

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND  
TRANSPORTATION COMMISSION

Complainant,

v.

VERIZON NORTHWEST INC.,

Respondent.

DOCKET NO. UT-040788

COMMISSION STAFF  
RESPONSE TO VERIZON NW's  
PETITION FOR COMMISSION  
REVIEW OF ORDER NO. 9

**I. OVERVIEW**

1 On September 15, 2004, Commission Staff filed a "Motion to Compel Production of Documents and/or Information" (Motion to Compel). The Motion to Compel asked the Commission to order Verizon NW to produce specific documents: Verizon Communications Inc. Board of Director minutes, complete and un-redacted versions of certain journal entries on Verizon NW Inc.'s books of account, and documents related to Verizon's sale of its telephone operations in the state of Hawaii.

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Until the Company filed its response September 22, 2004, one day before oral argument, the Company had registered only a relevance objection to producing these documents. See *Motion to Compel, Attachment 2, first ¶; Attachment 8, page 1 Response*. In its September 22, 2004 response, the Company argued for the first time that the documents were not producible under *Waste Management of Seattle, Inc. v. WUTC*, 123 Wn.2d 621, 869 P.2d 1034 (1994). Accordingly, some aspects of this issue were not fully addressed to the ALJ.

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After oral argument on September 23, 2004, ALJ C. Robert Wallis issued Order No. 9 (October 2, 2004), ordering Verizon NW to produce the documents requested.

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Verizon NW has never told the Commission it *cannot* produce the documents requested. Verizon NW is arguing that it *will not* produce the documents requested, because the information is allegedly: a) irrelevant; and b) beyond the Commission's power to order the Company to produce.

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The Company's arguments are misplaced. Order No. 9 correctly concluded that the information requested is relevant, or will lead to the production of relevant information. The Company itself has placed into issue the matters about which relevant documents are being requested. The Company should not be allowed to block reasonable discovery of the Company's own case. Finally, the documents are

relevant to an “arrangement” between Verizon NW and an affiliate, so the decision in *Waste Management of Seattle, Inc. v. WUTC* does not apply.

6           The Commission should affirm Order No. 9 for these reasons, as more fully developed below.

## II. THE COMPANY’S RELIANCE ON THE WASTE MANAGEMENT DECISION IS MISPLACED

7           In its Petition, Verizon NW constantly refers to the *Waste Management* case as the primary basis for its opposition to producing the requested documents. But however the Company wishes to read that case, it does not apply to the journal entries, because those journal entries are documents within the books of account of Verizon NW Inc.; they are not documents of an affiliate.

8           *Waste Management* is not applicable to the Board Minutes or Hawaii sale documents because there is an affiliated “arrangement” between Verizon NW and Verizon Communications in this case. There is also an affiliated interest arrangement between Verizon NW and Verizon Directories Corp. (VDC). Some of VDC’s assets are being “spun off” in that Hawaii sale.

9           The arrangement between Verizon NW and Verizon Communications is demonstrated by the Company’s own testimony and data request responses. For example, Verizon NW testifies that 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. 1-19.*

10           In data request responses, the Company conceded that Verizon Communications sets the policies of Verizon NW with respect to several matters, for example, financing, income tax returns, pensions, employee compensation including employee incentive plans, stock-based compensation plans and workforce reductions. *See Motion to Compel, 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.*

11           The affiliated interest arrangement between Verizon NW and VDC is contained in a contract between VDC and Verizon NW. *See Exhibit No. \_\_\_ (DBT-1T), Direct Testimony of Dennis B. Trimble at 17.*

12           In its direct case, the Company has specifically placed into issue the reasonableness of the test year cost of pensions, employee compensation, and workforce reductions. *See, Exhibit No. \_\_\_ (NWH-1T), Direct Testimony of Nancy W. Heuring, at 16, ll. 7-15.* Moreover, as noted in Order No. 9, Verizon NW pays dividends that flow to its parent.<sup>1</sup> The Company has also placed into issue the

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<sup>1</sup> The Company objects to payment of dividends being used as a basis for finding that an affiliated arrangement exists between Verizon NW and Verizon Communications, because allegedly, no dividends have accrued from the Company's Washington intrastate operations recently. *Petition at 6, n7.* The flaw in the Company's logic is obvious: Even assuming the lack of a payment, that does not prove an affiliated interest "arrangement" does not exist. For example, assume that a

reasonableness of the money flow between Verizon NW and its affiliate, Verizon Directories. See, Exhibit No. \_\_\_\_ (DBT-1T), Direct Testimony of Dennis B. Trimble, and Exhibit No. \_\_\_\_ (MJD-1T), Direct Testimony of Michael J. Doane.

13           Despite this evidence, Verizon NW disputes the existence of an affiliated interest arrangement between Verizon NW and Verizon Communications. The Company argues that Order No. 9 “converts this ‘arrangement’ into the equivalent of a contract, even though no such document exists ....” *Petition at 7, ¶ 15*. The Company is wrong, for several reasons.

14           First, RCW 80.16 applies to both “contracts” and “arrangements,” and subjects each of these categories of agreements to the same statutory requirements.<sup>2</sup> E.g., RCW 80.16.020. Accordingly, there is no meaning to Verizon NW’s concept of “converting an arrangement into a contract” because the statute applies equally to both arrangements and contracts.

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particular affiliated interest contract filed pursuant to RCW 80.16 did not call for the public service company to make a payment under certain stated conditions, and those conditions materialized. That does not mean the contract is not, or somehow ceased to become, an affiliated interest contract for purposes of RCW 80.16.

<sup>2</sup> The term “arrangement” as used in the Donnelly Act, takes on a connotation similar to that of the other terms with which it is found in company and thus must be interpreted as contemplating a reciprocal relationship of commitment between two or more legal or economic entities similar but not embraced within the more exacting terms “contract,” “combination” or “conspiracy”. *State v. Mobil Oil Corp.*, 344 N.E. 2d 357, 359 (1976). The term “arrangement” like other terms “contract,” “agreement,” and “combination,” in section in Donnelly Act refers to bilateral conduct and does not connote one-sided practice. *Commonwealth Elec. Inspection Services, Inc. v. Town of Clarence*, 6 A.D. 3d 1185, 1186 (2004).

15           Second, the statute itself refutes Verizon’s argument that there is no affiliated interest arrangement because there may be no document evidencing that arrangement. RCW 80.16 expressly contemplates the situation when no document exists. As required by RCW 80.16.020, if the affiliated contract or arrangement is not in writing, the utility must file a “verified summary” of the contract or arrangement. *RCW 80.16.020.*

16           Moreover, even if there was no “contract or arrangement” between Verizon NW and Verizon Communications, it is not at all clear the Company can use the *Waste Management* decision to oppose production of the documents requested. In *Waste Management*, the public service company did not place into issue the reasonableness of the costs of the affiliate at issue in that case; the Commission raised that issue on its own motion.

17           In this case, Verizon NW has placed into issue the fact that Verizon Communications Inc. dictates its policies. It has placed into issue the fact that it is seeking rates to recover costs incurred as the direct result of implementing those policy decisions. It has placed into issue the issue of directory imputation. The Company should not be allowed to deny the Commission the opportunity to get relevant information about these issues, or how those policies are set, planned, or implemented. There is nothing to suggest the court in *Waste Management* intended its decision to be used in the manner Verizon NW now advocates.

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Finally, the Commission should recall that at page 16 in its Fourth Supplemental Order in Docket No. UT-981367 (the Bell Atlantic/GTE Corp. Merger Case), the Commission recognized that the parent of the local telephone company was in control:

Similarly, we cannot ignore the integral role of GTE Corporation both in the day-to-day operations of GTE Northwest and in shaping the corporate strategy that will determine larger concerns, such as investments in Washington State, service offerings, and other matters that impact Washington consumers very directly. After the merger, Bell Atlantic Corporation [later Verizon Communications] will assume these roles for GTE Northwest.

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This rationale was used by the Commission to justify asserting approval authority over the GTE Corp./Bell Atlantic Merger, against arguments that the securities statute (RCW 80.08) and the transfers of property statute (RCW 80.12) did not apply. The same rationale fully supports a finding of an arrangement between Verizon NW and Verizon Communications in this case, and requiring the documents to be produced.

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In sum, there is no dispute that VDC and Verizon Communications are affiliates of Verizon NW. There is no dispute that there is a contract between VDC and Verizon NW. The Company's own testimony and data request responses describe many aspects of the "arrangement" between Verizon NW and Verizon Communications. An affiliated interest arrangement need not be in writing.

Accordingly, *Waste Management* does not apply, and Order No. 9 was correct to so hold.

### III. THE INFORMATION REQUESTED IS RELEVANT

21           The standard for production of responses to data requests is whether the information is relevant, or may lead to the production of relevant information. WAC 480-07-400(4). The information requested satisfies this standard.

#### **A. Board Minutes**

22           Staff did not initially request minutes of the Verizon Communications Board of Directors. Staff merely asked for the board minutes for entities of Verizon Corporation that affect Verizon NW. *See Motion to Compel, Attachment 2, page 5, Email from Paula Strain to Gregg Diamond.*

23           It is a standard audit function to trace the development of policies to the implementation of the policies. If the Board of Verizon NW established any policies, that would have been the focus, but as it turns out, that Board does very little of substance. *See Motion to Compel, Attachment 4, first Declaration of Paula M. Strain.* It was Verizon NW who indicated that the documents requested would be Verizon Communications board minutes.

24           As noted above in Section II, ¶¶ 10-15, it is the Verizon Communications Board who sets the policies and provides the corporate governance for Verizon



NW. Those policies translate directly into costs sought to be recovered through rates. This arrangement fully justifies production of these documents.

25           The Company argues that Verizon NW “is not discussed at the parent board meetings.” *Petition at 9, ¶ 20*. During oral argument, Verizon NW also represented that Verizon NW is “small change and small potatoes when the Board of Directors of Verizon Corporation get together in New York to talk.” *TR. 715:19-22*.

26           Staff cannot confirm or deny these advocacy statements because the board minutes have not been produced. But even if these statements are true, that is likely because the policies of Verizon Communications apply to Verizon NW, as well as other companies in the Verizon family of companies. That confirms the relevance of these Board minutes.

27           Verizon NW also claims this information should not be provided because Verizon NW is “working diligently” on a Staff data request asking for copies of the policies of the Board that are applicable to Verizon NW. *Petition at 9, ¶ 20*. The Company mischaracterizes Staff Data Request No. 452, which in fact requested a list and description of all Corporate Policy Statements that apply to or affect Verizon Northwest’s Washington operations.

28           That data request was issued September 22. The Company’s response was received October 13, 2004, and includes over 80 separate corporate policies affecting Verizon Northwest. *See Attachment A, Verizon NW Response to Staff Data Request No.*

452. Only a handful of these have been provided to Staff either in Verizon testimony, exhibits, workpapers or data responses. Moreover, this list is not evidence of how the policies were set, or how they were intended to be implemented.

29           In sum, Verizon NW has placed into evidence the issue that its policies are set by Verizon Communications. The Board minutes of Verizon Communications are relevant to the setting of those policies. There is an affiliated interest arrangement between Verizon NW and Verizon Communications. The documents should be produced.

30           To address any confidentiality concerns, Staff is willing to review the documents at Verizon NW's local offices, and take notes, not copies, though reserving the right to request copies later, if necessary.

**B. Journal Entries**

31           Staff provided the Company a list of some 23 journal entries, which Staff wished to review during its audit in Texas. The journal entries were those of Verizon NW, not an affiliate. When the Company provided Staff the journal entry documents requested, almost all of the documents were redacted to remove information allegedly related to other jurisdictions.

32           At bottom, the Company’s argument is that the Staff does not need  
information attributable to other jurisdictions, because that information is  
irrelevant. *Petition at 12, ¶ 28.*

33           Quite the contrary. The complete, un-redacted journal entries are needed in  
order to understand the nature of those journal entries, and to determine whether  
the Washington amount is reasonable. For example, assume the amount on a single  
journal entry sheet on Verizon NW’s books, but attributable to Pennsylvania, was  
\$200,000, but the amount attributable to Washington operations was \$2,000,000.  
Naturally, that would cause a question to be asked. That is a standard audit  
function. If Staff did not ask that question, it would be subject to justifiable  
criticism. That question cannot be asked because the Company would have  
redacted the \$200,000 amount.

34           The Company claims “the requested journal entries reflect the total [Verizon  
NW] amount from which the Washington portion could be determined.” *Petition at  
11, ¶ 28.* Although that does answer Staff’s main concern, Verizon’s statement is  
false. As the attached declaration of Paula Strain attests, of the 23 journal entry  
copies provided to Staff in the Response to Data Request No. 418,<sup>3</sup> 12 entries that  
contained redacted entry amounts showed redacted totals. Of the 12 entries, those

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<sup>3</sup> Staff Data Request No. 418 formalized the informal data request made for purposes of the on-site audit.

that presented Verizon Northwest totals on supporting schedules did not contain account numbers or other information sufficient to demonstrate that they track with the Washington journal entry amounts.

35           Finally, the Company states “the schedules were provided in response to Staff Data Request No. 418.” *Id.* That does not solve the problem because, as attested to by Ms. Strain in her Second Declaration (Attachment B to this Response), the “schedules” are copies of the journal entry page and in some cases additional schedules showing dollar amounts in more detail than the dollar amounts shown on the journal entry pages themselves. However, the basis for the charges to Washington are not explained or described in the documents furnished in this Response.

36           As the Second Declaration of Paula M. Strain concludes:

Based on the Company’s inadequate response to Staff Data Request No. 418, I am unable to verify 12 of these journal entries by amount. For none of the journal entries has the Company provided a complete explanation, as requested in Staff Data Request No. 418, so I cannot verify the propriety of any of the journal entries or how the Washington amounts were determined. Finally, because the Company has redacted amounts on Verizon NW’s books that allegedly are attributable to other states, I cannot determine whether the amount recorded for Washington is reasonable by comparing the amounts booked to Verizon NW that are attributable to other states.

37           A complete response to Staff Data Request No. 418, including a complete explanation of these journal entries, should be provided.

**C. Hawaii sale documents**

38 In Verizon NW's direct testimony, witness Mr. Trimble describes one of the issues surrounding the directory imputation issue: whether "an affiliate's revenues may and should be considered when *determining the appropriate compensation due the affiliated ILEC.*" *Trimble Direct Testimony, Exhibit No. \_\_\_ (DBT-1T) at 11:8-9 (emphasis supplied).*

39 Simply put, "determining the appropriate compensation due the affiliated ILEC" involves consideration of the value the "ILEC" (here Verizon NW) provides to the affiliate (here VDC).

40 Staff became aware that Verizon Communications was selling its Hawaii operations, and was packaging telephone operations with directory operations. As part of that transaction, VDC is selling the Hawaii portion of its directory business.

41 In other words, in the Hawaii sale transaction, the market is making an unambiguous statement that directory operations have the most value in conjunction with the telephone operations, *i.e.*, the telephone operations lend value to the directory operations. If the opposite were true, the directory business would have been sold separately.

42 Staff issued Data Request No. 277 in order to obtain relevant transaction documents to further analyze this plainly relevant issue.

43 Verizon NW argues that events in Hawaii have no relationship to Washington. Verizon NW is entitled to its opinion, but it is certainly reasonable to conclude that evidence of this actual market transaction in Hawaii is relevant to the issue whether Verizon NW provides value to its directory affiliate in this state. It is simply not credible that Hawaii is the only place in the world where telephone operations provide value to directory affiliates.

44 Verizon NW continues to use declarations of Mr. Dale Chamberlain in an attempt to prove there are no documents responsive to Staff's interest. *Petition at 10, ¶¶ 23-24 and n.18*. However, Mr. Chamberlain's declarations address only the issue of whether the responsive documents contain a statement of a separate and specific dollar value associated with the directory operations there. Assuming Staff is required to accept his statements as a factual description of the contents of the responsive documents,<sup>4</sup> they simply do not fully address the issue.

45 For example, assume the prospectus for the Hawaii sale states the benefits of the directory business being sold as part of the overall telecommunications operations in Hawaii. Though no specific "dollar value" might be calculated, such a statement would further support the notion that a directory business in

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<sup>4</sup> Note that Mr. Chamberlain's declarations do not state what in fact is or is not contained in the documents. His declarations are based only on his knowledge of the documents. His knowledge may not be complete.

association with a telephone business has greater value than as a separate, unaffiliated entity.

46           That is relevant to the directory imputation issue in this case. Indeed, the Company's position is that there should be no adjustment imputing value that the directory operations of VDC in this state receive from Verizon NW. *See Exhibit No. \_\_\_ (DBT-1T), Direct Testimony of Mr. Trimble at 3:3-4.* The Hawaii transaction documents may contradict that position, or lead to evidence contradicting that position. They should be produced.

47           As Order No. 9 correctly concluded, "[t]he relationship of the directory and the local exchange operators is a matter of corporate policy, as shown in Exhibit 70. Staff may make reasonable inquiry into those policies, including inquiries into instances of their implementation."

48           Verizon NW has already supplied one document responsive to Staff Data Request No. 277, though the Company provided it to the Commission to support the Company's position on Staff's Motion to Compel, and not to respond to Staff Data Request No. 277. *See Attachment A to Verizon NW's Supplemental Response to Motion to Compel (September 29, 2004).*

49           In any event, to the extent there are any burden concerns, Staff is convinced that if the Company provides the prospectus and other offering or marketing

documents, and in good faith accurately and fairly describes the remaining document categories, there will be little or no burden involved.

#### IV. CONCLUSION

50 For the reasons stated above, the Commission should affirm Order No. 9.

DATED this 15<sup>th</sup> day of October, 2004.

CHRISTINE O. GREGOIRE  
Attorney General

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DONALD T. TROTTER  
Senior Counsel  
Washington Utilities and  
Transportation Commission