



00247

1 I N D E X

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3 WITNESSES: D C RD RC EXAM

4 THOMAS SPINKS 249 251 292 293 285  
5 280  
6 282

6 KING 295 300  
7

8 EXHIBITS: MARKED ADMITTED

9 T-10 251  
T-11 251  
10 12 251  
13 251  
11 14 251  
T-16 299  
12 17 299  
18 299  
13 19 299  
20 299  
14 21 299  
30 248  
15 38 250 251

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1 P R O C E E D I N G S

2 JUDGE PRUSIA: Let's be back on the record.

3 Today is July 29, 1997 and we're reconvened in docket  
4 No. UT-961632. This is the matter of the petition of  
5 GTE Northwest, Incorporated for depreciation  
6 accounting changes. I will note for the record that  
7 the appearances are the same today as they were  
8 yesterday. I believe Commissioner Gillis will be  
9 attending today's session and will be arriving  
10 shortly.

11 Today we'll be hearing from Commission  
12 staff witness Spinks and also from public  
13 counsel/TRACER witness King. I don't believe I  
14 thanked Dr. Vanston for his appearance yesterday. I  
15 thank you for your testimony.

16 Is there anything we need to cover?  
17 Exhibit 30 was not admitted so if you would like to  
18 move for the admission of that.

19 MS. JOHNSTON: I do. I move for the  
20 admission of Exhibit 30, please.

21 JUDGE PRUSIA: Is there any objection to  
22 the admission of Exhibit 30? That will be admitted  
23 into the record.

24 (Admitted Exhibit 30.)

25 JUDGE PRUSIA: Any other preliminary

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1 matters we need to consider before we hear from Mr.

2 Spinks?

3 Whereupon,

4 THOMAS SPINKS,

5 having been first duly sworn, was called as a witness

6 herein and was examined and testified as follows:

7 JUDGE PRUSIA: Ms. Johnston.

8

9 DIRECT EXAMINATION

10 BY MS. JOHNSTON:

11 Q. Good morning, Mr. Spinks.

12 A. Good morning.

13 Q. Please state your full name for the record  
14 and spell the last.

15 A. Thomas L. Spinks, S P I N K S.

16 Q. What is your occupation and by whom are you  
17 employed?

18 A. I'm employed by the Washington Utilities  
19 and Transportation Commission as a regulatory  
20 consultant.

21 Q. Did you prefile written direct testimony  
22 and exhibits in this case?

23 A. Yes, I did.

24 Q. In preparation for your testimony here  
25 today, did you predistribute what's been marked for

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1 identification as Exhibits T-10, T-11, 12, 13?

2 MS. JOHNSTON: And excuse me, Your Honor, I  
3 believe we need a number for TLS-3.

4 JUDGE PRUSIA: Yes. I will mark for  
5 identification a one-page exhibit with a cover sheet  
6 which is Exhibit TLS-3. It is a calculation of staff  
7 recommended depreciation rates, and that will be  
8 marked for identification as Exhibit No. 39 -- no 38.

9 (Marked Exhibit 38.)

10 Q. Mr. Spinks, did you also predistribute  
11 what's been marked for identification as Exhibit 38?

12 A. Yes, I did.

13 Q. Are there any revisions, additions,  
14 corrections or modifications to either your testimony  
15 or your exhibits this morning?

16 A. Not that I am aware of.

17 Q. Are these exhibits true and correct to the  
18 best of your knowledge?

19 A. Yes.

20 Q. Were they prepared by you or under your  
21 direction or supervision?

22 A. Yes, they were.

23 Q. If I were to ask you the questions set  
24 forth in Exhibits T-10 and T-11, would your answers be  
25 the same?

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1           A.     Yes, they would.

2                   MS. JOHNSTON: Your Honor, move for the  
3 admission of Exhibits T-10, 11, 12, 13 and 38.

4                   JUDGE PRUSIA: Is there any objection to  
5 the admission of those exhibits?

6                   MR. RIGOVIN: No.

7                   JUDGE PRUSIA: Let the record reflect that  
8 there is none. The exhibits are admitted.

9                   (Admitted Exhibits T-10, T-11, 12, 13 and  
10 38.)

11                  MS. JOHNSTON: Thank you. Mr. Spinks is  
12 available for cross-examination.

13                  MR. RIGOVIN: Thank you.

14                  JUDGE PRUSIA: Is there any  
15 cross-examination for this witness, Mr. Rigovin?

16                  MR. RIGOVIN: Yes.

17                  JUDGE PRUSIA: Please proceed.

18

19                               CROSS-EXAMINATION

20 BY MR. RIGOVIN:

21           Q.     Good morning, Mr. Spinks.

22           A.     Morning.

23           Q.     Would you agree that the purpose of this  
24 proceeding is GTE's capital recovery?

25           A.     Well, I believe that GTE has petitioned the

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1 Commission for revisions to its depreciation rates.

2 Q. Would you agree that the importance of the  
3 depreciation rates for GTE is whether GTE achieves  
4 capital recovery?

5 A. I'm sorry, I missed a word in there.

6 JUDGE PRUSIA: Excuse me, Mr. Rigovin.

7 Could you put the microphone closer.

8 MR. RIGOVIN: Yes.

9 Q. Would you agree that the importance of  
10 depreciation rates for GTE is whether GTE achieves  
11 capital recovery?

12 A. Well, I think capital recovery rates or  
13 depreciation rates are important to GTE, as well as to  
14 ratepayers to both achieve the capital recovery and to  
15 set fair, just and reasonable rates.

16 Q. Do you agree that GTE is entitled to  
17 capital recovery?

18 A. I think in terms of the regulatory paradigm  
19 that GTE, any company, all companies, regulated public  
20 utilities, are entitled to a reasonable opportunity to  
21 recover return on and of their capital.

22 Q. You referred to the regulatory paradigm.  
23 Could you explain what you mean?

24 A. The framework within which public utilities  
25 are regulated by government.

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1           Q.     I just want to make sure that you and I  
2     have the same idea what you mean by "regulatory  
3     framework." Is that sometimes referred to as the  
4     regulatory contract or the regulatory compact?

5           A.     I think -- I'm not sure how -- I've heard  
6     others describe a social compact, and I'm not sure  
7     whether that's the same thing that I am talking about.  
8     The regulatory framework that I'm talking about  
9     involves the balancing of the public interest which is  
10    a balance between the financial viability of the  
11    utility and its ability to sell stock, and fair, just  
12    and reasonable rates for the customers of the utility.  
13    That balancing of the public interest, I think that is  
14    at least what some people have in mind when they refer  
15    to the regulatory compact.

16          Q.     Mr. Spinks, would you say that GTE is now  
17    in a competitive environment or a regulated  
18    environment or something else?

19          A.     I would term it emerging competitive or  
20    nascent competition.

21          Q.     Do you agree that in the nascent  
22    competitive environment as you've described it that  
23    economic depreciation is the proper analysis to use?

24          A.     No. Economic depreciation refers to using  
25    the impact of inflation on the value of the assets



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1 which in turn dictates whether you have front loaded  
2 or back loaded depreciation. Both within and without  
3 regulated utilities straight line depreciation is  
4 really the convention that's used. So in regulation  
5 and outside of regulation I don't think that  
6 accelerated depreciation methods are what we're  
7 interested in. Had your question said economic lives  
8 rather than economic depreciation, though, I would  
9 agree that economic lives are relevant to attempt to  
10 ascertain and use in this current environment.

11 Q. I'm not sure I understand what you mean by  
12 economic depreciation. Do you mean, for example,  
13 price level?

14 A. Yes. Well, economic depreciation has been  
15 defined in a series of journal articles going back to  
16 1992 in the Journal of Regulatory Economics, and  
17 there's a mathematical foundation for it. In essence,  
18 it involves the effect of inflation on the value of  
19 assets and the resulting accrual patterns that would  
20 be optimal to give you an optimal allocation of  
21 resources.

22 Q. Could you define what you mean by an  
23 economic life?

24 A. Well, the economic life of an asset is the  
25 period of time in which -- within which the asset

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1 produces revenues.

2 Q. Just any revenues, you know, in other  
3 words, if one dollar comes off that asset, does that  
4 asset still have "economic life"?

5 A. If what you're referring to is the  
6 difference between revenues and net income, I would  
7 say you can't distinguish in the sense that a  
8 telephone company produces services that use many  
9 different classes of asset. In order to determine the  
10 return to each class of asset, you would have to do  
11 some kind of returns to capital analysis in which --  
12 within which that analysis it would be possible that  
13 one class of assets did indeed not recover net income,  
14 but did produce, was responsible in the production of  
15 revenues. As long as overall the business as a whole  
16 made money that wouldn't be inappropriate.

17 Q. So if a particular asset cost \$3 to run and  
18 it generates \$2 in cash flow, does that asset have  
19 economic life?

20 A. Well, as you stated the question, I can't  
21 answer. I don't know. You would have to be more  
22 specific about the context of the -- if the asset were  
23 the only revenue-producing asset of the firm the  
24 answer is no.

25 Q. And if it's part of a larger plant the

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1 answer to your question would be you don't know  
2 because you don't know what's in the rest of the  
3 plant; is that right?

4 A. It could be either way.

5 Q. Right, okay. Are you familiar with Dr.  
6 Crew's writings?

7 A. Somewhat, yes.

8 Q. For example, his testimony in this docket?

9 A. Yes.

10 Q. And the two exhibits 23 and 24 that were  
11 entered into evidence?

12 A. I didn't read those, but I was here at the  
13 time and am aware of them.

14 Q. I'm sorry, you haven't read those?

15 A. That's correct.

16 Q. Does your definition of economic  
17 depreciation differ from Dr. Crew's?

18 MS. JOHNSTON: I would object, Your Honor.  
19 I've allowed several of these questions that are far  
20 afield to be answered by this witness, but on page 2  
21 of Mr. Spinks's testimony it explicitly states that  
22 Dr. Crew will address GTE's request to use economic  
23 depreciation and the TFI study sponsored by Dr.  
24 Vanston. This witness is here to testify about staff  
25 recommendations concerning GTE's Washington-specific

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1 depreciation parameters and rates. That's the extent  
2 of this witness's testimony, and I would object to  
3 counsel cross-examining Mr. Spinks on Mr. Crew's  
4 testimony. Mr. Crew was here, withstood  
5 cross-examination on July 14.

6 MR. RIGOVIN: Well, I strongly disagree. I  
7 think that the philosophy for setting depreciation is  
8 critical to the work of this Commission. I think it's  
9 important to understand what is the philosophical  
10 framework upon which Mr. Spinks is making his  
11 recommendations. I don't understand at this point in  
12 the cross-examination whether Mr. Spinks agrees with  
13 Mr. Crew or not. That's really all I'm trying to get  
14 to, and I think that's a critical issue to understand  
15 both for GTE as well as for the Commission and all the  
16 parties in the matter, so that's the purpose of my  
17 line of questioning. It's not to trip up Mr. Spinks  
18 in any way. I'm just trying to understand whether he  
19 agrees with Mr. Crew. That's the gist of it.

20 JUDGE PRUSIA: The witness said he hasn't  
21 read those two articles, but if he feels he can answer  
22 the question I will allow him to go ahead and do that.

23 A. I will need the question reread or  
24 repeated, please.

25 Q. Do you agree with the way Dr. Crew has

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1 defined economic depreciation?

2 A. Dr. Crew and I have had a number of  
3 discussions about economic depreciation, and as near  
4 as I can tell in these discussions, yes. Insofar as  
5 everything he said in journal articles and how those  
6 might be interpreted, I wouldn't know.

7 Q. Is it fair to say that Dr. Crew defines  
8 economic depreciation as the decline of net present  
9 value measured over time of the firm -- excuse me --  
10 of the assets?

11 A. Roughly. The definition I'm familiar with  
12 is the change in the net present value of the asset as  
13 time periods go on. There are a couple of different  
14 approaches that have been taken. They're all  
15 mathematically equivalent, but that's one way of  
16 describing it, and yes.

17 Q. You referred to economic lives, and I  
18 thought that you had testified that in this period in,  
19 again, as you described it, of nascent competition  
20 that using an economic life was appropriate; is that  
21 right? Did I hear you right?

22 A. Yes, and clarify a little bit. Since there  
23 are no economic depreciation models from which  
24 economic lives can be calculated, in a sense what  
25 we're doing is attempting to recognize that economic

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1 lives which involve the value of the assets and the  
2 revenue-producing capability may lead to a different  
3 life span for an asset than what physical life  
4 mortality analysis type indications may give you.

5           So when mortality analysis indicates the  
6 life of plant as, say, 45 years, that may be the  
7 physical life which includes factors like wear and  
8 tear, and in fact even the economics behind the  
9 existence of that plant up to the current point in  
10 time. What it doesn't tell you is about the future.  
11 And to the extent in the future the revenue streams of  
12 assets may be different than they were in the past  
13 then the economic life of the asset would also be  
14 different.

15       Q.     So the point of using the economic life is  
16 that the life statistic that's used in depreciation  
17 should reflect the underlying economics of what's  
18 happening to that firm; is that right?

19       A.     No, I wouldn't state it that way as the  
20 underlying economics of the firm. I would state it as  
21 the expected net present value of the revenue stream  
22 for the services produced and anticipated to be  
23 produced by the firm by the class of assets under  
24 study.

25       Q.     You've referred a couple of times to

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1 revenue when defining economic life, and I wanted to  
2 ask you about that, and I think perhaps refers back to  
3 some earlier questions that we had. What's really  
4 important is not so much revenue as much as positive  
5 cash flow; isn't that right?

6 A. I'm not sure about that.

7 Q. Well, for example, if I'm a firm and I'm a  
8 company and I was making a hundred bucks and my  
9 revenues have jumped to 150 bucks but my costs are  
10 \$200, it really doesn't much matter that I've seen an  
11 increase in revenues, does it? I'm still losing  
12 money; isn't that right?

13 A. Yes, but that doesn't have to do with cash  
14 flow. That has to do with net income. You're talking  
15 about having negative net income; we've already  
16 discussed that.

17 Q. So I think maybe when you say net income  
18 that must mean the same thing as what I'm talking  
19 about positive cash flow. Does that sound right?

20 A. I don't know. The net income --

21 Q. Do you understand the basic problem that  
22 I'm having understanding how you're using the term  
23 "economic life" and defining it based on revenue?

24 A. I don't believe that anywhere in my  
25 testimony I've, in this case at least, discussed the

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1 relationship between economic depreciation and  
2 revenues. Generally speaking, as I understand the  
3 literature in the academia, it is referred to as net  
4 present value of the revenues, changing of the  
5 revenues produced by the assets. That is the essence  
6 of what economic depreciation is about. You know,  
7 again, I have not tried to define economic  
8 depreciation in the context of this testimony in this  
9 case.

10 Q. When you were talking about ADSL on page 9  
11 of your testimony you referred, for example, to  
12 greater revenue potential, didn't you?

13 A. Yes.

14 Q. So I'm a little bit confused when you said  
15 earlier that you hadn't discussed revenue.

16 A. In the context of economic depreciation,  
17 that's correct. I stand by that, in the context of  
18 ADSL in talking about a change in economic life of the  
19 asset. Certainly there's an expectation that there  
20 will be a net positive income from the asset or  
21 companies would not be implementing ADSL today, so I  
22 think trying to make a distinction as regards ADSL  
23 between the revenues they produce and the net income  
24 wouldn't make sense to me. It would call into  
25 question why the companies were implementing it today



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1 if they didn't expect, anticipate, net income from the  
2 asset.

3 Q. Let's talk just about economic life. Do  
4 you agree that understanding whether a company's  
5 revenue, just the revenue, has gone up is sufficient  
6 for you to make an assessment as to whether that life  
7 statistic, based on an economic life analysis, should  
8 go up, down or stay the same?

9 A. No.

10 Q. You don't agree?

11 A. I'm sorry, I must not have understood your  
12 question. I think I was agreeing that you couldn't  
13 tell simply by a change in revenue whether the  
14 economic life of the asset was changing in gross  
15 revenue.

16 Q. You stated in your supplemental testimony,  
17 I think on page 3, that depreciation expense is often  
18 the largest single source of cash flow generation.  
19 Does that sound right?

20 A. I don't see it in my supplemental  
21 testimony. It's in my --

22 Q. I apologize. It's in your direct.

23 A. Yes, I see that.

24 Q. You also said that, I think referring on  
25 page 4 of your direct, depreciation expense is to be

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1 used to produce cash flow and reduce financing needs.

2 Let me just check that.

3 A. Yes, I see that.

4 MS. JOHNSTON: Where?

5 THE WITNESS: On page 4 at lines 1 and 2.

6 MS. JOHNSTON: Thank you.

7 Q. Are those observations true for a company  
8 both under regulation and under competition?

9 A. Well, let's see. The sentence reads that  
10 because of the potential for depreciation rates to be  
11 used as a device to manipulate the financial picture  
12 of a company, would it be used to produce cash flow  
13 and reduce financing needs or create rates that caused  
14 customers to pay more or less, a determination of  
15 proper rates and methods has always been important.  
16 Now, the question is, is the statement referring to  
17 the part about producing cash flow and reducing  
18 financing needs true for both regulated and  
19 competitive firms?

20 Q. That's right.

21 A. Well, I guess the quick answer is I didn't  
22 examine it in that context. The sentence was made in  
23 the context of regulated public utilities.

24 Q. I just want to understand. I think I  
25 understand the importance of depreciation expense for

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1 a regulated public utility company, but a company  
2 under competition it seems to me could look all day at  
3 the issue of depreciation expense and could in fact  
4 advocate almost any number, and it wouldn't really  
5 matter that depreciation expense doesn't generate  
6 revenue for a firm under competition; isn't that  
7 right?

8 A. Well, I would say that's true for  
9 competitive markets, firms operating in competitive  
10 markets.

11 Q. What about for a firm operating under  
12 nascent competition as you've defined it?

13 A. Well, I think that GTE, in particular,  
14 still operates under a de facto monopoly. The other  
15 side of that de facto monopoly coin is what we call  
16 emerging or nascent competition. I would think that  
17 the regulatory paradigm still more applies to GTE than  
18 it doesn't.

19 Q. Is it your testimony then that GTE is a de  
20 facto monopoly? Is that what you said?

21 A. That's correct.

22 Q. And is it also your testimony that GTE is  
23 operating under nascent competition?

24 A. Well, emerging competition. There are --  
25 we are aware of a number of firms that have registered

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1 with the state that provide -- that intend to provide  
2 or do provide various local exchange services. We're  
3 aware of the facilities they have and where they're  
4 located, broadly aware of their plans. We're also  
5 aware of GTE's revenues, operations, number of  
6 customers and the like, and on that basis I would  
7 conclude that GTE is still -- again, operates in de  
8 facto monopoly, as a de facto monopoly company.

9 Q. With that background, then, is it your  
10 testimony that -- your observation that depreciation  
11 expense is often the largest single source of cash  
12 flow generation -- that observation still applies to  
13 GTE in the environment of "emerging competition"?

14 A. Certainly.

15 Q. Do you know if Dr. Crew agrees with that?

16 A. No, I don't.

17 Q. You would agree, then, in a competitive  
18 environment what's going to drive the ability of the  
19 firm to have cash flow is its ability to compete?

20 A. I have not really studied cash flow  
21 questions or issues related to depreciation in the  
22 context of this case. This question and answer that  
23 your questions have been predicated on are some in  
24 introductory materials intended to provide the  
25 nonexpert, if you will, with some background about

1 what depreciation is about. That was the intent of  
2 this question and answer. It wasn't to provide some  
3 professional exposition upon of the intricacies of  
4 each of these statements. It was merely provided as  
5 general background material.

6 Q. Just trying to make sure I understand what  
7 your philosophy is in terms of your recommendations  
8 about depreciation rates. Is it true, then, that cash  
9 flow analysis or any proxies for that would have --  
10 strike that. Is it true then that cash flow analysis  
11 has no part in your assessment of what the proper  
12 depreciation rates should be for GTE?

13 A. No. And to go further, you have mentioned  
14 more than once now a philosophy that I may or may not  
15 have regarding my depreciation recommendations in this  
16 case. My depreciation recommendations in this case  
17 are made in the context of Dr. Crew's testimony in  
18 which he concludes that the proposals of GTE should be  
19 rejected. Once that point is reached, my testimony  
20 picks up, if you will, and I go on to recommend  
21 parameters to the Commission for GTE. So there really  
22 isn't in the context of this case testimony on my part  
23 regarding depreciation philosophy and in particular  
24 cash flow. As I said, this particular portion of my  
25 testimony is included to provide the nonexpert with

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1 some background as to why depreciation issues are  
2 important in regulation.

3 Q. Could you briefly describe, and if you've  
4 already done this, I apologize, but could you briefly  
5 describe what your philosophy is in setting  
6 depreciation rates for GTE as it faces a period of  
7 emerging competition?

8 A. Well, I don't think it would be proper to  
9 describe the process that we use to recommend  
10 depreciation projection lives and salvage parameters  
11 as a philosophy. I don't know that it rises to that  
12 level. It's a series of analytical tasks that are  
13 tempered and controlled by both policy and legal  
14 requirements. All of those have to be considered in  
15 the context of developing depreciation recommendations  
16 for regulated public utilities.

17 Q. Could you explain, Mr. Spinks, what  
18 relevance for you a utilization of plant has in coming  
19 up with your recommendations for proper depreciation  
20 for GTE?

21 A. The specific utilization of plant is not  
22 considered in the context of developing plant  
23 recommendations, projection life recommendations.  
24 Utilization of plant is considered in the context of  
25 ratemaking proceedings; whether or not it's used and

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1 useful would be considered.

2 Q. So whether the plant is being used or not  
3 or utilized is not relevant then?

4 A. Well, those are controlled by accounting  
5 conventions. The company has specific accounting  
6 instructions which control whether or not plant is --  
7 when it's put on the books, when it gets taken off in  
8 terms of if it's plant held for future use or plant in  
9 service. So generally, no. Utilization isn't  
10 considered. However, if what you're talking about is  
11 the issue that has been raised by GTE in the past  
12 about having a hundred pair copper cable in which only  
13 two pairs are used, I would say if the company  
14 provided a study which demonstrated that such plant  
15 existed and quantified the amounts of it, I believe  
16 that staff would be willing to take that into  
17 consideration in developing the projection life  
18 recommendations.

19 We certainly did that for U S WEST some  
20 years ago for its interoffice feeder copper plant  
21 where the company broke out the percentage of  
22 investment in the interoffice feeder. We assigned a  
23 much shorter projection life to that plant and then  
24 weighted it with the distribution plant to develop the  
25 projection life. So if that's the type of utilization

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1 you're talking about, yes, that can and has been  
2 considered but the company has to provide hard data  
3 about it.

4 Q. Is an analysis of GTE's cash flow relevant  
5 to your thinking of what the proper life statistics  
6 should be?

7 A. The question was really pretty broad. The  
8 relevance of cash flow to setting a life or  
9 considering projection life would have to do with the  
10 projection of future cash flows and discounting those  
11 back to the present value. That type of a cash flow  
12 analysis would be relevant, yes.

13 Q. So if you had that available to you, you  
14 would take advantage of it and factor it into your  
15 analysis; is that right?

16 A. Well, yesterday Dr. Vanston spent several  
17 minutes describing a type of analysis which he  
18 apparently performs from time to time, did not perform  
19 in this case, which sounded to me to contain the sorts  
20 of considerations the commissions would be interested  
21 in reviewing and myself in the context of determining  
22 economic lives. Unfortunately, there hasn't been any  
23 done in this case, but that kind of an analysis, had  
24 it been done, could have then and had it contained the  
25 factors explicitly stated about growth, about expected



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1 exchanges in prices and costs, about the planned  
2 services of the company and then the resulting  
3 revenues, cash flows and their discounting to present  
4 value, and you had all of those factors before you,  
5 you would be able to evaluate then, and if you agreed  
6 you could change those factors and rerun the study and  
7 you could probably come up with a pretty good  
8 understanding of the implications of that kind of  
9 analysis and what they would have on the life of the  
10 plant. So they would be useful, yes.

11 Q. Do you agree that the decisions of this  
12 Commission with respect to retail prices and prices  
13 for unbundled network elements and wholesale prices  
14 for resold services would be relevant to a cash flow  
15 type analysis as you've described it, the present  
16 value of expected future cash flows?

17 A. Certainly the rates that the Commission  
18 sets for services produced the revenues that are  
19 integral to the development of the cash flows.

20 Q. So is that a yes to my question?

21 A. So I think they would be relevant, but you  
22 need to understand the Commission sets rates at a  
23 point in time whereas the type of a present value  
24 analysis that one would have in mind in developing  
25 these future revenue and cash flow streams that you

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1 would look at in evaluating economic life are sort of  
2 an apples and oranges comparison.

3 Q. Why do you say apples and oranges?

4 A. Well, the Commission is setting rates in a  
5 discrete time period, this year, next year. The type  
6 of cash flow analysis that you would use would take  
7 whatever rates are in effect and project those out  
8 into the future, and I guess unless you varied those  
9 or assume they would vary you would very quickly  
10 depart from what would likely be the reality of the  
11 future.

12 Q. Could you explain what role mortality  
13 analysis played in your recommendations?

14 A. The mortality analysis that I reviewed  
15 played the role of assuring -- providing staff with  
16 some assurance that -- I shouldn't say assurance --  
17 starting point for assessing whether the current  
18 projection lives that were being used required a  
19 change or not.

20 Q. And what were your conclusions?

21 A. Well, in the absence of a full depreciation  
22 study and in the absence of knowledge of the company's  
23 short-term plans, much other information that would  
24 normally be provided in a depreciation study that was  
25 not provided in the context of this case, it wasn't

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1 possible to develop specific projection life  
2 recommendations.

3           In the context of this case where the  
4 company has submitted a -- or filed a petition,  
5 petitioned the Commission for a change, it has  
6 proposed a set of lives, staff witness Dr. Crew has,  
7 through his testimony, explained why those lives  
8 should not be accepted by the Commission. My task  
9 came to be which of the life -- in the absence of a  
10 full depreciation study with which to give the sorts  
11 of in-depth consideration that we would normally give  
12 to each plant account, I was really forced to do a  
13 very limited kind of an analysis in which I  
14 essentially looked at what information was available  
15 with the idea that was did it need to be changed on  
16 the basis of that data or should the status quo be  
17 maintained.

18           And as you can see by my recommendations,  
19 it was largely -- I've largely concluded that there's  
20 no information that would cause me to change the  
21 status quo, that the current projection lives should  
22 be continued until such time as we receive the  
23 information we need that would lead us to believe  
24 otherwise.

25           Q.     So is it fair to say your conclusion was

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1 that the future would look a lot like the past or that  
2 you had no reason to believe that the future would not  
3 look like the past?

4 A. No. No. I just explained, and that wasn't  
5 what I explained. I didn't have information upon  
6 which to make a judgment.

7 Q. So you didn't have information upon which  
8 to make a judgment that the future would not look like  
9 the past?

10 A. Well, the company didn't provide a  
11 depreciation study with its petition other than the  
12 work of Dr. Vanston, which was rejected. Staff was  
13 able to obtain some information late in the case about  
14 the mortality characteristics of the plant, but there  
15 was still much information lacking about that would  
16 normally be included in a regular depreciation study,  
17 information about the company's plans and the like  
18 specific to Washington which would have allowed us to  
19 consider its situation here and to make  
20 recommendations as appropriate. That information was  
21 not provided; hence staff wasn't able to make a  
22 consideration of a projection life other than if the  
23 company's proposals were not appropriate, which they  
24 were not, that the status quo should be maintained at  
25 this time.

1                   So I anticipate, for instance, that if the  
2 Commission were to reject this petition the company  
3 could file a depreciation study, a normal depreciation  
4 study, and it may well lead to a different result than  
5 the recommendations we made in this case.

6           Q.     But at present you have no information to  
7 conclude that the future won't look like the past; is  
8 that right?

9           A.     No. I think that in a general sense the  
10 future in some ways will, in some ways won't. That's  
11 just such a broad-based kind of a question that it's  
12 impossible to answer.

13          Q.     For purposes of projection lives.

14          A.     My answer is the same.

15          Q.     In a purely competitive environment, what  
16 role do you think that mortality analysis would play?

17          A.     I'm not sure in a purely competitive  
18 environment. What kind of an industry, what kind of  
19 companies, what kind of markets, what kind of  
20 services? I can't answer with the information you've  
21 given me.

22          Q.     If GTE were in a competitive environment in  
23 the state of Washington and were still regulated by  
24 this Commission, what role would mortality analysis  
25 play and you were assigned the task of recommending

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1 projection lives?

2       A.     I think in the current state of competitive  
3 environment, as you use the term, the mortality  
4 analysis still has a relevant role to play. Again,  
5 the degree of competition is the other side of the  
6 coin of still having an effect on the monopoly. At  
7 such time as there is effective competition in  
8 Washington, a time at which you could not -- when  
9 prices disciplined the behavior of the company, I  
10 would think that, if I understand Dr. Crew's writings,  
11 the mortality analysis would play less of a role  
12 because firms would earn a total return upon which it  
13 would both achieve its return of and return on  
14 capital, but it does not -- unlike in regulated  
15 industries, do competitive firms separate out the two  
16 as separate components of a revenue requirement in the  
17 bottoms-up kind of analysis that we use in regulation  
18 today.

19       Q.     Would you agree that to the extent  
20 mortality analysis is useful in making predictions its  
21 usefulness is because it is essentially predicting a  
22 cash flow that could be expected from the asset or  
23 plant?

24       A.     No.

25       Q.     So mortality analysis is untethered to what

00276

1 would be expected in terms of cash flows from that  
2 asset; is that right?

3       A.     No, I wouldn't say that either. Mortality  
4 analysis is a powerful tool to analyze projection  
5 lives with because it tells you through time how all  
6 of the forces of retirement have affected that plant  
7 as well as whatever economic situations existed that  
8 may have caused early retirement or later retirement  
9 of plant. There is a connection to the  
10 revenue-producing life of an asset under regulation in  
11 the sense that if the company doesn't have plant  
12 that's used and useful it wouldn't be on the books of  
13 the company. So, by implication, if it's on the books  
14 and it's in the study the revenue-producing assets or  
15 assets necessary for the firm to operate in the  
16 production of revenues -- I guess I was thinking of  
17 the president's desk probably doesn't produce revenues  
18 directly, but those are also costs of the firm that  
19 would be included.

20       Q.     It seems that you came back to this point  
21 that if an asset is being used it must be generating  
22 revenue of some kind; is that right?

23       A.     Well, I think I just qualified that in the  
24 sense that it's either directly producing revenue,  
25 like the cable plant of the company or the switches

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1 or it's related to -- it's not directly revenue  
2 producing like the president's desk but it is part of  
3 the necessary assets of the firm to operate. There  
4 are categories of plant called plant held for future  
5 use whereas a plant is being constructed, it is held  
6 in an account that is not the plant in service  
7 accounts that are analyzed in a depreciation study,  
8 for instance, so they wouldn't be considered in the  
9 study and they're not producing revenues. Once a  
10 plant comes on line it's put into the plant in service  
11 accounts and it's then a used and useful asset of the  
12 company.

13 Q. But if what we're talking about is a loop,  
14 for example, that's been ordered to be leased out by  
15 the company at a below cost rate, that's not -- that  
16 may be used and may stay on the books but it's not of  
17 much use to the company in terms of a cash flow,  
18 positive cash flow, is it?

19 A. No, but your assumption that the Commission  
20 would permit a loop to be leased out below cost I  
21 think is not a very realistic one.

22 Q. Dr. Crew testified on page 3 of his  
23 testimony, direct testimony, I quote: "The FCC's move  
24 to employ economic depreciation is thus constrained  
25 because straight line depreciation is used. Given



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1 this, changes in depreciation policy are achieved by  
2 adjusting prescribed lives." That's line 16 through  
3 18. Do you agree with that proposition?

4 A. Yes. That's exactly what I'm talking about  
5 when I say the mortality life of an asset is 45 years  
6 but the currently projected life is 27 years. It's  
7 exactly that difference that -- it is exactly for  
8 those reasons that that difference exists.

9 MR. RIGOVIN: If I could just have one  
10 second, I think I might be able to finish up.

11 JUDGE PRUSIA: Let's be off the record for  
12 a second.

13 (Recess.)

14 JUDGE PRUSIA: Let's be back on the record.  
15 Mr. Rigovin.

16 Q. Mr. Spinks, assuming that the company, as  
17 GTE's concerns pan out, that the depreciation rights  
18 were not -- strike that. What is your understanding  
19 of the term asset impairment?

20 A. I don't think I have one in particular in  
21 mind. I haven't used that term. To try to be  
22 responsive, I would generally understand asset  
23 impairment to refer to its ability to produce, to  
24 operate as an asset either to produce revenues or  
25 perform its function. Could be physical, could be

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1 financial, I suppose.

2 Q. Do you agree that if the depreciation  
3 expense is not set correctly that could lead to an  
4 asset impairment for GTE?

5 A. No.

6 Q. Are you familiar with the accounting  
7 requirements for disclosing asset impairment?

8 A. No. Like I say, what I had in mind wasn't  
9 a specific definition. I was just trying to give you  
10 a real broad general understanding and then your  
11 follow-up question, I didn't see how that necessarily  
12 followed, given my broad kind of a definition.

13 Q. What do you think will happen to GTE if the  
14 depreciation rates are not set correctly, if anything?

15 A. I'm not sure what you mean by what will  
16 happen. Like when, under what circumstances? We have  
17 historically prescribed depreciation rates for the  
18 company periodically, three-year periods. The purpose  
19 for that relatively close time period is to stay on  
20 top of and be able to take proactive reaction  
21 regarding changes in the projection lives of the  
22 assets of the company. That's all the reason why we  
23 have a represcription process that's based on  
24 three-year periods.

25 Q. As competition, full competition, over

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1 takes nascent or emerging competition, is this  
2 Commission still going to be in a position to ensure  
3 that it can set the depreciation rates in a way that  
4 GTE can recover its capital?

5 A. Well, I don't think there's any such thing  
6 as certainty in the future. I think that the  
7 Commission will continue to afford to give GTE, as  
8 well as other, all other utilities, a reasonable  
9 opportunity to recover and to earn a return on and of  
10 its assets.

11 MR. RIGOVIN: Thank you, Mr. Spinks.

12 THE WITNESS: You're welcome.

13 JUDGE PRUSIA: Does public counsel have any  
14 cross for this witness?

15 MR. FFITCH: Just one or two questions,  
16 Your Honor.

17

18 CROSS-EXAMINATION

19 BY MR. FFITCH:

20 Q. Morning, Mr. Spinks.

21 A. Morning.

22 Q. I'm Simon ffitich for public counsel.  
23 Depreciation setting forms the basis in part for  
24 setting rates; isn't that correct?

25 A. That's correct.

00281

1 Q. And those rates in turn generate revenue  
2 for the company?

3 A. Yes.

4 Q. And the revenue then in turn generates cash  
5 flow; isn't that correct?

6 A. Yes.

7 Q. So if you set cash -- if you use cash flow,  
8 then, as the basis for setting depreciation rates  
9 you've completed the circle, have you not?

10 A. I'm not sure what you mean by "the circle."

11 Q. Well, I shouldn't say the circle. Does  
12 not that result in a circular arrangement or analysis?

13 A. Yes. Generally the way I understand it is  
14 there are three: a balance sheet, an income statement  
15 and a cash flow analysis or cash flow statement.  
16 Those three statements are the three financial tools  
17 that you use to judge the health of companies by and  
18 the like. They're all interrelated to each other. As  
19 you increase the amount of depreciation expense, you  
20 increase the amount of cash available to the company,  
21 and there may be different circumstances that vary  
22 that, but that's essentially the way the variables  
23 work, interact with each other.

24 MR. FFITCH: Thank you. No further  
25 questions.

1 JUDGE PRUSIA: Mr. Butler, does TRACER have  
2 any cross-examination of the witness?

3 MR. BUTLER: Yes, a few questions.

4

5 CROSS-EXAMINATION

6 BY MR. BUTLER:

7 Q. Mr. Spinks, we heard testimony yesterday  
8 that GTE's composite depreciation rate in Washington  
9 is 5.5 percent and the national average composite  
10 depreciation rate for reporting local exchange  
11 companies is 7.1 percent. Can you explain why GTE's  
12 rate appears to be so low relative to the national  
13 average?

14 A. When I heard that testimony yesterday I  
15 wondered about that myself, and this morning I did a  
16 couple of calculations to sort of answer in my own  
17 mind the question as to why GTE's rate was around in  
18 the range of 5.3, 5.4 relative to U S WEST which was  
19 around 6.9. And in the past when we have analyzed  
20 this issue the mix of plant was one of the factors  
21 that we know has an effect.

22 So I looked at some of the -- several of  
23 the plant accounts to see whether there was a  
24 difference, and I think that that attribute -- some of  
25 the difference can be laid at that doorstep. The

00283

1 buildings account for U S WEST is 6.8 percent of the  
2 investment and but for GTE it's 8.1 percent, and that  
3 plant has a low rate on it so the more of that you  
4 have the more that would tend to pull your composite  
5 rate down.

6           The other account I looked at was circuit  
7 equipment, which has a lot of investment in it and has  
8 a relatively high rate. For U S WEST 21.3 percent of  
9 their plant is in circuit equipment; GTE only 15.6  
10 percent. So -- and the plant that has high rates on  
11 it GTE has less than U S WEST and plant that has low  
12 rates on it GTE has more than U S WEST. So it's clear  
13 that the plant mix is at least part of the reason for  
14 that. I suspect that the curve shapes may also be a  
15 part of that issue, and again, without the full  
16 depreciation study from GTE this year we weren't able  
17 to review any curve shape analysis to see whether  
18 changes weren't necessary there.

19       Q.     GTE is authorized to employ ELG procedures  
20 on a going forward basis; isn't that correct?

21       A.     That's correct, as of 1-1-95.

22       Q.     If all life parameters were to stay the  
23 same, would you expect GTE's composite rate to  
24 increase in the future given the fact that it is  
25 entitled to employ ELG?

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1           A.     Generally, yes. That's what would occur.  
2     We've seen that in U S WEST in the last year with no  
3     change in the parameters; just adding another year of  
4     ELG vintages has driven up their composite rate by a  
5     couple of tenths of a percent. So yes, that  
6     definitely will have an effect.

7           Q.     You are a staff witness in the generic case  
8     to determine costs and prices for unbundled network  
9     elements; is that correct?

10          A.     Yes.

11          Q.     And as part of your responsibilities in  
12     that case you have reviewed the total element long-run  
13     incremental cost or TELRIC models proposed by the  
14     various parties; is that correct?

15          A.     Yes, I did.

16          Q.     Can you tell me what the least cost  
17     forward-looking technology assumed in the GTE/U S WEST  
18     models is for loop plant? Is it copper or fiber or  
19     mix?

20          A.     I think they had a mix of fiber feeder and  
21     copper distribution loops.

22          Q.     Do the GTE and U S WEST models design the  
23     distribution plant just to meet the level of current  
24     demand or do they design to meet the ultimate expected  
25     future demand?

00285

1           A.     Their models were placed plant for what  
2 they termed to be the ultimate demand.

3           Q.     In your opinion, do the incumbent local  
4 exchange companies such as GTE have economies of scale  
5 and scope that would not be available to a new  
6 facilities-based entrant?

7           A.     Absolutely.

8           Q.     Do you have any information which, in your  
9 opinion, establishes that facilities-based competition  
10 will develop to an extent and with an underlying cost  
11 structure in Washington that will permit it to  
12 constrain GTE's prices to the point where it cannot  
13 recover its depreciation expenses in the foreseeable  
14 future?

15          A.     No.

16                   MR. BUTLER: Thank you. I have no further  
17 questions.

18                   JUDGE PRUSIA: Commissioner Gillis, do you  
19 have any questions for this witness?

20                   COMMISSIONER GILLIS: One or two.

21

22                               EXAMINATION

23 BY COMMISSIONER GILLIS:

24           Q.     Mr. Spinks, you've been with the staff for  
25 a number of years now, since 1982. Is that when you



1 started?

2 A. I've been with this staff since 1984.

3 Q. How many represcription processes have you  
4 been through with GTE Northwest, approximately?

5 A. Oh, probably a half a dozen.

6 Q. I want you to dig into your historical  
7 memory bank if you can a bit. Think of one in  
8 sometime mid '80s, and I'm interested in what factors,  
9 if any, that you have considered concerning -- with  
10 regard to setting appropriate lives for depreciation  
11 purposes. What factors, if any, did you consider in  
12 your recommendations in this docket that you may not  
13 have considered in, say, a represcription process in  
14 the mid 1980s?

15 A. Well, I think after divestiture, so from  
16 '84 on, we were operating under the notion that both  
17 technological change and competition was out there in  
18 the future, and at that time we began ratcheting the  
19 lives down from their mortality, their historic  
20 mortality ranges, to lower levels. In each succeeding  
21 three-way, I think if you looked at them over time,  
22 stacked, say, four of them up together, you might find  
23 the underground cable life moving from 40 years down  
24 to 38 years, down to 34 years, down to 30 years and  
25 now maybe down to 27 years. Each three-way was a

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1 successive process wherein we evaluated and tried to  
2 anticipate how the forces of technological change,  
3 which is really what underlies competition, how those  
4 changes were likely to affect the future ability of  
5 the plant to operate and produce services.

6           For sometime in the mid '80s, we expected  
7 that copper cable may indeed be entirely replaced with  
8 fiber. By the early '90's, there was a fiber co-ax  
9 paradigm in which while we didn't have to go to fiber  
10 all the way into the home for broad band, now we can  
11 use co-ax, and that was quickly followed by the  
12 development of the ADSL technologies which allowed you  
13 to bring the broad band to the home on the existing  
14 copper. So there's been this kind of back and forth  
15 movement of the factors that affect the lives.

16           We tried to be careful not to have knee  
17 jerk reactions, if you will, in setting the  
18 parameters, and we tried instead to anticipate events.  
19 I think that the events that we need to anticipate  
20 that would cause the staff to come more into agreement  
21 with the parameters that GTE proposes in this case  
22 have not yet occurred.

23       Q.     Other than the depictions of technological  
24 change, how if at all in your methodology do you  
25 consider either the lack of present or near term

00288

1 competition or the potential for present or near term  
2 competition?

3       A.     Well, if the -- let me put it this way, and  
4 I think Mr. King has in his testimony talked about it  
5 some. If this were an electric company, and we were  
6 evaluating its overhead conductors, and the mortality  
7 study said that there was a 43-year life on those  
8 conductors, the service life that we would use to  
9 develop the depreciation rate for that plant would be  
10 right around 43 years if not exactly 43 years.  
11 Because of the forces of competition, technological  
12 change and the other forces of retirement acting on  
13 telephone plant, that very same plant that has a life  
14 indication of 43 years we're currently using, say, a  
15 27-year life on. So, I don't know whether I've been  
16 responsive to your question or not.

17       Q.     To some extent. I'm trying to get a little  
18 better handle on the supposition of at least GTE  
19 Northwest appears to be that competition is imminent  
20 and that affects the economic lives of the asset.  
21 I'm just wondering, trying to get a better  
22 understanding, within your analysis and your approach  
23 you used in making your recommendations, if and how  
24 the potential of competition would affect recommended  
25 lives for the purposes of depreciation.

1           A.     The main way in which competition is taken  
2 into account is through technological change. It's  
3 technological break-throughs that allow for the  
4 introduction of perhaps lower cost alternatives to  
5 services that are offered over existing facilities of  
6 the company. Either competitors or the company can  
7 adopt that technology and use it to compete with GTE.

8                     That's what makes Mr. Vanston's forecasts  
9 have some value to them. We consider the Fisher-Pry  
10 analysis and do not reject it as one of the factors  
11 that we need to look at in determining the projection  
12 life that we're going to use for the next three years.  
13 Mind you, when we set these lives we're not setting  
14 them for eternity, we're setting them for the next  
15 three years. And Dr. Vanston's type analysis I think  
16 is something necessary that needs to be done.

17                    The problem we have with it, though, in  
18 following it to the extent that the company does is  
19 that you're essentially asking to control the rate of  
20 recovery of billions of dollar assets on 10 data  
21 points, on a line drawn through 10 data points, and it  
22 seems to me that that is not sufficient analysis on  
23 which to base those major types of decisions, that  
24 there's a lot more to that underlying factor, tone,  
25 that's in his model in which is this all-encompassing

00290

1 factor. There's a lot more underneath that that could  
2 be different in the future that says -- that calls his  
3 forecasts into doubt.

4 I think that when Fisher-Pry developed  
5 their model -- I went back and read those early  
6 articles and some of the things they did to say look  
7 did the replacement of a single horse-drawn plow for a  
8 two-drawn plow and then a motorized plow, for  
9 instance, I wondered how many -- they only could look  
10 at those in the context of they knew what happened,  
11 but how many types of technologies were developed but  
12 never went anywhere. How many times were there  
13 technologies developed that were thought to be  
14 substitutes but they never turned out to be  
15 substitutes. Those failures, if you will, aren't  
16 considered also in that Fisher-Pry type analysis. It  
17 always assumes that there is a successful  
18 substitution.

19 So those kinds of problems with that  
20 particular analysis don't allow us to accept it as  
21 that's what's -- that's most likely thing that's going  
22 to happen. You have requirement of public authorities  
23 can be a very big factor in determining the future of  
24 the plant. So in each three-way we sit down and have  
25 to consider all these factors. We debate them,

00291

1 discuss them and try to arrive at a consensus judgment  
2 of experts and bring those parameters to the  
3 Commission to use for the next three years.

4 Q. I think I read in your testimony that the  
5 '96 Act there was some statutory language the FCC  
6 participation is now optional in depreciation setting.  
7 Was that right? I guess what I'm getting at is will  
8 there be a future three-way review or not?

9 A. Well, my understanding is that the FCC is  
10 going to issue a notice of proposed rulemaking in  
11 which it will ask the question as to whether it ought  
12 to continue having three-ways and it will be asking  
13 for comment from the states and the different parties.  
14 I'm not sure if that's the same NRPM that Mr.  
15 Sovereign was referring to, but I think it is. And my  
16 understanding is the purpose of it is to get input on  
17 that particular issue. I would like to see that  
18 continue. I think that's been a very useful process.

19 Q. Thank you.

20 JUDGE PRUSIA: Just a brief recess.

21 (Recess.)

22 JUDGE PRUSIA: Let's be back on record.

23 Our brief recess turned into our midmorning break and  
24 we're back on the record. Mr. Spinks is still on  
25 the stand and Ms. Johnston, do you have any redirect

00292

1 for this witness?

2 MS. JOHNSTON: Just a couple of questions.

3

4 REDIRECT EXAMINATION

5 BY MS. JOHNSTON:

6 Q. You're a firm. If you have the opportunity  
7 to earn one dollar in revenue from plant in service  
8 and already paid for, should you take that dollar from  
9 that plant or retire that plant?

10 A. You would take the dollar.

11 Q. Does that mean that that plant has economic  
12 value?

13 A. Yes. In a sense, yes.

14 Q. You were asked a question whether  
15 Commission decisions of retail and wholesale prices  
16 are relevant to a cash flow analysis. Do you recall  
17 that question?

18 A. Yes.

19 Q. Are decisions or actions of the company  
20 also relevant? For instance, if an incumbent local  
21 exchange company obtained high prices on unbundled  
22 network elements or made it difficult for competitors  
23 to use those elements, could that affect the pace of  
24 facilities-based competition?

25 A. Yes, it could.

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1           Q.     Could it also induce competition that would  
2     limit the incumbent's opportunity to recover its  
3     investment?

4           A.     I'm not sure if I understood that.

5           Q.     Well, could the company's efforts to make  
6     it difficult for competitors to use its facilities and  
7     if they then build their own facilities, could that  
8     induce competition that would limit the incumbent's  
9     opportunity to recover its investment?

10          A.     Yes, under that circumstance.

11          Q.     If GTE were subject to effective  
12     competition, would the Commission prescribe  
13     depreciation at all?

14          A.     No, of course not.

15                 MS. JOHNSTON:  That's all I have.  Thank  
16     you.

17                 JUDGE PRUSIA:  Is there anything further  
18     for this witness?

19                 MR. RIGOVIN:  One second.

20

21                         RE CROSS-EXAMINATION

22     BY MR. RIGOVIN:

23           Q.     Mr. Spinks, one last question.

24                 JUDGE PRUSIA:  Could you move the  
25     microphone, closer, please.



1               MR. RIGOVIN: Never believe that from a  
2 lawyer, by the way.

3           Q.     In the example that Ms. Johnston gave of  
4 the dollar for the firm, it seemed that the underlying  
5 issue there was capital recovery. If you could just  
6 please state your definition of capital recovery.

7           A.     I didn't get that out of the question that  
8 it was related to capital recovery. It's the issue  
9 that the assets -- it's a sunk cost. Once you buy the  
10 asset and you pay for it and you have it in place it  
11 becomes a sunk cost in terms of further economic  
12 analysis. If the asset will produce -- can produce a  
13 dollar's worth of revenue, whether that's enough to  
14 cover the costs, the question is do you take the  
15 dollar or do you sell the asset or -- you're better  
16 off by a dollar to take the dollar than you are not  
17 to. That was the context for the question that I  
18 understood and that I answered yes to.

19          Q.     The parameters of the question in your  
20 mind, do they tell you necessarily whether you've  
21 gotten a return of and a return on that investment?

22          A.     No. I didn't make any assumptions about  
23 that.

24               MR. RIGOVIN: Thank you.

25               JUDGE PRUSIA: Thank you for appearing

00295

1 today, Mr. Spinks.

2 THE WITNESS: You're welcome.

3 JUDGE PRUSIA: You may be excused. That  
4 finishes Commission staff's witnesses and now we'll  
5 move to the witness for public counsel and TRACER.

6 MR. FFITCH: Public counsel/TRACER call  
7 Charles King.

8 Whereupon,

9 CHARLES KING,

10 having been first duly sworn, was called as a witness  
11 herein and was examined and testified as follows:

12

13 DIRECT EXAMINATION

14 BY MR. FFITCH:

15 Q. Morning, Mr. King.

16 A. Good morning.

17 Q. Could you please state your full name and  
18 spell your last name for the record.

19 A. My name is Charles W. King, K I N G.

20 Q. What is your business address?

21 A. 1220 L Street Northwest, Washington D. C.

22 Q. And you are the president of the consulting  
23 firm of Snavelly King Majoros O'Connor and Lee; is that  
24 correct?

25 A. Yes, I am.

1           Q.     You have prefiled direct testimony and  
2     accompanying exhibits in this proceeding which have  
3     been marked for identification as Exhibits T-16 and  
4     Exhibit 17 through 22; is that correct?

5           A.     That's correct.

6           Q.     Were these exhibits prepared by you or  
7     under your direct supervision?

8           A.     Yes, they were.

9           Q.     Do you have any additions or corrections  
10    this morning to your testimony or exhibits?

11          A.     Yes. Number of minor typos and one exhibit  
12    was corrected because of a missed transcription of  
13    some data from Dr. Vanston's study. The first typo is  
14    very minor, but I committed the cardinal sin of a  
15    consultant of garbling the name of my client so that  
16    if you look at page 2, line 6 it should read I'm  
17    appearing on behalf of the public counsel section of  
18    the attorney general of the state of Washington.

19                 Then on page 23 in the footnote the  
20    citation to the data request, footnote 20, should be  
21    not 119 but 115. And that would help anyone trying to  
22    access those data requests. Then I have to change the  
23    numbers that I had taken from Exhibit 22, and put into  
24    my testimony, and those numbers are found initially on  
25    page 27. I can recite the corrected numbers.

1                    Opposite 1995 under TFI predicted  
2 retirements the figure that begins with 18 million  
3 should be stricken and the number 15,960,972  
4 substituted. Then directly under that the figure  
5 160454 should be converted to 16,621,094 and the  
6 number under -- opposite 1994 through 1996 instead of  
7 48.8 million should be 46,459,529.

8                    The third column to the right, percent  
9 overstatement, the opposite 1995 instead of 76.1  
10 should be 71.6. Opposite 1996 instead of 81 -- 68.1  
11 should be 69.2. And opposite 1994 through 1996  
12 instead of 64.6 should be 62.7.

13            Q.        And just to clarify for the bench, those  
14 are corrections which are the result of corrections  
15 made to your Exhibit 22?

16            A.        That's correct. Similarly, we have to  
17 change the numbers on page 29. At lines 10 and lines  
18 13 a number 48,898 should now be 46,460. On lines 13  
19 and 14 you will find the figure 733,470. That now  
20 should be 696,900.

21                    And finally at line 15, 42.3 years should  
22 be 40.2 years. And that concludes my corrections.

23            Q.        Mr. King, just to clarify on page 29 --  
24 perhaps you made this correction -- at line 7?

25            A.        Oh, yes. Those same numbers should be

00298

1 changed as well in that. The 48,898 should be 46,460  
2 and the 42.3 years in line 6 should be 40.2.

3 Q. Do you have any further corrections on that  
4 page?

5 A. I don't believe so.

6 Q. Do you have any other changes or  
7 corrections?

8 A. One change I could offer would be to  
9 provide additional data on page 29. Let me quickly  
10 recite the further life indications shown by the  
11 subsequent document that was submitted by the company  
12 after the submission of this testimony. Opposite  
13 aerial cable we have for 1992/94 three-year band a  
14 life indication of 24.4 years; '93-95, 27.8; '94-96,  
15 34.9. Opposite underground cable for the period '92  
16 through '94, 38.2 years; opposite for '93-'95, 37.6  
17 years; '94-96, 43.3 years.

18 Finally for buried cable '92-94, 24.3  
19 years; '93-95, 28.0 years; and '94-96, 31.0 years.

20 Q. And were you referring to page 29?

21 A. 29, the bottom of the page is a table  
22 which provides the historical life indications only up  
23 through the three-year band centered on 1992. And  
24 what I just provided for the record was the subsequent  
25 three-year bands that bring it up to the latest

00299

1 report. Those were not in the original testimony  
2 because at that time GTE declined to provide the  
3 calculations. Subsequently, at the urging of staff,  
4 GTE was persuaded to submit a report and these are the  
5 results.

6 Q. Thank you. Any further additions or  
7 corrections to your testimony?

8 A. No.

9 Q. As corrected, is this testimony true and  
10 correct to the best of your knowledge?

11 A. Yes, it is.

12 Q. If I were to ask you these same questions  
13 set out in Exhibit T-16 today, would your answers be  
14 the same?

15 A. Yes, they would.

16 MR. FFITCH: Your Honor, I would like to  
17 offer Exhibits T-16, 17 through 22 into evidence.

18 JUDGE PRUSIA: Is there any objection to  
19 the admission of documents marked for identification  
20 as T-16 and 17 through 22?

21 MR. RIGOVIN: No objection.

22 JUDGE PRUSIA: Those exhibits will be  
23 admitted.

24 (Admitted Exhibits T-16, 17 - 22.)

25 MR. FFITCH: Thank you, Your Honor. The

00300

1 witness is available for cross-examination.

2 JUDGE PRUSIA: Is there any  
3 cross-examination for this witness?

4 MR. RIGOVIN: Yes.

5

6 CROSS-EXAMINATION

7 BY MR. RIGOVIN:

8 Q. Good morning, Mr. King.

9 A. Good morning.

10 Q. I wondered if we could begin by your  
11 defining the term "capital recovery."

12 A. Capital recovery is the recapture of the  
13 initial investment made by the company's investors in  
14 their plant over the life of that plant.

15 Q. Does that include a return on that  
16 investment?

17 A. Conventionally capital recovery is a return  
18 of investment. Return on investment is known as  
19 return.

20 Q. As I understand your testimony, the  
21 basic philosophy that you've used in terms of setting  
22 the correct lives for depreciation is a mortality  
23 analysis; is that right?

24 A. No.

25 Q. What was your philosophy in coming up with

00301

1 the right depreciation?

2       A.     The philosophy was to use whatever data are  
3 available. It is true that mortality data are  
4 available and that I did use them. I would much have  
5 preferred to have used the company's plans and  
6 projections for future additions and retirements.  
7 Its business plan for future service offerings or  
8 possibly the cancellation of future service offerings,  
9 and made a number of data requests designed to elicit  
10 that information.

11               Unfortunately, I was not successful in  
12 getting any data that would indicate the future plans  
13 of the company. I would also have liked to have used  
14 the data that would support the substitution analyses  
15 of Dr. Vanston, and to that end we asked numerous data  
16 requests that went to the very specifics of Dr.  
17 Vanston's speculations as to new service developments,  
18 the effect of competition and principally substitution  
19 of new technologies.

20       Q.     I'm sorry to interrupt. What I'm really  
21 asking for is what you did use, not what you didn't  
22 use.

23       A.     I'm getting to that. What we got back in  
24 that case was a finding that most of the technologies  
25 and services that Dr. Vanston anticipated --



00302

1 MR. RIGOVIN: I'm going to object to.

2 A. -- were not being rolled out.

3 MR. RIGOVIN: The witness is making  
4 somewhat of a speech here about a lot of issues that  
5 are not called for by the question. The question  
6 simply asked what did he base it on and it's not  
7 intended as a question to raise all of the various  
8 things that he would have liked to have used. If  
9 those are important he can have put those in his  
10 direct or possibly on redirect.

11 MR. FFITCH: May I respond, Your Honor?

12 JUDGE PRUSIA: Yes.

13 MR. FFITCH: I believe the witness was  
14 asked for his philosophy on this issue and counsel  
15 actually interrupted the answer before it was  
16 complete.

17 MR. RIGOVIN: I think it was tied to the  
18 issue of mortality analysis.

19 A. Well, you asked me did I use mortality  
20 analysis as the basis for my lives, and I said no.  
21 Then you said what did I use. I'm trying to tell you  
22 what I used, what I sought to use.

23 MR. RIGOVIN: If I could get a ruling from  
24 the bench. I don't mean to make this a big deal, but  
25 I would like to proceed in a somewhat orderly fashion

00303

1 and address what Mr. King did use in the role of  
2 mortality analysis, not frankly a speech about Dr.  
3 Vanston.

4 MS. JOHNSTON: Well, I would just like to  
5 add and perhaps remind the bench that Dr. Vanston was  
6 permitted to speechify at length yesterday, so perhaps  
7 we have a situation here of the pot calling the kettle  
8 black.

9 MR. RIGOVIN: It's just an objection. It's  
10 not the pot calling anything.

11 JUDGE PRUSIA: I will allow the witness to  
12 continue with his answer in the manner he's answering  
13 to this question. I would ask in future questions  
14 that he try to limit his answer to the question asked.

15 THE WITNESS: Yes, sir.

16 A. The mortality data all indicated that the  
17 existing service lives were too short. However, I am  
18 sufficiently aware of the influences that Dr. Vanston  
19 identifies, that Mr. Sovereign discusses and that I  
20 know independently to recognize that it would be  
21 inappropriate to use unadjusted the mortality data.  
22 So I looked at those data. I looked at the direction  
23 that those data indicate, namely, whether there is any  
24 indication of shortening of service lives and found  
25 none.

00304

1                   And so in general what I have proposed is  
2 what Mr. Spinks proposed which is retention of the  
3 status quo with a couple of modifications specifically  
4 aerial cable and underground cable. Those  
5 modifications based on a finding in the case of aerial  
6 cable that the retirement patterns and the effect of  
7 technology and competition, if there is any, should be  
8 no different for aerial than for buried cable, and  
9 therefore I selected the same life for those two; and  
10 the case of underground cable where the history of  
11 retirements seem to be going in the exact opposite  
12 direction from that predicted by the company, I  
13 selected a slightly longer life.

14           Q.     Does that conclude your answer?

15           A.     Yes, it does.

16           Q.     You've determined that new technology has  
17 little relevance in coming up with a depreciation  
18 rate; is that right?

19           A.     No. That's an overstatement.

20           Q.     Did you testify in your direct testimony  
21 when asked the question "How relevant are these  
22 technological developments to GTE's Washington  
23 operations? "ANSWER: They appear to have relatively  
24 little relevance"?

25           A.     Would you cite the --

00305

1           Q.     On pages 7, lines 14 through 16 of your  
2 direct testimony.

3           A.     Yes. That was referring, of course, to the  
4 prior answer where I was quoting from Dr. Vanston's  
5 report and Mr. Sovereign's testimony where they  
6 emphasize the replacement of fiber in the loop; the  
7 installation of asynchronous transfer mode switching;  
8 the implementation of SONET signaling and digital  
9 wireless technologies. None of these appear to have a  
10 -- these particular technological developments appear  
11 to be a significant impact on GTE based on GTE's  
12 responses to our data requests. Specifically, GTE  
13 said that there was no plan to install fiber in the  
14 loop and there was no plan to install ATM switching.

15          Q.     Is there any new technology that you  
16 assessed in your -- strike that. When assessing what  
17 the proper depreciation rate should be in this docket,  
18 is there any new technology that you think is  
19 significant in terms of that assessment?

20          A.     Yes.

21          Q.     What would that be?

22          A.     It depends on the -- on the area. In the  
23 case, for example, of circuit plant, GTE has a circuit  
24 equipment account which combines analog with digital,  
25 unlike U S WEST, which has those separated. In the

00306

1 case of GTE, however, they're all together and so  
2 there has been a significant and continues to be a  
3 significant changeover from analog circuit signaling  
4 to digital circuit signaling. And there are  
5 expectations that there will continue to be further  
6 changes as new generation digital loop carriers are  
7 installed, and for that reason I selected a  
8 recommended retention of the present service life  
9 notwithstanding that the mortality indications all  
10 suggest a longer life.

11           In the case of digital switching there are  
12 a variety of modular changes that Dr. Vanston  
13 identifies. I don't think that ATM switching is a  
14 major replacement switching technology, but it may be  
15 out in the distant future. ATM switching, if it were  
16 to develop, would be driven by an effort to develop a  
17 fully integrated broad band network, and it appears  
18 now that most of the telephone companies, that is  
19 incumbent telephone companies, including GTE, have  
20 cancelled their plans for broad band networks.

21           So I allow for the possibility that there  
22 will be an acceleration in the economic -- in the  
23 technological development of switching, once again, by  
24 allowing for -- by recommending a shorter service life  
25 than historical retirements would suggest.

00307

1                   In the case of the cable accounts, there's  
2 no question that as time goes on much of the existing  
3 application of copper in the interoffice and feeder  
4 facilities, particularly long haul feeders and for  
5 virtually all interoffice uses, will be substituted  
6 for by fiber. And once more, I have recommended  
7 service lives significantly shorter than those  
8 indicated by the mortality analysis.

9                   The numbers I just read off that would be  
10 put on page 29 all are significantly longer than the  
11 service life I have recommended. So I believe I have  
12 acknowledged the probability that technology will  
13 accelerate retirements in the future and therefore  
14 service lives should be shorter than historical  
15 mortality indications.

16           Q.     As to competitive developments, your  
17 testimony is that the -- that there's an uncertain  
18 relevance to that; is that right?

19           A.     Yes. I am much less optimistic that we  
20 will have an effective facilities-based telephone  
21 network competition, particularly for the critical  
22 function of access between the end office switch and  
23 the subscriber's premise. If you look at the data  
24 that has been put in the models in the interconnection  
25 dockets you will find extraordinary economies of

00308

1 density, which is to say scale, that is, density of  
2 route, in every function pertaining to the local loop.  
3 In effect, it is vastly cheaper per circuit to put in  
4 cables than have hundreds of circuits than to put in  
5 cables that only have a relative handful for the  
6 simple reason you've got to trench them. You've got  
7 to put them in the ground, and there's a negligible  
8 increment in cost to put a high capacity cable in  
9 relative to a low capacity cable. The effect of that  
10 is to perpetuate, I think indefinitely, the effective  
11 monopoly of the incumbent local exchange carriers over  
12 this critical subscriber access function.

13           And while there will be competition, that  
14 competition will be in the trunking and the switching  
15 area, but most of the competitors will continue to be  
16 reliant almost totally on the incumbent carrier for  
17 the local loop function, and that function, of course,  
18 is the one that dominates the cable accounts, and for  
19 that reason I do not think that competition will have  
20 a significant impact on the cable accounts. That is  
21 the copper cable accounts, fiber possibly, but not  
22 copper.

23           Q.     Are you familiar with the concept of  
24 "economic depreciation"?

25           A.     I've heard it discussed considerably, yes.

00309

1 Q. What is your understanding of that?

2 A. My understanding is that economic  
3 depreciation is a recognition of the annual decline  
4 and the future income earning capability of an asset  
5 as compared with the simple time-based treatment of  
6 depreciation under conventional straight line  
7 depreciation.

8 Q. How about the term "economic life"?

9 A. Economic life in a regulated context is  
10 synonymous with life in service. In theory, economic  
11 life could be shorter than life in service if the  
12 plant loses all future income earning capability at  
13 the end of its physical life. As a practical matter,  
14 in a regulated enterprise, this never happens because  
15 as long as the plant has net investment value it is  
16 included in the rate base which in turn permits it to  
17 earn depreciation and a return. Therefore, it has, it  
18 takes on, economic value simply by reason of its  
19 incorporation into the regulated rate base.

20 Q. What if you're not a regulated environment?

21 A. Not in a regulated environment economic  
22 life then becomes possibly different from a -- well,  
23 not in a regulated environment, I think you mean in a  
24 competitive environment.

25 Q. I meant in a non fully regulated



00310

1 environment.

2       A.     Well, non fully regulated is a little  
3 caveat. I'm not sure what you mean. If we're talking  
4 about a totally competitive enterprise then economic  
5 life could be significantly different from physical  
6 life.

7       Q.     Do you think the "conventional way," as  
8 that was your phrase that you used, is the right way  
9 to approach depreciation in this docket or an economic  
10 depreciation or economic life-based analysis is the  
11 right way?

12       A.     I think I mentioned a moment ago that in a  
13 regulated context, because of the practices of rate  
14 base rate of return regulation, the two are the same.  
15 There is no difference between economic life and  
16 physical life, because as long as the plant is in  
17 telephone plant in service account, it is part of the  
18 rate base of the utility and therefore generates  
19 depreciation expense, which is charged to ratepayers,  
20 and it generates return on the net investment -- that  
21 is the undepreciated portion of the plant, which is  
22 also charged to ratepayers.

23               And because we have in a monopoly  
24 environment a market power, which means the utility  
25 can charge effectively anything it can get away with

00311

1 charging and expect to recover that revenue, the plant  
2 is therefore revenue-producing and it has economic  
3 value notwithstanding its technology.

4 Q. The world that you're describing in which  
5 as long as the plant is on the books there's going to  
6 be a recovery is not a world that we're now living in,  
7 is it?

8 A. Yes, it is. I believe GTE is regulated on  
9 a rate base rate of return basis. Even when we get  
10 into the unbundled network element environment the  
11 rates set for those unbundled network elements will be  
12 largely determined by this Commission based on costs,  
13 albeit forward-looking economic costs, but still based  
14 on costs, and the reason they will be set by this  
15 Commission is that GTE and the other incumbent  
16 telephone companies will continue to exert market  
17 power, very strong market power, over the local loop  
18 function and to a lesser degree the local switching  
19 function.

20 Q. But in a competitive environment the  
21 recovery of depreciation expense is not going to be  
22 assured by the Commission. It's going to be either  
23 allowed or not allowed by the marketplace; isn't that  
24 right?

25 A. Your assumption, Mr. Rigovin, is that there

00312

1 will be a competitive environment, and that assumption  
2 I challenge, particularly with respect to the  
3 subscriber access function. I do not expect that to  
4 be a fully competitive function for the duration of  
5 our lifetime. I just don't think the economics of  
6 land line transmission lends itself to a fully  
7 competitive, that is, facilities-based competitive  
8 situation for the subscriber access function.

9 Q. So is it fair to say, then, that you reject  
10 the use of economic depreciation for this docket?

11 A. It isn't a matter of rejection. As I said  
12 before and will say again and as many times as you ask  
13 me, in a regulated environment where there are  
14 administered prices based on the costs of the company  
15 and those costs include a recognition of the plant  
16 that is in service and is presumed used and useful for  
17 the provision of service, economic depreciation or  
18 economic life -- I'm sorry -- economic life and  
19 physical life are one and the same.

20 Q. So there's no need, then, to use a cash  
21 flow analysis; is that right?

22 A. Well, cash flow analysis is circular in a  
23 regulatory situation, as we pointed out with Mr.  
24 Spinks. Depreciation determines the major element of  
25 cost of most facilities. That cost in turn determines

00313

1 the rates that can be charged for the services that  
2 use those facilities. Those rates in turn determine  
3 revenue. Revenue determines cash flow, and if you  
4 then tell me that cash flow should determine  
5 depreciation you have completed the circle. It is a  
6 totally circular exercise. So, it is irrelevant to  
7 perform cash flow analysis when the cash flow is  
8 driven by the depreciation charges.

9           In a competitive environment -- that is, a  
10 fully competitive environment -- depreciation does not  
11 determine revenue, does not determine cash flow, and  
12 is generally left out of cash flow analyses completely  
13 because it's not a cash -- neither a cash expense nor  
14 cash generation -- source of generation.

15       Q.     Did I hear you correctly say that we're not  
16 going to have a fully competitive environment for our  
17 lifetimes?

18       A.     For the function of subscriber access for  
19 most subscribers, not all, the answer is yes. We will  
20 not have a competitive environment I would say for the  
21 next few decades. I don't think anyone appreciates  
22 the enormous power of incumbency that firms like GTE  
23 have with a fully built-out system of land line  
24 connections to every subscriber in the state. No one  
25 is going to be able to replicate that and no one

00314

1 should because it's not economical to do so.

2           The appropriate approach is the one taken  
3 by Congress to require the incumbent to unbundle its  
4 facilities to offer these loops for lease by  
5 competitors so that competitors can at least  
6 participate in the switching and trunking functions  
7 and the customer service functions. But they will not  
8 be able to build out local loops to every residence  
9 and every business in the state, and that's something  
10 that GTE has already done in its service territory.

11       Q.     So if I understand your testimony  
12 correctly then, Mr. King, what you're saying is that  
13 there's no need to do a cash flow analysis or economic  
14 depreciation or use of economic lives at least for the  
15 next couple of decades. Isn't that what you're  
16 saying?

17       A.     With respect to the elements that make up  
18 the local loop function and to a lesser extent the  
19 switching function. It isn't a matter of not needing  
20 to. As I indicated, cash flow economic depreciation  
21 is what -- cash flow in particular is a totally  
22 circular exercise when you have cost-based rates that  
23 are set by regulators.

24       Q.     As I understand it, then, your testimony is  
25 -- for this Commission it's just business as usual.

00315

1 There shouldn't be any changes. There's no need to  
2 switch regulatory gears. There's no need to do  
3 anything special about the "competition" that's been  
4 ordered by the 1996 Act, by any state initiatives for  
5 competition within the state of Washington. All that  
6 can be swept aside, business as usual, no need to  
7 change anything, just stay the course; is that right?

8 A. I don't know why you're saying that. I  
9 certainly don't think that the establishment of  
10 interconnection rates based on total element long-run  
11 incremental costs, the establishment of mandatory  
12 wholesale/retail discounts, that's not business as  
13 usual. That's the appropriate steps that we're  
14 undertaking to bring into this industry as much  
15 competition as it will support. My only statement is  
16 that notwithstanding all those efforts, I do not  
17 anticipate there to be effective facilities-based  
18 competition for most subscriber access functions.

19 Q. Mr. King, what you're saying then --

20 MR. FFITCH: Excuse me. Would you please  
21 let the --

22 Q. I apologize. I thought you were done.

23 A. You're casting my testimony in very  
24 pejorative terms which totally misrepresents what I'm  
25 saying. All I have asserted is that when you are

00316

1 talking about prospective service lives for copper  
2 cable, for example, I don't anticipate that  
3 competition, facilities-based competition, will have  
4 much impact on those plant lives in the next several  
5 decades. As a consequence, I do not see any  
6 justification for using competition as an excuse for  
7 radically shortening those service lives as the  
8 company is proposing in this proceeding.

9           Now, that's all I've suggested. Nothing  
10 about business as usual and forgetting about  
11 competition and forgetting about the 1996  
12 Telecommunications Act. This Commission has been  
13 working on those proceedings, I gather, almost  
14 full-time. I don't know what else they've got time to  
15 do because they're extraordinarily complex  
16 proceedings.

17       Q.     The gist of what you're saying, though, is  
18 that nothing is going to affect GTE's ability to  
19 recover the revenues to cover the depreciation  
20 expense. I mean, that is the gist of what you're  
21 saying, right?

22       A.     For the functions relating to the natural  
23 monopoly that I believe GTE will have over the next  
24 coming few decades, yes. I don't think there is any  
25 threat to GTE's ability to continue to exert market

00317

1 power. By market power I mean the ability to charge  
2 rates that bear little relationship to the underlying  
3 costs as would be required by a competitive market.

4 Q. And if a cash flow analysis were prepared  
5 and were to demonstrate that there was actually a  
6 disruption in that revenue sufficient to cover  
7 depreciation expense you would agree, then, that that  
8 would be relevant for the setting of the projection  
9 life, wouldn't you?

10 A. I think what you're asking me is if I were  
11 wrong would I not be wrong because a cash flow  
12 analysis would suggest such a disruption only if there  
13 were serious loss of market power --

14 Q. It might demonstrate that you're right.

15 A. I'm sorry?

16 Q. It might demonstrate that you're right. I  
17 don't think it necessarily has to demonstrate that  
18 you're right or wrong, but the question is if it were  
19 to demonstrate that there were insufficient revenues,  
20 would that in your mind affect how you would decide  
21 what the proper depreciation expense, which is to say  
22 the projection life, should be?

23 A. Well, again, you're asking me if I were  
24 wrong, which is to say if I am incorrect about the  
25 persistence of market power by GTE for the indefinite



00318

1 future, and that were to indicate that the company in  
2 fact was not able to recover its capital, would not I  
3 therefore be wrong with respect to economic service  
4 lives, and obviously that's a truism. That's a  
5 statement that it does not require -- well, it answers  
6 itself.

7 Q. Could you answer it?

8 A. I have.

9 Q. I didn't quite understand the question had  
10 answered itself. That's why I asked it.

11 MR. FFITCH: I'm going to object. The  
12 question was asked and answered.

13 JUDGE PRUSIA: Could you be a little  
14 clearer on what you didn't understand?

15 Q. What is the answer to the question would it  
16 affect your assessment of what the proper depreciation  
17 rate should be for a plant if there were insufficient  
18 revenues to cover the depreciation expense?

19 A. What you're hypothesizing, if there were  
20 insufficient revenues to recover the depreciation  
21 expense, would it not be correct that the economic  
22 life would be different than the physical life?

23 Q. Yes. You said that eloquently.

24 A. And that obviously would be a highly  
25 significant finding. That finding, however, would

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1 require finding totally wrong my assertion that this  
2 company will enjoy market power indefinitely, because  
3 with market power there will never become a situation  
4 when it cannot recover its depreciation expense.

5 Q. You've testified that there's no evidence  
6 that GTE is maintaining under utilized plant on its  
7 books; isn't that right?

8 A. We attempted to identify that information  
9 by asking for utilization data. The company initially  
10 said it was irrelevant to the case, which is clearly  
11 not so, and then went on to say that relevant or not  
12 it had no such data. Now, if the company had the data  
13 and could demonstrate that pursuant to the effects  
14 that Dr. Vanston asserts that there were severely  
15 under utilized cables, severely under utilized -- I  
16 guess he doesn't hit it so much in the switching area,  
17 but cables particularly, owing to the conversion of  
18 interoffice cable, for example, from copper to fiber,  
19 then I might be persuaded that there's some substance  
20 to Dr. Vanston's model.

21 My understanding from the telephone  
22 engineer on our staff is that the routine practice  
23 when a cable, a copper cable, is taken out of  
24 interoffice service is to convert that cable to feeder  
25 service for short haul feeder routes where copper is

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1 routinely assigned as the most effective form of  
2 communication and that when feeders are taken out of  
3 copper, feeders are taken out of feeder service, they  
4 are routinely re-assigned to distribution service. So  
5 that notwithstanding the substitution of fiber for  
6 copper there are no retirements. In fact the plant  
7 lives on, it just lives on in a different function.

8 Q. In assessing GTE's plant, isn't the key  
9 issue, Mr. King, whether there is positive cash flow  
10 coming from the assets?

11 A. It really isn't an issue as long as the  
12 company exerts market power, the company is able to  
13 charge sufficient prices at all times to recover its  
14 depreciation and therefore to generate positive cash  
15 flow. I know of no facilities in GTE that do not  
16 generate positive cash flow. If they did not they  
17 should be written out of the rate base because right  
18 now customers are being overcharged. They're being  
19 overcharged because they are being required to pay  
20 rates reflecting depreciation charges and return on  
21 plant that is not economic. It is not used and useful  
22 in the provision of utility service.

23 Q. Mr. King, you don't have any studies to  
24 back up your prediction that GTE will continue to be  
25 able to cover its depreciation expense from its

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1 current plant as it faces competition and new  
2 technology, do you?

3       A.     Like Dr. Vanston, I am looking at the  
4 present economics of telecommunications service and  
5 speculating on the future. My speculations are backed  
6 up by data, and I refer you again to the models that  
7 have been produced in the interconnection proceeding  
8 which display the characteristic that I have just  
9 described. Enormous economies of scale, specifically  
10 economies of route density which mean that no  
11 incumbent -- that every incumbent with all of the  
12 lines accessing a given area trunked into its own  
13 cables enjoy enormous economies, economic advantages  
14 over any competitor that would seek to string separate  
15 cables which suffer from a much lower level of route  
16 density.

17             As a consequence, it's not likely that any  
18 competitor in the foreseeable future will be able to  
19 replicate in any significant way the route layout and  
20 the cable layout and the access to subscribers that  
21 GTE now has, particularly as GTE has cables that are  
22 already significantly depreciated, and these cables  
23 provide an incumbent advantage that I do not see can  
24 be overcome. So the studies that I would cite you to  
25 are those in the interconnection models.

1           If you would like evidence that the plant  
2 is already largely depreciated, I would refer you to  
3 my Exhibit 19 and specifically page 3 which shows that  
4 the copper metallic cable accounts are now 43.5  
5 percent depreciated, and that depreciation is  
6 increasing at rates of approximately 3 percentage  
7 points every year. That is, that reserve ratio is  
8 increasing at a rate of 3 percentage points per year.

9           Q.     Mr. King, in your testimony you pointed to  
10 the electric industry as another industry that has  
11 plant similar to that of GTE; isn't that right?

12          A.     What I said was if you want to look at  
13 industries that have plant similar to GTE, you may as  
14 well look at the electric industry.

15          Q.     Mr. King, let's think ahead in the next  
16 year or two when the electric industry is deregulated  
17 either by federal and/or state law. That seems to be  
18 very much in the wind these days. Would you expect  
19 that there would be a disruption to the cash flow of  
20 any given major utility in the electric industry as  
21 competition is opened up?

22                 MR. FFITCH: I'm going to object to the  
23 question as assuming facts that are not in evidence in  
24 this proceeding. Perhaps you can convert that to a  
25 hypothetical. You're assuming a fact of introduction

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1 of competition.

2 Q. Assume competition comes to the electric  
3 industry. Would you foresee any disruption to the  
4 cash flow in that industry for a given utility?

5 A. Well, there really will be three electric  
6 industries, because the competition that is impending  
7 in the electric industry is really only for  
8 generation. The two other major functions of the  
9 electric industry are transmission and distribution,  
10 and those will continue to be effective monopolies.

11 The paradigm that is developing is that the  
12 transmission function will be operated by independent  
13 system operators who are separated structurally from  
14 the generation companies who will compete. The  
15 distribution function will continue very much as the  
16 electric distribution function -- I mean, the  
17 telephone distribution function I have described will.  
18 Namely, it will continue to be a natural monopoly.  
19 There will be no disturbance in the cash flow or in  
20 the expected service life of the distribution lives of  
21 the electric utilities for the simple reason that  
22 there will be no disturbance in their monopoly hold  
23 over the prices charged for the distribution function.  
24 Q. Mr. King, do you know if AT&T suffered any  
25 disruption to its cash flow when it was opened up to

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1 competition in the long distance market?

2 A. It experienced major loss in the customer  
3 premise equipment because suddenly what had been  
4 property of AT&T was conveyed to the customers  
5 themselves.

6 Q. I'm sorry, I'm talking about the -- are you  
7 talking about the long distance market?

8 A. Well, you asked about AT&T.

9 Q. In the long distance market. Maybe I  
10 wasn't clear.

11 A. The company did not significantly suffer  
12 disruption in the long distance market.

13 Q. Thank you. Moving on to the depreciation  
14 reserve in Washington. You've testified that you  
15 think a figure of 33.5 percent was not correct, is  
16 that right?

17 A. I'm sorry, I was distracted. Could you  
18 repeat the question, or begin the question over again?

19 Q. Yeah. On page 16 of your direct testimony,  
20 lines 3 through 5 you've testified that the correct  
21 figure for GTE's depreciation reserve should be 39  
22 percent; is that right?

23 A. Yes. That's on Exhibit 18. The right-hand  
24 column, bottom right number is 39.9 percent.

25 Q. Is that what's also labeled as attachment

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1 4?

2 A. Attachment 4, that's correct.

3 Q. And so you looked to the figure on the  
4 bottom right-hand corner, is that right, 39.9 percent?

5 A. That's right. This paragraph is simply  
6 putting in the text the numbers from this attachment.

7 Q. Mr. King, the source for that is the ARMIS  
8 reports; is that right?

9 A. That's correct. One of the confusions is  
10 that this does not pertain just to Washington. This  
11 is GTE Northwest which would, I understand, include  
12 Oregon, and I do not know whether it includes Idaho as  
13 well.

14 Q. Do you know for interstate or intrastate?

15 A. I cannot say. The ARMIS data --

16 Q. Subject to check would you agree that the  
17 ARMIS, that data is for interstate?

18 A. Well, there are reports that do contain  
19 intrastate data but I think you may be right.

20 Q. If I could just have one minute, please.

21 JUDGE PRUSIA: Yes.

22 MR. RIGOVIN: I just have a couple of more  
23 questions and then I will be finished.

24 JUDGE PRUSIA: If you could just clarify  
25 for the record what you meant by "interstate."



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1                   MR. RIGOVIN: As I understand it, the ARMIS  
2 data report captures the interstate -- the accounting  
3 for the interstate operations in Washington for GTE  
4 Northwest. It's not purely intrastate figure whereas  
5 the 33 percent figure I had understood to be an  
6 intrastate.

7                   JUDGE PRUSIA: So you mean total state?

8                   MR. RIGOVIN: It's total for interstate  
9 booking, I am told, for GTE Northwest and not  
10 specifically to Washington.

11                  JUDGE PRUSIA: Thank you.

12           Q.     Mr. King, I just have a couple of more  
13 questions, and I will be brief. A lot of your  
14 observations focused on the ability of GTE to continue  
15 to have the same revenue stream from its, as you put  
16 it, distribution -- what we're really talking about  
17 here is the local customer; is that right?

18           A.     That's correct.

19           Q.     Do you know what percentage the local  
20 customer provides to GTE's revenues as opposed to the  
21 business customer's?

22           A.     I believe business customers are local  
23 customers. I think what you asked is residential  
24 versus business; is that correct?

25           Q.     Yes, that's correct.

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1           A.     I do not know. I suspect given that  
2 usually business rates are significantly higher than  
3 residential rates, a significant portion of GTE's  
4 revenue comes from its business clientele.

5           Q.     You would agree, wouldn't you, that there's  
6 going to be brisker competition for those business  
7 customers as opposed to residential customers,  
8 wouldn't you?

9           A.     To the extent that there is any competition  
10 for the local distribution function, that is, the  
11 local loop function, it will fall in the business  
12 area, and it will fall for certain types of business  
13 where you have a high concentration of end use  
14 customers in a relatively tight geographic area.

15          Q.     If you were a CLEC, would you go after the  
16 business customer or the residential customer first?

17          A.     I would go after high concentration business  
18 customers, and I would go after possibly apartment  
19 complexes in the residential area. The rest I would  
20 serve through leased lines from the telephone company.

21          Q.     Were your observations today on the effects  
22 of competition, do they take account of the effect of  
23 wireless and cable competition?

24          A.     Yes. A lot of talk about wireless  
25 replacing voice. I have really two observations. One

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1 is that wireless is extraordinarily expensive. Our  
2 firm was hired to conduct some studies of wireless by  
3 a firm that was considering bidding on the PCS  
4 licenses, which, as you recall, were up for  
5 competitive bid about a year ago, and one of the  
6 biggest costs is what's called back haul. The  
7 property of wireless, effect of wireless, is to have a  
8 lot of antennas distributed around the community.  
9 These antennas for PCS have to be within a couple of  
10 miles of each other because the propagation radius of  
11 that particular band width that they are using in the  
12 two gigahertz range is only about a mile and a half.

13           The result is that the principal cost of  
14 establishing a wireless system is not the antennas,  
15 which are not all that expensive but reaching the  
16 antennas, and for that purpose the wireless companies  
17 use the lines of the telephone, the incumbent  
18 telephone carrier, so that it's not clear that  
19 wireless necessarily results in a net loss of revenue  
20 to the incumbent telephone carrier because the biggest  
21 expense in wireless is reaching not customers but  
22 reaching antennas over the lines of the incumbent  
23 telephone company.

24       Q.     Just one second, please. Isn't it true  
25 that wireless carriers can use other means to reach

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1 the antennas instead of the incumbent?

2 A. Well, technically it's possible, but once  
3 more, we're into the economics. What's going to be  
4 the cheapest way to get into the antenna sites. And I  
5 think in general that the cheapest way will be through  
6 the lines of the preexisting lines of the incumbent  
7 telephone company.

8 Q. What's the basis supporting your last  
9 statement?

10 A. The basis is that no one has come up with a  
11 cheaper way of providing private line service than the  
12 wire lines of the telephone company, particularly  
13 given -- in particular given the sophistication of  
14 modern carrierization that permit you to trunk a large  
15 number of calls over a given telephone line. If there  
16 were cheaper ways to use dedicated service from point  
17 A to point B they would be more heavily employed  
18 already. It was certainly in our economic analysis  
19 studies that we performed for our client. We explored  
20 alternatives, but the telephone company was the only  
21 one that made any economic sense.

22 MR. RIGOVIN: Thank you. That's all I  
23 have.

24 JUDGE PRUSIA: Does Commission staff have  
25 cross for this witness?

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1 MS. JOHNSTON: No, we don't.

2 JUDGE PRUSIA: Mr. Gillis, do you have  
3 questions for this witness?

4 COMMISSIONER GILLIS: No.

5 JUDGE PRUSIA: Is there any redirect?

6 MR. FFITCH: May we have just a short  
7 recess, Your Honor, before we report on that question?

8 JUDGE PRUSIA: How long do you need? About  
9 five minutes?

10 MR. FFITCH: Five minutes or less.

11 JUDGE PRUSIA: We'll take a five-minute  
12 recess.

13 (Recess.)

14 JUDGE PRUSIA: Let's be back on the record.  
15 Do you have redirect for this witness?

16 MR. FFITCH: No redirect.

17 JUDGE PRUSIA: Very well. Then there  
18 should be nothing further for the witness. Are there  
19 any further witnesses? There are none that I am aware  
20 of. Is there anything further to come before us this  
21 morning?

22 MR. FFITCH: No, Your Honor. Nothing from  
23 public counsel.

24 JUDGE PRUSIA: The briefs are due on the  
25 29th, and I understand the parties will be conferring

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1 with one another to come up with a matrix of issues to  
2 cover in their briefs. There being nothing further to  
3 come before us, we'll stand adjourned and be off the  
4 record.

5 (Hearing adjourned at 11:47 a.m.)

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