



DEPARTMENT OF THE ARMY  
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REPLY TO  
ATTENTION OF

Regulatory Law Office  
U 4124

August 26, 2004

**VIA ELECTRONIC FILING (8/27/04) & OVERNIGHT MAIL**

Commission Secretary  
Washington Utilities & Transportation Commission  
P.O. Box 47250  
1300 S. Evergreen Park Drive, S.W.  
Olympia, WA 98504-7250

Subject: **DoD/FEA's Brief (Interim Rate Case)**

In Re: **Docket No. UT-040788** – Washington Utilities and Transportation Commission,  
Complainant, v. Verizon Northwest Inc., Respondent.

To The Honorable Commission Secretary:

Pursuant to the Protective Order (Order No. 03, May 26, 2004) in the above-referenced proceeding, enclosed for filing are the original and fifteen (15) copies of the Brief (Interim Rate Case) of the United States Department of Defense and All Other Federal Executive Agencies (collectively referred to herein as "DoD/FEA").

In accordance with the Commission's Rules, a Certificate of Service is appended. Copies of this filing are being sent to all parties of record in accord with the Certificate of Service. Inquiries to this office regarding this proceeding should be directed to the undersigned at (703) 696-1643.

Thank you for your cooperation and assistance in this matter.

Sincerely,

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Enclosure: Fifteen (15) Copies

CF: See Certificate of Service (8/27/04 electronic service & 8/26/04 first class mail)  
Honorable C. Robert Wallis (Email on 8/27/04)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION  
COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION,

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

Docket No. UT-040788

THE UNITED STATES DEPARTMENT  
OF DEFENSE AND ALL OTHER  
FEDERAL EXECUTIVE AGENCIES'

CERTIFICATE OF SERVICE

**CERTIFICATE OF SERVICE**

I certify that I have caused a copy of the foregoing document, together with this Certificate of Service, in Docket No. UT-040788 to be sent this day by postage prepaid, properly addressed, first class U.S. Mail (or private courier) and by electronic service (email) to be sent August 27, 2004 to the counsel and parties named below, as indicated:

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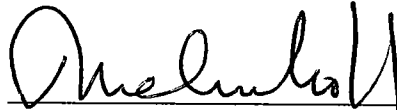
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Dated this 26th day of August 2004,  
at Arlington County, Virginia.

  
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(8/05/04)

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION  
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THE UNITED STATES DEPARTMENT  
OF DEFENSE AND ALL OTHER  
FEDERAL EXECUTIVE AGENCIES'

BRIEF (Interim Rate Case)

**BRIEF**  
**(Interim Rate Case)**

of

**THE UNITED STATES DEPARTMENT OF DEFENSE AND  
ALL OTHER FEDERAL EXECUTIVE AGENCIES**

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Filing Due: August 27, 2004

Dated: August 26, 2004

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION  
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THE UNITED STATES DEPARTMENT  
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FEDERAL EXECUTIVE AGENCIES'

BRIEF (Interim Rate Case)

**I. INTRODUCTION**

The Secretary of Defense, through duly authorized counsel, on behalf of the customer interests of the United States Department of Defense and All Other Federal Executive Agencies (collectively referred to herein as "DoD/FEA"), hereby submits its Brief in the above-captioned proceeding. For the reasons set forth herein, DoD/FEA recommends that the Washington Utilities and Transportation Commission ("the Commission") deny the pending request of Verizon Northwest, Inc. ("Verizon" or "the Company") for interim rate relief.

On April 30, 2004, Verizon filed two petitions with the Commission. The first sought an interim increase in its rates for local exchange service totaling \$29.7 million annually. These revenues would be recovered by an interim surcharge of \$3.54 per access line per month, until permanent rate relief is obtained. Verizon filed proposed testimony, consisting of only 28 pages of text, and several exhibits in support of that petition. The amount sought was equal on an annual basis to the rate reduction that Verizon implemented pursuant to the Commission's decision in Docket No. UT-020406,

the AT&T Access Charge Case. The second petition was for commencement of a general rate case designed to provide additional annual revenues of \$239.5 million.<sup>1</sup> Verizon sought a waiver of the statutory requirement that specific tariffs be filed at the commencement of a rate increase proceeding, and asked the Commission to first determine the revenue deficiency and then approve the rate increases appropriate to generate the additional revenues.<sup>2</sup>

The Commission suspended the proposed interim tariff provisions, convened a prehearing conference, and granted petitions for leave to intervene.<sup>3</sup> By Order No. 5 served July 2, 2004, the Commission denied a petition filed by various parties, including DoD/FEA, that sought to dismiss the interim rate request, concluding that:

Verizon has made a *prima facie* showing, in light of all relevant circumstances when seen [in] a light most favorable to Verizon, that its circumstances could constitute a gross inequity that renders interim rates consistent with the public interest.<sup>4</sup>

Verizon had prefiled testimony of three witnesses as to interim relief. The Commission's staff presented three witnesses and Public Counsel, AARP and WeBTEC jointly presented a witness.<sup>5</sup> The Staff and Public Counsel witnesses opposed a grant of interim relief. Verizon filed rebuttal testimony. Hearings were held from August 10-12.

This brief is submitted pursuant to the schedule set forth in Order No. 3, served on May 26, 2004. We are submitting a short document to avoid burdening the Commission

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<sup>1</sup> In fact, the proposed general rate case tariffs would produce additional revenues of only \$110 million. Verizon witness Banta stated that the Company needs the larger amount to earn a reasonable return, and that the Company might address the need for full relief at a later date. Tr. 372.

<sup>2</sup> The Commission denied this request in Order No. 4, served June 23, 2004. Verizon subsequently filed proposed tariffs increasing rates for its local services. Hearings on Verizon's request for permanent rate relief are scheduled to commence on February 28, 2005.

<sup>3</sup> Order No. 1, dated May 12, 2004.

<sup>4</sup> Order No. 5, para. 32.

<sup>5</sup> For convenience, we will refer to that witness herein as the "Public Counsel witness".

with repetitious arguments, because DoD/FEA is in general agreement with the positions advocated by the Staff and Public Counsel, except for the Staff's proposed rate design.

## II. LEGAL AND POLICY ISSUES

### A. What are the Proper Factors for Interim Rate Relief?

DoD/FEA views interim rate relief as an extraordinary action by a regulatory commission, reserved for situations where a failure to act would result in demonstrable harm to the utility (and thus to ratepayers). Reserving interim relief for extraordinary circumstances provides a fair balance between the interests of ratepayers and the utility, and reflects the manner in which a regulated company's charges are adjusted. As Staff witness Folsom pointed out, a utility that is earning an excessive return may continue to do so until the regulatory agency orders a rate decrease, and in such a case the utility retains the excessive earnings during the rate investigation.<sup>6</sup> Correspondingly, ratepayers should not have to pay increased rates during an investigation initiated by the company in its discretion to obtain rate relief. If the utility were able to immediately and routinely recover a revenue deficiency before the regulatory agency had a full opportunity to consider the company's financial position, ratepayers would experience the worst of both worlds. Thus, regulatory policy best reserves interim relief to circumstances in which the company faces an emergency situation not of its own making, and clearly would suffer irreparable harm without immediate relief. Accordingly, regulatory agencies such as the Commission have formulated criteria to ensure that ratepayers are not subjected to increased rates absent extraordinary circumstances. DoD/FEA generally agrees that the

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<sup>6</sup> Ex. 121-T, p. 6.

Commission's factors noted in Section III, below, cover the relevant areas that should underlie a decision.

B. Order No. 5.

In Order No. 5, the Commission denied a petition that sought dismissal of the request for interim relief because, as noted above, Verizon was seen to have made a *prima facie* case for some level of relief, when the facts were viewed entirely in its favor.<sup>7</sup> The Commission reiterated that the six factors that are "appropriate to discuss" in assessing interim rate requests are not standards to be mechanically applied, and not all factors will necessarily be applicable to all companies.<sup>8</sup> The Commission further ruled that it would review Verizon's request on a Washington intrastate basis, and noted that the intrastate operations "have been subjected to a significant precipitating factor -- the access charge decision, which is totally intrastate in nature."<sup>9</sup> Thus, the Commission found that under a stand-alone analysis, Verizon would appear to face a "gross inequity".<sup>10</sup>

DoD/FEA respectfully disagrees with the Commission's approach in Order No. 5 as to the Company's reliance on Washington intrastate<sup>11</sup> data alone, without observing the financial health or the needs and activities of the parent company. This disagreement reflects our view that the critical factors upon which the Commission seeks discussion cannot be looked at in the isolation of a Washington intrastate operation, because that operation does not obtain funds in the capital market or construct plant only for its own

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<sup>7</sup> Order No. 5, para. 11.

<sup>8</sup> *Id.*, para 13.

<sup>9</sup> *Id.*, para. 19.

<sup>10</sup> *Id.*, para. 23.

<sup>11</sup> The term "intrastate" is also used interchangeably in this document to refer to Washington intrastate operations.



needs. Nor, apparently, are complete, detailed accounting records kept by Verizon on its Washington intrastate operations.<sup>12</sup> Given Verizon's reliance herein on the state of its finances, its ability to attract capital and its ability to continue necessary construction during the rate investigation, its need for interim relief should be assessed by considering the operating data of the entity that performs such activities. That entity is Verizon Northwest, Inc. We will further address this issue in subsequent paragraphs.

C. Precedent on Interim Relief from Other Jurisdictions

DoD/FEA will not attempt to compile a summary of decisions from other jurisdictions as to the circumstances under which interim rate increases have been granted. We expect that other parties will do so, and in any event we believe that the precedent that the Commission has established over a long period of time in this regard pursuant to its own policies is still valid and sufficiently comprehensive to inform the Commission as to whether Verizon has met its burden of proof for obtaining relief because it has shown "an unexpected or unusual need".<sup>13</sup> However, we do bring to the Commission's attention a recent ruling of the Idaho Public Utilities Commission as to a request for interim rate relief. In Case No. IPC-E-03-13, that Commission denied a request by Idaho Power Company for interim relief. The Commission cited precedent from an earlier case holding that such relief is appropriate only in an emergency or "where there is danger that the utility will not be able to render adequate service if relief is withheld," a situation, as noted below, which is not present in the instant case.<sup>14</sup>

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<sup>12</sup> See Order No. 7, served August 24, 2004, p. 3, *citing* Tr. 143-144.

<sup>13</sup> Order No. 5, para. 12.

<sup>14</sup> Application of Idaho Power Company for Authority to Increase its Interim and Base Rates and Charges for Electric Service, Order No. 29403, December 22, 2003, p. 5.

Furthermore, in contrast to the WUTC Staff's rate design proposal in the instant case, the Idaho Commission significantly held:

Finally, the inequitable burden of a uniform percent increase over customer classes actually using electric service over the next six months cannot be fully cured by the fact that we can set different rates with the Final Order. We suspect that even the Company would agree that there is a time value to money for everyone.<sup>15</sup>

### **III. HAS VERIZON SATISFIED THE APPROPRIATE INTERIM RATE RELIEF FACTORS?**

#### **A. Consideration of the Relevant Factors**<sup>16</sup>

##### **1. Factor No. 1: Opportunity for adequate hearing**

The first factor that the Commission assesses in determining whether to grant interim relief is whether there has been an opportunity for an "adequate hearing".

DoD/FEA does not dispute that this factor has been satisfied by the hearings and briefing that the Commission has conducted in this proceeding.

##### **2. Factor No. 2: Actual emergency, gross hardship or gross inequity**

a. DoD/FEA believes that Verizon has failed to show that there exists an "actual emergency". Indeed, Verizon witness Banta does not even use the term in his direct testimony when discussing this factor.<sup>17</sup> Rather, he addresses whether there is a "gross hardship" or a "gross inequity".

b. Mr. Banta concludes that gross hardship is demonstrated by Verizon's negative intrastate rate of return and negative net operating income, and gross inequity results from the Commission's decision in Docket No. UT-970325 decreasing

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<sup>15</sup> *Id.*, p. 6.

<sup>16</sup> These relevant factors are acknowledged by all parties and cited by the Commission in Order No. 5, Appendix A.

<sup>17</sup> Ex. 61-T, p. 5.

Verizon's access charges without correspondingly increasing rates for other services.<sup>18</sup>

DoD/FEA finds this reasoning to be unpersuasive, because the "gross hardship" merely relies on the allegedly inadequate intrastate rate of return (caused by the earnings) -- and, as discussed below, earning less than the authorized rate of return does not form a basis for the grant of interim relief under the Commission's factors. Moreover, it is not at all clear that Verizon is experiencing a negative Washington intrastate operations rate of return. Staff witness Strain calculated Verizon's intrastate rate of return, including the access charge reduction but without the restating adjustments to be 2.03%, and to be 2.09% with the imputation of directory revenues.<sup>19</sup>

c. As to "gross inequity" that Mr. Banta finds as a result of the reduction in access charges without a corresponding increase in other rates, DoD/FEA would use the adjective "minor" rather than "gross". The annual revenue impact of the reduction (\$29,219,000) is less than 8% of the annual intrastate operating revenues of \$369,397,000.<sup>20</sup> If the Commission in the Access Charge Case thought that the decrease were so great that it warranted extraordinary relief to avoid an emergency situation, the Commission presumably would have taken corrective action. Moreover, Verizon presumably knew at that time that it needed rate relief and that its access charge rates were excessive -- thus it had notice that it needed to file a general rate case to ensure an adequate earnings level in the face of Commission-mandated rate reductions. In short,

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<sup>18</sup> *Id.*

<sup>19</sup> Ex. 142, p. 1. DoD/FEA believes that the Staff has properly imputed revenues from directory services, and will consider that issue more fully in the main case.

<sup>20</sup> *Id.* Public Counsel witness King also observed that Verizon cannot recover the \$29 million that it seeks, because interim rates would be in effect less than a year, due to Verizon's delay in filing its "gross hardship" request. He calculated the impact of a grant of Verizon's request to be \$21.04 million, or 5.7% of its annual operating revenues. Ex. 101-T, pp. 8-9.

Verizon contributed to any inequity that arose from the earlier order by its failure to act, and can not now seek reliance on this factor for obtaining extraordinary rate relief.

d. Interim rate relief will not, in DoD/FEA's view, resolve any problem that Verizon is now experiencing, if indeed any exists. The witnesses discussed this issue extensively, citing such factors as interest coverage. Verizon has no problem obtaining capital, if it is needed,<sup>21</sup> whether or not it receives interim rate relief, because it is not constrained from obtaining funds from an affiliate.<sup>22</sup> Moreover, as we detail below, interim relief will not affect the near-term construction program, is not needed to create a positive cash flow for Verizon's intrastate Washington operations, and will not have any impact on Verizon's bond rating.

### 3. Factor No. 3: Rate of return

The third factor that the Commission considers is that the failure to earn the currently-approved rate of return is not adequate, standing alone, to justify granting interim relief. DoD/FEA submits that Verizon's direct case supporting interim relief is based entirely on the allegedly inadequate intrastate rate of return (albeit stemming in minor part from the access charge reduction). Verizon's showing on this point permeates its entire presentation. There are no external events that caused the allegedly inadequate return. Verizon's intrastate earnings appear to have been below the authorized level for several years, following years of earning in excess of its rate of return, and it was within Verizon's power to initiate a rate case to correct any underearnings. Accordingly,

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<sup>21</sup> In fact, the availability or flow of capital to the Company's intrastate operation has not been cut off. Ex. 121-T, pp. 14-19.

<sup>22</sup> Ex. 121-T, p. 16.

Verizon's request for extraordinary interim relief is also wanting when this factor is taken into account.

4. Factor No. 4: Financial indices as they concern the applicant

Witnesses for Verizon, Staff and Public Counsel addressed a variety of such indices. In discussing this issue, DoD/FEA supports the adjustments to the stated results of operation for the test year, as computed by the Staff's witnesses. Accordingly, we will not address each adjustment or sub-factor as a separate item. Those adjustments reflect proper and established ratemaking adjustments. Moreover, in the interest of brevity and our desire not to cover extensively issues that Staff and Public Counsel will address in detail, the following discussion is limited to several key financial indices as they concern Verizon. Furthermore, as a general matter, we observe, as noted above, the inappropriateness of looking at only Washington intrastate operations as the basis of extraordinary interim relief.

First, as to interest coverage, the Commission must first consider whether this is a relevant criterion at all. Interest is paid by the parent company, because the parent company handles financing for the Washington operations. Thus, there is no such thing as interest coverage for the jurisdictional operations. Verizon's earnings at the parent company level are undisputedly adequate to cover interest. Verizon, however, relies on computations of interest coverage as if Washington intrastate operations were a separate debt-issuing entity. To address this coverage, Verizon witness Vander Weide calculated the EBIT interest coverage ratio for 2003 to be (0.7), the EBITDA interest coverage to be 4.8 and FFO/Total Debt Ratio to be 29.9%.<sup>23</sup> In all three cases he used 2003 intrastate

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<sup>23</sup> Ex. 1-T, p. 9.

data as adjusted by Verizon witness Heuring -- which adjustments were disputed by the Staff. He concluded that Verizon's earnings with access charge reductions "are insufficient to pay even the interest on its debt."<sup>24</sup>

Staff witness Strain calculated the same three indices, but with the Staff's adjustments to the 2003 test year data. She computed EBIT interest coverage to be 0.9 before an interim increase, EBITDA interest coverage to be 6.5 and FFO/Debt to be 36.3%.<sup>25</sup> More importantly, she presented a more comprehensive analysis of these three financial indices that included total Washington data and total company data. Those computations, which she states are more important than the Verizon approach because it is the parent company that conducts financing, budgeting and construction, reflect that there are no adverse financial implications resulting from denial of interim relief.<sup>26</sup>

Public Counsel witness King also addressed relevant financial indices in connection with his assessment that interim relief is not required. In his view, the strongest justification for interim relief would be a showing that Verizon lacked cash to fund its ongoing operations.<sup>27</sup> He then calculated Washington intrastate cash generation with cash requirements for the test year, and found that the cash generation exceeded cash requirements by \$4 million.<sup>28</sup> He also noted, as did Staff witness Folsom, that Verizon can meet capital and operational needs by drawing on the pool maintained by its

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<sup>24</sup> *Id.* As noted above, Witness Vander Weide is incorrectly referring to "its debt" when addressing the Verizon Washington intrastate operations as if it were a debt-issuing entity.

<sup>25</sup> Ex. 144, p. 1.

<sup>26</sup> *Id.*; Ex. 141-T, p. 28.

<sup>27</sup> Ex. 101-T, p. 13.

<sup>28</sup> *Id.*, p. 14; Ex 104. The cash flow is even greater for Washington operations and total company. Ex 101-T, pp. 20-21. On cross-examination, he agreed that the excess intrastate cash would be lower if he included interest that it capitalized, but cash flow would still be positive. Tr. 435-436. Staff witness Folsom also conducted a cash flow analysis, and concluded that the net cash from operations "is sufficient for the Company to fund its construction, repay its debt, and pay dividends to its parent company." Ex. 121-T, p.

affiliate, Verizon Network Funding Corp.<sup>29</sup> Finally, witness King computed EBIT and EBITDA coverages for Washington operations and total company, and found them to be well within an acceptable range.<sup>30</sup>

The immediate and short-term financing needs were explained by the witnesses' presentations on the financial indices. Staff witness Folsom, for example, stated that Verizon will meet capital needs through the issuance of notes to its affiliates. There are no plans to issue debt or obtain equity infusions.<sup>31</sup> In contrast to these facts, based on Verizon documents, Verizon witness Vander Weide implies that the Company's financial condition is so poor that investors have little incentive to invest in the Company's intrastate operations and earnings are insufficient to allow continued investment in the Washington network.<sup>32</sup> He does not address at all, however, the actual short-term financing demands or the ability of Verizon to meet those demands internally. Likewise, Verizon witness Banta fails to provide a reasoned analysis of Verizon's near-term financing needs. Rather, he states that a BB bond rating (which does not exist for Verizon) would not allow access (the need for which Verizon has not shown) to the capital needed to fund ongoing intrastate capital expenditures, implying that without relief Verizon will not fund its 2004 construction program.<sup>33</sup> In fact, he could not

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25. Staff witness Strain also concluded that Verizon had \$17.5 million in cash (including imputed directory revenues) in excess of that needed to cover expenses, interest and construction. Tr. 600.

<sup>29</sup> Ex. 101-T p. 15; Ex.121-T, p. 13.

<sup>30</sup> Ex. 106.

<sup>31</sup> Ex. 121-T, p. 18-19.

<sup>32</sup> Ex. 1-T, pp. 10; 14.

<sup>33</sup> Ex. 61-T, p. 6. Public Counsel witness King questioned the Company's assertion that its financial indices would be associated with a BB bond rating if it were a stand-alone company. He noted that Dr. Vander Weide used data applicable to industrial companies, not utilities, in arriving at this conclusion, but the rating companies look to the business rating and risk of the Company. Ex. 101-T, pp. 19-20.

provide evidence that the alleged Washington intrastate revenue shortfall had any relationship to capital reductions.<sup>34</sup>

Finally, as noted above, DoD/FEA believes that a grant of interim relief would have no effect on the Company's financing demands. Verizon has access to funds from affiliated entities under terms that do not require specific financial ratios or other requirements.<sup>35</sup> Mr. Banta expressly stated on cross-examination that Verizon's parent company is making capital available.<sup>36</sup> Interim relief would have no impact on its financing sources in this regard.

5. Factor No. 5: Whether failure to grant relief would cause clear jeopardy to the utility and detriment to its ratepayers and stockholders

Initially, we point out that there is absolutely no evidence that the failure to grant relief would be detrimental to ratepayers. Rather, ratepayers would experience higher local exchange service rates that are admittedly not based on any cost analysis for support. Although Verizon witness Banta raises the specter of impending disaster -- inability to fund construction, restricted maintenance and repair, cessation of overtime and hiring freezes, and lowered service quality -- there is nothing in the record to justify such predictions.<sup>37</sup> Indeed, he conceded that Verizon Northwest had not developed a list of proposed "impaired obligations" or coordinated that matter with its parent company.<sup>38</sup> Although Verizon has apparently implemented a hiring freeze, that action was not specific to Washington state, or its intrastate operations; rather, the freeze is company-

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<sup>34</sup> Tr. 277.

<sup>35</sup> Ex. 121-T, pp. 15-16.

<sup>36</sup> Tr. 425-426.

<sup>37</sup> Ex. 61-T, pp. 6-7. Moreover, it is doubtful that the parent company would allow such drastic measures to occur when the prospect of permanent rate relief is in sight.

<sup>38</sup> Tr. 327.



wide.<sup>39</sup> Finally, we note that, when requested during discovery, Verizon produced no contemporaneous documents discussing that the Company was experiencing an "emergency" or its plans to address the situation.<sup>40</sup>

As to stockholders, we note that Verizon paid a dividend of \$221.8 million in 2003, up from \$135 million in 2002.<sup>41</sup> Verizon's parent has been treated well during this period of allegedly "inadequate earnings" and "financial emergency" in Washington, and in any event the impact of a loss of the interim relief (about \$21 million) would be an insignificant percentage of the parent company's revenues. Finally, DoD/FEA believes that there is no showing that the utility is in jeopardy absent interim rate relief. Unlike the situation in other interim rate proceedings, there is no external factor that has pressured Verizon to seek interim relief. In so concluding that the Company is not in jeopardy, even considering Washington intrastate operations alone, we rely on the cash flow and other financial analyses that the Staff and Public Counsel witnesses have presented, as well as the Company's own actions and inactions discussed above.

#### 6. Factor No. 6: Public interest

Finally, DoD/FEA believes that the public interest would be served by denial of the request for interim relief. Although the Commission clearly has considerable discretion with respect to the disposition of Verizon's request, the equities require that ratepayers not experience increased rates during the period that the general request is being considered. As we noted above, the public experiences rate increases when the carrier takes the initiative to make a filing and prove its case. When the carrier is

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<sup>39</sup> Tr. 329.

<sup>40</sup> Tr. 280-283.

<sup>41</sup> Ex. 121-T, p. 25.

overearning, however -- as Verizon did from 1996 through 1999<sup>42</sup> -- Verizon had no incentive to volunteer a rate reduction and in fact did not do so. Rather, the public paid excessive rates and would have continued to do so until the Commission initiated a rate case and prescribed lower rates.

B. Whether This Request Should Be Considered Different in Character from Other Interim Requests

1. DoD/FEA will defer to the Staff and Public Counsel for a recitation of precedent applicable to a "rebalancing".

2. Verizon has emphasized that its request for interim relief has been driven by the Commission's decision to reduce its access charges, and that it is attempting only to recover the equivalent amount as interim relief. DoD/FEA does not believe that the existence of the access charge reduction and the limited relief that it seeks here remove Verizon's request from the scope of the Commission's traditional procedures for considering extraordinary requests for interim relief. Had Verizon experienced a modest expense reduction, we doubt that it would have agreed to an interim rate reduction in that amount. Moreover, as we have explained above, the Company had the ability to file a general rate case long before the Commission's access charge reduction became effective -- indeed, in view of its admission that "it's clear that the rates are out of alignment," it was incumbent for the Company to initiate a rate proceeding earlier to minimize the impact on ratepayers being charged non-cost based rates.<sup>43</sup> Accordingly, DoD/FEA urges the Commission not to treat this interim "rebalancing" proposal differently from any other proceeding for extraordinary interim rate relief.

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<sup>42</sup> Ex. 143, p. 4.

<sup>43</sup> Tr. 302.

### C. Other

DoD/FEA believes that the discussion presented in connection with the six factors discussed above adequately assesses the need for interim rate relief. Thus, we do not urge the Commission to consider additional factors, nor is there a need for additional analytical factors.

## IV. RATE DESIGN

### A. Introduction

Staff witness Zawislak stated that interim rate relief, if required, should be applied to a broad variety of services, and that a rate design should be "simple, practical and equitable".<sup>44</sup> We agree with that description of the goals for determining how to recover interim revenues, should they be authorized. We will show below, however, that the Staff's proposal, Equal Percentage Increase, while simple, is not equitable in light of the absence of cost support and given the testimony to the contrary. Rates for a service -- interim or permanent -- should be designed to correspond to the costs of supporting those specific services. It is apparent from the testimony in this phase of the case, however, that neither Verizon's nor the Staff's proposal is supported by cost studies. Accordingly, Commission discretion will be required to ensure that any relief is fair to all customers.

### B. Equal Percentage Increase Proposal (Staff Proposal)

The Staff has proposed to raise all rates by an equal percentage which, if Verizon's request is granted in full, would amount to an increase of 15.78%.<sup>45</sup> Staff witness Zawislak used an equal percentage so as not to change the rate relationship

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<sup>44</sup> Ex. 181-T, p. 3.

<sup>45</sup> *Id.*, p. 8.

between residential and business customers, and within customer classes, in the absence of a cost basis for altering the relationship.<sup>46</sup>

DoD/FEA cannot support the Staff's approach, primarily because it increases in dollar terms the gap between business and residential exchange service that already appears to be excessive. Already, business rates are more than double the corresponding residential rates.<sup>47</sup> Mr. Zawislak admitted that his analysis is not based on costs.<sup>48</sup> Mr. Zawislak complains that Verizon's proposed surcharge forces one customer class (residential) to assume a "disproportionate share of the burden," and cites as an example that Verizon's approach results in a percentage increase of only 5.93% for one business service.<sup>49</sup> But that service already is priced at \$59.70 a month, and the proposed increase adds an even greater burden to a service that, in Mr. Banta's view, is similar to the residential offering charged at \$28.00 per month.<sup>50</sup> The Staff has no evidence at this point to support any conclusion that business customers are not carrying their fair share of Verizon's revenue requirement. Moreover, Staff witness Zawislak had not performed an elasticity study and was unaware generally of the competitive nature of the services for which his increases would be applied.<sup>51</sup> Clearly, the Staff does not know what the impact of its proposal would be in the competitive marketplace. For these reasons, the Commission should reject the Staff's proposal. Further rationale for rejection is discussed in Sections IV C and D below.

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<sup>46</sup> *Id.*, p. 7.

<sup>47</sup> Ex. 184.

<sup>48</sup> Tr. 626. Verizon's proposal likewise was not accompanied by a cost analysis, but we give more credit to Mr. Banta's general assertions that the business/residential ratio is out of balance.

<sup>49</sup> Ex.181-T, p. 7.

<sup>50</sup> *See* Tr. 261.

<sup>51</sup> Tr. 627-628.

### C. Equal Dollar Increase Proposal (Verizon Proposal)

Verizon proposes to add a monthly surcharge of \$3.54 to most access lines to recover the interim increase.<sup>52</sup> This approach, too, is simple and practical. DoD/FEA believes, moreover, that it is more equitable than the Staff's approach. Verizon witness Banta, while not having supporting cost studies, stated in rebuttal testimony that "The current rate and cost relationship between residential and business rates and cost is already out of alignment."<sup>53</sup> In his view, the services are essentially the same, and in fact the cost of providing a business loop is even less than the cost of providing a residential loop, because the average loop length is less.<sup>54</sup> Moreover, as Mr. Banta acknowledged, increasing rates for competitive services to the extent that customers (particularly large business) migrate to competitors would simply exacerbate the alleged financial problem.<sup>55</sup> This self-defeating negative effect is a function of both the size of the surcharge and the type of services to which it is applied. Thus, he proposed a rate design, unlike the Staff's proposal, that would lessen this negative effect.<sup>56</sup> For these reasons, DoD/FEA urges the Commission, if it grants any extraordinary interim relief, to base the rate design on Verizon's Equal Dollar Increase proposal.

### D. Services Subject to a Surcharge

The Staff believes that Verizon failed to include certain access lines that should be subjected to an interim increase, if the Commission grants Verizon's request.<sup>57</sup>

However because of the possible self-defeating negative effect, noted in Section IV C

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<sup>52</sup> Ex. 61-T, p. 8.

<sup>53</sup> Ex. 63-T, p. 11. The cost relationship between business and residential is also described in Ex. 74C, which contains estimates that show business loops as being less costly to provide. See Tr. 313.

<sup>54</sup> Tr. 261; 302.

<sup>55</sup> Tr. 325.

<sup>56</sup> Tr. 303; 325.

<sup>57</sup> Ex. 181-T, pp. 9-14.

above, DoD/FEA believes, and recommends that the Commission find, that access lines (excluding UNEs and services for which competitive forces would create a self-defeating negative effect) not subject to a term contract should bear the cost of any interim rate increase. Interim rates are not appropriate for services provided pursuant to a contract, however, where the customer agreed to a term commitment.<sup>58</sup>

E. Mechanics of Calculating a Surcharge, if One is Authorized

DoD/FEA believes that the surcharge, if approved, be determined as Verizon proposed -- simply divide the interim increased revenue requirement amount by the number of appropriate access lines to determine the annual impact per line, and divide by 12 to calculate a monthly surcharge.

**V. DEFERRAL ACCOUNT PROPOSAL**

During cross-examination of Verizon witness Banta, counsel for WeBTEC asked about the feasibility of a deferral account. Counsel described this concept as follows:

"... an account where Verizon, side account, collects money that would be authorized by the Commission just as an account. If the Commission at the end of the general rate case were to conclude that Verizon were entitled to all or a portion of that, Verizon would then be permitted to recover that amount with interest in future rates according to the rate design that would be found to be fair, just, and reasonable by the Commission in the general rate case."<sup>59</sup>

DoD/FEA does not take a position on whether such a deferral account proposal is appropriate in this case.

**VI. REFUND ISSUE**

A. Whether and How to Apply Refunds

DoD/FEA believes that the Commission must make provisions for refunds to customers in the event that interim relief is approved. Staff witness Zawislak proposes

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<sup>58</sup> See, e.g., Tr. 316-319.

that Verizon maintain a record for each customer who paid interim rates, and report on the interim revenues received by both customer class and uniform service ordering code.<sup>60</sup> If rate relief for a service granted in the general case is less than the rate that the customer paid as an interim rate, each customer for that service should receive a refund, including interest at the currently authorized rate of return. Verizon would obtain forwarding information about customers in that category who discontinue service during the interim rate period so that they also can be compensated.<sup>61</sup>

Verizon simply stated initially that it would make its surcharge subject to refund.<sup>62</sup> During cross-examination, however, Mr. Banta stated that Verizon proposed that no refunds be made unless the interim award is at least \$30 million (on an annual basis).<sup>63</sup> He admitted, however, that such qualifying language was not in the proposed tariff supporting interim rates, nor in the notice to the public.<sup>64</sup> DoD/FEA urges the Commission to find that this approach is clearly unsatisfactory, whatever advantage it has as to simplicity. Customers who pay interim rates that are higher than permanent rates deserve a refund, simply because they have paid an unlawfully high rate that was found not to have reflected the costs of providing the service.

#### B. Other Issues

DoD/FEA has no other refund issues.

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<sup>59</sup> Tr. 322.

<sup>60</sup> Ex. 181-T, p. 15.

<sup>61</sup> *Id.*

<sup>62</sup> Ex. 61-T, p. 8.

<sup>63</sup> Tr. 296.

<sup>64</sup> Tr. 301; 296.

## VII. CONCLUSION

For the reasons set forth above, DoD/FEA urges the Commission to deny Verizon's request for interim rate relief. Our objection is based primarily on the existence of certain undisputed facts in this record: there exists a positive cash flow for both Verizon Washington and for its intrastate operations, Verizon is experiencing no inability to obtain financing needed for operations and construction, and there is no evidence that Verizon will be unable to perform its public service responsibilities before conclusion of the main case. There is, in short, no emergency or gross hardship in this case. Verizon has not shown that the inequity that it experienced by the access charge rate reduction is "grossly inequitable," and in fact Verizon had it within its ability during that time period to bring to the Commission's attention, and obtain relief for, its declining earnings and the imbalance between residential and business rates.

In the event that the Commission grants the requested extraordinary interim relief in whole or part, DoD/FEA urges that the increase should be imposed in an equal dollar amount on exchange services other than UNEs, services provided under contract and those services subject to competitive forces that may lead to customer migration. That the business rates are out of line compared to similar residential services is obvious



and supported by the record. The Staff's rate design proposal for equal percentage increases applied to an expansive list of services would simply exacerbate this imbalance, and possibly lead to the inappropriately "forced" loss of business lines and revenues to competitive alternatives.

Respectfully Submitted,



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For

The United States Department of Defense  
And  
All Other Federal Executive Agencies

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