BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Petition of Verizon Northwest Inc. Seeking Interim Rate Increase	))))))	**Docket No. UT-** **PETITION OF VERIZON NORTHWEST INC. SEEKING INTERIM RATE INCREASE**

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I. VERIZON NW'S REQUEST FOR INTERIM RELIEF

1. Pursuant to WAC 480-07-370 and WAC 480-07-395, Verizon NW requests that the Commission approve $29.7 million in interim rate relief, subject to refund, pending a decision in the general rate case. As discussed in the supporting testimony of Verizon NW witness Steven M. Banta, Verizon NW will collect this interim revenue through a surcharge on basic local services of $3.54 per month.

2. In this application for interim relief, Verizon NW is not requesting the *entire* revenue requirement it seeks in its general rate case; instead, Verizon NW is requesting only the amount of revenues that the Commission took away from it in the AT&T Access Complaint Case, Docket No. UT-020406. By limiting its request to $29.7 million[1] – caused by governmental action beyond Verizon NW's control – Verizon believes the Commission can and should approve this application expeditiously. Indeed, the Commission itself acknowledged that Verizon NW's access charges helped contribute to Verizon NW's overall revenue requirement, which must remain "sufficient," and the Commission admitted that its reduction "will cause a considerable reduction in Verizon NW's revenues."[2] In other words, the Commission established Verizon NW's revenue requirement and subsequently slashed it without considering

[1] The Commission's Order in Docket No. UT-020406 calculated a $32 million annual reduction. The $29.7 million requested here is based on the rate reductions ordered in UT-020406 multiplied by the test year units used in Verizon NW's general rate case filing (Oct. 2002 through Sept. 2003).

[2] ***Id***. at 43, para. 144.

the sufficiency of Verizon NW's remaining revenues. Given these unique circumstances – indeed, Verizon NW has not found any reported case that is even remotely similar to this one – interim relief is warranted.[3]

For all these reasons, and for the reasons discussed below, Verizon NW requests that the Commission approve an interim increase of $29.7 million.

II. FACTUAL BASIS WARRANTING INTERIM RELIEF

3. Interim relief is warranted because, as explained in the supporting testimony of Verizon NW witness Nancy W. Heuring filed herewith**,** Verizon NW's current intrastate return is a *negative* 0.47%**.**[4] This return is well below Verizon NW's current authorized rate of return of 9.76%. Furthermore, as explained in the testimony of Verizon NW's expert witness Dr. James H. Vander Weide filed herewith**,** Verizon NW's current financial condition for its intrastate operations in Washington is such that (1) Verizon NW's earnings are insufficient to allow Verizon NW to pay the interest and principal on its debt, (2) Verizon NW's earnings are insufficient to allow Verizon NW to continue to invest in its network in Washington, (3) Verizon NW's key financial ratios indicate a bond rating of BB, which is *below* investment grade, and (4) Verizon NW is not earning a return that is commensurate with a return on other investments of the same risk. Under these circumstances, interim relief is necessary.

III. DISCUSSION

A. <u>The Commission Has the Power to Award Interim Relief</u>

4. The Commission has recognized that interim rate relief "is an appropriate vehicle to avoid the consequences of regulatory lag during the Commission's consideration of the overall

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[3] Also, the Commission invited Verizon NW to file this application for interim relief in response to the $32 million reduction. For example, in opposing Verizon NW's Motion for Supersedeas filed with the superior court, the Commission explained that Verizon NW could "file for an interim increase pending the outcome of a formal rate case." WUTC's Opposition to Verizon's Motion for Supersedeas at 11 (filed September 2, 2003).

[4] Verizon NW's actual current return is a *negative* 3.73%, as explained in Ms. Heuring's testimony that supports Verizon NW's general rate case. For purposes of this interim relief application, Verizon NW eliminated certain adjustments to expedite and simplify this matter. These adjustments, which produce a *negative* 0.47% return, are explained by Ms. Heuring.

financial needs of a utility company in the context of a general rate case."[5] For example, the Commission allowed a pipeline company to increase its intrastate revenues by 24% on an interim basis where the company contended that, without an increase, its anticipated intrastate rate of return would be a negative six percent.[6]

5. The Commission has the power to authorize interim rate relief, subject to refund or other conditions, as a part of its power to regulate the rates of public utilities.[7]

6. The Commission is not bound by any specific criteria for granting interim relief, although the Commission adopted six factors for evaluating such relief in *WUTC v. PNB*, Cause No. U-72-30.[8] These factors are:

- An opportunity for adequate hearing.
- A demonstration that an actual emergency exists or to prevent gross hardship or gross inequity.
- The failure to not earn the authorized rate of return is not sufficient, standing alone, to justify the grant of interim relief.
- Examination of key financial indices.
- Jeopardy to the utility or detriment to ratepayers.
- The relief must be in the public interest.

7. The Commission has made clear that these factors are not "standards" to be mechanically applied, and that not all factors are applicable to all companies.[9] Indeed, under

[5] *WUTC v. Puget Sound Energy, Inc*., Docket Nos. UE-011163 and UE-011170, Sixth Supplemental Order at 9, para. 25 (Oct. __, 2001)

[6] *WUTC v. Olympic Pipeline Co.*, Docket No. TO-011472, Third Supplemental Order at 9, para. 36 (Jan. 31, 2002).

[7] *State ex rel. Puget Sound Navigation Company v. Department of Transportation*, 33 Wn.2d 448, 206 P.2d 456 (1949).

[8] Second Supplemental Order (Oct. 10, 1972). *See also Avista Corporation d/b/a/Avista Utilities, Request Regarding the Recovery of Power Costs Through the Deferral Mechanism*, Docket No. UE-010395 (WUTC Sept. 24, 2001).

[9] *Olympic Pipeline Co.*, Docket No. TO-011472, Third Supplemental Order at 11, n.6.

certain circumstances, the Commission has granted interim relief without applying any of these factors.[10]

8. In addition, the Commission has explained that requests for interim relief are more likely to be granted if made at the same time a general rate case is filed, because they are more likely "to be seen in a proper perspective and less likely to constitute 'single issue' requests whose effect might actually be moderated or exacerbated by other aspects of a company's operation."[11] This request is brought as part of a general rate case.

9. As discussed in the following sections, application of the relevant factors makes clear that interim relief is appropriate.

B. <u>Interim Relief Is Warranted</u>

10. Verizon NW proposes that an evidentiary hearing be held in approximately three months, followed by public hearings. This is adequate time to develop an adequate record, especially since the fundamental issue presented in this case – Verizon NW's earnings – was addressed and briefed in the AT&T access charge complaint case, Docket UT-020406.

11. For example, the attached testimony of Verizon NW witness Nancy Heuring explains that Verizon NW's earnings are well below the level authorized by the Commission. This testimony presents the same type of data that Ms. Heuring provided in the AT&T complaint case. The parties in that case – especially the WUTC Staff – were given the opportunity to review this data and seek discovery on it. In addition, Commission Staff continued to propound discovery on Verizon NW as to its earnings since the hearing in the AT&T complaint case. Thus, unlike a typical application for interim relief, the essential facts supporting Verizon NW's request have already been presented and reviewed**.** No party would be prejudiced by Verizon NW's suggested schedule.

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[10] *WUTC v. Pacific Northwest Bell*, Cause No. U-85-52, Third Supplemental Order (Jan. 10, 1986) (granting interim relief of $13.9 million in part because company's expenses increased due to revised depreciation schedules ordered by the FCC, over which the company had no control). Here, Verizon NW had no control over the $32 million revenue reduction ordered in the AT&T complaint case.

[11] *Puget Sound Energy*, Docket Nos. UE-011163, UE-011170, Sixth Supplemental Order at 10, para. 27.

12. Moreover, the attached testimony persuasively establishes Verizon NW's need for interim relief on an expedited basis. Indeed, Staff counsel stated at a March 7, 2003 hearing before the full Commission in the AT&T complaint case that the type of evidence Verizon NW has provided here is "more information in the record than is required by the WAC in a rate case."[12] This statement was made in response to a question from Commissioner Hemstad as to whether the Commission had before it all the evidence that would be presented in a rate case to determine the reasonableness of a settlement between Staff, AT&T, WorldCom and Verizon NW that raised local residential rates by $2.00 per month.[13] Because Verizon NW's evidence was deemed sufficient to support a *permanent* rate increase, it certainly is sufficient to support an *interim* rate increase that is subject to refund with interest. Verizon NW's complete proposed schedule is attached as Exhibit A.

2. Gross Hardship and Gross Inequity

13. There can be no doubt that Verizon NW is suffering gross financial hardship and gross inequity at the current time and will continue to without interim relief.

14. First, Verizon NW's intrastate rate of return is *negative* 0.47%, which is significantly below its current authorized rate. In short, Verizon NW has no intrastate net operating income, and this fact alone establishes a gross hardship.

15. Second, Verizon NW's situation is unique because the interim relief Verizon NW seeks is intended to replace the permanent revenue loss it suffered as a result of the Commission's decision in the AT&T complaint case. This loss was not due to any management decision or operational result within Verizon NW's control. Rather, the Commission took this revenue away in the AT&T complaint case even though it has repeatedly recognized that ILEC access charges are inextricably linked to an ILEC's overall profits, which must, by law, be fair just and reasonable:

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[12] WUTC Docket No. UT-020406, Tr. 236 (March 7, 2003).

[13] Settlement Stipulation at 4.

> [ILEC's] rates are regulated by the Commission and must be fair, just, reasonable and sufficient. A decrease in access charges will result in either a decrease in their overall profits (which must remain "sufficient") or an offsetting increase in other rates, or some combination of the two.[14]

16. The Commission made the access charge reduction without considering whether Verizon NW's remaining revenues would maintain Verizon NW's financial integrity or provide Verizon NW with the reasonable opportunity to earn its authorized rate of return. Indeed, the Commission itself recognized that the access charge reductions would cause a "considerable reduction" to existing earnings, and it invited Verizon NW to file a rate case and pursue interim relief. Under these circumstances, interim relief must be awarded to avoid gross hardship and gross injustice.[15]

17. As discussed in the testimony of Mr. Banta, the Commission's access charge reduction is significant to Verizon NW. He explains that the $29.7 million revenue reduction equates to: (1) the elimination of 35.3% of the capital investment Verizon NW made in services subject to the WUTC's jurisdiction in 2003; (2) the elimination of 38.7% of the amount Verizon NW spent to maintain and repair the network it used to provide those services; or (3) the elimination of 3.1 months payroll expense for Verizon NW's employees in Washington.[16] These facts plainly demonstrate that Verizon NW has a clear and present extraordinary need for interim rate relief.

3. Verizon NW's Current Earned Rate of Return

18. While the failure to earn the currently authorized rate of return may not be sufficient, standing alone, to justify interim rate relief**,** Verizon NW is not simply **e**arning under

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[14] Docket No. UT-970325, *General Order No*. R-450 at 4.

[15] Also, Verizon NW appears to be treated differently than any other carrier in the context of access charge reductions. For example, Qwest's charges were reduced in the context of a general rate case (Docket No. UT-950200), where the Commission considered the sufficiency of Qwest's overall revenues. Moreover, a recent filing by the WECA companies states that over the past several months Staff has asked the companies to "find ways to lower access charges on a *revenue neutral basis* through increases in other service rates." (*WUTC v. WECA*, Docket No. UT-971140, Petition to Amend the WCAP, at 2 (filed Oct. 13, 2003). It is a gross inequity to single out Verizon for disparate treatment in the context of access charge reductions.

[16] These calculations are based on the test period data included in Verizon NW's general rate case filing. The test period is the twelve months that ended September 30, 2003.

its authorized rate of return by 100 or 200 basis points; rather, Verizon NW's return is a *negative* 0.47%. This Commission cannot allow Verizon NW to have no net operating income. Under these extreme circumstances interim relief is required.

4. Key Financial Indices

19. The Commission often examines key financial indices such as the rate of return, interest coverage, and earnings coverage to assess a company's financial health**.** The Commission recognizes, however, that for companies with multi-jurisdictional operations, the Commission "must look at the intrastate portion of the operations as though it were independent," and in determining rates it considers "only the intrastate revenues and only the intrastate-allocated portion of the company's investment and expenses."[17] This is because the Commission "has no jurisdiction to regulate interstate commerce."[18]

20. Dr. Vander Weide's testimony presents the key financial indices associated with Verizon NW's intrastate operations. He examined the values of three key financial ratios used by Standard & Poor's to assess a company's ability to pay the interest and principal on its debt: (1) EBIT interest coverage; (2) EBITDA interest coverage; and (3) funds from operations ("FFO") to total debt. He concludes, among other things, that (1) Verizon NW's future earnings are insufficient to pay even the interest on its existing debt, and (2) that the financial ratios associated with Verizon NW's Washington intrastate operations would only support a bond rating of BB, which is below investment grade. His analysis confirms that interim relief is necessary.

5. Jeopardy to Utility and Ratepayers

21. As noted above, Verizon NW earnings are not simply just below its authorized return. Adequate cash flows are not available from intrastate operations to continue to render service on a business as usual basis. Verizon NW witness Banta explains that, like any company, if Verizon NW's revenues do not cover its costs, then Verizon NW (1) cannot fund

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[17] *Olympic Pipeline,* Docket No. TO-011472, Third Supplemental Order at 7, para. 27.

[18] *Id.*

planned construction and thus must defer (or forego) capital spending; (2) must restrict spending on maintenance and repair; (3) must eliminate overtime and implement hiring freezes and other cost-cutting measures; and (4) must revise its internal goals of always *exceeding* service quality standards to simply try to meet the absolute *minimum* requirements.

22. The Commission has recognized that interim relief is a necessary, appropriate tool to avoid adverse future financial results and to prevent the types of problems Mr. Banta describes; in fact, the Commission has explained that interim relief should not be withheld until after disaster has struck or is imminent.[19] Here, there is clear evidence of adverse financial results, and absent interim relief this problem will not be resolved until Verizon NW's general rate case could be completed.

6. Relief is in the Public Interest

23. As the Commission has recognized, its "ultimate responsibility" is to "regulate in the public interest."[20] Here, the public interest supports the granting of interim relief because, as explained above, Verizon NW's actual intrastate return is negative, clearly *significantly* below its authorized return; Verizon NW is losing more than $2 million per month due to the AT&T complaint case; the Commission has already been presented with abundant evidence on Verizon NW's revenue needs in the AT&T complaint case; and the public will be protected because the relief Verizon NW seeks is interim relief subject to refund.

IV. EXHIBITS AND TESTIMONY

Attached to this Application are the following exhibits and testimony:

1. Verizon NW's proposed procedural schedule.

2. The testimony of Steven Banta **(**Exhibit No. SMB-2T**)**, which explains the adverse consequences if interim relief is not granted and which describes Verizon NW's proposed rate design for the interim increases.

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[19] *See, e.g.*, *Olympic Pipeline*, Docket No. TO-011472, Third Supplemental Order at 12, para. 45 (quoting the *PNB* case).

[20] *Puget Sound Energy*, Docket Nos. UE-011163, UE-011170, Sixth Supplemental Order at 13, para. 39 (discussing sixth factor).

3. The testimony of Nancy Heuring (Exhibit No. NWH-4T), which sets forth Verizon NW's current intrastate rate of return.

4. The testimony of Dr. James H. Vander Weide (Exhibit No. JHW-4T), which explains how Verizon NW's intrastate financial ratios were calculated and what these ratios show.

V. CONCLUSION

WHEREFORE, Verizon NW requests that the Commission enter an order approving $29.7 million in interim rate relief subject to refund.

Respectfully submitted this 30th day of April 2004.

GRAHAM & DUNN PC

By ________________________________

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