Before the

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of	)	DOCKET NO. UT-003013, PHASE B
The Continued Costing and Pricing	)	
of Unbundled Elements, Transport	)	VERIZON NORTHWEST INC.
and Termination, and Resale	)	RESPONSE TO BENCH REQUEST NO. 43

<u>Bench Request No. 43</u>

Verizon is requested to calculate a common cost factor using in the numerator the common costs identified in response to Bench Request #14. In the denominator, please place the Direct Costs of the Company. The Bench requests that the direct costs be calculated using the same type of information that the Company has used to determine its common costs (which the bench understands to be combination of activity based cost data and ARMIS information).

The basic steps for the calculation of the Joint and Common cost factor would be as follows:

- Step 1: Apply adjustments, as appropriate, for one-time events (e.g., for transition benefit costs,[5] merger impacts). Provide an explanation of why the adjustments were made.
- Step 2: Apply the Current Cost to Booked Cost Ratios to investments.[6]
- Step 3: Apply capital cost factors to investments.[7]
- Step 4: Assign costs to direct or common classification (see below).
- Step 5: Divide common cost by the direct cost.

The Bench asks that in response to this bench request, the company assign its expenses and investments in a manner that is consistent with the treatment of expenses and investments within ICM. For each expense and investment account, Verizon is asked to explain why it believes the account should be treated as a direct, common, or a direct and common expense.

Response:

A common cost factor was developed (see attachments) using in the numerator the common costs identified in response to Bench Request #14 submitted on April 2, 2001.

[5]Transition benefit obligation costs is associated with an accounting rule change to account for the earned benefits of all employees, both exiting and retired. Generally stated the new accounting treatment accounts for benefits (current and post employment) while the employee is on the payroll earning the right to those benefits. The prior method accounted for these costs as employees incurred them even after the employee retired. The change in accounting methods left a large sum of costs that either needed to be expensed in a single accounting period or accrued over several accounting periods. These costs may have been amortized over the remaining employment lives of employees at the time of the change.

[6] The current cost to booked cost ratios should be the same as those utilized in the development of the UNE costs maintaining consistency and an appropriate relationship with the UNE cost studies.

[7] Capital cost factors are applied only to investments. The capital cost factors are the same capital cost factors utilized in the development of the UNE costs. The utilization of the same capital cost factors maintains an appropriate relationship with the Unbundled Network Elements Cost studies. The capital cost factor is designed to reflect the cost of money, depreciation and the composite state, local and federal taxes.

The denominator used the Direct Costs of the company. Direct costs were calculated using the same type of information that the company used to determine its common costs (reference the ICM filing package, ICM Expense Documentation, stamped pages 14-001 to 14-689), rather than the Direct Costs adopted by the Commission in UT-960369.

Step 1 – Started with adjusted ARMIS expense balances. See attached stamped pages 14-064, 14-074 to 14-075, and 14-502 to 14-503. Applied other adjustments as appropriate (see attached calculation schedules).

Step 2 – Used modeled ICM investment balances (instead of Current Cost to Booked Cost Ratios) to be consistent with how UNE costs were developed. See attached calculation sheet. See attached stamped page 14 620.

Step 3 – Applied capital cost factors to investments, which included cost of money, depreciation, and the state, local, and federal composite taxes.

Step 4 – Assigned costs to direct or common classification using the ICM assignment process described on the attached stamped pages 14-008 to 14-016. The summary of this assignment process by expense and investment account can be found on stamped pages 14-490 to 14-501 for expenses and 14-595 to 14-596 for investments in the ICM Expense Documentation.

Step 5 – Calculates the common cost factor assuming the Company refiled new direct costs for all UNEs. Common cost factor equals (Total common cost) divided by (Total FCC defined TELRIC direct cost). See attached calculation schedules.

Step 5s resultant common cost factor is 17.89 percent and can be found on page 1 of 2 in the attached section titled “Step 5.” The 17.89 percent common cost factor is what would occur if Verizon Northwest filed totally new direct and common cost studies.

The use of the 17.89 percent factor in this proceeding is inappropriate for two basic reasons. First, the Commission has previously found and ordered what it believes the Company’s direct costs are for several UNE items. Thus, the direct costs derived from ICM should be adjusted to represent the Commission’s previous findings. For example, end-office switching and port TELRICs have already been ordered and are significantly below the costs that are generated by ICM.

	Basic Port TELRIC	EOS TELRIC
Commission Ordered	$ 1.29	$ 0.00136
ICM	$ 2.65	$ 0.00286
DIFFERENCE	($ 1.36)	($ 0.00150)

Using in-service lines and a conservative estimate of 890 minutes of use per month would lead to a negative adjustment of $28 million in the Company's total direct costs. Thus the $394 million of direct costs derived from ICM should be reduced to $366 million based on previous Commission findings. The resultant effect on the common cost factor would be to increase it to 19.3 percent ($70.5 million divided by $366 million).

Second, the Commission's previous orders on UNE price sets used the following common cost allocation factors (based on the Commission's finding for direct costs) for the various UNEs:

Loops .... 17.93 percent
Ports .... 3.88 percent
EOS .... 4.05 percent

These factors are significantly less than the 19.3 percent that would be required to allow the Company a theoretical opportunity to recover its hypothetical forward looking common costs. For all remaining UNE items (which account for a relatively small portion of direct costs) a common cost factor significantly in excess of 19.3 percent would be required to give the Company a theoretical opportunity to recover its hypothetical forward looking common costs.

Applying the common cost factor of 24.75% provides a reasonable and yet conservative estimate of the common cost to be assigned to each of the remaining UNEs being addressed in this proceeding.

Response by: Laura Brevard
Manager - Pricing