Exhibit T-___ (BAE-RT)
Docket No. UT-020406
Witness: Betty A. Erdahl

BEFORE THE
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.,	)	**DOCKET NO. UT-020406**
Complainant,	)	
v.	)	
VERIZON NORTHWEST INC.	)	
Respondent.	)	

REBUTTAL TESTIMONY OF

Betty A. Erdahl

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

February 7, 2003

Q. Please state your name and business address.

A. My name is Betty A. Erdahl, and my business address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington 98504. My business e-mail address is berdahl@wutc.wa.gov

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as a Regulatory Analyst - Telecommunications.

Q. What are your education and experience qualifications?

A. I graduated from Washington State University with a Bachelor of Arts in Accounting, December 1988. I worked as a Subsidiary Accountant at Pacific First Bank for two years and have worked at the Commission as an analyst since June 1991. While employed at the Commission, I have attended the New Mexico State University class on the Basics of Regulation and the Rate Making Process Technical Program, and the USTA class on Understanding Separations, Access Charges, and Settlements. As a Regulatory Analyst, I am responsible for auditing the books and records of regulated companies, analyzing cost of service studies, examining affiliated interest transactions, and making policy recommendations to this Commission. In addition, I recommend rates to the Commission that allow for the appropriate revenue requirement, prepare exhibits and testimony regarding these investigations for presentation before the Commission. I also have worked on policy issues relating to payphone deregulation, number resources, local calling areas, and implementation of 911 pursuant to the Telecommunications Act of 1996.

Q. Have you previously filed testimony in this proceeding?

A. No.

Q. What is the purpose of your testimony at this time?

A. The purpose of my testimony is to rebut the December 3, 2002, testimony of Verizon witness Nancy W. Heuring. My testimony explains why Staff believes Verizon's presentation of its earnings is flawed and should not be relied upon for setting rates in Washington State.

Q. What are Commission Staff's main concerns regarding Ms. Heuring's testimony?

A. Staff does not agree with Ms. Heuring's presentation of Verizon's financial situation. Importantly, Verizon has not filed documentation required by WAC 480-09-330 to support a general rate case. When calculating Verizon's rate of return, Ms. Heuring fails to make adjustments for ratemaking. Thus, she significantly understates the company's achieved return. If its return is as low as Ms. Heuring contends, Staff questions why Verizon hasn't filed for a general rate increase irrespective of this case now that it is relieved from the merger settlement conditions.

Q. What adjustments did Ms. Heuring omit when determining Verizon's intrastate rate of return?

A. First, Ms. Heuring mentions but fails to include the effect of Verizon Information Services (directory) imputation to the Washington intrastate jurisdiction. Second, Ms. Heuring's results of operations show a very low rate of return for intrastate, which leads Staff to the question of jurisdictional separations and why the interstate return is so high. Third, she did not include an adjustment for line sharing per WUTC Docket No. UT-003013 Part "A." Fourth, large fluctuations occur in October expenses and November revenue during 2001 that seem to be related to the reintegration of Verizon Advanced Data Inc. ("VADI"). Finally, Staff made an adjustment to directory assistance (DA) revenue. DA is a competitively classified service, which allows for pricing flexibility. Verizon's current DA price is below the going rate other carriers charge. The company did not make an adjustment to increase its DA rate, but had it done so, this adjustment would have increased revenue received on a pro forma basis.

Q. Is Staff advocating any specific adjustments to Verizon's results of operations in this case?

A. No, because this is not a rate case. Staff has made some very high-level adjustments in order to rebut Verizon's claim that it is under earning and that the Commission must allow the company to increase its general rates if the Commission orders a reduction to Verizon's access charges.

Q. Did Staff prepare a summary of Verizon's results of operations including Staff adjustments?

A. Yes, it is provided as Exhibit C-_____(BAE-1C). It begins with the total regulated booked amounts provided in Ms. Heuring's Exhibit NWH-2, Page 2 of 3. Column (f) labeled Interstate equals total regulated (col. e) less Intrastate (col. g), columns (h) though (l) show the effect of the adjustments discussed below, and finally, column (m) is the restated total intrastate results of operations for Verizon.

Q. Did you include an adjustment for the imputation of directory revenue?

A. Yes, it is included on Exhibit C_____(BAE-1C) in column (l), line 27 in thousands. This adjustment was calculated by the company in its response to WUTC Data Request No. 57. I have included the data request response as Exhibit C _______(BAE-2C). Page 2, line 14 shows the adjustment to net operating income in millions.

Q. Please address the downward trend in intrastate earnings as discussed by Ms. Heuring on page 5, lines 6-12 of her direct testimony?

A. Verizon submits annual reports to the Federal Communications Commission (FCC). These reports show that from 1998 to 2001, Verizon's intrastate revenues decreased while the investment and expenses Verizon allocated to intrastate increased. During the same time, Verizon's interstate expenses and investment increased, but at a much smaller rate than the growth in interstate revenues. This emphasizes the fact that while more expenses and investment are booked to intrastate, Verizon channels the revenues to interstate.

Q. Why would the expenses and investment allocated to intrastate increase while the revenue for intrastate either deceases or increases at a slower rate?

A. It is unclear, but it seems that Verizon's jurisdictional allocation process is flawed. While Part 36 is an outline of the separations procedure, 47 CFR 36.1 (h) states, "The separations procedures described in this part [36] are not to be interpreted as indicating what … should or should not be considered in any investigation or rate proceeding." This section of the rule clearly states that Part 36 is a starting point for the allocation process. The freeze of allocation factors relating to Internet minutes of use is an example of the need to adjust current allocations.

Verizon does not measure dial-up minutes of use. More and more minutes of use are Internet-related and therefore interstate according to FCC rulings, while the expenses and investment continue to be booked to the intrastate jurisdiction. This is one example of the effects of the jurisdictional separations mismatch, there may be other unidentified issues that would be disclosed in a general rate case. It is unfair to saddle intrastate ratepayers with the expenses and investment while the interstate jurisdiction enjoys the effects of increased returns.

Q. What adjustment does Staff make to correct the mismatch of revenue, expense, and investment?

A. In Exhibit C_______(BAE-1C), column (k), Staff calculated the additional interstate expense and investment that would have resulted had these amounts kept pace with the changes in interstate revenues during the period from 1998 to 2001. These additional amounts were subtracted from the intrastate results and added to the interstate results. It is worth noting that, even with this adjustment, Verizon's Washington interstate rate of return is still well above its Washington intrastate rate of return.

Q. Did Verizon make an adjustment for line sharing?

A. No. According to Verizon's response to WUTC Data Request No. 65, line sharing revenues were not booked for Verizon Washington in 2001. Staff included the company response as Exhibit _____(BAE-3C).

Q. Please explain Staff's line sharing adjustment.

A. Staff is using 2001 as a test year and made a line sharing adjustment of $4.00 to reclassify some of the revenue on each xDSL line for the portion of the loop that is used for high-speed access. The $4.00 adjustment made by Staff and established by the Commission in Docket No. UT-003013 Part "A"[1] would reclaim some of the revenue that correctly should be classified as intrastate.

This adjustment is in column (j) of Exhibit _____(BAE-1C). Staff calculated this by multiplying the number of in-service DSL lines as of September 2002, provided in Verizon Response to WUTC Staff Data Request No. 64, by $4.00 times 12 months. This adjustment may be conservative given 2002 line count shows an increase in DSL lines. Verizon's response to WUTC Staff Data Request No. 64 is provided as Exhibit_______(BAE-4C).

Q. What accounting adjustment did Staff make to expenses and revenues during 2001?

A. In October, expenses were higher than normal and in November intrastate access revenue was lower than normal. It seems that these variances relate to the reintegration of VADI. Staff made an adjustment shown in column (i) of Exhibit C_____(BAE-1C) to adjust these expenses and revenues for the months of October and November to be more representative of the other months during the year.

[1] *See* Part A, 13th Supplemental Order, 26 & 31; *see also* Part A, 23rd Supplemental Order, 3-5.

Q. Please address the decline in revenue due to uncollectible accounts receivables from other carriers in 2002?

A. The large level of uncollectibles experienced by Verizon is not typical. It was due to the WorldCom bankruptcy. At this time, it is unknown how much money Verizon will receive from WorldCom once the bankruptcy is settled. Once that amount is determined, it may be reasonable to amortize the lost revenue over some reasonable period of time. Although this is a cost of doing business in the access market, Staff is not convinced that this cost should be the burden of local ratepayers. Any recovery of these losses should be through access charges. Verizon had the opportunity to mitigate this loss by exercising its rights afforded by *former* WAC 480-120-057, which authorized Verizon to collect deposits from interexchange carriers.

Q. Do you agree with Ms. Heuring's reference to merger transition costs and savings?

A. No, I do not agree with Ms. Heuring's discussion (page 5, lines 14-21) of merger costs and savings. The costs of the merger should not be included in expenses for setting rates. The costs were taken into consideration in the merger settlement at which time the company agreed to not increase rates for two years.

On the other hand, since the merger savings will be experienced annually, they should be included when determining rates. It is inappropriate to further decrease the return to reflect the merger transition costs.

Q. Why is it incomplete to look only back to Verizon's last rate case order for appropriate ratemaking adjustments?

A. To do this ignores Commission decisions made in more recent rate cases and fails to address more current issues such as the jurisdictional separations relating to Internet usage v. allocation of costs, line sharing adjustment, competitively classified services such as DA, and uncollectibles from other carriers. While Ms. Heuring mentions an imputation for VIS-Directory, she does not include it in Exhibit NWH-2.

Q. What is wrong with the 2002 pro forma financials?

A. The company's suggested test period is based on the first nine months of 2002, which presents several problems. There are high levels of uncollectibles included in the numbers and lower revenues than may otherwise reasonably be expected for a normal test period. These items may be known, but Verizon has not shown them to be measurable by the company in this proceeding.

Q. What is wrong with Ms. Heuring's depreciation adjustment based on Dr. Vander Wiede's rate of return analysis?

A. If Verizon would like to file a depreciation case, it should do so. In 1996 Verizon filed a depreciation case that was rejected by the Commission in WUTC Docket No. UT-961632[2]. Verizon's simple assertion that depreciation lives are too long does not give the Commission any evidence that would support a change to the current approved depreciation lives. Until Verizon files and adequately supports a depreciation case, it is only reasonable to use the current Commission-approved depreciation rates. The same applies to rate of return.

Q. Is Staff advocating that the Commission take action regarding Verizon's earnings in this proceeding?

A. No. However, Staff strongly disagrees with the earnings analysis advocated by Ms. Heuring in her testimony.

Q. What is Staff's reaction to Verizon's earnings analysis in this proceeding?

A. Staff believes Verizon's earnings are well above its current authorized return of 9.76 percent. Staff bases this opinion on monthly reports and quarterly reports

[2] Fourth Supplemental Order Denying Petition; Ordering Other Accounting Changes.

Verizon filed at the Commission, the testimony and exhibits the company filed in this case, the material obtained through discovery, and Staff's adjustments. This is a high level analysis, which could vary and more adjustments necessarily would be included if Verizon were to file a general rate case. As shown on Exhibit C_____(BAE-1C), Verizon is earning an 11.57 percent return. According to this analysis, the company could absorb a 24.5 million dollar rate decrease.

Q. Do you believe Verizon should file a general rate case?

A. No. However, I do recognize that the company's perspective may be different than mine. Given the company's perspective, it may very well wish to file a general rate case in order to justify its testimony in this case. Verizon should follow the Commission's rules and comply with them through a separate rate case if it feels that it is presently underearning. To the extent AT&T's complaint against Verizon results in lower access charge revenues, Staff would expect to see Verizon propose a pro forma adjustment to reflect such known and measurable adjustments to its results of operations, in that proceeding. Additionally, if Verizon chooses to file a general rate case it must also comply with the Commission's customer notice rules as well.

Q. Does this conclude your rebuttal testimony?

A. Yes it does.