BEFORE THE WASHINGTON UTILITIES & TRANSPORTATION COMMISSION

DOCKET NO. UT-040788

DIRECT TESTIMONY OF CHARLES W. KING (CWK-1T)

ON BEHALF OF

PUBLIC COUNSEL, AARP & WeBTEC

REGARDING

INTERIM RELIEF

JULY 14, 2004

INTRODUCTION

Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.

A. My name is Charles W. King. I am President of the economic consulting firm of Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

Q. PLEASE DESCRIBE SNAVELY KING.

A. Snavely King, formerly Snavely, King & Associates, Inc., was founded in 1970 to conduct research on a consulting basis into the rates, revenues, costs and economic performance of regulated firms and industries. The firm has a professional staff of 12 economists, accountants, engineers and cost analysts. Most of its work involves the development, preparation and presentation of expert witness testimony before federal and state regulatory agencies. Over the course of its 34-year history, members of the firm have participated in over 1000 proceedings before almost all of the state commissions and all Federal commissions that regulate utilities or transportation industries.

Q. HAVE YOU PREPARED A SUMMARY OF YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. Exhibit ___ (CWK-2) is a summary of my qualifications and experience.

Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN REGULATORY PROCEEDINGS?

A. Yes. Exhibit ___ (CWK-3) is a tabulation of my appearances as an expert witness before state and federal regulatory agencies, including the Washington Utilities and Transportation Commission ("the Commission").

Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?

A. I am appearing on behalf of the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel), WeBTEC and AARP.

Q. WHAT IS THE OBJECTIVE OF YOUR TESTIMONY?

A. The objective of this testimony is to evaluate the claim of Verizon Northwest ("Verizon" or "the Company") for annualized interim rate relief of $29.7 million.

Q. PLEASE SUMMARIZE YOUR TESTIMONY AND RECOMMENDATIONS.

A. I evaluate Verizon's claim for interim relief in Washington in two primary ways. First, I apply the six *PNB* factors the Commission has employed previously to measure whether Verizon's claim has merit. In so doing, I evaluate and critique some of the evidence the Company presents which purports to support a claim for relief based on Washington intrastate operations. Second, I compare the Company's claim to recent claims for interim relief before this Commission. Using these analytical tools, I find that Verizon fails to demonstrate a need for interim relief. I recommend the Commission deny the Company's request and evaluate the Company's need for general rate relief, if any, in the general rate case to follow.

Q. PLEASE DESCRIBE THE BACKGROUND OF VERIZON'S CLAIM FOR INTERIM RATE RELIEF.

A. On August 12, 2003, the Commission found that Verizon's access rates were excessive, and it reduced them by $32 million. On April 30, 2004, Verizon filed for a $239.5 million permanent increase and $29.7 million in interim relief to recover the reduction in access charges. The Company's justification for the interim relief filing is its claim that without such relief it is earning a negative rate of return and that its Washington intrastate financial results would cause its bonds to lose investment grade ratings.

Q. HAS THE COMMISSION SET FORTH GUIDELINES FOR THE GRANTING OF INTERIM RATE RELIEF?

A. Yes. On October 10, 1972 in Cause No. U-72-30, *PNB v. WUTC*., the Commission's order reviewed interim relief cases in Washington and other states and concluded by articulating six factors for granting interim relief to Pacific Northwest Bell. Those factors were:

1. Interim relief may be granted "only after there has been opportunity for an adequate hearing."
2. An interim rate increase "should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity."
3. "The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient standing alone to justify granting interim relief."

4. "The Commission should review all financial indices concerning the applicant..."
5. Interim rate relief should be "applied only in a case where not to grant relief would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders."
6. Interim relief must be in the public interest.

Q. HAS THE COMMISSION SUBSEQUENTLY APPLIED THESE FACTORS TO UTILITIES SEEKING INTERIM RATE RELIEF?

A. Yes. As the Commission's 5th Order notes, there have been some 20 interim relief cases to come before the Commission.[1] In recent years, the Commission has applied the *PNB* factors on several occasions. On September 24, 2001, in Docket No. UE-010395, the Commission approved interim relief for Avista Utilities based on *PNB* factors. One month later, in October 2001, in Docket No. UE-011163, the Commission denied interim relief to Puget Sound Energy by finding that it had not made an adequate *prima facie* showing and comparing its situation with that of Avista. On January 31, 2002, in Docket No. TO-011472, the Commission approved interim relief for Olympic Pipeline using an analysis of the *PNB* factors similar to that applied to Avista.

Q. ARE THERE ANY CHARACTERISTICS THAT DISTINGQUISH VERIZON FROM THE OTHER SUCCESSFUL APPLICANTS FOR INTERIM RATE RELIEF IN PREVIOUS CASES?

[1] 5th Order, ¶¶ 4, 12.

A. Yes, there are several.

First, there is no stand-alone Verizon company for Washington. Rather, Verizon's Washington operations are part of a larger company, Verizon Northwest, which serves Washington, Oregon and Idaho. Verizon Northwest in turn is part of the largest telecom company in the nation: Verizon Communications.

Second, neither Verizon Northwest nor Verizon's Washington operation raises capital in the open markets. All capital, both debt and equity, is raised through the parent company.

Third, the part of Verizon Northwest that is allegedly earning a negative return is not all of Verizon Northwest but only that part that operates in the State of Washington, and then only the intrastate portion of that part.

Fourth, the regulated portion of Verizon in Washington does not sell all of the telephone services used by its customers. Other, affiliated entities sell:

- DSL Internet services
- Directory Advertising
- Long-distance services
- Wireless service

Fifth, it is not clear that Verizon's Washington intrastate operations are in fact earning a negative return. Just the imputation of directory advertising revenues, pursuant to Commission practice, raises the return on rate base above zero.

FACTOR NO. 1: ADEQUATE HEARING

Q. IS THE REQUIREMENT FOR AN ADEQUATE HEARING AT ISSUE IN THIS CASE?

A. No. The Commission is allowing for an adequate hearing in this case.

FACTOR NO 2: ACTUAL EMERGENCY; HARDSHIP AND INEQUITY

Q. IS VERIZON EXPERIENCING AN ACTUAL EMERGENCY THAT REQUIRES INTERIM RATE RELIEF?

A. No. The timing of the interim relief request demonstrates that Verizon itself has not considered an emergency to exist. Additionally, the amount of the requested relief bears no relation to any demonstrated need for emergency relief. To the contrary, the relief requested would have no material effect on Verizon's ability to fund its operations.

Q. WHY DO YOU SAY THAT THE TIMING OF THE INTERIM RELIEF REQUEST DEMONSTRATES THAT VERIZON DOES NOT REGARD AN EMERGENCY TO EXIST?

A. The purported basis for the request for emergency relief was the access charge reduction ordered by the Commission last August. It its order in that case, the Commission expressed sympathy for Verizon's need to assess the consequences of its order, to determine whether it needs to increase other rates, and to prepare a procedurally proper response to that need. For this reason, the Commission delayed implementation of the access charge rate reduction until October 1, 2003.[2] Yet, Verizon did not seek rate relief until April 2004. When it did file, it sought to bifurcate its permanent relief into revenue requirements and rate design phases, further extending the normal 10-month schedule for resolving the case. The Commission has since denied Verizon's bifurcation request and has ordered the Company to file a proposed rate design. The result has been that Verizon, through its own actions, has delayed any possible consideration of its permanent relief of $239 million until well into 2005.

Q. WHY DO YOU SAY THAT THE AMOUNT OF THE REQUEST BEARS NO RELATION TO ANY DEMONSTRATED NEED FOR EMERGENCY RELIEF?

A. The amount of the interim relief sought, $29.7 million, is based solely on the access charge reduction. Indeed, that reduction was believed to be $32 million at the time of the decision, but Verizon has since re-estimated the impact of the rate change to be $2.3 million less, and so the "emergency" relief requested is now $29.7 million.

Moreover, Verizon would not even realize the entire $29.7 million before its permanent rates would go into effect. If the Commission acts promptly on the emergency request, then it would go into effect about the end of August. The schedule adopted by the Commission calls for a final rate order on May 15, 2005. Thus, if there is an emergency, its resolution must rest on Verizon's realizing increased revenue for eight and one-half months at an annualized rate of $29.7 million. That is, Verizon must be "saved" from its emergency by receiving

[2] Docket No. UT-020406, Eleventh Supplemental Order, August 12, 2003, ¶¶ 114, 116.

$21.04 million[3] in added revenue between September 2004 and mid-May 2005. This figure represents 5.7 percent of the $370 million in regulated intrastate revenue that Verizon realized during the test year ended September 30, 2003.[4]

Verizon has made no demonstration that this figure of $21.04 million represents the solution to any actual emergency. At best, Ms. Heuring purports to demonstrate in exhibit (NWH-8) that $29.7 million annualized would raise Verizon's rate of return from a negative 0.47 percent to a positive 1.47 percent. There is no demonstration whatsoever that the appearance of a negative .47 percent return on rate base a year ago constitutes an emergency from which Verizon will be delivered only if it receives an additional $21.04 million in revenue between September 2004 and May 2005.

Q. IF THERE IS NO EMERGENCY, DOES VERIZON DEMONSTRATE GROSS HARDSHIP OR INEQUITY THAT WOULD SUGGEST A NEED FOR INTERIM RELIEF?

A. No. Gross hardship or inequity, if it existed, would be felt by Verizon Northwest's equity and debt investors as the result of a delay in receiving $21.04 million over the 8½ months between September 2004 and May 2005. As noted, this delay is largely self-inflicted. Verizon has already delayed six to eight months before applying for any relief whatsoever, and by applying for bifurcation of its permanent relief, it further delayed the Commission's ultimate resolution.

[3] (8.5 months/12 months) x $29.7 million
[4] Schedule L1 in Verizon's Interim Rate Relief Workpapers.

As it is, the $21.04 million represents 5.0 percent of the Company's 2003 Washington intrastate revenues,[5] 3.1 percent of its total Washington revenues,[6] and 1.3 percent of all Verizon Northwest's revenues.[7] It is 0.28 percent of Verizon Communications' 2003 net income of $7,494 million.

Bondholders are not under threat, since Moody's gives Verizon Northwest's bonds an A1 rating, Fitch an AA rating (two notches above the parent company, Verizon Communications), and S&P gives AA rating. These bond ratings belie the contention of Verizon witness VanderWeide that Verizon could not maintain an investment grade bond rating.

Q. ARE VERIZON'S SERVICES IN OTHER JURISDICTIONS BEING INEQUITABLY FORCED TO SUPPORT VERIZON'S WASHINGTON INTRASTATE OPERATIONS?

A. No. There is no doubt that Verizon has earned much higher returns on its inter state operations than on its intrastate operations, as demonstrated by the following data from the surveillance reports that Verizon files with the Commission:

Adjusted Return on Rate Base	Total State	Intrastate
2000	10.71%	4.90%
2001	11.28%	5.14%
2003	9.39%	2.42%

For the test year in this case, 12 months ended September 30, 2003, the adjusted rate of return on interstate operations was 26.71 percent.

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[5] $419.8 million, 2003 Annual Report to the WUTC, Schedule I-1, line 60, column (e).
[6] $678.8 million, Id., column (c).
[7] $1,158.9 million, Id. column (b).

These results, however, do not justify a conclusion that interstate services are "subsidizing" intrastate services. That is because the interstate services are priced under a wholly different regulatory scheme than intrastate services. Specifically, the interstate rates are subject to price cap regulation that permits the carrier to earn whatever rate of return it can provided its rates do not exceed a ceiling level established by the Federal Communications Commission ("FCC"). Given this regulatory scheme, there is no reason to believe that interstate rates would be one cent lower if the Company's intrastate operations were earning the authorized rate of return. Nor is there any reason to believe that the granting of either interim or permanent intrastate rate relief will affect interstate rates in any way. The interstate and intrastate rates are set totally independently of each other. Neither operation "subsidizes" the other.

The same is true of the other state jurisdictions, Idaho and Oregon. Their rates are set independently from those in Washington, based on jurisdictionally separated costs. There is no way that the level of intrastate rates in Washington could influence the rates in these states.

Q. BUT ISN'T IT TRUE THAT THE ONLY WAY THE COMPANY COULD SURVIVE FINANCIALLY WITH SUCH LOW INTRASTATE RETURNS IS TO HAVE HIGH INTERSTATE RETURNS?

A. Arguably, this could be the case. However, the Company's surveillance reports reveal that this condition has existed since the year 2000. Initially, Verizon was precluded from filing for a rate increase by the terms of the Commission's merger approval.[8] That constraint expired on July 1, 2002, yet Verizon has chosen to ignore the financial performance of its Washington intrastate operations until April 2004, when it suddenly decided it faced an emergency that, if not rectified, would result in gross hardship and inequity.

Q. WILL REGULATORY LAG IMPOSE A GROSS HARDSHIP ON VERIZON IF IT DOES NOT RECEIVE INTERIM RELIEF?

A. No. Verizon has imposed regulatory lag on itself. First, it waited eight months between the time it was ordered to reduce its access charges and the time it filed for rate relief. Then, by proposing to bifurcate its permanent rate relief, it delayed the Commission's resolution of its $239 million permanent rate request. Had Verizon filed for $239 million in April 2004 without bifurcation, the statutory suspension of its rates would have expired in February 2005. As it is, the Commission will not reach a decision on permanent rates until May 15, 2005, 3½ months later. Indeed, Verizon originally proposed a schedule that would postpone its permanent rate relief until the summer or autumn of 2005. All told, Verizon has imposed on itself a regulatory lag of approximately 9½ months from August 2003 – 10 months following October 2003 -- until May 15, 2005.

As a general matter, regulatory lag is a well-known characteristic of regulation that cuts both ways. When costs are declining, Verizon can chose not to file for lower rates and thereby enjoy excessive earnings. But it must accept

[8] In the Matter of Application of GTE Corporation and Bell Atlantic Corporation for An Order Disclaiming Jurisdiction or in the Alternative Approving the GTE Corporation – Bell Atlantic Corporation Merger, UT-981367 et al., Fourth Supplemental Order Approving and Adopting Settlement Agreement, Granting Application Subject to Conditions, p. 23.

that when costs are increasing, new rates will not be reset until the statutory time limit of ten months has elapsed, potentially causing a period of inadequate earnings.

Q. IS THERE ANY JUSTIFICATION OF INTERIM RELIEF ON THE BASIS OF GROSS INEQUITY OR HARDSHIP?

A. The strongest justification for interim rate relief would be a demonstration by Verizon that it lacked the cash to fund its operations. If Verizon could show that it would "run out of money" without the 8½ -month interim rate increase, then the Commission might be able to conclude that an "actual emergency" or "gross inequity" exists. Yet, the facts on the record demonstrate that even if we focus solely on Washington intrastate operations, the Company can generate sufficient internal cash to cover its cash operating requirements without any rate relief whatever.

Q. WHAT "FACTS ON THE RECORD" DEMONSTRATE THAT VERIZON COULD FUND ITS WASHINGTON INTRASTATE OPERATIONS WITHOUT ANY RATE RELIEF WHATSOEVER?

A. Exhibit **___** (CWK-4) is drawn from data submitted by Company witness Heuring. It compares Verizon's Washington intrastate cash generation with its cash requirements for the test year ending September 30, 2003. The exhibit begins with Verizon witness Heuring's quantification of revenue for the year net of the access charge reduction, in the amount of $342.5 million. I then compute the cash expenses, which are Ms Heuring's reported operating expenses net of depreciation, a non-cash expense. I then subtract cash expenses from revenue to arrive at Earnings Before Interest, Taxes, Depreciation and Taxes ("EBITDA") of $108.9 million. This is the cash generation of the Company's Washington intrastate operations.

The cash requirements consist of two components: fixed charges (principally interest) of $20 million, and capital additions for the next year (2004), the intrastate portion of which comes to $84.9 million. The total cash requirements are $104.9 million, or about $4 million <u>less</u> than the internal cash generation.

Q. HOW DOES YOUR ANALYSIS COMPORT WITH THE ASSERTIONS OF COMPANY WITNESS BANTA THAT VERIZON'S CONSTRUCTION PLANS WILL BE SCALED BACK, ITS MAINTENANCE AND REPAIR EFFORTS WILL BE CUT, AND ITS SERVICE QUALITY WILL SUFFER?

A. Mr. Banta appears to suggest that Verizon's construction plans for 2004 of $112.5 million must be met only with intrastate revenues. In fact, since the intrastate portion is only $84.9 million, Verizon will generate enough cash to avoid the consequences he predicts.

Q. SUPPOSE VERIZON WERE TO RUN OUT OF INTERNALLY GENERATED CASH BETWEEN SEPTEMBER 2004 AND MAY 2005. WOULD THE ABSENCE OF $21.04 MILLION IN ADDITIONAL REVENUE PREVENT IT FROM RAISING FUNDS EXTERNALLY TO SUPPORT THE INTRASTATE OPERATIONS WHILE THE COMMISSION CONSIDERS THE GENERAL RATE REQUEST?

A. No. First of all, "externally" for Verizon Northwest means internally within the family of companies owned by Verizon Communications, Inc., the nation's (and possibly the world's) largest telephone company. On February 19, 2003, Verizon Northwest filed a Notice of Termination of Registration with the Securities and Exchange Commission. This means that Verizon Northwest no longer sells any financing instruments to the public that are based on the results of its specific operations. All financing, both debt and equity, is now handled through parent company financial subsidiaries. Even prior to its Notice of Termination, Verizon Northwest never issued bonds or short term notes solely on the basis of its Washington intrastate earnings.

Furthermore, Verizon has access to a "cash pool" of $500 million maintained by Verizon Network Funding Corp.[9] During the period September 2004 through May 2005, it can draw upon that pool to support its operations while it awaits the Commission's decision in the general rate case.

There is no indication, let alone demonstration, that Verizon's parent company is unwilling, let alone unable, to provide financing for capital expenditures by Verizon Northwest within the State of Washington.

FACTOR NO 3: RATE OF RETURN

Q. WHAT BEARING DOES VERIZON'S RATE OF RETURN HAVE ON ITS CASE FOR INTERIM RELIEF?

[9] Verizon Response to Staff Data Request No. 32.

A. Verizon claims that its rate of return is negative, and therefore it is relevant to the need for an interim rate increase.

Q. IS THIS A VALID CLAIM?

A. No. This contention is based only on assertion, without any careful analysis of revenues, expenses and rate base. As the Commission is well aware, the amount presented by the utility as its revenue requirement is rarely the amount that the Commission finally approves. At a minimum, the Company's calculation ignores the Commission's practice of imputing directory revenues to intrastate operations. Ms. Heuring estimates that imputed directory revenues would come to $23.5 million,[10] or about 80 percent of the amount of the interim relief requested. Exhibit ___ (CWK-5) shows the rate of return calculation if this one ratemaking adjustment is made to Verizon's test year financial statement. With Ms. Heuring's estimate of directory revenue imputation, the negative 0.47 percent becomes positive 1.085 percent. This exhibit does not include any other Commission ratemaking adjustments which would likely increase the return even more.

Q. WHAT ABOUT MS. HEURING'S CLAIM AT PAGE 4 OF HER TESTIMONY THAT VERIZON NEEDS $159 MILLION TO ACHIEVE ITS AUTHORIZED RATE OF RETURN?

A. As the Commission has long recognized, that is an issue for the general rate case. Merely under-earning the authorized level of return is not grounds for an interim rate increase.

[10] Workpaper C6.1.3.1

<u>FACTOR NO. 4: ALL FINANCIAL INDICATORS</u>

Q. ASIDE FROM RATE OF RETURN, WHAT OTHER FINANCIAL INDICATORS HAS THE COMMISSION STATED SHOULD BE REVIEWED BEFORE GRANTING INTERIM RATE RELIEF?

A. In the seminal *PNB* case, the Commission listed "interest coverage, earnings coverage and the growth, stability or deterioration of each, together with the immediate and short term demands for new financing." Another consideration is "whether the grant or failure to grant interim relief will have such an effect on financing demands as to substantially affect the public interest."

Q. WHAT IS THE INTEREST AND EARNINGS COVERAGE OF VERIZON'S WASHINGTON INTRASTATE OPERATIONS?

A. Exhibit ___ (CWK-6) shows the extent to which earnings and internally generated cash cover interest and capital commitments for Verizon's Washington intrastate operations for the test year ending September 30, 2003. Most of these data are drawn from Exhibit ___ (CWK-4). The exhibit reveals that earnings coverage of interest is less than 1.0 both with and without the access charge reduction, and therefore with and without interim relief. This means that purely from the standpoint of earnings, the presence or absence of interim rate relief would make no difference in the Company's ability to cover its fixed interest charges during the test year.

Earnings, however, are not the sole source of internal cash. Depreciation is an "expense" which involves no cash outlay and so constitutes internally generated cash if recovered in rates. When depreciation accruals are added to earnings, total internal cash generation covers interest costs by 6.91 times with interim relief and 5.45 times without it. Again, interim relief has no material effect on the outcome. Finally, internally generated cash covers not only interest but also construction expenditures both with and without the interim relief to offset the access charge reduction.

Q. WHAT IS THE GROWTH, STABILITY OR DETERIORATION OF THIS INTEREST COVERAGE?

A. Assuming the validity of the data shown in Exhibit ___ (CWK-6), intrastate earnings and cash flow coverage should improve when the Commission reaches a decision on permanent rates on May 15, 2005. These coverages would have improved in the summer of 2004 if Verizon had filed for a rate increase immediately following the Commission's August 2003 order reducing access charges. As it is, the presence or absence of interim relief will have no material impact on the adequacy of earnings or cash flow coverage, as demonstrated by Exhibit ___ (CWK-6).

Q. WHAT ARE THE COVERAGES AT THE WASHINGTON STATE AND TOTAL COMPANY LEVEL?

A. Exhibit ___ (CWK-6) shows the calendar year 2003 interest and cash flow results for total Washington operations, both intrastate and interstate, and for all operations of Verizon Northwest, Inc. The exhibit reveals that earnings (EBIT) coverage at the Washington State level was 2.42 times, and at the total company level, it was 3.34. Cash flow (EBITDA) coverage was 11.79 times for Washington operations and 12.76 times for the total company. These coverages are well up in Standard & Poor's A to AA ratings range, as presented by Verizon witness Vander Weide on page 12 of his prefiled testimony.

Q. WHY HAVE YOU INCLUDED RESULTS AT THE TOTAL WASHINGTON AND COMPANY LEVELS, NOT JUST FOR THE WASHINGTON INTRASTATE OPERATIONS?

A. The Commission's 5th Order focuses on the scenario most favorable to Verizon, which is the Company's claimed results at the Washington intrastate level. From the standpoint of raising capital, however, this scenario is entirely hypothetical. In determining whether an "actual emergency" exists, the Commission should recognize that Verizon actually finances its operations on a total company level. Exhibit **___**(CWK-6) demonstrates that regardless of the level at which the request is evaluated, the Company simply does not need interim relief.

Q. DO THESE COVERAGES SUGGEST THE PRESENCE OF AN ACTUAL FINANCIAL EMERGENCY?

A. No. At page 12 of his testimony, Verizon witness VanderWeide shows the coverage ratios used by Standard and Poor's to rate the bonds of industrial companies. According to this presentation, the 2.42 and 3.34 EBIT coverages are inadequate for an investment grade rating. However, the standards shown in Dr. VanderWeide's testimony are for industrial companies that generally have relatively less capital assets, and therefore less cash flow from depreciation, than do utilities. S&P's utility standards vary according to the "business rating" of the company, that is, the degree of business risk that the particular company faces. On a scale of 1 to 10, with 1 being the least risky, the EBIT coverages of Verizon

Northwest at the state and total company level would justify a AA rating if the company has a business rating of 1 or 2, and an A rating if its business risk is below 4.[11] Those, indeed are Verizon Northwest's S&P bond ratings.

The EBITDA coverages, which reflect depreciation cash flow, are between the A and the AA ratios required by S&P. Given its robust cash flow from collection of non-cash depreciation expenses in excess of capital expenditures, there is no doubt about why Verizon Northwest maintains its AA and A+ ratings with S&P.

Q. **ARE THERE ANY OTHER FINANCIAL RATIOS THAT THE COMMISSION SHOULD REVIEW IN DETERMINING WHETHER VERIZON REQUIRES INTERIM RATE RELIEF?**

A. Yes. The Commission should also review the ratio of the free cash flow, as measured by EBITDA, against the Company's requirement for cash. The requirement for cash over and above operating expenses includes interest payments and capital construction expenditures.

I have already performed this analysis for Washington intrastate operations in Exhibit ___ (CWK-4). That exhibit demonstrates that without interim relief, the Company's intrastate operations cover their cash requirements, but only barely. Exhibit ___ (CWK-6), which makes this same presentation for all Washington operations and for the total Company, shows that there is considerably more latitude in cash flow than Exhibit ___ (CWK-4) would suggest. For Washington operations as a whole, the surplus of cash flow over

[11] Standard & Poor's "Utilities & Perspectives," June 21, 1999

cash requirements is $172 million, for a multiple of 2.4. For the Company as a whole, the surplus cash flow is $323.5 million, for a ratio of cash to cash requirements of 2.62.

Q. ARE THERE ANY OTHER CORPORATE RELATIONSHIPS THAT THE COMMISSION SHOULD CONSIDER IN DETERMINING WHETHER TO GRANT INTERIM RATE RELIEF?

A. Yes. We have so far dealt only with the regulated side of Verizon's business. Verizon has a number of unregulated businesses that use local telephone service as a platform from which to launch their operations. These include:

- Verizon Long Distance,
- Verizon Directory Assistance,
- Verizon Internet Solutions a/k/a Verizon OnLine, and
- Verizon Directories, Inc.

Verizon Wireless is arguably a competitor to Verizon's land line services, but there are complementary aspects as well, such as the brand recognition and potential marketing opportunities that land line services provide.

Thus, in addition to the evidence that Verizon's is not nearly as unprofitable as the Company asserts, there are other unidentified benefits that the parent company realizes from its presence in the local services market. These benefits relate to Verizon's competitive ventures, the profitability of which is not subject to the constraints of regulation. They are benefits that the Commission should consider in evaluating whether the company faces gross inequity that would warrant interim relief.

FACTOR NO. 5: CLEAR JEOPARDY TO UTILITY AND RATEPAYERS

Q. IS THERE ANY EVIDENCE THAT FAILURE TO GRANT INTERIM RELIEF WOULD "CAUSE CLEAR JEOPARDY TO THE UTILITY AND DETRIMENT TO ITS STOCKHOLDERS AND RATEPAYERS?"

A. No. I have already addressed the issues related to this guideline. The effect of the 8½ month delay in receiving $21.04 million in revenue (which delay is self-inflicted) is to reduce Verizon Communications' net income by 0.28 percent. There is no effect whatsoever on Verizon Northwest's bondholders, as Moody's, S&P or Fitch all award investment-grade ratings to the Company's bonds. There is no threat that Verizon will not be able to support its planned capital expenditures, since even intrastate operations, standing alone, generate enough cash to cover the construction program. There is no jeopardy to ratepayers because Verizon has not shown that it is unable to maintain its system or make the necessary capital expenditures during the 8½ month period that it will have to wait for full revenue relief.

FACTOR NO. 6: PUBLIC INTEREST

Q. WOULD IT BE IN THE PUBLIC INTEREST FOR THE COMMISSION TO GRANT THE INTERIM RELIEF THAT VERIZON IS REQUESTING?

A. No. Interim relief is an extraordinary remedy intended for only the most serious circumstances. It is not in public interest to grant <u>any</u> interim relief unless there is clear, demonstrable evidence that failure to grant such relief would cause such financial distress as to create irreparable harm to investors and ratepayers. That is because such a practice, if it became routine, would shortcut the process of regulatory review. Residential ratepayers face the prospect of a 27 percent increase in their local service rates for 8 ½ months, with business customers facing a 12 percent increase. These are real financial burdens that should not be imposed lightly, whether or not refunds are offered. If the Commission, based on superficial evidence, were to grant interim relief, only to find later that such relief is not justified, it would have to reverse itself to the detriment of the regulatory process and to ratepayers. Such reversal would also encounter administrative problems, such as finding all of the customers to whom refunds are due. Finally, multiple rate changes are generally disfavored, since they can cause confusion for customers.

AVISTA/PUGET SOUND ENERGY COMPARISONS

Q. PLEASE DESCRIBE THE *AVISTA/PUGET SOUND ENERGY* COMPARISONS.

A. In September 2001, the Commission accepted the application of Avista Utilities for emergency interim relief.[12] Only one month later, in October 2001, the Commission rejected the application of Puget Sound Energy for similar relief.[13] In its Puget Sound Energy decision, the Commission compared Puget Sound Energy with Avista to demonstrate the inadequacy of Puget Sound's application. The specific comparisons were as follows:

[12] Docket No. UE-010395, Sixth Supplemental Order, September 24, 2001.
[13] Docket No. UE-011163, Sixth Supplemental Order, October 4, 2001.

- Avista filed detailed documentation of specific indicators that would demonstrate the urgency of relief. Puget Sound Energy did not.
- Avista stated it is already taking extraordinary steps to preserve financial integrity. Puget Sound Energy did not.
- Avista contended it could not receive any financing to support major construction. Pound Sound Energy did not.
- Avista asserted it would lose access to capital markets. Puget Sound Energy did not.
- Puget Sound Energy failed to show that its rates would be fair, just and reasonable.
- Avista asserted that its rate of return would be negative; Puget Sound Energy merely showed that it would not earn its authorized return.

Q. HAS VERIZON PROVIDED DETAILED DOCUMENTATION OF SPECIFIC INDICATORS THAT DEMONSTRATE THE URGENCY OF RELIEF?

A. No. The primary indicator of the need for relief offered by Verizon is its assertion that without the rate relief it has requested, it would earn a negative rate of return. The Commission has stated quite explicitly that a rate of return demonstration is not sufficient, standing alone, to justify interim rate relief. The only other evidence is witness VanderWeide's demonstration that on an entirely hypothetical stand-alone basis, Verizon's intrastate financial ratios would not support an investment-grade bond rating. This later demonstration must be rejected, as Verizon Northwest's bonds receive ratings well into the investment grade levels.

Q. HAS VERIZON DEMONSTRATED THAT IT IS ALREADY TAKING EXTRAORDINARY STEPS TO PRESERVE FINANCIAL INTEGRITY?

A. No. Verizon asserts that it has cut back its staff and its construction program. Verizon has not, however, demonstrated that these cutbacks are due to 8½ - months' delay in receiving $21.04 million in added revenue. Verizon has not even demonstrated that such steps are necessarily related to financial considerations at all. Rather, they may be in response to the industry-wide pattern of softened growth, and in some cases reduction, in the number of access lines in the last few years.

Q. HAS VERIZON DEMONSTRATED THAT IT COULD NOT RECEIVE ANY FINANCIAL SUPPORT FOR MAJOR CONSTRUCTION PROJECTS?

A. No. Verizon has not identified any major construction that would have to be canceled if interim relief is not granted. Nor has Verizon demonstrated that it cannot finance the construction it has planned. To the contrary, I have demonstrated that Verizon can fund its construction internally, even on a Washington intrastate basis.

Q. HAS VERIZON DEMONSTRATED THAT IT WOULD LOSE ACCESS TO CAPITAL MARKETS?

A. No. The best that Verizon has been able to demonstrate is that it would not receive an investment-grade rating if, hypothetically, it had to rely on its

Washington intrastate financial results to raise capital. The reality is that Verizon does not go to capital markets based on its Washington intrastate results. Verizon does not have to go to capital markets at all. First, it can finance its construction from internally generated funds. Second, its composite business, interstate and intrastate, is sufficiently healthy to cover all conceivable capital requirements. Finally, it does not need to go to capital markets because all of Verizon's capital is raised by its parent company, Verizon Communications.

Q. HAS VERIZON DEMONSTRATED THAT ITS PROPOSED INTERIM RATES WOULD BE FAIR, JUST AND REASONABLE?

A. No. Verizon has made no such demonstration.

Q. HAS VERIZON DEMONSTRATED THAT ITS RATE OF RETURN WOULD BE NEGATIVE WITHOUT RATE RELIEF?

A. No. This is Verizon's principal claim, but as noted, it fails to reflect all Commission ratemaking adjustments, most notably the imputation of Yellow Pages directory revenues. When such directory revenues are imputed at the level estimated by the company, Verizon's test year rate of return is positive 1.085 percent. More importantly, Verizon's return is only minimally impacted by the collection of the proposed interim revenues. The Company asserted no need for rate relief at all, in spite of its allegedly low returns, until the Commission ordered reductions in its access revenues.

CONCLUSION

Q. WHAT DO YOU CONCLUDE WITH RESPECT TO VERIZON'S CLAIM FOR INTERIM RATE RELIEF?

A. I conclude that even on an intrastate basis, Verizon has no need for interim relief to cure an actual emergency or grossly inequitable situation. No such actual emergency exists, nor will any grossly inequitable or harmful situation result from the denial of interim relief. If the Company faces an intrastate revenue deficiency, it can be addressed in the general rate case. When the factors for interim relief set forth in the Commission's 1972 *PNB* decision are applied to Verizon's petition, the Company's claims fall short. I also conclude that Verizon fails the comparisons between Avista and Puget Sound Energy that were made in the Commission's *Puget Sound Energy* interim relief case. Verizon's request for interim rate relief should be denied.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. It does.