

ATTACHMENT A

RECEIVED
SEP 17 2004
GRAHAM & DUNN

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

DOCKET NO. UT-040788

MOTION TO COMPEL
PRODUCTION OF DOCUMENTS
AND/OR INFORMATION

1 This Motion is filed on behalf of Commission Staff. Staff seeks the relief
described in ¶¶ 36, 37, and 38 below.

2 This Motion places into issue no particular Commission rules or statutes.

3 This Motion asks the Commission to order Verizon Northwest Inc. ("Verizon
NW") to produce documents and/or information necessary for Staff to adequately
evaluate the Company's results of operations in this rate case. There are three data
requests at issue.

FACTS AND ARGUMENT

4 For the Commission's convenience, below we separately discuss each item.
The facts regarding each data request item are provided, followed by argument
relating to each item.

A. Board Minutes for Verizon Communications

Facts Related to Item A

5 Verizon Communications owns 95.25% of GTE Corporation, which owns all
of Verizon NW. Verizon Communications provides overall corporate governance
and direction for Verizon NW. Accordingly, Verizon NW is subject to the policies
established by Verizon Communications.

6 Commission Staff personnel Paula Strain and Betty Erdahl went to Verizon
NW's corporate offices located in Irving, Texas, for purposes of conducting an audit
of Verizon NW's books and records, and other relevant documents. Ms. Strain was
present there from September 6 to 11. Ms Erdahl was there from September 8 to 11.

7 Prior to embarking on the trip, Ms. Strain sent Verizon NW an e-mail listing
the documents Staff wished to review. It was Staff's understanding that Verizon
NW would only permit Staff to have access to certain of these documents on-site.

8 One item on the list was the minutes from the Board of Director meetings
held by the Board of Directors of Verizon NW's parent, Verizon Communications.

Another item was the minutes of the Audit and Finance Committee of the Board.

See Attachment 1, e-mails from Paula Strain to Gregg Diamond, et al., dated August 2, August 18, and August 27, 2004; and from Gregg Diamond to Paula Strain, dated August 17, 2004.

9 At no time prior to Staff's trip to Texas did Verizon NW inform Staff that the Company would refuse Staff full access to these documents.

10 After Staff arrived in Texas, Verizon NW refused Staff any access whatsoever to any Board of Director minutes of Verizon Communications. Verizon NW permitted limited access to the minutes of the Verizon Communications Audit and Finance Committee of the Board, redacting certain items.

11 Counsel for the Commission contacted Verizon NW's counsel by e-mail and telephone. By e-mail dated September 9, 2004, Verizon NW's counsel stated the Board minutes would not be produced for inspection. Counsel for the Commission, by e-mail dated September 9, 2004, then asked for the basis for redaction of the Board Audit and Finance Committee minutes,¹ and asked Verizon NW to clarify whether it was the Company's position that the Verizon Communications Board did not set policy for Verizon NW.

¹ The September 9, 2004, e-mail (in Attachment 2) asking Verizon for the basis for redaction incorrectly referred to "VNW minutes," it should have said Verizon Communications Audit and Finance Committee minutes. In any event, Verizon's September 14, 2004, e-mail response, also in Attachment 2, indicated that the basis was provided verbally by Mr. Diamond to Ms. Strain. Staff is seeking that this verbal communication of information be provided in writing.

12 On September 14, 2004, Verizon NW's counsel responded by e-mail, stating that Ms. Strain was told the basis for redacting, and reiterated that the Board minutes would not be provided. Verizon NW did not respond to the question whether it was the Company's position that the Verizon Communications Board did not set policy for Verizon NW. *See Attachment 2, September 9, 2004, e-mail from Donald T. Trotter to Judith Endejan, and June 14, 2004, e-mail from Judith Endejan to Donald T. Trotter.*

Argument Related to Item A

13 The Commission should order Verizon NW to produce the Verizon Communications Board minutes, and to state the specific basis for each redaction of the Board committee minutes.²

14 These documents are relevant, or are likely to lead to relevant evidence. Verizon Communications owns virtually all of Verizon NW and provides overall corporate governance and direction for Verizon NW. *See, Exhibit ___ (NWH-1T, Direct Testimony of Nancy W. Heuring, at 37 ll. 14-19.* Verizon Communications sets the policies of Verizon NW with respect to, for example, financing, income tax returns, pensions, employee compensation including employee incentive plans,

² While reviewing the Audit and Finance Committee minutes, Staff learned that the Verizon Communications Board of Directors also had a Management Audit Committee that was separate from the Audit and Finance Committee. Staff asked to review the Management Audit Committee minutes, and Verizon NW has agreed to provide access to those minutes at its offices in Olympia, but has indicated they will be provided in redacted form. The Commission should require the Company to provide a specific description of the basis for redaction of these minutes as well.

stock-based compensation plans and workforce reductions. *See Attachment 3, Verizon NW's, Response to Staff Data Request 207a, Verizon Northwest Inc. Financial Statements, esp. Footnotes 1, 2, 8, and 9, at pages 8, 11, 15 and 15, respectively.*

15 Reviewing just the minutes of Verizon NW's Board is insufficient to determine what the policies are and how the policies are implemented for Washington operations. Indeed, based on the on-site review performed by Paula Strain, Verizon NW's board minutes contain little more than the authorization of agreements with affiliates, adopting of policies and contracts developed by other Verizon entities, and dividend payments to its parent. *See Attachment 4, Declaration of Paula M. Strain.*

16 Reviewing Board of Director minutes is a standard audit function. The Rate Case and Audit Manual prepared by the NARUC Staff Subcommittee on Accounting and Finance (2003) contemplates review of minutes of Board of Directors' meetings, both for the utility and for the utility's parent company. *See Attachment 5, NARUC Rate Case and Audit Manual (2003), pp 7, 14, 35, 38.* The review of the parent company's board minutes is especially important when, as here, the parent company provides direction and policy for the regulated utility.

17 The minutes of the Verizon Communications Board of Directors for the period January 1, 2002 to date should be produced.

B. Data Request No. 418: Year End Journal Entries for Verizon NW

Facts Related to Item B

18 On August 27, 2004, Commission Staff requested a list of year-end journal entries for 2002 and 2003. *See Attachment 1, e-mail from Paula Strain to Gregg Diamond, dated August 27, 2004.* Like the previous data request item described in Part II.A of this motion, this information was to be reviewed on site in Texas during Staff's audit.

19 On September 7, 2004, in Texas, Commission Staff was provided a list of year-end journal entries for Verizon NW Inc. for 2002 and 2003 and selected certain journal entries from the list for on-site review. However, Verizon NW provided only partial year-end journal entries; the Company redacted figures from other jurisdictions, and other Verizon companies affected by the journal entries.

20 Staff later issued Data Request No. 418, seeking this information on a more formal basis. Staff does not anticipate the answer will be any different.

Attachment 6 is a copy of Staff Data Request No. 418.

Argument Related to Item B

21 The total journal entry information requested, un-redacted, is necessary for Staff to review how, and the extent to which total journal entry figures became Verizon NW Washington figures.

22 For example, assume there was an entry for \$1 million in expense to Verizon Northwest – Washington operations in the test year results of operations. If Staff is unable to review the entire journal entry, and follow the allocation of the total journal entry amount to the Washington level, Staff cannot assess the reasonableness of the allocation method used or the overall magnitude of the adjustment.

23 Accordingly, the Commission should order Verizon NW to provide the year-end journal entries, un-redacted.

C. Data Request No. 277: Hawaii Sale Documents

Facts Related to Item C

24 On June 9, 2004, Commission Staff issued Staff Data Request No. 277, seeking all documents related to a sale of Verizon's telephone operations in the state of Hawaii, including the Directory business. *See Attachment 7, Staff Data Request No. 277.*

25 On June 22, 2004, Verizon NW objected to the request, and did not produce any of the documents requested. *See Attachment 8, and Verizon NW's June 22, 2004 response to Staff Data Request No. 277.*

26 Discussions ensued. Commission Counsel sent a follow-up e-mail dated July 21, 2004, to which the Company responded by a July 23, 2004 e-mail, asking whether the request could be refined. Staff endeavored to refine the request, and

did so via an e-mail sent the same day: July 23, 2004. The Company sent an e-mail July 27, 2004, indicating it was looking into the matter. *See Attachment 9 for these three e-mails.*

27 The refined Staff Data Request No. 277 solicited by the Company asked the Company to produce only those documents covered by Staff Data Request No. 277 that mention the directory business, and to simply list all of the other documents responsive to the original data request. Verizon NW did not promptly respond.

28 On August 17, 2004, Commission Counsel sent an e-mail to Verizon NW's counsel, asking for the documents. *See Attachment 10, the August 17, 2004 e-mail from Commission Counsel to Verizon NW's counsel.* That evening, during the public hearing in Everett, Verizon NW's counsel stated to Commission Counsel that some documents would be forthcoming.

29 Once again, the promised documents were not forthcoming.

30 On September 3, 2004, following yet another round of correspondence by Commission Counsel, once again following up on this item, Verizon NW finally provided two documents: 1) a "portion" of an internal management presentation, and 2) certain "reporting information" Verizon NW says was provided to all potential buyers. *See Attachment 10, Verizon's September 3, 2004 response (the documents provided were designated confidential; they are not included for that reason. The cover sheets to the documents are provided, and the response identifies the documents).*

31 The two documents the Company provided are not the only documents responsive to Data Request No. 277, as originally written, or as refined at the Company's request. No list of the documents responsive to Data Request No. 277 was provided, as specifically requested in the refined request.

32 In its September 3, 2004, response, the Company for the first time objected to responding to the refined data request, because it would be "burdensome and onerous" to review each document to determine whether it would be responsive. The Company did not indicate the number of documents involved nor did it quantify the burden alleged. *See Attachment 11 at 1.*

Argument on Item C

33 The Company should be ordered to provide all documents described in the July 23, 2004, e-mail, on page 7 of Attachment 8, including the list of responsive documents not provided. This information is directly 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.

34 Verizon NW's September 3, 2004, objections (*Attachment 11 at 1*) are untimely because the request was issued June 8, 2004. The objections are also disingenuous, because the burden the Company alleges is caused by a refinement to the data request the Company itself solicited.

35 It should not take months of continuous Staff efforts to get the Company to produce extant documents that are plainly relevant to this case. In the alternative, to eliminate the burden Verizon NW alleges, the Company should simply produce all documents responsive to Staff Data Request No. 277 as originally stated.

RELIEF SOUGHT

36 The Commission should order Verizon NW to produce for review by Commission Staff the minutes of the Verizon Communications Board of Directors for the period January 1, 2002 to date. The review can, at the Company's election, be at Company offices in Olympia, and Staff will review and take notes, but will not copy. Staff will reserve the right to request specific minutes be produced for copying, however. The Commission should also order Verizon NW to state in writing the specific basis for redaction of any Board Audit and Finance Committee minutes that were provided for review, and any Management Audit Committee minutes that are provided in redacted form.

37 The Commission should order Verizon NW to produce the 2002 and 2003 year-end journal entries for Verizon NW Inc. without redaction.

//

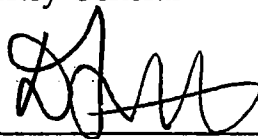
//

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The Commission should order Verizon NW to provide the documents requested in Staff Data Request No. 277, either as originally requested, or as modified, with the list requested in that modification.

DATED this 15th day of August 2004.

CHRISTINE O. GREGOIRE
Attorney General



DONALD T. TROTTER
Senior Counsel
Washington Utilities and
Transportation Commission

ATTACHMENT 1

E-mails from Paula Strain to Gregg Diamond, et al. dated August 2, 18, and 27, 2004, and e-mail from Gregg Diamond to Paula Strain dated August 17, 2004



Paula Strain/WUTC
08/02/2004 12:08 PM

To "Gregg Diamond" <gregg.diamond@verizon.com>
cc Kathy Folsom/WUTC@WUTC, Don Trotter/WUTC@WUTC

bcc

Subject Records that we would like to review in WA

Gregg, to follow up on our phone call from few minutes ago, we would like to have in-state access, either electronic or hard copy (but preferably electronic to start with), to the following items, as contemplated in our statute RCW 80.04.100:


1. Audit committee minutes
2. Board of Director minutes
3. Audit report and supporting workpapers for Ernst & Young audits of FCC 43-03 ARMIS Joint Cost Report for 2002 and 2003 for Verizon NW (I understand that their workpapers don't belong to your company).
4. External audit workpapers prepared by Ernst & Young for their 2002 and 2003 opinions on financial statements for Verizon NW.

We would also like to explore the possibility of being able to review (read-only access) accounting entries and subsidiary accounting records on-line as an alternative to requesting paper copies of trial balances and account detail.

Thanks for your consideration.

Regards,


Paula Strain
Telecom Policy Analyst
360-664-1278



Kathy Folsom/WUTC
09/14/2004 10:51 AM

To Paula Strain/WUTC@WUTC
cc
bcc
Subject Fw: ACCESS TO VZ ACCOUNTING RECORDS

— Forwarded by Kathy Folsom/WUTC on 09/14/2004 10:51 AM —




Kathy Folsom/WUTC
09/08/2004 11:49 AM

To Don Trotter/WUTC
cc
Subject Fw: ACCESS TO VZ ACCOUNTING RECORDS

Prior e-mail from Paula to Gregg Diamond regarding board minutes for other Verizon entities.

— Forwarded by Kathy Folsom/WUTC on 09/08/2004 11:47 AM —



Paula Strain/WUTC
08/18/2004 03:28 PM

To gregg.diamond@verizon.com
cc Kathy Folsom/WUTC@WUTC, Don Trotter/WUTC@WUTC
Subject Re: ACCESS TO VZ ACCOUNTING RECORDS

Thanks Gregg. I've attached my original Email because as to board and audit committee minutes, we were not prescriptive about them being only Verizon NW's minutes. We will also want to review audit committee and board minutes for entities of Verizon Corporation that affect Verizon NW also, e.g., decisions made about Verizon West, Verizon TOCs, etc. I don't know what those corporate levels are so I'm relying on you to let me know. Thanks.

Regards,

Paula Strain
Telecom Policy Analyst
360-664-1278

Gregg, to follow up on our phone call from few minutes ago, we would like to have in-state access, either electronic or hard copy (but preferably electronic to start with), to the following items, as contemplated in our statute RCW 80.04.100:

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We would also like to explore the possibility of being able to review (read-only access) accounting entries and subsidiary accounting records on-line as an alternative to requesting paper copies of trial balances and account detail.

Thanks for your consideration.

Regards,

Paula Strain
Telecom Policy Analyst
360-664-1278



Paula Strain/WUTC
08/27/2004 05:31 PM

To "Gregg Diamond" <gregg.diamond@verizon.com>
cc Kathy Folsom/WUTC@WUTC, Betty Erdahl/WUTC@WUTC,
Tim Zawislak/WUTC@WUTC
bcc

Subject PARTIAL list of things to review in Texas.

Hi Gregg, I'm calling this partial because I don't want to foreclose the possibility of working on items that aren't listed here, for example items in EY audit workpapers the company decides they don't want to allow EY to provide us. So here's a list to start with:

1. An explanation or walkthrough of the process, subsidiary records, etc. that result in plant items getting booked to Verizon NW Washington's plant accounts. I would like to see this for the two largest projects added during the test year in the following accounts: 2212, 2232, 2423.1, and 2121. I would also like to have a list of all the additions in those accounts by identifiable designation (name and workorder number probably) and dollar amount booked to the account.
2. OPEB, Pension and other employee benefit items - walk through with appropriate person (Nancy, Will, whoever) to discuss the adjustments proposed.
3. Time with someone who does your part 36 separations work to talk about when direct assignment is used vs. allocations.
4. Time with someone who can give us some further explanation on the restating adjustments, and answer followup questions. (this could probably also be done on another call on 9/1 through 9/3 if that would be preferable).
5. Year-end Journal Entries, 12/31/02 and 12/31/03.
6. We would also like to review, or have available for reference, the following:
 - a. Monthly Trial Balances for test year - Washington and NW (available)
 - b. Risk Committee Minutes and Documentation, January 2002 - present.
 - c. Audit committee meeting minutes, January 2002 - present.
 - d. Board of Director minutes for V-NW and parent, from January 2002 - present

Gregg, I hope this gives you something to go on. I'll be back in the office Wednesday and we can talk then. I felt the work at E&Y was productive and I want to thank you for setting it up for us to do that in Seattle. We really appreciate it.

Regards,

Paula Strain
Telecom Policy Analyst
360-664-1278

Paula Strain/WUTC

08/18/2004 03:28 PM

To
gregg.diamond@verizon.com
cc
Kathy Folsom/WUTC@WUTC, Don Trotter/WUTC@WUTC
Subject
Re: ACCESS TO VZ ACCOUNTING RECORDS

Thanks Gregg. I've attached my original Email because as to board and audit committee minutes, we were not prescriptive about them being only Verizon NW's minutes. We will also want to review audit committee and board minutes for entities of Verizon Corporation that affect Verizon NW also, e.g., decisions made about Verizon West, Verizon TOCs, etc. I don't know what those corporate levels are so I'm relying on you to let me know. Thanks.

Regards,

Paula Strain
Telecom Policy Analyst
360-664-1278

Gregg, to follow up on our phone call from few minutes ago, we would like to have in-state access, either electronic or hard copy (but preferably electronic to start with), to the following items, as contemplated in our statute RCW 80.04.100:

1. Audit committee minutes
2. Board of Director minutes
3. Audit report and supporting workpapers for Ernst & Young audits of FCC 43-03 ARMIS Joint Cost Report for 2002 and 2003 for Verizon NW (I understand that their workpapers don't belong to your company).
4. External audit workpapers prepared by Ernst & Young for their 2002 and 2003 opinions on financial statements for Verizon NW.

We would also like to explore the possibility of being able to review (read-only access) accounting entries and subsidiary accounting records on-line as an alternative to requesting paper copies of trial balances and account detail.

Thanks for your consideration.

Regards,

Paula Strain
Telecom Policy Analyst
360-664-1278



gregg.diamond@verizon.com
08/17/2004 04:07 PM

To pstrain@wutc.wa.gov
cc gregg.diamond@verizon.com

bcc

Subject ACCESS TO VZ ACCOUNTING RECORDS

Paula:

Here is our formal response to your questions regarding access to Verizon NW accounting records. Our financial people were in meetings all day, I will try to get back with you tomorrow regarding the timing of your trip to Irving.

1. Audit committee minutes

There are no VZ NW audit committee minutes.

2. Board of Director minutes

The VZ NW Board of Director minutes would be available for your review when you come to Irving.

3. Audit report and supporting workpapers for Ernst & Young audits of FCC

43-03 ARMIS Joint Cost Report for 2002 and 2003 for Verizon NW (I understand that their workpapers don't belong to your company).

We are currently checking to see if there are specific VZ NW workpapers. To the extent there are, we will make them available for your review in the Ernst & Young office in Seattle (see below).

4. External audit workpapers prepared by Ernst & Young for their 2002 and 2003 opinions on financial statements for Verizon NW.

Workpapers as set forth in the consent letters from Ernst & Young will be made available for your review in the E&Y office in Seattle. We expect they will become available in about a week. We will work with you to set up an appointment.

We would also like to explore the possibility of being able to review (read-only access) accounting entries and subsidiary accounting records on-line as an alternative to requesting paper copies of trial balances and account detail.

For security reasons, we do not allow outside parties access to our

financial systems. However, we are committed to expediting your requests for quick turnaround and will provide responses electronically to the extent possible.

Gregg Diamond
Regulatory Policy & Planning
(972) 718-3504
(972) 719-7948 (fax)

ATTACHMENT 2

**E-mail from Donald T. Trotter to Judith
Endejan dated September 9, 2004, and
e-mail from Judith Endejan to Donald T.
Trotter dated September 14, 2004**



<JEndejan@GrahamDunn.com>
 09/14/2004 09:22 AM

To <DTrotter@wutc.wa.gov>
 <chuck.carrathers@verizon.com>,
 cc <gregg.diamond@verizon.com>,
 <tom.parker@verizon.com>
 bcc
 Subject RE: more on minutes

Don, I am sorry that I did not get back to you immediately on this. I was wrapped up in another emergency. AS I understand it, Gregg orally explained to Paula Strain last week the basis for the redaction of the VZNW minutes. And, as to your second question, we are saying that the Board Minutes of Verizon Corporation are not relevant to Verizon NW.

Finally, could we nail down the details of Nancy Heuring's deposition, i.e. time, place etc.? Also, you said that you would be providing an issues/questions list to us for Ms. Heuring's deposition. The sooner we could have that, the better, if at all possible to allow Ms. Heuring to prepare. She will be unable to due so later in the month because of another commitment that precluded her from being available until the first week in October.

Thank you so much!
 Judy Endejan

-----Original Message-----

From: Don Trotter [mailto:DTrotter@wutc.wa.gov]
 Sent: Thursday, September 09, 2004 10:03 AM
 To: Endejan, Judith A.
 Cc: chuck.carrathers@verizon.com; gregg.diamond@verizon.com;
 tom.parker@verizon.com
 Subject: RE: more on minutes

Thanks for responding promptly.

1. We still need the basis for the redaction of the VNW minutes.
2. Are you saying that what the board at VC does is "not relevant to the utility?"

DTT

<JEndejan@GrahamDunn.com>

09/09/2004 09:26 AM

To <DTrotter@wutc.wa.gov>
 cc <chuck.carrathers@verizon.com>,
 <tom.parker@verizon.com>,
 <gregg.diamond@verizon.com>
 Subject RE: more on minutes

Don, We have looked at this manual and think that it applies only to the "utility"--not the parent corporation. I have been directed by my client to tell you that Verizon will not make available to Staff the minutes of the Board of Director's meetings for Verizon Communications, the parent corporation. It has provided all minutes relevant to the utility. I will be in Olympia this afternoon at the Commission with Chuck Carrathers if you want to discuss this further. Thank you. Judy Endejan

-----Original Message-----

From: Don Trotter [mailto:DTrotter@wutc.wa.gov]
Sent: Wednesday, September 08, 2004 3:59 PM
To: Endejan, Judith A.
Subject: more on minutes

In talking to Paula Strain and other staff accountants, reviewing board minutes is routine

I have also been told it is a standard step listed in the NARUC Accounting Committee audit manual for auditing utilities.

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If you believe that it has been sent to you in error, do not read it.
Please reply to the sender that you have received the message in error, and then delete it.
Thank you.

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Thank you.

ATTACHMENT 3

**Verizon NW's response to Staff Data
Request No. 207a, Verizon NW Inc.
Financial Statements**

Verizon Response to WUTC Staff Data Request No. 207
UT-040788

Attachment 207a

Verizon Northwest Inc.

**Financial Statements
As of December 31, 2003 and 2002
and for the years then ended**

Verizon Northwest Inc.
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Verizon Northwest Inc.

REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Shareowner
Verizon Northwest Inc.

We have audited the accompanying consolidated balance sheets of Verizon Northwest Inc. (the Company) as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareowner's investment, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Verizon Northwest Inc. at December 31, 2003 and 2002, and the consolidated results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 2 to the consolidated financial statements, Verizon Northwest Inc. changed its method of accounting for asset retirement obligations effective January 1, 2003.

Ernst + Young LLP

New York, New York

January 29, 2004

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF INCOME
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
OPERATING REVENUES	<u>\$1,163.3</u>	<u>\$1,201.0</u>
OPERATING EXPENSES		
Cost of services and sales (exclusive of items shown below)	344.6	319.7
Selling, general and administrative expense	420.7	315.6
Depreciation expense	237.4	249.0
TOTAL OPERATING EXPENSES	<u>1,002.7</u>	<u>884.3</u>
OPERATING INCOME	160.6	316.7
OTHER INCOME AND (EXPENSE), NET	1.1	.4
INTEREST EXPENSE	<u>(39.3)</u>	<u>(44.6)</u>
INCOME BEFORE PROVISION FOR INCOME TAXES AND CUMULATIVE EFFECT OF ACCOUNTING CHANGE	122.4	272.5
PROVISION FOR INCOME TAXES	<u>(44.6)</u>	<u>(98.2)</u>
INCOME BEFORE CUMULATIVE EFFECT OF ACCOUNTING CHANGE	77.8	174.3
CUMULATIVE EFFECT OF ACCOUNTING CHANGE, NET OF TAX	<u>71.2</u>	<u>—</u>
NET INCOME	<u>\$ 149.0</u>	<u>\$ 174.3</u>

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

ASSETS

	December 31	
	2003	2002
CURRENT ASSETS		
Short-term investments	\$ 41.1	\$ 33.9
Note receivable from affiliate	13.9	—
Accounts receivable:		
Trade and other, net of allowances for uncollectibles of \$33.3 and \$44.9	152.9	163.0
Affiliates	16.0	20.3
Material and supplies	14.1	11.0
Prepaid expenses	9.1	3.3
Deferred income taxes	2.1	7.3
Other	25.0	25.9
Total current assets	<u>274.2</u>	<u>264.7</u>
PLANT, PROPERTY AND EQUIPMENT	4,214.9	4,148.0
Less accumulated depreciation	<u>2,614.3</u>	<u>2,600.2</u>
	1,600.6	1,547.8
PREPAID PENSION ASSET	285.3	319.0
OTHER ASSETS	44.7	54.4
TOTAL ASSETS	<u>\$2,204.8</u>	<u>\$2,185.9</u>

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED BALANCE SHEETS
(Dollars in Millions)

LIABILITIES AND SHAREOWNER'S INVESTMENT

	December 31	
	2003	2002
CURRENT LIABILITIES		
Debt maturing within one year:		
Notes payable to affiliates	\$ 240.5	\$ 229.3
Other	.9	.9
Accounts payable and accrued liabilities:		
Affiliates	102.1	80.9
Other	92.4	87.5
Other current liabilities	90.7	77.8
Total current liabilities	526.6	476.4
LONG-TERM DEBT	563.4	563.8
EMPLOYEE BENEFIT OBLIGATIONS	87.4	72.8
DEFERRED CREDITS AND OTHER LIABILITIES		
Deferred income taxes	305.8	263.6
Other	42.8	57.7
	348.6	321.3
SHAREOWNER'S INVESTMENT		
Common stock (one share, without par value)	448.0	448.0
Contributed capital	165.8	165.8
Reinvested earnings	65.0	137.8
Total shareowner's investment	678.8	751.6
TOTAL LIABILITIES AND SHAREOWNER'S INVESTMENT	\$2,204.8	\$2,185.9

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREOWNER'S INVESTMENT
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
COMMON STOCK		
Balance at beginning of year	\$448.0	\$448.0
Balance at end of year	<u>448.0</u>	<u>448.0</u>
CONTRIBUTED CAPITAL		
Balance at beginning of year	165.8	155.9
Capital contribution from parent	—	9.9
Balance at end of year	<u>165.8</u>	<u>165.8</u>
REINVESTED EARNINGS		
Balance at beginning of year	137.8	98.5
Net income	149.0	174.3
Dividends declared	<u>(221.8)</u>	<u>(135.0)</u>
Balance at end of year	<u>65.0</u>	<u>137.8</u>
TOTAL SHAREOWNER'S INVESTMENT	<u>\$678.8</u>	<u>\$751.6</u>

See Notes to Consolidated Financial Statements.

Verizon Northwest Inc.

CONSOLIDATED STATEMENTS OF CASH FLOWS
For the Years Ended December 31
(Dollars in Millions)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Income before cumulative effect of accounting change	\$ 77.8	\$ 174.3
Adjustments to reconcile income before cumulative effect of accounting change to net cash provided by operating activities:		
Depreciation	237.4	249.0
Deferred income taxes, net	6.1	28.6
Employee retirement benefits	65.8	(8.4)
Provision for uncollectible accounts	5.2	46.2
Changes in current assets and liabilities:		
Accounts receivable	9.2	(4.6)
Material and supplies	(3.1)	4.9
Other current assets	(4.9)	2.5
Accounts payable and accrued liabilities	26.1	(44.9)
Other current liabilities	12.9	(1.9)
Other, net	(21.2)	(20.3)
Net cash provided by operating activities	<u>411.3</u>	<u>425.4</u>
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures (including capitalized network software)	(178.7)	(232.5)
Purchases of short-term investments	(41.1)	(33.9)
Proceeds from sale of short-term investments	33.9	34.2
Investment in unconsolidated business	—	(9.7)
Net change in note receivable from affiliate	(13.9)	—
Other, net	—	(2)
Net cash used in investing activities	<u>(199.8)</u>	<u>(242.1)</u>
CASH FLOWS FROM FINANCING ACTIVITIES		
Principal repayments of borrowings and capital lease obligations	(9)	(9)
Net change in notes payable to affiliates	11.2	(57.4)
Dividends paid	(221.8)	(135.0)
Capital contribution from parent	—	9.9
Net cash used in financing activities	<u>(211.5)</u>	<u>(183.4)</u>
NET CHANGE IN CASH	<u>—</u>	<u>(.1)</u>
CASH, BEGINNING OF YEAR	<u>—</u>	<u>.1</u>
CASH, END OF YEAR	<u>\$ —</u>	<u>\$ —</u>

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business

Verizon Northwest Inc. is a wholly owned subsidiary of GTE Corporation (GTE), which is a wholly owned subsidiary of Verizon Communications Inc. (Verizon). We presently serve a territory consisting of Local Access and Transport Areas (LATAs) located in California, Idaho, Oregon and Washington. We have one reportable segment which provides domestic wireline telecommunications services. We currently provide two basic types of telecommunications services:

- *Exchange telecommunication service* is the transmission of telecommunications among customers located within a local calling area within a LATA. Examples of exchange telecommunications services include switched local residential and business services, local private line voice and data services and Centrex services. We also provide toll services within a LATA (intraLATA long distance).
- *Exchange access service* links a customer's premises and the transmission facilities of other telecommunications carriers, generally interLATA carriers. Examples of exchange access services include switched access and special access services.

The communications services we provide are subject to regulation by the state regulatory commissions of California, Idaho, Oregon and Washington with respect to intrastate rates and services and other matters. The Federal Communications Commission (FCC) regulates rates that we charge long distance carriers and end-user subscribers for interstate access services.

Basis of Presentation

We prepare our financial statements using generally accepted accounting principles which require management to make estimates and assumptions that affect reported amounts and disclosures. Actual results could differ from those estimates. Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangibles and other long-lived assets, valuation allowances on tax assets and pension and postretirement benefit assumptions.

The consolidated financial statements include the accounts of Verizon Northwest Inc. and its wholly owned subsidiary, Verizon West Coast Inc. All significant intercompany accounts and transactions have been eliminated.

We held an investment in Verizon Ventures III Inc. (Ventures III), an affiliated company which provided new exchange access services through a separate subsidiary, and was accounted for using the equity method of accounting. At December 31, 2003 and 2002, we had no investment in Ventures III (see Note 11).

We have reclassified certain amounts from prior periods to conform with our current presentation.

Revenue Recognition

We recognize service revenues based upon usage of our local exchange network and facilities and contract fees. In general, fixed fees for local telephone, long distance and certain other services are billed one month in advance and recognized the following month when earned. Revenue from other products that are not fixed fee or that exceed contracted amounts is recognized when such services are provided.

We recognize revenue for services, in which we bundle the equipment with maintenance and monitoring services, when the equipment is installed in accordance with contractual specifications and ready for the customer's use. The maintenance and monitoring services are recognized monthly over the term of the contract as we provide the services. Long-term contracts are accounted for using the percentage of completion method. We use the completed contract method if we cannot estimate the costs with a reasonable degree of reliability.

Customer activation fees, along with the related costs up to, but not exceeding the activation fees, are deferred and amortized over the customer relationship period.

Verizon Northwest Inc.

Maintenance and Repairs

We charge the cost of maintenance and repairs, including the cost of replacing minor items not constituting substantial betterments, primarily to Cost of Services and Sales as these costs are incurred.

Cash and Cash Equivalents

We consider all highly liquid investments with a maturity of 90 days or less when purchased to be cash equivalents, except cash equivalents held as short-term investments. Cash equivalents are stated at cost, which approximates market value.

Short-term Investments

Our short-term investments consist of cash equivalents held in trust to pay for certain employee benefits. Short-term investments are stated at cost, which approximates market value.

Material and Supplies

We include in inventory new and reusable materials which are stated principally at average original cost, except that specific costs are used in the case of large individual items.

Plant and Depreciation

We record plant, property, and equipment at cost. Depreciation expense is principally based on the composite group remaining life method and straight-line composite rates. This method provides for the recognition of the cost of the remaining net investment in telephone plant, less anticipated net salvage value (if any), over the remaining asset lives. This method requires the periodic revision of depreciation rates. We used the following asset lives:

<u>Average Lives (in years)</u>	
Buildings	25 - 35
Central office equipment	5 - 12
Outside communications plant	16 - 50
Furniture, vehicles and other	3 - 15

When we replace or retire depreciable telephone plant, we deduct the carrying amount of such plant from the respective accounts and charge it to accumulated depreciation. (See "Accounting Changes - Asset Retirement Obligations" below.)

We capitalize network software purchased or developed in connection with related plant assets. We also capitalize interest associated with the acquisition or construction of plant assets. Capitalized interest is reported as a cost of plant and a reduction in interest cost.

Impairment of Long-Lived Assets

Our plant, property, and equipment are reviewed for impairment in accordance with Statement of Financial Accounting Standards (SFAS) No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets," which we adopted effective January 1, 2002. Under SFAS No. 144, these assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable. An impairment charge is recognized for the amount (if any) by which the carrying value of the asset exceeds its fair value.

Computer Software Costs

We capitalize the cost of internal-use network software which has a useful life in excess of one year in accordance with Statement of Position (SOP) No. 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." Subsequent additions, modifications or upgrades to internal-use software are capitalized only to the extent that they allow the software to perform a task it previously did not perform. Software maintenance and training costs are expensed in the period in which they are incurred.

Verizon Northwest Inc.

Goodwill and Other Intangible Assets

Effective January 1, 2002, we adopted SFAS No. 142, "Goodwill and Other Intangible Assets." SFAS No. 142 no longer permits the amortization of goodwill and indefinite-lived intangible assets. Instead, these assets must be reviewed annually (or more frequently under prescribed conditions) for impairment in accordance with this statement. Intangible assets that do not have indefinite lives are amortized over their useful lives. The adoption of SFAS No. 142 did not impact our results of operations or financial position because we had no goodwill or indefinite-lived intangible assets at December 31, 2003 and 2002.

Advertising Costs

We expense advertising costs as they are incurred.

Stock-Based Compensation

We participate in employee compensation plans sponsored by Verizon with awards of Verizon common stock.

Prior to 2003, Verizon accounted for stock-based employee compensation under Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations, and followed the disclosure-only provisions of SFAS No. 123, "Accounting for Stock-Based Compensation."

Effective January 1, 2003, Verizon adopted the fair value recognition provisions of SFAS No. 123, using the prospective method (as permitted under SFAS No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure") to all new awards granted, modified or settled after January 1, 2003. Under the prospective method, employee compensation expense in the first year will be recognized for new awards granted, modified, or settled. The options generally vest over a term of three years; therefore the expenses related to stock-based employee compensation included in the determination of net income for 2003 are less than what would have been recorded if the fair value method was also applied to previously issued awards (see Note 2 for additional information on the impact of adopting SFAS No. 123).

Employee Benefit Plans

We participate in the Verizon benefit plans. Under these plans, pension and postretirement health care and life insurance benefits earned during the year as well as interest on projected benefit obligations are accrued currently. Prior service costs and credits resulting from changes in plan benefits are amortized over the average remaining service period of the employees expected to receive benefits.

Income Taxes

Verizon and its domestic subsidiaries, including us, file a consolidated federal income tax return.

Current and deferred tax expense is determined by applying the provisions of SFAS No. 109, "Accounting for Income Taxes" to each subsidiary as if it were a separate taxpayer.

Derivative Instruments

We employ risk management strategies to manage our exposure to fluctuations in interest rates. We do not hold derivatives for trading purposes.

In accordance with SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities" and related amendments and interpretations, we measure all derivatives, including derivatives embedded in other financial instruments, at fair value and recognize them as either assets or liabilities on our balance sheets. Changes in the fair values of derivative instruments not qualifying as hedges or any ineffective portion of hedges are recognized in earnings in the current period. Changes in the fair values of derivative instruments used effectively as fair value hedges are recognized in earnings, along with changes in the fair value of the hedged item. Changes in the fair value of the effective portions of cash flow hedges are reported in other comprehensive income (loss), and recognized in earnings when the hedged item is recognized in earnings.

Verizon Northwest Inc.

Comprehensive Income

We had no comprehensive income components for the years ended December 31, 2003 and 2002. Therefore, comprehensive income is the same as net income for both years.

2. ACCOUNTING CHANGES

Stock-Based Compensation

We participate in employee compensation plans sponsored by Verizon with awards of Verizon common stock. As discussed in Note 1, we adopted the fair value recognition provisions of SFAS No. 123 using the prospective method as permitted under SFAS No. 148.

The following table illustrates the effect on net income if the fair value method had been applied to all outstanding and unvested options in each period.

(Dollars in Millions)	Years ended December 31	
	2003	2002
Net Income, As Reported	\$149.0	\$174.3
Add: Stock option-related employee compensation expense included in reported net income, net of related tax effects	.1	—
Deduct: Total stock option-related employee compensation expense determined under fair value based method for all awards, net of related tax effects	(.4)	(2.2)
Pro Forma Net Income	\$148.7	\$172.1

After-tax compensation expense for other stock-based compensation included in net income as reported for the years ended December 31, 2003 and 2002 was not material.

For additional information on assumptions used to determine the pro forma amounts as well as other information related to our stock-based compensation plans, see Note 8.

Asset Retirement Obligations

Effective January 1, 2003, we adopted SFAS No. 143, "Accounting for Asset Retirement Obligations." This standard provides the accounting for the cost of legal obligations associated with the retirement of long-lived assets. SFAS No. 143 requires that companies recognize the fair value of a liability for asset retirement obligations in the period in which the obligations are incurred and capitalize that amount as part of the book value of the long-lived asset. We have determined that we do not have a material legal obligation to remove long-lived assets as described by this statement. However, prior to the adoption of SFAS No. 143, we included estimated removal costs in our group depreciation models. These costs have increased depreciation expense and accumulated depreciation for future removal costs for existing assets. These removal costs were recorded as a reduction to accumulated depreciation when the assets were retired and removal costs were incurred.

For some assets, such as telephone poles, the removal costs exceeded salvage value. Under the provisions of SFAS No. 143, we are required to exclude costs of removal from our depreciation rates for assets for which the removal costs exceed salvage. Accordingly, in connection with the initial adoption of this standard on January 1, 2003, we have reversed accrued costs of removal in excess of salvage from our accumulated depreciation accounts for these assets. The adjustment was recorded as a cumulative effect of an accounting change, resulting in the recognition of a gain of \$112.5 million (\$71.2 million after-tax). Effective January 1, 2003, we began expensing costs of removal in excess of salvage for these assets as incurred. The ongoing impact of this change in accounting resulted in a decrease in depreciation expense and an increase in cost of services and sales, which was not material to our total operating expenses for the year ended December 31, 2003.

Verizon Northwest Inc.

Debt Extinguishment

In April 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections." SFAS No. 145, among other things, eliminates the requirement that all gains and losses on the extinguishment of debt must be classified as extraordinary items on the income statement, thereby permitting the classification of such gains and losses as extraordinary items only if they meet the criteria of APB Opinion No. 30, "Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions." We adopted this provision of SFAS No. 145 effective January 1, 2003 and, upon adoption, reclassified the losses on the early extinguishment of debt and related tax benefits that were previously reported in our statements of income as extraordinary items to Other income and (expense) and Provision for income taxes.

3. PLANT, PROPERTY AND EQUIPMENT

The following table displays the details of plant, property and equipment, which is stated at cost:

(Dollars in Millions)	December 31	
	2003	2002
Land	\$ 12.7	\$ 12.8
Buildings	295.6	286.2
Central office equipment	1,700.8	1,670.1
Outside communications plant	1,971.9	1,918.6
Furniture, vehicles and other work equipment	164.9	194.9
Construction-in-progress	22.8	18.2
Other	46.2	47.2
	<u>4,214.9</u>	<u>4,148.0</u>
Accumulated depreciation	<u>(2,614.3)</u>	<u>(2,600.2)</u>
Total	<u>\$ 1,600.6</u>	<u>\$ 1,547.8</u>

See "Accounting Changes – Asset Retirement Obligations" in Note 2.

4. LEASES

We lease certain facilities and equipment for use in our operations under both capital and operating leases. There were no initial capital lease obligations in 2003 and 2002.

Capital lease amounts included in plant, property and equipment are as follows:

(Dollars in Millions)	December 31	
	2003	2002
Capital leases	\$2.0	\$2.0
Accumulated amortization	(2)	(1)
Total	<u>\$1.8</u>	<u>\$1.9</u>

Total rent expense amounted to \$60.8 million in 2003 and \$52.8 million in 2002. Of these amounts, \$39.0 million in 2003 and \$27.8 million in 2002 were lease payments to affiliated companies for land and buildings.

This table displays the aggregate minimum rental commitments under noncancelable operating leases for the periods shown at December 31, 2003:

(Dollars in Millions)	
Years	
2004	\$3.1
2005	2.9
2006	1.6
2007	.9
2008	.3
Thereafter	.3
Total minimum rental commitments	<u>\$9.1</u>

Verizon Northwest Inc.

5. DEBT

Debt Maturing Within One Year

Debt maturing within one year consists of the following at December 31:

<u>(Dollars in Millions)</u>	<u>2003</u>	<u>2002</u>
Notes payable to affiliates:		
VNFC	\$240.5	\$124.3
GTE Funding	—	105.0
Long-term debt maturing within one year	.9	.9
Total debt maturing within one year	\$241.4	\$230.2
Weighted average interest rate for notes payable outstanding at year-end	1.1%	1.6%

We have a contractual agreement with an affiliated company Verizon Network Funding Corp. (VNFC), for the provision of short-term financing and cash management services. VNFC issues commercial paper and obtains bank loans to fund the working capital requirements of Verizon's network services subsidiaries, including us, and invests funds in temporary investments on their behalf. During 2002 and 2003, we also obtained short-term financing from an affiliated company, GTE Funding Incorporated (GTE Funding).

Long-Term Debt

Long-term debt consists principally of debentures that we have issued. Interest rates and maturities of the amounts outstanding are as follows at December 31:

<u>Description</u>	<u>Interest Rate</u>	<u>Maturity</u>	<u>2003</u>	<u>2002</u>
			<u>(Dollars in Millions)</u>	
Ten year debenture	5.55 %	2008	\$200.0	\$200.0
Twelve year debenture	6.3	2010	175.0	175.0
Thirty year debenture	7.875	2026	175.0	175.0
Twenty year first mortgage bond	9.67	2010	4.9	5.7
			<u>554.9</u>	<u>555.7</u>
Unamortized premium and discount, net			9.4	9.0
Total long-term debt, including current maturities			<u>564.3</u>	<u>564.7</u>
Less maturing within one year			(.9)	(.9)
Total long-term debt			\$563.4	\$563.8

The aggregate principal amount of bonds and debentures that may be issued is subject to the restrictions and provisions of our indentures. None of the securities shown above were held in sinking or other special funds or pledged by us. Debt discounts and premiums on our outstanding long-term debt are amortized over the lives of the respective issues. Substantially all of our property is subject to the lien of our mortgage bond indenture securing funded debt.

We are in compliance with all of our debt covenants.

Maturities of long-term debt outstanding at December 31, 2003, excluding unamortized discount and premium are as follows:

<u>(Dollars in Millions)</u>	
Years	
2004	\$.9
2005	.9
2006	.9
2007	.9
2008	200.9
Thereafter	350.4
Total long-term debt outstanding	\$554.9

Verizon Northwest Inc.

6. FINANCIAL INSTRUMENTS

Derivatives

We did not have any derivatives as of December 31, 2003 and 2002. Consequently, SFAS No. 133 did not have an impact on our results of operations or financial position.

Concentrations of Credit Risk

Financial instruments that subject us to concentrations of credit risk consist primarily of short-term investments and trade receivables. Concentrations of credit risk with respect to trade receivables, other than those from AT&T, are limited due to the large number of customers. We generated revenues from services provided to AT&T (primarily network access and billing and collection) of \$42.4 million in 2003 and \$52.1 million in 2002.

While we may be exposed to credit losses due to the nonperformance of our counterparties, we consider this risk remote and do not expect the settlement of these transactions to have a material effect on our results of operations or financial position.

Note Receivable

The Financial Services Agreement between GTE Funding and us specifies that we are permitted to borrow or advance funds on a day-to-day (demand) basis to finance our ordinary business and capital requirements. Since these borrowings and advances are based on a variable interest rate and demand note basis the carrying value of the notes approximates its fair market value. As of December 31, 2003, we had a note receivable from GTE Funding for \$13.9 million.

Fair Values of Financial Instruments

The table below provides additional information about our material financial instruments at December 31:

Financial Instrument	Valuation Method			
	2003	2002		
Short-term note receivable from (GTE Funding)	Carrying amounts			
Short-term notes payable to affiliates (VNFC and GTE Funding) and short-term investments	Carrying amounts			
Debt (excluding capital leases)	Future cash flows discounted at current rates			
	Carrying Amount	Fair Value	Carrying Amount	Fair Value
	(Dollars in Millions)			
Short-term note receivable from (GTE Funding)	\$ 13.9	\$ 13.9	—	—
Debt and notes payable to affiliates	\$804.8	\$852.5	\$794.0	\$840.8

7. COMMON STOCK

On August 12, 2002, pursuant to an amendment to our Restated Articles of Incorporation, we exchanged all of our issued and outstanding shares of Common Stock, without par value, for one share of Common Stock, without par value.

Verizon Northwest Inc.

8. STOCK INCENTIVE PLANS

Stock-option related employee compensation expense for 2003 grants and the pro forma amounts for prior years (see Note 2) were determined using the Black-Scholes option-pricing model based on the following weighted-average assumptions:

	2003	2002
Dividend yield	4.0%	3.2%
Expected volatility	30.9%	28.5%
Risk-free interest rate	3.4%	4.6%
Expected lives (in years)	6	6

The weighted-average value of options granted during 2003 and 2002 was \$8.41 and \$12.11, respectively.

Beginning in 2003, stock option grants to some levels of management were reduced, and accompanied by performance-based share awards.

The structure of Verizon's stock incentive plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2003.

9. EMPLOYEE BENEFITS

We participate in Verizon's benefit plans. Verizon maintains noncontributory defined benefit pension plans for many of our management and associate employees. The postretirement health care and life insurance plans for our retirees and their dependents are both contributory and noncontributory and include a limit on the company's share of cost for recent and future retirees. We also sponsor defined contribution savings plans to provide opportunities for eligible employees to save for retirement on a tax-deferred basis. We use a measurement date of December 31 for our pension and postretirement health care and life insurance plans.

The structure of Verizon's benefit plans does not provide for the separate determination of certain disclosures for our company. The required information is provided on a consolidated basis in Verizon's Annual Report on Form 10-K for the year ended December 31, 2003.

Pension and Other Postretirement Benefits

Pension and other postretirement benefits for the majority of our employees are subject to collective bargaining agreements. Approximately 85% of our employees (associates) are covered by collective bargaining agreements. Modifications in benefits have been bargained from time to time, and Verizon may also periodically amend the benefits in the management plans.

Benefit Cost

(Dollars in Millions)	Years ended December 31			
	Pension		Health Care and Life	
	2003	2002	2003	2002
Net periodic benefit (income) cost	\$(15.8)	\$(30.2)	\$19.8	\$16.3
Termination benefits	32.2	.6	12.3	—
Settlement loss	18.8	4.9	—	—
Curtailment gain	(1.5)	—	—	—
Subtotal	49.5	5.5	12.3	—
Total (income) cost	\$ 33.7	\$(24.7)	\$32.1	\$16.3

Verizon Northwest Inc.

As part of a Verizon workforce reduction plan, we have continued to reduce our headcount as allowed under various management and associate employee benefit plans. As a result, we recorded \$44.5 million and \$.6 million in 2003 and 2002, respectively, in connection with various pension and retirement benefit enhancements. In addition, we recorded pension settlement losses of \$18.8 million in 2003 and \$4.9 million in 2002 as lump-sum payments exceeded the threshold of service and interest costs. Further, we recorded a curtailment gain of \$(1.5) million in 2003 associated with a significant reduction of the expected years of future service of present employees, which was largely impacted by employee terminations in 2003. The special termination benefits and settlement of pension obligations are recorded in accordance with SFAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Pension Plans and for Termination Benefits" and SFAS No. 106, "Employers' Accounting for Postretirement Benefits Other than Pensions."

Amounts recognized in the consolidated balance sheets consist of:

(Dollars in Millions)	December 31			
	Pension		Health Care and Life	
	2003	2002	2003	2002
Prepaid pension asset	\$285.3	\$319.0	\$ —	\$ —
Employee benefit obligations	.5	.8	77.3	60.6

The changes in the employee benefit asset and obligations from year to year were caused by a number of factors, including changes in actuarial assumptions (see Assumptions), curtailments, settlements and special termination benefits.

Assumptions

The actuarial assumptions used are based on market interest rates, past experience, and management's best estimate of future economic conditions. Changes in these assumptions may impact future benefit costs and obligations.

The weighted-average assumptions used in determining benefit obligations at December 31,

	Pension		Health Care and Life	
	2003	2002	2003	2002
Discount rate	6.25%	6.75%	6.25%	6.75%
Rate of future increases in compensation	5.00	5.00	4.00	4.00

The weighted-average assumptions used in determining net periodic cost for years ended December 31,

	Pension		Health Care and Life	
	2003	2002	2003	2002
Discount rate	6.75%	7.25%	6.75%	7.25%
Expected return on plan assets	8.50	9.25	8.00	8.00
Rate of compensation increase	5.00	5.00	4.00	4.00

In order to project the long-term target investment return for the total portfolio, estimates are prepared for the total return of each major asset class over the subsequent 10-year period, or longer. Those estimates are based on a combination of factors including the following: observable current market interest rates, consensus earnings expectations, historical long-term performance and value-added, and the use of conventional long-term risk premiums. To determine the aggregate return for the pension trust, the projected return of each individual asset class is then weighted according to the allocation to that investment area in the Trust's long-term asset allocation policy. The projected long-term results are then also compared to the investment return earned over the previous 10 years.

The assumed health care cost trend rates at December 31,

	Health Care and Life	
	2003	2002
Health care cost trend rate assumed for next year	10.00%	11.00%
Rate to which cost trend rate gradually declines	5.00%	5.00%
Year the rate reaches level it is assumed to remain thereafter	2008	2007

Verizon Northwest Inc.

Medicare Drug Act

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (Medicare Drug Act) was signed into law. The Medicare Drug Act introduces a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Verizon sponsors several postretirement health care plans that provide prescription drug benefits that are deemed actuarially equivalent to the Medicare Part D and has elected to recognize the impact of the federal subsidy on their accumulated postretirement benefit obligation and net postretirement benefits costs. Specific authoritative guidance on the accounting for the federal subsidy is pending and that guidance, when issued, could impact current accounting for the effects of the Medicare Drug Act.

Savings Plans and Employee Stock Ownership Plans

Substantially all of our employees are eligible to participate in savings plans maintained by Verizon. Verizon maintains a leveraged employee stock ownership plan (ESOP) for its management employees of the former GTE Companies. Under this plan, a certain percentage of eligible employee contributions are matched with shares of Verizon's common stock. Verizon recognizes leveraged ESOP cost based on the modified shares allocated method for this leveraged ESOP that purchased securities before December 15, 1989. We recognize savings plan cost based on our matching obligation attributed to our participating management employees. In addition to the ESOP, Verizon also maintains a savings plan for non-management employees. We recorded total savings plan costs of \$5.1 million in 2003 and \$5.4 million in 2002.

Severance Benefits

We maintain ongoing severance plans for both management and associate employees, which provide benefits to employees that are terminated. The costs for these plans are accounted for under SFAS No. 112. We accrue for severance benefits based on the terms of our severance plan over the estimated service periods of the employees. The accruals are also based on the historical run-rate of actual severances and expectations for future severances. As a result of the Verizon workforce reduction plan in 2003 and 2002, it was determined that the severance liability was not sufficient and we recorded a special charge of \$26.6 million and \$3.8 million, respectively. Severance costs are included in selling, general and administrative expense in our statements of income. The following table provides an analysis of our severance liability:

(Dollars in Millions) Year	Beginning of Year	Charged to Expense (a)	Payments	Other (b)	End of Year
2002	\$12.1	\$ 4.1	\$ (7.7)	\$(1.1)	\$ 7.4
2003	7.4	25.9	(19.7)	10.9	24.5

(a) Includes (1) accruals for ongoing employee severance costs, (2) special charges of \$26.6 million in 2003 and \$3.8 million in 2002.

(b) Includes amounts reallocated to other Verizon affiliates. From time to time, Verizon must redistribute across its subsidiaries the amount of severance liability based on actual experience at the companies.

The remaining severance liability includes future contractual payments to employees separated as of the end of the year. As of December 31, 2003, a total of over 600 employees have been separated under the 2002 and 2003 severance programs.

Verizon Northwest Inc.

10. INCOME TAXES

The components of income tax expense are presented in the following table:

(Dollars in Millions)	Years ended December 31	
	2003	2002
Current:		
Federal	\$36.2	\$65.2
State and local	2.3	4.4
	<u>38.5</u>	<u>69.6</u>
Deferred:		
Federal	6.0	27.0
State and local	.1	1.6
	<u>6.1</u>	<u>28.6</u>
Total income tax expense	<u>\$44.6</u>	<u>\$98.2</u>

The following table shows the primary reasons for the difference between the effective income tax rate and the statutory federal income tax rate:

	Years ended December 31	
	2003	2002
Statutory federal income tax rate	35.0%	35.0%
State income taxes, net of federal tax benefits	1.3	1.5
Other, net	.1	(.5)
Effective income tax rate	<u>36.4%</u>	<u>36.0%</u>

Deferred taxes arise because of differences in the book and tax bases of certain assets and liabilities. Significant components of deferred tax liabilities (assets) are shown in the following table:

(Dollars in Millions)	December 31	
	2003	2002
Depreciation	\$216.2	\$156.1
Employee benefits	88.8	105.2
Allowance for uncollectible accounts	(10.4)	(14.2)
Other, net	9.1	9.2
Net deferred tax liability	<u>\$303.7</u>	<u>\$256.3</u>

Employee benefits include \$28.5 million deferred tax asset at December 31, 2003 and \$22.6 million at December 31, 2002 related to postretirement benefit costs recognized under SFAS No. 106. This deferred tax asset will gradually be realized over the estimated lives of current retirees and employees.

Verizon Northwest Inc.

11. TRANSACTIONS WITH AFFILIATES

Our financial statements include transactions with Verizon Services, (including Verizon Services Corp., Verizon Services Group, Verizon Corporate Services Group Inc. as previously described), Verizon Internet Services Inc., Verizon Global Networks Inc., Verizon Long Distance, Verizon Wireless Inc., Verizon Operating Telephone Companies, Verizon Information Services Inc., Verizon Advanced Data Inc., Verizon Data Services Inc., GTE Communication Systems Corporation, GTE Funding Incorporated, Verizon Network Funding Corp., GTE Corporation, Verizon Ventures III Inc. and other affiliates.

Transactions with affiliates are summarized as follows:

(Dollars in Millions)	Years ended December 31	
	2003	2002
Operating revenues:		
Verizon Internet Services Inc.	\$ 37.4	\$ 21.0
Verizon Global Networks Inc.	20.0	—
Verizon Long Distance	15.3	32.0
Verizon Wireless Inc.	10.2	9.4
Verizon Operating Telephone Companies	7.6	10.4
Verizon Information Services Inc.	.7	.5
Other	.2	10.7
	91.4	84.0
Operating expenses:		
Verizon Services	160.8	129.8
Verizon Data Services Inc.	63.5	52.1
Verizon Advanced Data Inc.	20.4	23.8
GTE Communication Systems Corporation	14.5	14.9
Verizon Operating Telephone Companies	1.8	1.8
Verizon Wireless Inc.	.1	.6
Verizon Information Services Inc.	.1	.3
Other	.5	.4
	261.7	223.7
Other income and (expense), net:		
Interest income from GTE Funding Incorporated	.8	—
Interest income from Verizon Services	.1	—
Interest income from GTE Corporation	—	.1
	.9	.1
Interest expense:		
Interest expense to Verizon Network Funding Corp.	3.0	.2
Interest expense to GTE Funding Incorporated	(2)	5.4
	2.8	5.6
Plant, property and equipment:		
Purchases from GTE Communication Systems Corporation	26.8	37.0
Transfer of advanced data assets from Verizon Ventures III Inc.	—	13.2
	26.8	50.2
Equity contributed to Verizon Ventures III Inc.	—	9.7
Dividends to GTE Corporation:		
Dividends declared	221.8	135.0
Capital contribution from GTE Corporation	—	9.9

Outstanding balances with affiliates are reported in the balance sheets at December 31, 2003 and 2002 as Note Receivable from Affiliate, Accounts Receivable - Affiliates, Notes Payable to Affiliates, and Accounts Payable and Accrued Liabilities - Affiliates.

Verizon Northwest Inc.

Verizon Services

We have contractual arrangements with Verizon Services for the provision of various centralized services. These services are divided into two broad categories. The first category is comprised of network related services which generally benefit only Verizon's operating telephone subsidiaries. These services include marketing, sales, legal, accounting, finance, data processing, materials management, procurement, labor relations, and staff support for various network operations. The second category is comprised of overhead and support services which generally benefit all subsidiaries of Verizon. Such services include corporate governance, corporate finance, external affairs, legal, media relations, employee communications, corporate advertising, human resources, and treasury. Costs may be either directly assigned to one subsidiary or allocated to more than one subsidiary based on functional reviews of the work performed.

Verizon Internet Services Inc.

Our operating revenues include transactions with Verizon Internet Services Inc. (Verizon Internet Services) associated with the provision of network access and billing and collection services. These revenues are earned from Verizon Internet Services who utilizes our facilities to provide Internet access services to their customers.

Verizon Global Networks Inc.

Our operating revenues include transactions with Verizon Global Networks Inc. (Global Networks) associated with the provision of network access and long distance services. These revenues are earned from Global Networks who utilizes our facilities to provide access and data transport to their customers.

Verizon Long Distance

Our operating revenues include transactions with Verizon Long Distance associated with the provision of local and network access and billing and collection services. These revenues are earned from Verizon Long Distance who utilizes our facilities to provide long distance services to their customers.

Verizon Wireless Inc.

Our operating revenues include transactions with Verizon Wireless Inc. (Verizon Wireless) associated with the provision of local and network access services, billing and collection services, interconnection agreements and commission fees. These revenues are earned from Verizon Wireless who provides wireless voice and data services, paging services and equipment sales to their customers.

Our operating expenses also include transactions with Verizon Wireless. We recognize costs associated with wireless voice and data services, paging services and for interconnection agreements.

Verizon Operating Telephone Companies

Our operating revenues and expenses include transactions with other Verizon Operating Telephone Companies. Revenues associated with transactions with these affiliates are primarily earned from the rental of our facilities and equipment. In addition, we also recognize expenses associated with transactions with these affiliates. These costs primarily relate to fees associated with the termination of our customer's calls on their network.

Verizon Information Services Inc.

We have an agreement to provide subscriber lists, billing and collection and other services to Verizon Information Services Inc. (Directories). Directories bills us for printing and other costs associated with regulatory requirements included in the telephone directories, including the cost of any Extended Area Service sections in the directories. Directories also bills us for any advertising we place in the telephone directories.

Verizon Northwest Inc.

Verizon Advanced Data Inc.

Our operating revenues included transactions with Verizon Advanced Data Inc. (VADI) associated with the provision of local telephone services.

We also have a contractual arrangement with VADI for the provision of various centralized services associated with advanced data services. These services are divided into two broad categories. The first category is comprised of network related services which include provisioning, maintenance, engineering, and data processing for various network operations. The second category is comprised of overhead and support services which include finance, human resources, treasury, procurement, marketing, sales, and support staffs. The costs are allocated based on advanced data services revenues.

Verizon Data Services Inc.

Verizon Data Services Inc. provides data processing services, software application development and maintenance, which generally benefit Verizon's operating telephone subsidiaries, including us. We are charged for these affiliated transactions based on proportional cost allocation methodologies.

GTE Communication Systems Corporation

GTE Communication Systems Corporation (GTE Communication Systems) provides construction and maintenance equipment, supplies and electronic repair services to us. We record these purchases and services at cost, including a return realized by GTE Communication Systems.

Verizon Network Funding Corp. and GTE Funding Incorporated

We have a contractual agreement with an affiliated company, Verizon Network Funding Corp. (VNFC), for the provision of short-term financing and cash management services. VNFC issues commercial paper and obtains bank loans to fund the working capital requirements of Verizon's network services subsidiaries, including us, and invests funds in temporary investments of their behalf. We also recognize interest expense/income associated with short-term financing through advances from an affiliated company, GTE Funding Incorporated (GTE Funding).

Other Affiliates

Other operating revenues and expenses include miscellaneous items of income and expense resulting from transactions with other affiliates. These transactions include the provision of local and network access services, billing and collection services, rental of facilities and equipment, and sales and purchases of material and supplies.

Investment in Verizon Ventures III Inc.

We acquired an ownership interest in Verizon Ventures III Inc. (Ventures III), an affiliated company which we accounted for under the equity method of accounting, as a result of the transfer of certain advanced data assets in December 2000 and throughout 2001. Ventures III was established to satisfy a condition of the Federal Communication Commission's (FCC) approval of the Bell Atlantic - GTE merger, which required the provision of advanced data services through a separate affiliate. In September 2001, the FCC issued an order eliminating this merger condition. We subsequently obtained approval from our regulatory commissions in Idaho and Oregon for the reintegration of these assets with our operations. On January 1, 2002, after state regulatory approvals were obtained, Ventures III transferred advanced data assets back to us with an aggregate net book value of \$13.2 million in Washington. In consideration of the transfer of these assets, we have surrendered our common stock in Ventures III and remitted cash compensation.

In connection with this reintegration, we received a capital contribution from our parent of \$9.7 million in the first quarter of 2002. This equity was immediately contributed to Ventures III. No gain or loss was recognized as a result of the reintegration of the advanced data assets to us. This reintegration did not have a material effect on our total results of operations or financial condition.

Verizon Northwest Inc.

12. ADDITIONAL FINANCIAL INFORMATION

The tables below provide additional financial information related to our financial statements:

(Dollars in Millions)	Years ended December 31	
	2003	2002
STATEMENTS OF CASH FLOWS:		
Cash paid during the year for:		
Income taxes, net of amounts refunded	\$52.8	\$113.7
Interest, net of amounts capitalized	39.1	48.3
STATEMENTS OF INCOME:		
Interest expense incurred, net of amounts capitalized	39.3	44.6
Capitalized interest	.8	1.2
Advertising expense	4.6	5.2

Advertising expense includes \$4.5 million in 2003 and \$5.1 million in 2002 allocated to us by various affiliates.

In 2002, we recorded an impairment charge of \$12.5 million driven by our financial statement exposure to WorldCom Inc. This charge was recorded in selling, general and administrative expense in our consolidated statements of income.

13. COMMITMENTS AND CONTINGENCIES

Various legal actions and regulatory proceedings are pending to which we are a party and claims which, if asserted, may lead to other legal actions. We have established reserves for specific liabilities in connection with regulatory and legal matters that we currently deem to be probable and estimable. We do not expect that the ultimate resolution of pending regulatory and legal matters in future periods will have a material effect on our financial condition, but it could have a material effect on our results of operations.

From time to time, state regulatory decisions require us to assure customers that we will provide a level of service performance that falls within prescribed parameters. There are penalties associated with failing to meet those service parameters and we, from time to time, pay such penalties. We do not expect these penalties to have a material effect on our financial condition, but they could have a material effect on our results of operations.

14. SEGMENT INFORMATION

We have one reportable segment, which provides domestic wireline telecommunications services. Specifically, we provide local telephone services including voice and data transport, enhanced and custom calling features, network access, directory assistance and private lines. In addition, we provide customer premises equipment distribution, billing and collection and pay telephone services.

15. SUBSEQUENT EVENT

On February 2, 2004, we declared and paid a dividend in the amount of \$32.0 million to our parent, GTE.

ATTACHMENT 4

Declaration of Paula M. Strain

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

DOCKET NO. UT-040788

DECLARATION OF PAULA M.
STRAIN

I, Paula M. Strain, provide the following declaration in support of Staff's Motion to Compel. The following statements are true and correct to the best of my knowledge and belief, and are based on my personal knowledge.

I am employed by the Washington Utilities and Transportation Commission as a Telecommunications Expert. In the course of my duties as a Telecommunications Expert, I reviewed the meeting minutes of the Verizon Northwest Inc. Board of Directors covering the period January 2002 through August 2004. Based on my review of these meeting minutes, the Verizon Northwest Board of Directors' actions primarily consisted of the following:

Approval of dividend payments to its parent company, GTE Corporation (a subsidiary of Verizon Communications), every three months.

Adoption of restated Articles of Incorporation and Bylaws.

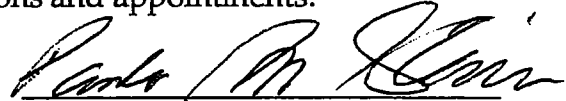
Exchange of outstanding Verizon NW shares of stock for one share of stock.

Authorization of one surplus property sale.

Adoption of an amendment to an employees' pension plan to reflect voluntary separation and recent collective bargaining.

Resolution to receive financial services from a Verizon affiliate.

Acceptance of board member resignations and appointments.



Paula M. Strain
Commission Staff

September 16, 2004
at Olympia, WA

ATTACHMENT 5

**Excerpts from NARUC Rate Case and
Audit Manual (2003)
Pages 7, 14, 35 & 38**

Focusing the Audit

The auditor may want to prepare an analysis, in order to better focus one's time and resources on portions of the expenses, revenues, and investment that are most likely to impact customers' rates. For instance, it would be easy to get lost in the political sensitivities of trying to eliminate donations and political expenditures that regulators may consider to be offensive, but in doing so, one could overlook the larger expense of special pensions for the Board of Directors that may also be inappropriate. By identifying the big ticket items – those that really matter to the overall level of rates – one can determine the issues about which to inquire first, and those that can wait or move to the bottom of the list.

The spreadsheets of historical data and trends can be very useful in identifying the more significant items. One may want to focus on those costs that have changed the most from historical levels. Regardless of the change from historical levels, the auditor may want to focus on those few items that make up the most significant portion of the operating costs (e.g., salaries, depreciation, and purchased power costs).

Another approach to focusing the audit is to compute ranges of change that would have to be incurred to impact rates. What percentage change in rate base would have to occur in order to change the earned return by one percentage point (or 100 basis points)? In another instance, a utility could be asking for less than its fully authorized return in order to mitigate rate impacts on customers. If so, what dollar level of expense or rate base adjustment would be required in order to exceed the requested authorized return level? These boundaries can assist the auditor in deciding whether to pursue a more difficult or questionable adjustment.

There is another area related to focusing the audit of which the auditor will want to be aware: What limitations or constraints exist regarding the areas to review? If the auditor believes that it is important to review affiliate transactions, it is useful to know early in the process whether one might be overstepping the Commission's authority to review such transactions, or whether the Commission has broad powers of review in this area. Similarly, if the auditor wants to review not only the minutes of the Board of Directors' meetings for the utility, but also for the Board of the parent company, may he/she do so? When looking at these sensitive areas, the auditor should have thought through answers to questions of relevance to the utility operations and Commission authority.

Reviewing Federal Regulatory Reports, Shareholder Reports, and SEC Filings

Reports filed by the utility with the Securities and Exchange Commission (SEC), the FCC, the FERC, and other regulatory bodies may contain a host of information over and above the traditional financial information that becomes the mainstay of an auditor's work. This information will reveal everything from lawsuits pending against the utility to the significant accounting practices, if the auditor takes the time to read the footnotes. The perspective provided to shareholders in these reports is often significantly different than the outlook provided to regulators, and may provide the auditor insights into management's views.

RECORDS TO BE REVIEWED

The following is a list of records that the auditor may consider obtaining or reviewing during the audit or site visit:

- Affiliate Agreements for Inter-affiliate Transactions
- Audit Committee Minutes
- Billing Records (registers, etc.)
- Board of Director Minutes
- Chart of Accounts and Accounts Manual
- Construction Work Orders
- Construction Budgets
- Continuing Property Records
- Depreciation Studies
- External Independent Audit Reports and Workpapers (looking especially at the adjustments that the company chose not to make in spite of the auditor's recommendations)
- Franchise Fee Records (collection and payment)
- General Ledger and Subsidiary Ledgers
- Income Tax Returns
- Internal Audit Reports and Workpapers
- Invoices
- Lead-Lag Studies
- List of Property Units
- Monthly or Quarterly Operating/Financial Reports
- Monthly or Quarterly Trial Balances
- Organizational Charts (one showing the corporate (parent and affiliate entities) and one showing internal reporting lines and internal departments)
- Payroll Records
- Property Tax Statements
- Risk Committee Minutes and Documentation
- Sample of Customer Bills (to verify rates and information)

OPERATING EXPENSES OTHER THAN DEPRECIATION AND INCOME TAXES

General Review

In reviewing operating expenses, the auditor may wish to begin by again turning to the historical analysis of expenses that was prepared during the preliminary procedures and the analysis of the month by month test year data. An examination of these spreadsheets will assist one in identifying the initial areas upon which to focus during the audit. It will assist in pinpointing anomalies in the expenses, as well as trends in the expenses. Besides the list of hot topics that might be particular to one's individual jurisdiction, one will want to focus on the oddities indicated by the data.

In looking at the numbers that stand out of the analyses, one will want to gather background on the events that occurred during the test year that may have caused unusual expense levels. Was there a major storm that would have caused the need for unusual levels of maintenance and repair? Was there a labor strike that would have impacted salaries and wage levels? Did a new switch (or power plant) come on line that will change the overall operating costs?

One of the overriding principles to remember when reviewing expense related adjustments is the concept of *known and measurable*, particularly when dealing with adjustments to historic test periods. It is widely accepted that adjustments should have a strong degree of certainty associated with them, and that there should be a reasonable ability to measure the item underlying the adjustment. For example, there might be different mindsets about including an adjustment for additional personnel in the administrative expenses if the job descriptions for the people had been prepared and a classified help wanted ad were being run, compared to simply indicating that additional people were needed but they had not yet been included in corporate budgets. Similarly, there might be a world of difference between indicating that it is the utility's general policy to grant cost of living increases to employees and the situation where one can view the Board of Directors' minutes showing that a specific percentage increase has been approved.

Maintenance and Repair Expenses and Practices

The auditor will want to look at general maintenance practices of the utility and determine whether the expenses incurred appear reasonable based on those practices. Has there been an increasing or decreasing trend of maintenance expenses? Is there an indication that maintenance is the victim of cost cutting measures in order to maintain shareholder dividends?

One may also wish to consider whether those maintenance practices are consistent with Commission expectations as well as the provisioning of safe, adequate, and reliable service. For example, does the utility have a practice or policy relative to the testing of meters? How often is it done and how does this compare to the manufacturer recommendations? Does it test them

salaries than another with fewer, higher paid employees, but it may be that if the costs are similar, the ratepayers are indifferent.

As to the actual expenses in the filing or utility submission, the auditor could assure that the filing reconciles with various payroll records, such as quarterly tax reports. Also, the auditor will want to look for supporting documentation for any payroll adjustments that are proposed. Is there a union contract denoting the increase reflected in the case? Is there a minute of the Board of Directors' authorizing salary changes? Are there payroll records verifying the number of employees during the test year? The auditor should also remember that as salaries and wages are adjusted, so are payroll taxes.

Another area often examined relates to overtime. One will want to determine if the amount of overtime included in the test year is reasonable and more importantly, typical. Therefore, the auditor may wish to look at the percentage of overtime worked during the past few years (generally three to five years) and compare it to the percentage of overtime in the test year. If there is a large difference between the historical numbers and the test year numbers, one will want to obtain an explanation. Additionally, one may wish to consider using a multiple year average percentage of overtime to use in the computation of the revenue requirement in order to normalize any test year anomalies. One may wish to look at capitalization versus expense ratios, and contract labor levels in a similar manner to that just described for overtime.

The auditor may also find it informative to look at severance costs (e.g., for recent changes of top management) and stock options in terms of the overall reasonableness of compensation packages. It is important to remember that through the audit, the auditor is not trying to manage the company, or even tell the company what the utility policies are to be. Rather, one is attempting to determine what is a reasonable level to be included in revenue requirement for inclusion in customer rates. The auditor should find out whether his/her Commission has allowed severance costs and stock options to be included in setting rates.

Pensions

A basic understanding of SFAS 87, Employers' Accounting for Pensions, will want to be held by the auditor. This accounting standard requires that pension plans be accounted for on an accrual basis rather than on a cash basis. In other words, the cost of an employee's pension is recognized over that employee's approximate service life, and the books reflect those expenses over that life, rather than basing it on the amount the employer decides to contribute to that plan for any particular period. The statement also requires immediate recognition of a liability when the accumulated benefit obligation exceeds the fair value of plan assets. This later provision of recognizing an additional liability may have ratemaking relevance with continued dramatic movements in stock values and thus, the value of pension plans. The auditor will want to see what has transpired with the pension plan relative to recent changes in the stock market.

ATTACHMENT 6

Data Request No. 418



(EXCERPT)

Christine O. Gregoire

ATTORNEY GENERAL OF WASHINGTON

Utilities and Transportation Division

1400 S Evergreen Park Drive SW • PO Box 40128 • Olympia WA 98504-0128 • (360) 664-1183

September 13, 2004

Sent Via E-mail, Facsimile, and U S Mail

Gregg E. Diamond
Director, Regulatory
MC: HQE02E84
600 Hidden Ridge
Irving, TX 75038

Re: *Verizon Rate Case*
Docket No. UT-040788
WUTC Staff *General* Data Request Nos. 414-428

Dear Mr. Diamond:

To facilitate the Washington Utilities and Transportation Commission (WUTC or Commission) Staff's examination in Docket No. UT-040788, please provide responses to each of the following requests on separate sheets of paper, and repeat the data request at the top of the page on which the response begins. Also, indicate on both the hard copy and any electronic version provided, the date the data response was prepared, the individual who prepared the response, the telephone number of the preparer, and the witness who will stand cross-examination on the response.

These data requests are governed by Commission rules, including WAC 480-07-400 and 405. Each of these data requests relates to the Company's request for general rate relief.

The term "documents" is used in its broadest sense, and includes all writings and records of any type in your possession, control or custody, including paper documents, emails, electronic files or computer data of any type, mechanical or electric recordings, etc., and any copies of the foregoing. A document with handwritten notes on it is not a copy of the document on which it is written, but a separate document. If there is any question whether a responsive item is a "document," assume it is and produce it.



If you refuse to respond to any data request, or if you cannot respond fully to any data request, please provide as complete a response as you are capable, and state all reasons why a full response is not forthcoming. If you object to any data request, you must do so within the time limits prescribed by WAC 480-07-405. If you object on the basis of privilege, state the privilege, describe the responsive documents and name each person who has possessed it. If a document is unavailable, identify it, and state why. If it can be obtained elsewhere, please state where. If a responsive document has been destroyed, please describe the document and explain in detail how and why, identify who did it, and who has knowledge of the document's contents.

If a data request can be answered in whole or in part by a response to another data request, please so state and cite the specific part of that other data request that is responsive. If that other data request only responds to part of the data request, please proceed to answer the remaining parts of the data request.

You have a duty to supplement your responses, per WAC 480-07-405(8).

Please provide an original and two (2) copies of your responses to these data requests in accordance with WAC 480-07-405. Please direct all responses to these requests to Donald T. Trotter, Senior Counsel, P.O. Box 40128, 1400 S Evergreen Park Drive SW, Olympia, Washington, 98504-0128. Any questions concerning these Data Requests should be directed to Kathy Folsom at (360) 664-1279.

Very truly yours,


DONALD T. TROTTER
Senior Counsel

DTT:kl

cc: All Parties

General Rate Case:

Regarding Revenue Requirements and Testimony of Ms. Heuring:

WUTC STAFF DATA REQUEST NO. 414:

Please provide an explanation of how plant items get booked to Verizon NW's plant accounts for the two largest projects added during the test year in the following accounts: 2121, 2212, 2232, and 2423.1. Please also provide a list of all additions in those accounts by identifiable designation (name and work order) and dollar amount booked to the account.

WUTC STAFF DATA REQUEST NO. 415:

Regarding the Gross Addition Detail for accounts 2121, 2212, 2232, and 2423.1, please provide the documentation behind the Transfer to In Service for the following projects:

- a. Building construction in Mount Vernon;
- b. Building addition and HVAC expansion to Bothell North Co;
- c. RSU at Redmond Ridge and remote site;
- d. Replace switch system RSCS 1900;
- e. Marconi cue with three access maxes systems; and
- f. Place IOF cable F96 from Meadow Springs to Benton City boundary.

WUTC STAFF DATA REQUEST NO. 416:

Please provide a list of codes that show the intelligence built into the work order number.

WUTC STAFF DATA REQUEST NO. 417:

Please provide a vendor list that shows how the adjustment to Staff Data Request No. 328 was made. Please breakdown the list between direct and Verizon West allocated.

WUTC STAFF DATA REQUEST NO. 418:

Please provide an explanation and documentation for the year-end 2002 and year-end 2003 journal entries requested by Paula Strain during the on-site audit visit. . Please include dollar amounts associated with each expense-related journal entry made in December 2002 and 2003.

ATTACHMENT 7

Staff Data Request No. 227 (June 9, 2004)



10/23

Christine O. Gregoire

ATTORNEY GENERAL OF WASHINGTON

Utilities and Transportation Division

1400 S Evergreen Park Drive SW • PO Box 40128 • Olympia WA 98504-0128 • (360) 664-1183

June 9, 2004

Sent Via Facsimile and U S Mail

Gregg E. Diamond
Director, Regulatory
MC: HQE02E84
600 Hidden Ridge
Irving, TX 75038

Re: *Verizon Rate Case*
Docket No. UT-040788
WUTC Staff *General* Data Request Nos. 277-280

Dear Mr. Diamond:

To facilitate the Washington Utilities and Transportation Commission (WUTC or Commission) Staff's examination in Docket No. UT-040788, please provide responses to each of the following requests on separate sheets of paper, and repeat the data request at the top of the page on which the response begins. Also, indicate on both the hard copy and any electronic version provided, the date the data response was prepared, the individual who prepared the response, the telephone number of the preparer, and the witness who will stand cross-examination on the response.

These data requests are governed by Commission rules, including WAC 480-07-400 and 405.

Each of these data requests relates to the Company's request for general rate relief. However, it is possible the requests or responses may apply to the interim rate filing.

The term "documents" is used in its broadest sense, and includes all writings and records of any type in your possession, control or custody; including paper documents, emails, electronic files or computer data of any type, mechanical or electric recordings, etc., and any copies of the foregoing. A document with handwritten notes on it is not a copy of the document on which it is written, but a separate document. If there is any question whether a responsive item is a "document," assume it is and produce it.



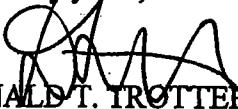
If you refuse to respond to any data request, or if you cannot respond fully to any data request, please provide as complete a response as you are capable, and state all reasons why a full response is not forthcoming. If you object to any data request, you must do so within the time limits prescribed by WAC 480-07-405. If you object on the basis of privilege, state the privilege, describe the responsive documents and name each person who has possessed it. If a document is unavailable, identify it, and state why. If it can be obtained elsewhere, please state where. If a responsive document has been destroyed, please describe the document and explain in detail how and why, identify who did it, and who has knowledge of the document's contents.

If a data request can be answered in whole or in part by a response to another data request, please so state and cite the specific part of that other data request that is responsive. If that other data request only responds to part of the data request, please proceed to answer the remaining parts of the data request.

You have a duty to supplement your responses, per WAC 480-07-405(8).

Please provide an original and two (2) copies of your responses to these data requests in accordance with WAC 480-07-405. Please direct all responses to these requests to Donald T. Trotter, Senior Counsel, P.O. Box 40128, 1400 S Evergreen Park Drive SW, Olympia, Washington, 98504-0128. Any questions concerning these data requests should be directed to Paula Strain at (360) 664-1278.

Very truly yours,


DONALD T. TROTTER
Senior Counsel

DTT:kl

cc: All Parties
Judith A. Endejan
Richard E. Potter

General Rate Case

WUTC STAFF DATA REQUEST NO. 277:

With respect to the recently-announced sale of Verizon's wireline-related businesses in Hawaii to the Carlyle Group, please provide the following documents pertaining to the sale:

- a. Sales Agreement(s);
- b. Due Diligence investigation documents ;
- c. Prospectus (or similar document)
- d. Board of Director minutes;
- e. Any other agreements containing terms and conditions of sale;
- f. State and federal regulatory submittals including property transfer applications, SEC filings, DOJ or FCC submittals.

To the extent that formal agreements or documents have not yet been executed, please provide a description of the terms and conditions pertaining to the sale, and supply formal documents when available.

WUTC STAFF DATA REQUEST NO. 278:

Regarding the exhibit of Verizon witness Ms. Heuring: Exhibit No. ____ (NWH-2), page 1, column (b), please provide data in a similar format, for the test year, for the following:

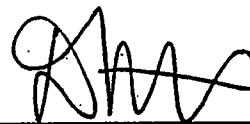
- a) Verizon Northwest Inc. - Total Company
- b) Verizon Northwest Inc. - Total Company Washington
- c) Verizon Northwest Inc. - Washington Subject to Separations
- d) Verizon Northwest Inc. - Washington Non-Regulated
- e) Verizon Northwest Inc. - Washington Regulated

WUTC STAFF DATA REQUEST NO. 279:

As a follow-up to your response to Data Request No. 213 (which asked how \$526 million in additions to gross plant since 2000 has increased intrastate rate base by \$40 million over the same period), please specify the basis of the \$526 million referred to in Mr. Banta's testimony at Exhibit No. ___ (SMB-1T) at page 5, lines 9-10, and whether it represents gross plant additions for Verizon Northwest Inc. total company, Verizon Northwest total Washington, Verizon Northwest total Washington – regulated, or some other jurisdictional subdivision.

WUTC STAFF DATA REQUEST NO. 280:

Please provide a list of all external and internal audits involving or affecting Verizon Northwest Inc. from January 2001 to the present. Please provide the subject of the audit, the entity being audited, the external entity or internal Verizon group performing the audit, the period being audited, and the date of the audit report.



DONALD T. TROTTER
Senior Counsel

ATTACHMENT 8

**Verizon NW's June 22, 2004, Response to
Staff Data Request No. 227**

Data Request No. 277 (General):

With respect to the recently-announced sale of Verizon's wireline-related businesses in Hawaii to the Carlyle Group, please provide the following documents pertaining to the sale:

- a. Sales Agreement(s);
- b. Due Diligence investigation documents ;
- c. Prospectus (or similar document)
- d. Board of Director minutes;
- e. Any other agreements containing terms and conditions of sale;
- f. State and federal regulatory submittals including property transfer applications, SEC filings, DOJ or FCC submittals.

To the extent that formal agreements or documents have not yet been executed, please provide a description of the terms and conditions pertaining to the sale, and supply formal documents when available.

RESPONSE:

Verizon objects to this data request because it seeks information that is not relevant to this adjudicative proceeding.

Prepared By: Gregg Diamond
Date: June 16, 2004
Witness: n/a

ATTACHMENT 9

**E-mails between Donald T. Trotter and
Judith Endejan re Staff Data Request
No. 277, dated July 21, 2004, and July 23,
2004 (2) and July 27, 2004**

Don Trotter/WUTC
07/21/2004 02:19 PM

To jendejan@grahamdunn.com
cc
bcc Paula Strain/WUTC@WUTC; Greg
Trautman/WUTC@WUTC; Chris Swanson/WUTC@WUTC
Subject Verizon rate case, Docket No. UT-040788; Company's
response to Staff Data Request No. 277

This communication is made in a good faith attempt informally to resolve what appears to be a discovery dispute. Hopefully, we can resolve this amicably.

In Staff Data Request No. 277, Staff requested Verizon to supply the specific information relating to a sale of a Verizon local exchange business in the state of Hawaii. Verizon responded that the information requested was "not relevant."

First, "relevance" does not accurately reflect the applicable standard for data requests. The applicable standard is whether the "information is relevant to the issues in the adjudicative proceeding, or that may lead to the production of information that is relevant." WAC 480-07-400(4).

Second, the information is relevant, or may lead to the production of information that is relevant, because the Hawaii sale includes the sale of the directory associated with that local exchange business. Directory revenues (or, per Verizon's direct case, the lack of directory revenues) are at issue in Docket No. UT-040788. Verizon has offered at least 2 witnesses on the subject.

How Verizon, or the market, values a directory business associated with a local exchange business is directly relevant to an analysis of the value of such a business in Washington. The information requested seeks documents that likely contain that information, or would likely refer to documents that contain that information.

If it is Verizon's belief that the documents requested contain no information whatsoever about the directory business, then please so advise, and explain the basis for Verizon's belief.

Please consider this email at your earliest convenience. This information is needed by Staff, and I need to know promptly whether the Company is willing to provide the requested information.

Thank you for your cooperation.

Donald T. Trotter
Assistant Attorney General
Counsel for WUTC in Docket No. UT-040788

360-664-1189

Don Trotter/WUTC
07/23/2004 08:45 AM

To <JEndejan@GrahamDunn.com>
cc
bcc
Subject RE: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

Thanks Judy.
<JEndejan@GrahamDunn.com>



<JEndejan@GrahamDunn.com>
m>
07/23/2004 07:58 AM

To <DTrotter@wutc.wa.gov>
<tom.parker@verizon.com>,
cc <gregg.diamond@verizon.com>,
<chuck.carrathers@verizon.com>
Subject RE: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

Don, I am sorry--I have been out in deps in another case for the past two days. I will forward this immediately to my client and try to get you an answer as soon as I can! Thanks. Judy

-----Original Message-----

From: Don Trotter [mailto:DTrotter@wutc.wa.gov]
Sent: Wednesday, July 21, 2004 2:20 PM
To: Endejan, Judith A.
Subject: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

This communication is made in a good faith attempt informally to resolve what appears to be a discovery dispute. Hopefully, we can resolve this amicably.

In Staff Data Request No. 277, Staff requested Verizon to supply the specific information relating to a sale of a Verizon local exchange business in the state of Hawaii. Verizon responded that the information requested was "not relevant."

First, "relevance" does not accurately reflect the applicable standard for data requests. The applicable standard is whether the "information is relevant to the issues in the adjudicative proceeding, or that may lead to the production of information that is relevant." WAC 480-07-400(4).

Second, the information is relevant, or may lead to the production of information that is relevant, because the Hawaii sale includes the sale of the directory associated with that local exchange business. Directory revenues (or, per Verizon's direct case, the lack of directory revenues) are at issue in Docket No. UT-040788. Verizon has offered at least 2 witnesses on the subject.

How Verizon, or the market, values a directory business associated with a local exchange business is directly relevant to an analysis of the value of such a business in Washington. The information requested seeks documents that likely contain that information, or would likely refer to documents that contain that information.

If it is Verizon's belief that the documents requested contain no information whatsoever about the directory business, then please so advise, and explain the basis for Verizon's belief.

Please consider this email at your earliest convenience. This information is needed by Staff, and I need to know promptly whether the Company is willing to provide the requested information.

Thank you for your cooperation.

Donald T. Trotter
Assistant Attorney General
Counsel for WUTC in Docket No. UT-040788

360-664-1189

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Thank you.

Don Trotter/WUTC
07/23/2004 12:48 PM

To <JEndejan@GrahamDunn.com>
cc
bcc
Subject RE: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

Thanks for the response. I hope to discuss (today) with my client ways to respond to your request.

DTT
<JEndejan@GrahamDunn.com>



<JEndejan@GrahamDunn.com>
m>
07/23/2004 11:48 AM

To <DTrotter@wutc.wa.gov>
cc <tom.parker@verizon.com>, <chuck.carrathers@verizon.com>
Subject RE: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

Don, I've had a chance to speak with my client and I suggest that take a slightly different tack.. It seems like you want more specific information about the Hawaii sale as it pertains to the directory associated with the local exchange business. I'm not clear on whether that is what you rally want. Would you be kind enough to re-write your data request to specify exactly what you want form the Hawaii sale and then we can take a closer look at it and get back to you? Thanks so much, Judy

-----Original Message-----

From: Don Trotter [mailto:DTrotter@wutc.wa.gov]
Sent: Wednesday, July 21, 2004 2:20 PM
To: Endejan, Judith A.
Subject: Verizon rate case, Docket No. UT-040788; Company's response to Staff Data Request No. 277

This communication is made in a good faith attempt informally to resolve what appears to be a discovery dispute. Hopefully, we can resolve this amicably.

In Staff Data Request No. 277, Staff requested Verizon to supply the specific information relating to a sale of a Verizon local exchange business in the state of Hawaii. Verizon responded that the information requested was "not relevant."

First, "relevance" does not accurately reflect the applicable standard for data requests. The applicable standard is whether the "information is relevant to the issues in the adjudicative proceeding, or that may lead to the production of information that is relevant." WAC 480-07-400(4).

Second, the information is relevant, or may lead to the production of information that is relevant, because the Hawaii sale includes the sale of the directory associated with that local exchange business. Directory revenues (or, per Verizon's direct case, the lack of directory revenues) are at issue in Docket No. UT-040788. Verizon has offered at least 2 witnesses on the subject.

How Verizon, or the market, values a directory business associated with a local exchange business is directly relevant to an analysis of the value of such a business in Washington. The information requested seeks documents that likely contain that information, or would likely refer to documents that contain that information.

If it is Verizon's belief that the documents requested contain no information whatsoever about the directory business, then please so advise, and explain the basis for Verizon's belief.

Please consider this email at your earliest convenience. This information is needed by Staff, and I need to know promptly whether the Company is willing to provide the requested information.

Thank you for your cooperation.

Donald T. Trotter
Assistant Attorney General
Counsel for WUTC in Docket No. UT-040788

360-664-1189

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Thank you.



Don Trotter/WUTC
07/26/2004 02:01 PM

To jendejan@grahamdunn.com
cc
bcc
Subject Staff Data Request No. 277

After discussions, Staff has attempted to narrow its request for documents regarding the Hawaii sale. See attached document. Thank you for your attention to this matter. We are confident this can be resolved amicably.

Please review and contact me as soon as possible.

DTT



- Doc2.doc

→ see next page for this document

Regarding Staff Data Request No. 277:

Verizon NW has asked Staff to refine its request. Staff is willing to do so, as follows:

Without waiving any right to seek further documents under this data request, Staff would ask that the Company provide, from the universe of documents covered by Staff Data Request No. 277 as written, supply:

- 1) any document that mentions directory operations, and
- 2) a list of the documents responsive to Staff Data Request as written that are not being produced under item 1).

A non-exclusive list of examples of the meaning of "mention" for purposes of Item 1) include: described in writing in text, or in a dollar figure, or identified in an omitting phrase, such as "this value does not include directory operations."

Don Trotter/WUTC
07/27/2004 03:51 PM

To <JEndejan@GrahamDunn.com>
cc
bcc
Subject Re: DR 277 Hawaii issues

Thanks. A small comment: You use the phrase "address the directories" while the "refined" DR asked for documents that "mentioned" the directory operations. I assume Verizon will not attach interpretive significance to the difference.

Thanks again

DTT
<JEndejan@GrahamDunn.com>



<JEndejan@GrahamDunn.com>
m>
07/27/2004 03:43 PM

To <DTrotter@wutc.wa.gov>
cc
Subject DR 277 Hawaii issues

Tom, I am speaking with Don and he wants us to lists the docs that we aren't giving to him and to provide any docs that refer or relate to the directory business in connection with the sale of the business--transaction-related documents that address the directories. Are there such beasts? What does the prospectus or offering doc say about the directories, for example. I'm not sure I read the revised DR 277 correctly to understand that that us what Staff really wants.

-----Original Message-----

From: Don Trotter [mailto:DTrotter@wutc.wa.gov]
Sent: Tuesday, July 27, 2004 3:40 PM
To: Endejan, Judith A.
Subject: Please provide a listing of all other economic entities (other than Bremerton-Kitsap Airporter) which Richard Ashe has any ec

(See attached file: Verizon General 277-280.doc)

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Thank you.

ATTACHMENT 10

**August 17, 2004, e-mail from Donald T.
Trotter to Judith Endejan re Staff Data
Request No. 277**

Don Trotter/WUTC
08/17/2004 08:29 AM

To jendejan@grahamdunn.com
cc
bcc
Subject Staff Data Request No. 277

This was the data request we discussed at various times during the July 21-27 time frame. It regards the Hawaii transaction. We have not seen a response, and we have not heard from you since then.

Could you please check the status of this and report back? Thanks very much.

DTT

ATTACHMENT 11

**Verizon NW's September 3, 2004,
Response to Staff Data Request No. 277
(Confidential documents are excluded)**

Regarding Staff Data Request No. 277:

Verizon NW has asked Staff to refine its request. Staff is willing to do so, as follows:

Without waiving any right to seek further documents under this data request, Staff would ask that the Company provide, from the universe of documents covered by Staff Data Request No. 277 as written, supply:

- 1) any document that mentions directory operations, and
- 2) a list of the documents responsive to Staff Data Request as written that are not being produced under item 1).

A non-exclusive list of examples of the meaning of "mention" for purposes of Item 1) include: described in writing in text, or in a dollar figure, or identified in an omitting phrase, such as "this value does not include directory operations."

RESPONSE: Verizon continues to object to this question because it seeks information that is not relevant to this adjudicatory proceeding. In addition, the modified request is unduly burdensome and onerous as it would require Verizon to review each and every document associated with the Hawaii sale, which are voluminous. Without waiving the foregoing objection, Verizon responds as follows.

Verizon assumes the purpose of the request is to ascertain the valuation of the directories business in the Hawaii sale. Verizon did not structure the sale offering so as to assign a particular value to that portion of the business that was sold by Verizon Corporation. The buyer paid a single amount for all of the Hawaii ventures of Verizon Corporation that included the ILEC operations, Verizon Internet Services, Inc., (a separate Verizon subsidiary), Verizon Long Distance (a separate Verizon subsidiary) and Verizon Information Services (VIS) (a separate subsidiary that included the directories operation). Verizon does not know how the buyer valued each of these business units in Hawaii in calculating the purchase price. There has been no allocation of the purchase price for each business unit involved in the Hawaii sale.

Attached hereto are two documents. Confidential Attachment 277a is the portion of an internal Verizon Management presentation concerning this sale dated December 2003 as it pertains to VIS. Confidential Attachment 277b is the VIS segment reporting information that was provided to all potential buyers so they could formulate their assessment of the offer.

Prepared by: Gregg Diamond

Date: September 3, 2004

Witness: n/a

Confidential Attachment 277a

(Confidential per Protective Order in WUTC Docket No. UT-040788)

[Not provided in this motion]

Confidential Attachment 277b

(Confidential per Protective Order in WUTC Docket No. UT-040788)

[Not provided in this Motion]

ATTACHMENT B

As explained herein, VZNW's position in resisting this discovery is reasonable for three key reasons. First, the requested records do not belong to VZNW and are not subject to inspection under RCW 80.04.070. Second, the Commission has no authority as a matter of law to examine the financial records of Verizon Communications Inc., including its board of directors minutes and records relating to the sale of its Hawaii operations. Third, the requested information is not relevant to the issues in this case – which is an examination of the intrastate operations of Verizon Northwest – not the financial results of any other Verizon entity outside the jurisdiction of the Commission.¹

A line must be drawn here, based upon the Commission's jurisdictional limits, that forecloses Staff from demanding the financial records of businesses that are unrelated to VZNW's Washington intrastate operations. Otherwise, there will be no reasonable limit to what Staff will seek under its theory of relevancy that suggests that it can basically engage in a fishing expedition concerning financial records of entities that the Commission does not regulate.

As explained herein the law does not support Staff's views.

II. ARGUMENT

A. The Records At Issue Do Not Belong to VZNW.

As a starting point, the Commission must determine whether the records at issue are subject to Commission examination under Washington law under its general regulatory authority. They are not because they do not belong to a "public service company." Under RCW 80.04.070 the Commission's authority to "inspect books, papers, and documents" is limited to "public service" companies. VZNW is that "public service company," the definition of which includes telecommunications companies that own, operate or manage "any facilities"² used to

¹ As discussed in Section II, the Commission's authority to examine the financial records of an unregulated company affiliated with a regulated company is limited by the affiliated interest statutes, RCW Ch. 80.16, which requires a contractual arrangement as the basis for limited examination.

² "Facilities" means lines, conduits, ducts, poles, wires, cables, cross-arms, receivers, transmitters, instruments, machines, appliances, instrumentalities and all devices, real estate, easements, apparatus, property and routes used, operated, owned or controlled by any telecommunications company to facilitate the provision of telecommunications service. RCW 80.04.010.

provide telecommunications for hire, sale, or resale to the general public within this state.” RCW 80.04.010. VZMW is the owner, operator or manager of those facilities -- not its corporate parent, Verizon Communications Inc. RCW 80.04.070 by its express terms is limited to the owner of the intrastate “facilities.” Had the Legislature intended to include parent corporations who manage the companies that own, operate or manage the intrastate facilities, it would have said so

“Where a statute specifically designates the things or classes of things upon which it operates, an inference arises in law that all things or classes of things omitted from it were intentionally omitted by the legislature under the maxim expression unius est exclusio alterius -- specific inclusions exclude implication. Washington Natural Gas Co. v. Public Util. Dist. No. 1, 77 Wash. 2d 94, 98, 459 P.2d 633 (1969).

Silver First Town Homes, Inc. v. Silver Lake Water District, 103 Wn. App. 411, 421, 12 P.3d 1022 (2000)³

Reading the definition to construe the Commission’s jurisdiction to intrastate operations is consistent with Order No. 05 in this case as well as RCW 80.01.040(3), which states the Commission’s jurisdiction pertains only to telecommunications companies operating “within this state.” Statutes should be read in harmony “to the end that a harmonious total statutory scheme evolves which maintains the interpretation of the respective statutes.” *State v. Wright*, 84 Wn.2d 695, 650, 529 P.2d 453 (1974). Thus, the statutory scheme in Title 80, RCW clearly shows that the Commission’s authority only pertains to records of the company providing the intrastate service.

Because Items A, B and C cover documents that do not belong to VZMW, but instead belong to corporations beyond the Commission’s statutory jurisdiction, the Commission has no authority to compel their examination. It is well settled that an agency has only the authority that the legislature grants it by statute. *Edelman v. State ex. rel. Public Disclosure Com’n*, 68 P.2d

³ In this case the court found that a municipal water corporation was not subject to WUTC jurisdiction because the definition of “water company” in RCW 80.04.020 makes no mention of “municipal corporations.” So too, the definition of “telecommunications company” in that statute makes no mention of parent corporations that manage the “facilities” owners, so the parent corporation is beyond WUTC jurisdiction.

296 (2003). No Washington statute grants the Commission the general authority to examine the financial records of a corporate parent that include its Board of Directors' minutes, and documents relating to the sale of properties with no relation to Washington, or journal entries not associated with Washington intrastate operations.

Rather, the only statutory authority that allows the Commission to examine records that do not belong to the utility it regulates appears in RCW Ch. 80.16 "Affiliated Interests." As explained in the next section, the Washington Supreme Court has expressly found that a utility need not produce documents from an affiliate⁴ except as required by RCW Ch. 80.16. Because the discovery requests at issue do not fall within that chapter, VZNW need not answer them.

B. The WUTC Has No General Ratemaking Authority to Inspect the Financial Records of Verizon Communications.

Staff cites no legal authority for its purported entitlement to examine the minutes of the board of directors meetings for VZNW's parent corporation, Verizon Communications Inc. and documents relating to the sale of the Hawaii telephone properties of Verizon Communications Inc. Instead, Staff relies on the NARUC Rate Case and Audit Manual but the passages relied upon fail to establish the Commission's authority over the financial records of Verizon Communications Inc. In fact, p. 7 of the Manual establishes that NARUC advises commissions that they may not have authority to examine the financial records of entities other than the utility subject to the commission's regulation. The Manual notes:

If the auditor believes that it is important to review affiliate transactions, it is useful to know early in the process whether one might be overstepping the Commission's authority to review such transactions, or whether the Commission has broad powers of review in this area. Similarly, if the auditor wants to review not only the minutes of the board of directors meetings for the utility, but also for the board of the parent company, may he/she do so? On looking at the sensitive areas, the auditor should have thought-through answers to questions of relevance to the utility operations and Commission authority.

The requests here fail both as to relevance and Commission authority.

⁴ Which by definition includes a corporate parent. RCW 80.16.010

In *Waste Management of Seattle, Inc. v. the WUTC*, 123 Wn.2d 621, 869 P.2d 1034 (1994), the Washington Supreme Court ruled that the WUTC **has no authority** to review the records of affiliated companies under its general ratemaking authority to ensure that rates are just and reasonable, but can only examine the records of affiliated companies that are “contracts or arrangements” under the affiliated interest statutes.

In *Waste Management*, Staff had requested and been denied financial records of two affiliates of the regulated utility, Waste Management of Seattle, Inc. That utility collected commercial solid waste from its customers in Seattle and transferred it to a waste processing division, paying the City of Seattle a disposal fee pursuant to a city ordinance. An affiliate, Washington Waste Systems, Inc., had a contract with the city to transport the waste to a landfill in eastern Oregon operated by another affiliate, Oregon Waste. Washington Waste, Oregon Waste, and Waste Management are all subsidiaries of Waste Management of North America, Inc., which in turn is a subsidiary of Waste Management, Inc.

In *Waste Management*, the Staff argued, like here, that it may review financial records of affiliated companies that were not affiliate contracts under its general ratemaking authority. In that case, the Court held that the WUTC’s authority to obtain records from unregulated companies stems from RCW 81.16.030, the affiliate interest statute.⁵ The Washington Supreme Court concluded that the WUTC does *not* have general authority to examine financial records of an unregulated company affiliated with a regulated company unless there is a contract or arrangement between that company and the regulated company subject to review under RCW 81.16.030. *Id.* 123 Wn.2d at 641, 869 P.2d at 1045.

Item A does not involve any contract or arrangement reviewable under the affiliate interest statutes. Rather, it is a blatant request for private proprietary financial records of a

⁵ RCW 80.16 is the parallel statutory chapter for telecommunications companies.

company not subject to Commission jurisdiction. Under *Waste Management* the Commission has no authority to compel their production.⁶

Similarly, Item C also asks for financial records of Verizon Communications Inc. and other affiliates relating to an asset sale which have nothing to do whatsoever with any contract or arrangement involving VZNW. Under *Waste Management*, the Commission utterly lacks authority to examine the financial records associated with the sale of the Hawaii properties, either under RCW Ch.81.16 or its general authority.

In *Waste Management* the Washington Supreme Court drew a clear box around the Commission's authority to examine financial records of any entity **other than the utility subject to its direct regulation**. These requests are outside that box.

C. The Data Requests Are Also Irrelevant.

VZNW objects to the data requests at issue here for another fundamental reason – they seek information that is not relevant and not reasonably calculated to lead to the discovery of information relevant to this case and, as such, fall outside the scope of permissible discovery under the Commission's rules. See WAC 480-07-400(4). In Order No. 5 in this Docket, the Commission ruled that it would only look at the Washington intrastate portion of VZNW's operations (¶¶ 27, 30). The Commission only has jurisdiction over telecommunications companies operating "within this state." RCW 80.01.040(3). Thus, except as allowed by Washington's affiliated interest statutes, financial records of other companies or operations beyond its jurisdiction simply are not relevant.

Staff argues that the minutes of the parent corporation's board of directors meetings are somehow relevant to a determination of policies for Washington operations. However, of course, this argument ignores the fact that Staff data requests have already inquired into those items, on a Washington-specific basis, that are allegedly discussed at parent board meetings. VZNW has responded to data requests about "financing, income tax returns, pensions, employee

⁶ There can be no question that the WUTC has no jurisdiction over the parent corporation, Verizon Communications Inc. See Section II.A.

compensation including employee incentive plans, stock-based compensation plans and workforce reductions.”⁷ See Attachment A for examples in this respect.

Staff has made no showing that it could not obtain what it seeks from existing data requests. Nor has it shown that the Board Minutes of Verizon Communications Inc. expressly makes policy for VZMW, as opposed to the entire parent corporation. Quite simply, VZMW is not discussed at the parent board meetings. Exhibit NWH-5 to the Direct Testimony of Nancy Heuring includes the Verizon Corporation organization chart. This shows that VZMW is just a small part of a much greater business operation (less than 1%) that might be considered at a Board of Directors meeting, which would include discussion of business units at a consolidated level, such as Verizon Wireless, Verizon International Telecom or Verizon Information Services. To argue that a review of the parent Board of Directors’ meetings minutes is essential to reviewing VZMW’s Washington intrastate results of operations is a mischaracterization of the NARUC manual and stretches beyond all reason any relevancy to the issues in this case. Given the extensive discovery that has occurred, and is occurring the parent Board minutes should not be produced on relevancy grounds alone. The Staff should not be allowed to engage in a fishing expedition which is an unreasonable intrusion into corporate governance of a major private unregulated U.S. corporation.

Similarly, the discovery requested regarding Item B seeks journal entry figures for jurisdictions other than VZMW. Staff suggests that it needs to review the entire journal entry in order to follow the allocation of the total journal entry amount to the Washington level. However, as explained in Attachment B, the Declaration of Nancy W. Heuring, Staff’s view erroneously assumes that an allocation is made. Ms. Heuring explains why Staff’s position is quite simply incorrect and why all pertinent, relevant Washington numbers were provided to Staff.

⁷ Staff Motion to Compel, pp. 4-5.

Item C, which requests information about the sale of Verizon's Hawaii operations, is even more tangential and irrelevant to any issue in this case. First, the data request does not relate to any contractual arrangement between VZNW and Verizon Hawaii. Therefore, under *Waste Management*, the WUTC has no authority to inquire into the financial records that relate to the sale of that company to the parent corporation. Staff has established no connection between VZNW and any portion of the Verizon Hawaii entities sold, including directories. Second, the financial records regarding the sale of the Hawaii operations belong not only to the incorporated Verizon Hawaii units, but also to Verizon Communications Inc., the seller, all of which are well beyond the jurisdiction and authority of this Commission.

Staff cites no legal authority, nor is there any, for requiring the production of the Hawaii sale documents. It argues that, "this information is directly 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." (Motion to Compel, p. 9.) Even if the issue of imputation of directory revenues to VZNW is proper in the general rate case, a point VZNW disputes, Staff presents no basis for connecting the sale of Verizon's entire Hawaii operations⁸ to some value for the directory operations at issue in Washington, which have never belonged to VZNW and which are not being sold. Furthermore, as the Attachment C, the Declaration of Dale Chamberlain establishes there was no such evaluation, a fact which was included in VZNW's response to DR No. 277. Therefore, Staff's factual predicate for its assumption does not exist and there is no information about the Hawaii directories' valuation that could be provided. There is no further response to compel from Verizon, even if found to be relevant.

Furthermore, Staff has made no showing whatsoever of the relevancy of requiring VZNW to list the records relating to the Verizon Hawaii sale that VZNW would not be

⁸ That consisted of operations other than the local exchange company, including the Hawaii assets of Verizon Information Systems ("VIS"), publisher of directories.

producing.⁹ There is simply no relationship between the sale of one piece of Verizon Communications Inc. thousands of miles away with VZNW's rate case in Washington. To find otherwise would give Staff the right to ask for records relating to the sale of other assets of Verizon Communications Inc. -- a right that no court of law would sustain. In sum, no connection between the non-existent evaluation of a directory operation sale in a state thousands of miles away has any bearing on the imputation of directory revenues to the Washington operations of VZNW. Verizon objected to the relevancy of this request initially, tried to work with Staff to reach a reasonable compromise, but Staff persists in asking for financial information that it has no legal right to see.

The Commission recently has refused to allow unfettered discovery that seeks information the Commission deems not relevant to the scope of the issues in the case. VZNW was denied discovery on relevancy grounds in *AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest Inc.*, Docket No. UT-02-0406, Fifth Supplemental Order (February 21, 2003). In that decision, the Commission reversed the decision of the administrative law judge requiring AT&T to respond to VZNW data requests seeking information as to AT&T's competitive harm, as alleged in AT&T's Complaint. AT&T claimed that it did not have to provide this discovery because it was no longer claiming that it was suffering any competitive losses. The Fifth Supplemental Order took a narrow view of the scope of this case and therefore reversed the discovery ruling. VZNW should be subject to the same standard of relevancy applied by the Commission in refusing to allow VZNW discovery in the *AT&T* case. Because there is no relevancy to the issues in this case, the discovery at issue should be denied.

As stated above, the scope of the proceeding here addresses only VZNW's intrastate operations and discovery addressed to financial records beyond the intrastate borders that do not relate to those operations are simply not within the scope of this proceeding.

⁹ Staff fails to explain how a description of what was not produced about the Hawaii sale would lead to the discovery of relevant evidence in the Washington Rate Case?

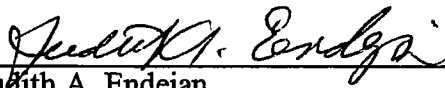
Finally, Staff asks VZNW to provide the basis for its redactions of audit reports in writing. VZNW will do so, reserving all of its rights to challenge future motions to compel on this issue.

III. CONCLUSION

For the foregoing reasons, Verizon Northwest asks the Commission to deny the Staff's Motion to Compel in its entirety.

DATED this 22nd day of September, 2004.

GRAHAM & DUNN PC

By 
Judith A. Endejan
WSBA# 11016
Email: jendejan@grahamdunn.com
Attorneys for Respondent

ATTACHMENT A

Docket No. UT-040788
WUTC Staff Data Requests to Verizon Nos. 1-28
May 21, 2004

Data Request 2 (General)

Please produce, for the past five years:

- a) all bond rating documents for Verizon Northwest Inc. (or any affiliate thereof) issued by any bond rating agency (*e.g.*, Standard & Poor's, Moody's, *etc.*). This includes documents such as the bond rating itself, any associated analysis, "credit watch" type analysis, bond rating upgrades, downgrades, *etc.*
- b) all correspondence between Verizon Northwest Inc. (or any affiliate thereof) and any bond rating agency (*e.g.*, Standard & Poor's, Moody's, *etc.*) relating to any document or rating related to Item (a) of this data request.
- c) all documents in which Verizon Northwest Inc. (or any affiliate thereof) discusses Verizon Northwest Inc.'s bond rating including any written record of presentations that Verizon Northwest Inc. or Verizon Communications Inc. has made to any bond rating agency.
- d) any reports, notes or other written materials furnished by brokerage firms or other financial institutions in which Verizon Northwest Inc. or Verizon Communications Inc. or its subsidiaries were discussed. Please include the date of discussion and any creditworthiness evaluations.

RESPONSE:

- a) See files provided on CD in the folder labeled as DR #2 - Attachment 2a.
- b) There is no correspondence relating to Item (a).
- c) See files provided on CD in the folder labeled as DR #2 - Attachment 2c.
- d) See files provided on CD in the folder labeled as DR #2 - Attachment 2d.

Prepared By: Robert G. Deter
Date: May 13, 2004
Witness: James H. Vander Weide

Docket No. UT-040788
WUTC Staff Data Requests to Verizon Nos. 1-28
May 21, 2004

Data Request No. 25 (Heuring testimony)

With respect to the \$10 million in employee separation expenses included in test year Corporate Operations expense as documented on Schedule C1, Heuring workpapers Tab 4, please provide Verizon Northwest Inc.'s estimate of annual savings it expects to realize from the employee separation and all documents supporting the estimate. Please explain why the estimated savings from the employee separation are not recognized in the test year.

RESPONSE:

Estimated savings associated with employees leaving the payroll during the test year were identified and included in the general rate case filing. See WP P12.1.7, Note (B), included herewith as Attachment 25, for the estimated annual savings of \$17,150,458 associated with the actual headcount reduction in the test year. Of this total annual savings, \$9,173,780 is included in the Test Year booked amounts, as the force reductions occurred over the entire twelve-month period. The incremental difference of \$7,976,678 is included as a proforma adjustment in the general rate case filing.

Prepared By: Jane Lee
Date: May 19, 2004
Witness: Nancy Heuring

Docket No. UT-040788
WUTC Staff Data Requests to Verizon Nos. 29-30
Related to Interim Rate Relief Case
June 2, 2004

Data Request No. 30

Please provide the end-of-month short-term debt balances for Verizon Northwest Inc., for the preceding 36 months and include the monthly cost rate of that short-term debt.

RESPONSE:

See Attachment 30.

Prepared By: Robert G. Deter
Date: May 25, 2004
Witness: James H. Vander Weide

Verizon Response to WUTC Staff Data Request No. 30
UT-040788

Attachment 30

VERIZON NORTHWEST INC.
MONTH END SHORT-TERM DEBT
(Thousands of Dollars)

Attachment 30

	Amount	Cost Rate
Sep-03	\$153,268	1.115%
Aug-03	\$200,329	1.120%
Jul-03	\$181,704	1.156%
Jun-03	\$206,433	1.240%
May-03	\$240,061	1.291%
Apr-03	\$175,307	1.280%
Mar-03	\$187,530	1.285%
Feb-03	\$214,865	1.350%
Jan-03	\$195,487	1.365%
Dec-02	\$173,617	1.383%
Nov-02	\$196,451	1.939%
Oct-02	\$167,117	2.055%
Sep-02	\$208,995	2.033%
Aug-02	\$209,746	1.966%
Jul-02	\$246,518	1.899%
Jun-02	\$300,097	1.887%
May-02	\$267,801	1.870%
Apr-02	\$244,740	1.880%
Mar-02	\$261,063	1.922%
Feb-02	\$282,971	1.925%
Jan-02	\$255,641	2.031%
Dec-01	\$294,728	2.136%
Nov-01	\$276,712	2.340%
Oct-01	\$254,979	2.861%
Sep-01	\$293,324	3.479%
Aug-01	\$318,428	3.678%
Jul-01	\$296,832	3.855%
Jun-01	\$345,829	4.195%
May-01	\$343,762	4.667%
Apr-01	\$107,908	5.086%
Mar-01	\$92,242	5.286%
Feb-01	\$160,298	5.811%
Jan-01	\$114,982	6.376%
Dec-00	\$150,929	6.571%
Nov-00	\$53,699	6.553%
Oct-00	\$56,867	6.563%
Sep-00	\$60,591	6.564%

Docket No. UT-040788
WUTC Staff Data Requests to Verizon Nos. 31-34
June 9, 2004

Data Request No. 32

Verizon Northwest Inc.'s response to WUTC STAFF DATA REQUEST NO. 8 (General) stated the following:

“Since January 1, 1999, Verizon Northwest has financed its annual construction budget via funds from operations (internally generated funds) and short-term notes with GTE Funding Incorporated and Verizon Network Funding Corp.”

Please provide a list of the short-term notes obtained from GTE Funding Incorporated and Verizon Network Funding Corp., and for each note, state the term of the note, interest rate, and any conditions or criteria Verizon Northwest Inc. must comply with to avoid default on such financing.

RESPONSE:

Verizon Northwest Inc. borrows and invests short-term funds with GTE Funding Incorporated according to the conditions and criteria outlined in the attached Financial Services Agreement dated January 3, 1997 (Attachment 32a). The Financial Services Agreement was authorized by the Commission in Docket UT-960952 on October 9, 1996. The agreement works on a “cash pool” basis and has no associated promissory notes. The amount borrowed or invested is rolled over each business day. The interest rate during the month of September 2003 was 1.115%.

Verizon Northwest Inc. borrows and invests short-term funds with Verizon Network Funding Corp. according to the conditions and criteria outlined in the attached Financial Services Agreement dated June 1, 2002 (Attachment 32b). The Financial Services Agreement was filed with the Commission August 16, 2002. The agreement works on a “cash pool” basis and utilizes the attached promissory note dated September 1, 2002 (Attachment 32c), which limits the amount of borrowing to \$500 million. The amount borrowed or invested is rolled over each business day. The interest rate during the month of September 2003 was 1.115%.

Prepared By: Robert G. Deter
Date: June 1, 2004
Witness: James H. Vander Weide

Verizon Response to WUTC Staff Data Request No. 32
UT-040788

Attachment 32a

FINANCIAL SERVICES AGREEMENT

This Agreement, dated as of January 3, 1997, by and between GTE NORTHWEST INCORPORATED, a Washington corporation (the "Operating Company") whose common stock is wholly-owned by GTE Corporation, a New York corporation ("GTE"), and GTE FUNDING INCORPORATED, a Delaware corporation ("GTEFI") whose common stock is wholly-owned by GTE Florida Incorporated, a Florida corporation whose common stock is wholly-owned by GTE;

WITNESSETH:

WHEREAS, GTEFI has been formed to perform financial services for the Operating Company and for other corporations which are GTE Affiliates (as hereinafter defined); and

WHEREAS, the parties have determined to enter into this Agreement for the provision of financial services by GTEFI to the Operating Company as more fully described below;

NOW THEREFORE, in consideration of the mutual promises herein contained, the parties hereto agree as follows:

1. Eligible GTE Affiliate. The Operating Company hereby represents to GTEFI that it is an Eligible GTE Affiliate. For the purposes of this Agreement, an Eligible GTE Affiliate shall mean a corporation (a) which provides telephone service in the United States of America, (b) whose telephone service or rates for service are regulated by a public body, (c) which is at least 25% owned (as determined by the ownership of its outstanding voting securities), directly or indirectly, by GTE (a "GTE Affiliate"), and (d) which maintains either a publicly issued or a privately provided Minimum Rating (as hereinafter defined) for its short-term commercial paper from at least two of the following rating agencies (collectively, the "Rating Agencies"), and no Rating Agency publishes a rating for its short-term commercial paper which is less than a Minimum Rating: Standard & Poor's Corporation ("S&P"), Moody's Investors Service ("Moody's"), Duff & Phelps Credit Rating Company ("DCR"), and Fitch Investors Service ("Fitch"). For the purposes of this Agreement, a Minimum Rating shall mean: (a) A-1 or its successor equivalent from S&P, (b) P-1 or its successor equivalent from Moody's, (c) D-1 or its successor equivalent from DCR, and (d) F-1 or its successor equivalent from Fitch.

2. Services to be Performed. GTEFI agrees to provide, either directly or through arrangements with third parties for the benefit of the Operating Company, such

financial services as the Operating Company may from time to time specify, including but not limited to the following services:

a. Loans from GTEFI to the Operating Company. The Operating Company shall be permitted to borrow short-term funds from GTEFI subject to the following provisions:

(i) Availability of Funds. The Operating Company shall be permitted to borrow short-term funds on a day-to-day (demand note) basis from GTEFI on any business day to finance the Operating Company's ordinary business and capital requirements.

(ii) Limitations on Borrowing. As long as GTEFI shall remain below ninety-two percent (92%) of the total external indebtedness limitation agreed to by GTEFI (the "GTEFI Borrowing Limit") in that certain Support Agreement, dated as of January 3, 1997, between GTEFI and GTE, as such agreement may be amended from time to time (the "Support Agreement"), GTEFI shall not impose any limit on the principal amount of funds that may be borrowed by the Operating Company from GTEFI on any business day or the aggregate principal amount of indebtedness that may be due and owing by the Operating Company to GTEFI from time to time. GTEFI may restrict the right of the Operating Company to borrow from GTEFI, or the amount of any such new borrowings, if GTEFI's external indebtedness exceeds ninety-two percent (92%) of the GTEFI Borrowing Limit. The Operating Company understands and agrees that GTEFI shall not be permitted to lend funds to the Operating Company if GTEFI shall at such time have total external indebtedness in excess of the GTEFI Borrowing Limit.

(iii) Interest Rate. The Operating Company shall pay interest on the aggregate principal amount of all funds borrowed by it from GTEFI at the Applicable Rate (as defined herein), which may change daily.

(iv) Calculation of the Applicable Rate. The Applicable Rate shall mean the rate of interest established by GTEFI as its "Applicable Rate" on a day-to-day basis. The Applicable Rate shall be set by GTEFI to approximate GTEFI's net weighted average daily borrowing rate, which shall be determined in part by including in the calculation of such rate the fees which shall be paid or payable by GTEFI to brokers and banks for the issuance by GTEFI of external indebtedness to fund its financial requirements and for the establishment or maintenance of lines of credit to which GTEFI shall have access. The Applicable Rate shall be based upon a 360-day year.

(v) Repayment of Loans. The Operating Company shall have the right to repay all or any part of the principal amount and accrued interest of the loan or loans outstanding that were made to the Operating Company by GTEFI at any time without penalty.

b. Investments by the Operating Company in GTEFI. The Operating Company shall be permitted to invest excess short-term funds in GTEFI (such funds, together with funds invested in GTEFI by other GTE Affiliates, being hereinafter referred to as "Deposits") subject to the following provisions:

(i) Availability of Investment Alternative. The Operating Company shall be permitted to make Deposits on a day-to-day basis with GTEFI on any business day.

(ii) Interest Rate. GTEFI shall pay interest on the aggregate principal amount of all Deposits by the Operating Company at the Applicable Rate, which may change daily.

(iii) Repayment of Investments. The Operating Company shall have the right to demand repayment of any or all Deposits by the Operating Company at any time without penalty.

c. Cash Management. GTEFI will provide cash management services to the Operating Company, including, but not limited to, the opening and closing of bank accounts, transfers of funds into and out of bank accounts, electronic funds transfers, instructions to banks and dealers, negotiation and payment of bank and dealer fees, disbursements and collections of funds and the management of related supporting cash management systems (collectively, "Cash Management Services") subject to the following provisions:

(i) Types of Services. GTEFI shall provide such Cash Management Services to the Operating Company as shall be reasonably requested from time to time by the Operating Company.

(ii) Performance Standard. GTEFI agrees to provide Cash Management Services to the Operating Company in a manner which will efficiently utilize the cash resources of the Operating Company.

(iii) Compensation. GTEFI shall be compensated for the provision of Cash Management Services to the Operating Company based upon the costs incurred in providing such Cash Management Services.

3. Financing Activities. During the term of this Agreement, GTEFI shall loan to Eligible GTE Affiliates at least 85% of any cash or cash equivalents raised through either (a) Deposits, (b) the issuance by GTEFI of commercial paper with a maturity of 270 days or less, or (c) the incurrence by GTEFI of short-term indebtedness with a maturity of less than one year (collectively, "Financing Activities"). Such loans shall be made as soon as possible, but in no event later than 30 days after GTEFI receives such cash or cash equivalents through such Financing Activities.

4. Limitation on Types of Investments. During the term of this Agreement, GTEFI shall not be permitted to invest in, own, hold or trade any securities other than the following permitted investments ("Permitted Investments"):

a. debt securities issued by Eligible GTE Affiliates, including the Operating Company,

b. debt securities, including repurchase agreements, which are exempted by the provisions of the Securities Act of 1933 by Section 3(a)(3) of such Act and issued by corporations which maintain Minimum Ratings from at least two Rating Agencies, and

c. government securities as defined in Section 2(a)(16) of the Investment Company Act of 1940.

5. Inspection Rights. Upon request, GTEFI agrees to make available to the Operating Company for inspection GTEFI's books, records, bills and accounts with respect to the Operating Company, as well as any documents which describe or pertain to the Cash Management Services provided by GTEFI to the Operating Company. GTEFI understands and agrees that copies of such books, records, bills, accounts and documents with respect to the Operating Company may be required to be provided by the Operating Company to public regulatory bodies, and GTEFI hereby consents to such arrangement.

6. Maximum Liability. The maximum liability of the Operating Company to GTEFI hereunder at any time shall be the principal amount plus accrued and unpaid interest of all loans outstanding from GTEFI to the Operating Company at such time plus any compensation which may be due and owing to GTEFI in connection with Cash Management Services previously provided by GTEFI to the Operating Company minus the amount of any Deposits by the Operating Company together with any accrued and unpaid interest related to such Deposits.

7. Scope of Business Limitation. During the term of this Agreement, GTEFI shall limit its business activities to the following:

a. the raising of funds and the repayment of funds obtained through Financing Activities,

b. the making of Permitted Investments,

c. the lending of funds obtained through Financing Activities to Eligible GTE Affiliates,

d. the performance of Cash Management Services for GTE Affiliates,

e. the establishment and maintenance of fee-paid back-up bank lines of credit (which may not be canceled by the issuer thereof due to the occurrence of a material adverse change in the financial or business affairs of GTEFI or any

Eligible GTE Affiliate) covering all of commercial paper indebtedness obtained through Financing Activities that may be utilized by GTEFI and Eligible GTE Affiliates to repay such commercial paper indebtedness obtained through Financing Activities, and

f. activities directly related to and in furtherance of the foregoing.

8. **Corporate Formalities.** During the term of this Agreement, GTEFI shall maintain all corporate formalities generally associated with separate and distinct corporate entities, including, but not limited to, the following:

a. the maintenance of separate and distinct GTEFI corporate minute books and records,

b. the maintenance and usage of separate and distinct GTEFI bank accounts (including checking accounts),

c. the maintenance and usage of separate stationery in connection with GTEFI's external correspondence, and

d. the execution of contracts and agreements in GTEFI's own name.

9. **Financial Statements.** During the term of this Agreement, GTEFI shall prepare quarterly unaudited financial statements and annual audited financial statements, and shall make such financial statements available to lenders and rating agencies upon request as soon as such financial statements shall become available (which, for quarterly unaudited financial statements, shall be within 60 days after the end of each of GTEFI's first three preceding fiscal quarters and, for annual audited financial statements, shall be within 120 days after the end of GTEFI's preceding fiscal year).

10. **Termination.** Notwithstanding anything to the contrary contained in this Agreement, this Agreement may be terminated by the parties hereto, and the effect of such termination shall be, as follows:

a. **Termination by the Operating Company Following Notice.** The Operating Company may unilaterally terminate this Agreement by giving two business days prior written notice of such termination to GTEFI.

b. **Termination by the GTEFI Following Notice.** GTEFI may and, if the Operating Company shall no longer be an Eligible GTE Affiliate, GTEFI shall, unilaterally terminate this Agreement by giving two business days prior written notice of such termination to the Operating Company.

c. **Immediate Termination.** This Agreement shall be terminable immediately by either party hereto if the Support Agreement or any similar substituted agreement shall no longer be in full force and effect, or if all of the

common stock of GTEFI shall no longer be directly or indirectly wholly owned by GTE.

d. Effect of Termination. Upon any such termination, GTEFI shall immediately repay to the Operating Company with interest any Deposits made by the Operating Company, and the Operating Company shall immediately repay to GTEFI with interest any loans from GTEFI to the Operating Company.

11. Other Agreements with Eligible GTE Affiliates. The parties acknowledge that GTEFI intends to execute financial services agreements similar to this Agreement ("Other Agreements") with other Eligible GTE Affiliates. GTEFI agrees to terminate any Other Agreement within two business days if the party to such Other Agreement shall no longer be an Eligible GTE Affiliate.

12. Effectiveness of this Agreement. Although this Agreement has been executed by both parties hereto, to the extent that any state statute, order, rule or regulation or any state regulatory body having competent jurisdiction over either of the parties to this Agreement shall require that this Agreement be filed with or approved by such regulatory body before this Agreement may become effective, this Agreement shall not become effective for such party until the first business day after such approval or filing shall have been obtained or such other date approved by such regulatory body.

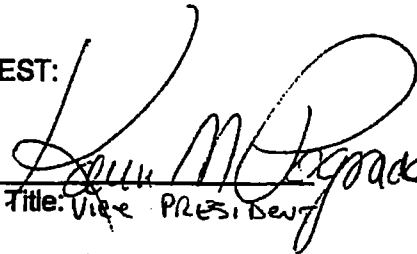
13. Amendment. This Agreement may be amended or rescinded only by written instrument signed by both of the parties hereto, but no such amendment shall become effective until five business days after a copy of such amendment shall have been provided by either party hereto to each of the Rating Agencies.

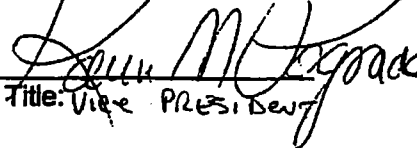
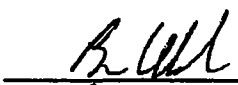
14. Successors. The covenants, representations, warranties and agreements herein set forth shall be mutually binding upon, and inure to the mutual benefit of, each of the parties hereto and its successors and assigns.

15. Multiple Counterparts. This Agreement may be executed by the parties in one or more counterparts, and each executed counterpart shall be considered an original.

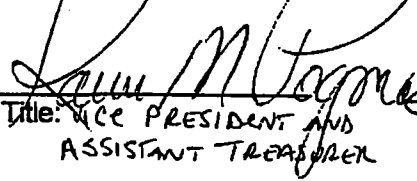
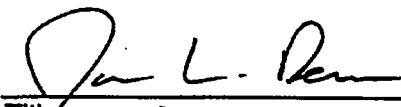
16. Governing Law. This Agreement shall be governed by the laws of the State of Delaware which are applicable to agreements made and performed in that state.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers thereunto duly authorized as of the day and year first above written.

ATTEST:  GTE NORTHWEST INCORPORATED

By:  Title: Vice President By:  Title: ASSISTANT TREASURER

ATTEST:  GTE FUNDING INCORPORATED

By:  Title: VICE PRESIDENT AND ASSISTANT TREASURER By:  Title: VICE PRESIDENT - General Manager and ASSISTANT TREASURER

Verizon Response to WUTC Staff Data Request No. 32
UT-040788

Attachment 32b

FINANCIAL SERVICES AGREEMENT

THIS AGREEMENT, dated as of June 1, 2002, by and between Verizon Northwest Inc. ("Operating Company") and Verizon Network Funding Corp. ("Network Funding").

WITNESSETH:

WHEREAS, Network Funding has been formed to perform financial services for the Operating Company and for other corporations which are Eligible Verizon Affiliates (as hereinafter defined); and

WHEREAS, the parties have determined to enter into this Agreement for the provision of financial services by Network Funding to the Operating Company as more fully described below;

NOW THEREFORE, the parties agree as follows:

1. Eligible Verizon Affiliate. For the purposes of this Agreement, an Eligible Verizon Affiliate shall mean each direct or indirect subsidiary of Verizon Communications Inc. ("Verizon") which has entered into a financial services agreement that is similar to this Agreement (an "Other Agreement") and either (a) provides telephone service in the United States of America and its telephone service or rates for service are regulated by a public body (a "Regulated Telephone Affiliate"), or (b) provides administrative and other support services to a Regulated Telephone Affiliate which are necessary or desirable to permit the Regulated Telephone Affiliate to conduct its operations.
2. Services to be Performed. Network Funding agrees to provide either directly or through arrangements with third parties for the benefit of the Operating Company, such financial services as the Operating Company may from time to time specify, including but not limited to the following services:
 - a. Short-Term Loans from Network Funding to the Operating Company. The Operating Company shall be permitted to borrow funds on a day-to-day basis from Network Funding subject to the following provisions:
 - (i) Short-Term Loans. The Operating Company shall be permitted to borrow funds on a day-to-day basis from Network Funding on any business day ("Short-Term Loans") up to the Maximum Principal Sum outlined in the Promissory Note between the Operating Company and Verizon Network Funding.

- (ii) **Interest Rate and Payments.** The Operating Company shall pay interest on its unpaid outstanding principal balance of all Short-Term Loans from Network Funding at a rate per annum equal to the Short-Term Interest Rate to be determined in the manner set forth below.
- (A) **Weighted Average Interest Rate.** If Network Funding shall pay any interest, premiums, discounts, commissions or fees in connection with its short-term borrowings during any month, the Short-Term Interest Rate shall be equal to the weighted average of all interest, premiums, discounts, commission and fees paid by Network Funding in connection with its short-term borrowings for each month.
- (B) **Selected Interest Rate.** If Network Funding shall not pay any interest, premiums, discounts, commissions or fees in connection with its short-term borrowings during any month, the Short-Term Interest Rate shall be an interest rate to be selected by Network Funding and to be accepted by the Operating Company; provided, however, that any rate which is at least equal to the interest rate paid by the United States government on its 90-day Treasury securities on the last business day of such month shall be deemed acceptable to the Operating Company.
- (C) **Timing of Payments.** The Operating Company shall pay interest on Short-Term Loans to Network Funding on the first business day of each month following a month during which any Short-Term Loans were outstanding for at least one business day; provided, however, that the Operating Company and Network Funding may mutually agree to change the date or frequency of interest payments if it becomes desirable and beneficial to do so.
- (iii) **Repayment of Short-Term Loans.** The Operating Company shall have the right to repay all or any part of the principal amount and accrued interest of any Short-Term Loans outstanding at any time without penalty. Network Funding shall have the right to demand repayment of all or any part of the principal amount and accrued interest of any Short-Term Loans outstanding at any time without penalty.

b. **Short-Term Investments by the Operating Company in Network Funding.** The Operating Company shall be permitted to invest funds in Network Funding subject to the following provisions:

- (i) **Short-Term Investments.** The Operating Company shall be permitted to lend funds on a day-to-day basis to Network Funding on any business day ("Short-Term Investments").
- (ii) **Interest Rate and Receipts.** Network Funding shall pay interest on the aggregate principal amounts of all Short-Term Investments by the Operating Company at the Short-term Interest Rate. Network Funding shall pay interest on Short-Term Investments to the Operating Company on the first business day of each month following a month during which any Short-Term Investments were outstanding for at least one business day; provided, however, that the Operating Company and Network Funding may mutually agree to change the date or frequency of interest payments if it becomes desirable and beneficial to do so.
- (iii) **Repayment of Short-Term Investments.** Network Funding shall have the right to repay all or any part of the principal amount and accrued interest of any Short-Term Investments outstanding at any time without penalty. The Operating Company shall have the right to demand repayment of all or any part of the principal amount and accrued interest of any Short-Term Investments outstanding on any business day without penalty.

c. **Financial Management Services.** Network Funding shall provide financial management services to the Operating Company, including but not limited to, the opening and closing of bank accounts, transfers of funds into and out of bank accounts, foreign currency transactions, electronic funds transfers, instructions to banks and dealers, negotiation and payment of bank and dealer fees, disbursements and collections of funds, long-term debt portfolio management, the establishment and maintenance of back-up bank lines of credit, the establishment and maintenance of standby letters of credit and financial guarantees, and the management of related supporting financial management systems (collectively, "Financial Management Services").

- (i) **Cost of Services.** The Operating Company agrees to pay to Network Funding each month a financial management fee to provide Financial Management Services to the Operating Company (the "Financial Management Fee").

- (ii) **Calculation of Financial Management Fee.** The Financial Management Fee shall be the sum of bank account service fees and general overhead costs, and shall be calculated by Network Funding as follows:
 - (A) **Bank Account Service Fees.** Bank account services fees shall be based upon actual usage when bank accounts are solely for use by the Operating Company, and based upon relative usage of bank account services when bank accounts are shared between the Operating Company and other Eligible Verizon Affiliates; and
 - (B) **General Overhead Costs.** General overhead costs of Network Funding, including some bank fees that cannot reasonably be allocated according to the above methodology, shall be allocated among the Operating Company and other Eligible Verizon Affiliates based on the percentage of each Eligible Verizon Affiliate's total capital to the sum of the total capital for all Eligible Verizon Affiliates or through the same methodologies utilized by Verizon for allocation of common costs among Verizon's operating telephone companies.
- (iii) **Payment for the Cost of Services.** Network Funding shall prepare and deliver to the Operating Company a monthly statement specifying the Financial Management Fee. The Operating Company shall pay the amount shown on such statement within 30 days after the billing date.

- 3. **Limitations on Types of Investments.** During the term of this Agreement, Network Funding shall not be permitted to invest in, own, hold, or trade any securities other than the following permitted investments ("Permitted Investments"):
 - a. **Affiliate Debt Securities.** Debt securities issued by Eligible Verizon Affiliates, including the Operating Company;
 - b. **Section 3(a)(3) Securities.** Debt securities, including repurchase agreements, which are exempted by the provisions of the Securities Act of 1933 Section 3(a)(3) of such Act; and
 - c. **Government Securities.** Government securities as defined in Section 2(a)(16) of the Investment Company Act of 1940.

4. **Inspection Rights.** Upon reasonable notice, Network Funding agrees to make available to the Operating Company for inspection Network Funding's books, records, bills, accounts, with respect to the Operating Company, as well as any documents which describe or pertain to the calculation of the Financial Management Fee. Network Funding understands and agrees that the Operating Company may provide copies of such books, records, bills, accounts, and documents to public regulatory bodies, and Network Funding hereby consents to such arrangement.

5. **Maximum Liability.** The maximum liability of the Operating Company to Network Funding hereunder at any time (the "Maximum Liability") shall be the sum of net short-term indebtedness and unpaid financial services, to be determined as set forth herein.
 - a. **Net Short-term Indebtedness.** Net short-term indebtedness shall be calculated as follows:
 - (i) the principal amount plus accrued and unpaid interest of all Short-Term Loans outstanding from Network Funding to the Operating Company at such time, minus
 - (ii) the amount of any Short-Term Investments by the Operating Company with Network Funding together with any accrued and unpaid interest related to such Short-Term Investments.
 - b. **Unpaid Financial Services.** Unpaid financial services shall be all compensation which may be due and owing to Network Funding in connection with the Financial Management Services previously provided by Network Funding to the Operating Company, and

6. **Scope of Business Limitation.** During the term of this Agreement, Network Funding shall limit its business activities to the following:
 - a. the raising of funds on behalf of Eligible Verizon Affiliates;
 - b. the lending of funds to Eligible Verizon Affiliates;
 - c. the making of Permitted Investments;
 - d. the performance of Financial Management Services for Eligible Verizon Affiliates;
 - e. activities directly related to and in furtherance of the foregoing.

7. **Termination.** Notwithstanding anything to the contrary contained in this Agreement, this Agreement may be terminated by the parties hereto, and the effect of such termination shall be, as follows:
 - a. **Termination by the Operating Company Following Notice.** The Operating Company may unilaterally terminate this Agreement by giving 90 business days prior written notice of such termination to Network Funding.
 - b. **Termination by Network Funding Following Notice.** Network Funding may unilaterally terminate this Agreement by giving 90 business days prior written notice of such termination to the Operating Company.
 - c. **Immediate Termination.** This Agreement shall be terminable immediately by either party hereto if all of the common stock of Network Funding shall no longer be directly or indirectly wholly owned by Verizon or its successor.
 - d. **Effect of Termination.** Upon any such termination, the Operating Company shall immediately repay to Network Funding the Maximum Liability; provided, however, that if the Maximum Liability shall be less than zero, Network Funding shall pay the amount by which the Maximum Liability is less than zero to the Operating Company.
8. **Other Agreements with Eligible Verizon Affiliates.** Network Funding agrees to terminate any Other Agreement within 90 business days if the party to such Other Agreement shall no longer be an Eligible Verizon Affiliate.
9. **Effectiveness of this Agreement.** Although this Agreement has been executed by both parties hereto, to the extent that any state statute, order, rule or regulation or any state regulatory body having competent jurisdiction over either of the parties to this Agreement shall require that this Agreement to be filed with or approved by such regulatory body before this Agreement may become effective, this Agreement shall not become effective for such party until the first business day after such approval or filing shall have been obtained or such other date approved by such regulatory body.
10. **Governing Law.** This Agreement shall be governed by the laws of the State of New York, which are applicable to agreements made and performed in that state.
11. **Execution and Amendment.** This Agreement may be executed by the parties in one or more counterparts, and each executed counterpart shall be considered an original. This Agreement may be amended or rescinded only by written instrument signed by both of the parties hereto.

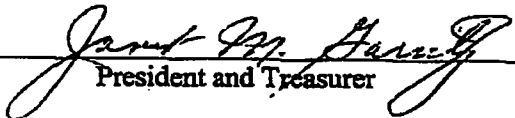
12. Successors. The covenants, representations, warranties, and agreements herein set forth shall be mutually binding upon, and inure to the mutual benefit of, each of the parties hereto and its successors and assigns.

IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed by their respective officers thereunto duly authorized as of the day and year first above written.

ATTEST: VERIZON NORTHWEST INC.

By: 
Treasurer

ATTEST: VERIZON NETWORK FUNDING CORP.

By: 
President and Treasurer

Verizon Response to WUTC Staff Data Request No. 32
UT-040788

Attachment 32c

PROMISSORY NOTE

\$500,000,000

September 1, 2002

FOR VALUE RECEIVED, Verizon Northwest Inc., a Washington corporation (herein "Borrower") hereby promises to pay **ON DEMAND** to the order of Verizon Network Funding Corp. (formerly Bell Atlantic Network Funding Corporation), a Delaware corporation (herein "Lender"), in same day funds at its offices at 3900 Washington Street, 2nd floor, Wilmington, Delaware 19802 or such other place as Lender may from time to time designate, the principal sum of Five Hundred Million (\$500,000,000.00) (the "Maximum Principal Sum"), or such lesser amount as shall equal the aggregate unpaid principal amount of the loans made by Lender to Borrower, together with interest thereon from the date hereof until paid in full. Interest shall be charged on the unpaid outstanding principal balance hereof at a rate per annum equal to Lender's Cost of Funds (defined hereunder as the weighted average of all interest, premiums, discounts, commissions and fees paid by Lender in connection with its borrowings for each month), such rate to change as Lender's Cost of Funds changes. Interest on borrowings shall be due and payable on the first business day of each month, commencing with the first business day of the month after the month in which this Note is executed. In the absence of manifest error, the records maintained by Lender of the amount and term, if any, of such borrowings shall be deemed conclusive.

Borrower may borrow, repay and reborrow hereunder in amounts which do not, in the aggregate outstanding at any time exceed the Maximum Principal Sum.

The occurrence of one or more of any of the following shall constitute an event of default hereunder:

- (a) Borrower shall fail to make any payment of principal and/or interest due hereunder within five (5) days after the same shall become due and payable, whether at maturity or by acceleration or otherwise;
- (b) Borrower shall apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, admit in writing its inability to pay its debts as they mature, make a general assignment for the benefit of creditors, be adjudicated a bankrupt, insolvent or file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation of law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law, or if action shall be taken by Borrower for the purposes of effecting any of the foregoing; or

(c) Any order, judgment or decree shall be entered by any court of competent jurisdiction, approving a petition seeking reorganization of Borrower or all or a substantial part of the assets of Borrower, or appointing a receiver, trustee or liquidator of Borrower or any of its property, and such order, judgment or decree shall continue unstayed and in effect for any period of sixty (60) days.

Upon the occurrence of any event of default, then the entire unpaid principal sum hereunder plus all interest accrued thereon plus all other sums due and payable to Lender shall, at the option of Lender, become due and payable immediately without presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor, all of which are hereby expressly waived by Borrower.

In addition to the foregoing, upon the occurrence of any event of default, Lender may forthwith exercise singly, concurrently, successively or otherwise any and all rights and remedies available to Lender by law, equity, statute or otherwise.

Borrower hereby waives presentment, demand, notice of nonpayment, protest, notice of protest or other notice of dishonor, and any and all other notices in connection with any default in the payment of, or any enforcement of the payment of, all amounts due hereunder. To the extent permitted by law, Borrower waives the right to any stay of execution and the benefit of all exemption laws now or hereafter in effect. Borrower further waives and releases all errors, defects and imperfections in any proceedings instituted by Lender.

Following the occurrence of any event of default, Borrower shall pay upon demand all costs and expenses (including all amounts paid to attorneys, accountants, and other advisors employed by Lender), incurred by Lender in the exercise of any of its rights, remedies or powers hereunder with respect to such event of default, and any amount thereof not paid promptly following demand therefor shall be added to the principal sum hereunder and shall bear interest at the contract rate set forth herein from the date of such demand until paid in full. In connection with and as part of the foregoing, in the event that this Note is placed in the hands of an attorney for the collection of any sum payable thereunder, Borrower agrees to pay reasonable attorneys' fees for the collection of the amount being claimed hereunder, as well as all costs, disbursements and allowances provided by law.

In the event that for any reason one or more of the provisions of this Note or their application to any entity or circumstances shall be held to be invalid, illegal or unenforceable in any respect or to any extent, such provisions shall nevertheless remain valid, legal and enforceable in all such other respects and to such extent as may be permissible. In addition, any such invalidity, illegality or unenforceability shall not affect any other provisions of this Note, but this Note shall be construed as if such invalid, illegal or unenforceable provision had never been contained herein.