

BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

In the Matter of the Petition of QWEST CORPORATION

To be Regulated Under An Alternative Form of Regulation Pursuant to RCW 80.36.135

DOCKET NO. UT-061625

CROSS-ANSWERING TESTIMONY OF ROBERT LOUBE, Ph.D. (RL-12T)

ON BEHALF OF

PUBLIC COUNSEL

FEBRUARY 16, 2007

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DR. ROBERT LOUBE’S EXHIBIT LIST

Exhibit No. ____ (RL-13C) Modification of Exhibit No. ____ (TLW-4C)
Summary of Rural vs Urban Lines and Hypothetical Revenues
Adjusted to Include the Subscriber Line Charge

Exhibit No. ____ (RL-14) Public Counsel AFOR Proposal

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I. INTRODUCTION

Q: Please state your name and business address.

A: My name is Robert Loube. My business address is 10601 Cavalier Drive, Silver Spring, Maryland 20901.

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

A: I am the Director, Economic Research, Rhoads and Sinon, LLC.

Q: On whose behalf are you testifying?

A: I am testifying on behalf of Public Counsel.

Q: Are you the same Robert Loube who provided direct testimony in this proceeding?

A: Yes.

II. PURPOSE OF TESTIMONY

Q: What is the purpose of your testimony?

A: The purpose of my testimony is to rebut the testimony of Mr. Thomas L. Wilson and to support Public Counsel’s alternative AFOR proposal. The Public Counsel AFOR proposal is an alternative to the AFOR proposal supported by the testimony of Staff’s witnesses Wilson, Strain, Reynolds and Russell.

III. THE TESTIMONY OF MR. THOMAS L. WILSON

Q: What portions of Mr. Wilson’s testimony do you wish to discuss?

A: I wish to discuss Mr. Wilson’s use of the total element long run incremental cost (TELRIC) based rates. In particular, Mr. Wilson asserts that TELRIC

1 rates can be used to determine if a rate is compensatory, to determine if
2 customers receive a subsidy if the rate for a service is below the TELRIC rate,
3 and to serve as an appropriate imputation floor for Qwest retail pricing.¹

4 **Q: What is TELRIC?**

5 **A:** TELRIC is the total long run incremental cost of network elements. A
6 network element is a facility or equipment used in the provision of a
7 telecommunications service.² It is not a service. For example, the local loop
8 provides local voice service, access to state and interstate toll service, data
9 services and the ability to use all other local exchange services.

10 The term, “total” is understood to mean the cost of providing the
11 current total demand for the element. The term, “long run” refers to a period
12 long enough so that all of a firm’s costs become variable or avoidable.
13 “Incremental cost” is the additional cost associated with meeting the total
14 demand. Incremental cost is measured using the most efficient
15 telecommunications technology currently available and the lowest cost
16 network configuration, given the existing locations of incumbent local
17 exchange carriers’ wire centers.³

¹ Direct Testimony of Thomas L. Wilson, p. 57, l. 19 to p. 58, l. 9, and p. 68, l. 20 to p. 69, l. 9.

² 47 USC 153 (29).

³ 47 C.F.R. §51.05; *In the Matter of Implementation of the Local Competition Provisions in the Telecommunications Act*, CC Docket No. 96-98, FCC 96-325, released August 8, 1996, ¶¶ 674-703, (Local Competition Order).

1 **Q: How did Mr. Wilson use TELRIC to determine if a service is non-**
2 **compensatory?**

3 **A:** Mr. Wilson compares the total monthly revenue based on current rates to the
4 total monthly revenue that would be reported if the local service rate were set
5 equal to the UNE loop rate that has been set using the TELRIC standard. He
6 computed that reported revenues were less than the revenues that would have
7 been recovered if the rate had been set at the UNE-loop rate for total
8 residential service, urban residential customers and rural residential
9 customers. Given this relationship, he finds that the current rate is not
10 compensatory.

11 **Q: Why should TELRIC not be used to determine if a rate is compensatory?**

12 **A:** A rate is compensatory if it allows the carrier to recover the costs of providing
13 the particular service. TELRIC is not the cost of a service. It is the cost of the
14 element that is used in the provision of the service. Instead of comparing the
15 rate to TELRIC, Mr. Wilson should have compared the local service rate to
16 the incremental cost of the service.

17 **Q: Do you have other concerns with Mr. Wilson's comparisons?**

18 **A:** Yes. Even if, for the sake of argument, I agreed that a comparison between a
19 rate or rates and TELRIC should be made, Mr. Wilson still made a mistake
20 because TELRIC is determined on an unseparated basis. That is, TELRIC
21 includes both the intrastate and interstate jurisdictional costs. The interstate
22 jurisdictional costs are recovered by the FCC authorized subscriber line

1 charge (SLC). Thus, Mr. Wilson’s comparison, using Mr. Wilson’s standard
2 for determining compensatory rates, should have compared the sum of the
3 local service rate and the SLC to the loop TELRIC.

4 **Q: Have you made a comparison of TELRIC to the sum of the local rate and**
5 **the SLC?**

6 **A:** Yes. In Exhibit No. ____ (RL-13C), I compared the revenue associated with
7 the sum of the local service and SLC with the revenue that would have been
8 collected if the rate had been set at the loop TELRIC (the “as if” revenue).⁴

9 **Q: What are the results of your comparisons?**

10 **A:** The result of my comparison, that is, the result of the corrected Wilson
11 standard, is that reported revenue is greater than the “as if” revenue for the
12 entire residential customers class. The reported revenue is also greater than
13 the “as if” revenue for urban residential customers. Finally, the reported
14 revenue is less than the “as if” revenue for rural residential customers.
15 Therefore, according to the corrected Wilson standard, as long as there is only
16 one state-wide rate, the residential rate is compensatory, and there is no reason
17 to increase the current residential basic local exchange service rate.

18 **Q: What does Mr. Wilson assert about cross-subsidies?**

19 **A:** Mr. Wilson does not make a direct assertion regarding cross-subsidization.
20 Rather, he believes that inferences about cross-subsidies can be drawn from
21 his comparison of rates and TELRIC. Thus, he implies that because the rate is

⁴ These comparisons all assume that the quantity demanded remains constant at the different rates.

1 less than the loop TELRIC, the customers purchasing basic local residential
2 service are being subsidized.

3 **Q: Do you agree with Mr. Wilson?**

4 **A:** No. A cross-subsidy has nothing to do with TELRIC nor with comparisons to
5 TELRIC based rates. Rather, a subsidy is related to the stand-alone and
6 incremental cost of a service.

7 **Q: Please define the term “subsidy.”**

8 **A:** A generally accepted definition of a subsidy is that a service is subsidized if
9 its price is less than the incremental cost and the service pays a subsidy if its
10 price is above the stand-alone cost of service. This definition was introduced
11 into the academic literature in 1975.⁵ Since then, the definition has been
12 adopted to determine whether to establish a state universal service fund.⁶ In a
13 recent Florida state proceeding, for example, witnesses for the consumer
14 advocate, the carrier, and the interveners all agreed that a subsidy occurs only
15 when the price is below the incremental cost of service.⁷

16 **Q: Can any inference be made about the existence of a subsidy to residential**
17 **customers from the information in Mr. Wilson’s testimony?**

⁵ Faulhaber, G.R., Cross-subsidization: pricing in public enterprise. American Economic Review 65, 966-977.

⁶ New Mexico Public Regulation Commission, The identification of all subsidies in the existing rates of Qwest Corporation, Final Order, Utility Case No. 3325, December 19, 2000.

⁷ Caldwell, D.D. Testimony, prepared on behalf of BellSouth, Gabel D., Testimony prepared on behalf of the Office of Public Counsel, Mayo, J.W., Testimony on behalf of AT&T Communications of the Southern States and MCI WorldCom Communications, Inc., The Petitions of Verizon Florida Inc., BellSouth Telecommunications Inc., Sprint-Florida Inc. to reform their intrastate network access and basic local telecommunications rates in accordance with Florida Statutes, Section 364.164, Florida Public Service Commission Docket Nos. 030867-TL, 030868-TL, and 030896-TL, October 31, 2003.

1 A: No. Mr. Wilson did not provide an estimate of the incremental cost of
2 residential service. Because no estimate of the incremental cost of service
3 was provided, it is not possible to determine whether a subsidy exists.

4 **Q: Do you have other concerns with Mr. Wilson’s use of the loop TELRIC**
5 **for the purpose of measuring a subsidy?**

6 A: Yes. Mr. Wilson should not have used the loop TELRIC even as a proxy for
7 the basic exchange service total service incremental cost (TSLRIC) because
8 this commission has found that “the local loop is not appropriately included in
9 the incremental cost of local exchange service. The local loop facilities are
10 required for nearly every service provided by the Company to a customer.”⁸

11 **Q: Should TELRIC be used as an appropriate imputation floor for retail**
12 **pricing?**

13 A: No. It is not appropriate to use TELRIC as an imputation floor for any one
14 particular retail service because TELRIC measures the cost of using an element
15 and does not measure the cost of providing any individual service. Instead,
16 TELRIC could be part of an all revenues test. In an all revenues test, a
17 comparison is made between all of the revenues a provider could obtain using a

⁸ See the *Washington Utilities and Transportation Commission v. U.S. West Communications Inc.*,
Docket No. UT-950200, Fifteenth Supplemental Order, p. 83.

1 set of network elements to the cost of those elements plus a reasonable amount of
2 retail cost. This test would show whether an alternative provider could earn a
3 reasonable profit.⁹

4 **IV. PUBLIC COUNSEL'S AFOR PROPOSAL**

5 **Q: Have you reviewed the Commission Staff's alternative recommendations**
6 **for an AFOR plan in this docket?**

7 **A:** Yes. I have reviewed the testimony of Commission Staff witnesses and their
8 recommended improvements to the Qwest AFOR proposal. Mr. Wilson's
9 Exhibit No. ____ (TLW-3) illustrates the Staff proposals in the form of a single
10 document entitled "Staff's Improved Proposal For A Qwest AFOR."

11 **Q: Do you agree with the Staff's recommendations?**

12 **A:** I agree with some elements of the Staff alternative. Overall, however, I do not
13 believe that Staff's alternative plan represents a significant improvement over
14 the Qwest proposal. Staff's plan falls short in a number of important areas.

15 For example:

- 16 • It allows for unwarranted increases in basic residential telephone service.
17 • It provides an inadequate approach to address deployment of advanced
18 services to underserved areas and populations that requires no binding
19 commitment by the company.

⁹ *In the Matter of Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, FCC 03-36, released August 21, 2003, ¶100, ("The Triennial Review Order", or "The TRO").

- 1 • It offers no specific plan for preserving and enhancing service quality.
- 2 • It establishes no guidelines for bundled services to protect consumers.
- 3 • It recommends an unclear and insufficient process for Commission review
- 4 of AFOR performance and consideration of termination, extension, or
- 5 modification at the end of the term.

6 **Q: Do you have a response to the Staff plan set out in Exhibit No. ____**
7 **(TLW-3)?**

8 **A:** Yes. Exhibit No. ____ (RL-14) illustrates how Public Counsel's
9 recommended alternative AFOR proposal, as contrasted with Staff's would
10 look as a single document. This exhibit is based on my review of Staff's
11 testimony, material provided in discovery, and my review and analysis of
12 Staff's Exhibit No. ____ (TLW-3).

13 **V. CONCLUSIONS AND RECOMMENDATIONS**

14 **Q: Please summarize your conclusions and recommendations.**

15 **A:** I recommend that the Commission reach the following conclusions in this
16 proceeding with respect to retail rate pricing:

- 17 • There is no evidence in the record to support a finding that the
- 18 residential service rate is non-compensatory.
- 19 • There is no evidence that can be used to infer that residential customers
- 20 receive a subsidy.

- 1 • TELRIC should not be used as the appropriate imputation floor for
2 Qwest retail pricing.

3 I further recommend that the Commission adopt Public Counsel's
4 recommended AFOR plan set forth in Exhibit No. ____ (RL-14), rather than
5 the proposal which has been filed by Staff, as better meeting the goals of the
6 AFOR statute, RCW 80.36.135.

7 **Q: Does this conclude your testimony?**

8 **A:** Yes.