

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,)	Docket No. UT-020406
)	
Complainant,)	VERIZON'S MOTION FOR RECONSIDERATION OF THE NINTH SUPPLEMENTAL ORDER
)	
vs.)	
)	
VERIZON NORTHWEST INC.,)	
)	
Respondent.)	

Introduction

1 Verizon Northwest (Verizon) seeks reconsideration of paragraph 14 of the *Ninth Supplemental Order*. There, the Commission held that the surrebuttal testimony of Nancy Heuring, Dennis B. Trimble and Duane K. Simmons – all of which address Verizon’s regulated earnings – should not be permitted because this testimony “merely discusses earnings and does not address how earnings might be related to costs.”

2 This ruling contradicts the Commission’s previous decision in the *Seventh Supplemental Order* on the relevance and admissibility of Verizon’s "earnings evidence." The "earnings" evidence in question inherently includes evidence of the Company's costs, because "earnings" are simply the difference between revenues and costs. As discussed below, the Commission has never set the level of access charges based solely on the "costs of access service." Rather, the ratemaking and policy issue for the Commission is what portion of the Company's total costs should be recovered by access charges, and what portion should be recovered by the rates for local and other services. Thus, the relevance and admissibility of such evidence is a crucial point in this case, and for this reason Verizon takes the extraordinary step of again seeking reconsideration.

Discussion

3 In paragraphs 24-27 of the *Seventh Supplemental Order*, the Commission specifically addressed the question, “Should the Commission consider earnings testimony or the effect of access charges on Verizon’s overall revenue?” Verizon and Staff said “yes.” AT&T said “no,” and AT&T asked the Commission to strike Verizon’s earnings testimony. The Commission agreed with Verizon and Staff and refused to strike the earnings testimony, recognizing that “access charges may include a contribution to earnings” and expressly holding that “the Commission *will* consider earnings testimony during this hearing.”

4 The surrebuttal testimony of Heuring, Trimble and Simmons address Verizon’s earnings; therefore, under the plain language of the *Seventh Supplemental Order*, such testimony is relevant and, in the words of the *Seventh Supplemental Order*, “will be considered” in this proceeding.

5 Paradoxically, the *Ninth Supplemental Order* states that Verizon’s testimony “merely” addresses earnings and therefore is not relevant. On this point, the *Ninth Supplemental Order* directly conflicts with the *Seventh Supplemental Order*. Put another way, if earnings testimony is relevant, as the Commission expressly held in the *Seventh Supplemental Order*, then testimony that “merely” addresses earnings also must be relevant.

6 This conflict between the two orders appears to stem from the fact that the *Ninth Supplemental Order* adopted Staff’s argument that Verizon failed to show how its surrebuttal testimony on earnings “might be related to costs.”¹ Staff’s argument is demonstrably wrong. First, as Staff itself has acknowledged on several occasions, earnings is a relevant issue in this

¹ *Ninth Supplemental Order* at para. 14.

proceeding and the Commission should consider evidence of Verizon's earnings.² Staff gives no reason for taking the opposite position now.

7 Second, Staff cannot seriously contend that a regulated company's earnings – especially a company subject to rate-of-return regulation – are not related to the regulated company's costs. The indisputable link between a regulated company's earnings and its costs was explained by the Supreme Court of Washington in *POWER v. WUTC*, 711 P.2d 319 (Wa. 1985):

In order to control the aggregate revenue and set maximum rates, regulatory commissions such as the WUTC commonly use and apply the following equation: $R = O + B(r)$

In this equation,

R is the utility's allowed revenue requirements;
O is its operating expenses;
B is its rate base; and
r is the rate of return allowed on its rate base.

[T]his basic equation is the one which has evolved over the past century of public utility regulation in this country and is the one commonly accepted and used.

8 This equation illustrates the simple and well-settled proposition that a regulated company's earnings (revenues) is inextricably linked to its costs, including its rate base, its operating expenses, and its return on its investment. Thus, it is indisputable that all of Verizon's earnings testimony directly relate to the company's actual, regulated costs.

9 Verizon did, in fact, explain this obvious link between its revenues and its costs in its direct testimony. Specifically, Verizon explained that it must have an opportunity to recover the costs it incurs in providing service – which includes a reasonable rate of return on its investment

² Indeed, Staff witness Glenn Blackmon's rebuttal testimony (p. 9) states, "In this case, Staff recommends that the Commission consider all the evidence about Verizon's earnings levels..."

– in the direct testimony of Verizon witness Orville D. Fulp, which referenced the Commission’s own mission statement:

Q. PLEASE DESCRIBE HOW THE COMMISSION HAS REGULATED VERIZON.

A. The Commission has regulated Verizon under rate-of-return regulation to accomplish two things: (1) ensure customers receive quality service at a reasonable price, and (2) ensure Verizon has an opportunity to recover their costs of, and earn a reasonable return on, its reasonable investment. The Commission’s own web page, in the section entitled “What We Do,” makes this very point:

“By law, the Commission must set rates that are fair, just, reasonable, and sufficient. This means that the Commission must balance the interest of customers, in receiving service at the lowest cost against that of investors, who have an opportunity to earn a rate of return on their reasonable investment used in providing service.”

Verizon’s Commission-authorized rate-of-return is 9.76%, and neither the complaint nor AT&T’s and Staff’s testimonies seek to change this.

* * *

Q. WHAT CONCLUSIONS DO YOU DRAW FROM YOUR ANALYSIS AND FROM MS. HEURING’S [EARNINGS] CLACULATIONS?

A. I draw two principal conclusions. First, Verizon’s current access charges are just, reasonable, and compensatory³

¹⁰ Verizon also discussed this fundamental principle in paragraph 3 of its “Reply to Staff’s Petition for Interlocutory Review and Petition for Clarification of the Fifth Supplemental Order,” filed February 26, 2003. There, Verizon once again explained the link between revenues and costs:

³ Direct Testimony of Orville D. Fulp at pp. 4-5, 7.

Verizon agrees with Staff that access charges may be just and reasonable even if they exceed LRIC, and Verizon has filed testimony on this point. For example, Verizon's testimony explains that access charges generate significant contribution that helps Verizon recover its total cost of providing service in Washington. Verizon, however, disagrees with Staff that the *Fifth Supplemental Order* precludes such evidence. Staff's position is based on its assumption that wherever the order speaks of "cost," it means LRIC, and therefore all other costs are irrelevant. Staff expands on this point in paragraph 3 of its Petition for Clarification, where Staff states that the Commission's access charge rule requires that cost be determined on the basis of LRIC. Verizon disagrees. Under the Commission's access charge rule, and under long-standing Commission precedent, access charges recover more than just the LRIC of access. Indeed, the Commission's access charge rule expressly permits -- even requires -- originating access charges to be significantly higher than LRIC, and the Interim Terminating Access Charge is not limited to the LRIC of any access function. Given this, Verizon does not believe the *Fifth Supplemental Order* intended to limit the hearing to address only LRIC. (Verizon also explained this point in its own Motion for Clarification, which was filed electronically on January 24.) Accordingly, all testimony relating to Verizon's earnings and its total cost of providing service in Washington (i.e., Verizon's revenue requirement) is relevant and should be allowed in this phase of the proceeding.

As noted above, the Commission in its *Seventh Supplemental Order* agreed with Verizon and refused to strike the company's earnings evidence.⁴

11 In sum, Verizon has explained the link between earnings and costs in its testimony and its pleadings, and the Commission acknowledged this link by allowing in Verizon's earnings testimony. Therefore, *all* of Verizon's earnings testimony -- including the surrebuttal testimony of Heuring, Trimble and Simmons -- is relevant and admissible.

12 Finally, the *Ninth Supplemental Order* must be reconsidered because it leads to illogical results. The surrebuttal testimony of Heuring, Trimble and Simmons responds to the rebuttal

⁴ For this reason, Verizon did not believe it was necessary to repeat its arguments on the link between revenues and costs in its Motion for Clarification or Reconsideration of the *Seventh Supplemental Order*.

testimony of Staff witness Erdhal. If Verizon's *surrebuttal* testimony is not relevant because it does not address "costs," then the Staff *rebuttal* testimony to which it responds also must not be relevant and should be stricken. The *Ninth Supplement Order* could not have intended such a result.

13 For all these reasons, Verizon requests that the Commission grant this motion and allow Verizon to submit the surrebuttal testimony of Heuring, Trimble and Simmons.⁵

Respectfully submitted,

Verizon Northwest Inc.

By _____
Judith A. Endejan
Graham & Dunn PC
1420 Fifth Avenue, 33rd Floor
Seattle, WA 98101
206-340-9694
Fax: 206-340-9599

By _____
Charles H. Carrathers, III
Vice President and General Counsel
Verizon
P.O. Box 152092
HQE02H20
Irving, TX 75015-2092
972-718-2415
Fax: 972-718-3926

Dated this 25th day of April 2003.

⁵ Given that all of Verizon's earnings surrebuttal testimony is relevant, the only ground for striking it is if it did not respond to issues raised by Staff or AT&T in their rebuttal testimony. This is not the case. As Verizon explained in its Motion for Clarification or Reconsideration of the *Seventh Supplemental Order*, the surrebuttal testimony of Heuring, Trimble and Simmons respond to issues raised for the first time in the other parties' rebuttal testimony.