 government bonds, which is 5.1 percent, and that's
14 where the 7.1 percent comes from.

15 Similarly, for the intermediate term bonds
16 that is 12.2 percent return on large company stocks
17 minus the income return from intermediate term
18 government bonds of 4.7 percent.

19 Q. Are the market risk premiums equal for
20 intermediate and long-term?

21 A. No. One is 7.1, the other is 7.5.

22 Q. Do you have before you what's been marked
23 for identification as Exhibit 312?

24 A. Yes.

25 Q. Do you recognize this as your response to

01811

1 public counsel request 01-977? I'm sorry, wrong one.

2 Beg your pardon. Make that 01-970?

3 A. Yes.

4 Q. This was prepared by you, was it not?

5 A. It was prepared by one of my associates.

6 Q. The question was obviously written by
7 someone for whom English was a second language. I
8 think it should read is the purpose of financial
9 accounting as prescribed by the FASB to provide the
10 most accurate representation of the firm's financial
11 representation? You seem to be responding no. Is that
12 a correct impression?

13 A. I think the response speaks for itself that
14 financial reporting is not an end in itself but it's
15 intended to provide useful information, and it goes on
16 to say that despite the aura of precision that
17 surrounds financial reporting financial statements are
18 essentially approximation and they have different
19 uses.

20 Q. Let me ask you if you have in front of you
21 what's been identified as Exhibit 309 being your
22 deposition upon oral examination taken July 10, 1995?

23 A. Yes.

24 MR. CUNNINGHAM: Your Honor, at this
25 juncture I would offer Exhibits 309 through 312.

01812

1 JUDGE WALLIS: Is there objection?

2 MR. VAN NOSTRAND: We have no objection to
3 310 through 312. With respect to 309 we do object
4 that the entire deposition transcript is being offered
5 for the reasons stated by Mr. Owens yesterday
6 regarding the Commission's rule refers to offering
7 specified portions of a deposition transcript and does
8 not seem to contemplate an entire deposition
9 transcripts to be offered so we object to the
10 introduction of 309 on those grounds.

11 MR. CUNNINGHAM: Your Honor, I believe the
12 Commission ruled on receipt of complete depositions
13 yesterday. We are offering the entire deposition. I
14 believe that is consistent with the intent of the
15 rule. If I might make one further comment. Well,
16 anyway it's offered.

17 MR. VAN NOSTRAND: Your Honor, if I could
18 refresh your recollection the offer yesterday was that
19 public counsel would offer only its portion of the
20 deposition transcript and that offer was accepted by
21 the company. I don't believe the bench ruled on this
22 motion.

23 MR. CUNNINGHAM: If Your Honor please, I
24 don't think the offer is conditioned upon the
25 company's acceptance. I think this offer is fully

01813

1 consistent with the Commission's rule and I think the
2 Commission would be ill-advised to interpret its rule
3 so narrowly that it could not consider matters in
4 context of the entire deposition.

5 JUDGE WALLIS: I have Mr. Owens's arguments
6 in mind and believe that the rule should not be so
7 narrowly read as to allow only portions. I think that
8 would not be a sensible reading of the rule. The
9 portion which is offered is the entire document. The
10 issue of credibility was raised and I don't believe
11 that that is a reason to foreclose admission of the
12 document in that the witness is before the Commission
13 and the witness's credibility maybe judged. The rule
14 does now allow documents for admission of depositions
15 for any purpose. Consequently, the objection is
16 overruled and the exhibit is received.

17 MR. CUNNINGHAM: Thank you. I have no
18 further questions.

19 JUDGE WALLIS: Are there questions from
20 other parties? Commissioners.

21 CHAIRMAN NELSON: Pass.

22 COMMISSIONER HEMSTAD: Pass.

23 COMMISSIONER GILLIS: No questions.

24 JUDGE WALLIS: Redirect?

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

01814

1

2

REDIRECT EXAMINATION

3 BY MR. VAN NOSTRAND:

4 Q. Mr. Cummings, do you recall some questions
5 yesterday from staff counsel regarding the SFAS 106
6 and 71 impacts on the companies cited by staff witness
7 Folsom in her exhibit KMF-3?

8 A. Yes.

9 Q. I believe you indicated you wished to offer
10 some distinctions regarding the impact of those
11 accounting pronouncements on the various companies
12 cited. Do you recall that?

13 A. Yes.

14 Q. And what are the remarks you wish to make
15 in that regard?

16 A. What I wished to say was that in response
17 to counsel's statement that all of the companies in
18 that group had adopted SFAS 106 prior to the test
19 period. I wanted to make the company that that was
20 true but that there was a distinction that could be
21 made among the companies that's important, and that is
22 that when FAS 106 was ordered, the companies had the
23 option for their financial statements of taking a
24 large one time write-off or amortizing that effect over
25 a period of up to 20 years, and there are companies

01815

1 that adopted that different ways. Some wrote it off
2 and some amortized and so my point was that if you're
3 reporting the capital structure of those companies you
4 will see an artificial distinction depending upon which
5 option that they chose.

6 To give you an example, among the RH Bell
7 companies Ameritech and Bell Atlantic did a write-off.
8 Bell South and NYNEX amortized -- Bell South amortized
9 over 15 years. And Pacific Telesis, Southwestern Bell
10 and U S WEST also did a one time write-off. Among
11 independent companies GTE did a write-off, Cincinnati
12 Bell, Rochester Tel and Southern New England Tel
13 amortized. I'm not sure about Alltel but anyway my
14 point is that it's very difficult to do an apples to
15 apples comparison on capital structure given those
16 differences in their financial reporting.

17 Q. If we can turn for a moment to 308 which is
18 the Smith Barney analysis introduced yesterday by
19 staff. Do you have that?

20 A. Yes, I do.

21 Q. And this analysis purports to evaluate the
22 large telephone company's competitive vulnerability;
23 is that correct?

24 A. Yes.

25 Q. And one of the factors examined in the

01816

1 analysis looks at residential business as a percentage
2 of access lines or revenues. Do you see that on page
3 2?

4 A. Yes.

5 Q. And one of the observations in this article
6 is that with respect to residential customers that
7 they are likely to have a choice of only two local
8 service providers, a cable or a telephone company. I
9 would ask you, is this a reasonable observation to
10 make with respect to the company's operations in
11 Washington?

12 A. I don't think so. There are a number of
13 companies that have actually made application to
14 provide local telephone service in Washington. In
15 addition to a cable company, TCI, I am aware of
16 Electric Lightwave, AT&T and MCI.

17 Q. And another observation made with respect
18 to that factor was the reporting case in the same
19 park. "We exclude wireless as a primary access
20 technology for at least three to five years due to
21 issues of quality and the increasing desire of high
22 usage customers for broadband or near broadband types
23 of services." Is exclusion of wireless a reasonable
24 approach with respect to the state of Washington?

25 A. I don't think so. Analysts differ on their

01817

1 assessment of the wireless competitive impact. I've
2 read other analyst reports which would indicate that
3 wireless competition is more imminent than the view
4 taken here by Smith Barney. It's my personal opinion
5 that we're going to see more wireless competition
6 sooner than the Smith Barney analysts indicates. I
7 think three to five years out is too long a view for
8 wireless competition, particularly in Washington.

9 Q. A second factor considered in this analysis
10 is the customer density in service areas also
11 discussed on page 2 of Exhibit 308, and one of the
12 statements made in that paragraph notes that "U S WEST
13 with 50 percent of its population residing outside of
14 metropolitan areas of 100,000 or more people appears
15 to be less exposed to competition." Do you agree with
16 this statement?

17 A. There seems to be some common sense that
18 goes with the idea that urban concentration gives rise
19 to more concentration and rural populations are going
20 to have less competition, but I think the important
21 point is that all of the companies that are mentioned
22 in this report are vulnerable to competition, and U S
23 WEST may be less vulnerable because of some factors
24 but nevertheless we are still vulnerable. It would be
25 my view along with what I said just a minute ago about

01818

1 wireless technology that I think we will see wireless
2 technology providing a viable alternative in the rural
3 areas along with cable penetration in those areas as a
4 viable competitors.

5 MR. VAN NOSTRAND: I have no further
6 questions, Your Honor.

7 JUDGE WALLIS: Recross.

8 MR. SMITH: Just a few.

9

10 RE CROSS-EXAMINATION

11 BY MR. SMITH:

12 Q. Mr. Cummings, your discussion with counsel
13 on the effect of SFAS 106, is it your testimony that
14 the only valid capital structure comparison to the
15 companies would be one in which all the companies
16 adopted consistent treatment of the effects of SFAS
17 106?

18 A. I think there are two ways to make that
19 comparison. One way is the way that I've done it in
20 my company which is to use the company's regulated
21 reporting which is specified by the FCC. They
22 mandated that for regulatory reporting all companies
23 were to choose the amortization method.

24 Another way to do it would be to use
25 financial reporting but to make an adjustment to put

01819

1 all the companies on the same basis and I have seen
2 some equity analysts that have done that.

3 Q. So is your answer yes to the question?

4 A. Could you repeat the question, please.

5 Q. Is it your testimony that the only valid
6 capital structure comparison for these companies would
7 be one in which all the companies adopted the same
8 treatment for purposes of SFAS 106?

9 A. My answer, I guess, would be yes, that in
10 fact they didn't all adopt the same treatment but if
11 you put them all on a consistent basis one way or the
12 other then you can make comparisons among the
13 companies.

14 Q. Then your counsel asked you some questions
15 about Exhibit 308 which is the Smith Barney report,
16 and on page 2 you took some issue with the statement
17 that residential customers are likely to only have a
18 choice of two local service providers. Do you recall
19 that?

20 A. Yes.

21 Q. And you indicated that a number of
22 companies had made application in the state of
23 Washington so you didn't think that statement was
24 applicable here. Was that your testimony?

25 A. Yes.

01820

1 Q. How many local service providers are
2 providing residential exchange service in competition
3 with U S WEST today?

4 A. I don't know.

5 Q. Do you know whether any are providing
6 residential service?

7 A. I don't believe they are. The issue,
8 though, is how many are planning to do it. That was
9 the question I was addressing.

10 MR. SMITH: That's all I have.

11 JUDGE WALLIS: Anything further?

12 MR. WAGGONER: Yes. Just one or two
13 questions.

14

15 RE-CROSS-EXAMINATION

16 BY MR. WAGGONER:

17 Q. You've indicated you believed that wireless
18 is going to be a particularly strong competitor in
19 Washington state. Is there any particular reason you
20 have that belief?

21 A. Yes. In addition to having the two very
22 active cellular competitors right now, I believe that
23 Washington state will see PCS or personal
24 communication systems development earlier than other
25 parts of the country will, and I am referring to a

01821

1 start up -- can't think of the name of the company
2 right now -- but it's headed by the man who used to
3 run U S WEST New Vector. And I think Mr. McCaw will
4 be providing some additional wireless services as
5 well.

6 Q. And it's your testimony that those two
7 individuals Mr. DeFao whose name you did not recall
8 and Mr. McCaw are going to be focusing on Washington
9 state?

10 A. I wouldn't say they were going to be
11 focusing on Washington state. I said they will be
12 operating in Washington state.

13 Q. Their headquarters are in Washington state?

14 A. Right.

15 Q. In terms of the likelihood of PCS serving
16 as a direct competitor for residential exchange
17 service, have you ever looked at PCS pricing?

18 A. That's kind of theoretical right now
19 because we don't have operating systems in place.

20 Q. Are you aware that there's currently a PCS
21 system operating on a commercial basis in Washington
22 D. C.?

23 A. No.

24 Q. You've talked about AT&T as a potential
25 competitor for local service, correct?

01822

1 A. Yes.

2 Q. And are you aware of any offerings of AT&T
3 for local service in Washington state at this time?

4 A. No.

5 Q. And are you aware of AT&T's plans that it
6 has announced publicly that it will attempt to resell
7 the local exchange service of such companies as U S
8 WEST?

9 A. I have seen some press on that, yes.

10 Q. And did you take into account in your
11 opinion about AT&T the statements that it would be
12 reselling the local service of U S WEST?

13 A. It's my understanding that AT&T could
14 provide a local service interface by reselling by
15 direct connection or through its wireless subsidiary.

16 MR. WAGGONER: No further questions.

17 JUDGE WALLIS: Anything further of the
18 witness? It appears that there's not. Mr. Cummings,
19 thank you for appearing here today. You're excused.

20 (Recess.)

21 JUDGE WALLIS: Let's be back on record,
22 please, following a morning recess. The company is
23 calling Brian Farrow to the stand at this time. Mr.
24 Farrow, welcome.

25 Whereupon,

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1 BRIAN FARROW,
2 having been first duly sworn, was called as a witness
3 herein and was examined and testified as follows:

4 JUDGE WALLIS: I will note that exhibits
5 for Mr. Farrow have been identified for record
6 purposes.

7

8 DIRECT EXAMINATION

9 BY MR. OWENS:

10 Q. Morning, Mr. Farrow, would you please state
11 your name and address for the record and spell your
12 last name?

13 A. My name is Brian E. Farrow, F A R R O W.
14 I'm employed at 1314 Douglas On The Mall, Omaha,
15 Nebraska for U S WEST Communications as director of
16 product costs.

17 Q. Are you the same Brian Farrow who has
18 caused to be predistributed in this case the exhibits
19 that have been premarked as Exhibits 83T, 84 through
20 89, 90C, 332C, 333T, 334, 335, 336C, 337C, 338T,
21 339, 340, 342 and 343?

22 A. Yes.

23 Q. With regard to your testimony and Exhibits
24 83T, 333T and 338T, are there any corrections other
25 than as have been already submitted on the marked

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1 errata sheet?

2 A. No, there are the not.

3 Q. So if I were to ask you the questions
4 printed on Exhibits 83T, 333T and 338T, would your
5 answers be as set forth therein?

6 A. Yes, they would.

7 Q. With regard to Exhibits 84 through 89, 90C,
8 332C, 334, 335, 336C, 337C, 339, 340, 342 and 343,
9 were those exhibits prepared by you or under your
10 direction and supervision?

11 A. Yes.

12 Q. And are they true and correct to the best
13 of your knowledge and belief?

14 A. Yes, they are.

15 MR. OWENS: U S WEST offers at this time
16 the Exhibits 83T, 333T, 338T and the other previously
17 identified exhibits into evidence at this time.

18 JUDGE WALLIS: Is there any objection?

19 MR. SMITH: No.

20 JUDGE WALLIS: There being no objection
21 those exhibits are received in evidence. Let's be off
22 the record for just a moment.

23 (Admitted Exhibits 83T, 333T, 338T.)

24 (Discussion off the record.)

25 JUDGE WALLIS: Let's be back on the record,

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1 please.

2 MR. OWENS: Mr. Farrow is available for
3 cross-examination and examination by the Commission.
4 I'm sorry. I neglected to indicate, we had informed
5 the parties, as you had requested, that we had a few
6 oral surrebuttal questions to ask Mr. Farrow in
7 response to the supplemental filing in the middle of
8 December, and I would like to proceed with that at
9 this time.

10 MR. TROTTER: Your Honor, just note for the
11 record I was so notified. I did ask what the nature
12 of the question was and I was not favored with a
13 response other than it was related to the December
14 testimony.

15 JUDGE WALLIS: Very well.

16 Q. Mr. Farrow, have you -- actually this would
17 more be in the nature of an update, I suppose, to your
18 supplemental testimony where you indicate that at the
19 time of filing of that testimony you had not received
20 any response to the proposed stipulation that was
21 attached as an attachment to your testimony on what
22 the company could do to provide additional information
23 on costs. Have you since that time received some
24 response and if so what's your reaction or perception
25 to that response?

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1 A. Yes. I did receive a response from the
2 WUTC staff, and based upon my analysis it looks like
3 that we're very close on reaching an agreement. There
4 are just a couple of items that I just need to talk to
5 them about just to clarify.

6 MR. WAGGONER: Your Honor, I would like to
7 enter an objection at this time. I think this is a
8 highly objectionable line of inquiry.

9 First of all, they haven't favored us with
10 the exhibit which he's now testifying about apparently.

11 Second of all, it was certainly my
12 understanding of the settlement discussions that those
13 discussions among the parties about stipulations,
14 unless they were memorialized in a signed stipulation,
15 would be in the nature of settlement discussions, and
16 those would not be appropriate on this record.

17 MR. OWENS: Your Honor, it's U S WEST's
18 understanding that the Commission specifically asked U
19 S WEST to try to work with the parties to reach some
20 agreement and accommodation on this issue, and we're
21 simply reporting on the progress of that. We're not
22 attempting to compromise the privacy of any specific
23 representations or statements in the settlement
24 process. We're simply trying to report.

25 MR. WAGGONER: May I respond briefly? It

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1 seems to me they are trying to exactly do that.
2 They're trying to characterize the positions of
3 different parties apparently with a desire to prejudice
4 settlement discussions.

5 JUDGE WALLIS: Is it necessary that you
6 have that information in the record if it is merely a
7 report on ongoing negotiations?

8 MR. OWENS: If the Commission decides that
9 they don't want to hear the progress on the
10 negotiations that they earlier indicated they wanted
11 to be conducted, I suppose we can move on.

12 JUDGE WALLIS: Very well.

13 Q. Have you had a chance to review the
14 prefiled testimony of Dr. Zepp?

15 A. Yes, I have.

16 Q. Specifically where he indicates -- I
17 believe it's at page 16 of his supplemental filing --
18 that DID determinations should be at one dollar?

19 A. Yes. He indicated that DID determinations
20 should be costed at one dollar.

21 Q. And what's your response to that?

22 A. Well, we did provide a revised DID study
23 that did identify the costs of DID determinations, and
24 this study was done per the nine cost principles that
25 I talked about in my supplemental testimony, and we

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1 think the Commission ought to accept that cost study
2 as the service costs for DID studies rather than this
3 one dollar that Dr. Zepp discussed.

4 Q. Is there any support in Dr. Zepp's
5 testimony for his one dollar number?

6 A. I did not see any.

7 Q. With regard to the staff witness Spinks
8 supplemental testimony there's an implication I
9 believe at page 5 of his supplemental testimony that
10 U S WEST used objective fill only in the calculation
11 of feeder plant and used engineering design costs in
12 the calculation of distribution plant costs. Are the
13 costs for distribution calculated at objective fill in
14 this docket?

15 A. Yes. The costs of distribution in this
16 docket is calculated at objective fill, and that is
17 shown in the volume sensitive costs of the studies
18 that we provided. I think what he's referring to is
19 perhaps a conversation that we had at one of the
20 settlement meetings in which I said that objective
21 fill does not exist for distribution, and the reason I
22 said that because I'm very concerned about using a
23 flat 85 percent objective fill ratio for distribution.
24 I think that using an 85 -- I think in some situations
25 in using an 85 percent objective fill ratio will end

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1 up with some costs for some lines that will never be
2 revenue producing for U S WEST, and that's why I made
3 that statement, but we did calculate our costs at
4 objective fill and it's in the volume sensitive costs.

5 Q. Thank you. In conclusion on Mr. Spinks, at
6 page 9 he is asked that the company be required to
7 provide direct costs data. What if anything does the
8 company plan to do to satisfy that request?

9 A. Mr. Spinks, in particular, he talked about
10 being able to also have some judgment about whether or
11 not products are being subsidized, and in my
12 supplemental testimony, in the last exhibit, Exhibit 4
13 of my supplemental testimony I provided a comparison
14 of revenues and costs and what I would propose is that
15 we -- that U S WEST provide this type of analysis in
16 the future and in fact U S WEST is willing to provide
17 this type of analysis by USOC for at least 90 percent
18 of the top revenue producing products. And I think
19 this type of information will show from a total
20 revenue standpoint if you compare that total revenue
21 information to total costs whether or not a product is
22 being subsidized.

23 I need to caution you, however, as you look
24 at these exhibits because there's a revenue
25 calculation here and there's also a calculation of

01830

1 loop drop and NTS-COE costs you really cannot directly
2 compare those costs because there are other costs
3 associated with each one of these services but I'm
4 providing this to show you that this is the type of
5 format that we would like to provide in the future.

6 Q. Thank you. Moving to the testimony of
7 witness Murray for the Northwest Payphone Association.
8 Have you reviewed that testimony?

9 A. Yes, I have.

10 Q. This is the supplemental testimony?

11 A. Yes, I have.

12 Q. And there's an allegation at page 2 that
13 "U S WEST games its costs studies." Do you have any
14 response as to whether that's a true or untrue
15 statement?

16 A. That is untrue. We do not game our cost
17 studies.

18 Q. Further there's a suggestion at page 3 that
19 "U S WEST understates competitive costs and
20 overstates monopoly costs." Is that a true statement?

21 A. No. In fact it is not a study. There is
22 no particular definition of what's competitive and
23 what's monopoly so we do not do that.

24 Q. Do you agree with the statement at page 3
25 of Ms. Murray's testimony that U S WEST cost studies

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1 are inconsistent with economic concepts of cost?

2 A. No, I disagree with that also. In my
3 supplemental testimony I did provide nine cost
4 principles that even some parties in this room have
5 agreed to in other states, and U S WEST cost studies
6 do file those nine cost principles. In fact Dr.
7 Emmerson is also here and he was a party to writing
8 those nine cost principles and he can speak to the
9 principles themselves.

10 Q. There's an allegation at page 6 of Ms.
11 Murray's testimony that U S WEST omitted certain costs
12 of the refurbished pay phone terminal equipment in its
13 cost study. Is that a true statement?

14 A. No, that is not a true statement. We do
15 include the investment of refurbished sets in our cost
16 study.

17 Q. At page 7 of Ms. Murray's testimony she
18 makes an allegation that based on the response to a
19 data request U S WEST supposedly overstates the
20 appropriate period for amortization of nonrecurring
21 costs for public telephone service. Do you know
22 whether or not in that testimony Ms. Murray
23 mischaracterized both the data requests and U S WEST's
24 response to that request?

25 A. Yes, she did. What she specifically asked

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1 us for was average contract lives. She did not ask us
2 for customer lives so she is mischaracterizing that in
3 her testimony, and we provided contract lives not
4 customer lives.

5 Q. And when the contract expires is there
6 anything that precludes the company from renewing or
7 entering into a new contract with the same customer at
8 the same location?

9 A. No. Nothing precludes us from doing that.

10 Q. There's an extended discussion beginning at
11 page 7 of Ms. Murray's testimony concerning the
12 treatment in U S WEST cost studies of the compensation
13 that U S WEST Communications pays the site owner for
14 the privilege of having its telephone located there,
15 and the way that's calculated. Do you have any
16 response to that criticism?

17 A. Yes. Her criticism dealt specifically of
18 how that is calculated and she was referring to taking
19 the total compensation and dividing it by the number
20 of units, and her concern was that we had stated in
21 our testimony that -- I should say stated in the study
22 that these costs are volume sensitive and they vary
23 with revenues, and I guess my response to that is
24 that, yes, they do vary with revenues but the revenues
25 are based upon the units sold and since the revenues

01833

1 are based upon the units sold then it is proper for
2 us to divide those compensation expenses by the number
3 of units sold and so they're directly related.

4 Q. Is Ms. Murray correct that any U S WEST
5 cost study that has been submitted here showed the
6 ADSRC of a retail public telephone function as being
7 less than the ASIC of the same function?

8 A. No, that is incorrect. Our cost studies do
9 not show that.

10 Q. Did U S WEST Communications change its
11 costing methodology after Ms. Murray's initial
12 testimony as she alleges we did?

13 A. Change our methodology?

14 Q. Costing methodology?

15 A. No, we did not change our costing
16 methodology, no.

17 Q. Finally, with regard to the supplemental
18 testimony of Mr. Dunkel, are you familiar with his
19 recommendation that U S WEST be required to respond to
20 a standard filing requirement with regard to its
21 costs?

22 A. Yes, I am.

23 Q. And do you have any response to that
24 recommendation?

25 A. Well, I did take a look at his

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1 recommendation, but I would ask the Commission to take
2 a look at the stipulated agreement and what's going on
3 in the negotiations associated with the stipulated
4 agreement. I think we're pretty close to coming up
5 with an agreement with the staff.

6 MR. WAGGONER: Your Honor, may I make an
7 objection? He's obviously wandering back into the
8 settlement negotiations. Obviously the question
9 did direct him there but I don't think the witness may
10 be aware of what the earlier ruling was.

11 JUDGE WALLIS: The Commission has by rule,
12 which is in the process of being adopted, indicated
13 that settlement discussions are privileged and are not
14 subject to disclosure under ordinary circumstances,
15 and I would sustain an objection to the description of
16 settlement discussions or the specifics of
17 conversations that were entered in the course of
18 ongoing settlement discussions.

19 Q. Let me ask you this, Mr. Farrow. Compared
20 to what U S WEST has indicated a willingness to
21 provide and what Mr. Dunkel states the company should
22 be required to provide, what is your reaction to the
23 differences if any?

24 A. There are some similarities. But there is
25 some data in which Mr. Dunkel is asking us to provide

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1 that is not readily available. There are some
2 assumptions in his proposal that we don't think are
3 economically proper one of which is -- he says that 85
4 percent objective fill should be used in all cases,
5 and Dr. Emmerson can address how that is an improper
6 method for doing economic cost studies. Some of the
7 data in his matrix that he's requesting us to provide,
8 as I said, is not readily available. Some of it
9 really deals with market information rather than
10 costing information.

11 I would suggest that -- I would propose that
12 the Commission take a look at my exhibit, which is BEF
13 4 and my supplemental testimony. We plan on providing
14 that type of information on a USOC basis and I think
15 that type of information would be much more valuable to
16 the Commission.

17 MR. OWENS: That concludes the oral
18 surrebuttal and Mr. Farrow is available for
19 cross-examination and examination by the bench.

20 JUDGE WALLIS: Mr. Smith.

21

22 CROSS-EXAMINATION

23 BY MR. SMITH:

24 Q. Hello again, Mr. Farrow.

25 A. Hi, Mr. Smith.

01836

1 Q. Are the cost studies that you have
2 sponsored in this proceeding been intended to
3 represent the economic costs incurred by the company
4 in providing the service?

5 A. Yes, they are.

6 Q. And the design of the methodology followed
7 in those studies was undertaken in conformance with
8 economic costing principles; is that right?

9 A. That's correct.

10 Q. Now, let's clarify what economic principles
11 you're following. In the LTR proceeding, did you
12 testify that the company's average service incremental
13 cost methodology produces results that are equivalent
14 to the total service long-run incremental cost concept?

15 A. Yes.

16 Q. And can you tell me which economist's
17 definition of TS LRIC you were relying upon in that
18 testimony?

19 A. Dr. Emmerson here has put together -- I
20 should say we work very closely with Dr. Emmerson on
21 our cost methodology and the principles that are used
22 in those cost studies are included in my supplemental
23 testimony, and he is here to answer questions about
24 those principles.

25 Q. In your rebuttal testimony, 333-T at page 15

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1 you have stated that "There is no one definition of TS
2 LRIC." Do you see that, lines 22 and 23?

3 A. Yes. What I was referring to there is
4 obviously U S WEST has several jurisdictions that it
5 works in, and some of those state's jurisdictions in
6 the legislature have defined TS LRIC differently.

7 Q. And one of those state definitions is in
8 the Utah's 1995 Telecommunications Act which you refer
9 to there on that page?

10 A. Yes.

11 Q. And you say that "By that definition TS
12 LRIC is equivalent to U S WEST average direct and
13 shared residual costs"?

14 A. Yes.

15 Q. Is it the company's position that there are
16 multiple equally valid economic definitions of TS
17 LRIC?

18 A. We believe that the definitions shown here
19 in our testimony -- in my testimony, I should say, is
20 the definition that we think that the Commission ought
21 to adopt and this complies, and our cost studies do
22 comply with this. The reason I like this definition
23 is because of the fact that it deals with the cost
24 object in three different ways. It deals with it at a
25 service level. It deals with it at a functional level

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1 and it deals with it at a group level, and that's the
2 reason why I am proposing this definition or I have
3 included this definition in my cost study support.

4 Q. And what definition are you talking about
5 now?

6 A. The one on lines 10 through 19 on page 15
7 of my rebuttal testimony, and that the definition of
8 TS LRIC you used when you developed a costing
9 methodology that you followed in the cost studies you
10 are sponsoring in this proceeding?

11 A. Yes.

12 Q. Mr. Farrow, under the company's definition
13 of TS LRIC, does TS LRIC represent the economic price
14 floor for a particular service?

15 A. Yes. Under our definition what we have
16 labeled as TSIC, or on a unit level as ASIC that is
17 the economic price floor for a particular service.

18 Q. And I believe you stated in other testimony
19 or in your direct testimony in fact in this proceeding
20 that when a service is competitive that it may be best
21 to price it below ADSRC but above ASIC; is that
22 correct?

23 A. What I was referring to there if the market
24 conditions, and obviously the pricing witnesses can
25 talk more about how the product should be priced, but

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1 I'm just saying that if the market price is below
2 ASDRC then it may be proper to price there as long as
3 within that service group that other service will
4 recover the group-related costs.

5 Q. And is it your view that ASIC represents a
6 TS LRIC for an individual service? Let me strike that
7 question. If an individual service is priced below
8 ASIC, will that service be subsidized by other
9 services?

10 A. I believe that if the total service costs
11 is a TSIC is greater than the revenues is the total
12 revenues, then yes, there would be a subsidy.

13 Q. And on a unitized basis that would be ASIC,
14 as you indicated?

15 A. On a unitized basis, yes.

16 Q. So for any competitive service the
17 Commission should compare prices to ASIC in order to
18 make sure that it isn't subsidized?

19 A. They should compare prices to ASIC to
20 assure that it's not being subsidized at the direct
21 product level. However, it does not mean that pricing
22 above -- just pricing above ASIC is going to recover
23 the group-related costs. This is one of the reasons
24 why we provided ADSRC was to give a method of
25 determining whether or not your group-related costs

01840

1 are being recovered also.

2 Q. And the company has attached great
3 importance to insuring that services are not
4 subsidized, has it not?

5 A. Yes.

6 Q. In particular by proposing that residential
7 exchange rates must be increased because the service
8 is being subsidized at your current rates?

9 A. Yes.

10 Q. Is it true, however, that in your direct
11 testimony in this case, you did not present the
12 results -- you do not present the ASIC result for
13 local exchange services and nor for virtually all of
14 the other service for which you provided cost results?

15 A. Yes, but you've got to also remember that
16 we are -- for all those services we are proposing
17 prices above ADSRC, not immediately for residential
18 service but the ultimate proposal was to get residence
19 service above ADSRC so residence service will also
20 make a contribution towards recovering some of these
21 shared costs and once it's above ADSRC also make a
22 contribution to recovering common costs of the
23 corporation as well.

24 Q. But in your direct testimony, your
25 confidential Exhibit 332C, which is BEF 8, only MTS and

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1 Centrex show ASIC results; is that correct?

2 A. That's correct, and that support was
3 provided because the ASIC results are being used in
4 imputation analysis in Dan Purkey's testimony.

5 Q. And all the other services in BEF 8 show
6 ADSRC results; is that correct?

7 A. That's correct. By the way, the backup
8 documentation to the cost studies also included the
9 breakdown of the costs for both ASIC and ADSRC.

10 Q. Now, I think in response to one of my first
11 questions you agreed that the company's position is
12 that its cost studies are intended to represent the
13 economic costs incurred by the company in providing
14 the service?

15 A. That's right.

16 Q. In your direct on page 4 you state the
17 studies you presented reflect the economic principle
18 of cost causation in that they identify the average
19 unit costs caused by providing the total service in
20 question. Do you see that?

21 A. Which line?

22 Q. Lines 2 and 3.

23 A. Okay, yes. Yes, the studies do provide that
24 information.

25 Q. And in your view identifying TS LRIC costs

01842

1 using the principle of cost causation means that if
2 demand for a service decreases those costs that are
3 thus avoided were caused by the service in the first
4 place and thus are economic costs?

5 A. Yes, but there are also shared cost and
6 shared costs as well are economic costs.

7 Q. And if a service is discontinued entirely
8 those costs that are therefore avoided were caused by
9 the service in the first place and thus are economic
10 costs?

11 A. Yes.

12 Q. I'm sorry, did you say yes?

13 A. Yes.

14 Q. On page 7 of your direct testimony you
15 defined shared residual costs as volume insensitive
16 costs associated with a group, eliminated only if the
17 entire group is not offered. Do you recall that
18 definition?

19 A. Yes.

20 Q. So you would agree that for the shared
21 residual costs that you have identified in your cost
22 studies no individual service has caused those costs
23 to be incurred?

24 A. I am going to respond to that as not on an
25 individual basis but certainly to the extent that from

01843

1 from the fact that a service is part of a group it did
2 cause some of those costs to be caused.

3 Q. I'm not sure I understood your answer.

4 A. To the extent that that service is part of
5 a group it did cause some of those costs to be caused.

6 Q. But the SRC won't go away with the
7 disappearance of that service, will they?

8 A. To the extent that the SRCs are properly
9 identified, no, they would not go away.

10 Q. So that the SRC costs that you have
11 identified have not been assigned to individual
12 services on the basis of cost causation, have they?

13 A. Well, I explained in my testimony how they
14 are assigned to individual services. They are
15 assigned to individual services on the basis, the same
16 basis, that we assign the volume sensitive costs to
17 those individual services. We assign them in the same
18 proportion and so they are assigned to services on
19 that proportional basis.

20 Q. Well, aren't they assigned to a particular
21 family and then allocated to services within that
22 family?

23 A. They are assigned, usually on a functional
24 basis, and to the extent that a service uses one of
25 those functions then they will be assigned to that

01844

1 service.

2 Q. And under that allocation the same
3 proportioned amount of volume insensitive investments
4 is mapped to products as volume sensitive costs?

5 A. Yes, for the investment component of the
6 shared costs.

7 Q. Now, with respect to common overhead costs,
8 how are those defined by you?

9 A. Common overhead costs include, I believe I
10 defined in my testimony, such things as the president's
11 desk, the president's salary. It includes salaries of
12 and compensation of all of the directors of the
13 corporation. It is those costs that do not vary, in
14 other words, with a service or a group of services.

15 Q. And you've excluded common overhead costs
16 from your economic cost studies because their
17 inclusion would not be consistent with the principle
18 of cost causation. They do not vary with the
19 provision of a service or group of services, and they
20 would only be avoided if the company ceased operations
21 altogether?

22 A. Yes, to some extent, but one of the things
23 you've got to realize is that there are still costs
24 and they still have to be recovered through rates.

25 Q. Have your studies included SRC costs

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1 associated with end office switched?

2 A. Yes.

3 Q. Let's assume that the company provided only
4 switched services and in fact all of its services
5 utilized the end office switching function. In that
6 case those SRC costs would only be eliminated if the
7 entire company discontinued operations; isn't that
8 correct?

9 A. Could you repeat your question, please.

10 Q. Let's assume the company provided only
11 switched services and all of its services utilized the
12 end office switching function. In that case those SRC
13 costs would only be eliminated if the entire company
14 discontinued operations?

15 A. Yes.

16 Q. Therefore, following the principle of cost
17 causation, shouldn't you exclude those costs from the
18 determination of the TS LRIC costs for a particular
19 service since they cannot be attributed to a
20 particular service and are only avoided if the entire
21 company discontinued operations just like a common
22 overhead cost.

23 MR. OWENS: Excuse me, are we still on the
24 hypothetical where the only services the company
25 provides are switched and all services use the end

01846

1 office?

2 MR. SMITH: Yes.

3 MR. OWENS: Thank you.

4 A. Go back to your second question again and
5 repeat that.

6 Q. Do you have the hypothetical still in mind?

7 A. I sure do.

8 Q. Under the principle of cost causation,
9 shouldn't you exclude those shared residual costs from
10 the determination of the TS LRIC cost for a particular
11 service because they cannot be attributed to a
12 particular service and are only avoided if the company
13 ceases operation just like in the case of an overhead
14 cost?

15 A. That sounds like an economic question I
16 would really like to defer to our expert on economic
17 principles and that's Dr. Emmerson and he's here and
18 can answer that question for you.

19 Q. But you would agree, wouldn't you, that it
20 wouldn't matter whether those costs are defined as
21 shared residual costs or common overhead costs from
22 the standpoint of cost causation, that the costs are
23 not driven by a particular service?

24 A. I believe that depending upon the costs, if
25 the costs are associated -- if the costs are direct

01847

1 costs of the service and the service goes away then
2 those costs should go away. If there are
3 group-related costs and the group of service go away
4 then the group-related costs will go away. If the
5 corporation ceases to exist then there are some --
6 then the common costs would go away. They might not
7 go away. They still might have to pay some debt that
8 still occurs, but I believe the common costs will go
9 away.

10 Q. Will you turn to page 11 of your rebuttal
11 testimony. Referring to the question and answer
12 discussion beginning on line 10 on that page, it's
13 your testimony there that certain accounts classified
14 as common overhead are in fact assignable to services?

15 A. Is this rebuttal or direct?

16 Q. Your rebuttal testimony. The heart of it
17 begins on line 15 in the middle?

18 A. Ask your question again.

19 Q. Is it your testimony there that certain
20 accounts classified as common overhead are in fact
21 assignable to services?

22 A. No, it's not my testimony.

23 Q. Can you tell me what you mean there when
24 you say "based on Dr. Selwyn's list of accounts I agree
25 that some of the accounts and others not listed are

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1 assignable to services"?

2 A. I did not say that they were common
3 overhead accounts. I said those accounts that are not
4 common overhead accounts can be assignable to services
5 at a group level.

6 Q. Following on you say "those accounts that I
7 agree are assignable to services" are included in U S
8 WEST's shared residual costs using the administrative
9 factor that I discussed earlier." Do you see that?

10 A. Yes.

11 Q. And in footnote 5 among the accounts is
12 account 5301 for uncollectibles?

13 A. Yes.

14 Q. Would you agree that the level of
15 uncollectibles may vary among different types of
16 services?

17 A. I would agree to that.

18 Q. Your method however does not assign those
19 costs to specific services based on cost causation but
20 instead allocates them as another SRC through the
21 application of the administrative factor?

22 A. Yes. That's because we don't have a detail
23 on the service basis.

24 Q. And is that the reason --

25 A. So that's why we call them shared costs.

01849

1 Q. Is that the reason why you haven't followed
2 cost causation principles in that case, that your
3 accounting system doesn't allow it?

4 A. I did use cost causation principles.

5 Q. Well, in principle if uncollectibles vary
6 among different services they should be assigned to
7 those services and included in TS LRIC and your ASIC
8 results?

9 A. Yes, and if we had that type of detail in
10 our accounting system we would have assigned them on a
11 service specific basis.

12 Q. And would you agree in principle at least
13 that if a cost was classified as common overhead --
14 excuse me -- that a cost classified as common overhead
15 was misclassified and was in reality volume sensitive
16 it should be included in TS LRIC and your ASIC?

17 A. If we have the information available to us
18 to make that assignment, yes.

19 Q. I'm going to ask you or pose a hypothetical
20 for you. Let's assume you're a building contractor
21 and you've been retained to construct a building for a
22 customer who needs 10,000 square feet. You plan a
23 two-story building with 5,000 square feet first story
24 but you think the customer might expand in the future
25 and you want to capture his business so you add a

01850

1 third story with an additional 5,000 square feet,
2 since it's much cheaper to add it now than to do it
3 later or to build a different building. At \$100 per
4 square foot the cost without the third story would be
5 \$1 million, the incremental cost of the third story,
6 since it would be cheaper to do it at the same time,
7 is \$50 per square foot, or \$250,000 so that the
8 overall cost is \$1,250,000. Setting aside the
9 question of your profit would you set your price for
10 this project at the \$1 million two-story level or the
11 \$1,250,000 three-story level?

12 A. Would I set the costs of the project you
13 say, is that your question?

14 Q. Set your price for the project.

15 A. I'm not a pricing witness. I'm here to
16 really talk about cost studies. I think one of the
17 pricing witnesses would be better to answer a question
18 like that.

19 Q. The fact is Dr. Emmerson is here today and
20 he can probably answer that question because he's our
21 expert on economic theory.

22 If you priced at the \$1.25 million level,
23 however, wouldn't the customer refuse and take his
24 business elsewhere.

25 MR. OWENS: Well, Your Honor, the witness

01851

1 has already indicated he's not a pricing witness and
2 has asked that this line of inquiry be directed to a
3 witness who is here today, Dr. Emmerson.

4 MR. SMITH: Your Honor, Mr. Farrow's direct
5 testimony tries to address the practice of installing
6 three distribution pairs and this hypothetical goes to
7 that?

8 THE WITNESS: Can I comment?

9 MR. OWENS: There's an objection pending.
10 The witness indicated he's not a pricing expert.

11 MR. SMITH: Your Honor, I will withdraw the
12 question.

13 Q. Mr. Farrow, are you familiar with Mr.
14 Purkey's exhibit in this case and in the LTR case
15 which is the joint statement on cross subsidization?

16 A. No, I'm not familiar with that. I remember
17 seeing the statement but I'm not familiar enough to
18 answer questions about it.

19 Q. Is it the company's position that the ASIC
20 cost estimates shown -- starting over. Is it the
21 company's position that the ASIC cost estimates shown
22 in Exhibit BEF-4 of your supplemental testimony
23 represent the TS LRIC for residential local exchange
24 service including the loop?

25 A. BEF-4?

01852

1 Q. It is the rebuttal testimony, I'm sorry.

2 It is Exhibit 337C.

3 A. Is this the exhibit labeled Current
4 Residence Rates Versus Costs?

5 Q. Yes.

6 A. Yes.

7 Q. And is it your testimony that that exhibit
8 reflects the total revenue resulting from the loop?

9 A. No.

10 Q. This exhibit shows costs on a per unit basis
11 not on a total basis.

12 Q. I was asking about revenues.

13 A. Oh, no. It shows revenues on a per unit
14 basis not on a total basis. Fact is it shows rates.

15 Q. What revenues are missing?

16 A. This shows -- this exhibit shows a
17 comparison of rate and cost. If you want to look at a
18 from a total standpoint you would have to multiply the
19 number of units times the rate or the number of units
20 times the cost, and that's the type of information
21 that I said that U S WEST plans on providing the
22 Commission in the future on a total basis.

23 Q. Is it your testimony that the carrier
24 common line charge revenue is not part of a total
25 revenue resulting from the loop?

01853

1 A. It is part of the revenue resulting from
2 the loop.

3 Q. On page 6 of your supplemental testimony
4 you refer to an Exhibit BEF-2 titled Washington TS
5 LRIC Methodology; is that correct?

6 A. Yes.

7 Q. And turning to that exhibit which is marked
8 Exhibit 340, first page is entitled Washington TS LRIC
9 Methodology and it has your name under the title and
10 it's dated November 14, 1995; is that correct?

11 A. Yes.

12 Q. And looking at the following several pages,
13 each sheet appears to have two pages that look like
14 they might have been part of an overhead or slide
15 presentation. Is that where those sheets came from?

16 A. Yes.

17 Q. And when were the overheads prepared?

18 A. 11-14 -- on or about 11-14 of '95.

19 Q. So are the pages in that exhibit prepared
20 specifically for this exhibit for the first time?

21 A. Well, when I prepared this exhibit I
22 prepared it as a vehicle to use at one of the
23 settlement meetings, but this is something that we
24 never got to, and so I included it in this as part of
25 my testimony. It was prepared to give as a

01854

1 presentation but it never happened so I provided it
2 anyway.

3 Q. Your supplemental testimony on page 14,
4 lines 14 through 17 you propose that the Commission
5 deal with the recovery of loop costs as a pricing
6 exercise. Do you see that or do you recall that
7 testimony?

8 A. I do recall that testimony, yes.

9 Q. And the Commission indicated in the
10 interconnection order that all services that use the
11 loop should share in the cost of the loop. Do you
12 recall that?

13 A. Yes.

14 Q. And can you explain why the assignment of
15 loop costs to services should be accomplished as a
16 pricing exercise as opposed to being modeled in cost
17 models as part of each service that uses the loop?

18 A. What my studies calculate is the cost of
19 the loop as though the loop is the object that I am
20 determining a cost of. How we recover the cost of
21 those costs I believe is a pricing exercise, and I
22 believe we have witnesses who can discuss how that
23 should be recovered. Dr. Emmerson is here and we also
24 have rate witnesses here who will be testifying next
25 week who can discuss the recovery of those costs, but

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1 we have separately identified the costs of the loop.

2 Q. Well, you indicated you believed it's a
3 pricing exercise but can you tell us the basis of that
4 belief?

5 A. I guess my original response wasn't that
6 clear. Maybe I will just repeat it. My cost study
7 has identified the costs of the loop as though the
8 loop is the object that I am determining the cost of,
9 and I have made no allocations of those costs to any
10 services other than to the loop itself, and I believe
11 that a determination of how those loop costs should be
12 recovered is a pricing exercise and not a costing
13 exercise, and Dr. Emmerson, as I said, is here to
14 discuss that and he can follow up with you on that.

15 Q. Mr. Farrow, do you have before you what's
16 been marked as Exhibit 344C first page is entitled
17 Washington 976 Information Delivery Service Cost
18 Study?

19 A. I don't have that exhibit.

20 JUDGE WALLIS: Do you have it now?

21 THE WITNESS: Yes, I do.

22 Q. Do you recognize that study as one produced
23 by the company's market services and economic analysis
24 group?

25 A. Yeah, but this is not a study. This is

01856

1 just a page.

2 Q. Well, do you recognize it as a page from
3 that study?

4 A. Yes, I do. By the way, I've never had a
5 chance to review this before.

6 Q. I think maybe we can work through it. If
7 there's a problem I'm sure your counsel will leap in.

8 Beginning at the top of the one page there
9 are five column headings labeled Expense Description,
10 Type of Expense, Total Expense, Washington Percentage
11 of Revenue and Expense Specific to Washington; is that
12 correct?

13 A. Yes.

14 Q. And the column labeled Type of Expense has
15 the letters SFC next to each expense. Can you tell us
16 what SFC means?

17 A. Service specific fixed costs.

18 Q. And are the expenses shown in the study
19 considered to be incremental costs of providing the
20 service?

21 MR. OWENS: If you know.

22 A. I would assume that.

23 Q. And in the lower area of the page revenues
24 from six states are shown and each state's percent of
25 revenue is calculated; is that correct?

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1 A. Yes.

2 Q. And the revenue percentage used for
3 Washington in the study shows allocation of total
4 expense to Washington.

5 MR. OWENS: Your Honor, at this point I'm
6 going to object to the relevance of this line of
7 inquiry. The Commission recently approved the
8 company's withdrawal from this line of business. The
9 witness has indicated he's never seen this before.
10 It's not a study that was introduced by the company in
11 this case. The company hasn't proposed to reprice the
12 service in this case. I don't think it's information
13 that makes the truth or falsity of any fact at issue
14 more or less likely which is the test for relevance,
15 so we would object to further inquiry on it.

16 MR. SMITH: Your Honor, first of all, I
17 believe it shows the company's cost study allocation
18 methods. Secondly, Mr. Farrow in his testimony has
19 criticized Mr. Spinks for the manner in which he
20 allocates incremental cost, and this exhibit is
21 directed at.

22 MR. OWENS: There's no foundation. He
23 hasn't asked the witness whether any method of
24 allocation purportedly shown in this study is similar
25 to any method in any study that Mr. Farrow is

01858

1 sponsoring in this case.

2 MR. SMITH: I can re-ask the question.

3 Q. Mr. Farrow, you just indicated at the
4 bottom of the page there was an allocation of
5 each state's total expense; is that correct?

6 A. No, I did not.

7 Q. Can you tell me what the bottom --

8 A. I have no idea what this is doing here. I
9 would really need to see the complete study to
10 understand what's going on on this cost page.

11 JUDGE WALLIS: Mr. Farrow, I'm going to ask
12 if you could pull the microphone up closer to you so
13 that we're sure that not only everyone in the room but
14 those persons who are listening in on the bridge line
15 are able to hear you. Thank you very much.

16 Q. I believe in other sittings you've
17 explained that the product manager for each service
18 determined how the service is defined for costing
19 purposes.

20 MR. OWENS: Other sittings.

21 MR. SMITH: In his deposition. I believe
22 in the interconnect case as well?

23 A. The product manager defines a service and
24 we work with engineering to define the function -- the
25 network functional components of the service.

01859

1 Q. Turning now I think exclusively to your
2 supplemental testimony, page 2, lines 7 and 8 you say
3 that over the latter two years U S WEST has refined
4 its LRIC studies to embody the concept of total
5 service LRIC. What changes were made to the company's
6 cost models to embody the concept of TS LRIC?

7 A. Well, prior to going to this methodology
8 some of our models may have calculated costs on a unit
9 incremental basis. When I say unit incremental basis
10 I mean determine the costs of the -- the average costs
11 of an increase in demand rather than the average cost
12 of the total demand for the service, so now all of
13 our cost studies determine the average costs based
14 upon the total demand for the service.

15 Q. Are the company's cost estimates of average
16 direct costs for a given service any different than
17 the cost estimate for the same service that was
18 produced by the company's traditional LRIC cost model?

19 A. I don't understand that question when you
20 say traditional LRIC cost model.

21 Q. The old way you did it that you just
22 described in answering my last question before the
23 refinements you discuss in your supplemental
24 testimony?

25 A. Are you saying that -- are the costs we're

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1 calculating now different than the costs we calculated
2 before? Is that your question?

3 Q. The average direct costs.

4 A. Well, obviously the methodology has changed
5 but the methodology wasn't changed in all of our
6 models. Some of our models already used a total
7 service methodology and some of them used a unit
8 incremental cost methodology, so the costs have
9 changed to that extent that they cover the total
10 service rather than the unit incremental.

11 Q. And was one of the refinements to the
12 models the introduction of the concept of shared
13 residual costs?

14 A. One of the concepts of the new models and
15 reconfiguration of our models was to separately
16 identify those costs. They were always included in
17 our costs results in the past, but now we separately
18 identify them.

19 Q. Page 3, line 17 through 21 --

20 A. We're still in my rebuttal?

21 JUDGE WALLIS: Let's be off the record for
22 a minute.

23 (Recess.)

24 Q. In your supplemental testimony, Mr. Farrow,
25 page 3, lines 17 through 21 you indicate that if some

01861

1 rates are set at long-run incremental cost it would
2 require other ratepayers to pay unreasonable and
3 excessive rates. Do you see that?

4 A. Yes.

5 Q. If services on average required a 50
6 percent markup over long-run incremental cost to meet
7 the company's revenue requirement and the company
8 proposes some services to have a 10 percent markup
9 while other services have a 90 percent markup, are you
10 saying that the services with the 90 percent markup
11 should be considered unreasonable or excessive?

12 A. You're saying that all of them are priced
13 above direct costs?

14 Q. Yes.

15 A. It's very difficult to answer a question
16 like that when you aren't specifically defining the
17 shared portion of the costs. I've already said that I
18 believe that prices should recover at a minimum
19 average service incremental costs, but you also need
20 to take into consideration when you price your
21 services the shared costs of the corporation, the
22 shared costs of the product family, the common costs
23 of the corporation as well. And that's my belief. I
24 think pricing questions should better be directed to
25 Dr. Emmerson.

01862

1 Q. One last question. In your surrebuttal I
2 believe you said you would be willing to provide 90
3 percent of the top revenue producing products on a
4 USOC basis?

5 A. Yes.

6 Q. Did you mean 90 percent of the revenue from
7 products?

8 A. Yes, 90 percent based upon the revenue. 90
9 percent or higher but at least 90 percent.

10 MR. SMITH: Your Honor, those are all my
11 questions. I'm also moving for the admission of
12 Exhibit 345, which is Mr. Farrow's deposition in this
13 proceeding.

14 MR. OWENS: Well, he wasn't asked to
15 identify it but we'll stipulate to that but we make
16 the same objection that we made to the wholesale
17 incorporation of prior depositions.

18 JUDGE WALLIS: I am going to reserve ruling
19 on the admissibility of the deposition. I would ask
20 Mr. Smith to review the deposition and determine
21 whether all of it is relevant and necessary, and if
22 not to identify those portions that are relevant and
23 necessary to your case.

24 MR. SMITH: We can do that.

25 JUDGE WALLIS: Very well. Let's be off the

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1 record for a moment for scheduling.

2 (Recess.)

3 JUDGE WALLIS: Let's be back on record for
4 a moment. We will take our noon recess and will return
5 at 1:15. I do have a couple of administrative
6 matters. There appeared to be some confusion as to
7 what the Commission is asking for in terms of advising
8 other parties that there may be surrebuttal and I think
9 this morning I indicated that we would ask parties to
10 discuss that and that would mean indicating the area
11 and if the questions are known, the questions. That
12 would be helpful for the parties to prepare to
13 determine whether an expert is necessary to be
14 involved.

15 I also wanted to clarify the ruling on
16 settlement negotiations, first of all, by saying that
17 the lack of comment from counsel for U S WEST I
18 interpreted as acceptance of the ruling. Maybe that
19 was not accurate.

20 MR. OWENS: It wasn't.

21 JUDGE WALLIS: But I want to make it clear
22 that counsel does have the option of indicating that
23 he wishes to make further argument.

24 MR. OWENS: I would simply observe that in
25 the context of what the witness was stating he was

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1 simply asking the Commission to take those discussions
2 into account in its decision on the issue raised by
3 Mr. Dunkel but I realize you've made your ruling. I'm
4 not contesting that, Your Honor.

5 JUDGE WALLIS: I do believe that the status
6 of negotiations is not relevant. I don't see the
7 relevance of status of negotiations at this point.
8 The witness is advancing the testimony that he's
9 prepared and the position that he's prepared on behalf
10 of the company and certainly the fact that
11 negotiations are going on may be of some interest.

12 MR. OWENS: That's fine. I was only
13 responding to the part of the objection that appeared
14 to claim that we were by that testimony somehow
15 violating the rule when all he was, as I understand it,
16 saying was that the Commission should consider the
17 outcome of what was going on. He was attempting to
18 speak to the substance of that topic.

19 JUDGE WALLIS: And I did not mean to imply
20 that I was relying on a rule that didn't exist yet but
21 merely calling attention to that as an indication of
22 the public policies which underlying the exclusion of
23 settlement offers in the context of negotiation which
24 is important to allow full discussion. And so is
25 there anything further on those matters?

01865

1 MR. SHAW: Your Honor, if I could speak
2 briefly to that. We would certainly not desire to try
3 to relate anybody's position in settlements, say,
4 settlements for this entire rate case, rule or no
5 rule. We certainly agree that those should be
6 privileged and confidential to encourage frankness.
7 This situation is somewhat unique. The Commission by
8 its ninth supplemental order, I believe, instructed
9 the parties to deal with access to data issues as
10 opposed to ultimate issues for decision. And because
11 of the Commission's expressed frustration on
12 understanding exactly what data is needed to audit
13 complex cost models and so forth we thought it was
14 very important to indicate that we thought there was
15 agreement at least between the primary parties on that
16 issue. So it's different than, if you will, the
17 settlement negotiations dealing with the entire case
18 which I think is a different kind of thing.

19 MR. WAGGONER: I would simply respectfully
20 disagree with Mr. Shaw's characterization that they
21 are sort of somehow not important issues.

22 MR. SHAW: That wasn't my characterization
23 but I've said what I said.

24 JUDGE WALLIS: Thank you all very much.
25 Let's take our noon recess now.

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

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1 AFTERNOON SESSION

2 1:20 p.m.

3 JUDGE WALLIS: Let's be on the record,
4 please, following our noon recess. I understand there
5 is a preliminary matter. Mr. Harlow.

6 MR. HARLOW: Thank you, Your Honor. For
7 the record, my name is Brooks Harlow. As respects
8 this motion to strike, I'm representing the Northwest
9 Payphone Association which sponsored the prefiled
10 testimony of Terry L. Murray. It's my understanding
11 that Mr. Farrow sometime this morning was given an
12 opportunity to conduct oral surrebuttal to Ms.
13 Murray's prefiled testimony. It's also my
14 understanding -- I was listening on the bridge line
15 this morning when this was discussed at least one time
16 -- that Your Honor has requested that parties
17 intending to sponsor oral surrebuttal notify the
18 opposing parties or the other parties so that they
19 would have an opportunity to be present and to respond
20 to that and prepare for that.

21 I received a voice mail this morning that
22 was left last night at 6:50 p.m. from a legal
23 assistant of U S WEST named Ms. Bewick, I understand,
24 notifying me that U S WEST intended to conduct oral
25 surrebuttal of Dr. Emmerson, and so I appeared here

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1 this morning a little bit before noon in order to be
2 prepared to address Mr. Emmerson's proposed
3 surrebuttal. There was no mention made of Mr.
4 Farrow's surrebuttal, and accordingly I was not here
5 to cross-examine that testimony or object to the
6 testimony.

7 Of course there's several purposes for the
8 Commission's rule requiring prefiling of testimony,
9 particularly of technical witnesses. One of them is
10 of course to enable all the parties to study it, to
11 review the testimony with their own expert and if
12 necessary to conduct discovery regarding the proposed
13 testimony. Obviously that was not possible, but even
14 more extreme in this situation where we have two to
15 three weeks of hearings, 25, 30 witnesses or more, one
16 of the purposes is so the parties can review the
17 testimony in advance and determine whether or not they
18 need to attend all of the hearings, and in my case I
19 made what I thought was an informed decision based on
20 Mr. Farrow's prefiled testimony to not attend this
21 morning, and so my client has been denied an
22 opportunity to object to that testimony and to
23 cross-examine on it as well. So on that basis I will
24 move to strike all of the surrebuttal of the testimony
25 of Mr. Farrow as it regards Ms. Murray's testimony.

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1 JUDGE WALLIS: Mr. Owens.

2 MR. OWENS: Well, I guess in the first
3 place, it seems to me that a party, when the hearing
4 is scheduled for a continued session as this hearing
5 has been, makes a choice to absent itself, and I
6 suppose there are some risks that are associated with
7 that. We've done the best we can, given the number of
8 witnesses and the inability to predict with great
9 certainty the amount of time that each witness will be
10 on the stand, to try to schedule these people, and to
11 try to notify people in accordance with your request
12 of the desire to offer oral surrebuttal. It seems to
13 us as the party with the burden we have the right to
14 close the evidence and since the Commission granted
15 parties leave to file supplemental testimony in
16 December to which we had no opportunity to prefile
17 testimony, the issue of a lack of prefiling is
18 somewhat moot.

19 The claim that the Northwest Payphone
20 Association has been denied the opportunity to
21 cross-examine I think is facetious. Mr. Farrow is on
22 the stand. I suppose there could be some way that we
23 could indicate the substance of the questions and
24 answers that were given if counsel wants to ask
25 cross-examination questions of Mr. Farrow, or in lieu

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1 of that we could simply re-ask the questions now that
2 he's here in the room.

3 So I don't think there's any legitimate
4 claim of prejudice. If there was an oversight on
5 counsel's part in designating one of two witnesses
6 that would deliver oral surrebuttal that's an
7 oversight and we apologize for it. I wasn't under the
8 impression that we had limited our statement only to
9 Dr. Emmerson, but be that as it may I still don't
10 think there's any basis shown for the striking of his
11 testimony simply because a party chose to absent
12 itself from the hearing.

13 I think we have the right to surrebuttal,
14 and the fact that notice of a particular session may
15 have been given in an imperfect sense, I don't think,
16 is any basis for the relief that's requested here. So
17 we would oppose that motion.

18 MR. HARLOW: Brief response. I don't think
19 there is a right to surrebuttal under the procedures
20 that U S WEST has followed. There might be if a
21 motion were made for permission to file surrebuttal
22 and that were granted by the Commission and then
23 surrebuttal were prefiled in advance. As with all
24 other testimony then the procedure would be totally
25 appropriate, but springing it on the morning of the

01871

1 hearing with no notice to the parties is totally
2 improper, denies due process and really encourages, I
3 think, parties to lay in the weeds.

4 As Mr. Owens noted, Ms. Murray's testimony
5 was filed in December, approximately a month ago, so
6 29 out of the 30 days that they had to provide notice
7 to the parties and to develop the substance of their
8 testimony were evidently not used advantageously and
9 they saved it for the last possible day.

10 JUDGE WALLIS: Have you inquired as to
11 whether the substance of Mr. Farrow's remarks are
12 available from the court reporter today?

13 MR. HARLOW: My understanding is they will
14 be available on Monday morning.

15 JUDGE WALLIS: I am quite concerned
16 inasmuch as the company was asked to provide notice to
17 parties of potential surrebuttal, and I think the
18 record reflects that now at a couple of different
19 places, and it does strike me as unfair to Mr. Harlow
20 to put him in the situation now of having to cross
21 without knowledge of the questions and answers. My
22 recollection is that the testimony of the witness was
23 relatively short as to Ms. Mercer. Is that your
24 recollection, Mr. Owens?

25 MR. OWENS: I think it was about eight or

01872

1 nine questions.

2 JUDGE WALLIS: Ms. Murray.

3 MR. OWENS: Yes. I can certainly provide a
4 list of the questions to Mr. Harlow if he wants to
5 have those for the benefit of his cross-examination.

6 JUDGE WALLIS: I would request that that be
7 done and that because of the relatively short nature
8 that if Mr. Harlow wishes the questions to be reasked
9 that that would be done also.

10 MR. HARLOW: Is there any possibility that
11 Mr. Farrow could return next week so that I might have
12 the benefit of reviewing these questions and answers
13 and consulting with our economic experts since I
14 understand these questions involve technical costing
15 issues?

16 JUDGE WALLIS: I would prefer that we not
17 rule on that until we determine that it's necessary in
18 light of the exact questions and answers that are the
19 subject of your concern.

20 We also had pending the matter of Exhibit
21 345 for identification. I had asked if staff could
22 identify whether the entire deposition of Mr. Farrow
23 was required in their view or whether less than the
24 entire document would be required. Mr. Smith.

25 MR. SMITH: Your Honor, we're working on

01873

1 that now and we're trying to cut it down as much as we
2 can as requested by the bench, but we would request
3 the opportunity to present that on Monday.

4 MR. OWENS: I have no problem with that,
5 Your Honor.

6 JUDGE WALLIS: Very well, we will reserve
7 ruling on Exhibit 345 until a later time.

8 MR. TROTTER: Your Honor, I did look
9 through the document and I did believe that it should
10 also be admitted, but I can also take another look at
11 it if you wish.

12 JUDGE WALLIS: Very well. If you would
13 consult with Mr. Smith I would appreciate that as
14 well. Are we ready to proceed with Mr. Trotter's
15 examination? It appears that we are.

16

17 CROSS-EXAMINATION

18 BY MR. TROTTER:

19 Q. Thank you. Like to start with your oral
20 surrebuttal of Mr. Dunkel, and I thought you said in
21 reference to his standardized filing recommendation
22 that some of the information requested was marketing
23 information. Did you say that?

24 A. Market segment information. He was asking
25 for information outlining the method that we don't

01874

1 calculate our costs and in some cases we don't keep
2 track of such as residence versus business revenues
3 for certain products for services.

4 Q. So it was market segment not marketing you
5 referred to?

6 A. Yes, market segments.

7 Q. I would like to start with hopefully
8 a simple hypothetical to get some concepts clear. I
9 would like you to assume that we're talking about a
10 single company that has two products or services.
11 Service A has a direct cost of \$3 and service B has a
12 direct cost of \$2, and there's a shared cost between
13 the two of \$10, as you define SRC. Do you have that
14 in mind?

15 A. Yes.

16 Q. And would it be correct under your
17 methodology that the cost floor for those two services
18 you would exclude the shared cost and find a cost
19 floor for service A to be \$3 and service B to be \$2?

20 A. Yes, if we do it on a service specific
21 basis.

22 Q. And in that situation the total cost of the
23 services would not be covered, would it, if it was
24 priced at those two prices, those two levels?

25 A. If it was priced at the direct costs there

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1 would be other costs, shared costs, associated with
2 those services that would not be covered.

3 Q. Would it be correct that the cost of
4 producing service A by itself would be the \$3 that you
5 computed in this hypothetical, plus \$10?

6 A. The cost of the service A, direct cost of
7 the service, as you define it, not as I computed it,
8 you said it was \$3?

9 Q. Yes.

10 A. But it's \$3, the direct cost of the
11 service?

12 Q. I hope that's what I said because that's
13 what I meant.

14 A. Yes.

15 Q. Just on a stand alone basis if you were to
16 produce service A, would it --

17 A. On a stand alone basis, you still had the
18 shared costs of \$10?

19 Q. Yes.

20 A. Then it wouldn't be a shared costs then if
21 it was only a single product. Then it would be part
22 of service A.

23 Q. Would it be a direct cost of service A?

24 A. Yes.

25 Q. So, then, the total cost of service A under

01876

1 that scenario would be \$13?

2 A. Yes.

3 Q. And likewise, if you did service B on a
4 stand alone basis its direct cost would be \$12 on a
5 stand alone basis?

6 A. When you say stand alone I'm assuming you
7 mean that the other product does not exist.

8 Q. Correct. And that's how you were assuming
9 it?

10 A. Yes.

11 Q. Is a stand alone cost, to your
12 understanding, is that a cost that can be used to
13 determine a cost ceiling?

14 A. A stand alone cost?

15 Q. Yes.

16 A. I don't think I've made any discussion
17 before about cost ceiling. I think the corporate has
18 many costs that need to be recovered such as our
19 service specific costs, our shared costs and common
20 costs, and there are some embedded costs that we need
21 to recover that fell unrecovered. Those are total
22 costs.

23 Q. So you would not understand a stand alone
24 cost to be a cost ceiling?

25 A. You're saying if there is only one product

01877

1 and if there's only one product the cost of that
2 product would be basically the cost of the
3 corporation?

4 Q. Yes. And would you agree that that is a
5 cost ceiling?

6 A. I am just not familiar with the concept of
7 cost ceiling.

8 Q. And then just carrying the example one step
9 further, in your methodology --

10 A. By the way, Dr. Emmerson can probably
11 answer that question for you on cost ceiling.

12 Q. In your methodology applied to this
13 hypothetical, after you derived your direct cost you
14 then allocated the shared costs between the services
15 that are applicable; is that right?

16 A. Yes. Sometimes it was done at the same
17 time.

18 Q. And in this hypothetical we assumed that
19 the shared costs totals \$10. Do you remember that?

20 A. Yes.

21 Q. And that is the cost that you spread to the
22 various services. You didn't spread \$20, correct?

23 A. Well, I assume the shared costs you gave me
24 of \$10 were the total shared costs?

25 Q. Yes.

01878

1 A. That's correct.

2 Q. Turn to page 12 of your supplemental
3 testimony, and this was also touched on in your
4 surrebuttal. You indicate in response to a question
5 "Has U S WEST filed cost studies that identify costs
6 at an objective fill level," and your answer is that
7 you did so at volume sensitive costs, is that right,
8 for volume sensitive costs?

9 A. That's correct.

10 Q. You have before you Exhibit 346 which is
11 your response to our data request 941.

12 A. What is the number again?

13 Q. 941 and it's Exhibit 346.

14 A. I have it.

15 Q. And in this request we asked you to -- in
16 item C there, we asked you to provide objective fill
17 that was applied to distribution portion and in part
18 D, the drop portion; is that correct?

19 A. That's correct.

20 Q. And your answer in short at least was that
21 objective fill was not applied in either of those
22 elements in the ASIC calculation?

23 A. Yes.

24 Q. I would like to take a look at your
25 response to item C on the first page of this exhibit,

01879

1 and midway down you are referring as an example to
2 density group 3; is that right?

3 A. Yes.

4 Q. And you started with an out count and
5 multiplied by 85 percent and took that figure, that
6 result -- let me start over. You started with an out
7 count of 1800. Would that be loops or wires, pairs?

8 A. That would be pairs, yes.

9 Q. And you multiplied by 85 percent to get
10 1530 pairs?

11 A. That's correct.

12 Q. Did you then assume that there were 373
13 working units?

14 A. We also assumed there were 373 working
15 units.

16 Q. So does that imply that the fill for this
17 particular density group was 373 divided by 1530 or
18 about 21 percent?

19 A. No. What this implies is that we
20 calculated volume-sensitive costs. We used the 1530.

21 Q. Would you just tell me, then, why doesn't
22 the working units divided by 1530 give the fill that
23 is implied for this density group?

24 A. The working units are used to calculate the
25 ASIC costs in this particular case.

01880

1 Q. So you have 373 units in this loop -- pair
2 in this design group; is that correct?

3 A. Yes, that's correct, working pairs, working
4 units, yes. Working units.

5 Q. Working units. Out of a total of 1800 that
6 were put into the ground or put into service?

7 A. Of the out count of 1800 we have 373
8 working units, and these units are homes.

9 Q. And could you just define out count then?

10 A. Out count are the number of pairs that come
11 out of the first SAC point in the distribution area.
12 Those pairs are then tapered down into the
13 neighborhood and the fact is the design is really from
14 the opposite end. We start with the neighborhood
15 where the homes are located and build the distribution
16 area back to the SAC point where it is connected to
17 the feeder.

18 JUDGE WALLIS: Mr. Farrow, could you again
19 pull the microphone up closer so that everyone in the
20 room can hear you.

21 Q. How many total loops are associated with
22 the dedicated -- idle dedicated loops of 373 that you
23 reference here in your response?

24 A. I believe the idle dedicated should be in
25 the backup to the study. I don't have the information

01881

1 with me right here at this table.

2 MR. TROTTER: Your Honor, I would ask if
3 that information can be supplied and we can put it in
4 by stipulation if it can be obtained.

5 MR. OWENS: What information is required
6 here?

7 MR. TROTTER: The amount of loops that are
8 associated with the 373 -- the total loops associated
9 with the 373 working units in response to Exhibit 346.
10 He said it was in the backup and this would just save
11 time.

12 MR. OWENS: We'll attempt to provide it.

13 Q. Mr. Farrow, you assumed a cost of three
14 pair of loops for both the distribution and drop for
15 each living unit, is that correct, in your study?

16 A. We assumed a three pair per living unit
17 design for DG3. Just for DG3 now.

18 Q. Was the study that you did prior to this
19 study, was that done in 1993?

20 A. I do not know the date the study was done
21 prior to that.

22 Q. Would you call this study that you did in
23 this case a 1994 study or 1995?

24 A. The study that was provided in this case is
25 a 1995 study.

01882

1 Q. In your immediately prior study that would
2 have been done in the year or two prior?

3 A. Yes, that's correct.

4 Q. That's close enough. You assumed two
5 distribution and drop pairs in that study, did you
6 not?

7 A. I really don't know what was assumed in
8 that study. The previous study?

9 Q. Yes.

10 A. I don't know. The study that was filed
11 here was the same as the one in the prior case I
12 testified in Washington. Case prior to that there was
13 another witness involved, and I don't know what was in
14 that particular study.

15 Q. So you don't know whether the number of
16 residential loops that you're assuming in your study
17 has increased over the past couple of years.

18 MR. OWENS: Asked and answered.

19 MR. TROTTER: I'm just trying to confirm
20 it.

21 A. No. I don't know that for this state, no.

22 Q. Is the reason that the company assumes
23 three pairs is because consumers -- you are projecting
24 that consumers will want additional pairs to their
25 homes for additional services?

01883

1 A. We assume three pairs based upon our work
2 with our engineering group and they stated they were
3 designing distribution areas of this type with three
4 pairs, and that's why we assumed three pairs in our
5 study.

6 Q. You don't know why?

7 A. I believe some of it had to do with
8 incidence of bad pairs, had to do with a possibility
9 also of additional lines.

10 Q. If a certain customer had two services to
11 their home that would average one and one half pairs
12 per service, would that be correct, based on your
13 design?

14 A. If a person had two pairs in service? You
15 mean everybody had two pairs for service?

16 Q. A customer.

17 A. A customer? If we had one customer and
18 there were three pairs, the average -- if we had three
19 pairs going to someone's home the average --

20 Q. Would be one and a half pairs per service?

21 A. Okay. Three divided by two, okay.

22 Q. And in your cost study for basic
23 residential exchange service you include three
24 distribution pairs and three drop pairs; is that
25 right?

01884

1 A. Yes. For this DG3 arrangement.

2 Q. And that DG3 is a residential?

3 A. Yes, but it's not the only residential.

4 Q. In your other residential models did you
5 also assume three distribution pairs and three drop
6 pairs?

7 A. Not in all of them, no, we did not.

8 Q. Is it your testimony that the facilities
9 your company actually has in the field today contains
10 three drop pairs and three distribution pairs for each
11 living unit in this design group area?

12 A. No, that's not my testimony.

13 Q. On page 25 of your rebuttal, at the bottom
14 of the page and continuing to the other page 26 you're
15 referencing Mr. Dunkel's testimony. He stated that
16 LRIC does not reflect the real world costs that have
17 actually been incurred and he says that LRIC is based
18 on hypothetical investments and you challenge that
19 testimony; is that right?

20 A. Page 25 --

21 Q. Lines 27 through 30 and then over on the
22 next page.

23 A. Yes.

24 Q. Your study assumed that you rebuild or
25 build your network as if no embedded network existed

01885

1 so it's brand-new, placed today, or currently at
2 today's material costs and labor costs and so on; is
3 that correct?

4 A. That's correct.

5 Q. And of course you don't actually go out and
6 do that, do you? You don't replace your entire system
7 currently?

8 A. What we do is we file the nine cost
9 principles when we do our cost studies and we are
10 doing a forward looking type of cost. We assumed a
11 scorch node type of arrangement and this is why we
12 calculated the costs this way. So we are following
13 those nine principles.

14 Q. I'm just asking, physically in the world
15 outside the window here, you're not out there every
16 time you do your study replacing your entire system,
17 are you?

18 A. Every time we do our study?

19 Q. Right.

20 A. When we do our study we calculate the costs
21 of the total service, cost of providing the service in
22 the long run as though from a scorch node, at least
23 from the standpoint we developed the costs of the
24 loop, so the basis assumes that only the central
25 office nodes are there.

01886

1 Q. But I think it's a fairly simple question,
2 at least I hope so. You're not actually out there
3 physically replacing all of that plant each time you
4 do a study, are you?

5 A. I don't understand. How could we
6 physically be --

7 Q. That's the point.

8 A. Okay, no, we are not.

9 Q. Sometimes they're very extreme questions.
10 So you understand my question?

11 A. I understand your question. No, we're not
12 physically going out and doing that.

13 Q. Would you accept that the average age of
14 U S WEST buried cable is about 11 years pursuant to
15 your response to our request 634?

16 A. Yes.

17 Q. And so a customer who is served from -- a
18 new customer today who is served from facilities that
19 you have in the ground might actually be allocated or
20 provided facility that may be on average about 11
21 years old?

22 A. You say a new customer?

23 Q. Yes.

24 A. I don't know that.

25 Q. There was an issue that arose during this

01887

1 case regarding the use of IDC in your loop studies.

2 Do you recall that?

3 A. Yes.

4 Q. And IDC stands for what?

5 A. Interest during construction.

6 Q. And I believe U S WEST does not include
7 that in the study, is that right, in its study?

8 A. I believe we were asked to remove it on a
9 special run, and we did, but generally we do include
10 IDC in our study.

11 Q. But am I correct that the inclusion or
12 exclusion of this is extremely small and doesn't
13 affect the bottom line?

14 A. It is very small, very, very small.

15 Q. And there's no significant impact on the
16 bottom line?

17 A. No, it is not.

18 Q. Turn to page 6 of your rebuttal testimony.
19 Here you are contesting Mr. Dunkel's assessment that
20 the access line cost is a joint cost. Do you see
21 that?

22 A. Yes.

23 Q. Is it your position that the access line in
24 and of itself is a service that is available to basic
25 exchange ratepayers?

01888

1 A. It is my opinion that the person that
2 purchases 1FR service purchases access and the loop is
3 required to provide that access.

4 Q. If one of your product managers came to you
5 and asked you to cost out a service and they told you
6 that that service was to provide toll services only,
7 would you include the loop in the cost analysis?

8 A. With the way the network is constructed
9 today, no.

10 Q. Would you tell -- would it be correct to
11 tell your product manager that you couldn't offer that
12 service without a loop?

13 A. No, it would not be correct to tell the
14 product manager that.

15 Q. Why?

16 A. It would not be correct to tell him that
17 because it's only MTS service, and MTS service
18 provides switching long distance switching.

19 Q. You're not denying that MTS service used a
20 loop, are you?

21 A. I'm denying that the service requires U S
22 WEST to have a loop.

23 Q. How do you provide MTS service without a
24 loop?

25 A. Well, we can provide MTS service for two

01889

1 other exchange carriers and just provide the switching
2 between two locals.

3 Q. MTS is a tariffed service, is it not?

4 A. Yes, it is a tariffed service.

5 Q. And that's a service you sell to retail
6 customers, isn't it?

7 A. Well, we also provide -- it could be we
8 could provide it to two customers of two basic
9 exchange companies that are not U S WEST. You didn't
10 define the service. I'm defining it for you. It
11 could be defined that way.

12 Q. I was referring in your reference to MTS
13 but let's do it this way. Does your retail toll
14 service that you provide to retail residential
15 customers use loop that you provide to residential
16 customers?

17 A. In order to get access to MTS service our
18 customers are required to have a loop or they're
19 required to go to some location where there is a loop.
20 Of course they purchase that access through their
21 1FR service.

22 Q. And that same loop is used to provide
23 access to your interexchange carrier customers, is it
24 not?

25 A. Yes. It provides access to that network as

01890

1 well, yes. But again, they purchased access through
2 their lFR service.

3 Q. If an interexchange carrier wanted to use
4 your facilities to complete a toll call one of the
5 facilities they use is the loop, is it not?

6 A. We provide access to our customers through
7 the loop that our customers have purchased from us,
8 yes.

9 Q. And if the loop wasn't there that
10 interexchange carrier would have to provide loop
11 facilities itself, would it not, to complete that
12 call?

13 A. Not necessarily. They could -- if there's
14 a competing service they could get access to that
15 customer through that other exchange carrier's loop.

16 Q. Some loop facility would have to be used to
17 get to that customer?

18 A. Assuming the customer -- yes, some type of
19 loop facility or some type of wireless type
20 arrangement.

21 Q. On page 23 of your rebuttal testimony at
22 the bottom of that page you are responding to
23 testimony of Mr. Dunkel that the provision of
24 additional services will lead to an increase in common
25 overhead cost levels. Do you see that?

01891

1 A. Which line?

2 Q. It's in the question on line 25 through 28.

3 A. I had the wrong page. Which page?

4 Q. 23. Maybe I can just ask for counsel to
5 stipulate to --

6 A. Okay, yes.

7 Q. The question should read, "Mr. Dunkel said
8 that it is incorrect to assume that the provision of
9 additional services will not lead to an increase in
10 common cost overhead"?

11 A. I filed a correction on this this morning.

12 Q. Thank you, because I missed it. In your
13 rebuttal exhibit 335 you show a pricing decision
14 process; is that right?

15 A. Yes.

16 Q. And the cost information is considered in
17 step 4, 5 and 6; is that right?

18 A. Yes.

19 Q. And would it be fair to say that cost
20 information was not used to determine the price but
21 rather a check to see whether the proposed price is
22 appropriate?

23 A. Yes.

24 Q. One of your steps on step 6, adequate
25 contribution to SRC or shared residual cost. Do you

01892

1 see that?

2 A. Yes.

3 Q. And according to -- strike that. Turn to
4 your supplemental testimony, page 3, and you take one
5 example here on line 5, one example regarding cost of
6 money. A change in 100 basis points in the cost of
7 money only changes your study results 3.5 percent. Do
8 you see that?

9 A. Yes.

10 Q. Would I be correct to state that
11 differences in depreciation rates, fill factor and
12 treatment of common line costs are factors that can
13 significantly change cost results significantly more
14 than 5 percent?

15 A. The common line factor.

16 Q. Now, to cost or assign the local loop
17 costs, that's an issue in this case, is it not?

18 A. Yes, so my answer is no.

19 Q. Let me ask it again. You isolated the cost
20 of money difference 100 basis points making a 3 and a
21 half percent change in the cost study result, correct?

22 A. Yes.

23 Q. Would it be fair to say that there are
24 other major issues in this docket relating to
25 depreciation rates, how to allocate loop costs and

01893

1 fill factor, that those are issues that have been
2 raised in this docket?

3 A. Those issues have been raised.

4 Q. And depending on how those are treated they
5 can have very significant differences in cost results?

6 A. I don't think the allocation of the loop
7 has any significant difference in the costs that we've
8 calculated in for the loop.

9 Q. What about depreciation and fill factor?

10 A. Depreciation and fill factor, the fill
11 factor will -- that's used will affect the volume
12 sensitive costs of the study and depreciation will
13 have some effect on the study as well. I should say
14 the objective fill factor will have an effect on the
15 volume sensitive costs.

16 Q. In the study that you filed in this docket,
17 what cost of money did you assume?

18 A. I used a cost of money of 11.3 percent --
19 I'm sorry, would you repeat?

20 Q. Which cost of money did you assume?

21 A. In which results?

22 Q. The results you filed with your testimony.

23 A. 11.3 percent.

24 Q. And the cost of money that you would
25 support now is 10.4 percent?

01894

1 A. Yes.

2 Q. On page 9 of your supplemental testimony
3 you identify that cost change, is that right, on line
4 18?

5 A. Yes.

6 Q. And you didn't rerun your study because the
7 difference was just in this range. Is that a fair
8 statement?

9 A. No. That's not why we didn't rerun the
10 study. We are going to redo all our studies based on
11 this 10.4 percent. There just wasn't time enough for
12 this particular hearing. By the way, when we do make
13 a change like this there's a lot of other things that
14 we change in our cost studies because we update all of
15 the factors that we use in our cost studies, so when
16 you see new results you got to keep in mind that
17 there's other things being updated besides just the
18 cost of money.

19 Q. Would it be correct to say, however, that
20 the concepts that you would apply would not change?
21 You haven't changed your underlying theories or
22 concepts? It's just the inputs?

23 A. Generally, no.

24 Q. Generally you just changed the inputs not
25 the underlying?

01895

1 A. Right.

2 Q. Turn to Exhibit 347, which is your response
3 to our data request 614.

4 MR. TROTTER: And Your Honor, I do see the
5 second page of this is confidential. It should be
6 marked as such.

7 JUDGE WALLIS: 347 should be designated as
8 347C.

9 Q. Is it fair to conclude from the second
10 paragraph of your response that you do not measure
11 fill for the distribution portion of the loop?

12 A. We don't develop an average fill factor for
13 the distribution portion of the loop.

14 Q. The data request asked for the local loop
15 fill factor. First of all, is average the same as
16 embedded in your just completed answer? Do you use
17 those terms synonymously?

18 A. No, I don't use them synonymously all the
19 time, but when when we deal with the main frame we're
20 talking about the existing fill of the main frame
21 itself.

22 Q. What about the distribution portion?

23 A. Distribution portion, no, we do not develop
24 an average fill, similar type fill factor for that.
25 We did make a calculation in our study based upon

01896

1 objective fill and we discussed that earlier.

2 MR. TROTTER: I would move for the
3 admission of Exhibit 346 and 347C.

4 MR. OWENS: No objection.

5 JUDGE WALLIS: The exhibits are received.
6 (Admitted Exhibits 346 and 347C).

7 MR. TROTTER: That completes my
8 questioning. Thank you.

9 JUDGE WALLIS: Mr. Waggoner.

10

11 CROSS-EXAMINATION

12 BY MR. WAGGONER:

13 Q. Good afternoon, Mr. Farrow.

14 A. Hi.

15 Q. I would like to spend a few minutes first
16 on just clearing up a few questions that have come up
17 and then eventually spend some time with your
18 supplemental testimony. First I'm a little confused
19 as to Dr. Porter's role versus Dr. Emmerson's role in
20 helping to develop the cost study principles. Did Dr.
21 Porter have anything to do with developing the cost
22 study principles or cost studies of U S WEST to the
23 best of your knowledge?

24 A. Dr. Porter?

25 Q. Yes.

01897

1 A. The principles that we use, the nine
2 principles that I use in my supplemental testimony,
3 were developed by Dr. Emmerson. In other words, Dr.
4 Emmerson participated in development of them. I do
5 not know, and he could probably answer that question,
6 whether Dr. Porter had supported these or not, but I
7 know Dr. Porter in the past has reviewed our cost
8 studies and has supported the methodology.

9 Q. So it's been a joint task as far as you
10 know it between Dr. Porter and Dr. Emmerson?

11 A. As far as -- no. As far as this case is
12 concerned -- as far as these principles are concerned
13 they would come from Dr. Emmerson.

14 Q. And the principles you're referring to, I
15 believe, are found in your cost study manual that's
16 been marked as Exhibit 340 and attached to your
17 supplemental testimony; is that correct?

18 A. Yes.

19 Q. And they are found -- there are no page
20 numbers apparently but on the view graphs there are
21 little numbers and this would be view graph No. 8; is
22 that correct?

23 A. You don't have tab numbers. You have a tab
24 labeled TS LRIC concepts.

25 Q. Well, what I'm looking at is Exhibit 340.

01898

1 About five pages into it down in the lower right-hand
2 corner it's got little 8 on it. This is in your
3 supplemental testimony.

4 A. Yeah, those are them: They are spelled
5 out. In more detail later on in that same --

6 Q. Those are not confidential, are they?

7 A. The principles?

8 Q. Right.

9 A. No, they're not.

10 Q. And in fact in this exhibit, are you
11 claiming confidentiality as to anything other than the
12 actual numbers?

13 A. The confidentiality, the pages that are
14 confidential are labeled as such in this particular
15 exhibit.

16 Q. The pages labeled confidential on this
17 page --

18 A. Which page?

19 Q. The one we're talking about. I think we
20 may have a gap in the confidentiality designation
21 inside the company so do you want to take a second to
22 discuss your confidentiality here?

23 A. Most of the pages, by the way, considerable
24 number of the pages in this attachment are
25 confidential.

01899

1 MR. WAGGONER: I would just request that
2 the company let us know which pages are not
3 confidential at the next break to save time.

4 MR. OWENS: We'll do that.

5 Q. Do you know Mr. Copeland? I believe it's
6 Peter B. Copeland who is going to be testifying today?

7 A. Yes.

8 Q. Do you and he work in the same group?

9 A. No, we do not.

10 Q. What is the relationship in terms of
11 responsibilities between you and Mr. Copeland?

12 A. Mr. Copeland has worked on the DCM model,
13 and I am director of product costs and our
14 relationship -- really has not been any relationship
15 between us up until the point at which the DCM model
16 was actually filed.

17 Q. So has Mr. Copeland to the extent you know
18 provided input into the cost studies you are
19 sponsoring in this case?

20 A. No, he did not.

21 Q. I believe in a conversation with Mr.
22 Trotter you used the term scorch node. Did I hear
23 that correctly?

24 A. Yes.

25 Q. And you were using that to describe your

01900

1 cost study methodology; is that correct?

2 A. Yes.

3 Q. Can you define what you mean when you say
4 scorched node, please?

5 A. When I say scorch node I assume that the
6 nodes, the switching locations, are the same as they
7 are today and when we develop our cost studies we
8 select the least cost technologies that are available
9 today and design our cost studies. The service is
10 based upon those technologies.

11 Q. It's correct, isn't it, that that scorched
12 node approach is the same as used in Dr. Mercer's cost
13 studies?

14 A. The only thing I know about Dr. Mercer's
15 testimony is he said it was and I don't know if it is
16 in fact or not, but I really think you ought to ask
17 Mr. Copeland about that.

18 Q. Are you familiar with the term "green
19 field" study?

20 A. Yes, I've heard that term, yes.

21 Q. What does it mean to you?

22 A. It means to me scorched earth type of
23 methodology.

24 Q. And how would you distinguish between a
25 scorched earth and a scorched node methodology?

01901

1 A. A scorched earth methodology would be a
2 methodology in which there were no switches there
3 today and which you would do the cost study on the
4 basis of what is the ideal way of developing the
5 services if there was nothing there today, and
6 typically my knowledge of scorch -- of the green field
7 exercise is that you also assume that there are --
8 there is only one company or there is no company
9 there. I tell you, Dr. Emmerson is very familiar
10 with the green field process and you should probably
11 ask questions about that to him.

12 Q. But it's your opinion that a scorched node,
13 as you use it, is not the same as a green field study?

14 A. Based upon my knowledge of that I really
15 think you should ask Dr. Emmerson.

16 Q. I'm just trying to understand your
17 knowledge. The costing principles we were just
18 referring to a few minutes ago that you say were
19 written by Dr. Emmerson, nine principles --

20 A. Him and others.

21 Q. Are those the principles you developed in
22 applying the cost studies in this case?

23 A. Yes.

24 Q. In your response to data request WUTC
25 01-214 you state, "USWC cannot track our forward

01902

1 looking LRIC studies back to the embedded books of the
2 corporation because our LRIC studies are forward
3 looking and use forward looking technology. They
4 don't represent all of the embedded technologies of
5 the corporation."

6 MR. OWENS: Can the witness be provided
7 with a copy of that if he's going to be asked if
8 that's an accurate quotation? Do you have that in
9 front of you, Mr. Farrow?

10 MR. WAGGONER: I would be happy to give him
11 my copy if he doesn't have it.

12 JUDGE WALLIS: Does the witness have it in
13 front of him now?

14 THE WITNESS: Yes.

15 Q. Do you recall stating that?

16 A. Well, there was a supplemental response on
17 that sent out, but I do remember that response, yes.

18 Q. And certainly feel free with your counsel
19 if you would like to bring up the supplemental
20 response. Do you consider based on this statement
21 that your cost study offers a proxy cost?

22 A. Proxy to what?

23 Q. Proxy for the embedded historical plant.

24 A. My cost study calculates a forward looking
25 cost.

01903

1 Q. And have you looked at Dr. Mercer's
2 testimony or methodology enough to know whether you
3 and he employed different forward looking
4 technologies?

5 A. Dr. Emmerson has reviewed Dr. Mercer's
6 methodology and he can answer your question.

7 Q. So you've not looked at it?

8 A. No, I have not reviewed it.

9 Q. In your supplemental testimony, and you can
10 certainly check this if you want --

11 A. When I say I have not reviewed it, I have
12 not reviewed it in detail. I read through his
13 testimony but I have not --

14 Q. Did you notice in reading through his
15 testimony that he used different forward looking
16 technology than you did?

17 A. No, I don't recall.

18 Q. In your supplemental testimony at page 4,
19 line 1 you state that U S WEST uses "very considerable
20 resources and effort" in doing cost studies. Do you
21 recall that?

22 A. Yes.

23 Q. How many cost groups does U S WEST have
24 within the company that do the type of cost studies
25 you're sponsoring?

01904

1 A. We have one organization that does that
2 called the MSEA.

3 Q. And do they do all of the cost studies for
4 U S WEST to the best of your knowledge?

5 A. They do the LRIC studies for U S WEST
6 Communications.

7 Q. And are there other people that do other
8 kinds of cost studies for U S WEST Communications?

9 A. Yes. There are people who handle our
10 embedded costs.

11 Q. Just focusing on the LRIC cost study group
12 how many people are in that group?

13 A. I don't know the current number of people
14 in the group.

15 Q. Would you accept subject to check that it's
16 more than 100 people?

17 A. No, I would not accept that. I'm not
18 certain how many there are.

19 Q. You can't find out?

20 A. Oh, yeah, I can find out.

21 Q. And I am asking you to accept subject to
22 check that it's more than 100?

23 A. I expect that there are less than 100.

24 Q. Well, you can correct us if we're wrong
25 about that. Do you know how much money on an annual

01905

1 basis U S WEST spends on cost studies?

2 A. I don't have that number.

3 Q. Do you believe it's more than a million
4 dollars?

5 A. I really don't know how much we spend on
6 the cost group. I have not seen the budget for the
7 cost group.

8 Q. Well, how can you state that U S WEST
9 spends -- what was your phrase here -- a very
10 considerable resources and effort if you don't know
11 how many people or how much money is spent?

12 A. Well, I don't know the exact number but it
13 is fairly close to 100 and I don't know what the total
14 dollar amount for those people is but it is a
15 considerable amount when you consider that many
16 people.

17 Q. Is the cost study group considered a shared
18 residual cost?

19 A. I have to check that but I believe we are
20 -- that group is.

21 Q. You're not in the cost group any more?

22 A. I'm associated with the cost group. We
23 work very closely together. I don't report to the
24 same person as the cost group people.

25 Q. Do you actually do cost studies personally?

01906

1 A. No, I do not.

2 Q. In your rebuttal testimony at page 35 you
3 state that it's burdensome for U S WEST to have to
4 rerun cost studies for staff before staff finalizes
5 its position. Do you recall that?

6 A. Yes, I do.

7 Q. If staff or someone else prepared the cost
8 study model U S WEST wouldn't have that burden, would
9 it?

10 A. If staff prepared their own model, would we
11 have the burden of doing cost studies for them, no, we
12 would not.

13 Q. In the current cost studies is spare
14 capacity within the ASIC costs or the shared residual
15 costs?

16 A. There is spare capacity in both the ASIC
17 costs and the shared residual costs.

18 Q. In going forward with future cost studies,
19 are you going to be trying to include more of the
20 spare capacity in ASIC and less in the shared residual
21 costs?

22 A. We are reviewing our methodology and going
23 forward. There may be some situations where there may
24 be more spare capacity included in the ASIC.

25 Q. So that's why earlier you were careful to

01907

1 say that generally you don't change the methodology
2 going forward but you do make changes in the
3 methodology?

4 A. Yes, we do.

5 Q. I would like now to turn to your
6 supplemental testimony. And just to try and make this
7 as simple as possible we'll just kind of go from near
8 the front to the back rather than going all over the
9 place. In your supplemental testimony at page 4,
10 lines 6 through 9 you explain that only U S WEST has
11 the capacity to produce the kinds of cost studies that
12 U S WEST produces and that other LECs may not have
13 that capacity. Do you see that discussion?

14 A. Yes.

15 Q. Do you think it would be appropriate for
16 the Utilities and Transportation Commission to apply
17 U S WEST cost studies to other LECs' costs?

18 MR. OWENS: I'm going to object to this
19 question. It appears to go beyond the scope of his
20 testimony and also appears to have little if any
21 relevance to the issues in this case. No other LECs'
22 costs are before the Commission or rates for that
23 matter.

24 MR. WAGGONER: I will be happy to respond,
25 Your Honor. It's our point of view in this case that

01908

1 costs should be applied on a much more systemic,
2 generic basis, not under the control of individual
3 companies because they're too susceptible to
4 manipulation, and the point here is to suggest that
5 one cost study type of approach, if it were properly
6 done, could be used for the whole industry.

7 MR. OWENS: That's really not an issue in
8 this case. This is a U S WEST rate case. It's not a
9 rulemaking. It's not a generic investigation.

10 MR. WAGGONER: Well, I believe the
11 Commission notices have made very clear that U S WEST
12 cost study methodology is an issue in this case, and
13 it's our position that that methodology is flawed and
14 that a generic approach for the industry would be
15 preferable.

16 JUDGE WALLIS: The witness may respond to
17 the question. Do you have the question in mind?

18 Q. I would be happy to repeat it. Referring
19 to your testimony on page 4, lines 6 through 9, do you
20 think it would be appropriate for U S WEST's cost
21 studies to be applied to set the costs of other LECs
22 in the state?

23 A. I believe that the cost studies are
24 properly applied to U S WEST's services and to the
25 extent that other LECs want to use our cost studies we

01909

1 have no objection to that.

2 Q. Like to turn now to what we were talking
3 about earlier, Exhibit 340, your cost manual that
4 you've attached to your supplemental testimony, and
5 this is a document you could have prepared earlier in
6 1995 or are there inputs into this document that are
7 brand-new in, say, the subsequent to September 1995?

8 A. Most of these, I believe all of the items,
9 in fact are not new. Fact is many of the items that
10 are in this document are presentations that we've
11 given to the staff and other parties here before.

12 Q. Turning past the costing principles we've
13 already reviewed -- again, I will have to continue
14 using my little view graph numbers.

15 A. There is a larger one in there under TS
16 LRIC concepts, that tab, if you turn the few pages.

17 Q. Let me see if I can ask the question.
18 You've got a page that's got a little view graph No.
19 14 and it's called "general assumptions," and if you
20 don't know this and you've already answered me, I
21 apologize. Do you know whether those general
22 assumptions that you use in your cost study
23 methodology differ from Dr. Mercer's?

24 A. No, I do not know that.

25 Q. Later on you have in your binder something

01910

1 that's labeled SCM, U S WEST switching cost model?

2 A. Yes.

3 Q. It's correct that the switching cost model
4 that U S WEST has been using has been employed for
5 several years?

6 A. Yes.

7 Q. Subsequent to this you have an SS7 cost
8 model; is that correct?

9 A. Yes.

10 Q. And do you know when that was developed?

11 A. I don't know a specific date but it was
12 within the last three to four years.

13 Q. And then subsequent to that you have what
14 you call the RLCAP model. Is that something that's
15 been developed recently or more than a year or two
16 ago?

17 A. We've had this for several years.

18 Q. Mr. Farrow, I hate to do this to you, but
19 into every day there must be a little fun, and if you
20 look back in your factors under the methodology issues
21 there is a document that I am going to pass out. It's
22 in the middle of the factors and it's a U S WEST
23 Communications view of methodology.

24 MR. OWENS: Is this an exhibit that wasn't
25 premarked?

01911

1 MR. WAGGONER: No. It's in the document.
2 I'm just passing it out to make it easier for people
3 to find it. Ms. Proctor, could you give that also
4 to the witness, please.

5 MR. PROCTOR: Certainly.

6 Q. Mr. Farrow, this is apparently a picture of
7 a wizard and I just wondered if this was intended to
8 represent that there are magical aspects to U S WEST's
9 costing methodology.

10 MR. OWENS: Sounds like a fairly facetious
11 question if we're going to burden the record with that
12 kind of interrogation.

13 A. No, it is not.

14 Q. Do you know what it is there for?

15 A. I believe it was there to show people that
16 it's not magical, and when the presentation was given
17 it was relayed in that fashion.

18 Q. So this is from a view graph type of
19 presentation that was offered?

20 A. Yes.

21 Q. Your confidential Exhibit 341C, which you
22 premarked as BEF-3, I just wanted to ask you a few
23 questions about it and I will obviously avoid the
24 numbers since it's been denominated as confidential.
25 At the bottom it says "to evaluate the impact of

01912

1 stimulation and repression on this service please use
2 the average volume sensitive costs." Could you
3 explain how you would evaluate the impact of
4 stimulation and repression for the average volume
5 sensitive costs?

6 A. Well, the idea behind the average -- the
7 idea behind this statement was to give product
8 managers a number that they can look at if there is --
9 if they have a sales promotion in which they need to
10 evaluate profitability of their sales promotion, and
11 we asked them to use the average volume sensitive
12 costs plus any other service-specific costs associated
13 with that promotion because only the volume-sensitive
14 costs change with the level of demand for a service.

15 Q. So if I wanted to do a promotion, for
16 instance, for residence access line, you would ask me
17 to look at the average volume sensitive costs plus the
18 costs of the promotion?

19 A. I don't think we do promotions for
20 residence access lines. I don't think we do
21 advertised promotions for them.

22 Q. Did anyone during this case -- strike that.
23 You're going to have to help me out with one thing
24 here and I apologize, this is very basic engineering.
25 Can you tell me the physical difference between a

01913

1 residence access line, a business access line and a
2 NAC as you're using them in your cost study?

3 A. The difference is in the length of the
4 loop.

5 Q. The length of the loop?

6 A. The length of the loop, the design of the
7 distribution area and the amount of usage on the
8 switch portion of the network.

9 Q. All three of them, however, can be
10 comprised of either copper loop or other distribution
11 facilities; is that correct?

12 A. That's correct.

13 Q. Did anyone -- strike that. Could you turn
14 to page 11 of 17 in this exhibit we're just
15 discussing, 341C, and I am afraid I am still trying to
16 figure out a little bit how these cost studies work,
17 so let me try and use an example without using the
18 numbers. This is something called channel performance
19 and optional features and functions. Can you just
20 briefly tell me what those are?

21 A. These are -- these channel performance
22 optional features and functions are sold along with
23 our private line service. If a customer requires a
24 certain level of channel performance associated with
25 the service we provide these and these are tariffed

01914

1 services that go along with private line.

2 Q. Can you look down the left-hand column.

3 About halfway down the page there's something called

4 McCollough Bridging Report. Do you see that?

5 A. Yes.

6 Q. I'm not going to ask you about the numbers

7 because they're confidential. Do you know what a

8 McCollough Bridging Report is?

9 A. No, I am not familiar with that one.

10 Q. Darn.

11 A. I will tell you, we do have a witness

12 coming in next week who can talk to you about that.

13 Q. Well, I will put off on that one then.

14 MR. WAGGONER: Let me review my questions

15 and see if I have anything more for this witness.

16 Q. Just so I'm clear on this, Mr. Farrow, in

17 your scorched node methodology, do you use the

18 existing locations and numbers of switches but put in

19 forward looking technology in those switches? Is that

20 how you do it?

21 A. Yes. In some cases the technology of the

22 switch that's there right now matches up with the

23 technology that is -- which is the forward looking

24 technology.

25 Q. But you don't go out and obliterate all the

01915

1 switches and try and design the most efficient network
2 with the fewest number of switches; is that correct?

3 A. No, we do not obliterate the network.

4 MR. WAGGONER: Thank you. No further
5 questions.

6 JUDGE WALLIS: Mr. Nichols.

7

8 CROSS-EXAMINATION

9 BY MR. NICHOLS:

10 Q. Good afternoon, Mr. Farrow.

11 A. Hi. Mr. Nichols, which company are you
12 with?

13 Q. I represent MCI. You've heard of us?

14 A. Oh, yes.

15 Q. Mr. Farrow, you've undergone a fair amount
16 of cross-examination today on costing studies, and
17 while I was not privileged to be here in the previous
18 proceeding, in the interconnection docket, I
19 understand you testified at some length in that
20 proceeding with regard to costing matters; is that
21 correct?

22 A. Yes.

23 Q. I'm going to try not to duplicate any of
24 that or what I've heard today, so I would like to
25 start by asking a few questions to put some of the

01916

1 costing principles that you've talked about in some
2 perspective, so I would like to first ask you about a
3 topic that you mention in your testimony, and that is
4 fully distributed costing methodology or FDC. Do you
5 recall that?

6 A. Yes.

7 Q. Can you describe to me just very briefly
8 what you mean by FDC costing methodology?

9 A. In my reference to FDC costing methodology
10 I was referring to allocating portions of the switched
11 network to different jurisdictions such as from taking
12 the total cost and splitting it between the intrastate
13 and interstate jurisdictions.

14 Q. Don't you also use that term in the sense
15 that allocation of costs -- in such a manner that
16 those allocations do not mirror cost causation
17 principles, is also a feature of a fully distributed
18 cost study?

19 A. Yes.

20 Q. Now, fully distributed cost principles were
21 in vogue at what time? When did U S WEST do fully
22 distributed cost studies?

23 A. We do some of it now for the C.

24 Q. With regard to this Commission, for
25 example?

01917

1 A. I do not know that when we've done it for
2 this Commission. I know we've done LRIC studies for
3 quite a long time.

4 Q. But can we say that in the '50s, '60s and
5 '70s generally fully distributed cost studies were
6 performed by companies like U S WEST?

7 MR. OWENS: If you know.

8 Q. If you know.

9 A. I don't know for certain, no, I don't.

10 Q. Would that surprise you if that were the
11 case?

12 MR. TROTTER: Your Honor, I will object to
13 the question.

14 Q. I'm just trying to get a sense of the
15 industry, the nature of the industry, when fully
16 distributed cost studies --

17 A. You can ask Dr. Emmerson that question. He
18 should be able to answer it.

19 Q. Then there's a second kind of category of
20 cost studies is what you've called LRICs or L R I C.
21 Sometimes you've called it TS LRIC; is that right?

22 A. Yes.

23 Q. Now, based on your understanding of fully
24 distributed cost studies could you describe to me the
25 essential difference between LRIC studies and FDC

01918

1 studies?

2 A. In our LRIC studies we define what the
3 object is that we're going to determine the cost of
4 and we do a forward looking cost on that particular
5 object. In an FDC study one would take those object
6 costs and split them to other jurisdictions.

7 Q. And I believe you also agreed with me in an
8 FDC study you not only allocate some costs between
9 jurisdictions but you also allocate costs between
10 different services but not following the rule of cost
11 causation?

12 A. That's correct.

13 Q. So a LRIC study does not do those types of
14 allocations, that is, to different jurisdictions or to
15 different services based on a noneconomic cost
16 causation principle; is that correct?

17 A. That's correct.

18 Q. Now, I'm going to ask you some questions on
19 and off about one of your exhibits so I thought maybe
20 we could get that in front of us, and that's Exhibit
21 340. It's entitled Cost Manual, I believe, and
22 initially I'm going to just ask you some questions
23 about the very first portion of this exhibit. I
24 believe Mr. Waggoner asked you a question or two about
25 this as well, and the portion that I'm going to

01919

1 initially ask you a question about is right under the
2 cost manual title of Exhibit 340, and it's entitled
3 Washington TS LRIC methodology. Do you see that?

4 A. Yes.

5 Q. Now, I believe Mr. Waggoner asked whether
6 or not some of this was confidential, and you said
7 that it was. Since I'm going to be asking you
8 something about some of these, at least the words in
9 here, I wondered if you could examine whether or not
10 the first 25 pages might not well be nonconfidential
11 in that I don't see a single number in those pages?

12 A. The pages that are confidential are the
13 pages that are marked, "Notice: The information
14 contained herein is confidential and proprietary and
15 should not be disclosed to unauthorized persons. It
16 is meant for use by authorized representatives of U S
17 WEST Communications Inc. only." Now, the first page
18 was entitled that way just to indicate that there is
19 information within the document that is confidential,
20 but the pages themselves that are confidential are
21 marked like that, as I've identified.

22 Q. And the confusion that I have is perhaps
23 what Mr. Waggoner had is that there's a big
24 confidential stamp down at the bottom of each of the
25 pages that we have, so let -- I think I know what you

01920

1 mean. It's in small print right under that first view
2 graph, or whatever it was, there's the language you
3 read; is that right?

4 A. That's correct.

5 Q. So any of these pages that don't have that
6 language are not confidential?

7 A. That's correct.

8 Q. And as I went through and looked at that
9 the first 24 pages are of that type. Will you just
10 check on that so that I don't inadvertently talk about
11 something that is confidential?

12 A. That is correct.

13 Q. Now, these first 24 pages on the first page
14 you describe that this presentation provides
15 definitions and a general methodology that U S WEST
16 uses to calculate its costs; is that correct?

17 A. Yes.

18 Q. And the costing principles which are
19 actually listed on page 8, nine principles there that
20 Mr. Waggoner referred you to, do you have that in
21 front of you?

22 A. Yes.

23 Q. Those are costing principles that U S WEST
24 applies according to your testimony in its production
25 of its cost studies that are in this docket; is that

01921

1 right?

2 A. Yes.

3 Q. Now, my review of the cross-examination in
4 the previous docket and listening to the examination
5 today certainly leads -- I think it's fair to say that
6 there's several areas of controversy with regard to
7 the costing studies, and I am not going to go over
8 each one but just ask you a few questions about a
9 couple of areas of these controversy. The first area
10 of controversy appears to be about how you have
11 characterized or equated the term total service LRIC
12 with the cost studies produced by U S WEST in this
13 docket. Would you agree with me that's an area of
14 controversy?

15 A. Yes.

16 Q. And if I heard you right earlier in your
17 testimony today, I believe in response to a question
18 from Mr. Smith you stated that U S WEST's ADSRC, which
19 is the general cost output of your studies or one of
20 them, is equal to TS LRIC; is that right? It's the
21 same as?

22 A. I'm sorry. I said that ASIC or total
23 service incremental costs had a unit level ASIC that
24 is equivalent to service TS LRIC, in other words, TS
25 LRIC at a service level. However, at a group level

01922

1 the ADSRC recovers an average share of the shared
2 residual costs. Therefore, I'm calling those shared
3 residual costs group TS LRIC. Those are the group
4 related costs.

5 Q. So you're making a distinction with what
6 you're calling group TS LRIC and regular TS LRIC; is
7 that right?

8 A. Yes. By the way, I got this terminology
9 out of an MCI document.

10 Q. Yes. My notes don't show that that's what
11 you answered when you first responded but we'll deal
12 with that MCI document in a moment. Let me ask you
13 while we're there, are you familiar -- since you quote
14 from an MCI document or you refer to it I assume
15 you've read that document?

16 A. It's been some time but I have.

17 Q. It's not your testimony that the MCI use of
18 the term group LRIC provides for or advocated any type
19 of formula to allocate such costs, are you?

20 A. No, that's not my testimony but it
21 certainly said they should be recovered in pricing.

22 Q. As a matter of pricing?

23 A. Yes.

24 Q. I don't think we have any disagreement
25 there. Now, I would like to turn to a different

01923

1 portion of the exhibit we were looking at. Exhibit
2 340, there is a tab in that exhibit labeled -- I think
3 you were also asked about this earlier -- tab is
4 labeled TS LRIC concepts. Do you see that?

5 A. Yes.

6 Q. Could you turn to that, please. Now, this
7 is several pages long. First of all, let me deal
8 with the confidentiality issue. On my tab page I have
9 a stamp that says confidential. Then I don't have any
10 confidential stamps or indications on any of the
11 documents in that tab. Should I take that to mean
12 there are no confidential materials there?

13 A. That's correct.

14 Q. Now, the initial page of this tab says that
15 you've attached two documents. One is called "The
16 Cost Principles," which you refer to U S WEST, AT&T
17 and MCI and others having dealt with in other states;
18 is that correct?

19 A. Yes.

20 Q. And the second is called Total Service
21 Long-Run Incremental Cost Concepts; is that correct?

22 A. Yes.

23 Q. And this you state was performed -- was a
24 paper developed by M E S A?

25 A. Yes.

01924

1 Q. And what is that group?

2 MR. OWENS: I think it's MSEA.

3 MR. NICHOLS: Well, there's a typo then.

4 A. It should be MSEA. Market Services
5 Economic Analysis organization. That's our cost
6 group.

7 Q. So MSEA are the people that you talked with
8 Mr. Waggoner about that perform all of U S WEST TS
9 LRIC studies?

10 A. Yes.

11 Q. So is it your testimony that this document
12 that's attached, contained in this tab from MSEA,
13 describes in general the principles they use in
14 performing those cost studies?

15 A. Yes.

16 Q. Let me ask you to turn to a couple of those
17 pages. Let me ask you to turn to page 9 at the bottom
18 of the page. This is a document -- it's the document
19 called the MSEA Total Service LRIC Guide. Do you see
20 page 9?

21 A. Yes.

22 Q. I'm going to call your attention to the
23 lower part of that page where there's a discussion of
24 the term total service long-run incremental cost, TS
25 LRIC. Do you see that?

01925

1 A. Yes, I do.

2 Q. So we're together, let me just read this
3 sentence or so, "This is the essence of the TS LRIC
4 concept. It is the sum of adding VSC." Now that's
5 what?

6 A. Volume sensitive costs.

7 Q. Volume sensitive costs -- "and SFC," and
8 those are what?

9 A. Service specific fixed costs.

10 Q. -- "together"?

11 A. That's correct.

12 Q. "Since VSC and SFC are direct and avoidable
13 costs of a single service, so is TS LRIC, by
14 definition." Do you see that?

15 A. Yes.

16 Q. Now, let me ask you to turn to the next
17 page in this document or actually page 11. Do you see
18 a chart there that says TS LRIC format?

19 A. Yes.

20 Q. Would you turn your attention to the right
21 side of that chart. Do you see where it says VCS?
22 That's the volume sensitive costs?

23 MR. OWENS: VSC.

24 MR. NICHOLS: I'm sorry.

25 Q. Do you see that?

01926

1 A. Yes.

2 Q. Then there's a plus outside of that?

3 A. Yes.

4 Q. Then under that there's SFC and there's a
5 plus outside of that?

6 A. Yes.

7 Q. And then there's an equal?

8 A. Yes.

9 Q. And it says it equals TS LRIC; is that
10 right?

11 A. (No response.)

12 Q. That's what that chart says?

13 A. I've got a couple of equal signs. Maybe I
14 was looking at the wrong line. You are talking about
15 the line that says TS LRIC all the way across? Am I
16 looking at the right page?

17 Q. Looking on page 11 of the MSEA work and up
18 on the top part where it says, "TS LRIC format is
19 approximately," the third column in from the left,
20 there's a plus, a plus and an equal?

21 A. Yeah, I got that. It says equals TS LRIC.

22 Q. So that's saying, if I'm reading this
23 right, that VSC plus SFC equals TS LRIC?

24 A. Yeah, at a service level, that's correct.

25 Q. Which equals ASIC?

01927

1 A. This doesn't say equals ASIC.

2 Q. That's correct, but I'm assuming -- what
3 does that assume?

4 A. That ASIC is over there, along there with
5 TS LRIC. ASIC, average service incremental cost, is a
6 TS LRIC shown on a unit basis and so this is a price.
7 This is a total cost, TS LRIC is. You have one column
8 that says total cost basis and the other column is
9 labeled unit basis.

10 Q. Right. So on a unit basis ASIC is TS LRIC.
11 That's what that's representing?

12 A. For service, yes.

13 Q. I don't notice that it says for service
14 anywhere on that chart.

15 MR. OWENS: Is that a question?

16 A. It is for service, yes.

17 Q. That's your testimony?

18 A. That is my testimony.

19 Q. Now, I would say that perhaps the second
20 area of controversy after trying to figure out exactly
21 what is equivalent to TS LRIC is the whole concept of
22 families in groups of services. Families in groups of
23 services are important in U S WEST cost studies
24 particularly with regard to the category of costs
25 called shared costs or SRC; is that correct?

01928

1 A. That's correct.

2 Q. And is it right that SRC represents costs
3 that are not caused or avoidable as pertains to a
4 single service but only to a collection or group of
5 services, I believe that's what you testified?

6 A. Yes.

7 Q. Let me ask you to turn for a moment to your
8 rebuttal, page 13 of your rebuttal. Begins at line
9 14. There you state that "total shared costs
10 sometimes represent many different products and
11 overlapping service families."

12 A. Yes.

13 Q. And the amount of overlapping is very
14 complex?

15 A. Yes.

16 Q. I'm going to come back to that in just a
17 moment, but the first thing you have to do with regard
18 to, certainly a step with regard to, evaluating shared
19 costs is to determine what a service is. Is that not
20 correct?

21 A. Yes.

22 Q. Now, how many services does U S WEST have
23 for costing purposes?

24 A. It has many services. Within those
25 services there are also optional questions of the

01929

1 service as well. And I should point out that we not
2 only calculate the costs at a service level but we
3 also calculate costs at a functional level as well, at
4 some function that is below the service.

5 Q. I understand.

6 A. So the costs object may be different in
7 different cases I'm saying.

8 Q. I understand but bear with me and we'll
9 take this one at a time. Services are important, and
10 I asked about how many services for cost purposes U S
11 WEST has. Do you know?

12 A. I don't know the total number.

13 Q. Can you give me a range?

14 A. I can give you a range of the service areas
15 and those are in my attachment BEF-1 there's a list
16 there.

17 Q. I'm going to get to service families or
18 groups in a moment. I'm just trying to get through
19 services. So you don't know --

20 A. There's a list of services here. It was
21 meant to be as comprehensive as possible with the
22 expenses, that there are some options associated with
23 a lot of these services that aren't listed here, and
24 also we did not list out all the central office
25 features that U S WEST sells.

01930

1 Q. So you're saying that a good approximation
2 of service would be to look at your Exhibit 334 which
3 was an attachment to your rebuttal, I believe, is that
4 right?

5 A. That's correct.

6 Q. And that's four pages long?

7 A. Yes.

8 Q. And we should add to that a list of bunch
9 of option which would multiply the number of services
10 by some factor; is that right?

11 A. There are options to some of these
12 services, right.

13 Q. Now, if the first -- a first step in doing
14 a cost study is to determine a service. Who decides
15 -- who makes the definition of a service? Is that
16 done by a product manager?

17 A. What a product manager usually defines
18 is what they want the cost study done on, the service
19 they want us to do a cost study on.

20 Q. So does that mean that the cost manager
21 decides this is the service, this is what I mean by
22 service X and I would like a cost study done on that.
23 Is that how it happens?

24 A. The product manager.

25 Q. The product manager?

01931

1 A. Yes.

2 Q. How many product managers are there in

3 U S WEST?

4 A. I don't know what that number is.

5 Q. Hundreds?

6 A. I don't know what the number is.

7 Q. You don't even know a range?

8 A. I really don't know the range either.

9 Q. Is there a product manager for every
10 service or a product?

11 A. I believe there are, yes.

12 Q. So we take the number of services or
13 products, and we have approximately the same number of
14 product managers. Now, how does a product manager
15 determine the definition of the service? Does he or
16 she do that kind of within his or her own discretion
17 or do they follow a policy guidelines?

18 A. I guess they would use a lot of things in
19 determining a service. A new service you're talking
20 about?

21 Q. Yes. Let's try a new service.

22 A. Use their imagination or they could study
23 the market or, you know, you could ask our product
24 manager, price witnesses, who will be here next week
25 about how this happens, how this works.

01932

1 Q. So there's a very significant amount of
2 discretion in the product manager to be able to define
3 what a service is; is that correct?

4 A. To the extent when they are designing a new
5 service, yes.

6 Q. And those service definitions then drive
7 what the costing group does costs on; is that correct?

8 A. When we do service, when we do a cost study
9 at the service level, yes.

10 Q. Are there any company guidelines or rules
11 with regard to how one defines a service?

12 A. I don't believe there are.

13 Q. So there's nothing someone could look at in
14 terms of basic principles to review the definition of
15 service contained in U S WEST's cost studies?

16 A. I don't think there is.

17 Q. Now, let's turn to the concept beyond
18 services but groups or families of services. There's
19 been some discussion about that. Do you recall that?

20 A. Yes, I do.

21 Q. Now, we just read together your rebuttal
22 testimony, I believe, on page 13 and you said that
23 there are many different products and there are
24 overlapping service families and the amount of
25 overlaps is very complex?

01933

1 A. Yes.

2 Q. What do you mean by that?

3 A. Well, this is an example right here of how
4 complex it can be. To give you an example, if you
5 look at the column labeled base network functions.

6 Q. Where are you looking now?

7 A. I'm looking at page 1 of 4 of my Exhibit
8 BEF-1 attached to my rebuttal testimony.

9 Q. Okay. And I think that's been labeled as
10 Exhibit 334?

11 A. 334.

12 Q. Go ahead.

13 A. If you take a look at the column labeled
14 usage under base network functions you will see two
15 columns there, intraoffice and interoffice, and you
16 also see central office end office switching, so what
17 it's saying is that these usage functions are
18 performed in the central office or end office
19 switching, and below that you will see what models are
20 used to calculate the costs associated with this.

21 If we move further down you will see where
22 there is X marked in the box on the flat rated local
23 exchange service, and you know that there are
24 X's under both columns, but if you move down further
25 you will find services under which there are no X's in

01934

1 both columns because interoffice switching is not
2 required for some of the services, and if you follow
3 that concept all through this chart you can see where
4 some of the overlapping occurs between different
5 functions required for each service. And this is what
6 I was referring to when I said there was overlapping.

7 Now, when we calculate our group-related
8 costs associated with these functions, we assign a
9 group-related cost. For instance, going back to flat
10 rate local exchange service, there would be a
11 group-related cost associated with this interoffice
12 switching and a shared residual cost, and we would
13 assign that to local rated local exchange service for
14 intraoffice. It would also get a piece of the
15 interoffice. But if you move down here under message
16 toll service there is no intraoffice switching
17 associated with message toll service, so it would not
18 -- the shared costs associated with that would not be
19 overlapping with the intraoffice switching. But
20 obviously it would be for the interoffice switching.

21 Q. You've certainly convinced me that there's
22 a complex process of decision making which has a lot
23 of overlaps.

24 A. That's why we use models. That's why we
25 use investment models to calculate the investments

01935

1 associated with these costs because of the complexity
2 of this.

3 Q. Let me ask you a question now about this.
4 Who determines what constitutes a family of services
5 for purposes of costing?

6 A. Well, it's determined -- we don't really
7 determine what constitutes the family. We determine
8 -- we calculate the costs on a functional basis and if
9 that particular product or service needs or uses that
10 particular function then it gets assigned costs
11 associated with that function.

12 Q. Who makes that determination?

13 A. We work with the engineers in determining
14 how the service is ultimately going to be provided and
15 what are the network functions. The cost groups works
16 with them.

17 Q. The costs -- when the costs group is trying
18 to decide whether there are families of services to
19 which there may be allocated some shared residual
20 costs the costs group works with the engineering
21 group, looks at a matrix something like Exhibit 334
22 and proceeds; is that right?

23 A. No, that's not what I said.

24 Q. I'm just trying to summarize.

25 A. What I said was we work with engineers --

01936

1 and this is in my testimony. We work with engineers
2 to determine what functions, what network functions
3 are required for the service, and we've done cost
4 studies at a functional level. If that service
5 requires one of those functions then we assign the
6 costs associated to that function to that service.

7 Q. Mr. Farrow, I realize this is a complicated
8 subject, and I'm trying to ask specific questions as I
9 can, but at some point I thought we started this
10 discussion by saying that service groups or families
11 of services were significant in how the SRC, or the
12 residual, shared residual, costs are actually
13 allocated in your costing studies; is that correct?

14 A. Yes.

15 Q. Now, I'm trying to just find out -- maybe
16 I'm dense but I'm trying to find out how the family is
17 defined so that that happens. Do I understand your
18 answer to be that you go back to the functional levels
19 and do the analysis that you just described to me as a
20 part of that process?

21 A. Yes, we do.

22 Q. How does the label "family" get
23 accomplished?

24 A. If you look again at intraoffice switching,
25 in that column, you will see an X marked in several

01937

1 boxes for different services. You can consider that
2 those particular services would be in the same family
3 associated with intraoffice switching.

4 Q. And about how many families do you end up
5 with in U S WEST, families of service for costing
6 purposes in terms of using the concept of the shared
7 residual cost?

8 A. Well, again you're starting with family
9 moving back, moving into functions, and I told you we
10 started functions. We define the service and what
11 functions are required and that defines the families.
12 I told you how the process works. Now, I don't have a
13 specific count of how much overlapping goes on in this
14 matrix here. What I think I've clearly shown you
15 is how we map these different functions to different
16 services and if a service gets mapped, if a function
17 gets mapped to that specific service then it would be
18 in the same family.

19 Q. Let me try to end this line of questioning
20 by just asking you this. Have you supplied to the
21 staff of this Commission a description of the families
22 or groups of families of services so that they can
23 examine whether or not those groups are created in a
24 verifiable way?

25 A. What I have supplied to the Commission is

01938

1 this document that I've provided with my rebuttal
2 testimony.

3 Q. Exhibit 334?

4 A. Exhibit 334, this defines -- this lists
5 out and shows how functions are assigned to different
6 services. This is the document that I have provided.

7 Q. Let me ask you to turn now briefly to tab
8 TS LRIC concepts again. This is the piece done by
9 MSEA and ask you to turn to pages 12 and 13. On the
10 left-hand side in this description of mapping of TS
11 LRIC, they're referring to the matrix on the right-
12 hand page or page 13 and it says, "in using this
13 matrix keep in mind that the definition of service
14 plays a key part in knowing into which category to
15 slot costs. For instance, to slot capital costs or
16 operating expenses to VSC or SFC or SRC depends on how
17 the firm defines a service." Do you see that?

18 A. Yes.

19 Q. And you agree with that?

20 A. Yes.

21 Q. Have you given the staff of this Commission
22 or have you submitted in your testimony or exhibits
23 anything that describes how the company defines a
24 service?

25 A. This is not referring to a general

01939

1 definition of the service. This is referring to the
2 definition of the service of the object being costed.

3 Q. With that understanding have you done that?

4 A. Our tariffs define all the services that we
5 have.

6 Q. So the tariff is the basis upon which you
7 use service definitions?

8 A. Yes.

9 Q. Now, turn to the top of page 13. It there
10 describes a situation where the firm will unbundle
11 more service in the future and as this occurs customer
12 specific services will be designated facility-based
13 services. Let's just take that much. Could you
14 explain what that means to me, if you know?

15 A. This deals with a situation that we've
16 already seen happen in many of our states and that is
17 where we've been asked to unbundle certain component
18 of our network, for instance the loop, in which case
19 this is referring to the fact that if you unbundle the
20 loop and the loop becomes a service then that is what
21 they're referring to as a facility-based service.

22 Q. A facilities-based service is what then?

23 A. Well, it's an unbundled service. It's an
24 unbundled function of the network.

25 Q. Sentence goes on to say, "As this

01940

1 unbundling occurs, these designated facility-based
2 services will fall into one of three unbundled
3 categories, network access, switching or transport."

4 Do you see that?

5 A. Yes.

6 Q. Can you describe to me what that means?

7 A. Network access would be access to the
8 network. This is generally considered to be the loop
9 and any terminations in the switching office and
10 switching would be the switching office. Transport
11 would be interoffice facilities including the
12 terminating equipment in the different end office and
13 any multiplexing equipment associated with
14 transporting costs.

15 Q. I'm less interested in the specific
16 definition of each one of those categories, but is
17 this saying to your understanding that somehow
18 there are going to be three large families of services
19 as you unbundle services more and more?

20 A. No. This says unbundled categories. It
21 doesn't say services.

22 Q. What isn't unbundled category?

23 A. Network access switching and transport.

24 Q. For what purpose in a costing world will
25 these unbundled categories be put?

01941

1 A. For me they define a separation between --
2 it's called access switches and transport. Why don't
3 we turn to, in the same document, turn to page 25.

4 Q. Now, is this going to describe to me what
5 purpose or for what these three categories of service
6 are going to be used in a costing study?

7 A. Well, yeah, it is.

8 Q. Go ahead?

9 A. If you turn to page 25 and you look at the
10 diagram on page 25 there --

11 Q. Is this in your rebuttal?

12 A. This is in -- no, this is in my
13 supplemental testimony. And this would be the
14 attachment BEF-2, which is the same document that we
15 were just referring to with the TS LRIC guide. If you
16 turn to the front of that document you see the
17 presentation, and on page 25 of that presentation --

18 Q. Well, I can't seem to find it.

19 A. I will hold it up for you. I think you
20 need to look at it.

21 Q. It's the same as we were looking at before
22 in the other place. I'll go with the one where we had
23 it before. And that's where we should look to find
24 out how that works?

25 A. Yeah. If you look at this diagram what you

01942

1 have here is you've got some loop and drop equipment
2 and some NTS-COE type equipment that I consider to be
3 access, and then you have some traffic sensitive
4 equipment labeled TS in each one of the switching
5 offices which I consider to be switching. And the
6 interoffice facilities would be the terminating the
7 IEO facilities, what have you.

8 Q. Let's go on to my final question or two and
9 that's on -- to try to get a handle on what are we
10 really talking about in terms of the magnitude of
11 costs when we talk about shared residual costs, the
12 category SRC. I understand from your rebuttal
13 testimony, I believe it's on page 12, line 14, that
14 you said that there are two main categories of costs
15 that are in this lump called SRC and those are spare
16 capacity and administrative expenses; is that correct?

17 A. That's correct. Those are two main
18 categories. There are other costs in there.

19 Q. What are the others by category?

20 A. There's business fees in there and there's
21 also -- under some circumstances there may be some
22 sales expense in there, for some business products.

23 Q. Now, without giving me a number, have you
24 anywhere in your exhibit or testimony provided the
25 level of costs, total level of SRC costs, for U S WEST

01943

1 either by these categories or all together?

2 A. Well, we've provided some total numbers in
3 some of the exhibits. For instance, if you go back to
4 that page 25 again at the bottom of that page there's
5 a nonproprietary page there on page 26. It lists end
6 office switching, IAO, which is intraoffice, and IEO.
7 It lists measurement and tandem switching. There is a
8 page in our local usage cost study as well as in our
9 tandem cost -- excuse me -- our MTS cost study switch
10 access cost study. Any cost studies that uses these
11 elements there's a page in there that shows the total
12 shared residual costs.

13 Q. So if I were to look --

14 A. And by the way, in those studies you will
15 find that that is the same page in all of those
16 studies because we do use the same functional costs
17 for each one of those services.

18 Q. So if I were to look up all the studies
19 that you submitted they all have a page --

20 A. Not all the studies. I just mentioned the
21 ones I know there's a total in there for.

22 Q. So there's some studies that have numbers
23 that represent the total shared residual costs for
24 that service or group?

25 A. Right, yes.

01944

1 Q. You don't have any idea of what the total
2 number of SRC costs for U S WEST in all of its studies
3 added together constitutes?

4 A. No, not in the state of Washington, I
5 don't.

6 Q. In general terms can you give me a
7 percentage as compared to the percentage of the other
8 costs that are there?

9 A. Yeah. We will be able to do that, by the
10 way, when we finish our matrix that we're putting
11 together. As I said earlier, we are going to provide
12 you with an analysis showing revenues and direct costs
13 but we're also going to show you shared costs as well
14 and total up the shared costs on that exhibit as well
15 so you will have that in the future.

16 Q. But we don't have that today; is that
17 correct?

18 A. No, you do not have that today.

19 Q. Will we have it in the record of this
20 proceeding, if you know?

21 A. Total shared costs?

22 Q. Yes.

23 A. I believe so.

24 Q. And who would be supplying that if you
25 know?

01945

1 A. I believe Mary Owen will be supplying that
2 information.

3 Q. Finally, I think you refer to Dr. Emmerson
4 as a person who helped develop the costing principles
5 used in your cost studies; is that correct?

6 A. Yes.

7 Q. Did Dr. Emmerson supervise the preparation
8 of U S WEST cost studies in my way?

9 A. He did not supervise the preparation but he
10 has reviewed our cost studies.

11 Q. Is he involved in any way in the definition
12 of service or groups of services?

13 A. No, he was not involved in that process.

14 MR. NICHOLS: I have no further questions.

15 JUDGE WALLIS: Let's take a 15 minute break
16 at this time.

17 (Recess.)

18 JUDGE WALLIS: Let's be back on the record,
19 please. We're engaged in the examination of Mr.
20 Farrow and Mr. Nichols had concluded on behalf of MCI.
21 TRACER and DIS have indicated that they have
22 questions.

23 MR. BUTLER: I've discussed with council
24 for U S WEST the two exhibits that we wanted to
25 introduce, Exhibit 348 and 349C and had suggested that

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1 they be admitted by stipulation to speed things along
2 but U S WEST wanted to supplement 349C by adding the
3 remainder of the response since 349C is only the last
4 two pages of the response and that's fine with us if
5 they want to supplement that later.

6 MR. OWENS: We have it right here.

7 MR. BUTLER: It would be fine with us if we
8 simply substituted this for the document we handed out
9 earlier as Exhibit 349C.

10 MR. OWENS: That's acceptable, Your Honor.

11 JUDGE WALLIS: Very well. I am designating
12 as replacement 349C a multipage document designate
13 request No. TRA 01-064. And this will be substituted
14 for the document earlier marked as 349C.

15 MR. BUTLER: Are those admitted then?

16 JUDGE WALLIS: Is there objection to
17 receiving those documents?

18 MR. OWENS: None.

19 JUDGE WALLIS: Let the record show that
20 there is no objection and those documents are
21 received.

22 (Admitted Exhibits 348 and 349C.)

23

24 CROSS-EXAMINATION

25 BY MR. BUTLER:

01947

1 Q. I have a couple of questions that were
2 inspired by Mr. Nichols's questions, and it's a
3 confusion that I have, I hope you can help clear up
4 for me, about how ASIC is calculated. Am I correct
5 that ASIC is calculated by adding the average service
6 specific volume sensitive costs and the average
7 service specific fixed cost figures?

8 A. Yes, that's correct.

9 Q. In calculating average service specific
10 volume sensitive costs or AVSC, you take the total
11 service specific costs and you divide it by a number
12 of units, correct, to get the average figure?

13 A. That's how we calculate the average service
14 specific fixed costs.

15 Q. How about the average volume sensitive
16 costs, AVSC?

17 A. Yes. In some cases we do take the total
18 and divide it by the number of units associated with
19 that and sometimes we calculate it on a unit basis.

20 Q. Do you use objective fill unit for that
21 calculation, for the volume sensitive costs?

22 A. Yes. If there's an objective fill defined
23 we will use objective fill for that in the studies
24 that were filed in this case.

25 Q. In calculating the average specific

01948

1 fixed cost figure -- again, that is a figure that is
2 expressed on a unitized basis -- do you use average
3 fill or objective fill for that calculation?

4 A. In some cases we would use average fill for
5 the calculation of the ASIC, but most of our studies
6 depend upon whether or not the spare capacity is
7 service specific or whether or not it is shared. In
8 the studies that are shared we would use that average
9 fill at the ADSRC costs.

10 Q. In calculating just ASIC, would it be the
11 case that there would be occasions when you would be
12 using objective fill to calculate the volume-sensitive
13 portion of the cost and average fill to calculate the
14 service specific fixed cost portion?

15 A. I don't think there are any circumstances
16 in the studies that were filed where we use what you
17 would call average fill to calculate average service
18 incremental costs.

19 Q. Would you use the total number of units
20 sold to make that calculation?

21 A. In the total number of units -- yeah, the
22 demand for the total units, in some circumstances,
23 yes, in making that calculation, and we would only do
24 this in circumstances where we considered the spare
25 capacity to be service-specific.

01949

1 Q. And again, if I'm correct, that a
2 service-specific fixed cost is a cost which is not
3 caused by any particular unit of service, correct, but
4 by the service as a whole?

5 A. Yes.

6 Q. So the decision to express it on a unitized
7 basis is really a decision in a factor for an
8 arbitrary expression of that figure? In other words,
9 you could have used different units in order to come
10 up with an expression of that cost? For example, you
11 could have used customers or lines or minutes of use;
12 isn't that correct?

13 MR. OWENS: Your Honor, there are three
14 questions in there. I would ask that counsel break it
15 up into individual questions.

16 MR. BUTLER: It was just an elaboration of
17 one.

18 JUDGE WALLIS: I heard just one with some
19 optional responses so if the witness is able to
20 understand the question the witness may respond.

21 A. Was that it?

22 Q. Yes.

23 A. If I understand your question correctly
24 you're asking how do we break up the service specific
25 fixed cost, what units do we use in it and you gave

01950

1 some examples.

2 Q. I'm saying that that decision about what
3 unit to use and how to express that --

4 A. Is based upon the demand for the service.

5 Q. But that in effect is an arbitrary
6 decision?

7 A. The demand for the service? We're
8 displaying the costs --

9 JUDGE WALLIS: Excuse me, we need to have
10 one person talking, and I would like to give
11 preference to the witness unless there's a problem
12 with that.

13 A. The units that are used to calculate is
14 based upon a demand for the service. Now, since we
15 are calculating a cost per unit based upon that demand
16 then we would use the demand for the service. No,
17 it's not arbitrary.

18 Q. If I could direct your attention to page 15
19 of that total service LRIC guide in Exhibit 334, third
20 paragraph.

21 A. Give me the page number again.

22 Q. Page 15.

23 A. Okay.

24 Q. And this is directed to the issue of how to
25 display shared residual costs as average costs. And

01951

1 there it notes that "the problem is how to display
2 shared residual costs as average costs. In reality
3 SRIC is truly volume insensitive." Do you see that?

4 A. Yes, I do see that.

5 Q. Can the same thing be said with respect to
6 service specific fixed costs?

7 A. Yes. Service specific fixed costs are
8 volume insensitive.

9 MR. BUTLER: Thank you. I have no further
10 questions.

11

12 CROSS-EXAMINATION

13 BY MS. MARCUS:

14 Q. Good afternoon, Mr. Farrow. I represent
15 the Department of Information Services. I don't
16 believe we ever met. My questions are mostly going to
17 focus on your channel performance cost studies and to
18 start with I would like to ask you if you are aware of
19 the Commission's fourth supplemental order in the
20 prior terminal loop case which was docket 93-0957?

21 A. Yes, I am aware of it.

22 Q. And are you aware in that order, the fourth
23 supplemental order, on page 14 the Commission
24 addressed your prior channel performance cost study
25 and found it flawed. The company failed to

01952

1 demonstrate that the study examines "the least cost
2 manner of provisioning CP." Are you aware of that?

3 A. Yes.

4 Q. And are you aware also in that fourth
5 supplemental order the Commission directed the company
6 to file a channel performance cost study that
7 "demonstrates the company is provisioning the service
8 in a least cost manner and separately identifies the
9 costs of testing"?

10 A. Yes.

11 Q. Now, in your testimony you address the fact
12 that you believe your channel performance study in
13 this docket represents the least cost method of
14 provisioning channel performance?

15 A. Yes.

16 Q. And then you submitted what has been
17 entered as Exhibit 336C. Do you have that before
18 you?

19 A. Would you give me the other exhibit label
20 on it.

21 Q. It's BEF-3.

22 A. Yes, I have that.

23 Q. Now, am I correct that this exhibit is
24 showing the costs for the least cost method and then
25 it's showing the cost for 100 percent pair gain and

01953

1 then the last column shows the costs for 100 percent
2 copper?

3 A. That's correct.

4 Q. Am I also correct in looking at that
5 document that in five categories the least cost mix is
6 more expensive than the 100 percent copper costs?

7 A. Yes, but I probably should explain that.
8 One of the things that you have to keep in mind when
9 you look at this is that we also have to provide a
10 private line along with this, and when we do our
11 private line study we also use a least cost mix of
12 technologies in there, so you can't just take the
13 channel performance and separate it from the NAC
14 study, the network access channel study. You've
15 got to look at both at the same time, and the channel
16 performance study actually reflects the least cost mix
17 of technologies that are also used in the NAC as well.
18 In other words, if I provided a cost that was 100
19 percent copper for the channel performance and the NAC
20 is composed of fiber and copper, then I have really
21 reflected the least cost mix of technologies because
22 I'm avoiding what's going on in the loop, so you have
23 to look at both of them not just the channel
24 performance as well.

25 Q. But in your study you were just looking at

01954

1 the channel performance costs; is that correct?

2 A. In the channel performance study we looked
3 at the channel performance costs and we took into
4 consideration the configuration of the loop when we
5 did that cost study.

6 Q. Turning to page 29 of your rebuttal
7 testimony you state, beginning in line 7, that the
8 cost studies only use technologies that are currently
9 available for widespread deployment. Do you see that?

10 A. Yes. I remember making that statement,
11 yes.

12 Q. Do you agree that digital cross-connects
13 are currently available for widespread appointment?

14 A. Yes, I do believe that they are.

15 Q. Continuing on page 29 you also state on
16 line 10 that some technologies are obsolete and have
17 been discontinued by manufacturers. Do you see that?

18 A. Yes, I do see that.

19 Q. And do you agree that digital
20 cross-connects are not obsolete?

21 A. Yes, I do agree with that.

22 Q. I think you have before you what has been
23 marked as Exhibit 350 which is the response to TRACER
24 data request 01-094?

25 A. Yes, I have it.

01955

1 Q. Was that prepared by you or under your
2 supervision?

3 A. Yes, it was.

4 Q. The next exhibit after that would be
5 Exhibit 351 which would be a response to TRACER data
6 request 01-097. Do you have that?

7 A. Yes, I do.

8 Q. And was that prepared either by you or
9 under your supervision?

10 A. Yes.

11 Q. Do you have before you Exhibit 352 which is
12 response to TRACER data request 01-098?

13 A. Yes.

14 Q. Was that prepared by you or under your
15 supervision?

16 A. Yes, it was.

17 MS. MARCUS: I would move to admit Exhibit
18 350, 351 and 352.

19 MR. OWENS: Your Honor, I think we have to
20 deal with a best evidence problem here. We've got
21 three out-of-court statements apparently referring to
22 written documents that aren't here. We also have
23 apparently in each case, have testimony by somebody
24 who is not here to be cross-examined in this case. I
25 don't think we have a particular problem if the quoted

01956

1 material is stricken in terms of being offered for the
2 truth of what's asserted, but we certainly can agree
3 to the question that's asked and the answers that are
4 provided. I don't necessarily think that the quoted
5 material adds anything to the record in any case. So
6 we would object to the quoted material but not to the
7 rest of the documents.

8 JUDGE WALLIS: Well, I guess in 350 it's
9 unquoted but it's a description of testimony by the
10 DIS's witness, I guess it is, quoting or reciting the
11 substance of his testimony.

12 MS. MARCUS: That would be fine to put in
13 the questions and answers.

14 JUDGE WALLIS: To strike the quoted
15 material?

16 MS. MARCUS: Yes.

17 JUDGE WALLIS: Whether a direct or an
18 indirect quote.

19 MS. MARCUS: (Nodding head).

20 JUDGE WALLIS: That satisfies your
21 interests?

22 MR. OWENS: It does, Your Honor. Thank
23 you, Counsel.

24 JUDGE WALLIS: Are there any other
25 objections to the exhibits? Let the record show that

01957

1 there is no response and Exhibits 350, 351 and 352 as
2 edited are received in evidence.

3 (Admitted Exhibits 350, 351 and 352.)

4 JUDGE WALLIS: Any other questions from
5 parties? Commissioners? Commissioner Hemstad.

6

7

EXAMINATION

8 BY COMMISSIONER HEMSTAD:

9 Q. Mr. Farrow, I only have two or three
10 questions and some of this has been covered at least
11 in part but perhaps this is a different way of asking
12 it for some of the same kind of information. In your
13 direct testimony, page 19, you describe an example
14 showing cost of the higher spare capacity in the
15 development of a residential neighborhood. Do you
16 recall that testimony?

17 A. Yes, I do.

18 Q. Is the point that it is more efficient to
19 put in initially three pairs of capacity for each
20 residence and that would involve only a 25 percent
21 more total investment than the one pair?

22 A. Yes, that's correct.

23 Q. Is the choice of using three pairs as
24 opposed to say using either two or four based on some
25 analysis of how many pair would ultimately be required

01958

1 by a neighborhood and the relative economics of
2 installing now versus later?

3 A. The decision as to how many pairs are made
4 is made by our engineering organization, and they take
5 a look at the demographics of the neighborhood that
6 they're going to install that in and how many pairs
7 they're going to install and sometimes it's going to
8 be more than three pairs.

9 For purposes of our cost study we talked to
10 engineering and they provided us with -- we worked
11 with them on coming up with a typical type design to
12 use for our model, and they told us that for this type
13 design they typically would design it based upon three
14 pairs, and that's how we came up with the number.

15 Q. And that's based on the assumption that
16 there would be more than a single unit of service
17 going to each residence?

18 A. Yeah, and based upon the assumption that
19 some pairs are going to be bad.

20 Q. Part of it is for repair purposes?

21 A. For repair purposes as well, yes. You have
22 to remember that it doesn't mean that there's going to
23 be more than one service at each one of those
24 residences. It means that we have to be able to serve
25 if they do order more than one service that requires

01959

1 an access line.

2 Q. Is there some standard figure for how much
3 reserve is needed for repair purposes?

4 A. I'm pretty sure that in the engineering
5 guidelines, the guidelines they use, that they must
6 have that type of information but I don't have it
7 currently available. We could probably get that
8 information for you.

9 Q. Well, let's just assume that for purposes
10 of this discussion that two pairs are expected to be
11 made available for multiple usage or multiple service
12 usage. As I understand it, the cost is assigned 100
13 percent to the first unit of service. Is that true?

14 A. That is correct. We assign the costs to
15 the first unit of service, because we don't really
16 know whether that customer is going to buy any
17 additional service, so when we do our cost studies
18 lacking that information we assign the costs to the
19 first line. In actuality a person could move in and
20 they could order additional lines. They could move
21 out after a short period of time and no longer use
22 those additional lines and as it stands those
23 additional lines are sitting there and by the fact
24 that they -- well, let's say somebody else moves into
25 that location and they only order one line, well,

01960

1 those additional lines that were there are still there
2 and, you know, we'll still have that investment there
3 and it would be unrecovered because of the fact that
4 this new customer didn't place service on those
5 additional lines.

6 Q. But I assume there must be some assumption
7 that there will be an offering more than a single unit
8 of service per residence?

9 A. We do have information about the level of
10 additional lines purchased by residence. I don't have
11 that information available to me. That information is
12 available, yes.

13 Q. Well, wouldn't that reduce the per unit
14 cost if there is an assumption or the actuality that
15 there will be more than one unit of service per
16 residence?

17 A. We are calculating the costs on a customer
18 basis and if we look at the customer as the cost basis
19 here then we have to provide -- what we're doing is
20 providing the ability for that customer to have -- we
21 are trying to provide ability to have additional lines
22 if that customer wants to purchase them but they do
23 not have to purchase them. But to answer your
24 question, yes, we can go and calculate an average,
25 yes, we can, but that's not the way we're doing our

01961

1 study. We're doing it on a customer basis.

2 Q. With respect to business exchange service,
3 do you follow a similar pattern? Do you have, like,
4 say three wire pairs going to each business?

5 A. Well, the business designs are different
6 from the residence designs, and we assume one pair to
7 a line. The calculation is based upon working pairs
8 rather than working units. For residence we use
9 working units. In business we use working pairs.

10 Q. I guess I don't understand that.

11 A. The difference? The working units would be
12 like a home, the customer, the home. The working
13 pairs would be like a business has more than one pair
14 then we would assign costs of the loop to each one of
15 those pairs, the costs of the distribution to each one
16 of those pairs.

17 Q. But you build spare capacity for
18 anticipated multiple usage into the business line?

19 A. Into the distribution?

20 Q. Yes.

21 A. Yes, we do build spare capacity into there.

22 Q. Is there kind of a figure you could give me
23 for that?

24 A. Yes. That information is in the backup
25 information to the study. I could go through it and

01962

1 get it out but it is in there. It's tab 8 of the
2 study.

3 Q. And that's part of the record?

4 A. I don't know that --

5 THE WITNESS: Has the backup information
6 been entered into the record?

7 MR. OWENS: I don't believe so. We would
8 be happy to provide that information for you as a late
9 filed response or perhaps Mr. Farrow could answer your
10 question when he reappears next week.

11 COMMISSIONER HEMSTAD: Fine.

12 A. Can I do a follow-up about when you asked
13 about dividing -- taking an average number of pairs
14 for residence? I just want to caution you, on page 19
15 the reason I put this discussion together was to show
16 that even if you take that average you must also
17 consider the fact that we have to put a trench into
18 that location anyway and that we do believe that you
19 have to consider that when you -- if you start to take
20 any type of averages and what have you, that the
21 averages ought to be based upon the what actually goes
22 into the ground rather than placing it into the
23 ground.

24 Q. In your rebuttal dealing with Mr. Dunkel,
25 the reference here is to your testimony -- rebuttal

01963

1 testimony at page 28. Discussion there is about the
2 judgmental weighting of density groups, and I think
3 your response is that you use a standard set of
4 density group designs which reflect the engineering
5 standards used in the actual placement of facilities.
6 I believe Mr. Dunkel's point is that the weighting of
7 each density group is a matter of judgment. How does
8 the company decide the weight that should be given to
9 each group design when it arrives at its overall
10 average?

11 A. We used a weighting based upon the actual
12 distribution of customers along a feeder route. In
13 other words, we actually looked at data from the state
14 of Washington to determine where customers are along
15 the feeder route, and this tells us where our business
16 customers were, where all different types of customers
17 were, and then we used that information to determine
18 -- looked at that information to determine how would
19 we serve customers at those various distances, what's
20 the probability of some of them being in high rise,
21 what's the probability of some of them being in the
22 business part type of arrangement, and for the
23 residence what's the probability of them being also in
24 the high rise or in a DG3 type arrangement. But it
25 was based on the actual distribution of customers

01964

1 along that route. And we worked together with
2 engineering to come up with the probability at each
3 kilofoot length of the feeder.

4 Q. I believe that your testimony on your --
5 supplemental testimony at page 3 you indicate that
6 embedded cost couldn't be recovered if price were set
7 at LRIC. Is that because costs are dropping over time
8 so that forward looking incremental costs are less
9 than embedded costs?

10 A. Our cost studies obviously do forward
11 looking type of cost studies and my statement in my
12 testimony was to reflect the fact that we don't
13 include any embedded cost in our cost study support
14 and that there may be some embedded costs -- and there
15 are some embedded costs of the corporation that need
16 to be recovered, and I'm just saying that those are
17 not included in the study. Therefore, if you identify
18 -- that is, if you price at TS LRIC, service TS LRIC,
19 you won't recover those costs.

20 Q. Is it your view that incremental costs
21 looking forward are less than the overall embedded
22 costs of the company?

23 A. I've seen it both ways, and it depends upon
24 the service, but I would say for the most part of the
25 corporation U S WEST is finding more efficient ways

01965

1 to provide service going forward, that costs will tend
2 to go down. I'm hoping labor rates will hold steady
3 at the same time, but sometimes labor increases to the
4 extent -- labor rates increase to the extent that
5 costs appear to be going up but for the most part
6 price are going down. This is one of the reasons why
7 we are installing new technologies to find more
8 efficient ways of providing service.

9 Q. Do you have any estimate of the difference
10 between the company's revenue requirement and the
11 revenue that would result if every services were
12 provided at LRIC?

13 A. Yes. We have been working on a document
14 like that, but it's not on an every service basis.
15 It's a group of the major service that we provide. We
16 haven't taken it to a level of all services and we may
17 not have current data on some of the -- some of our
18 services that are in much less demand so it's not an
19 exhaustive list but we do have that.

20 Q. Is that the study that you referenced just
21 before our break here?

22 A. Yes. I do need to correct something about
23 that study while I'm talking here. I don't think that
24 the study is going to show total shared residual costs
25 because it won't have all services reflected in it.

01966

1 COMMISSIONER HEMSTAD: That's all I have.

2

3 EXAMINATION

4 BY COMMISSIONER GILLIS:

5 Q. Mr. Farrow, for visual reference I'm
6 looking at your confidential exhibit BEF-3. I think
7 the exhibit number is 341C, the first page of 17.
8 Mr. Waggoner referred to it earlier. It's the MSEA?

9 A. Yes.

10 Q. At the bottom of that matrix there, total
11 1FR, what's FR refer to on residence line?

12 A. Total 1FR, this is 1FR, first service,
13 first line residence service.

14 Q. Then the number that's cited there for ASIC
15 is the average service incremental cost per unit for
16 all first line residential service U S WEST has in the
17 state of Washington; is that right?

18 A. Yeah. This number is based upon Commission
19 prescribed depreciation lives and the 10.53 percent
20 cost of money, but that is the number that's based
21 upon your orders in previous dockets.

22 Q. What I'm really after is just to make sure
23 I understand that this is a number for -- it's the
24 average incremental -- service incremental cost for
25 the unit basis is all first line residentials in the

01967

1 state of Washington?

2 A. Right.

3 Q. And for an individual residential line some
4 will be higher than the average, some would be less
5 than the average, correct?

6 A. Yes.

7 Q. This is an average?

8 A. This is an average cost, yes.

9 Q. As far as your model is concerned, then,
10 the length of the local loop and the size of the wire
11 center are the main factors that would determine how
12 much an average service incremental cost would be for
13 a particular locale?

14 A. Yes, and we take into consideration when we
15 do our loop costs the wire center size as well as the
16 switching costs. In our loop cost study we basically
17 model four different wire center sizes, a very small,
18 a small, medium and a large wire center and this is an
19 average of the models based upon those different
20 sizes. In a switching study we take a look at the
21 actual demand for each switching office in the state
22 of Washington. We look at the actual size of each
23 switching office in the state of Washington and come
24 up with our costs.

25 Q. Would the length of the local loop be

01968

1 another factor?

2 A. The length of the local loop is a factor in
3 the costs, yes, it is.

4 Q. Are there any others, any important --

5 A. In the loop costs, another factor is the
6 density of the distribution areas is the factor.

7 Q. And comparing in this same exhibit the ASIC
8 number for resident access lines and then also for
9 business access lines I note the numbers are quite
10 different for the total?

11 A. Yes.

12 Q. Is that the result of different loop length
13 and different wire line size -- wire line center
14 sizes?

15 A. Yeah. That's because of loop length and
16 distribution area designs. Typically you will find
17 our business customers are located closer to the
18 switching office so their loop lengths tend to be
19 shorter, and this was a factor in the study.

20 Q. Are there any other major reasons for that?

21 A. Not as major as the loop.

22 Q. Loop length is the main thing and density?

23 A. Uh-huh, but, you know, there are some
24 things that are associated with loop that are high in
25 residence.

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1 Q. That are what?

2 A. That are more costly in residence such as
3 usage is higher because they tend to make more calls
4 and costs us more to bill them as well.

5 Q. On the next exhibit, BEF-4, the first page
6 of that one, 342C. There's a list of rate groups
7 down the column C of the spread sheet?

8 A. Yes.

9 Q. What do those refer to?

10 A. These refer to rate groups out of the
11 tariff.

12 Q. What's the difference between the rate
13 group 1 and rate group 3?

14 A. You know, I don't know. I'm pretty sure
15 Mary Owen can answer that for you.

16 Q. There's something I want to ask you about
17 -- do you know I guess if -- if you don't know, you
18 may not, but do the rate groups vary in terms of some
19 of the factors we've talked about, the length of loop
20 or the size of wire line centers?

21 A. No, they do not. As far as the way we did
22 our cost study they do not vary. We used the same
23 cost for each one of these.

24 Q. Well, that's what I was getting at. I may
25 need to ask it in a different way but what I'm

01970

1 interested in is, in different locales anyway, that
2 there would be a situation where there would be longer
3 loops or shorter loops or more density and less
4 density and the wire lines centers would be of
5 different sizes, and looking down at that ASIC number
6 in that spreadsheet it's the same number, and I think
7 you just answered why that is, because in your cost
8 study you treat them the same?

9 A. We did an average cost study.

10 Q. Right. But do you have the capability
11 within each group to calculate a different ASIC? Like
12 for, say, rate group 1 could you calculate an ASIC for
13 rate group 1, an ASIC for rate group 1A and so forth?

14 A. We do not have the capability with our
15 model right now. In fact I think it would probably
16 take considerable effort to do it because we would
17 have to actually go out and sample customers in the
18 different rate groups to determine what their distance
19 is from the switching office.

20 Q. So you don't keep it in that format to be
21 able to do a distribution?

22 A. No, we don't.

23 Q. Would you be able to come up with any
24 description of in the sense of what percentage on
25 ASIC that exceeds the average by at least 50 percent

01971

1 or some kind of -- what I'm looking for is some kind
2 of distribution of your customers. Maybe you could do
3 it with the accounting tab but it would be interesting
4 if you could.

5 A. I believe we could do it based upon the
6 probability of distributions that we use in our
7 models, in other words, the probability to the
8 customers at each -- it wasn't really probability, the
9 distribution areas were probability. We used the
10 actual number of customers at each length of feeder.
11 We could probably do it. Fact is I'm sure we could.
12 We've already provided the backup detail, the average
13 length and we could tell you how many units are beyond
14 that average length and less than that average length.
15 I'm pretty sure we could pull that out of the study.

16 Q. And then associate an ASIC with it or not?
17 What you said is helpful. I don't know if you could
18 take it the next step or not.

19 A. We could calculate an average cost out to
20 that average loop length and beyond that average loop
21 length, two separate average costs. The model is
22 capable of doing that.

23 Q. That would be useful to do that. Along the
24 same lines in U S WEST proposal there is a --

25 MR. OWENS: I'm sorry to interrupt,

01972

1 commissioner. Was that a bench request?

2 COMMISSIONER GILLIS: Yes.

3 MR. OWENS: I think we understand what you
4 would like. Sorry for the interruption.

5 Q. In the U S WEST proposal there is a
6 proposal to have two different rates for zone 1, zone
7 2 for both business and residential?

8 A. Yes.

9 Q. And along the same lines have you -- are
10 these differentials based on the difference in ASIC of
11 serving an average customer in each of those zones?

12 A. Yes, they are.

13 Q. And have you calculated that somewhere in
14 our materials what the ASIC is in each of those?

15 A. Yes. That's in my exhibit -- you want the
16 ASIC. We have that information. It's in the backup
17 detail to the study.

18 COMMISSIONER GILLIS: I would like that
19 also.

20 JUDGE WALLIS: Can we collectively term
21 those bench requests No. 14?

22 MR. OWENS: Very well, Your Honor.

23 COMMISSIONER GILLIS: That's all my
24 questions.

25

01973

1

EXAMINATION

2 BY JUDGE WALLIS:

3 Q. I would like to ask Mr. Farrow if you
4 know or could you calculate the difference between the
5 company's revenue requirement as requested in this
6 proceeding and the revenues that would result if every
7 service were provided at LRIC.

8 A. When you say LRIC you're referring to
9 ASIC or ADSRC?

10 Q. ASIC.

11 A. We can make that calculation. The concern
12 I have is that we don't have a cost study for every
13 single service so we don't have the most up-to-date
14 information. We can get to it at least a 90 percent
15 level. The information that is going to be provided,
16 I think later, is not going to be necessarily at the
17 90 percent level but our intention is at a minimum to
18 do it at a 90 percent level in the future and we will
19 provide that to the Commission in the future whenever
20 the Commission requires it.

21 Q. By 90 percent level, do you mean 90 percent
22 level of confidence?

23 A. Based on 90 percent of the revenues.

24 Q. And then extrapolated for the remainder?

25 MR. OWENS: Only that's what we're going to

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1 be presenting. I don't mean to interrupt. What we're
2 going to be presenting, as I understand it, a
3 calculation that attempts to provide a summation of
4 the revenues that would be produced if services that
5 today produced approximately 90 percent of the
6 company's revenues, that is, on a service basis, all
7 totaled up, as if those were priced at the ASIC. Is
8 that correct?

9 THE WITNESS: Yes, that's correct. That's
10 what his study was asking.

11 MR. OWENS: We can hand that out now. A
12 sponsoring witness will appear next week but we can
13 hand it out at this time if you would like.

14 JUDGE WALLIS: You have that available?

15 MR. OWENS: We sure do.

16 JUDGE WALLIS: Very well. Rather than take
17 time right now how about if we handle that
18 administratively when the witness is completed.

19 MR. OWENS: Very well. You know, the
20 problem that you asked him about extrapolating or
21 interpolating is when -- and perhaps Mr. Farrow should
22 be testifying rather than me, but let me just ask him
23 since this was in response to your inquiry. Is there
24 a fairly significant number of small volume service in
25 that last 10 percent?

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1 THE WITNESS: Yes. I know we did a similar
2 type of analysis in Wyoming and the lists went on and
3 on and forever and so it is a very significant list of
4 services in that lower 10 percent.

5 JUDGE WALLIS: Very well. That satisfies
6 my inquiry. Are there further questions? Redirect.

7 MR. OWENS: Thank you, Your Honor.

8

9 REDIRECT EXAMINATION

10 BY MR. OWENS:

11 Q. Mr. Farrow, there seems to be a lot of
12 interest from the bench on the topic the relationship
13 between the sum of the TS LRIC, that is, if all
14 services were priced at that, and the company's
15 embedded cost. Are you aware of whether or not the
16 company by virtue of being a multi product firm of a
17 particular size enjoys any economies of scope or
18 scale?

19 A. Yes, we do.

20 Q. Would that account or have any role in the
21 fact that the sum of the price for the company's
22 services at TS LRIC would tend to be less than its
23 fully distributed embedded costs?

24 A. When you ask the question, I was not -- my
25 understanding was not he was talking about fully

01976

1 distributed embedded cost. I was thinking about when
2 he was talking about embedded costs I thought you were
3 referring to some measure of direct costs on an
4 embedded basis, but on a fully distributed basis
5 those costs would definitely be higher than the direct
6 costs.

7 Q. Is that related to the phenomenon I asked
8 you about, the economies of scope and scale for a
9 multi product firm such as U S WEST?

10 A. Our costs are lower because of the fact
11 that we do have economies of scale because of our
12 size, yes.

13 Q. When you say costs are you referring to the
14 TS LRICs?

15 A. The embedded cost and our TS LRIC studies
16 reflect that.

17 Q. Counsel for the Commission staff asked you
18 a question in which the concept that shared residual
19 costs was mapped to volume sensitive costs appeared,
20 and I believe you indicated in some fashion an
21 affirmative answer to that. Do you recall that
22 question? What's the significance of that to you?

23 A. I recall the question. Maybe I
24 misunderstood the question but the shared residual
25 costs are not mapped to volume sensitive costs.

01977

1 Q. To what are they mapped, if anything?

2 A. Shared residual costs are calculated
3 separately and they are assigned to services at the
4 group level.

5 Q. You were asked another question which
6 assumed a hypothetical that the company had but a
7 single end office and that all of its services used
8 that end office switching function, and you were asked
9 whether the common costs would go away, I believe, if
10 the entire company were to shut down or if that was
11 the only way that common costs would go away. Do
12 you recall that?

13 A. Yeah. I remember that line of questioning,
14 yes.

15 Q. In answering that question yes, did you
16 make any assumption about whether the company would
17 continue to serve exactly the same geographical area
18 at all times or the only alternative would be for end
19 service in its entire area?

20 A. I assumed that it would be end service in
21 its entire area.

22 Q. When you were asked about the shared
23 residual relating to switching functions, did you
24 assume that the whole function is shared?

25 A. No, I did not. I assumed that some of the

01978

1 function would be volume sensitive.

2 Q. Counsel for the staff asked you about the
3 question of uncollectibles. Do you recall those
4 questions and the inclusion of those in shared
5 residual?

6 A. Yes, I do.

7 Q. I believe you stated that company's
8 accounting system did not allow you to relate
9 uncollectibles to specific services; is that correct?

10 A. That's correct.

11 Q. Now, is that the only reason why you
12 believe it's appropriate to treat uncollectibles as
13 part of shared residual?

14 A. Well, there are some circumstances
15 obviously where it may not be service specific because
16 of the fact that some customers just don't pay their
17 bill and there could be more than one service on the
18 bill, so it could be associated with not just the
19 service but also a bill as well.

20 Q. Counsel also asked you whether or not the
21 revenue from the carrier common line charge was
22 revenue resulting from the use of the loop. Do you
23 recall that question?

24 A. Yes, I do.

25 Q. And do you want to amend your answer at

01979

1 this point?

2 A. Yeah. I misunderstood. I was thinking end
3 user common line rather than carrier common line, and
4 end user common line is revenue that is received to
5 recover the cost of the loop. Carrier common line is
6 not.

7 Q. Counsel for MCI asked you, I believe, about
8 the relationship between products and product managers
9 and I believe you answered that each product had a
10 manager and then I believe Mr. Nichols as a prefatory
11 remark to a follow-up question said that we could
12 assume that there was an equal number of product
13 managers to the number of products. Do you agree with
14 that conclusion following from what you stated?

15 A. No, I do not.

16 Q. In fact, do some product managers manage
17 more than one product?

18 A. Yes, they do.

19 Q. There was a question asked you about
20 whether or not the company does promotions for
21 residence based service. Do you recall that?

22 A. Yes, I do.

23 Q. When you answered in the negative were you
24 thinking about only the first line?

25 A. Yes, I was. I was thinking about the first

01980

1 line of service.

2 Q. Does the company in fact do promotions for
3 additional lines in the residence market?

4 A. Yes, we do.

5 Q. Directing your attention to Exhibit 348,
6 which was the response to TRACER data request No. 99,
7 and the answer to question D at the bottom is that U S
8 WEST does not study analog switching costs. Costs are
9 studied only for digital offices. Would you state why
10 that is?

11 A. We do a forward looking cost study and use
12 the least cost technology. Analog switching is not
13 the least cost technology so our studies only reflect
14 the digital technology, digital switches.

15 Q. Directing your attention to Exhibit 350
16 which was a response to TRACER data request No. 94,
17 did the company examine the impact of building the
18 network under the assumption of 100 percent digital
19 pair gain deployment?

20 A. We did it for -- yes, we did.

21 Q. What would have been the impact had the
22 company's network actually been built that way
23 compared to what --

24 A. Costs would have been higher.

25 Q. Compared to what the existing environment

01981

1 is; is that correct?

2 A. Higher than the existing cost study.

3 Q. Subsequent to your testimony this morning
4 in which you identified your supplemental testimony
5 and indicated that the answers printed in it were what
6 you would state if asked. Did you learn that there
7 was a number on page 9 that needed to be corrected?

8 MR. TROTTER: Is it supplemental?

9 THE WITNESS: Yeah, supplemental.

10 MR. OWENS: It would be page 14, I'm sorry,
11 page 14.

12 A. Yes.

13 JUDGE WALLIS: 338T?

14 MR. OWENS: Yes, Your Honor.

15 Q. What is that number? Where is it on the
16 page and what should it be?

17 A. I know the number isn't correct. I don't
18 have the correct number with me here.

19 Q. Can you accept subject to check?

20 A. Wait a minute. Maybe I do have it here.

21 Q. Do you now have the correct number before
22 you?

23 A. Yes. I do have the number before me.

24 Q. Is it the number on line 1? I guess that's
25 the only number on the page. Oh, that's right.

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1 Is it the number on line 1?

2 A. It's on line 2. Wait a minute. It's on,
3 I'm sorry, my copy must be different than yours.

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

6 (Recess.)

7 Q. Is it the number that's given in answer to
8 the question, "What is the total of residence loop
9 drop and NTS-COE costs"?

10 A. Yes, that's the number.

11 Q. Would you please read into the record what
12 the correct number is?

13 A. It's 298,017,789 dollars.

14 Q. Commissioner Gillis had asked you about
15 what the acronym 1FR means. And I believe you said
16 first residential line. Is it first residential line
17 or one party flat residential service?

18 A. One party flat residential service.

19 Q. In response to questions by the staff you
20 had some discussions about joint costs of various
21 products. In your cost studies, is a joint cost of a
22 product the same thing as a common cost?

23 A. No, it is not. Joint costs is used
24 synonymously with shared costs in our cost studies.

25 Q. If every product of a company uses an end

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1 office switch, does that make the cost of the end
2 office switch a common cost?

3 A. No, it does not.

4 THE WITNESS: While they're doing that can
5 I make a correction?

6 JUDGE WALLIS: Yes.

7 THE WITNESS: On my exhibits BEF-4, on page
8 2, there's a column K and it says annual ASIC. That
9 should be not ASIC but TSIC.

10 MR. BUTLER: Which exhibit?

11 THE WITNESS: That was page 1.

12 BY MR. OWENS:

13 Q. Just so the record is clear, the use of the
14 T as far as total service incremental cost, does that
15 refer to only the items that are listed on the upper
16 part of that exhibit, that is, the loop drop and
17 NTS-COE costs?

18 A. Yes, that's correct.

19 Q. So it doesn't refer to any other part of
20 the provision of residence one party flat service; is
21 that correct?

22 A. That's correct.

23 JUDGE WALLIS: So the record makes sense,
24 we were off the record when the witness offered his
25 correction so let's let him state it for the record

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1 now.

2 THE WITNESS: In my Exhibit BEF-4 to my
3 supplemental I have a correction in the last column of
4 pages 1, 3, and 5.

5 JUDGE WALLIS: For the record, that is
6 Exhibit 342C.

7 THE WITNESS: And the designation as
8 labeled ASIC should be labeled TSIC.

9 Q. Are these figures on a Commission basis or
10 a company basis?

11 A. These are on a Commission basis.

12 Q. Counsel for AT&T asked you if there's a
13 physical difference between residence and business
14 access service and a NAC and you discussed the length
15 and the fact that there was usage. Were you
16 recognizing that at least the NAC is not a usage rated
17 service in that answer? Is that part of your
18 distinction?

19 A. Yeah. The difference between the services
20 themselves, there is some usage difference in the
21 services, how much use they make of the switched part
22 of the network. So it's not part of the access line
23 itself. So those costs are shown separately in the
24 cost study.

25 Q. And did you understand the question as

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1 referring to the entire service or just to the loop
2 part of each one of those three services?

3 A. To the entire service.

4 Q. Public counsel asked you a number of
5 questions about whether there were -- it was necessary
6 for the company in providing its retail toll service
7 to residence customers for those customers to use the
8 local loop, and you were asked if there were any other
9 ways in which residence customers would make a retail
10 toll call without using the loop. Did you have in
11 mind any kind of cellular alternative in making that
12 response?

13 A. Yeah. I thought I added the fact that they
14 could get access through a wireless methodology as
15 well and I was talking -- referring to cellular.

16 Q. So did you intend that response to refer to
17 that entire series of questions that you were asked
18 about the alternative ways in which certain services
19 could be provided?

20 A. Yes.

21 Q. And finally, I believe Commissioner Hemstad
22 asked you a question about the use of three pairs as
23 the assumption in the distribution and drop. Do you
24 recall those questions?

25 A. Yes, I do.

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1 Q. And I believe you indicated that one
2 hypothesis would be that the customer would move out
3 and another customer might move in and not order the
4 connection of the additional line; is that correct?

5 A. That's correct.

6 Q. Do you know whether in fact people
7 sometimes disconnect their additional lines without
8 moving out because their usage patterns change over
9 time?

10 A. Well, I'm about to do it real soon as soon
11 as my daughter moves out to go to college so, yeah, it
12 does happen.

13 MR. OWENS: Thank you. That's all I have
14 on redirect.

15 JUDGE WALLIS: Mr. Smith.

16

17 RECROSS-EXAMINATION

18 BY MR. SMITH:

19 Q. Mr. Farrow, in response to questions,
20 redirect from Mr. Owens, you indicated that you had
21 misunderstood my earlier question. When I talked
22 about carrier common line charge you thought I meant
23 end user charge. So is it now your testimony that the
24 carrier common line charge revenue is not part of the
25 total revenue resulting from the loop?

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1 A. That is my testimony.

2 Q. Do you know how the carrier common line
3 charge is calculated in this state?

4 A. No, but Barbara Wilcox can answer that
5 question for you.

6 Q. If you assume for purposes of this question
7 that the CCLC charge is based upon loop and other
8 NTS costs, is it still your position that the revenue
9 resulting from the charge should not be considered
10 part of the total revenue resulting from the loop?

11 A. My understanding of carrier common line
12 charge is --

13 Q. I asked you a specific assumption in my
14 question.

15 A. That's right, yes. That's my assumption.
16 The answer is yes, that it is not part of the revenues
17 associated with the loop.

18 Q. One last question. I'm not sure I
19 understood. Commissioner Hemstad asked you for some
20 comparisons of embedded costs with forward looking
21 long-run incremental costs and you said you've seen it
22 both ways. Sometimes one was higher as I understood
23 your answer. How about in the case of loop costs in
24 Washington? Are you familiar with that comparison?

25 A. No, I am not. I have not seen such a

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1 comparison.

2 MR. SMITH: That's all I have.

3 JUDGE WALLIS: Mr. Trotter.

4

5 RECROSS-EXAMINATION

6 BY MR. TROTTER:

7 Q. Mr. Farrow, a customer can complete a local
8 call using cellular technology as well, can he or she?

9 A. Yes.

10 Q. And you were asked some questions about
11 customers that move in and out of a particular
12 residence and either order more or less services when
13 they do. Do you recall those questions?

14 A. Yes.

15 Q. For the customer that moves out and
16 customer that moves in orders one line instead of two,
17 is it also possible for a customer to move in and
18 order two lines instead of the previous one; is that
19 right?

20 A. That's correct.

21 Q. Do you know on a forward looking basis does
22 U S WEST assume that customers will be ordering more
23 1FR services per residence or less or the same as
24 currently?

25 A. I don't know for certain but Mary Owen

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1 could answer that question for you.

2 MR. TROTTER: Thank you. That's all I
3 have.

4 JUDGE WALLIS: Any further questions for
5 the witness? It appears that there are not. Mr.
6 Farrow, thank you very much. You're excused from the
7 stand subject to return next week. Let's be off the
8 record to discuss scheduling.

9 (Discussion off the record.)

10 JUDGE WALLIS: Let's be back on record,
11 please. Dr. Emmerson has been called to the stand by
12 U S WEST. It has been determined for scheduling
13 purposes that U S WEST will ask its direct questions
14 at this time and then we will be in recess and Dr.
15 Emmerson will return to the stand next Wednesday. So,
16 at this time, Dr. Emmerson, if you would rise and
17 raise your right hand, please.

18 Whereupon,

19 RICHARD EMMERSON, PhD
20 having been first duly sworn, was called as a witness
21 herein and was examined and testified as follows:

22 JUDGE WALLIS: I was going to note that the
23 exhibits for this witness have been previously
24 identified as 360T, 361 and 362.

25

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1 DIRECT EXAMINATION

2 BY MR. SHAW:

3 Q. Dr. Emmerson, could you state and spell
4 your name and address, please.

5 A. Yes. My name is Richard D. Emmerson, E M M
6 E R S O N. My address is 341 L'Amatista, Delmar,
7 California.

8 Q. What is your occupation, sir?

9 A. I'm an economist. I have a PhD in
10 economics.

11 Q. Did you have cause to be prepared Exhibits
12 360T and 361, your prefiled rebuttal testimony in
13 this case?

14 A. Yes.

15 Q. And other than minor typographicals that do
16 not change the meaning or the intent, is that
17 testimony correct and true to your best belief?

18 A. Yes, it is.

19 MR. SHAW: Your Honor, we would move the
20 admission of 360T and 361.

21 JUDGE WALLIS: Is there an objection? Let
22 the record show there is no objection and those
23 documents are received.

24 (Admitted Exhibits 360T and 361.)

25 Q. Dr. Emmerson, have you had occasion to

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1 review the supplemental testimony on cost issues filed
2 by the various parties in December of last year?

3 A. Yes, I have.

4 Q. And I would just ask you to comment on the
5 main issues that you see presented by that
6 supplemental testimony filed by the other parties in
7 this case.

8 A. Yes, I have two very general comments and
9 they pertain to the testimonies of Mr. Dunkel and to
10 some extent to Mr. Zepp and Mr. Spinks but the two
11 issues are the pervasiveness of attempts, particularly
12 in Mr. Dunkel's testimony to take the concepts that
13 are more pertinent to regulatory accounting and bring
14 them into or carry them over into an incremental cost
15 world, and that is a pervasive problem that I see
16 throughout the testimonies, examples of which are
17 desires to use historical values for calculating
18 incremental costs, the continued attempt to try to
19 include separated costs as a relevant component of an
20 incremental cost study. It is not. Attempt to
21 suggest that even pricing in a competitive environment
22 can still be developed through the use of fully
23 distributed costs. Many of his examples and much of
24 his discussion in essence then is an attempt to
25 preserve regulatory accounting concepts in an

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1 environment where it's inappropriate.

2 The reason it's inappropriate is not that
3 revenue requirements are irrelevant, that's an
4 exercise which very much depends on regulatory
5 accounting. The reason is that the incremental cost
6 studies provided are specifically designed to promote
7 and protect the competitive process and that means
8 reporting costs that are pertinent to conducting
9 business in the future, and those costs should be
10 reported as they are likely to be incurred by the
11 company not as they have been incurred in the past.
12 Competitive safeguards generally means performing
13 imputation tests and establishing price floors to
14 avoid cross subsidizing competitive services with
15 monopoly services, and those functions are not served
16 by the recommendations that Mr. Dunkel puts forth.

17 The second matter, and the second issue
18 which I think is of great importance is the attempt to
19 use standard cost studies. This is recommended by
20 both Mr. Zepp and Mr. Dunkel. Standard cost studies
21 may be appropriate or standardization may be
22 appropriate again for accounting purposes. It is not
23 appropriate for long-run incremental cost studies.
24 Again, the reason is that if standard cost studies are
25 performed and they do not reflect the practices of the

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1 company, the way in which the company performs its
2 business, the resources the company buys and the means
3 by which it provides its services, the cost standards
4 that are set through standardized cost studies may be
5 too low or may be too high. If they're too high they
6 put in place inappropriately high price floors under
7 services which competitive services would otherwise
8 drive prices down below. If they're too low they may
9 allow the company to price at levels which are anti-
10 competitively low. Therefore it's very important to
11 have the cost studies in a forward looking incremental
12 cost environment reflect as accurately as possible the
13 actual costs of the company conducting business in
14 this future competitive environment.

15 I understand and I empathize with the
16 reason for asking for standardized cost studies, and I
17 think part of the reason is to insure greater
18 consistency and insure greater transparency of cost
19 studies. I do empathize with that concern. I just
20 believe that there are far better ways that that
21 concern can be met than by trying to incorporate
22 standardized cost studies.

23 In essence what you would be asking for is
24 two sets of cost studies. Resources are already very,
25 very scarce at U S WEST, and to ask for standardized

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1 cost studies and in addition to that total service
2 long-run incremental cost studies that serve the
3 competitive environment would be simply asking for a
4 wasteful level of resources to be devoted to cost
5 studies.

6 A parenthetical remark here, and this is
7 not quite related to the standardization of cost
8 studies but it is very much related to the research
9 requirement of doing cost studies. Mr. Spinks
10 suggests that cost studies be performed based on
11 utilizing engineering integrals. I have attempted to
12 do this in some circumstances in the past and many
13 companies I have worked for have attempted to do that.
14 It enormously increases the requirements for resources
15 and is unnecessary in a long-run incremental cost
16 study. The engineering intervals are always accounted
17 for in the algorithms and principles that underpin
18 the cost studies today. So, again, I would urge not
19 requiring unnecessary expenditures of resources in
20 that regard as well.

21 That really concludes my general comments
22 and my general concerns with the supplemental
23 testimonies which I've seen. Obviously, there are
24 lots of details with which I could and probably would
25 take exception but I think it's appropriate to confine

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1 my comments to the most important issues as I see
2 them.

3 Q. Directing your attention specifically to
4 Ms. Murray's testimony on behalf of the Northwest
5 Payphone Association, have you read her supplemental
6 testimony of December 15?

7 A. Yes, I have.

8 Q. Directing your attention to her assertions
9 that U S WEST's cost studies are designed to defend
10 prices that would put her clients in a price squeeze.
11 In regard to a price squeeze, is it important in
12 testing whether there's a price squeeze to not only
13 correctly calculate the costs of inputs but the
14 revenues against which those costs are being compared.

15 MR. HARLOW: Your Honor, I would like to
16 state an objection as to the specific question. It's
17 quite leading. Also, I would like to reserve the
18 right to object generally to this line of questioning
19 as being improper, and that will not become clear
20 until it's concluded. It's based on Mr. Owens's
21 representation to me of a topic, so if it's all right
22 with you I would like to reserve that until the
23 examination is concluded.

24 JUDGE WALLIS: The objection to the
25 phrasing of the question is denied and your objection

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1 as to the line of questions is acknowledged and
2 reserved.

3 Q. Do you have the question in mind?

4 A. Yes, I do. At least I have the preface to
5 the question in mind.

6 Q. Is it important that in analyzing whether
7 there's any price squeeze to recognize the correct
8 revenues as well as the cost side?

9 A. Yes. It's extremely important to recognize
10 the correct revenues. The correct revenues in
11 evaluating whether or not there is a price squeeze are
12 the revenues associated with what economists call the
13 contested or addressable market. All revenues which
14 are contested in the market should be included in an
15 imputation requirement as should all of the associated
16 costs.

17 Q. Specifically in the case of pay telephone
18 service, in your opinion, are the revenues that should
19 be considered in this Commission analyzing whether
20 there is a price squeeze contain more than just the
21 revenues from local calls?

22 A. Yes. It should contain the revenues which
23 literally swing on the competition. The competition
24 is for the site, the site of the public telephone.
25 When that site is won by a competitor a body of

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1 revenues swings on that contest. That may be local
2 revenues. That may include operator revenues and
3 other such revenues. If U S WEST were to win that
4 site, similarly they would acquire those revenues and
5 those contested revenues and the associated costs are
6 the appropriate basis for an imputation test.

7 Q. Will you please contrast the logic between
8 excluding all revenues but just the revenue of the
9 specific service in pay phone, the local service, with
10 the assertion that the costs for residential service
11 should be considered covered by all the revenues that
12 may be gained from selling a residential customer any
13 service, not just the basic exchange service?

14 A. If I understand your question correctly, I
15 think the analogy would be the pay phone offers a
16 variety of services for which revenues compensate its
17 costs. The residence loop also offers a variety of
18 services and the question is what's the difference
19 between the two environments, as I understood it. Why
20 is it appropriate to consider all revenue sources in
21 comparison to the cost of pay phone service while it
22 would be not appropriate to consider all revenue
23 sources as compensation for the cost of the loop. Is
24 that the comparison?

25 Q. Is that the comparison.

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1 Q. Yes. Assertion that revenues should be
2 excluded from a price squeeze test but they should be
3 included for deciding whether a service covers its
4 costs. Is there an illogic in those two situations?

5 A. Yes. There's some very important
6 differences between the pay telephone environment and
7 the residential line. While both offer a variety of
8 services the first difference is that pay telephones,
9 like stores and gas stations, are located at the
10 discretion of the provider, except in certain public
11 interest cases, but by and large profitable locations
12 are sought out just as a store is located in a
13 profitable site. While the store would mark up its
14 beans and dog food and other items to cover the loss
15 of that location -- it would not locate there were
16 there not enough things purchased at that location to
17 make this a profitable site. Same thing is true
18 with a public telephone. One would normally put a
19 public telephone out where enough things are sold,
20 local calls, toll calls, et cetera, to make that site
21 a profitable location. The residential line is not
22 placed at such discretion. One does not have the
23 option of saying because you bought the competitor's
24 toll and the competitor's voice mail I'm going to pull
25 this location. The cost is required and the facility

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1 is dedicated to the customer. That's a particularly
2 important distinction.

3 Second distinction is that again the body
4 of business which is contested is different. In the
5 pay phone site it is, as I said before, the body of
6 business that comes to that pay phone that is at
7 issue. In a customer individual revenue sources can
8 be competed away. One may or may not buy U S WEST
9 toll service. One may or may not buy the other
10 services U S WEST has to offer. This gets
11 increasingly true, of course, in an unbundled
12 environment where one may have the discretion to buy
13 any number of services from any number of sources, so
14 what's being contested are individual services in the
15 case of a residential customer not the body of
16 business in its entirety.

17 Q. Dr. Emmerson, have you and your firm been
18 retained by U S WEST to audit and critique its cost
19 studies and cost study methodologies?

20 A. Yes. One of the divisions in my firm is
21 specifically in that business both domestically and
22 abroad. And yes, we have been retained by U S WEST.
23 I would not say to audit the cost studies in their
24 entirety but certainly to review the cost
25 methodologies and principles and models.

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1 Q. Have you reviewed, for instance, the cost
2 manual that's appended to Mr. Farrow's supplemental
3 testimony in this case?

4 A. Yes. I've reviewed it and my staff has
5 reviewed it in more more detail than I have.

6 MR. TROTTER: Your Honor, could I interrupt
7 and object and ask to what supplemental testimony this
8 testimony is intended to respond to?

9 MR. SHAW: This is intended to respond very
10 specifically to public counsel's witness Mr. Dunkel in
11 terms of urging what is needed or what is not needed
12 to audit U S WEST cost studies.

13 MR. TROTTER: I should also note for the
14 record, unlike Mr. Harlow the company never notified
15 me of the subject of their inquiry here today.

16 MR. SHAW: I'm not sure that's the case,
17 Your Honor, but in any event Dr. Emmerson is going to
18 be back in a week so this line of questioning is not
19 very long.

20 JUDGE WALLIS: Please proceed.

21 Q. Dr. Emmerson, in reviewing the
22 documentation and the way that U S WEST presents its
23 costs to regulators, do you have any critique of that
24 documentation and any suggestions on how it can be
25 improved?

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1 MR. NICHOLS: I'm going to object to that
2 question, Your Honor. It seems to me that this is not
3 directed at the testimony referred to just a moment
4 ago by public counsel, but rather to cross-examination
5 that was heard today, and if all of us have a chance
6 to have our witnesses sit and listen to
7 cross-examination and do a surrebuttal of cross we
8 truly would be here many weeks, and I think a line has
9 to be drawn somewhere.

10 MR. SHAW: This is not surrebuttal of
11 cross, Your Honor. This is rebuttal of supplemental
12 testimony filed by other parties. Recall the
13 Commission ordered U S WEST to file supplemental
14 testimony on costs and particularly on documentation
15 of costs and accessibility and auditability of costs
16 and gave other parties permission -- as a result a
17 great deal of testimony came in which the company has
18 never had the opportunity to rebut and unless we're
19 going to set another hearing proceeding, this is our
20 one and only chance to rebut. As the company with the
21 burden we have an absolute right to rebut. These
22 questions are directed to rebutting the accusations,
23 in the company's view, the self-serving accusations,
24 by all of the competitors and opponents in this
25 proceeding that U S WEST cost studies are not

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1 auditable, not transparent, not stable, et cetera.
2 And this is the expert, the acknowledged expert that
3 U S WEST has hired to advise it on exactly those
4 issues, and I think his opinion is very relevant to
5 this proceeding on whether the documentation and
6 auditability of U S WEST cost studies is sufficient.

7 JUDGE WALLIS: The Commission acknowledges
8 the procedural status and it believes that U S WEST
9 should have the opportunity to respond to the
10 testimony that's filed. To date that has been through
11 a relatively brief line of examination, relatively few
12 questions which are or have been apparently well
13 focused on the inquiry, and on that basis I will allow
14 the examination to continue. I am concerned that,
15 again, in a spirit of fairness all parties whose
16 submissions are surrebutted have the information that
17 they need to listen to the questions and answers and
18 respond appropriately, and as I say I am quite
19 concerned about the recurring reports that parties
20 don't have that information, and I would ask the
21 company to review whether it has such lines of
22 questioning for future witnesses and to assure itself
23 and the Commission that sufficient knowledge is
24 provided to other parties including, if appropriate,
25 the exact questions that would be asked so that

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1 parties have a chance to determine where they are and
2 need to be. So with that the examination may
3 continue.

4 A. I do recall the question if you would like
5 me to proceed.

6 Q. Go ahead and answer it, sir.

7 A. I'm afraid after all that argument I'm
8 going to be perhaps a little more friendly to the
9 those who have criticized the cost studies than might
10 have sounded like the case given all the arguments to
11 get this far. I did find some of the documentation
12 and organization of materials lacking in many regards
13 as we reviewed the cost studies. It was difficult to
14 ferret out the underlying consistencies of the cost
15 studies in some cases. While they're there I think
16 that there are some distinct areas in which the cost
17 studies and in particular the organization of the
18 information and presentation of the information could
19 be improved, and I would be happy to elaborate on that
20 if you wish. But perhaps I should stop now.

21 Q. Please state briefly what would improve, in
22 your opinion, the auditability of the cost studies by
23 improving the documentation.

24 A. Part of this would be based on what my
25 staff reports to me. Most of it is also, however,

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1 based on my own personal experience with the cost
2 studies. I think the chain of logic that allows one
3 to trace a cost from the service level back to all of
4 the underlying resources the company employs and
5 purchases to provide that service could be better
6 documented. That logic is in part missing because the
7 cost study information tends to be highly
8 compartmentalized, and that's largely due to the fact
9 that the various job junctions are compartmentalized
10 and so the documentation tends to reside in similar
11 compartments. Sometimes difficult to see how, for
12 example, information flows from one compartment to
13 another and the chain of logic that leads there.

14 It's also -- it was difficult for me to see
15 in some cases that the same foundation was there for
16 each portion of the cost study, and by foundation I
17 really mean the basic underlying principles, the basic
18 assumptions, the basic concepts upon which the cost
19 studies are based. While it's there in the
20 documentation it tends to be there in one place and
21 it's not always clear how it appears and reappears in
22 each of the compartment as I described them.

23 In most cases I found the arithmetic
24 examples and samples of how the models do the
25 calculations extremely useful but I did not find them

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1 present in all models. For example, I had trouble
2 finding such arithmetic examples for the conversion of
3 investments to annual costs, and while I'm fortunate
4 enough to know what model is used and how it works I
5 didn't find it well documented in the materials.

6 And I would say, finally, just in a more
7 cross referencing as to between the portions of the
8 studies, cross referencing such as this number comes
9 from here and then the numbers that make it up come
10 from somewhere else. The ability to immediately go
11 back to any level of detail that may be necessary may
12 be improved. None of this is to say that cost studies
13 were found to be wrong. It simply says that to some
14 extent I do share the concerns that the information be
15 more accessible. But I would reiterate, as I said
16 earlier, that I don't think that we accomplished that
17 by providing standardized cost studies or historical
18 values for cost studies. I think it's accomplished
19 through methods I just described.

20 Q. Finally, if you were to be retained to
21 audit cost studies such as presented by U S WEST in
22 this proceeding, what would you need at your disposal
23 in order to perform that audit?

24 A. Pretty much the materials that are
25 provided, I think, with a couple of major exceptions.

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1 I think you need a human being who is very well versed
2 in the cost studies and the logic of the cost studies.
3 Someone to literally guide one through the process of
4 performing a cost study, and that's best done in
5 context of sessions where one literally goes and sits
6 at the terminals and sees how things are developed and
7 how the information flows through from beginning to
8 end. I generally require in getting at least sample
9 inputs and outputs -- and in many cases I will take
10 those inputs and outputs and do my own calculations
11 knowing that they are economically sound, that my own
12 calculations are economically sound and compare my
13 outputs with the company's outputs based on the same
14 inputs and if the differences are minor, a couple
15 percent difference, it's often due to just minor items
16 like midyear conventions, end of year conventions,
17 rounding differences. When the difference gets to be
18 15 percent or 20 percent then it raises a flag and
19 usually that indicates that there are substantive
20 difference in the way the calculations are performed.

21 Sometimes that turns out to be errors in
22 the calculations. Sometimes that turns out to simply
23 be that portion of the calculations are done elsewhere
24 and added in, but again having a clear flow of logic
25 would generally reveal that. And of course access to

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1 the block diagrams and flow charts that show what
2 makes up services. Show what basic resources are
3 required to provide those services and the costing
4 capacities of those services in some cases or those
5 pieces of equipment in some cases can help verify that
6 the things like capacity cost calculations are being
7 done correctly.

8 Q. Finally, do you find the basic
9 methodologies of the company and the models that it
10 has constructed to implement those methodologies a
11 sound and correct from an economist point of view?

12 A. Yes, I do. Certainly most of the
13 methodologies, in fact in virtually all of the
14 methodologies I've seen are based on the training
15 courses I've provided to U S WEST over the past decade
16 or so and they are reflected in the cost studies.

17 Q. Is ADSRC a valid additional data point for
18 the company and for this Commission for that matter to
19 know?

20 A. Well, given the confusion it seems to have
21 created in this case it may be more of a liability
22 than a useful data point for that reason alone, but
23 yes, it is. It's a useful piece of information but in
24 my opinion in this proceeding much too much has been
25 made of it. It should be very clear in everyone's

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1 mind by now that ADSRC is not a price floor for an
2 individual service. It is an indicator of what
3 additional revenues would be required in order to be
4 sure that the shared underlying facilities like spare
5 capacity in the switch are compensated. It does not
6 mean to set a price, does not mean to provide a price
7 floor. It is something to be used as what I sometimes
8 call the executive's security blanket. Very often
9 executives are concerned about passing off an
10 incremental cost and fearing someone will price at or
11 above that level, and they've done that job and the
12 executives get very concerned that you're not done
13 yet. You're got shared costs to to be recovered, we
14 have common costs to be recovered. This company is
15 not yet whole. Be reminded, there are more revenues
16 required than that, and that's probably about as much
17 as should be made of that. The only other thing that
18 it's useful for in this case is that if one had market
19 conditions that allowed one to price at that number
20 one could be assured that the respective product
21 families are not being subsidized as well as the
22 individual products, but that does not mean that one
23 should price at that level.

24 MR. SHAW: Thank you, Dr. Emmerson. That
25 concludes our oral rebuttal of the supplemental

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1 testimony.

2 MR. WAGGONER: Your Honor, I have a
3 slight favor to ask. I may not be able to be here
4 next Wednesday afternoon when he returns. And since I
5 have only a few brief questions I wonder if I could
6 ask them at this time.

7 JUDGE WALLIS: Is there an objection to
8 doing that?

9 MR. HARLOW: May I state my objection? I
10 do have one to a portion of the direct surrebuttal
11 testimony. It is limited basically to the part in the
12 middle, if you will, the testimony by Mr. -- excuse
13 me, Dr. Emmerson, regarding Ms. Murray's testimony,
14 and specifically regarding what revenues Dr. Emmerson
15 testified should be included in performing an
16 imputation test for pay phone services.

17 There are two grounds for this objection.
18 Number one, as Mr. Shaw stated at one point on another
19 objection the whole purpose of this unusual testimony
20 this evening was to rebut the supplemental testimony
21 that was filed in December of this year. Ms. Murray's
22 initial testimony was filed in August, excuse me --
23 that was December of last year. Ms. Murray's
24 testimony was initially filed in August of 1995. That
25 testimony contained the exact same imputation analysis

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1 that was also attached to the supplemental testimony
2 addressed in December, filed in December. The only
3 difference between the imputation analysis Ms. Murray
4 filed in December compared to the one she filed much
5 earlier than that is that she made some corrections to
6 call volumes and she made some corrections to cost
7 data based on some alleged need for corrections that
8 Mr. Lanksbury asserted in his rebuttal testimony.

9 So the issue of the appropriate revenues to
10 be included in the imputation analysis was -- and Ms.
11 Murray's position on that was quite clear at the time
12 she filed her testimony in August. And indeed Mr.
13 Lanksbury responded in kind using exactly the same
14 revenue sources in his imputation analysis that he
15 filed in October. So there's no grounds for such a
16 late attempt to introduce additional revenues,
17 unspecified revenues, in the imputation analysis on
18 oral testimony.

19 Secondly, this issue was very recently
20 decided by the Commission in docket UT 920174. In the
21 fourth supplemental order in that case the Commission
22 stated that it "believes the appropriate pay phone
23 imputation analysis compares the revenue derived from
24 a local call with a tariff rate for 'bottleneck
25 network services,'" and so on and so forth. Indeed

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1 the Commission reaffirmed that holding in its fifth
2 supplemental order denying U S WEST's motion for
3 reconsideration stating that the Commission limited
4 the imputation test to local pay phone revenues in
5 order to determine whether the relationship between
6 the public access line rate and the 25 cents per local
7 call created a price squeeze. That's at page 6. That
8 order was served on July 30, 1995. Under RCW
9 80.04.200, "a company that deems itself affected by
10 any order may not address the same matters again for
11 two years if it should petition the courts for review
12 of that order." U S WEST currently has on review in
13 King County Superior Court the Commission's fourth and
14 fifth orders in docket UT 920174. It's been much less
15 than two years since these matters were decided by the
16 Commission and for U S WEST to come in at the last
17 minute and attempt to get the Commission to reconsider
18 its prior orders yet again is A, untenable, but B,
19 precisely in violation of 80.04.200 and that testimony
20 should be stricken.

21 MR. SHAW: May I respond?

22 JUDGE WALLIS: Yes.

23 MR. SHAW: Ms. Murray's testimony is in
24 many ways objectionable. U S WEST did not object. It
25 is not directed to the issues that the ninth

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1 supplemental order directed it to. Specifically on
2 page 3, she goes on about anticompetitive price
3 squeezes and emphasizes that the company's costs
4 should be, in the company's view, computed in ways
5 that do not realistically reflect the actual costs of
6 the company and be compared against a very limited
7 revenue.

8 On page 4 she again uses provocative
9 language accusing U S WEST of using its costing
10 methodology to raise the cost of a monopoly inputs as
11 part of a price squeeze on competitors. And so forth.
12 She has raised and continues to reargue this. This is
13 fundamental to the very presence of this intervenor in
14 this case, and why U S WEST has objected to this
15 intervenor in this case.

16 This intervenor has filed an antitrust
17 lawsuit against U S WEST arguing anticompetitive price
18 squeeze. It's very important that this Commission in
19 light of that make sure that it understands what it is
20 doing and understands carefully the appropriate
21 evidence before it finds that any regulated company
22 has an unregulated competitor in any kind of a price
23 squeeze. In this case it is being argued by other
24 parties that residential service covers its cost
25 because you can sell toll, you can sell voice mail,

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1 you can sell any number of things to a residential
2 customer and that should all go to considering whether
3 residential service covers its costs.

4 That's a fundamental inconsistency with the
5 very narrow price squeeze tests being urged by the pay
6 phone association in this case, based upon previous
7 Commission orders, which we don't think considered the
8 implications of what is now clear. It cannot be
9 both ways. In terms of a price squeeze the company
10 cannot be limited to ignoring revenues and internally
11 deciding whether something else cover costs to have a
12 bunch of revenues imputed to it.

13 That is the purpose of the limited rebuttal
14 of Ms. Murray's testimony. She brought it up in the
15 first place and I think it's important that Dr.
16 Emmerson be allowed to address what would be the
17 appropriate economic theory if the Commission is going
18 to continue to consider whether U S WEST has an
19 unregulated competitor in a price squeeze. I think
20 that the evidence is very appropriate for the
21 Commission to consider.

22 MR. HARLOW: I don't think I need to
23 respond to Mr. Shaw except to clarify that the
24 Northwest Payphone Association does not have an
25 antitrust case pending against his client and I think

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1 if he thinks about it he would probably agree with it.

2 MR. SHAW: I agree that they are not a
3 named plaintiff. They are individual members in the
4 Pacific Northwest --

5 JUDGE WALLIS: I'm going to take that under
6 advisement and the matter will be ruled upon prior to
7 Dr. Emmerson's return. Mr. Waggoner.

8

9 CROSS-EXAMINATION

10 BY MR. WAGGONER:

11 Q. Dr. Emmerson, you stated that you reviewed
12 the cost studies submitted by Mr. Farrow; is that
13 correct?

14 A. Yes, but not in the state of Washington. I
15 reviewed the cost studies being prepared in other
16 jurisdictions.

17 Q. Have you reviewed Mr. Farrow's -- I'm
18 sorry?

19 A. I have reviewed his testimony pertaining to
20 the costs but not the cost studies themselves.

21 Q. So you've reviewed everything that's been
22 filed as testimony by Mr. Farrow but not the actual
23 cost studies for Washington state on which this
24 testimony is based?

25 A. That's correct.

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1 Q. Have you reviewed Dr. Mercer's two items of
2 testimony in this case?

3 A. Yes.

4 Q. Do you know that Mr. Farrow used what he
5 called a scorched node approach to his cost studies in
6 this case?

7 A. Yes, I am aware of that.

8 Q. Do you believe that is an appropriate
9 approach?

10 A. Yes, but for reasons I would explain
11 slightly differently than Mr. Farrow explained them.
12 I would not describe it as a replacement cost
13 technology. While that's what it is and the numbers
14 come out the same the economic rationale for doing
15 that is slightly different, and that is not that we
16 would expect to replace the network with new least
17 cost technology but that any additions or deletions of
18 service today have a forward looking impact of adding
19 or not adding forward looking technology, so it's
20 really a matter of saying it is the forward looking
21 placement of technology to replace and expand the
22 network in the future that are really affected by
23 current decisions. That's the primary rationale for
24 using the forward looking costs of things like digital
25 switches and so forth.

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1 Q. But you do agree that it's appropriate to
2 use the existing switched locations and use new
3 forward looking technology in those switched
4 locations?

5 A. I agree it's appropriate to use the
6 existing switch locations and except to the extent
7 they're planned to be changed and economically so,
8 the existing routing of loops and the like, and to use
9 the technologies that will be used in the future to
10 expand capacities in those routes and those switches
11 and to replace the capacities as obsolete equipment
12 ages and is replaced.

13 Q. In your review of Mr. Farrow's testimony,
14 did you look at the mix of technologies he assumed
15 would be used on a forward looking basis?

16 A. Generally, yes, and specifically in another
17 jurisdictions, again, I did. Not specifically in
18 Washington. I was not asked to review the Washington
19 cost studies.

20 Q. So you don't know whether Mr. Farrow and
21 Dr. Mercer used the same or a different mix of
22 technologies?

23 A. I believe that they used different
24 technologies mixes.

25 Q. And how do you know that if you didn't

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1 review?

2 A. Only because I have reviewed Dr. Mercer's
3 reports and based on that I did not find complete
4 consistency with what I know are U S WEST practices,
5 but I have not reviewed, again, specifically in
6 Washington the cost studies in Washington to verify
7 that.

8 Q. So you're making an assumption, then,
9 aren't you, that the Washington cost studies use
10 similar technologies as the ones you've looked at in
11 other states; is that correct?

12 A. Correct, or at least they're based on the
13 same economic principles.

14 Q. Do you disagree with the technologies that
15 Dr. Mercer used in his studies?

16 A. Well, I disagree with the general
17 assumptions underneath his cost studies, namely, as I
18 said in my testimony, the green field assumptions
19 which means that networks are somehow built from
20 scratch entirely. That I did take exception with.

21 Q. Is it your testimony that you understand
22 Dr. Mercer's second study filed in his supplemental
23 testimony to be a green field study?

24 A. No, I do not know that for a fact. I am
25 referring specifically to the cost studies which I

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1 have reviewed and in my testimony I was very clear
2 about that. I said I did not review that document. I
3 reviewed his prior papers and cost studies which tend
4 to be moving targets, admittedly so. They could be
5 very well and likely are different now from when I
6 reviewed them.

7 Q. So you didn't review either of the studies
8 that Dr. Mercer offered in this case, did you?

9 A. Well, I guess I should ask specifically
10 which studies he offered in this case and compare
11 those to the two studies that I did review which I did
12 cite in my testimony.

13 Q. Well, my question for you, Doctor, is very
14 simple. Did you review the studies and testimony
15 filed by Dr. Mercer in this case?

16 A. The answer is I don't know if I reviewed
17 the studies filed in this case because I do not know
18 specifically what was filed in this case. My guess is
19 I did not review the studies specifically filed here.

20 Q. You're aware that Dr. Mercer has offered
21 nationally a variety of studies on different
22 approaches to measuring costs, correct?

23 A. Yes.

24 Q. And those are the ones you've looked at,
25 correct?

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1 A. I have looked at those, yes.

2 MR. WAGGONER: No further questions.

3 JUDGE WALLIS: Very well. That according

4 to the earlier arrangements ends today's sessions.

5 Dr. Emmerson, thank you for appearing. We expect you

6 back next week. And we are off the record.

7 (Hearing adjourned at 5:50 p.m.)

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