

**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**

**REBUTTAL TESTIMONY OF**

**PHILIP E. GRATE**

**ON BEHALF OF**

**QWEST CORPORATION**

**FEBRUARY 16, 2007**

**CONFIDENTIAL VERSION**

**REDACTED  
CONFIDENTIAL PURSUANT TO WAC 480-07-160**

## TABLE OF CONTENTS

	<u>Page</u>
<b>INDEX OF EXHIBITS</b> .....	<b>ii</b>
<b>I. Identification of Witness</b> .....	<b>1</b>
<b>II. Purpose of Testimony</b> .....	<b>2</b>
<b>III. Qwest’s Financial Performance</b> .....	<b>2</b>
<b>IV. Rebuttal of Paula M. Strain</b> .....	<b>18</b>
A. Financial Reporting .....	18
B. Regulatory Accounting.....	19
C. Commission Basis Adjustments .....	21
D. Transition Review Filing Requirements.....	22
<b>V. Rebuttal of Robert Loube, PhD</b> .....	<b>29</b>
A. Reporting Requirements Proposal .....	29
B. Proposal to Apply Discounts Elsewhere than in Washington .....	31
C. Allegation of an Insufficient Record .....	32
D. Allegation that the Dex Settlement Order Would be Violated .....	34
E. Allegation that Qwest is Violating FCC Separations Rules .....	37

## **INDEX OF EXHIBITS**

<b><u>Exhibit</u></b>	<b><u>Title</u></b>
PEG-2CR	Response to Staff's Proposed Adjustments to Qwest Earnings
PEG-3CR	Response to Allegation that Qwest is violating Separations rules
PEG-4R	Information Qwest Will Provide for Six Month AFOR Review
PEG-5R	Comments of the State Members of the Joint Board released 2004
PEG-6R	April 29, 2004 letter from FCC to Qwest regarding Separations

1                                   **I.        IDENTIFICATION OF WITNESS**

2    **Q.        PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND EMPLOYMENT.**

3    A.        My name is Philip E. Grate and my business address is 1600 7<sup>th</sup> Ave., Room 2911,  
4                    Seattle, Washington, 98191. I am employed by Qwest Corporation (“Qwest”) as  
5                    Staff Director Accounting in the Regulatory and Cost Accounting organization of the  
6                    Qwest Finance Department.

7    **Q.        PLEASE REVIEW YOUR PRESENT RESPONSIBILITIES.**

8    A.        My primary responsibility is state and federal regulatory relations and advocacy  
9                    regarding regulatory accounting involving Qwest Corporation. My responsibilities  
10                   include working with the FCC and all states in which Qwest is an incumbent local  
11                   exchange carrier (ILEC).

12   **Q.        BRIEFLY OUTLINE YOUR EDUCATION AND EMPLOYMENT**  
13                   **BACKGROUND.**

14   A.        I received a B.S. from Indiana University in 1979 and a J.D. from Indiana University  
15                   in 1982. I am licensed to practice law and as a certified public accountant (CPA) in  
16                   Washington. Both licenses are inactive because they are not necessary for my  
17                   current responsibilities. I can reactivate both licenses by meeting the requirements  
18                   for continuing legal and professional education. I began my professional career at  
19                   the “Big Eight” public accounting firm Touche Ross in 1982. I began my career in  
20                   the telecommunications industry at Pacific Northwest Bell Telephone Company  
21                   (which became U S WEST Communications, Inc. and is now Qwest Corporation) in  
22                   1984. I served in the tax department in positions of increasing responsibility until  
23                   1990 when I became the director of Accounting Standards for U S WEST  
24                   Communications. In 1995 I assumed my current position with responsibilities for

1 the state of Utah. Over the past twelve years I have become responsible for an  
2 increasing number of jurisdictions. At the present time I am assigned to seven states  
3 and the FCC.

4 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

5 A. Yes. I testified in Docket UT-970766, a revenue requirement case, and docket UT-  
6 021120, the case involving the sale of the Dex Yellow Pages directory business.

7 **II. PURPOSE OF TESTIMONY**

8 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

9 A. The purpose of my testimony is to respond to the testimonies of Paula M. Strain on  
10 behalf of Staff and Robert Loube, Ph.D. on behalf of Public Counsel.

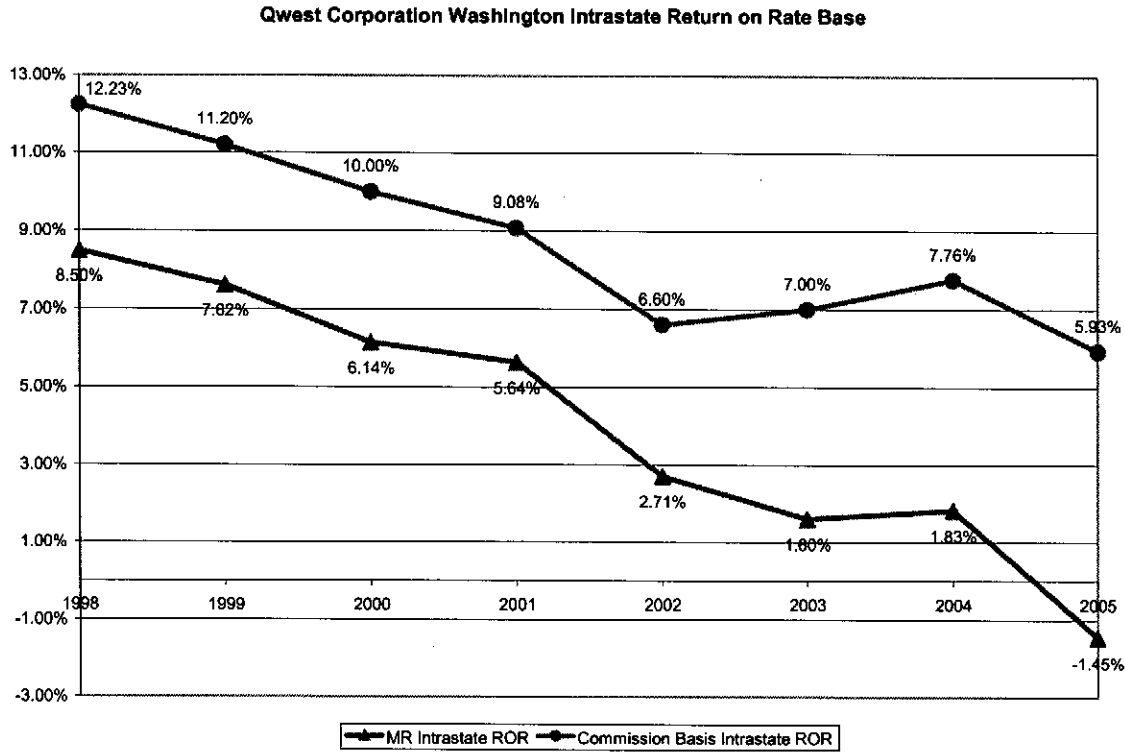
11 **Q. HOW IS YOUR TESTIMONY ORGANIZED?**

12 A. Because these two witnesses have introduced testimony concerning Qwest's  
13 financial performance, I begin with an overview of Qwest's financial results in  
14 Washington. I then respond to particular points made in Ms. Strain's and Dr.  
15 Loube's testimonies.

16 **III. QWEST'S FINANCIAL PERFORMANCE**

17 **Q. PLEASE SUMMARIZE QWEST'S FINANCIAL PERFORMANCE IN**  
18 **WASHINGTON SINCE THE COMPANY'S LAST RATE CASE.**

19 A. Generally speaking, Qwest's Washington intrastate financial performance has been  
20 declining. Following is a graph that shows Qwest's annual return on rate base since  
21 1998 as reported in its quarterly reports of intrastate results of operations filed with  
22 the Commission in accordance with WAC 480-120-385(2). Both lines on the graph  
23 reflect declining financial performance.



1

2 **Q. WHAT DOES THE LOWER LINE ON THE GRAPH REPRESENT?**

3 A. The lower line on the graph represents the return on rate base on the FCC reporting  
 4 (MR) basis of accounting and without any Commission Basis adjustments.

5 **Q. WHAT DOES THE UPPER LINE ON THE GRAPH REPRESENT?**

6 A. The upper line represents the effect of four Washington jurisdictional (JR)  
 7 accounting differences and eight Commission Basis adjustments. The following  
 8 table sets forth the effect of the four JR accounting differences and the eight  
 9 Commission Basis adjustments.

	2005 Return on Rate Base
MR Basis	-1.45%
JR Accounting Differences	1.65%
Commission Basis Adjustments	5.73%
Commission Basis	<u>5.93%</u>

10

1 **Q. WHAT ARE THE FOUR JR ACCOUNTING DIFFERENCES?**

2 A. The four JR accounting differences are for Depreciation Expense and Reserve  
3 Differences; AFUDC; Flow-through Non-property Income Tax; and Software  
4 Capitalization. Under Qwest's AFOR proposal and under the modification's to  
5 Qwest's proposal that Ms. Strain proposes, Qwest would discontinue accounting for  
6 the JR differences and capture their rate base effect in a standing "MR Transition"  
7 adjustment to rate base. These four adjustments increased Qwest's 2005 return on  
8 rate base 165 basis points.

9 **Q. WHAT ARE THE EIGHT COMMISSION BASIS ADJUSTMENTS?**

10 A. The eight Commission Basis adjustments are ratemaking adjustments that reflect  
11 Commission decisions in Qwest rate cases and other dockets. Ms. Strain's testimony  
12 discusses these Commission Basis adjustments.<sup>1</sup> Their effect is to increase Qwest's  
13 reported return on rate base. In 2006 the overall effect of these eight adjustments  
14 increased reported return on rate base 573 basis points.

15 **Q. WHAT IS THE MOST SIGNIFICANT COMMISSION BASIS ADJUSTMENT?**

16 A. By far, the most significant Commission Basis adjustment is the Annual Revenue  
17 Credit prescribed by the *Dex Stipulation*<sup>2</sup> that the Commission adopted in the *Dex*  
18 *Settlement Order*.<sup>3</sup> Qwest and Public Counsel are signatories to *the Dex Stipulation*.  
19 For 2005 the *Dex Stipulation* prescribes an Annual Revenue Credit of \$110 million.  
20 It increased Qwest's 2005 Commission basis return on rate base 581 basis points or

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<sup>1</sup> See Direct Testimony of Paula M. Strain, page 6, line 5 to page 9, line 9 and Exhibit No. \_\_\_ (PMS-5)

<sup>2</sup> Stipulation and Settlement Agreement entered into between Qwest, Dex Holdings, Public Counsel, AARP, WeBTEC, and DoD/FEA (*Dex Stipulation*) adopted by the Commission in its Tenth Supplemental Order In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate, Docket No. UT-021120 (*Dex Settlement Order*)

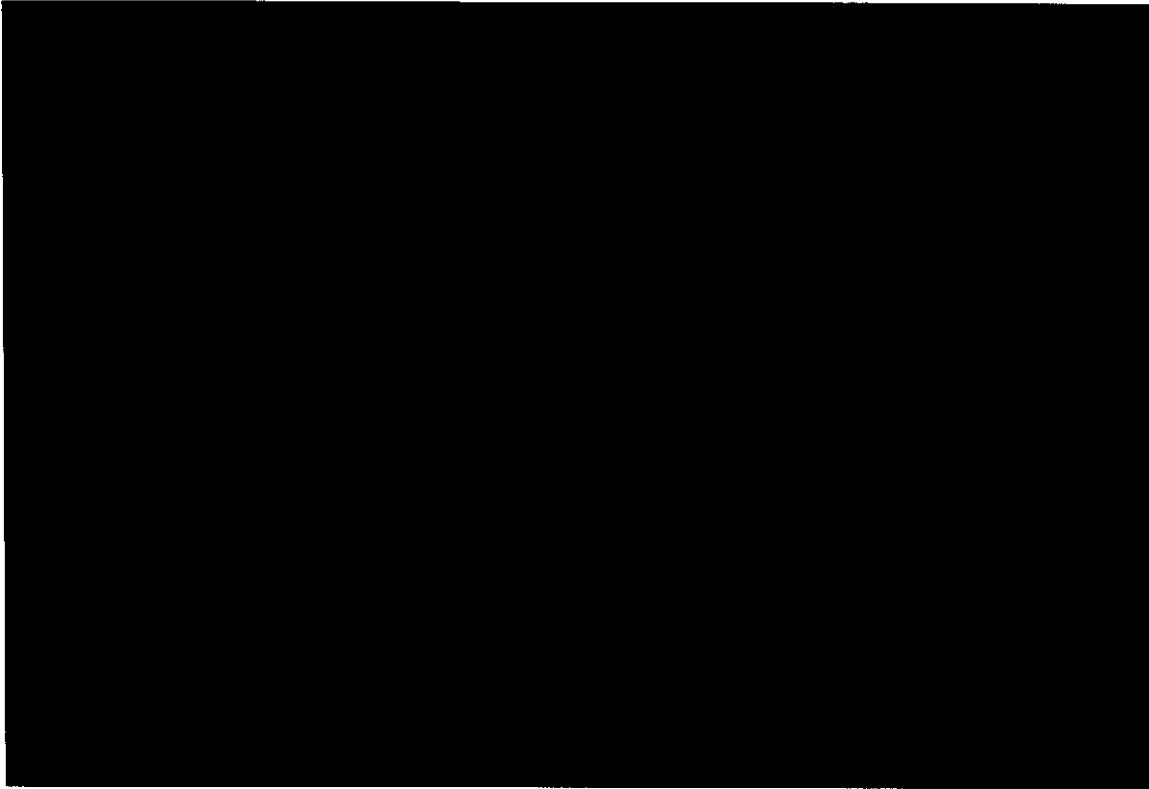
<sup>3</sup> Tenth Supplemental Order In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate, Docket No. UT-021120 (*DEX Settlement Order*)

1 101 percent of the 573 basis point increase from all eight Commission Basis  
2 adjustments combined. Viewed differently, the Annual Revenue Credit accounted  
3 for 79 percent of the difference between Qwest's **\*\*BEGIN REDACTED**  
4 **XXXXXXXXXXXXX END REDACTED** **\*\*** percent return on rate base on the MR basis  
5 and its **\*\*BEGIN REDACTED XXXXXXXXXXXXXXXX END REDACTED\*\*** percent  
6 return on rate base on a Commission Basis in 2005.

7 **Q. WHAT IS CAUSING THE DECLINE IN QWEST'S FINANCIAL**  
8 **PERFORMANCE IN WASHINGTON?**

9 A. Qwest's **\*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXX. END**  
10 **REDACTED\*\*** The following graph shows Qwest's annual MR basis intrastate net  
11 income, as reported in its quarterly reports to the Commission since 1998.  
12 **\*\*BEGIN REDACTED\*\***





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2 END REDACTED\*\*

3 **Q. WHAT IS CAUSING QWEST'S NET INCOME TO DECLINE?**

4 A. Qwest's revenues are falling faster than its expenses. Following is a graph showing  
5 Qwest's annual intrastate revenues and expenses since 1998 as reported in its  
6 quarterly reports to the Commission. \*\*BEGIN REDACTED



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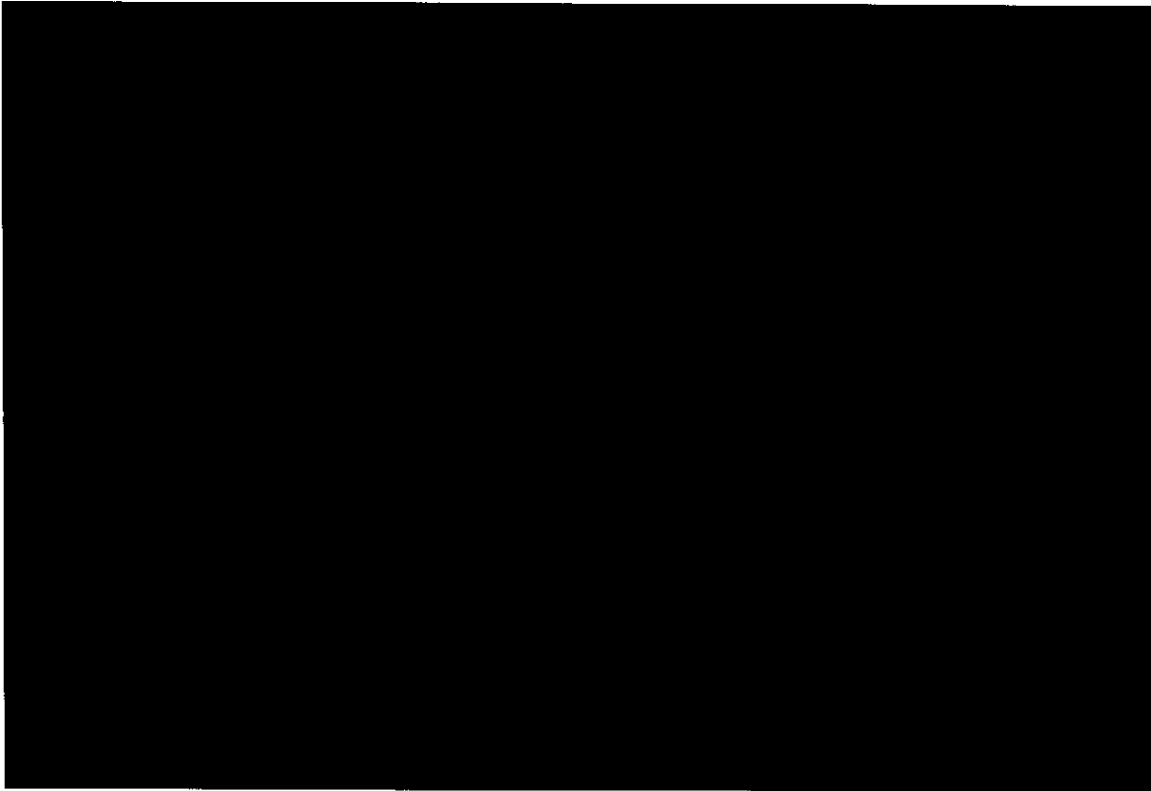
END REDACTED\*\* The graph shows that between 2000 and 2005, expenses  
\*\*BEGIN REDACTED XXXXXXXXXXXXXXXX END REDACTED \*\* percent while  
revenues \*\*BEGIN REDACTED XXXXXXXXXXXXXXXX END  
REDACTED\*\*percent.

**Q. PLEASE DESCRIBE THE COMPONENTS OF QWEST'S REVENUES.**

A. Qwest's Washington intrastate revenues fall into six general categories: 1) Access; 2)  
Toll; 3) Miscellaneous; 4) Local – Residential; 5) Local - Business and 6) Local –  
Other.

1 **Q. PLEASE REVIEW THE CHANGE IN ACCESS SERVICE REVENUES.**

2 A. The following graph shows annual revenues generated from intrastate access service  
3 from 1998 to 2006. \*\*BEGIN REDACTED



4  
5 END REDACTED\*\* The category of Intrastate Access includes services such as  
6 intrastate switched access and intrastate private line transport. The graph shows that  
7 revenues from intrastate access have fluctuated over the past nine years. Estimated  
8 2006 revenues are \*\*BEGIN REDACTED

9 XXX  
10 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. END REDACTED\*\*

11 **Q. PLEASE REVIEW THE CHANGE IN TOLL AND MISCELLANEOUS**  
12 **REVENUES.**

1 A. The following graph shows annual revenues generated by toll and miscellaneous  
2 revenues from 1998 to 2006. \*\*BEGIN REDACTED



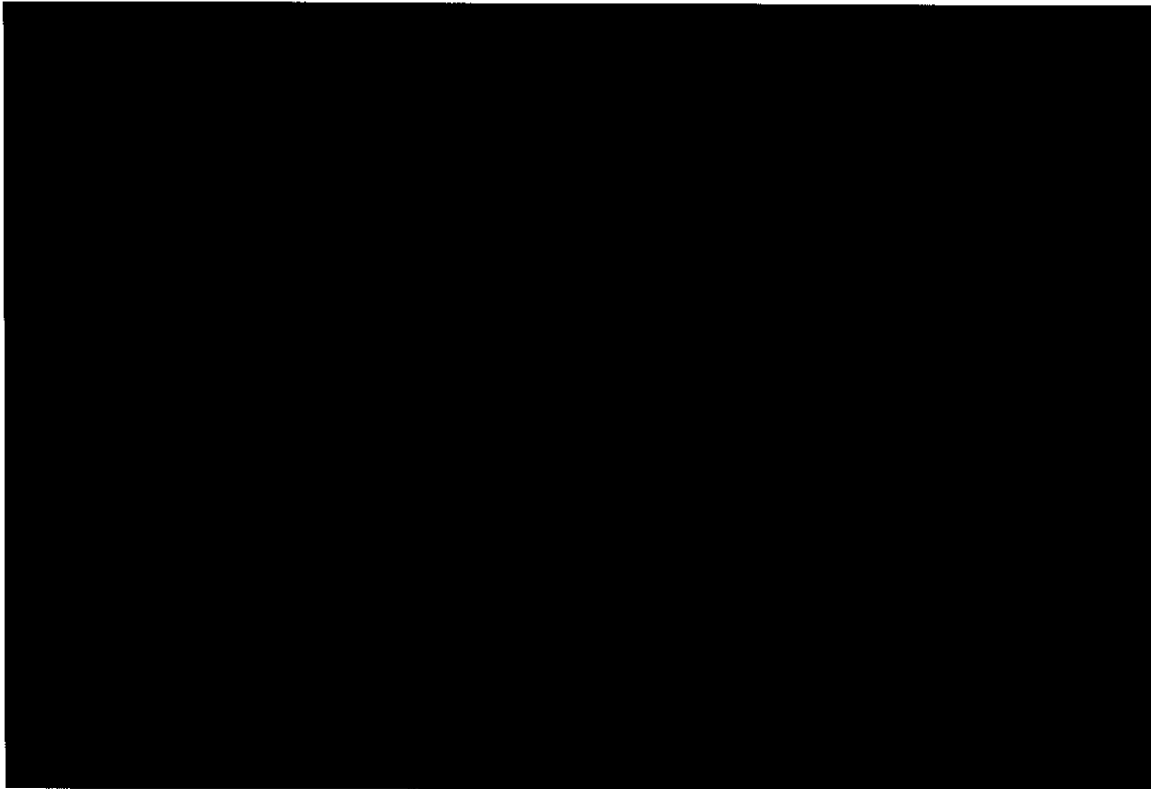
3  
4 END REDACTED\*\* The graph shows that revenues from intrastate toll have  
5 \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXXXXXXXXXX  
6 XXXXXXXXXXXXXXXX| END REDACTED\*\*

7 The Miscellaneous category includes services such as Account #s 5230-Directory  
8 Revenue, 5240-Rent Revenue (this includes unbundled/rebundled interconnection/  
9 UNE revenues as well as Rent Compensation), 5250-Corporate Operations Revenue,  
10 5260-Miscellaneous Revenue, 5261-Special Billing Arrangements Revenue-, 5262-  
11 Customer Operations Revenue, 5263-Plant Operations Revenue, 5264-Other  
12 Incidental Regulated Revenue, 5270-Carrier Billing and Collection Revenue Non-  
13 Regulated Revenue. Between 1998 and 2004, revenues from the Miscellaneous

1 category \*\*BEGIN REDACTED  
2 XX. END REDACTED\*\*  
3 Since 2004, Miscellaneous revenues have \*\*BEGIN REDACTED  
4 XX END REDACTED

5 **Q. PLEASE REVIEW THE CHANGE IN LOCAL SERVICE REVENUES.**

6 A. The following graph shows annual revenues generated by the three categories of  
7 local service from 1998 to 2006. \*\*BEGIN REDACTED



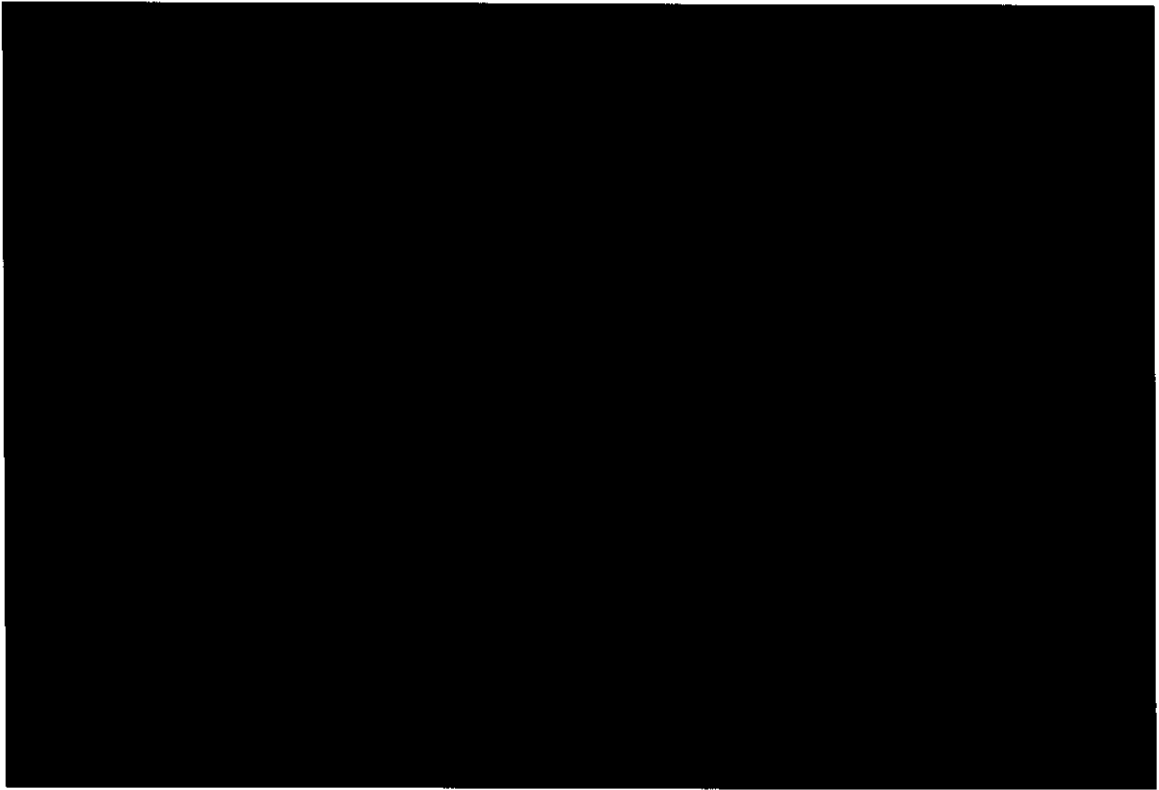
8  
9 END REDACTED\*\* The category of Local – Other includes services such as  
10 Resale. The graph shows this category contributes a relatively small amount to  
11 Qwest’s revenues. Between 2004 and 2006, Local – Other revenues \*\*BEGIN  
12 REDACTED XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. END REDACTED\*\*

1 Local – Business is comprised primarily of recurring service, non-recurring charges,  
2 local private line, central office features and directory assistance. The graph shows  
3 that Local – Business revenues \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXX  
4 XXXXXXXXXXXXXXXX. END REDACTED\*\* Since then they have declined \*\*BEGIN  
5 REDACTED XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. END REDACTED\*\*

6 Local – Residential is comprised primarily of recurring service, non-recurring  
7 charges, local private line, central office features and directory assistance. Local –  
8 Residential revenues \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXXXXXX  
9 END REDACTED\*\* Since then they have declined \*\*BEGIN REDACTED  
10 XXXXXXXXXXXXXXXXXXXXXXXXXXXXXXXX. END REDACTED\*\*

11 **Q. PLEASE SUMMARIZE QWEST’S INTRASTATE REVENUES.**

12 A. The following graph shows total annual intrastate revenues generated by all six  
13 categories from 1998 to 2006. \*\*BEGIN REDACTED



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END REDACTED\*\* This chart reflects an overall \*\*BEGIN REDACTED  
XXXXXXXXXX END REDACTED\*\* intrastate revenues between 2000 and 2006.  
Washington intrastate revenue \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXXXXXX  
END REDACTED\*\* in 2000. In 2006 I estimate they will be very close to \*\*BEGIN  
REDACTED XX. END  
REDACTED\*\*

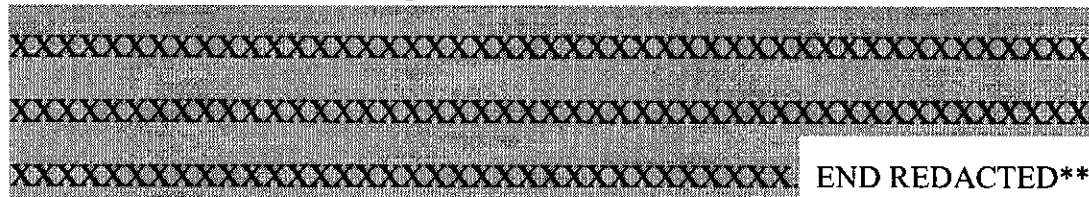
**Q. IN THE PAST YEAR, HOW DID QWEST'S INTRASTATE REVENUES  
CHANGE?**

A. Between 2005 and 2006, Qwest's intrastate Washington revenues \*\*BEGIN  
REDACTED XXXXXXXXXXXXXXXXXXXXXXXX. END REDACTED. The following  
graph shows the change in the six categories of revenue between 2005 and 2006.  
\*\*BEGIN REDACTED



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END REDACTED \*\* This graph shows that in 2006, the \*\*BEGIN REDACTED

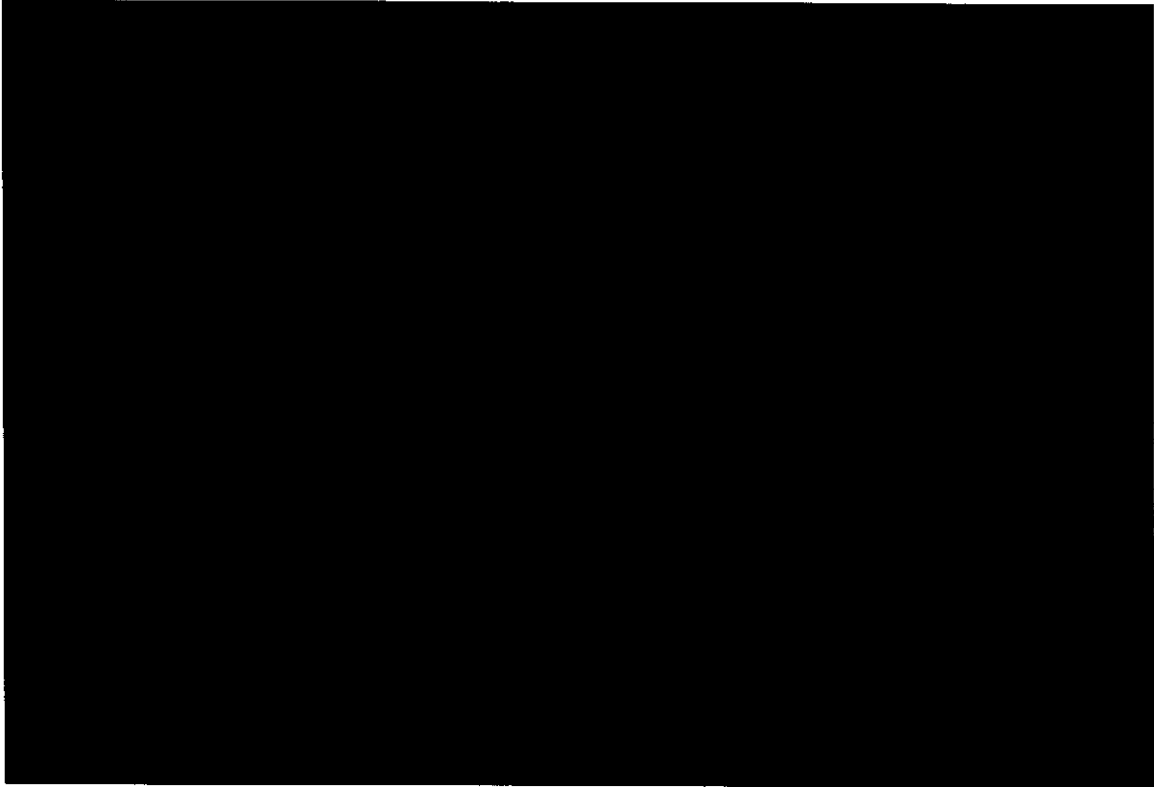


Revenue losses in \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXX END  
REDACTED\*\* of the total Washington intrastate revenue loss in 2006.

**Q. WHAT EXPLAINS THE REVENUE LOSSES OCCURING IN THE LOCAL – RESIDENTIAL REVENUE CATEGORY?**

A. Local – Residential revenue losses are very closely correlated with residential access line losses. The following graph shows annual average residential access lines in service and annual Local – Residential revenues. \*\*BEGIN REDACTED





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END REDACTED\*\* A linear regression analysis of the data on this graph for the period 2000 through 2005 shows that residential access lines and Local – Residential revenues are very closely correlated.

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4

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**Q. WHAT IS A LINEAR REGRESSION ANALYSIS?**

6

A. A linear regression analysis is a statistical analysis that indicates whether an independent variable (in this case residential access lines) explains a change in a dependent variable (in this case residential revenues). A linear regression analysis yields a coefficient of determination (R-squared) for the independent variable using the dependent variable. The R-squared indicates the extent to which the independent variable has a statistically meaningful relationship to (i.e. explains) the dependent variable.

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1 The linear regression analysis of Local – Residential revenue yields an R-squared of  
2 .985 for average annual residential access lines in service. This R-Squared indicates  
3 that 98.5% of the variation in recorded Local – Residential revenues is explained by  
4 changes in the annual average count of residential access lines.

5 The linear regression analysis also includes a component call the T-score. The T-  
6 score identifies the probability that the independent variable (residential access lines)  
7 is incorrectly identified as statistically correlated with the dependent variable  
8 (Residential – Local revenues). A T-score of 1.96 or greater indicates there is less  
9 than a 5% probability that the independent variable studied has been falsely identified  
10 as correlated with the dependent variable. In the case of Local - Residential revenues  
11 and average annual residential access lines, the T score is 16.27, which indicates the  
12 probability of a false correlation is very low.

13 In other words, between 2001 and 2006, 98.5% of the decrease in Local – Residential  
14 revenues is explained by the decline in average annual residential access lines. The  
15 chance that this correlation is statistically spurious is very low. The conclusion is that  
16 residential access line losses explain the **\*\*BEGIN REDACTED XXXXXXXXXXXXX**  
17 **END REDACTED\*\*** of Qwest’s Local – Residential revenues since 2001.

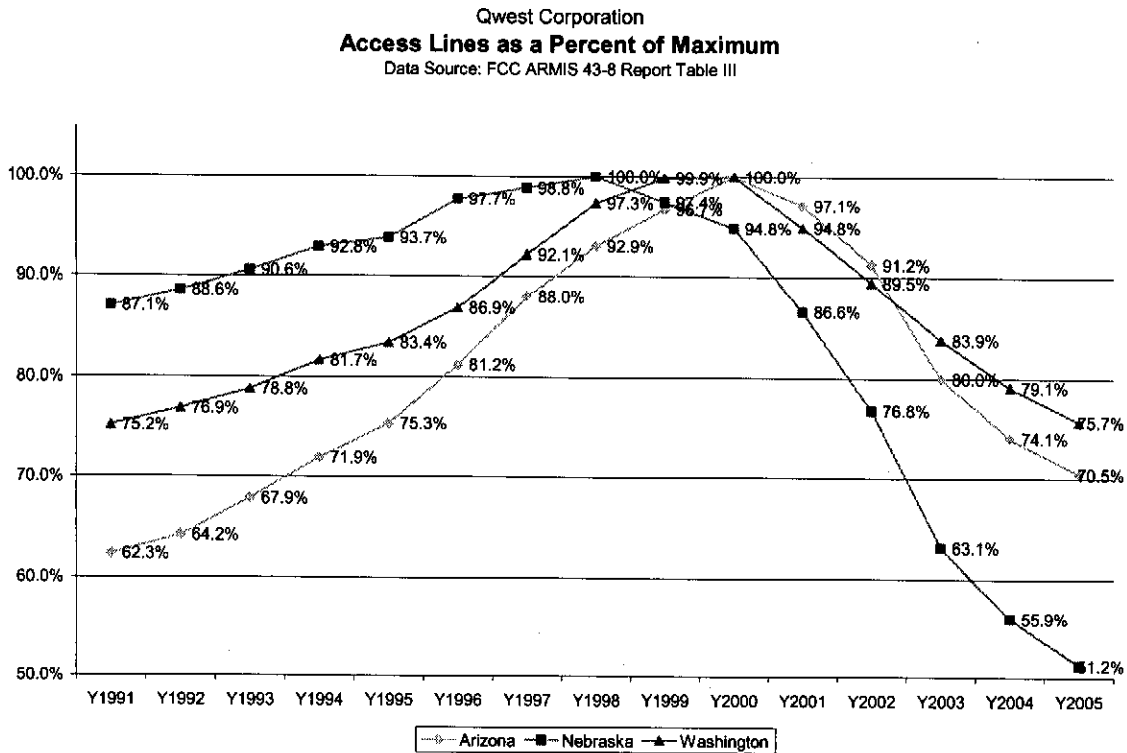
18 **Q. WHAT EXPLAINS THE REVENUE LOSSES OCCURING IN THE LOCAL –**  
19 **BUSINESS CATEGORY?**

20 A. As is the case for Local – Residential, Local – Business revenue loss is closely  
21 correlated with access line losses. The following graph shows annual average  
22 business access lines in service and annual Local – Business revenues. **\*\*BEGIN**  
23 **REDACTED**



1 **Q. WHAT HAS BEEN QWEST'S ACCESS LINE LOSS EXPERIENCE IN**  
 2 **STATES WHERE CABLE TELEVISION COMPANIES ENTERED THE**  
 3 **TELEPHONY MARKET EARLIER THAN THEY HAVE IN WASHINGTON?**

4 **A.** In other Qwest states—Arizona and Nebraska to be specific—where cable television  
 5 companies began offering telephone service earlier than they have in Washington,  
 6 Qwest's access line losses have been significantly more severe than in Washington.  
 7 Following is a graph that charts the growth and decline in access line counts in the  
 8 three states expressed as percentages:



9

10 The graph shows how much more quickly access lines have decreased in states where  
 11 cable television companies entered the telephony market earlier than they have in  
 12 Washington. I know no reason why access line losses in Washington should not

1 follow a pattern similar to the pattern Qwest has experienced in Arizona and  
2 Nebraska.

3 **IV. REBUTTAL OF PAULA M. STRAIN**

4 **Q. WHAT IS YOUR GENERAL RESPONSE TO MS. STRAIN'S TESTIMONY?**

5 A. Although there are portions of Ms. Strain's testimony with which I disagree, in  
6 general, the differences between Ms. Strain and me are generally not terribly  
7 significant. My discussion of Ms. Strain's testimony includes five topics:

- 8 • Regulatory accounting;  
9 • Financial reporting;  
10 • Commission basis adjustments;  
11 • Transition review filing requirements;  
12 • Qwest earnings.

13 A. **Financial Reporting**

14 **Q. WHAT DOES MS. STRAIN CONCLUDE REGARDING FINANCIAL  
15 REPORTING TO THE COMMISSION?**

16 A. With regard to financial reporting to the Commission, Ms. Strain concludes:

- 17 • Qwest should be allowed to discontinue filing the quarterly financial  
18 reports required by WAC 480-120-385(2);  
19 • During the AFOR term, Qwest should be allowed to file its annual reports  
20 as proposed, with a results of operations report that includes regulatory  
21 adjustments for Dex, sharing, rural sales, and the transition from JR to MR  
22 books;<sup>4</sup>

23 **Q. WHAT IS YOUR REACTION TO MS. STRAIN'S CONCLUSIONS?**

24 A. I agree with Ms. Strain. Consequently, I propose that the AFOR include the  
25 following language under "Exceptions":

26 Notwithstanding #1 above (Provisions), which would allow Qwest to file an  
27 annual report in accordance with WAC 480-120-382, Qwest shall continue to file  
28 an annual report in accordance with WAC 480-120-385(1). In addition, Qwest

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<sup>4</sup> Testimony of Paula M. Strain, page 4, line 13.

1 shall file an annual report of Washington intrastate regulated results of operations.  
2 The report shall be based on Qwest's MR Books and shall include the following  
3 adjustments:

- 4 • a directory revenue credit in the amount specified by the settlement  
5 agreement the Commission approved in the Dex case;<sup>5</sup>
- 6 • a credit to its depreciation reserve required for prior sale of rural  
7 exchanges;<sup>6</sup>
- 8 • a credit to its depreciation reserve for sharing under a prior AFOR;<sup>7</sup> and
- 9 • a standing adjustment reflecting the difference in rate base between its MR  
10 Books and its Washington Jurisdictional Books of Account (JR Books) on  
11 the date of transition from JR books to MR Books.

12 **B. Regulatory Accounting**

13 **Q. WHAT DOES MS. STRAIN CONCLUDE REGARDING REGULATORY**  
14 **ACCOUNTING IN WASHINGTON?**

15 **A.** With regard to regulatory accounting, Ms. Strain concludes:

16 Qwest should be permitted to maintain its accounting records using FCC Part  
17 32 accounting rules during the transition period. However, Qwest's proposal  
18 to use whatever version of the FCC rules is in effect at the time raises the issue  
19 of whether the Commission would be delegating its authority over accounting  
20 records to the FCC. The safer course is to have the effective date of the FCC  
21 Part 32 rules be a fixed date, rather than whatever version of the FCC rules is  
22 in effect at any one time during the transition period.

23 My viewpoint is slightly different than Ms. Strain's testimony. I believe Qwest  
24 should be permitted to use the same accounting methods for Washington regulatory  
25 accounting and reporting purposes as it uses for FCC accounting and reporting  
26 purposes. In general, this basis is the "MR" basis of accounting which is based on  
27 FCC Part 32 rules.<sup>8</sup> Allowing Qwest to keep one set of books on the MR basis of  
28 accounting in Washington instead of two sets of books will reduce the burden of

<sup>5</sup> 2<sup>nd</sup> Supplemental Order in WUTC Docket No. UT-021120.

<sup>6</sup> 3<sup>rd</sup> Supplemental Order in WUTC Docket No. 940701, June 8, 1995

<sup>7</sup> 5<sup>th</sup>, 16<sup>th</sup>, 21<sup>st</sup>, 22<sup>nd</sup> and 23<sup>rd</sup> Supplemental Orders in WUTC Docket No. U-89-3245-P.

<sup>8</sup> I say that MR accounting is based on Part 32 rules "in general" because Qwest has a petition before the FCC for a waiver of several Part 32 rules regarding depreciation. In the waiver petition, Qwest commits to four conditions outlined in an FCC depreciation order, FCC 99-397, Report and Order released December 30, 1999 in CC Docket 98-137. One of the four conditions is that Qwest use the same accounting for depreciation on its MR books that it uses for its financial reporting in statements filed with the SEC.

1 regulation on Qwest in Washington. Qwest has already adopted the MR basis of  
2 accounting in several states and aims to adopt it in all states as soon as possible.  
3 Other states, such as California, have recently concluded that it is appropriate to allow  
4 local carriers to use MR accounting.

5 Concerning accounting standards, there is no reason to continue to require a  
6 set of regulatory accounts with California jurisdictional adjustments. Since the  
7 regulatory adjustments no longer serve a ratemaking purpose, the only result  
8 of the requirement is to create a confusing proliferation of regulatory accounts  
9 that make utility operations less transparent. For these reasons, therefore, we  
10 adopt the FCC standard accounting practices for California carriers. We  
11 clarify that this modification of our accounting practices extends to our  
12 affiliate-transaction rules. We hereby end all California-specific affiliate  
13 transaction rules that apply to carriers, and instead we elect to rely on FCC  
14 rules.<sup>9</sup>

15 However I appreciate Ms. Strain's concern that the Commission not completely  
16 surrender all oversight of accounting methods. The Commission's accounting rule for  
17 competitively classified companies<sup>10</sup> requires a carrier to use accounting methods in  
18 conformance with Generally Accepted Accounting Principles (GAAP) or another  
19 accounting method acceptable to the Commission. In order to address Ms. Strain's  
20 concern, and preserve the Commission's oversight of accounting methods, I  
21 recommend that Qwest's AFOR include language as follows under "Exceptions":

22 Qwest will keep its books of accounts in accordance with WAC 480-120-355.  
23 The accounting method that Qwest commits to use is the same accounting  
24 method (the MR basis of accounting) that it uses to maintain its books for  
25 FCC accounting and reporting purposes (its MR books). When, in accordance  
26 with 47 CFR 32.16, Qwest informs the FCC of its intention to follow a new  
27 accounting standard Qwest shall also file notice of intent with the  
28 Commission. Qwest will provide available information concerning the new

<sup>9</sup> Section XIV. Monitoring, Auditing, and Reporting Requirements, Opinion of the Public Utilities Commission of the State of California, Decision 06-08-030 August 24, 2006 Order Instituting Rulemaking on the Commission's Own Motion to Assess and Revise the Regulation of Telecommunications Utilities, Rulemaking 05-04-005 Filed April 7, 2005 (emphasis added)

<sup>10</sup> Competitively classified companies must keep accounts using generally accepted accounting principles (GAAP), or any other accounting method acceptable to the commission. In addition, the accounts must allow for identification of revenues for Washington intrastate operations subject to commission jurisdiction. WAC 480-120-355, Competitively classified companies.

1 accounting standard as requested by Staff. If the FCC does not accept the new  
2 accounting standard, it shall be deemed unacceptable to the Commission. If  
3 the FCC accepts the new accounting standard then it shall be deemed  
4 acceptable to the Commission unless Staff opens a docket to investigate  
5 adoption of the new accounting standard within 30 days of its acceptance by  
6 the FCC or 120 days of Qwest's filing of its notice of intent, whichever is  
7 later. If the FCC changes accounting methods used in 47 CFR Part 32, Staff  
8 may open a docket to investigate the changes to determine whether such  
9 methods are acceptable to the Commission.

10 **C. Commission Basis Adjustments**

11 **Q. WHAT DOES MS. STRAIN CONCLUDE WITH REGARD TO**  
12 **COMMISSION BASIS ADJUSTMENTS?**

13 A. Ms. Strain's testimony proposes that Qwest be required to maintain the ability to  
14 produce updated amounts for its "regulatory adjustments," if requested."<sup>11</sup> A few  
15 pages later, Ms. Strain states that Staff recommends the Commission make it a  
16 requirement that Qwest maintain the ability to update any of the "JR adjustments".

17 **Q. WHAT IS YOUR REACTION TO THIS TESTIMONY?**

18 A. I confess that I experienced some initial consternation over this testimony. I thought  
19 that Ms. Strain's reference to the ability to update any "JR adjustments" meant that  
20 Qwest would need to continue to maintain its Washington jurisdictional books so  
21 that it would be able to provide results of operations on the JR basis of accounting  
22 instead of the MR basis of accounting. Requiring Qwest to maintain the capability  
23 of producing JR basis results would have defeated the purpose of using the MR  
24 basis, which is to have one set of regulatory books in Washington.

25 However, I now understand that what Ms. Strain referred to as "JR adjustments" is  
26 what Qwest calls "Commission Basis" adjustments. A review of Ms. Strain's

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<sup>11</sup> At page 4, line 19,



1 Exhibit PMS-5 reveals that Ms. Strain does not mean for Qwest to continue to  
2 maintain the capability of producing JR basis results of operations after the JR to  
3 MR basis transition. However, Ms. Strain does expect Qwest to maintain the ability  
4 to produce Commission Basis results of operations. Qwest is willing to do this.

5 In addition to the four Commission Basis adjustments that Qwest will include in its  
6 an annual report of Washington intrastate regulated results of operations (discussed  
7 above), Qwest is agreeable to maintaining the ability to calculate the five additional  
8 Commission Basis adjustments which it included in its 2006 quarterly reports to the  
9 Commission: Pension Asset; Post-Retirement Benefits; Disallowed Plant; Interest  
10 Synchronization and End Of Period Deferred Income Tax. Accordingly, I  
11 recommend that the AFOR include the following language under "Exceptions":

12 Also, in addition to the four adjustments listed above, Qwest shall maintain the  
13 capability of calculating the following Commission Basis Adjustments that it  
14 included in its quarterly financial reports to the Commission for 2006:

- 15
- 16 • Pension Asset
- 17 • Post-Retirement Benefits
- 18 • Disallowed Plant
- 19 • Interest Synchronizations
- 20 • End-of-Period Deferred Income Tax

21 **D. Transition Review Filing Requirements**

22 **Q. WHAT DOES MS. STRAIN CONCLUDE WITH REGARD TO THE END-OF-**  
23 **AFOR REVIEW CALLED FOR IN THE "PROVISIONS" PORTION OF**  
24 **QWEST'S AFOR PROPOSAL?**

25 **A.** Ms. Strain's testimony states:

26 Qwest should be required to file comprehensive information on its financial  
27 condition for the transition review contemplated in the AFOR. In that filing,  
28 Qwest must include its current regulatory adjustments in the analysis. In that  
29 filing, Qwest must include its current regulatory adjustments in the analysis,

1 and current versions of those developed by Staff in this case, as well as any  
2 other adjustments needed to account for changes in law or policy during the  
3 transition period.<sup>12</sup>

4 **Q. WHAT IS YOUR REACTION TO THIS TESTIMONY?**

5 A. Although I agree that it makes sense for Qwest to file information on its financial  
6 condition six months before the four year anniversary of the AFOR, I have three  
7 concerns with Ms. Strain's position. First, I believe that if a dozen accountants were  
8 asked what constitutes "comprehensive financial information," a dozen different  
9 answers would be given. Consequently, I believe it is important to agree on what  
10 information Qwest will be expected to provide so that no expectations are  
11 disappointed.

12 Second, and more importantly, I believe it is improper for Qwest to be required to  
13 include adjustments that have not been fully litigated before the Commission and  
14 that the Commission has not required by order. In my opinion, the adjustments that  
15 Ms. Strain has proposed are improper. Even if the adjustments unrelated to  
16 Separations were proper now, they will not necessarily be proper four years hence.  
17 Requiring Qwest to include such adjustments would be prejudicial. It would pre  
18 judge whether or not such adjustments are correct, before the Commission has heard  
19 all of the evidence concerning them. Consequently, I recommend that the  
20 Commission reject Ms. Strains' proposal that Qwest "include its current regulatory  
21 adjustments in the analysis, and current versions of those developed by Staff in this  
22 case...." Not compelling Qwest to include them will not prevent Staff from  
23 proposing them if Staff still believes they are appropriate in four years.

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<sup>12</sup> Testimony of Paula M. Strain, page 5, line 4.

1 Third, Ms. Strain proposes that Qwest be required to include “any other adjustments  
2 needed to account for changes in law or policy during the transition period.” This  
3 proposed requirement raises the same concerns as does the requirement to file  
4 “comprehensive” financial information. No two regulatory accountants are likely to  
5 agree on exactly what adjustments are “needed” to account for changes in law or  
6 policy. For an illustration of this point one need look no further than this case, in  
7 which Ms. Strain, Dr. Loube and I have all have substantially different views on what  
8 adjustment is needed to address changes in the FCC’s Jurisdictional Separations rules  
9 since Qwest’s last rate case. A requirement to include “needed” adjustments for law  
10 and policy changes does not lend itself to sufficient definition to be workable. I  
11 recommend it not be adopted. Again, by not requiring Qwest to make such  
12 adjustments, the Commission is not precluding Staff or Public Counsel from  
13 proposing them.

14 **Q. DO YOU HAVE A PROPOSAL REGARDING THE INFORMATION THAT**  
15 **QWEST WOULD PROVIDE FOR THE TRANSITION REVIEW?**

16 A. Yes. I recommend that instead of requiring Qwest to provide “comprehensive  
17 financial information” the AFOR specify the information that Qwest be required to  
18 file. Accordingly, I recommend the “Provisions” portion of Qwest’s AFOR include  
19 the following language:

20 No less than six months prior to the 4-year anniversary of the AFOR, Qwest  
21 will file information on its financial condition as set forth in Exhibit 1 to this  
22 AFOR agreement.

23 The information that I propose be included in Exhibit 1 to the AFOR is set forth in  
24 my Exhibit PEG-4R.

1 **Q. PLEASE DESCRIBE GENERALLY WHAT IS INCLUDED IN EXHIBIT**  
2 **PEG-4R.**

3 A. The exhibit describes the specific financial information Qwest will agree to file with  
4 the Commission six months prior to the fourth annual anniversary of the AFOR.  
5 Specifically, Qwest will file Annual Results of Operations reports for all calendar  
6 years of the AFOR that are available. Additionally, the Washington Annual Results  
7 of Operations report for the most recent calendar year will include the five  
8 Commission adjustments—Pension Asset, Post-Retirement Benefits, Disallowed  
9 Plant, Interest Synchronization and EOP Deferred Income Tax—that I discussed  
10 earlier. Lastly, the exhibit includes a recognition of the Commission’s authority to  
11 request additional, pertinent information throughout the course of the AFOR in order  
12 that Staff might assess the company’s financial performance from future “changes in  
13 accounting requirements, law or policy”<sup>13</sup> that could occur during the course of the  
14 AFOR.

15 **Q. PLEASE EXPLAIN WHY YOU ARE PROPOSING THAT QWEST PROVIDE**  
16 **THE INFORMATION SET FORTH IN PEG-4R.**

17 A. With each calendar year’s Annual Results of Operations report Staff and the  
18 Company will have common ground upon which to make their independent  
19 assessments of Qwest’s financial performance experienced throughout the course of  
20 the AFOR. An adjusted Annual Results of Operations report for the most recent  
21 calendar year’s report will permit a more direct comparison of Qwest’s financial  
22 performance at that time with the Annual Results of Operations report for the year  
23 prior to the AFOR (which includes these same adjustments). Including the  
24 additional adjustments will permit a more direct “apples to apples” comparison of

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<sup>13</sup> Testimony of Paula M. Strain, page 16, line 13.

1 Qwest's financial performance before the start of the AFOR and after it is well  
2 underway.

3 **Q. DOES THE INFORMATION THAT QWEST IS AGREEING TO PROVIDE**  
4 **INCLUDE A CALCULATION OF THE FOUR ADJUSTMENTS TO**  
5 **QWEST'S 2005 RESULTS OF OPERATIONS THAT MS. STRAIN**  
6 **PROPOSES?**

7 A. No. As I explain in the next section of my testimony concerning Qwest earnings,  
8 Qwest and Staff disagree on the appropriateness of these adjustments and on the  
9 propriety of including them in an examination of Qwest's financial performance.  
10 However, once Qwest files its financial information with the Commission nothing in  
11 the AFOR would prevent Staff from proposing whatever adjustments they deem  
12 appropriate at the time.

13 **Q. DOES THIS INFORMATION INCLUDE "ANY OTHER ADJUSTMENTS**  
14 **NEEDED TO ACCOUNT FOR CHANGES IN LAW OR POLICY DURING**  
15 **THE TRANSITION PERIOD"?**

16 A. No. In my opinion, Qwest should not commit to modifying its results of operations  
17 with adjustments for unknown future changes. Neither Qwest nor Staff can  
18 anticipate what such changes might be, what data might be or what data and  
19 algorithms ought to be used to an adjustment. However, the last provision in PEG-  
20 4R recognizes that Commission can request additional information so that Staff can  
21 determine for itself what adjustment, if any, to make.

1 Q. IS THE INFORMATION THAT YOU PROPOSE QWEST PROVIDE FAIRLY  
2 DESCRIBED AS “COMPREHENSIVE FINANCIAL INFORMATION?”

3 A. Yes. I believe that for purposes of reviewing Qwest’s financial performance under  
4 the AFOR, the information is sufficiently comprehensive.

5  
6 Q. WHAT DOES MS. STRAIN CONCLUDE WITH REGARD TO QWEST’S  
7 EARNINGS IN 2005?

8 A. Ms. Strain concludes:

9 Based on Staff’s analysis, Qwest is earning a \*\*BEGIN REDACTED XXXX  
10 END REDACTED\*\* percent rate of return on its intrastate rate base. This is  
11 \*\*BEGIN REDACTED XXXXXX END REDACTED\*\* its authorized rate  
12 of return of 9.367 percent.<sup>14</sup>

13 I agree that Qwest is earning a rate of return that is \*\*BEGIN REDACTED  
14 XXXXXX END REDACTED\*\* the 9.367 percent rate of return the Commission  
15 used to determine Qwest’s revenue requirement in Qwest’s last rate case.<sup>15</sup> However,  
16 I do not agree that it is \*\*BEGIN REDACTED XXXXXXXXXXXXXXXXXXXXXXX  
17 END REDACTED\*\* percent rate of return that Ms. Strain computes. Because both  
18 Ms. Strain and I only disagree about \*\*BEGIN REDACTED XXXXXXXX END  
19 REDACTED\*\* Qwest’s rate of return \*\*BEGIN REDACTED XXXXXXXXXXXXXXX  
20 XXXXXXXXXXXXXXX—END REDACTED\*\* and not on whether \*\*BEGIN  
21 REDACTED XXXXXXXXXXXXXXXXXXXXXXX, END REDACTED\*\* I do not  
22 consider this disagreement to be important to Qwest’s AFOR petition for two reasons.

<sup>14</sup> Testimony of Paula M. Strain, page 3, line 11.

<sup>15</sup> Docket No. UT-970766, Tenth Supplemental Order, January 15, 1998. Finding of Fact paragraph 11. See also derivation of Revenue Requirement on page 22.

1 First, Ms. Strain concludes that even with her proposed adjustments, Qwest's return  
2 on rate base is **\*\*BEGIN REDACTED XXXXXXXX END REDACTED\*\*** percent.<sup>16</sup>  
3 This figure is **\*\*BEGIN REDACTED XXXXXX END CONFIDENTIAL\*\*** the  
4 9.367 percent rate of return the Commission used to determine Qwest's revenue  
5 requirement in Qwest's last rate case.<sup>17</sup> If the Commission determines that it must  
6 find Qwest's return on rate base to be below 9.367 percent, Ms. Strain's conclusion  
7 will support that finding even with the four adjustments she proposes.

8 Second, the Commission may determine that it need not make a finding with regard to  
9 Qwest's return on rate base in order to approve Qwest's AFOR proposal. Instead, the  
10 Commission may choose to rely on other criteria to determine whether Qwest's rates  
11 are fair, just and reasonable such as an assessment of competition in the telephony  
12 market that Qwest serves in Washington. If that is the case, then Ms. Strain's  
13 testimony will be moot.

14 **Q. ARE YOU OFFERING A DETAILED RESPONSE TO MS. STRAIN'S**  
15 **PROPOSED ADJUSTMENTS IN THE BODY OF YOUR REBUTTAL?**

16 A. No. Rather than burden the main body of my rebuttal with testimony that may well  
17 be unnecessary or irrelevant, I have made my detailed response to Ms. Strain's  
18 proposed adjustments in Exhibit PEG-2R to my testimony. The Commission can  
19 review this testimony if and as necessary.

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<sup>16</sup> Direct Testimony of Robert Loube, Ph.D., page 64, line 20 through line 21.

<sup>17</sup> Docket No. UT-970766, Tenth Supplemental Order, January 15, 1998. Finding of Fact paragraph 11.  
See also derivation of Revenue Requirement on page 22.

1 **Q. WITH THE CHANGES YOU PROPOSE TO THE ADJUSTMENTS MS.**  
2 **STRAIN PROPOSES, WHAT RATE OF RETURN DOES QWEST ACHIEVE**  
3 **IN 2005?**

4 A. With the changes I propose in Exhibit PEG-2R to Ms. Strain's proposed  
5 adjustments, Qwest's Commission Basis intrastate return on rate base in 2005 is  
6 **\*\*BEGIN REDACTED XXXXX. END REDACTED \*\***

7 **V. REBUTTAL OF ROBERT LOUBE, PHD**

8 A. **Reporting Requirements Proposal**

9 **Q. WHAT RELIEF FROM CURRENT REGULATORY REPORTING BURDENS**  
10 **DOES DR. LOUBE BELIEVE QWEST SHOULD BE GIVEN UNDER AN**  
11 **AFOR?**

12 A. None. At various points in his testimony Dr. Loube states:

13 No matter which alternative the Commission decides to follow, it is necessary  
14 to continue to require Qwest to maintain and file all of its current reports so  
15 that the Commission would have the information required to make its future  
16 decision.<sup>18</sup>

17 \* \* \*

18 Qwest should continue to file reports associated with Qwest's financial and  
19 public safety activities.<sup>19</sup>

20 **Q. DO YOU AGREE WITH DR. LOUBE?**

21 A. No. As I explained in my rebuttal of Ms. Strain, I agree with her position on this  
22 question.

<sup>18</sup> Direct Testimony of Robert Loube, Ph.D., page 7, line 14. (emphasis added)

<sup>19</sup> Direct Testimony of Robert Loube, Ph.D., page 11, line 1.



1 **Q. DOES DR. LOUBE OFFER A REVIEW OR ANALYSIS OF THE REPORTS**  
2 **QWEST CURRENTLY FILES IN WASHINGTON?**

3 No. Unlike Ms. Strain—who offers a detailed review of the reports Qwest files in  
4 Washington, and a recommendation with regard to each and every one—Dr. Loube  
5 offers no analysis of the individual reports and no reason why the reporting  
6 requirements that Ms. Strain recommends be waived are necessary during the AFOR.  
7 Specifically, Dr. Loube offers no reason why reporting under the following statutes  
8 and rules is necessary under an AFOR.

- 9 • WAC 480-120-365 Issuing securities
- 10 • WAC 480-120-389 Securities report.
- 11 • WAC 480-143-190 Annual filing of property transferred without  
12 authorization.
- 13 • RCW 80.16.020 Dealings with affiliated interests — Prior filing with  
14 commission required — Commission may disapprove.
- 15 • WAC 480-120-375 Affiliated interests — Contracts or arrangements.
- 16 • Section 4 of WAC 480-120-395 Affiliated interest and subsidiary transactions  
17 report.
- 18 • WAC 480-120-359 Companies not classified as competitive.
- 19 • Section 2 of WAC 480-120-385 Annual report and quarterly results of  
20 operations reports for companies not classified as competitive.

21 Ms. Strain recommends that these requirements be waived.

22 **Q. DOES DR. LOUBE EXPLAIN WHY THE COMMISSION NEEDS**  
23 **QUARTERLY RESULTS OF OPERATIONS REPORTS THAT PROVIDE**  
24 **MONTHLY AND TWELVE-MONTHS-ENDED COMMISSION BASIS DATA**  
25 **FOR EACH MONTH OF THE QUARTER REPORTED?**

26 A. No. Dr. Loube offers nothing except a blanket assertion that Qwest must continue to  
27 file the same earnings reports it files now because these reports are necessary to  
28 detect over-earnings and confiscation.

29 The Commission must continue to require Qwest to report its earnings on a  
30 regular and uniform basis because those filings allow the Commission to  
31 determine if Qwest is either over-earning or if Qwest earnings have sunk so  
32 that the current rates could be considered confiscatory. The Commission

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1 needs these reports because over-earnings are a clear indication that Qwest is  
2 not subject to competition in many of its markets. On the other hand achieving  
3 significant under-earnings would indicate that the Commission may have to  
4 change the regulatory environment in short order.<sup>20</sup>

5 **Q. DOES QWEST FILE COMMISSON BASIS RESULTS OF OPERATONS**  
6 **MORE FREQUENTLY THAN ANNUALLY IN ANY OTHER STATE?**

7 A. No. In every other state besides Washington Qwest files Commission Basis results  
8 of operations reports no more frequently than annually. In most states Qwest files no  
9 Commission Basis reports at all.

10 **B. Proposal to Apply Discounts Elsewhere than in Washington**

11 **Q. DR. LOUBE PROPOSES THAT REVENUE ASSOCIATED WITH QWEST'S**  
12 **PACKAGES THAT INCLUDE INTERSTATE OR NON-REGULATED**  
13 **SERVICES SHOULD BE ALLOCATED SUCH THAT THE DISCOUNT**  
14 **ASSOCIATED WITH THE PACKAGE IS ALLOCATED TO THE**  
15 **INTERSTATE JURISDICTION OR THE NON-REGULATED SECTOR.**  
16 **HOW DO YOU RESPOND?**

17 A. I do not believe it is necessary for the Commission to address the application of  
18 discounts in this AFOR docket. In general, the allocation of revenues and discounts  
19 is determined by tariff. I have not reviewed Qwest's tariffs in Washington.  
20 However, it my understanding and belief that under tariff, discounts are applied first  
21 to non-regulated services. If the amount of the discount exceeds the revenues from  
22 non-regulated services, then it is applied to services other than basic service.

23 In the case of promotions, I am advised the application of the discount is specified in  
24 the promotional tariffs. In the case of mass market bundles, the discount is not

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<sup>20</sup> Direct Testimony of Robert Loube, Ph.D., page 15, line 3.

1 applied to Qwest services. Instead, it is applied to services provided by other  
2 companies. Because the application of discounts is a subject that has already been  
3 addressed in Washington (and Qwest's other states) the subject need not be addressed  
4 in Qwest's AFOR. Qwest's AFOR proposal does not include language that would  
5 disturb the current application of discounts.

6 Moreover, under Qwest's AFOR proposal, the application of discounts is irrelevant  
7 because the Company is not regulated based on cost-of-service regulation. When  
8 the establishment of rates and is no longer linked to the recognition of costs, the  
9 assignment of discounts is meaningless. I should also point out that under Generally  
10 Accepted Accounting Principles, discounts are spread pro-rata to all items included  
11 in the discounted offering based on their market value.

12  
13 **C. Allegation of an Insufficient Record**

14 **Q. DR. LOUBE ASSERTS THERE IS NO BASIS IN THE RECORD FOR THE**  
15 **COMMISSION TO ADOPT AN AFOR WHICH ALLOWS QWEST TO**  
16 **AUTOMATICALLY INCREASE RATES<sup>21</sup> HOW DO YOU RESPOND?**

17 **A.** Dr. Loube's assertion is inconsistent with the facts. Qwest's reports to the  
18 Commission show that on a Commissions Basis Qwest achieved a \*\*BEGIN  
19 REDACTED XXXXXXXXX END REDACTED \*\* return on rate base in 2005.<sup>22</sup> In  
20 addition, both Ms. Strain and Dr. Loube include computations of Qwest's current  
21 return on rate base that show that Qwest is currently earning less than the 9.367  
22 percent rate of return the Commission used to determine Qwest's revenue

<sup>21</sup> Direct Testimony of Robert Loube, Ph.D., page 66, line 8.

<sup>22</sup> See Direct Testimony of Paula M. Strain, page 13, line 2.

1 requirement in Qwest's last rate case.<sup>23</sup> Ms. Strain concludes that BEGIN  
2 REDACTED\*\*  
3 XXX  
4 XXXXXXXXXXXXXXXXXXXX.<sup>24</sup> END REDACTED\*\*My testimony will show that  
5 both Ms. Strain and Dr. Loube include improper adjustments that cause their  
6 calculations to substantially overstate Qwest's 2005 return on rate base.

7 The intrastate return on rate base is the return on services subject to the Commission's  
8 jurisdiction. Ms. Strain testifies that for the period 1998 to 2005, Qwest's intrastate  
9 return on rate base shows a sharp decline.<sup>25</sup> Neither Ms. Strain nor Dr. Loube asserts  
10 that Qwest's intrastate return on rate base will increase over the next four years. Nor  
11 does any witness suggest that the long decline in Qwest's annual return on intrastate  
12 rate base will not continue.

13 Dr. Loube complains that Qwest failed to file information necessary to conduct a rate  
14 case.<sup>26</sup> Nothing in the *AFOR statute*<sup>27</sup> requires a petitioner to file financial data with an  
15 AFOR petition. Nevertheless, Qwest made its financial information available to Staff  
16 and Public Counsel several months before Qwest filed its petition in October.<sup>28</sup>  
17 Public Counsel had ample opportunity to ascertain whether Qwest's return on rate

<sup>23</sup> Docket No. UT-970766, Tenth Supplemental Order, January 15, 1998. Finding of Fact paragraph 11. See also derivation of Revenue Requirement on page 22.

<sup>24</sup> Direct Testimony of Paula M. Strain, page 16, line 1.

<sup>25</sup> Direct Testimony of Paula M. Strain, Exhibit No. \_\_\_ C (PMS-3C)

<sup>26</sup> Q: Why do you not recommend a full rate case here?

A: I do not have any objection to the Commission conducting a full review of Qwest's rate levels. The practical reality, however, is that Qwest has not provided adequate information in the record for that review to occur. Notwithstanding this failure...

Direct Testimony of Robert Loube, Ph.D., page 65, line 13.

<sup>27</sup> RCW 80.36.135(3) (*AFOR Statute*)

<sup>28</sup> Prior to Qwest's filing its petition, Staff asked a substantial number of informal financial data requests, all of which Qwest answered. Public Counsel asked none.

1 base was problematic and to serve discovery requesting data necessary to investigate  
2 Qwest's earnings in this docket if it chose to take the position that such an  
3 investigation is necessary.

4 **D. Allegation that the Dex Settlement Order Would be Violated**

5 **Q. DR. LOUBE ASSERTS THAT WERE THE COMMISSION TO ALLOW**  
6 **QWEST TO INCREASE BASIC RESIDENTIAL SERVICE RATES BY UP TO**  
7 **50 CENTS PER YEAR IN ANY GIVEN YEAR, THE COMMISSION WOULD**  
8 **VIOLATE THE DEX SETTLEMENT ORDER.<sup>29</sup> DO YOU AGREE?**

9 A. No. As a witness in the Dex docket, I am familiar with the *Dex Settlement Order*<sup>30</sup>  
10 and the *Dex Stipulation*<sup>31</sup> it adopted. I am aware of nothing in either that provides or  
11 suggests that a rate increase of the type contemplated in Qwest's AFOR proposal  
12 would in any way violate any term or provision of those documents.

13 **Q. QUOTING THE PORTION OF THE *DEX STIPULATION* THAT**  
14 **ESTABLISHES THE ANNUAL REVENUE CREDIT, DR. LOUBE CLAIMS**  
15 **THAT UNDER QWEST'S AFOR PROPOSAL THE BENEFIT OF THE**  
16 **REVENUE CREDIT WOULD BE DILUTED OR LOST IF QWEST WERE**  
17 **ALLOWED TO INCREASE ITS BASIC RESIDENTIAL SERVICE RATES.<sup>32</sup>**  
18 **HOW DO YOU RESPOND?**

19 A. Nothing in the *Dex Stipulation* or the *Dex Settlement Order* supports Dr. Loube's  
20 assertion. The *Dex Stipulation* provides that the Annual Revenue Credit "shall be

<sup>29</sup> Direct Testimony of Robert Loube, Ph.D., page 68, line 8.

<sup>30</sup> Tenth Supplemental Order In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate, Docket No. UT-021120 (*Dex Settlement Order*)

<sup>31</sup> Stipulation and Settlement Agreement entered into between Qwest, Dex Holdings, Public Counsel, AARP, WebTEC, and DoD/FEA (*Dex Stipulation*)

<sup>32</sup> Direct Testimony of Robert Loube, Ph.D., page 67, line 13 to page 68, line 8.

1 recognized by the Commission in any proceeding before it where Qwest's earnings  
2 or revenues are under examination during the 15 year period [from 2004 through  
3 2018]."<sup>33</sup> The condition requires that the Commission recognize the Annual  
4 Revenue Credit in Qwest's earnings, no more and no less. Three witnesses—Ms.  
5 Strain, Dr. Loube and I—have presented evidence concerning Qwest's earnings in  
6 their testimonies. All three witnesses include the Annual Revenue Credit in their  
7 presentation.<sup>34</sup> None has proposed that the revenue credit be disregarded.

8 The *Dex Stipulation* also provides that the parties will not

9 ...argue that the annual revenue credit is inapplicable in any current or future  
10 review of Qwest's earnings or revenues, including but not limited to general  
11 rate cases, alternative forms of regulation proceedings, and competitive  
12 classification proceedings."

13 No witness in the docket has made such an argument. In short, Dr. Loube's assertion  
14 that Qwest's AFOR proposal violates the *Dex Stipulation* is baseless.

15 **Q. DR. LOUBE ASSERTS THAT ALLOWING QWEST'S RESIDENTIAL**  
16 **RATES TO INCREASE WOULD, "IN EFFECT, ALLOW QWEST TO**  
17 **DISREGARD THE AGREED REVENUE CREDIT."<sup>35</sup> HOW DO YOU**  
18 **RESPOND?**

19 A. Dr. Loube's assertion is wrong. The Annual Revenue Credit is included in all  
20 witnesses' earnings computations. In order for it to be disregarded the Commission

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<sup>33</sup> *Dex Stipulation*, page 5, lines 7 through 9.

<sup>34</sup> "My calculation that Qwest is currently earning close to its authorized return in Washington likewise incorporates the assumption that the credit is reflected on the books." Direct Testimony of Robert Loube, Ph.D., page 68, line 5. See also Testimony of Paula M. Strain, Exhibit PMS-C4, column d, row 4, and this testimony, page 4, line 16 to page 5, line 8.

<sup>35</sup> Direct Testimony of Robert Loube, Ph.D., page 68, line 10.

1 would have to disregard the testimony of all three witnesses and instead render a  
2 finding of fact regarding Qwest's earnings that excludes the Annual Revenue Credit.

3 **Q. DR. LOUBE ASSERTS THAT WITHOUT A REVIEW OF QWEST'S**  
4 **EARNINGS AND REVENUES, THERE IS NO WAY TO DETERMINE**  
5 **WHEN AN INCREASE OCCURS WHETHER QWEST'S OBLIGATION TO**  
6 **PROVIDE REVENUE CREDITS HAS BEEN MET.<sup>36</sup> HOW DO YOU**  
7 **RESPOND?**

8 A. Again, Dr. Loube's testimony is incorrect. Ms. Strain and Dr. Loube both offer  
9 analysis of Qwest's earnings and revenues. It may be that by "review of Qwest's  
10 earnings and revenues" Dr. Loube means a complete rate case. However, there is  
11 nothing in the *Dex Stipulation*, the *Dex Settlement Order*, or the *AFOR statute* that  
12 requires the Commission to conduct a rate case before ruling on an AFOR petition.  
13 Nor is there anything in the *Dex Stipulation*, the *Dex Settlement Order*, or the *AFOR*  
14 *statute* that would prevent the Commission from approving an AFOR that provides  
15 an opportunity to increase certain rates.

16 **Q. DR. LOUBE CLAIMS THAT THE DEX STIPULATION REQUIRES QWEST**  
17 **TO DISGORGE A PORTION OF THE GAIN ON THE SALE OF THE DEX**  
18 **YELLOW PAGES BUSINESS TO RATEPAYERS.<sup>37</sup> HOW DO YOU**  
19 **RESPOND?**

20 A. This claim is incorrect. The *Dex Stipulation* contains no reference to the amount of  
21 the gain on the sale of Dex. Nor does it address how gain from the sale of Dex is to  
22 be treated. Instead, it requires that in the event of any rate case, earnings  
23 investigation, or other proceeding that includes a review of Qwest's earnings the

<sup>36</sup> Direct Testimony of Robert Loube, Ph.D., page 68, line 12.

<sup>37</sup> Direct Testimony of Robert Loube, Ph.D., page 67, line 1 through line 5.

1 Annual Revenue credit be included and that the Commission recognize it.<sup>38</sup> Nothing  
2 in the *Dex Stipulation* or Commission's *Dex Settlement Order* that adopted it without  
3 modification requires Qwest to turn over gain to customers.

4 **E. Allegation that Qwest is Violating FCC Separations Rules**

5 **Q. DR. LOUBE PROPOSES A "DSL ADJUSTMENT" AND A "NON-DSL**  
6 **SPECIAL ACCESS ADJUSTMENT" TO QWEST'S REPORTED RESULTS**  
7 **OF OPERATIONS. DO YOU AGREE WITH THESE TWO ADJUSTMENTS?**

8 A. No. Dr. Loube claims: "Qwest's accounting practices are inconsistent with the FCC  
9 Part 36 rules that require carriers to directly assign investment that was directly  
10 assigned prior to the adoption of the freeze order." He proposes these two  
11 adjustments in an effort to correct this alleged violation of FCC rules. I disagree that  
12 the two adjustments are appropriate because I disagree that Qwest is violating the  
13 FCC Part 36 rules. Dr. Loube's assertion that Qwest is required to directly assign  
14 investment under the Separations Freeze Order is incorrect and without substantial  
15 support.

16 **Q. ARE YOU OFFERING A DETAILED RESPONSE TO THESE PROPOSED**  
17 **ADJUSTMENTS IN THE BODY OF YOUR REBUTTAL TESTIMONY?**

18 A. No. Rather than burden the record with testimony that may well be irrelevant, I have  
19 made my detailed response to Dr. Loube's proposed adjustments in Exhibit PEG-3R  
20 to my testimony. The Commission can review this testimony if and as necessary.

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<sup>38</sup> *Dex Stipulation*, page 5, lines 4 through 9.



1 **Q. WHY DO YOU BELIEVE A RESPONSE TO DR. LOUBE'S TWO**  
2 **ADJUSTMENTS MAY NOT BE RELEVANT TO THIS CASE?**

3 A. I have two reasons which are the same reasons I did not include a rebuttal of Ms.  
4 Strain's proposed adjustments in the main body of my rebuttal. First, the  
5 Commission may determine that it need not make a finding with regard to Qwest's  
6 return on rate base in order to approve Qwest's AFOR proposal. Instead, the  
7 Commission may choose to rely on other criteria to determine whether Qwest's rates  
8 are fair, just and reasonable such as an assessment of competition in the telephony  
9 market that Qwest serves in Washington.

10 Second, Dr. Loube concludes that even with the two adjustments he proposes,  
11 Qwest's return on rate base is **\*\*BEGIN REDACTED XXXXXX END**  
12 **REDACTED\*\*** percent.<sup>39</sup> This figure is **\*\*BEGIN REDACTED XXXXXX END**  
13 **REDACTED\*\*** the 9.367 percent rate of return the Commission used to determine  
14 Qwest's revenue requirement in Qwest's last rate case.<sup>40</sup>

15 **Q. WITH THE CHANGES YOU PROPOSE TO THE ADJUSTMENTS DR.**  
16 **LOUBE'S TESTIMONY PROPOSES, WHAT RATE OF RETURN DOES**  
17 **QWEST ACHIEVE IN 2005?**

18 A. With the changes I propose in exhibit PEG-3R to Dr. Loube's proposed adjustments,  
19 Qwest's Commission Basis intrastate return on rate base in 2005 is **\*\*BEGIN**  
20 **REDACTED XXXXXX. END REDACTED\*\***

21 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

22 A. Yes.

<sup>39</sup> Direct Testimony of Robert Loube, Ph.D., page 64, line 20 through line 21.

<sup>40</sup> Docket No. UT-970766, Tenth Supplemental Order, January 15, 1998. Finding of Fact paragraph 11. See also derivation of Revenue Requirement on page 22.

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