

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

In the Matter of Investigation on)
the Commission's Own Motion:)
)
Into the Propriety and Adequacy)DOCKET NO. UT-951425
of Certain Current Depreciation) VOLUME 2
Rates of U S WEST COMMUNICATIONS,) Pages 19 - 74
INC.,)
)
And the Changes, If Any, that)
Should be Ordered to Such)
Depreciation Rates.)
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A hearing in the above matter was held on August 13, 1997 at 1:45 p.m. at 1300 South Evergreen Park Drive Southwest, Olympia, Washington, before Chairman SHARON L. NELSON, Commissioners RICHARD HEMSTAD, WILLIAM R. GILLIS and Administrative Law Judge JOHN PRUSIA.

The parties were present as follows:

THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION STAFF, by SALLY G. JOHNSTON, Assistant Attorney General, 1400 South Evergreen Park Drive Southwest, Olympia, Washington 98504

U S WEST COMMUNICATIONS, INC., by ED SHAW, Attorney at Law, 1600 Seventh Avenue, Room 3206, Seattle, Washington 98181.

FOR THE PUBLIC, ROBERT MANIFOLD, Assistant Attorney General, 900 Fourth Avenue, Suite 2000, Seattle, Washington 98164.

Cheryl Macdonald, CSR

Court Reporter

APPEARANCES (Cont'd.)

TRACER, by ARTHUR A. BUTLER, Attorney at Law, 5450 Two Union Square, 601 Union Street, Seattle, Washington 98101.

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P R O C E E D I N G S

JUDGE PRUSIA: Let's be on the record. The hearing will please come to order. This is a hearing before the Washington Utilities and Transportation Commission in docket No. UT-951425. This is in the matter of the investigation on the Commission's own motion into the propriety and adequacy of certain depreciation rates of U S WEST Communications, Inc., and the changes if any that should be ordered to such depreciation rates.

The purpose of today's hearing is the presentation of a stipulation between Commission staff, U S WEST, public counsel and TRACER which would resolve the issues in this proceeding. The hearing is being held before Chairman Sharon L. Nelson, Commissioner Richard Hemstad and Commissioner William R. Gillis. My name is John Prusia. I'm an administrative law judge with the Commission.

This hearing was set by notice of hearing served on August 5, 1997. Today's date is August 13. We're in the Commission's hearing room in Olympia, Washington. We'll begin by taking appearances beginning with Commission staff, Ms. Johnston.

MS. JOHNSTON: Sally G. Johnston, assistant attorney general appearing on behalf of Commission staff.

JUDGE PRUSIA: And for U S WEST.

MR. SHAW: Ed Shaw for U S WEST.

JUDGE PRUSIA: And for public counsel.

MR. MANIFOLD: Robert Manifold, assistant attorney general.

JUDGE PRUSIA: And for TRACER.

MR. BUTLER: Arthur A. Butler appearing for TRACER.

JUDGE PRUSIA: Thank you. Before we went on the record exhibits were premarked for identification as follows: Marked as Exhibit T-1 is the prefiled direct testimony of Thomas L. Spinks plus the document TLS-1, qualifications of Thomas L. Spinks.

Marked for identification as Exhibit 2 is TLS-2, a one page comparison of current parameters and staff-recommended parameters.

Exhibit 3 is TLS-3, one page, regression analysis of interim retirements.

Marked for identification as Exhibit No. 4 is TLS-4, one page, deficiency amortization schedule.

Marked for identification as Exhibit T-5 is the prefiled rebuttal testimony, 10 pages, of Thomas Spinks.

Marked for identification as Exhibit T-6 is the prefiled supplemental rebuttal testimony of Thomas Spinks, three pages.

Marked for identification as Exhibit No. 7 is the exhibit to the supplemental rebuttal testimony of Thomas Spinks. That's four pages long.

And marked for identification as Exhibit No. 8 is the stipulation filed by the parties on August 4th.

(Marked Exhibits T-1, 2-4, T-5, T-6, 7 and 8.)

JUDGE PRUSIA: Before we went on the record we discussed how we would proceed this afternoon, and we decided that, first of all, I would swear in the four potential witnesses who are, as I understand it, Mr. Spinks, Glenn Blackmon, William R. Easton and Theresa Jensen. Then I will ask Mr. Shaw if he would please describe the stipulation and then I will ask the other counsel if they have anything to add to that description. Then we'll get the premarked exhibits into evidence and then the commissioners or I may have questions for the panel. So at this time I will swear the four potential witnesses in.

Whereupon,

THOMAS SPINKS, WILLIAM EASTON, GLENN BLACKMON and THERESA JENSEN, having been first duly sworn, were called as witnesses herein and were examined and testified as follows:

JUDGE PRUSIA: We might as well enter the exhibits at this time before Mr. Shaw describes the stipulation. On the understanding that the parties reserve the right to object to the testimony and other exhibits of Mr. Spinks in the event the Commission rejects the stipulation, may we enter the documents marked 1 through 8 for identification into the record by

agreement of counsel?

MS. JOHNSTON: Yes.

MR. MANIFOLD: Yes.

MR. BUTLER: Yes.

MR. SHAW: Yes.

JUDGE PRUSIA: Thank you. Mr. Shaw, then would you please describe the stipulation.

(Admitted Exhibits T-1, 2-4, T-5, T-6, 7 and 8.)

MR. SHAW: Yes, thank you. Stipulation is very simple and straightforward, and the operative provisions are paragraph 2 and paragraph 4 on the second page. Procedurally, the Commission will recall that this docket was started by Commission notice back in February of this year and the parties filed the testimony in three rounds, and as staff's position evolved over the course of that prefiled testimony the company resolved in discussions with the staff that in consideration of avoiding prolonged proceedings and potential litigation that we would accept the final position of the staff as reflected in Mr. Spinks's rebuttal and surrebuttal or supplemental rebuttal testimony. And so if you approve this stipulation it will have the bottom line effect of adopting lives for plant of the company that produces an increase in revenue requirement of approximately \$36 and a half million.

This stipulation does not provide for any rates to implement this booked depreciation expense increase, and as paragraph 4 relates, the parties are working on an audit wherein the company is hopeful that the parties will agree that the company has an increased revenue requirement consisting of this amount plus additional amounts from truing up the adjustments made in the last rate case, and that the parties will be able to then stipulate as to an overall increased revenue requirement including this amount and a rate spread to gain that revenue requirement, and the company at least is very hopeful that in a very short period of time we'll be able to bring another stipulation before you that will provide for the actual rate treatment of this docket as well as a true-up of the company's overall revenue requirement.

So this stipulation is pretty straightforward and will conclude the

Commission-initiated investigation into the need to update the lives for regulatory purposes of the company's plant accounts. It does provide additionally that the company will file a new study, depreciation study, no later than January 1, 1999. The company has the right to file that study sooner and request further examination of its lives in this rapidly changing environment that we found ourselves in. So that is the stipulation from the company's perspective.

MS. JOHNSTON: I have nothing to add to Mr. Shaw's description of the stipulation.

JUDGE PRUSIA: Mr. Manifold.

MR. MANIFOLD: Yes. I have just one item to add, and that is that it's my understanding that the 36-some-million dollars that's recited in paragraph 4 is not, cannot be, compared to the 91 and a half million dollars negative revenue requirement that was ordered in the last general rate case.

MR. SHAW: I don't know how to interpret that statement. In the last general rate case Commission will recall that it used then currently prescribed lives. If the Commission accepts this stipulation there will be new prescribed lives. There's nothing on the face of the stipulation that indicates that these lives will be retroactive back to predate the last rate case, if that's counsel's point.

MR. MANIFOLD: My point was mainly that there's been a lot of apparently erroneous press coverage of this as being a potential buck and a half increase, depending on which article you read, residential or all rates, and that while we obviously are all in agreement on the revenue requirement effect of this one element taken by itself, as you stated, there's no agreement on rate design, and it's my understanding that because of the difference in timing and how things have been booked since the rate order you don't necessarily start from zero or minus 91 in applying this 36 million, and that's an important thing for people to understand, I think. I can't explain it any further than that, but that's why there's some people sworn in here.

MR. SHAW: Well, clearly, the finality of the negative 91 is awaiting the Supreme Court's decision. It would not serve us, I guess, to

speculate on how that is going to turn out. That whole rate case is on a separate track. This is simply a recognition by the parties that the depreciation expense has changed since the record was closed in the rate case, and we're simply asking the Commission to prescribe a new depreciation expense level by accepting the stipulation, so it's very simple.

MR. BUTLER: I have nothing to add to Mr. Shaw's description of the stipulation.

JUDGE PRUSIA: Very well. Thank you. Do the commissioners have any questions for the members of the panel or for counsel?

CHAIRMAN NELSON: Yes.

COMMISSIONER HEMSTAD: Well, if I could ask, is there going to be any presentation or is it going to be merely question and answers?

MR. SHAW: We had proposed that we simply make the witnesses available for any questions that the Commission might have about the arcane details of the depreciation schedules, and Mr. Easton and Mr. Spinks are available for that, and if you wish to discuss matters on policy level Mr. Blackmon and Ms. Jensen, who were the primary negotiators, are available.

CHAIRMAN NELSON: Mr. Shaw, you just said shortly you hoped there might be another stipulation filed.

MR. SHAW: Yes.

CHAIRMAN NELSON: Can you give me months, ballpark estimate of when?

MR. SHAW: Yes. Subject to correction by Mr. Blackmon and Ms. Jensen who are doing the negotiations, my understanding that we're just completing the audit of the additional revenue requirement that will include this amount. Public counsel intends to have their outside expert look at the numbers that the staff and the company have arrived at. If we come to agreement on that we would hope to file tariffs and a stipulation for the Commission's consideration next month.

CHAIRMAN NELSON: Mr. Shaw -- Ms. Jensen and Mr. Blackmon, maybe I should ask this question. Mr. Shaw just referenced the Supreme Court case which is pending. I guess I have concerns about announcements made in the

press and confusing the public about what kind of rates they are going to be faced with paying, and the timing of any potential change to rates that they are paying. Have you explored a schedule for implementation of rate changes flowing from that stipulation.

MR. BLACKMON: We've discussed it at several points during the course of this audit. So while the more technical accounting work has been going on, we've also been discussing how the results of that audit, should a revenue requirement be shown, would be implemented, and I think that we share the concern that you've expressed about trying not to -- or trying to avoid rates that go down and then up or up and then down, to try to wherever possible offset changes against each other to implement them in some coordinated way wherever possible.

CHAIRMAN NELSON: Go ahead.

COMMISSIONER HEMSTAD: Well, I'm not sure what that means.

MS. JENSEN: Maybe I could help, add a comment. We have tried to, as we've approached rate design, and we're truly in the early phases of that, recognize from the prior order the direction that the Commission was taking, and what we've attempted to do is to not look at proposals that might have some conflict with that original position. So we have assumed for planning purposes that the Commission order will be implemented and then we have looked at rate design based on that assumption going forward.

What we would not want to do is increase a rate only to turn around and have the court decrease a rate which would require us to go back to rate design again. So we are being very careful, but we are working with public counsel and TRACER and with the staff to try to design a rate design that makes sense as we deal with the revenue requirement that we'll eventually present, and clearly there will be opportunity for public feedback in that process as well as your feedback in that process, and we'll just continue to work the issue.

CHAIRMAN NELSON: Let me ask a more pointed question. If a filing comes in September that has a rate plan in it, are you saying that you assume there will be some public process, so from September to, say, December 31, if

this informal audit is delayed beyond that -- there's reference made in paragraph 4 there, you're counting on a Supreme Court decision perhaps being issued between September and the end of December?

MS. JENSEN: No. What we're really trying to do, as Mr. Shaw stated, is keep the two very separate, and so our goal would be to try to stay away from any rate design that's been stayed by the court, and if we're forced to approach rates that are included in that then we may look at a different approach than changing those rates. For instance, if we were forced to deal with a particular rate design, say business rates, then rather than implementing it pending the court decision we may stipulate to some type of an agreement around that.

So we are working with the parties, but we're trying to avoid the rate design scenarios that have been stayed by the court as best as possible, and if we're not successful in doing that because of the revenue requirement then we'll look at doing it in such a fashion that it's not disruptive to our customers or confusing to them, and I believe we have fairly good commitment amongst the parties as a primary goal there.

We think this is going to be a very difficult communications issue, but we are trying to keep them as separate as possible. We really -- we assume the one is implemented in this review for purposes of planning going forward. We assumed that all the adjustments have been applied, whether we concur with them or not, and we designed the rates as best as we're able assuming that the Commission's order design has been implemented.

And so we are very much striving to keep it simple and straightforward and not to send mixed messages to the public. I would hope, by the way, that we'd be close to filing it the first week of September and having roughly a 60 to 90 day interval of public opportunity to comment, and a lot of that will depend on how much we accomplish over the next three weeks.

MR. MANIFOLD: If I might add to that answer, when Ms. Jensen was saying "we" she was meaning U S WEST. We haven't really talked yet. I know that there's been a number of discussions between the company and staff.

Public counsel hasn't even talked to the company yet about any part of this other than getting our consultant some documents which will be in the next couple of days so he can start taking a look at the revenue requirement issue.

Not to pre-judge where we're all going to come out, but our starting thought is that rate design should not be addressed until the Supreme Court has ruled in order to avoid the potential for inconsistent or unknown effects of doing two things at different times.

I take it that's sort of what the question went to, and we may have a different perspective on that than the company does. We haven't sat down and talked about it yet, but since you asked about it I would feel badly to sit here and be quiet and not indicate at least where our thinking is at this point.

COMMISSIONER GILLIS: I'm not sure I fully understand. Is your hope that what would be brought to the public eventually would include a rate design proposal with it?

MS. JENSEN: Yes, it would. U S WEST is in a very serious situation in that even with a Commission adjustment we are not earning our authorized rate of return, and so it's very important that we move forward in terms of some kind of rate relief to the business, and we have full confidence that the process will proceed in a manner that's in the best interests of all parties involved, but clearly, it's something that we actually started back in April.

There's been a very thorough examination of the rates. There will continue to be a thorough examination of the revenue requirement expenses and so forth, and so we will be pressing ahead with this. This is a very important case to us. We hoped by working with the parties that we could avoid the delay that typically occurs with litigation.

COMMISSIONER HEMSTAD: Well, it would appear, then, that it's not agreed upon between the parties at least with respect to timing. Not being critical in saying this. Relationship of what Commission and Commission staff are doing and what the Supreme Court may do. Here Mr. Manifold would see one single rate design coming out of both the historical case now being litigated

and this current proceeding and the other true-up going on and company apparently would see two steps, the implementation of what the Commission is currently doing and staff and then some later adjustment with what the Supreme Court may order.

MR. SHAW: That's correct, Commissioner. I think that they can be married very well. I mean, just to make it more specific, let's assume for discussion purposes that the Supreme Court affirms the Commission. Remember that the Commission did not order a decrease as such in residential rates, so one scenario which obviously the company is interested in is an increase in residential rates. So let's say we increase residential rates as a result of this current revenue requirement. Even if the court affirmed the Commission's past rate order that would not mean that the rates would be yo-yoing in any way because we are charging today what the Commission ordered as to residential rates in the last rate order. The big decreases that are on appeal are primarily in toll and access charges and to some degree in business charges.

We hope to work out with the business community on what a fair rate spread would be of this current revenue requirement and to get agreement of the customers, but the number that obviously most people are interested in and has the most sensitivity around it is residential rate increases, and we frankly hoped to bring to you a stipulated residential rate increase. Obviously public counsel is not there yet and we'll continue to work on them.

MR. MANIFOLD: We aren't even at the starting gate yet because we haven't started discussion so it's a little -- excuse me for interrupting, but it's a little awkward, I think. You need to have your questions answered and we will answer them as best possible, but I hope you understand that this is really the first I've heard of some of what the company plans and this is, I know, the first they've heard of any of my thoughts about it, so it's necessarily things upon which we haven't had a meeting of minds because we haven't even had a meeting.

MR. SHAW: And I accept that. I was just trying to be very clear.

It's no secret that U S WEST feels its residential rates are extremely low and are way overdue to be increased, and if we have an independent revenue requirement here, that's obviously something we're going to be talking about.

I don't think that's any secret to Mr. Manifold or anybody else.

COMMISSIONER GILLIS: Let me ask, I guess, the more pessimistic question, and assuming that we would approve the settlement with its revenue requirement and the, I guess, the rest of the discussion breaks down and I guess begins to slow, what will be your reaction? How long would you wait before you would be wanting to come in to find some rate treatment on this particular settlement?

MR. SHAW: If you see the last sentence that the parties stuck in on the second page, and that's designed to address that issue, and if it appears to us that the stipulation about the overall revenue requirement is impossible, say by the end of September or whatever, and so that it looks like there is going to be a delay beyond September 31, the way we are interpreting this is that we would have the ability to file tariffs that would go the traditional way. We would obviously be urging expedited treatment. We hope we don't have to do that, but if we cannot make any progress on the process contemplated by paragraph 4, we reserve the right to file tariffs reflecting this \$36 million before the end of the year.

COMMISSIONER HEMSTAD: And as I read that language, company would not be authorized to make a filing prior to December 31, 1997. Is that your reading of it?

MR. SHAW: No. That is not the way I'm reading it, Commissioner. As we indicated that if we can file the stipulated agreement in September then we would expect that there's going to have to be some period of time while the Commission goes through some sort of a public hearing process to where that the rates, even if we keep on our schedule, wouldn't be effective towards the end of the year. If it becomes clear that we're not going to be -- get to a stipulation and the company is facing potential 11 months suspension period we reserve the right to get that period started before December 31. So, this reads, if rate implementation results is delayed

beyond December 31, and if we cannot fit together a schedule that would get rates into effect by December 31, then we would have the right to file this stand alone tariff.

The company's intent is not to exercise that until there's no hope that we can't work something out. Obviously this is just part, and in fact the smaller part, of what we believe our additional revenue requirement is, even accepting all the adjustments made by the Commission in the last rate case, so we're talking about a very significant sum of money that the company believes, of course, that it's entitled to sooner rather than later. So our pragmatic hope is that we can get that through negotiations as opposed to getting bogged down in an 11-month proceeding.

CHAIRMAN NELSON: Let me ask Mr. Manifold --

MR. MANIFOLD: May I add something to that? It should be noted, of course, that the company is continuing to collect the rates that existed prior to the last general rate case so that if the Supreme Court appeal were unsuccessful even within the range of numbers that are being discussed the company would not be receiving more money on a going forward basis. So, I mean, we've got to factor all of that into the thing. Excuse me.

CHAIRMAN NELSON: So your preferred scenario would be to agree on a revenue requirement but wait for any sort of rate design discussions until after the court acts?

MR. MANIFOLD: I think so. I must say that this is the starting thinking and certainly subject to change as we discussed ideas with other parties, but it seems very difficult to me at the outset to determine rate design for one pot of money when you don't know what's going to happen to another pot. You don't know if it's going down, going up, going sideways, part of it. I mean, obviously one scenario is that the appeal is completely denied. There are other scenarios that call for various things in between total affirmance, and clearly -- presumably no one wants to have rates doing a yo-yo, and so it seems to me at this point at least that the prudent thing to do is to hold off on rate design as long as possible in order to get a Supreme Court ruling. I read this stipulation as being our commitment to the

company and to the other parties that if this goes beyond -- we're sort of giving the Supreme Court until the end of the year, if you will, or giving ourselves until the end of the year for the Supreme Court to have ruled, perhaps more politic, and that if that hasn't occurred that the parties to this stipulation are interested in doing something to bring this \$36 million into rates for whatever the right number is as it gets regularized with other things. Does that make sense?

CHAIRMAN NELSON: Somewhat. Mr. Butler, you've been silent, and your association's clients are, of course, the ones where rates -- or there's been a stay issue. Do you have any views on how to manage the September-to-December time frame?

MR. BUTLER: We have started from the standpoint of being hopeful that the Supreme Court will act in a timely manner that will enable us all to know exactly what the final amount will be that needs to be recovered, if any, but we are not presupposing any particular action by the court and we are not proceeding on the assumption that we must presuppose any particular result. If the court does not act in a timely manner we are prepared to just deal with the problems that presents when they come up.

We are taking the position that under this stipulation we believe we should be as flexible as we can to make it possible, to the extent that we can, for other parties to reach agreement to allow the company to get this additional revenue requirement reflected in rates, and we're prepared to deal with that on any time line that the other parties can make that possible. If the company wants to file tariffs, if they believe they've reached sufficient degree of agreement with others so that they can include the informal audit amounts, that's fine. We're prepared to go ahead on that.

If they believe that there's not going to be consensus and they wish to go ahead prior to December 31 on the depreciation amount, we're prepared to deal with that as well. Obviously everyone would prefer that everything be done all at one time, but we'll deal with the circumstances they present themselves.

MR. BLACKMON: I would just add, I think our position is probably

very similar to Mr. Butler's, that we have been looking at U S WEST's -- whether U S WEST has a revenue requirement using a 1996 test year and as strictly as possible applying the results of the Commission's order that was issued in 1996, and if that shows a revenue requirement then staff is prepared to implement that and to do so trying to minimize adverse affects on customers wherever possible. We think that where there is that possibility that in most cases that will exist because there is money being collected subject to refund, and a logical approach, at least from staff's perspective, would be to offset the increase against the amount that's being collected subject to refund. Other rates where there's nothing being collected subject to refund, if an increase is in order for those, we don't see any reason not to go ahead with implementing it, again, given the fact that it was an amount calculated using all of the decisions made by the Commission in that general rate case.

COMMISSIONER GILLIS: I think part of the struggle is that there's some logic in a description of the process, and then there's the reality of what is perceived by the customers, and I don't know exactly how we balance that, and I'm wondering if it's been talked about among the members of the parties here of we obviously can't control what's printed in the newspapers, but it is confusing when articles appear that make assertions about what is the outcome of -- associated even with this narrow stipulation as far as the rate impact, and do you have any suggestions of ways the parties can collaborate effectively and I guess minimizing the chances that that occurs.

MR. SHAW: It's been my experience when I was information officer for this Commission that the press is interested only in one thing when you take over to them the results of a complex financial audit of a regulated company. What does this translate into for basic rates? And they always demand that number.

I presume that's what happened here. Somebody translated this \$36 million into a residential rate increase as if it would all go on the residential rate increase. That's unfortunate but that's the number that the

press always looks for. All that we can do is strive, I think, from the Commission's statement to the press and the company's statements to the press that the rate spread is yet to be decided, and, as I said, we obviously believe that when we have a revenue requirement that's totally uncontested that we're entitled to it now, not later, and that's going to be our driving argument.

If it's impossible to get agreement of the parties then we will file tariffs to reflect that and we will make a rate spread proposal. We obviously much prefer to have some agreement around that rate spread proposal before we file it because then we get into a lot of press reaction to what the company proposes. It's a difficult situation, but it's not a new issue. It's been around for the 30 years I've been doing this. Company certainly is not going to put out any inflammatory numbers about individual rate increases and hasn't done that in the context of this new revenue requirement. We will be advocating to the other parties and eventually to this Commission that the time is overdue for a residential rate increase. We have the lowest rates in the country virtually. So I don't want to beat around the bush about that. We'll make it very clear.

MR. BLACKMON: Just have one point on that, that the increase amount, the \$36 million, we provided to the news media the \$1.50 as the amount which is simply the amount per customer assuming that each customer, residential, business, everybody, paid the same amount. We were very clear with the news media, that was to show the order of magnitude and that no increase for any specific rate had been agreed to.

I also agree with Mr. Shaw that nonetheless the news media does quickly become either confused or bored or probably both with the depreciation rates and things like that and they do want to be able to bring it to a bottom line residential number, and I don't know any way to avoid confusion in that area short of not telling the news media that we've reached this agreement, and that seemed to be not the way that we were willing to go.

So what we tried to do was lay it out factually in terms of the magnitude of this increase, explain that it was part of an ongoing process and

then hope that they will do a good job of explaining it to the public.

COMMISSIONER HEMSTAD: Well, I have several questions, and I don't mean to expect long, elaborate answers, but I would like to understand from staff how its position -- I think Mr. Shaw used the word the staff's testimony has "evolved." Can you walk through where the staff started at the end of the three-way negotiations and then prefiled testimony and now its final testimony.

MR. SPINKS: Thank you. None of the staff's recommended parameters have really changed. I think what's evolved is simply the passage of time causes the plant to age. I think I explained on page 6 of my rebuttal testimony a list of factors that played into the changes in the rates, why over time they were going up, and one of those is you implement new vintages of ELG. As you put those into your composite calculation of the plant the higher ELG rates then drive up the overall rate.

The second is that as a plant ages, as time goes on, there are additions and retirements to plant and mix of plant is changing, and the company has made a lot of new investment in circuit equipment, digital circuit equipment, which has one of the highest rates of all plant accounts. So what's changed, I think, is just, again, the passage of time has changed the numbers. The staff's recommendation on the life projection of lives have not changed since we developed and presented them to you last year.

COMMISSIONER HEMSTAD: What lives will be used? By that I mean, is there a difference between projection lives and average service lives? What are the lives that the staff or what are the lives that are contemplated in the stipulated settlement?

MR. SPINKS: You begin with the projection life, and then you use the projection life and the mortality dispersion and the actual existing vintages of plant investment in each year to develop the average remaining life for each plant account. It's that average remaining life that's used in the denominator of the calculation to calculate the rate. So for the purposes of calculating the regulated depreciation rate, for the purposes of booking depreciation expense you would use the remaining life, and that's

different than in docket 960369 where we're talking about developing a forward looking depreciation rate based on an economic life where staff has recommended you wouldn't use the salvage, for instance, or even a mortality dispersion in that calculation. You would simply use what you project your economic life to be just one over that as the rate and that type of a calculation for a cost study, but for the purposes of what they book you would use the remaining life rates that are shown in Exhibit 7, and I believe I identified the column, column H, page 204 in Exhibit 7.

COMMISSIONER HEMSTAD: Perhaps either Mr. Prusia or Mr. Lott may have -- may want to pursue that further, but on a different subject, I note in your supplemental rebuttal testimony at page 3 you discuss issue of amortization of the reserve in balance, and with a conclusion at line 16, "Therefore the company's proposal to amortize the newly created reserve in balance should be denied." I don't believe there's any discussion in the stipulation about amortization. Would you discuss -- correct me if I'm wrong, but would you discuss the issue of amortization as it currently is in place and what you see occurring as a result of this settlement proposal?

MR. SPINKS: The amortization that's currently in place resulted from docket 940461. It's a five-year amortization of the reserve in balance.

It was the first and only time the Commission has undertaken an amortization of a reserve deficiency. We recommended that because I believe the reserve was about 4.6 percent lower than -- the actual reserve was 4.6 percent lower than the theoretical level, and that's slightly outside the guidelines of generally accepted rule of thumb for when you ought to think about considering addressing a reserve deficiency. In Mr. Easton's rebuttal testimony he included discussion of what certain amounts were of depreciation expense and of a reserve deficiency, which I did address, I believe, on the prior page or I had addressed in my rebuttal testimony one. And so this was to address what Mr. Easton's testimony had done, had raised by way of issues.

As far as the stipulation goes, there is no amortization, anticipated amortization of reserve deficiency anticipated in the stipulation. By using these remaining life rates the assumption is that any deficiency

will be recovered over the remaining life of the plant. That's why we use the method, so it's not necessary to undertake an additional amortization.

COMMISSIONER HEMSTAD: And that amortization reserve fund, apparently from your testimony, is increasing more rapidly than had been expected?

MR. SPINKS: No. Every time you change the parameters it changes the theoretical reserve, and so as we moved these projection lives, as we changed those, that created something. At the point in time that you change the parameters there is this new theoretical reserve, which I believe is identified in Exhibit 7 in the range of \$90 million. That will be recovered over the remaining life of the plant, though, assuming that the parameters don't change any more, but it's not increasing it -- I anticipate that because of the amount of annual accruals exceed the amount of annual retirement the depreciation reserve is automatically growing, and what I anticipate is that by '99 or 2000, over the next several years, because of that change, there may be no reserve deficiency at all left, but it's going to depend on additions in retirements that are made to plant, and what happens to the plant over the next few years, too, so you can't say for sure.

COMMISSIONER HEMSTAD: Well, based on current patterns, when will the amortization that was authorized in 940461 be accomplished or when will that disappear?

MR. SPINKS: At the end of 1999. And so the stipulation provides for them to file a new study at the beginning of '99, by the beginning of '99, so that we will be able to anticipate that.

COMMISSIONER HEMSTAD: This is addressed to Mr. Manifold. Has public counsel participated in the informal rate review proceeding now going on?

MR. MANIFOLD: It has not to date. We will be starting this week. We have retained the same consultant we used for revenue requirement in the general rate case and have made arrangements with the company for him to get appropriate confidential clearance and to get the sum of the information that staff has received to date so that he can look that over and provide us with

a judgment on it.

COMMISSIONER HEMSTAD: Is that also true of TRACER?

MR. BUTLER: That's correct. We have not participated and do not anticipate reviewing the informal audit or the backup to it. Basically we'll take whatever the company, the staff and public counsel agree upon. We have had discussions, preliminary discussions, with the company about variety potential of rate design proposals, assuming different levels of revenue requirement that might result from that exercise. But we have not specifically been involved in reviewing the informal audit.

COMMISSIONER HEMSTAD: That's all I have for the moment.

COMMISSIONER GILLIS: I have just one more for Mr. Shaw, I think. The point three of the stipulation asks the Commission to require the company to submit a new depreciation study to the Commission no later than January 1, 1999. Do you anticipate that the company will be raising the issue of appropriate lives with the Commission prior to that time?

MR. SHAW: Yes. If things continue to erode as quickly as they are today and our plant becomes ever more obsolete, the telecommunications revolution that's going on, I think, will be in prior to that, so this requirement is not a burden on the company and does not preclude it from coming in sooner than that.

CHAIRMAN NELSON: I have a follow-up to that. First, Mr. Spinks, I appreciated your direct testimony summary of the way the Commission has done depreciations during my tenure here, that is, the informal process, and at page 6 of your testimony, you mention the new Telecom Act of 1996, and I would like to ask you if you can follow up at the sentence at lines 15 and 16. Has the FCC issued a notice of proposed rulemaking on how they might handle depreciation on a going forward basis?

MR. SPINKS: As far as I know they have not yet issued that, but that it was in the works and was imminent.

CHAIRMAN NELSON: Well, as you indicated in that portion of your testimony, this has usually been done as a three-way negotiation. Is this now more informal settlement presented to the Commission going to mean in the

future we will have five-way negotiations?

MR. SPINKS: I hope not.

CHAIRMAN NELSON: That is with the addition of public counsel and TRACER?

MR. MANIFOLD: Not our idea of heaven.

CHAIRMAN NELSON: So in '99 you're contemplating perhaps that there still will be an FCC staff involved with the company and the state staff.

MR. SPINKS: I certainly can't speak for the FCC. I think they're trying to determine -- as you know, some of the language in the Act made the depreciation rate setting process for them permissive, not mandatory. Some of the companies have asked for different process, I think, and so the FCC has suspended three-ways and will issue this NOPR to address, to ask parties -- my understanding is they will be asking parties how we ought to proceed in the future.

My advice to the Commission would be that we continue with the three-way process. It has been a good process to get information on a nationwide level. Combined with what the FCC provides combined with the state-specific knowledge that we have, and then including the company's own plans and the like, and the process has, I think, led to satisfactory results, and I would like to see that process continue.

CHAIRMAN NELSON: Does the company have anything to add or differ with that?

MR. BUTLER: Yes. We have a differing view, of course. Always in the past we've been able to come to a three-way agreement. This is the first time, at least to my knowledge, that we have not. If the staff would have agreed with the FCC's treatment we would be talking about \$57 million and not \$36 million, so apparently we are on a diverging path where at the state level believes plant is going to last a lot longer than the FCC believes it's going to last. So on that basis I don't see any point in the three-way personally in the future. There will just simply be a meeting and no result.

So it was always an informal process and worked well, perhaps, in a monopoly environment, but I think if the state is going to insist on

prescribing different lives for intrastate results there's no need to do it jointly with the FCC. And we ought to come up with a process to do it on a timely basis, and the three-year period doesn't seem to be timely in this environment. So that is our reaction, and that is why we would plan to be filing another updated study long before three years passes at the state level.

MR. MANIFOLD: Madam Chairman, if I might add to my flip comment, I don't know what the future holds for our participation in those meetings. We haven't, as you know, been invited to participate in the past, and I don't know if we will either be invited or choose to want to participate in the future.

CHAIRMAN NELSON: Well, I guess we'll see what the NPRM has to say.

MR. MANIFOLD: Could I also address Commissioner Gillis's question regarding future filing? On page 2 of the stipulation the first sentence on the page provides that this stipulation affords U S WEST a reasonable opportunity for capital recovery and creates reasonable incentives for U S WEST to invest in this state. Obviously, things change over time. Hence Mr. Shaw's response to your question, but as of to date, as of today, my understanding is that the parameters of the settlement are that it is a reasonable place to be.

MR. SHAW: Well, I think that is a misstatement of what that says. It says it's in the public interest. It's an abstract statement to provide sufficient depreciation expense to incent the company to invest. The company does not agree that this amount is adequate. It's simply a pragmatic and prudent judgment by the company that to prove this amount we're going to have to go through quite a considerable amount of litigation, and we're going to not get the rates on a timely basis.

So that is why we are agreeing to the stipulation. We are not attempting to back out of the stipulation in any way. We enter it with our eyes wide open and it's our fervent hope that by doing so we'll get at least this much reflected in rates within a reasonable time.

COMMISSIONER GILLIS: I guess my question was more pragmatic in knowing what to expect. If you know, can we expect to see you soon once again before us with the same exact issues prior to January 1, 1999?

MS. JENSEN: Commissioner Gillis, I would like to address that. There are a number of proceedings pending before this Commission, and the outcome of those proceedings dramatically affects our future, and our ability in this state to compete as well as to operate. So to attempt to look at one sole issue isn't adequate for us to say yes, this is sufficient or, no, we won't be filing again next year, yes, we will.

We think there is an opportunity before us in the next three to six months to resolve a number of issues that are critical to our future in this state, and that are vital to our ability to invest in this state, and dependent upon how those decisions fall out they may be sufficient for us to minimize the need to continue to revisit repetitive issues before this Commission, and that's our goal and our hope. If those pending dockets are not resolved in a manner that appropriately allows us to continue forward as we traditionally have in a very new environment, then we may be forced to come back and reopen this issue again.

COMMISSIONER GILLIS: Let me probe that a bit more then. Are you satisfied with the results of this stipulation as it pertains to appropriate economic lives for depreciation or are you accepting the stipulation as, I guess, as a balance for a revenue requirement that you're going to have to consider as a part of a broader package that's going to merge out of a set of events? In other words, is the economic -- is the appropriate lives forward depreciation an issue by itself or is this just a part of a broader balance?

MS. JENSEN: This is part of a broader balance.

MR. SHAW: I think what the entire industry is discussing, I think, and all regulators are discussing is the need to move on to some sort of a price regulation where we don't deal with these kinds of issues in the future, and that's our fervent hope that we can get to that point. If we can get our rate structure set based upon market issues as well as revenue requirement issues maybe we'll never have to have another sit-down about depreciation. We

just don't know that. That's certainly our goal.

COMMISSIONER GILLIS: Well, let me just check what I think I'm hearing. What I think you're saying is that if you perceive that you have some additional revenue requirements that you need to meet that you would revisit lives, appropriate lives of depreciation, as one source for that revenue requirement.

MR. SHAW: Well, as long as we're under traditional rate of return regulation we have no choice but to address depreciation expense every time we address revenue requirement. If we don't address revenue requirement in the future and we're under some sort of a price regulation, incented regulation, then all of the issues at the level of depreciation expenses, the level of the company's revenue requirement become moot, and company earns whatever it earns, whether that is 30 percent or 8 percent.

So that was what I was trying to get across. As long as we're under a traditional approach it is our belief that we will have to re-address depreciation expense on an ever more increasing basis than we have in the past, which was every three years in the past, but that was in an era where both the company and the Commission was able to essentially manage investment to manage revenue requirement, and we're not going to be able to do that in the future.

CHAIRMAN NELSON: One more for Ms. Jensen. Ms. Jensen, I know you're in charge of regulatory relations but that last set of questions prompted this question. Will the company be contemplating any future legislation to deal with lives?

MS. JENSEN: I think at this point in time there's a possibility of that. I mean, clearly we believe that the industry we're in is very competitive, particularly in some critical areas where the bulk of our revenue is derived from, and again, dependent upon our ability to recover our investment and how that investment is used not only by U S WEST to serve its retail customers but by alternative providers on a resale basis will have a direct implication as to whether we're comfortable that our investment is going to be appropriately recovered and adequately recovered. So I would have

to say at this point in time there's been no firm decision, but we do have a very serious concern that our practices as it relates to depreciation expense and recovery of that are still somewhat from a monopoly context, and clearly our environment is changing. So I think there's a good possibility that it will continue to be an issue, and my hope would be that we can work together with the Commission on a plan to adequately address it be it here or at the legislature.

MR. SHAW: As my previous remarks, if we could arrive at some consensus legislation around a new price regulation regime in the competitive environment it would indirectly deal with the depreciation issue and moot it out. So that's one of our concepts that we would like to talk about for upcoming legislation is fine tuning or updating the Commission's current statutory language around price cap regulation.

MR. MANIFOLD: I would like to add that I'm a little surprised to hear those responses. I should indicate one caveat, and that is Mr. ffitich was the person who was handling this, as you may know, and he's not available this week, but certainly in our discussions it was our understanding that the meaning of the first sentence on page 2 was that at this point in time these depreciation rates do provide a reasonable opportunity for capital recovery and do create a reasonable incentive for U S WEST to invest in this state. I hear the interpretation that the company is putting on that today, but I guess we can all read that sentence and that's my understanding of it.

CHAIRMAN NELSON: Anything else?

COMMISSIONER HEMSTAD: Well, I was a bit surprised at Mr. Shaw's responses with regard to that sentence. I had read it to mean that the company was accepting that the stipulated rates agreed to here met that test.

MR. SHAW: As you know, our testimony here and our testimony around our jurisdictions is for economic lives that are comparable to what our competitors use. The Idaho Commission just issued an order adopting such lives. We think lives should be shorter. This is a stipulation and settlement of a contested case where the company is willing to accept these

lives at this point with the opportunity to continue to work on it. There doesn't appear to be consensus on how fast things are changing, and, of course, when we're setting depreciation lives we're predicting the future and so we need to continue to work on that.

We have a different view on how the future is going to play out than apparently the other parties in this case. This is the art of the possible, and we are willing to agree to these lives now to get this proceeding over and to get on to the next step. I'm trying to be just as candid and direct as I can with you. We're not stating that we think that these are the appropriate lives. We are settling this case, and we will go forward with these lives and work on the next step.

COMMISSIONER GILLIS: I guess what I'm concerned about and I want to discuss with you a little bit, Mr. Shaw, is it doesn't appear that you're settling on the lives. Your settlement, I guess, is on a whole position or a revenue requirement deal, but I think you're saying pretty clearly that you're not done --

MR. SHAW: Yes.

COMMISSIONER GILLIS: -- in pursuing lives so you're not settling on the issue of lives.

MR. SHAW: Well, that's all that we're settling here certainly. If the Commission accepts the stipulation all that it is doing is closing this docket out on Mr. Spinks's testimony, and we've identified what the revenue requirement is. There's no rates, there's no promise that there's ever going to be any rates. We're obviously interested in the bottom line. We need more revenues. We need cash, and we're trying to work with the staff to come up with that cash in the most expeditious way possible.

So these lives in and of themselves don't do anything. I mean, it's just an exercise, but they do produce a revenue requirement that we would like to get recognized into rates into customers as soon as we can. And we also are hopeful that there will be recognition by the Commission that even given their last rate case order we have additional revenue requirement that should be recognized in rates to customers. Obviously, it's our last choice

to increase rates for this \$36 million and then increase rates again a few months later for additional revenue requirement that the Commission would recognize by updating the last rate case.

So that would be inappropriate for our customers to have to keep dealing with that. We're trying to tie those two together and we were hopeful that we can, and that will result from the company's perspective in increased revenues that we in turn can use for investment in improving services and expanding services. Lives in and of themselves don't mean anything.

MS. JENSEN: I would just add to that, Commissioner Gillis, that we think this is an important first step, and so while there's been a lot of discussion the reality is that we're in a very changing environment but we did utilize the mutual means process. We have worked on this for several months with the Commission staff and the staff has compromised in areas and the company has compromised in areas, and we do feel it's a very important first step in trying to make progress in this state.

The company has continued to invest in this state as it has in the past. We are very concerned about our future depreciation in that area and this is an important first step and good sign of good faith that we will rebuild what is necessary to keep this network healthy, and so I don't want to discredit the stipulation. If we did not feel it was a good healthy first step we would not have signed it, and so I hope you understand that.

MR. MANIFOLD: I would like to request that we have the opportunity for a short break at some point before we adjourn today. I don't care when.

JUDGE PRUSIA: I have a couple of clarifying questions relating to the stipulation. The stipulation provides that the Commission should authorize an increase in U S WEST depreciation rates set forth in the testimony. If the Commission does that, what has it approved? Has it approved an average depreciation rate of 7.4 percent or has it approved those individual depreciation rates for those 35 accounts, whatever it is?

MR. SPINKS: Historically what we've done in the nonlitigated proceeding was to send the company a letter authorizing rates that would be shown on Exhibit 7, page 204, column H, and typically the letter would say

the Commission hereby authorizes these rates effective 1-1-97, and they would apply to the individual plant accounts. It simply depends on the amount of investment in each account as to what it composites to, so you wouldn't approve a composite. That's just an after effect of applying the individual rates to the individual account investments.

JUDGE PRUSIA: Another question is, Mr. Shaw said at one point that the bottom line effect of the Commission accepting a stipulation is adopting lives, and then at another point he said we agreed to these lives now. If the Commission accepts a stipulation, is it accepting the lives set out in the stipulation and have the parties agreed that those are the appropriate lives for those plant categories?

MR. SPINKS: I can't speak for the company obviously, but yes, the Commission would implicitly be accepting the lives, salvages and other parameters used in the calculation of the rate.

JUDGE PRUSIA: Are you asking the Commission to explicitly accept those or to --

MR. SPINKS: Yes. Typically the documentation which we would send to the company authorizing the rates would also include the mortality dispersion, the projection or average service life and the remaining life and the net salvage values that were all used in the calculation. The Commission has approved both parameters and then the methodologies were determined from outside of the immediate process, but whatever methodologies were in effect would then be applied to the parameters to produce the rate. So, I think in my view that if this -- in the sense that this would be done or in a traditional way the Commission would be adopting or approving everything from the lives to the rate, all of the elements that go into making it up.

JUDGE PRUSIA: Is that your understanding also, Mr. Shaw?

MR. SHAW: Yes. That certainly is the effect.

JUDGE PRUSIA: And the company has agreed to the lives set out in that exhibit?

MR. SHAW: By signing this stipulation we've agreed to terminate this investigation by agreeing to those lives.

JUDGE PRUSIA: Another question is when do the new depreciation rates go into effect? Is it 1-1-97? Would that be the effective date of the revised --

MR. SPINKS: Yes. That should be the effective date for the new rates to take effect.

JUDGE PRUSIA: And concerning the amortization that will end at the end of 1999. Without the amortization Mr. Spinks's exhibit calculates that U S WEST composite depreciation rate effective in 1997 will be 6.9 percent. If you include the amortization it will be 7.4 percent. Now, after the current amortization goes away at the end of 1999, will the composite depreciation rate revert to 6.9 percent if there's no further Commission action?

MR. SPINKS: Probably not because the investments in the different plant accounts would be changed by '99 so there would be a different composite. What would be important -- and that's why we authorized the individual account rates is that those would stay the same but you would apply them to the new investment levels in '99 and that would probably produce a different composite rate.

JUDGE PRUSIA: I have no further questions. We'll take a 15 minute recess at this point.

(Recess.)

JUDGE PRUSIA: Let's be back on the record. We're back on the record after a 15 or 20-minute break. Is there anything further to come before us, then, this afternoon? Commissioners have additional comment or questions? Mr. Manifold.

MR. MANIFOLD: I will go after the commissioners.

JUDGE PRUSIA: I believe the commissioners are deferring to you.

MR. MANIFOLD: Okay. Thank you for the break, by the way. I just have an observation. This depreciation docket could be coming to the commissioners in any of three ways as far as I can see. One would be a fully litigated one in which case we would have been in hearings this week, and it would have a record and the usual thing. A second way would have been if the company had simply withdrawn its testimony and accepted the staff testimony

which was also being supported by TRACER and public counsel, and that's not how we're here. A third way is if a stipulation was reached among the parties that incorporated a number of things, and that's what we're here for, and we support the stipulation as a whole.

CHAIRMAN NELSON: Well, I'm not sure I'm going to be around to sign the order so we thought we would all say a few words about what we had heard today. I had hoped, as I think Commissioner Hemstad's question had indicated, that we were buying perhaps some more time for this set of lives, and what we've heard is that we may still see a filing much earlier than 1999 and perhaps even legislation. But it seems to me that -- and I would support approving the settlement if an order can be written in time. But what we're really doing is just incentivizing the parties to continue to negotiate a revenue requirement case.

I'm concerned that the parties not feel too incentivized. I am concerned about simplicity and transparency and predictability for customers so that I encourage the parties to, on the rate design issues, either to try to coordinate as closely as they can with the court's issuance of its opinion or if there is to be a rate design settlement offered to the Commission to make it as transparent and easy for the commissioners to understand and for the public to understand as possible. Often with settlements they appear very much as black boxes to commissioners.

So, I would hope that in the fall the Commission is not raising rates for one class of customers, decreasing for another within a few weeks apart of each other. I hope there can be some simultaneity about the filing of any such settlements and the Commission's dealing with them.

And lastly, company has said in legislative forums that these are the lowest in the nation, and I just didn't want to let that go by on this transcript. Having set on a joint board for the last couple of years I am aware of rates all over the country, and I just would share with you that the chairman of the Wisconsin Commission told me that she pays only \$6 a month flat rate, albeit to a rural independent phone company, and the Wisconsin Commission has recognized that that small rural phone company can't exist in

the future on that rate and has ordered it to begin ratcheting up its rates, but there are other lower rates in the country. Thanks.

COMMISSIONER GILLIS: I don't have much to add other than an agreement that I would be willing to also consider approval of this. I think Chairman said it well. There's not a whole lot to add. It's an incentive to continue to negotiate a revenue requirement.

I do feel based on the questions and answers today it's been a little disingenuous as a settlement on the issue of appropriate lives for depreciation if we're not -- if at least one of the parties is not willing to endorse the paragraph that is in the settlement that it provides for fair recovery of capital, but would like to see continued negotiation on the revenue requirement, and I would hope two principles would be accomplished.

One is that there is a factual basis for that we can review as commissioners, because it is difficult to get settlements. We don't have the benefits of weeks of hearings, and to the extent that the parties can provide us with the information in a way that we can carefully review it, that's important.

And secondly that the -- it will be my preference that whatever rate design occurs it's a one shot deal, that to the extent possible that it does reflect the reasonable near term decisions that are in different venues so that the customers don't get a lot of up and down.

COMMISSIONER HEMSTAD: I concur in the remarks of my two colleagues and I really don't have anything further to add. I am prepared to support the settlement.

JUDGE PRUSIA: Is there anything further to come before us this afternoon? Very well. The Commission will be entering a written order and there being nothing further the hearing is adjourned and we'll be off the record. Thank you.

CHAIRMAN NELSON: Thank you.

MS. JOHNSTON: Thank you.

(Hearing adjourned at 3:40 p.m.)