

August 20, 2004

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VIA FACSIMILE, EMAIL & FEDERAL EXPRESS

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

**Re: WUTC v. Verizon Northwest Inc.
Docket No. UT-040788**

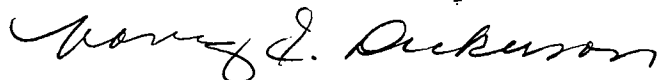
Dear Ms. Washburn:

Enclosed please find the original and 15 copies of Opposition of Verizon Northwest Inc. to Motion to Strike Verizon Northwest Inc.'s Response to Bench Request No. 3, Or in the Alternative, For an Order Striking a Portion of That Response and Requiring the Company to Supplement That Response. Please stamp one of the copies and return it to us in the enclosed stamped self-addressed envelope provided for your convenience.

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

Sincerely,

GRAHAM & DUNN PC



Nancy E. Dickerson
Legal Secretary

Enclosure

cc: All Parties

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ORIGINAL

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

) Docket No. UT-040788
)
) RESPONSE OF VERIZON NORTHWEST
) INC. TO MOTION TO STRIKE VERIZON
) NORTHWEST INC.'S RESPONSE TO
) BENCH REQUEST NO. 3, OR IN THE
) ALTERNATIVE FOR AN ORDER
) STRIKING A PORTION OF THAT
) RESPONSE AND REQUIRING THE
) COMPANY TO SUPPLEMENT THAT
) RESPONSE
)

Commission Staff moves to strike Verizon's Response to Bench Request No. 3. Verizon disagrees with Staff's characterization of Verizon's response, but Verizon does not oppose striking this response in its entirety. However, Verizon would oppose any partial striking that would omit the narrative to the Response.

**VERIZON CREATED ITS RESPONSE TO BENCH REQUEST NO. 3 AS A
DIRECT RESULT OF THE COMMISSIONER'S REQUESTS AT
THE INTERIM RATE RELIEF HEARING**

Staff criticizes Verizon for complying with a Commission Bench Request. As explained by Verizon's counsel at hearing, (Attachment 1) an analysis for projected cash flows did not exist for the time period requested, but Verizon agreed to prepare one. Thus, Verizon accurately answered WUTC's Staff Request No. 43 (Exhibit 130) by informing Staff that it does not produce cash flow statements at the state level and therefore existing documentation could not be

produced at that time. Indeed, in answering a later Data Request (No. 78) (Attachment 2), Verizon provided Staff with an intrastate cash flow analysis for the test period.

The creation of these Washington State Cash Flow Analyses were special projects, out of the norm for Verizon's finance department. Both Verizon's Response to Bench Request No. 3 and Attachment 78, provided in response to Bench Request No. 4, were prepared by Dr. Vander Weide in conjunction with Verizon's finance and regulatory accounting staff. In sum, Staff's criticisms are both unfair and unfounded in that Verizon performed special Washington intrastate cash flow analyses in order to respond to both Staff and Commissioner requests for information. Verizon could not produce information from extent documents at the time of its response to WUTC Staff Data Request No. 43.

Staff was afforded time to cross-examine Dr. Vander Weide on Attachment 78, but chose not to do so. Verizon's Response to Bench Request No. 3 simply brings forward Dr. Vander Weide's analysis, as requested by the Commissioners. The information provided will be useful for the record and parties are free to argue as to the weight that should be accorded to it, if it is included in the record.

**VERIZON SHOULD BE ALLOWED THE OPPORTUNITY TO EXPLAIN ITS
ANALYSIS AND ASSESSMENT OF ITS PROJECTED CASH FLOW ANALYSIS THAT
WAS SPECIALLY PREPARED PURSUANT TO A COMMISSIONER BENCH
REQUEST**

Verizon included the narrative that accompanies its projected cash flow analysis simply because Verizon would be prejudiced if the Commission was not advised as to how the Company's expert, Dr. Vander Weide, views this projected cash flow. The parties are free to argue different conclusions based upon their own expert witnesses' testimony as to cash flow analysis, but Verizon should not be penalized for attempting to provide a thorough explanation in direct response to the Commissioner's requests and concerns.

Furthermore, Verizon could not have provided this additional evidence to the parties prior to August 17, 2004, simply because it had not been asked for, had not been created and did

not yet exist. This circumstance was not within the Company's control. It should not be prejudiced by this fact.

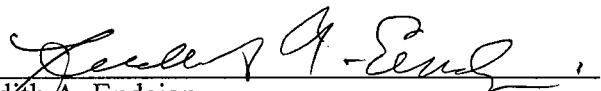
SUMMARY

The Commissioners asked for the information contained in Verizon's Response to Bench Request No. B-3. The Commissioners should decide whether it should be in the record and if they decide to include it, such inclusion should cover the full response. The parties are not prejudiced by allowing this full response because the response is entirely consistent with, and flows from, Dr. Vander Weide's direct testimony.

If the Commission orders further supplementation to understand the source of the numbers on the projected cash flow analysis, the Company will supplement this Response accordingly.

DATED this 20th day of August 2004.

GRAHAM & DUNN PC

By 
Judith A. Endejan
WSBA# 11016
Email: jendejan@grahamdunn.com
Attorneys for Verizon Northwest Inc.

ATTACHMENT 1

1 COMMISSIONER HEMSTAD: I think that's all I
2 have now, thank you.

3 COMMISSIONER OSHIE: I would like to -- I
4 want a clarification on Bench Request Number 5 I guess,
5 and that is the respective earnings within intrastate,
6 the other intrastate jurisdictions of Oregon and Idaho,
7 is that looking just at the historical, or are we
8 looking at projected numbers or both?

9 JUDGE WALLIS: That relates to Dr. Vander
10 Weide's rebuttal testimony, table 1, Exhibit 3T, page 8,
11 so let's refer back to that.

12 That's titled 2003, so according to its terms
13 it would be historical.

14 COMMISSIONER OSHIE: I would like to add to
15 that the projected revenues during the period that the
16 proposed interim rate increase would be in effect, I
17 believe that's nine months until April or May 2005 for
18 the other jurisdictions.

19 MR. PARKER: Your Honors, we will, you know,
20 certainly do, you know, as requested. You know, this
21 information on a projected basis, number one, is an
22 internal extremely sensitive matter within Verizon.
23 Number two, it doesn't exist. I mean we're going to
24 have to go back and, for Washington itself, and create
25 this information, and we're just going to have to do it

1 two more times for Idaho an Oregon. And if appropriate,
2 I would request that we do this on a historical basis.
3 I am, of course, I'm here at your pleasure and will do
4 as told.

5 COMMISSIONER OSHIE: My interest here,
6 counsel, is that what the company is asking for at least
7 in part in their case is for us to compare the
8 intrastate earnings in its respective jurisdictions, and
9 I think the most pertinent factor is what it is earning
10 during the period that interim relief is being
11 requested, because that's the period in which there is a
12 purported emergency. And so looking at the comparison,
13 if there's a gross inequity it's looking at that period
14 in which these earnings are going to be in effect and
15 essentially in play and would be in effect in
16 Washington, and what's the comparison to the intrastate
17 earnings within Oregon and Idaho, and then we would
18 really have a clearer picture I think of whether there
19 is a gross inequity in earnings during the period in
20 question. That's my point on it.

21 MR. PARKER: Ask and you shall receive.

22 COMMISSIONER OSHIE: Thank you.

23 And I don't have any questions of Mr. Banta,
24 thank you.

25

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

ATTACHMENT 2

Before the

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Docket No. UT-040788

VERIZON NORTHWEST INC.

**SUPPLEMENTAL
RESPONSE TO STAFF DATA REQUEST NO. 78
*Interim Rate Relief***

August 5, 2004

Docket No. UT-040788

Verizon Supplemental Response to WUTC Staff Data Request No. 78

August 5, 2004

WUTC STAFF DATA REQUEST NO. 78:

Please state or estimate the portion (in dollars) of the dividends Verizon NW paid to Verizon Communications each year 1999-2003, that were from Verizon NW's Washington intrastate operations. If assumptions are necessary to respond, please state the assumptions and explain how they were applied.

RESPONSE: (dated August 4, 2004)

As shown on Attachment 78, the percentage of cash flows generated by Washington Intrastate operations for the years 1999 through 2003 has consistently been significantly less than the percentage of revenues from Washington Intrastate operations. Thus, Washington Intrastate operations have contributed an inequitably low percentage of the cash flows required to pay dividends.

With regard specifically to the 12 months ending September 30, 2003, the data on the attached spreadsheet indicate that the cash flows from Washington Intrastate operations were barely sufficient to cover interest expense and capital expenditures. As Dr. Vander Weide explains in his rebuttal testimony, when a company has cash flows that are barely sufficient to cover interest expense and capital expenditures, it would certainly not be in a position to pay dividends. Indeed, Washington Intrastate operations, considered as a stand-alone company, would have little ability to attract capital in the capital markets because its bonds would likely be rated below investment grade. This conclusion is further supported by the observation that the financial ratios, revenues, and EBIT of Washington Intrastate operations, considered as a stand-alone company, have been declining.

SUPPLEMENTAL RESPONSE: (dated August 5, 2004)

The attachment to Data Request No. 78 provides cash flow data for the period 1999-2003 that support Dr. Vander Weide's conclusion that Washington Intrastate Operations, considered on a stand-alone basis, were not in a position to pay dividends for the 12-month period ending September 30, 2003. However, Staff Data Request No. 78 is not as simple as the supplemental request implies because dividend policy is based on both quantitative and qualitative factors. Cash flow is only one of various qualitative and quantitative factors that influence dividend policy. Further considerations in developing dividend policy include, but are not limited to, historical and expected trends regarding earnings, cash flows, and financial ratio targets. In light of both the negative trend in cash flow as well as the fact that, as Dr. Vander Weide noted, Washington Intrastate Operations would have financial ratios indicative of a below investment grade credit rating, it would be unlikely that Washington Intrastate Operations would have paid a dividend in 2003 if it were a stand alone entity. With regard to the period 1999 – 2002, because dividend decisions are based on both quantitative and qualitative factors, Verizon

Docket No. UT-040788

Verizon Supplemental Response to WUTC Staff Data Request No. 78

August 5, 2004

does not believe that there is a reasonable basis for estimating the amount of dividends that the Washington Intrastate Operation would have paid.

Prepared By: Robert G. Deter

Date: August 5, 2004

Witness: James H. Vander Weide

CASH FLOW ANALYSIS
VERIZON NORTHWEST - WASHINGTON INTRASTATE OPERATIONS
(Millions of Dollars)

	12 Months-to-Date September 30, 2003			
	Actual Amount	Revenue Reduction Adjustment	Post Revenue Reduction Amount	
<u>Verizon Northwest EBITDA</u>				
1 Net Income From Continuing Operations	\$169.5	(\$19.0)	\$150.5	\$237.1
2 Interest Expense	\$42.2	\$0.0	\$42.2	\$55.1
3 Income Tax	\$95.7	(\$10.2)	\$85.5	\$139.9
4 Depreciation and Amortization	\$246.9	\$0.0	\$246.9	\$237.1
5 Earnings Before Interest, Taxes, Depreciation & Amortization (EBITDA)	\$554.3	(\$29.2)	\$525.1	\$669.2
6 Income Tax Paid, Net of Amounts Refunded	(\$50.9)	\$10.2	(\$40.7)	(\$126.0)
7 Gross Interest Paid	(\$47.2)	\$0.0	(\$47.2)	(\$65.3)
8 Capital Expenditures	(\$172.6)	\$0.0	(\$172.6)	(\$355.1)
9 Verizon Northwest Cash Flow	\$283.6	(\$19.0)	\$264.6	\$122.8
<u>Washington Intrastate EBITDA</u>				
10 Net Income From Continuing Operations	(\$4.3)	(\$19.0)	(\$23.3)	\$19.4
11 Interest Expense	\$20.0	\$0.0	\$20.0	\$27.2
12 Income Tax	(\$2.3)	(\$10.2)	(\$12.5)	\$10.5
13 Depreciation and Amortization	\$124.7	\$0.0	\$124.7	\$115.5
14 Earnings Before Interest, Taxes, Depreciation & Amortization (EBITDA)	\$138.1	(\$29.2)	\$108.9	\$172.6
15 Income Tax Paid, Net of Amounts Refunded	\$0.0	\$0.0	\$0.0	(\$9.5)
16 Gross Interest Paid	(\$22.7)	\$0.0	(\$22.7)	(\$32.2)
17 Capital Expenditures	(\$84.7)	\$0.0	(\$84.7)	(\$165.7)
18 Washington Intrastate Cash Flow	\$30.7	(\$29.2)	\$1.5	(\$34.8)
19 Verizon Northwest Operating Revenues	\$1,175.6	(\$29.2)	\$1,146.4	\$1,233.8
20 Washington Intrastate Operating Revenues	\$370.2	(\$29.2)	\$341.0	\$412.9
21 Washington Intrastate Operating Revenues %	31.49%		29.75%	33.47%
22 Washington Intrastate Cash Flow %	10.83%		0.57%	-28.30%

2002 2001 2000 1999