

BEFORE THE WASHINGTON UTILITIES AND 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

REDACTED

CONFIDENTIAL EXHIBIT TO

REBUTTAL TESTIMONY OF

PHILIP E. GRATE

ON BEHALF OF

QWEST CORPORATION

Response to Allegation that Qwest is violating Separations Rules

FEBRUARY 16, 2007

1 **Q. DR. LOUBE ASSERTS: “QWEST’S ACCOUNTING PRACTICES ARE**
2 **INCONSISTENT WITH THE FCC PART 36 RULES THAT REQUIRE**
3 **CARRIERS TO DIRECTLY ASSIGN INVESTMENT THAT WAS**
4 **DIRECTLY ASSIGNED PRIOR TO THE ADOPTION OF THE FREEZE**
5 **ORDER.” DO YOU AGREE?**

6 A. No. Qwest’s accounting practices comply with the FCC’s Part 36 rules. Dr.
7 Loube proposes a “DSL adjustment” and a “Non-DSL Special Access
8 Adjustment” that—taken together—increase Qwest’s income from operations
9 before taxes by \$48 million¹ and, according to Dr. Loube, increase Qwest’s 2005
10 return on rate base from ****BEGIN CONFIDENTIAL XXXXXXXXXXXX END**
11 **CONFIDENTIAL**** percent.² Both adjustments are inappropriate and
12 inconsistent with Part 36. The Commission should reject them.

13 **Q. ARE YOU SURPRISED TO BE IN DISAGREEMENT WITH DR. LOUBE**
14 **ON THIS ISSUE?**

15 A. No. Dr. Loube’s position and mine echo the positions being taken in a larger
16 debate occurring before the FCC in the *Jurisdictional Separations Docket*.³ On
17 May 16, 2006, the FCC issued an Order and Further Notice of Proposed
18 Rulemaking (*Notice*) in this docket.⁴ The *Notice* asked for comments on a variety
19 of issued involving jurisdictional separations.

¹ Direct Testimony of Robert Loube, Ph.D., page 59, line1 through page 64, line 17 and exhibits RL-9, RL-10 and RL-11.

² Direct Testimony of Robert Loube, Ph.D., page 64, line20 through line 21.

³ FCC CC Docket No. 80-286

⁴ *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, Order and Further Notice of Proposed Rulemaking, CC Docket No. 80-286, 21 FCC Rcd 5516 released as FCC 06-70 (2006) (“*Notice*” or “*FNPRM*”).

1 Initially fifteen comments were filed in response to the FCC's *Notice*. The
2 commenting parties can be classified as follows: 1) large local exchange carriers
3 ("LECs") subject to price cap regulation⁵; 2) consultants and associations⁶; 3)
4 state public utility commissions⁷; and 4) state ratepayer/consumer advocates.⁸
5 With the exception of the joint filing representing the interests of state consumer
6 advocates (*i.e.*, NASUCA⁹), there was a fair degree of agreement among the
7 parties. For example, most parties, other than NASUCA, favored extending the
8 existing separations freeze. Several commenters also acknowledged that the Part
9 36 rules in effect prior to the separations freeze are unnecessarily complicated and
10 outdated. Similarly, many commenters recognized that the separations process
11 could be affected significantly by FCC decisions in the Intercarrier Compensation
12 ("IC") and Universal Service ("USF") proceedings before the FCC and advocate
13 that separations changes be deferred until the FCC completes its IC and USF
14 proceedings. With the exception of NASUCA, most commenters also
15 acknowledged that separations requirements serve little, if any, purpose for
16 carriers subject to price cap regulation.
17 In arguing for more extensive regulation, NASUCA and its consultants, one of
18 whom was Dr. Loube, asserted, among other things, that: local exchange
19 competition is negligible and does not constrain rates; incumbent LEC interstate
20 rates are excessive; state regulatory agencies have the authority to reassign costs

⁵ These filers included: Verizon; Qwest Corporation; BellSouth Corporation; AT&T INC.;

⁶ These filers included: Western Telecommunications Alliance; ITTA, NECA, NTCA, OPASTCO and ERTA; John Staurulakis, Inc.; United States Telecom Association; and Alexicon Telecommunications Consulting

⁷ These filers included: Vermont Public Service Board, Vermont DPS, Nebraska Public Service Comm'n' Idaho Public Utilities Commission; Iowa Utilities Board; Pennsylvania Public Utility Commission; and Public Service Commission of Wisconsin

⁸ NASUCA, NJDRC, MeOPA

⁹ National Association of State Utility Consumer Advocates.

1 between jurisdictions; the Bells are re-monopolizing telecommunications; costs are
2 over-allocated to intrastate regulated services; and price cap companies (which
3 includes Qwest) are not complying with existing separations rules. Qwest's
4 position is that all of these allegations are without merit and should be rejected by
5 the FCC.

6 In support of its allegations, NASUCA relied on affidavits prepared by
7 consultants Susan M. Baldwin and Dr. Loube. As would be expected, Dr.
8 Loube's testimony with regard to jurisdictional separations in this docket is, in
9 many instances, a verbatim restatement of the affidavit he prepared for NASUCA.

10 **Q. WHAT IS THE CRUX OF DR. LOUBE'S ARGUMENT WITH REGARD**
11 **TO DIRECT ASSIGNMENT?**

12 A. As stated in his affidavit for NASUCA and echoed in his testimony for Public
13 Counsel in this docket, Dr. Loube argues:

14 The general [separations] freeze applies only to investment that is
15 allocated on the basis of relative use or fixed factors. It does not apply to
16 investment allocated through direct assignment.¹⁰

17 **Q. DOES DR. LOUBE BASE HIS ARGUMENT ON AN FCC ORDER THAT**
18 **CONCLUDES THAT PRICE CAP ILECS, SUCH AS QWEST, ARE**
19 **REQUIRED TO DIRECTLY ASSIGN INVESTMENT?**

20 A. No. Nor could he. The FCC has issued no such order. In fact the FCC's *Notice*
21 seeks comment on this issue.

22 **B. Reallocation of Investment Categories**
23

¹⁰ ¶14 Affidavit of Robert Loube, on behalf of the Maine Office of the Public Advocate and the National Association of State Utility Consumer Advocates dated August 22, 2006 and filed in FCC Docket No. 80-286.

1 38. While the Commission froze the separations category relationships
2 and the jurisdictional cost allocation factors in the *2001 Separations*
3 *Freeze Order*, the Commission also required that categories or portions of
4 categories that had been directly assigned prior to the separations freeze
5 would continue to be directly assigned to each jurisdiction.⁹⁰ The
6 Commission's rules provide that direct assignments shall be updated
7 annually.⁹¹ There has been some disagreement, however, between state
8 commissions and carriers regarding the application of this direct
9 assignment requirement. For instance, at its February 2006 Winter
10 Meetings, the NARUC Board of Directors adopted a resolution stating
11 that the Commission "should clarify that all carriers must continue to
12 directly assign all private lines and special access circuits based on
13 existing line counts."⁹² Conversely, USTelecom requests that the
14 Commission "reaffirm" that, under the *2001 Separations Freeze Order*,
15 state regulators may not compel LECs to reallocate categories of
16 investment from the intrastate to the interstate jurisdiction while the freeze
17 remains in effect.⁹³ USTelecom asserts that the direct assignment provision
18 "is narrow and does not require investment studies," but that some state
19 regulators are attempting to compel carriers to demonstrate that costs are
20 directly assigned in the proper manner.⁹⁴ We seek comment on the
21 clarifications sought by NARUC and by USTelecom.¹¹

22 If the FCC agreed with Dr. Loubé's argument and NARUC's resolution, it could
23 have so stated. Instead, it is seeking comment on this debate.

24 **Q. DR. LOUBE CLAIMS NARUC¹² AGREES THAT THE SEPARATIONS**
25 **FREEZE ORDER "REQUIRES DIRECT ASSIGNMENT OF SPECIAL**
26 **ACCESS FACILITIES."¹³ WHAT DOES THE RESOLUTION ACTUALLY**
27 **SAY?**

28 A. The NARUC resolution says.

29 Resolved, the FCC should clarify that all carriers must continue to directly
30 assign all private lines and special access circuits based on existing line
31 counts in such a manner that the Joint board will be able to complete its
32 work before the extended freeze expires.¹⁴

¹¹ *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, Order and Further Notice of Proposed Rulemaking, CC Docket No. 80-286, 21 FCC Rcd 5516 (2006) ("Notice" or "FNPRM"). Paragraph 38 footnotes omitted.

¹² National Association of Regulatory Utility Commissioners.

¹³ Direct Testimony of Robert Loubé, Ph.D., page 56, line 7 through line 17.

¹⁴ Committee Resolution TC-2 Relating to Separations Reform passed by the Board of Directors on February 15, 2006 at the February 2006 Winter Meetings of the National Association of Regulatory Utility Commissioners in Washington, DC.

1 **Q. WHAT EVIDENCE DID NARUC CONSIDER BEFORE ADOPTING ITS**
2 **RESOLUTION?**

3 A. The Resolution was sponsored by NARUC's Committee on Telecommunications
4 at the February 2006 Winter Meetings of NARUC in Washington, DC. During
5 the Winter Meetings, Dr. Loube delivered a Separations Tutorial to the
6 Committee on Telecommunications. In his tutorial, Dr. Loube explained how
7 direct assignment would reduce intrastate investment and expense and increase
8 intrastate rates of return.

9 **Q. ARE NARUC RESOLUTIONS AN AUTHORITATIVE SOURCE OF**
10 **INTERPRATIVE GUIDANCE OF FCC SEPARATIONS RULES?**

11 A. No. NARUC resolutions are not authoritative. They simply represent the views
12 and advocacy positions of NARUC members, as a group.

13 **Q. DR. LOUBE CLAIMS THE FEDERAL-STATE JOINT BOARD ON**
14 **SEPARATIONS AGREES THAT THE SEPARATIONS FREEZE ORDER**
15 **REQUIRES DIRECT ASSIGNMENT.¹⁵ DOES THIS ASSERTION HAVE**
16 **MERIT?**

17 A. No. The Comments of the State Members of the Joint Board that Dr. Loube cites
18 were released in October 2004, almost two years before the FCC's *Notice*. The
19 Comments include a four paragraph discussion of direct assignment. A copy of
20 that discussion is included as Exhibit PEG-5R. A reading of those comments—
21 including and especially the portion Dr. Loube quotes—reveals that they say
22 nothing to the effect that Joint Board agrees that the 2001 *Separations Freeze*
23 *Order* requires Price Cap ILECs such as Qwest to directly assign.

¹⁵ Direct Testimony of Robert Loube, Ph.D., page 56, lines 7 through page 57, line 3.

1 **Q. WHAT IS QWEST’S UNDERSTANDING OF THE CORRECT**
2 **INTERPRETATION OF THE SEPARATIONS FREEZE ORDER WITH**
3 **REGARD TO DIRECT ASSIGNMENT?**

4 A. Qwest’s position on this issue is quite clear and is based on the explicit language
5 in the Commission’s separations rules that were adopted in the *Separations*
6 *Freeze Order*.

7 While it is true that Qwest has not been updating direct assignments annually—as
8 Dr. Loube and others contend it should—the Commission’s rules do not permit
9 price cap carriers, such as Qwest, to do so. The language that Dr. Loube relies on
10 to support his position that direct assignment of investment be updated annually is
11 contained in 47 C.F.R. § 36.3(a) of the Commission’s separations rules and
12 applies generally to all ILECs.¹⁶ On the other hand, 47 C.F.R. § 36.3(b) applies
13 specifically to ILECs subject to price cap regulation and requires that all
14 investment categories and sub-categories be frozen. It is impossible both to
15 annually update direct cost assignments and to use frozen factors.¹⁷ Clearly, 47
16 C.F.R. § 36.3(b) is an exception to the general rule contained in 47 C.F.R. §
17 36.3(a). Standard rules of statutory construction dictate that when there is a
18 conflict between a general rule and a specific rule, the specific rule controls. As
19 such, Part 36.3(b) applies to Qwest, as an ILEC subject to price cap regulation,
20 and prohibits Qwest from directly assigning costs during the freeze period.¹⁸

21 Furthermore, not only do Qwest’s separations practices comply with a reasonable
22 reading of the FCC’s rules, but, as NARUC admits, FCC staff has provided

¹⁶ 47 C.F.R. § 36.3(a)

¹⁷ This is because the periodic updating of direct assignments would change the amounts in different categories thereby changing the percentages assigned to the two jurisdictions effectively negating the freeze of separations in violation of the Commission’s *Freeze Order* and §36.3(b).

¹⁸ 47 C.F.R. § 36.3(b).

1 similar advice concerning compliance with the requirements of the separations
2 freeze.¹⁹

3 **Q. DOES DR. LOUBE’S ASSERTION—THAT QWEST IS VIOLATING THE**
4 **SEPARATIONS RULES—DISREGARD OTHER CLEAR LANGUAGE IN**
5 **THE SEPARATIONS RULES?**

6 A. Yes. Dr. Loube’s adjustment, which includes Cable and Wire Facilities (C&WF)
7 investment,²⁰ does not comply with Section 36.152(d) of the FCC’s separations
8 rules.²¹ The language of this section of the Part 36 rules was adopted in the
9 *Separations Freeze Order* and does not allow the direct assignment of any C&WF
10 facilities by price cap ILECs. With regard to all C&WF, Section 36.152(d) states:

11 Effective July 1, 2001, through June 30, 2006, study areas subject to price cap
12 regulation, pursuant to Sec. 61.41, shall assign the average balance of
13 Account 2410 to the categories/subcategories, as specified in Sec. Sec.
14 36.152(a) through (c), based on the relative percentage assignment of the
15 average balance of Account 2410 to these categories/subcategories during the
16 twelve month period ending December 31, 2000.²²

17 In its May 16, 2006 Order extending the separation freeze, on an interim basis, for
18 three years or until comprehensive separations reform is completed, whichever
19 occurs sooner, the FCC left Section 36.152(d) in place and simply extended the
20 July 1, 2006 expiration date.²³ The language of this section is not permissive and
21 specifically directs Qwest and other price cap ILECs to assign the average
22 balance of the C&WF account 2410 based on relative percentages during the year
23 2000. It is impossible to simultaneously comply with this requirement and also

¹⁹ See NARUC Ex Parte Letter, dated April 6, 2006, FCC Dockets Nos. 80-286 and 96-45 at 10 citing a letter, from Fatina Franklin of the FCC to Ann Berkowitz of Verizon Communications, dated June 9, 2004.

²⁰ Direct Testimony of Robert Loube, Ph.D., page 60, line 10.

²¹ 47 C.F.R. §36.152(d) Categories of Cable and Wire Facilities (C&WF).

²² Id.

²³ In the Matter of Jurisdictional Separations and Referral to the Joint Board, Order and Further Notice of Proposed Rulemaking, released May 16, 2006, CC Docket 80-286 at §§15-24.

1 directly assign C&WF. Nevertheless, Dr. Loube—claiming Qwest is violating
2 the separations rules—proposes an adjustment to C&WF because Qwest is not
3 directly assigning it.

4 Similarly, Dr. Loube adjusts circuit equipment (Accounts 2230 through 2232)²⁴ in
5 violation of Section 36.126(b)(5).²⁵ This section states:

6 Effective July 1, 2001, through June 30, 2006, study areas subject to price cap
7 regulation, pursuant to Sec. 61.41, shall assign the average balances of
8 Accounts 2230 through 2232 to the categories/subcategories as specified in Sec.
9 Sec. 36.126(b)(1) through (b)(4) based on the relative percentage assignment
10 of the average balances of Accounts 2230 through 2232 costs to these
11 categories/subcategories during the twelve month period ending December 31,
12 2000.²⁶

13 Dr. Loube’s position must be rejected since it is impossible to comply with this
14 requirement and directly assign circuit equipment.

15 **Q. DO OTHER INDUSTRY PARTICIPANTS SUPPORT QWEST’S**
16 **POSITION ON DIRECT ASSIGNMENT?**

17 A. Yes. A White Paper that the United States Telecom Association (USTelecom)
18 filed with the FCC comes to the same conclusion that price cap ILECs are not
19 required to update direct assignment during the Separations Freeze.²⁷ This White
20 Paper argues that price cap LECs (such as Qwest) need not perform investment
21 studies to enable “direct assignment” of particular investment categories,
22 subcategories, and subclassifications to the interstate jurisdiction.

²⁴ Direct Testimony of Robert Loube, Ph.D., page 60, line 20 through page 61, line 2.

²⁵ 47 C.F.R. §36.126(b)(5) Circuit equipment.

²⁶ Id. As with Section 36.152(d), the FCC extended the expiration date for this section to the sooner of three years or when the FCC completes its comprehensive reform of separations.

²⁷ §IV of USTelecom White Paper entitled “Paving the Way for Jurisdictional Separations Reform” dated December 12, 2005 and attached to a Notice of ex parte presentation dated January 20, 2006 filed with the Federal Communications Commission in CC Docket No. 80-286.

1 The White Paper explains that investment studies are a necessary prerequisite to
2 direct assignment. Under the FCC's *2001 Separations Freeze Order*²⁸, price cap
3 LECs are not required to conduct investment studies. The *2001 Separations*
4 *Freeze Order* specified that price cap carriers "will not have to perform the
5 analyses necessary to categorize annual investment changes for interstate
6 purposes" and held that, "[b]ecause a goal of the freeze is to reduce administrative
7 burdens on carriers . . . any Part 36 requirement to segregate costs recorded in
8 Part 32 accounts into categories, subcategories, or further sub-classifications shall
9 be frozen at their percentage relationship for the calendar year 2000."²⁹ While the
10 FCC also stated that categories or portions of categories that had been directly
11 assigned prior to the freeze should continue to be directly assigned, this exception
12 to the freeze is narrow and does not require investment studies: "portions of
13 facilities that are utilized *exclusively* for services within the state or interstate
14 jurisdiction are readily identifiable, [so] the continuation of direct assignment of
15 costs [for those categories] will not be a burden."³⁰ Conversely, if plant is used for
16 both interstate and intrastate purposes, the categories, sub-categories, and
17 subclassifications containing that plant, and the allocation of those categories,
18 subcategories, and subclassifications, remains frozen at their 2000 levels.

19 **Q. HAVE THE RBOCS RECEIVED CONFIRMATION FROM THE FCC**
20 **THAT THEY ARE NOT TO UPDATE DIRECT ASSIGNMENT?**

21 A. Yes. Following release of the *2001 Separations Freeze Order*, in 2001, RBOC
22 representatives met jointly with Commission staff to clarify the relationship
23 between paragraphs 22 and 23 of that *Order*. At the meeting, the RBOC

²⁸ Jurisdictional Separations and Referral to the Federal-State Joint Board, Report and Order, 16 FCC Rcd. 11382, (2001) ("*Separations Freeze Order*").

²⁹ *2001 Separations Freeze Order*, ¶¶ 14, 22.

³⁰ *Id.* ¶ 23 (emphasis added).

1 representatives explained that the only way to update direct assignments without
2 conducting an investment study was if the directly assigned amounts were based
3 on amounts that were readily identifiable from the company's general ledger. In
4 response, the staff confirmed that investment studies were no longer required and
5 that direct assignment applied only to categories and portions of categories that
6 had been directly assigned prior to the freeze and were readily identifiable
7 without the use of studies.

8 **Q. DOES THE FCC PERFORM AN ANNUAL ANALYSIS AND REVIEW OF**
9 **THE PART 36 SEPARATION INFORMATION THAT QWEST FILES IN**
10 **ITS ARMIS REPORT 43-04?**

11 A. Yes.

12 **Q. UNDER THE SEPARATIONS FREEZE DOES QWEST DIRECTLY**
13 **ASSIGN INVESTMENT FOR SEPARATIONS PURPOSES?**

14 A. No.

15 **Q. HAS THE FCC NOTIFIED QWEST THAT ITS PART 36 REPORTS**
16 **WERE INCORRECT BECAUSE QWEST DID NOT DIRECTLY ASSIGN**
17 **INVESTMENT?**

18 A. No.

19 **Q. HAS THE FCC EVER NOTIFIED QWEST THAT IT IS OUT OF**
20 **COMPLIANCE WITH THE SEPARATIONS FREEZE?**

21 A. Yes. In a letter dated April 29, 2004 to Qwest's assistant controller, Fatina K.
22 Franklin, Assistant Division Chief of the FCC's Industry Analysis and
23 Technology Division (*Franklin letter*), indicated that in a verification of Qwest's
24 frozen category factors, impermissible variances between calendar years 2000 and

1 2003 were detected. Referring to Part 36.3 for authority the letter asserts: “The
2 category factors were frozen in 2000 and should match the 2003 factors.” The
3 letter directs Qwest to “make the necessary changes and provide your re-
4 filling...” A copy of the letter is provided as Exhibit PEG-6R.

5 **Q. WOULD THE ADJUSTMENTS DR. LOUBE CALCULATES BE**
6 **CONSISTENT WITH THE FCC’S INTERPRETATION OF PART 36.3 AS**
7 **SET FORTH IN THE *FRANKLIN LETTER*?**

8 A. No. The *Franklin letter* makes clear that under Part 36.3, Qwest’s category
9 factors are to be frozen. An attachment sets forth the discrepancies discussed in
10 the letter. The attachment identifies impermissible variances between 2000 and
11 2003 in several categories of Cable and Wire Facilities (C&WF), some of which
12 are the very category factors that Dr. Loube’s adjustment aims to modify. By
13 way of introducing his proposed adjustments Dr. Loube testifies:

14 **Q: To what portion of the carrier’s investments and costs does the freeze**
15 **apply?**

16 **A:** The general freeze applies only to investment that is allocated on the basis
17 of relative use or fixed factors.

18 **Q: Has Qwest directly assigned cable and wire facilities?**

19 **A:** No. Qwest has frozen the cable and wire facilities category allocation at
20 their calendar-year 2000 level. The effect of this freeze is shown in
21 Exhibit RL-5. The exhibit shows the investment in cable and wire
22 facilities and the category allocation of that investment for the years 2000
23 through 2004. Note that the percentage of cable and wire investment
24 allocated to Category 1 remained at 91.23 percent, the 2000 level, for the
25 years 2002 through 2004. The year 2001 differed from the other years
26 because the freeze was not effective until July 1, 2001.

27 **Q: Are Qwest’s accounting practices consistent with the FCC rules?**

28 **A:** No. Qwest’s accounting practices are inconsistent with the FCC Part 36
29 rules that require carriers to directly assign investment that was directly
30 assigned prior to the adoption of the freeze order.³¹

31

* * *

³¹ Direct Testimony of Robert Loube, Ph.D., page 55, line 13 through page 56, line 6 (emphasis added and footnotes omitted).

1 **Q: Please describe the procedure you used to adjust the cable and wire**
2 **special access investment.**
3 **A: The procedure I used contains a series of calculations. First, I identified**
4 **and sum the special access investment using the ARMIS 43-04 Reports.**
5 **Second, I multiplied the special access investment by a preliminary**
6 **adjustment factor. Third, I reduced the non-special access investment**
7 **through a pro-rated adjustment to offset the increase in special access**
8 **adjustment. These three steps determine a preliminary special access**
9 **adjustment. The final adjustment is made in coordination with the**
10 **adjustment to circuit equipment and general support investment. .³²**

11 The clear aim of Dr. Loube’s adjustment is contrary to the clear expectation set
12 forth in the *Franklin letter*. Were Qwest to change its category factors to reflect
13 direct assignment of C&WF as Dr. Loube asserts Qwest should, the *Franklin*
14 *letter* indicates the FCC would consider this an impermissible discrepancy. There
15 is no reason to believe that the FCC would not consider Dr. Loube’s adjustment
16 for circuit equipment to be impermissible as well.

17 **Q. DID THE WASHINGTON UTILITIES AND TRANSPORTATION**
18 **COMMISSION (“WUTC”) FILE REPLY COMMENTS IN RESPONSE TO**
19 **COMMENTS FILED UNDER THE FCC’S *NOTICE*?**

20 A. Yes. David W. Danner, Executive Director, filed reply comments on behalf of
21 the Commission November 17, 2006. The reply comments strongly supported the
22 comments of other filers expressing concern that the FCC’s separations freeze, as
23 implemented, produces a jurisdictional imbalance that risks subsidizing interstate
24 investments by raising local exchange rates. The reply comments assert that the
25 *Separations Freeze Order* has created a large mismatch between revenues and
26 costs for certain services, led to uncertainty in intrastate ratemaking, and provided
27 opportunities for double recovery and potential anti-competitive behavior by
28 telecommunications companies. The reply comments also recommend that the
29 FCC give particular consideration to the option of assigning regulation of rates for

³² Direct Testimony of Robert Loube, Ph.D., page 60, line 10 (emphasis added).

1 all services (intrastate and interstate) to those states that retain rate-of-return
2 regulation.

3 **Q. DO THE WUTC'S REPLY COMMENTS AGREE WITH DR. LOUBE'S**
4 **ASSERTION THAT PRICE CAP ILECS SUCH AS QWEST ARE**
5 **VIOLATING THE SEPARATIONS RULES UNDER THE SEPARATIONS**
6 **FREEZE ORDER?**

7 A. No. The Commission's reply comments do not assert that price cap ILECs, such
8 as Qwest, are violating the Part 36 separations rules because they have not been
9 directly assigning during the separations freeze.

10 **Q. ARE THERE OTHER STATE REGULATORY COMMISSIONS THAT**
11 **BELIEVE THAT NASUCA AND DR. LOUBE ARE MISTAKEN IN THEIR**
12 **CLAIM THAT LECS ARE VIOLATING THE FCC'S *SEPARATIONS***
13 ***FREEZE ORDER* BY NOT UPDATING DIRECT ASSIGNMENTS**
14 **DURING THE SEPARATIONS FREEZE?**

15 A. Yes. Several state regulators agree that LECs are merely following the explicit
16 direction of the FCC in not updating direct assignments and continuing to use
17 frozen factors and category relationships in effect as of June 30, 2001.³³ In
18 comments filed August 22, 2006, the Idaho PUC makes reference to a letter dated
19 June 9, 2004 from the Assistant Division Chief of the Industry Analysis and
20 Technology Division of the FCC's Wireline Competition Bureau to Verizon
21 Communications that "stated that carriers were not permitted to make any

³³ See Vermont PSB comments, filed August 22, 2006 in FCC Docket 80-286, at 19 citing a letter from Fatina Franklin of the FCC to Verizon. "The letter stated that carriers were not permitted to make any adjustment to frozen categories until the freeze expires." *Also see*, Idaho PUC comments at 16; Verizon at 18-21.

1 adjustment to frozen categories until the freeze expires.”³⁴ As noted above, Qwest
2 also believes that the Commission’s Part 36 rules require such an outcome.

3 **Q. ARE THERE OTHER REASONS TO REJECT DR. LOUBE’S PROPOSED**
4 **ADJUSTMENTS?**

5 A. Yes. Although Dr. Loube claims he proposes his adjustment because Qwest is
6 violating the FCC’s Part 36 rules, his special access adjustment does not comply
7 with Part 36. Instead, it relies on a cost allocation scheme based on jurisdictional
8 revenues.

9 **Q: How did you remove the distortion associated with the failure to**
10 **directly assign special access?**

11 A. **A:** I divided the task into two parts. First, for the non-DSL portion of
12 Special Access services, I equated the ratio of carrier special access
13 investment to carrier regulated investment that is subject to separations
14 (the investment ratio) to the ratio of carrier special access revenue to
15 carrier regulated revenue that is subject to separations (the revenue ratio).
16 I contend that matching these ratios matches revenues to cost because
17 jurisdictional cost is driven by jurisdictional investment in the separations
18 process.³⁵

19 The rules for the Separation of Telecommunications Plant in Service are found in
20 Subpart B of Part 36 of the FCC’s rules. Nowhere in Subpart B is any mention of
21 revenues found. Dr. Loube’s allocation scheme is his own invention.

22 Dr. Loube’s invention gets jurisdictional separations completely backwards. The
23 purpose of jurisdictional separations is to assign costs to jurisdictions. The costs
24 thus separated are used to facilitate cost-of-service rate-of-return (traditional)
25 ratemaking. Under traditional ratemaking the regulator determines the amount of
26 revenues a firm needs to satisfy its “revenue requirement” based on the firm’s

³⁴ Page 9 of Comments of the Idaho Public Utilities Commission filed with the FCC August 22, 2006 in CC Docket No. 80-286.

³⁵ Direct Testimony of Robert Loube, Ph.D., page 55, line 13 through page 56, line 6 (emphasis added and footnotes omitted).

1 costs. Thus, the separation of costs is used to determine what revenues are
2 required, not the other way around. Despite this fundamental premise underlying
3 the separations process, Dr. Loube uses revenues as the basis for adjusting the
4 jurisdictional separation of costs.

5 **Q. MAY STATE COMMISSIONS ORDER LECS TO SEPARATE COSTS IN**
6 **NON-CONFORMANCE WITH THE PART 36 RULES?**

7 A. No. The Communications Act of 1934, as amended, makes it clear that the only
8 role for state regulators in the separations process is an advisory role through the
9 Joint Board.³⁶ Contrary to Dr. Loube's suggestions, state regulators have no right
10 to reclassify intrastate costs as interstate costs if regulators dislike the outcome of
11 the separations process.³⁷ Likewise, state regulators have no authority to re-
12 interpret the FCC's rules regarding direct assignment and frozen separations
13 factors and category relationships.

14 Regardless of whether or not consumer advocates or regulated ILECs or state
15 regulatory agencies agree with the FCC's separations rules, one thing is clear:
16 they cannot ignore or modify them. In 1988 the Federal Court of Appeals for the
17 9th circuit (which includes Washington) concluded, "The field of separations --
18 the assignment of telecommunications costs between state and interstate
19 jurisdictions -- has been entirely preempted by the [Federal Communications]
20 Commission."³⁸

21 Dr. Loube's proposed separations adjustment must be rejected since this
22 adjustment violates the Part 36 Jurisdictional separations rules as the FCC has

³⁶ 47 U.S.C. § 410(b).

³⁷ NASUCA at 6-7 and Loube Affidavit at 11-12.

³⁸ *Hawaiian Telephone Company v. Public Service Commission of the State of Hawaii*, 827 F.2d 1264, 1275 (9th Cir. 1987), *cert. denied*, 487 U.S. 1218 (1988).

1 interpreted and applied them. Any such adjustment would be beyond the scope of
2 the Washington Commission's jurisdiction since the FCC has preempted the field
3 of separations.

4 **Q. HOW DO THE TWO SEPARATIONS ADJUSTMENTS THAT DR.**
5 **LOUBE PROPOSES COMPARE WITH THE TWO SEPARATIONS**
6 **ADJUSTMENTS THAT MS. STRAIN PROPOSES?**

7 A. Assuming a 9.367 percent cost of capital and the same income-to-revenue
8 conversion factor that Ms. Strain employs, Dr. Loubé's two adjustments would
9 reduce Qwest's revenue requirement \$68 million on a 2005 test year. Using the
10 same assumptions, Ms. Strain's two adjustments would reduce Qwest's revenue
11 requirement \$30 million. Obviously, the effect of the adjustments is a function
12 their design. That Ms. Strain and Dr. Loubé arrive at quite different answers
13 underscores the fact that they are creating their adjustments without reliance on
14 any authoritative guidance from the FCC and that they are ignoring the explicit
15 language of the FCC's applicable separations rules.

16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY REGARDING DR.**
17 **LOUBE'S SEPARATIONS ADJUSTMENTS?**

18 A. Yes.