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August 27, 2004

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Carole J. Washburn, Secretary  
Washington Utilities and Transportation Commission  
1300 S. Evergreen Park Dr. SW  
P. O. Box 47250  
Olympia, Washington 98504-7250

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

Dear Ms. Washburn:

Enclosed for filing are the original and 15 copies of the Brief On Behalf Of Commission Staff Regarding Verizon Northwest Inc.'s Request For Interim Rate Relief, and Certificate of Service.

In Paragraph 82, Staff includes a brief discussion regarding the Company's Response to Bench Request No. 5. Staff will file today a motion to strike that Response. If that motion is granted, Paragraph 82 should be disregarded.

Very truly yours,

  
DONALD T. TROTTER  
Senior Counsel

DTT:kl  
Enclosures  
cc: Parties



BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

DOCKET NO. UT-040788

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**BRIEF ON BEHALF OF COMMISSION STAFF  
REGARDING  
VERIZON NW'S REQUEST FOR INTERIM RATE RELIEF**

**August 27, 2004**

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\* The format of this brief was agreed to among the parties, except all of Section III.B, and the heading for Section III.A, were provided at the Commission’s request.

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## I. INTRODUCTION AND SUMMARY OF POSITION

1 Verizon NW's request for interim rate relief should be denied. Verizon NW is not facing a financial emergency. The Company is a vibrant utility. It is financially strong and enjoys AA and A+ credit ratings on its debt. ¶¶ 37-70, *infra*.

2 Verizon NW has not even proved a need for external capital, how it intends to finance that need, or why a \$29.7 million interim rate increase is necessary and sufficient to enable the Company to acquire external capital to finance its operations. If the Company had proved a need to finance, it can acquire capital on reasonable terms today, tomorrow, and into the foreseeable future, by accessing the cash pool created by Verizon Network Funding Corp. This cash pool is one of the merger benefits to which ratepayers are entitled. ¶¶ 56-57, 61-63 and 84-89, *infra*.

3 Verizon NW is not the victim of any gross inequity or gross hardship occasioned by the Commission's Order in the Access Charge Case ("Access Charge Order").<sup>1</sup> It was *the Company* that was charging unlawful rates as demonstrated in that case. If there were harm to Verizon NW from that Order, it is more than offset by the \$44.6 million the Company gained by imposing unlawful access charges for just the 1½-year period prior to that Order. ¶¶ 71-83, *infra*.

4 Nor has the Company made a case for gross hardship or gross inequity based on allegations of "subsidy" from other states. While the Company states an

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<sup>1</sup> *AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest Inc.*, Docket No. UT-020406 (Eleventh Supplemental Order)(August 12, 2003).

economic test for subsidy, it fails to provide the evidence necessary to pass that test. In any event, the amount of revenue to be derived from Washington intrastate operations is an issue to be resolved in the general rate case, not in a case for interim rate relief case. ¶¶ 79-83, *infra*.

5           Verizon NW’s “stand alone” theory also lacks merit. Allocation and separation factors are important in setting permanent rates, but they are not relevant to how the Company finances. But even if Verizon NW were a “stand alone” Washington intrastate company, it would still have sufficient cash flows to fund its operations while the rate case proceeds. ¶¶ 64-70 and 135-144, *infra*.

6           In the end, by any reasonable measure, Verizon NW has failed to sustain its burden of proving it is entitled to relief. The Commission should deny the Company’s request for interim rate relief.

## II. LEGAL AND POLICY ISSUES

### A.    What are the proper factors for interim rate relief?

7           The Commission’s interim rate relief factors remain appropriate for analyzing Verizon NW’s request for interim rate relief. Verizon NW itself based its case on these factors. *Petition of Verizon Northwest Inc. Seeking Interim Rate Increase (April 30, 2004) at 5-9, ¶¶ 9-23*. Commission Staff and other parties have responded to the Company’s presentation. It would be unfair to change the approach now, because the parties would not have an opportunity to respond.

8 More importantly, the Commission's interim rate relief factors reflect appropriate public policy. They are true to the purpose of interim rate relief: addressing a real financial problem that cannot await resolution of the general rate case.

9 The legislature has established the "ordinary" procedure for increasing rates: the utility files tariffs, and if the increase is reasonable, it is allowed to take effect by operation of law. If the Commission is not convinced the increase is reasonable, the tariffs are suspended. A ten-month period ensues during which the Commission determines, "after full hearing," whether the increase is appropriate. *RCW 80.04.110*.

10 Interim rate relief is the exception. Interim rate relief is evaluated without a full investigation and hearing on the utility's revenue requirements. Accordingly, ratepayers should pay higher rates on an interim basis only if a real, urgent problem is preventing the utility from meeting its public service obligations.<sup>2</sup>

11 Moreover, the Commission's interim rate relief factors are well known to the utilities the Commission regulates. The Commission developed these factors in 1971, based on significant precedent from many other jurisdictions. The

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<sup>2</sup> The Arizona court of appeals has ruled that the Arizona commission cannot grant interim rate relief absent an emergency situation, the posting of a bond, and a subsequent full rate case. *RUCO v. Arizona Corp. Comm'n*, 20 P.3d 1169, 1173 (Ariz. Ct. App. 2001).



Commission consistently has applied these interim rate relief factors in the twenty interim rate relief orders it has issued over the past 33 years.<sup>3</sup>

12 This has provided certainty to ratepayers and utilities alike. Ratepayers have certainty their rates rarely will gyrate over the short term, which promotes rate stability, and the customer's ability to budget. On the other hand, ratepayers should understand a prompt and temporary rate increase may be required if necessary for the utility to fulfill its public service obligations.

13 Utilities have certainty that seeking interim rate relief is a choice sparingly made. This promotes rational behavior, by requiring utilities to actively monitor their rate structure. If the utility can prove a real problem exists that is affecting its

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<sup>3</sup> *WUTC v. Pacific N.W. Bell Tel. Co.*, Cause No. U-72-30 tr, Second Supplemental Order (October 10, 1972). After the PNB Order: *WUTC v. Puget Sound Power & Light Co.*, Cause No. U-73-57 (Second Supplemental Order)(1974); *WUTC v. Cascade Natural Gas Co.*, Cause No. U-74-20 (Second Supplemental Order)(1974); *WUTC v. Cascade Natural Gas Co.*, Cause No. U-74-20 (Second Supplemental Order)(1974); *WUTC v. Pacific Northwest Bell Tel. Co.*, Cause No. U-75-40 (11 PUR 4<sup>th</sup> 166)(1975); *WUTC v. Washington Water Power Co.*, Cause No. U-77-53 (Second Supplemental Order)(1977); *In re Puget Sound Power and Light Co.*, Cause No. U-79-73 (Order) (1979); *WUTC v. Puget Sound Power & Light Co.*, Cause No. U-80-10 (Second Supplemental Order)(1980); *WUTC v. Washington Water Power Co.*, Cause No. U-80-13 (Second Supplemental Order)(1980); *WUTC v. Washington Natural Gas Co.*, Cause No. U-80-111 (Second Supplemental Order)(1981); *WUTC v. Washington Water Power Co.*, Cause No. U-83-26 (Fourth Supplemental Order)(1983); *WUTC v. Skamania County Sanitary Service*, Cause No. TG-2108 (First Supplemental Order)(1987); *WUTC v. Richardson Water Cos.*, Docket No. U-88-2294-T (Second Supplemental Order)(1988); *WUTC v. South Bainbridge Water System, Inc.*, Docket Nos. U-87-1355-T and U-83-50 (Second Supplemental Order)(1988); *WUTC v. Ludlow Utilities Co.*, Cause No. U-87-1550-T (Second Supplemental Order) (1988); *WUTC v. Alderton-McMillin Water Supply, Inc.*, Docket No. UW-911041 (First Supplemental Order)(1992); *WUTC v. Puget Power & Light Co.*, Cause Nos. UE-920433, UE-920499, UE-921262 (Fifteenth Supplemental Order)(1993); *WUTC v. Washington Natural Gas Co.*, Docket No. UG-950278 (Third Supplemental Order)(1995); *In re Avista Corp.*, Cause No. UE-010395 (Sixth Supplemental Order)(2001); *WUTC v. Puget Sound Energy, Inc.*, Cause No. UE-011163 (Sixth Supplemental Order) (2001); *WUTC v. Olympic Pipe Line Co.*, Cause No. TO-011472 (Third Supplemental Order)(2002).

ability to finance to meet near-term operational and construction needs, interim rate relief will be forthcoming.

14           If a utility, like Verizon NW, may be under-earning on a per books, separated and allocated basis, but faces no actual inability to operate or to finance, it is not entitled to interim rate relief. In that circumstance, the utility's focus should be on filing a rate case on a timely basis, and seeing that case through to conclusion.

15           In sum, the Commission should continue to apply its interim rate relief factors. They reflect a rational public policy that is fair to ratepayers and investors. They have provided certainty to both ratepayers and investors for 33 years. And they have proved to be flexible and adaptable over that period despite changes in the regulatory environment across various industries.<sup>4</sup>

**B.     Order No. 05**

16           The Commission issued Order No. 05 based on a summary determination motion filed by Staff, Public Counsel and Intervenors.<sup>5</sup> Accordingly, the Commission was required to consider the matter in a light "most favorable to Verizon." *E.g., Order No. 05 at 4, ¶ 11.*

17           The Company's position is that Order No. 05 mandates the Commission consider Verizon NW's Washington intrastate operations on a "stand alone" basis,

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<sup>4</sup> As the Commission reiterated in this case, these factors do not reflect a "formulaic" approach; they are not to be applied mechanically. *Order No. 05 at 4-5, ¶ 13, quoting Olympic Pipe Line Order at 11, n.6.*

<sup>5</sup> AT&T did not sign the Joint Motion for Summary Determination.

exclusively. *E.g.*, TR. 87:14-20, TR. 330:20-22; *Banta, Exh. No. 63-T at 1:21 to 2:7; Vander Weide, Exh. No. 3-T at 3:1-14.* Accordingly, the Company's case provides no evidence whatsoever regarding its actual ability to finance its operations between now and the conclusion of the general rate case. *E.g.*, *Vander Weide, TR. 66:8-12.*

18           The Company's reliance on Order No. 05 is misplaced. The Commission did not hold that Washington intrastate results were the *exclusive* basis for interim rate relief. The Commission simply said: "We find it appropriate to consider the Company's need for interim rate relief based on a Washington intrastate basis only, and to determine whether the level of its intrastate revenues constitutes a 'gross inequity' justifying interim relief." *Order No. 5 at 7, ¶ 20 (footnote omitted).*

19           The Commission went on to observe that a showing based on Washington intrastate results could constitute a *prima facie* case for interim rate relief. *Id. and at 11, ¶ 32.* However, the Commission was careful to point out that consideration of "financial distress" remains "one factor to consider," though not the only one. *Id. at 11, ¶ 31.* As the Commission emphasized: "our inquiry is whether interim rates are in the public interest, *considering* (not requiring dispositive proof of) *all* relevant factors." *Id., emphasis in original.*

20           Consequently, Verizon NW is wrong to argue that Order No. 05 held that the

only relevant evidence in this case is its Washington intrastate financial results.<sup>6</sup>

21 Verizon NW is also wrong to rely on the *Olympic Pipe Line Order* as mandating an “intrastate only” approach to interim rate relief.<sup>7</sup> In that case, the Commission examined the financial situation of Olympic Pipe Line on a total company basis, and calculated the appropriate amount of interim relief using total company results. The resulting percentage increase was the intrastate increase amount. *Olympic Pipe Line Order* at 13-15, ¶¶ 48-58, and Attachment A to that Order.

22 Indeed, the Commission consistently has looked to total company results in determining a need for interim rate relief. For example, in *WUTC v. Ludlow Utilities Co.*, Cause No. U-87-1550-T, Second Supplemental Order (February 19, 1988) at 4-5, one reason the Commission gave for denying interim rate relief was that Ludlow Utilities was recently able to obtain financing for its unregulated sewer operations.

23 In *WUTC v. Avista Corporation*, Docket No. UE-010395, Sixth Supplemental Order (September 24, 2001) (*Avista Order*) at 13-21, ¶¶ 32-54, the Commission examined Avista’s overall financial condition and ability to finance before

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<sup>6</sup> In Order No. 05 at 5-6, ¶ 16, the Commission also noted with concern the “reverse” situation, where a utility’s non-jurisdictional operations were affecting its ability to finance, thereby generating a request for interim rate relief. This indeed would be a cause for concern. However, under the Commission’s interim rate relief factors, the analysis would be: 1) whether there was an actual financial emergency, and if so, 2) should Washington intrastate operations help address it? In the non-regulated operations example, the answer to the first question would be “yes,” and the answer to the second question would depend on how the utility’s service is affected, and whether, in its exercise of discretion, the Commission believed ratepayers would be better off with interim rate relief. See *Exh. No. 149 at 18, Staff’s Response to Verizon NW Data Request No. 16.*

<sup>7</sup> See, e.g., *Petition of Verizon Northwest Inc. Seeking Interim Rate Increase* (April 30, 2004) at 4, ¶ 19 (quoting the Commission’s Third Supplemental Order in *WUTC v. Olympic Pipe Line Company*, Docket No. TO-011472 (January 31, 2002), (*Olympic Pipe Line Order*)).

determining to grant interim rate relief. The Commission paid particular attention to Avista's bond covenants in its actual bonds (*id. at 20-21, ¶¶ 51-54*), which are issued on a total company basis.

24           Indeed, in ratemaking generally, though state commissions set rates only for the intrastate jurisdiction, the law does not require that state commissions be blind to the economic realities facing the utility.

25           For example, the courts have long recognized that regulatory agencies have discretion to consider the impact of an unregulated company's capital structure on the cost of capital of a wholly owned, regulated utility. Typical of these cases is *General Tel. Co. of the Southwest v. Public Util. Comm'n of Texas*, 628 S.W.2d 832 (Texas Ct. App. 1982). In that case, Verizon NW's sister company challenged the Texas commission's practice of imputing the unregulated parent's cost of debt to the equity capital component of the regulated utility.<sup>8</sup>

26           Like Verizon NW here, General Tel. Co. of the Southwest argued that the law required an "independent entity analysis" that treated the utility "as though it were standing alone." 628 S.W.2d at 838. The court rejected that argument, and affirmed the Commission.

27           As the court stated in *United Gas Pipe Line Co. v. Louisiana Pub. Serv. Comm'n*, 130 So. 2d 652, 707 (La. 1961): "It is well established that, in making a determination

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<sup>8</sup> This is often called a "double leverage" adjustment. 628 S.W.2d at 837. The court observed this is a common regulatory practice. 628 S.W.2d at 837-38 and 838 at n.5.

of costs for rate purposes, the reviewing Commission may look through the corporate form of affiliated corporations and probe for economic realities.”

28           It is particularly important for the Commission to “probe for economic realities” in a case for interim rate relief, because interim rate relief is, and should be, an extraordinary procedure necessitated by actual or imminent financial peril.

29           Indeed, the Commission recognized the economic realities of the relationship of Verizon NW to its parent company in its order granting approval of the merger:

...we cannot ignore the integral role of GTE Corporation both in the day-to-day operations of GTE Northwest and in shaping the corporate strategy that will determine larger concerns such as investment in Washington State, service offerings, and other matters that impact Washington consumers very directly. After the merger, Bell Atlantic Corporation will assume these roles for GTE Northwest.

*Re Application of GTE Corp. & Bell Atlantic Corp., Docket No. UT-981367 et al., Fourth Supplemental Order, at 16.*

30           The Commission should continue to recognize “financial realities” in this case and refuse Verizon NW’s offer to focus exclusively on Verizon NW’s Washington intrastate operations. The law requires nothing different.

**C. Precedent on interim relief from other jurisdictions**

31           The Bench asked most witnesses about interim rate relief precedent from other jurisdictions. Appendix A to this brief is a matrix of decisions Staff could

locate from other jurisdictions on the subject.<sup>9</sup> As Attachment A shows, the weight of authority is that proof of a genuine emergency is required before an interim rate increase is allowed.<sup>10</sup>

### III. HAS VERIZON NW 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?

32 For the reasons stated in Section II.A., *supra*, ¶¶ 7-15, each of the Commission's interim rate relief factors should be considered and applied in this case. As we discuss below, while the Commission may weigh some factors more than others, Verizon NW has failed to satisfy any of the Commission's interim rate relief factors.

##### 1. Factor No. 1

**The 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.**

33 This factor requires an "adequate hearing." In this case, testimony and exhibits were filed, and hearings were held. However, it became apparent during

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<sup>9</sup> Given the short time available to produce this summary, Staff cannot determine how comprehensive it is. Moreover, Staff was unable to conduct an analysis of the relevant statutes in each jurisdiction. This can be important, because the analysis of a particular state's procedures can be affected by the presence of show cause authority, for example. *Strain, TR. 590:2-13.*

<sup>10</sup> Staff did not include FERC in its table. As discussed at hearing, FERC has a policy of placing all rates into effect subject to refund. The attendant administrative problems are obvious. Moreover, FERC sets wholesale rates that are tracked to intrastate rates via purchased cost adjustment clauses at the state level. There is no similar mechanism for telecommunications rates, to our knowledge.

this process that Verizon NW had not answered all Staff Data Requests completely or accurately. In some cases, Bench Requests were issued for data the Commission Staff previously requested, but was told by the Company that the data was unavailable, and/or would not be provided.

34           These Company actions have effectively deprived the Commission and the parties of conducting cross-examination, or follow-up data requests, based on full and complete Company responses. In short, the Company's conduct in this case has deprived the Commission and the parties of an adequate hearing. The Company's actions have caused it to fail Factor No. 1.

**2.     Factor No. 2**

**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.**

35           This factor acknowledges that interim rate relief is an extraordinary remedy. There should be a "high bar" for receiving such relief. *Folsom, TR. 512:15-17.* Indeed, when the Company was earning very high returns between 1996 and 1999 (*Exh. No. 144 at 4, "Rate of Return" line*), the Company offered no immediate, voluntary rate reductions or "rebalancing." Instead, the Company kept the extra money. As Mr. King observed:

When costs are declining, Verizon can choose not to file for lower rates and thereby enjoy excessive earnings. But it must accept that when costs are increasing, new rates will not be reset until the statutory time limit of ten months has elapsed, potentially causing a period of inadequate earnings.



*Exh. No. 101-T at 12:19 to 13:3. See also Folsom, TR. 512:15 to 513:9.*

36           Accordingly, it is fair to require that a utility not get a rate increase before it  
can prove its revenue requirement, unless it can prove that an actual emergency, or  
gross hardship or gross inequity requires it.

**a.       Is there an actual emergency?**

37           As we demonstrate below, there is no emergency. This is readily proved not  
only by Verizon NW's ready access to capital to fund its Washington intrastate  
operations, but also to Verizon NW's actions: it has not acted like a utility in any  
emergency situation.

38           A "stand alone" analysis should not be a paramount consideration when it is  
used to create a hypothetical emergency. Moreover, one of the benefits of the 1999  
merger was that Washington intrastate ratepayers would benefit from the merged  
company's financial strength. The "stand alone" analysis offered by the Company  
would wrongly deprive ratepayers of that benefit.

39           But even if a "stand alone" analysis is presented, the Company has not borne  
its burden of proving an emergency would exist if Verizon NW was truly a "stand  
alone" company.

## The Company's Actions Show No Emergency

40 Verizon NW's litigation position is that the Commission's Access Charge Order precipitated an alleged financial "emergency" (as well as "gross hardship" and "gross inequity"). *E.g., Banta, TR. 281:21-23, and Exh. No. 61-T at 5:6-11.* Yet the Company could supply no documents (other than its direct case) in which this so-called "emergency" was discussed. *Banta, TR. 279:14 to 280:14.*

41 Moreover, the complaint in the Access Charge Case was issued in May 2002, yet Verizon NW waited two years to file a rate case. The Company could have filed a rate case in July 2002 to be resolved along with the Access Charge Case, but the Company deliberately "chose not to file" then, *Banta, Tr. 235:25 to 236:13*, despite the fact that its return was not much higher than the current return it alleges in this case. *Heuring, TR. 163:11 to 164:22.*

42 Instead of focusing on its rates, Verizon NW focused on its litigation strategy, urging in the Access Charge Case that the Commission could not reduce access charges without granting offsetting revenue increases. That litigation strategy failed before the Commission.

43 In the aftermath of the Access Charge Order, Verizon NW once again chose to focus on its litigation strategy. The Company frankly admitted that it believed the court was the "best forum." *Banta, Exh. No. 63-T at 4:15-17.* The Company took the risk that the court was not the "best forum," and it wasn't: to date, every court

that has considered Verizon NW's appellate position has rejected it.

When the Company finally did file for a rate increase on April 30, 2004, the Company chose to file a "bifurcation" proposal. The Company took the risk that proposal would be rejected, and additional time would be lost. The Company's "bifurcation" proposal *was* rejected, and additional time *was* lost.

44 A utility's failed litigation strategy is no basis for granting interim rate relief. The financial impact of these deliberate Company choices is entirely the Company's responsibility.

45 By a different measure, if there were an emergency, the Company would have prepared a plan to document the Company's plight, and its strategy to address that plight. Yet the Company could produce no document in which it identified the alleged financial emergency, and a plan to address it. *Banta, TR. 279:14 to TR. 280:14, and TR. 283:24 to 285:12.*

46 Staff specifically asked for Verizon NW's financing plans, including those for Washington intrastate. Such a plan would be essential to any utility seeking to address a true emergency. The Company tersely responded that it "does not produce" such a plan. *Exh. No. 126.*

47 It is true that Verizon NW has done some budget cutting recently, but on a total company level, *Banta, TR. 329:15-19*, and not because of Washington intrastate operations, but rather due to "normal business practices." *Banta, TR. 274:4-19.*

Verizon NW asks the Commission to believe it was “waiting” to see how those efforts would turn out, but no document exists to confirm the existence of that alleged strategy. *Exh. No. 81*. And no document exists that identifies the Company’s contingency plan if company-wide cost cutting efforts were not sufficient.

48           The Company can only point to Exhibit No. 83 at 7-8, termed the “Verizon Earnings Recovery Plan, State of Washington, Capital Reduction Initiatives.” These two pages are the entirety of that “Plan.” *Banta, TR. 414:5-24*.<sup>11</sup> They list \$11.47 million in projects the Company claims it has deferred because of its Washington intrastate business. In fact, this document proves no emergency exists.

49           Recall that according to the Company, the alleged precipitating emergency event was the Commission’s Access Charge Order. That Order was issued in August 2003. Yet Mr. Banta waited until March 2004 before asking his staff to consider the project deferrals resulting in the so-called “Plan” in Exhibit No. 83, pages 7-8. *Banta, TR. 412:25 to 413:10*.

50           If there were an emergency, the Company would have prepared a contingency plan months before the Access Charge Order was issued. No utility, or any business for that matter, that was actually facing an emergency would wait

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<sup>11</sup> Despite a long-standing data request from Commission Staff, the Company failed to timely provide the June 2004 revisions to its construction budget. The Company waited until the week before hearing to provide this information. *Banta, TR.277*.

*seven months* after that “emergency” allegedly began before suggesting responsive action.

51 Consider also that over half of the deferred project costs in the so-called “Plan” in Exhibit No. 83 at 7, relate to DSL service, the revenues from which are interstate. *Banta, TR. 277:19-25*. The Company has not described, or even studied how deferring these interstate projects, or any other project in Exhibit No. 83, will increase its intrastate cash flow. *Banta, TR. 415:6-14*.

52 In the *Avista Order, supra*, at 15, ¶ 38, the Commission noted the significant steps the utility had taken to address its financial emergency, which resulted in some \$170 million in power cost savings to ratepayers. In the instant case, Verizon NW has only Exhibit No. 83 at 7, without any measure of its impact on Washington intrastate operating results.

53 Avista proved an emergency, and it took prompt, decisive actions to mitigate it. Verizon NW has done neither.

**Verizon NW Is Able To Finance its Washington Intrastate Operations on Reasonable Terms Pending Resolution Of The General Rate Case.**

54 The reason why Verizon NW prepared no documents contemporaneous with what it now calls an “emergency,” is because there is no emergency. As the Company admitted: “There is capital available.” *Banta, TR. 426:7*. That admission should shut the door on interim rate relief. Indeed, Verizon NW will have no difficulty raising capital over the near term, assuming it needs to do so. The

Company can wait until its general rate case is resolved.

55 Verizon NW is a very healthy utility with AA and A+ credit ratings on its debt. This means Verizon NW's obligations are subject to "low credit risk" and its capacity to meet its obligations is "very strong." *Exh. No. 121-T at 25:4-9*. The Company is not in default on any of its loans, or even close to it. *Folsom, Exh. No. 121-T at 28:1-11*. Indeed, since 1999, the Company has paid dividends of nearly \$1 billion to its parent, Verizon Communications, the highest annual payment being in 2003 (\$221.8 million). *Folsom, Exh. No. 121-T at 30:7-17*.<sup>12</sup>

56 Verizon NW has ready access to a \$500 million cash pool. *Folsom, Exh. No. 121-T at 16-19*. As Staff testified: "Verizon NW does not need to receive either interim rate relief or meet an interest coverage test to obtain money from those financing arrangements." *Folsom, Exh. No. 121-T at 20:1-3*. Public Counsel agreed: "During the period September 2004 through May 2005, [Verizon NW] can draw upon that pool to support its operations while it awaits the Commission's decision in the general rate case." *King, Exh. No. 101-T at 15:11-14*.

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<sup>12</sup> Verizon NW testified that only Washington intrastate's portion of those dividend payments are relevant. *Vander Weide, Exh. No. 3-T at 9:15-22*. However, Staff asked for that portion, and Verizon NW could not provide it. *Vander Weide, TR.75:7 to 76:12*. The Company should not be rewarded for its own inability to provide relevant information.

In any event, as we point out *infra* at ¶ 67, Verizon NW's Washington intrastate operations generated net income (after taxes) of some \$391,521,000 between 1996 and 1999. A "stand alone" company would have retained some of those earnings to weather potential future financial difficulties.

57           Indeed, the Company admitted this cash pool “is there for Verizon NW” as a source of funding. *Banta, TR. 416:5-6; See also, Folsom, Exh. No. 121-T at 16:12-15.*

58           Although Verizon NW’s bond ratings are excellent, the Company will not issue new debt “for the foreseeable future.” *Exh. No. 126.* It also appears Verizon NW now relies on its parent for debt financing, and does not issue debt to the public on its own account. *King, Exh. No. 101-T at 15:1-8.* But if Verizon NW needed to issue debt on its own, it easily can do so. *Folsom, Exh. No. 121-T at 24; King, Exh. No. 101-T at 10:5-9.*

59           Nor is Verizon NW unable to raise equity capital. As with debt, Verizon NW no longer issues equity via public offerings. *King, Exh. No. 101-T at 15:1-8.* Therefore, any equity infusion would come from the parent, Verizon Communications. The Company has no plans to receive an equity infusion for at least the next two years. *Exh. No. 128.* However, if it needed to obtain equity capital, there is little question Verizon Communications easily can provide it: for the most recent quarter, Verizon Communications had consolidated net income of \$1.8 billion, and free cash flow of \$1.6 billion. *Exh. No. 65 at 1, second ¶ and second bullet.*

60           In sum, there is no actual financial emergency facing Verizon NW in this case.

## Verizon NW's Access To The \$500 Million Is A Merger Benefit

61 As Verizon NW testified, a specific benefit of the merger between GTE Corp. and Bell Atlantic is the "cash pool" created by Verizon Network Funding Corp. for the use of Verizon NW. *Banta, TR. 355:2-15 and TR. 415:15-24*. This testimony is consistent with what the merging companies told the Commission in the merger case, Docket No. UT-981367.<sup>13</sup>

62 This is the same cash pool Verizon NW intends to use to fund its Washington intrastate operations over the next few years. *Folsom, Exh. No. 121-T at 16:12-15*. It is undisputed that Verizon NW has immediate access to this cash pool to fund its Washington operations. *See Banta, TR. 416:5-6 and ¶¶ 56-57, supra*.

By trying to force the Commission to consider Verizon NW on a "stand alone" basis only, Verizon NW would have the Commission disregard the fact that this cash pool that is actually there, ready to assist Verizon NW in meeting its utility obligations.

63 The Commission should deny Verizon NW interim rate relief because

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<sup>13</sup> When Verizon Communications was formed, the merging companies (GTE Corp. and Bell Atlantic) testified before the Commission that the scope and scale of the merged company would assure that the local company would be "financially sound" and have "access to the capital markets." *Exh. No. 66*. According to the Merger Application, Commission approval of the merger would "translate these parent company benefits into stronger support for its operations in Washington, thereby benefiting both business and residential customers." *Exh. No. 67 at 10*.

Note that in Exhibit No. 66, the Company stated this was the testimony of Bell Atlantic. However, the Company conceded that GTE Corp. took no exception to this testimony. *Banta, TR.231:14 to 232:19*. In any event, the Merger Application (*Exh. No. 67*), filed by both GTE Corp. and Bell Atlantic, says the same thing as the testimony. *See Exh. No. 67 at 9-10 and Banta, TR. 232:25 to 234:20*.



anything less will result in ratepayers failing to receive the merger benefits to which they are entitled, and which the Company itself intended ratepayers to receive.

**The Company's "Stand Alone" Analysis Does Not Truly Reflect Verizon NW Washington Intrastate Operations On A "Stand Alone" Basis**

64 Verizon NW's request should be denied because a "stand alone" analysis is purely hypothetical. The Company's Washington intrastate results cannot be divorced from the decisions, financial and marketing relationships, and other financial realities reflecting the corporate structure Verizon Communications has created for itself. They cannot be divorced from the merger promise that Washington ratepayers would receive the financial benefits of a merged company, including access to the \$500 million cash pool.

65 Verizon NW in effect is asking the Commission to pretend an emergency exists, because Verizon NW Washington intrastate allegedly would have a financial emergency if it were truly a "stand alone" company. *E.g., Banta, TR. 417:12-18.*

66 This is a purely hypothetical inquiry, because as the Company admits, its Washington intrastate operations, allocated and separated, "is not a stand alone company," *Banta, TR. 420:19-21*; it is not trying to raise capital, *Banta, TR. 425:3-7*; and it has no bond rating. *Banta, TR. 424:9-10*. Neither does Verizon NW "issue financings, develop budgets, or perform construction on a Washington intrastate stand-alone basis." *Strain, Exh. No. 141-T at 36: 9-11.*

67 Moreover, if Verizon NW were a "stand alone" company, it would look

much different than it does today. For one thing, it would have its own dividend policy. Verizon NW earned \$391,521,000<sup>14</sup> in Washington intrastate net income (after taxes) from 1996 to 1999, a period when it enjoyed very high earnings. A “stand alone” company surely could have retained some of that net income, to weather less favorable times.

68 If Verizon NW Washington intrastate were truly a “stand alone” company, it would not be subject to what may be arbitrary or erroneously applied allocations and separations factors; it would be using 100% of its own plant and expenses. Moreover, it could publish its own directory, or sign a lucrative contract with someone else to do so, rather than ceding directory revenues to an affiliate in a non-arms’ length transaction.

69 A “stand alone” company could also choose its marketing partners, and its merger partners, and it could have proposed a late payment charge tariff consistent with other utilities in this state. A 1% late payment charge for Verizon NW is worth about [REDACTED]<sup>15</sup> annually. Verizon NW would have collected over [REDACTED] [REDACTED] more revenue than it did over the 1997 to 2003 period, had it only done what many other telecommunications companies did in

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<sup>14</sup> Exh. No. 143 at 4, “Net Operating Income” line: 1996: \$89,658,000 + 1997: \$96,698,000 + 1998: \$93,015,000 + 1999: \$112,150,000 = \$391,521,000.

<sup>15</sup> This figure is 2/3 of the revenue shown on Exhibit No. 83-C. Exhibit No. 83-C shows the annual revenue impact of a 1.5% late payment charge. Because a 1% late payment charge is 2/3 of a 1.5% charge, the assumption was made that a 1% late payment charge would generate 2/3 the revenues.

this state years ago.<sup>16</sup>

70 In short, a “stand alone” analysis requires multiple assumptions about what would have been. Verizon NW’s analysis fails to account for these assumptions.

**b. Is there gross hardship?**

71 There is no gross hardship. The primary “gross hardship” alleged by Verizon NW relates to the revenue reductions ordered by the Commission in the Access Charge Case. *Banta, Exh. No. 61-T at 5:9-11.*<sup>17</sup> Verizon NW’s basic and misplaced argument is that the Access Charge Order was a Commission action “beyond [the company’s] control,” and thus the resulting revenue reductions constitute gross hardship (or gross inequity). *Banta, TR. 223:24 to 224:5.*

72 The issue whether the effect of the Commission’s Access Charge Order constitutes “gross hardship” or “gross inequity” should not be answered in the

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<sup>16</sup> Qwest: Docket No. UT-971482; Hood Canal Tel. Co.: Docket No. UT-970268; Yelm Tel. Co., Docket No. UT-970274; Telephone Utilities of Wash., Docket Nos. UT-970275 and 970277. Each of the foregoing dockets was resolved in 1997.

<sup>17</sup> The Company also suggested that a low return constituted gross hardship or inequity, *Banta, Exh. No. 61-T at 5:6-7*, but in cross-examination of Staff, Verizon NW noted it was only asking for interim rate relief to address causes for its return that were due to reasons beyond its control, and the Company places the Access Charge Order in that category. *TR. 535:17-21 and TR. 223:24 to 224:5.*

As an afterthought, Verizon NW stated on redirect examination by Company counsel that Exhibit No. 134, Public Counsel’s letter to CenturyTel, and referencing “rate rebalancing,” constituted “gross inequity.” *Banta, TR. 393:13 to 394:1.* Verizon NW’s tactic of raising this issue for the first time on redirect deprived the other parties from filing testimony on this issue. In any event, there is no evidence that the CenturyTel letter accurately describes the discussions, *Folsom, TR. 525:17 to 526:7*, or that Verizon NW and CenturyTel are similarly situated. *Folsom, TR. 526:16 to 527:8.*

Nonetheless, even this incomplete, one-sided presentation by the Company demonstrates: a) that Staff has engaged in discussions about local rates with both CenturyTel (in 2003-04) and Verizon NW (in 2003, during the access charge complaint case, *Banta, TR. 411:14-25*); and b) that the Commission has neither acted on, nor even had the opportunity to act on, a proposal arising from either discussion.

abstract. All pertinent facts should be considered.

73           The primary reason there is no gross hardship from the Access Charge Order is that for purposes of interim rate relief, gross hardship is demonstrated only if it is (or soon will be) preventing the utility from meeting its ongoing public service obligations. Verizon NW cannot make that demonstration because it can finance on reasonable terms today, tomorrow and for the foreseeable future. ¶¶ 54-63, *supra*.

74           Moreover, the Access Charge Order was not “beyond the Company’s control.” While Verizon NW did not issue the Access Charge Order, it was maintaining the inappropriately high access charges that prompted the AT&T complaint that resulted in that Order.

75           Moreover, Verizon NW failed to make any reasonable efforts to protect its interests in the Access Charge Case, choosing instead to pursue failed litigation strategies. ¶¶ 41-44, *supra*. Any “hardship” that may have resulted from the Company’s choices is the sole responsibility of the Company. It does not constitute “gross hardship” that could satisfy Commission interim rate relief Factor No. 2.

**c.       Is there gross inequity?**

76           For the same reasons there is no “gross hardship,” there is no “gross inequity,” either. Moreover, to the extent “equity” requires more of a balancing of factors than “hardship,” the balance weighs decidedly against the Company.

77           Indeed, if the Commission were to presume gross inequity or hardship to  
Verizon NW from the Access Charge Order, it is more than offset by the \$44.6  
million<sup>18</sup> in excessive access charge rates Verizon NW collected (and kept) during  
the 1½ year period from the complaint filing date to that Order.

78           The ratepayers did not get that \$44.6 million back. The Company got to keep  
it. If the equities are weighed fairly, they weigh decidedly in favor of the  
ratepayers, not Verizon NW.

79           One “gross inequity” alleged by Verizon NW is based on its claim that other  
states are “subsidizing” the Company’s Washington intrastate allocated and  
separated operations. This is yet another claim the Company chose to raise for the  
first time on rebuttal. *E.g., Vander Weide, Exh. No. 3-T at 8:1-17, including “Table 1.”*

80           According to the Company, a subsidy occurs when “Service A” is priced  
above long-run average cost, while “Service B” is priced below long-run average  
cost. In that situation, “Service A” subsidizes “Service B.” *Id. at 7:16-18.* The  
Company relies on Dr. Vander Weide’s Table 1 on page 8 of Exhibit No. 3-T, but  
that table compares revenues and expenses, not service costs and prices.

81           Because Table 1 does not show that any services in any other states are  
priced above long-run average cost, or that any Washington intrastate services are  
priced below long-run average cost, there is no proof of any subsidy. Notably, the

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<sup>18</sup> \$29.7 million times 1.5 years from the date of the Access Charge Complaint (May 2002) to the date  
of the tariffs filed based on Access Charge Order (October 2003) = \$44.55 million.

Company makes no claim that the rates in any other state are higher because of whatever is going on in the Washington intrastate allocated and separated part of the Company's business.

82           The Company's response to Bench Request No. 5 shows the same situation is occurring in Oregon and Idaho. The fact that Verizon NW has made no request for interim rate relief in those states to address this alleged concern proves Verizon itself does not consider this situation to constitute a "gross inequity" requiring an immediate rate increase in ~~this state~~. *Intrastate rates.*

83           It is not surprising that from time to time, a utility's operations in some states may generate higher margins than its operations in other states. That is primarily due to how the utility manages its rate structure in each state, and secondarily to the function of each state's ratemaking policy, and the status of competition there. In any event, if a utility believes there is a problem in a particular jurisdiction, it should file a rate case.

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

84           The ultimate goal of interim rate relief is to provide additional revenue to the Company so that it may finance during the time while its general rate case is pending, in order to fulfill its obligations as a public service company. See ¶¶7-15, *supra*. The Company's direct case made no connection whatsoever between the relief the Company is seeking (\$29.7 million annually) and its ability to finance.

85           At a minimum, Verizon NW should tell the Commission in precise terms: a) exactly how much it needs to finance; b) how it will finance that amount; and c) when it will finance, and on what terms and conditions; and d) how \$29.7 million will accomplish that. The Company has supplied *none* of this information.

86           On rebuttal, Verizon NW offered an opinion that if the Company's request were approved, Verizon NW Washington intrastate on a "stand alone" basis would receive an investment grade, BBB rating. *Vander Weide, Exh. No. 3-T at 11:9-17.* Verizon NW offered this opinion even though Verizon NW would fail to qualify for such a rating under what the Company considers to be the "more meaningful" financial measure for bond rating purposes (*i.e.*, Verizon NW's Washington intrastate EBIT). *Vander Weide, TR. 66:23 to TR. 68:23.*

87           This opinion addresses a hypothetical situation only, because no bond rating agency has actually given Verizon NW's Washington intrastate operations a bond rating. *Folsom, Exh. No. 121-T at 27:13-15; Vander Weide, TR. 68:24 to TR. 69:2.*

88           Indeed, if Verizon NW wants to deal in the hypothetical, it should be offering testimony that is consistent with the Company's proposed hypothetical capital structure of 75% equity and 25% debt. A Washington intrastate "stand alone company" with the need for such a capital structure would be arguing for a need to issue equity, not debt. ¶ 168, *infra*. Yet the Company has provided no information

in this case regarding what is necessary, if anything, to accomplish that. In fact, the Company has no Washington intrastate financing plan whatsoever. *Exh. No. 126.*

89 In the end, Verizon NW could only offer a vague assertion that if interim rate relief were granted, the Company would “reassess the projects and operations that are at the margin.” *Banta, TR. 385:4-7.* It is not worth it to the ratepayers to be forced to pay \$29.7 million a year for no concrete and foreseeable benefit.

3. **Factor No. 3**

**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.**

90 Much of Verizon NW’s evidence centers on its relatively low rate of return on a Washington intrastate allocated and separated basis. The Company also offered Exhibit No. 151, which lists returns from certain Commission orders, most of which deal with interim rate relief. Commission Staff and Public Counsel also presented evidence regarding Verizon NW’s rate of return on several jurisdictional levels. *Strain, Exh. No. 142 at 1; Exh. No. 144, 1 and 3; King, Exh. No. 105.*

91 But as Commission interim rate relief Factor No. 3 states, a utility’s failure to earn its authorized return is relevant, but not dispositive. Under the Commission’s interim rate relief analysis, there must be a connection between the utility’s financial condition, its ability to access financial markets in order to satisfy its public



service obligations, and the amount of interim rate relief necessary to accomplish the required financing. Verizon NW has not provided that connection.

4. **Factor No. 4**

**The Commission should review all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage 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.**

92 Factor No. 4 is straightforward: it requires a link among the financial indices of a utility, its financing requirements, and the impact of interim rate relief on its ability to finance.

93 The Company has filled the record with evidence on rate of return, coverage ratios, and earnings, including an opinion about a hypothetical bond rating for its Washington intrastate allocated and separated operations. However, as we noted earlier, the Company has provided no evidence on: a) exactly how much it needs to finance; b) how it will finance that amount; and c) when it will finance, and on what terms and conditions; and d) how \$29.7 million will accomplish that.

**a. Adjustments to consider**

94 In considering the financial indicators, the question arises as to whether any adjustments should be considered, and if so, which ones. In its presentation, the Company presented only Washington intrastate allocated and separated results,

including restating adjustments, and an adjustment for the impact of the access charge reductions. *Heuring, Exh. No. 22 and 25.*

95 Commission Staff presented information for Washington intrastate allocated and separated operations, as well as for Washington interstate, and total Company. *Strain, Exh. No. 142 at 1, 143 at 4-6, and 144 at 3.* In some of its scenarios, Staff made restating adjustments and adjusted for directory imputation, employee separation program, uncollectibles, flow-through of FIT and interest synchronization. *Strain, Exh. No. 142 at 1.* These adjustments were made to “smooth out” the test year in order to provide a more representative view of the results, and to properly reflect Commission policy. *Strain, Exh. No. 141-T at 12:7 to 15:16.*

96 Public Counsel made the same restating adjustments and access charge reduction adjustments as the Company, and the same directory imputation adjustment as Staff. *King, Exh. Nos. 105 and 106.*

97 As we discuss below, all the adjustments Staff proposes are appropriate to consider. In particular, a directory imputation adjustment is necessary, because among other reasons, it is the only way to hold the Company to its commitment that the loss of that revenue stream would not affect any bond rating.

#### **1) Access charge revenue reduction**

98 It is appropriate to adjust for the \$29.7 access charge reduction. It was implemented in October 2003. All parties agree to this adjustment. The net

operating income effect of this adjustment is (\$18,922,000) as shown on Exhibit No. 142, page 1, column (e).

## 2) Directory imputation

99           The Commission should definitely make a directory imputation adjustment because it is necessary in order to fairly judge Verizon NW's financial condition. When the Company terminated the directory revenue sharing agreement in 2000, it made two commitments: 1) that the "shift in revenues" away from Verizon NW to Verizon Communications "*will not affect bond ratings;*" and 2) that in states where imputation is required, "imputation will continue to occur."<sup>19</sup> *Banta, TR. 226:4 to 227:5 and Exh. No. 70 at 3, item 9, emphasis supplied, and Exh. No. 70 at 1, "Key Messages" #1.* Imputation is required to enforce Verizon NW's commitments and to comply with Commission policy.

100           Verizon NW objects to imputation.<sup>20</sup> First, the Company says an FCC Order issued in 1999 prohibits imputation. *Heuring, TR. 172:6-23.* That FCC Order<sup>21</sup> was decided under Section 222(e) of the Telecommunications Act of 1996. In that Order, the FCC set presumptively reasonable rates LECs could charge for directory listings

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<sup>19</sup> The Commission has a policy requiring imputation of directory revenues. See *WUTC v. US WEST Communications, Inc.*, Docket No. UT-950200, Fifteenth Supplemental Order (April 11, 1996) at 32-41.

<sup>20</sup> The Company did not object to imputation on the grounds that it was somehow an improper "subsidy" under Section 254 of the Telecommunications Act of 1996. In any event, the Commission properly rejected that argument in *WUTC v. US WEST Communications, Inc.*, Docket No. UT-950200, Fifteenth Supplemental Order (April 11, 1996) at 36, item 8.

<sup>21</sup> Third Report and Order, *In re Implementation of the Telecommunications Act of 1996*, CC Docket No. 96-115 *et al.*, 14 FCC Record 15550 (September 9, 1999). This Order is briefly excerpted in Exhibit No. 161.

and listings updates, and it required LECs to provide non-discriminatory access to such directory listings to all requesting directory publishers. *14 FCC Record at 15604, ¶ 98-99 and at 15582, ¶ 58.*

101           The FCC did not address directory imputation in that Order. More to the point, Congress did not address directory imputation when it enacted Section 222(e). The manner and charges for which the Company is to provide directory listings are entirely separate from the compensation due to Verizon NW for allowing its affiliate, Verizon Directories, to be its official publisher, with whom Verizon NW will not compete. *Strain, TR. 551:18 to 552:8.*

102           The FCC had previously acknowledged that states may impute directory revenues where they have authority to do so.<sup>22</sup> If the FCC intended to end directory revenue imputation by the states in 1999, it would have said so.

103           Moreover, other states continue to impute directory revenues for Verizon NW local exchange companies, in a post-FCC Order environment. Two examples are California<sup>23</sup> and New Hampshire. Last month, the New Hampshire Public Service Commission expressly rejected Verizon's Section 222(e) argument, in part because "[Verizon] has provided no citations to authority, and we have found none,

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<sup>22</sup> *In re Local Exchange Carriers' Permanent Cost Allocations manuals for the Separation of Regulated and Nonregulated Costs* (August 29, 1994), 9 FCC Record 4457. At ¶ 7 of that Order, the FCC said: "States, however, may have the authority to impute revenues related to affiliate publishing of yellow pages directories for state ratemaking purposes. If they have such authority, states must exercise this authority without the use of Part 32 accounts."

<sup>23</sup> *See Re Pacific Bell Rulemaking Proceeding* 01-09-002, Decision 03-02-073, Order Denying Rehearing of Decision No. 02-10-020, 2003 WL 1338092 (February 27, 2003).

from the FCC or any other body in support of its position."<sup>24</sup>

104           Next, Verizon NW argues that the Commission's policy on imputation from the US WEST case does not apply because Verizon NW's affiliate's directory operations are "totally different," *i.e.*, Verizon's directory operations were never the property of the local exchange company. *Heuring, TR. 177:3-15.*

105           Assuming this is true for the sake of argument, it is "not at all a key distinction." *Strain, TR. 545:23-24.* An independent ground for directory imputation in the US WEST case was the affiliated interest statute, RCW 80.16. That statute does not require the utility to have previously owned the affiliate's operations as a pre-condition for making an affiliated interest adjustment. The court expressly held that directory imputation is lawful in this state under RCW 80.16. *US WEST v. WUTC, 134 Wn.2d 74, 92-94, 949 P.2d 1337 (1997).*

106           Finally, the Company argues that imputation does not provide cash to Verizon NW. *E.g., TR. 556:16 to 557:3.* This argument is entirely inconsistent with the Company's insistence on a "stand alone" analysis. Verizon NW gets no directory cash only because Verizon Directories is not paying Verizon NW for the benefits Verizon NW confers, *Strain, TR. 556:22-23 and TR. 596:9-13*, and in the Company's words: "that ain't going to happen." *TR. 596:14-16.*

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<sup>24</sup> *In re Investigation of Verizon New Hampshire's Treatment of Yellow Page Revenues, Docket DT 02-165, Order Addressing Treatment of Yellow Page Revenues (July 9, 2004), at 10-12 and 131.*

107           If Verizon NW does not get the value it deserves from an affiliate, that  
should not be allowed to create or exacerbate an “emergency,” “hardship” or  
“inequity” which the ratepayers are required to address through higher rates.

108           In sum, Verizon NW has provided no basis for the Commission to refuse to  
consider directory revenues in this case. The Company committed to continue to  
impute where imputation was required, and it committed that cutting off the  
revenue flow to Verizon NW would not affect any bond ratings. The Company  
should be held to its commitments. An imputation adjustment should be made.

109           The net operating income effect of the directory imputation adjustment is  
\$19,007,000 as shown in Exhibit No. 142, page 1, column (i). There is no rate base  
effect.

### **3) Verizon NW’s restating adjustments**

110           Verizon NW made 21 adjustments that it termed “restating adjustments.”  
*Heuring, TR. 174:18-22.* Staff has not yet analyzed them in depth, so Staff only  
accepts them for purposes of this interim phase. *Strain, TR. 605:12-19.*

111           The total net operating income effect of these adjustments is (\$4,547,000), and  
the rate base impact is \$52,382,000, as shown in Exhibit No. 142 at 1, column (c).

### **4) Employee separation program**

112           During the test year, 209 employees departed Company service. The  
Company’s “per books” figures reflect over \$10 million in the associated costs, but

only \$9.1 million of the \$17.1 million that will be saved. It is appropriate to match the costs with the benefits. *Strain, Exh. No. 141-T at 13:2 to 14:3.*

113           The Company observed that Staff's testimony as originally filed referred to the wrong program. *Heuring, Exh. No. 23-T at 9:13-15.* Staff revised its testimony to make the reference correct. *See Exh. No. 141-T at 13:7-13.* The Company also suggested that additional adjustments are necessary to fully reflect the costs and benefits. *Heuring, Exh. No. 23-T at 9:15-18.* If there were any such adjustments, the Company had the burden to identify them for Commission consideration. It did not. Staff's adjustment should be accepted.

114           The net operating income effect of this adjustment is \$5,185,000, as shown in Exhibit No. 142 at 1, column (f). There is no rate base impact.

#### **5) Other**

115           Staff made three other adjustments designed to reflect Verizon NW's financial results on a more representative basis.

116           Staff restated uncollectibles to the test year actual level. The Company agrees this adjustment is appropriate, but not for interim rate relief, absent other "associated and offsetting pro formas." *Heuring, Exh. No. 23-T at 10:16.* The Company had the burden to provide and defend any such adjustments; it did not do so. This adjustment simply restates booked results to actual results; it should be accepted. The net operating income effect of this adjustment is \$1,419,000, as shown

in Exhibit No. 142 at 1, column (g). There is no rate base impact.

117 Staff also made an adjustment to reflect Commission precedent that income tax benefits should be flowed through to rates currently. Staff's final adjustment was made to synchronize the interest used for federal income tax purposes with the Commission-approved capital structure. *Strain, Exh. No. 141-T at 14:15 to 15:2.*

Both of these adjustments "go in the Company's favor." The Company's only response is that these adjustments are addressed in the Company's general rate case presentation. *Heuring, Exh. No. 23-T at 10:20-23.* These adjustments should be made so the Commission can consider the Company's financial results from a basis that reflects prior Commission policy.

118 The flow-through adjustment increases net income by \$1,310,000, but increases rate base by \$35,508,000. The interest synchronization adjustment decreases net income by (\$1,050,000), with no rate base effect. These adjustments are shown in Exhibit No. 142 at page 1, columns (j) and (k).

**b. Levels and trends in financial results**

119 A significant issue in this case was consideration of the trends and causes of the low return Verizon NW is allegedly experiencing on a Washington intrastate, allocated and separated basis.

120 As Staff explained through detailed analysis, the Company's rate of return was very high for the four years 1996 to 1999. During that time frame, the



Company enjoyed returns well in excess of authorized levels. *Exh. No. 143 at 4, "Rate of Return" line, col. 1996-1999.* During that period, the Company did not seek any rate decreases.<sup>25</sup>

121           The decline in the Company's return is due primarily to choices the Company made. In 2000, the Company's return declined substantially, due in large part to a \$45 million revenue reduction, 75% of which was due to the Company's choice to eliminate the significant (\$34 million in 1999) stream of directory revenues paid by its directory affiliate. *Strain, Exh. No. 141-T at 21:7-19 and Exh. No. 142 at 6, Heuring, TR. 173:19-22.* The loss of that revenue stream continues to this day.

122           This \$34 million loss had a more significant dollar impact on the Company than the Commission's Access Charge Order. Nonetheless, the Company failed to inform the Commission of this impact when it first offered to explain the causes of its current low return in this case. *See Heuring, Exh. No. 21-T at 5:6-16.*

123           Another cause of a low return was the \$30 million in rate reductions Verizon NW voluntarily agreed to implement as a result of the settlement of three Commission proceedings concerning Verizon NW (then GTE NW): the GTE-Bell Atlantic merger; an informal Commission Staff investigation of excess intrastate earnings; and a Commission complaint against the Company's terminating access

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<sup>25</sup> The Commission Staff began an informal earnings review of the Company, which was ultimately resolved at the same time as the merger docket was resolved.

charges. The revenue reductions stemming from the settlement of these three cases were implemented over a two-year period ending July 2001.

124 Verizon NW agreed to these reductions even though Docket No. UT-992009 (a Company request to re-prescribe its depreciation rates) was pending at the time the settlement was reached. The Commission approved an additional \$21.5 million in depreciation in that docket. *Exh. No. 69; Banta, TR. 236:14 to 237:18*. Verizon NW admitted it “took the risk” that it would receive relief in that docket and be unable (until July 1, 2002 at least) to reflect that in rates. *Banta, TR. 238:8-12*. Even after the settlement “rate freeze” expired in July 2002, Verizon NW chose not to file a rate case to reflect those new depreciation rates in its tariffs.<sup>26</sup>

125 The Company also alleges that its low return is due to “losses in line growth.” *Heuring, Exh. No. 21-T at 5:11-12*. In fact, the number of lines increased by 400,000 between 1999 and 2003. *Heuring, TR. 190:14 to 191:1*.<sup>27</sup>

126 Staff pointed out that revenue loss by Verizon NW Washington intrastate allocated and separated results of operations could be a revenue gain by an affiliate, such as Verizon Long Distance (VLD). *Strain, Exh. No. 141-T at 22:9 to 23:20*.

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<sup>26</sup> Docket No. UT-040520 is currently under way to determine the Company’s appropriate depreciation rates.

<sup>27</sup> The Company fails to explain why any alleged line losses are occurring. *Strain, Exh. No. 141-T at 12:12 to 13:4*. That may be because the Company has made no systematic study of all causes of disconnects due to competition, and it is not maintaining the information necessary to do so. As the Company admitted in Exhibit No. 41-C at 3, Part 2, the *only* study of disconnects the Company has made is shown on page 4 of that exhibit. Page 4 contains insufficient categories to determine whether customers are switching to services of other providers or not.

Indeed, the Commission specifically directed that the relationship between the Company and VLD be thoroughly examined “in any future proceeding where the revenues or the consequences of the actions of the two entities are relevant to the matter at issue.” *Access Charge Order at 27, ¶ 92*. The Company chose not to comply in its interim case.

127 Staff also examined trends in the Company’s revenues, expenses and rate base over time. As pages 1-3 of Exhibit No. 143 show, over the 1994-2003 period, interstate revenues are increasing, while intrastate revenues are decreasing. Intrastate expenses are not decreasing to match the revenue decrease. And interstate expenses increased at a far slower pace than interstate revenues. This may reflect an inappropriate mismatch of revenues and expenses between the interstate and intrastate jurisdictions. *Strain, Exh. No. 141-T at 27:6 to 28:13 and at 29:5 to 31:2*.

128 Verizon NW offers a simplistic response. The Company says Staff’s numbers are just “the result of mathematical calculations,” *Heuring, Exh. No. 23-T at 13-14-20*, and Staff’s testimony is “sheer speculation.” *Banta, Exh. No. 63-T at 8:15-21*. While it is true Staff has not completed its analysis, Ms. Strain provided two specific examples of projects that appear to be interstate in nature that Verizon NW is allocating 75% to intrastate. *Strain, Exh. No. 141-T at 30:5-13*. The Company chose not to address these specific examples in its rebuttal case.

129

If this were a true emergency affecting the Company's actual ability to finance, allocations and separations would not matter. If the Commission permits Verizon NW to use only Washington intrastate results in an effort to create a hypothetical financial emergency, they do matter. As Staff testified: "the Company has not proved that its intrastate results of operations reflect a proper match of revenues, expenses and rate base." *Strain, Exh. No. 141-T, at 30:20 to 31:2*. The Commission should deny interim relief on that basis.

**c. Rate of return/capital structure**

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The Company has maintained an equity ratio in the 59% to 62% range during 2002 to 2003. *Exh. No. 123 at 3*. The Company reported intrastate returns on rate base of 2.42% in 2002 and -.084% in 2003. On an interstate Washington basis, they were 26.91% in 2002 and 26.71% in 2003. On a total Washington basis, they were 8.39% in 2002 and 5.87% in 2003. *Strain, Exh. No. 143 at 4*. After adjustments, the Company shows a 2.09% intrastate return on rate base for the test year. *Exh. No. 142 at 1, col. (l)*.

131

These intrastate returns are below the Commission authorized return of 9.76%. However, as interim rate relief Factor No. 3 states, this alone is not sufficient to justify interim rate relief. This factor has special application in this case, because the Company filed tariffs in the general rate case phase of this docket that will generate a return on rate base of only 3.54%. *Exh. No. 32, col. (g) and (h)*.

132 A 3.54% return on rate base is in the range of the 2.09% return developed by Staff in Exhibit No. 142 at page 1, column (l), without any interim rate relief. The Company's general rate case tariff filing belies any claim it has for interim rate relief based on an inadequate rate of return.

**d. Interest coverage**

133 Verizon NW has a 2.0 times interest coverage requirement in its existing debt instruments. *Folsom, Exh. No. 121-T at 21:12-18, and Exh. No. 125 at 7.* This coverage requirement is computed on a total company basis. Verizon NW surpasses this coverage requirement by a wide margin. *Exh. No. 144, col. (d), EBIT Interest Coverage.* There are no coverage or other requirements in any of these debt instruments that are based on Washington intrastate only results. *Folsom, Exh. No. 121-T at 22:7-18.*

134 If the Company were to be evaluated on a "stand alone" intrastate basis, *with or without interim rate relief*, the Company would not meet a two times coverage requirement. *King, Exh. No. 101-T at 17:12-17.* This proves Verizon NW has not filed a credible case under its own "Washington intrastate only" theory.

**e. Intermediate and short term financing demands**

135 The Company has offered no information on its intermediate and short term financing demands on a Washington, or Washington intrastate basis. The

Company provided no financing plan whatsoever, hypothetical or real. *Exh. No. 126.*

136           The Company has provided its construction budget for total Washington of some \$112.5 million. But as Ms. Folsom explained, Staff cannot determine how much of this amount would be intrastate. *Folsom, Exh. No. 121-T at 33:3 to 34:8 and Exh. No. 131.*<sup>28</sup> More to the point, nowhere in the record does the Company indicate how much of this amount it needs to finance on a Washington intrastate allocated and separated basis, or any other basis, for that matter.

137           There was evidence that examined the Company's cash flows. Remarkably, all witnesses who offered testimony on this issue agree on one thing: Verizon NW has sufficient cash flow, even on a Washington intrastate basis, to cover its interest payments and pay for its construction costs and all other expenses. The analyses are summarized on Attachment B to this brief.

138           Staff calculated "free cash" of \$46.3 million, which reflects all adjustments described in Section IV.A. (including the \$29.7 million access charge revenue reduction).<sup>29</sup> Second, Staff calculated "free cash" of \$16.9 million, based on Verizon

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<sup>28</sup> In its cash flow analysis, Staff assumed a capital allocation factor would apply, but that is a weak substitute for close examination of the specific projects involved to assure each was assigned to its proper jurisdiction.

<sup>29</sup> During cross-examination, Staff calculated "free cash" of \$46.7 million, based on Staff's Exhibit No. 144, column (b). *Strain, TR. 583-584.* However, that calculation included a rounding error and was based on an incorrect allocation percentage for intrastate capital expenditures. The correct figure is \$46.3 million, as reflected on Attachment B to this brief.

NW's Washington intrastate results of operations before any adjustments, but incorporating the access charge revenue reduction.<sup>30</sup>

139 Dr. Vander Weide agrees that Verizon NW's cash flows are "approximately equal" to its test year interest and capital expenditures. He did not supply the exact figures on which his conclusion was based. *Exh. No. 3-T at 6:17-19*. The Company's Response to Bench Request No. 3 shows nearly \$8.6 million in free cash over cash requirements.

140 Mr. King calculated an amount of "free cash" of about \$1.25 million,<sup>31</sup> after payment of all interest and full funding of the Company's construction program. *Exh. No. 104, as explained at TR. 432:23 to 436:15*. If the Company's \$11.474 (total company) budget reductions were taken into account, Mr. King's free cash figure would be \$9.922 million.<sup>32</sup>

141 Because the Company does not calculate cash flows on a Washington intrastate basis, *Exh. No. 130*, the foregoing cash flow analyses are, once again,

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<sup>30</sup> During cross-examination, Staff calculated unadjusted "free cash" of \$17.5 million. *Strain, TR. 600*. However, this calculation was based on the same incorrect allocation percentage for intrastate capital expenditures used to develop the \$46.7 million figure described in the prior footnote. The correct calculation of \$16.9 million is shown on Attachment B to this brief.

<sup>31</sup> The figure Mr. King stated on the record was \$1.1 million, the result of subtracting \$2.8 from the \$3.965 million shown in his Exhibit No. 104. *TR. 436:10-16*. The correct figure is \$1.252 million, as explained in Attachment B to this brief.

<sup>32</sup> \$11.474 million, per Exhibit No. 83, page 7, times the capital allocation factor of 75.5366% = \$8.67 million. \$8.67 million + \$1.252 million = \$9.922 million. The other major difference between Mr. King's \$1.252 million cash flow figure and Staff's \$16.9 million cash flow figure is that Mr. King's figure includes the Company's restating adjustments (\$6,996,000 earnings impact; Ex. 142 at 1, col. (c), line 22), while Staff's \$16.9 million figure does not include any adjustments other than the access revenue reduction of \$29.7 million (or \$29.2 million, net of uncollectibles).

purely hypothetical. However, should the Commission decide to consider interim rate relief based on a “stand alone” theory, it should deny interim rate relief because there would be sufficient cash to fund any emergency need for capital by a hypothetical, “stand alone” utility. *See also Folsom, TR. 496:1-7.*

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

142 Because the Company has not identified its financing demands, the Commission cannot determine the effect of the grant of interim rate relief on such demands.

143 The Company opines that a grant of interim rate relief would give its Washington intrastate operations a hypothetical BBB investment grade rating, but that does not address how much Verizon NW intends to finance, how it would finance (debt or equity) and the terms and conditions of that financing.

144 For all the reasons provided above at ¶¶ 86-89, this hypothetical bond rating testimony raises more questions than it answers, and it certainly does not justify a grant of interim rate relief.



5. Factor No. 5

**Interim relief is a useful tool in an appropriate case to fend off impending disaster. However, the tool must be used with caution and applied only where not to grant would cause clear jeopardy to the utility and detriment 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.**

145 In this factor, Commission re-emphasizes that interim rate relief is a regulatory tool to be used sparingly, and only when there is “clear jeopardy” and “clear detriment” to ratepayers, the utility and shareholders. The critical question is whether the general rate case can be resolved without such an impact. If so, interim rate relief should not be granted.

146 For many of the reasons already discussed, there is no clear detriment to the utility and its investors because Verizon NW has no problem financing its Washington intrastate operations pending the resolution of its general rate case. The investors in Verizon NW’s Washington intrastate operations have learned that over time, Verizon NW will enjoy excess returns, and sometimes it will earn returns lower than authorized. On balance, history shows there has been no “clear detriment to investors.” *See Exh. No. 143 at 4, “Rate of Return” line.*

147 As for ratepayers, Verizon NW attempts to argue service quality may suffer if the Commission does not grant interim rate relief. *E.g., Banta, TR. 326:6-14.*

However, in its case for interim rate relief, the Company offered no evidence on

historical trends in service quality, any decline in that trend, or any connection between such a decline (assuming there was one) and Washington intrastate financial results.

148            Contrast this to the general rate case, where the Company is offering witness Ms. Anders to testify on service quality issues. In her testimony, Verizon NW offers analysis of specific service quality performance measures, and concludes that Verizon NW's quality of service has been "excellent," exceeding that of other companies in this state. *Exh. No. \_\_\_ (DA-1T) at 7:9-15 and at 11:6-7*. The Company also concludes that Verizon NW "provides quality service in accordance with Commission and customer expectations." *Id. at 16:2-4*.

149            If Verizon NW wished to sustain a claim that service quality is declining, it should have provided evidence in the same form as Exhibit No. \_\_\_ (DA-1T), and proved a connection between that evidence and its Washington intrastate return. The Company chose not to do so. Consequently, the unfounded, generalized Company statements about service quality in the interim rate relief phase provide no basis for granting interim rate relief.

6. **Factor No. 6**

**The commission must reach its conclusion with its statutory charge to "Regulate in the public interest" in mind. This is our ultimate responsibility and a reasoned judgment must give appropriate weight to all salient factors.**

150 In all matters, the Commission must satisfy itself that it is acting in the public interest, as provided in the public service laws. *RCW 80.01.040(1)*. In doing so, the Commission needs to balance the interests of the utility and the ratepayers.

151 The Commission's interim rate relief factors strike an appropriate balance in the context of a utility seeking to increase its rates before a full hearing can be held. For all of the reasons stated in this brief, denying Verizon NW's request for interim rate relief is in the public interest.

**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?**

152 Verizon NW is not requesting rate "rebalancing" in this case. The Company has petitioned for \$29.7 million in interim rate relief, subject to refund, based on the Commission's interim rate relief factors, *Petition of Verizon NW Inc. Seeking Interim Rate Relief at 3-9*, and the Company filed testimony consistent with its Petition. If Verizon NW wanted its filing to be considered under different criteria, the Company should have filed under those criteria, justified those criteria, and presented evidence under those criteria, so the Commission and the parties would have time for investigation, review and analysis.

Moreover, to treat this filing as a rate rebalancing request that does not require the thorough review of all the issues in a general rate case, would give Verizon NW precisely what the Commission denied it in the Access Charge Case. Indeed, Verizon NW's current request for an increase in local rates to offset its access revenue reduction is strikingly similar to its position in that prior case:

Verizon does not object to reducing its originating access charges; *provided, however*, that Verizon is permitted to increase other rates—notably, basic residential rates, on a revenue neutral basis, without a review of its earnings or overall rate structure.

*Access Charge Order at 7, ¶ 14, quoting Verizon NW's opening brief at 16.*

The Commission rejected this attitude of “entitlement without examination:”

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 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.<sup>33</sup> 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 NW 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.

*Access Charge Order at 7, ¶ 15, footnote included.*

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<sup>33</sup> 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 of this Commission to ensure that a regulated company will fully recover its costs regardless of any changes in the economic, technological, or business environments.

155 Verizon NW may yet prove in the general rate case that its local rates should increase to offset a reduction in access revenues. In the meantime, the Commission should not treat this request for interim relief as a “rebalancing filing,” and it should not grant now what it rejected in the Access Charge Case.

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

156 Staff considers the term “rebalancing” to refer to situations where the utility’s overall revenues stay approximately the same (*i.e.*, “in balance”), but the relative shares of contribution to overall revenues, by services or classes of service, changes by altering the rates and charges after considering the underlying costs, and other factors. Rate rebalancing has occurred in only limited circumstances.

157 One example involves access charges. In WAC 480-120-540(6), the Commission provides local exchange companies the opportunity to increase or restructure its originating access charges when it reduces terminating access charges to comply with the rule. This rebalances revenue contribution within the access charge tariff.

158 Another example was in the context of Extended Area Service (EAS) tariff filings. Commission rules allowed telephone utilities to add surcharges to their local rates to recover toll revenues lost when local calling areas were expanded. Again, the revenues were rebalanced, whereby toll and access revenues were

converted to local service revenue, and the customers received expanded, flat-rated local service (including calls previously rated as toll calls) in exchange for an increased local rate.<sup>34</sup>

159           The Commission has “restructured” rates on a non-revenue neutral basis. This often happens, on a small scale, at Commission open meetings, where tariff changes are presented and resolved without contest, or by settlement.<sup>35</sup> When the revenues are significant, the predominant forum for rate restructuring is the general rate case, where the utility’s revenue requirements, and an appropriate rate design and rate spread, are determined.<sup>36</sup>

**2.       What policy factors should bear in determining whether this request differs from other requests for interim relief?**

160           There are several policy factors to consider. First, the Commission should consider that the Company filed its case based on the Commission’s interim rate

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<sup>34</sup> The Commission repealed the rules authorizing these procedures (former WAC 480-120-405 to – 435), effective January 15, 1999.

<sup>35</sup> Rate restructuring may also occur in the context of unopposed tariff filings in which the tariff changes go into effect without suspension. That is not the context of this proceeding. In addition, rate restructuring can occur in the context of settlement. It has been typical that in approved settlements in cases involving utility mergers and acquisition applications, rate restructuring has occurred. The GTE Corp.-Bell Atlantic merger is one example. As a result of the settlement in that case (Docket No. UT-981367 *et al.*), some residential and business rates were increased and some were decreased, with the goal of standardizing rates within customer classes.

<sup>36</sup> The Company itself identified the 1995-1996 US WEST rate case as an example of rate rebalancing in the context of access charge reductions. *Banta, TR. 380:11-22*. However, that particular example is more accurately termed a rate restructuring. In any event, in that case, the Commission did not raise local rates to offset a reduction in access charge revenues; it restructured rates by lowering local rates less than it lowered access rates.

relief factors, and the parties have responded. If the Company filed under the wrong theory, the Company should re-file under a correct one.

161           Second, the Commission should adhere to a policy of holding utilities to their promises, including Verizon NW's promises that the financial benefits of the merged company would inure to the benefit of ratepayers in this state, that directory imputation would continue, and that the termination of directory revenues would not impair any bond ratings. Adhering to such a policy requires the Company's request for relief to be denied.

162           Third, the Commission should adhere to a policy of not raising rates on an interim basis absent a showing of a genuine problem that is adversely affecting the utility's actual ability to meet its public service obligations. The Commission has never granted interim rate relief to a utility with A-rated debt, when there was no imminent prospect of a reduction in that rating.

163           Fourth, the Commission should adhere to a policy that the utility be consistent in its general rate case presentation, and its interim rate relief presentation. Verizon NW violates that policy. *See pp 166-169, infra.*

164           Finally, the Commission should consider the specific circumstances associated with this request for interim rate relief. A general rate case has been filed, and hearings are scheduled. Verizon NW made a deliberate choice, as a litigation strategy, not to make a rebalancing filing while the Access Charge Case

was pending. And the Commission has already told the Company that it should file a rate case if it wished to pursue a rate restructure.

165           Implementation of these rational policies fully justifies rejection of the Company's interim rate relief filing in this case.

**C. Other**

166           In its analysis of interim rate relief factors, the Commission requires the utility's case for interim rate relief and its case for general rate relief be "interrelated and consistent:"

The Company's full circumstances have been presented in its prefiled [general rate case] exhibits and will be explored fully at hearing. The evidence is interrelated and consistent. The proceedings are independently prosecuted, but the two are not independent in content or context.

*WUTC v. Puget Sound Energy Co., Docket Nos. UE-011163 & 011170 (Sixth Supplemental Order)(2001) at 10, ¶ 27.*

167           Verizon NW fails this requirement in at least two major respects. First, as noted above in the discussion of Factor No. 5, in its interim rate relief case, Verizon NW is expressing general concerns for service quality, while in its general rate case testimony, Verizon NW uses specific service quality performance parameters to demonstrate Verizon NW's service quality is excellent. The result is an inconsistent presentation on service quality analysis the Commission should not tolerate.

168           Second, in the general rate case, the Company is proposing a 75% equity ratio for setting rates for Verizon NW. *Strain, TR. 593:6-7.* Yet Verizon NW is



currently financed with about 62% equity. *Exh. No. 123 at 3, "Common Equity" columns, "Test Year" lines.* Accordingly, for the Company's interim case and its general case to be consistent, the Company would need to offer testimony that it needs equity capital; its testimony would state the specific criteria of Verizon Communications that must be met to get an infusion of equity capital; and it would prove how \$29.7 million in interim rate relief will allow the Company to meet those criteria. Verizon NW has provided no testimony whatsoever on any of these issues.

169 In sum, Verizon NW has not filed an interim case consistent with its case in chief. By doing so, the Company violates a central policy underlying the Commission's interim rate relief analysis.

#### IV. RATE DESIGN

##### A. Introduction

170 Should interim relief be granted, Staff proposes an equal percentage increase to all intrastate retail and resale tariffed, price listed, and contracted access lines, including Washington Telephone Assistance Program (WTAP), but excluding unbundled network elements (UNEs) subject to FCC pricing rules.

171 The Company proposes an equal dollar amount increase of \$3.54 per line, but excludes approximately sixteen percent of the lines.

172 Staff and the Company agree on several points: 1) rate design that increases only line rates is desirable because it is relatively simple and, if properly designed,

applies to most customers; 2) any increase in switched access charges would be inappropriate; 3) any interim rate surcharge should not be applied to ancillary services or long distance services because of administrative difficulties; and 4) an interim rate surcharge should not apply to UNEs because they are subject to the FCC's UNE pricing rules. *Zawislak, Exh. No.181-T at 7:4 to 8:2.*

## **B. Equal Percentage Increase Proposal**

173 Rate design for interim rate relief should reflect rates which pass appropriate, extraordinary costs on to the consumer on an actual or reasonably known and measurable basis; it should minimize relative rate shock for all customer classes; it should defer difficult or complex issues until the general rate case; it should not implement a substantive alteration of the rate structure; and it should not reflect a piecemeal or fragmented approach to ratemaking.<sup>37</sup>

174 An equal percentage increase satisfies these sound policies. It is a more equitable way to spread any interim revenues in this case. It does not require one

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<sup>37</sup> *WUTC v. Washington Natural Gas Company*, Docket No. U-80-111, Second Supplemental Order (March 3, 1981) at 3: extraordinary costs should be "passed on to the consumer on an actual or reasonably known and measurable basis" and it "is not intended to be employed nor will it be considered by this Commission as a stopgap or piecemeal approach to a utility's overall financial requirements." *WUTC v. Puget Sound Power and Light Company*, Docket No. U-80-10, Second Supplemental Order (June 25, 1980) at 5: the Commission will consider whether a proposal is a "substantive alteration of rate structure." In *In re Avista Corporation*, Docket No. UE-010395, Sixth Supplemental Order at 31, ¶ 83, n. 7: accepting a uniform percentage surcharge to all rate schedules because the alternate proposal would "not reduce the rate impact to the residential class relative to what occurs using the uniform percentage approach, yet would cause some other customer classes to experience dramatically higher *relative* [emphasis added] impacts." The Commission also observed: "[t]he ultimate allocation of prudently incurred costs awaits the outcome of the general rate case."

customer class to suffer “rate shock” relative to other classes, or to pay a disproportionate share of the revenue burden. The same share of revenues from each class remains the same as under current tariffs.

175           An equal percentage increase does not require speculation about complex issues such as the cost relationship between residential and business classes or price elasticities. Nor is the Commission forced to resolve such issues before all necessary evidence has been received. These issues are appropriately addressed in the general rate case, not in a case for interim rate relief. *Zawislak, TR. 621:14-20.*

### **C.    Equal Dollar Increase Proposal**

176           The Company’s proposed equal dollar (\$3.54) increase suffers from a number of problems. As Exhibit No. 184 illustrates, the residential customers will see rate increases as high as 48.83% for some services, while business customers will see rate increases as low as 5.93% for some services, and even zero for others. *Exh. No. 181-T at 8:16 to 9:4.* Instead of minimizing rate shock for all customer classes, the Company’s proposal maximizes rate shock for the residential class, and minimizes rate shock for the business class.

177           By contrast, an equal percentage approach permits rates to go into effect gradually for all classes.

178           The Company and business customers argue that the dollar difference between residential and business rates is maintained only under the Company’s

equal dollar increase approach. *E.g., TR. 615:10-15.* However, maintaining the same dollar difference between business and residential rates causes rate shock for residential customers.

179 Through Exhibit No. 74-C and cross-examination of Staff, the Company and business customers also tried to argue that the elasticity of business lines and/or the cost relationship between business and residential lines should control. However, there are no cost or elasticity studies in the record, and Exhibit No. 74-C does not reflect Commission policy on any key cost inputs. *Banta, TR. 406:22 to 408:5.*<sup>38</sup>

180 The better approach is to leave the accepted rate structure in place and defer complex rate design issues until the general rate case, where all parties may properly analyze the relevant evidence, such as costs, cross elasticity of demand, equity, market conditions, and required revenue. As the Commission observed in adopting an equal percentage interim increase in *In re Avista Corporation, Docket No. UE-010395*, Sixth Supplemental Order at 31, ¶ 83, n. 7: “[t]he ultimate allocation of prudently incurred costs awaits the outcome of the general rate case.”

181 In summary, the Company’s proposal is inappropriate because it results in rate shock to residential customers, it substantively alters the rate structure and

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<sup>38</sup> The relevance of Exhibits 73 and 191, two other exhibits offered to support the company’s rate design proposal, is similarly questionable. In fact, no party has provided direct testimony as to their relevance in this proceeding, therefore, it is unclear how these exhibits, relating to UNEs, are useful in any way in an interim *retail* rate proceeding. They certainly do not substitute for the highly complex, fact-specific, and expert-intensive inquiry involved in a cost study.

revenue relationships between business and residential classes, and it requires the Commission to address and resolve complex cost study issues without even having the cost studies, let alone a complete record. The better approach is an equal percentage increase as advocated by Staff.

**D. Services Subject to Surcharge**

182           The Company proposes to exclude from any interim surcharge several types of business access lines, lines sold under contract, lines sold to other telecommunications companies for resale to end users, and lines subscribed through the Washington Telephone Assistance Program (WTAP).<sup>39</sup> This renders the Company's proposal inequitable because it effectively increases the surcharge for other residential and simple business exchange customers. *Zawislak, Exh. No. 181-T at 11:6 – 11.*

183           If the lines Staff proposes were included, the amount of the Company-proposed surcharge would be reduced from \$3.54 to \$2.98, and more customers would participate. *Exh. No. 81-C and Banta, TR. 247:6-9.*

184           WTAP lines should be included because otherwise, other customers would pay twice for WTAP – once in the form of an excise tax, and again through a higher interim surcharge than otherwise would apply. *Zawislak, Exh. No. 181-T at 12:14 to*

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<sup>39</sup> The scope of the Company's proposed exclusions can be best seen by comparing Exhibit Nos. 62-C, 186-C and 185-C. The net result is that the Company excludes about 16% of its eligible (and in many cases higher revenue producing) lines.

13:9.<sup>40</sup> Also, excluding WTAP lines unfairly singles out one low-income group among many who presumably would suffer equally under the interim proposal. *Id.*

185           Finally, the Company's proposal to exclude "data and other specialized services provided to business and governmental agencies" also lacks substantial support. The Company says it is concerned about "vigorous competition," *Banta, Exh. No. 61-T at 9:1-2*, yet the Company has not even tried to get competitive classification for these services, and no objective analysis supporting the competitiveness of these services was provided. *Zawislak, TR. 627:18 to 628:3 and TR. 631:24 to 632:3*. The Commission should not presume effective competition exists with no evidence in the record.

186           Accordingly, if a surcharge is ordered, it should be applied to all the lines recommended by Staff in Exhibit No. 185-C.

**E.     Mechanics of calculating a surcharge, if one is authorized**

187           Should the Commission authorize interim rate relief, and decides an equal percentage increase is appropriate, the Commission should use Exhibit No. 185-C to calculate the percentage.<sup>41</sup> The Commission should include in the denominator the revenue from the associated line services it determines should be subject to the

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<sup>40</sup> The rate impact of excluding WTAP lines from the interim surcharge is approximately 11 cents more per month based on the Company's proposal. *Zawislak, Exh. No. 181-T at 13:12-15*. Thus, excluding WTAP from the interim surcharge results in a measurable increase in the interim surcharge, with little or no benefit to customers of any class.

<sup>41</sup> The formula is:  $A / B = C$ , where A = amount of interim relief (annualized amount); B = total annual revenue of services to be assessed a surcharge; and C = resulting equal percentage increase on services included in B.

surcharge. Exhibit No. 185-C summarizes the revenues from the various categories of access line services and Exhibit No. 186-C provides the detailed services, rates, units, and ordering codes from which it was derived.<sup>42</sup>

## VI. DEFERRAL ACCOUNT PROPOSAL

188 In a colloquy with Verizon NW's counsel, WebTec's counsel described a proposal whereby any revenue increase awarded by the Commission through interim rate relief would not be paid by ratepayers currently, but would be recorded in a deferral account on the Company's books, to be paid later based on the ultimate rate design to be approved by the Commission in the general rate case. TR. 322:3 to 323:2. Counsel did not indicate whether he was assuming the Company's financial statements would recognize the revenues currently.

189 There is no basis to conclude that such revenues could be recorded because of GAAP's requirement of a level of certainty that the revenues will be recovered. (The same concern applies to the refund condition proposed by Verizon NW).

190 Absent evidence regarding how these deferred revenues would be perceived from a financial viewpoint, Staff cannot recommend the Commission accept this proposal.

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<sup>42</sup> If the Commission chooses a uniform dollar surcharge, then the Commission should calculate such a surcharge using Exhibit No. 81-C, by dividing the interim relief amount by the access lines depicted in that exhibit, and by dividing that annual number by twelve to arrive at a monthly figure. The various categories of lines and annual revenues are summarized on this exhibit (Exhibit No. 81-C), and the detailed services, rates, units, and ordering codes can be found, again, in Exhibit No. 186-C.

## VII. REFUND ISSUE

### A. Whether and how to apply refunds

191 Verizon NW offered to make any interim rate relief refundable. *Banta, Exh. No. 61-T at 8:11-12*. No party has declined that offer. However, as Staff pointed out, if a utility truly needs funds to address an imminent problem that is affecting its ability to finance, it should use the money to solve that problem. *Folsom, TR. 501:4-9*.<sup>43</sup>

192 Refunds can be difficult to administer, and ratepayer confusion can result. For example, if a rate goes up in the interim case, but it is lower as a result of the general rate case, the affected ratepayers will expect a refund. However, if the ultimate revenue deficiency determined by the Commission were higher than \$29.7 million, the Company intends to give no refunds. *See King, TR. 457:17-23, and Banta, TR. 295:4 to 296:25*.

193 In no event should refundability be used to reduce the Company's burden of proof. Ratepayers should be able to keep their money unless the Company proves otherwise. *Folsom, TR. 519:22 to 520:20*. The Company's proposed 27% increase to residential rates imposes "real financial burdens that should not be imposed lightly, whether or not refunds are ordered." *King, Exh. No. 101-T at 23:5-6*.

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<sup>43</sup> Only three of the Commission interim rate relief orders had a refund condition: The *Avista Order*, the *Olympic Order*, and the Commission's Second Supplemental Order in *WUTC v. The Washington Water Power Co.*, Cause No. U-77-53 (September 23, 1977) at 10, ¶ 9.



194

If interim rate relief is granted, and refunds are required, the Commission should impose the same requirements the Commission prescribed in the *Avista Case*. These requirements are identified in Exhibit No. 181-T at 18:8 to 19:11.

**B. Other issues (N/A)**

**VIII. CONCLUSION (WITH SPECIFIC RECOMMENDATIONS)**

195

This case is about the choices Verizon NW has made. Many of those choices, including the Company's litigation strategies, either have failed, or, in the case of Verizon Directories, have visited substantial revenue losses upon Verizon NW. The Company alone is responsible for the results of those choices.

196

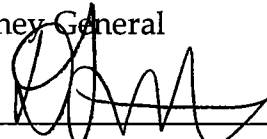
Interim rate relief is a short-term solution to real financial problems. Verizon NW has no problems that cannot await resolution of the general rate case.

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The Commission should deny Verizon NW's request for interim rate relief. If any relief is afforded, any revenues should be spread on an equal percentage basis as described in ¶ 187, *supra*.

DATED this 27<sup>th</sup> day of August 2004.

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# **ATTACHMENT A**

## **Matrix of Interim Rate Relief Cases From Other Jurisdictions**

State	Factors	Citation
Alaska PUC	<p>An interim rate increase may be awarded to a utility that satisfies a five element test: “(1) that its existing rates are confiscatorily low; (2) that those confiscatorily low rates will remain in effect for unreasonably long period of time; (3) that the utility will suffer irreparable harm in the event interim relief is not granted; (4) that the ratepayers can be adequately protected by a bond, escrow, or other arrangement in the event the interim increase is ultimately determined to be excessive in amount; and (5) that the utility has raised ‘serious’ and ‘substantial’ questions that are not ‘frivolous’ or ‘obviously without merit.’”</p>	<p><i>Re Municipality of Anchorage d/b/a Anchorage Sewer Utility, 37 PUR4th 97 (1980).</i></p>

<p>Arizona</p>	<p>“[i]nterim ratemaking authority is limited to circumstances in which (1) an emergency exists; (2) a bond is posted by the utility guaranteeing a refund to customers if the interim rates paid are higher the final rates determined by the Commission; and (3) the Commission undertakes to determine final rates after a valuation of the utility’s property.”</p> <p>Argument by Commission that its power to set interim rates “is not limited to emergency situations” rejected. The court said that “[a]lthough the Commission’s authority to prescribe rates is plenary, the Commission’s ratemaking authority is subject” to the requirement that it prescribe just and reasonable rates. The court cited other case law for the proposition that just and reasonable rates must be related to a finding of fair value and because interim relief does not involve a full analysis of the utility’s rate base, interim relief is only permitted on a finding that an emergency exists.</p> <p>Court indicated that “piecemeal” rate making was fraught with potential abuse.</p> <p>“the public is entitled to the same level of [due process] protection [as the public utility] when the government seeks to increase the utility rates the public is obligated to pay.”</p>	<p><i>Residential Utility Consumer Office v. Arizona Corporation Commission</i>, 20 P.3d 1169 (Ariz. Ct. App. 2001)</p>
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Arkansas	<p>The standards for interim relief are “immediate and impelling necessity” and “confiscation”.</p> <p>The intent of a state statute governing interim rate relief is that a utility has the option of applying for interim rate relief as a protection to it, in the event that financial stability of the utility would, or could, be placed in jeopardy by reason of undue delay in rate adjustments.</p>	<p><i>Arkansas Public Service Commission v. Yelcot Telephone Company</i>, 585 S.W.2d 362 (1979).</p>
District of Columbia PSC	<p>Circumstances which would justify the granting of interim relief would be showing of “(1) a present of clearly imminent threat that the utility would not be able to continue to meet its public service obligation and, (2) a present or clearly immediate threat the utility would not be able to obtain necessary capital funds (to finance the construction of necessary new or replacement plant).”</p>	<p><i>Re Potomac Electric Power Company</i>, 9 PUR4th 363, (1975).</p>
District of Columbia PSC	<p>In the context of this case, the critical question for granting of interim rate relief was whether the telephone company would be “unduly harmed” if its request for immediate rate relief were denied or deferred.</p>	<p><i>Re Chesapeake and Potomac telephone Company</i>, 56 PUR4th 53 (1983).</p>
Florida PSC	<p>An electric utility was granted interim rate relief where its rate of return has fallen below that which was found to be reasonable in its last rate case.</p>	<p><i>Re Florida Power Corporation</i>, 8 PUR4th 95 (1975)</p>

Florida PSC	<p>“ . . . the test to support an interim rate increase should be whether the commission has additional or corroborative data on which to grant temporary rate relief at the time it lifts its suspension - data which it did not originally have, or data which clarify or amplify matters initially found to be inadequate.”</p>	<p><i>Re General Telephone Company of Florida</i>, 19 PUR4th 227 (1977)</p>
Hawaii PUC	<p>In order to be granted a temporary rate increase under HRD 269-16(c), financial need must be shown, and the legislature intended that financial need be deemed to include financial hardship, but a mere showing of revenue deficiency or revenue loss that will not be recovered without a temporary rate increase is not sufficient for the granting of temporary relief.</p> <p>The relief of a temporary rate increase is available on an emergency basis to meet a sudden and urgent financial need, and the commission formulated a standard for granting such increases, requiring utility applicants to show “irreparable harm resulting from a distinctive and sudden deficiency in revenue which is not subject to recovery.”</p> <p>Pursuant to HAR 269-16(c) the commission may in its discretion, upon showing by a utility of “probable entitlement and financial need” authorize a temporary increase in a utility’s rates, pending a final determination by the commission of just and reasonable rates.</p>	<p><i>Re East Honolulu Community Services, Inc.</i>, 118 PUR4th 259 (1990).</p>

Idaho PUC	<p>“[a] revenue deficiency which impairs a public utility’s ability to serve its customers or obtain reasonable financing tends to indicate that interim relief is appropriate.”</p> <p>Interim relief is justified upon a showing of a financial condition so severe that the utility’s ability to serve its customers or to obtain reasonable financing is seriously impaired. The mere fact that a public utility is not earning its previously authorized rate of return is not sufficient to compel interim rate relief.</p>	<i>Re Washington Water Power Company, 22 PUR4th 485 (1977).</i>
Illinois Commerce Commission	When a utility files a request for interim rate relief, the utility is not guaranteed a grant of an amount of interim relief by a specified date even if the utility meets the interim rate relief standards.	<i>Re Illinois Power Company, 74 PUR4th 420 (1986)</i>
Illinois Commerce Commission	<p>A utility may be granted a temporary increase while its application for permanent increase is pending only if it makes a positive showing that absent the interim increase, it would not be able to fulfill its service obligations because of an inability to raise adequate capital or because of unanticipated revenue losses or expense increases caused by factors both unforeseeable and beyond the utility’s control.</p> <p>A utility will be granted a temporary rate increase while its application for a permanent increase is pending only if it appears that the utility will be entitled to a permanent increase at the end of a full hearing.</p>	<i>Re Temporary Rate Increases, 77 PUR 4<sup>th</sup> 747 (1986)</i>

Indiana PSC	<p>“A grant of emergency rate relief requires proof that a situation exists which absent immediate corrective action will result in serious harm to the petitioning utility and its customers”; “[r]elavant to such a determination would be evidence of possible curtailments of service, serious deterioration of the utility’s financial condition, an inability to meet day-to-day cash operating expenses, and the utility’s efforts of to reduce operating costs.”</p>	<p><i>Re Public Service Company of Indiana, Inc., 72 PUR4th 660 (1986).</i></p>
Indiana PSC	<p>Although the AT&amp;T divestiture was bound to cause a telephone company to lose revenue associated with its former interLATA services, the commission said that such a loss did not constitute an emergency warranting full interim rate relief.</p>	<p><i>Re Indiana Bell Telephone Company, Incorporated, 59 PUR4th 49 (1984)</i></p>
Indiana PSC	<p>An electric granted an emergency temporary rate increase was ordered to provide the state public service commission with quarterly reports including: “(1) nonenvironmental construction expenditures; (2) environmental construction expenditures; (3) forecasts of all construction expenditures; (4) the amount spent on significant power plant maintenance programs performed” pursuant to the operation of the plant utility; “(5) balance sheet; (6) income statement; (7) statement of source and use of funds; (8) report on progress toward financial restructuring; and (9) projected sales in kilowatt-hours compared to actual sales by major customer classes.”</p>	<p><i>Re Public Service Company of Indiana, Inc., 72 PUR4th 660 (1986)</i></p>



<p>Indiana PSC</p>	<p>State law, INC.(U.R.C.) Code 8-1-2-113, provides that the commission shall have the power in case of any emergency “to temporarily alter, amend, or with the consent of the public utility concerned, suspend any existing rates, service, practices,” and schedules relating to or affecting any public utility in the state.  Commission may grant interim relief in a non-emergency situation – i.e. , where there is no threat to the utility’s solvency or ability to render service, provided that the circumstances rendering interim rate relief necessary were brought about by some factor outside the control of the utility.  The enactment of the Tax Reform Act of 1986, together with the consequent unanticipated diminishment of revenues brought about by the commission’s treatment of the act justified consideration of relief.</p>	<p><i>Re Indiana American Water Company, Inc.</i>, 88 PUR4th 43 (1987)</p>
<p>Maine PUC</p>	<p>The remedy of a temporary rate increase is extraordinary in nature and must be granted in situations “which cannot await relief through the normal channels” of a general rate case.  The risk that a utility’s securities would be downgraded to a level below investment quality was of a sufficient magnitude to require the granting of a temporary rate increase.</p>	<p><i>Re Central Maine Power Company</i>, 45 PUR4th 191 (1982).</p>
<p>Massachusetts Department of Public Util.</p>	<p>The commission returned “to a strict emergency standard” under which it will “grant interim relief only in extraordinary cases where a genuine emergency is clearly shown to exist.”</p>	<p><i>Re Fitchburg Gas and Electric Light Company</i>, 52 PUR4th 197 (1983).</p>

<p>New Jersey Bd. Of Public Util. Commissioners</p>	<p>There “must be clear showing from specific factors that immediate and irreparable damage will probably result if relief is not given prior to full hearing.” The Board requires a “necessary connection between interim relief, immediate necessary financing, and necessary construction projects”</p>	<p><i>Re Public Service Electric &amp; Gas Co.</i>, 6 PUR4th 302 (1974)</p>
<p>New Mexico Corporation Comm’n</p>	<p>The commission has a constitutional duty to fix interim rates when “(a) existing rates are not fair and reasonable, and (b) a considerable length of time would elapse before permanent rates could be fixed.” In cases where a utility is seeking (emergency or interim relief) <i>prior</i> to a determination of a revenue requirement, the company must demonstrate by clear and convincing evidence that without an emergency rate increase the company would be unable to (1) maintain its financial integrity, and (2) continue providing adequate service to its customers.” In cases where a utility is seeking emergency rate relief after the commission has determined the utility’s revenue requirements, “[t]he company must demonstrate that the granting of interim relief prior to a rate design determination would not unduly burden its customers, and if not granted, would result in an extreme hardship to the utility.”</p>	<p><i>Re Gas Company of New Mexico</i>, 28 PUR4th 20 (1978)</p>

New York PSC	Temporary rate requests granted on a case by case basis.	<i>Re Financing Plans for New York State Gas and Electric Companies, 49 PUR 4th 329 (1982)</i>
New York PSC	Commission granted temporary relief because of the company's "massive construction program" (\$1.1 billion for one year and \$10 billion over 10 years), and its proven for an amount of money necessary to maintain good credit in order to finance that program and "other necessary steps for restoring good service." Commission required certain volume discounts be eliminated, and non-recurring charges increased.	<i>Re New York Telephone Co., 90 PUR3d 335 (1971)</i>
Ohio PUC	The commission set out several conditions by which it is guided in exercising its discretion to grant emergency relief: (1) "the existence of an emergency is a condition precedent to any grant of temporary rate relief", (2) "applicants evidence will be reviewed with strictest scrutiny and that evidence must clearly and convincingly demonstrate the presence of extraordinary circumstances which constitute a genuine emergency situation", (3) emergency rate relief will not be granted if the emergency request was filed merely to circumvent and as a substitute for permanent rate relief, and (4) "the commission will grant temporary rate relief only at the minim level necessary to avert or relieve the emergency."	<i>Re Dayton Power and Light Company, 41 PUR4th 136 (1980)</i>

<p>Pennsylvania PUC</p>	<p>State statutes provide that an operating utility would be entitled to “extraordinary rate relief only if it could show that such relief was immediately necessary for the maintenance of (its) financial stability (i) in order to continue providing normal service, (ii) avoid reduction in its normal maintenance programs, and (iii) avoid substantially reducing employment.” Proof requires showing that financial stability is actually in jeopardy.</p>	<p><i>Pennsylvania Public Utility Commission v. Pennsylvania Electric Company</i>, 26 PUR4th 337 (1978)</p>
<p>Pennsylvania</p>	<p>The Pennsylvania Supreme Court, consistent with state statutes and, in order to avoid <i>due process challenge</i> to a sua sponte decision of the Commission to grant interim relief, determined that the state legislature expanded the prior utility statute for the purpose of preventing the routine administrative allowance of temporary rates. The change prohibited temporary rate increases pending general rate cases except in extraordinary situations.</p>	<p><i>Joseph Horne Company v. Pennsylvania Public Utility Commission</i>, 485 A.2d 1105 (1985)</p>

<p>Vermont Public Service Board</p>	<p>To determine the meaning of the phrase “public interest” for the purposes of granting temporary rates under state statute, the Board noted that the Vermont Supreme Court stated in <i>Re Green Mountain Power Corp.</i>, 455 A.2d 823 (1983) that the compelling inference was that the temporary rate provision in the statute was intended to permit the board to deal with a “pressing situation”; the board has interpreted the “pressing situation” standard to be “some financial need that is out of the ordinary and demands immediate correction.”</p>	<p><i>Re Franklin Electric Light Company</i>, 118 PUR4th 267 (1990)</p>
<p>Vermont Public Service Board</p>	<p>The key criteria for determining the financial condition of a utility, in a proceeding to determine the need for temporary rate relief are (1) need for external financing, (2) ability to obtain external financing, (3) level of short term debt, and (4) cash flow.</p>	<p><i>Re Green Mountain Power Corp.</i>, Docket No. 4796 (June 16, 1983)</p>
<p>Virginia Corporation Commission</p>	<p>Where the total amount of increase requested for a “first step” expedited rate increase, would produce additional annual revenue in excess of the consumer price index (CPI) limitation (a commission imposed guideline which limits annual revenues in excess of the CPI), the request is denied.</p>	<p><i>Re Virginia Electric and Power Company</i>, 53 PUR4th 165 (1983)</p>

# **ATTACHMENT B**

## **Summary of Cash Flow Analyses**

Verizon Northwest - Washington Intrastate Operations  
Free Cash over Cash Requirements  
Test Year Ending September 30, 2003  
(Dollars in Thousands)

	A	B	C	Projected
	Charles King Ex. 104	Paula Strain Adjusted Ex. 144 Col. (a)	Paula Strain Unadjusted Ex. 144 Col. (b)	Verizon Response Bch. Req. No. 4
1 Operating Revenue	\$342,470	\$373,894	\$369,937	\$272,750
2 Access Charge Reduction - Ex. 142 col. (e) line 3			(29,219)	
3 Operating Expense	<u>358,286</u>	<u>350,310</u>	<u>349,538</u>	<u>295,088</u>
4 EBIT	Ln 1+2+3	23,584	(8,820)	(22,338)
5 Add Back Depreciation Expense	<u>124,692</u>	<u>124,692</u>	<u>124,692</u>	<u>104,508</u>
6 EBITDA	Ln 4 + 5	108,876	115,872	82,169
7 Fixed Charges/Gross Interest Paid	22,700	25,700	22,700	17,720
8 Capital Additions- Washington	112,428	100,928	100,928	
9 Percent Intrastate	75.5366%	75.5366%	75.5366%	
10 Capital Additions Allocated to Intrastate Ln 8 x Ln 9	84,924	76,238	76,238	55,852
11 Non-operating Cash Commitments Ln 7 + Ln 10	107,624	101,938	98,938	73,572
<b>12 Free Cash over Cash Requirements Ln 6 - Ln 11</b>	<b>\$1,252</b>	<b>\$46,338</b>	<b>\$16,934</b>	<b>\$8,597</b>

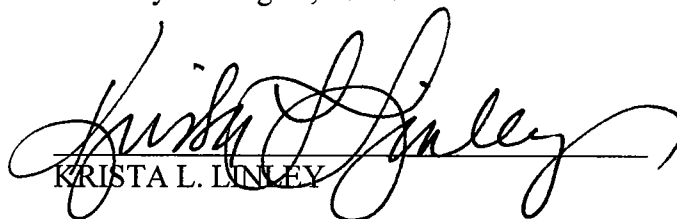
Assumptions used for each Column:

- A. Revenue and Expenses are as adjusted by Heuring (Ex. 22).  
Fixed Charges are increased to include \$2.7 million Capitalized Interest and AFUDC, to reflect Mr. King's correction on the stand (TR 436).  
Capital Additions not reduced for effect of budget reductions (Ex. 83)
- B. Revenue and Expenses include all Heuring and Strain adjustments (Ex. 142, page 1, column (l)).  
Fixed Charges include adjustment for synchronized interest expense (Ex. 144, col. (a)).  
Capital Additions reduced for intrastate portion of budget reductions (Ex. 83).  
Intrastate allocation of capital additions corrected to use Company factor of 75.5366% (TR 587)
- C. Revenue and Expenses are unadjusted (Ex. 142, page 1, column (b), except for access charge reduction).  
Capital Additions reduced for intrastate portion of budget reductions (Ex. 83).  
Intrastate allocation of capital additions corrected to use Company factor of 75.5366% (TR 587)

Docket No. UT-040788  
CERTIFICATE OF SERVICE

I hereby certify that I have this day served the Brief On Behalf Of Commission Staff Regarding Verizon Northwest Inc.'s Request For Interim Rate Relief, upon the persons and entities listed on the Service List below via e-mail and by depositing a copy in the United States mail, addressed as shown on said Service List, with first class postage prepaid.

DATED at Olympia, Washington this 27<sup>th</sup> day of August, 2004.

  
KRISTA L. LINLEY

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