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February 13, 2003

HAND DELIVERED

Ms. Carole Washburn
Secretary
Washington Utilities and Transportation Commission
P.O. Box 47250
1300 South Evergreen Park Dr. S.W.
Olympia, WA 98504-7250

Re: AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest Inc., Docket No. UT-020406

Dear Ms. Washburn:

Enclosed please find the original and 19 copies each of the Verizon's First Motion to Strike and For Summary Determination, Verizon's Opposition to Public Counsel's Motion to Strike and Motion In Limine to Limit Hearings and the Certificate of Service in the above-referenced matter.

If you should have any questions, please contact me. Thank you.

Sincerely,

GRAHAM & DUNN PC

Nancy E. Dickerson
Assistant to Judith A. Endejan

Enclosures

cc: All Parties

m26420-409941.doc

ORIGINAL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., Complainant, vs. VERIZON NORTHWEST INC., Respondent.	Docket No. UT-020406 **VERIZON'S OPPOSITION TO PUBLIC COUNSEL'S MOTION TO STRIKE AND MOTION IN LIMINE TO LIMIT HEARINGS**

VERIZON'S OPPOSITION

Verizon Northwest Inc. ("Verizon") opposes Public Counsel's "Motion to Strike Testimony and In Limine to Limit Hearings." The essence of the motion is that Verizon's testimony on the need to increase other rates if access charges are reduced constitutes "impermissible single-issue ratemaking." Public Counsel has the right idea but the wrong party: it is AT&T that has proposed single-issue ratemaking, not Verizon. AT&T is attempting to reduce the rates of a single Verizon service – intrastate access – while ignoring Verizon's rates for other services as well as Verizon's overall intrastate earnings. Indeed, the very testimony Public Counsel seeks to strike was filed to ensure that this case does *not* result in impermissible

single-issue ratemaking. For this reason, and for the reasons stated below, Public Counsel's motion must be denied.

I. AT&T HAS PROPOSED SINGLE-ISSUE RATEMAKING, NOT VERIZON

Verizon agrees with Public Counsel that this case involves impermissible single-issue ratemaking, but it is AT&T's complaint, not Verizon's defense, that is improper. Public Counsel admits that, stripped to its essence, the Complaint deals with single-issue ratemaking – "the proper level of Verizon's access charges."[1] In contrast, Verizon's testimony merely responds to this attack.

Verizon also agrees with Public Counsel that single-issue ratemaking is "impermissible."[2] Such ratemaking attempts to change the rates and revenues associated with a single service, and thereby ignores a carrier's other rates and revenues and overall earnings. As Public Counsel (and the Commission) recognizes, single-issue ratemaking is particularly pernicious when access charges are involved, because "changes to access rates could have a substantial effect on the company's overall results of operations and therefore should not be addressed in a single-issue rate proceeding."[3]

Here, AT&T has proposed single-issue ratemaking: it seeks to reduce Verizon's access charges by more than $40-$50 million per year while ignoring Verizon's other services, rates, and overall intrastate earnings. In response, Verizon filed testimony on its earnings and revenue-neutral increases to other rates, which Public Counsel now seeks to strike. In other words, Public

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[1] Motion to Strike at 8.

[2] Id. at 3.

[3] *MCI Telecommunications Corp. v. GTE Northwest*, Docket No. UT-970653, Second Supplemental Order Dismissing Complaint at 6 (Oct. 22, 1997).

Counsel seeks to strike the very testimony that was filed to ensure this case does *not* result in single-issue ratemaking. Public Counsel's motion should be directed toward AT&T, not Verizon.

II. PUBLIC COUNSEL'S MOTION PROVES THAT THIS CASE MUST BE DISMISSED

Public Counsel is correct that this case violates the prohibition against "single-issue ratemaking,"[4] and therefore it must be dismissed. Indeed, the very case quoted by Public Counsel in its motion – *City of Chicago v. Illinois Commerce Commission* – supports this conclusion. As Public Counsel explains, that case holds that single-issue ratemaking is prohibited because it "considers changes in isolation, thereby ignoring offsetting considerations and risking understatement or overstatement of the overall revenue requirement."[5] This is precisely the danger raised by AT&T's complaint: if Verizon's access charges are reduced, it will result in an understatement of its overall revenue requirement, which is unlawful. (Indeed, Verizon's "First Motion to Strike and for Summary Determination," which was filed separately today, explains that the lawful evidence on Verizon's overall earnings is undisputed.)

Public Counsel appears to dispute the logic of Verizon's argument by attempting to distinguish its motion to strike based on single-issue ratemaking from Verizon's motion to dismiss based on single-issue ratemaking. In Public Counsel's words,

> The present motion is distinguishable from that brought by Verizon last summer. Verizon's motion to dismiss sought to foreclose AT&T's access to the Commission to seek access charge reductions. By contrast, the present motion seeks to properly limit the testimony and subject matter of the hearing to those remedies appropriate to the subject matter of the complaint, namely Verizon's access charges.[6]

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[4] Motion to Strike at 2.

[5] 281 Ill. App. 3d 617, 627 (1996), *quoted in* Public Counsel's Motion to Strike at 2.

[6] Motion to Strike at 4.

This argument, although difficult to comprehend, appears to be that the Commission can limit its consideration to only one rate – access charges – and not run afoul of the prohibition against single-issue ratemaking because access charges are "the only subject matter of [AT&T's] complaint." This argument leads to the bizarre (and erroneous) conclusion that the prohibition against single-issue ratemaking doesn't apply if someone only complains about a single rate.

In sum, Public Counsel cannot distinguish its motion to strike from Verizon's motion to dismiss. In fact, Public Counsel's motion proves that this case is single-issue ratemaking and the Commission should dismiss it.

III. VERIZON HAS THE RIGHT TO PRESENT ITS EVIDENCE, WHICH THE COMMISSION CANNOT IGNORE

Verizon has an unqualified right to present evidence of its overall earnings and the need for revenue-neutral offsets if access charges are reduced. State law is clear: "the person or corporation complained of shall be entitled to be heard and introduce such evidence as he or it may desire."[7]

Moreover, the Commission *must* consider Verizon's evidence. The Commission has a constitutional and statutory obligation to ensure that Verizon's rates are "just, reasonable and *sufficient*."[8] As the Washington Supreme Court has repeatedly held, the Commission must "endeavor to not only assure fair prices and service to customers, but also to assure that regulated utilities earn enough to remain in business – each of which functions is as important in the eyes

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[7] RCW 80.04.120.

[8] *See, e.g.*, RCW 80.36.080; RCW 80.36.140; 80.04.110.

of the law as the other."[9] The Commission must not set confiscatory rates, which would result if Verizon's access charges were reduced without offsetting rate increases:

> There is a constitutionally based floor below which a rate ceiling set by a regulatory agency will be reversed by the courts as confiscatory. This is based on the prohibitions in the Fifth and Fourteenth Amendments of the United States Constitution against taking private property for a public use without just compensation. Put succinctly, the "power to regulate" is not a power to destroy.[10]

As we explain in our accompanying Motion to Strike and Motion for Summary Judgment, Verizon's intrastate regulated earnings are well below the authorized level,[11] and therefore requiring access charge reductions without revenue-neutral increases to other rates would be confiscatory.

For all these reasons, Verizon has a right to proffer the evidence Public Counsel seeks to strike, and the Commission must consider it.

IV. PUBLIC COUNSEL'S CONCERN OVER CUSTOMER NOTICES CAN BE ADDRESSED

Public Counsel argues that Verizon's rate rebalancing testimony must be stricken because any rate rebalancing remedy would violate customers' due process rights.

As a threshold matter, the statutes and rules Public Counsel references apply to general rate cases initiated by a company. Here, Verizon has not initiated a rate case; rather, Verizon is responding to AT&T's request for single-issue ratemaking. In any event, Public Counsel's concerns about notice to customers are, at this point, hypothetical, and if they arise they can be addressed in ways that do not violate Verizon's due process rights. For example, if the

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[9] *Power v. Utilities & Transportation Commission*, 104 Wn.2d 798, 808, 711 P.2d 319 (1985).

[10] *Id.* at 812 (citations omitted).

[11] Moreover, Verizon's 3rd Quarter Earnings Report for 2002, which was filed with this Commission, shows a return of less than 2%.

Commission finds that Verizon's toll rates do not pass imputation, it can remedy this problem by requiring Verizon to reset its toll rates. This remedy would obviate the need for customer notice. Alternatively, if the Commission decided to reduce Verizon's access charges, it could implement a separate phase (with appropriate notice) to establish offsetting rate increases, and thereafter implement access reductions and other rate increases simultaneously. Or the Commission could simply replace the current procedural schedule with one that provides enough time for customer notice.

In sum, there are many remedies available to the Commission, but Public Counsel's remedy should not and cannot be imposed because it would violate Verizon's due process rights.

For all these reasons, Public Counsel's motion must be denied. Alternatively, if it is granted, then AT&T's complaint must be dismissed.

Respectfully submitted,

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Dated this 13th of February, 2003.

ORIGINAL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., Complainant, vs. VERIZON NORTHWEST INC., Respondent.	Docket No. UT-020406 CERTIFICATE OF SERVICE

Nancy E. Dickerson affirms and states:

That on this day, I caused to be served true and correct copies of **Verizon's First Motion to Strike and for Summary Determination and Verizon's Opposition to Public Counsel's Motion to Strike and Motion In Limine to Limit Hearings**, by the method indicated below, and addressed to each of the following:

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I declare under penalty of perjury under the laws of the State of Washington, that the foregoing is true and correct to the best of my knowledge.

Executed at Seattle, Washington this 13th day of February, 2003.

By Nancy E. Dickerson
Nancy E. Dickerson
Legal Secretary

ORIGINAL

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., Complainant, vs. VERIZON NORTHWEST INC., Respondent.	Docket No. UT-020406 **VERIZON'S FIRST MOTION TO STRIKE AND FOR SUMMARY DETERMINATION**

VERIZON'S FIRST MOTION TO STRIKE AND FOR SUMMARY DETERMINATION

Verizon Northwest Inc. ("Verizon") requests that the Commission (1) strike the testimony of AT&T and Staff that proposes to adjust Verizon's *intra*state earnings based on Verizon's *inter*state costs and revenues; and (2) find that Verizon's regulated intrastate earnings are below its authorized level.

I. INTRODUCTION

From the start of this case, Verizon has explained that the Commission cannot engage in single-issue ratemaking, and therefore AT&T's complaint must be dismissed. Nevertheless, the Commission has allowed this case to go forward (at least to this point) reasoning that "there are

factual disputes relevant to the legal issues."[1] Verizon does not agree with the Commission, but, as a defensive measure, Verizon has submitted evidence that it is not overearning and that the Commission cannot reduce Verizon's access charges unless it allows Verizon to increase basic rates on a revenue-neutral basis.

This issue is now ripe for summary determination, because the undisputed evidence is that Verizon is *not* overearning. Verizon's direct testimony shows that Verizon's intrastate rate-of-return is only 2.84% as of September 2002, well below its authorized rate of 9.76%. After months of discovery, AT&T and Staff filed their rebuttal testimony addressing Verizon's earnings. AT&T proposes several adjustments, but even with all of its adjustments it calculates Verizon's return to be 9.09%. Staff also proposes several adjustments, the most significant of which "reduces" Verizon's revenue requirement by unlawfully shifting intrastate costs to the interstate jurisdiction. As we explain below, such cost-shifting is prohibited by law, and therefore Staff's testimony on this adjustment must be stricken. The remaining Staff adjustments result in a return of 8.72%, which, of course, is below Verizon's authorized return.[2]

In sum, the factual question of whether Verizon is overearning has been answered, and the Commission should grant summary judgment on this point.

II. DISCUSSION

A. Motion to Strike

In her rebuttal testimony, Staff witness Betty A. Erdahl proposes to adjust Verizon's earnings by "re-allocating" costs from the intrastate to interstate jurisdiction supposedly to reflect increased Internet usage, claiming she can do so under the FCC's Part 36 separations rules.[3] She does this by developing an allocation factor that assumes Verizon's interstate expense and investment increased in proportion to Verizon's interstate revenues during the period 1998-2001.

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[1] Second Supplemental Order Denying Motion to Dismiss at 8.

[2] Staff's calculations, adjusted to exclude the unlawful interstate costs allocations, are shown on Attachment A.

[3] Erdahl Rebuttal at 6.

She then applies this factor to Verizon's *intra*state expense and investment to shift costs from the intrastate to the interstate jurisdiction.

Ms. Erdahl's testimony on this point must be stricken because it ignores the FCC's separations freeze, which states are required to follow. The FCC has been investigating changes to its separations rules for several years. In May 2002, the FCC adopted its *Separations Freeze Order*,[4] which imposes an interim freeze on its Part 36 cost allocation factors. In that docket, several states requested the FCC to adjust some separations factors "to compensate for the impact of the Internet on local calling patterns."[5] Also, the Federal-State Joint Board on Separations proposed a 5% adjustment factor to account for increased Internet usage.[6] The FCC, however, rejected both proposals and instead implemented the current freeze. The FCC explained that it had the legal authority to implement a freeze under *Smith v. Illinois*.[7]

Here, Ms. Erdahl ignores the FCC's freeze; indeed, she readily admits the purpose of her adjustment is to counter what she believes is the "jurisdictional separations mismatch" caused by the freeze:

> The freeze of allocation factors relating to Internet minutes of use is an example of the need to adjust current allocations. . . . More and more minutes of use are Internet-related and therefore interstate according to FCC rulings, while the expenses and investment continue to be booked to the intrastate jurisdiction.[8]

Ms. Erdahl's adjustment ignores the fact that the FCC's *Separations Freeze Order* is binding on the states. The United States Court of Appeals for the Ninth Circuit addressed this

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[4] In the Matter of Jurisdictional Separations, CC Docket No. 80-286, Report and Order (rel. May 22, 2001) (*Separations Freeze Order*).

[5] *Id.* at para. 9.

[6] *Id.* at paras. 39-42.

[7] 282 U.S. 133 (1930). The only state that argued the FCC did not have this authority was California.

[8] Erdahl Rebuttal at 6.

very point in *Hawaiian Telephone Co. v. Public Utilities Commission of Hawaii*,[9] where it struck down a state commission decision that did not follow an FCC separations order. In that case, the state consumer advocate argued that the FCC's separation procedures did not preempt state-developed procedures for intrastate ratemaking. The Court disagreed, holding that the FCC's order preempts the states under *Smith v. Illinois*. The Court struck down the state commission's "transparent and improper attempt to circumvent the FCC mandate."[10]

The Ninth Circuit's decision is directly on point. Here, as there, a party is attempting to circumvent an FCC separations order. It cannot do this. Accordingly, Staff's testimony on this adjustment must be stricken.

For this same reason, AT&T's rebuttal testimony on Verizon's interstate operations must be stricken. For example, AT&T witness Selwyn argues that the Commission must consider Verizon's "combined regulated intrastate/interstate operations" in evaluating Verizon's earnings and any "confiscation" or "takings" claim.[11] This testimony, like Ms. Erdahl's is contrary to law because it ignores the FCC's separations rules and ignores the obvious fact that the Commission has jurisdiction only over a company's *intra*state operations.[12]

The specific portions of Staff's and AT&T's testimony that must be stricken are set forth in Attachment B. Once Staff's testimony is stricken, there is absolutely no evidence that Verizon is overearning, and therefore the Commission must grant summary determination on this point.

B. Motion for Summary Determination

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[9] 827 F.2d 1264 (9th Cir. 1987).

[10] *Id.* at 1277.

[11] Selwyn Rebuttal at 42-43.

[12] This point is indisputable. Indeed, the State Members of the Federal-State Joint Board on Jurisdictional Separations have acknowledged this fundamental principle: "[T]he separations process provides the cost information that is the basis for determining the confiscation liability of each jurisdiction. Indeed, it may be said that the fundamental purpose of separations is to determine the potential confiscation liability of both the federal and state jurisdictions." In the Matter of Jurisdictional Separations Reform, CC Docket No. 80-286, State Members' Report at 3 (Dec. 21, 1998).

The legal standard for summary determination is well-settled: The moving party is entitled to summary judgment *as a matter of law* "where the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits, if any, show that there is no issue as to any material fact."[13] The decision-maker must view the evidence in a light most favorable to a non-moving party; however, the non-moving party "may not rely upon speculation or on argumentative assertions that unresolved factual issues remain."[14]

Applying this standard to the facts of this case, there can be no doubt that Verizon is entitled to summary determination as a matter of law:

1. Verizon filed its direct testimony on December 3, 2002. This testimony shows that Verizon's intrastate rate-of-return is only 2.84% as of September 2002, well below its authorized rate of 9.76%.[15]

2. AT&T filed its rebuttal testimony on January 31, 2003. Even after accepting all AT&T's proposed adjustments, AT&T's testimony shows that Verizon is earning 9.09%, which is below its authorized return.

3. Staff filed its rebuttal testimony on February 7, 2003. After Staff's illegal cost-shifting adjustment is stricken, Staff's testimony shows that Verizon is earning only 8.72%, which is below the company's authorized return.

4. No party challenges Verizon's current authorized rate of return. In fact, Staff affirmatively states that it is not asking the Commission to change this return.[16]

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[13] *Brannan v.Qwest*, Docket No. UT-010988, et al., Final Order at 10-11 (W.U.T.C. Jan. 11, 2002). *See also* WAC 480-09-426.

[14] *Id.*

[15] Direct Testimony of Nancy Heuring at 2.

[16] Zawislak Rebuttal at 5, lines 3-6.

In sum, the evidence is clear: Verizon is not overearning, and the Commission must grant summary determination on this point.

Respectfully submitted,

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By _____

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Dated this 13th day of February, 2003.

Attachment A
Staff's Rate of Return Calculation
Adjusted to Remove Unlawful Interstate Mismatch Adjustment

	(g) Total Restated Intrastate	(h) Rate Increase Directory Assistance	(I) Adjust Oct. Nov. Rev. and Exp to normalize	(j) Line Sharing	(l) Directory Publishing Imputation	(m) STAFF ADJUSTED
NET OPERATING INCOME	53,038	1,713	5,214	2,218	21,979	84,159
Rate Base	965,116	965,116	965,116	965,116	965,116	965,116
Rate of Return	5.50%	0.18%	0.54%	0.23%	2.28%	8.72%

Col (g) : Per Exhibit NWH -2 Page 2 of 3
Col (h) through Col (I) : Betty Erdahl's adjustments per Exhibit C-(BAE-1C)

ATTACHMENT B

Selwyn Rebuttal Testimony	p. 42	lines 11-24
	p. 43	lines 1-9, 13-19
	p. 44	lines 1-2
Erdahl Rebuttal Testimony	p. 3	lines 14-16
	p.5	lines 11-19
	p.6	lines 1-18
	p.7	lines 1-9
	p.10	lines 8-9
		BAE-1C