ORIGINAL

Exhibit No. _____ (TRD-4TC)
Docket No. UT-020406

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,	)	
Complainant	)	**DOCKET NO. UT-020406**
v.	)	
VERIZON NORTHWEST INC.,	)	
Respondent	)	

SURREBUTTAL TESTIMONY OF

TERRY R. DYE

ON BEHALF OF
VERIZON NORTHWEST INC.

SUBJECT: IMPUTATION AND ITAC

FEBRUARY 24, 2003

I. INTRODUCTION

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

A. My name is Terry R. Dye. My business address is 600 Hidden Ridge Drive, Irving, Texas 75038. I am employed by Verizon Services Group as Senior Staff Consultant-Financial Planning and Analysis.

Q. DID YOU FILE DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes. I filed direct testimony on December 3, 2002.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. My testimony responds to the rebuttal testimony of Staff witness Tim Zawislak regarding (1) Verizon's "conversion factor" and (2) Verizon's Interim Terminating Access Charge (ITAC). My testimony also responds to AT&T witness Lee Selwyn's criticisms of Verizon's imputation test.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The central issue in this case is whether Verizon's toll plans pass the Commission's imputation test. To determine this, we must compare (1) the average per minute-of-use ("MOU") price of each plan to (2) Verizon's price floor.

Based on their direct and rebuttal testimony, neither Staff nor AT&T object to Verizon's calculations of the per MOU price for each Verizon toll plan; thus, the parties' dispute centers solely on the price floor calculation.

Staff proposes one adjustment to Verizon's price floor: it adjusts Verizon's conversion factor – the factor that adjusts the access cost per toll MOU to account for non-conversation time differences between access MOUs and toll MOUs. I explain how Staff's adjustment is wrong, and how Verizon's calculations properly take into account the non-conversation time associated with billed access minutes and billed toll minutes.

AT&T proposes two adjustments: first, it adjusts Verizon's transport costs to assume 100% use of tandem switched transport; second, it adjusts Verizon's billing and collection (B&C) cost and retailing/marketing costs to reflect stand-alone costs rather than incremental costs. I explain why both these adjustments are incorrect and violate the Commission's imputation test. Also, I explain that AT&T failed to update its calculations to reflect more current usage data that Verizon provided the parties, and I correct this apparent oversight.

Finally, I conclude that *every* Verizon toll plan passes imputation under Staff's and AT&T's calculations once their improper adjustments are corrected.

My confidential Exhibit (TRD-5C) is a chart that sets forth the parties' proposed calculations and adjustments. This chart summarizes the disputed issues and illustrates

that all Verizon toll plans pass imputation once Staff's and AT&T's calculations are corrected.

II. STAFF'S CONVERSION FACTOR ADJUSTMENT

Q. DOES STAFF AGREE WITH VERIZON'S "PRICE PER PLAN" CALCULATION?

A. Yes. Staff did not propose any changes.[1]

Q. DOES STAFF AGREE WITH VERIZON'S PRICE FLOOR CALCULATIONS?

A. Yes, with one exception: Staff proposes an improper adjustment to Verizon's conversion factor that accounts for "non-conversation" time differences between an access MOU and a toll MOU. Staff does discuss various other updates Verizon made to its imputation study, but Staff does not oppose any of these adjustments; in fact, Mr. Zawislak's confidential Exhibit C-___ (TWZ-12C), page 1 of 3, shows Staff's calculations using Verizon's updated inputs.[2]

Q. PLEASE EXPLAIN STAFF'S CONVERSION FACTOR ADJUSTMENT.

A. In order to impute access charges into the price floor for a toll MOU, one must derive the number of equivalent access MOUs paid per toll MOU billed. An access MOU is not the same as a toll MOU due to differences in the way non-conversation time is handled.

[1] See Zawislak Rebuttal, Exhibit T-___(TWZ-RT), page 11.

[2] Staff claims that Verizon "changed the way" billing and collection (B&C) and sales, advertising and marketing (SAM) expenses are calculated, although Staff does not oppose Verizon's calculations (Zawislak Rebuttal at 9). Verizon has *not* changed the way it calculates these costs – it calculates them in the same manner it did in 1997, and simply updates the costs using Verizon's latest cost studies. The methodology remains the same.

IXCs pay access charges based on network usage – including, on the originating side; non-conversation time associated with dial time, busy signals, and unanswered attempts. For toll, minutes are billed based on "conversation" time only and rounded up to the next highest tariffed increment (often full minutes). IXCs do not pay for access once the call is disconnected, but toll customers can continue to pay toll charges beyond disconnection due to this "rounding up". The first adjustment for pre-connection non-conversation time, which is made only on the originating side *always increases* the number of access minutes relative to toll minutes, and the second adjustment for post-connection non-conversation time *always decreases* the number of access minutes relative to the number of toll minutes. A proper conversion factor must reflect both adjustments. Since the conversion factor is the "net" of these two adjustments, it can be either less than or more than one—depending on which adjustment is the larger.

Staff claims that Verizon's conversion factor is wrong because it fails to properly account for "non-conversation" time, and Staff proposes an adjustment that raises Verizon's price floor by ****CONFIDENTIAL**** per MOU (Zawislak Rebuttal at 10, line 1).

Q. DO YOU AGREE WITH STAFF'S ADJUSTMENT?

A. No. Verizon's conversion factor does properly reflect non-conversation time, and it is Staff's adjustment that is wrong. As I explained, the access-to-toll conversion factor must account for two differences between access minutes and toll minutes. The *first* is non-conversation network usage, which is billed as originating switched access minutes but not billed as toll minutes. The *second* is the fact that toll minutes are "rounded up"

and the end user is billed for a partial toll minute after disconnection but the IXC is not billed for a corresponding amount of access. Verizon's conversion factor accounts for both differences properly, and Staff's proposed adjustment does it wrong.

Q. PLEASE SUMMARIZE YOUR CALCULATION OF THE CONVERSION FACTOR.

A. I can summarize it in three steps. First, let's assume that access MOUs equal toll MOUs. In this instance, the conversion factor is "1.0", i.e., the toll price floor per minute would include the cost of one access minute.

Second, we adjust the factor to reflect the fact that toll minutes are rounded up for billing, whereas access minutes are not. Verizon used data from its December 2001 billing records to develop an average holding time per toll message and used a standard rounding factor of .48; that is, every toll call, on average, is rounded-DOWN by .48 minutes (or about 29 seconds) in order to remove, on average, the effect of rounded-up billing of toll. This rounding adjustment *reduces* the access minute to toll minute conversion factor, adjusting for the fact that access minutes are not rounded-up in this manner.

Third, we adjust the factor for originating MOUs to recognize that access charges are billed on attempts and "non-conversation time" but toll is not. Verizon used a standard originating access conversion factor of 1.12. This rounding factor *increases* the originating access minute to toll minute conversion factor. Both the toll rounding factor and the originating access conversion factor are the same factors and formula used by

Verizon in our previous price floor calculations that supported our current toll plans and relied upon by Dr. Selwyn in his price floor calculation. On the originating side, the only change from the previously filed imputation study was an updated holding time and Staff does not appear to oppose updates of this nature[3]

The end result of these offsetting adjustments is that the effect of the rounding factor on toll minutes (a reduction in access minutes of .48) is slightly greater than the originating access conversion factor (an increase of .475, as shown on Table 1 below). Note that on the terminating side, there is no adjustment for pre-connection non-conversation time, and therefore terminating access minutes will always be less than toll minutes. Thus the terminating conversion factor will *always* be less than one.

[3] See Rebuttal Testimony of Timothy W. Zawislak, page 9. "However, Verizon does appear to have updated its traffic percentages, usage levels, and customer choices based on the plans it currently offers (compare Exhibit C-_____(TWZ-8C) with Exhibit C-_____(TWZ-9C). Staff does not oppose updates of this nature because they appear consistent with what the Commission ordered in Docket UT-970767."

****Confidential Table 1****
Derivation of Conversion Factors

			ORIGINATING		
			STAFF	AT&T [1]	VERIZON [2]
1	"Average Holding Time"				
2	Toll Rounding				
3	Conversation Minute	(1) - (2)			
4	Combined NCTA/Attempts Factor				
5	Originating Access Minute	(3) * (4)			
6	Billed Minute/Originating Access per Staff	(1) / (5)			
7	Originating Access/Billed Minute per VZ	(5) / (1)			
8					
9			TERMINATING		
10			STAFF	AT&T [1]	VERIZON [2]
11	"Average Holding Time"				
12	Toll Rounding				
13	Terminating Conversation Minute	(15) - (16)			
14	Billed Minute/Terminating Access per Staff	(15) / (17)			
15	Terminating Access/Billed Minute per VZ	(17) / (15)			

(1) From Verizon's March 2000 Imputation Study (See Confidential Attachment D of Verizon's response to WUTC Staff DR#7)
(2) From Verizon's December 2001 Imputation Study (See Verizon's response to WUTC Staff DR#26)

Q. PLEASE SUMMARIZE STAFF'S ERROR.

A. As stated earlier, to impute the proper level of access charges paid into the price floor per toll minute one must derive the number of chargeable access MOUs per billed toll MOU. Staff's error is that they divided billed toll minutes by (the correctly derived) access minutes rather than dividing the derived access MOUs by the toll MOUs to obtain the conversion factor. Staff's conversion factor simply doesn't work out because Staff's factor is dimensioned as "toll MOU / access MOU" which when multiplied by the charge per access MOU, doesn't give you a meaningful number. The proper calculation produces a factor dimensioned as "access MOU / toll MOU" which when multiplied by the charge per access MOU derives the proper level of access charges to impute into the price floor per toll MOU.

access MOUs times charge per access MOU = access cost per toll MOU
toll MOUs

Staff's error can be thought of in terms of currency conversion, where the exchange rate is 0.9 Dollars per EURO. If we have 100 EUROs, we can exchange them for 90 dollars (100 x 0.90). If we have 100 Dollars, we have to multiply by the inverse of the Dollar/EURO exchange rate (1/0.9 = 1.1111) to get 111.11 EUROs. What Staff has done is convert EUROs to dollars (toll to access) by multiplying EUROs (toll) by a EURO/Dollar exchange rate (toll per access minute conversion factor).

In sum, Verizon's conversion factor correctly reflects non-conversation time, and Staff's adjustment is inappropriate.

III. STAFF'S ITAC ADJUSTMENT

Q. PLEASE EXPLAIN STAFF'S ITAC ADJUSTMENT.

A. Staff's testimony on this point remains confusing, but, as I discussed in my direct testimony, Staff appears to be "double counting" federal support. According to Staff witness Tim Zawislak, Verizon's intrastate ITAC should be reduced by about $21 million because Verizon receives this amount in interstate access support (IAS). His adjustment continues to ignore the fact that $21 million in IAS simply replaced the $21 million that used to be reflected in interstate access charges. As I explained in my direct testimony,

the IAS did not provide Verizon with additional federal support; instead, it reflected a revenue-neutral outcome.

The bottom line is that Staff's adjustment double-counts the $21 million. Here's why: When the Commission relied on the "revenue benchmark" it used to help calculate the ITAC, the revenue benchmark included interstate access revenues that existed *before* the IAS was created. These revenues included the $21 million that is now explicitly identified as IAS. If Staff is going to add this $21 million in IAS, then it must also deduct the $21 million (or more) that was included in the original ITAC calculation. Again, I raised this point in my direct testimony, but Staff did not bother to address it in its rebuttal.

In any event, Verizon does not know why Staff has raised the ITAC issue. The question in this case is whether Verizon's existing toll plans are priced above the price floor and thus pass the imputation test. In addressing this question, Verizon imputes its current ITAC, and the complainants do not challenge the ITAC's level.

IV. AT&T'S PROPOSED ADJUSTMENTS

Q. DOES AT&T PROPOSE ANY CHANGES TO VERIZON'S PRICE FLOOR?

A. Yes. AT&T witness Lee Selwyn proposes two changes: first, he adjusts Verizon's transport costs to assume 100% use of tandem switched transport; second, he adjusts

Verizon's billing and collection (B&C) cost and retailing/marketing costs to reflect stand-alone costs rather than incremental costs.

Q. DR. SELWYN CLAIMS THAT VERIZON'S IMPUTATION STUDY IS WRONG BECAUSE IT USES DIRECT TRUNK TRANSPORT RATE ELEMENTS (SELWYN REBUTTAL AT 18). PLEASE COMMENT.

A. Dr. Selwyn's criticism ignores the purpose of the imputation study, which is to "impute" the access-related charges an IXC would incur when carrying Verizon's toll traffic. In preparing its study, Verizon assumed a mix of direct trunked transport and tandem switched transport that is based on the IXCs' actual use of transport facilities. In this way, Verizon is able to impute the access costs that IXCs would incur.

Dr. Selwyn, however, criticizes this input to Verizon's study because Verizon itself does not use direct trunked transport; in other words, Dr. Selwyn argues that Verizon should not *impute* access costs a competitor would pay to Verizon for switched access but instead should impute the access costs Verizon would actually incur. This position, of course, argues against the use of an imputation test.

Dr. Selwyn's rebuttal testimony also conflicts with his own *direct* testimony on this very point. On page 18, footnote 27 of his direct testimony, Dr. Selwyn explains that when IXCs provide toll service, they must pay Verizon for several interoffice transport and switching functions; when Verizon provides toll service, the route may involve fewer transport and switching functions, resulting in lower costs. According to Dr. Selwyn,

"[t]his is why Verizon Northwest is required to impute the access charge that its competitors pay rather than its own costs for the equivalent functionality in determining whether its retail price satisfies the imputation price floor" (Selwyn Direct at 18-19, n.27). Verizon did precisely what Dr. Selwyn advocated in his direct testimony: it calculated the transport costs IXCs would incur, which include a mix of tandem switched and direct trunked transport. It is this very calculation Dr. Selwyn now attacks in his rebuttal testimony.

Q. DR. SELWYN ALSO CLAIMS THAT VERIZON'S ASSIGNMENT OF "INCREMENTAL" BILLING AND COLLECTION (B&C) COSTS TO ITS TOLL PRICE FLOOR IS INAPPROPRIATE, AND THAT 100% OF THE "GAINS FROM JOINT PRODUCTION OF A REGULATED AND NON-REGULATED SERVICE" SHOULD "INURE TO THE REGULATED SERVICE" (SELWYN REBUTTAL AT 19-20). PLEASE COMMENT.

A. Dr. Selwyn's argument is confusing. First, he appears to believe that Verizon does not allocate sufficient B&C costs to its "unregulated" services, and therefore consumers are harmed. He is incorrect: Verizon allocates regulated and unregulated B&C costs in accord with the FCC's rules (Part 64). If Dr. Selwyn disagrees with these rules, he should talk to the FCC.

Second, Dr. Selwyn appears to believe that Verizon's intraLATA toll services are "unregulated." Here, too, he is wrong: Verizon's local services *and* intraLATA toll services are, in fact, regulated; indeed, when the WUTC examines Verizon's earnings, it

includes the costs and revenues associated with intraLATA toll. Given this, his "cost-shifting" argument – Verizon is "harming consumers" by shifting most of its B&C costs to "regulated" services – is meritless.

Finally, the thrust of Dr. Selwyn's proposal is that, for purposes of imputation, the Commission should *not* allow companies to use incremental costs. But Dr. Selwyn himself contradicts this position. For example, on page 34 of his direct testimony, he recognizes that the appropriate standard is the incremental cost standard: "The Commission has repeatedly stated that since B&C are competitive services, it is appropriate to impute the Long Run Incremental Cost (LRIC) rather than tariffed rates." His proposal to ignore such costs must be rejected.

Q. PLEASE DESCRIBE HOW VERIZON DEVELOPED THE RETAIL/MARKETING COSTS IT USES IN ITS STUDY.

A. Verizon's sales, marketing and advertising (SMA) cost study is in binder 7 of 9 in the Company's recurring cost study filing. The SMA costs are modeled as a percent of revenues for services in three broad market segments: consumer, business and carrier. Based on an analysis of individual budget centers, the SMA expenses were identified for (1) basic business and residential exchange service; (2) message toll service; (3) custom calling and CLASS services; and, (4) intrastate switched and special access service. These expenses exclude billing and collection costs, are Washington specific, and are based on the non-regulated expenses recorded in three accounts:

(1) Product Management (account 6611);

(2) Sales (account 6612); and

(3) Product Advertising (account 6613).

Account 6611 includes the costs incurred in performing administrative activities related to marketing products and services. These activities include competitive analysis, product and service identification and specification, test market planning, demand forecasting, product life cycle analysis, pricing analysis, and identification and establishment of distribution channels. Examples of specific groups and activities within this account that relate to switched access include the Market Strategies group which is responsible for carrier market analysis and customer segmentation, and the Network Access Services group which is responsible for the management of the network access functions, including allowing other carriers' access onto Verizon's network.

Account 6612 includes costs associated with the determination of individual customer needs, development and presentation of customer proposals, sales order preparation and handling, and preparation of sales records. Examples of specific groups and activities within this account that relate to switched access include the National Sales Account group which is responsible for network access sales to other carriers, including AT&T, MCI, and Sprint. These activities include sales, sales follow-up, customer service, and customer assurance. Also, Carrier Operations is responsible for running the day-to-day activities of the carrier market business segment, including operations support.

Account 6613 includes costs incurred in developing and implementing promotional strategies to stimulate the purchase of products and services. This account excludes nonproduct-related advertising, such as corporate image, stock and bond issuance and employment advertisements. Examples of specific groups and activities within this account that relate to switched access include the Product Marketing group which acts as the communications liaisons for Verizon to plan and coordinate direct marketing efforts for all carrier markets customers. Product Marketing deals primarily with Product Management in coordinating new product introductions and specific product promotions as well as other efforts.

In sum, Verizon's SMA expenses are based on Washington-specific data, and Verizon has calculated these expenses in the same manner for every imputation study it has filed.

Q. DO YOU HAVE ANY OTHER COMMENTS ON AT&T'S PRICE FLOOR CALCULATION?

A. Yes. AT&T failed to update its calculations to reflect more current usage data that Verizon provided the parties, and I have corrected this apparent oversight.

Dr. Selwyn's switched access-related component of his price floor calculation relied upon Verizon's March 2000 imputation study, which was submitted in response to Staff Data Request No. 7. Verizon updated this study in response to Staff Data Request No. 26, Attachment 26b, and this update included new traffic distribution data. The relevant

portion of Verizon's response to Staff DR No. 26 is included in Staff witness Zawislak's rebuttal testimony, Exhibit C-___ (TWZ-10(C)).

Q. WHAT CHANGE, ON A PER MOU BASIS, RESULTS FROM USING THE UPDATED DATA?

A. The traffic distribution update affects the weighted carrier common line ("CCL") rate and the distribution of terminating traffic between Verizon, Quest and other carriers. Updating AT&T's price floor for the updated traffic and usage data Verizon supplied in response to Staff's Data request #26, reduces AT&T's price floor from $0.1444 to **CONFIDENTIAL** or a reduction of **CONFIDENTIAL**

Q. HAVE YOU QUANTIFIED ON A PER MOU BASIS EACH OF AT&T'S ADJUSTMENTS?

A. Yes. The results of these calculations are shown on Exhibit (TRD-5C). In making these calculations, I relied on Dr. Selwyn's relevant workpapers supplied in response to Verizon's Data Request No. 15 and Verizon's response to Staff's Data Request No. 26.

Q. HAVE YOU CALCULATED A NEW PRICE FLOOR ONCE AT&T'S ERRONEOUS ADJUSTMENTS ARE REMOVED AND THE UPDATED USAGE DATA IS USED?

A. Yes. I replaced Dr. Selwyn's costs with the correct costs and used updated traffic percentages to calculate a new floor. The itemization of these calculations is shown on Exhibit (TRD-5C). This corrected price floor is lower than the per MOU price of every

Verizon toll plan, and therefore all of Verizon's plans pass the Commission's imputation test.

Q. HAS VERIZON COMPARED THE LONG-RUN INCREMENTAL COST OF SWITCHED ACCESS WITH THE REVENUE FROM SWITCHED ACCESS?

A. Yes. Exhibit (TRD-6C) provides a comparison of the revenues and direct costs for both switched access and residential service. Based on the cost information supported by Verizon witness Mr. Tucek, and the unit information provided in Mr. Fulp's Direct testimony the total direct costs for switched access is ** **CONFIDENTIAL****. Verizon's corresponding revenue is $61,783,143. These costs do not include any assignment of common costs, and therefore exclude any allocation of loop costs as suggested by Mr. Blackman in his Rebuttal testimony[4], or universal service costs recovered in the ITAC rate. This analysis therefore, represents Verizon's view of only the direct costs and revenue comparisons of switched access.

Q. HAS VERIZON ALSO PREPARED A SIMILAR COMPARISON OF ITS BASIC RESIDENTIAL SERVICE?

A. Yes. The billable residential lines (569,624 R-1 flat, 14,630 R-1 measured, 32,313 Local Package and 17,629 Local Package Standard) as of September 30, 2002 were compared the current price of R-1 service to its total service long-run incremental cost (TSLRIC).[5]

[4] Glenn Blackmon, PhD. Rebuttal, discussion starting on page 14.
[5] The Average TSLRICs can be found in Binder 1 of 9Tab 2, page 1.

More specifically, the cost study sponsored by Verizon witness Dave Tucek provides the TSLRICs for each of Verizon's R-1 services, taking these costs times the units and annualizing the revenue produces a total TSLRIC of ** **CONFIDENTIAL**. The current R-1 flat rate is only $13.00, well below the TSLRIC. And even if we include in the $6 per month federal subscriber line charge (SLC), the resulting R-1 "rate" is only $19.00. The revenue produced from all residential lines was $152,511,473, or **CONFIDENTIAL** below the direct costs of providing the service.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. There are only a handful of adjustments in dispute. Staff's sole adjustment for "non-conversation" minutes is wrong and Verizon's conversion factor correctly accounts for this. AT&T's transport adjustment and B&C and SAM adjustments are wrong because they ignore the Commission's imputation test. When Staff's and AT&T's calculations are corrected, they result in price floors that are less than Verizon's toll prices, and therefore all of Verizon's toll plans pass imputation.

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.