Exhibit No. ____(SMB-1T)
Docket No. UT-

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Verizon Northwest Inc. for an Order Approving Commencement Of Bifurcated General Rate Case and Waiver of WAC 480-07-510(2)	))))	**DOCKET NO. UT-**

DIRECT TESTIMONY OF

STEVEN M. BANTA

ON BEHALF OF
VERIZON NORTHWEST INC.

APRIL 30, 2004

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Steven M. Banta. My business address is 600 Hidden Ridge Drive, Irving, Texas, 75038.

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

A. I am employed by Verizon as Group President – Northwest and Southwest Regions and have responsibility for public policy and external affairs in Washington, Idaho, Oregon, and Texas. I am testifying on behalf of Verizon Northwest Inc. ("Verizon NW" or "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A. I graduated from Central Michigan University in 1975 with a Bachelor of Science Degree in Business Administration. I earned a Master of Science Degree in Accounting from Central Michigan in 1976. In October 1976, I joined General Telephone Company of Michigan as an accounting assistant. I held various positions of increasing responsibility in the Accounting and Regulatory Departments until February 1984, when I was promoted to the position of Regulatory Affairs Manager. In July 1986, I was promoted to State Director – Regulatory and Legislative Affairs in Harrisburg, Pennsylvania for GTE North. In April 1992, I was promoted to Director – Business Matters for GTE Telephone Operations. In March 1996, I accepted the position of Assistant Vice President – Government Relations for GTE Wireless. In this capacity I was responsible for state and federal regulatory and legislative matters for GTE Wireless in Atlanta, Georgia. In

March 1998, I became the Regulatory and Governmental Affairs Vice President, Central, for GTE Service Corporation leading Verizon's efforts in 11 central states until being selected as Group President in my present position in July 2000.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to introduce the other witnesses testifying in this proceeding and to explain why the Company is filing this rate case. I will also identify the Company's initiatives to improve efficiencies in the operations and discuss steps to retain or grow revenue. Finally, I will discuss the potential consequences to future investment and service quality if Verizon's capital recovery and financial condition do not improve.

Q. PLEASE IDENTIFY THE OTHER WITNESSES PRESENTING TESTIMONY IN THIS PROCEEDING.

A. **Nancy Heuring, Director – Regulatory Accounting**, presents the Company's intrastate operating results and revenue requirement for the October 1, 2002 through September 30, 2003 test year and for the pro forma period October 2003 through September 2004. Ms. Heuring's analysis shows a *negative* intrastate return of 3.73%.

Deborah Anders, West Coast Region President, presents a description of Verizon's Washington operations and explains how Verizon continues to provide high quality service our customers have come to expect in an efficient manner. Ms. Anders also discusses Verizon's performance compared to the Commission's service quality rules, and she explains the Company's level of capital investment.

James A. Vander Weide, Ph.D., Fuqua School of Business of Duke University, presents the appropriate market-based cost of equity and capital structure for the Company. Dr. Vander Weide assesses risk factors such as competition, rapidly changing technology, and the regulatory environment and compares Verizon's risks to a proxy group of companies. Dr. Vander Weide then estimates Verizon's overall weighted average cost of capital used in setting the revenue requirement. He concludes that Verizon's overall rate of return should be set at 12.03%.

Dennis B. Trimble, PM KeyPoint LLC, explains that the yellow page revenues generated by an unregulated affiliate, Verizon Directory Corporation (VDC), should not be imputed to Verizon's regulated earnings.

Michael J. Doane, PM KeyPoint LLC, presents his evaluation of the competitiveness of the yellow pages directory services provided by VDC in the Verizon Washington operating area.

Q. WHY IS THE COMPANY FILING THIS CASE?

A. The Company is filing this case so that, on a prospective basis, the Company has a fair opportunity to recover its cost of providing service plus a reasonable return.

The Commission regulates Verizon under rate-of-return regulation, under which Verizon must be given an opportunity to recover its operating expenses plus a reasonable return on its investment. As Ms. Heuring explains, Verizon's intrastate revenues in the test period are $335.9 million but its operating expenses alone exceed $400 million. Therefore, Verizon does not have sufficient revenues to cover its expenses much less earn a reasonable return on its investment. Verizon has more than $965 million in rate base in Washington, but is not earning a penny in return on it. Indeed, as Ms. Heuring explains, Verizon's current intrastate return is a *negative* 3.73%. Given these adverse financial circumstances, Verizon has no choice but to seek rate relief.

In short, Verizon is requesting a permanent revenue increase of $239.5 million per year. This increase will allow Verizon to recover its operating expenses plus a reasonable return of 12.03% on its investment.

Q. IS THE COMPANY ALSO FILING FOR INTERIM RATE RELIEF?

A. Yes. Verizon is also requesting interim rate relief equal to the revenue reduction the Commission ordered in the AT&T Complaint Case, Docket No. UT-020406. I have filed separate testimony in support of Verizon's request for interim relief along with Ms. Heuring and Dr. Vander Weide.

Q. PLEASE IDENTIFY THE MAJOR FACTORS THAT HAVE CAUSED VERIZON'S REVENUE DEFICIENCY.

A. There are seven major factors that explain the changes in Verizon's revenue requirement during the past several years: (1) the Commission reduced Verizon's intrastate access charges by $29.7 million in the AT&T Access Charge Complaint Case; (2) Verizon's revenues have decreased due to erosion of access lines and minutes-of-use; (3) Verizon's revenues were reduced by $30 million per year beginning in May 2000 as a result of the GTE-Bell Atlantic merger Settlement Agreement; (4) since 2000, Verizon has made more than $526 million in additional gross plant investments in Washington resulting in an increased intrastate rate base of $40 million, and this additional rate base increases Verizon's intrastate revenue needs (compared to 2000 levels) by $15 million per year; (5) Verizon's intrastate depreciation expense has increased by $64 million per year; (6) Verizon's directory revenues have declined by about $34 million per year due to a new contract with Verizon's directory publisher that reflects the market rate for directory listings; and (7) Verizon's cost of capital has increased to 12.03%, which yields an additional revenue need of about $34 million per year when compared to 2000.

These major factors – excluding the loss of revenues due to erosion in access lines and minutes-of-use – equate to more than $200 million in annual revenue.

Q. PLEASE DISCUSS THE AT&T ACCESS CHARGE COMPLAINT CASE.

A. In August 2003, the Commission ordered Verizon to cut its intrastate access charges by $29.7 million with an effective date of October 1, 2003. Verizon's position in the case was that its intrastate access charges could not be reduced in a vacuum. It further explained that these charges generate a significant part of Verizon's overall revenues, and that the Commission could not, by law, reduce them because Verizon's resulting revenues would not be sufficient without an offsetting increase in other rates. Verizon made a proposal to offset any access reduction with an increase to local rates and submitted earnings data showing that Verizon's earnings were well below the level authorized by the Commission. The Commission did not consider this evidence and concluded a rate proceeding was a more appropriate forum for Verizon to seek rate relief to allow it the opportunity to earn a fair return.

Q. PLEASE DISCUSS THE IMPACT THE COMPETITIVE ENVIRONMENT HAS HAD ON VERIZON'S BUSINESS.

A. Verizon's services are under increasing competitive pressure from a wide variety of largely unregulated telecommunications providers using a multitude of technologies. These competitive inroads are eroding revenue streams and can be measured by a 4.0% drop in access lines and a 15.7% drop in switched access minutes-of-use in 2003. In fact, Verizon was *adding* nearly 4,200 lines per month in 1999, but by 2003 it was *losing* almost 2,900 lines per month. And as mentioned in the testimony of Ms. Anders, the capital intensive nature of Verizon's business prevents a dollar-for-dollar cut in operating costs to match revenue decreases.

Q. PLEASE EXPLAIN THE SETTLEMENT AGREEMENT FROM THE GTE-BELL ATLANTIC MERGER ORDER.

A. The Commission issued its order (UT–981367) on December 16, 1999 granting the Joint Motion for Approval of the GTE Corporation – Bell Atlantic Corporation Merger subject to the conditions imposed under the Settlement Agreement. The Settlement Agreement required Verizon to reduce rates for regulated services in four phases to achieve a $30 million net annual revenue reduction by July 1, 2001, as follows:

- First phase $7 million by May 1, 2000
- Second phase $8 million by July 1, 2000
- Third phase $8 million by January 1, 2001
- Fourth phase $7 million by July 1, 2001

Q. PLEASE DISCUSS VERIZON NW'S CONTINUED INVESTMENT IN THE NETWORK.

A. In an effort to meet customer demand and ensure a high level of service quality, Verizon NW has invested over $526 million in the network from the period 2000 through the test period. This increase in investment, including the depreciation on the additional plant in service and a return on that investment, increases the revenue requirement by approximately $15 million.

Q. PLEASE DISCUSS VERIZON'S INCREASED DEPRECIATION EXPENSE.

A. Verizon must increase its depreciation expense to better reflect the useful life of it assets. On June 16, 2000, the Commission approved in Docket No. UT-992009 a $21.5 million increase to the Company's total annual depreciation expense effective January 1, 2000. This total company expense yields an increased *intrastate* expense of approximately $16.1 million per year ($21.5 million x 75%). This increase in depreciation expense reduced Verizon's earnings because there was no associated increase in revenue.

This previous increase in depreciation rates, however, did not solve the Company's significant capital recovery problem. This problem is illustrated by the Company's current "depreciation reserve," which is the amount of investment the Company has recognized on its books through the accumulation of annual depreciation expenses. The higher the reserve (or "reserve ratio"), the more depreciation expense has been recognized and the less the risk that the investment will never be fully recovered. Verizon's intrastate accumulated depreciation reserve ratio for Washington is only 43.3%, while the comparable number for other states in which Verizon and its affiliates operate is greater than 55%. The Washington intrastate accumulated reserve ratio also severely lags both the FCC accumulated reserve ratio for Washington and the financial reporting (GAAP) reserve ratios for Washington of 53.1% and 62.3%, respectively. This comparison proves that the current depreciation rates are too low. On March 22, 2004, Verizon filed a depreciation study in (UT-040520) requesting an additional increase in intrastate depreciation expense of approximately $47.4 million. This increase, plus the

$16.1 million increase approved in Docket No. UT-992009, equates to a total annual increase of $63.5 million in intrastate depreciation expense.

Q. PLEASE EXPLAIN THE CHANGES IN VERIZON'S DIRECTORY REVENUES.

A. As discussed in the testimony of Verizon witnesses Dennis Trimble and Michael Doane, Verizon's current contract with its directory publisher, VDC, reflects market rates for directory listings and other services. These witnesses explain why the Commission should not and cannot "impute" any portion of VDC's revenues to Verizon. In short, VDC can no longer subsidize Verizon's ratepayers.

Q. PLEASE EXPLAIN THE COMPANY'S INCREASED COST OF CAPITAL.

A. The Company's current Commission-prescribed cost of capital is 9.76%. Verizon witness Dr. James Vander Weide explains why this return is too low and why a return of 12.03% is reasonable. This increased return raises Verizon's revenue requirement by about $34 million per year compared to 2000.

Q. HAS THE REGULATORY ENVIRONMENT PROVIDED ANY INCENTIVES FOR INVESTMENT IN WASHINGTON?

A. No. The past Commission decisions addressing capital recovery have led to an extremely low percentage of past investment recovered, less than any other state where Verizon operates. Businesses invest where they see favorable opportunities to earn a return and recover their investments, as the facilities those investments purchased become obsolete and wear out.

Verizon has announced the rollout of a new fiber network in its footprint. While there are several market factors that come into play in deciding where to deploy this new network, Verizon must also consider the regulatory environment. Washington's record on capital recovery and unilaterally reducing rates without even considering earnings is hardly conducive to discretionary capital deployment. If a company can't recover its existing investment or earn a reasonable return on it, the case for substantial new investment is nonexistent. Verizon's investments in Washington State to the extent it can make them at all will be limited to meeting its most basic obligations.

Q. HAS VERIZON'S SIGNIFICANT UNDEREARNINGS CAUSED ITS SERVICE QUALITY TO DETERIORATE IN 2003?

A. No. As shown in the testimony of Verizon witness Deborah Anders, the Company's Washington service quality in 2003 was excellent. Verizon's performance, when measured against the service quality rules in WAC 480-120, was strong and customer survey results rated Verizon's installation and repair service very highly. Verizon views its service quality as a differentiator when customers are making a choice between providers and would never allow it to slip except for a financial crisis. However, it is inevitable that service quality will start to deteriorate if poor financial results persist. Limits will have to be placed on capital spending and the maintenance and repair budget.

Q. WHAT STEPS HAS VERIZON TAKEN TO OPERATE EVEN MORE EFFICIENTLY?

A. First, cost savings from the merger of GTE – Bell Atlantic were first realized in Year 2000. Merger savings are the reduction in overall expenses incurred by the merged company compared to the expenses that would have been incurred by the respective merger partners had the merger not been consummated. Examples of expense saving opportunities include eliminating redundant functions, increasing economies of scale, and adopting the most efficient business methods, or "best practices".

Second, ongoing cost savings will be realized with the Management Voluntary Separations Plan ("MVSP") in which more than 21,000 employees left the payroll on November 21, 2003. (As explained in the testimony of Nancy Heuring, Washington's intrastate share of the cost savings were estimated, but net savings are not expected to materialize until after the test period utilized in this case.)

Third, Verizon's Domestic Telephone Operations is driving a series of cost containment programs across its footprint. Increased use of "Customer Self Service" through Verizon.com, enhanced voice response units, and touchless ("B2B") trouble management for enterprise customers has led to a series of efficiencies in internal processes. Finally, a number of operational efficiencies have been identified in the testimony of Ms. Anders.

Q. WHAT STEPS HAS VERIZON TAKEN TO RETAIN OR GROW ITS REVENUE?

A. Verizon offers an array of packaged services designed to retain customers in a competitive environment by offering them multiple services. Verizon offers Local Package and Local Package Extra, which combines local service, touch-tone, unlimited local directory assistance with a choice of many value-added features such as Caller ID, Call Waiting, Speed Dialing, Distinctive Ring, Priority Call, and Three-Way Calling. Verizon plans to offer a bundled package with unlimited long distance in the future.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.