BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION, Complainant, v. VERIZON NORTHWEST INC., Respondent.	Docket No. UT-040788 SUPPLEMENTAL RESPONSE OF VERIZON NORTHWEST INC. TO MOTION TO COMPEL PRODUCTIONS OF DOCUMENTS RELATING TO HAWAII SALE

I. INTRODUCTION

At the hearing on the Motion to Compel filed by Commission Staff on September 23, 2004, ALJ Wallis asked Verizon Northwest Inc. ("VZNW") to address the issue of whether the documents relating to the sale of various operations ultimately owned by Verizon Communications Inc. in the state of Hawaii (Staff's "Item C") are relevant to the issues in this case, based upon the testimony of Dennis B. Trimble (DBT-1T), Michael Doane (MJD-1T), and Exhibit 70 (admitted in the interim rate case hearings in this docket). For the reasons stated herein, the Hawaii sale documents have no relevancy to any issue in this case.[1]

[1] Verizon submits this supplemental brief only to address the narrow issue raised by ALJ Wallis' request. In addition to being irrelevant, the documents relating to the Hawaii sale are simply beyond the jurisdiction of this Commission for the reasons stated in VZNW's Response filed on September 22, 2004. Under *Waste Management of Seattle v. The Utilities and Transportation Commission*, 123 Wn.2d 621, 869 P.2d 1034 (1994), the Commission cannot compel VZNW to

II. THE THEORY OF "RELEVANCY" ARGUED BY STAFF/PUBLIC COUNSEL

Verizon understands that Staff and Public Counsel allege that the Hawaii sales documentation is somehow relevant to "the valuation of directory operations which is an issue in this case. This information may lead to relevant information to the extent it contains any evaluation of the value of the directory operations to the telecommunications operations." (Staff Motion to Compel, p. 9). At the hearing on the Motion to Compel, Staff further explained its theory, arguing that the value of a directory business is maximized if sold as part of a bundle that includes regulated local telephone operations. Staff speculates that the market more highly values a directory operations that is affiliated with a regulated local telephone company. Public Counsel also argued that somehow the Hawaii sale documents should be examined because they may be inconsistent with the Company's expressed "imputation policy" as set forth in Exhibit 70 admitted during the interim rate proceedings.

As explained below, first, Staff and Public Counsel are wrong in their characterization of the relevant issues in this case. Second, even assuming for the sake of argument that their theories of relevancy have merit, which they do not, none of the Hawaii sale documents will prove or disprove such theories.

III. A DESCRIPTION OF THE HAWAII SALE

The sale of the included Hawaii assets owned by Verizon Communications Inc. is complex. A helpful overview of the transaction can be drawn from the Application on file with the Hawaii Public Utilities Commission for approval of the merger transaction.[2] The Application (Attachment A) describes the $1.65 billion transaction, which will involve the transfer of all of

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produce its affiliates' financial records relating to the sale of unrelated Verizon Hawaii operations.

[2] Attached hereto is the Application in Docket No. 04-0140 downloaded from the Hawaii Commission's website. Some attachments to the Application are filed under Protective Order and are not publicly available and could not be provided. Verizon downloaded and printed what was available on the Website, with the exception of Exhibits B and D to Exhibit 1 and Exhibits 4, 5 and 6. These were not included due to volume, but can be obtained from the Hawaii PUC Website.

the assets of Verizon Hawaii Inc. (the Hawaii local exchange operations) and all of the Hawaii assets of Bell Atlantic Communications, Inc., dba Verizon Long Distance ("VLD") and Verizon Select Services Inc. ("VSS"). These entities are owned entirely by GTE Corporation, a New York corporation, which is not regulated by the Hawaii PUC. In turn, GTE Corporation is owned by Verizon Communications Inc. Paradise Merger Inc. is the purchaser.

Exhibit 2 to the Application describes in a nutshell how the merger transaction is to occur. The assets of three distinct entities, Verizon Hawaii Inc., Verizon Asset Co., and GTE Hawaii Intel Insurance Company Incorporated will be transferred to Verizon Hold Co. LLC, which in turn will merge with the purchasing entity, Paradise Merger, Inc. The sale of certain non-regulated assets, including directories assets, GTE.net LLC, Verizon Network Integration Corp. and GTE Communications Systems Corporation are addressed in footnote 18 of the Application. These entities will contribute certain assets directly or indirectly to Verizon Asset Co.

The $1.65 billion base purchase price is a total price, with no individual value ascribed to any piece of this complicated transaction. As the Application clearly demonstrates, nothing about the Hawaii sale relates to, or includes, any assets of VZNW. Requiring the production of documents relating to this complex merger transaction, based upon a fishing expedition is simply unwarranted.

IV. VZNW HAS NOT RAISED DIRECTORY VALUATION AS AN ISSUE

As a threshold matter, it is critical to understand that VZNW has not raised the issue of directory valuation; it has only raised the issue of the continued propriety of directory imputation as a matter of law and regulatory and economic policy.

Public Counsel's interpretation of Exhibit 70 is incorrect. This document does not reflect any general corporate policy with respect to directory imputation. It is simply a document that discusses how local operating companies are to deal with the regulatory issues associated with changing from a Master Publishing Agreement to fee for service contracts. This four year old document notes on page 1, "In states where we are required to impute, the imputation will

continue to occur." This statement does not mean that going forward VZNW was foreclosed from challenging another parties' proposal in a general rate case to apply old imputation practices to contemporary circumstances, which is what the testimony of Dennis Trimble and Michael Doane does.

Mr. Trimble's testimony does not raise the issue of the value associated with any directory operations, let alone VZNW's. He states his purpose as explaining why "VDC (Verizon Directories Corp.) earnings should not be imputed to Verizon Northwest." (Ex. DBT-1T, p. 3). He testifies that:

- The VZNW-VDC contractual arrangements are consistent with affiliate interest guidelines and provide for reasonable and prudent revenue flows between the affiliated companies;
- Imputation should not occur on the basis that ratepayers funded the development of VDC, because that is factually not the case for VZNW;
- He describes the yellow imputation process and explains why such imputation is bad public policy;
- He describes the imputation calculation process, which is based upon the directory affiliate's earnings or revenues within the state (Ex. DBT-1T, p. 6).

Mr. Trimble does not testify to any valuation of VDC's directory operations in Washington. He does not testify to any nexus, or lack thereof, between any such value and the practice of revenue imputation. He does not testify about any theory that the value of a directory operation is maximized if sold in a bundle that includes regulated local telephone operations.

Mr. Doane does not testify to any of these topics either. Mr. Doane's testimony comments on the economic issues raised by the practice of imputing revenues generated by the unregulated publishing business of VDC to VZNW for rate-making purposes. (Ex. MJD-1T, p. 3). A major focus of his testimony is an examination of the competitive market in which VDC operates vis-à-vis other directories and other local advertising outlets. He concludes that there is

no economic basis for imputing "excess directory earnings in rate-making proceedings to offset the cost of Verizon Northwest's local telephone service."

In sum, while VZNW has raised as an issue the continuing practice of directory imputation, VZNW's witnesses have not submitted any testimony on what is an entirely separate question posed by Staff – directory valuations for purposes of sale.

V. THE HAWAII SALE IS IRRELEVANT TO THE WASHINGTON RATE CASE

WAC 480-07-400(4) limits permissible data requests to information that is "relevant to the issues in the adjudicative proceeding or that may lead to the production of information that is relevant." This rule does not define "relevant evidence." Evidence Rule 401 defines relevant evidence as "evidence having any tendency to make the existence of any fact that is of consequence to the determination of the action more probable or less probable without the evidence." The definition encompasses two concepts -- probative value and what is often referred to as "materiality." "Thus, evidence is not relevant unless, (1) it has a tendency to prove or disprove a fact, and (2) that fact is of consequence in the context of the other facts and the applicable substantive law." Tegland, 5 Wash. Practice, Evidence, Section 401.2 (4th Ed.).

Documents relating to the sale of Verizon's Hawaii operations have no tendency to prove or disprove any fact of consequence to this rate case for the following reasons: First, there is no question that the documents at issue do not belong to VZNW; they do not relate to any VZNW operations and do not relate to any Washington State operations of Verizon Directories Corporation. As such, they would have no tendency to prove or disprove any fact that is of relevance to this Washington State rate case. Second, there is no connection between the issue of the continued viability of the practice of directory revenue imputation and the sale of directory operations as part of the sale of certain of a corporation's operations in a different state. Simply put, there is no nexus between an aggregate sale price, that includes a directories operation, and the revenue imputation process in Washington, which is based on the directory affiliate's earnings. (Ex. DBT-1T, p. 6). Valuation of a directories business in Hawaii for sale purposes,

assuming *argeundo* that one exists, which it does not, has no relationship at all to the extent of the Washington directory affiliate's earnings.[3]

Furthermore, the information Staff speculates it might find in the Hawaii sale documents could not *prove* anything with respect to the Washington directory revenue imputation issue. First, it is impossible to draw the foregoing conclusion in this case because, as noted, the Hawaii sales price is an aggregate figure that includes many assets and was set up by the purchaser. There is simply no way to separate out in this complicated transaction any independent "added value" that may inure to the ILEC due to an association with a directories company. Second, there is no way to ascertain if the sales price reflects in any manner added value to the directories company due to its association with a regulated local telephone company. In this case, the fact that directory operations are sold as a part of an overall asset sale of various entities does not prove that its value is enhanced by the bundled sale of the local telephone operation. It is equally as, or more, plausible that the buyer placed more value on the non-directory assets included in the sale (i.e., VLD, VSS, GTE Hawaii Intel Insurance Company, GTE.net LLC, Verizon Network Integration Corp. or GTE Communications Systems Corporation).[4]

Finally, the Hawaii sale deals with a different state, with different market characteristics and a different history of operations. Even if an independent economic value could be derived (which cannot be done), this fact is immaterial because it is based upon Hawaii-specific conditions. There simply is no relevancy between the Hawaii sale documents and Washington State's specific issues and practices.

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[3] Verizon did not value the Directories business for purposes of the sale nor did Paradise assign a value to the Directories business in making its offer. *See* Chamberlain Declaration filed on September 22, 2004.

[4] Furthermore, documents relating to the Hawaii sale are not probative of any "company-wide" practice with respect to imputation as argued by Public Counsel at hearing. It is illogical to conclude, as Public Counsel suggests, that the fact that Verizon is selling its Hawaii directory assets in conjunction with its Hawaii Telco means anything in connection with a revenue imputation practice.

VI. CONCLUSION

Leaving aside the jurisdictional issues, Staff cannot prove the relevancy of Hawaii sale documents to a Washington rate case proceeding. Discovery into the Hawaii sale truly is nothing but the proverbial fishing expedition that will lead to nothing that is probative on the issue of the continued practice of directory revenue imputation in Washington.

DATED this 28th day of September 2004.

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