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1 P R O C E E D I N G S

2 JUDGE WALLIS: The hearing will please come
3 to order. This is a Commission hearing in the matter of
4 Docket Number UT-040788, which is an application by
5 Verizon for an increase in its rates and charges, which
6 has been suspended by the Commission. This phase of the
7 proceeding involves Verizon's request for an interim
8 rate increase of approximately \$30 Million.

9 This hearing is being held at Olympia,
10 Washington before the Commissioners, Chairwoman Marilyn
11 Showalter, Commissioner Patrick Oshie, we expect
12 Commissioner Richard Hemstad is to join us momentarily.
13 My name is Robert Wallis, and I am the presiding
14 Administrative Law Judge.

15 Let's begin this morning with appearances of
16 counsel for the record, please, beginning with the
17 company, Ms. Endejan.

18 MS. ENDEJAN: Good morning, Your Honor,
19 Judith Endejan of Graham & Dunn for Verizon Northwest,
20 Inc., and I believe my address and contact information
21 is on file. With me is Tom Parker, and I will let him
22 state his full name and title for the record.

23 MR. PARKER: Good morning, Commissioners,
24 Your Honor, it's Thomas R. Parker, 600 Hidden Ridge,
25 Irving, Texas, on behalf of Verizon Northwest.

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1 JUDGE WALLIS: For Commission Staff.

2 MR. TROTTER: Donald T. Trotter, Assistant
3 Attorney General.

4 JUDGE WALLIS: Public Counsel.

5 MR. FFITCH: Simon ffitch, Assistant Attorney
6 General for the office of Public Counsel.

7 JUDGE WALLIS: Department of Defense.

8 MR. MELNIKOFF: Stephen Melnikoff for --

9 JUDGE WALLIS: Mr. Melnikoff, would you use
10 the microphone, please.

11 MR. MELNIKOFF: Is this better?

12 JUDGE WALLIS: Much better, thank you.

13 MR. MELNIKOFF: Sorry. Stephen S. Melnikoff,
14 I represent the consumer interests of the US Department
15 of Defense and all other Federal Executive Agencies,
16 good morning.

17 JUDGE WALLIS: For AARP.

18 MR. ROSEMAN: Ronald Roseman, Attorney at
19 law, appearing on behalf of AARP.

20 JUDGE WALLIS: And for WeBTEC.

21 MR. BUTLER: Arthur A. Butler of the law firm
22 Ater Wynne LLP on behalf of WeBTEC.

23 JUDGE WALLIS: Are there any other
24 appearances to be made this morning?

25 Let the record show that there is no

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1 response.

2 Are there any preliminary matters before we
3 begin?

4 Let the record show that there is no
5 response.

6 Our first scheduled witness today is James H.
7 Vander Weide appearing on behalf of the company. Would
8 the witness please step forward and be sworn.

9 (Witness James H. Vander Weide was sworn.)

10

11 (The following exhibits were identified in
12 conjunction with the testimony of JAMES H.
13 VANDER WEIDE.)

14 (Verizon)

15 1T JHV-4T, Direct testimony (14pp)

16 2 JHV-5, Interim Rate Relief Filing, revised May
17 24, 2004 (1p)

18 3T JHV-6T, Rebuttal Testimony (11pp)

19 (Staff)

20 4 Verizon response to Staff Data Request Nos.
21 26, 52, & 53 (3pp)

22 (Public Counsel)

23 5 Verizon response, Staff DR No. 8 (1pg)

24 6 Verizon response, Staff DR No. 32 (21pp)

25 7 Verizon response, Staff DR No. 36 (1pg)

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1 8 Verizon response, Staff DR No. 49 (1pg)

2 9 Verizon response, Staff DR No. 50 (1pg)

3

4 JUDGE WALLIS: Please be seated.

5 Ms. Endejan or Mr. Parker.

6 MR. PARKER: Thank you, Your Honor.

7 JUDGE WALLIS: Mr. Parker.

8

9 Whereupon,

10 JAMES H. VANDER WEIDE,

11 having been first duly sworn, was called as a witness

12 herein and was examined and testified as follows:

13

14 D I R E C T E X A M I N A T I O N

15 BY MR. PARKER:

16 Q. State your name for the record, please.

17 A. Yes, my name is James H. Vander Weide.

18 Q. Your address, please.

19 A. My address is 3606 Stonybrook Drive, Durham,

20 North Carolina 27705.

21 Q. Doctor, do you have before you what's been

22 marked for identification as Exhibit 1T, which is your

23 direct testimony consisting of 14 pages?

24 A. Yes, I do.

25 Q. Do you also have before you Exhibit 2, which

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1 is one exhibit attached to your direct testimony?

2 A. Yes.

3 Q. And do you also have before you Exhibit 3T,
4 which is your rebuttal testimony consisting of 11 pages?

5 A. Yes, I do.

6 Q. All right. Are there any corrections or
7 deletions that need to be made to those documents at
8 this time?

9 A. No, there are not.

10 Q. All right. Are they true and correct to your
11 best belief and knowledge?

12 A. Yes.

13 Q. Do you adopt that as your testimony here
14 today?

15 A. Yes, I do.

16 MR. PARKER: Dr. Vander Weide is available
17 for cross-examination.

18 JUDGE WALLIS: Is there objection to any of
19 the exhibits?

20 Let the record show that there is no
21 response, and Exhibits 1T, 2, and 3T are received.

22 MR. PARKER: Thank you.

23 JUDGE WALLIS: Mr. Trotter.

24 MR. TROTTER: Thank you.

25

0066

1 C R O S S - E X A M I N A T I O N

2 BY MR. TROTTER:

3 Q. Good morning, Dr. Vander Weide.

4 A. Good morning.

5 Q. Is this the first time you have testified on
6 interim rate relief in this jurisdiction?

7 A. Yes, it is.

8 Q. And as a preliminary matter, your testimony
9 and exhibits, your direct testimony and exhibits,
10 examine only Verizon Northwest Washington intrastate
11 operations; is that true?

12 A. That's correct.

13 Q. And in preparing your testimony, did you
14 review any documents or transcripts from the
15 Commission's docket in which GTE Corp. and Bell Atlantic
16 merged?

17 A. No, I did not.

18 Q. Turn to your Exhibit 1T, page 6, and here on
19 line 10 you begin to discuss what you call key financial
20 ratios used by Standard & Poors to rate a utility's or a
21 company's debt; is that right?

22 A. Yes.

23 Q. And the first two measures that you identify
24 are the EBIT interest coverage and the EBITDA interest
25 coverage; is that right?

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1 A. Yes, it is.

2 Q. And over on page 8, line 7, 7 through 10, you
3 note that the rating agencies put more emphasis on EBIT
4 than EBITDA; is that correct?

5 A. Yes, it is.

6 Q. Turning to page 12, line 13, you further
7 observe that the EBIT interest coverage is a more
8 meaningful measure of the company's ability to pay
9 interest on its debt than the other two factors you
10 mention, EBITDA or the FFO/total debt, correct?

11 A. Yes.

12 Q. Now staying on page 12, table 2, based on
13 your calculations for, excuse me, just on table 2 which
14 is the median financial ratios for US industrial
15 companies, the very first item is the EBIT, and you show
16 what EBIT factors or ratios will result in what bond
17 ratings, correct?

18 A. That's not quite correct. These are the
19 median financial ratios for companies with those bond
20 ratings.

21 Q. Okay. So, for example, a company with a
22 median EBIT interest coverage of 1 would qualify for a B
23 rating?

24 A. What that indicates is that of all the
25 companies with a B rating, their median EBIT interest

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1 coverage is a 1.

2 Q. And based on your calculations, an additional
3 \$29.7 Million annually for Verizon Northwest Washington
4 intrastate would produce an EBIT interest coverage of
5 .6, is that correct?

6 A. Yes.

7 Q. And according to your table on page 12, that
8 would imply a bond rating of between B and CCC; is that
9 right?

10 A. If one looked only at that one criteria. As
11 I indicated in my testimony, although EBIT is the most
12 important criteria, the rating agencies do look at all
13 three, and in addition they look at the trend in the
14 ratios over time. And so one couldn't make a judgment
15 just by looking at the 0.6 and comparing it to the bond
16 rating or to the median for those companies with that
17 bond rating, one would still have to look at all three
18 ratios and look at the trend of the ratios over time.

19 Q. Based on the most meaningful of those ratios,
20 a .6 EBIT coverage standing alone would merit a below
21 investment grade rating, would it not?

22 A. Yes, but again, one wouldn't look just at
23 that one criteria.

24 Q. Now S&P has not actually given Verizon's
25 Washington intrastate results of operations a bond

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1 rating, has it?

2 A. No. From Order Number 5, it's my
3 understanding, and as an economist it makes sense, that
4 one should look at intrastate operations only, and so
5 I'm looking at the ratios that are -- I'm looking at the
6 ratios for the intrastate operations and determining
7 what the implied credit rating would be for those
8 intrastate operations on a stand-alone basis.

9 Q. Please turn to Exhibit 4, and do you
10 recognize this as at least the first page of Staff Data
11 Request Number 26 and your response?

12 A. Yes.

13 Q. And the second and third page are follow ups
14 to Data Request 26, and they were called Staff Data
15 Requests 52 and 53; is that right?

16 A. Yes.

17 Q. And do you have that exhibit in three pages
18 in front of you?

19 A. Yes.

20 Q. Now to calculate financial ratios for Verizon
21 Northwest's Washington intrastate operations, you
22 assumed that those Washington intrastate operations were
23 financed with the same proportion of debt and equity as
24 Verizon Northwest's total company operations, correct?

25 A. Yes.

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1 Q. And you needed to make that assumption
2 because Verizon Northwest does not carry debt and equity
3 at the Washington state intrastate level separately,
4 does it?

5 A. No, it doesn't carry debt and equity at the
6 Washington intrastate operations only. This is a very
7 common type of assumption in rate proceedings where
8 you're looking -- where the -- you're looking at a
9 jurisdiction that does not correspond to the whole
10 company, and it was the same assumption that was used in
11 the Olympic Pipeline case, for example.

12 Q. Could you state the specific assumption that
13 was made in the Olympic Pipeline case according to your
14 understanding?

15 A. Yes, in the Olympic Pipeline case it was
16 assumed that the debt -- that the capital structure that
17 was appropriate for both the intrastate and the
18 interstate jurisdiction, that is the jurisdiction that
19 was regulated by the FERC and the jurisdiction -- the
20 Washington state jurisdiction were both the same, that
21 the capital structure that was used to finance the
22 entire entity was also used for Washington intrastate
23 operations.

24 Q. Turn to your Exhibit 2, and this exhibit is
25 the detail behind the table that you show on page 9 of

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1 your direct testimony, Exhibit 1T?

2 A. Yes.

3 Q. And according to your testimony on page 9,
4 you state that the data shown for 1999 through 2002 are
5 actual data for the 12 months ending December 31 as
6 reported in Verizon Northwest's quarterly surveillance
7 reports to the Commission; is that correct?

8 A. Yes, it is.

9 Q. And by surveillance reports to the
10 Commission, you're referring to the documents entitled
11 Quarterly Compliance Reports that are filed by the
12 company with the UTC?

13 A. Yes.

14 Q. Turning then to Exhibit 2, you show your
15 three different calculations, the EBIT interest
16 coverage, the EBITDA interest coverage, and the funds
17 from operations/total debt ratio figure, correct?

18 A. Yes.

19 Q. And under each of those calculations, there
20 appears a figure for interest expense and gross interest
21 paid; is that right?

22 A. That's correct.

23 Q. Interest expense is not reported to the UTC
24 in the company's quarterly compliance reports, is it?

25 A. No.

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1 Q. Ms. Heuring, a witness for Verizon, provided
2 you those figures based on total company numbers which
3 she allocated to Washington intrastate?

4 A. Yes.

5 Q. Let's go to Exhibit 4 again, and the first
6 page, excuse me, the second page shows the 10K and 10Q
7 as the source for the 2002 amounts listed in your table
8 Exhibit 2 for the interest expense and gross interest
9 paid; is that right?

10 A. You're referring to Data Request Number 52,
11 which is the second page of Exhibit 4?

12 Q. Yes, and the same question applies to the
13 prior years, which is shown on the third page of that
14 exhibit.

15 A. Yes, the response indicates that that amount
16 is from the Verizon Northwest 2002 bond holder report,
17 Footnote 13.

18 Q. Okay. And then on the next page it shows
19 that the source for 1999, 2000, and 2001 for gross
20 interest paid is Footnote 11 from the company's 2001
21 10K, correct?

22 A. Yes.

23 Q. And then you set forth the source figures.
24 Those figures are not Washington intrastate figures, are
25 they?

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1 A. Those are amounts that are allocated to
2 Washington intrastate operations.

3 Q. I'm not disagreeing with that, I'm just
4 trying to point out these figures are total company
5 figures which then were allocated to Washington
6 intrastate in your calculations; is that right?

7 A. Yes.

8 Q. Okay. You use telephone plant in service to
9 allocate total company interest amounts to Washington
10 intrastate; is that correct?

11 A. Yes.

12 Q. Turn to page 14 of your direct testimony,
13 Exhibit 1T, beginning on line 6 you state that:

14 A company has no incentive to invest in
15 operations when its investors could earn
16 higher return on other investments of
17 the same risk.

18 Do you see that?

19 A. Yes, I do.

20 Q. And you state that your:

21 Studies indicate Verizon Northwest
22 investors could earn a rate of return of
23 12.03% on other investments of the same
24 risk.

25 That 12.03% in the other studies that you're

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1 referring to in that testimony is your direct testimony
2 in the general rate case part of this docket, isn't it?

3 A. Yes, it is.

4 Q. And that's the overall return that you are
5 recommending in the general rate case; is that right?

6 A. Yes.

7 Q. And you testify in the general rate case
8 testimony that Verizon Northwest will only have an
9 incentive to invest in its intrastate operations in
10 Washington state if it is given an opportunity to earn
11 12.03% on its rate base; is that correct?

12 A. Yes, it is.

13 Q. Verizon Northwest is the investor in Verizon
14 Northwest's Washington intrastate operations, correct?

15 A. Yes.

16 Q. Turn to your rebuttal testimony, Exhibit 3T,
17 page 10, and the question beginning on line 4 and your
18 answer going through line 14, you discuss the company's
19 inability to pay dividends to its parent for the test
20 year; is that right?

21 A. Yes.

22 Q. And at the bottom of page 9, you state that:
23 Since the dividends paid by Verizon
24 Northwest's total company operations are
25 based on the results of its

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1 non-Washington jurisdictional
2 operations, they are irrelevant to the
3 request for interim rate relief in this
4 proceeding.

5 Do you see that?

6 A. Yes.

7 Q. Now in 1999 when Verizon had Washington
8 intrastate net income of \$112 Million, that's per the
9 compliance report it filed with the Commission, how much
10 of that income was paid in a dividend to Verizon
11 Communications?

12 A. There are no direct dividends that come from
13 Washington intrastate operations. Let me see, are you
14 referring -- you're referring to Washington intrastate
15 operations and what they earned in 1999?

16 Q. Yes.

17 A. There are no direct -- no, there's nothing
18 that's labeled a dividend that comes from Washington
19 intrastate operations.

20 Q. So you can't tell us how much was dividended
21 in fact from Washington intrastate results of operations
22 to the parent?

23 A. That's correct.

24 Q. And the parent that we're talking about here
25 would be Verizon Communications, not Verizon Northwest

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1 obviously?

2 A. Well, there possibly could have been a
3 dividend to Verizon Northwest, but there's nothing
4 labeled a dividend.

5 Q. Okay.

6 A. To Verizon Northwest. There are cash flows,
7 and that's what I report.

8 Q. Okay. And so you can't tell us the amount of
9 dividends that came from Verizon Northwest's Washington
10 operations in 1999 or any other year in which it had a
11 positive net income; is that correct?

12 A. That's correct.

13 Q. To your knowledge, isn't it true that Verizon
14 Northwest is not required to pay dividends to Verizon
15 Communications, payment is discretionary?

16 A. Would you repeat the question, please.

17 Q. I will restate it.

18 Is payment of a dividend from Verizon
19 Northwest to its parent discretionary on the part of
20 Verizon Northwest?

21 A. That's a question that's difficult to answer.
22 I don't know whether -- I don't believe it ultimately is
23 discretionary, because Verizon Communications owns the
24 stock in Verizon Northwest and ultimately has the
25 ability to choose the management. Whether it's -- so it

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1 would be difficult to define whether it's discretionary
2 or it's not discretionary.

3 Q. Would it be a management decision?

4 A. Yes.

5 Q. Of Verizon Northwest?

6 A. I believe it would be a management decision,
7 yes.

8 Q. Okay. And in the general economy, if a
9 company has net income and has discretion whether to pay
10 out a dividend, it could choose to retain that dividend,
11 could it not, and use it to fund operations?

12 A. It certainly could choose to do that. It
13 would make the decision based on what it thought was in
14 the best interests of its shareholder.

15 Q. Would it consider the best interests of its
16 business on an ongoing basis?

17 A. In the general economy, what's in the best
18 interests of the business is what creates value for the
19 shareholder, and so whatever creates the greatest value
20 for the shareholder would be in the interest of the
21 business and what -- and that's what management would
22 decide to do.

23 Q. Okay. So if it was in the best interests of
24 the company to retain a dividend and reinvest it in its
25 business, that would by definition be in the best

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1 interests of the shareholder?

2 A. Yes, and they would decide to retain it if
3 they thought they could earn a return that was at least
4 as great as what -- as the return that their
5 shareholders could earn on other investments of the same
6 risk.

7 Q. And when a company earns higher than average
8 returns in a particular period, its dividend payments,
9 all else equal, would be greater, would they not?

10 A. I don't think I could answer that one way or
11 the other. First of all, it depends on expected future
12 returns, not just entirely on what was earned last
13 period if that was what you were referring to when you
14 say a company earns a return. And secondly is that if a
15 company expects returns that are higher than what the
16 investor could earn elsewhere, it would decrease its
17 dividend rather than increase it, because it would be in
18 the interests of the shareholder to keep the money
19 within the company and earn the higher return.

20 Q. Please turn to page 7 of your rebuttal
21 testimony, Exhibit 3T, line 16, and here you're
22 addressing the issue of subsidization, and you provide
23 your statement of an economist's definition of
24 subsidization, do you see that?

25 A. Yes, I do.

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1 Q. Am I correct in understanding that according
2 to your testimony, economists define subsidization as a
3 situation where a price for one of a company's services
4 is above its long run average cost and it provides a
5 subsidy to another service that is priced below its long
6 run average cost?

7 A. Yes.

8 Q. And can you give a definition of what you
9 mean by long run average cost?

10 A. Yes, it would be the cost on a forward
11 looking basis in the long run of operating the business,
12 including the cost of capital. So it would include
13 operating expenses, it would include the economic
14 depreciation on the company's assets, it would include
15 the interest rate on the company's debt, and it would
16 include the required return on the company's equity or
17 the cost of equity.

18 Q. And is that the same -- are you using that
19 term long run average cost to be the same as marginal
20 cost?

21 A. No, marginal cost refers to the increment in
22 cost of increasing production by one unit. I'm
23 referring to what might more appropriately be called
24 incremental cost, which would be the cost of going from
25 zero to the level of output that the company chooses.

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1 That's not an increment of one unit, it's the increment
2 of -- it's the entire output of the company, and then
3 it's the average cost of that entire output.

4 Q. With respect to pricing of utility services
5 under regulation, is marginal cost the starting point,
6 should marginal cost be the starting point? Let me
7 phrase it another way.

8 Should price equals marginal cost be the
9 starting point?

10 A. Under rate of return regulation, was that
11 part of the question?

12 Q. Yes.

13 A. Under rate of return regulation, price is in
14 general the average price of all the company's services
15 or their revenues, price times quantity, have been equal
16 to average cost, all, that is not just the marginal
17 cost, the average cost of production. In the past, it
18 was certainly true or certainly understood to be true by
19 most economists that utility commissions didn't do that
20 for each service, that it was true for the bundle of
21 services that revenues were to be equal to average price
22 was equal to average cost and revenues were to equal
23 total cost, but that some services, particularly
24 interstate services and services to customers in denser
25 population areas, were priced above average cost in

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1 order to subsidize primarily residential customers and
2 those -- especially those in rural areas.

3 Q. Do actual long run average costs in the
4 market for Verizon intrastate differ between Washington
5 and other jurisdictions to your knowledge? Have you
6 studied that issue?

7 A. I'm trying to understand the question with
8 regard to average costs. Do you mean average costs per
9 unit, or do you mean average cost over all the units
10 that are produced?

11 Q. Average cost per unit.

12 A. I would -- with regard to basic network
13 services, I would assume it's reasonable to assume that
14 average costs would be the same across the different
15 state jurisdictions so that the cost of intrastate
16 service per unit I would assume -- it would be very
17 reasonable to assume it would be reasonably similar.

18 Q. Would you agree that Verizon's rates in the
19 various jurisdictions in which it operates, talking
20 about Verizon Northwest, are based on a combination of
21 regulatory policies and market factors?

22 A. Yes.

23 Q. Do regulatory -- and regulatory policies and
24 market factors vary by jurisdiction in which Verizon
25 Northwest operates, correct?

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1 A. I think that would be a reasonable
2 assumption.

3 Q. Turn to page 8 of your rebuttal, and you use
4 on line 6 the term operating margin, can you give us the
5 definition of that term as you're using it?

6 A. Yes, and perhaps the best way is to look at
7 table 1. Operating margin is just net operating income
8 divided by revenue.

9 Q. Is there any difference in your mind in the
10 way subsidization is defined by you on page 7 of your
11 testimony, the economist's definition that we discussed
12 previously, and the way that you're measuring on page 8
13 using operating margin?

14 A. Yes, there is a difference, because the way
15 economists define it is always forward looking, and so
16 one would always have to estimate the forward looking
17 economic cost in order to define the average cost for
18 the subsidy. However, forward looking costs are always
19 very difficult to estimate, and I was looking for
20 evidence of -- that could be obtained without doing a
21 forward looking cost study.

22 And this to me is very strong evidence that
23 by looking at actual operating margins for the different
24 jurisdictions that the other jurisdictions provide a
25 very strong subsidy to Washington intrastate operations,

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1 especially since Washington intrastate operations have a
2 negative operating margin and the other jurisdictions
3 are very significantly positive, there can be little
4 doubt that Washington intrastate operations are
5 subsidized by the other jurisdictions.

6 Q. Now operating margin differences can be due
7 to competition or different regulatory policies in a
8 specific jurisdiction, can't they?

9 A. I don't know how they could be different with
10 regard to regulatory policies for across the whole
11 jurisdiction. I could see it across different services.
12 But across a whole jurisdiction it's my understanding
13 that rates are supposed to be sufficient.

14 Q. I'm talking about as between jurisdictions,
15 not within a particular jurisdiction.

16 A. Then I don't see how regulatory policies
17 could be significantly different to the extent that
18 rates are supposed to be designed to cover the company's
19 expenses and provide -- including the return to the
20 investor.

21 Q. Would you agree that operating margin
22 differences that are not explained by relative costs may
23 distort competition?

24 A. I don't know what you mean by distort
25 competition.

0084

1 Q. I mean that it would not be -- it would be
2 indicative of a market that's not effectively
3 competitive.

4 A. No, I don't -- I wouldn't agree by that, with
5 that.

6 Q. Now your table 1 on page 8 of your rebuttal
7 testimony is based on data from Ms. Heuring's Exhibit
8 24, NWH-10, correct?

9 A. Yes.

10 Q. Which you state on page --

11 A. The answer is yes.

12 Q. Okay. And her data was based on the period
13 January through December 2003, correct?

14 A. Yes.

15 Q. And just looking at your table, line 3, other
16 state jurisdictions, the company did not show data for
17 each other state intrastate jurisdiction separately, did
18 it?

19 A. No.

20 Q. And would you accept subject to your check
21 that Staff asked that Exhibit 24 be revised to add that
22 detail of other state intrastate operations and the
23 company refused to supply it?

24 A. Are you asking if I would accept that subject
25 to check?

0085

1 Q. Yes.

2 A. I guess I can, yes, I guess I can check that.

3 MR. TROTTER: Those are all my questions,
4 thank you, Dr. Vander Weide.

5 JUDGE WALLIS: Is there objection to receipt
6 of Exhibit 4?

7 MR. PARKER: No.

8 JUDGE WALLIS: Exhibit 4 is received.

9 Mr. FFITCH.

10 MR. FFITCH: Thank you, Your Honor.

11

12 C R O S S - E X A M I N A T I O N

13 BY MR. FFITCH:

14 Q. Good morning, Dr. is it Vander Weide?

15 A. Yes, it is.

16 MR. FFITCH: I may be a bit rough here, Your
17 Honor, Mr. Trotter covered a number of areas that I had,
18 so I will try to step around those.

19 BY MR. FFITCH:

20 Q. And some of these may just clarify some of
21 the answers you gave to Mr. Potter's or Trotter's
22 questions, excuse me, I knew that was going to happen in
23 this case. Hopefully I have gotten that out and it
24 won't happen again.

25 Does Verizon Northwest secure credit from

0086

1 anyone, any entity, based solely on its Washington
2 intrastate earnings?

3 A. The credit ratings agencies do not -- are you
4 asking if they get capital or if they get a credit
5 rating, a credit rating?

6 Q. Well, why don't you take each of those, and
7 just first of all tell me about the credit rating.

8 A. Okay. They do not have a credit rating by
9 the credit rating agencies. However, it's my
10 understanding as an economist and as my understanding of
11 Order Number 5 that the company's request for interim
12 rate relief is to be evaluated on the basis of its
13 intrastate operations only, and it is certainly very
14 reasonable to calculate ratios for its intrastate
15 operations as I have done and to assess the credit
16 ratings or the credit capability of its intrastate
17 operations by comparing those ratios to the ratios of
18 companies with different -- which do have credit ratings
19 to see what its financial condition is.

20 Q. Well, I understand that that's your theory in
21 this case, and my question is, and I think you have
22 answered it, that actually does not happen in the real
23 world, correct? Verizon Northwest does not secure
24 credit from anyone based solely on its Washington
25 intrastate earnings, correct?

0087

1 MR. PARKER: Your Honor, just so I get the
2 objection out here and we can deal with it up front,
3 Order Number 5 in Paragraph 20, you know, has already
4 discussed this on the motions that came in here to have
5 this case dismissed, and the Commission -- the words are
6 fairly black and white. It says:

7 We find it appropriate to consider the
8 company's need for interim rate relief
9 based on a Washington intrastate basis
10 only and to determine whether the level
11 of its intrastate revenues constitutes a
12 gross inequity justifying interim
13 relief.

14 And so, you know, all of these questions
15 about what happens at the parent level, what happens at
16 a Verizon Northwest total company level which includes
17 Idaho, Oregon, Washington, plus interstate and
18 non-regulated operations, it's my reading of Order
19 Number 5 the Commission has ruled on this issue and has
20 found it not to be relevant to this case.

21 JUDGE WALLIS: Mr. ffitich.

22 MR. FFITCH: Well, Your Honor, we are
23 familiar with the Commission's interlocutory decision in
24 Order Number 5. We don't agree with the company reading
25 of it, and we certainly do not read it as precluding any

0088

1 discussion or any evidence in this case whatever of
2 anything except the company's theory of the case. That
3 pretty much collapses the case down to one question,
4 which is the company's view of the case, and we don't
5 agree with that view of the case. We think it's
6 relevant for the Commission to hear evidence about the
7 actual financial condition of Verizon Northwest and the
8 actual financing mechanisms that it has available to it.
9 The company can argue these issues on its brief.

10 (Discussion on the Bench.)

11 JUDGE WALLIS: The objection is denied. We
12 think it's appropriate that counsel be allowed some
13 latitude to explore counsel's theory of the case and to
14 provide a basis for relevant arguments that may be made
15 as to the result.

16 MR. PARKER: Thank you.

17 MR. FFITCH: Your Honor.

18 JUDGE WALLIS: Mr. ffitch.

19 MR. FFITCH: I have lost my question I think,
20 can I have the court reporter read it back.

21 (Record read as requested.)

22 A. It is correct that Verizon Northwest obtains
23 credit based on its total operations, period.

24 BY MR. FFITCH:

25 Q. Would a, in your professional opinion, would

0089

1 a rating agency downgrade a bond issue because of poor
2 earnings when there is a certainty that the regulatory
3 commission will be reconsidering the company's rates in
4 a pending general rate case with a statutory deadline of
5 less than one year?

6 MR. PARKER: I would like to object to the
7 form of the question and ask counsel to clarify what he
8 means that the Commission will with a certainty
9 reconsider. That means they're going to increase rates
10 or they're just going to hear it?

11 JUDGE WALLIS: Mr. ffitch.

12 MR. FFITCH: The Commission with certainty
13 will be conducting a full evidentiary review under its
14 general rate case proceedings of the company's formally
15 filed request for a general rate increase, a revenue
16 increase.

17 A. And the question again was whether a bond
18 rating agency would lower a company's rating if they
19 knew that the company had a rate case pending?

20 BY MR. FFITCH:

21 Q. Correct, that's a good summary of the
22 question.

23 A. I believe that they would if the company's
24 financial condition reflected the ratios that the
25 intrastate operations reflect at the present time.

0090

1 Q. Are you aware of any instances where that has
2 occurred?

3 A. I would have to study -- I would have to
4 study that issue. It's a little hard for me to go back
5 in my memory and remember and try to think of all the
6 cases that have taken place and think of when bond
7 ratings were lowered compared to a rate case filing.

8 Q. Would you agree that it would be unlikely to
9 happen although that it might happen? Your testimony is
10 it could happen, would you agree that the odds of it
11 happening are small?

12 A. No.

13 Q. But you don't have any research or any
14 specific information to base that answer on?

15 A. That's a different question. What I said is
16 I couldn't recall an incident just because of the volume
17 of data that would be required where a company's bond
18 ratings had been downgraded at the same time that it had
19 a rate case pending. From my 25 years of experience
20 though in this industry and rate setting in general, I
21 know that rating agencies tend to look at their
22 forecasts of a company's -- at the company's current
23 condition and their forecasts of the company's likely
24 future condition, and they -- the fact that the company
25 had a rate case pending would be one among many other

0091

1 factors that the rating agencies would consider, and
2 they certainly would not conclude that just because a
3 company had a rate case pending they should wait to
4 lower the company's ratings. I can't recall a situation
5 where that's ever occurred.

6 Q. Does Verizon Northwest have access to lines
7 of credit within Verizon Communications?

8 A. Yes.

9 Q. Can you describe what that access is?

10 A. Well, they have a -- they have access to a
11 pool of funds through Verizon funding for Verizon from
12 Verizon Communications.

13 Q. Do you have any other information about the
14 nature of their access to lines of credit?

15 A. We have supplied that information in response
16 to a data request.

17 Q. I can check with counsel on that at another
18 time unless you remember the data request response.
19 It's not necessary for you to look it up. I can --

20 A. I don't recall the specific number, but I do
21 recall making that response and supplying the
22 information.

23 Q. Now I would like to ask you to turn to your
24 rebuttal testimony, which is Exhibit 3T, and turn to
25 page 4, and we're going to come back to this issue of

0092

1 subsidy that you discussed with Mr. Trotter. And if you
2 could look at line 18, there you suggest that Verizon's
3 intrastate Washington operations are requiring customers
4 in other jurisdictions to support customers in
5 Washington state. Is that a fair paraphrase of that
6 sentence there?

7 A. No, I don't think that is a fair paraphrase.
8 I said there's no justification on economic grounds to
9 require that customers in other jurisdictions support
10 customers in Washington state. And I believe the
11 Commission made the same -- made a very similar
12 statement in Order Number 5, which said that to base a
13 request -- to base the consideration of a request for
14 interim rate relief on operations in other states would
15 allow the possibility that the customers in the state
16 would not support themselves, that they, in other words,
17 that they would be supported by customers in other
18 states.

19 Q. Okay, well, I'm just trying to understand
20 this testimony right here.

21 A. Right, and as I understood it, your
22 paraphrase said that they are required, and my statement
23 is, there's no economic justification to require.

24 Q. Okay, well, maybe we're going round in
25 circles a bit. What I want to ask is, is it your

0093

1 testimony that Washington's -- that customers in other
2 jurisdictions are currently supporting customers in
3 Washington's intrastate -- excuse me, I'm getting turned
4 around myself.

5 Is it your testimony that customers in other
6 jurisdictions are currently supporting customers
7 intrastate in Washington?

8 A. Yes, that's the evidence I present in table 1
9 on page 8, that in fact the operating margins in other
10 states are considerably higher than they are in
11 Washington intrastate, and in fact the operating margin
12 in Washington intrastate is negative. Washington
13 intrastate on a stand-alone basis would have a below
14 investment grade credit rating, and if one considers the
15 results of operations on a total company basis, my
16 testimony is that would be tantamount to a further
17 requirement that customers in other states support or
18 subsidize more than they already are customers in
19 Washington intrastate.

20 Q. Have you done an analysis of how much Oregon
21 and Idaho rates are inflated due to the current rate
22 levels in Washington?

23 A. No, I have done the analysis that's contained
24 in table 1, which is all other jurisdictions compared to
25 Washington intrastate.

0094

1 Q. Right, I'm sorry, could you just stick to
2 answering my question. I know you have testified about
3 your table at some length, and that's fine. And my
4 question is, have you done another analysis to show how
5 much customer rates in Oregon and Idaho are inflated due
6 to the subsidization of Washington --

7 A. No.

8 Q. -- customers rates? And you haven't done
9 anything other than table 1, correct?

10 A. Correct.

11 Q. All right. And is it your testimony then
12 that if the company's rate requests are granted in this
13 case that it would be your professional recommendation
14 that rates be reduced in Oregon and Idaho?

15 A. No, my testimony -- I didn't say that the
16 rates are unreasonable in Oregon and Idaho. What I said
17 is that the operating margins are higher there than they
18 are in Washington intrastate, and they're obviously so
19 because Washington intrastate is as a negative return.

20 Q. So in your mind, it's not unreasonable for
21 customers in Oregon and Idaho to pay significantly
22 higher rates to subsidize Washington intrastate rates?

23 A. Recall --

24 MR. PARKER: Objection, that's an
25 argumentative question, Your Honor, mischaracterizes his

0095

1 testimony.

2 MR. FFITCH: I believe I used the witness's
3 own words, Your Honor. He has testified that the rates
4 in those states were not necessarily unreasonable in his
5 view.

6 MR. PARKER: The witness's testimony is that
7 the earnings from the other state are subsidizing
8 Washington, not that the rates are inflated in
9 subsidizing Washington.

10 JUDGE WALLIS: Mr. ffitch, will you modify
11 your question, please.

12 MR. FFITCH: Thank you, Your Honor, yes.

13 BY MR. FFITCH:

14 Q. Perhaps I'm just getting clarification of
15 your previous testimony, Dr. Vander Weide, but as I
16 understand it, you would not recommend any rate
17 reduction in Oregon or Idaho in the event that this
18 Commission raised customer rates at the company's
19 request in Washington?

20 A. Well, you recall that I haven't specifically
21 studied Oregon or Idaho. What I have specifically
22 studied is all other jurisdictions, which would include
23 interstate jurisdictions and would group together all
24 the jurisdictions other than Washington intrastate, so
25 it also would include Washington interstate. And it's

0096

1 impossible just from that data to study Idaho and Oregon
2 to determine whether their rates are higher than
3 justified, and nor have I done such a study.

4 Again, I have only suggested that all other
5 jurisdictions taken together have a higher operating
6 margin than Washington intrastate, and that considering
7 Washington Northwest as a whole in judging the
8 reasonableness of the request for interim rate relief is
9 tantamount to requiring customers in other
10 jurisdictions, Washington Northwest as a whole, to
11 support customers in Washington intrastate.

12 Q. Well, I was looking for a yes or a no answer,
13 and I'm not sure if I got that. Is that an I don't know
14 or I can't tell whether those rates should be reduced or
15 not?

16 A. I believe I stated that I did not study Idaho
17 or Washington state, which generally can be taken to be
18 I don't know since I haven't studied it.

19 Q. I think you meant to, I'm sorry, I think you
20 meant to say you did not study Idaho or Oregon.

21 A. Idaho or Oregon.

22 Q. All right, thank you.

23 Just one or two other areas here. We have
24 already touched on the relevance of the Washington
25 intrastate financial condition for purposes of the

0097

1 rating agencies, just one other question on that. It's
2 true, is it not, that adoption of the company request in
3 this case would not actually cause any bond to be issued
4 or bond rating change to occur on a Washington
5 intrastate basis, correct?

6 A. I believe that I have answered that already,
7 which is that Washington intrastate operations do not
8 have a bond rating per se, and so it could not change
9 since they don't have a bond rating.

10 Q. Right. Now I'm going to ask you to turn to
11 page 6 of your rebuttal testimony, and look at lines 20
12 through 22, and there you testify that Verizon Northwest
13 also has a commitment to provide a return on investment
14 to its parent to justify continuing investment, correct?

15 A. Yes.

16 Q. And ideally if rates are set appropriately,
17 that's going to be a reasonable return, correct?

18 A. Yes.

19 Q. And isn't the establishment of a reasonable
20 rate of return on investment classically a task
21 undertaken in a general rate case?

22 A. That is a task in a rate case, but it's my
23 understanding that among the many factors that one would
24 consider in an interim case would be the return that the
25 company is earning on its operations.

0098

1 Q. And the establishment of a reasonable rate of
2 return on investment for Verizon will be examined in the
3 company's general rate case in this docket, won't it?

4 A. Well, the establishment of a reasonable rate
5 of return will be considered, but the establishment of
6 whether the company is in a financial emergency or in a
7 financial -- is in financial ill health because of its
8 rate of return among other things, including its
9 financial ratios, is a matter of the interim rate
10 proceeding.

11 MR. FFITCH: All right, thank you.

12 Your Honor, I would like to now address the
13 cross-examination exhibits that were identified for
14 Dr. Vander Weide.

15 JUDGE WALLIS: Very well, Mr. ffitch, about
16 how much longer after the exhibits are dealt with do you
17 expect to have in cross-examination?

18 MR. FFITCH: That would actually conclude my
19 examination.

20 JUDGE WALLIS: Very well, let's take that and
21 then consider a morning recess.

22 MR. FFITCH: I guess the first thing I would
23 like to do perhaps to streamline this is to again ask
24 Ms. Endejan if there is any objection to --

25 JUDGE WALLIS: Mr. Parker.

0099

1 MR. FFITCH: Mr. Parker, okay, I apologize,
2 to Mr. Parker. In looking at, let me get my numbers
3 correct here, Exhibits 5, 6, and 7, those were not
4 objected to in the original responses, and I'm not sure
5 it serves us to kind of go through the labor of
6 questioning to establish that those are responses to
7 data requests. Is there still an objection to those
8 three DR's, 5, 6, and 7?

9 MR. ROSEMAN: Exhibits 5, 6 and 7?

10 MR. FFITCH: Yeah, I apologize, it's Exhibits
11 5, 6, and 7, those are DR's 8, 32, and 36.

12 MR. PARKER: Your Honor, just with noting for
13 the record our previous objection to the total company
14 in Order Number 5, we have no objection to these
15 exhibits coming in.

16 JUDGE WALLIS: Very well, Exhibits 5, 6 and 7
17 are received.

18 MR. FFITCH: Now with regard to Exhibits 8
19 and 9, as I understand it the company did state
20 objections to those two requests, I believe that those
21 objections were along the lines of the objection that
22 was just argued, so perhaps with a similar comment for
23 the record from Mr. Parker those could be admitted too.
24 I'm just trying to figure out if we still have an
25 argument to have here on these 8 and 9.

0100

1 MR. PARKER: It would be the same objection
2 on Data Request Number 50 which is Exhibit 9.

3 On Exhibit 8, which is Data Request Number
4 49, there's just an additional objection for the record
5 is that it requests data all the way back to 1994, which
6 we deem totally irrelevant.

7 MR. FFITCH: Your Honor, it sounds like I
8 guess I need to inquire whether the Bench wants to hear
9 argument so it can rule on the objections or -- I'm not
10 sure if the company is agreeing to have these admitted
11 or whether we need to clear that up.

12 MR. PARKER: Standing objection to Exhibit
13 Number 9, and Number 8 I just stated the additional
14 objection that 1994 is irrelevant to this case.

15 JUDGE WALLIS: Exhibit 9 is received.

16 As to Exhibit 8, do you have a pithy
17 response, Mr. ffitich?

18 MR. FFITCH: Just give me one moment, Your
19 Honor.

20 MR. TROTTER: Your Honor, this is Staff
21 counsel, Ms. Folsom sponsors this same exhibit in her
22 testimony, so I prefer to be heard on it, because it may
23 prejudice the result of my offering her testimony and
24 exhibits at a later date.

25 JUDGE WALLIS: Mr. Trotter.

0101

1 MR. TROTTER: If necessary.

2 MR. FFITCH: Your Honor, I for Public Counsel
3 would just note that Dr. Vander Weide has argued that
4 with regard to the issue of equity infusions about
5 Verizon Northwest, to Verizon Northwest from the parent
6 company, and the significance of this DR going back to
7 '94 is to actually show the historical context for
8 equity infusion behavior by the parent with respect to
9 Verizon Northwest to sort of shed some light or allow us
10 to give some weight to sort of a narrower focus than
11 Dr. Vander Weide asks us to take.

12 JUDGE WALLIS: Mr. Trotter.

13 MR. TROTTER: I would just add to that, Your
14 Honor, there's two ways a company can get financing, one
15 is debt, the other is equity. On the other data
16 requests in this series and in Ms. Folsom's testimony
17 address the history on debt, and this goes to the
18 history on equity. I would agree, 1994 is probably
19 marginally relevant to this case, but that would go I
20 think just to the weight. But certainly, counsel is
21 objecting to the whole thing, but certainly it's
22 relevant to, highly relevant to more recent periods. So
23 I think the company can argue about the weight. I don't
24 think we will be arguing 1994 is particularly relevant
25 in this case.

0102

1 JUDGE WALLIS: Very well, the objection is
2 overruled, and Exhibit 8 is received as well.

3 Let's take a morning recess at this time of
4 15 minutes, and we will be back at about 5 after 11:00.

5 (Recess taken.)

6 JUDGE WALLIS: Let's be back on the record,
7 please, after our morning recess. The next examiner in
8 the previously determined order would be Mr. Roseman.
9 Do you have any questions?

10 MR. ROSEMAN: No, I don't, Your Honor.

11 JUDGE WALLIS: Then Mr. Melnikoff.

12 MR. MELNIKOFF: Thank you, Your Honor.

13

14 C R O S S - E X A M I N A T I O N

15 BY MR. MELNIKOFF:

16 Q. Good morning, Professor.

17 A. Good morning, Mr. Melnikoff.

18 Q. I just have a few questions to make some
19 clarifications in my mind about your testimony. If you
20 would go to 1T, page 9 of your direct testimony, lines
21 20 to 21, you state that Verizon Northwest's 2003
22 earnings with access reduction are insufficient to pay
23 even the interest on debt. Are you referring to Verizon
24 Northwest, the company that issued the debt, or
25 Verizon's Washington intrastate operation?

0103

1 A. I'm referring to Washington's intrastate
2 operations.

3 Q. Now Verizon Washington intrastate operations
4 doesn't or hasn't issued debt, correct?

5 A. That's correct, but they have been allocated
6 -- but it's possible to allocate interest to them, and
7 that's what I have done.

8 Q. And on what basis, what factor did you use to
9 allocate that interest?

10 A. Total plant in service.

11 Q. Do investment analysts use such a factor in
12 assessing a company's financial health?

13 A. Yes, they do. And indeed in the Olympic
14 Pipeline case plant was used as I recall to allocate
15 debt and hence interest to the intrastate jurisdiction
16 as opposed to the FERC jurisdiction.

17 Q. But investment analysts when they look at the
18 financial health of a debt issuing company, do they
19 allocate among and use plant in service as a factor in
20 that allocation to assess the company's health?

21 A. Well, they would look to what a reasonable
22 indicator would be of the debt cost for such a company,
23 and it would vary depending on what industry that
24 company was in what might be a reasonable indicator of
25 the level of company debt that could properly be

0104

1 assigned to that entity. For a telecommunications
2 company, plant in service is a very reasonable indicator
3 because plant in service is the largest investment that
4 the company has to make that requires financing, and so
5 the total financing, debt and equity, would be allocated
6 to jurisdictions primarily on the basis of plant in
7 service.

8 Q. On page 10, line 5 and 6, you state that
9 Verizon Northwest's earnings are clearly insufficient to
10 allow the company to invest in its network in Washington
11 state. Is that not correct?

12 A. Yes.

13 Q. Are you stating or implying that Verizon will
14 not make network investments in Washington if the
15 interim relief is denied?

16 A. No, I certainly am not authorized to speak on
17 behalf of Verizon, nor do I. That's a management
18 prerogative. I'm speaking as an economist and talking
19 about whether the earnings are sufficient to cover the
20 company's capital expenditures. And clearly since the
21 earnings coverage ratio is negative .7, the company's
22 earnings are insufficient to even pay its interest if
23 one looks only to earnings, and hence they would
24 certainly in addition be insufficient to cover capital
25 expenditures.

0105

1 Q. And in your mind, this insufficiency has been
2 occurring for how long?

3 A. I was mainly focusing on the current
4 situation. I guess one could determine it from the data
5 that I have if you would like me to look at the data,
6 but with regard to the current situation is what I was
7 focusing on. Do you want me to look at --

8 Q. If you could quickly look and give me an
9 approximation of how long that insufficiency as an
10 economist, as an economic principle has been existing?

11 A. Well, the company's earnings have been
12 insufficient to cover, in and of themselves, have been
13 insufficient to cover the capital expenditures in each
14 of the years of my study as shown on JHV-5. The story
15 is a little different with regards to cash flows, but
16 with regard to earnings, earnings are less than capital
17 expenditures in each of those years.

18 JUDGE WALLIS: For clarification of the
19 record, you're referring to what's been marked as
20 Exhibit 2?

21 THE WITNESS: Yes.

22 BY MR. MELNIKOFF:

23 Q. So I can take it from your answer that -- and
24 that would be -- that would suffice that for at least
25 going back to 2000, the year 2000, to the year ending

0106

1 September 30th, 2003, this insufficiency has existed?

2 A. It has existed, but the company could
3 struggle along. What is quite a dramatic difference is
4 2003, for the 12 months ending September 30, 2003, than
5 it is for the period prior to that, so for the period
6 2003 it took another step downward that certainly
7 required dramatic action.

8 Q. And to your knowledge, has the company
9 stopped any of its investment into Washington intrastate
10 operations?

11 A. I believe that that has been discussed in the
12 testimony of Mr. Banta. I wouldn't be the appropriate
13 witness to discuss that.

14 Q. To your knowledge, are they contemplating
15 stopping investment on any of the projects?

16 A. Again, I would refer you to Mr. Banta. I'm
17 not capable or I'm not in a position to be able to
18 discuss the company's plans.

19 Q. So the answer to both those questions is no
20 to your knowledge?

21 A. The answer is I don't know whether it's yes
22 or no.

23 Q. Prior to your writing that part of your
24 testimony, did you discuss pending and planned
25 Washington network investment plans with anybody at

0107

1 Verizon?

2 A. No.

3 Q. Have you conducted any analysis of what
4 network investment projects, if any, should be
5 discontinued during the pendency of this insufficiency
6 and particularly this proceeding if interim relief is
7 denied?

8 A. No, I have not.

9 Q. Going to your direct testimony, 1T, Exhibit
10 1T, page 5, line 13 through 16, as I understand it your
11 2003 data reflects the adjustments that Ms. Heuring made
12 to the book financial, financial data; is that correct?

13 A. Yes.

14 Q. Did you make any independent analysis of her
15 adjustments, the appropriateness of her adjustments?

16 A. No, I did not.

17 Q. Now one last point, in general as a financial
18 economist, does a company's ability to pay a continuous
19 and ever increasing dividend reflect positively on its
20 financial health in general?

21 A. Yes.

22 MR. MELNIKOFF: Thank you, I have no further
23 questions.

24 JUDGE WALLIS: Mr. Butler, you earlier
25 indicated you had no questions for the witness, is that

0108

1 still true?

2 MR. BUTLER: That's correct.

3 JUDGE WALLIS: Very well, are there questions
4 from the Bench?

5 CHAIRWOMAN SHOWALTER: Yes.

6 JUDGE WALLIS: Chairwoman Showalter.

7 CHAIRWOMAN SHOWALTER: Thank you.

8

9 E X A M I N A T I O N

10 BY CHAIRWOMAN SHOWALTER:

11 Q. I want you to clarify some terminology you
12 have used. If you could turn to Exhibit 3, page 7.

13 A. Yes, I'm there.

14 Q. And in lines 16 to 19 you have given an
15 economist's definition of subsidization in which prices
16 above long run average cost subsidize services that are
17 priced below long run average cost. And I'm just
18 wondering what is the term, if there is one, for a
19 company that is earning below long run average cost in
20 general, but there is a disproportionality within
21 jurisdictions? Supposing some are lower than others is
22 what I'm wondering, is that not subsidization, or is it
23 another term?

24 A. Certainly in the everyday use of the word,
25 that would be subsidization. Economists don't always

0109

1 use words exactly the same way that people would in an
2 ordinary situation. So I was giving the economic
3 definition, and I was particularly highlighting the fact
4 that it's irrelevant whether the rate setting process is
5 independent of each other, as Mr. King was suggesting.
6 But I believe that in a situation where the percentage
7 of earnings, even though the whole company was earning
8 less than its required return, but where the percentage
9 of earnings from one jurisdiction in relationship to
10 revenues say were much higher than that in another, the
11 average person would say that yes, that was a
12 subsidization.

13 Q. All right. And then in another part of your
14 questioning here I think you said that the revenues from
15 different jurisdictions ought to add up to suffice for a
16 company's operations. Do you recall when you were --

17 A. No, I don't recall that.

18 Q. I think it was with respect to a question
19 from Mr. Trotter. Well, I can change my question.

20 The question I am wondering is what happens
21 if there are different regulatory regimes, for example
22 rate based rate of return in one state and say
23 performance base or price cap regulation in another
24 state. While one would want I suppose there to be
25 sufficient revenues overall for the company to maintain

0110

1 itself, isn't it possible that the result of three
2 different states' regulatory regimes as applied would
3 add to more or less than some theoretical 100%?

4 A. Yes, it is. There isn't some super
5 regulatory agency that guarantees that the company will
6 earn its rate of return across all jurisdictions, and so
7 each state regulatory agency really has to focus in my
8 opinion on the revenues and the expenses that are under
9 its jurisdiction. And that's why as an economist I
10 think it's a very reasonable thing to focus specifically
11 on Washington intrastate operations, because that's
12 really all that can be controlled by the Commission. It
13 can't set rates in other jurisdictions, and so its
14 responsibility is primarily related to the revenues and
15 the expenses in its jurisdiction, in its own
16 jurisdiction.

17 Q. Could you turn to page 8 of Exhibit 3.

18 A. Yes.

19 Q. You may have done this elsewhere in your
20 testimony, but can you define what operating margin is?

21 A. Yes. If you look at table 1 on page 8,
22 operating margin is net operating income, which is shown
23 in column 2, divided by revenues, which is shown in
24 column 1. So the 11%, for example, for Washington in
25 line 2 would be \$73,122 divided by \$678,809.

0111

1 Q. All right.

2 A. And that's usually -- that's a very common
3 term, it's basically the operating income earned on your
4 revenues.

5 Q. Okay. And looking at that table 1, do you
6 agree that it's important to make the appropriate
7 allocation between interstate and intrastate, and in
8 this case for example lines 6 and 7?

9 A. I'm trying to understand the question, what
10 you mean by make the appropriate allocation. I didn't
11 -- that allocation was based on the FCC's rules for
12 allocating expenses to the interstate and intrastate
13 jurisdictions. Revenues are basically directly assigned
14 because they don't really have to be allocated. So the
15 appropriate allocation is the one that complies with the
16 FCC's guidelines for allocating expenses between
17 interstate and intrastate.

18 Q. Have you been a witness in other interim
19 requests for relief?

20 A. No, I have not.

21 CHAIRWOMAN SHOWALTER: I have no further
22 questions, thank you.

23 JUDGE WALLIS: Commissioner Hemstad.

24

25

0112

1 E X A M I N A T I O N

2 BY COMMISSIONER HEMSTAD:

3 Q. Pursuing that last question from Chairwoman
4 Showalter, it was an area where I was going to explore
5 the matter further with you. Is it your view from your
6 overall testimony, which looking at the purpose of your
7 testimony was to consider whether intrastate operations
8 in Washington had an investment grade credit rating and
9 would be able to attract capital, but is it your view
10 that the company here is entitled to interim relief?

11 A. Yes, it is.

12 Q. And what is your understanding of what
13 interim relief means or when it will be granted?

14 A. It's my understanding that there are a lot of
15 factors that should be considered, and especially one
16 ought to consider the individual circumstances. But I
17 was focusing on the financial health of the company as
18 judged by its credit standing and its ability to pay the
19 interest and principal on its debt and meet its capital
20 expenditure requirements. And if the company on its
21 intrastate operations on a stand-alone basis, which is
22 all that can be regulated, is in a financially poor
23 health, that is its credit standing would justify below
24 investment grade credit rating, that it should have
25 interim rate relief in order to restore it to financial

0113

1 health until its rate request could be evaluated in a
2 rate case.

3 Q. Have you done any independent analysis of the
4 books of the company, or have you simply accepted as
5 fact that which has been provided to you by the company?

6 A. I haven't done an independent assessment of
7 the books of the company. I have looked at the
8 quarterly surveillance reports filed with the
9 Commission, and I have looked at the results of
10 operations for the 12 months ending 2003 as reported in
11 the testimony of Ms. Heuring.

12 Q. Considering this as a hypothetical, if after
13 the adjudicative process here it is determined that the
14 statement of the company's earnings level needs to be
15 adjusted and in fact the company had positive earnings
16 rather than the negative earnings as it's your
17 understanding, if they were positive even though low,
18 that would not constitute subsidization by other
19 jurisdictions, would it, in the sense that an economist
20 uses the term?

21 A. I believe it would constitute subsidization.
22 It's not a -- the issue isn't whether they're positive
23 or negative. The issue is whether the other
24 jurisdictions are contributing much more substantially
25 to cover the company's expenses than is this

0114

1 jurisdiction, and one indicator of that is the rate of
2 return. So that if we would -- if the company were
3 earning say 1% or 2% but just above zero, a positive
4 amount just above zero but a small amount, certainly
5 less than the company's allowed rate of return of 9.76%,
6 and it were earning -- and in other jurisdictions it
7 were earning 9.76% let's say for the sake of the
8 discussion, I would say that the other operations were
9 subsidizing intrastate operations here. It's not a
10 question of whether it's negative or positive, it's a
11 question of is the company in a financial situation of
12 very poor health.

13 Q. Well, I thought, maybe I have been in error
14 for a long time here, but I thought a subsidy occurs
15 only, a cross-subsidy occurs only when one product is
16 being sold below its cost?

17 A. Yes, but one of those costs is the cost of
18 capital, so that when we say below cost as an economist,
19 we really mean earning -- it's similar to saying earning
20 less than your allowed rate of return. Because if the
21 cost of capital is 9.76 or 12.03, depending on whether
22 we're looking at the allowed or the forward looking,
23 that's one of the costs of the company's operations.

24 Q. Well, is it your testimony then that any time
25 a company is earning less than its allowed rate of

0115

1 return and it has multiple jurisdictions that there is a
2 cross-subsidy occurring?

3 A. The economist definition is forward looking,
4 and one would have to look at the individual case if
5 we're looking at accounting data as opposed to long run
6 incremental cost. So economists wouldn't necessarily
7 jump immediately to the conclusion that one jurisdiction
8 is subsidizing another just because you're earning a
9 little bit less than your allowed rate of return. One
10 would have to investigate it further. It would be an
11 indicator, however, of something that should be examined
12 further.

13 With regard to this case, my primary task was
14 not to determine subsidization, but to determine
15 financial health. And I don't -- I think all the
16 witnesses in this proceeding agree that the company is
17 earning significantly less than its allowed rate of
18 return and that its cash flows have declined very
19 significantly and that its coverage ratios if considered
20 on a stand-alone basis would be very low.

21 Q. Well, that gets us back to the issue of the
22 circumstances within which interim relief would be
23 granted. Would you characterize the company and its
24 Washington intrastate operations as having an emergency?

25 A. Yes, I would view them as in a financial

0116

1 emergency in the sense that their bonds, if they were
2 considered on a stand-alone basis, would be below
3 investment grade, and that's a financial emergency as
4 viewed by the financial community.

5 Q. And so serious that a remedy that would be
6 available in May of 2005 is inadequate?

7 A. Yes, May of 2005 is a long ways away in terms
8 of the company's ability to meet its interest payments
9 and meet its capital expenditure requirements when one
10 considers the general trend that the company's revenues
11 and earnings are declining.

12 Q. Well, on a short-term basis, not long-term
13 but short-term basis, is the cash flow from Washington
14 intrastate operations incapable of meeting its
15 operational costs?

16 A. In my opinion, if one were to look ahead nine
17 months or ten months or a year --

18 Q. We're not looking that far ahead, we're
19 looking between now and May of 2005.

20 A. Well, that's why -- I have a hard time doing
21 the arithmetic, but I thought that might be about nine
22 months. This is what, August.

23 Q. Maybe you're right, okay, your arithmetic is
24 better than mine.

25 A. It's quick arithmetic, which isn't always

0117

1 perfectly accurate.

2 But my view is that yes, given the decline in
3 their cash flows and given the decline in their revenues
4 and their earnings, they would be a significant risk for
5 covering their basic operating expenses including their
6 capital expenditures.

7 COMMISSIONER HEMSTAD: That's all I have,
8 thank you.

9 JUDGE WALLIS: Commissioner Oshie.

10 COMMISSIONER OSHIE: Yes.

11

12 E X A M I N A T I O N

13 BY COMMISSIONER OSHIE:

14 Q. Mr. Vander Weide, I don't think in your
15 testimony that you have offered your definition of the
16 term gross inequity as used in our order, as used in the
17 PNB elements, and do you have or can you proffer to us
18 your opinion of what constitutes a gross inequity or a
19 definition of that term?

20 A. Well, I certainly have some intuitive ideas
21 of what a gross inequity is. It seems to me a gross
22 inequity at the very least would be a situation where
23 the company is not able to meet its obligations on an
24 intrastate basis so that customers in other states were
25 being asked to contribute to its financial health, and

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1 it's during the interim period.

2 Q. Now do you only look at the other states as a
3 whole, or do you look at -- or would your definition
4 include looking at one state compared for example in
5 this situation to Washington intrastate? Could we look
6 only at Oregon and Washington to determine whether there
7 was some inequity between the returns to the company in
8 Oregon and Washington alone?

9 A. I guess one could. I didn't. I looked at
10 all jurisdictions, inter and intra and between various
11 states, to determine whether customers in other
12 jurisdictions were contributing to the ability of
13 Washington intrastate operations to meet its
14 obligations, including its capital expenditures.

15 Q. Hypothetically, would it matter to you when
16 you look at -- when you do the analysis as to how the
17 company has gotten into or has -- let me restate that.

18 Does it matter whether decisions of the
19 company have affected the revenue and earned return?

20 A. I'm sorry, let me --

21 Q. Maybe I can restate that.

22 A. Okay.

23 Q. If the company's -- if the company that the
24 decision -- if the decision that the company made has
25 affected its return negatively, does that change your

0119

1 analysis as to whether a gross inequity is present
2 between this Washington intrastate and Verizon Northwest
3 as a whole?

4 A. I have a difficult time understanding the
5 situation without a particular decision in mind. Do you
6 have a particular decision in mind?

7 Q. Let's look at let's say for example Verizon,
8 the decision to -- let's say that Verizon has -- Verizon
9 Washington intrastate does not get credit for directory
10 revenues, and that was a decision that the company made
11 to forgo that opportunity and to allow, I don't know
12 whether it's Verizon Northwest or Verizon, excuse me,
13 Communications, to receive the revenues from the
14 directory business. Now that's a decision that the
15 company made. It's affecting the bottom line of
16 Washington intrastate. Does that make a difference to
17 you when you analyze its financial situation to
18 determine whether we should grant relief in this
19 situation if we find that there's gross inequity?

20 A. Well, first let me say I don't have an
21 opinion on whether it was a company decision or not, but
22 accepting the premise of the question, I would note that
23 the other witnesses that I have reviewed imputed revenue
24 to the company's operations, and that even imputing that
25 directory assistance revenues, their rates of return

0120

1 were 1% or 2%. And the financial ratios would not be
2 significantly improved if the rate of return were only
3 1% or 2%. So it seems to me that whether directory
4 revenues were or were not imputed, and I don't have an
5 opinion, I'm not here to testify on whether they should
6 be or should not be, would not affect my analysis of
7 their financial health, because it has very little
8 impact on their rate of return.

9 Q. And if it, let's say hypothetically that the
10 impact of directory revenues would have resulted in a
11 rate of return of let's say 7% compared to the other
12 jurisdictions let's say earning in your situation the
13 9.76% you said as an example, is that a gross inequity?

14 A. I believe I would have to examine that on an
15 individual basis. I haven't examined that.

16 Q. But in your opinion, the roughly 2% earnings
17 in Washington if you imputed the directory revenues as
18 compared to the other jurisdictions, let's say the
19 example 9.76%, that was a gross inequity?

20 A. Well, it was a gross --

21 Q. Or it would be, excuse me.

22 A. It was a gross inequity because not only were
23 the other states or other jurisdictions, I keep saying
24 states when I mean jurisdictions, the other
25 jurisdictions had a far higher operating margin than

0121

1 Washington intrastate, but also because Washington
2 intrastate was in very poor financial health, and a rate
3 of return of 1% or 2% would not improve their financial
4 health significantly to put them above investment grade.

5 I haven't examined what a rate of return of
6 7% would do, whether that would be just sufficient to
7 put them above investment grade or not, so I haven't
8 examined that particular rate of return. It could be,
9 however, that there was still some subsidy at 7% because
10 the rate of return was still considered less than their
11 allowed rate of return, and it could have been less than
12 the returns in other states. Whether that was a gross
13 inequity, I don't know.

14 But I do feel comfortable that at the company
15 -- at the company's return as it has described it in the
16 testimony of Ms. Heuring and in its quarterly financial
17 reports and even in the testimonies of other witnesses
18 that that would still constitute a gross inequity in my
19 opinion.

20 COMMISSIONER OSHIE: I don't have any further
21 questions, thank you.

22 COMMISSIONER HEMSTAD: I have one follow up.

23

24

25

0122

1 E X A M I N A T I O N

2 BY COMMISSIONER HEMSTAD:

3 Q. Is it your view then that take a freestanding
4 company in a single jurisdiction with a below investment
5 grade rating in any general rate case proceeding would
6 automatically be entitled to interim relief?

7 A. I think one would have to look at their rate
8 of return as well, if their rate of return were low and
9 they were in well below investment grade.

10 Q. Well, what do you mean by well below, let's
11 say one notch below.

12 A. All right, well, let me define what I mean by
13 well below. If the interest coverage ratio is negative
14 0.7, that's well below investment grade. If it's one
15 notch below, one would have to consider whether -- what
16 their ability was to pay the interest on their -- and
17 principal on their debt, pay their operating expenses
18 and meet their capital expenditures and continue to
19 provide service on an intrastate stand-alone basis.

20 Q. Okay, so my layman's translation of that,
21 would one be looking at cash flow in their ability to
22 meet their expenses as they fall due pending the outcome
23 of the general rate case?

24 A. That would certainly be one of the factors
25 one would consider, yes. And in my opinion, the cash

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1 flow is inadequate at the present time to do that when
2 one considers the downward trend in revenues and
3 operating income.

4 COMMISSIONER HEMSTAD: Thank you.

5 JUDGE WALLIS: Is there redirect?

6 MR. PARKER: Just a few, Your Honor.

7

8 R E D I R E C T E X A M I N A T I O N

9 BY MR. PARKER:

10 Q. Doctor, could I turn you to page 12 of
11 Exhibit 1T, please.

12 A. Yes.

13 Q. Given your intrastate analysis, what is your
14 conclusion as to what the bond rating would be out of
15 all those set forth on the top of page 12?

16 A. I conclude that the company would have a bond
17 rating of BB, which is below investment grade.

18 Q. And the bond rating if this commission were
19 to grant the amount requested would be what?

20 A. Just barely into the BBB category, which is
21 just barely above investment grade.

22 Q. Now Mr. Trotter cross-examined you regarding
23 EBIT; is that correct?

24 A. Yes.

25 Q. All right. Now the EBIT for a BBB bond

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1 rating is 3.9; is that correct?

2 A. Yes, it is.

3 Q. And the EBIT given the interim amount
4 requested would be what?

5 A. 0.6.

6 Q. Would you explain to the Commission why in
7 your opinion that that .6 EBIT interest coverage would
8 likely lead to a BBB bond rating?

9 A. Yes. Well, one of the most important factors
10 that bond rating looks -- bond rating agencies look at
11 is the trend in financial ratios. And they also,
12 although EBIT is to me the most significant, it's not
13 the only financial ratios. So if the company, even
14 though the company would have an EBIT of 0.6, which
15 would be a real negative in terms of investment grade,
16 they would look at the fact that the trend was no longer
17 downward, it would be about level over the last several
18 years, maybe slightly downward but not as dramatically
19 downward. And they would look to the fact that the
20 EBITDA interest coverage in the funds from operations to
21 total debt were slightly above the BBB rating. So
22 looking at all of those factors and looking at as well
23 the Commission's awareness that through the granting of
24 interim relief that the company was in financial ill
25 health, that they would probably grant it an investment

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1 grade rating.

2 Q. All right. Changing subjects on you, Doctor,
3 you and Mr. Trotter discussed dividend payments and
4 whether you could tell him whether a dividend was paid
5 in 1999; do you recall that?

6 A. Yes, I do.

7 MR. TROTTER: I will object to the question.
8 The question was actually whether a dividend was paid
9 from Washington intrastate operations in 1999.

10 MR. PARKER: I appreciate that, so corrected.

11 BY MR. PARKER:

12 Q. Do you recall that?

13 A. Yes, I do.

14 Q. Has the company provided to the Staff in data
15 requests the same cash flow analysis for 1999 through
16 2002 that is contained in your testimony for 2003?

17 A. Yes, it has.

18 Q. And are there any conclusions that can be
19 drawn from that cash flow analysis that was provided?

20 A. One could conclude that the company would
21 have had the ability to pay some dividends in 1999 and
22 in 2001 and 2002. In 2000 they had actually negative
23 cash flows. So they would have had the ability to pay
24 some dividends as long as they had also met the
25 company's dividend policy, which is that before a

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1 dividend can be made, the company has to make sure that
2 its service -- it meets its service quality standards
3 and that it is able to -- that it makes the required
4 capital expenditures to provide safe and reliable
5 service.

6 Q. Now there's been some discussion here today,
7 Doctor, about allocation of interest down to the
8 intrastate jurisdiction. Do you recall that?

9 A. Yes, I do.

10 Q. And you and Mr. Trotter discussed the Olympic
11 Pipeline case; is that correct?

12 A. Yes.

13 Q. And was there an allocation of interest in
14 that case?

15 A. Yes, there was.

16 Q. And what entity proposed that allocation of
17 interest?

18 A. It was the Staff that proposed that
19 allocation.

20 Q. Doctor, does Verizon have an existing
21 authorized rate of return?

22 A. Yes, it does.

23 Q. What is that number?

24 A. 9.76%.

25 Q. During cross-examination of Public Counsel,

0127

1 you discussed average cost. Can you tell me what you
2 meant by the term average cost?

3 A. Yes, average cost is used by economists in a
4 forward looking sense, and it would be the total cost of
5 the company's operations on a going forward basis
6 divided by the number, by some indicator of the number
7 of units of service that they provided, the number of
8 units of output as an economist would say. So that
9 would be the average cost on a forward looking basis.

10 Q. Would loop lengths that are different from
11 one jurisdiction to another jurisdiction change the cost
12 between the two states?

13 A. Yes, one of the biggest factors affecting
14 costs is customer density, and another factor is
15 geography, and so the loop length would be a factor that
16 had fairly dramatic impact on cost, average cost.

17 Q. Finally, Dr. Vander Weide, a few questions on
18 some inquiries from the Bench, do you know whether or
19 not this Commission has granted interim rate relief to a
20 utility with a 7% ROR?

21 A. No, I don't.

22 MR. PARKER: All right, I have nothing
23 further, thank you.

24 JUDGE WALLIS: Is there recross?

25 MR. TROTTER: I just have a few, Your Honor.

0128

1 R E C R O S S - E X A M I N A T I O N

2 BY MR. TROTTER:

3 Q. Dr. Vander Weide, you spoke about the
4 company's dividend policy and you spoke about service
5 quality standards and capital expenditure requirements;
6 do you recall that?

7 A. Yes.

8 Q. Did Verizon -- and those are requirements of
9 Verizon Northwest total company; is that right?

10 A. I believe those are requirements of Verizon
11 Communications.

12 Q. I mean but they're applicable to Verizon
13 Northwest total company, correct?

14 A. Yes.

15 Q. And did Verizon Northwest total company meet
16 those standards in 1999, 2001 and 2002?

17 A. Yes.

18 Q. And can you tell us what amount of net income
19 from Verizon Northwest Washington intrastate was paid in
20 the form of a dividend in whole or in part to Verizon
21 Communications in those years?

22 A. I believe we covered that earlier in our
23 cross-examination, I answered no. Because we can't
24 identify dividends specifically, we can only identify
25 the ability to pay dividends from cash flows.

0129

1 Q. Okay. Now with respect to the Olympic
2 Pipeline case, you said there was an allocation of
3 interest.

4 A. Yes.

5 Q. Do you recall that?

6 A. Yes, I do.

7 Q. And that was in the general rate case phase
8 of that case and not in the interim rate case phase of
9 that case; isn't that true?

10 A. I believe it was in the interim phase of the
11 case.

12 Q. Okay, what document are you referring to?

13 A. I am referring to an order in Docket Number
14 TO-011472.

15 Q. And what is the number on that order?

16 MR. PARKER: I will help out, it's the Third
17 Supplemental Order granting interim relief in part.

18 MR. TROTTER: Okay, thank you, nothing
19 further.

20 JUDGE WALLIS: Are there further questions?

21 MR. FFITCH: Just a couple, Your Honor.

22 JUDGE WALLIS: I would point out that we are
23 going to have to break relatively close to noon.

24 MR. FFITCH: I think I will be done, Your
25 Honor.

0130

1 JUDGE WALLIS: Excellent, thank you.

2

3 R E C R O S S - E X A M I N A T I O N

4 BY MR. FFITCH:

5 Q. Dr. Vander Weide, you were asked by
6 Commissioner Hemstad if the company had an emergency,
7 and you said yes, it did. Is your testimony with regard
8 to Verizon Northwest the company or with regard only to
9 the intrastate portion of the company?

10 A. It's regard to the intrastate portion of the
11 company.

12 Q. All right. And so when you in that line of
13 questioning used the word company, you're not referring
14 to an actual company, correct, you're just referring to
15 the intrastate portion of the larger Verizon Northwest
16 corporate entity, correct?

17 A. Yes, I state that right at the beginning of
18 my direct testimony, that I'm going to be considering
19 the Verizon intrastate operations as on stand-alone
20 basis.

21 Q. Right. So when you used the word company in
22 response to those questions with regard to an emergency,
23 you weren't actually speaking about a company, were you,
24 any real existing company, correct?

25 A. Correct.

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1 MR. FFITCH: That's all the questions I have,
2 thank you.

3 JUDGE WALLIS: Is there anything further?

4 MR. PARKER: Nothing further, Your Honor.

5 JUDGE WALLIS: Very well, Dr. Vander Weide,
6 thank you very much for appearing today, you're excused
7 from the stand at this time.

8 We will be in recess until 1:30 and take up
9 then with the questioning of the next witness.

10 MR. PARKER: Your Honor, just so I don't get
11 in trouble, we had planned to put Dr. Vander Weide on a
12 plane in the morning, is he excused all the way or just
13 part of the way?

14 CHAIRWOMAN SHOWALTER: Kansas.

15 JUDGE WALLIS: Is there any desire to have
16 Dr. Vander Weide available?

17 It appears that there is no need for him to
18 remain, so he may catch his plane and proceed to
19 wherever he needs to proceed to.

20 MR. PARKER: Thank you.

21 (Luncheon recess taken at 12:00 p.m.)

22

23

24

25 A F T E R N O O N S E S S I O N

0132

1 (1:30 p.m.)

2

3 JUDGE WALLIS: We're resuming today's session
4 with Verizon calling its next witness, who is Nancy W.
5 Heuring.

6 Ms. Heuring, would you please stand and raise
7 your right hand.

8 (Witness Nancy W. Heuring was sworn.)

9 JUDGE WALLIS: In conjunction with
10 Ms. Heuring's appearance, a number of documents have
11 been identified, presented as possible exhibits in this
12 proceeding, they are Exhibits 21T through 49, and I will
13 note that Exhibit Numbers 35 and 40 have no documents
14 assigned to them. I will ask the court reporter to
15 identify those for the record at this point in the
16 transcript.

17 (The following exhibits were identified in
18 conjunction with the testimony of NANCY W.
19 HEURING.)

20 (Verizon)

21 21T NWH-7T, Direct testimony (5pp)

22 22 NWH-8, Washington Intrastate Results of
23 Operations & Revenue Requirement (2pp)

24 23T NWH-9T, rebuttal testimony (14pp)

25 24 NWH-10, Verizon NW financial results, 12

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1 months 2003 (1pg)
2 25 NWH-11, Verizon WA IAS Results & Revenue
3 Requirement, adjusted (2pp)
4
5 26 NWH-12, Verizon WA IAS 1999-2003, restated
6 (1pg)
7 (Staff)
8 27 Verizon Response to Staff DR No. 207,
9 Attachment 207a (excerpt), (5pp)
10 28 Verizon Response to Staff DR No. 21, (2pp)
11 29 Verizon Responses to Staff DR No. 66 (4pp)
12 30 EXCERPT from CONFIDENTIAL Verizon Corporation
13 and Subsidiaries Income Statement -
14 Consolidated - Year-to-date for period
15 December 03 (3pp)
16 31 Verizon Response to Staff DR No. 69 (2pp)
17 32 Verizon Response to Staff DR No. 70 (2pp)
18 33 Verizon Workpaper No. C 6.1.3.
19 34 Verizon Workpaper No. C 6.1.3.1.
20 (Public Counsel)
21 36 Verizon access lines, 1999-2003 (10pp)
22 37 Verizon response to Staff DR No. 20 (3pp)
23 38C Verizon response to PC DR No. 6 (CONFIDENTIAL,
24 6pp)
25 39 Verizon response to PC DR No. 7 (1pg)

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1 (Staff)

2 41C Verizon response to Staff DR No. 72 (6pp incl
3 CONFIDENTIAL att. 72, 2pp)

4 42 Verizon response to Staff DR No. 77 (3pp)

5 43 Verizon response to Staff DR No. 86 (9pp)

6 44 Verizon response to Staff DR No. 97 (1pg)

7 45 Excerpts from Verizon NW 2003 annual report
8 (4pp)

9 (Public Counsel)

10 46 Form 10K excerpt (3pp)

11 (Staff)

12 47C Verizon response to Staff DR No. 92 (1pg)

13 CONFIDENTIAL

14 48 Verizon response to Staff DR No. 95 (1pg)

15 49 Verizon response to Staff DR No. 96 (1pg)

16

17 JUDGE WALLIS: Ms. Endejan.

18 MS. ENDEJAN: Mr. Parker.

19 JUDGE WALLIS: Mr. Parker.

20 MR. PARKER: Thank you.

21

22

23

24

25

0135

1 Whereupon,

2 NANCY W. HEURING,

3 having been first duly sworn, was called as a witness

4 herein and was examined and testified as follows:

5

6 DIRECT EXAMINATION

7 BY MR. PARKER:

8 Q. State your name for the record, please.

9 A. Nancy W. Heuring.

10 Q. And by whom are you employed, Ms. Heuring?

11 A. By Verizon.

12 Q. Business address, please.

13 A. 600 Hidden Ridge, Irving, Texas.

14 Q. And do you have before you, Ms. Heuring, what

15 has been marked as 21T, which is your direct testimony

16 consisting of five pages?

17 A. Yes, I do.

18 Q. Do you have Exhibit 22, which is an exhibit

19 to your direct testimony?

20 A. Yes, I do.

21 Q. Do you have Exhibit 23T, which is your

22 rebuttal testimony consisting of 14 pages?

23 A. Yes.

24 Q. And do you have Exhibits 24, 25, and 26,

25 which are exhibits to your rebuttal testimony?

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1 A. Yes, I do.

2 Q. Are there any additions, corrections, or
3 deletions that need to be made to those documents at
4 this time?

5 A. No.

6 Q. Are they true and correct to the best of your
7 belief and knowledge?

8 A. Yes.

9 MR. PARKER: I would offer those exhibits,
10 Your Honor, and the witness is available for
11 cross-examination.

12 JUDGE WALLIS: Is there objection to the
13 receipt of those documents?

14 Let the record show that there is no
15 response, and Exhibits 21T through 26 are received in
16 evidence.

17 Mr. Trotter.

18 MR. TROTTER: Yes, Your Honor, and I advised
19 Ms. Heuring and her counsel before we started that some
20 of my first questioning will be in relation to Exhibit
21 143, which may be in a different notebook for various
22 people in the room, so I would offer you the opportunity
23 to turn to that exhibit. I believe it will be on page 4
24 of that exhibit.

25 JUDGE WALLIS: Please hold on until we're all

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1 on the same page. That was Exhibit 143?

2 MR. TROTTER: Yes.

3 JUDGE WALLIS: And page?

4 MR. TROTTER: 4.

5 JUDGE WALLIS: 4.

6

7 C R O S S - E X A M I N A T I O N

8 BY MR. TROTTER:

9 Q. Now I will get to that in just one moment,
10 but, Ms. Heuring, in your direct testimony, Exhibit 21T,
11 you observe on page 5 that the company's Washington
12 intrastate return as filed with this Commission in the
13 quarterly surveillance report has consistently been
14 below 2.5% since early 2002; is that correct?

15 A. Could you tell me where you are again?

16 Q. 21T, page 5, lines 1 to 2.

17 A. Yes, that's correct.

18 Q. And these quarterly surveillance reports are
19 the quarterly compliance reports, that's the title of
20 them; is that right?

21 A. That's correct.

22 Q. Now turn to Exhibit 143, page 4, and you have
23 seen this exhibit before, have you not?

24 A. I believe it's an exhibit to Ms. Strain's
25 testimony.

0138

1 Q. And the top half of that exhibit represents
2 the Washington intrastate revenues, expenses, and rate
3 base as reported from the quarterly compliance reports
4 from the company; is that correct, is that your
5 understanding?

6 A. Yes.

7 Q. And would you accept that the rate of return
8 reported by the company for 1996 was 11.01%, for 1997
9 11.86%, 1998 10.95%, and 1999 12.50%?

10 A. Those numbers reflect the numbers that were
11 reported on our quarterly surveillance report, that's
12 correct.

13 Q. And in each of those years the company earned
14 in excess of the return that was authorized in the last,
15 in the prior rate case?

16 A. In each of those years, yes, the actual
17 reported return was in excess of the 9.76% that's
18 authorized.

19 Q. Now I would like to turn to your Exhibit 22,
20 and am I correct that page 1 of this exhibit is your
21 analysis that leads to your conclusion that return on
22 rate base for the test year with the adjustments that
23 you have made for purposes of the interim case is
24 negative .47%?

25 A. Yes, this analysis is a summary, or this

0139

1 exhibit is a summary of the analysis that gets to that
2 conclusion.

3 Q. Referring to line 16 for depreciation, you
4 show \$124,692,000?

5 A. Yes.

6 Q. And depreciation is a non-cash expense, that
7 is it is an expense that does not represent a current
8 outlay of cash from the company; is that correct?

9 A. That's correct.

10 Q. I would like you to now return to your
11 rebuttal testimony, Exhibit 23T, page 5, and on line 17
12 you're asked a question about Ms. Folsom's comment that
13 Verizon Northwest does not maintain or make available
14 its financial statements on a Washington intrastate
15 basis. Do you see that question?

16 A. Yes, I do.

17 Q. And you say that she's incorrect; is that
18 right?

19 A. Yes.

20 Q. I would like you to turn to Exhibit 144,
21 please.

22 A. And what is that again? Is it the same one
23 we were looking at?

24 Q. It's the one right after.

25 A. Okay.

0140

1 Q. And I'm going to focus on page 6 of that
2 exhibit. It's the company response to Staff Data
3 Request 276.

4 A. So this is PMS-4?

5 Q. Yes.

6 CHAIRWOMAN SHOWALTER: Mr. Trotter, can you
7 slow down just a little bit.

8 THE WITNESS: It would help.

9 BY MR. TROTTER:

10 Q. I'm on Exhibit 144, the last page of that
11 exhibit, and do you recognize this as the company's
12 response to Staff Data Request 276?

13 A. Yes, I do.

14 Q. And that data request asked you in part, I'm
15 focusing on part E, to provide a balance sheet and
16 income statement matching the test period for each of
17 the following entities, and the entity in E is Verizon
18 Northwest, Inc., Washington intrastate operations; is
19 that right?

20 A. Yes.

21 Q. Would you please read your response to item
22 E?

23 A. Yes, the response is, income statement and
24 balance sheets are not maintained at an intrastate
25 level, which obviously is an incorrect statement.

0141

1 Q. And, in fact, you did not produce any --

2 CHAIRWOMAN SHOWALTER: I'm sorry, did you say
3 obviously is an incorrect or a correct?

4 THE WITNESS: Incorrect.

5 BY MR. TROTTER:

6 Q. And, in fact, you did not supplement this
7 response with a correct response, did you?

8 A. We have not supplemented this response yet,
9 but the actual intrastate operations income statements
10 and balance sheets are on file with the Commission for
11 all of the time periods, including the test period.

12 Q. They're on file with the Commission?

13 A. Right.

14 Q. And under what filing are those filed with
15 the Commission?

16 A. Well, for example, the income statement on
17 intrastate basis is the same as the quarterly
18 surveillance report, which we referred to previously in
19 Ms. Strain's exhibits. And then the balance sheet, we
20 maintain the balance sheet for the rate base items,
21 which we also file as part of our quarterly surveillance
22 report.

23 Q. So you consider the quarterly compliance
24 report to be an income statement and a balance sheet?

25 A. For the intrastate Washington operations,

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1 yes. And as I mentioned, on the balance sheet side we
2 just maintain the rate base items, we don't maintain,
3 you know, cash or accounts receivable or accounts
4 payable. But it's the balance sheet items that are
5 applicable to the intrastate jurisdiction for
6 surveillance reporting.

7 Q. Would you please turn to Exhibit 27.

8 Before we talk about that exhibit, when do
9 you plan to supplement your response to Exhibit 276?

10 A. We can do it as soon as this proceeding is
11 done.

12 Q. This response is dated June 22, 2004, is it
13 not?

14 A. I have actually turned the page, so I don't
15 know what the date was.

16 Q. Would you accept that?

17 A. But if you're reading it off the document, I
18 accept that.

19 Which exhibit are you asking me to look for
20 now?

21 Q. 27.

22 A. Thank you.

23 Okay.

24 Q. Do you recognize Exhibit 27 as an excerpt
25 from Verizon's response to Staff Data Request Number

0143

1 207?

2 A. Yes, I do.

3 Q. Now these are pages 3 to 5 from Verizon
4 Northwest, Inc.'s financial statements as of December
5 31st, 2003?

6 A. Yes.

7 Q. Turn to page 3 of the exhibit, and this is
8 the consolidated statements of income. Am I correct
9 that the company does not maintain interest expense and
10 other income and expense net on a Washington intrastate
11 basis?

12 A. So you're referring to the line that says
13 interest expense and other income and expense?

14 Q. Net, yes.

15 A. And your question is again?

16 Q. You do not maintain those values, those
17 items, on a Washington intrastate basis?

18 A. Well, the values are maintained at a
19 Washington basis, and then we use separation factors to
20 determine the amount of interest that's applicable to
21 the intrastate jurisdiction, for example for a tax
22 calculation in accordance with Part 36 rules.

23 Q. Turn to page 4, consolidated balance sheet,
24 assets. Am I correct that the only items on this page
25 that are reported to the UTC on an intrastate basis are

0144

1 property, plant, and equipment, prepaid pension asset,
2 and deferred income taxes?

3 A. We would also report the other long-term
4 liabilities and other jurisdictional liabilities and
5 deferred credits which roll into -- oh, these are the
6 assets, I'm sorry. For assets that would be correct,
7 yes.

8 Q. So none of the other line items on page 4
9 would be maintained on a Washington intrastate basis?

10 A. That is correct.

11 Q. Let's go to your Exhibit 26, and this is an
12 exhibit that's related to your rebuttal testimony,
13 correct?

14 A. Yes, it is.

15 Q. And the purpose of this exhibit was to supply
16 information that was contained in your workpapers and
17 direct testimony explaining certain fluctuations in the
18 company's revenues and expenses over recent years; is
19 that right?

20 A. Yes, and in addition, as I state in my
21 testimony, we added the years 1999 and 2000 over and
22 above what was in my workpapers.

23 Q. With respect to columns D and E, 2001
24 intrastate restated and 2002 intrastate restated, and
25 then column F, test year intrastate restated, those

0145

1 three columns reflect figures -- let me start over.

2 With columns B and C for 1999 intrastate
3 restated and 2000 intrastate restated, those figures in
4 those two columns are taken directly from your
5 compliance reports for those years; is that right?

6 A. Yes, they are.

7 Q. But for the following three columns, D, E,
8 and F, they are -- those figures are not all the same as
9 in the compliance reports for those years because you
10 made additional restating adjustments for those years;
11 is that correct?

12 A. Yes, we did additional analysis for the
13 purpose of the interim case and made additional
14 restating adjustments.

15 Q. Now the very first note that you have is note
16 1 opposite line 2, local network service; do you see
17 that?

18 A. Yes.

19 Q. And note 1 refers to access line losses which
20 are described in the note; is that right?

21 A. Yes.

22 Q. And you also refer to this in your direct
23 testimony as one of the reasons why the company's return
24 has declined?

25 A. That's correct.

0146

1 Q. And am I correct that your workpaper
2 supporting your note 1 is Exhibit 28, workpaper C 4?

3 A. Yes.

4 Q. And then also if you could keep that exhibit
5 and then also flip over to Exhibit 41C, excuse me, 47C,
6 Exhibit 47C is some further detail on what makes up the
7 line loss figures you show back on Exhibit --

8 A. Is 47C Data Request Number 92?

9 Q. Yes.

10 A. Thank you.

11 Okay.

12 CHAIRWOMAN SHOWALTER: Well, hold on, we have
13 a 46C, which looks like what you're talking about, at
14 least I do. My 47 is something -- is not a C, so I just
15 want to make sure we're on the same page.

16 JUDGE WALLIS: That may be misnumbered.

17 CHAIRWOMAN SHOWALTER: Well, which exhibit?

18 MR. TROTTER: Yes, 46 should be an SEC Form
19 10K excerpt, and 47C should be the company's response to
20 Staff Data Request 92.

21 COMMISSIONER HEMSTAD: Ours are incorrectly
22 numbered, so perhaps you could give -- we're talking
23 about Data Request Number 92?

24 MR. TROTTER: That's right, that should be
25 47C.

0147

1 CHAIRWOMAN SHOWALTER: Just while we're here,
2 what exhibit is Data Request Number 95?

3 MR. TROTTER: That is 48.

4 CHAIRWOMAN SHOWALTER: Well, it looks as if
5 we're one off, and I don't know how far that one off
6 goes.

7 MR. TROTTER: Do you want to go off the
8 record to straighten this out.

9 JUDGE WALLIS: Let's be off the record,
10 please.

11 (Discussion off the record.)

12 BY MR. TROTTER:

13 Q. Ms. Heuring, just to kind of summarize where
14 we are here, Exhibit 26 contained a note 1 which
15 referred to access line loss. Your workpaper supporting
16 that is Exhibit 28, and then some further information
17 about line loss data is contained in 47C; is that right?

18 A. That's correct.

19 Q. Okay. And so let's go to 47C, I believe it's
20 the last page, and this is confidential so I don't think
21 the -- I just think the numbers are confidential, so
22 hopefully we will be okay. First of all, workpaper C 4,
23 the first column of data there, that is Exhibit 28,
24 correct?

25 A. Yes.

0148

1 Q. Okay. And then that ties directly to your
2 Exhibit 26, right, note 1?

3 A. Yes.

4 Q. Okay. And so the line loss figures that
5 you're reporting in that Exhibit 26 includes resold
6 lines and UNE-P lines but not company use lines or
7 interstate only lines; is that right?

8 A. That's correct.

9 Q. And by resold lines, would that include
10 switched access lines leased to competitive local
11 exchange carriers?

12 A. Yes.

13 Q. And so therefore would all of the switched
14 access lines that are included in your Exhibit 28, page
15 2, line 1, would those generate all of the local network
16 service revenue on line 2 of Exhibit 26?

17 A. These are the switched access lines that are
18 associated with the revenue that's recorded in local
19 network service revenues. In addition, you asked about
20 like UNE-P lines or resold lines, some of that is
21 recorded in miscellaneous revenues per the FCC
22 definition, which is on line 5 of Cross-Exhibit 26.

23 Q. Okay. So the switched access lines that you
24 show on Exhibit 28, some of those, the revenues from
25 some of those lines might show up in miscellaneous

0149

1 revenue --

2 A. Right.

3 Q. -- or local network service revenue?

4 A. Right, the bulk of it would be local network
5 service, and then the UNE-P or resold would be in the
6 miscellaneous revenues.

7 Q. Okay. Are there any other types of lines
8 that would generate revenue that would show up in local
9 network service?

10 A. Well, we obviously also have special access
11 lines, our special lines, but I'm not aware of -- I
12 can't answer whether those, if they're intrastate in
13 nature, which line item they fall into.

14 Q. Are there any other categories of lines
15 you're aware of that might show up as operating revenue
16 local network service?

17 A. Well, I'm not quite sure how to answer that
18 question. We also have lines that are like WATTS lines
19 or Feature Group A lines that you will see on some of
20 the reporting that we do like in an annual report for
21 example, but I can't tell you directly which category of
22 revenue those affect.

23 Q. Those are not --

24 A. I'm just not familiar with that side.

25 Q. Those would not be included as switched

0150

1 access lines, would they?

2 A. They're not listed on C 4, but on our annual
3 report there's a schedule that's called an S3 schedule
4 where we report lines, and it has a little bit different
5 definition, and it brings in some of these different
6 lines.

7 Q. Okay. Now going to page 2 of Exhibit 28,
8 your workpaper C 4, am I correct that the line counts
9 shown there represent a greater number of access lines
10 than the billed number of lines, and that's because ISDN
11 lines are multiplied by 2 to arrive at the reportable
12 totals in Exhibit 28?

13 A. Are you referring -- I don't have billable
14 lines in front of me that I know of.

15 Q. I'm trying to short-circuit it.

16 A. Okay, I know.

17 Q. Go to Exhibit 47C, page 2.

18 A. Okay.

19 Q. And in the last paragraph, does it not
20 indicate that multipliers are applied to the ISDN and
21 fiber DS1 access lines to represent voice equivalent
22 lines?

23 A. Which paragraph again, please?

24 Q. Page 2, last paragraph, and it goes over to
25 the next page.

0151

1 A. On Exhibit 47C?

2 Q. Yes.

3 A. But that paragraph doesn't talk about
4 multiplying lines, so.

5 Q. Could you look over on the next page.

6 A. I don't have another -- you mean the
7 attachment?

8 Q. Exhibit 47C, your response to Staff Data
9 Request Number 92.

10 CHAIRWOMAN SHOWALTER: The cover page is page
11 1.

12 THE WITNESS: Thank you, thank you. I'm
13 sorry, I was on the wrong page, thank you.

14 BY MR. TROTTER:

15 Q. By page numbers, I'm looking in the upper
16 right-hand corner.

17 A. That's all right, I was looking at actual
18 page 2 of the data request. Thank you for the
19 clarification.

20 Yes, it does indicate that, that there is a
21 difference between reportable and billable.

22 Q. Okay. And your Exhibit 28 sets forth
23 reportable, correct?

24 A. Yes, that's correct.

25 Q. All right. And do you know the multiplier

0152

1 that is used for the fiber DS1 lines?

2 A. I do not.

3 Q. Would you accept subject to your check it's
4 24?

5 A. Indicating like a 24 channel line, yes.

6 Q. Is that something you can check?

7 A. Yes.

8 Q. So if ISD lines and fiber DS1 lines are
9 declining at a higher rate than single voice lines,
10 would that tend to overstate the reduction in actual
11 lines?

12 A. Well, but the -- I don't think so, because
13 year to year to year they're reported on a consistent
14 basis. So if it's multiplied by 24 when the lines are
15 going up and it's the same multiplier when the lines are
16 going down, you will see a similar impact of a increase
17 or a decrease.

18 Q. If a Verizon residential customer with three
19 telephone lines decides to convert to DSL, digital
20 subscriber line, that would represent a loss of two
21 switched access lines, would it not?

22 MR. PARKER: Objection, lack of foundation.
23 The question is why the other two lines would be
24 removed.

25 MR. TROTTER: It's a hypothetical question,

0153

1 Your Honor. We're trying to figure to out how they
2 calculate their line losses.

3 JUDGE WALLIS: The objection is overruled.

4 A. Could you ask your question again, please.

5 BY MR. TROTTER:

6 Q. If a residential customer has three telephone
7 lines to their home and decides to convert to digital
8 subscriber line service, DSL, that would represent a
9 loss of two switched access lines, would it not?

10 MR. PARKER: Objection. I'm not trying to be
11 obnoxious here, but the hypothetical is wrong. When you
12 remove a DSL line, you would pull out one second line,
13 not two.

14 MR. TROTTER: That wasn't the question, Your
15 Honor. Could I just have her answer the question that
16 was asked. I did not ask --

17 MR. PARKER: I have an objection --

18 MR. TROTTER: -- about removing a DSL line.

19 JUDGE WALLIS: Hold on, hold on, just one at
20 a time, please.

21 MR. TROTTER: I did not ask about removing a
22 DSL line.

23 (Discussion on the Bench.)

24 JUDGE WALLIS: Mr. Trotter, could you make
25 the assumptions in your question apparent and define

0154

1 those in the question. That might help us proceed.

2 MR. PARKER: It would help, Your Honor, I'm
3 certainly willing to stipulate to the hypothetical that
4 if you have two lines in a house and you put in a DSL
5 line that there would be a removal of one line. I would
6 stipulate to those facts.

7 MR. TROTTER: I will restate it, Your Honor,
8 thank you.

9 BY MR. TROTTER:

10 Q. Let's go with the hypothetical of two lines,
11 and one is converted to DSL, that would represent a loss
12 of one switched access line to Verizon Northwest
13 Washington intrastate operations; is that correct?

14 A. That's correct.

15 Q. And would that also result in a loss of local
16 network service revenue?

17 A. Any revenue that was associated with that
18 second line that is being removed would no longer be
19 revenue that would be collected by Verizon Northwest.

20 Q. Would the new DSL line be reflected in your
21 access line counts such as Exhibit 28?

22 A. I'm going to tell you I don't know the answer
23 to that. This exhibit was sponsored by Steve Banta,
24 Mr. Banta, and I can testify to it as far as what was
25 reflected on C 4, but when you start getting into the

0155

1 technical things of how much of a -- of what's going to
2 happen with a line count with a DSL line or -- I'm just
3 not the right person to address that.

4 Q. Do you know what revenues Verizon Northwest
5 intrastate would receive from the customer's new DSL
6 line?

7 A. Well, Verizon Northwest obviously still
8 receives the revenue from the local line that is
9 providing the local service to that house.

10 Q. What about the DSL line?

11 A. The DSL line is an interstate tariff service,
12 and the interstate jurisdiction reflects the resale of
13 that line to whatever DSL provider is providing that
14 service.

15 Q. So --

16 CHAIRWOMAN SHOWALTER: I'm going to interrupt
17 here, I just want to make sure I understand what the
18 question is, because I don't think the assumptions were
19 laid out clearly at the beginning. Were you assuming at
20 the beginning that there were two lines, one of which
21 was used for computer, and that then you wanted not to
22 convert a line to DSL but to eliminate one line and in
23 the remaining line have both local service and DSL?

24 MR. TROTTER: No, let me restate the
25 assumptions then.

0156

1 CHAIRWOMAN SHOWALTER: Then I didn't
2 understand the question.

3 MR. TROTTER: I apologize, I will try to
4 clarify it.

5 BY MR. TROTTER:

6 Q. Ms. Heuring, did you understand the
7 hypothetical to be --

8 A. No, I did not.

9 Q. -- that the residential customer had two
10 local exchange lines into their house.

11 A. Okay.

12 Q. And that they decided to convert one of them
13 to DSL service to hook up their computer.

14 A. I did not understand that's what you were
15 asking. So the customer still has two local lines
16 coming into the house?

17 Q. They have --

18 CHAIRWOMAN SHOWALTER: Two lines.

19 A. Two lines.

20 Q. They have two lines, one is a local exchange
21 line, and the other is a DSL line.

22 A. But I guess I'm struggling because my
23 understanding would be that they would -- you have a
24 local line that you're paying for, and then you have a
25 local line that has local service and DSL service

0157

1 provided over it. I'm not -- I'm having trouble with
2 the hypothetical that you have just a local line that
3 just has DSL and nothing --

4 Q. Okay.

5 A. I don't know how that operationally would
6 work.

7 Q. Fine. So the customer before ordering DSL
8 service had two lines going into their house and decides
9 to add DSL capability over one of them.

10 A. Well, and I still say that the Verizon
11 Northwest intrastate operations would have the local
12 revenue for both of those local lines, and then the DSL
13 provider receives the DSL revenue, and Verizon Northwest
14 receives the revenue from the DSL provider through the
15 sale of that interstate loop.

16 Q. Okay, let's change the hypothetical.

17 A. Okay.

18 Q. A customer has a single line to their home
19 that they use for plain old telephone service. Do you
20 have that assumption in mind?

21 A. Yes.

22 Q. They then wish to add an additional line that
23 they're going to use exclusively for DSL service, and
24 they're going to hook it up to their computer. Do you
25 have that assumption in mind?

0158

1 A. Yes.

2 Q. What revenues would Verizon Northwest
3 intrastate operations receive from the customer's DSL
4 line?

5 MR. PARKER: I hesitate to interpose an
6 objection, but we don't do that.

7 A. That's why I'm having trouble answering the
8 question, I can't --

9 MR. TROTTER: Just a moment.

10 CHAIRWOMAN SHOWALTER: Mr. Trotter, it might
11 be easier if you start from sort of the ground up.
12 Start with one person with one telephone line that they
13 use for voice, then they add DSL to that line. It's
14 still one line, part voice, part DSL. That would be the
15 conventional paradigm. And maybe you have some other
16 scenarios in mind, but I think at least I for one had
17 that paradigm in mind when you asked your original
18 question, but I think your actual question was different
19 from that.

20 MR. TROTTER: You're right, and I will go
21 with that.

22 BY MR. TROTTER:

23 Q. Let's assume a customer has a single line
24 from Verizon Northwest that they're using for plain old
25 telephone service. Do you have that assumption in mind?

0159

1 A. Yes.

2 Q. They now want to add DSL service to that
3 line. Do you have that assumption in mind?

4 A. Yes.

5 Q. What revenues would Verizon Northwest
6 intrastate operations receive from the customer's DSL
7 service?

8 A. A DSL service is tariffed interstate by the
9 FCC rules, so Verizon Northwest in their interstate
10 jurisdiction receives that revenue, but the intrastate
11 jurisdiction does not receive anything for DSL but
12 continues to receive the revenue from the local loop.

13 Q. So the revenue from the DSL service would not
14 show up on your Exhibit 26, for example?

15 A. No, because it's tariffed interstate by the
16 FCC.

17 Q. Let's go back to Exhibit 26. I would like to
18 focus now on line 13 entitled access.

19 A. Can you give me a second to put these back
20 away.

21 Okay.

22 Q. And the only note you show for this item is
23 note 7 under the 2001 to 2002 period, and you note a
24 decrease in interconnection expense; do you see that?

25 A. Yes.

0160

1 Q. And the decrease between 2001 and 2002 is
2 approximately \$5 Million?

3 A. Yes, that's correct.

4 Q. Now looking at the change between 1999 and
5 2000, that was an over \$8 Million increase, was it not?

6 A. Yes.

7 Q. And there's a over \$13 Million decrease from
8 2000 to 2001 for access, was it not?

9 A. Yes.

10 Q. And those fluctuations are much larger in
11 amount than the \$5 Million change that you note on note
12 7, isn't that right?

13 A. They are, and they're just driven by change
14 in traffic volumes for companies, competitors that
15 terminate their traffic on our network. And the item
16 that I referenced in Footnote Number 7 relates to an FCC
17 order that required the charge from -- that we pay to be
18 decreased, and that's what I'm reflecting in Footnote 7.

19 Q. Turn to Exhibit 48, oh, excuse me, I'm sorry,
20 I'm sorry, 49, excuse me.

21 A. Could you just identify for me what 49 is.

22 Q. Staff Data Request 96.

23 A. Okay.

24 Q. And this data request asks you to explain the
25 fluctuations in 2000 and 2001 and 1999; is that right?

0161

1 A. Yes, it does.

2 Q. And the entirety of your response is that
3 access expense can fluctuate for Verizon Washington due
4 to compensation paid to other competing carriers for
5 increased terminating traffic?

6 A. Right, which is correct. My only other
7 choice is to start identifying carriers that we're
8 paying expense to for terminating the traffic, and I
9 didn't feel like that was appropriate for the data
10 request response. It's simply driven by fluctuations in
11 the terminating traffic.

12 Q. And those fluctuations appear to be quite
13 large from time to time, are they not?

14 A. Well, they obviously were in the year 2000
15 when there was a lot of competitive, you know, entry
16 where carriers were, you know, when we had traffic on
17 our network that we had to terminate on a competing
18 network. And then you can see that it came back down in
19 the later years, and then we had the rate change that I
20 mentioned in Footnote Number 7.

21 Q. Let's look at line 14, customer operations,
22 and you have a note there, Note 10, with respect to the
23 difference in 1999 to 2000 there was a higher customer
24 operating expense of \$8 Million; do you see that?

25 A. Yes, I do.

0162

1 Q. Please turn to Exhibit 48, and you were asked
2 to explain that change, and you said the increase is
3 primarily driven by higher business service order
4 processing in account 6623; is that right?

5 A. Yes.

6 Q. And account 6623 is a customer services
7 account; is that right?

8 A. It's a customer services account where the
9 FCC requires that costs associated with business service
10 order processing be recorded.

11 Q. So you had a large increase in business
12 service orders in that period?

13 A. In the year 2000 we're talking about now, we
14 had activity IT cost and salary and wage cost associated
15 with customer order processing, and what that was
16 related to is processing UNE requests that we saw
17 activity in in that particular year. And then you can
18 see in the remaining years and in the test years it's
19 down to a normal level again.

20 Q. Just going back to Exhibit 26, am I correct
21 that of all of the explanations for the fluctuations
22 that you have provided in Exhibit 26, the only one that
23 was unilaterally -- that was a result of action,
24 unilateral action by the Commission, was the access
25 charge reduction last October?

0163

1 A. Well, you could also -- when you say
2 unilaterally, but the Footnote Number 13 is a result of
3 a Commission or a company request and a Commission order
4 for depreciation rate increase, which increased our
5 depreciation expense. But they're all items that are --
6 reflect the operations of the company, the change in the
7 telecommunications industry where we saw competing
8 carriers coming in and affecting our access lines and
9 our costs associated with, you know, access and
10 connection. It's a myriad of items on here.

11 Q. And the company did not seek a rate increase
12 associated with the depreciation change in the year
13 2000; is that correct?

14 A. We were in the stay out period at that point
15 in time.

16 Q. And you haven't applied for it yet, have you?

17 A. Yes, we have, we have a capital recovery case
18 on file which reflects the status of those rates plus
19 the additional capital recovery.

20 Q. And the rate effect of that is being sought
21 in the general rate case in this docket; is that right?

22 A. Yes.

23 Q. And the stay out provision you were referring
24 to ended July 1st, 2002, did it not?

25 A. Yes, but you wouldn't come in on a single

0164

1 issue. You don't come in and ask for a rate increase
2 just for a single issue.

3 Q. Right. And if that -- on the other hand, if
4 that single issue caused you to earn less than a fair
5 rate of return, you would come in, wouldn't you?

6 A. But when you come in it's your whole revenue
7 requirement that's at issue. It's not one particular
8 issue like depreciation.

9 Q. Right.

10 A. So you're coming in seeking treatment
11 consideration of your entire revenue requirement.

12 Q. And if you have a large single item expense
13 that is driving your return downward on a normalized pro
14 forma basis, you would come in for rates, wouldn't you?

15 A. I guess I have the same answer. It depends
16 on your overall financial situation of the company, and
17 you go through and evaluate your earnings and that one
18 particular issue in relation to your earnings.

19 Q. And your overall earnings according to
20 Exhibit 26 in the year 2002 was a 2.58% return on rate
21 base; is that correct?

22 A. Yes, that's correct.

23 Q. Would you turn to Exhibit 42, please, and do
24 you recognize this as the company's response to Data
25 Request 77, which asked for certain information

0165

1 regarding an investor quarterly bulletin for the second
2 quarter of '04 issued by Verizon?

3 A. Yes, I do.

4 Q. And on the first part of the request, which
5 is on the first page of the exhibit, it asked you to
6 provide the corresponding information for Washington
7 interstate and intrastate with respect to each of the
8 bullets stating the Verizon corporate entity in which
9 the activity occurred; do you see that?

10 A. Yes.

11 Q. Would you turn to page 2 of the exhibit, and
12 other than a reference to Verizon non-regulated
13 entities, you did not state the Verizon corporate entity
14 in which the activity occurred, did you?

15 A. You're referring to Part A of the response?

16 Q. Yes.

17 A. Yeah, I mean from my position as a financial
18 person for a domestic telecom which includes Verizon
19 Northwest, my understanding is that earnings release
20 statement refers to services provided out of
21 non-regulated entities. What all those non-regulated
22 entities are, I don't know.

23 Q. Does someone in Verizon know?

24 A. Sure, whoever wrote the earnings release.

25 Q. Did you consult them in preparing this

0166

1 response?

2 A. We asked for information related to the
3 earnings release and how it relates to Verizon
4 Washington operations.

5 Q. Well, let's just go with what you gave us.
6 Staying with page 2, item A, the bullet refers to DSL
7 lines, and your answer says, this metric represents
8 total DSL retail lines served by Verizon non-regulated
9 entities; do you see that?

10 A. Yes.

11 Q. And do you know the name of the Verizon
12 non-regulated entity that operates in Washington that
13 offers DSL retail lines?

14 A. Well, I know from the preparation of the
15 affiliate report that we provide to the Commission that
16 we have Verizon Online and potentially Verizon Avenue.
17 You know, if there's others or what their official legal
18 name is, I don't know.

19 Q. And Verizon Northwest does not offer that
20 service, does it?

21 A. DSL retail, you will have to ask Mr. Banta,
22 I'm not aware of that.

23 Q. The second item refers to data revenue
24 increase of 5.7%, and you indicate in the response that
25 service included in that category included point to

0167

1 point, private line, special access, ATM, frame relay,
2 DSL, and data related CPE sales; do you see that?

3 A. Yes.

4 Q. And are any of those provided by Verizon
5 Northwest?

6 A. I believe they are. I believe point to
7 point, private line, special access, ATM, frame relay,
8 are provided by Verizon Northwest.

9 Q. But DSL and data related CPE sales are
10 provided by affiliates; is that correct?

11 A. Well, DSL, DSL as a resale I don't know how
12 -- what the right words are for that, but we obviously
13 -- Verizon Northwest obviously provides DSL, as I
14 mentioned earlier, we receive revenue through a
15 interstate tariff for that.

16 Q. Verizon Northwest does?

17 A. Verizon Northwest the legal entity?

18 Q. Yes, that's interstate only, correct?

19 A. Interstate per the FCC rules. And then CPE
20 sales, I'm not aware of what entity, but it would be a
21 non-regulated activity.

22 Q. Okay. Item C, switched access lines, and
23 then right below that it says in response to item 2,
24 Verizon reported long distance revenues of \$1 Billion
25 for second quarter 2004, which was a 14.7 increase over

0168

1 the quarter, same quarter of the prior year; is that
2 right?

3 A. Yes.

4 Q. And you state that long distance revenue
5 includes both intraLATA toll services from the regulated
6 OTC's, and can you tell us what OTC stands for?

7 A. The operating telephone company.

8 Q. And the revenues generated by the other
9 non-regulated entity, i.e., interLATA toll; do you see
10 that?

11 A. Yes.

12 Q. And is that a reference to Verizon Long
13 Distance?

14 A. Yes.

15 Q. Turn to the next page of the exhibit, in the
16 third paragraph down, it says:

17 In the state of Washington,
18 approximately 62% of residential
19 customers have purchased local services
20 in combination with either Verizon Long
21 Distance or DSL or both.

22 Is that right?

23 A. Yes.

24 Q. Now Verizon Northwest can offer interLATA
25 long distance, can't it?

0169

1 MR. PARKER: I'm sorry, could you repeat the
2 question.

3 Q. Well, I will ask it this way. Is Verizon
4 Northwest prohibited from offering any service that
5 Verizon Long Distance offers?

6 A. I can't answer that question.

7 Q. Who sells these combined services to the
8 customer?

9 A. I think those questions probably are best
10 directed toward Mr. Banta.

11 Q. The next item is in response to item 5,
12 Verizon reported average revenue per Verizon residential
13 wireline customer increased nearly 6% in the second
14 quarter of 2004; do you see that?

15 A. Yes.

16 Q. You go on to say that Verizon does not
17 compute this metric at a specific state level, and at
18 the end of that paragraph, the computation of the
19 equivalent metric for the state of Washington would
20 require arbitrary allocations, correct?

21 A. Yes.

22 Q. And by for the state of Washington, do you
23 mean Washington intrastate?

24 A. Either way, just for the state, because this
25 metric was developed from data which is at a total

0170

1 domestic telecom level, which includes all of the
2 residential wireline activity.

3 Q. Okay. And what sort of arbitrary allocations
4 did you have in mind?

5 A. I'm not sure I can answer that I had anything
6 specific in mind there. It's data that it was polled at
7 the total domestic telecom level, so someone would have
8 to analyze that to determine what would be, if you
9 wanted to allocate it back down to state, what would be
10 an appropriate measure to allocate it back down, and I
11 don't have any thought in mind as to what that would be.

12 Q. But Verizon Northwest does record its
13 revenues.

14 A. But the question in the data request asked to
15 take this earnings release and break it all down, and
16 the data wasn't compiled at the level of here's all the
17 state data and then we add it all up to get to this
18 earnings release. It's extracted at that highest level.

19 Q. The last item on the page refers to Freedom
20 packages, and these are packages of long distance,
21 wireless, and Internet access; is that right?

22 A. Depending on the package.

23 Q. In various combinations?

24 A. Right.

25 Q. And this was just launched in July of this

0171

1 year in Washington, so there's no data for Washington;
2 is that the gist of the response?

3 A. As it relates to the statement in the
4 earnings release.

5 Q. Okay. Do you anticipate that sales from
6 Freedom pack type services to Washington customers will
7 cause an increase in Verizon Northwest Washington
8 intrastate revenues?

9 A. You will have to direct that to Mr. Banta.

10 MR. TROTTER: Your Honor, this might be a
11 good opportunity for an afternoon break. I can keep
12 going.

13 JUDGE WALLIS: About how much longer do you
14 expect you have, Mr. Trotter?

15 MR. TROTTER: It's going to take about I
16 would say 45 minutes. I'm happy to keep going.

17 BY MR. TROTTER:

18 Q. Ms. Heuring, could you or your counsel
19 provide you with Exhibit 142, which contains your
20 response to Staff Data Request Number 20 that's on page
21 6 of the exhibit.

22 A. Okay.

23 Q. And under the contracts with affiliates
24 paragraph, the company --

25 COMMISSIONER HEMSTAD: What page are you on?

0172

1 MR. TROTTER: I'm sorry, page 6.

2 CHAIRWOMAN SHOWALTER: Can you just wait
3 until --

4 MR. TROTTER: Sure.

5 BY MR. TROTTER:

6 Q. 142, page 6, do you recognize this as the
7 company's response to Staff Data Request 20?

8 A. Yes.

9 Q. And here you describe a change in a contract
10 with an affiliate, Verizon Directory Corp., starting in
11 the year 2000; is that right?

12 A. Yes.

13 Q. And the change resulted in an estimated
14 annual revenue impact of \$34.2 Million to Verizon
15 Northwest's Washington intrastate operations, correct?

16 A. Based on 1999 levels, that's correct.

17 Q. Now the year 2000 was the first year in which
18 Verizon Northwest stopped receiving that revenue flow;
19 is that correct?

20 A. Well, it's the first year that the new
21 contract went into place, and that contract follows the
22 FCC order, which is the result of the -- which resulted
23 in the change in the contract.

24 Q. Would you accept subject to your check that
25 according to the company's compliance reports its

0173

1 Washington intrastate revenues declined by approximately
2 \$45 Million in 2000 compared to 1999?

3 A. Declined by what amount?

4 Q. Approximately \$45 Million.

5 A. And which revenue stream are you referring to
6 again?

7 Q. Washington intrastate.

8 A. Total operating revenues?

9 Q. Yes.

10 A. Around \$43 Million.

11 Q. Okay. So the decrease from Verizon
12 Directories Corp. accounted for around three quarters of
13 that loss; is that correct, decline?

14 A. Well, there were two revenue declines in that
15 year. One of them was associated with the change in the
16 contract and with the new contract following the FCC
17 pricing rules. And the second one was the portion of
18 the merger rate reduction that affected the year 2000.

19 Q. Would you agree with me that \$34 Million is
20 approximately 75% of \$45 Million?

21 A. If that's the math, yes, I don't have a
22 calculator to calculate it.

23 Q. Now are you saying that the contract
24 arrangement was changed because of an FCC order?

25 A. Yes, the FCC as part of the 1996 order

0174

1 designated what the rate was for the sale of directory
2 listings to 4 and 6 cents, and the contract that went
3 into place in the year 2000 reflects that, the FCC
4 rates.

5 Q. And that order was issued in 1996; is that
6 your statement?

7 A. That's correct.

8 Q. Why did it take until the year 2000 if that
9 was the actual cause of the contract change?

10 A. I can't address -- I don't have any personal
11 knowledge of that.

12 Q. Turn to your Exhibit 21T, page 4, and on line
13 16 you refer to the adjustments you made to the test
14 period, which you say was restated to reflect
15 adjustments to financials as required by WUTC accounting
16 rules. Do you see that?

17 A. Yes.

18 Q. You made 21 restating adjustments; is that
19 right?

20 A. Do you want me to count them?

21 Q. You can just accept it subject to check.

22 A. That's fine.

23 Q. Would you turn then to Exhibit 44, response
24 to Staff Data Request 97.

25 A. And if I could just state though, the part of

0175

1 my testimony that you referred to there actually refers
2 only to one particular adjustment where we restated
3 PAYGO, one adjustment.

4 Q. And that's Exhibit 44.

5 A. Okay, thank you.

6 Q. So just to follow up then with respect with
7 referring you to Exhibit 44, the only adjustment you
8 made that you deemed necessary because of the
9 Commission's accounting rules was the adjustment for
10 other post employment benefits?

11 A. Right, and what I'm referring to there as
12 accounting rules are those where the Commission has
13 directed us to record something that's different from
14 either generally accepted accounting principles or Part
15 32.

16 Q. So general Commission policy on how certain
17 adjustments are to be made would not fit in that
18 category?

19 A. No.

20 Q. Please turn to Exhibit 33, and this is your
21 workpaper that purports to calculate Yellow Page
22 revenues per docket U-8245 and U-8248, and the
23 adjustment is in the right-hand column, zero; is that
24 right?

25 A. That's correct.

0176

1 Q. Is it your understanding that this
2 Commission's policy is to impute directory revenues in
3 determining a local telephone company's intrastate
4 revenue requirement?

5 A. No, not based on my personal experience with
6 our case. U-82 reflected revenues that were based on
7 the contract that we had in place with our directory
8 company. And in our rate case at that point in time,
9 the revenue requirement included the revenues consistent
10 with our contract and then included a cost plus fair
11 return adjustment. And what we have in our revenue
12 requirement here is the same, what I have reflected is
13 the value of the revenues per the affiliate contract
14 that's in place. So it's on a consistent basis.

15 Q. And the contract you currently have in place
16 calls for zero revenue flow?

17 A. Well, the revenue flow is already reflected
18 in the case, in the financials in the case, and it's
19 consistent with, as I mentioned previously, the FCC
20 rates that have been dictated for us to provide. This
21 zero reflects, this whole adjustment, the rate case
22 rules require if you're following a method that's
23 different than was used in your last case to show what
24 the difference is, and the Staff asked us to use a U S
25 West adjustment that was specific to U S West to reflect

0177

1 their calculation so that the case would have this data
2 in it.

3 Q. Did you review the Commission's order in the
4 U S West rate case UT-950200?

5 A. I have read that order.

6 Q. And in that case the Commission imputed
7 Yellow Pages revenue, did it not?

8 A. Because of the ownership issue with U S West
9 owned their directory company, and the rate payers
10 contributed to the development of the directory company.
11 GTE Northwest never owned the directory company, and the
12 rate payers of GTE Northwest never contributed to the
13 development of the directory company. So the two
14 situations are totally different, and the U S West issue
15 is not a precedent for our situation.

16 Q. Turn to page 3 of your rebuttal testimony,
17 Exhibit 23T, which --

18 A. Which page, please?

19 Q. 3.

20 A. Okay.

21 Q. And you state there on lines 3 to 5 that your
22 imputed directory calculation produced a negative
23 number, not a positive number.

24 A. That's correct.

25 Q. And you go on to say that that was because

0178

1 the affiliate earned a return lower than that authorized
2 for Washington intrastate operations Verizon Northwest,
3 correct?

4 A. That's correct.

5 Q. Turn to Exhibit 43, and do you recognize this
6 as your response to Staff Data Request 86?

7 A. Yes, I do.

8 Q. And this asks for workpapers supporting
9 Exhibit 33; is that right?

10 A. Yes.

11 Q. It also asks you to include definitions of
12 terms such as domestic directory franchise and
13 non-franchise; is that right?

14 A. Yes, it does.

15 Q. We didn't find a definition of domestic
16 directory in your response; can you please define it?

17 A. Domestic meaning United States versus
18 international, something outside the United States.

19 Q. Turn to page 3 of the exhibit.

20 A. Could you tell me the schedule number on page
21 3 just to make sure I'm on the right page.

22 Q. It's Attachment 86a, Schedule 6.

23 A. Thank you.

24 Q. 1.3.1.

25 A. Yes, thank you.

0179

1 Q. Now on the first line you show negative
2 directory revenues of something over \$890 Million; is
3 that right?

4 A. That's correct.

5 Q. And that's really a -- is that really a loss
6 before interest and taxes, or is that income before
7 taxes?

8 Shall we just say it's negative income?

9 A. It's negative income, and the data request
10 response explains what it is.

11 Q. Okay. Let's go then to Exhibit 45, which is
12 an excerpt from the company's 2003 annual report, page 2
13 of the exhibit.

14 A. Okay, just a second, please.

15 46, I don't think I have a 46.

16 Q. 45.

17 MR. TROTTER: Perhaps the witness can be
18 provided a copy.

19 MR. PARKER: (Complies.)

20 THE WITNESS: Thank you.

21 BY MR. TROTTER:

22 Q. Page 2, and looking in the lower right
23 corner, the cumulative effective accounting change; do
24 you see that?

25 A. Yes, I do.

0180

1 Q. Would you agree that the accounting change
2 described there was to recognize a change in the
3 recognition of revenue expense related to directory
4 publication?

5 A. Yes.

6 Q. And that accounting change took effect in the
7 test year; is that right?

8 A. It says here retroactive to January 1st,
9 2003, so that would be correct.

10 Q. Let's go back to Exhibit 43, and I want to
11 refer you to page 5a.

12 MR. TROTTER: And I will mention to the
13 record that this was inserted by Staff because some of
14 the figures on the prior page were difficult to read,
15 and we will be -- actually there is an errata that will
16 be sent out shortly.

17 THE WITNESS: Is that the same as 86b? It's
18 our attachment to the data request response?

19 MR. TROTTER: No.

20 THE WITNESS: I don't have that.

21 MR. TROTTER: Let me just finish my
22 completion.

23 We added this page to our exhibit that we
24 distributed in order to clarify the calculation, and the
25 \$890 Million figure, the last three zero's should read

0181

1 700, and we will file an errata.

2 But if the witness could please be given a
3 copy of the exhibit that was transmitted to the parties,
4 I would appreciate it.

5 BY MR. TROTTER:

6 Q. Do you recognize page 5a of the exhibit is
7 simply taking figures from the prior page and just
8 reporting them for clarity purposes?

9 A. Yes, I do.

10 COMMISSIONER HEMSTAD: I'm having difficulty
11 getting focused. Can we go off the record for a moment.

12 JUDGE WALLIS: Let's be off the record.

13 (Discussion off the record.)

14 BY MR. TROTTER:

15 Q. Looking at page 5a, am I correct that you
16 computed the \$890 Million loss by subtracting from over
17 \$1 Billion in revenue this cumulative adjustment for the
18 prior period accounting change?

19 A. Well, the \$1 Billion is the income available
20 for return.

21 Q. Yes.

22 A. And then the accounting change is subtracted
23 from the income, yes.

24 Q. Okay. So if that accounting change were
25 excluded from the imputation calculation, there would be

0182

1 a positive imputation amount; is that correct?

2 A. Using the Staff's calculation that they
3 provided from the U S West case, which is irrelevant to
4 us, but if you follow that and don't use the directory
5 company financials for the year by excluding their
6 accounting change, the amount that is calculated
7 mathematically from that would be a positive number.

8 Q. Put another way, the negative, the large
9 negative number is driven by the accounting change, is
10 that correct, and the cumulative effect of that --

11 A. It's driven by the --

12 Q. -- being recognized in one period?

13 A. Yes.

14 Q. Turn to Exhibit 29, your response to Staff
15 Data Request 66.

16 A. Actually, this request was sponsored by Deb
17 Anders, who is a witness in the rate case. It's a
18 general rate case data request, or I don't know if it's
19 an interim data request, but it's not sponsored by me.
20 So I mean you can ask your questions, but it's doubtful
21 that I will be able to answer that.

22 Q. Well, this data request asked for detail on
23 the number of disconnects.

24 A. Right, and I'm the accounting witness, so I
25 really can't address that topic.

0183

1 Q. You don't have any knowledge of it?

2 A. Not disconnects, no.

3 Q. Okay. And so there was a supplement to this
4 exhibit, which is Exhibit 41C, you don't have personal
5 knowledge of the information in that exhibit?

6 A. No, I do not.

7 Q. We'll try Mr. Banta, thank you.

8 Turn to your rebuttal testimony, Exhibit 23T,
9 page 13.

10 A. Which page, please?

11 Q. 13, lines 10 through 12, or 9 through 12.

12 You refer to interstate revenues and interstate end user
13 access and special access, and you say:

14 These revenues are jurisdictionally
15 booked because they are based on the
16 interstate demand applied to tariffed
17 interstate rates.

18 Do you see that?

19 A. Yes, I do.

20 Q. And by that you mean that 100% of the
21 revenues from these services that are in an interstate
22 tariff are booked to interstate, correct?

23 A. Yes, and that the increase or decrease in the
24 associated revenues is associated with the demand, a
25 change in demand.

0184

1 Q. Are 100% of the investment and expenses used
2 to provide interstate services booked to interstate?

3 A. They're booked to accounts in Part 32, which
4 then we follow the Part 36 separation rules, and there's
5 certain items that are booked 100% interstate per the
6 separation rules, and then the remaining items are
7 separated in accordance with those rules.

8 Q. Well, in Ms. Strain's testimony, she
9 identified two projects that were DSL related, and would
10 those types of projects be included in a Washington
11 intrastate rate base?

12 A. Could you refer me to what portion of her
13 testimony you're asking about.

14 Q. Page 30 of Exhibit 141T.

15 A. And what line item?

16 Q. Lines 5 through 13.

17 A. And what is your question again?

18 Q. She refers to two projects, DSL wire center
19 move and DSL PIP blanket work order. Would those two
20 items be directly assigned to interstate?

21 A. It depends on what type of capital investment
22 is included in those projects. If it's, for example,
23 what they call a DSLAM, which I can't tell you the
24 definition of but it's a piece of equipment that's used
25 to provide interstate DSL, then that would be

0185

1 jurisdictionally booked 100% interstate.

2 Q. Now she raised this in her direct testimony,
3 but you did not address it, these two projects,
4 specifically in your rebuttal, did you?

5 A. Well, I believe Mr. Banta talks about the
6 projects and Verizon's reduction in its capital program
7 in his testimony.

8 Q. But he doesn't speak to how they're booked,
9 does he?

10 A. Well, this doesn't speak to how it's booked
11 either. It talks about how the Part 36 separation
12 process related to these projects.

13 Q. Just let me ask it this way. If a certain
14 project is designed to provide or enhance DSL service,
15 it should be assigned 100% to interstate because that's
16 where DSL is tariffed; is that correct?

17 A. It should follow the Part 36 rules, and the
18 Part 36 rules say if there's an item that is
19 specifically identifiable to the interstate
20 jurisdiction, then it should be booked to interstate.
21 If it's an item that carries joint traffic, then it is
22 separated per the Part 36 rules.

23 Q. Turn to Exhibits 31 and 32. These are my
24 final questions of you at this time. Now you're aware,
25 are you not, that Verizon is seeking to increase its

0186

1 overall revenues by \$109.8 Million in the general rate
2 case?

3 A. I object to the characterization of that
4 unless the attorney wants to --

5 MR. TROTTER: I'm sorry, Your Honor, could
6 the witness be directed to --

7 A. I filed the revenue requirement portion of
8 the rate case, and we're seeking \$240 Million.

9 BY MR. TROTTER:

10 Q. Let me restate it, I apologize.

11 In July of this year Verizon filed tariffs in
12 the general rate case part of this case that are
13 designed to generate \$109.8 Million in additional
14 revenue; is that correct?

15 A. That is correct.

16 Q. And Exhibit 31 asked you to recast your
17 interim rate relief Exhibit 22 assuming an increase of
18 \$109.8 Million; is that right?

19 A. That's correct.

20 Q. And on the second page of that exhibit, that
21 would produce a 6.66% return on rate base; is that
22 correct?

23 A. Yes.

24 Q. Turning to Exhibit 32, the same question was
25 asked with respect to your general rate case pro forma

0187

1 statement; is that right?

2 A. Yes.

3 Q. And page 2 of that exhibit shows that if you
4 add \$109.8 Million to the pro forma statement that you
5 filed, the resulting rate of return on rate base would
6 be 3.54%; is that correct?

7 A. That is correct.

8 Q. So if Mr. Vander Weide, excuse me, Dr. Vander
9 Weide is correct that Verizon Northwest needs to earn
10 12.03% on its rate base to have an incentive to invest
11 in its Washington intrastate operations, then the tariff
12 Verizon filed will not give that incentive in either the
13 interim rate case or the general rate case; is that
14 correct?

15 A. I'm not sure I can answer about giving
16 incentive, but the general rate case we're still asking
17 for a \$240 Million deficiency. That is our deficiency,
18 and that is the amount of revenue that needs to be
19 increased to earn the 12.03%.

20 Q. But the tariffs you filed won't generate
21 that?

22 A. Well, Mr. Banta can address why and talk
23 about the rate shock issues and any other concerns that
24 go along with the tariff, but the general rate case
25 we're asking for \$240 Million revenue deficiency.

0188

1 Q. So put another way, you're asking for the
2 Commission to make a finding that your revenue
3 deficiency is around \$240 Million, but the tariffs by
4 which you would seek to implement a Commission order in
5 the general rate case will generate \$109.8 Million.

6 A. That's correct.

7 Q. Is that a fair statement, okay.

8 MR. TROTTER: Your Honor, I'm done with my
9 questions, I would like to move for the admission of
10 Exhibits 28 through 34.

11 MR. PARKER: No objection.

12 MR. TROTTER: 41C through 49.

13 MR. PARKER: Still no objection.

14 JUDGE WALLIS: The exhibits are received.

15 Do you have anything further, Mr. Trotter?

16 MR. TROTTER: Not at this time, Your Honor,
17 thank you.

18 JUDGE WALLIS: Very well, let's take our
19 afternoon recess for 15 minutes. We will be back at
20 about 3:20.

21 (Recess taken.)

22 JUDGE WALLIS: Let's be back on the record,
23 please, following our afternoon recess. A housekeeping
24 carryover from the conclusion of the prior session is
25 that Mr. Trotter moved Exhibits 27 through 34 and 41C

0189

1 through 49 inclusive, that's adding 27 to the exhibit
2 numbers he mentioned. Those were not objected and have
3 been received into evidence.

4 Mr. ffitch, do you still want your turn at
5 this witness?

6 MR. FFITCH: Yes, Your Honor, although
7 Mr. Trotter has really, really shortened our questions
8 up.

9

10 C R O S S - E X A M I N A T I O N

11 BY MR. FFITCH:

12 Q. Good afternoon, Ms. Heuring.

13 A. Good afternoon.

14 Q. I'm Simon ffitch with the Public Counsel
15 office and literally just have a few questions, just a
16 couple of areas. First of all, I would ask you to look
17 at your rebuttal testimony, please, which is Exhibit
18 23T, and at page 11. Do you have that?

19 A. Yes, I do.

20 Q. Lines 15 to 16, you list loss of access lines
21 as one of the reasons for declining intrastate revenues,
22 correct?

23 A. Yes, I do.

24 Q. I think there has been quite a bit of
25 discussion about that generally in your previous

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1 questioning. Can I ask you to look now at our
2 cross-examination Exhibit 36, which is the access line
3 counts for '99 through 2003. Do you have that?

4 A. Yes, I do.

5 Q. And this is excerpts from the annual report
6 of Verizon Northwest, Inc., for Washington, correct, as
7 the cover sheets show?

8 A. Yes, it's the annual report that we file with
9 the Commission for Washington.

10 Q. And I have first of all just kind of a
11 housekeeping thing, mine are in reverse order with 2003
12 on top; is that what yours are?

13 A. Yes, they are.

14 Q. Okay. And if we go to -- let's go to the
15 back first just to start in 1999, if we look at the
16 total access lines in the far right-hand column, that
17 number is 1.42 million, correct?

18 A. Yes.

19 Q. And let's flip ahead to the last report for
20 2003, and that shows 1.82 million total access lines for
21 Washington state, correct?

22 A. Yes.

23 Q. Now my rough math indicates that that is an
24 increase over that time period of approximately 400,000
25 total access lines; is that correct?

0191

1 A. Yes, that's correct.

2 Q. All right. And all of those lines generate
3 revenue for Verizon; isn't that true?

4 A. All of them generate revenue for Verizon
5 Washington, and that revenue would be reflected in the
6 jurisdictional books based on whether it's an intrastate
7 tariff or an interstate tariff.

8 Q. All right. Now I would like you to go to
9 your rebuttal testimony at page 3, again this is Exhibit
10 23T. Actually, I'm sorry, I'm not going to take you
11 there, I have had a bit of a revision to this after the
12 cross-examination on imputation already, so I'm just
13 going to ask you to take a look at Public Counsel
14 Exhibit 46, and that is the excerpts from the 10K. Do
15 you have that?

16 A. Yes, I do.

17 Q. Now we have a cover sheet for the 10K, and
18 then can you just generally describe what pages 2 and 3
19 of that exhibit show, what the general topic is?

20 A. Page 2 is the segment information for the
21 segment information services, and it shows the revenues
22 for a three year period and has some description of
23 those revenues. Page 4, or sorry, page 3 of the
24 exhibit, which is the following continuation of the
25 previous page, is again the segment information for

0192

1 information services, and it shows their operating
2 expenses and then their segment income and then a
3 description of that.

4 Q. All right. And the information services
5 segment of Verizon is the domestic and international
6 publishing businesses; is that a fair statement?

7 A. That's what it says at the beginning, at the
8 top of page 2.

9 Q. And so that would include the domestic
10 directory publishing businesses?

11 A. Yes, that's correct.

12 Q. And on page 2, pardon me, page 3 of this
13 exhibit, the income that is shown for the segment for
14 2003 is \$1.2 Billion, correct?

15 A. That is correct.

16 Q. Now here's where I'm kind of jumping off the
17 edge. You had quite a bit of discussion with Staff
18 counsel about the negative \$800 Million accounting
19 adjustment, and I just want to get clear in my own mind
20 how the negative \$800 Million accounting adjustment that
21 was previously discussed, I'm just using a rounded
22 number, is taken into account or not in this \$1.2
23 Billion.

24 A. Well, if you look at page 3 of the exhibit on
25 the bottom portion, which says segment income, it

0193

1 describes there the decline in segment income, and then
2 it states that there were -- that there was a special
3 item booked in 2003 related to the accounting change,
4 which was part of the issue we discussed earlier.

5 Q. All right. So does that mean that absent
6 that accounting change that we talked about, which was
7 rather sizable, that this \$1.2 Billion would be a larger
8 number?

9 A. It appears from the reading of this that the
10 segment income reflects the accounting change, and since
11 the accounting change was a reduction in income, the
12 segment income would be higher without that item.

13 Q. So would you add in the \$800 Million figure
14 roughly speaking to get the, absent the accounting
15 adjustment -- I'm sorry, let me rephrase that.

16 Absent the accounting adjustment, the figure
17 would be approximately a little over \$2 Billion?

18 A. I can't speak for that since this is
19 information services financials, which I'm not familiar
20 with. The item from that prior discussion that we had,
21 I'm not sure if it's on the same basis as this
22 information here.

23 Q. Okay, thank you, I was just seeking
24 clarification, I appreciate your effort to provide that.

25 Would you now turn to your rebuttal again,

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1 page 1, that's Exhibit 23T. Do you have that?

2 A. Yes, I do.

3 Q. And at lines 15 to 17 you say:

4 I do not agree with the calculations by
5 Mr. King and Ms. Strain, which even if
6 accepted fail to rebut the need for
7 interim relief, because each respective
8 return is substantially below the last
9 return authorized by the WUTC.

10 A. I'm sorry, you need to redirect me again to
11 which page and line number.

12 Q. This is page 1 of Exhibit 23T, lines 15
13 through --

14 A. Okay, thank you.

15 Q. No, actually we get onto line 18.

16 Was that a fair reading of your testimony?

17 A. Yes, now that I'm on the right page.

18 Q. Okay. You're not arguing, are you,
19 Ms. Heuring, that the Commission should grant Verizon
20 interim relief solely on the basis of a low rate of
21 return, are you?

22 A. Well, I think as outlined in Mr. Banta's
23 testimony there were several -- there are several
24 factors that are to be considered when granting interim
25 relief, and the negative and declining return that we

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1 have is just one of them.

2 Q. But again, you are not testifying that
3 interim relief should be granted on that basis alone,
4 are you?

5 A. I'm not testifying on what the basis,
6 Mr. Banta is testifying on that. What I'm testifying to
7 and presenting is that these are the company's
8 financials, the return is negative, and it is declining,
9 and it has been declining over the last several years,
10 and I'm putting forth that presentation for the interim
11 relief.

12 Q. And you're not suggesting that that by itself
13 warrants interim relief, are you?

14 A. As I stated, Mr. Banta and Mr. Vander Weide
15 have gone through the issues that are appropriate to
16 consider for interim relief, and one of them is the
17 return and the financial condition of the company, of
18 the intrastate operations.

19 MR. FFITCH: Those are all the questions I
20 have.

21 Thank you, Your Honor.

22 Thank you, Ms. Heuring.

23 JUDGE WALLIS: Mr. Roseman.

24 MR. ROSEMAN: (Shaking head.)

25 JUDGE WALLIS: Mr. Melnikoff.

0196

1 MR. MELNIKOFF: I have nothing of the
2 witness, Your Honor.

3 JUDGE WALLIS: Mr. Butler.

4 MR. BUTLER: No.

5 JUDGE WALLIS: Questions from the Bench.

6 MR. FFITCH: Excuse me, Your Honor, I realize
7 I forgot to offer exhibits, and I would like to do that
8 when the time comes.

9 JUDGE WALLIS: Very well, why don't you do
10 that now.

11 MR. FFITCH: We would like to offer Public
12 Counsel Exhibits 36, 37, 38C, and 39.

13 JUDGE WALLIS: Is there objection?

14 MR. PARKER: No objection, Your Honor.

15 JUDGE WALLIS: The exhibits are received.

16 MR. FFITCH: Thank you, Your Honor. There is
17 one housekeeping matter with regard to 38C, and perhaps
18 counsel for the company can assist me if I go wrong on
19 this, but we were provided with a revised version of 38C
20 late yesterday, and I can make copies of that to
21 substitute into the record. I have a single copy here
22 with me right now, but we received this very late
23 yesterday, and just for accuracy I think we need to put
24 in the revision that Verizon provided us with.

25 JUDGE WALLIS: Can we deal with that at the

0197

1 conclusion of the questioning for this witness?

2 MR. FFITCH: Yes.

3 JUDGE WALLIS: Now questions from the Bench.

4

5 E X A M I N A T I O N

6 CHAIRWOMAN SHOWALTER:

7 Q. Regarding Exhibit 144, that was one of
8 Ms. Strain's exhibits, and you said that you could
9 provide an update to the request on part E that had to
10 do with income statement and balance sheets on an
11 intrastate level.

12 A. Yes.

13 Q. I think you said you could get it in I think
14 maybe after the hearing was over.

15 A. Yes.

16 Q. I wanted to make sure that you can get it in
17 before this record is closed in this case.

18 A. Yes, that's no problem.

19 CHAIRWOMAN SHOWALTER: I don't know if we
20 need to make a Bench request for that, we probably do.

21 JUDGE WALLIS: I think it would be tidiest to
22 have a Bench request, we will call it Bench Request
23 Number 1.

24 And when is the witness able to provide that?

25 MS. ENDEJAN: Your Honor, I believe there

0198

1 already is a Bench Request Number 1 that you sent out,
2 so --

3 JUDGE WALLIS: I'm sorry, Bench Request
4 Number 2, thank you.

5 THE WITNESS: Is Monday okay, or is it --

6 CHAIRWOMAN SHOWALTER: Yes, that's fine.

7 JUDGE WALLIS: Very well, we will note that
8 as -- and how would you title it?

9 THE WITNESS: Can we just title it as an
10 update to that exhibit, is that -- or do you need a
11 name, because it was a data request response that we
12 need to update.

13 JUDGE WALLIS: What was the data request
14 number?

15 MR. TROTTER: 276.

16 JUDGE WALLIS: 276 due on Monday, and that's
17 Bench Request 2.

18 COMMISSIONER HEMSTAD: And would you repeat
19 what is the content of that Bench request?

20 THE WITNESS: It would be the last item on
21 that data request response which asked about intrastate
22 income statement and balance sheets.

23 BY CHAIRWOMAN SHOWALTER:

24 Q. Okay, can you turn to Exhibit 143.

25 A. Is that Ms. Strain's testimony?

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1 Q. Yes, it is.

2 A. Is it the testimony itself?

3 Q. No, it is PMS-3.

4 A. Thank you.

5 Q. Page 4.

6 A. Okay, I have that.

7 Q. You were asked some questions on this page,
8 and I'm just trying to clarify your whole testimony. I
9 admit that especially when it comes to fast questions on
10 accounting I'm often about three sentences behind trying
11 to unpack terms and et cetera, so I may be asking you
12 things that you clearly did cover, but I might not have
13 heard it.

14 A. Okay.

15 Q. If you could look at this table on page 4,
16 and in particular you were asked a question about the
17 rate of return row.

18 A. Yes.

19 Q. And if I draw a line, a vertical line, after
20 the 1999 column, it's clear that beginning in 2000 there
21 is a large drop in rate of return.

22 A. That is correct.

23 Q. Now you were asked many questions about the
24 difference between 1999 and 2000 on with respect to
25 different documents. I just want to clarify here, is

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1 the major -- are the two major reasons for a drop from
2 1999 to 2000 on this document the same as the others
3 that you mentioned, i.e., a change in directory service
4 revenue accounting and merger related promises I guess?

5 A. On the revenue side, the two main issues that
6 affected the revenues were the change in the directory
7 contract and the reduction in revenues associated with
8 the merger order.

9 Q. All right. But I guess you refined my
10 question to focus on the revenue side.

11 A. Okay.

12 Q. And then on the expense side, are there also
13 one or two major changes?

14 A. Yes, on the expense side, referring to my
15 rebuttal exhibit, which is Cross Exhibit Number 26, I
16 outline there an increase in customer operations
17 expense, which I believe we talked about, which was
18 associated with the business service order processing
19 for that one year, and then it went back down. And then
20 also we had some merger costs in that year, which of
21 course we no longer have after the merger period. There
22 were transition or implementation type of costs.

23 Q. Okay, so there were, both on the revenue side
24 and the expense side, there are effects from the merger?

25 A. Yes.

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1 Q. Okay.

2 A. And then, of course, we still had a rate base
3 growth, which you can see there from the 897 million to
4 the 925 million, which also contributes to decreasing
5 return on rate base.

6 Q. All right.

7 A. Which is from gross additions.

8 Q. All right. Now with respect to directory
9 revenues, tell me if this is an accurate summary of your
10 testimony, that prior to 2000 directory revenues were
11 attributed or allocated to intrastate operations; is
12 that correct?

13 A. The intrastate operations included a portion
14 of directory revenues consistent with the contract that
15 was in place between Washington and the directory
16 company.

17 Q. All right. But that after 1999, because of
18 an FCC order, revenues were no longer allocated to
19 intrastate or simply reduced?

20 A. Well, and I will just maybe use a little bit
21 different words than you used, because we never
22 allocated the revenues there. There was a contract
23 between Verizon Directory Corporation and Verizon
24 Washington, which in compliance with the affiliate rules
25 resulted in certain revenues related to directory

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1 publishing being on the directory books and certain
2 revenues being on Verizon Washington intrastate
3 financials. And then in 1999, which I misstated earlier
4 as 1996, the FCC issued an order on directory listings
5 and dictated that directory listings be charged at --
6 sold by the ILEC at 4 and 6 cents respectively to
7 anybody who wanted to buy them, whether it was our
8 affiliated directory company or not, and so there was a
9 contract change in the year 2000. And then at that
10 point in time, the revenues that are reflected on
11 Verizon's Washington books reflect the money we received
12 from Verizon Directory Corp. for those sale of the
13 listings in accordance with the FCC rates.

14 Q. All right. So first, the correct date of the
15 FCC order is what year?

16 A. 1999. That was my mistake.

17 Q. All right. And I'm still unclear whether the
18 order required, well, I don't know what the right word
19 is if it's not allocation, but are revenues from
20 directories still attributed to intrastate or not?

21 A. Maybe I will say it a little bit different.
22 When we have a contract between Verizon Washington and
23 an affiliate company, the affiliate records their
24 revenues for their services that they provide, okay.
25 And Verizon Washington will record the revenues for

0203

1 services that they are providing to the affiliate
2 company, okay. So prior to 1999 or prior to 2000 and
3 after that, the ILEC books reflect the revenues that the
4 ILEC received for providing service to the affiliate
5 company, which in this case is the sale of the directory
6 listings. So before and after, the revenues are there.
7 They're in a different amount because of the order.

8 Q. Okay, so the change from '99 to 2000 was of
9 amount, not where something got put into an account?

10 A. Yes, because it was never allocated. It's an
11 arms length transaction, you know. Per contract we
12 provide services to them, they provide services to us,
13 and there's a -- we follow the affiliate rules. And in
14 this case starting in the year 2000, the FCC set the
15 rate for the listings, and so the directory company
16 along with any other company that might be buying our
17 listings pays that tariffed rate. And before that,
18 there was no specific tariffed rate associated with
19 directory listings.

20 Q. I see. Then your third point was that
21 because Verizon, because the regulated company, Verizon
22 Northwest, does not own and I gather never did own or
23 not in recent times owned the directory pages that
24 imputation a la Qwest is not appropriate. Am I correct
25 on that?

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1 A. That's correct. If you refer to
2 Mr. Trimble's testimony in the general rate case, the
3 directory company actually existed before GTE as an ILEC
4 existed and has been and remains separate since like the
5 early 1920's and has never been part of an ILEC, of
6 Verizon Washington, never funded by the rate payer,
7 never developed by rate payer funds, it has always been
8 separate. Very different than the Qwest situation.

9 Q. And I guess I'm still a little confused. If
10 we go back to let's just say 1995, something in the
11 past, how if at all does that -- did revenue or some
12 kind of value or service show up in intrastate
13 operations, if it ever did?

14 A. It did.

15 Q. And how?

16 A. But it was for -- it's not directory
17 publishing revenue, because that's the revenue of the
18 directory business. It's revenue that Verizon
19 Washington received from providing a service, the sale
20 of the listings for example, to Verizon Directory
21 Corporation. And likewise if there were services that
22 Verizon Directory Corp. provided to Verizon Washington,
23 we would record an expense in accordance with the
24 contract, which is consistent with the affiliate rules.

25 Q. All right. So in 1995, the regulated company

0205

1 received revenue from the directory company for the --

2 A. For --

3 Q. -- for providing names or some other service?

4 A. Whatever services we provided, that's

5 correct.

6 Q. All right. In the year 2003, did the

7 regulated company receive revenue in the same manner,

8 some amount of revenue in the same manner?

9 A. They received revenue through a contract for

10 services provided in accordance with the affiliate

11 rules, yes.

12 Q. And is that reflected in intrastate

13 operations?

14 A. Yes, it is.

15 Q. So it's simply at a lower level than it used

16 to be?

17 A. Yes.

18 Q. Because of the FCC order?

19 A. That's correct.

20 Q. Thank you, and I'm sorry it took me so long

21 to work through that.

22 A. That's all right.

23 CHAIRWOMAN SHOWALTER: That's all I have.

24 JUDGE WALLIS: Are there other questions from

25 the Bench? Commissioner Hemstad.

0206

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2

E X A M I N A T I O N

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BY COMMISSIONER HEMSTAD:

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Q. I'm still trying to grasp the directory revenue issue. With the change that the FCC apparently ordered, did overall revenue to Verizon Communications, Inc., go down?

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9

10

A. Did revenue go down, is that what you said?

Q. Of the parent company, the parent of Verizon Northwest and of the affiliate publisher.

11

12

A. To Verizon Communications, you're asking if the revenue for Verizon Communications went down?

13

Q. Yeah.

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A. The revenue of Verizon Communications before and after the year 2000 would not have been affected. The best way I can explain that is Verizon Directories Corporation would have directory publication revenues, and Verizon Northwest Washington would have revenues for providing affiliate service to the directory company, and at the Verizon Communication level those revenues would be eliminated as intercompany elimination, okay. And then that same process occurs post the change. When there is an affiliate relationship, it essentially is eliminated so you don't double count when you're providing -- representing the corporate parent books.

0207

1 Q. Well, what I'm trying to get at is in the
2 overall consolidated books of the entire company,
3 Verizon Communications, Inc., I guess is the parent.

4 A. Mm-hm.

5 Q. Was there any reduction in revenue or
6 earnings as a result of what the FCC ordered?

7 A. No, because of the elimination that takes
8 place, just an accounting issue that happens.

9 Q. All right. So what we're talking about then
10 is a shifting of revenues between Verizon Northwest and
11 the affiliate publishing company?

12 A. No, the Verizon Publishing Company has always
13 had their directory revenue for selling Yellow Pages,
14 okay. That revenue, you know, is what it is before and
15 after. What we're talking about is the value of the
16 sale of that listing, the white page listing that the
17 ILEC has for their customers to an affiliated or
18 non-affiliated directory provider. The FCC essentially
19 established a value for that by saying your tariff rate
20 should be 4 and 6 cents, okay. And so that revenue for
21 the ILEC is now based on that tariffed rate.

22 Q. Well, all right, let me phrase it this way.
23 The result of whatever happened there, the publishing
24 company is better off, and Verizon Northwest is worse
25 off?

0208

1 A. The publishing company has the publishing
2 revenues, and Northwest has lower revenues from
3 providing the sale of directory listings because of the
4 tariffed rate by the FCC.

5 Q. I at least scanned the exhibit with the
6 testimony dealing with this issue about the history, and
7 is it the position of the company that the historical
8 imputation never was proper?

9 A. Well, I mean I guess I'll go back and restate
10 what I said before. The majority of the revenues that
11 we had reflected like in the 1992, or '82, excuse me,
12 rate case were not an imputation. It was associated
13 with an affiliated contract, so it's not an imputation.
14 It was a business, you know, contract that was there.
15 But in general it would -- if you're asking would
16 directory imputation be appropriate, no.

17 Q. Then I was trying to grasp the dialogue back
18 and forth here about the relationship of this issue and
19 the position of the Staff. Was it Staff's position then
20 that post FCC tariff or order dealing with this issue
21 that the company should impute?

22 A. I haven't seen anything from the Staff
23 related to the order. What they asked us to do was
24 calculate the imputation based on what they're familiar
25 with with U S West.

0209

1 Q. And when did they do that?

2 A. Originally in the access case.

3 Q. And what year was that?

4 A. Last year for purposes of the financials that
5 we filed in the access case, and then in preparing for
6 this rate case we continued with that same calculation.

7 Q. In the questions and answers from Mr. Trotter
8 and again your conversation back and forth, I was trying
9 to follow and find is there anywhere in any of the
10 exhibits a statement of your cash position?

11 A. That would have been in Dr. Vander Weide's
12 testimony.

13 Q. And you in your capacity can't identify that?

14 A. Well, if I had Dr. Vander Weide's exhibits, I
15 don't have any of his exhibits or anything with me.

16 Q. Well, I was left with the impression that in
17 the reports made by the company here, your quarterly
18 reports apparently weren't -- doesn't show your cash
19 position.

20 A. No, we report earnings, the intrastate
21 earnings.

22 Q. But that's not cash.

23 A. Net income, not cash.

24 Q. So in that sense, a financial statement is
25 not listed, but that's apparently what you're going to

0210

1 provide?

2 A. Right, well, that's what I testified to
3 previously, that the rate base elements that are used in
4 rate making, plant, the reserve, different taxes, those
5 are the balance sheet items that I testified to earlier
6 that we maintain at the intrastate level. But the items
7 like cash and those type of things we're not required to
8 report to the Commission, and they're not used in rate
9 making from the earnings standpoint, which is what I
10 provide. We do have like the annual report will show
11 the balance sheet at a Washington level, which is what
12 we're required to provide.

13 Q. So from that I would take it then that there
14 is no exhibit in front of us that would show any
15 projection of your cash levels between now and next May?

16 A. Yeah, this -- I can't speak for Dr. Vander
17 Weide's testimony, whether he has any projections in it
18 or not, but all of the financial information that I
19 filed with the case is historical in nature.

20 Q. Well, one of the elements that the Commission
21 at least historically has looked at in a request for
22 interim relief is the ability for the company to
23 continue to carry on its operations and have the cash to
24 do so. Do you have any knowledge or expertise about
25 that issue and the ability of the company to have cash

0211

1 flow over the next several months to meet its
2 operational requirements?

3 A. Yeah, I mean the only thing I can testify to
4 in that, because I mean that was Dr. Vander Weide's
5 area, but I'm not aware of anything that is expected to
6 happen over the next, you know, six months or whatever
7 that would change our current financial situation.

8 Q. Do you anticipate any extraordinary expenses
9 over that period of time?

10 A. I don't think I'm in the position to answer
11 that.

12 Q. Would Mr. Banta know that?

13 A. For maybe the area that he's responsible for.

14 COMMISSIONER HEMSTAD: That's all I have,
15 thank you.

16 THE WITNESS: Thank you.

17

18 E X A M I N A T I O N

19 BY CHAIRWOMAN SHOWALTER:

20 Q. Could I ask just one follow-up question.
21 Commissioner Hemstad, he asked you about a question
22 using imputation, and I'm just going to ask you a
23 question without using that word. Is it the case that
24 the FCC essentially found that the contract amount that
25 the regulated company was charging to the directory

0212

1 services was too sweet a deal for the regulated company?

2 A. I mean there isn't any specific finding
3 related to Verizon, but that is essentially it. Because
4 what they did at that point was establish the value for
5 the sale of the directory listings, and what we were
6 receiving was far in excess of that.

7

8 E X A M I N A T I O N

9 BY COMMISSIONER HEMSTAD:

10 Q. But I'm still having trouble grasping this,
11 and maybe the answer is simple, but why would the FCC
12 care about whether it was too sweet for you in dealing
13 with an unregulated affiliate?

14 A. Yeah, and again, it wasn't anything that was
15 unique to Verizon, it was an industry order where they
16 set the value of the directory listings. What the
17 entire history of that is I can't speak to.

18

19 E X A M I N A T I O N

20 BY CHAIRWOMAN SHOWALTER:

21 Q. It might have been competition, that if a
22 regulated company charged a very high price to its
23 affiliate, that wouldn't hurt the company, but if it
24 charged the same very high price to a non -- to an
25 unrelated company, it would make a difference to that

0213

1 unrelated company, and/or simply the real either cost or
2 value was lower than what was being charged.

3 A. Right, because I do believe the rate was set
4 based on the cost, and then there's the value, the rate
5 associated with that cost, and that rate applies to
6 affiliated and non-affiliated directory publishers, that
7 is correct.

8 Q. So at least relative to Verizon, the effect
9 of the general order was to reduce the amount that the
10 regulated company could charge Verizon Yellow Pages or
11 anybody else?

12 A. That is correct.

13 Q. And so then if you take the FCC as an
14 authority on this, then what, the years prior to 1999 or
15 prior to 2000 were too rich, and now that revenue
16 requirement is "just right" if the FCC is the authority
17 on the issue?

18 A. That is correct.

19 CHAIRWOMAN SHOWALTER: Okay, thank you.

20

21 E X A M I N A T I O N

22 BY COMMISSIONER OSHIE:

23 Q. Ms. Heuring, I just want to perhaps be the --
24 receive some of your insight into the history of the
25 publishing business that was owned by GTE. It seems as

0214

1 if your references to those prior arrangements were
2 always to Verizon or Verizon Directory. I'm assuming
3 that prior to the merger that GTE owned a directory
4 publishing business as well as the ILEC.

5 A. GTE Corporation?

6 Q. Yes.

7 A. Had two subsidiaries, in this case Verizon
8 Washington and Verizon Directory Corporation. And what
9 I testified to is that starting, and this is on
10 Mr. Trimble's testimony in the general rate case, but
11 that the genesis of the directory company was back in
12 the 1926 time frame prior to the existence of GTE as a
13 telephone operating company.

14 Q. But they were -- but they owned the directory
15 publishing business, GTE, the parent company, so to
16 speak?

17 A. The parent company owned both the regulated
18 ILECs and the directory publisher.

19 Q. And just to be clear, in the merger the
20 directory publishing business was also sold to Verizon
21 by GTE, or acquired, let's use that term?

22 A. Right, because it was a merger.

23 Q. Yeah.

24 A. So yes.

25 COMMISSIONER OSHIE: All right, no other

0215

1 questions, thank you.

2 JUDGE WALLIS: Mr. Parker.

3 MR. PARKER: Just a few.

4

5 R E D I R E C T E X A M I N A T I O N

6 BY MR. PARKER:

7 Q. Staying on Yellow Pages for a moment,

8 Ms. Heuring, have the rate payers of Verizon Northwest

9 ever supported the development of the directory company?

10 A. No, they have not.

11 Q. Has the directory company ever been a

12 regulatory asset on the ILEC's books?

13 A. No, it has not.

14 Q. Ms. Heuring, have you in your personal life

15 ever had a second line?

16 A. Yes, I have.

17 Q. Do you still have that second line?

18 A. No, I do not.

19 Q. Why not?

20 A. For a number of reasons. The primary one is

21 that the second line doesn't provide the speed or

22 capacity that I need to work from home and allow my

23 children to access the Internet and for me to access,

24 you know, and do work from the house, and I can do it

25 all with one line and have the speed that I need.

0216

1 MR. PARKER: I have nothing further.

2

3 E X A M I N A T I O N

4 BY CHAIRWOMAN SHOWALTER:

5 Q. Well, I think the implication there was you
6 have DSL and voice on your one line.

7 A. Yeah, I'm sorry if I didn't say that. I used
8 to have two lines, one for the home and one for computer
9 and fax machine, and now I have one line which has DSL,
10 and it has distinctive ring for the fax line, and that's
11 what I use today.

12 JUDGE WALLIS: Are there other questions?

13 MR. TROTTER: Your Honor.

14 JUDGE WALLIS: Mr. Trotter.

15 MR. TROTTER: Just one.

16

17 R E C R O S S - E X A M I N A T I O N

18 BY MR. TROTTER:

19 Q. Ms. Heuring, are you aware that the New
20 Hampshire Public Utility Commission earlier this summer
21 issued an order confirming imputation of directory
22 revenues and rejecting Verizon's arguments that
23 imputation was prohibited by the Telecommunications Act
24 or the FCC order that you're referring to?

25 A. I'm aware of the order, and I will explain to

0217

1 you the difference. New Hampshire is part of the former
2 NYNEX, which is a Bell company, which owned the
3 directory company, and the rate payers funded the
4 development of the company.

5 Q. Okay. Do you see anything in the FCC order
6 that you rely on that creates such a distinction or
7 recognizes such a distinction whatsoever?

8 A. What distinction are you talking about?

9 Q. Between prior ownership of a directory asset
10 and non-prior ownership of a directory asset.

11 A. In that I'm not referring to the FCC order,
12 that's --

13 Q. I am, my question was related exclusively to
14 the FCC order.

15 A. The FCC -- the answer is no, the FCC order
16 addressed the sale of directory listings.

17 Q. Okay. And so the New Hampshire Commission in
18 its order rejected your arguments that that FCC order
19 controlled, didn't it?

20 A. No, it did not.

21 Q. I will accept your answer, and we'll argue
22 it, thank you.

23 A. Thank you.

24 JUDGE WALLIS: Are there other questions?

25 It appears not.

0218

1 We do have a Bench request for the company.
2 It may or may not be something that this witness would
3 provide, and that is that the company provide the
4 company's projected cash flow through June 1 of 2005 on
5 a Washington intrastate basis.

6 MR. PARKER: That would be Bench Request
7 Number 3, Your Honor?

8 JUDGE WALLIS: Yes, it is.

9 MR. PARKER: All right.

10 JUDGE WALLIS: Very well, and with that I
11 believe there's nothing further of this witness.
12 Ms. Heuring, thank you for appearing, you're excused
13 from the stand at this time.

14 Let's be off the record for a brief period to
15 allow a change in witnesses.

16 (Discussion off the record.)

17 JUDGE WALLIS: Let's be back on the record,
18 please, following a brief recess. Verizon has called
19 its next witness, Steven M. Banta, to the stand. In
20 conjunction with Mr. Banta's appearance, a number of
21 documents have been proposed for consideration. Verizon
22 has submitted Exhibits 61T through 63T, 64C, excuse me.
23 Commission Staff and others have also proposed exhibits
24 through Exhibit Number 83, and I will ask that the court
25 reporter identify these for the record at this point in

0219

1 the record.

2

3

(The following exhibits were identified in
4 conjunction with the testimony of STEVEN M.
5 BANTA.)

6 (Verizon)

7 61T SMB-2T, Direct Testimony

8

9 62C SMB-3C, table of rates and revenues, REVISED
10 5/, 2004 (1pg) CONFIDENTIAL

11 63T SMB-4T, rebuttal testimony (12pp)

12 64C SMB-5C, summary of Interim Surcharge proposal,
13 REVISED AUG. 3, 2004 (1pg)

14 (Staff)

15 65 News Release, July 27, 2004: Verizon

16 Communications Reports 6% Second-Quarter

17 Revenue Growth, Led by Wireless Revenue Growth
18 of 25% (7pp)

19 66 Verizon Response to Staff Data Request No. 67,
20 (1pg)

21 67 Certified copy, Application of Bell Atlantic

22 Corporation and GTE Corp. for Approval of

23 GTE-Bell Atlantic merger, WUTC Docket No.

24 UT-981367 (21pp)

25

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1 68C CONFIDENTIAL Revenue impact of Company's
2 proposed late payment charges, 1 page
3 69 Verizon Response, Staff DR No. 221 (1pg)
4 70 Verizon Response, Staff DR No. 250, Attachment
5 250 (4pp)
6 71 Verizon Web pages, Verizon Product
7 Description, (3pp)
8 (Public Counsel)
9 72 Verizon web site pages (4pp)
10 (WebTEC)
11 73 Verizon NW WN U-21 Tariff Sheets, Sec. 5
12 (25pp)
13 74C Verizon response to WebTEC DR No. 3
14 CONFIDENTIAL
15 (Staff)
16 75 Verizon response to Staff DR No. 79 (1pg)
17 76 Verizon response to Staff DR No. 80 (1pg)
18 77 Verizon response to Staff DR No. 81 (1pg)
19 78 Verizon response to Staff DR No. 82 (1pg)
20 79 Verizon response to Staff DR No. 83 (1pg)
21 80 Verizon response to Staff DR No. 91 (1pg)
22 81C Verizon response to Staff DR No. 76 (2pp,
23 incl. one CONFIDENTIAL pg)
24 82 Verizon response to Staff DR No. 84 (1pg)
25 83 Verizon response to Staff DR No. 11 (8pp)

0221

1 JUDGE WALLIS: Mr. Banta, would you please
2 stand and be sworn.

3

4 Whereupon,

5 STEVEN M. BANTA,
6 having been first duly sworn, was called as a witness
7 herein and was examined and testified as follows:

8

9 D I R E C T E X A M I N A T I O N

10 BY MR. PARKER:

11 Q. State your name for the record, please.

12 A. Steven M. Banta.

13 Q. And your business address, Mr. Banta?

14 A. I'm at 600 Hidden Ridge, Irving, Texas 75038.

15 Q. Mr. Banta, do you have before you what's been
16 marked as Exhibit 61T, which contains your direct
17 testimony?

18 A. Yes, I do.

19 Q. And there is an exhibit to that, which is
20 marked 62C; is that correct?

21 A. That's correct.

22 Q. And do you also have before you your rebuttal
23 testimony, which has been marked as 63T, with its
24 associated exhibit marked 64C?

25 A. That's correct.

0222

1 Q. Are there any corrections, additions, or
2 deletions that need to be made to those exhibits at this
3 time?

4 A. No, there are not.

5 Q. And are they true and correct to your best
6 belief and knowledge?

7 A. Yes, they are.

8 MR. PARKER: Mr. Banta is available, and I
9 would offer those exhibits, Your Honor.

10 JUDGE WALLIS: Is there objection to the
11 exhibits?

12 Let the record show that there's no response,
13 and 61T through 64C are received.

14

15 C R O S S - E X A M I N A T I O N

16 BY MR. TROTTER:

17 Q. Good afternoon, Mr. Banta.

18 A. Good afternoon.

19 Q. You are Verizon Northwest's policy witness in
20 this case, correct?

21 A. That is correct.

22 Q. And Verizon is seeking \$29.7 Million in
23 interim rate relief by means of a \$3.54 surcharge to
24 many of its business and residential line rates; is that
25 correct?

0223

1 A. That is correct.

2 Q. Please turn to page 2 of your direct
3 testimony, 61T, line 10.

4 A. I'm there.

5 Q. And you start off by saying that you're
6 requesting interim relief:

7 Because the company's current intrastate
8 rate of return is well below authorized
9 levels, indeed it is non-existent.

10 Interim relief is also needed to avoid
11 gross hardship.

12 Do you see that?

13 A. Yes.

14 Q. And the return you're referring to is the
15 negative .47% testified to by Ms. Heuring?

16 A. That's correct.

17 Q. Now a 3.5% return would also be well below
18 authorized levels, would it not?

19 A. Yes, that would be well below authorized
20 levels.

21 Q. Now Verizon selected the \$29.7 Million amount
22 because that is the amount by which Verizon's access
23 charges were reduced in October of 2003; is that right?

24 A. Well, we picked -- yes, that is -- that is
25 right. We chose the 29.7 because that is a clearly

0224

1 defined number that reflects the revenue that we lost as
2 a result of the Commission action. And we used that
3 number, even though we could have probably justified a
4 higher number, that was a clearly defined number that
5 was beyond our control.

6 Q. Turn to page 5 of your direct testimony, and
7 you talk about the gross hardship and gross inequity,
8 and you cite the AT&T access charge complaint case, and
9 that's the access charge reduction that we just talked
10 about, right?

11 A. Yes.

12 Q. Now in the year 2000, Verizon Directory, and
13 we have heard testimony on this, ceased paying Verizon
14 Northwest some \$34 Million annually related to
15 directory, correct?

16 A. That's right.

17 Q. And that revenue reduction had a more
18 significant financial impact on Verizon Northwest than
19 the Commission's order in the access charge docket, did
20 it not?

21 A. Well, at that time that was the impact, but I
22 think Ms. Heuring gave you many of the reasons why that
23 change was made. And it was done in a different time
24 also in terms of where we were in terms of our earnings.

25 CHAIRWOMAN SHOWALTER: In terms of what?

0225

1 A. In terms of the Northwest company's earnings.

2 Q. Well, that impact continues to the present,
3 does it not?

4 A. I think this is why we're addressing this in
5 the general rate case, because the yellow page industry
6 is highly competitive. What the FCC did was say that we
7 want this to be done on a non-discriminatory basis.
8 They changed the rules that we had to play by. And so
9 we have to provide our listings on a non-discriminatory
10 basis to whoever wants them, and so there is no special
11 advantage for a Verizon entity to be able to publish
12 that. Why would they pay us more than they pay somebody
13 else? So I think that what I'm trying to say is that if
14 you look at that business today, that trying to sustain
15 that type of a relationship just could not have
16 happened. But that's why, that's why we're addressing
17 that in the general rate case.

18 Q. I would like an answer to my question, and
19 the question was, the impact of the loss of directory
20 revenue didn't just occur in the year 2000, but every
21 year since, correct?

22 A. I would not agree that it would be the same
23 amount of revenue.

24 Q. Turn to Exhibit 70.

25 A. Yes.

0226

1 Q. And do you recognize this as a portion of the
2 company's response to Staff Data Request 250?

3 A. Yes.

4 Q. And is this exhibit the company's advocacy
5 plan regarding directory services that was issued in
6 March of the year 2000?

7 A. Yes, it is.

8 Q. Under the key messages section it states:
9 The new fee for service contract will
10 not impact the rates of the subscriber.
11 Customers will continue to be charged
12 their current rates. In states where we
13 are required to impute, the imputation
14 will continue to occur.

15 Do you see that?

16 A. Yes, I do.

17 Q. Now there are some terms on this sheet that
18 may not be apparent. Can you define what GTE DC means?

19 A. Directory Company.

20 Q. And GTE NS?

21 A. Network Services.

22 Q. Turn to page 3 of the exhibit, item 9, the
23 question is asked:

24 How will this shift in revenues affect
25 the bond rating of a company?

0227

1 Do you see that?

2 A. Yes, I do.

3 Q. What's the answer?

4 A. What it says here is, will not affect bond
5 ratings.

6 May I clarify what my understanding of this
7 message is?

8 Q. Go ahead.

9 A. Thank you. At the time that we made this
10 change that -- where there was an imputation, we were
11 saying that imputation would not change or that the
12 change itself would not impact the rates of subscribers.
13 That should not have been meant to be interpreted that
14 some day at some time when we come before a regulator
15 that there may not be an impact, but it's a combination
16 of the change in the contract and what was going on in
17 the yellow pages industry at that time.

18 Q. And how do you explain the language, in
19 states where we are required to impute, the imputation
20 will continue to occur?

21 A. That's simply stating that the imputation is
22 there, and until a commission makes a different, a
23 decision otherwise, we were -- it would not change.

24 Q. Would you turn now to Exhibit 65, and do you
25 recognize this as a press release issued on July 27th of

0228

1 this year by Verizon Communications?

2 A. Yes.

3 Q. And Verizon Communications owns 100% of
4 Verizon Northwest, correct?

5 A. Yes, it does.

6 Q. All of Verizon Northwest's operating results
7 are reflected on the consolidated books of Verizon
8 Communications, correct?

9 A. I'm not an accountant, but that would be my
10 assumption.

11 Q. And just overall, would it be fair to say
12 that Verizon Communications had an outstanding second
13 quarter for 2004?

14 A. I think Verizon Wireless had an outstanding
15 quarter.

16 Q. So you interpret this press release as being
17 a positive only with respect to Wireless?

18 A. I think with some of our growth areas and
19 especially with Verizon Wireless, that is where the real
20 strength came from.

21 Q. Turn to page 4 of the exhibit, and the fourth
22 bullet down says:

23 Approximately 50% of Verizon residential
24 customers have purchased local services
25 in combination with either Verizon Long

0229

1 Distance or Verizon DSL or both.

2 Do you see that?

3 A. Yes, I do.

4 Q. Is that a positive development for Verizon
5 Communications?

6 A. I think what it says is that one of our
7 primary competitors being the cable industry that we
8 have found a way to begin to make inroads with cable,
9 and it's really -- I think the only way you can look at
10 that is that it is the customers that are setting the
11 standards for what their expectations are. And if we
12 can't make inroads with the cable companies, chances are
13 if we lose somebody to a high speed cable modem, next
14 we're going to lose their telephone line, and we no
15 longer have them at all for a customer. So yes, in
16 terms of being able to retain customers and retain
17 revenue, I think that is a positive statement.

18 Q. And is that percentage consistent with
19 Verizon Northwest's experience in Washington?

20 A. No, it is not.

21 Q. And is that because Verizon DSL has not been
22 rolled out in all of your exchanges in Washington?

23 A. I can't tell you precisely where we offer DSL
24 in Washington, so I can't -- I don't know if that's
25 driven by marketing or by our competitors already having

0230

1 the customers or by some other factor.

2 Q. The next bullet says:

3 The average revenue per month per
4 Verizon residential wireline customer
5 increased nearly 6% in the second
6 quarter 2004 compared to the second
7 quarter 2003.

8 Do you see that?

9 A. Yes.

10 Q. And would revenue from wireline customers
11 include DSL and long distance services provided by
12 Verizon Long Distance?

13 A. I can't speak to the basis for that statement
14 in this release.

15 Q. Changing subjects, Verizon Communications
16 exists as the result of a merger between GTE Corp. and
17 Bell Atlantic; is that correct?

18 A. Yes, that is correct.

19 Q. And before the merger, Verizon Northwest was
20 called GTE Northwest, and it was wholly owned by GTE
21 Corp.; is that correct?

22 A. Yes.

23 Q. And the Commission held hearings on whether
24 that merger should be approved or not, correct?

25 A. Yes, it did.

0231

1 Q. Would you turn to Exhibit 66, please.

2 A. I'm there.

3 Q. And do you recognize this as the company's
4 response to Staff Data Request 67?

5 A. Yes.

6 Q. And this was an excerpt of the transcript in
7 the Commission dockets, one of which involved the
8 merger, correct?

9 A. That's correct.

10 Q. And Ms. McHeran is the witness, and she was
11 appearing on behalf of Bell Atlantic Corporation; is
12 that right?

13 A. Yes.

14 Q. And beginning on line 24 of the transcript,
15 there she testified:

16 The scope and scale --

17 Small digression here, she's referring to the
18 scope and scale of the merged company.

19 The scope and scale is critical to
20 making sure that all consumers in
21 Washington state are served by a company
22 that is financially sound and has access
23 to the capital markets and has the
24 personnel and the experience and
25 expertise to compete vigorously in what

0232

1 is an increasingly consolidating market,
2 and this will allow us to provide growth
3 opportunities as well as to achieve
4 efficiencies.

5 Is that what she said?

6 A. Yes, it is.

7 Q. Now doesn't that say that the scope and scale
8 of the merged company would inure to the financial
9 benefit of the local operating company in the state of
10 Washington?

11 A. Yes, it does.

12 Q. Turn then to, well, at the bottom of that
13 exhibit, the company noted that she appeared on behalf
14 of Bell Atlantic Corporation only; do you see that?

15 A. Yes.

16 Q. And would you accept subject to your check
17 that GTE Corporation, the other merging company, took no
18 exception to her testimony on that docket?

19 A. I would agree with that statement.

20 Q. Let's turn --

21 A. Well, maybe I need to qualify that. I would
22 not take exception to what I have seen here.

23 Q. And you can accept that subject to check?

24 A. Yes.

25 Q. Turn to page 60, excuse me, Exhibit 67, and

0233

1 do you recognize this as the merger application that was
2 filed with this Commission excluding attachments?

3 A. Yes.

4 Q. And this is the work of both Bell Atlantic
5 and GTE Corp., correct, as shown on page 17?

6 A. Yes.

7 Q. Turn to page 9 of that exhibit, and beginning
8 on the second new paragraph:

9 GTE and Bell Atlantic give several
10 reasons why merging will better achieve
11 their mutual goals in the changing
12 telephone environment.

13 Do you see that?

14 A. Yes.

15 Q. And the first reason is to ensure that each
16 company, I think that refers to GTE and Bell Atlantic,
17 will remain a strong, healthy provider of basic
18 telecommunications services in its current territories,
19 correct?

20 A. Yes.

21 Q. A second reason was so that each company as a
22 merged company would be able to offer fully integrated
23 telecommunications services to both business and
24 residential customers, correct?

25 A. Yes.

0234

1 Q. And that includes wireless, video, long
2 distance, as well as voice, correct?

3 A. That's correct.

4 Q. On page 10, the company also said beginning
5 with that first new paragraph:

6 The merged company will have more
7 financial and operational strength than
8 either company would have on its own.

9 Do you see that?

10 A. Yes.

11 Q. And then the final sentence of that paragraph
12 says:

13 Consequently, the merged company can
14 over the long term translate these
15 parent company benefits into stronger
16 support for its operations in
17 Washington, thereby benefiting both
18 business and residential consumers.

19 Do you see that?

20 A. Yes, and that has happened.

21 Q. Let's go back to your -- oh, excuse me, turn
22 to your rebuttal testimony, Exhibit 63T, page 5, I'm
23 sorry, I meant your direct testimony, I apologize, 61T,
24 page 5, line 19.

25 A. Okay.

0235

1 Q. And you note that, and I think you're talking
2 about the \$29.7 Million:

3 Verizon will not be able to recover this
4 shortfall even if the Commission
5 determines that every single dollar in
6 access charged reductions should be
7 recovered.

8 Do you see that?

9 A. Yeah, what I'm saying is that even -- we have
10 lost approximately \$22 Million in revenues even if the
11 Commission takes action.

12 Q. And that's because of the time required to
13 conduct a rate case; is that right?

14 A. That is one component, yes.

15 Q. And the time you are referring to to prepare
16 a rate case is the time from the Commission order in the
17 access charge complaint case in August of 2003 to the
18 date the company filed its general rate case in April of
19 2004?

20 A. Yes. I think I should explain, if you would
21 like, the series of events to explain why it took us so
22 long to be able to do that.

23 Q. That's not where I'm going with this.

24 A. All right.

25 Q. Now the access charge complaint by AT&T was

0236

1 filed in May of 2002, correct?

2 A. Subject to check, yes.

3 Q. And the company could have filed a general
4 rate case any time after July 1, 2002, correct?

5 A. I don't think that was a realistic option for
6 the company at that time.

7 Q. The July 1st, 2002, date was the end of the
8 stay out provision in the merger settlement that Verizon
9 agreed to.

10 A. Technically we could have filed a rate case
11 at that time, but when we looked at the AT&T access
12 complaint and other issues that we had, we chose not to
13 do so at that time.

14 Q. Now the Commission approved the merger in
15 December of 1999, correct?

16 A. Yes.

17 Q. And another event that was going on in the
18 1999 to 2000 time frame was a represcription of Verizon
19 Northwest's depreciation rates for Washington
20 intrastate, correct?

21 A. That is correct.

22 Q. Please turn to Exhibit 69, and do you
23 recognize this as your response to Data Request 221 of
24 Staff?

25 A. Yes.

0237

1 Q. And this regards your testimony regarding
2 docket, in this case, regarding Docket UT-992009, and
3 that was that represcription docket that was going on in
4 the 1999-2000 time frame?

5 A. Yes.

6 Q. And the question asked whether Verizon asked
7 the Commission to change its rates to address the
8 increased depreciation expense that resulted from that
9 case with some \$21.5 Million, and your answer was that
10 the depreciation rate order came out in June of 2000,
11 and you were in the stay out period at that time. Is
12 that right?

13 A. Yes.

14 Q. Now the settlement agreement that included
15 that stay out provision was negotiated at a time when
16 the depreciation Docket UT-992009 was pending, was it
17 not?

18 A. It was pending.

19 Q. So you knew that it was possible, if not
20 likely, that the Commission would represcribe your
21 depreciation rates in that docket during the stay out
22 period?

23 A. I don't think it's fair to say that we knew
24 what the outcome of that represcription would be.

25 Q. Right, but you knew there would be an outcome

0238

1 during the stay out period?

2 A. It could have been -- yes.

3 Q. And --

4 A. It could have been denied the represcription
5 entirely, or it could have been some other amount, but
6 we just knew that it would be decided in that time
7 frame.

8 Q. Would it be fair to say that Verizon by
9 agreeing to the stay out period while that docket was
10 pending took the risk that the Commission would
11 prescribe \$21.5 Million in additional depreciation?

12 A. Yes.

13 Q. Please turn to your rebuttal testimony, 63T,
14 page 8, and on line 15 you address the issue of Verizon
15 Northwest shifting revenue from regulated local exchange
16 service to non-regulated affiliates; is that right?

17 A. Yes.

18 Q. And you state on line 18:

19 When Verizon Northwest customers migrate
20 to any competitive carrier, including
21 Verizon Wireless or Verizon Online for
22 DSL, it is driven completely by customer
23 choice.

24 Do you see that?

25 A. Yes.

0239

1 Q. You go on to say:
2 Verizon Northwest works to be responsive
3 to the needs of our customers but has no
4 control over their decisions.

5 That's also your testimony?

6 A. Yes.

7 Q. Now Verizon Northwest does not offer DSL
8 service, does it?

9 A. Verizon Northwest does not offer DSL service.

10 Q. Is Verizon Northwest technically capable of
11 providing DSL service?

12 A. I'm not an engineer, and I think that that is
13 more -- well, I would say that that technical capability
14 would be there.

15 Q. Okay. So the reason Verizon Northwest does
16 not offer DSL is a result of a choice made by
17 management; is that correct?

18 A. I think it's driven more by regulatory
19 dictate in that DSL being an interstate service and
20 defined as such that we put in place an affiliate that
21 could market DSL on a national basis.

22 Q. And that entity was not Verizon Northwest; is
23 that right?

24 A. That's correct.

25 Q. Would you turn to Exhibit 71, please, and do

0240

1 you recognize Exhibit 71 as an excerpt from Verizon's
2 Web page?

3 A. Yes.

4 Q. And this is a service called Verizon Freedom
5 with DSL; is that right?

6 A. That's correct.

7 Q. And this service includes local and toll
8 calling, calling features, and online DSL service, among
9 other things, correct?

10 A. That's correct.

11 Q. Now on the first page if we go a little over
12 halfway down, it says, how to get started, and one
13 condition is that the customer must have Verizon as its
14 local service provider, right?

15 A. That's correct.

16 Q. So if I lived in Everett, I would qualify for
17 this service, correct?

18 A. That's correct.

19 Q. But if I lived in Ellensburg, I would not,
20 correct?

21 A. Yes.

22 Q. And by local service, this means basic
23 exchange service regulated by this Commission?

24 A. That's correct.

25 Q. Now the other conditions are that the

0241

1 customer must select Verizon Long Distance or VLD as its
2 long distance provider and Verizon Online as its DSL
3 service provider, correct?

4 A. That's correct.

5 Q. And those two companies are affiliates of
6 Verizon Northwest, correct?

7 A. That's also correct.

8 Q. Now this example of marketing services is
9 Verizon's choice, is it not?

10 A. Well, it's our choice driven by what our
11 customers tell us that they want. And as I stated
12 earlier, what we have found is that we're competing with
13 cable providers, and we're not the only network out
14 there anymore, and that if we want to be able to retain
15 our customers and provide them services that they want,
16 that this is a desirable package for them. So from the
17 Northwest company perspective, this is a way to be, I
18 believe, to retain customers and revenues.

19 Q. If a customer is using Verizon Northwest for
20 toll, it must switch to VLD in order to get this
21 service, right?

22 A. Yeah, but I think it's better for Verizon
23 Northwest to be able to retain the customer and be able
24 to get revenue from resold toll rather than lose that
25 toll all together and lose that customer all together.

0242

1 Q. Can a customer sign up for this service by
2 calling its local Verizon Northwest office?

3 A. Yes, they can.

4 Q. Does Verizon permit Comcast to package
5 Verizon Long Distance service and Verizon local service?

6 A. I don't believe they have ever asked us, but
7 no, we would not.

8 Q. Changing subjects, the company is proposing
9 that the \$3.54 surcharge per line be subject to refund;
10 is that right?

11 A. That's correct.

12 Q. I would like to go through a hypothetical
13 example to understand how it works, and I would first
14 like you to assume that the company's interim rate
15 relief request is granted in full. And second, assume
16 that in the general rate case the Commission grants \$50
17 Million in general rate relief, in other words in excess
18 of the \$29.7 Million. Do you have those assumptions in
19 mind?

20 A. Okay.

21 Q. Next assume that the Commission in that order
22 decides that the residential line rate and business line
23 rate should only increase \$3 per line instead of, per
24 month, instead of the \$3.54 that was in effect on the
25 interim basis. Do you have that assumption?

0243

1 A. Okay.

2 Q. In that scenario, would customers be entitled
3 to a refund of 54 cents per line per month during the
4 time that \$3.54 rate was in effect?

5 A. No.

6 Q. But as to those customers, they would have
7 paid a rate in excess of what the Commission determined
8 was fair, just, and reasonable in a general rate case;
9 isn't that right?

10 A. Well, they would have paid the rate that was
11 approved by the Commission, \$3.54, as a surcharge
12 subject to refund if the Commission finds that the \$30
13 Million in revenue, annual revenue that we received, was
14 not appropriate, not if there was a change in rate
15 design.

16 Q. So your refund proposal applies only if the
17 revenue requirement in the final order in this docket is
18 less than \$29.7 Million?

19 A. That's correct.

20 Q. Turn to page 68C, Exhibit 68C.

21 A. Okay.

22 Q. And do you recognize this as a document that
23 was not prepared by Verizon but accurately sets forth
24 the consumer late payment charge and business late
25 payment charge revenue increase the company is proposing

0244

1 in the general rate case?

2 A. Yes.

3 Q. And I caution you not to mention the numbers,
4 they're confidential. And do you agree that the total
5 on line 3 is accurate?

6 A. That's what, yes, that's what's in our
7 filing.

8 Q. Now these proposed charges are a new tariff
9 item for Verizon because it has not had a late payment
10 charge before, correct?

11 A. That is correct.

12 Q. Are you aware that other utilities regulated
13 by this Commission have had them, had such charges, for
14 many years?

15 A. Well, we applied for late payment charge some
16 time ago with this Commission, but the terms under which
17 we were required to offer it, it would have cost us more
18 to change the billing system than the late payment
19 charge would have generated, so we abandoned that idea.

20 Q. Qwest has had a late payment charge since
21 1997; isn't that correct?

22 A. I'm not familiar with their -- what was in
23 effect.

24 Q. Is it your understanding that most of the
25 late payment charges the Commission has approved provide

0245

1 for a charge of 1.5% on the unpaid balance, that is no
2 dollar charge greater, which is what you're proposing?

3 A. Are you making a statement or asking me a
4 question?

5 Q. Asking you if that's your understanding.

6 A. I will accept that subject to check.

7 Q. Okay. And is a 1.5% charge, ignoring the \$5
8 feature which is on the last sentence of this exhibit,
9 would just a flat 1.5% charge be a net cost to your
10 company?

11 A. I'm not sure I understand what you're saying.

12 Q. Well, you said in the past that you had a
13 problem with a late payment charge because it would have
14 ended up costing you more than it would to implement it.

15 A. What I said was that it would have cost us
16 more to change our billing system to implement it the
17 way we were asked to do so, so it was not worth
18 implementing at that time.

19 Q. Okay. Now today and perhaps with new
20 computer systems or whatever, is it relatively simple to
21 implement just a flat 1.5% late payment charge?

22 A. It would depend on how we were asked to
23 implement it, but I would think that that would be
24 something that we could do.

25 Q. Is there a reason that, given the magnitude

0246

1 of the dollars here, is there a reason that Verizon did
2 not propose this late payment charge in response to the
3 Commission's order in Docket UT-020406, the access
4 charge complaint case, as an offsetting item?

5 A. How is this tied to the access complaint
6 case? You mean is this -- why didn't we implement this
7 to help generate additional revenue?

8 Q. Yes.

9 A. I think this amount here triggers the 3% rule
10 and would be too much revenue to implement without a
11 general rate case.

12 Q. Could you have scaled it back so it did not
13 implicate the 3% rule?

14 A. Yes, we could have done so.

15 Q. Could you have asked to waive the 3% rule?

16 A. Yes, I suppose we could have done that also.

17 Q. Now in the general rate case Verizon is
18 proposing a premium one party flat business rate of
19 \$39.50, a \$9.80 increase, correct?

20 A. Yes.

21 Q. And it's proposing a premium one party flat
22 residential rate of \$22.50, correct?

23 A. Yes.

24 Q. Please turn to Exhibit 81C, and this data
25 request asks the company to portray the amount of the

0247

1 increase that results from the company's proposed
2 interim revenue increase and rate design by using the
3 number of access lines testified to by Staff witness
4 Zawislak; is that right?

5 A. Yes.

6 Q. And I believe this is a non-confidential
7 number, but the surcharge would go to \$2.98 instead of
8 \$3.54 per line?

9 A. Yes.

10 Q. And are the average increase percentages in
11 that middle column confidential?

12 A. Well, this was filed as a confidential
13 document, so.

14 Q. Okay. In any event, we can see the
15 percentage increase that would result by looking at that
16 average increase percentage column?

17 A. Yes.

18 Q. Now you're aware that Staff witness Zawislak
19 proposes to include more lines subject to a surcharge
20 than the company?

21 A. Yes.

22 Q. And one of those is to include the WTAP or
23 the Washington Telephone Assistance Program, the lines
24 that are eligible for that program or actually being
25 served by that program?

0248

1 A. Yes.

2 Q. Turn to page 12 of your rebuttal testimony,
3 Exhibit 63T, and there you state in essence that Verizon
4 Northwest could support Staff's proposal as it relates
5 to retail, intrastate retail and resale tariff price
6 listed and contracted access lines except UNEs and then
7 you go on to say on a fixed amount per line basis, but
8 with respect to the number of lines you said you can
9 accept the Staff's proposal to that extent, right?

10 A. That's correct.

11 Q. And you also say you could agree to apply the
12 surcharge to WTAP lines, right?

13 A. Yes.

14 Q. Now yet the company's position is not to
15 include those additional lines and not to include WTAP,
16 is that right, because you're still sponsoring the \$3.54
17 proposal?

18 A. Yes, we are.

19 Q. So do I take it that you're supporting the
20 \$3.54 proposal, but you don't have a real strong feeling
21 against the Staff proposal regarding the lines that you
22 have identified here?

23 A. If the Commission so chooses, we would
24 support Staff's recommendation for the lines to be
25 included in the count but retain the flat surcharge,

0249

1 \$2.98.

2 Q. Well, if the Commission orders it, you don't
3 have much choice, do you?

4 A. That's correct.

5 Q. Okay. Neither in your direct or rebuttal did
6 you explain why you are proposing to exclude WTAP lines,
7 and so could you tell us why?

8 A. Well, we simply excluded the WTAP lines so
9 there would not be an impact on the fund or the
10 customers that avail themselves of that fund.

11 Q. That's it?

12 A. Yes.

13 Q. And, well, Mr. Zawislak testifies that there
14 are many organizations that may be in financial need,
15 persons or organizations in financial need, or those
16 that serve persons in financial need that would
17 nonetheless get the surcharge. You're not proposing to
18 exclude those people or organizations, are you?

19 A. No.

20 Q. So why WTAP and not them?

21 A. Well, this is a defined group of our
22 customers that are part of a Washington Telephone
23 Assistance Plan, so that's why we chose to do that.

24 Q. And the effect of excluding WTAP lines from
25 the surcharge has the effect of increasing the surcharge

0250

1 that would apply to other customers, correct?

2 A. Yes.

3 MR. TROTTER: Your Honor, I'm approaching a
4 break point depending on your intentions.

5 JUDGE WALLIS: I think in light of the fact
6 that we're able to begin a little bit earlier tomorrow
7 that it would be appropriate to break now, and we will
8 take our recess resuming tomorrow morning at 10:30
9 taking up with Mr. Trotter's examination where he is now
10 leaving off.

11 (Hearing adjourned at 5:00 p.m.)

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