Exhibit No. _____ (SES-1T)
Docket No. UT-050814
Witness: Stephen E. Smith

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of	)	
Verizon Communications Inc. and MCI, Inc.	)	**Docket No. UT-050814**
for Approval of Agreement and Plan of Merger	)	

REBUTTAL TESTIMONY OF

STEPHEN E. SMITH

ON BEHALF OF

VERIZON COMMUNICATIONS INC. AND

MCI, INC.

REDACTED VERSION

October 6, 2005

Confidential per Protective Order in
WUTC Docket No. UT-050814

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Stephen E. Smith. My business address is 1717 Arch Street, Philadelphia, Pennsylvania 19103.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am Group Vice President, Business Development for Verizon's Domestic Telecom Group. In that position, I have responsibility for the evaluation, and subsequent execution, of mergers, acquisitions, dispositions, and strategic alliances for the lines of business within Verizon's Domestic Telecom Group. I have worked with Verizon (or its predecessor) for twenty-eight years in the areas of finance, strategy, planning, and mergers and acquisitions.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND, EXPERIENCE AND QUALIFICATIONS.

A. I received my B.A. in Finance from Georgetown University. I began my career at the company in 1977, when I started as a Staff Associate in the Comptrollers Department of C&P Telephone in Washington D.C. I have since held various assignments in Accounting, Accounting Operations, Financial Planning, and Business Strategy. Prior to assuming my current position in 2000, I was a Vice President with Bell Atlantic Global Wireless, where I was responsible for Strategy and Development. In that position I worked on both the formation of the Bell Atlantic – Vodafone Partnership, as well as on the various transactions (mergers and dispositions) surrounding the creation of Verizon wireless. Prior to the public announcement of Verizon's acquisition of MCI in February 2005, Verizon personnel developed an estimate of the synergies that we expect to result from the transaction. I was responsible for coordinating that effort.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to rebut the testimony filed on September 9, 2005, by Staff Witness Ms. Kathleen M. Folsom and Public Counsel Witness Mr. Charles W. King. I will explain how Verizon performed its synergy analysis attributable to the Washington intrastate rate regulated operations of Verizon Northwest Inc.[1] and show the flaws in Ms. Folsom's and Mr. King's presentations. In particular, I will show the fatal errors in Mr. King's "systemic" synergy analysis.

II. <u>VERIZON NORTHWEST SYNERGY ANALYSIS</u>

Q. PLEASE SUMMARIZE VERIZON'S WASHINGTON SYNERGY ANALYSIS FILED IN RESPONSE TO PUBLIC COUNSEL DATA REQUEST NO. 131.

A. By way of background, before entering into the merger agreement with MCI, Verizon's management team developed synergy estimates that the company expects to achieve, on

[1] All references to Verizon Northwest herein refer to the company's intrastate business in the state of Washington.

an enterprise-wide basis over time. This type of financial analysis is common and helps inform the value that the executive leadership places on a potential transaction. Prior to commencing this proceeding, Verizon had not developed a similar analysis that was specific to Washington, and so Petitioners did not submit such an analysis in its direct case. Verizon subsequently prepared an analysis solely at the request of Public Counsel and Staff. That analysis stems from the enterprise-wide synergies analysis that had previously been prepared for Verizon's upper management, and was based on a set of solid and appropriate financial principles and assumptions that are consistent with the earlier study.

While Petitioners expect to achieve synergies benefits, it is reasonable to assume that market forces can be relied upon to ensure than an equitable share of these benefits is passed on to the combined company's customers. As Dr. Taylor and others have observed, the telecommunications market in which the new Verizon will operate is rapidly changing and highly competitive. This is particularly true of the enterprise segment, which is the principal focus of the transaction. As a result, market forces will compel the combined companies to pass on to consumers, in the form of lower prices, new service offerings, increased investment and improved service quality, an equitable share of the benefits of the transaction. For all these reasons, Petitioners believe that it is unnecessary and unwise for regulators to attempt to determine an explicit allocation of transaction benefits in a particular jurisdiction and to devise regulatory mandates for flowing through a portion of such benefits to discrete groups of customers. Such an approach is ultimately arbitrary and inappropriate. This issue is discussed in Mr.

Danner's testimony. With this background and caveat in mind, here is how Verizon prepared its analysis:

As a starting point, Verizon estimated that the merger transaction would generate on a nationwide basis $7.3 billion of present value arising from new revenues and expense and capital savings, net of costs to achieve those benefits and net of related taxes. The synergy savings are attributable to information technology, network operations, international activities, headcount reductions, and revenue enhancements.

The first step in developing a Washington specific synergy analysis for regulated intrastate operations was to identify how the synergies described above would be distributed between Verizon's and MCI's operations. This step is necessary in order to determine how the transaction-related synergies could be attributed to Verizon Northwest's intrastate regulated operations. For example, information technology savings are attributed to MCI's operations because the transaction will enable the implementation of MCI's existing plan to construct a unified interface for various existing MCI systems. Conversely, vendor savings are attributed to Verizon's operations because the transaction will enable the new company to reduce the payments Verizon currently makes to other carriers for traffic that can be migrated onto underutilized portions of MCI's network.

Headcount reductions are attributed to Verizon's or MCI's operations based on functional area. We attributed **[BEGIN HIGHLY CONFIDENTIAL]** ***** **[END HIGHLY**

CONFIDENTIAL] of the headcount reductions in ESG (the enterprise services group) to Verizon's operations. This attribution reflects the expectation that MCI's personnel in the enterprise line of business will continue to be employed by the new firm. Indeed, MCI's strength in the enterprise line of business is one of the significant rationales for the acquisition. By similar reasoning, we attributed **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** of the headcount reductions in the mass market and commercial line of business to MCI's operations, reflecting Verizon's strength in this area and MCI's announced intention not to focus on this segment. Similar attributions were made for other functional areas using this same logic. In sum, **[BEGIN HIGHLY CONFIDENTIAL]** **** **[END HIGHLY CONFIDENTIAL]** of the headcount reductions were attributed to Verizon's operations. Finally, it is plainly obvious why savings from international operations, wireless, and other non-regulated operations are not attributed to Verizon Northwest's intrastate operations.

In step 2, we allocated Verizon's share of transaction costs of approximately **[BEGIN HIGHLY CONFIDENTIAL]** ****** **[END HIGHLY CONFIDENTIAL],** which includes the cost of investment bankers, outside counsel, accountants, and other professionals. We deducted this amount from Verizon's share of the synergies, applying the deduction pro rata against each category of synergies allocated to Verizon's operations.

In step 3, we allocated the remaining net transaction-related synergies to Verizon companies in Washington. We allocated cost savings in accordance with cost allocation procedures that Verizon Northwest uses in the ordinary course of business. For example, in network operations, we attributed the cost savings associated with avoided vendor costs to Verizon NW's Washington operations based on specific identification of circuits. This resulted in an attribution of 0.37% of those savings to Verizon Northwest. Similarly, we allocated 1.38% of the cost savings associated with headcount reductions in the enterprise and wholesale lines of business to Verizon Northwest.

In step 4, we excluded synergies that Verizon Northwest will realize in operations beyond its intrastate regulated operations. Accordingly, we excluded revenue and cost savings attributable to interstate services regulated by the Federal Communications Commission, unregulated services, and services provided by entities other than Verizon Northwest.

As a final step in the analysis, we converted the remaining synergies into a net present value of income over four years, using Verizon Northwest's weighted average cost of capital of 8.68%. Verizon's Washington synergy analysis and narrative are provided in Exhibit No. _____ (SES-2HC).

The net present value of the annual synergies attributable to Verizon Northwest's regulated intrastate operations for 2006-2009 is shown below:

[BEGIN HIGHLY CONFIDENTIAL]

Net revenue synergies *************

Net expense synergies *************

[END HIGHLY CONFIDENTIAL]

These synergy amounts reflect the nature of the MCI transaction, which will result in only a very small amount of synergies that will relate to regulated ILEC activities in the state. This transaction is primarily about combining the complementary skills and assets of Verizon and MCI to create a service capability that is able to meet the advanced communications service needs of enterprise customers. By and large, enterprise services and the networks and systems used to deliver those enterprise services are not rate regulated. Moreover, a substantial portion of the synergies relate to MCI's operations, which are not and will not be subject to rate-of-return regulation by the Commission.

III. SYNERGY ANALYSIS COMPARISON

Q. PLEASE PROVIDE A COMPARISON OF THE SYNERGY ANALYSES FROM THE PARTIES.

A. As shown on the table above, for the period 2006 through 2009, Verizon's total synergy calculation is $2.1 million; Staff's is $11.1 million; and Public Counsel's is about $10.1 million.

WA INTRASTATE SYNERGY ANALYSIS

	VERIZON	STAFF	PUBLIC COUNSEL
2006	$ 0	$ .8	--
2007	$.5	$2.7	$2.3
2008	$.7	$3.6	$3.4
2009	$.9	$4.0	$4.4
TOTAL	$2.1M	$11.1M	*$10.1M

*Based on net synergies before present value calculation.

Sources:
Staff-Exhibit No. ___HC(KMF-2HC)
Public Counsel-Exhibit No. ___(CWK-7HC)

In addition to the calculation of $10.1 million shown in the above table, Public Counsel developed a separate, apparently alternative analysis it calls a "SystemWide" or "Systemic" Analysis. Later in my testimony I explain the many flaws in this alternative calculation.

Q. WHY DO STAFF'S AND PUBLIC COUNSEL'S SYNERGY ANALYSES PRODUCE HIGHER NUMBERS?

A. In contrast to Verizon, Staff and Public Counsel use methodologies that improperly allocate synergy savings from activities outside Verizon Northwest's intrastate regulated operations, which inflate the results. These methodologies would not be acceptable in a rate case. For example, Public Counsel witness King (p.17) assumes that MCI's "go to market" revenue benefits will show up in Verizon Northwest's intrastate regulated revenue requirement. Nothing could be farther from the truth. Following the merger, MCI will be a subsidiary of Verizon, Inc., the corporate parent, and a separate affiliate of Verizon Northwest. For ratemaking purposes, Verizon Northwest's books of account will not contain any of MCI's revenues, expenses, or investments. There are no current plans to merge the two entities. Any flow of services between the two entities will proceed according to appropriate affiliate agreements that the Commission can review. The essence of these facts is that the two operations will be entirely separate for ratemaking purposes. It is inappropriate for any party to suggest, effectively, that these circumstances should selectively be ignored when they might find it convenient.

Q. STAFF AND PUBLIC COUNSEL PROPOSE SHARING PERIODS THAT EXTEND FAR BEYOND FOUR YEARS, I.E., THROUGH 2014. WHAT IS VERIZON'S POSITION ON THIS?

A. Even if any sharing were appropriate, a sharing period of four years or more would be wholly unreasonable. Verizon witness Dr. Danner expands on this point.

IV. REBUTTAL OF SPECIFIC ISSUES

A. General Areas

Q. MR. KING (P. 11 LINES 5-7) STATES THAT VERIZON'S ALLOCATION IS BASED ON THE PRESUMPTION THAT THE TWO COMPANIES WILL

CONTINUE TO OPERATE INDEPENDENTLY AND THAT MCI'S SYNERGIES WILL NOT AFFECT WASHINGTON. IS HE CORRECT?

A. No. The synergies will be realized through the combination of Verizon and MCI at the national level. However, to determine the portion of those synergies that relate to Verizon Northwest's intrastate regulated operations, it is necessary to determine how those synergies will be realized. As shown in Exhibit No. ____ (SES-2HC), a significant portion of the synergies are properly assigned to MCI's operations, which would not be included in the synergy allocation to Verizon Northwest's intrastate regulated operations. For example, the integration of MCI information technology systems would not impact Verizon Northwest.

Q. MR. KING CLAIMS (P. 11 LINES 10-13) THAT IN ORDER TO ACHIEVE MOST OF THE SAVINGS THE OPERATIONS OF THE TWO COMPANIES WILL HAVE TO BE COMBINED, SO MCI BENEFITS WILL FLOW TO VERIZON OPERATIONS AND VICE VERSA. HOW DO YOU RESPOND?

A. He is incorrect, and is simply speculating about what the companies might do in the future. The savings do not depend on a combination of Verizon's regulated ILEC operations with MCI's competitive operations. As previously discussed, a portion of the synergies relate to revenue uplifts and expense savings that are expected in MCI's operations, which will not affect Verizon Northwest's intrastate regulated results.

Q. MS. FOLSOM (P. 26 LINES 5-6) STATES THAT "TRANSACTION COSTS ARE ONE-TIME, NON-RECURRING CHARGES WHICH TRADITIONALLY HAVE

NOT BEEN RECOVERED FROM RATEPAYERS." HOW DO YOU RESPOND TO THIS STATEMENT?

A. Verizon is not suggesting that transaction costs should be recovered from ratepayers in this case. Ms. Folsom is nevertheless incorrect because in a rate case scenario, transaction costs have been offset against savings. In U S WEST's 1995 general rate case nonrecurring costs of a four-year restructuring program were netted against the savings in the test year. In that proceeding, Public Counsel and TRACER had recommended that the test year costs be removed but not the test year savings. The Commission, however, rejected the Public Counsel/TRACER proposed adjustment.[2] This was, and is, plainly the common sense thing to do. If a firm incurs costs to realize benefits that are passed on to customers by regulators, the companies are clearly entitled to recover these costs; i.e., only the net should be passed through. Besides simply being the fair approach, it incents companies to continue to make investments in their operations.

B. Allocation Factor

Q. DO YOU AGREE WITH MR. KING'S USE OF A COMPOSITE VERIZON AND MCI ALLOCATION FACTOR FOR WASHINGTON INTRASTATE SERVICES?

A. No, I do not. Mr. King's analysis is flawed in the following areas:

1. Incorrect inclusion of MCI in factor computation;
2. Incorrect calculation of Washington allocation factor;
3. Inappropriate allocation factor basis; and

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[2] Docket No. UT-950200, Fifteenth Supplemental Order, dated April 11, 1996, p. 39-40

4. Incorrect adjustment for subscriber line revenues.

I address each of these flaws in turn.

Q. WHY IS IT INCORRECT FOR MR. KING TO INCLUDE MCI REVENUES IN THE COMPUTATION OF HIS COMPOSITE ALLOCATION FACTOR?

A. MCI revenues should not be used in the computation of the composite allocation factor because MCI synergies should not be included in Mr. King's analysis at all. MCI faces price constraining competition today in all of its operations and will continue to face such competition after the transaction, so there is no reason to consider, or require sharing of synergies attributed to MCI's operations. Doing so would be inconsistent with the Commission's "hands off" approach towards competitive service providers. The Commission does not exercise the type of ratemaking authority with respect to MCI's rates as it does with respect to the rates of incumbent local exchange carriers (ILECs). Accordingly, any synergies that relate to MCI's operations in Washington should not be subject to a Commission mandated pass-through.

Q. DO YOU AGREE WITH MR. KING'S CALCULATION OF A WASHINGTON ALLOCATION FACTOR?

A. No. Mr. King calculated an allocation factor for Washington by dividing 2004 Total Operating Revenues for Verizon Northwest's operations by 2004 Total Operating Revenues for the Domestic Telecom sector of Verizon Communications. (CWK-5HC) This approach is flawed because he applied his allocation factor to the entire amount of synergies, not just those realized in the Domestic Telecom sector. In other words, he calculated the factor using Domestic Telecom revenues as the denominator but he applied the factor to total Verizon synergies, which includes all sectors of Verizon Communications (which are more than just Domestic Telecom). His application of the factor would require the use of total Verizon Communication revenues instead of the smaller amount of Domestic Telecom revenues. This mistake nearly doubled the allocation factor, since revenues of $35.551 billion, instead of $71.283 billion, were used in his calculation.

Q. ARE THERE OTHER FLAWS IN THE METHODOLOGY USED TO DEVELOP HIS ALLOCATION FACTOR?

A. Yes. His methodology used revenues as the allocation basis for all areas of synergies. (CWK 4-HC, CWK 6-HC, CWK 8-HC) In contrast, Verizon made every effort in its model to use cost causal allocation bases to apportion the various areas of synergies. Mr. King chose to allocate synergies such as headcount savings to Washington based on revenues, which clearly have no relationship to headcount. The Washington allocation factor is, therefore, derived using an inappropriate basis and an incorrect level of revenues.

Q. IN DEVELOPING HIS WASHINGTON ALLOCATION FACTOR, MR. KING ALSO DECLINED TO ACCEPT THE INTRASTATE REVENUES REPORTED BY VERIZON NORTHWEST IN THE SURVEILLANCE REPORTS FILED WITH THE WUTC (PAGE 14, LINE 21). DO YOU AGREE WITH HIS ADJUSTMENTS?

A. No. Mr. King decided not to accept the Company's intrastate revenues which are reported to the WUTC. Verizon Northwest's intrastate revenues are determined by tariffed rates and demand which become a product of the billing system used by the Company, in addition, the intrastate revenues in question are reported in accordance with FCC Part 36 and consistent with the rules prescribed by the WUTC. There is no basis for Mr. King's arbitrary and selective changes to those allocation factors, which results in a significant increase in the allocation factor to Washington. Mr. King's opinion that the FCC's 25/75 interstate/intrastate allocation factor is out of date should be addressed, if at all, in a generic FCC proceeding relating to jurisdictional allocations, and not altered selectively for purposes of this case.

Q. DID MR. KING MAKE ANY OTHER MISTAKES IN HIS ADJUSTMENT OF END USER REVENUES?

A. Yes. He stated that, in developing an intrastate allocation factor, he intended to adjust subscriber line revenues (page 15, lines 2-5). Instead, Mr. King incorrectly adjusted all network access revenues, including switched and special for interstate and intrastate and all local service revenues. (CWK-5HC) The Annual Report submitted by Verizon Northwest, which Mr. King references in his testimony (page 14, line 22), clearly identifies End User Revenues as a subset of Total Network Access Revenues. However, Mr. King chose to adjust the Total Network Access Revenues with a 25% interstate factor. He then inexplicably applied the same 25% interstate factor to all Washington local service revenues, which is clearly a blatantly erroneous approach. The sum of these two products was the basis for his adjustment to WUTC reported intrastate revenues. This illogical process is simply wrong and should be rejected.

C. Headcount Savings

Q. MR. KING (P. 13) AND MS. FOLSOM (P. 23) MAKE THE POINT THAT EFFICIENCIES FROM MCI HEADCOUNT REDUCTIONS WILL CAUSE COST ALLOCATIONS TO VERIZON NORTHWEST'S INTRASTATE REGULATED OPERATIONS TO DECREASE. DO YOU AGREE?

A. No. Headcount savings from MCI's operations is not equal to the avoided cost of MCI employees and will not have any measurable impact on Verizon Northwest's intrastate operations allocated costs. Dr. Danner addresses this further in his testimony. By and large, corporate cost allocations are based on time studies of the work effort required to support Verizon's various business units. Pre-merger MCI incurs corporate expenses and, by definition, those expenses relate to the work efforts required to support MCI's business. However, pre-merger MCI experiences a higher corporate expense per head than Verizon. Post-merger, through synergy headcount savings, Verizon expects to lower MCI's corporate expense per head to levels that are in line with Verizon's pre-merger corporate expense per headcount rate (even though both total corporate expenses and total headcount are increasing). In doing so, Verizon will realize combination expense savings, but these savings are not expected to change corporate expense allocations to other Verizon units, as the savings will flow back to the MCI unit where a fewer number of headcount will be supporting the continuing corporate support needs of MCI.

Q. HOW DID MR. KING ESTIMATE WASHINGTON INTRASTATE HEADCOUNT SAVINGS?

A. Mr. King applied his flawed Washington regulated factor to total (MCI & Verizon) headcount savings by organization. (CWK-4HC)

Q. DO YOU AGREE WITH THIS APPROACH?

A. Absolutely not. Notwithstanding his flawed allocation factor, Mr. King grossly overstated the Washington headcount savings by including savings from all 7,000 employees in his calculation. The vast majority of these headcount reductions will occur within MCI operations (and outside of the state of Washington) and have no impact on the intrastate regulated results of Verizon Northwest.

Q. DO YOU AGREE WITH MS. FOLSOM'S APPROACH TO CALCULATING HEADCOUNT SYNERGIES?

A. No, I do not. Ms. Folsom's methodology is incorrect in a number of areas. First, she apportioned headcount savings to Verizon and MCI based on force levels as of December 31, 2004. She made no effort to assess the areas of synergies to determine how the headcount reductions would benefit the various lines of business of the two companies. For example, her projections would have 76% of the Information Technology (IT) headcount savings accruing to Verizon operations. In fact, the IT synergies will be achieved by developing a unified interface for MCI's numerous IT systems. Clearly, these synergies have no impact on Verizon's operations in Washington, yet her projections would have most of the savings flowing to Verizon. Obviously, her assumption that headcount reductions will precisely follow the existing force configuration is unfounded and wrong. As I described before, Verizon's own analysis properly tied synergy savings to specific functional areas. This is a more appropriate way of addressing these matters than the arbitrary ways in which Ms. Folsom and Mr. King have calculated various amounts.

A second area in which Ms. Folsom's methodology is severely flawed is her use of improper Washington allocation factors. She used the proper allocation factor for Enterprise Markets headcount synergies, which is the salaries and wages based 1.38% allocation factor used by the Company in its synergy analysis. However, instead of using the same cost causal allocation factor for all organizations, she used a much higher and improper factor for the other organizations. For the Mass Markets/Commercial organization she used Small and Mid-size Business (SMB) revenues as the basis for allocation. Again, revenues obviously have no relationship to headcount reductions. Finally, her method of allocating all other organizations' headcount savings to Washington was even more illogical, as she used a weighted average factor of salary and wages and SMB revenues. It is interesting to note that the logical and most appropriate basis for allocating headcount savings (i.e., salaries and wages) is a much smaller factor than the factors she chose to use. Ms. Folsom's methodology of computing headcount savings is fundamentally wrong and should be rejected by the Commission.

D. Revenue Synergies

Q. ARE YOU IN AGREEMENT WITH MR. KING'S DERIVATION OF ENTERPRISE GO-TO-MARKET AND SMALL AND MID-SIZE BUSINESS REVENUE SYNERGIES?

A. No, I am not.

Q. WHAT IS WRONG WITH HIS METHODOLOGY FOR CALCULATING REVENUE SYNERGIES?

A. Mr. King has made two mistakes in his methodology for calculating revenue synergies. First, and most importantly, he disregards the distribution of revenue synergies among the operations of the two companies. For example, all of the "Financial Stabilization" revenue synergies in the enterprise area reflect the retention of existing MCI customers. By definition, these synergies relate entirely to MCI's operations, which are and will continue not to be rate regulated by the Commission. In addition, Petitioners estimated that nearly 60% of the Go-To-Market synergies will be achieved within MCI's operations. Similarly, MCI is expected to achieve 30% of the Small & Mid-size market revenue synergies by taking advantage of Verizon's strong relationships with many of these customers. Mr. King chose to ignore where the synergies would be achieved and assigned 100% of the synergies to Verizon. His arbitrary approach leads to incorrect results that should not be relied upon by the Commission.

Mr. King also modified, without basis, Petitioners' estimates of the portion of revenue synergies that would relate to Verizon Northwest's intrastate regulated operations. Mr. King did not support his recommendation to reduce the decline by half the rate from 2007-2009, other than his view that the Petitioners' view that the proportion of services that would be intrastate "…seems highly unlikely." In fact, Verizon provided a reason for the decline in intrastate factors in response to PC Data Request No. 207. Verizon stated "Most of the synergy growth over the next five years is weighted towards Non-Regulated products and services (Voice and Data Long Distance, Data IP Services, and

CPE). While there is regulated intrastate growth synergy projected as it relates to the merger, it is not going to keep pace with these non-regulated services in terms of growth." This view is reasonable, and Mr. King's unsupported contrary assumption should be rejected.

E. "Systemic" Synergies

Q. PLEASE DISCUSS MR. KING'S "SYSTEMIC" SYNERGY APPROACH THAT BEGINS ON P. 20.

A. Mr. King argues that the Commission should take a "broader view" and allocate to Washington ratepayers merger benefits that will occur in areas beyond the jurisdiction of the Washington Commission and that would not be considered as part of the intrastate revenue requirement in a conventional rate case. He states "it should be recognized that merger synergies are systemic that is, that synergies affecting one component of the merged company's operations benefit all other components. They cannot be limited to specific services or classes of customers".

Q. DOES MR. KING PROVIDE ANY EXAMPLES?

A. Yes. He cites two examples that stretch the imagination as to how benefits could rationally be attributed to Verizon NW's intrastate regulated operations. First, he states that network synergies that are mostly interstate would benefit local service if they result in better prices for local and long-distance services. In addition, he states that disposing of MCI's money-losing Canadian operations would benefit local service if it frees up capital for fiber optic loops. The Commission should reject out of hand the suggestion that it allocate any such extra-jurisdictional savings to Washington ratepayers. Public Counsel's recommendation that it do so further undermines the credibility of its entire approach to this issue.

Q. WHAT IS YOUR RESPONSE TO MR. KING'S SUGGESTION (P. 20 LINES 14-21) THAT PROCUREMENT COSTS SAVINGS MAY ALSO BE ATTRIBUTED TO VERIZON?

A. When management performed its due diligence for the transaction, it did not identify any procurement savings for Verizon. Mr. King acknowledges as much, yet offers no basis to second guess management on this matter. The Commission should disregard his idle speculation.

Q. WOULD THESE INDIRECT ATTRIBUTION ARGUMENTS BE SUSTAINABLE IN A RATE CASE?

A. No they would not. Generally, rate case rules require that adjustments to revenues, expenses, and capital that impact a company's intrastate revenue requirement must be "known and measurable". In other words, a specific dollar amount for the synergy savings must be correlated to intrastate results. None of the examples described above meet this criterion.

Q. HOW DOES MR. KING ALLOCATE SYNERGIES UNDER THE "SYSTEMIC" APPROACH TO VERIZON NW'S INTRASTATE REGULATED OPERATIONS?

A. He takes the total national synergies identified in Exhibit No. _____ (SES-3C) from 2007-2014 and multiplies these totals by a Washington intrastate factor of 1.1898%.

Q. WHAT IS WRONG WITH THIS ALLOCATION?

A. The national synergies shown in Exhibit No. ______ (SES-3C) including synergies from activities that have no relationship to Verizon Northwest's intrastate regulated operations. Some of these categories include synergies from international, wireless, and network activities that are primarily interstate, and information technology synergies that solely benefit MCI's systems infrastructure.

Q. IS MR. KING'S SHARING PROPOSAL, WHICH WOULD REDUCE VERIZON'S LOCAL RATES BY $1.00 BEGINNING JULY 1, 2007, BASED ON THE "SYSTEMIC" SYNERGY APPROACH?

A. Yes. Since the "systemic" approach is fatally flawed, Mr. King has no support for his proposal to reduce rates, and it should be rejected by the Commission.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.