BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. VERIZON NORTHWEST INC., Respondent.	DOCKET NO. UT-040788

INITIAL BRIEF OF PUBLIC COUNSEL, AARP, AND WEBTEC

INTERIM RATE RELIEF

AUGUST 27, 2004

I. INTRODUCTION

1. Public Counsel, AARP, and the Washington Electronic Business and Telecommunications Coalition **(**WeBTEC) [1] recommend that the Commission deny Verizon's request for interim relief in this proceeding. Verizon has presented no adequate justification for awarding any relief prior to a full review of its finances in the pending general rate case. Rather than follow the Commission's repeated suggestions that it seek to address its revenue concerns in a general rate case, Verizon has built delay upon delay, and in the end presented a strained and insufficient claim for interim relief. Had Verizon acted promptly it could by now have had a decision in a full rate case. Instead, in a diversion from full scale review, it now asks the Commission to grant relief based on an artificial and theoretical claim of financial distress , distress which appears nowhere except in the accounting and cost allocation constructions of this docket. The hypothetical problems presented in Verizon's case do not exist in the real world, nor do they have any actual impact on the company's Washington intrastate operations. Verizon has not raised a single issue that cannot wait for resolution until the full review in the general case and it has ample resources to sustain its Washington business until that review occurs.

II. LEGAL AND POLICY ISSUES

A. What Are The Proper Factors For Interim Rate Relief?

2. The interim relief factors first announced in *WUTC v. Pacific Northwest Bell*, Cause No. U-72-30, Second Supplemental Order Denying Petition for Emergency Rate Relief (October 1972)("*PNB* case" "*PNB* factors"), p. 13, continue to represent a reasonable and balanced approach to the issue of interim rate relief. These factors should be applied in this case, not because "that's the way it has always been done" but because the factors make sense. This is not to suggest that the *PNB* factors must act as some rigidly mechanical formula or strait jacket

[1] The parties will be referred to in the brief by the joint acronym PC/AARP/WeBTEC. **NOTE:** WeBTEC does not join in Sections IV (Rate Design) and V (Deferral Account Proposal) and files a separate brief on those issues.

for Commission decision making. These factors are broad enough to allow Commission discretion to review a wide variety of specific fact situations and policy considerations.

3. It is reasonable that interim relief be granted after only after a hearing, so that parties can receive due process, so that a record can be created for decision, and so that evidence can be presented and tested through cross-examination to ensure that it is the most reliable possible in the shortened time available..

4. It makes sense to treat interim relief as an extraordinary remedy. Washington statute does not give the Commission express authority to award interim rate relief. The expectation under Title 80 is that, if rates are suspended, a full rate making proceeding will form the basis for a determination that rates are fair, just, reasonable, and sufficient. RCW 80.04.130; 80.36.110, 80.36.140. A departure from the statute's express procedures, with more abbreviated process and less chance for careful review, analysis, and discovery, and hence a less well-developed record must have some justification beyond the mere convenience, preference or desire of the utility. More compelling factors such as emergency, or gross hardship or inequity provide a reasonable justification or "good cause" for this alternative procedure with its inevitable compromises in thoroughness and process.

5. To determine if a utility company is facing a situation which cannot wait for remedy until the end of the ordinary rate case, it makes sense to review aspects or indices of the utility's finances which act as flags or leading indicators of serious financial trouble. Because rate of return regulation does not guarantee a set rate of return, but only an opportunity to earn, underearning by itself does not provide such an indicator. Between rate cases, the utility's rate of return can both exceed and fall short of the authorized level at different times. On the other hand, items like interest and earnings coverage, and immediate financing needs act as "canaries in the coal mine" to determine whether there is a need that requires more immediate attention. As with any extraordinary remedy, it makes sense that interim relief be used with caution, in

cases where risk of harm to ratepayers and shareholders is clear. Factual circumstances such as deferred construction or other operational impairments are additional indicators.

6. These factors have provided a workable framework for analysis of every interim rate case in every WUTC-regulated industry for the past thirty years. PC/AARP/WeBTEC is not aware of any utility company or other stakeholder who has urged revision or abandonment of these factors on the ground that they are unreasonable, impractical or outdated. Nor are we aware of any proposals for alternative tests or standards that have been made. Regulatory predictability and stability is of significant value to regulated industries and their stakeholders. As a result of the Commission's consistency in this area, companies have been able to evaluate their need and in appropriate cases have been able to structure their requests for relief accordingly with the knowledge of what approach the Commission will use to evaluate their interim requests. Likewise, in this case, Verizon's petition and evidence in this case have been presented within the *PNB* framework, as has all the responsive testimony. Verizon has not sought an alternative standard, and nothing about this case warrants a change.

B. Order No. 05

7. Verizon appears to read Order No. 5 as precluding the Commission from considering any evidence about Verizon's finances or operations that is not consistent with the company's theory of the case. Verizon in effect asks the Commission to put on blinders and to disregard any information about Verizon Northwest, its parent, or their relationship with the intrastate operation. This is not a fair reading of Order No. 05, nor is it a basis for a reasoned decision on the interim case. The order is a preliminary ruling on a motion to dismiss for failure to make a prima facie case. The Commission viewed the circumstances in the light most favorable to Verizon. Order No. 05, ¶ 32. While the Commission held that the company had stated a case sufficient to withstand dismissal, it did not hold that no other information could be considered to rebut the prima facie case, or to put the company's claims in context of actual financial circumstances and corporate structure. Indeed, the Commission stated that its purpose was to

determine whether interim relief was in the public interest considering "all relevant factors." Order No. 05**, ¶** 31. Verizon wants its theory of the case elevated to be the law of the case. This was not the holding in Order No. 05.

C. Precedent On Interim Relief From Other Jurisdictions

8. We note, first and foremost, that in its *PNB* decision, the Commission itself performed an exhaustive review of no fewer than seventeen interim rate cases in at least ten different jurisdictions. Based on "the overwhelming weight of [those] cases," the Commission then concluded that "an interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or inequity." *Id.* p. 13.

9. In the years, following the *PNB* order, many other jurisdictions have considered requests for interim rate relief and applied a standard very similar to that articulated by this Commission in *PNB.* For example, in *Residential Utility Consumer Office v. Arizona Corporation Commission*, 199 Ariz 588, 20 P.3d 1169 (Ariz App 2001), the Arizona Court of Appeals set aside and remanded an order of the Arizona Corporation Commission ("ACC")granting an interim rate increase to a public utility. The court rejected the ACC's argument that "its power to set interim rates was not limited to emergency situations," holding instead that "interim rate making requires all three elements—an emergency situation, the posting of a bond, and a subsequent full rate case." 20 P.3d at 1173. Applying that standard to the facts of the case, the court held that the increase in the cost of water did not rise to the level of an emergency justifying an interim rate increase. *See also* Re Mount Tipton Water Company, Inc., W-02105A-03-0805, ACC Decision No. 66732, (January 20, 2004) (applying same standard).

10. The Missouri Public Service Commission has consistently upheld a similarly rigorous standard for the granting of interim rate relief. As the Missouri PSC explained in *In the Matter of Arkansas Power & Light Company*, 1986 WL 293065, Case No. ER-86-52, Order (January 14, 1986):

> In recent years, this Commission has usually followed the practice of requiring that a Company show that an emergency, a near emergency, or immediate need exists to justify the granting of interim rate relief. * * * In *Re: Missouri Public Service Company*, Case No. 18,502, 20 Mo. P.S.C. 244 (1975), the standard was stated as follows: "[I]t is incumbent upon the company to demonstrate conclusively that an emergency does exist. The company must show that (1) it needs additional funds immediately, (2) that the need cannot be postponed, and (3) that no other alternatives exists to meet the need but rate relief." The Commission has reaffirmed the emergency, near emergency, or immediate need type standard on a number of occasions.

Applying that standard, the MPSC denied Arkansas Power & Light's request for interim rate relief, stating that "when it cannot be determined from the record whether an emergency or near-emergency exists, and when no compelling reason is shown for departure from the standard, the request for interim rate relief should be denied."

11. Finally, even jurisdictions that do not apply an "emergency" standard like Washington, Arizona and Missouri do apply a rigorous analysis and evaluation of a company's request for interim rate relief. In *Re Pacificorp*, 2001 WL 1672469, Docket No 20000-EP-01-167 (October 3, 2001), the Wyoming Public Service Commission denied Pacificorp's emergency motion for interim rate relief as follows:

> The emergency situation portrayed by PacifiCorp remains speculative and subject to a wide range of variables, only a few of which pertain to Wyoming. PacifiCorp did not show the Commission, beyond a possibility, that its credit ratings would be downgraded or that it would suffer detriment during the time before this case is heard in full. PacifiCorp accurately, to the extent possible, described the factors that would bear on a rating decision but did not show that those factors would be applied to PacifiCorp at any particular time or in any particular way to any specific detriment. As seen above, the facts produced at the hearing are very much in conflict as to the severity of PacifiCorp's cash flow problem and its financial crisis in general. We will not establish an 'immediate and substantial financial harm' standard for interim relief, but we note that such harm has not been demonstrated. We further do not believe that it would be wise to use general rating agency parameters as a basis for rate making in derogation of Wyoming law. We do not believe that rates set merely to avoid changes in a credit rating would be set justly or reasonably as those terms are used in our statutes.

These cases are consistent with the general weight of authority.

> At the very least, an agency will require a clear showing that the temporary rate increase prior to full hearing is required to meet an unusual financial need that demands immediate correction. Goodman. The Process of Ratemaking (1998), p. 95.

See also, § 47, *Corpus Juris Secundum*, 262, Interim or Temporary Rates; Emergency.

12. This review of interim rate authorities from other jurisdictions makes it clear that the WUTC should again conclude that "an interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or inequity." *PNB*, p. 13.

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

A. Consideration Of Factors: To What Degree, If Any, Should the Following Factors Bear on the Commission's Decision?

13. As this brief argues above, PC/AARP/WeBTEC believes that the following factors continue to offer a workable, fair, and reasonable framework for the analysis of interim rate relief requests, including this one.

1. Factor No. 1 – Adequate Hearing

> This Commission has authority in proper circumstances to grant interim rate relief to a utility but this should be done only after an opportunity for an adequate hearing.[2]

14. An evidentiary hearing has been held, as contemplated by this factor, and the hearing has been adequate, with one proviso. At time of brief filing, there may remain outstanding questions about Verizon responses to bench requests, and whether they should be part of the record without other parties having the chance to rebut them. Absent such rebuttal, there may be a question about the adequacy of the hearing as to those items.

2. Factor No. 2 – Actual Emergency/Gross Hardship or Inequity

> An interim rate increase is an extraordinary remedy and should be granted only where an actual emergency exists or where necessary to prevent gross hardship or gross inequity.

[2] *PNB*, p. 13. Factor descriptions in the headings throughout are quoted from page 13 of the *PNB* order without further citation.

a. Is there an emergency?

15. Verizon faces no financing emergency, no cash emergency, and no operations emergency. While the answer to this question is a clear "no," it is even more appropriate in this case to ask , as the Commission has asked in the past, whether there is an "actual" emergency. Again, the answer is an unequivocal "no." Neither Verizon Northwest, nor its separate Washington operations face a financial situation or any other circumstance that requires that immediate action be taken before the completion of the rate case.

16. The primary indicator of the need for relief which Verizon offers is its low rate of return. King, 101T, p. 24. By itself, this factor has never justified relief in Washington, nor should it, because it is an issue best addressed in the full review of a general rate case (see discussion under Factor No. 3 below).

17. The only other evidence of urgency offered is Dr. Vander Weide's testimony that on a hypothetical stand-alone basis, Verizon's intrastate Washington financial ratios would not support an investment grade bond rating. This is of little relevance since there is no dispute in this case that Verizon's intrastate Washington operation does not issue any equity or debt. Tr. 85-88**.** This analysis asks the Commission to ignore the non-hypothetical fact that no Verizon bond holder faces any actual financial threat. Moody's gives Verizon Northwest an A1 rating, Fitch gives the company an AA rating, and S&P rates Verizon as AA. Verizon Northwest has never issued bonds or short term notes based solely on Washington intrastate earnings. King, Ex. 101T, p. 15. Indeed, even Verizon Northwest no longer relies on external financing. It has sold no financing instruments to the public since February 2003 based on the results of its specific operations. All financing is now handled through parent company financial subsidiaries. Id. Verizon has failed to make any demonstration that it will actually lose access to financial markets. Id., pp. 25-26.

18. No emergency exists in intrastate operations either. Verizon has not demonstrated that the staff or construction program changes it cites have any relation to the revenue shortfall its

seeks to remedy in this case, or that the changes have any relation to intrastate financial considerations at all, as opposed to industry-wide patterns. King, Ex. 101T, p. 25. Verizon has not credibly identified any major construction that would have to be cancelled if interim relief is not granted. Id. [3]

19. Verizon's own decisions with respect to rate relief also cast serious doubt on any claim of urgency or emergency. Even when the Commission specifically delayed the effective date of its *AT&T v. Verizon*[4] order to allow Verizon time to file for relief, the company chose not to avail itself of the opportunity and to pursued a different course, delaying any request for relief for months. Any reasonable company management facing financial emergency does not act in this way. The company's actions and decisions speak louder than any argument they now make in this case.

b. Is there gross hardship or inequity?

(1) Verizon has not established either gross hardship or gross inequity.

20. Verizon has not shown that it is experiencing gross hardship nor has it shown the existence of gross inequity. It has not shown that either will result from a denial of interim relief. From a financial perspective, the best justification for interim relief on the basis of gross hardship would be an argument that Verizon would run out of money during the interim period. King, Ex. 101T, p. 13. As Charles King has demonstrated, however, Verizon can generate sufficient cash to cover its cash operating requirements without any rate relief whatever. (see discussion below).

21. Mr. King testified at the hearing about the concepts of gross hardship and inequity, in response to a question from Chairwoman Showalter:

[3] Capital spending reductions listed in Ex. 83, for example, appear to be part of broader company activity and include DSL projects. Verizon Northwest does not provide DSL service. Tr. 239.

[4] *AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest, Inc.*, Docket No. UT-020406, Eleventh Supplemental Order, ¶146. (Ex. 111 in this proceeding)(*AT&T v. Verizon* or Eleventh Supplemental Order).

Q: All right. I would like to talk about the word --- the term gross inequity. First of all, do you see any possible distinction between the term gross inequity and gross hardship? Doesn't hardship imply – well, hardship on the company, perhaps not.

A. Well, hardship on the company can only mean hardship on the company's owners. I mean, they're the people who hurt, or at least the company's creditors and owners. And if the condition imposes a measurable hardship on those owners and creditors --- example, there is a significant drop in the price of the stock by reason of investment analysts finding out that the company's going to be in terrible straits because it doesn't get --- if it doesn't get interim relief, or there's an impending bond downgrading. That's gross hardship.

Inequity relates to the relationship between ratepayers and owners. If, as a result of the failure to grant interim relief, we are really subsidizing ratepayers and forcing owners to effectively eat costs that should be borne by the ratepayers in a gross manner, then that's inequity, but I see neither of those conditions in this present case.

Tr. 449-450. *See also*, Ex. 101T, p. 9, ll. 12-18.

(2) Verizon's interjurisdictional subsidy argument is a red herring and lacks evidentiary support.

22. Verizon also rests its gross inequity argument on the supposed existence of inter-jurisdictional subsidies. Vander Weide, Ex. 3T, p. 8**.** Verizon attempts to suggest that other states and jurisdictions are somehow supporting Verizon's Washington operations and customers. Tr. 93. To support this argument, Dr. Vander Weide offers his own "economists" theory of subsidization – "a situation where one of a company's services is priced above long-run average cost, and hence provides a subsidy, while another service is priced below long-run average cost, and hence receives a subsidy." Id., p. 7. Dr. Vander Weide does not offer any study or other empirical support, however, that establishes that any Verizon service or group of services intrastate or otherwise is above or below long-run average cost.

23. In lieu of any proof of subsidy under his own theory, Dr. Vander Weide points instead to a table showing operating margins. Id., p. 8. (Table 1). What the table shows, however, is that Verizon's Washington combined operations reflect a healthy positive operating margin of 11 % overall. Id.. Dr. Vander Weide's chart relies on segmentation of the Washington market to show poor operating margins in one aspect of state operations, and hence to show a supposed subsidy. The flaw here is that Washington customers subscribe to multiple services both jurisdictional and non-jurisdictional, regulated and non-regulated, all of which provide revenue flows to Verizon. This customer behavior in many cases is the direct result of Verizon marketing of a range of jurisdictional and non-jurisdictional services to customers. Ex. 71, Tr. 240-242. In the case of DSL, customers likely have no choice but to subscribe to Verizon. Id. As a general proposition, the supposedly subsidizing and subsidized Washington customers are the same customers. Verizon's effort to conjure up some imaginary set of unfairly burdened customers in another state or jurisdiction who subsidize the laggard Washington consumer is a red herring. Even under Dr. Vander Weide's theory, there is no basis for believing there is any "subsidy" from other states, because the operating margin for Washington as a whole (11 %) is quite respectable --- as a result of the very robust 33 % margin for Washington interstate services. Id.

24. As Charles King points out in his testimony, the subsidy argument is further flawed because it suggests that rates in other jurisdictions or other states are higher than they should be because they are supporting Washington. Rate setting simply does not work in this fashion. For example, while Verizon's interstate operations have earned much higher returns than its intrastate operations, this does not mean there is a subsidy. King, Ex. 101T, pp. 10-11. Interstate services are priced under a wholly different regulatory scheme and are priced totally independently. They are subject to a price cap scheme which allows much greater rates of return so long as the cap is not exceeded. Id. p. 11. There is no reason to believe that Verizon's

interstate rates would be one cent lower if rate relief is granted in this case and Verizon earns its authorized rate of return.

25. The same is true of other state jurisdictions. Idaho and Oregon rates for Verizon Northwest customers are set independently from Washington, based on jurisdictional separations. Washington's rate levels do not and cannot affect these rate levels in neighbor states. Although he testified at the hearing that Verizon's intrastate financial status was "tantamount to a further requirement that customers in other states support or subsidize more than they already are customers in Washington intrastate," Tr. 93, Dr. Vander Weide acknowledged on cross examination that he had done no analysis of how much customer rates in Idaho and Oregon are inflated due to current Washington rate levels, Tr. 94, and declined to state that rate levels in those states are unreasonable. Tr. 94. As noted above, he provided no evidence of whether any services in any of the states where above or below long run average cost – his test for subsidy.

(3) The *AT&T v. Verizon* decision does not constitute a gross inequity.

26. The company has had some difficulty articulating what it believes gives rise to the gross hardship or inequity in this case. In some cases, Verizon appears to treat these factors as simply a synonym for financial distress. Tr. 290-291. At other times, Verizon describes the gross inequity as arising from the perceived unfairness of the Commission's access charge reduction in the *AT&T v. Verizon* case. Tr. 292. In essence the company seems to continue to harbor a grievance about the decision, and now seems to suggest that it is entitled to a remedy for that grievance. But there was nothing inequitable about the *AT&T v. Verizon* decision. The Commission found after a hearing that Verizon was not charging lawful rates for access and ordered a reduction. The Commission even noted that Verizon conceded on the record that its access charges needed restructuring. *Eleventh Supplemental Order*, Synopsis, p. 1**.** The Commission held that Verizon was "not entitled as a matter of law to 'rate rebalancing'" but

could seek rate relief under RCW 80.04.130 and RCW 80.36.130. *Eleventh Supplemental Order,* ¶ 175

27. The potential revenue impact of the decision was not a surprise. It had been raised in the case and discussed in the order. The Commission made a special effort to provide an opportunity for the company to address its concerns in an expeditious fashion by delaying the effective date of its August order until October of the year. *Eleventh Supplemental Order,* ¶ 146.. Instead of taking the proffered opportunity Verizon voluntarily chose to delay pursuing any kind of rate relief before the Commission for months.

28. The self-inflicted nature of the delay is underlined by the Commission's admonition even earlier to Verizon that it should consider seeking rate relief. In February 2003, PC/AARP/WeBTEC filed a Motion to Strike Testimony and In Limine to Limit Hearings, seeking to limit the scope of the case to the access charge issues, and preclude testimony about rate rebalancing. The Commission granted Public Counsel's motion and stated:

> If Verizon believes that changes in its rates may be necessitated by the outcome of the complaint, it has options regarding how it may choose to proceed. It may seek to negotiate an implementation plan with the parties. It may ask the Commission to hold a second stage of hearings in which it determines implementation issues. *If Verizon wants to obtain the earliest possible resolution of any "rate leveling" issues, it may file a general rate increase request at any time.* Fifth Supplemental Order, UT-020406, February 21, 2003, ¶ 24. (emphasis added)

29. Not until a year later did Verizon file its interim case. In light of this history, Verizon's assertions of gross inequity and hardship resulting from the revenue loss under the *AT&T v. Verizon* decision are undercut by the company's own delays in seeking rate relief. The company is largely responsible for the situation it finds itself in.

(4) Regulatory lag.

30. It is important not to confuse normal regulatory lag with gross inequity or with emergency. Regulatory lag cuts both ways. King, Ex. 101T, p.12. When costs are declining Verizon can choose not to file for lower rates and can then enjoy excessive earnings. Indeed,

that is what Verizon did in Washington. When costs are increasing, on the other hand, the company must accept that there will be a delay in resetting rates pending completion of a general case. The mere existence of this lag, a well-understood aspect of rate of return ratemaking, does not create an emergency or an inequity, especially when exacerbated by the company's own decisions.

31. To the extent that Verizon argues that it is here because of events beyond its control, the argument has no merit. Verizon has had reason to know, at least since the MCI complaint,[5] that its access charges might be the subject of Commission action. The company had control over the level of its own access charges and had the ability to modify the access charges in keeping with Commission policy. It also could have responded more quickly to the impending loss of revenues, once the AT&T complaint was filed. Until April of 2004, Verizon chose to pursue other strategies to deal with its revenue loss. The company has had ultimate control over the timing of potential relief and cannot now claim that its current situation was a grossly inequitable result of events beyond its control.

c. Will interim rate relief resolve any emergency or prevent any gross hardship or gross inequity?

32. The interim relief requested is not necessary in this case to resolve any emergency or to remedy or prevent any gross hardship or inequity. No such conditions exist in this case. Verizon has presented no plan to use interim revenue to address its alleged problems to remedy any particular financing difficulty. It is telling that Verizon's outside economics and finance expert, Dr. Vander Weide, was not asked to help develop an amount of interim relief that would address the company's short term needs for financing, interest coverage and the like. Instead, he was simply given the *AT&T v. Verizon* access charge reduction figure by the company and asked to build his testimony on that basis. Tr. 292-293. The company's concededly hypothetical case for financial need has no nexus to any real world problem faced by Verizon's Washington intrastate operations.

[5] *MCI Telecommunications Corp. v. GTE Northwest, Inc.*, UT-970653.

3. Factor No. 3 – Rate of Return

> The mere failure of the currently realized rate of return to equal that approved as adequate is not sufficient standing alone to justify the granting of interim relief.

a. Verizon's intrastate rate of return is positive.

33. Although the Commission has cautioned on many occasions that rate of return alone is not a determinative factor, much of Verizon's case is nevertheless devoted to emphasizing its allegedly negative rate of return. *See e.g.*, Heuring, Ex. 23, line 16. Even when rate of return is considered, however, the record casts serious doubt on Verizon's assertions. Verizon's rate of return can only be found to be negative if the Commission accepts Verizon's revenue assertions, and disregards strong contrary evidence in the record. Reasonable adjustments proposed by Staff and PC/AARP/WeBTEC show that Verizon is actually earning a positive rate of return. King, Ex. 105 (ROR 1.464 %); Strain, Ex. 142 (ROR 2.09 %)**.** This positive rate of return is before making any additional ratemaking adjustments that would occur during a general rate case. The amount presented in a rate case filing is rarely the amount approved the Commission after a full hearing. In recent memory, U S West sought a rate increase of approximately $200 million and was ultimately found to be overearning by over $90 million. *WUTC v. U S West Communications, Inc.*, Docket No. UT-950200, Fifteenth Supplemental Order, April 11, 1996, p. 1. A determination of the Verizon's actual rate of return is not possible to make at this stage, and is properly a matter for the general rate case. The evidence of record certainly indicates that Verizon's return is only negative if the company's one-sided financial analysis is accepted without question.

b. Directory revenue imputation must be taken into account.

34. A salient area of dispute is directory imputation. As noted in the prior section, if directory revenues are considered, Verizon is experiencing a positive rate of return. Verizon tries to avoid imputation by arguing that its situation can be distinguished from that of U S West, which has been addressed in detail by the Commission. *See, In Re The Petition of U S West*

Communications, Inc., For An Accounting Order, Docket UT-980948, Fourteenth Supplemental Order.[6] There are several problems with this argument, however. Verizon cannot deny that directory publishing is immensely profitable and produces substantial cash flow that would not exist but for Verizon's participation in both the telephone and directory publishing business in Washington.

35. First, Verizon has been historically engaged in both directory publishing and telephone services, attributing a large share of its directory revenues to the local operating companies so as to recognize the valuable publishing rights associated with being the incumbent telephone company. Ex. 70, p. 1 (Background Information). While Verizon has structured a new arrangement for directory publishing, and would like to now change its position on sharing directory revenue with the telephone company (or imputation in place of such sharing), Ex. 70 shows that historically, under the previous Master Directory Publishing Agreement, "the telephone companies retain approximately 61 % of the advertising revenue. The 39 % remainder represents GTE Directories' share of the revenue. Basically the directory publisher pays a royalty payment to the Telephone Company based on a publishing right which varies by state from a low of 56.89 % in Iowa to a high of 66.89 % in Hawaii." This reflects a long-time recognition of the value to the directory publishing entity of the established incumbency of the operating company. It is far too convenient for Verizon to argue that this historic understanding is to be suddenly disregarded for purposes of this interim request. None of the points Verizon raises in attempting to distinguish its publishing arrangements from those of U S West/Qwest can be attributed to the date when Verizon's telephone operations began to give away its publishing rights without a share of the revenues under the new affiliate contract.

36. Second, Verizon is simply wrong that the siting of GTE directory publishing in a separate affiliated corporate entity disposes of the imputation question.[7] Here the U S West/Qwest

[6] *See also, In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate,* Docket No. UT-021120, Tenth Supplemental Order, ¶¶ 12-19.

[7] Its worth recalling that, whatever its origins, the U S West directory publishing business was sited in a separate corporate entity from the local Bell phone company from the time of Bell divestiture, throughout the entire 20 year history of Commission consideration of Yellow Pages imputation issues in Washington. *In Re The Petition*

regulatory history is dispositive, since U S West also sought to distance the directory revenue stream from the reach of regulators by moving them into a separate affiliate. The Commission must engage in a thorough affiliated interest analysis into attribution of revenue, arms length dealings between the incumbent and the publishing business, and adequacy of reimbursement from the publisher for the value provided by the incumbent telephone company. This analysis lies ahead as an important part of the general case, as Paula Strain noted in response to questions from Commission Hemstad. Tr. 591-592 (including the issue of whether the current contract is an arms length transaction). It is certainly not possible to conclude at this stage, that Verizon is correct in excluding directory imputation from its calculation of rate of return. On the contrary, under the Commission's prior imputation decisions, there is more properly a presumption that imputation should occur. *WUTC v. U S West Communications*, UT 950200, Fifteenth Supplemental Order, p. 32 et seq.[8]

4. Factor No. 4 – Financial Indices

> The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverages, earnings coverages, and the growth, stability or deterioration of each, together with the immediate and short term demands for new financing and whether the grant or failure to grant interim relief will have such an effect on financing demands as to substantially affect the public interest.

a. Adjustments

37. It is appropriate for the Commission to consider certain adjustments preliminarily in reviewing the financial condition of the company. PC/AARP/WeBTEC, through the testimony of Mr. King, has submitted some restating adjustments and an access charge reduction

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OF U S West Communications, Inc. For An Accounting Order, UT-980946, Fourteenth Supplemental Order, ¶¶6-20 (short history and decision summary), ¶¶ 21-46 (full history). The Washington Supreme Court upheld imputation, on the separate basis of affiliated interest analysis in *U S West v. WUTC*, 134 Wn. 2d 74, 92-94, 949 P. 2d 1337 (1997).

[8] *In Re The Petition of U S West Communications, Inc., For An Accounting Order*, Docket UT-980948, Fourteenth Supplemental Order; *see also, In re Investigation of Verizon's New Hampshire Treatment of Yellow Pages Revenues*, Docket DT 02-165, Order Addressing Treatment of Yellow Pages Revenues, pp. 10-12 (July 9, 2004). Verizon's reliance on the FCC order regarding compensation for subscriber listings, *see Ex. 161*, is misplaced. The FCC order cited has nothing to do with and does not address imputation issues.

adjustment, which generally track those submitted by Staff. King Exs. 105, 106. As discussed above under Factor No. 3 (Rate of Return), the directory imputation adjustment is of particular importance. because by itself it places Verizon in a positive return situation.

b. Levels and trends in financial results

38. There are several points to be made about the trends in financial results presented in this case. First, it bears repeating that Verizon attempts always to keep the focus on its Washington intrastate operation, rather than on Verizon Northwest, or on the parent, both of which are healthy. Thus, much of the "problem" is hypothetical, resulting from separations, accounting, and the way Verizon chooses to structure its business.

39. Second, data in the record reminds us of how well Verizon was doing up until 2000. Ex. 143, p. 4**.** Verizon does not dispute that it was significantly overearning during the 1990s. It did not seek rate reductions during that period, and not until 2000 in the merger were rate reductions offered in the context of settlement to obtain merger approval.

40. Third, while declining revenue trends must certainly be considered by the Commission, the fact of declining revenues does not by itself justify interim relief. Company revenue levels are an issue which will be properly and fully considered in the general rate proceeding. Presumably almost any regulated utility which files a general rate case will be able to point to declining revenue trends in its recent past.

41. Fourth, the historic data in this case regarding Verizon's low rates of return since 2000 actually undermines Verizon's claims in the interim case that its need for relief is urgent. Verizon Northwest, and its parent, at least since the end of the rate freeze in 2002, have apparently been quite comfortable with the earnings levels achieved intrastate in Washington. No interim or general rate case was filed during that period, although a number of changes in revenue occurred, including a major and voluntary reduction in revenue from directory publishing. Strain, Ex. 141T, p. 21.

42. In summary, while these trends may have some relevance for the general rate case, they in no way demonstrate the existence of an emergency or exigent situation that must of necessity be addressed prior to the general rate case.

c.-e. Financial indices

43. PC/AARP/WeBTEC witness Charles King conducted an analysis of the relevant financial indices in his direct testimony, reviewing the interest and earnings coverages for Verizon's intrastate Washington operations, along with the immediate and short term demands for new financing. Ex. 101T, pp. 17- 21. Mr. King recommended that the Commission review Verizon's free cash flow, as measured by EBITDA, against the company's requirements for cash. The analysis takes into account the cash requirements over and above operating expenses, including interest payments and capital construction expenditures. As Exhibit 104 shows, even on an intrastate basis, for the test year, Verizon generates enough cash flow to cover its operating expenses, including capital additions and interest coverages. The margin in Exhibit 104 was nearly $3.9 million.[9] Mr. King adjusted his calculation on the stand to a figure of $1.1 million. In fact, this figure is actually much higher. If the figure provided by Verizon in Ex. 83 for intrastate Capital Reduction Initiatives is incorporated into Kings' Exhibit 104, the resulting free cash amount is $9.7 million.[10]

44. Staff witness Paula Strain calculates Verizon's free cash flow to be between $17.5 million, Tr. 602, and $46.9 million, Tr. 594, depending on which adjustments are used. Verizon's own projections for the amount, presented in response to Bench Request No.3 is $8.597 million.

45. The significance of these calculations is that all three parties submitting evidence on this point agree enough free cash flow exists to allow the company to meet its obligations pending a

[9] The figure does not include imputation of directory revenues. Tr. 470.

[10] Ex. 83 reflects Capital Reduction Initiatives of $11.474 million. Subtract this amount from Ex. 104, line 7. Allocating 75.565% of the total to Washington intrastate (Ex. 104 , line 8), reduces Ex. 104 , line 9 (Intrastate Capital Adds) by $8.667 million and increase the free cash shown in line 11 by the same amount. Line 11 was adjusted on the stand to $1.1 million. With the Capital Reduction Initiative incorporated, the free cash would be $9.776 million.

final decision in the rate case. This means that even if this request is examined from the hypothetical intrastate only perspective urged by Verizon, the need for "green cash" has not been shown. Tr. 459. There is no immediate financial crisis, even on an intrastate regulated service basis only. This conclusion is further supported by the fact that Verizon has available to it a cash pool from Verizon Network Funding Corp which it can draw upon to support its operations pending the decision in the general case. Ex. 101T, p. 15.

46. While Verizon may urge a focus on earnings coverage, this perspective has limitations. Earnings are not the sole source of internal cash. Ex. 101T, p. 17. Earnings review includes non-cash expenses such as depreciation. If depreciation accruals are taken into account, interest coverages are dramatically improved. Id. p. 18. Earnings information also has not yet been subjected to the full review of the general rate case, and is of questionable relevance when the company does not face any bond covenant or financing condition. Because there is no actual Washington company, and the no debt or equity is issued by the intrastate operations, no such covenants or conditions exist. This is in stark contrast to the *Olympic Pipeline* case,[11] much relied on by Verizon, where there was imminent default on debt, where debt exceeded net book value, and where Olympic Pipeline had to finance externally. Tr. 478-479. Here, all the cash needs of Verizon can be (and will be in fact) met by internally generated cash, even when one looks only at the intrastate operations. Tr. 479.

f. Effect of the grant of interim relief on financing demands

47. The grant or denial of interim relief will have no effect on financing efforts by Verizon's intrastate Washington operations. There are no such financing efforts, since the intrastate portion of the company does not separately issue debt or equity financing and has never done so. King Ex. 101T, p. 15. As noted above Verizon's Washington operations have access to a $500 million "cash pool," which access will not be affected by a denial (or grant) of relief in this case. Id. Nor will any grant or denial have any impact on Verizon Northwest, or its

[11] *WUTC v. Olympic Pipeline Company*, Docket No. TO-011472, Third Supplemental Order, Order Granting Interim Relief In Part.

parent. Verizon Northwest no longer sells any financing instruments to the public. All debt and equity financing is handled through subsidiaries of the parent. Id.

5. Factor No. 5 – Clear Detriment

> In the current economic climate the financial health of a utility may decline very swiftly and interim relief stands as a useful tool in an appropriate case to stave off impending disaster. However, this tool must be used with caution and applied only in a case where not to grant would cause clear jeopardy to the utility and determinant to its ratepayers and stockholders. That is not to say that interim relief should be granted only after disaster has struck or is imminent, but neither should it be granted in any case where full hearing can be had and the general case resolved without clear detriment to the utility.

48. This factor is really an elaboration of the important principle that interim relief is an extraordinary remedy designed to be used sparingly in cases of real and imminent need. It can be viewed as a summary of the high burden of proof to be met by a utility which seeks interim relief. The threat of harm to the utility must be serious (impending disaster, clear jeopardy, clear detriment) and relief must be necessary to avoid harm to ratepayers and shareholders.

49. As Charles King testified in this proceeding, there is no evidence in this case that either shareholders or creditors of Verizon are experiencing any detriment, nor will they if interim relief is denied. Tr. 450.

50. A significant consideration here is the recognition that the general rate case is the preferred forum for resolving revenue and earnings issues. Only when the utility will suffer clear detriment should a rate increase to be ordered on a preliminary record. The Commission in the *PNB* decision and its subsequent interim relief orders reflects the legal structure and policy underpinning of the Title 80, which establishes the full rate case review as the preferred method for determining rates.

6. Factor No. 6 – Public Interest

> Finally, as in all matters, we must reach our conclusion with the statutory charge to the Commission in mind, that is to "Regulate in the public interest" (RCW 80.01.040). This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.

51. This factor recognizes the discretion which the Commission has to use its informed judgment to resolve cases with the ultimate goal of protecting the public's interest in fair, just, reasonable, and sufficient rates. Beginning with the original *PNB* case, through the *Olympic Pipeline* decision, the Commission has found that the factors listed above have provided a way for it to consider in a transparent, organized and deliberate fashion the public interest in the context of interim rate relief.

52. In weighing the public interest, the Commission should consider not only the impact on Verizon's financial situation, but also the impact on the company's ratepayers. Many ratepayers have voiced their opposition to the Verizon interim request by emailing and writing the Commission and Public Counsel. Ex. 200 contains over 500 statements in opposition to the request. Some example of public comment include:

> I am a senior on a fixed income and have only basic residential telephone service (no caller ID, no call waiting etc.), and an additional $3.54 a month surcharge would certainly work a hardship on my finances.
>
> Valerie Studyvin, Edmonds, Washington, Ex. 200, p. 42.
>
> In our view, a proposal for a surcharge of this magnitude clearly has little or nothing to do with providing "a fair opportunity to recover its reasonable cost of doing business"….Where innovations have occurred, largely for the benefit of high-tech applications, the costs have been borne disproportionately by the basic service rate payers. Cutting to the chase, Verizon is a monopoly operating under the aegis of a commission obligated to maintain fair balance in consideration of public needs. Nodding heads in agreement with every such proposal looks more like an indulgence.
>
> Don W. Spencer (Environmental Associates, Inc.), Bellevue, Washington, Ex. 200, p. 498.
>
> After thoughtful review of Verizon's proposed rate increase to recover lost revenue, I firmly conclude that this is absurd. I wish as a consumer I could request retribution from the Commission for lost revenues due to my job elimination in March 2002….I take responsibility to eliminate non-core expenses from my household budget, to improve the productivity of my household, and to look of income producing opportunities through value added services. I think Verizon should do the same. I passionately ask that you do not support this absurdity of a rate increase to improve corporate profits and executive pay, funded by the poor average person like me.
>
> Patricia Larson, Kirkland, Washington, Ex. 200, p. 88.

53. At the public hearing in Everett on August 17, a number of ratepayers attended to express opposition. While a number of witnesses also spoke in support of the company, many were beneficiaries of Verizon's' charitable activities in the community who spoke to the company's corporate citizenship rather than to the specific issues in this case. Several of these witnesses acknowledged that their organizations had not studied or taken a position on the request for interim relief.

54. An additional public interest consideration is the public's interest in rate stability. Frequency of rate changes is generally to be avoided in ratemaking. As with other factors, this militates against granting interim relief lightly with the result that ratepayers could face two rate changes in a short period of time. In addition, even if refunds are ultimately granted, the ratepayer has incurred an added financial obligation and lost the use of funds from the family budget for a period of months.

B. Should This Request, Seeking Rebalancing for Reductions In Revenue That The Commission Ordered, Be Considered As Different In Character From Other Requests For Interim Relief?

55. This is not a rate rebalancing case. Verizon has not presented it as such, instead seeking to show that it qualifies for interim relief under Commission precedent. It is not surprising that the company does not explicitly seek rate rebalancing in this proceeding because the Commission has already rejected rate rebalancing for Verizon as a means of replacing its lost access charge revenue.

56. In the *AT&T v. Verizon* case, the Commission devoted special attention to this question, responding to the company's assertion that if the Commission proceeded to "reduce revenues from access charges, *Verizon is entitled to rate 'rebalancing' that leaves its overall revenues unchanged."*[12] The Commission rejected Verizon's claim of entitlement:

> AT&T's opening brief addresses this argument by stating that Verizon has felt no need to initiate rate rebalancing, citing testimony of Verizon witness Mr. Fulp. More telling, though, is the lack of any legal or policy argument from Verizon that supports its contention that it is entitled to rate rebalancing to

[12] Eleventh Supplemental Order, ¶ 14.

> effect a major shift in its revenue that involves a major increase in rates for local service. We find none in its presentation, and know of none.[13] A company is not entitled to a level of revenue. It is entitled to the opportunity to earn at a level allowing it to meet its reasonable expenses, including the cost of capital needed to support its operations. *An appropriate means to demonstrate the need for a general increase in its rates and charges is a general rate increase proceeding. Verizon offers no objection to reducing access rates if it is entitled to increase other rates. The Commission rules that it may be so entitled, if it demonstrates the need for a rate increase of that magnitude through a general rate case, and if it provides the Commission with the opportunity to consider a spread of rates that is fair, just, and reasonable.*
>
> *A rate case is the appropriate forum for addressing Verizon's earnings issues.* Verizon witnesses demonstrate that the Company has been concerned about its earnings and its reported intrastate regulatory rate of return for some time. We believe that Verizon's evidence underlying this concern, and the preparations for this proceeding, will enable it to file promptly for any rate relief that it believes is sufficient to address its concerns. (emphasis added).

It is difficult to imagine a clearer statement. Verizon is not entitled to rate rebalancing. The Commission states it knows of no legal or policy argument to support an entitlement to rebalancing. If Verizon wishes to address revenue concerns, a general rate case is the proper forum to raise them. In that case, the company must demonstrate a need for a rate increase "of that magnitude" (i.e. of the same amount as the reduction). In other words, the issue is not automatic revenue replacement, it is determination of what revenue amount, if any, is appropriate.

57. Later in its decision, the Commission reaffirms this holding:

> It is unnecessary for us to address earnings in this decisions, because procedural means exist for Verizon to seek rate relief as a result of this decision that will allow it the opportunity to earn a fair return. It is inappropriate to address earnings in this decision because, consistent with the fifth and sixth supplemental orders in this docket, the status of the Company's earnings is not relevant to the issues raised by the complaint, and also because *a rate proceeding initiated by Verizon will afford a much greater opportunity to explore the issues that this decision has acknowledged and any others that may require attention.* Id., ¶ 140.

[13] *See, In re the Petition of GTE Northwest, Docket No. UT-961632, Fourth Supplemental Order (Dec. 1997),* where the Commission ruled that there is no obligation on this Commission to ensure that a regulated company will fully recover its costs regardless of any changes in the economic, technological, or business environments.[footnote in original].

The clear directive from the Commission to Verizon was that it should present its revenue concerns in the context of a general rate case. While it has chosen to initially present them as a petition for interim relief, this by definition involves a review of Verizon's financial condition. In view of the clear holding by the Commission, Verizon should not be able to revive its rate rebalancing claims under the guise of a request for interim relief. It cannot qualify for interim relief by simply stating, "we have experienced a loss of access revenue and must replace it." The company must establish a need for revenue under the standards for interim relief and ultimately of general relief, as the Commission has said. This is the reason, why at bottom, the Verizon case is not fundamentally different in character from other requests for interim relief.

a. What precedent, if any exists at the Commission regarding rebalancing of the sort requested?

58. As noted in the discussion above of the *AT&T v. Verizon* decision, neither the Commission nor the company were able to identify authority that would support the company's rate rebalancing proposal.

59. The Commission has faced this issue on at least one other occasion and concluded that revenue deficiencies associated with single issues should be addressed in a separate proceeding. *WUTC v. US West Communications, Inc.* UT-980340, Commission Order Granting Summary Determination; Ordering Implementation of 1+ Toll Dialing Parity, p. 11 (October 14, 1998). In that case the Commission Staff brought a complaint seeking determination of whether US West should be ordered to provide intraLATA 1+ toll dialing parity. US West argued against dialing parity until it was either granted §271 relief or it was allowed to concurrently rebalance existing rates to compensate it for revenue losses resulting from implementation of dialing parity. The Commission granted Commission Staff's motion seeking summary determination and ordered US West to implement dialing parity without the requested rate rebalancing. We believe that same analysis should be applied by the Commission in this proceeding.

60. Regulated companies that have suffered substantial revenue losses in the past have sought to address revenue shortfalls by filing for either interim or general rate relief or both.

PC/AARP/WeBTEC submits that the precedent that is relevant here is the body of over twenty Commission decisions on interim relief.

b. What policy factors should bear on determining whether this request differs from other requests for interim relief.

61. One very important factor to consider is that a request by Verizon for rate rebalancing , i.e., automatic substitution of lost revenue without earnings review, would violate the prohibition against single-issue ratemaking.

> Single-issue ratemaking is prohibited because it considers changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement. *City of Chicago v. Ill. Commerce Commn.*, 281 Ill.App.3d 617, 627 (1996)[14]

This Commission has followed this rule:

> The Commission generally will not engage in single issue or "piecemeal" ratemaking… The Commission has consistently held that these questions are resolved by a comprehensive review of the company's rate base and operating expenses, determining a proper rate of return, and allocating rate changes equitably among customers. *MCI Telecommunications Corp. v. GTE Northwest, Inc.*, UT-970653, Second Supplemental Order Dismissing Complaint, p. 5 (October 22, 1997).[15]

Rebalancing rates presents just the type of limited rate case the Commission has condemned. "Such limited rate cases likely would result in unfair and unequal allocation of rates among the company's ratepayers, and would not be a productive use of the Commission's resources." *Id.* at 6. The proper context for consideration of cost shifting, rate spread and similar issues is in a general rate case where all revenues and costs are before the Commission.

IV. RATE DESIGN

(This section of the brief is supported by Public Counsel and AARP only. WeBTEC is submitting a separate Rate Design/Deferral Account brief.)

[14] See also 8 Am. Jur. 2d, Public Utilities § 118.

[15] MCI's complaint was dismissed for failure to state a claim against GTE. The Commission's decision was affirmed in an unpublished opinion by Div. 1 of the court of appeals. The court adopted the Commission's analysis and the above cited language. *US West Comm., Inc. v. Washington Utils. And Transp. Commission*, 2001 WL 783746 (2001).

A. Introduction

62. The rate design issues in the interim phase of this case present two significant choices for the Commission. First, which services should be subject to any interim increase the Commission grants? Second, which methodology should the Commission adopt to spread any increase it orders? On the first question, PC/AARP recommends the Commission apply any increase to the broadest possible set of access lines, as advocated by Staff witness Zawislak. On the second, Public Counsel/AARP recommends the Commission employ a methodology which uses an equal percentage increase rather than an equal dollar amount increase.

B. Equal Percentage Increase Proposal

63. Public Counsel/AARP supports Staff's proposal to require an equal percentage increase in the event the Commission orders interim rate relief. Applying an equal percentage increase is the best option in the record for providing whatever level of interim relief the Commission grants for numerous reasons: (1) an equal percentage increase preserves the existing rate relationships while the cost studies necessary to change those relationships are analyzed in the general rate proceeding; and (2) prior commission policy on interim relief supports the use of equal percentage; (3) rate design must balance competing policy goals, an equal percentage increase best does that in this proceeding.

1. Preserving existing rate relationships

64. The use of an equal percentage increase preserves the existing relationship between basic rates in Verizon's current rate structure while the costs underlying those rates are fully examined in the ongoing general rate case. Verizon attempts to suggest that an equal percentage methodology would exacerbate some alleged disparity in rates. TR 352, ll. 14-21. This is simply incorrect, and this argument should be rejected.[16] An equal percentage increase, of any

[16] Product A priced at $30, Product B at $15. An equal ten percent increase to each results in prices of $33 and $16.50 respectively. The relationship between the prices, a 2-1 ratio, remains unchanged.

magnitude, maintains the exact same ratio of rates among services as exists today (for all services that receive the increase).

65. Furthermore, there is no useful cost information in the record upon which the Commission might rely to change rates differentially. There are no cost studies at all in the record of the interim proceeding. Indeed, the company has only recently, on August 23, filed underlying cost studies for its general rate request. Tr. 301, line 25, 302, line 1. Verizon acknowledges the cost "data" purported to be shown in Ex. 74-C do not reflect the Commission's prior orders for Verizon's loop costs, usage levels, fill factors, depreciation rates or cost of money. Tr. 406, line 22-25; 407, lines 1-20. There is simply no reason for the Commission to adjust the relationships between different rates in the interim phase when it will have the ability in the general rate case to do so, based on a full and complete record of the company's underlying costs and all parties' arguments about the proper application of cost information, as well as other policy goals, in the rate-setting process.

2. Prior Commission policy

66. Prior Commission policy suggests the use of an equal percentage methodology. The two interim decisions offered into the record by Verizon in this case, the *Olympic Pipeline* and *Avista* decisions, both employed an equal percentage increase. Ex. 109, Synopsis,; Ex. 110, Synopsis. Furthermore, the other most recent Commission decision granting interim relief also used an equal percentage methodology.[17]

67. The Avista decision perhaps best articulates the Commission's recent view of the merits of uniform percentage methodologies. The Commission states: "[o]ur decision to adopt the uniform percentage basis rate design is based on our concern that rate shock be minimized for all customer classes." Ex. 110, ¶ 83, note 7. PC/AARP notes this has been, and continues to be, a compelling policy goal in rate design for this Commission. Similar rate shock concerns are

[17] WUTC v. Puget Sound Energy, DOCKET NO. UE-011570 and UG-011571 (consolidated) NINTH SUPPLEMENTAL ORDER: REJECTING TARIFF FILING; APPROVING AND ADOPTING SETTLEMENT STIPULATION; AUTHORIZING AND REQUIRING COMPLIANCE FILING, paragraph 17. This was the result of the Commission adoption of a settlement among the parties as to rate design and other issues.

present in this case, consideration of them strongly suggests the use of the equal percentage rate design. We discuss the rate shock issue more fully in (C) below.

3. Balancing competing policy goals

68. Public Counsel/AARP believes that the general rate proceeding is the appropriate forum for examining the costs underlying rates and the relationship of rates to costs, and among rates. Indeed the examples of prior US West cases cited in Exhibits 188 and 190 are Commission decisions on general rate requests, in which the Commission explicitly balanced one policy goal at that time - bringing business and residential rates closer together - with numerous and competing goals: avoiding rate shock , Ex. 110, ¶ 83, ensuring rates cover costs, services make a contribution to loop costs (and "other general costs of doing business"), promoting universal service, and maintaining affordability. Ex. 188, p. 5

69. If the Commission considers the numerous policy objectives inherent in setting rates, Public Counsel/AARP suggests the proper conclusion is that the equal percentage methodology achieves a better balance of all the goals. Minimizing rate shock, preserving affordability and promoting universal service favor an equal percentage methodology since the rate increase experienced by residential customers is minimized by this approach. Covering costs and making a contribution to the company's other costs cannot be determined absent the yet-filed cost studies. Only the goal of narrowing the gap between business and residential rates, unsupported by any evidence about the costs underlying such a gap, is furthered by not employing a uniform percentage increase. Happily, the pending general rate case offers all parties the chance to opine on the competing goals of rate design, to evaluate the underlying cost data, and to offer the Commission evidence that might suggest one policy outcome over another, and the Commission can await that phase of the proceeding to make a change to the underlying relationship of costs and rates.

C. Equal Dollar Increase Proposal

70. Public Counsel/AARP recommends that the Commission reject Verizon's proposal to spread any increase on an equal dollar basis. We disfavor Verizon's proposal because it alters, without any supporting cost basis, the existing relationship between rates, it departs from the Commission's past practice on interim increases, it is inequitably limited to a small subset of the company's customers, and it would impose rate shock on residential customers. Exhibit 184. Many of these issues we discuss in section (B) above, and we will not repeat those arguments here.

Public Counsel/AARP is very concerned with rate shock under the equal dollar proposal. Exhibit 184 demonstrates that under the company's proposal, residential rates would increase more than 27% and in the case of residential measured service over 48% . By contrast, business rates increase by from 5.93% to 11.92%, with the exception of 20 % for business measured service. Adopting Staff's equal percentage and larger set of access lines, the increase is a uniform 15.78% to all affected customers – still large, but obviously lower for residential customers. Ex. 184. This Commission has generally viewed increases greater than 10% as creating rate shock for customers, and has attempted to mitigate them.

71. The company suggests that business customers will flee in the face of a slightly larger absolute increase resulting from an equal percentage increase instead of a dollar increase. Ex. 184 ($4.69 v. $3.54, or $2.97 if spread using Staff's set of lines). Plainly, this makes no sense. The company cannot claim to be truly worried about customer migration based on a $4.69 increase when it has itself proposed a much larger increase in the general phase of this case.

72. We sympathize with the large customers concerns, indeed we all share the basic belief that no increase is warranted at this time. However, business customers generally have more competitive options open to them than do residential customers so they are more able to avoid an onerous increase if indeed the marginal difference between the equal percentage and the equal

dollar proposals drives them to do so. No one has sponsored any evidence that price elasticity will in fact result in this migration.

D. Services Subject To a Surcharge (includes the WTAP issue)

73. If the Commission imposes a rate increase, Public Counsel/AARP recommends that it be applied to all intrastate retail and resale tariffed, price listed and contracted access lines, except for UNEs as described in the testimony of Staff witness Zawislak. Ex. 181, pp. 2-3. Verizon, while continuing to support its testimony limiting any increase to a subset of lines, could agree to Staff's expanded set of access lines. Tr. 248, ll. 2-25.

74. Public Counsel/AARP believes that applying any increase to the larger base of products and services is a more equitable result. Verizon has rested its request for interim relief upon the premise that its intrastate customers are not bearing the weight the company would put upon them. Assuming for the moment that the company is correct, that intrastate revenues are deficient in such a manner as to require immediate relief or the consequences of declining ability to perform, then it is apparent that all customers are likely to bear the brunt of such a failure. If the Commission believes the company faces a situation so dire as to require interim relief, all customers are at risk and thus all should contribute to the redress of that situation.

75. There are two specific situations that merit separate discussion-- WTAP customers and late payment charges.

1. WTAP lines.

76. Public Counsel/AARP concurs with the recommendation of Staff witness Timothy Zawislak that WTAP lines not be excluded from application of a surcharge. Ex. 181T, p. 12-15. The recommendation will not impact the rate WTAP participants pay themselves. Id., p. 14. We share the concern that exclusion of WTAP would increase the surcharge amount for other customers. Exclusion of WTAP is also generally inconsistent with the design of the WTAP program, in which the WTAP rate paid by eligible participants is a separate matter, not tied to

the underlying rate charged by the serving telephone company. The WTAP program presumably contemplates that changes will occur from time to time in basic telephone rates.[18]

2. Late Payments.

77. Public Counsel/AARP opposes the inclusion of a late payment fee at this time. This is properly a general rate request item, subject to the use of underlying costs studies. Additionally, should the Commission decide to employ a subject to refund condition, the late payment fee will be extremely difficult to track and return.

E. Mechanics of Calculating a Surcharge, If One Is Authorized

PC/AARP does not have a recommendation regarding mechanics of the surcharge calculation.

V. DEFERRAL ACCOUNT PROPOSAL
(This section of the brief is supported by Public Counsel and AARP only. WeBTEC is submitting a separate Rate Design/Deferral Account brief.)

78. Public Counsel/AARP does not support WeBTEC's proposal to create a deferred account from which any increase might eventually be recovered after the general rate case is completed. Public Counsel/AARP generally disfavors the use of deferred accounting except in all but the most tightly limited situations. While the deferred account has some appeal because it postpones payment by customers, our experience has been that the creation of such accounts creates significant pressures on the company to seek and the Commission to authorize recovery, and the evaluation of the accounts themselves becomes the subject of considerable debate and oversight. Such a remedy is not necessary in this situation, where the Commission can swiftly act upon the company's request and resolve the issue.

[18] There is some cause for concern about the general pressure placed on the WTAP fund as explained in Mr. Zawislak's testimony. This is an aspect of the impact of any interim relief awarded, and provides another reason that weighs against a grant of Verizon's request absent a showing of actual, serious and imminent need.

VI. REFUND ISSUE

A. Whether and How to Apply Refunds

79. In the event any interim relief is allowed, PC/AARP/WeBTEC supports the recommendation that it be made subject to refund. However, PC/AARP/WeBTEC cautions the Commission to avoid any temptation to view the availability of refunds as a rationale for granting relief in the first instance. We strongly urge against giving Verizon "the benefit of the doubt" on any issue on the theory that mistaken conclusions can be corrected in the refund process. The company's request for relief must withstand scrutiny on its own merits and Verizon cannot excuse itself from meeting its burden by saying it will refund money later. Any interim rate increase will impose real financial burdens on ratepayers during its term - - real dollars out of household and business budgets. In addition, the refund process itself is problematic administratively as the Commission's past experience has amply demonstrated. Administration of the refund process from the 1995 U S West rate case continues to this day.[19]

80. In the event the Commission does grant relief, Verizon should be ordered to create a detailed accounting process to track all surcharges paid by customers for all services so that if refunds are ultimately ordered, Verizon will have the records necessary to calculate refunds on a customer specific basis and direct them to the proper recipients. To assist in this process, PC/AARP/WeBTEC recommends that the Commission adopt the approach ordered in the Avista interim relief case, in which the company was directed to establish a separate off-book record (side-account) and report monthly to the Commission the amount of the surcharge revenues billed and collected from its customers under each of its rate schedules. Ex. 110, ¶ 109.

[19] The King County Superior Court has continuing jurisdiction over the U S West 1995 rate case refunds and the related settlement. *See, U S West Communications, Inc. (dba Qwest) v. WUTC*, King Cty. Superior Court No. 96-2-09623-7 SEA, Order Granting Joint Motion of WUTC and Public Counsel For Order Directing Transfer of Monies By Qwest, p. 2.

B. Other issues

81. Verizon's initial filing for interim relief stated that any relief granted would be subject to refund.[20] Verizon subsequently filed a tariff to establish an interim surcharge of $3.54 applicable to a stated list of services. Ex. 84, p.3. The tariff also states: "[t]he interim surcharge is subject to refund with interest as may be ordered by the Commission and will expire once permanent rates are made effective in Docket No. UT-040788." At the hearing, Verizon witness Banta announced a qualification to the refund proposal, confirming it "only applies if the revenue requirement in the final order in this docket is less than $29.7 Million." Tr. 243. As a result, even if a residential customer's final increase is $3.00 per month, a reduction from the surcharge amount, that customer would not receive any refund unless the total revenue requirement was less than the interim amount. PC/AARP/WeBTEC opposes this modification of the refund proposal. It is not contained in the tariff, or to PC/AARP/WeBTEC's knowledge anywhere else in the company's case. From a customer perspective, offering a refund is an empty gesture if his or her rates go down, but no refund is forthcoming. PC/AARP/WeBTEC requests that any refund be calculated on a service basis.

VII. CONCLUSION (WITH SPECIFIC RECOMMENDATIONS)

82. For the foregoing reasons, Public Counsel, AARP, and WeBTEC submit that Verizon has not established any basis for a grant of interim rate relief. Its concerns regarding revenue should be addressed in the full general rate case. The company has not demonstrated that it is unable to await that proceeding. Indeed, the record is undisputed that Verizon, even on an intrastate only basis, has access to sufficient cash resources to cover its needs pending a final rate decision.

Public Counsel, AARP, and WeBTEC respectfully recommend:

1. That Verizon's request for interim rate relief be denied.

2. If any rate relief is awarded, that it be made subject to refund and that specific tracking measures be ordered to assist with administration of refunds.

[20] Petition of Verizon Northwest Inc. Seeking Interim Rate Increase, p. 2.

3. If any rate relief is ordered, Public Counsel/AARP and WeBTEC, respectively, rely on the rate design recommendations contained in their rate design briefs.

DATED this 27th day of August, 2004.

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