Exhibit No. _________ (DKS-1T)
Docket No. UT-040788

BEFORE THE

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION,	)	
Complainant,	)	
v.	)	**DOCKET NO. UT-040788**
VERIZON NORTHWEST INC.,	)	
Respondent.	)	
. . . .	)	

REBUTTAL TESTIMONY OF

DUANE K. SIMMONS

ON BEHALF OF
VERIZON NORTHWEST INC.

FEBRUARY 2, 2005

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Duane K. Simmons. My business address is 750 Canyon Drive, Coppell, Texas 75019.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT CAPACITY?

A. I am employed by Verizon Services Organization Inc. as Manager – Separations Results with responsibilities for jurisdictional separations processing and results for all Verizon telephone companies, including Verizon Northwest Inc. ("Verizon NW" or the "Company").

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND EXPERIENCE QUALIFICATIONS.

A. I am a graduate of the University of Northern Iowa with a Bachelor of Arts degree in Financial Management. I began my career with GTE/Verizon in 1978 as an outside plant engineer. In 1982, I joined the Business Relations group that had the primary responsibility for the development of Part 36 separations results. Since 1982, I have held a number of managerial positions of increasing responsibility, including positions in traffic separations, cost separations, and access costs. In 2000, I became Manager – Investment and Traffic for the merged Verizon operations. I was responsible for directing and managing the development and analysis of monthly and basic traffic and investment studies for all Verizon operating study areas, which included the former Bell

Atlantic and former GTE study areas. In 2001, I transferred to my current position, where I am responsible for directing and managing the Part 36 separations results, Part 69 access cost results, and other related cost accounting studies for all Verizon operating areas.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. No.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to rebut the November 22, 2004, testimony of Staff witnesses Dr. Glenn Blackmon, Mr. Tim Zawislak, and Ms. Paula M. Strain. I will clarify certain statements that Dr. Blackmon makes about FTTP investment and marketing expenses and show that Mr. Zawislak's line sharing adjustment violates FCC separations rules. My testimony also explains why the special access adjustment that Ms. Strain proposes is nothing more than a backdoor approach to rewriting the FCC's separations rules based on her own creation of an intrastate separations factor that has no linkage to the jurisdictional separations rules as codified in 47 CFR Part 36. She justifies her approach by ignoring well-settled separations principles of cost allocation under the guise of the regulatory concept of "used" and "useful", which has no relevance to the plant in question and is simply misapplied. I will show that the adjustment Ms. Strain proposes not only violates the Part 36 rules but also produces a result that is totally unrealistic.

II. FCC SEPARATIONS REQUIREMENTS

Q. WHY ARE COST SEPARATIONS REQUIRED?

A. Most of the regulated property and expenses of the Company are used to provide both intrastate and interstate services. It is, therefore, necessary to separate these costs in order to properly allocate investments, expenses, and taxes between the interstate and intrastate jurisdictions. One of the primary purposes of this process is to prevent Independent Local Exchange Carriers ("ILECs") from recovering the same costs in both the interstate and intrastate jurisdictions.

Q. WHAT IS THE BASIS FOR PERFORMING COST SEPARATIONS?

A. Cost separations are performed on the basis of standard FCC separations procedures as codified in 47 CFR Part 36.

Q. HOW ARE COST SEPARATIONS RESULTS USED IN THIS PROCEEDING?

A. Cost separations results are used to develop jurisdictional separations factors. Jurisdictional separations factors are percentages that represent the proportion of the Company's regulated investments, expenses, and taxes that are appropriately attributable to the intrastate or interstate jurisdiction. Jurisdictional separations factors were developed for the test period in this proceeding and used by Company witness Nancy Heuring to develop the intrastate revenue requirement.

Q. IS VERIZON NW'S ASSIGNMENT OF COSTS TO THE INTRASTATE JURISDICTION ARBITRARY, AS DR. BLACKMON ASSERTS IN HIS TESTIMONY?

A. No. Verizon NW is required to follow the Part 36 rules as dictated by FCC Order. The Part 36 rules identify specific steps that must be taken to identify costs between the interstate and intrastate jurisdictions. The Part 36 test period results submitted in this case were developed in accordance with the current separations rules.

Q. DOES VERIZON NW ALLOCATE MARKETING EXPENSES BASED ON 2000 REVENUES AS DR. BLACKMON CLAIMS (P22)?

A. Yes. In accordance with Part 36.372, Verizon NW allocates current marketing expenses based on the analysis of interstate and intrastate revenues from 2000. With the implementation of the Separations Freeze Order on July 1, 2001, Section 36.372 was amended to require the allocation of marketing expenses on the revenue allocator that was reported for the 2000 annual period. Verizon NW is required to use this allocator for the five-year period of the freeze.

Q. PLEASE COMMENT ON DR. BLACKMON'S CLAIM THAT VERIZON NW ASSIGNS 75% OF FTTP INVESTMENT TO THE INTRASTATE JURISDICTION.

A. His statement is incorrect. As a threshold matter, this issue is irrelevant to this proceeding because Verizon NW has not made any FTTP investment in Washington, and no such investment is at issue in the test period. In any event, Dr. Blackmon is wrong.

Verizon NW's current Cost Allocation Manual ("CAM"), on file with the FCC, reflects procedures that will assign the costs of the video and data services utilizing FTTP investment to nonregulated activities, which means that less than 75% of FTTP investment will end up in the intrastate jurisdiction.

Q. VERIZON NW WITNESS FULP'S REBUTTAL TESTIMONY EXPLAINS WHY STAFF WITNESS ZAWISLAK'S ALLEGED "LINESHARING" ADJUSTMENT IS INAPPROPRIATE. DOES THIS ADJUSTMENT ALSO VIOLATE THE FCC'S SEPARATIONS RULES?

A. Yes. Mr. Zawislak's proposal assumes that when a Verizon NW affiliate purchases Verizon NW's interstate wholesale DSL service, $4/month of this interstate revenue should be allocated ("imputed") to the intrastate jurisdiction. As Mr. Fulp explains, this adjustment is improper because it attempts to rewrite (or declare unreasonable) Verizon NW's interstate DSL tariff. The FCC's separations rules require that revenues earned pursuant to interstate tariffs must be assigned to the interstate jurisdiction.

III. STAFF'S CALCULATION ERRORS

Q. WHY IS THE SPECIAL ACCESS ADJUSTMENT THAT MS. STRAIN PROPOSES IN EXHIBIT NO. __-C (PMS-13-C), STAFF ADJUSTMENT SP24 WRONG?

A. Incumbent local exchange carriers use the same telecommunications plant and equipment for providing both network access to interexchange carriers ("IXCs") and local telecommunications services to subscribers. ILECs are required to use the jurisdictional separations procedures contained in the Code of Federal Regulations Title 47, Part 36 to determine what portion of their costs is attributable to the interstate jurisdiction, and what portion is attributable to the intrastate jurisdiction. Ms. Strain's proposed special access adjustment is calculated using an intrastate separations factor that does not comport with the Part 36 rules and is therefore incorrect. The current Part 36 separations rules require the calculation of certain separations categories and allocation factors based on calendar year 2000 frozen relationships.

Q. PLEASE DESCRIBE STAFF WITNESS STRAIN'S "SPECIAL ACCESS ADJUSTMENT" (SP24).

A. Ms. Strain proposes to remove a significant percentage of costs included in Account 2410 – "Cable and Wireless Facilities" – from the intrastate jurisdiction. Under the FCC's Part 36 separations rules, 75.8% of the costs in this account are allocated to the intrastate jurisdiction. This is the intrastate factor that Verizon NW reported to the FCC, and Ms. Strain agrees that Verizon NW calculated this factor correctly. She also agrees (p. 44) that state regulators must follow the FCC's separations rules. Paradoxically, however, she proposes an adjustment (SP24) that *reduces* the intrastate factor to 61%, which in turn reduces Verizon NW's intrastate annual revenue requirement by more than $22 million. This adjustment is unlawful because it violates the separations rules.

Q. PLEASE EXPLAIN HOW SPECIAL ACCESS COSTS IN ACCOUNT 2410 ARE REQUIRED TO BE ALLOCATED UNDER THE FCC'S PART 36 RULES.

A. Special access or "private line" costs are identified and allocated in Account 2410 under FCC Rules 36.154-157 (See Exhibit No. DKS-2). In general, Account 2410 is broken down into four major categories: Exchange Line, Wideband and Exchange Trunk, Interexchange, and Host/Remote Message. These categories and the numerous subcategories are set forth in Appendix B to the FCC Freeze Order.[1]

Under the FCC Freeze Order, the categorization (and subcategorization) of Account 2410 is calculated according to factors based on calendar year 2000 investment levels. These "frozen" factors were developed by taking into account many different types of information, such as loop counts, cost per loop, cost per mile, circuit kilometers, and various types of minutes of use. In addition, the "jointly used" exchange line investment in Account 2410 is allocated using a fixed 75% intrastate factor, which has been in place since 1993. As noted earlier, applying the FCC's separations rules and frozen factors yields a 75.8% intrastate factor for Account 2410.

Q. DOES MS. STRAIN'S ADJUSTMENT REFLECT THE FCC'S RULES?

A. No. She developed a totally new separations factor for portions of Account 2410 based solely on intrastate and interstate special and switched access line counts for 2002-2003 that Verizon NW provided in response to Staff Data Request No. 521. This methodology is not permitted by, and directly conflicts with, FCC Rules 36.154-157. Ms. Strain does

[1] CC Docket No. 80-286, Report and Order, released May 22, 2001

not even attempt to explain this conflict. Even more remarkably, Ms. Strain's adjustment reallocates *all* of the message/switched access costs in Account 2410 while characterizing her adjustment as pertaining to special access. Furthermore, she completely ignores the fact that most message/switched access investment pertains to the local loop which the Part 36 rules require to be allocated on the fixed 75% intrastate factor. What is so incredible about this reallocation is that Ms. Strain provides no support by FCC or WUTC rule for the use of the access line factor that she develops.

Q. HOW DOES MS. STRAIN ATTEMPT TO JUSTIFY SP24?

A. Ms. Strain does not demonstrate that any items or class of plant included in the Company's booked Cable & Wire Facilities investment is not used and useful for the provision of telecommunications services within the state of Washington. Nor does she question the prudence of the investment. She reasons that a portion of the investment allocated to the intrastate jurisdiction by the FCC's separations rules is "really" used for *inter*state services, not *intra*state services, and therefore is not "used and useful" for intrastate ratemaking purposes. The issue raised by Ms. Strain's reasoning is not a matter of whether the plant is "used" or "useful" but how to apportion the costs associated with the plant's use between the jurisdictions. As discussed above, that issue has been resolved by the FCC and Ms. Strain's position, reflects nothing more than a disagreement with the FCC's rules. Put more bluntly, Ms. Strain thinks that more and more plant is being used for interstate services and thus the FCC's frozen factors are no longer appropriate. But as Staff admits, this is an issue for the FCC to decide, and state regulators cannot ignore the current separations rules. Furthermore, Ms. Strain's adjustment would put a significant portion of Verizon NW's costs in regulatory limbo; i.e., Verizon NW could not recover the costs from intrastate rates because Ms. Strain believes the investment is used for interstate services, and Verizon NW could not recover the costs from interstate rates because the FCC deems them to be intrastate. The separations rules were created to prevent this exact result, and they cannot be ignored.

Q. DOES MS. STRAIN'S ADJUSTMENT CONTAIN OTHER FLAWS?

A. Yes. Not only does she fail to follow the FCC's rules, she also misapplies her methodology in a manner that significantly understates intrastate costs.

As noted, Ms. Strain develops an allocation factor based solely on access lines counts; i.e., she allocates *costs* based solely on the number of *lines*. This methodology is reflected on page 12 of Exhibit PMS-13-C, which is entitled "Staff Adjustment to Remove Non-jurisdictional Special Access Plant." Line 13 of that exhibit shows a "test year average" of special access line and private line counts. It shows that that 71.67% of Verizon NW's special access lines and private lines (collectively referred to as "dedicated lines") were used for interstate services and 28.33% were used for intrastate services. Line 19 shows a test year average for switched (i.e., non-dedicated) lines. It shows that 2.39% of switched lines were used for interstate services and 97.61% were used for intrastate services.

If Ms. Strain truly believes that the costs of access lines should be allocated based solely on line counts, she would have allocated 28.33% of dedicated line costs and 97.61% of switched line costs to the intrastate jurisdiction. But she did not do this. Instead, she lumped all of the dedicated and switched lines together to develop a single test year average for *all* lines. As shown on line 24 of her exhibit, 43.19% of all lines are used for interstate service and 56.81% are used for intrastate services.

She then applied this 56.81% intrastate factor in a way that almost defies description. First, she took *all* of the costs in Account 2410, including the Company's proforma adjustment for plant additions in the test period, and then subtracted the costs associated with dedicated lines from the historic period. The resulting investment subject to allocation is shown on line 34. Second, she applied the 56.81% factor to this investment amount (calculation on line 38) and added back the costs of the dedicated lines to reach the total amount of *intrastate* investment in Account 2410 (line 42). This amount is $157.7 million *less* than the amount Verizon NW allocated pursuant to the FCC's separations rules (line 44).

This complex calculation proves three things:

<u>First</u>, Ms. Strain's adjustment is *not* an adjustment "to remove non-jurisdictional special access plant," as she claims, because it re-allocates *all* the costs in Account 2410, including the significant costs associated with switched access lines.

<u>Second</u>, this adjustment re-allocates switched access (non-dedicated) line costs based on the number of special access and private (dedicated) lines, but there is simply no basis for

allocating costs for one type of investment based on the number of lines in service for a different type of investment. Ms. Strain could just as easily (and just as inaccurately) have allocated the costs in Account 2410 between the intrastate and interstate jurisdiction based on the number of windows in the WUTC's and FCC's offices.

Third, this adjustment underscores that Ms. Strain is violating the FCC's separations rules. Most of the costs included in Account 2410 are loop costs that are subject to a fixed 75/25 allocation factor per the FCC's separations rules.[2] (This fixed allocator has been in place since 1993.) There can be no doubt that Ms. Strain's adjustment violates the rules – she uses a 56.81% allocator to allocate all the loop costs in Account 2410.

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING STAFF ADJUSTMENT SP24.

A. The adjustment is unlawful because it violates the FCC's separations rules. It ignores the FCC's frozen factors; it attempts to allocate costs based solely on line counts, contrary to FCC rules even if the FCC's allocation factors were not frozen; and it specifically conflicts with the FCC's 75/25 loop cost allocation requirement that has been in place since 1993. Moreover, the adjustment is arbitrary, irrational and unsupported because it allocates costs for one type of investment based on the number of lines in service for a *different* type of investment.

[2] 47 CFR 36.154 (c)

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.