Exhibit No. _____(ODF-3CT)
Docket No. UT-040788
(Redacted Version)

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

ORVILLE D. FULP

ON BEHALF OF
VERIZON NORTHWEST INC.

FEBRUARY 2, 2005

CONFIDENTIAL PER PROTECTIVE ORDER
IN WUTC DOCKET NO. UT-040788

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I. INTRODUCTION

Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS, EMPLOYER AND TITLE.

A. My name is Orville D. Fulp. My business address is 600 Hidden Ridge Drive, Irving, Texas 75038. I am employed by Verizon as Director-Regulatory.

Q. DID YOU FILE DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes, I filed direct testimony on August 23, 2004.

Q. WHAT IS THE PURPOSE OF YOUR REBUTTAL TESTIMONY?

A. My testimony responds to the direct testimony of Staff witnesses Dr. Selwyn, Tim Zawislak, and Jing Roth; XO Washington, Inc. witness Rex Knowles; Department of Defense witness Robert Spangler; and Public Counsel/AARP witness Dr. Robert Loube. Part II of my testimony addresses revenue requirement issues; specifically, it responds to the Commission Staff's proposals regarding joint marketing and linesharing. Part III addresses rate design issues; specifically, it responds to the pricing proposals of Commission Staff and the other parties I mentioned above.

II. REVENUE REQUIREMENT

Q. PLEASE DESCRIBE STAFF WITNESSES SELWYN'S AND ZAWISLAK'S ADJUSTMENT REGARDING AFFILIATED SALES AND MARKETING EXPENSES (SR18).

A. Verizon Northwest Inc. ("Verizon NW") provides certain sales and sales inquiry services to Verizon Long Distance ("VLD") and Verizon Online ("VOL"). Dr. Selwyn believes the rates Verizon NW charges VLD are below their fair market value ("FMV") and proposes a significantly higher rate – $75 per acquisition – that is based on a single analyst report discussing consumer acquisition costs for AT&T.

Mr. Zawislak uses Dr. Selwyn's $75 rate to calculate a sales and marketing adjustment for the services Verizon NW provides to VLD. He also creates a *separate* sales and marketing adjustment for VOL that is based on the $75 figure. The net effect of these adjustments is to reduce Verizon NW's annual intrastate revenue requirement by about *********.

These adjustments must be rejected for two reasons. First, Dr. Selwyn's proposed FMV of $75 for the services Verizon NW provides to VLD is plainly wrong because it is an estimate for services that go far beyond the services Verizon NW provides to its affiliates. As discussed below, Verizon NW provides only limited services to VLD; in a nutshell, it takes and processes orders. In contrast, Dr. Selwyn's $75 figure purportedly represents *all* types of customer acquisition costs, including advertising, the cost of telemarketers, and so on. Second, even if Dr. Selwyn's $75 figure were relevant, which it is not, Mr. Zawislak erred in applying it.

Q. BEFORE ADDRESSING STAFF'S ERRORS, PLEASE BRIEFLY DESCRIBE THE SALES AND SALES INQUIRY TRANSACTIONS BETWEEN VERIZON NW AND ITS AFFILIATES, VLD AND VOL.

A. Verizon NW takes orders for VLD and VOL and enters the customer information into a computer. For example, when a customer calls Verizon NW to order local service, a representative asks the customer what long distance company he wants. If the customer selects VLD, the representative will describe the various VLD plans, take the order, and send the information to VLD. A similar process occurs for VOL. In short, Verizon NW only takes sales orders and responds to customer inquiries for VLD and VOL.

Verizon NW charges VLD three separate charges depending on whether (1) it takes a consumer call in its consumer sales and service center ("CSSC"), (2) it takes a business call in its business service center ("BSC"), or (3) it takes an order from a customer in one of its Verizon Plus retail stores ("phonemarts"). During the test year, in its CSSC, Verizon NW charged VLD on a "per contact" basis instead of on a "per successful sale" basis; this charge was $4.85 per contact. In the BSC, Verizon NW charged VLD $34.80 (on average) per successful sale. In the phonemarts, Verizon NW charged VLD $15.45 per successful sale.

Verizon NW provides the same type of sales, order entry and customer inquiry services to VOL, but charges different rates than it charges VLD because different products are involved and the amount of time needed to respond to inquiries about the products is different.

In addition to the specific "per sale" and "per contact" rates discussed above, Verizon NW also bills VLD and VOL for other sales-related expenses such as general inquiry, dedicated staff support, product support specialists, and other expenses that are not included in the sales unit rates.

The rates Verizon NW charges VLD and VOL are in accordance with the FCC's affiliate transaction pricing rules; i.e., Verizon NW charges the higher of fully distributed cost ("FDC") or fair market value ("FMV"). Dr. Selwyn acknowledges this fact, stating (page 9, line 17) that Verizon NW "is ostensibly compliant with the higher of FDC or FMV rule."

Q. HOW DID VERIZON NW CALCULATE THE PORTION OF SALES AND MARKETING COST THAT IS RELEVANT TO THIS RATE CASE?

A. For purposes of this rate case, one must identify the regulated, Washington intrastate portion of sales and marketing ("SAM") cost. To do this, a two-step process is needed. First, you must calculate the *total* SAM cost for Verizon NW, which includes non-regulated cost, intrastate and interstate cost, and cost for jurisdictions other than Washington (e.g., Oregon and Idaho). Second, once the total SAM costs are identified, you must separate these costs as follows: (1) separate regulated and non-regulated costs, then (2) separate Washington costs from the other jurisdictions, then (3) separate intrastate costs from interstate costs. The resulting costs are the regulated, Washington intrastate costs that are used for rate case purposes. (Staff does not challenge this allocation process, although, as I discuss below, it failed to follow it.)

For VLD, Verizon NW started with the total amount billed to VLD for sales, order entry, and inquiry. These amounts are billed for services provided in the three different ordering channels – CSSC ($4.85 per contact), BSC (average of $34.80 per sale), and phonemarts ($15.45 per sale) – as well as miscellaneous expenses unrelated to the number of contacts or sales units. The total amount billed for the test period was **** *****. The regulated revenues and expenses booked for services provided from the Washington centers was ***************, as reported in the test year Affiliate Report and in response to WUTC Data Request 203. The amount attributable to the Washington intrastate books is ************. These amounts are shown in Exhibit No.___(ODF-5C), column (g).

For VOL, the process is the same as explained above for VLD, although the amounts billed to VOL for sales, order entry and inquiry are much lower due to a lower volume of this activity for VOL in the Verizon NW sales channels.

Q. DR. SELWYN CLAIMS THAT RATES VERIZON NW CHARGES VLD ARE TOO LOW AND THAT THE "FAIR MARKET VALUE" OF THESE SERVICES IS $75 PER SALE. PLEASE RESPOND.

A. Dr. Selwyn is wrong. The only support he offers for this $75 figure is a Credit Suisse report that attempts to estimate the customer acquisition costs of AT&T's Consumer segment for 2002. This $75 figure appears in a part of the report entitled "Advertising and promotions budget." These customer acquisition costs presumably reflect many categories of costs, such as (1) internal "channel" costs for sales and customer inquiries, which include order entry; (2) advertising costs, such as print media, radio, TV, bill inserts, and direct mailings; (3) external vendors' channel costs; (4) telemarketing costs; and (5) credit verification costs. Another third party source, "Measuring and Managing Customer Lifetime Value" by Siebel, says on page 7 that "Acquisition costs typically include marketing process and people costs, material and collection cost, sales and channel resource-related costs, and discount and resale costs." In short, analysts like Credit Suisse and Siebel are interested in finding out the *total costs* of acquiring a customer, which is what the $75 is supposed to represent.

The services Verizon NW provides to VLD, however, at most comprise only *one component* of customer acquisition costs – the "internal channel costs" for customer inquiries and order taking. Thus, Dr. Selwyn is comparing apples to oranges. He erroneously applies his $75 figure for *total* customer acquisition costs to the simple sales and order-taking services Verizon NW provides VLD.

In addition to this error, Dr. Danner explains that the $75 is no longer relevant or supportable, because AT&T has stopped acquiring long distance customers for its Consumer segment.

Q. SETTING ASIDE THE FACT THAT DR. SELWYN'S $75 FIGURE IS WRONG, DID MR. ZAWISLAK PROPERLY APPLY THIS FIGURE IN CALCULATING A SALES AND MARKETING ADJUSTMENT FOR VLD?

A. No – Mr. Zawislak made a series of errors.

First, in his direct testimony, he applied Dr. Selwyn's $75 figure to the wrong number of units. As discussed, the $75 is a per acquisition figure, i.e., that amount spent per actual sale. Mr. Zawislak, however, applied this figure to all the *contacts* made through the CSSC channel as opposed to the number of *sales*. As shown on page 1 of Exhibit No. ___(TWZ-16C), Verizon NW billed VLD for ************* contacts at a rate of $4.85, and thus received ************ for its CSSC order-taking work. Mr. Zawislak's erroneous application of the $75 rate to every CSSC contact increased the total amount Verizon NW would have billed VLD for the CSSC channel sales and inquiry services from *********** to **************. In other words, his adjustment for VLD imputed an additional ************* in total billed costs (before the allocations process).

After reviewing Mr. Zawislak's direct testimony, we met with him to explain his math error. He agreed that the $75 should be applied on a per sale basis, not a per contact basis. As shown on his revised Exhibit No.___C(TWZ-16C), page 1, the number of successful sales from the CSSC channel was **********. What he should have done in his errata testimony was apply the $75 per sale to this number of units and then subtract the amounts Verizon NW actually received (*************) to arrive at a "corrected" total adjustment figure. If he did, his original ************** adjustment figure for CSSC services would have been reduced to *************. (This calculation is shown on Exhibit No.___(ODF-5C), column (b), line 18). After applying the appropriate allocation percentages, his VLD adjustment to the regulated, Washington intrastate books would have been *************. (*Id.*)

Q. DID MR. ZAWISLAK MAKE THIS SIMPLE CORRECTION IN HIS ERRATA TESTIMONY?

A. No. Instead he used his errata testimony to produce a totally new methodology for calculating a sales and marketing adjustment for VLD. His calculation is rather complicated, but I have attempted to summarize it here:

1. First, Mr. Zawislak corrected his earlier mistake by converting the CSSC per contact charge of $4.85 to a per sale charge of *********, as shown on page 1, line 17 of his Exhibit No. __C(TWZ-16C). As noted, Mr. Zawislak thinks the ********** rate per successful sale should be $75, so he divided the $75 per sale rate by the ********** per sale rate to create a ratio of *******. *Again, this ratio applies only to the CSSC channel services, because it is based on the ********** that Verizon NW actually charged VLD for each CSSC sale*. Given

this, Mr. Zawislak should have applied his ******** factor only to the ****** **** related to the CSSC channel.

2. But Mr. Zawislak applied the ******* factor to the total SAM billing, including those costs attributable to the sales made through the BSC and phonemarts. In other words, he assumed, incorrectly, that Verizon NW charged VLD ******** for every sale regardless of the sales channel used. As noted earlier, Verizon NW charges VLD different rates depending on whether a sale is made through the CSSC, BSC, or phonemarts. During the test year, it charged an average of $34.80 for successful sales made through the BSC and $15.45 per successful sale made through the phonemarts. By assuming that Verizon NW charged ********* for all successful sales, Mr. Zawislak overstated his adjustment. In short, Mr. Zawislak made a math error – he developed a single factor of ******* based on the CSSC rate, but he should have developed three different factors. Moreover, he erroneously applied his factor to those miscellaneous expenses that are unrelated to the number of contacts or sales.

3. After erroneously calculating the total amount that VLD supposedly should have paid Verizon NW for the sales and inquiry services, Mr. Zawislak only applied the intrastate jurisdictional allocator. He failed to separate out the non-regulated costs, and he failed to separate out the Washington costs from the other states' costs.

In short, Mr. Zawislak made two fundamental mathematical errors in applying the $75 rate. First, he failed to account for the undisputed fact that Verizon NW charges VLD *different* rates per sale for the CSSC, BSC and phonemart channels and also charges different rates for miscellaneous services that are not based on contacts or sales. Second, he made an error in failing to separate out non-regulated and non-Washington costs. With these two errors, he produced an adjustment for VLD of **********. This erroneous figure appears on page 2, line 23 of his revised exhibit.

Q. HAS VERIZON NW PREPARED AN EXHIBIT THAT CORRECTS THESE MATHEMATICAL ERRORS?

A. Yes. Exhibit No.___(ODF-5C) corrects Mr. Zawislak's calculation by (1) incorporating the correct billing rates for BSC and phonemart sales and applying them to the proper units, and (2) using the proper allocation factors. In short, if Mr. Zawislak had applied the $75 figure correctly, the resulting adjustment for VLD would have been ***********, as shown on line 31, column (e) of Exhibit No.___(ODF-5C), not *************. The impact of the math errors and corrections are summarized on Exhibit No.___(ODF-4C). Again, though, no adjustment is appropriate because the $75 figure that is the basis of Mr. Zawislak's adjustment is wrong.

Q. YOU HAVE EXPLAINED WHY MR. ZAWISLAK'S SALES AND MARKETING ADJUSTMENT FOR VLD IS INCORRECT. WHAT ABOUT HIS ADJUSTMENT FOR VOL?

A. This adjustment also is wrong. As a threshold matter, his adjustment relies on Dr. Selwyn's $75 figure, but this figure is based on an estimate of consumer acquisition costs for a *long distance company,* not an Internet service provider like VOL. Dr. Selwyn did not provide any analysis suggesting this figure could be applied to VOL, nor did Mr. Zawislak. For this reason alone Staff's VOL adjustment must be rejected; it is unsupported by any evidence.

In any event, Mr. Zawislak's VOL adjustment makes no sense. Here is what he did:

First, he divided his total adjusted sales and marketing "cost" for VLD (line 16, TWC-16C, page 2 of 2) by the total wholesale *revenues* Verizon NW received from VLD (line 17, TWC 16C, page 2 of 2) to establish a completely meaningless ratio.[1] Nowhere does Mr. Zawislak explain how the wholesale revenues Verizon NW receives from VLD (e.g., for the resale of intraLATA toll service) is related in any way to what Verizon NW charges VLD for sales, order entry, and inquiry services. In fact, there is no relationship between these two figures. Put simply, sales and marketing costs are to wholesale revenues as one's shoe size is to one's hair color – there simply is no relationship.

Second, Mr. Zawislak applied this meaningless ratio he developed using VLD information to VOL. But nowhere does he explain why a meaningless ratio for VLD can

[1] As discussed, Mr. Zawislak erred in calculating the total sales and marketing costs for VLD. Therefore, his ratio, which he applies to VOL, is wrong from the outset. Despite the enormous flaws embedded in Mr. Zawislak's calculation for VOL, if the calculation were revised by using the VLD adjustment as corrected in Exhibit No. ____ (ODF-5C) and by applying the appropriate jurisdictional allocation factors, the resulting adjustment would be ************, versus Mr. Zawislak's adjustment of ***************. See Exhibit No.____(ODF-6C). Of course, Verizon NW does not agree with this methodology for the reasons stated above.

or should be applied to VOL. These companies operate in completely unrelated businesses with different services and volumes. In fact, the majority of the wholesale revenues (*******) Verizon NW receives from VOL are *interstate* revenues. What Mr. Zawislak has effectively done is transfer this interstate revenue to the intrastate jurisdiction in the guise of sales and marketing expense.

Third, as he did with VLD, Mr. Zawislak failed to separate out the non-regulated costs for VOL, and he failed to separate out the Washington costs from the other states' costs. With these errors he produced an adjustment for VOL of *************.

Q. PLEASE SUMMARIZE THE FLAWS IN STAFF'S SALES AND MARKETING ADJUSTMENT FOR VLD AND VOL.

A. The fundamental flaws are as follows:

First, any comparison of Dr. Selwyn's $75 rate to the rates Verizon NW charges VLD and VOL is wrong – this is an "apples to oranges" comparison. The $75 figure purportedly represents the *total* customer acquisition costs for long distance service, whereas Verizon NW provides only sales, order entry, and inquiry services to VLD and VOL. (In addition to this error, Dr. Danner explains that the $75 is no longer relevant or supportable, because AT&T has stopped acquiring long distance customers for its Consumer segment.)

Second, Mr. Zawislak made two mathematical errors in applying the $75 rate to VLD. He failed to account for the fact that Verizon NW charges VLD *different* rates per sale for the CSSC, BSC and phonemart channels, and he failed to separate out non-regulated and non-Washington costs.

Third, Mr. Zawislak made numerous errors in developing an adjustment for VOL. He uses Dr. Selwyn's $75 figure that purports to be an estimate of consumer acquisition costs for a long distance company, not an Internet service provider like VOL; he develops a nonsensical ratio based on erroneous VLD data; he applies this meaningless VLD ratio to VOL, and, as with his VLD adjustment, he fails to separate out non-regulated and non-Washington costs.

For all these reasons, Staff's sales and marketing adjustment (SR18) must be rejected in its entirety.

Q. PLEASE DESCRIBE STAFF WITNESS ZAWISLAK'S RESTATING ADJUSTMENT SR17 AND PRO FORMA ADJUSTMENT SP22, WHICH CONCERN VERIZON NW'S INTERSTATE DSL SERVICE AND LINESHARING.

A. Here, the Staff is proposing that the Commission violate jurisdictional boundaries by pulling in non-existent revenue from the federal jurisdiction. These adjustments essentially impute revenue from Verizon NW's *interstate* DSL service to Verizon NW's *intrastate* operations. The end result of this imputation is to increase Verizon NW's intrastate revenue by ************. (Zawislak Direct at page 18)

Staff appears to reason as follows:

1. During the test year, when a CLEC purchased "linesharing," a UNE, it paid Verizon NW $4 for the high frequency portion of the loop ("HFPL"), which is the price the Commission established in Docket No. UT-003013. (Under current separations rules, a portion of this $4 charge is booked as intrastate revenues.) The CLEC could then use the HFPL to provide DSL, while Verizon NW could continue to use the loop to provide voice local exchange and other services.

2. When Verizon NW offered DSL, an interstate wholesale service, during the test year, it used the HFPL, and therefore the $4 linesharing UNE charge should have been imputed into Verizon NW's interstate DSL prices, and a portion of this charge should have been booked as intrastate revenue.

In short, for all practical purposes, Staff believes Verizon NW's interstate DSL tariff should include an additional, separate charge of $4 for the HFPL, and that a portion of this charge should be booked as intrastate revenue.

Q. IS LINESHARING THE SAME AS VERIZON NW'S INTERSTATE DSL SERVICE?

A. No. Linesharing is a UNE subject to the FCC's UNE rules. Under the FCC's current rules, state commissions apply FCC-imposed pricing standards and set the rates for UNEs. In contrast, Verizon NW's DSL service is a federally tariffed service – Verizon NW is required to charge its tariffed rates for this service, nothing more and nothing less.

Q. WHAT IS THE CURRENT STATUS OF LINESHARING?

A. The FCC has discontinued linesharing as a UNE.

Q. HAS VERIZON NW CHARGED THE $4 RATE FOR THE HFPL FOR ALL LINESHARING ARRANGEMENTS, AS ESTABLISHED BY THE WUTC?

A. Yes. Verizon NW has charged this rate to every company purchasing the linesharing UNE, regardless of whether or not the company is an affiliate of Verizon NW. This charge will be applied in accord with all lawful FCC rules.

Q. DID (AND DOES) VERIZON NW CHARGE ITS FEDERALLY TARIFFED WHOLESALE DSL RATES WHEN A CUSTOMER PURCHASES INTERSTATE DSL SERVICE?

A. Yes. Verizon NW charged (and will charge) the federally tariffed rates to all customers, regardless of whether a customer is an affiliate of Verizon NW.

Q. DOES MR. ZAWISLAK'S LINESHARING ADJUSTMENT CONFLICT WITH VERIZON NW'S FEDERALLY TARIFFED INTERSTATE DSL TARIFF RATES?

A. Yes. His adjustment applies a $4.00 per month linesharing rate – a rate the WUTC established for UNEs – to all of the interstate DSL lines Verizon NW provided out of its *interstate* DSL tariff, even though there is no linesharing UNE purchased in order to provide this service. This is obviously a direct conflict with the federal jurisdiction – Mr. Zawislak has rewritten the terms and prices of Verizon NW's interstate DSL tariff. His adjustment must be rejected.

Q. STAFF ARGUES THAT THE COMMISSION HAS ALREADY DECIDED THIS ISSUE IN THE 13TH SUPPLEMENTAL ORDER IN DOCKET NO. UT-003013. PLEASE RESPOND.

A. Verizon NW disagrees. Paragraph 70 of that order, on which Staff relies, states, "Verizon's subsidiary provisioning advanced telecommunications services in the state of Washington must also pay the flat-rate contribution to Verizon's regulated operations for use of the high frequency portion of the loop in Verizon's territory." This plainly means that Verizon NW's affiliates – i.e., companies separate from Verizon NW – would pay this contribution *if they purchased linesharing*, which was the UNE at issue in the Commission's order. Verizon NW has charged its affiliates the linesharing rate when they purchase the linesharing UNE, and this revenue is reflected in the Company's results of operation presented in this case. However, the data business conducted by the former Verizon affiliate, Verizon Advanced Data Inc., is no longer part of a separate affiliate, and imputing revenue to Verizon NW for its own use of the HFPL is not appropriate. In addition, nowhere in the 13th Supplemental Order did the Commission hold that Verizon

NW's *interstate* rates were improper and must be adjusted, which is appropriate because the Commission lacks authority over those rates.

Q. ARE THERE ANY OTHER FLAWS WITH STAFF'S PROPOSED LINESHARING ADJUSTMENT?

A. Yes. Even if Staff's theory were correct, i.e., Verizon NW's interstate DSL tariffed rate should be $4 higher per unit per month, all this additional interstate revenue would be booked to the *interstate* jurisdiction – it would have no effect on Verizon NW's intrastate revenues or intrastate revenue requirement. For this reason, too, his intrastate adjustment must be rejected.

III. RATE DESIGN/PRICING

Q. WHAT RATE DESIGN/PRICING ISSUES DO YOU ADDRESS IN THIS PART OF YOUR TESTIMONY?

A. First, I address the rate design/pricing testimony of Staff witness Jing Roth. She provides two separate proposals – one is based on Staff's claim that Verizon NW is overearning by $52 million (which is no longer Staff's position given its errata filing), and one is based on a $30 million increase to Verizon NW's revenues. I address only her latter proposal, which designs rates for a $30 million increase in revenue.

Second, I address the rate design testimony of Staff witness Tim Zawislak, and explain why his proposal to reduce Verizon NW's interim terminating access charge ("ITAC") should be rejected.

Third, I explain why the proposal of Rex Knowles, filed on behalf of XO Washington, Inc., to reduce intrastate special access rates to UNE levels also must be rejected.

Fourth, I respond to pricing proposals presented by Robert Spangler, on behalf of the Department of Defense, and Dr. Loube, on behalf of the Public Counsel and AARP.

Q. WHAT IS THE PRINCIPAL FEATURE OF STAFF'S RATE DESIGN PROPOSAL FOR A $30 MILLION REVENUE INCREASE?

A. The principal feature is that Staff proposes to recover most of the increase from basic local service rates. Verizon NW agrees with Staff on this fundamental point. The table below illustrates Staff's proposal, which actually increases residential and business rates by more than $40 million, in order to fund decreases to special access rates and eliminate the ITAC.

SERVICE	**STAFF** (Annual Revenue Increase)
Increase Residential and Business Rates	$40,405,540
Other Services	
Special Access Loop and Transport	($3,533,432)
Late Payment Charge	$4,805,994
DA	$3,185,854
Remote Call Forward	0
Custom Calling	0
Directory Listings	0
ITAC	($14,912,851)
	($10,454,435)
TOTAL	$29,951,106

Staff also states (page 37, lines 8-9), "If the company is allowed to recover a $110 million revenue shortfall, Staff does not propose any changes to the company's rate design proposal." In short, Staff and Verizon NW have similar positions on the fundamental point that most increases should be borne by basic services.

Nevertheless, we *disagree* with Staff on several specific (and significant) rate design issues. In particular, Staff proposes the following:

1. De-averaged local service rates for Residential and Business lines into five zones;
2. De-averaged and reduced rates for special access services;
3. Increased Directory Assistance per call rate and elimination of the free calls;
4. A new Late Payment Charge; and
5. No change to the current rates for Remote Call Forwarding, Directory Listing, and various custom calling features for which the Company has proposed rate increases.

Q. DO YOU AGREE WITH STAFF'S PROPOSAL TO DEAVERAGE LOCAL RATES INTO FIVE ZONES?

A. No. First, it would cause significant customer confusion. Ms. Roth appears to have an inconsistency in how she has incorporated rate deaveraging into her rate design. In Exhibit No. ___ (JYR-4) – List of Wire Centers by Five (5) Zones, Ms. Roth shows her proposed zones by wire center. However, when Ms. Roth developed her percents by zone in order to develop her deaveraged rates, she used "Verizon 132 Attachment CONFIDENTIAL Workpaper" which lists lines by EXCHANGE, not wire center.

Aside from this inconsistency, if residential and business rates are deaveraged into zones by wire center, this would create certain situations where exchanges with multiple wire centers could wind up with wire centers in different zones with different rates. For example, the Marysville exchange is made of two wire centers: Marysville and Lake Goodwin. On Exhibit No. ___ (JYR-4), staff shows Marysville under Zone 1, while Lake Goodwin is shown under Zone 2. So Staff's proposal would break apart the wire centers in the Marysville exchange into two different zones.

We have identified the following additional examples in Staff's deaveraging proposal where exchanges that today have a single uniform rate would wind up having wire centers in more than one zone with more than one retail residential and business rate.

Exchange	**Wire Center**	**Zone per Exh. No. ___ (JYR-4)**
Bothell	Bothell	1
	Duvall	2
Camas	Camas	2
	Washougal	2
	Washougal River	3
Kennewick	Kennewick Main	1
	Kennewick Highlands	1
	Kennewick Meadows	2
Richland	Richland	2
	North Richland	1
	West Richland	2
Wenatchee	Wenatchee	1
	East Wenatchee	2

In any event, even if Staff's deaveraging proposal were on an exchange basis, it would produce numerous instances where neighboring communities would have significantly different rates for what customers perceive to be the same services.

Second, it would put Verizon NW at a competitive disadvantage. Today, Verizon NW competes not only with CLECs (which may or may not use the deaveraged UNEs, on whose structure Staff wants to model the Company's retail rate design), but also with cable companies, VoIP providers, and wireless providers that offer bundles and packages with prices that, for the most part, do not vary based upon geography or density zones. Staff's proposal would force Verizon NW to use five sets of deaveraged rates to compete with firms that use a statewide uniform price.

Q. HOW DOES STAFF'S DEAVERAGING PROPOSAL COMPARE TO THE ACTIONS BY THE COMMISSION IN THE GTE/BELL ATLANTIC MERGER CASE?

A. Staff's proposal would reinstate some of the complex rate structure that the Commission eliminated in that case. Prior to the merger case,[2] Verizon NW had a more complicated rate design for local exchange service which included five rate bands for mandatory extended area service ("EAS") rate adders, measured EAS charges, optional local calling plans ("OCP") and seven different rate groups based upon the number of main telephones in the local calling area. As part of the merger case, the Commission approved a restructuring that essentially eliminated the prior complicated rate design and produced a much simpler structure, with uniform statewide rates for local exchange service, including the elimination of the numerous different mandatory EAS and similar rate adders.

This rate design is what is in place today. The Commission Staff's deaveraging proposal would move back towards a more complicated rate design, and recreate disparities in what customers pay for local service across Verizon NW's service territory.

Q. WHAT OTHER CONCERNS DO YOU HAVE WITH THE STAFF'S DEAVERAGING PROPOSAL?

A. Staff's five zone proposal is based solely on Staff's proposal in the pending UNE docket, UT-023003, where Staff proposed five zones for unbundled loops. Staff reasons that

[2] The Company was previously known as GTE Northwest Incorporated and, before that, General Telephone Company of the Northwest, Inc. Contel of the Northwest, Inc. merged with GTE Northwest in the early 1990's and had a similarly complex local rate structure.

basic exchange rates should be priced to reflect the costs that some CLEC competitors might face when entering a Verizon NW market (i.e., unbundled loop costs). But the UNE proceeding has nothing to do with Verizon NW's rate case and the pricing required to meet a given revenue requirement. Also, as stated earlier, even though CLECs might purchase UNEs based upon deaveraged UNE rates, they do not, for the most part, price *local exchange service* on a deaveraged basis. Thus, since Verizon NW's competitors do not strictly price based upon the cost they face to enter a particular market or zone (i.e., deaveraged zone rates), it makes no economic or market sense to *force* Verizon NW to price its local exchange service based upon a variation of competitors' zone costs.

Q. PLEASE DESCRIBE STAFF'S PROPOSAL FOR SPECIAL ACCESS RATES.

A. Staff is recommending that Verizon NW's current rates for special access be reduced to the level that is equal to Verizon NW's local interconnection rates. Staff also proposes to deaverage the two-wire and four-wire rates and set them at parity with the Staff's proposal in the UNE Docket UT-023003. Staff's proposal for special access rates requires that these products and services be priced at the level of unbundled network elements (UNEs).

Q. DOES VERIZON NW AGREE WITH STAFF'S PROPOSAL?

A. No. Staff's proposal attempts to solve a competition problem that does not exist, and would only serve to create pressure for higher local service rates.

Today, telecommunications carriers have the ability to purchase UNEs in order to compete with Verizon NW, and retail customers can purchase the Company's special access services at tariff rates. Most of the intrastate special access customers are end users, not carriers. The UNE and intrastate special access markets are separate and distinct markets, for the most part. Forcing the UNE and retail rates to be consistent does not solve any perceived competition problem and only puts more pressure on local exchange rates. Today, intrastate special access customers are, in general, end user business customers, not CLECs or carriers who compete with Verizon NW.

Also, the rates Verizon NW is proposing are in line with special access rates charged by Qwest and others in various states. Verizon NW's current special access line ("SAL") rates for 2-wire voice grade service and DDS service are priced below both Qwest's and Verizon NW's interstate rates for these services. Verizon NW's intrastate DS-1 prices are also below Verizon NW's interstate DS-1 rates and should be increased to allow for greater cost recovery, as pointed out in my direct testimony. There is no market justification for reducing these special access rates to UNE rate levels, and reducing these rates will only serve to put pressure on local exchange service rates.

Q. DOES VERIZON NW AGREE WITH STAFF'S PROPOSAL TO INCREASE DIRECTORY ASSISTANCE ("DA") RATES FROM $.95 PER CALL TO $1.25 PER CALL AND TO RETAIN THE TERMS AND CONDITIONS APPLICABLE TO PERSONS WITH A DISABILITY?

A. Yes, Verizon NW agrees with Staff's proposal to increase DA rates in conjunction with eliminating the free call allowance for both residential and business customers. Verizon NW also agrees to retain the no charge conditions for persons with a disability. Staff's calculation of the DA rate increase needs to be adjusted, however, to reflect the correct billing units for the test period. Staff should utilize the DA units provided in Verizon NW's response to Staff's Data Request No. 1009. Correcting for these units will result in a revenue impact for the Staff's proposal of $2,980,284 versus the $3,185,854 shown in Staff's Exhibit No.___C(JYR-3C).

Q. DOES THE STAFF AGREE WITH VERIZON NW'S PROPOSAL FOR LATE PAYMENT CHARGES?

A. Partially. While Staff agrees with Verizon NW's proposal to establish a late payment charge of 1.5 percent, Staff does not agree with establishment of the $5 minimum charge.

Compared to Staff's position, Verizon NW's proposal provides $7.5 million more contribution, which would mitigate basic local exchange rate increases, and it is consistent with other companies' late payment charges in Washington. AT&T and Vartec have a 1.5 percent late payment charge with a $5 minimum. The comparison in Ms. Roth's testimony (page 23, lines 4-8) is too narrow.

In any event, late payment charges also need to be viewed in the context of general business late payment charges. Customers will pay their bills in relation to other bills they have before them. If there are higher late payment charges associated with services other than Verizon NW's, customers will tend to pay those bills first. The Staff proposal for late payment will result in higher residential rates due to customers who do not pay their Verizon NW bills on time.

Q. THE STAFF PROPOSES NO INCREASES BE ALLOWED TO THE CURRENT RATES FOR REMOTE CALL FORWARDING ("RCF"), DIRECTORY LISTINGS ("DL"), AND THE VARIOUS CUSTOM CALLING FEATURES THAT VERIZON NW PROPOSES TO INCREASE. PLEASE RESPOND.

A. Staff's proposal to not allow increases to the rates for RCF, DL and customer calling features results in an additional $8,754,718 amount of revenue that would have to be picked up in local exchange rates. The Staff did not specifically state its rationale for this position.

Staff's proposal in this area again interferes with the market by setting constraints on the pricing of some products and services that the market would not or does not impose at this time. An example is the proposed directory listings rate increase from $0.55 to $2.50. As I pointed out in my direct testimony, these rates were set at $2.25 until 2001. When they were reduced to $0.55, there was not a problem in the market, and there does not seem to be a problem now, as shown by the DL rates in place today by our competitors. My direct testimony (page 9, line 17) shows that the current market will bear prices above Verizon NW's $0.55.

With regard to custom calling features, the Staff seems to be concerned that these non-basic services will be priced too far above cost. It is Verizon NW's judgment, however, that its proposed prices are sustainable in the market. Thus, implementing Staff's position would merely mean that local exchange service rates would need to be increased further to meet the overall revenue objective.

Q. DOES VERIZON NW AGREE WITH STAFF WITNESS ROTH'S CONTENTION THAT THE COST OF THE LOCAL LOOP IS NOT A DIRECT COST OF LOCAL EXCHANGE SERVICE?

A. No, but this issue becomes moot when setting rates to meet a revenue requirement. Under both Verizon NW's and Staff's rate design proposals, local exchange rates must bear a large part of any rate increase to meet a revenue requirement. Dr. Danner discusses the correct economics of this issue in his testimony.

Q. DOES VERIZON NW AGREE WITH STAFF WITNESS ZAWISLAK'S PROPOSAL TO ELIMINATE THE INTERIM TERMINATING ACCESS CHARGE ("ITAC")?

A. No.[3] The Commission has repeatedly endorsed the ITAC as a reasonable method to help cover some of the costs of serving Verizon NW's – and other companies' – many rural and relatively less dense service areas throughout the state. This proposal again would put additional pressure on local exchange rates and would only serve to further significantly shift Verizon NW's current revenue recovery from access to local exchange

[3] Staff's proposal, correctly, does not call for eliminating Verizon NW's use of the ITAC rate element to recover service extension costs under the Commission's rule WAC 480-120-071.

service. Moreover, this proposal singles Verizon NW out for different treatment, because all other carriers would still retain their ITAC.

In any event, Mr. Zawislak's ITAC calculation needs to be updated for the correct test year units and ITAC rates. Mr. Zawislak should utilize the ITAC units and rates provided in Verizon NW's response to Public Counsel's Data Request No. 764. Utilizing these corrected units and rates would result in an ITAC revenue calculation for the test year of $16,890,211 versus Mr. Zawislak's number of $14,912,851.

Q. DOES VERIZON NW AGREE WITH STAFF WITNESS ROTH'S PROPOSAL TO REDUCE THE DOLLAR GAP BETWEEN RESIDENTIAL AND BUSINESS LOCAL EXCHANGE RATES?

A. No. Verizon NW's proposal does reduce the rate gap in percentage terms. The Staff's proposal for a further reduction is not required by the market today and would put additional pressure on residential rates.

Q. PLEASE DESCRIBE THE RATE DESIGN PROPOSAL PRESENTED BY WITNESS KNOWLES FOR XO WASHINGTON, INC.

A. Mr. Knowles proposes that Verizon NW establish prices for DS1 and DS3 special access services at the UNE rates forthcoming in the UNE docket UT-023003.

Q. DOES VERIZON NW AGREE WITH THIS PROPOSAL?

A. No. Mr. Knowles is attempting to bring UNE pricing and provisioning issues into Verizon NW's rate case. The issues raised in his testimony should be addressed in the current UNE docket and before the FCC. Also, my rebuttal testimony that discusses Staff Witness Roth's special access proposal is applicable to Mr. Knowles' position as well.

Q. DOES VERIZON NW AGREE WITH THE TESTIMONY OF ROBERT W. SPANGLER ON BEHALF OF THE UNITED STATES DEPARTMENT OF DEFENSE AND ALL OTHER FEDERAL AGENCIES (DOD/FEA) TO REDUCE THE GAP BETWEEN RESIDENTIAL AND BUSINESS LOCAL EXCHANGE RATES FURTHER THAN PROPOSED BY VERIZON NW?

A. No, as stated previously in my rebuttal testimony, Verizon NW's proposals reduce the current gap between business and residential local exchange rates, which allows less of an increase to be applied to residential local exchange rates.

Q. DOES VERIZON NW AGREE WITH MR. SPANGLER'S PROPOSAL TO DECREASE THE $5.00 DIFFERENTIAL BETWEEN PBX TRUNK RATES AND BUSINESS LOCAL EXCHANGE RATES?

A. No. Verizon NW's proposal maintains this existing differential and should be accepted.

Q. DOES VERIZON NW HAVE COMMENTS ON DR. LOUBE'S RATE DESIGN PROPOSALS IN HIS TESTIMONY SPONSORED ON BEHALF OF THE PUBLIC COUNSEL AND AARP?

A. Yes. Dr. Loube (page 4, lines 13-16) disagrees with Verizon NW's proposed increases in special access and remote call forwarding rates. Dr. Loube also disagrees with the size of the late payment charge that Verizon NW is proposing and with Verizon NW's proposal to eliminate the directory assistance free call allowance. Verizon NW disagrees with Dr. Loube on these pricing issues for the reasons already discussed in my rebuttal testimony for all services he mentions, with the exception of directory assistance.

Q. DOES VERIZON NW AGREE WITH DR. LOUBE'S PROPOSAL TO RETAIN A ONE FREE CALL ALLOWANCE FOR DIRECTORY ASSISTANCE?

A. No. As discussed in my direct testimony, some discretionary services were priced in order to gain additional contribution. Verizon NW's proposed elimination of the current directory assistance call allowance allows additional revenue to be generated, which reduces the pressure on local exchange rates under Verizon NW's rate design proposal.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes it does.