

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION
COMMISSION

In the Matter of the Review of)
Unbundled Loop and Switching Rates; the) DOCKET NO. UT-023003
Deaveraged Zone Rate Structure; and)
Unbundled Network Elements, Transport,)
and Termination)
)

**PANEL TESTIMONY OF VERIZON NORTHWEST INC.
ON RECURRING COSTS**

Witnesses:

**William Jones
Thomas Mazziotti
Michael Norris
Randall Patton
Willett Richter
Gary Sanford**

June 26, 2003
ERRATA (May 26, 2004)

On Page 140, line 22 to Page 141, line 3:

- change "COEP database" to "general ledger."
- strike "two" and "complete."
- replace "years" with "year."
- replace "available in the COEP database are" with "was."
- strike "in a specific year."

1 non-recurring costs, retail costs avoided, and normalizations as necessary to
2 make them forward-looking (see *infra* Part X.C). The next step in Network Factor
3 development is to map (attribute) the forward-looking expense and investment
4 data to the network cost pools as described above. The factors are applied to
5 TCI for the relevant plant to produce the recurring annual network costs that
6 relate to these network elements.

7 3. Right-to-Use Expense-to-Investment Factors

8 Q. WHAT IS INCLUDED IN THE RIGHT-TO-USE COST FACTORS?

9 A. Right-to-Use (“RTU”) fees are the software costs that equipment manufacturers
10 charge Verizon NW for the operation of and feature functionality associated with
11 their equipment. Based on American Institute of Certified Public Accountants’
12 SOP 98-1, since January 1999, Verizon NW has capitalized *all* switch and other
13 network-related software costs and books them to the Intangible Asset Account
14 2690. All the capitalized software costs are amortized over the life of such
15 software. The only exception is for software costs that are incurred specifically to
16 fix a problem in previously installed software; these software fixes are treated as
17 expenses in the year incurred and are recovered in the Network Factors. The
18 RTU Factors are designed to express relationships between amortized software
19 costs and digital switching and digital circuit investments.

20 Q. HOW WERE THE RTU FACTORS DEVELOPED?

21 A. The RTU Factors are developed using data contained within the company’s
22 ~~COEP database~~ general ledger. Data from the ~~two most recent, complete~~
23 ~~calendar years available in the COEP database~~ are used to calculate the

1 factors. Regional data covering all the former GTE jurisdictions is used for each
2 plant account in order to minimize anomalies that might be present in a specific
3 market ~~or in a specific year~~ with respect to a particular type of equipment.

4 The RTU Factors are the ratio of annual RTU software costs to total
5 investment associated with either digital switching and operator system accounts
6 (accounts 2212 and 2220), or digital circuit and other terminal equipment
7 (accounts 2232 and 2362). The RTU factors are applied to appropriate
8 investments in the Digital Switching and Operator Systems and the Digital Circuit
9 and Other Terminal Equipment accounts. Collocation investments are removed
10 from the factor's investment denominator since the RTU factors are not used in
11 collocation studies.

12 4. Marketing and Other Marketing Support Loadings

13 **Q. WHAT COSTS ARE INCLUDED IN THE MARKETING AND OTHER**
14 **MARKETING SUPPORT LOADINGS?**

15 A. The Marketing Expense-to-Expense Loading includes the cost of product
16 management, sales, customer services, and product advertising associated with
17 Verizon NW's wholesale services. The Other Marketing Support Expense-to-
18 Expense Loading includes the costs of shared land and buildings, information
19 management, furniture, office equipment, and other support equipment costs
20 associated with product management, sales, customer services, and product
21 advertising. As with the Network Factors, the expenses are adjusted to make
22 them appropriate for use in a UNE study before they are used in the calculation
23 of each loading.

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and Termination)
)

**REBUTTAL PANEL TESTIMONY
OF VERIZON NORTHWEST INC.
ON VzCOST**

Witnesses:
Gerald Harris
John Hinton
William Jones
Thomas Mazziotti
Willett Richter
David Tucek

May 12, 2004
ERRATA (May 26, 2004)

On Page 130, line 8:

Replace current answer to question at lines Page 130, lines 5-7 with revised answer.

1 total installed investment are only those needed to complete the
2 installation of the major material, and are not part of the cost of the major
3 material. Thus, Verizon does not redesignate any part of the value of the
4 major material as minor material as Mr. Turner alleges.

5 **Q. MR. TURNER FURTHER CONTENDS THAT VERIZON NW**
6 **IMPROPERLY APPLIES ITS EF&I FACTOR TO MINOR MATERIAL**
7 **COMPONENTS. IS THIS CORRECT?**

8 A. In reviewing this claim, Verizon NW has confirmed that Mr. Turner is
9 correct. Although the EF&I factor is appropriately calculated by dividing
10 the investment and associated expenses by the major material investment
11 alone, the cost studies incorrectly multiplied that factor by amounts that
12 included the minor material as well as the major material. An example
13 from the file "WA_VZmatl_C07_2003_121503.xls" will illustrate the nature
14 of this error, and its lack of any significant impact in light of the small costs
15 associated with minor materials. On Tab "AFC ADSL detail," see the
16 components listed for a 2-wire universal local exchange terminal with 24
17 lines (manufactured by AFC) with a total material cost of \$15,100. In the
18 cost studies, the EF&I factor was applied to this investment amount, which
19 included \$150 of minor materials for a mounting adapter kit and expansion
20 bank fibers. Thus, the investment amount to which Verizon NW applied
21 the factor was overstated by 1%. Verizon NW has rerun all of its DLC
22 EF&I loadings without including these minor material costs in the amount
23 of the investment, and determined that the total change in loaded DLC

1 investment would be a reduction of no more than 1.74%. Verizon NW will
2 correct this error in the compliance phase of this proceeding, when it
3 resubmits its cost studies.

4 A. ~~No. The EF&I factors are only applied to major materials such as DLCs.~~

5 **Q. MR. TURNER STATES THAT THE FLORIDA AND GEORGIA**
6 **COMMISSIONS DECIDED TO USE BOTTOM-UP APPROACHES TO**
7 **DETERMINING INSTALLATION COSTS. DO THEY RAISE ANY**
8 **REASONS OTHER THAN THOSE ALREADY IDENTIFIED BY MR.**
9 **TURNER?**

10 A. No. Notably, both of these commissions focused their criticism on the use
11 of an EF&I factor for cable placement or for loop cost in general.¹⁷³
12 Verizon NW does not apply an EF&I factor for cable placement. And there
13 was no specific finding by either commission that an EF&I factor for DLCs
14 was not accurate.

15 **Q. MR. TURNER RELIES ON THE FACT THAT THE BUREAU IN THE**
16 **VIRGINIA ARBITRATION MADE SOME CRITICISM OF THE EF&I**
17 **FACTORS TO SUPPORT A BOTTOM-UP APPROACH. PLEASE**
18 **COMMENT.**

¹⁷³ See Order, *Investigation into pricing of unbundled network elements*, Docket No. 990649-TP, Order No. PSC-01-1181-FOF-TP, at 237 (FL PSC May 25, 2001); Order, *Review of Cost Studies, Methodologies, Pricing Policies, and Cost Based Rates for Interconnection and Unbundling of BellSouth Telecommunications, Inc.'s Services*, Docket No. 14361-U, at 12 (GA PSC Mar. 18, 2003).

1 A. While the Bureau did make some criticisms, it ultimately adopted an EF&I
2 factor approach for those aspects of the case in which it accepted
3 Verizon's model (and thus for which such factors were relevant).¹⁷⁴ As
4 noted below, AT&T at that time was also proposing EF&I factors rather
5 than a bottom-up approach.

6 In any event, the bottom-up approach is subject to the same
7 criticism that the Bureau made of EF&I factors. For any given installation
8 project, unique geographic and environmental conditions will affect the
9 actual installation costs. Those costs can vary dramatically from project to
10 project. Thus, when AT&T proposes a single installation cost for a type of
11 DLC, the actual costs of installing that equipment in the network is likely to
12 be more or less than that stated amount. Therefore, it is no more likely to
13 pinpoint the actual costs of a specific installation than an EF&I factor.

14 **Q. MR. TURNER IS TROUBLED BY THE FACT THAT EF&I FACTORS**
15 **PRODUCE INSTALLATION COSTS THAT ARE HALF THE COST OF**
16 **THE MATERIAL. IS THAT CONSISTENT WITH VERIZON NW'S**
17 **EXPERIENCE?**

18 A. Yes. In response to AT&T Data Request No. 8-028, Verizon NW
19 produced work orders from its seven most recent DLC installations.
20 Based on the information provided in this data request response, Verizon
21 NW found that costs for minor material, provisioning, sales tax and
22 installation amounted to 52 percent of the DLC material cost — *higher*

¹⁷⁴ See *Virginia Arbitration Order* ¶ 526.

1 than Verizon NW's proposed EF&I factor for DLCs of 46 percent.¹⁷⁵

2 Moreover, even the *Virginia Arbitration Order* on which AT&T itself
3 repeatedly seeks to rely approved an EF&I factor for IOF of 53.2% and an
4 EF&I for switching of 40%.¹⁷⁶

5 **Q. MR. TURNER PROPOSES REDUCING VERIZON NW'S EF&I**
6 **FACTORS BY 80% BECAUSE SBC CONCEDED THAT ITS EF&I**
7 **FACTORS WERE INFLATED. IS THIS PROPOSAL CREDIBLE?**

8 A. No. First, Mr. Turner has shown no logical connection between any
9 problems with the data used for SBC's EF&I factors and the data in
10 Verizon's databases. He merely assumes that any errors would be the
11 same, even though SBC and Verizon have different continuing property
12 records databases and there is no reason to think that an overstatement
13 of installation costs in SBC's database would also occur in Verizon's.

14 Second, Mr. Turner's assertion that SBC's EF&I factor was reduced
15 by 80% has never been tested. In the Illinois proceeding to which Mr.
16 Turner cites, the CLECs had asserted that problems existed with SBC's
17 continuing property records data. To avoid debate on that issue and
18 reduce the number of contested issues in the proceeding, SBC developed
19 new EF&I factors based instead on its general ledger data.¹⁷⁷ When
20 SBC's witness was asked on cross-examination whether this change

¹⁷⁵ See Exhibit No. ____ (RRP-5C).

¹⁷⁶ See *Virginia Arbitration Order* ¶¶ 444, 526.

¹⁷⁷ Illinois Commission Hearing Tr., AT&T Exhibit SET-3, at 718.

1 resulted in a reduction to the loading factor, he answered yes, but also
2 stated that he had not calculated the percentage of the reduction.¹⁷⁸

3 Thus, there is no documented evidence of an 80% reduction of SBC's
4 EF&I factor other than AT&T attorney's statement at the hearing. This
5 Commission cannot be asked to rely on such speculation.

6 Third, one of the problems mentioned at the SBC-Illinois hearing
7 was that some equipment in SBC's continuing property records databases
8 should have had a property record number assigned to it but it did not. As
9 a result, that equipment was included in the total installed investment, but
10 it was not identified in the material investment, where it should have been.
11 Mr. Turner has shown no similar example of a failure to identify material
12 investment in Verizon's continuing property records databases.

13 **Q. WHAT CRITICISMS DO YOU HAVE OF THE CALCULATION OF MR.**
14 **TURNER'S PROPOSED EF&I FACTOR PRESENTED IN EXHIBIT SET-**
15 **3?**

16 **A.** In the spreadsheet that Mr. Turner used to compute the 1.1144 EF&I
17 factor in his testimony, he applies an 80% reduction to the total Installed
18 Investment, amounting to over \$260 million for the Verizon East DCPR
19 data, as if those engineering and installation costs were never incurred.
20 But this is not the proper correction, even if AT&T's representation of the
21 problem was with SBC's DCPR database in Illinois were accurate. AT&T
22 did not contend that equipment or installation costs did not exist; it was

¹⁷⁸ *Id.* at 717-18.

1 AT&T's assertion that some equipment was not provided a part number
2 and was not identified in the material investment portion of the database
3 — the assertion was that it only was included in the total installed
4 investment portion of the database. If that equipment had been properly
5 identified, the amount of material investment would have been larger, but
6 the total installed investment would have been unchanged. Thus,
7 according to AT&T's logic, Mr. Turner erroneously reduces the total
8 installed investment by 80% rather than adjusting only the material
9 investment component. In addition, Mr. Turner only applies this incorrect
10 adjustment to Verizon East data and inexplicably excludes the Verizon
11 West (former GTE) COEP data to which he takes no exception.

12 Solely for the purpose of argument, if we adjust (increase) the
13 material investment component by 80% for the Verizon East DCPR data
14 and recalculate the factor, including the Verizon West COEP data, the
15 result would be 1.373, not 1.114 as he states in his testimony. Moreover,
16 If a serious problem existed with DCPR data, it would make sense to base
17 the EF&I factor only on the Verizon West COEP data. Using the Verizon
18 West data only would produce a factor of 1.397. Thus, not only does Mr.
19 Turner rely on unfounded assertions about unrelated SBC data from
20 another jurisdiction, he also does not even apply this speculative
21 adjustment in a manner consistent with its alleged justification.

22 **Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?**

23 **A.** Yes.