

Exhibit No. ____ (KMF-5)
Docket No. UT-040788
Witness: Kathleen M. Folsom

BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

DOCKET NO. UT-040788

EXHIBIT TO TESTIMONY
(INTERIM CASE)
OF
Kathleen M. Folsom

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Supplemental Response to Data Request No. 35

July 14, 2004

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Before the

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WUTC

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket No. UT-040788

VERIZON NORTHWEST INC.

**SUPPLEMENTAL
RESPONSE TO STAFF DATA REQUEST NO. 35
INTERIM RATE RELIEF**

July 6, 2004

July 6, 2004

Data Request No. 35:

Verizon Northwest Inc.'s response to WUTC STAFF DATA REQUEST NO. 3 (General) stated, in part, the following:

“The Company’s position is that it is experiencing an actual emergency for the simple reason that its Washington Intrastate operations are earning a negative rate of return as a result of the Access Charge case, and it cannot meet its intrastate financial obligations with its intrastate revenues.”

Please identify any debt covenants or any conditions or criteria that Verizon Northwest Inc., Verizon Communications, Inc. (or any affiliate thereof) must comply with to avoid default on the Company’s intrastate financial obligations. Produce the documents containing the covenants, conditions or criteria.

RESPONSE: (dated June 9, 2004)

The Company has two active indentures that must be satisfied: 1) First Mortgage Bond Indenture (FMB Indenture) dated March 1, 1939, which has been supplemented 36 times and 2) a Debenture Indenture dated April 1, 1994, which has been supplemented 1 time.

Events of default and remedies associated with the FMB Indenture are outlined in Article VI, which is attached as Attachment 35a. Included as default are the non-payment of interest and principal. Dr. Vander Weide’s testimony clearly shows that the contribution of the Company’s Washington Intrastate Operation towards the payment of interest and principal has declined sharply over the last 5 years. Article I, Section 14 of the FMB Indenture as supplemented also requires the Company to maintain 2.00 times interest coverage in order to issue new First Mortgage Bonds, which takes a financing tool away from the Company. Dr. Vander Weide’s testimony shows that this requirement is not being met by the Company’s Washington Intrastate Operation. Article V, Section 1 of the FMB Indenture as supplemented and modified requires the Company to maintain a minimum net worth of \$160.4 million. Default for a period of 60 days or more causes any debt issued under the Indenture to become due and payable immediately.

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Verizon Supplemental Response to WUTC Staff Data Request Verizon No. 35

July 6, 2004

Events of default and remedies associated with the Debenture Indenture are outlined in Article Six, which is attached as Attachment 35b. Included as default are the non-payment of interest and principal. Dr. Vander Weide's testimony clearly shows that the contribution of the Company's Washington Intrastate Operation towards the payment of interest and principal has declined sharply over the last 5 years. Default for a period of 30 days or more causes any debt issued under the Indenture to become due and payable immediately.

Prepared By: Robert G. Deter

Date: June 2, 2004

Witness: James H. Vander Weide

SUPPLEMENTAL RESPONSE: (dated July 6, 2004)

Attached is Article I, Section 14 (Supplemental Attachment 35a) and Article V, Section 1 (Supplemental Attachment 35b) of the First Mortgage Bond Indenture:

The table below shows how minimum net worth is determined.

Retained Earnings at 12/31/1991	\$427,730
Covenant Allowance*	(\$881,167)
Paid-in Capital at 3/31/2004	\$613,812
Minimum Net Worth Requirement at 3/31/2004	\$160,375

* Covenant Allowance = \$581,167,000 write-off from discontinuance of FAS 71 plus the sum of \$300,000,000 (see Modification Agreement)

Prepared By: Robert G. Deter

Date: July 6, 2004

Witness: James H. Vander Weide

Verizon Supplemental Response to WUTC Interim Data Request No. 35
UT-040788

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Supplemental Attachment 35a

VERIZON NORTHWEST INC.
FIRST MORTGAGE BOND INDENTURE DATED MARCH 31, 1939
INDEBTEDNESS RESTRICTIONS

Interest Coverage Requirement – Article I, Section 14

None of said remaining bonds shall be authenticated and delivered under the provisions of Section 13 of this Article I, until and unless the net earnings of the Company, as herein defined, for a period of twelve (12) consecutive calendar months ending not more than ninety (90) days prior to the date of filing of the application therefor with the Corporate Trustee, shall have been equal to at least one and three-quarters ($1\frac{3}{4}$) times the “annual interest charge” of the Company.

The term “annual interest charge”, as used in this Indenture, shall mean the annual interest charge on:

- (a) all bonds then outstanding hereunder, except bonds for the redemption of which funds have been deposited with the Corporate Trustee or will be deposited with the Corporate Trustee simultaneously with the issuance of the bonds, the issue and authentication of which are applied for hereunder;
- (b) all bonds, the issue and authentication of which are applied for hereunder;
- (c) all bonds or other obligations the lien securities which shall be prior to or rank equally with the lien of this Indenture.

The term “net earnings” of the Company as used in this Article I shall mean and include an amount computed as follows:

From the total operating revenues and non-operating income from all sources, there shall first be eliminated profit realized from the sale or other disposition of capital assets. There shall then be deducted all operating expenses, including salaries, rentals, taxes (except as hereinafter provided), insurance, charges, charges for depreciation, license fees, and expenditures for ordinary repairs and maintenance, but there shall not be included in operating expenses charges or reserves for property abandoned or otherwise retired from service, loss sustained upon the sale or other disposition of capital assets, interest charges, charges or reserves for amortization of debt and debt discount, or premium and expense upon the bonds outstanding under this Indenture, income or other taxes imposed on income only after the deduction of interest charges or tax on corporate debt.

If any of the property owned by the Company, as herein defined (exclusive of property acquired in exchange or substitution for property released from the lien hereof, or through the use of cash deposited with the Corporate Trustee under any of the provisions hereof, other than cash deposited as a basis for the issue of bonds), at the time of making any “net earnings certificate”, as hereinafter defined, shall not have been owned by it during the period for which earnings applicable to bond interest are to be computed, or shall have been owned by it during a part only of such period, the net earnings or income of such property computed as herein

provided during the whole of such period may, at the option of the Company, be included in “net earnings” for all purposes of this Indenture.

The term “net earnings certificate” shall mean a certificate signed and sworn to by the President or a Vice-President and the Treasurer or an Assistant Treasurer of the Company, stating the amount of “net earnings” for the specified period, computed as provided in this section, and showing in reasonable detail, how the same has be calculated.

VERIZON NORTHWEST INC.
36TH SUPPLEMTN TO THE FIRST MORTGAGE BOND INDENTURE
DATED FEBRUARY 26, 1993
DIVIDEND RESTRICTIONS

Article V, Section 2

The Company covenants that, so long as any of the Bonds of Series GG, Bonds of Series HH, or Bonds of Series II are outstanding, no additional bonds shall be authenticated and delivered under the provisions of Article I of the Indenture, until and unless the net earnings of the Company, as defined in Article I, Section 14, of the Indenture, for a period of twelve (1) consecutive calendar months ending not more than ninety (90) days prior to the date of filing of the application therefor with the Corporate Trustee, shall have been equal to at least two (2) times the "annual interest charge" of the Company.

Supplemental Attachment 35b

VERIZON NORTHWEST INC.
36TH SUPPLEMTN TO THE FIRST MORTGAGE BOND INDENTURE
DATED FEBRUARY 26, 1993
DIVIDEND RESTRICTIONS

Article V, Section 1

The Company covenants that, so long as any of the Bonds of Series GG, Bonds of Series HH, or Bonds of Series II are outstanding, it will not declare or pay any dividends (excepting stock dividends) on any share or shares of its common stock, or apply any of the funds or assets of the Company (excepting the proceeds from the sale of other shares of stock), to the purchase or retirement of any share or shares of common stock, in excess of the net income of the Company derived from the operation of its business after December 31, 1991, plus the sum of \$300,000,000, and that no such dividends will be paid or purchase or retirement of its common shares made at a time when the Company shall be in default under any of the provisions of said Indenture.

MODIFICATION AGREEMENT

Modification Agreement, dated as of December 29, 1995 (the "Agreement") by and among GTE Northwest Incorporated, a Washington corporation (the "Company"), the holders of the Series HH Bonds (as hereinafter defined) listed as signatories hereto (each a "Holder" and collectively, the "Holders") and First Trust of California, National Association (the "Corporate Trustee"), and Peet Saaret, an individual (the "Individual Trustee," and together with the Corporate Trustee, the "Trustees").

WHEREAS, the Company's predecessor executed and delivered a Trust Indenture dated as of March 1, 1939, to Bank of America National Trust and Savings Association, as Trustee (First Trust of California being the successor Corporate Trustee to Bank of America National Trust and Savings Association) and W.J. Kieferdorf, as Trustee (Peet Saaret being the successor Individual Trustee to W.J. Kieferdorf), to secure payment of the principal of and interest on bonds issued and to be issued by the Company's predecessor, which Indenture has been supplemented and amended by thirty-six supplemental indentures (said Indenture as so supplemented and amended hereinafter referred to as the "Indenture");

WHEREAS, the Company has succeeded to all rights and obligations of, and has been substituted for, its predecessor under the Indenture;

WHEREAS, pursuant to the Indenture as supplemented by the Thirty-Sixth Supplemental Indenture, dated as of February 26, 1993 (the "Supplemental Indenture"), the Company issued First Mortgage Bonds, 9.67% Series HH due 2010 in the original principal amount of \$15,000,000 (the "Series HH Bonds") and, pursuant to Article V, Section 1 of the Supplemental Indenture, the Company covenants that, so long as any of the Series HH Bonds are outstanding, it will not declare or pay any dividends on its common stock in excess of the net income of the Company derived from operation of its business after December 31, 1991, plus the sum of \$300,000,000.

WHEREAS, effective January 1, 1996, the Company is discontinuing the use of the accounting practices for regulated enterprises prescribed by Statement of Financial Accounting Standards No. 71 and, as a result of this decision, the Company will record a one time, non-cash, extraordinary charge during the fourth quarter of 1995 equal to \$581,167,000 (the "1995 Extraordinary Charge"), which will inhibit the Company's ability to pay dividends under Article V, Section 1 of the Supplemental Indenture due solely to the recording of the 1995 Extraordinary Charge;

WHEREAS, the Indenture provides that any provision of the Indenture which affects the rights of holders of a series of bonds may be modified, subject to certain restrictions, by the affirmative assent of the Trustees and the holders of at least 75 percent in principal amount of the series of bonds so affected; and

WHEREAS, the Trustees and the Holders (who hold in excess of 75 percent in principal amount of the Series HH Bonds) desire to modify Article V, Section 1 of the Supplemental Indenture so that the recording of the 1995 Extraordinary Charge will not inhibit the Company from declaring and paying dividends on its common stock.

NOW, THEREFORE, in consideration of the foregoing and for good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the parties hereto agree as follows: