

Agenda Date: May 12, 2004

Item Numbers: A1

Docket: UT-040788

Company: Verizon Northwest Inc.

Staff: Kathy Folsom, Regulatory Analyst

Recommendations:

1. Issue a complaint and order suspending interim tariff revisions as filed by Verizon Northwest Inc. in Docket No. UT-040788.
2. Set the general rate case filing for hearing and defer to the hearing process issues of: whether or not to grant the requested waivers; whether the filing is sufficient; whether additional notice to customers should be required; and other issues raised by the Petition of Verizon Northwest Inc. for an Order Approving Commencement of Bifurcated General Rate Case and Waiver of WAC 480-07-510(2).

Overview:

This docket reflects a very complex filing by Verizon Northwest Inc. (Verizon NW or Company). It is called a general rate case, but it is filed without general rate case tariffs; it includes a request for interim rate relief; and it has the potential for three separate rate changes: 1) interim rate change; 2) an “updating” of interim rates based on the Commission’s determination of revenue requirement; and 3) permanent rate changes at the conclusion of the docket. Refunds could flow to customers based on these rate changes. The only tariffs filed by the Company are for interim rate relief. No tariffs have been filed for either “updating” of interim rates or the general rate case.

Verizon NW requested that this filing be placed before the Commission at this open meeting. Staff has accommodated the Company’s request. However, Staff has discovered several areas where the Company’s filing is incomplete. Several required waivers and documents are missing. These items are described in detail below.

Discussion:

On April 30, 2004, Verizon NW filed a petition for an Order Approving Commencement of Bifurcated General Rate Case and Waiver of WAC 480-07-510(2). The Company did not include tariff changes to reflect the revenue requirement it is seeking to prove in its general rate case filing. Instead, Verizon NW wishes to defer the issue of final rate design until the Commission has made its determination of the Company’s overall revenue requirement. The Company states that it needs additional annual revenues of

\$239.5 million. This represents a 69.7 percent increase in its annual revenue. Additionally, Verizon NW asks the Commission to waive certain rules regarding what is to be contained in a general rate case filing.

Verizon NW also submitted a petition for interim rate relief. The Company proposes to implement an interim surcharge of \$3.54 per month on residential and business customers' line rates to recover \$29.7 million in annual revenue, subject to refund, pending a Commission's final decision in Verizon NW's general rate case. The interim rate relief petition was accompanied by tariff revisions reflecting the interim rate surcharge.

The proposed general rate case and the petitions for rule waivers and for interim rate relief present numerous issues to be resolved. Verizon NW's (then GTE Northwest) last general rate case was Docket No. U-82-45/U-82-48, with a rate order in August of 1983. Subsequent to this order, the Company merged with Contel of the Northwest (Docket No. UT-910499) and then with Bell Atlantic Corporation (Docket No. UT-981367).

Verizon NW's General Rate Increase and Petition for Rule Waiver Request

The Company, in testimony filed with the case, asserts that the proposed changes in Verizon's revenue requirement are explained by several factors. These factors include:

- A request to set rates based on a hypothetical equity ratio of 75 percent and a request that the Commission grant the Company a 13.95 percent return on common equity.
- A reduction in intrastate access charges resulting from the AT&T Access Charge Complaint Case (Docket No. UT-020406).
- An alleged reduction in access lines and minutes-of-use.
- Alleged reductions in revenues the Company agreed to implement in its GTE-Bell Atlantic Merger Settlement Agreement
- An alleged increase in plant investment.
- An alleged increase in depreciation expense.
- An alleged decline in directory revenues.

As noted earlier, Verizon NW's permanent rate relief filing is not accompanied by any proposed tariff revisions. Instead, the Company proposes that the Commission permit the Company to "bifurcate" the case so that the Company will not propose a final rate design until the Commission establishes Verizon NW's permanent revenue requirement. Therefore, Verizon is seeking a waiver of WAC 480-07-510(2) that requires the filing of tariff sheets in a general rate proceeding.

Staff counsel has advised that while RCW 80.04.130 and 80.36.110 contemplate tariff filings accompanying a utility's proposal to change rates, those statutes give the Commission some discretion in that regard. No Commission statute explicitly authorizes

or prevents a utility from filing a petition to establish a revenue requirement without filing tariff changes that reflect that requested revenue requirement. Presumably, if no tariff change is filed, the ten-month suspension period in RCW 80.04.130 does not apply. Indeed, the Company's proposed rate case schedule contemplates a final order of the Commission for the revenue requirement phase by March 2005 and a final order of the Commission for the rate design phase by September 2005. This is approximately 17 months after the date the Company filed its case.

The Company has proposed a schedule that contemplates a very quick start to the proceeding, including this open meeting. Staff has tried to accommodate Verizon NW's request, but our review is not complete as a result. Nonetheless, Staff has identified specific instances where the rule waiver petition is incomplete: Verizon NW has neither complied with nor requested exemption from WAC 480-07-510(4)(d) or WAC 480-07-510(4)(e) and Verizon NW has not filed various workpapers and documents (see attachment) that are required by WAC 480-07-510. Staff anticipates working with the Company to ensure compliance with the rules.

For these reasons, Staff recommends that consideration of the issues raised by the Petition of Verizon Northwest Inc., for an Order Approving Commencement of Bifurcated General Rate Case and Waiver of WAC 480-07-510(2) be deferred to the hearing process. The petition for the bifurcation of the general rate case into two phases – revenue requirement and then rate design- should be analyzed in a hearing so that all parties can participate in discussions regarding the propriety of that process, scheduling and other potential issues. The Company's rule waiver request (assuming its petition is supplemented to include all relevant waivers) should also be deferred to the hearing process in order to get all interested parties' participation and allow for full review, comment and recommendations.

Verizon NW's Petition for Interim Relief

In this petition, Verizon NW proposes a surcharge of \$3.54 per month for basic residential and business local services be implemented, subject to refund. This represents an additional \$29.7 million in overall annual revenue.

If approved, this would increase residential line rates by 24 percent and business line rates by 5 percent. The requested effective date is July 21, 2004.

Staff has just begun its analysis of this petition, but many challenging issues have been identified, including whether there is a need for interim relief, and if so, the level of interim relief, and the appropriate rate design. In addition, the interim rate tariff sheets the Company filed: 1) do not include language explicitly stating that the surcharge is subject to refund, as requested in Verizon NW's petition; 2) do not condition the surcharge to the Commission's final order in the general rate case; and 3) do not state that the refund, if any, will include interest calculated at the fair rate of return determined in the general rate case. Each of these deficiencies must be corrected.

Customer Notice

The Company has provided adequate notice to customers of the proposed interim rate request by indicating that a surcharge of \$3.54 per month for residential and business line rates is proposed, in order to recover the \$29.7 million in annual revenue Verizon NW is requesting.

However, Verizon NW's notice is not adequate to inform customers of the Company's "updating" of interim rates resulting from a revenue requirement determination, nor is it adequate to notify customers of the potential increases to rates implicit in the Company's general rate case filing. Customers will not understand how the Company's requested increase in overall revenues might affect future rates. For instance, Verizon NW's own news release announcing the filing did not include any specific statement about the amount of the general rate case increase.

Verizon NW states it is preferable to identify its rate design only after a revenue requirement is determined. However, while it is helpful to know the revenue requirement before designing rates, to Staff's knowledge, every other rate case filed with the Commission has been accompanied by initial tariffs, and this has not posed a problem. Moreover, Staff is concerned that customers may delay participation until they know the permanent rate design, but by then it may be too late to challenge the underlying revenue need that rate design is required to address. To the best extent practical, customers should be notified at the earliest date of the potential impact on the rates they pay.

There is no obvious reason the Company cannot give a proper notice. Verizon NW's interim case testimony makes the Company's position clear that only business and residential line rates can be increased to cover alleged revenue deficiencies. The Company testifies that this is the "most equitable approach since it covers the largest portion of the customer base." While rate design is a contested issue in every rate case, at this point, Verizon NW should provide additional notice to customers explaining the full impact of its revenue increase request by dollar amount and percentage increase, by customer class.

Staff believes that customer notice as well as the other issues previously identified should be deferred to the hearing process so that all parties can participate in discussions and allow for full review, comment and recommendations.

Conclusion:

There are many issues to be resolved with this filing. Therefore, Staff recommends that the Commission:

1. Issue a complaint and order suspending interim tariff revisions as filed by Verizon Northwest Inc. in Docket No. UT-040788.

2. Set the general rate case filing for hearing and defer to the hearing process issues of: whether or not to grant the requested waivers; whether the filing is sufficient; whether additional notice to customers should be required; and other issues raised by the Petition of Verizon Northwest Inc. for an Order Approving Commencement of Bifurcated General Rate Case and Waiver of WAC 480-07-510(2).