

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

**In The Matter Of The Petition Of )  
Verizon Northwest Inc. Seeking )  
Interim Rate Increase )**

**DOCKET NO. UT-040788**

**REBUTTAL TESTIMONY OF  
NANCY W. HEURING**

**ON BEHALF OF  
VERIZON NORTHWEST INC.**

**JULY 30, 2004**

1 **I. INTRODUCTION**

2

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

4 A. My name is Nancy W. Heuring. I am Director – Regulatory Accounting. My business  
5 address is 600 Hidden Ridge, Irving, Texas.

6

7 **Q. DID YOU FILE DIRECT TESTIMONY IN THIS CASE?**

8 A. Yes. I filed direct testimony on April 30, 2004.

9

10 **Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?**

11 A. My testimony rebuts the intrastate earnings presentation of Charles W. King, Paula M.  
12 Strain, and Kathleen M. Folsom. Mr. King and Ms. Strain make inappropriate  
13 adjustments to the *negative* 0.47% intrastate rate of return for the Washington operations  
14 of Verizon Northwest Inc. (“Verizon NW” or the “Company”) and present returns of  
15 1.085% and 2.09%, respectively. I do not agree with the calculations by Mr. King and  
16 Ms. Strain, which even if accepted, fail to rebut the need for interim relief because each  
17 respective return is substantially below the last return authorized by the Washington  
18 Utilities and Transportation Commission (“WUTC” or “Commission”) of 9.76%.<sup>1</sup>

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<sup>1</sup> Cause No. UT-931591

1 **Q. WHAT FINANCIAL EXHIBITS ARE YOU PRESENTING IN SUPPORT OF**  
2 **YOUR TESTIMONY?**

3 A. Exhibits NWH-10 through NWH-12 provide a summary of the financial data and  
4 calculations used in my testimony, as follows:

5  
6 NWH-10 Verizon Northwest Inc. 2003 Financial Results

7 NWH-11 Intrastate Results of Operations - Test Year

8 NWH-12 Intrastate Results of Operations 1999 through Test Year

9

10 **Q. HAVE YOU FILED WORKPAPERS SUPPORTING YOUR EXHIBITS?**

11 A. Yes.

12

13 **Q. WERE THE WORKPAPERS, EXHIBITS, AND ASSOCIATED TESTIMONY**  
14 **PREPARED BY YOU OR UNDER YOUR DIRECTION AND SUPERVISION?**

15 A. Yes.

16

17 **II. CHARLES W. KING EARNINGS PRESENTATION**

18

19 **Q. PLEASE SUMMARIZE MR. KING'S PRESENTATION OF VERIZON NW'S**  
20 **EARNINGS.**

21 A. Mr. King states it is not clear that Washington intrastate operations are earning a negative  
22 return because the imputation of directory advertising revenues alone raises the return  
23 above zero.

1 **Q. IS MR. KING'S CALCULATION OF A 1.085% INTRASTATE RATE OF**  
2 **RETURN CORRECT?**

3 A. No. Mr. King increases the Washington intrastate operating revenues by \$23.5 million  
4 for what he terms imputed directory revenues. In doing so, he ignores the fact that this is  
5 a negative and not a positive number. The negative \$23.5 million is referenced to  
6 workpapers supporting my direct testimony in the rate case. This workpaper presents a  
7 calculation of directory revenue imputation using a formula provided by the WUTC staff.  
8 The negative amount (or no imputation) is attributable to the fact that Verizon Directories  
9 Corporation achieved a return on investment lower than the last intrastate rate of return  
10 authorized for Verizon NW. Mr. King has incorrectly applied the result of this  
11 calculation as an increase in revenues.

12  
13 **Q. MR. KING STATES THAT NO EMERGENCY EXISTS BECAUSE VERIZON**  
14 **NW FAILED TO FILE A RATE CASE BETWEEN THE AUGUST 12, 2003**  
15 **ORDER IN THE ACCESS CASE AND THE OCTOBER 1, 2003**  
16 **IMPLEMENTATION OF THE ACCESS CHARGE RATE REDUCTION.**  
17 **PLEASE COMMENT.**

18 A. Mr. Banta addresses the overall timing of the Company's rate case filing. However,  
19 based on my knowledge and experience from an accounting perspective, 49 calendar  
20 days is an insufficient amount of time within which to prepare a full-blown rate case.  
21 The financial presentation in a rate case filing relies on the most recently available  
22 historical data as adjusted for pro forma data for the going-forward, twelve-month period.  
23 In the access case, Verizon NW presented extensive financial data for the period 2000,

1 2001, and year-to-date September 2002. This financial data had to be updated for the  
2 most recent available test period for the twelve months ending September 2003.  
3 Moreover, the preparation for, and filing of a new revenue requirement required  
4 extensive evaluation of the newest available financial data, an evaluation of the pro forma  
5 period, and development of the supporting workpapers and exhibits. This could not have  
6 been accomplished in 49 days. Mr. King suggests that 49 days is adequate time for the  
7 Company to conduct a thorough review of its books and records sufficient to compile a  
8 revenue requirement for a rate case proceeding yet, according to the schedule in Verizon  
9 NW's current rate case, the intervening parties have been allowed six months of time  
10 within which to conduct discovery on the revenue requirement, an amount of time these  
11 parties claimed was necessary for them to do their analysis.

12  
13 **Q. MR. KING HAS A TABLE ON PAGE 10 THAT PURPORTS TO REFLECT**  
14 **DATA FROM VERIZON NW SURVEILLANCE REPORTS FILED WITH THE**  
15 **WUTC. IS HIS DATA CORRECT?**

16 A. No. The table incorrectly labels "Regulated" data as "Total State." In addition, the data  
17 on the row labeled 2003 appears to be for the year-ended 2002. Finally, the Regulated  
18 return on this row, which currently reads as 9.39%, is actually 8.39% per the applicable  
19 surveillance report.

20  
21 **Q. MR. KING USES THE TABLE IN QUESTION TO CLAIM THAT NO SUBSIDY**  
22 **EXISTS BETWEEN WASHINGTON INTERSTATE AND INTRASTATE**  
23 **OPERATIONS AS WELL AS ACROSS THE OTHER STATE JURISDICTIONS**

1           **WHICH COMPRISE VERIZON NORTHWEST INC. HAVE YOU PREPARED**  
2           **AN EXHIBIT THAT DEMONSTRATES THE SUBSIDY FOR VERIZON**  
3           **NORTHWEST?**

4       A.     Yes. See Exhibit NWH-10, which presents the financial results for Verizon Northwest  
5           Inc. for 2003 by state jurisdiction. The results for Washington are further delineated  
6           between intrastate and other operations. As Dr. Vander Weide explains, this data shows  
7           that the Washington intrastate jurisdiction has *negative* net operating income and is  
8           clearly subsidized by the other jurisdictions within Verizon Northwest.

9  
10                                    **III. STAFF'S EARNINGS PRESENTATION**

11  
12       **Q.     PLEASE SUMMARIZE MS. STRAIN AND MS. FOLSOM'S PRESENTATION**  
13       **OF VERIZON NW'S EARNINGS.**

14       A.     Ms. Strain calculates a 2.09% intrastate rate of return and comments on perceived drivers  
15           to the decline in the return. Ms. Folsom uses this data in support of her presentation.

16  
17       **Q.     MS. FOLSOM COMMENTS THAT VERIZON NW DOES NOT MAINTAIN OR**  
18       **MAKE AVAILABLE ITS FINANCIAL STATEMENTS ON A WASHINGTON**  
19       **INTRASTATE BASIS. IS SHE CORRECT?**

20       A.     No. Verizon NW provides an intrastate income statement to the WUTC on a regular  
21           basis in the Separated Results Summary Quarterly Compliance Report and in the Annual  
22           Report. In addition, the Company routinely files the intrastate rate base elements of the  
23           balance sheet in these reports.

1 **Q. BOTH MS. FOLSOM AND MS. STRAIN COMMENT THAT THE COMPANY'S**  
2 **DECLINE IN INTRASTATE NET OPERATING INCOME WAS NOT SUDDEN.**  
3 **PLEASE COMMENT.**

4 A. As discussed in my direct testimony in the general rate case, the decline in the intrastate  
5 rate of return started in 2000 and has continued to date. However, the fact that this  
6 decline was not sudden and did not originate immediately before the filing for interim  
7 rate relief does not negate the fact that the intrastate return is negative.

8  
9 **Q. IN CALCULATING THE INTRASTATE RATE OF RETURN, MS. STRAIN**  
10 **STATES THAT THE COMPANY SHOULD HAVE STARTED WITH A BASE**  
11 **RETURN OF 2.03% VERSUS 1.46%. PLEASE COMMENT.**

12 A. Ms. Strain's point is not relevant. The 2.03% return referenced by Ms. Strain is the rate  
13 of return per the books and records prior to any normalizations to arrive at the restated  
14 return of 1.46%. This booked return and all of the subsequent normalizations are  
15 documented in the workpapers, which support my testimony. While either return could  
16 have been used as the starting point for the exhibit presentation, I believe that the restated  
17 return is more relevant since the largest normalization is a restatement required to bring  
18 the booked financials to a PUC basis financial presentation. In addition, Ms. Strain has  
19 not taken exception to this restatement or any of the other normalizations; she merely  
20 adds two additional columns to her exhibit to reflect the data presented in the  
21 workpapers. As shown on Exhibit NWH-11, both the analysis presented in my direct  
22 testimony and the analysis presented by Ms. Strain end up in the same place.

23

1 **Q. MS. STRAIN STATES THAT THE DECLINE IN RETURN STARTED IN 2000**  
2 **INSTEAD OF 1999. IS SHE CORRECT?**

3 A. Yes. The reflection of the year 1999 in my direct testimony was in error.  
4

5 **Q. MS. STRAIN STATES THAT STAFF HAS NOT HAD THE OPPORTUNITY TO**  
6 **PERFORM A COMPREHENSIVE AUDIT ON THE FIGURES USED BY**  
7 **VERIZON NW IN ITS CALCULATIONS AND THAT ITS REVIEW HAS BEEN**  
8 **LIMITED TO INFORMATION PROVIDED BY VERIZON NW. PLEASE**  
9 **COMMENT.**

10 A. Verizon NW filed extensive workpapers in support of the *negative* 0.47% rate of return  
11 and the resulting deficiency of \$158.6 million along with the direct testimony in the  
12 request for interim rate relief. This information includes monthly financial data for the  
13 test period and the preceding twelve-month period, documentation for each restating  
14 adjustment, period-to-period comparison schedules with explanations of fluctuations in  
15 financial results, and accounting documentation supporting the accounts and separations  
16 factors. In addition, this data was replicated in the general rate case filing where  
17 applicable. Sufficient data was provided with the direct filing of this interim case to  
18 support the negative return and explain any fluctuation in results.  
19

20 **Q. MS. STRAIN ATTEMPTS TO MAKE SEVERAL ADJUSTMENTS TO THE**  
21 **RETURN OF NEGATIVE 0.47% PRESENTED BY THE COMPANY. PLEASE**  
22 **DESCRIBE THESE ADJUSTMENTS.**



1 A. Ms. Strain apparently conducted a review of the workpapers filed in support of the  
2 general rate case and selectively brought in pro formas recommended by Verizon NW in  
3 the rate case filing for consideration in the interim case. Her analysis in this regard is not  
4 balanced as it does not take into consideration all of the pro formas in the general rate  
5 case filing. In addition, Ms. Strain makes several rate making adjustments to the interim  
6 financial presentation.

7  
8 **Q. PLEASE COMMENT GENERALLY ON THE USE OF THE PRO FORMA**  
9 **ADJUSTMENTS.**

10 A. Pro forma adjustments per WAC 480-07-510(3)(b) are defined as adjustments that adjust  
11 test period results for known and measurable changes, which are not offset by other  
12 factors. In adjusting the 2003 test year financials, Ms. Strain proposes one pro forma  
13 adjustment, which reduces Verizon NW's expenses, and an additional adjustment that  
14 increases Verizon NW's revenues. While Verizon NW does not disagree that a pro  
15 forma adjustment for the known and measurable item would be appropriate in the  
16 development of a test period for a rate case, Ms. Strain fails to include pro forma  
17 adjustments for all of the other known and measurable changes after the test year. For  
18 example, Ms. Strain proposes a pro forma that reduces employee labor cost but does not  
19 bring in a pro forma which reflects increases in employee related benefit cost. Likewise,  
20 she reflects a pro forma, which has the effect of increasing net revenues, but does not  
21 propose bringing forward the Company pro formas for declining net revenues. In short,  
22 Ms. Strain has chosen to only make pro forma adjustments that increase the net operating  
23 income.

1 **Q. MS. STRAIN EMPHASIZES THE FACT THAT HER PROPOSED**  
2 **ADJUSTMENTS BRING THE RETURN FROM A NEGATIVE 0.47% TO A**  
3 **POSITIVE 0.2%. PLEASE COMMENT.**

4 A. I see no significance to the fact that the proposed adjustments bring the return from  
5 slightly negative to slightly positive. The fact remains that the intrastate return is close to  
6 zero and is significantly below the authorized return.

7  
8 **Q. PLEASE COMMENT ON THE ADJUSTMENT TITLED EMPLOYEE**  
9 **SEPARATION PROGRAM.**

10 A. Ms. Strain uses data from the Verizon NW workpapers which support the general rate  
11 case filing to propose a reduction to operating expenses to reflect the fourth quarter 2003  
12 voluntary employee separation program offering. This adjustment contains several  
13 errors. First, the adjustment Ms. Strain pulls from the rate case workpapers is not related  
14 in any respect to the referenced voluntary separation. Instead, this reduction is related to  
15 headcount changes occurring during the test year. Second, while the consideration of the  
16 voluntary employee separation program is appropriate for the general rate case, Ms.  
17 Strain picks one element of the pro forma adjustment without consideration of the  
18 remaining pro forma elements. It appears, once again, that the only consistency in Ms.  
19 Strain's adjustment methodology is that she consistently chooses only those pro forma  
20 adjustments that increase earnings. Finally, as noted in my direct testimony in the rate  
21 case, any reduction in operating expense associated with the employee separation should  
22 be netted against the cost of the associated program. This is consistent with the order in  
23 WUTC Docket UT-950200 (US West rate case), which netted the test year costs and

1 associated benefits. Neither the costs nor savings from the fourth quarter 2003 voluntary  
2 separation program are included in the financials in the interim case since they occurred  
3 after the test year. However, this issue is presented in detail in the rate case workpapers  
4 along with all other pro forma adjustments.

5  
6 **Q. PLEASE COMMENT ON THE ADJUSTMENT TITLED UNCOLLECTIBLE**  
7 **RESTATEMENT.**

8 A. In the development of the rate case revenue requirement, Verizon NW removes the  
9 booked uncollectible revenue amounts that are recorded on an accrual basis and replaces  
10 them with actual write-off amounts via a pro forma adjustment. As noted in my direct  
11 testimony in the rate case, the actual write-off experience is more appropriate for  
12 ratemaking purposes. In addition, Verizon NW demonstrated that the actual write-off  
13 amounts in the test year were consistent with prior periods. While this pro forma  
14 adjustment is appropriate in the determination of a revenue requirement in the rate case, it  
15 should not be considered in isolation without the associated and offsetting revenue pro  
16 formas.

17  
18 **Q. PLEASE COMMENT GENERALLY ON THE USE OF THE RATEMAKING**  
19 **ADJUSTMENTS.**

20 A. Ms. Strain proposes three adjustments, which she says, reflect prior ratemaking  
21 precedent: directory revenue imputation, flow-through of Federal income tax items, and  
22 synchronized interest. Verizon NW addresses each of these issues in the general rate  
23 case filing including two witnesses on why directory revenue imputation is wrong.

1 **Q. MS. STRAIN INDICATES THAT VERIZON NW'S DIRECT TESTIMONY DID**  
2 **NOT FULLY IDENTIFY THE CAUSES OF THE DECLINE IN THE**  
3 **INTRASTATE RATE OF RETURN. PLEASE COMMENT.**

4 A. My testimony in the direct case provided a summary of the drivers for the decline in  
5 intrastate rate of return that started in 2000. In addition, the workpapers provided in  
6 support of my testimony in the interim case provided additional detailed support to the  
7 fluctuation in revenues, expenses, and rate base between the years 2001, 2002, and the  
8 test period ended September 2003. I prepared Exhibit NWH-12 Intrastate Results of  
9 Operations 1999 through Test Year that captures the information previously provided in  
10 the workpapers and adds information for the years 1999 and 2000.

11  
12 **Q. PLEASE SUMMARIZE THE CONCLUSIONS ON THIS EXHIBIT COMPARING**  
13 **THE RESULTS FROM 1999 THROUGH THE TEST YEAR ENDED**  
14 **SEPTEMBER 2003.**

15 A. Washington intrastate revenues over the period reflect a decline due to loss of access  
16 lines and minutes of use in addition to the \$30 million reduction resulting from the  
17 merger settlement and the revenue reduction related to the new directory contract.  
18 Operating expenses before depreciation increased between 1999 and the 2003 test year  
19 associated with circuit equipment expense, increased computer services expense,  
20 increased pension costs, and employee separation costs. These increases in expenses are  
21 partially offset by decreased interconnection expense and savings resulting from the  
22 Verizon merger. The growth in depreciation expense from 1999 to 2000 is due to an  
23 increase in depreciation rates authorized in Docket UT-992009 effective January 2000.

1 No corresponding increase in revenues was associated with the increase in depreciation  
2 expense. In addition, growth in depreciation expense from 2000 to the test year is  
3 associated with the continued plant additions. Growth in rate base over the period can be  
4 primarily attributed to the increase in plant additions and other assets.

5  
6 **Q. MS. STRAIN CLAIMS THAT RATE BASE GROWTH IS NOT A DRIVER TO**  
7 **THE DECLINE IN RETURN. PLEASE COMMENT.**

8 A. The intrastate rate base between 1999 and the 2003 test year increased by \$75 million.  
9 This alone dropped the intrastate rate of return by 75 basis points. In addition, when the  
10 additional depreciation expense associated with the growth in plant is considered, the  
11 continuing investment in the intrastate rate base contributed to a decline in the intrastate  
12 rate of return of 148 basis points.

13  
14 **Q. MS. STRAIN STATES THAT BASED ON A PRELIMINARY INVESTIGATION**  
15 **THERE MAY BE A MISMATCH BETWEEN JURISDICTIONAL REVENUES,**  
16 **EXPENSES, AND RATEBASE. IS SHE CORRECT?**

17 A. No. First, Verizon followed the FCC's Part 36 separation rules in developing the  
18 intrastate revenues, expenses, and rate base for the revenue requirement presentation in  
19 this interim case. Second, no witness has made any claims or presented any evidence to  
20 demonstrate that the Part 36 rules were not appropriately applied. Finally, while Ms.  
21 Strain discusses her preliminary concerns, she makes no recommendation in this regard.

1 **Q. WHAT ARE THE DRIVERS TO THE DIFFERING TRENDS IN INTERSTATE**  
2 **AND INTRASTATE REVENUES?**

3 A. As noted above, intrastate revenues are declining due to access line loss, minutes of use  
4 decline, and toll erosion. These revenues are jurisdictionally booked because they are  
5 based on intrastate demand applied to tariffed intrastate rates. In addition, the intrastate  
6 revenues have been reduced by the merger order, the new directory contract, and the  
7 ordered reduction in the access case.

8  
9 On the interstate side, interstate switched access revenues are declining, while interstate  
10 end user access and special access revenues are increasing. These revenues are  
11 jurisdictionally booked because they are based on the interstate demand applied to  
12 tariffed interstate rates.

13  
14 **Q. MS. STRAIN CONCLUDES THAT THE PERCENTAGE OF INTRASTATE**  
15 **REVENUES AS A PERCENT OF TOTAL WASHINGTON REVENUES HAS**  
16 **DECREASED AND THE PERCENT OF INTERSTATE REVENUES HAS**  
17 **INCREASED. IS THERE ANY SIGNIFICANCE TO THIS CONCLUSION?**

18 A. No. The percentages presented are merely the result of mathematical calculations. As  
19 noted above, the majority of Verizon NW Washington's regulated revenues are directly  
20 assigned per the Part 36 separation rules.

21

1 **Q. WHAT DO YOU CONCLUDE FROM MS. STRAIN'S TESTIMONY ON THIS**  
2 **ISSUE?**

3 A. That she believes this is an issue for further testimony in the permanent rate case.  
4 However, there is no evidence that can be used in the interim case.

5

6

**IV. SUMMARY**

7

8 **Q. ARE THE PROPOSED ADJUSTMENTS TO VERIZON NW'S EARNINGS**  
9 **PRESENTATION APPROPRIATE FOR CONSIDERATION IN THE INTERIM**  
10 **CASE?**

11 A. No. However, if their earnings presentations are accepted, the rate of return for intrastate  
12 operations of Washington as computed by Ms. Strain and Mr. King do not even approach  
13 the authorized level and result in revenue requirement deficiencies of \$118.9 million and  
14 \$134.5 million, respectively.

15

16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

17 A. Yes.