

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATION OF)
THE PACIFIC NORTHWEST, INC.)
Complainant,)
v.)
VERIZON NORTHWEST INC.)
Respondent)

Docket No. UT-020406

SURREBUTTAL TESTIMONY OF
ORVILLE D. FULP
ON BEHALF OF
VERIZON NORTHWEST INC.

FEBRUARY 24, 2003

I. INTRODUCTION

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- Q. PLEASE STATE YOUR NAME, POSITION, AND BUSINESS ADDRESS.**
- A. My name is Orville D. Fulp. I am Director-Regulatory. My business address is 600 Hidden Ridge Drive, Irving, Texas 75038.
- Q. DID YOU FILE DIRECT TESTIMONY IN THIS CASE?**
- A. Yes. I filed direct testimony on December 3, 2002.
- Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?**
- A. My testimony summarizes Verizon’s responses to the rebuttal testimony filed by AT&T and Staff. Also, I explain why AT&T’s proposals to impute alleged “value” to Verizon for services it provides to its long distance affiliates, and to inflate Verizon’s earnings based on the Continuing Property Records (“CPR”) Audit are wrong.
- Q. PLEASE SUMMARIZE THE ISSUES PRESENTED BY AT&T’S AND STAFF’S TESTIMONY AND VERIZON’S POSITION ON EACH ISSUE.**
- A. Given the Commission’s Fifth Supplemental Order, there are two questions addressing principal issues of fact in this phase of the proceeding: (1) Are Verizon’s access charges higher than Verizon’s costs, and if so, by how much? (2) Are the amounts that Verizon charges itself and its affiliates for access lower than the imputation floor for this cost?
- Issue #1 – Cost and Reasonableness of Verizon’s Access Charges.** On the first issue, Verizon shows that its access charges are not “above cost” because they provide

1 necessary contribution to Verizon's total costs. Staff witness Glenn Blackmon and
2 AT&T witness Lee Selwyn disagree; they claim that switched access charges should be
3 no higher than "long run incremental cost" (LRIC) or interstate switched access rate
4 levels. But Verizon witness Carl Danner explains that Staff and AT&T are inconsistent
5 in their analyses. For example, as witness Danner states, Dr. Blackmon claims that the
6 cost of the loop is a common cost that should be allocated among all services and Dr.
7 Selwyn claims that basic service is compensatory because one must look at *all* the
8 services and revenues allegedly associated with basic service, including access. If Dr.
9 Blackmon is correct, then access charges must include some loop costs if Dr. Selwyn is
10 correct, then access charges are just one component of basic service and generate
11 "contribution" for this service. *Under either position, the price of access should include*
12 *something more than just long-run incremental costs – as has always been the case for*
13 *Verizon access charges under the Commission's ratemaking in Washington.* This is a
14 critical point, because Dr. Blackmon's and Dr. Selwyn's arguments indicate that access
15 charges should *not* be reduced, or, at the very least, they should be higher than LRIC.

16
17 Furthermore, AT&T recognizes that "evidence of Verizon's overall earnings may be
18 germane to the issues of the reasonableness of Verizon's switched access and toll rates,"
19 and the Commission noted this point in its *Fifth Supplemental Order* (para. 16). Thus,
20 Verizon's access charges are just and reasonable if they allow Verizon the opportunity to
21 earn a sufficient rate of return. Here, the evidence shows that Verizon is most certainly
22 not over-earning and, therefore, its access charges are, as a matter of law, just and
23 reasonable.

1
2 Staff and AT&T also attempt to show that Verizon is over-earning, but their attempts fail.
3 Staff witness Betty Erdahl proposes several adjustments, and AT&T witness Lee Selwyn
4 proposes two: (1) he imputes the alleged “value” associated with marketing services that
5 VLD (or other Verizon affiliates) receives from Verizon; and (2) he relies on an outdated
6 and erroneous CPR Audit to reduce Verizon’s earnings. Verizon witness Nancy Heuring
7 addresses all of Staff’s adjustments except for the Yellow Page and directory assistance
8 adjustments, which are addressed by Verizon witness Dennis Trimble and me,
9 respectively. Together, we show that these adjustments are erroneous, and that Verizon
10 most certainly is *not* over-earning.

11
12 **Issue #2 – Imputation.** On the second issue, Staff proposes only one adjustment to
13 Verizon’s price floor calculation: it adjusts Verizon’s conversion factor – the factor that
14 converts access minute of use (“MOUS”) to toll MOUS – to reflect non-conversation
15 time associated with access MOUS. AT&T proposes two adjustments: it adjusts
16 Verizon’s transport costs to assume 100% use of tandem switched transport and it adjusts
17 Verizon’s billing and collection (B&C) cost and retailing/marketing costs to reflect stand-
18 alone costs rather than incremental costs. Verizon witnesses Terry Dye and Carl Danner
19 explain why all these adjustments are wrong, and they conclude that all of Verizon’s toll
20 plans pass imputation.

21
22 **Q. AS A GENERAL MATTER, DR. SELWYN CLAIMS THAT VERIZON’S**
23 **EARNINGS LEVEL “IS GROSSLY UNDERSTATED” AND DOES NOT**

1 **SUPPORT THE COMPANY’S CONTENTION THAT ACCESS CHARGES**
2 **MUST BE OFFSET WITH REVENUE-NEUTRAL INCREASES TO OTHER**
3 **RATES (SELWYN AT 28). PLEASE COMMENT.**

4 A. Quite frankly, I’m surprised by this statement, because ten pages later in his testimony
5 Dr. Selwyn concludes that Verizon is, in fact, *underearning* even after all of his proposed
6 adjustments are made. (*Selwyn at 38*) Specifically, Dr. Selwyn concludes that Verizon’s
7 intrastate return would increase to only 9.09% after all his adjustments. This return is, of
8 course, below Verizon’s authorized level. We don’t agree with any of Dr. Selwyn’s
9 adjustments, but the point here is that his own calculations support our position that a
10 revenue-neutral outcome is required.

11
12 **Q. DR. SELWYN CLAIMS THAT VERIZON SHOULD HAVE IMPUTED THE**
13 **“VALUE” VERIZON’S LONG DISTANCE AFFILIATES “RECEIVE” FROM**
14 **VERIZON DUE TO “INBOUND CUSTOMER CONTACTS.” PLEASE**
15 **RESPOND.**

16 A. Dr. Selwyn contends that Verizon Long Distance (“VLD”) avoids all customer
17 acquisition costs because when customers call Verizon (the ILEC) to order local service,
18 Verizon’s service representatives can take orders for VLD. He is not correct. Customer
19 acquisition costs are indeed incurred by VLD, however, those costs are beyond the scope
20 of this proceeding, VLD is not a party to this case and their cost for customer acquisition
21 is not known to Verizon’s ILEC. The costs that are “in scope” are those incurred by the

1 regulated telco in the provision of joint marketing services to VLD.¹ Those costs need
2 not be imputed, because the joint marketing services are transacted in accordance with
3 applicable FCC and WUTC rules (see cite below) for pricing transactions between
4 regulated telcos and their nonregulated affiliates and Verizon's contract with VLD is on
5 file with the WUTC. Indeed, AT&T's claim that Verizon undercharges its long distance
6 affiliate for these services ignores evidence to the contrary. (Dr. Danner and Mr. Dye
7 address other errors in Dr. Selwyn's analysis.)

8
9 Moreover, when reviewing Dr. Selwyn's analysis, it is difficult to determine whether he
10 grossly discounts or simply ignores the substantial costs that Verizon charges to its long
11 distance affiliates for joint marketing activities. And, as mentioned earlier, appears to
12 ignore that joint marketing transactions between Verizon and VLD are priced and
13 recorded as required by 47 C.F.R. § 32.27. This means that, at a minimum, Verizon
14 recovers fully distributed costs ("FDC") for services provided to its long distance
15 affiliates. In fact, in Washington, for calendar year 2002, VLD paid Verizon millions of
16 dollars for such marketing services.

17
18 **Q. SINCE YOU HAVE DISCUSSED HOW SOME OF THE NON-ACCESS**
19 **SERVICES ARE PROVIDED TO VLD, PLEASE DESCRIBE THE TOLL**
20 **SERVICES VERIZON PROVIDES TO VLD AND THE COMPENSATION**
21 **VERIZON RECEIVES FOR SUCH SERVICES.**

¹ Services, provided under a Marketing and Sales Agreement dated 7/31/99 with amendments thereafter, include Sales, Ordering and Customer Inquiry. Examples of services include sales negotiations, service orders, sales order status inquiry, sales quality control observations and certain post sales product support.

1 A. When Verizon provides toll services to VLD, VLD pays the same tariffed charges as any
2 other reseller for intraLATA toll. VLD purchases toll from Verizon out of the Verizon
3 intraLATA toll tariff. VLD also resales the interexchange services of unaffiliated
4 facilities-based carriers for its provision of interLATA and intraLATA out-of-franchise
5 toll.

6

7 **Q. DR. SELWYN PROPOSES TO REDUCE VERIZON'S RATE BASE TO**
8 **REFLECT THE RESULTS OF AN INFORMAL CONTINUING PROPERTY**
9 **RECORD ("CPR") AUDIT PERFORMED BY FCC STAFF IN 1997. PLEASE**
10 **COMMENT.**

11 A. Dr. Selwyn's reliance on the CPR audit is misplaced for several reasons. In addition, his
12 whole discussion on the regional Bell operating companies' audit has absolutely nothing
13 to do with Verizon's Washington territory. The physical audit itself concluded in 1994.
14 The FCC Audit Team did not issue the actual report until March of 1997. In April 1997,
15 GTE responded to the FCC and identified many mistakes with the audit.²

16

17 **Q. WHAT WERE THE CONCERNS THAT GTE RAISED ABOUT THIS AUDIT**
18 **REPORT?**

19 A. The first concern was that the audit did not use valid sampling techniques to choose the
20 limited number of items that were audited in each site. Since no proper statistical
21 sampling methods were employed, the conclusions extrapolated from the audit were
22 misleading. The second concern was the way the FCC Joint Team designated assets to

² GTE responses to draft joint audit report on the basis property records of GTE Corporation's Telephone Operations Companies April 18, 1997.

1 the categories of “MISSING” and “UNVERIFIED”. In multiple cases, an asset was
2 found in the field, and the asset was easily seen to be in-service, but the asset was not
3 shown in the correct shelf in the GTE CPR system – therefore the asset was marked as
4 “MISSING”. If an asset were found in the correct location, but the part number varied
5 slightly, the asset was shown as “MISSING” or “UNVERIFIED”. In one case in
6 Missouri, an entire switch (approximately \$1 million investment) was shown on the
7 books as a DMS10, when it really was a DMS100; this minor description error led the
8 auditors to categorize the entire investment to be “MISSING”. The third concern was
9 that if a sample record contained a multiple quantity record, for example a quantity of
10 300, and the entire 300 items were not found, for example only 290 were found, the
11 entire sample item was shown as completely “MISSING”.

12
13 **Q. WAS WASHINGTON ONE OF THE STATES INCLUDED IN THE FCC AUDIT?**

14 A. No. Washington was not included in this audit. More importantly, Washington was one
15 of the pilot states for GTE for implementation of Bar Coding of physical assets. In
16 Washington, Verizon (then GTE Northwest) completed the change to a bar coding
17 mechanism in December 1992, which was before the FCC audit started. Each piece of
18 equipment was tagged with a bar code number and reconciled to the basic property
19 records, and items not found during the reconciliation were written off as retirements.
20 The reconciliation amount booked for Washington was [\$9.6M] out of a total central
21 office equipment investment of [\$535.5M] or 1.8% of the total investment. This 1.8% is
22 significantly lower than the 36% that Dr. Selwyn utilizes from the flawed FCC audit.

1 Also, the states that were included in the FCC audit had not undergone the transition to
2 bar coding or the implementation of the controls that went along with its implementation.

3
4 **Q. HOW DOES “BAR-CODING” INSURE ACCURATE FINANCIAL CPR DATA?**

5 A. First, a 100% physical inventory is completed for each Central Office and a Serial
6 Number barcode is affixed to all assets, both plugin and hardware. The Physical
7 inventory is reconciled to the CPR and the Company’s financial records. Second,
8 barcode readers are provided to Central Office Technicians to record all movement of
9 plugin equipment in central offices. Barcode readers are also provided to installation
10 forces so that all new infrastructure, both hardware and plug-ins, are 100% barcoded and
11 recorded as-built into the CPR.

12
13 **Q. HAVE THESE FCC JOINT AUDIT FINDINGS EVER BEEN UTILIZED BY THE
14 FCC OR ANY STATE COMMISSION ON ANY RATEMAKING DECISIONS?**

15 A. No. These findings were never used to adjust or modify any GTE or Verizon financial
16 result, or used to adjust rates in any way. Although the FCC Audit Team published their
17 1994 Report, these findings were never officially addressed by the FCC. Only Texas met
18 with GTE on these findings, and concluded that no further investigation was warranted.

19 *(See Attachment ODF-4)*

20
21 **Q. DO YOU HAVE ANY COMMENTS ON STAFF’S TESTIMONY REGARDING
22 VERIZON’S EARNINGS?**

1 A. Yes. As I noted earlier, Verizon witnesses Heuring and Trimble address each of Staff's
2 proposed adjustments in detail. But I'd like to comment on Staff's claim that Verizon has
3 failed to prove that it is not over-earning. Verizon has worked with staff witness Erdahl
4 over the last 10 months in order to discuss our earnings and answer any questions she
5 might have. Verizon has responded to many data requests, and has had numerous calls
6 and several meetings with Staff. Also, Verizon has filed quarterly financial reports
7 showing that our earnings over the last few years have been, and continue to decline, with
8 the last report showing that Verizon earned 1.78% in 2002. Given all of this information
9 and examination, the only adjustments Staff can come up with are those in Ms. Erdahl's
10 testimony, the most significant of which is based on interstate costs and revenues. Quite
11 simply, Verizon has proved beyond a doubt that it is not "over-earning."

12

13 **Q. PLEASE COMMENT ON STAFF WITNESS ERDAHL'S IMPUTATION OF**
14 **REVENUES ASSOCIATED WITH POTENTIAL INCREASES IN DIRECTORY**
15 **ASSISTANCE RATES.**

16 A. Staff witness Erdahl erroneously imputed \$2.6M in directory assistance revenue based
17 upon an increase in directory assistance rates that Verizon has not requested or filed with
18 the WUTC. Even though Verizon has the ability to file for a directory assistance ("DA")
19 rate increase that should not provide the basis for the imputation adjustment that witness
20 Erdahl proposed. The basis for her calculation used incorrect test year units of 4M units;
21 she also utilized a price increase going from \$.60 to \$1.25 for her calculation. However,
22 Verizon's 2001 units for directory assistance are 2.5M and our current rate for DA \$.95.
23 Therefore, her calculation overstated the DA units by 1.5M and overstated the price

1 increase by \$.35. Based upon the correct units and price change, her proforma
2 adjustment would be \$750K not \$2.6M. She overstatement revenues by \$1.8M.

3

4 **Q. IN HIS REBUTTAL TESTIMONY, STAFF WITNESS ZAWISLAK SUGGESTS**
5 **THAT VERIZON “DOES NOT DISAGREE” WITH HIS “ALTERNATIVE**
6 **APPROACHES” OF (1) RECLASSIFYING VERIZON’S TOLL SERVICES AS**
7 **NON-COMPETITIVE, OR (2) REQUIRING A VERIZON AFFILIATE TO**
8 **OFFER INTRALATA TOLL. PLEASE RESPOND.**

9 A. He is incorrect. Verizon does not agree with either alternative. Mr. Zawislak criticizes
10 Verizon for not responding to these “alternatives,” but he should re-read his direct
11 testimony. His question asks, “if Verizon’s toll rates do not pass imputation,” what
12 should happen? Verizon does not believe its toll rates fail imputation, and therefore Mr.
13 Zawislak’s alternatives are irrelevant. But more importantly, his direct testimony makes
14 clear that Staff is *not* recommending either approach at this time. If Staff is not
15 recommending them at this time, then they are irrelevant to this part of the proceeding.

16

17 **Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?**

18 A. Yes.