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CERTIFICATE OF SERVICE

Arizona Corporation Commission
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I hereby certify that the original and 10 copies of the Surrebuttal Testimony of Arleen M. Starr, Lee L. Selwyn and Susan M. Gately on behalf of AT&T Communications of the Mountain States, Inc., regarding Docket No. T-01051B-99-0105, were sent via overnight delivery, this 7th day of September, 2000, to:

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Phoenix, AZ 85007

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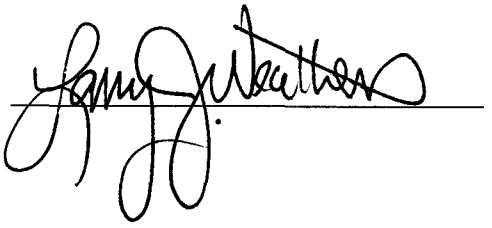

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September 7, 2000

Arizona Corporation Commission
Docket Control – Utilities Division
1200 West Washington Street
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Re: Docket No. T-01051B-99-0105, Surrebuttal Testimony

Dear Docket Control:

Enclosed for filing in the above named docket are the original and 10 copies each of the Surrebuttal Testimony of Lee L. Selwyn, Susan M. Gately, and Arleen M. Starr (Nonproprietary Version Only) on behalf of AT&T Communications of the Mountain States, Inc. If you have any questions regarding the enclosed filing please call me at (206) 628-7161.

Very truly yours,

Davis Wright Tremaine LLP

Larry J. Weathers

Larry J. Weathers
Paralegal

Enclosures
cc: Mary Steele
Rick Wolters

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BEFORE

THE

ARIZONA CORPORATION COMMISSION

*****

IN THE MATTER OF THE APPLICATION OF U S WEST COMMUNICATIONS, INC. FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON AND TO APPROVE RATE SCHEDULES	)	Docket No. T-01051B-99-0105

SURREBUTTAL TESTIMONY OF

ARLEEN M. STARR

ON BEHALF OF

AT&T COMMUNICATIONS OF THE

MOUNTAIN STATES, INC.

SEPTEMBER 8, 2000

NONPROPRIETARY VERSION

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1 I. BACKGROUND AND PURPOSE OF TESTIMONY

2 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

3 A. My name is Arleen M. Starr. My business address is 1875 Lawrence Street, Denver,
4 Colorado 80202.

5 **Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?**

6 A. Yes. I filed direct testimony on August 9, 2000.

7 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

8 A. The purpose of my surrebuttal testimony is to respond to portions of the testimony of
9 Scott A. McIntyre, Jerrold L. Thompson, David L. Teitzel and William E. Taylor filed on
10 behalf of Qwest Corporation ("Qwest") (formerly U S WEST Communications, Inc.),
11 specifically as it relates to the cost and price of intrastate switched access. In addition, I
12 will provide an update to Exhibit AS-1 presented with my direct testimony which
13 provides a comparison of Qwest's interstate switched access rates and the proposed
14 intrastate switched access rates for Arizona. This is due to Qwest's filing at the Federal
15 Communications Commission ("FCC") that revises its interstate switched access rates
16 effective August 8, 2000, reducing the interstate local and tandem switching rates.

17 **Q. PLEASE BRIEFLY OUTLINE YOUR RECOMMENDATIONS.**

18 A. My recommendation remains unchanged from my direct testimony. Qwest has not
19 provided any substantive evidence in its rebuttal testimony which would require any
20 changes to AT&T's position -- intrastate switched access rates should be based on
21 forward-looking economic cost and the Carrier Common Line Charge "(CCLC)" and the

Interconnection Charge ("IC") should be eliminated. This is the only way to prevent Qwest from taking advantage of its monopoly position in the provision of switched access and the only way to secure for consumers the full benefit of competition in the market for intrastate long distance services.

II. RESPONSE TO REBUTTAL TESTIMONY OF SCOTT A. MCINTYRE

Q. IN HIS REBUTTAL TESTIMONY MR. MCINTYRE CLAIMS THAT DS1 PRIVATE LINE IS A REASONABLE ALTERNATIVE TO SWITCHED ACCESS. IS THIS CORRECT?

A. No, not for the majority of customers, and particularly not for residential customers. As Mr. McIntyre admits, a minimum of $250 per month in toll usage is required before the use of a DS1 private line is economically feasible;[1] and, as Mr. McIntyre further admits, most residential customers do not generate this volume of toll revenue. For interexchange carriers ("IXCs") providing toll services to residential customers, therefore, private line service is not an alternative to switched access. Moreover, even for business customers, use of a DS1 private line is often not a realistic alternative to switched access. Mr. McIntyre states that a DS1 private line is an economical solution to provide toll services to some business customers, but admits the purchase of a DS1 private line in many cases is still revenue to Qwest.[2] He provides an analysis calculating the difference in revenue Qwest would receive from a DS1 private line of $250 per month, to $11,000 per month for switched access. I think Mr. McIntyre very clearly demonstrates that if

[1] Rebuttal Testimony of Scott A. McIntyre, August 21, 2000, at 5.

DS1 private line service for $250 per month was a realistic alternative to switched access, IXCs would not choose to pay $11,000 for switched access instead.

Q. WHAT ADDITIONAL INFORMATION DOES MR. MCINTYRE PROVIDE RELATED TO PRIVATE LINE SERVICES AS AN ALTERNATIVE TO SWITCHED ACCESS?

A. Mr. McIntyre states there is downward pricing pressure on private line services, therefore reducing the threshold for bypass from switched access to private line.[3] This statement is ironic, given that Qwest is proposing a rate increase for private line services in this docket.[4] If Qwest truly faced competition in providing private line services, it would not be seeking to increase its prices for those services.

Q. MR. MCINTYRE STATES THAT THE CHANGES QWEST PROPOSES FOR THE LOCAL TRANSPORT COMPONENT OF SWITCHED ACCESS WERE DONE TO MIRROR EXISITING FCC RATES.[5] IS THIS ACCURATE?

A. No. Mr. McIntyre states that the proposed DS1 and DS3 entrance facility rates have been set equal to FCC private line rates, and private line is a substitutable service for switched access entrance facilities.[6] The comparison made in Exhibit AS-1 filed with my direct testimony shows that this is incorrect. This Exhibit compares exact transport elements – Entrance Facilities at VG, DS1 and DS3 capacity levels - and shows the rates proposed

---

2 *Id.* at 6.

3 *Id.*

4 Supplemental Direct testimony of Scott McIntyre, May 19, 2000, at 12. The net increase of all private line price changes is a $5.6 million increase.

5 Rebuttal Testimony of Scott A. McIntyre, August 21, 2000, at 10.

by Qwest in Arizona are up to 35% higher than the exact same rate elements at the interstate level. Qwest has not provided any justification for this difference in rates between the interstate and intrastate jurisidictions. It is not clear why Mr. McIntyre has chosen to compare "substitutable" services, when the exact same rate elements exist in both jurisdictions. If these truly are "substitutable" services, rates should be the same. Additionally, Mr. McIntyre provides no explanation for the difference between the interstate rates at the FCC and the proposed Arizona intrastate rates for the remaining switched access rate elements. Nothing in Mr. McIntyre's testimony explains or justifies why the Commission should accept Qwest's position that only minimal reductions are required in rates for switched access.

III. RESPONSE TO REBUTTAL TESTIMONY OF DAVID TEITZEL

Q. MR. TEITZEL STATES THAT QWEST HAS NOT ENGAGED IN ANY ANTI-COMPETITIVE PRICING STRATEGIES IN THE TOLL MARKET, THAT IT DOES NOT INTEND TO DO SO AND THAT THERE ARE COMMISSION RULES THAT GOVERN HOW RATES SHOULD BE DETERMINED.[7] DOES THAT ELIMINATE THE CONCERNS OF AT&T RELATED TO THE POTENTIAL FOR ANTI-COMPETITIVE BEHAVIOR OF QWEST?

A. No. It is true the Commission currently has an imputation rule in place setting guidelines on how basic communication services can be priced. Rule R14-2-1310-B requires that basic communication services include the Total Service Long Run Incremental Cost

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[6] *Id.*

("TSLRIC") of all non-essential services and the imputed price of all essential services. But Qwest has petitioned Commissions in other states to eliminate the requirement that Qwest impute switched access rates into its price floor of intraLATA long distance services.[8] There is nothing to prevent Qwest from using the same tactics in Arizona. In addition, in this proceeding, Qwest's proposal for competitive zone classification would essentially eliminate the imputation requirement for toll services in the areas classified as competitive.[9] So Qwest's statement that it "has not engaged in anti-competitive pricing strategies in the toll market, nor do we intend to do so," provides no assurance that Qwest will not engage in anti-competitive behavior. Qwest's highly inflated access rates cause all toll rates to be higher than necessary -- consumers of toll services in Arizona are the real losers in this situation. The only effective solution to eliminate the potential for anti-competitive behavior in the toll market is to price access at forward-looking economic cost.

Q. MR. TEITZEL ATTEMPTS TO DISMISS THE FACT THAT QWEST IS AT AN ECONOMIC ADVANTAGE ON EVERY MINUTE OF TOLL SERVICES RELATIVE TO ITS COMPETITORS DUE TO THE DIFFERENCE BETWEEN THE PRICE AND COST OF ACCESS BY STATING THAT AT&T HAS A

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7 Rebuttal Testimony of David L. Teitzel, August 21, 2000, at 68.

8 *In the Matter of the Application of U S WEST Communications, Inc. for the Investigatory Docket to Eliminate, on an Expedited Basis, the Requirement that U S WEST Impute Switched Access Rates into the Floor of its IntraLATA Long Distance Service*, Colorado Docket No. 00A-201T.

9 As part of Qwest's competitive zone pricing proposal, Qwest would be able to price services below Total Service Long Run Incremental Cost ("TSLRIC"), with the exception of residence Basic Exchange Service. Prices for specific services may be offered below TSLRIC in competitive zones as long as the total revenue for the customer or group of customers is above TSLRIC. This essentially gives Qwest carte blanche to price services within a competitive zone in any manner it chooses.

VARIETY OF ALTERNATIVES TO SWTICHED ACCESS AND THAT AT&T CAN AVERAGE ITS COSTS OF INTERSTATE AND INTRASTATE ACCESS.[10] DOES EITHER OF THESE ALTERNATIVES HAVE ANY MERIT?

A. No. Mr. Teitzel's response to my testimony does not address the fundamental issue -- Qwest has a real economic advantage of 6.6 cents per conversation minute due to the difference in the price and the cost of switched access.[11] Mr. Teitzel attempts to avoid this fact by arguing that switched access is not a monopoly service due to the alternatives available -- like special access and the use of IP telephony. Mr. Teitzel's testimony provides no basis for concluding that there is any effective competition for switched access provided by Qwest. As admitted by Mr. McIntyre, the use of special access is simply not a viable alternative to switched access for most customers. In regards to IP telephony, Mr. Teitzel's testimony does not provide any evidence that IP telephony is being used in any magnitude that would indicate it is an alternative to switched access for IXCs. The reality is that Qwest remains a monopoly provider of switched access services and that there is no reasonable substitute for those services.

Mr. Teitzel's next suggestion is that IXCs average the cost of interstate and intrastate access. This really doesn't make much sense and is prohibited by Commission rule R14-2-1109 governing the pricing of competitive telecommunications services in Arizona. Rule R14-2-1109 states:

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[10] Rebuttal Testimony of David L. Teitzel, August 21, 2000, at 69-70.

> Pricing of Competitive Services.
>
> A telecommunications company governed by this Article may price a competitive telecommunications service at any level at or below the maximum rate stated in the company's tariff on file with the Commission, provided that the price for the service is not less than the company's total service long-run incremental cost of providing the service.

I agree there is customer confusion regarding the difference between interstate and intrastate toll rates. One of the solutions to alleviate this confusion is for Qwest to charge the same rates for switched access in both the intrastate and interstate jurisdictions. The same functionality is being provided via access elements, whether it is interstate or intrastate; and, therefore, there is no cost justification for the difference in rates.

Q. MR. TEITZEL CRITICIZES AT&T FOR RECENT CHANGES MADE TO ITS INTERSTATE RATES.[12] IS HIS STATEMENT AN ACCURATE PROTRAYAL OF THE CHANGES AT&T MADE TO ITS INTERSTATE RATES?

A. No. Although I am not involved with AT&T's pricing actions and my responsibilities do not include the interstate jurisdiction, I would like to provide the Commission with accurate information. Mr. Teitzel states that AT&T attempted to increase interstate long distance rates, and than subsequently withdrew the rate changes.[13] While Mr. Teitzel states that interstate rates were increased, he omits the fact there were also rate decreases

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[11] 6.6 cents = price of 7.8 cents minutes cost of 1.2 cents. Qwest's proposed switched access rate of 3.8806 per originating and terminating minute equals a price of 7.8 cents for a conversation minute of use. The cost of access of .61 cents per originating and terminating minute equals a cost of 1.2 cents based on the UNE local and tandem switching rates established by the Commission in Docket No. U-3021-96-448 et al., and Qwest's interstate transport rates.

[12] Rebuttal Testimony of David L. Teitzel, August 21, 2000, at 71.

[13] *Id.*

-- including the elimination of the $3.00 monthly minimum, which affected 15 million customers. AT&T redesigned its basic residential calling plan to lower costs for people who make few or no long distance calls and to give moderate callers a choice of plans designed to meet their calling preferences and save them money

IV. RESPONSE TO REBUTTAL TESTIMONY OF JEROLD L. THOMPSON

Q. MR. THOMPSON STATES THAT PRIOR TO THE CLOSING OF THE SALE OF EXCHANGES TO CITIZENS UTILITIES, IT WOULD BE PREMATURE FOR QWEST TO REFLECT THE SALE OF EXCHANGES.[14] IS THIS CONSISTENT WITH THE FILING REQUIREMENTS IN THIS DOCKET AND TESTIMONY FILED BY MR. REDDING ON BEHALF OF QWEST?

A. No. Mr. Redding's rebuttal testimony states that the revenues, expenses, taxes and investment related to the access lines to be sold have been removed from Qwest's filing.[15] This is based on the directive provided to Qwest at the prehearing conference to remove the exchanges being sold from its supplemental filing, along with updating its test year to 1999. This conflicts with the fact that the Qwest cost studies for switched access services still contain the exchanges being sold to Citizens Utilities.

Q. MR. THOMPSON SUGGESTS THAT AT&T'S PROPOSAL FOR INTRASTATE SWITCHED ACCESS RATES WOULD NOT PERMIT QWEST TO RECOVER

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[14] Rebuttal Testimony of Jerrold L. Thompson, August 21, 2000, at 23.

[15] Rebuttal Testimony of George Redding, August 21, 2000, at 31.

REASONABLE DIRECT, SHARED, AND COMMON COSTS.[16] IS THIS CORRECT?

A. No. AT&T's proposal for intrastate switched access rates provides full and complete compensation to Qwest. Qwest's criticism seems to assume that AT&T proposes excluding any joint and common costs in calculating the cost to be used in the determination of rates. This is incorrect. AT&T does not oppose a reasonable allocation of joint and common costs to contribute to the recovery of the corporate overhead of the firm. AT&T's proposal is that intrastate switched access rates should be based on forward-looking economic cost, including a reasonable allocation of joint and common costs and a reasonable profit.

Where AT&T and Qwest differ is in determining what level of costs are reasonably allocated to intrastate switched access. Exhibit AS-2 filed with my direct testimony provides a comparison of Qwest's Direct and Network costs to its proposed rates for switched access rate elements. This is the baseline from which to determine whether a proposed cost allocation is reasonable. The problem with Qwest's proposal is twofold. First, Qwest's proposed allocation of costs includes costs that are overstated and inappropriate. Second, and even more important, even accepting Qwest's allocation, the rates for switched access that Qwest proposes in this proceeding bear no rational relationship to the cost of providing switched access.

[16] Rebuttal Testimony of Jerrold L. Thompson, August 21, 2000, at 24.

Q. WHAT ARE SOME OF THE PROBLEMS WITH QWEST'S PROPOSED COST ALLOCATION?

A. Using Qwest's methodology, Fully Allocated Costs ("FAC") is comprised of direct expense, network support, attributable costs and common costs. The direct expense is developed by converting the loaded investment into an expense. This conversion is accomplished by using a series of factors which are applied to the investment. Included in the direct expense category are the following expenses: billing and collection, product management, sales, product advertising and business fees. Network support is comprised of network operations and network support assets. Attributable costs are comprised of general support assets, general purposes computers, uncollectibles, accounting and finance, human resource, information management and intangible expenses. In addition, common costs are then added in order to derive FAC. In the Qwest intrastate switched access cost studies, network support expenses account for approximately *[PROPRIETARY]*, attributable costs are approximately *[PROPRIETARY]* and common costs are approximately *[PROPRIETARY]* -- for a total that is almost *[PROPRIETARY]* above direct costs.[17]

Q. MR. THOMPSON STATES THAT AT&T'S CRITICISM OF THE COST OF MONEY USED BY QWEST IN ITS COST STUDIES IS INAPPROPRIATE.[18] DO YOU AGREE?

[17] Switched Access Service 2000 Cost Study, April, 2000 – data response WDA 21-006 Attachment G.

[18] Rebuttal Testimony of Jerrold L. Thompson, August 21, 2000, at 23.

A. No. Mr. Thomson states that Qwest is proposing a new forward-looking cost of money in this proceeding, and thus, that explains why Qwest did not use the previously Commission approved rate. The problem with Mr. Thompson's explanation is that Qwest is recommending an overall rate of return of 10.86% in this proceeding[19], but the rate used in the access cost studies is *[Proprietary]*.[20] Thus, Mr. Thompson's explanation doesn't explain anything; it only provides further evidence that Qwest is using an overstated cost of money in its access cost studies. Rates are developed using a cost of capital figure, which is intended to provide a reasonable return on investment. Qwest should be required to use a cost of money component approved by the Commission, not a rate that overstates costs.

Q. EVEN USING QWEST'S OWN FULLY ALLOCATED COSTS, ARE QWEST'S PROPOSED INTRASTATE SWITCHED ACCESS RATES REASONABLE?

A. No. Surrebuttal Exhibit AS-1 provides a comparison of Qwest's FAC and Qwest's proposed rates for all switched access rate elements. Even using Qwest's FAC, the exhibit demonstrates the significant difference from Qwest's proposed rates for the switched access rate elements. Qwest's proposed rates for almost all intrastate switched access elements are above FAC, and in most cases significantly above, and in one case, *[Proprietary]* above FAC. See Surrebuttal Exhibit AS-1. This shows the magnitude of the problem with the rates for switched access Qwest proposes in this proceeding. Unless

[19] Supplemental Direct Exhibits of Peter Cummings, May 3, 2000, Exhibit PCC-01.
[20] Switched Access Service, 200 Cost Study, April, 2000, Study Summary.

those rates are reduced substantially, both consumers and competition in the state of Arizona will suffer.

V. RESPONSE TO REBUTTAL TESTIMONY OF WILLIAM E. TAYLOR

Q. DR. TAYLOR SUGGESTS THAT THE 6.6 CENT PRICE ADVANTAGE QWEST HAS OVER ITS COMPETITORS IS NOT A BARRIER IN THE TOLL MARKET, MERELY CONTRIBUTION.[21] DO YOU AGREE?

A. No. Dr. Taylor states that carrier access service provides Qwest with contribution that can be used to support shared fixed and common costs, subsidize services or any other expenditure flow of the corporation.[22] AT&T does not disagree that access services should support shared fixed and common costs of the company. As demonstrated in Surrebuttal Exhibit AS-1, however, switched access services are priced significantly above Qwest's calculation of FACs and, therefore, are contributing to the shared fixed and common costs well above and beyond what should be considered to be reasonable. In addition, although subsidization of services may have been viable at one point in time, subsidization is not workable or permissible in a competitive environment. Apparently, Qwest agrees subsidies in rates should be eliminated. Qwest witness Mr. McIntyre states, "In general, subsidies do not work well in a competitive environment where artificially high margins invite more competition than might normally exist and subsidized services may thwart competitive entry."[23] Lastly, allowing access services, which is a monopoly

[21] Rebuttal Testimony of Dr. William E. Taylor, August 21, 2000, at 33-34.
[22] Rebuttal Testimony of Dr. William E. Taylor, August 21, 2000, at 34.
[23] Rebuttal Testimony of Scott A. McIntyre, August 21, 2000, at 12.

service, to support "any other expenditure flow of the corporation" in essence forces competitors to fund any expenditure of Qwest's choosing. None of the IXCs or competitive local exchange carriers have the ability to obtain monopoly profits from one telecommunication service to subsidize its other telecommunications services. This certainly should not be allowed, because it puts competitors at an extreme disadvantage.

Q. DR. TAYLOR ALSO SUGGESTS THAT ANY ANTI-COMPETITIVE CONCERNS ARE ALLEVIATED SINCE IT IS QWEST'S LONG DISTANCE AFFILIATE, NOT QWEST, PROVIDING TOLL SERVICES.[24] DO YOU AGREE?

A. No. First of all, I acknowledge that there are separate affiliate requirements provided under Section 272 of the Telecommunications Act. However, from an economic standpoint, requiring a separate affiliate in essence has no impact. In the case of a Qwest long distance affiliate, the Qwest affiliate is paying the "price" of access, but the corporation is really only incurring the "cost" of access. Thus, since all financial results are consolidated at the corporate level, this provides no benefit to IXCs competing with Qwest, and allows Qwest to retain monopoly profits.

VI. CONCLUSION

Q. WHAT DO YOU RECOMMEND THAT THE ARIZONA COMMISSION ORDER IN THIS PROCEEDING RELEVANT TO QWEST'S INTRASTATE SWITCHED ACCESS RATES?

A. There are several things this Commission needs to order. These include:

- Set access rates at forward-looking economic cost equivalent to the UNE rates established by the Commission in the cost proceeding in Arizona for local and tandem switching and equal to U S WEST's interstate rates for transport; and

- Eliminate the Carrier Common Line Charge and the Interconnection Charge, which have no cost basis and are merely subsidies being provided to U S WEST by IXCs at the ultimate expense of end users

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

[24] Rebuttal Testimony of Dr. William E. Taylor. August 21, 2000, at 34.

Revised Exhibit AS-1

COMPARISON OF QWEST ACCESS RATES PROPOSED ARIZONA INTRASTATE RATES TO FCC INTERSTATE RATES

		PROPOSED INTRASTATE RATES		FCC INTERSTATE RATES		DIFFERENCES	
Direct Trunked Transport		**Fixed per Month**	**Per Mile per Month**	**Fixed per Month**	**Per Mile per Month**	**Fixed per Month**	**Per Mile per Month**
VG	Over 0 - 8 Miles	$25.96	$0.17	$19.52	$0.25	33.0%	-32.0%
	Over 8 - 25 Miles	$25.96	$0.17	$19.91	$0.14	30.4%	21.4%
	Over 25 - 50 Miles	$25.96	$0.17	$19.05	$0.12	36.3%	41.7%
	Over 50 Miles	$32.45	$0.45	$24.67	$0.29	31.5%	55.2%
DS1	Over 0 - 8 Miles	$86.50	$13.55	$53.90	$8.16	60.5%	66.1%
	Over 8 - 25 Miles	$109.85	$14.19	$68.70	$8.61	59.9%	64.8%
	Over 25 - 50 Miles	$116.35	$14.63	$74.65	$9.06	55.9%	61.5%
	Over 50 Miles	$127.99	$15.11	$82.20	$9.48	55.7%	59.4%
DS3	Over 0 - 8 Miles	$714.84	$78.90	$477.65	$78.90	49.7%	0.0%
	Over 8 - 25 Miles	$714.84	$78.90	$457.88	$50.88	56.1%	55.1%
	Over 25 - 50 Miles	$714.84	$80.73	$459.50	$51.91	55.6%	55.5%
	Over 50 Miles	$805.44	$91.74	$520.36	$58.94	54.8%	55.6%
Tandem Switched Transport		**Per Minute**	**Per Minute per Mile**	**Per Minute**	**Per Minute per Mile**	**Per Minute**	**Per Minute per Mile**
	Tandem Transmission						
	Over 0 - 8 Miles	$0.000199	$0.000020	$0.000199	$0.000020	0.0%	0.0%
	Over 8 - 25 Miles	$0.000255	$0.000023	$0.000255	$0.000022	0.0%	2.9%
	Over 25 - 50 Miles	$0.000263	$0.000023	$0.000263	$0.000019	0.0%	18.7%
	Over 50 Miles	$0.000265	$0.000023	$0.000265	$0.000017	0.0%	35.2%
Tandem Switching			**Per Minute per Mile**		**Per Minute per Mile**		**Per Minute per Mile**
	Per Minute per mile		$0.005000		**$0.002760 ***		81.2%
Entrance Facilities			**Per Month**		**Per Month**		**Per Month**
	Voice Grade		$64.67		$48.06		34.6%
	DS1		$125.00		$108.44		15.3%
	DS3		$1,500.00		$1,203.92		24.6%
Multiplexer			**Per Month**		**Per Month**		**Per Month**
	DS1/VG Multiplexer		$250.00		$235.27		6.3%
	DS3/DS1 Multiplexer		$300.00		$280.41		7.0%
End Office Shared Port			**Per Minute**		**Per Minute**		**Per Minute**
			$0.001300		$0.000903		44.0%
Common Transport Multiplexing			**Per Minute**		**Per Minute**		**Per Minute**
			$0.000137		$0.0000303		352.0%
Tandem Trunk Port			**Per Month**		**Per Month**		**Per Month**
			$6.59		$5.24		25.7%
End Office Dedicated Trunk Port			**Per Month**		**Per Month**		**Per Month**
			$9.01		$6.50		38.6%
Local Switching			**Per Minute**		**Per Minute**		**Per Minute**
	Originating and Terminating		$0.017300		**$ 0.002250 ***		668.9%

SOURCE: Intrastate AZ - Qwest Data Response WDA 22-011 Att. F Interstate - QWEST FCC Tariff FCC No. 1, Section 6.8 8/8/2000

* Revised rates - QWEST filing lower local switching and tandem switching, effective 8/8/2000

Proprietary Exhibit
Rebuttal Exhibit AS-1

3 pages

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AZ CORP COMMISSION
DOCUMENT CONTROL

Before the

ARIZONA CORPORATION COMMISSION

In the Matter of the Application of US West Communications, Inc., a Colorado Corporation, for a Hearing to Determine the Earnings of the Company, the Fair Value of the Company for Ratemaking Purposes, to Fix a Just and Reasonable Rate of Return thereon and to Approve Rate Schedules Designed to Develop Such Return

Docket No. T-1051B-99-0105

Surrebuttal Testimony

of

LEE L. SELWYN

on behalf of

AT&T COMMUNICATIONS
OF THE MOUNTAIN STATES, INC.

September 8, 2000

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SURREBUTTAL TESTIMONY

Introduction

Q. Please state your name, position, and business address.

A. My name is Lee L. Selwyn. I am president of Economics and Technology, Inc., One Washington Mall, Boston, Massachusetts 02108.

Q. Have you previously submitted testimony in this proceeding?

A. Yes. On August 8, I submitted prefiled direct testimony on behalf of AT&T Communications of the Mountain States, Inc. ("AT&T")

Q. What is the purpose of your testimony at this time?

A. I will respond to certain statements and contentions contained in the reply testimony of Qwest witnesses Taylor and Koehler-Christensen.

Summary of testimony

Q. Please summarize the primary aspects of US West's filing that you address in your testimony.

A. My testimony primarily addresses the rebuttal testimony sponsored by Qwest witnesses Taylor, Teitzel, and Koehler-Christensen. Dr. Taylor challenges my conclusion that no consequential competition exists in the Arizona local exchange service market. He contends that my reliance upon market share is inappropriate, and that the Commission should focus upon the *future* prospects for competition rather than on the here and now. According to ARMIS Report 43-08 for December 31, 1999, Table 2, US West in Arizona served 2,861,742 switched access lines as of that date. In its just-released Local Telephone Competition Report as of December 31, 1999, CLECs currently serve only 125,991 end-user lines in the state.[1] On that basis, US West's market share expressed in terms of access lines, is 95.78%.[2] In view of Qwest's overwhelming 95.78% share of the Arizona local service market, it is of course not at all surprising that Dr. Taylor would undertake to dismiss market share as an indicator of market power. Unfortunately for Dr. Taylor, his theoretical discussion, which might perhaps be applicable in circumstances where more modest market shares are involved, simply cannot overcome the inescapable fact that Qwest maintains fortress-level control of the local telecommunications market in

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1. *Local Telephone Competition at the New Millennium*, FCC Industry Analysis Division, August 31, 2000, at Table 4. Note that the figure for "CLEC End-User Lines" would necessarily include lines served by CLECs in non-Qwest operating areas. Hence, comparing this figure with the *Qwest-specific* end user access lines from ARMIS Report 43-08 would likely *understate* Qwest's actual market share within Qwest's Arizona operating areas.

2. Market share should be calculated in terms of *revenues* rather than access lines, as I discuss below. However, in this instance, the average monthly rate per end-user access line would not be expected to vary significantly as between US West and CLECs; if anything, CLEC prices are likely below those of US West because CLECs are "price-takers" in the market and may find themselves required to offer lower prices than US West in order to induce customers to switch. In that event, the 95.78% US West share based upon end-user access lines likely *understates* a revenue-based market share.

all of its Arizona operating areas, both in the areas proposed for "competitive zone" pricing and regulatory flexibility as well as in all other parts of Qwest's service territory. The Commission should not rely upon Dr. Taylor's or other Qwest witnesses' speculations as to the future prospects for competition, because these have persistently proven to be unfounded. It is now more than four and one-half years since enactment of the federal *Telecommunications Act of 1996*, yet the hoped-for influx of new entrants and effective competition has failed to materialize both here in Arizona and nationally. Indeed, the FCC has thus far lifted the interLATA services line-of-business restriction, pursuant to Section 271 of the *Act*, in only two (2) states, *neither of which are in Qwest's service area*, and even in those two cases the FCC's finding that the BOCs involved had satisfied the Section 271 "competitive checklist" was not without considerable controversy, controversy that persists even now as competitors in these two states continue to encounter difficulties in placing service orders and other transactions with the BOC. Qwest (then US West) did not receive FCC approval of its petition for regulatory forbearance in the Phoenix and Tucson MSAs, and despite the fact that the FCC had provided a clear roadmap for such approval (one that Dr. Taylor himself appears to accept), Qwest has yet to refile with the FCC or provide the FCC with evidence that it has satisfied the new requirements.

Mr. Teitzel takes issue with several specific points I have raised in my direct testimony. He disagrees with my view that services that are incremental to the core service "platform" and that have no independent existence (i.e., they cannot be provided to customers who do not subscribe for the core service) should be classified in the same

1 category as the core service, i.e., as non-competitive. Despite his rhetoric on this subject,
2 Mr. Teitzel has offered no evidence that my assessment is incorrect, or that the incre-
3 mental services such as call waiting and caller ID confront greater competition than the
4 underlying basic exchange access service with which they are associated. Incredibly, Mr.
5 Teitzel also disputes my conclusion that the elimination of the one "free" directory
6 assistance call allowance and the increase in the directory assistance rate from 59 cents to
7 85 cents constitutes an increase in basic residential exchange service rates. In fact, his
8 contention that not all residential customers utilize the free call allowance, which in effect
9 concedes that at least some do, undercuts his own contention that no rate increase is
10 involved. By eliminating the one free DA call and by converting "local" DA into
11 "national" DA, Qwest will indisputably realize a net revenue increase.
12
13 Finally, Ms. Koehler-Christensen disputes my analysis demonstrating that ratepayers are
14 entitled to a substantial increase in the annual imputation of yellow pages profits, and in
15 fact persists in her position that the present $43-million imputation should be eliminated.
16 The various theories and contentions offered by Ms. Koehler-Christensen are virtually
17 identical to those that she had made before the Washington Utilities and Transportation
18 Commission, which soundly rejected each and every one of them. Qwest's directory
19 publishing affiliate, DEX, continues to benefit from its affiliation with the local Qwest-
20 Arizona operating telephone company, and the telephone company is entitled to a
21 substantial increase in the annual imputation based upon the increasing value of the
22 services it furnishes to DEX, as reflected in the extraordinary level of supranormal profit
23 that DEX continues to generate from the Arizona yellow pages market. Ms. Koehler-

Christensen's various contentions that DEX confronts extensive competition for its yellow pages are simply not supported by any of the evidence that she has offered; indeed, the only "competitor" to DEX that she has discussed explicitly has just 300 employees and hardly represents any sort of realistic "threat" to DEX's overwhelming dominance of the Arizona yellow pages business. The Commission should reject Qwest's effort to extricate itself from the imputation requirement, and should instead increase the annual imputation level to better reflect the ongoing value of the services that Qwest-Arizona continues to provide the DEX, as reflected in DEX's continuing and growing profit levels.

Qwest's overwhelming 95.78%-plus share of the Arizona local exchange market provides compelling and highly relevant evidence of the extent of its monopoly market power.

Q. Dr. Selwyn, Dr. Taylor has attempted to rebut your position that Qwest is a monopoly provider that should remain subject to regulation by this Commission. Have you changed your opinion based upon Dr. Taylor's arguments?

A. No, I have not.

A. In claiming that Qwest should qualify for pricing flexibility, Dr. Taylor' argues that market share is not indicative of a firm's market power. Do you agree?

A. No, I do not. Dr. Taylor's discussion is, at best, entirely theoretical, and ignores entirely the context of the actual local exchange market conditions extant in Arizona. Market share information may indeed be of limited importance when the largest firm in a market

1 controls only a moderate fraction of that market, for example, 30% to 40%. Here,
2 however, Qwest controls fully 95.78% of the Arizona local exchange service market, a
3 level of market dominance that by any objective standard indicates that Qwest, as
4 dominant firm, has the *ability* to exercise substantial market power to control price levels
5 and limit competitive entry. And Dr. Taylor's testimony as to the inapplicability of
6 market share data[3] does nothing to negate the obvious and indisputable dominance that
7 Qwest continues to maintain and to enjoy in Arizona.
8
9 Q. Dr. Taylor suggests that market share, if it is to be measured at all, should be stated in
10 terms of revenues or profits rather than access lines. Do you agree?
11
12 A. Actually I do, and so did the FCC. As I observed in my direct testimony at page 41, in
13 the FCC's decision in the US West petition for forbearance from regulation of its high-
14 capacity services in the Phoenix MSA,[4] the FCC explicitly concluded that calculating
15 market shares based upon DS1-equivalent channel *capacity* rather than on the basis of
16 relative revenues *overstates* competitive entry.[5] The FCC concluded that *revenues*, not

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17 3. Taylor (Qwest), rebuttal at 37-41.

18 4. *Petition of US West Communications, Inc. for Forbearance from Regulation as a*
19 *Dominant Carrier in the Phoenix, Arizona MSA* (CC Docket No. 98-157), *Fifth Report and*
20 *Order and Further Notice of Proposed Rulemaking*, FCC 99-206, released August 27, 1999
21 (hereinafter, "*Pricing Flexibility Order*") at para. 77.

22 5. *Petition of U S West Communications, Inc. For Forbearance from Regulation as a*
23 *Dominant Carrier in the Phoenix, Arizona MSA*, CC Docket No. 98-157 *et seq.*, FCC 99-365,
24 *Memorandum Opinion and Order* Adopted and Released November 22, 1999. ("FCC
25 Forbearance Order") The calculation that US West had proposed in that proceeding treated
26 (continued...)

DS1-equivalent channels, was the appropriate basis for measuring market share, and further concluded on that basis that US West and its Quality Strategies consultant had overstated competitor market shares:

> 27. In addition to the general shortcomings of the BOC petitioners' market share data, we also find that a market analysis based on "DS1 equivalents" fails to provide an accurate measure of competition for special access and high capacity dedicated transport services. The BOC petitioners use of a "DS1 equivalent" measure of market share overstates competitive inroads in a market by placing a disproportionate emphasis on DS3 circuits. For example, CTSI explains that a DS3 channel is equivalent to 28 DS1 channels; therefore, if a competitive LEC provides one DS3 channel to a customer and Bell Atlantic provides 28 DS1 channels to 28 different customers, Bell Atlantic claims that it has only 50 percent market share based on capacity. In contrast, CTSI states that if a CLEC provides a customer a DS3 channel at $100 per month and Bell Atlantic provides its customers with 28 DS1 channels at $50 per month per channel, then the CLEC's revenues would be $100 per month and Bell Atlantic's revenues would be $1400 per month. Measured on the basis of revenues, therefore, Bell Atlantic's market share would be 86 percent. Commenters note that 28 DS1 circuits will produce substantially more revenue and serve far more customers than a single DS3 circuit. We therefore reject the BOC petitioners' argument that the "DS1 equivalent" methodology provides a more accurate measure of market share than revenue data. Because one DS3 circuit costs less than 28 DS1 circuits, even though they provide equal capacity, measuring competitors' market presence on the basis of revenues gives a better indication of the extent to which competitors have made significant inroads into the market in question.[6]

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5. (...continued)
each DS3 channel as its equivalent in DS1 channels; for example, a DS3 was treated as the equivalent of 28 DS1 channels. The FCC determined that this calculation exaggerated actual competitive entry because US West's price for a DS3 channel is only a small percentage of the price for the equivalent number of DS1 channels.

6. *Id.*, at para. 27, footnotes omitted.

The Commission here should, in particular, take note of the fact that, while arguing against "channel equivalents" and in favor of "revenues" as a basis for assessing Qwest's market share, Dr. Taylor has not offered any evidence as to the revenue shares currently being held by its Arizona competitors. As I have noted, in the FCC *Forbearance* proceeding, the Commission found that market shares based upon physical circuits actually *overstated* the market share when viewed on the basis of revenues. Thus, in positing this refinement to a market share analysis, Dr. Taylor is blowing smoke, but without anything substantive in the way of actual, quantitative data, to back it up. Dr. Taylor asserts that "measuring market share loss in terms of lines may *understate* the real intensity of competition, i.e., the real degree of competitive loss."[7] In fact, as the text quoted above confirms, the FCC actually reached precisely the opposite conclusion to that asserted by Dr. Taylor, i.e., the FCC found that a market share based upon channels (lines) would actually *overstate* the extent of competition relative to a market share statistic based upon relative revenues.

Q. Dr. Taylor also claims that the Commission should look to the potential *capacity* of competing firms rather than to current sales as a basis for assessing the extent of competitive penetration.[8] Do you agree?

A. No. The "potential capacity" argument is a key element in the "market contestability" theory that Dr. Taylor espouses. The notion here is that the incumbent LEC's very

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7. Taylor (Qwest), rebuttal at 39, emphasis in original.

8. Taylor (Qwest), rebuttal at 40.

1 awareness that its rivals possess the capacity to expand into its market will work to
2 constrain the incumbent's exercise of market power. Inasmuch as Qwest persists in
3 charging grossly above-cost prices for many of its services, such as vertical features, DSL
4 and switched access, the "market contestability" notion fails on its very face. However,
5 to the extent that Dr. Taylor's argument has any merit, he is clearly focusing upon the
6 *wrong* measure of capacity: That is, he is referring to competitors' "raw" capacity in the
7 ground, rather than the capacity of Qwest to process competitor orders for services to the
8 competitors' customers.
9
10 Q. Please explain this last point.
11
12 A. To the extent that "potential" competitor capacity offers any price-constraining pressure
13 on the incumbent, it is because the competitors collectively possess relatively high
14 "elasticity of supply." Elasticity of supply refers to the ability of, and the rapidity with
15 which, competing firms to supply goods and services to the market in response to the
16 prices charged or profits earned by the incumbent. A relatively high supply elasticity
17 indicates that rival firms are able to respond quickly to excessive market prices, and such
18 a capability would have the effect of bringing those price levels down to long run
19 incremental cost. A low supply elasticity, on the other hand, suggests that competitors
20 are not able to respond quickly to satisfy market demand, which permits the incumbent to
21 maintain excessive prices, at least in the short run, until such future time as competing
22 firms acquire the capacity to supply customers presently served by the incumbent.
23

1 Significantly, in the instant situation, the incumbent, Qwest, is actually able itself to limit
2 the capacity of its rivals to respond rapidly to market demand and thereby to serve the
3 market in a way that would compel Qwest to lower its own excessive price levels.
4
5 Q. Does Dr. Taylor appear to agree with you that the supply elasticity reflecting
6 competitors' ability to rapidly satisfy market demand is, in fact, quite low?
7
8 Q. Yes. At page 43 of his rebuttal testimony, Dr. Taylor explicitly concedes that
9 "[n]aturally, it takes considerable time and effort on the part of those entrants to bring
10 about significant erosion in the market share of the incumbent firm."
11
12 Q. How is that possible?
13
14 A. Most of the "competition" in the local market that exists today involves, to varying
15 degrees, the *resale* of services furnished by Qwest. Total service resale (TSR), pursuant
16 to Section 251(c)(4) of the federal *Telecommunications Act of 1996* and the provision of
17 Unbundled Network Elements to CLECs, pursuant to Section 251(c)(3), are excellent
18 examples. Every time a competitor provides a service to one of its end user customers
19 that utilizes Qwest facilities either on a TSR or a UNE basis, Qwest must necessarily be
20 involved in facilitating and processing the transaction. Even where the competitor is
21 wholly or partially facilities-based, Qwest will typically be involved in the physical
22 cutover, except where the customer is not transferring his service from Qwest to a CLEC
23 but is ordering entirely new service from the facilities-based CLEC. In the recent

1 Verizon strike, for example, competitor installations came to a virtual standstill
2 throughout the 13-state Verizon operating region because Verizon's local telcos ostensibly
3 lacked the personnel to perform the transactions. Qwest has not, in fact, satisfied the
4 Section 271 competitive checklist in any of its fourteen states because (among other
5 things) it has not demonstrated that it is capable of offering seamless processing of
6 competitor orders, as expressly required by Sections 271(c)(2)(B)(i) and (ii). The FCC,
7 in its *First Interconnection Order* in CC Docket 96-98, interpreted Sections 251 and 252
8 as expressly requiring that CLECs be able to process service order transactions through
9 the incumbent LEC's operations support systems (OSS), and to be provided access to
10 those systems on a nondiscriminatory basis vis-a-vis the access arrangements provided by
11 the ILEC to itself.[9] Indeed, it was precisely this issue that held up Verizon-New York's
12 bid for long distance authority, which was finally awarded, after extensive testing, last
13 January. And in fact the post-award experience in New York has confirmed that Verizon

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14 9. *In the Matter of Implementation of the Local Competition Provisions in the*
15 *Telecommunications Act of 1996*, CC Docket No. 96-98; *Interconnection between Local*
16 *Exchange Carriers and Commercial Mobile Radio Service Providers*, CC Docket No. 95-185,
17 *First Report and Order*, FCC 96-325, Adopted: August 1, 1996, Released: August 8, 1996, at
18 para. 316. The Commission stated that "to enable new entrants, including small entities, to
19 share the economies of scale, scope, and density within the incumbent LECs' networks, we
20 conclude that incumbent LECs must provide carriers purchasing access to unbundled network
21 elements with the pre-ordering, ordering, provisioning, maintenance and repair, and billing
22 functions of the incumbent LECs operations support systems. Moreover, the incumbent must
23 provide access to these functions under the same terms and conditions that they provide these
24 services to themselves or their customers. ..."

1 does not yet actually possess the capacity to process "market quantity" orders.[10] Qwest-
2 Arizona is well behind Verizon-New York in satisfying Section 271.
3
4 The key point here is that what matters insofar as capacity is concerned is the *lesser* of
5 the CLECs' capacity to serve and the ILEC's capacity to process CLEC orders. Even if
6 a CLEC is capable of fulfilling 10,000 service orders a week, if the incumbent is capable
7 of handling only 500 such orders, then the relevant "capacity," even under Dr. Taylor's
8 largely discredited "market contestability" theory, is the smaller figure, i.e., 500 orders
9 per week in this example. Dr. Taylor, of course, offers no quantitative evidence
10 regarding the *relevant* capacity of his client's competitors to serve customers in the
11 Arizona local service market, and certainly fails entirely to demonstrate that in fact the
12 presence of whatever competitor capacity may actually exist in Arizona is sufficient to
13 actually constrain Qwest's pricing and marketing practices.
14
15 Q. Dr. Taylor contends, at page 42 of his rebuttal testimony, that measures of market power,
16 such as the Herfindahl-Hirschman Index ("HHI") are relevant only where mergers or

---

17 10. See, e.g., New York State Public Service Commission, *Complaint of MCI Worldcom,*
18 *Inc. against Bell Atlantic-New York concerning Billing Completion Notices, Firm Order*
19 *Commitments, Acknowledgements and Tracking Numbers, filed in 99-C-1529*, NYPSC Case
20 No. 00-C-0008; *Complaint of AT&T Communications of New York, Inc. against Bell Atlantic-*
21 *New York concerning Acknowledgements, Completion Notices and Pre-Order Outages, filed in*
22 *99-C-1529*, NYPSC Case No. 00-C-0009, *Order Directing Improvements to Wholesale*
23 *Service Performance*, Issued and Effective February 11, 2000; FCC, *In the Matter of Bell*
24 *Atlantic-New York Authorization Under Section 271 of the Communications Act to Provide In-*
25 *Region, InterLATA Service in the State of New York*, File No. EB-00-IH-0085, Acct. No.
26 X32080004, *Order and Consent Decree*, Released March 9, 2000. See also "New York PSC
27 Tells Bell Atlantic to Report OSS Results Daily," *Telecommunications Reports*, February 21,
28 2000.

acquisitions involving two or more firms in the same market are taking place. Do you agree?

A. I certainly agree that the HHI provides highly relevant information where a regulatory agency and/or the United States Department of Justice are evaluating the efficacy of a proposed merger or acquisition. However, the HHI is also highly relevant in providing a quantitative measure of market power when considering ILEC contentions that its market has become "competitive." Dr. Taylor correctly notes that the Department of Justice considers the extent of the increase in the HHI that would result from the merger or acquisition, but then attempts to imply that this is the *only* use to which the HHI can be put. That is obviously not true.

Q. What is the HHI for Qwest in Arizona?

A. The HHI is calculated as the sum of the squared market share percentages for each firm in the market. Dr. Taylor notes that HHI values as high as 1,800 "trigger no alarms from an antitrust perspective."[11] With a market share of 95.78% in Arizona, Qwest's HHI in this state is a whopping 9,174 out of a possible 10,000. While the selection of 1,800 as the upper limit of the HHI before any antitrust concerns are invoked may, as Dr. Taylor claims, be "arbitrary,"[12] there can be no question but that an HHI of 9,174 is so far

11. Taylor (Qwest), rebuttal at 42.

12. *Id.*

above 1,800 that there can be little doubt as to the presence of extreme market power on the part of the incumbent.

Q. Dr. Taylor contends that there is an "asymmetry" with respect to increases vs. decreases in the HHI, and that in the instant situation Qwest's HHI is decreasing. Does such asymmetry exist?

A. Perhaps, but once again Dr. Taylor advances only theoretical arguments that are in no sense satisfied by the facts on the ground. As I have previously noted, Dr. Taylor agrees that "it takes considerable time and effort on the part of those entrants to bring about significant erosion in the market share of the incumbent firm." He goes on to claim that it is not necessary for the HHI to fall to the 1,800 range "before the market could be declared competitive."[13] He states that "[t]he critical test there is not whether the HHI has fallen precipitously but, rather, whether the incumbent firm has the ability to exercise market power even in the early stages of competition when the HHI is necessarily high. Without the ability to exercise market power, a high HHI says nothing about the actual and potential state of competition in the market."[14] This argument could be true at a theoretical level, but only if the HHI does drop precipitously. For example, in less than a year following the break-up of the former Bell System, AT&T's share of the customer premises equipment (CPE) market dropped from the high 80% range to well below

13. *Id.*, at 43.

14. *Id.*

1 50%.[15] But in the four-and-one-half years since enactment of the federal
2 *Telecommunications Act of 1996*, ILEC market shares have hardly decreased at all, and
3 there is no indication that that situation will change any time soon. Dr. Taylor, in
4 speculating as to the rapidity with which he expects price-constraining competition to
5 arrive on the scene, he conveniently ignores this history and the inescapable fact that
6 Qwest is still far from satisfying the Section 271 requirements that are expressly intended
7 to *facilitate* competitive entry and development. Even if, in two to three years, Qwest's
8 Arizona market share were to drop to only 90% (which would imply a 137% increase in
9 competitor market shares relative to that which exists today), the HHI for Qwest in
10 Arizona would still *exceed* 8,100, or some four-and-one-half times the upper limit of
11 1,800 that the DoJ utilizes as a trigger for antitrust concerns. And nothing that Dr.
12 Taylor has offered in the way of hard facts would suggest that a decrease in Qwest's
13 overall Arizona market share to as low as 90% over the next two to three years is even
14 remotely possible.
15
16 Q. At page 46 of his rebuttal testimony, Dr. Taylor provides an example of a market
17 consisting of one facilities-based carrier with a 40% market share and 30 resellers each
18 with a 2% market share. Dr. Taylor contends that the HHI for this market would be
19 1,720. Has he correctly calculated the HHI for this hypothetical market?
20
21 A. No, he has not. There are, in fact, two separate "markets" here, one for the provision of
22 the underlying services by the sole facilities-based carrier, and the second for the

---

23 15. Can we get a cite for this - check with Levinson

provision of retail services by the facilities-based carrier and its 30 resellers. The HHI for the underlying service market is 10,000, because there is only one firm with market share of 100%. The HHI for the *retail* segment is, as Dr. Taylor has calculated it, 1,720. By any stretch of the imagination, the sole facilities-based carrier will have market power, and apparently Dr. Taylor agrees with that point. However, what he has attempted to accomplish through this highly misleading example is to suggest that a firm can still have market power even where the HHI is below 1,800. Obviously his example fails because he has misstated the actual HHI for the market for the underlying facilities-based service.

Q. In quantifying Qwest's market share, should the Commission confine itself solely to the so-called "competitive zones" that Qwest has proposed, or should it develop and rely upon an overall Qwest-Arizona statewide market share figure?

A. The latter. A major source of Qwest's market power in its so-called "competitive zones" stems directly from its virtual monopoly control of the remainder of its Arizona operating territory. Even if the Commission were to nominally "remove" the "competitive zones" from rate of return regulation, it would still be required to allocate costs as between the "competitive zones" and the remainder of Qwest's service areas. Qwest is in a position to shift costs out of its "competitive zones" and into the area in which it concedes that no consequential competition is present, thereby affording it the ability to effectively cross-subsidize the services in furnishes under "competitive" conditions with higher rates and revenues from its monopoly areas. The Commission needs to make an overall

assessment of the Company's statewide market share, because confining itself solely to the "competitive zones" would provide a misleading understatement of the actual extent of Qwest's market power even in these areas.

Q. Dr. Taylor challenges your dismissal of collocation as an indicator of the presence of competition. Please comment upon his discussion of this issue.

A. There is no question but that the presence of collocation in a large percentage of an ILEC's central offices is a *necessary* condition for effective competition in the areas in which such collocation is occurring. However, it is not in and of itself a *sufficient* condition to *prove* that competition is present at a level that is sufficient to adequately constrain Qwest's market power. Qwest's continuing failure to provide seamless and nondiscriminatory access to its operations support systems for purposes of permitted CLECs to perform preordering, ordering and provisioning of service functions essentially negates the effects of collocation insofar as it facilitates the CLECs' ability to gain effective access to Qwest's monopoly network resources. The *fact* that market penetration remains almost unmeasurable even in the central office serving areas in which CLEC collocation is present underscores this point, and undermines Dr. Taylor's argument.

Q. At pages 50-51 of his rebuttal testimony, Dr. Taylor contends that the FCC has rejected the use of market shares as a basis for pricing flexibility, and has instead adopted specific triggers that, once satisfied by an ILEC, would be used as a basis for approval of a

1 petition for pricing flexibility. Has Dr. Taylor correctly described the FCC's actions in
2 this regard?
3
4 A. No, and in fact his discussion appears to be deliberately misleading. Dr. Taylor states, at
5 page 51, that "in first undertaking reform of interstate *switched access* charges, the FCC
6 adopted a market-based, rather than an overtly-regulatory, approach."[16] His source for
7 this statement is given in footnote 36, the FCC *Access Charge Reform* First Report and
8 Order released May 16, 1997. Dr. Taylor provides no specific paragraph citation to
9 support his characterization. In fact, *nothing in the First Report and Order expressly*
10 *confers any pricing flexibility authority upon any ILEC*; at best the Commission
11 expressed an *intention* to pursue this course in the future.
12
13 In the very next sentence on page 51 of Dr. Taylor's rebuttal testimony, immediately
14 following the reference to the *Access Charge Reform* First Report and Order, Dr. Taylor
15 goes on to introduce a quotation: "The FCC explained that deference thus:" In fact, the
16 FCC order from which the quoted language was extracted was *not* the *Access Charge*
17 *Reform* First Report and Order at all, but was instead the *Fifth* Report and Order released
18 August 27, 1999, *more than two years later*. More importantly, the subject of the text
19 reproduced from the Fifth Report and Order was pricing flexibility for *special access and*
20 *dedicated transport*, distinctly *not* switched access. In fact, the FCC adopted far more
21 stringent requirements for switched access than for special access and dedicated transport.

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22 16. *Id.*, at 51, emphasis supplied.

At paragraph 108 of the Fifth Report and Order, relating to "Phase I Triggers for Other Switched Access Services," the FCC stated:

> 108. We conclude that an incumbent price cap LEC should be allowed Phase I pricing flexibility for common line and traffic-sensitive services, and the traffic-sensitive components of tandem-switched transport service, when it demonstrates that competitors, in aggregate, *offer service over their own facilities to at least 15 percent of incumbent LEC customer locations in the MSA.*[17]

And lest there be any doubt as to the fact that the FCC drew a bright line between switched and special access, one need look only as far as the very next two paragraphs in the same Fifth Report and Order, paragraphs 109 and 110:

> 109. We conclude above that Phase I relief for a particular service is warranted when an incumbent LEC demonstrates that competitors have made irreversible investment in facilities used to compete with the incumbent LEC in the provision of that service. For special access and dedicated transport services, we adopt a trigger based on collocation by competitors because competitors historically have collocated in incumbent LEC wire centers in order to provide transport and special access services. Thus collocation furnishes evidence of irreversible investment in facilities in part because it indicates competitive transmission facilities terminating at the collocation site. Although we acknowledge that some competitors provide these services exclusively over their own facilities (total facilities bypass), the extent of such competition is difficult to measure. Because collocation traditionally has served as the building block for competitive transport services, we conclude that it constitutes a sufficient measure of the degree to which competitors have invested in facilities to provide these services.[18]
>
> 110. Competition for common line and traffic-sensitive services, however, is a much more recent phenomenon, and it may not develop in this same manner. For this reason, a different approach to granting pricing flexibility for

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17. FCC *Pricing Flexibility Order*, at para. 108, footnote omitted, emphasis supplied.

18. *Id.*, footnotes omitted.

these services is warranted. For traffic-sensitive and common line services, we adopt a Phase I trigger that takes into account competitors that have wholly bypassed incumbent LEC facilities, as well as competitors that collocate in incumbents' wire centers so as to provide service over unbundled loops.

Q. Why is this distinction that the FCC has made as between switched and special access important in the context of the present proceeding here in Arizona?

A. Special access is furnished over dedicated facilities to a highly limited number of medium and large business/institutional/government customers and interexchange carriers. By contrast, switched access is provided over the same common line that is used to provide basic local residential and business exchange services. Competition for switched access will develop precisely in tandem with competition for basic local exchange service, and at the present time there is no consequential competition for basic local exchange or switched access service in Arizona.

Q. Given the fact that Dr. Taylor has extensively cited the FCC's Fifth Report and Order regarding pricing flexibility and the various triggers that, once satisfied, would permit an ILEC to attain pricing flexibility authority for special and switched access, as of this date has Qwest actually satisfied *any* of the specific conditions that are enumerated in the Fifth Report and Order?

A. No. In fact, the FCC soundly rejected US West's petition for forbearance, and to day Qwest has not re-petitioned the FCC for pricing flexibility authority pursuant to the Fifth

1 Report and Order.[19] Hence, as of this date there is not even a controversy as to whether
2 Qwest has satisfied the Phase I and/or Phase II triggers set forth in the Fifth Report and
3 Order, since it has not even so much as represented to the FCC that it has.
4
5 Q. Do you agree with Dr. Taylor's view that "[w]henever the benefits from granting pricing
6 flexibility outweigh costs of such a policy," regulation should be relaxed?
7
8 A. I am not exactly sure what Dr. Taylor meant by this statement, since the "costs of such a
9 policy" to which he refers in this sentence relate back to the granting of pricing
10 flexibility. I assume that what Dr. Taylor intended to refer to were the costs of continued
11 price regulation, not the costs of pricing flexibility. On that basis, it is difficult to
12 disagree in principle with his statement, but his view is not supported by the facts.
13 Absent actual *price-constraining* competition in the relevant market together with the
14 inability of the incumbent to cross-subsidize those services it furnishes under such
15 competitive conditions with revenues and profits from services that continue to be
16 provided under unchallenged monopoly conditions, the risks to consumers and
17 competitors of the kind of unfettered pricing flexibility that Dr. Taylor advocates grossly
18 exceed any nominal "benefits" that might potentially result from permitting the ILEC to
19 raise or lower prices at will. While it may be inconvenient for Qwest to come before this
20 Commission with specific tariff changes, that inconvenience to Qwest is easily
21 outweighed by the potential risks and costs that Qwest, through exercise of its extensive
22 market power, can impose upon consumers and competitors. Accordingly, while I agree

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23 19. See McIntyre (Qwest), rebuttal at 15.

that a cost/benefit test is always appropriate when considering any regulatory initiative, Qwest's situation as it exists today does not come even remotely close to actually satisfying such a cost/benefit test.

Mr. Teitzel's contentions as to the presence of competition and the adequacy of regulation to protect competitors and consumers is not supported by the "facts on the ground."

Q. At page 47 of his rebuttal testimony, Mr. Teitzel takes issue with your position that "services and features that have no independent existence and rely on a common infrastructure should take the regulatory status of the core service." Please comment on his testimony in this regard.

A. Mr. Teitzel has conveniently abbreviated my statement on this subject. At page 26 of my direct testimony, I explained this point as follows:

> Services and features that are incremental to a monopoly service "platform," i.e., that have no independent existence in that they cannot be provided to a customer unless the customer also subscribes to the "platform," are no more "competitive" than the basic platform itself, and thus should take the same regulatory status as the "platform" service. Services that have an independent existence but that are furnished out of the same common infrastructure/resource base along with monopoly services and which could not as a practical matter be furnished by US West without the use of that common infrastructure should also take the regulatory status of the core "monopoly" services.

My point here relates to both the demand and supply sides of these "incremental" services. Qwest cannot sell a service such as call waiting, caller ID or, for that matter, switched access independently of the dial tone line, which is indisputably a monopoly

service at the present time. Hence, there is no basis to consider any such vertical features, whether existing or new, as "competitive" because in fact there are no competitors who are in a position to provide these services to a Qwest dial tone line customer. That Qwest enjoys extensive market power with respect to such services is amply demonstrated by the price/cost relationships that presently exist: Most vertical features, such as call waiting and caller ID, exhibit incremental costs that are barely distinguishable from zero, yet carry prices set at hundreds of times these minuscule costs. Such prices could never be sustained if any of these features actually confronted effective competition independently of the core platform with which they are inextricably linked. Indeed, where the market for the core service is competitive, as is the case with wireless (cellular and PCS) services, vertical features such as call waiting, three-way calling, voice mail, and caller ID, are all offered free of charge.

My second point relates to the supply side. Qwest could not produce or provide many of its vertical and other services without the core infrastructure from which its basic dial tone line services are produced. There is no effective means for "allocating" costs of the common infrastructure between core and "incremental" services, because so much of the cost base is fixed, i.e., not materially affected by the demand for the "incremental" service. For example, Qwest's total operating costs would not be materially impacted if its penetration of caller ID were to increase to 100%, because the physical capability and capacity to furnish this service to each and every dial tone line served out of digital central offices is already in place. It makes no sense whatsoever for an incumbent LEC to be permitted to exploit its ratepayer-funded core infrastructure in this manner, and it

certainly does not create a "level playing field" for competitors. Even where a particular service could have an independent existence separate from the core dial tone line platform, any competitor would necessarily have to acquire and construct its own facilities to furnish that service on a stand-alone basis, whereas Qwest is able to provide the service on an incremental basis by "piggy-backing" the service onto its existing plant and organizational resources.

Q. Mr. Teitzel also disagrees with your statement that "Qwest's directory assistance proposal '... should be considered as an additional increase in rates for basic residential service...'"[20] Is his disagreement well-founded?

A. No. The basis for Mr. Teitzel's dispute with my statement is that "the majority of residential customers do not utilize D.A. service each month, the service is completely discretionary and a wide range of competitive alternatives to Qwest's D.A. are available to each and every Arizona consumer."[21] Each and all of these contentions are off-point. First, whether any particular customer does or does not utilize D.A. service in a given month is immaterial: Basic residential service currently includes one "free" directory assistance call each month, with additional calls being charged at the rate of 59 cents each. Qwest would eliminate the one-call allowance and increase the per-call rate to 85 cents for "local" directory assistance calls (by withdrawing "local" directory assistance service altogether and merging it with "national" D.A.). For those residential customers

20. Teitzel (Qwest), rebuttal at 48-49.

21. *Id.*, at 49.

1 who do utilize D.A. in a given month, the effect of this proposal would be to increase
2 their monthly charge by 85 cents. At the very least, if the one-call allowance is to be
3 unbundled, the basic residential rate should be reduced on a revenue-neutral basis to
4 reflect this diminution in the scope of the residential service offering. Qwest has made
5 no such proposal, so the result will indisputably be a net rate *and revenue* increase for
6 Qwest.
7
8 Mr. Teitzel's second point is that D.A. service is "completely discretionary." I take
9 strong issue with this contention. Where a number is listed in the local white or yellow
10 pages directory and the customer is simply too lazy to look it up, one could concede that
11 the use of D.A. is a discretionary choice being made by the customer. However, where
12 the listing is not included in the local directory (because, for example, the service was
13 initially installed after the directory went to press) or where the customer does not have a
14 copy of a particular directory in which the listing he or she needs appears, the require-
15 ment to obtain the desired telephone number from directory assistance is no more
16 discretionary than the ultimate call to that number. I do not see Qwest contending that
17 local calls are also "discretionary."
18
19 Related to this is Mr. Teitzel's third contention — that "a wide range of competitive
20 alternatives to Qwest's D.A. are available to each and every Arizona consumer" — which
21 is also off-point. First, only Qwest's D.A. offering can be accessed by a Qwest dial tone
22 line customer by using the highly familiar '411' dialing protocol; all other "competing"
23 D.A. services require the use of a different dialing sequence. Indeed, while I am not an

attorney and thus do not offer a legal opinion, I would nevertheless note that Section 251(b)(3) of the *Telecommunications Act of 1996* imposes upon *all* local exchange carriers (which would clearly include Qwest)

> [t]he duty to provide dialing parity to competing providers of telephone exchange service and telephone toll service, and the duty to permit all such providers to have nondiscriminatory access to telephone numbers, operator services, directory assistance, and directory listing, with no unreasonable dialing delays.

Section 3(a)(2) provides a definition of "dialing parity" as follows:

> (39) DIALING PARITY- The term 'dialing parity' means that a person that is not an affiliate of a local exchange carrier is able to provide telecommunications services in such a manner that customers have the ability to route automatically, without the use of any access code, their telecommunications to the telecommunications services provider of the customer's designation from among 2 or more telecommunications services providers (including such local exchange carrier).

To the extent that Qwest does not comply with the "dialing parity" requirement of the federal legislation, it cannot credibly contend that viable "competitors" to its 411-based "national D.A." service are actually present. Certainly there can be no dispute that any such "alternative" providers of local or national D.A. are in no sense provided with any sort of "level playing field" when their services cannot be accessed by means of '411'. Mr. Teitzel's contentions to the contrary are without merit, and should be ignored by the Commission.

1 Q. Mr. Teitzel disagrees with your view that resale and UNEs do not constitute "viable
2 forms of competition."[22] Please comment on his response.
3
4 A. Both Mr. Teitzel here, and as I have previously observed, Dr. Taylor as well, conven-
5 iently ignore the inescapable fact that the market for local telecommunications services
6 must necessarily be analyzed and addressed as separate "wholesale" and "retail"
7 segments. The presence of non-facilities-based competitors who utilize total service
8 resale or UNEs to furnish local services to their customers constitutes competition *at the*
9 *retail level*, but distinctly *not* at the wholesale level, since the underlying service and
10 facilities continue to be provided by Qwest. Returning to Dr. Taylor's example of a
11 market consisting of one facilities-based carrier with 40% of the retail market and 30
12 non-facilities-based resellers each with 2% of the retail market, in the real world case of
13 Qwest, its *wholesale* HHI is precipitously close to the theoretical maximum value of
14 10,000, even if its *retail* HHI is slightly less. The point is that Qwest continues to
15 exercise extreme market power even in geographic areas where non-facilities-based retail
16 competition is present.
17
18 Q. But what about the argument that since wholesale rates will continue to be regulated,
19 Qwest cannot exercise market power over its wholesale services?
20
21 A. There is no question but that continued regulation of Qwest's wholesale services is
22 essential for any meaningful competition at the retail level to develop and be sustainable.

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23 22. Teitzel (Qwest), rebuttal at 42.

However, Qwest retains strong incentives to shift as many joint costs as possible from its retail to its wholesale operations and to attempt to set wholesale rates (even if regulated) at levels that include disproportionate allocations of such costs. Moreover, competitors are not adequately protected by any "imputation" requirement, because the Commission will have no ability to assess the costs of Qwest's (effectively deregulated) retail operations, which must necessarily be added to the imputed cost of wholesale services to prevent an anticompetitive price squeeze from being perpetrated upon competitors. In addition, Qwest's retail operations will benefit from a wide range of non-tariffed corporate services and resources that are not even available to competitors, and for which no adequate "imputation test" can realistically be established and enforced. Both Dr. Taylor and Mr. Teitzel speak to and, in Dr. Taylor's case, cite to the FCC's determinations as to the difficulty in maintaining detailed regulatory oversight as a general matter, yet such oversight will be essential if regulation is to be relied upon to protect competitors and consumers from anticompetitive pricing and cross-subsidization. Their rhetoric aside, none of Qwest's witnesses have provided any basis for the Commission to conclude that it will have the capability to provide for this level of regulation in the event that Qwest's "competitive" retail services are afforded price-deregulation.

The Qwest/DEX Arizona yellow pages directory business is a regulatory asset of Qwest-Arizona, and ratepayers are entitled to all of the profits generated therefrom.

Q. Dr. Selwyn, Ms. Koehler-Christensen takes issue with your direct testimony regarding the imputation of yellow pages profits into Qwest-Arizona's revenue requirement. Have you reviewed her rebuttal testimony?

A. Yes, I have.

Q. Do any of her positions have validity in the context of this proceeding?

A. No, they do not. Ms. Koehler-Christensen contends, among other things, that ratepayers have been compensated for the transfer of the then-Mountain Bell yellow pages directory business to DEX in 1984, that DEX faces competition from seven other directory publishers in Arizona, and that DEX's extraordinary level of profitability is irrelevant to the Commission's determination as to the imputation issue. She is wrong with respect to each and all of these issues.

Q. Have Arizona ratepayers been compensated for the transfer of the yellow pages business from Mountain Bell/US West to DEX?

A. No. No such transfer ever took place, as most recently confirmed by the decision issued by the Washington Utilities and Transportation Commission (WUTC) to which I referred in my direct testimony. Attachment 1 is a copy of that decision, which I am providing

for the Commission's convenience in reviewing its content. In that ruling, the WUTC determined that no actual transfer took place, that in effect Pacific Northwest Bell had "outsourced" or "leased" the directory publishing business to its directory publishing affiliate, but that no permanent "sale" of the yellow pages business had occurred, and that no payment reflecting the going business value of the (Washington) yellow pages business had been made.[23] The Commission concluded that the ongoing imputation amounts recorded on US West-Washington's books reflected the outsourcing arrangement, and in no sense represented installment payments against some unspecified purchase price.[24] The conditions associated with the assignment of the directory publishing function to DEX in Arizona were substantially the same as that which existed in Washington State. Ms. Koehler-Christensen contends that "Arizona ratepayers have had their rates reduced by more than $700-million"[25] and that this constitutes full "compensation for the transfer" of the yellow pages business to DEX. It is worth noting that Ms. Koehler-Christensen made *exactly the same argument* in her testimony before the Washington Commission, which soundly rejected it.[26]

Q. What about Ms. Koehler-Christensen's claim that DEX faces real competition in Arizona from other directory publishers — is her contention supported by facts?

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23. WUTC Order, at para. 154.

24. *Id.*, at para. 181.

25. Koehler-Christensen (Qwest), rebuttal at 14.

26. *Id.*

1 A. Hardly. Ms. Koehler-Christensen contends that I have not "provid[ed] evidence to
2 support [my] claims" as to the lack of competition for yellow pages directories in
3 Arizona. In fact, there is significant evidence regarding the lack of competition for
4 yellow pages directories as presented in my testimony. In contrast, Ms. Koehler-
5 Christensen has failed to provide any support for her contentions that such competition is
6 actually present.
7
8 Q. Doesn't Ms. Koehler-Christensen state that "there are at least seven other directory
9 publishers that compete with DEX in Arizona"?
10
11 A. She does, but then only names one of them, and in fact she even got that company's
12 name wrong. She described a "Phone Directory Company" as a "large independent
13 publisher that publishes directories in eleven states and a number of Canadian provinces
14 and territories."[27] She provided no quantitative data as to this one company's size,
15 revenues, or profits.
16
17 Q. Did you undertake to obtain any additional information about this "Phone Directory
18 Company?"
19
20 A. Yes. I was unable to find any web site or listing for a "Phone Directory Company" on
21 the Internet. I then requested that calls be placed to Qwest directory assistance in
22 Arizona, Colorado, Minnesota and Washington State to obtain a telephone number for

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23 27. *Id.*, at 17.

this firm; the only listing was in Seattle, and repeated calls to that number resulted only in "no answer"

Upon further investigation, I did find a "Phone *Directories* Company" web site and was able to obtain some information about the company. According to its web site, Phone Directories Company currently has 300 employees and publishes directories with a total circulation of 3.0 million in twelve states and in Canada. See Attachment 2. Other information I obtained from the Yellow Pages Publishers Association web site indicated that PDC's Arizona directories have a combined circulation of only 555,200 (DEX directory circulation throughout Arizona is nearly four million), and those circulation figures appear not to have been audited by any independent circulation auditing organization.[28] PDC does not publish any directories for the major Arizona markets of Phoenix and Tucson, and in the few small cities and towns in which PDC and DEX both appear to publish directories, PDC's circulation as reported is decidedly less than DEX's. See Attachment 3. As I noted, PDC currently has all of 300 employees, presumably spread across the twelve states and Canada (either physically and/or with respect to their responsibilities), and provides only "approximate," and probably unaudited, circulation figures that in any event suggest that PDC's circulation in Arizona is only about one-eighth that of DEX. For Ms. Koehler-Christensen to seriously suggest that Phone

28. Although I have not been able to determine whether PDC's provides audited circulation figures, data obtained from its web site provide only "round" numbers like 51,500 for Flagstaff vs. DEX's circulation for Flagstaff of 126.848. Moreover, PDC itself describes its circulation figures as "approximate" (see Attachment 4 to my testimony).

1 Directories Company is in any sense a "large independent publisher" that is even
2 remotely comparable to DEX is nothing short of laughable.
3
4 Q. Have you been able to obtain any financial information about Phone Directories
5 Company?
6
7 A. No. The firm does not appear to be publicly traded and does not file a 10-K with the
8 SEC.
9
10 Q. What about the other six firms that Ms. Koehler-Christensen claims compete in the
11 Arizona yellow pages market?
12
13 A. She did not identify any of them in her testimony (although they are listed in her
14 Exhibit). The Yellow Pages Publishers Association web site[29] is, however, a source of
15 some of this information. Phone Directories Company, the one firm that Ms. Koehler-
16 Christensen did address specifically in her testimony, is actually the second largest of
17 these so-called "competitors" to DEX in Arizona, with directories that have a combined
18 circulation of "approximately" 555,200. National Directory Company seems to be
19 slightly larger in Arizona, with a claimed (but probably unaudited) circulation of 625,000.
20 By contrast, the circulation of DEX's Arizona yellow page directories is 3,977,582;
21 hence, the competitive impact of the other ten firms listed on the Yellow Pages
22 Publishers Association web site is surely inconsequential by any objective standard. A

23 29. www.yppa.org

total of nine other directory publishers (besides PDC and DEX) are identified on the Yellow Pages Publishers Association web site, and all but one of these are smaller than PDC. I have included the Arizona information from the Yellow Pages Publishers Association web site as Attachment 3 to my surrebuttal testimony. Incidentally, the data reported by the Yellow Pages Publisher Association does not track the data on Ms. Koehler-Christensen's Exhibit A Koehler-Christensen-1, and it appears that Ms. Koehler-Christensen's Exhibit overstates the actual extent of yellow pages competition, at least as reported by the Yellow Pages Publishers Association.

Attachment 4 to my surrebuttal testimony contains information provided to me by PDC with respect to each of its Arizona directories. As can be seen, these cover largely rural communities and certain individual communities on the periphery of the Phoenix metro.

The key point here is that all that Ms. Koehler-Christensen has done is to *identify* alleged competitors while providing absolutely no information as to the actual extent to which they represent substantive competition to DEX in Arizona. Her characterizations and information as to the competitiveness of this market would not even satisfy the extraordinarily loose standards set forth by Dr. Taylor for determining that competition is present.

Q. Ms. Koehler-Christensen is also asked "about [your] claim that DEX's earnings indicate that there is no effective competition." Are you satisfied with her response?

1 A. No, and in fact, Ms. Koehler-Christensen did not even answer the question that is
2 propounded to her in her prefiled rebuttal testimony. My point was that the extraordinary
3 rate of return that DEX has realized from its Arizona (and other) operations is
4 inconsistent with what one would expect to find in a competitive market. If there were
5 actual rivals in the market, the advertising rates would have been bid down toward cost,
6 and the ROI would have decreased to "competitive levels." I estimated DEX's rate of
7 return to be at least 90.5% based upon public (non-proprietary) data derived from the US
8 West 1999 Annual Report, and significantly more based upon proprietary data. In its
9 Order approving the split of US West and MediaOne, the Commission found that, for
10 1977, DEX's return on equity was given as 206.5%.[30] Profit levels of even the 90.5%
11 magnitude, let alone the higher figures, are entirely inconsistent with competitive market
12 conditions, and could never be sustained if actual competition were present in the
13 Arizona yellow pages market.
14
15 Ms. Koehler-Christensen responded to this question by asserting that "[t]he Arizona Court
16 of Appeals has already determined that the profits of DEX are not an appropriate basis
17 for an imputation ..." The veracity and validity of that legal opinion requires a legal
18 response; my point was simply that supranormal profits are consistent with monopoly and
19 inconsistent with competition, a point to which Ms. Koehler-Christensen does not
20 respond.
21

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22 30. *In the Matter of the Notice of US West, Inc. and US West Communications, Inc.*
23 *Concerning Restructuring of Holding Company*, Arizona Corporation Commission Docket No.
24 T-01051B-98-0104, Decision No. 61075 issued August 10, 1998, at 3, para. 7.

I would note, however, that not everyone shares Ms. Koehler-Christensen's legal opinion. In his dissenting opinion to the Commission's decision in the US West/MediaOne split proceeding, then-Commissioner Renz Jennings stated:

> In 1996, Judge Noel Fidel said that the 1988 yellow pages imputation agreement between US West and the Commission entitles the Commission to adjust the "43 million imputation either upward or downward as the evidence of fees and services supports." (US West v. ACC, 2/2/96, 185 Ariz. 277) Even US West has said that yellow pages' revenues and profits have increased significantly since 1988. ...

The decision that Commissioner Jennings cited was, of course, the "Arizona Court of Appeals" ruling to which Ms. Koehler-Christensen refers and which she claims precludes the Commission from adjusting the imputation amount. In fact, a more careful reading of that decision belies her contention:

> US West argues that the quoted language sets a $ 43 million cap on imputed income because only downward adjustments are mentioned. *We reject this interpretation.* The agreement merely indicates one particular factor — Mountain Bell's negotiation of a lesser amount with USWD - that will not suffice alone to warrant a downward adjustment; *it singles out no factors that will not suffice alone to warrant an upward adjustment.* The apparent purpose of the disputed provision is to preclude U.S. West and USWD from assigning an artificial value to fees and services and thereby preempting the Commission's independent assessment. The agreement authorizes the Commission staff to "present evidence in support of or in contradiction to" whatever value U.S. West and USWD might assign to fees and services, and it entitles the Commission to adjust the presumptive $ 43 million imputation either upward or downward as the evidence of fees and services supports.[31]

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31. *US West Communications, Inc. v. Arizona Corp. Comm'n*, 185 Ariz. 277, 281, 915 P.2d 1232, 1236 (1996).

Q. But in that case the Court expressly rejected the notion of treating DEX's "assets as if they were still a part of the regulated utility."[32] How does that square with your recommendation that all of DEX's profits attributable to Arizona be imputed to the Qwest-Arizona revenue requirement?

A. The $43-million grossly understates the value of the "fees and services" that Qwest-Arizona provides to DEX, as evidenced by the extraordinary and unique level of profits that DEX has been able to generate from its Arizona directories. The Washington Commission recognized this *ongoing* value of the affiliation and of the services that the operating telephone company provides to DEX, for example:

> Finally, some of Mr. Johnson's testimony relating to trademarks is not credible. We find no indication that the logo of U S WEST Communications, Inc., connotes in the popular view an entirely different company from that connoted by any other U S WEST corporate family logo. We find it not credible that consumers see the U S WEST Communications logo, with its stylized U S WEST lettering, see the identical U S WEST lettering with the name "Dex," and view them as totally distinct and unrelated companies as opposed to related products under a single umbrella. In any event, the substitution of the U S WEST logo for that of PNB was a choice made by U S WEST, Inc. and PNB and should not be used to justify the evaporation of any publishing rights or financial benefits previously held by PNB.[33]

32. *Id.*

33. *Id.*, at para. 151, pp. 39-40.

In fact, both the US West and DEX logos are prominently displayed on the front covers of several of Qwest's Arizona yellow pages directories (see Attachment 5, which reproduces Qwest's response to ACC Staff request UTI-43-011), and I have no reason to believe that the same is not also the case for every other DEX directory in Arizona. DEX clearly continues to receive enormous value from its affiliation with the telephone company and continues to exploit that relationship in presenting itself as 'the directory experts." Indeed if, as Ms. Koehler-Christensen contends, the Arizona yellow pages market is competitive, the only explanation for the extraordinary level of profit that DEX continues to amass and that continues to increase year-in and year-out is its affiliation with the monopoly local telephone utility.

The Court of Appeals ruling that Ms. Koehler-Christensen cited and that I have discussed above in no sense precludes the Commission from finding that the value of the services being furnished by Qwest-Arizona to DEX has in fact increased, and accordingly making an appropriate upward adjustment in the annual imputation amount. And, while the Commission may perhaps find that the ongoing value of the affiliation and of the services that DEX receives from Qwest-Arizona are less than the entire DEX profit attributable to Arizona (although I continue to believe that the full amount of DEX's profits most accurately represents the value of those services), there can be no question but that the value of the fees and services furnished by Qwest-Arizona to DEX grossly exceeds the nominal $43-million amount that was established way back in 1988.

1 Q. Does Ms. Koehler-Christensen offer any specific rebuttal to your calculation of DEX's
2 overall profitability, the portion attributable to Arizona, or the fair market value of DEX?
3
4 A. No, she does not. In her summary, she states that I have "excluded a large portion of
5 DEX's expenses in its calculation of DEX's profits and [have] compounded this error by
6 multiplying pre-tax net revenues by a gross revenue conversion factor,"[34] but provides
7 nothing more specific in the body of her testimony. The revenues, expenses and profits
8 that I reported were contained in the Company's response to UTI-47-013, Confidential
9 Attachment A. Ms. Koehler-Christensen has not offered any specific corrections to the
10 figures I have presented, nor has the Company revised or modified its response to UTI-
11 47-013. Finally, there is no obvious reason why the Arizona conversion factor would
12 differ as between pre-tax and after-tax income, as her testimony implies (but provides no
13 further details).
14
15 Q. Does this conclude your surrebuttal testimony at this time?
16
17 A. Yes, it does.

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18 34. Koehler-Christensen (Qwest), rebuttal at i-ii.

Attachment 1

Washington Utilities and Transportation Commission
Yellow Pages Decision

ECONOMICS AND
TECHNOLOGY, INC.

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In Re the Petition of	)	DOCKET NO. UT-980948
	)	
	)	FOURTEENTH
U S WEST COMMUNICATIONS, INC.,*	)	SUPPLEMENTAL ORDER;
	)	
for an Accounting Order	)	ORDER DENYING PETITION
. . . . .	)	

Synopsis

1 In this order, the Commission addresses a request by U S WEST Communications, Inc., (USWC) for an accounting order ending the Commission's practice of imputing to USWC, for ratemaking purposes, certain "excess" income earned by an affiliate in publishing directories of USWC subscribers and associated "Yellow Pages" commercial classified directory listings. The Commission denies USWC's request for an accounting order ending imputation. The Commission rules that, *U S WEST Comm. Inc. v. Wash. Util. & Transp. Comm., 134 Wn2d 74, 949 P.2d 1337 (1997),* does not require the end of imputation, that USWC has not shown the factual or legal existence of a permanent transfer of the publishing function, and that USWC has not shown a valid factual or legal reason to terminate imputation.

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*The Commission notes that since this matter was presented, U S WEST has merged with Qwest Communications International, Inc. pursuant to the Commission's authorization in Docket No. UT-991358. Although the company is now authorized to use the name Qwest Corporation, we continue to use the names under which the matter was filed and presented.

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I. SUMMARY[1]

A. Procedural Summary

2 ***Hearing.*** This matter came on regularly before the Commission on July 26 through 30, 1999, and August 26, 1999, at Olympia, Washington before Chairwoman Marilyn Showalter, Commissioners Richard Hemstad and William R. Gillis, and Administrative Law Judges Lawrence Berg and C. Robert Wallis upon due and proper notice to all interested persons.

3 ***Appearances.*** Petitioner, U S WEST Communications, Inc. (also called the Company, USWC or U S WEST in this order) appeared by Lisa Anderl and Douglas N. Owens, attorneys, Seattle. The Commission Staff appeared by Gregory N. Trautman, assistant attorney general, Olympia. Public Counsel appeared by Simon ffitch, assistant attorney general, Seattle. Intervenor Telecommunications Ratepayers Association for Cost-based and Equitable Rates (TRACER) appeared by Arthur A. Butler, attorney, Seattle. Intervenor American Association of Retired Persons (AARP) appeared by Ronald N. Roseman, attorney, Seattle.

4 ***Nature of the Proceeding.*** In this matter, U S WEST has asked the Commission for an order formally terminating an accounting practice that the Commission uses in calculating the proper rates USWC may charge its customers for regulated services. In that practice, the Commission attributes or "imputes" to the revenues of USWC (a subsidiary of U S WEST, Inc. or USWI) a sum that is related to the income that is actually earned from Yellow Pages publication by U S WEST Dex, another USWI subsidiary.

5 ***Commission decision.*** The Commission denies U S WEST's request, holding that the Commission is not required to approve the request by virtue of a Supreme Court decision,[2] and that the issues presented here have never been litigated; that the Commission has never approved the disposition of a valuable asset to an affiliate by means of an arrangement between the companies; and that the Commission retains continuing jurisdiction pending regulatory action at USWC's request.

B. Summary of Issues

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[1] The purpose of this discussion is to provide a summary for the reader. Each of the elements summarized in this section is addressed at greater length elsewhere in the order, and it is the later discussion that includes our findings, conclusions, and reasoning in support of the Commission decision.

[2] *U S WEST Comm. Inc. v. Wash. Util. & Transp. Comm.*, 134 Wn2d 74, 949 P.2d 1337 (1997).

6 The issues in this proceeding are whether the Commission must or should end the practice of attributing – "imputing" – to U S WEST Communications, Inc., a portion of the earnings of its affiliate U S WEST Dex from publication of the U S WEST classified business telephone listings known as the "Yellow Pages." The value of imputation (i.e., the value of Yellow Pages operations to the local exchange company) is significant. It was fixed at $50,934,378 per year at last calculation, in 1995, in Docket No. UT-950200.

7 The events giving rise to this litigation began late in 1983, as the divestiture from AT&T of its local exchange company business was being implemented. The local exchange company business was placed with seven newly created Regional Bell Operating Companies (the RBOCs or "Baby Bells"). Federal Judge Harold Greene, who oversaw the divestiture, decided that Yellow Pages businesses should remain with the regional operating companies to maintain their contribution to local company earnings.[3]

8 In late December 1983, Pacific Northwest Bell (PNB)[4] asked the Commission for authority to transfer certain specified assets to Landmark Publishing Co. in exchange for a .21 share of Landmark stock.[5] The application disclosed that PNB would not keep the partial share Landmark offered in exchange for the assets but would transfer it immediately to U S WEST. The shifting of assets among affiliated companies was thus without compensation to the local exchange company.

9 The application also sought approval for an intercompany arrangement between the two subsidiaries in which PNB authorized Landmark to publish telephone directories for PNB in exchange for what the application described as a guaranteed stream of payments to the local exchange company.

10 In the last days of December 1983, the Commission approved the January 1, 1984 transfer of the specified assets and the change in publication arrangements. Under the state's affiliated interest statute, however, the Commission reserved a ruling on the financial consequences for ratemaking purposes. The

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[3] *United States v. American Telephone and Telegraph Co., et al.,* 552 F. Supp. 131 (1982)

[4] PNB, a local operating company that had been a wholly owned subsidiary of AT&T, was becoming a subsidiary of regional Bell operating company U S WEST. PNB eventually merged with Northwestern Bell and Mountain States Telephone companies to become U S WEST Communications, Inc. For purposes of this Order, the terms PNB and USWC are interchangeable terms referring to the Washington State operating company.

[5] Landmark, like PNB a U S WEST subsidiary, was the parent of U S WEST Direct, which later became U S WEST Dex. For purposes of this order, the three names are interchangeable.

Commission also approved the publishing agreements. PNB agreed, five years later, without compensation, to the termination of the "guaranteed" payments, and USWC now contends that the entire directory business was transferred to Landmark with the transfer of physical assets in 1984.

11 PNB twice voluntarily agreed to imputation of yellow pages earnings. First, in 1989 it agreed to imputation on a temporary basis in settlement of an overearnings complaint and establishment of an Alternative Form of Regulation (AFOR). Later, also in 1989, it agreed to imputation in resolution of the merger of PNB, Mountain Bell and Northwestern Bell into the present local exchange company, U S WEST Communications, Inc.[6]

12 Despite the continuing imputation ordered in the merger docket, which the Company did not appeal, the Company challenged the Commission's authority to use imputation on some eighteen separate grounds in a major general rate case, which it filed in 1995, Commission Docket UT-950200. The Commission rejected the challenge in an order that was affirmed in all regards by the Superior Court and, on review, by the Washington State Supreme Court.

13 That brief history brings us to the matter before us. On the issue of whether the end of imputation is mandated, as U S WEST contends, the parties present the Commission with a single basic choice.

14 U S WEST bases its presentation upon its contention that the Washington State Supreme Court ruled that the transaction leading to imputation was a complete transfer of the business effective on January 1, 1984, and that imputation must end when the value of the imputation reaches the value of the business at the time of that transaction. The Company and its witnesses offer views of significant events and decisions that are consistent with their contentions arguing that the Commission must end imputation under the terms of the Supreme Court decision.

15 Commission Staff, Public Counsel, and intervenors respond that the Supreme Court decision did not need to, and did not, address the precise nature or timing of the transaction giving rise to imputation, and that contemporaneous features and descriptions of the transaction are inconsistent with the Company's view. They argue that the Commission need not and should not end the imputation of Yellow Pages revenue.

16 The Commission rejects the Company's view. A reading of the entire Supreme Court

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[6] The Company entered a settlement agreement in the merger proceeding, agreeing to imputation for a five-year period. The Commission refused to approve the merger unless the five-year limitation were removed. The Company accepted that provision.

decision, an examination of the issues that it resolved, and attention to its holding compel us to conclude that the Court did not rule as the Company contends and that the decision does not require us to end imputation. USWC's principal contentions about the meaning of the decision appear to be inconsistent with the Court's holding and with specific language in the decision.

17 Looking next at the record in this docket and at prior administrative and judicial decisions, the Commission decides that the evidence proves that USWC's first proposition – that a permanent transfer of the entire business was completed on January 1, 1984 – is incorrect. USWC's second proposition – that a valuation must occur on January 1, 1984, or any other date found to be the date on which the transaction was completed – fails when the Company's first proposition fails. The Company's arguments also fail to consider the nature of the transaction as one among affiliates and fail to consider the Commission's authority and responsibilities under the affiliated interest statutes.[7]

18 Finally, we find no credible evidence in the record of facts supporting the Company's contention that present circumstances render imputation improper or inconsistent with the public interest.

19 We hold that the Yellow Pages publishing activity has not been transferred

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[7] The Fifteenth Supplemental Order in Docket UT-950200 found the affiliated transaction imprudent. *U S WEST Comm., Inc. v. Wash. Util. & Transp. Comm'n,* Docket No. UT-950200, 169 PUR4th 417, 442-48 (April 11, 1996). While we do not base our decision on that rationale, because it is unnecessary, the following Company actions raise serious questions about the prudence of management under its theory of their case: agreeing to the transfer of the lucrative Yellow Pages activity to an affiliate without compensation and, insofar as this record shows, totally without documentation; and agreeing to the termination of payments for publishing rights without compensation. Although the decision does not use the terms "prudence" or "imputation," the U. S. Supreme Court found improper an analogous transfer without compensation to an affiliate during the 1920s, and approved imputation as a remedy to protect ratepayers without reference to any affiliated interest statute. *United Fuel Gas Co. v. Railroad Comm. Of Kentucky*, 278 US 300, 73 L.Ed. 390, 49 S.Ct. 150 (1929), affirming *United Fuel Gas Co. v. Railroad Comm. Of Kentucky*, 14 F.2d 209(D.W.Va., 1926); *United Fuel Gas Co. v. Railroad Comm. Of Kentucky*, 278 U.S. 322, 73 L.Ed. 390, 49 S.Ct. 150 (1929), affirming *City of Charleston v. Public Service Commission,* 95 W.Va. 91, 126 (1923), in which the state court said, "[T]he commission had the right to wholly disregard the [transaction] and in determining the question of rates to be allowed . . . to treat the matter as if [the regulated company retained the assets]." Permanent placement in an affiliate does not demand treatment as a sale. *United Fuel Gas Co.* cases, *supra.* The Commission has ordered imputation in such situations. *WUTC v. Continental Telephone Company of the Northwest, Inc.,* Cause No. U-82-41, Second Supp. Order, (August 12, 1983), *WUTC v. General Telephone Company of the Northwest, Inc., (Cause No. U-84-18, Second Supp. Order, (January 15, 1985).* Approval of a permanent transfer thus does not make treatment as a sale, and amortization, a legally necessary result.

permanently to USWC's affiliate for regulatory purposes. We hold that the Commission may properly order continuing imputation under the facts and circumstances shown on this record. The Commission's order continuing imputation in the merger docket supplants earlier orders and defines the appropriate remedy for the transaction that the Commission has approved, and that it remains effective until changed. We hold that the Commission will consider altering imputation upon a showing of changed conditions that render such a change consistent with the public interest and with relevant affiliated transaction statutes on a going-forward basis.

20 Procedurally and historically, this docket is complex. Several motions were reserved for ruling at the conclusion of the proceeding. The discussion of the factual and legal contentions is made lengthy by their number. We will begin the discussion on the merits with a history of events based upon the contemporaneous statements of the parties and orders of this Commission. Then we will address the motions, describing their interrelationship with the principal contentions. We will conclude by determining the facts to be found from this record and by resolving the legal points argued to us.

II. HISTORY

21 The relationship of this telephone company or its predecessor to directory and Yellow Pages publishing functions has been an issue, and has thus been described in some detail, in at least five relevant Washington State proceedings, and in one proceeding at the federal level (the AT&T divestiture). The five Washington State proceedings were before the Commission, including one eventually heard in the State Supreme Court. These are PNB's 1983 application for property transfer and affiliate transactions (FR-83-159); the 1986 approval of a second publishing agreement (U-86-156); the 1989 Commission complaint against PNB for overearning that resulted in the alternate form of regulation (AFOR) and that included imputation as an element in the settlement (U-89-2698 and U-89-3245-P); the merger that resulted in the formation of U S WEST Communications, Inc. (U-89-3524-AT); and the 1995 general rate case (UT-950200) that USWC appealed, resulting in the December, 1997, Supreme Court decision cited above.[8]

A. AT&T Divestiture and the Modified Final Judgment

22 Prior to the implementation of the 1982 AT&T divestiture decision,[9] telephone

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[8] In this Order, a citation to the "Supreme Court decision" without further citation is to the 1997 decision set out at 134Wn.2d 48.

[9] *United States of America v. American Telephone and Telegraph Company, et al.*, 552 F. Supp. 131, (1982).

service in much of the United States was an integrated, regulated monopoly service provided by a dominant carrier, AT&T. That company owned a number of operating companies, including Pacific Northwest Bell, USWC's predecessor in the state of Washington. Historically, PNB published directories of subscriber listings (white pages) that included classified business listings and advertisements printed on yellow paper and called the "Yellow Pages." It reported revenues from the advertising and publishing business in its regulated results of operation, that is, its statement of income and expenses for regulatory purposes.

23 Upon the divestiture by AT&T of its operating companies, U. S. District Court Judge Harold Greene held that the resulting seven regional Bell operating companies (RBOCs) should retain publication of the Yellow Pages businesses in their operating territories, in large part because of the contribution of Yellow Pages revenues to local telephone rates. *USA v. AT&T, supra., note 8, at pp. 193-4.*

B. Transfer of the Publishing Function

1. PNB's Application for Transfer

24 As part of the reorganization of AT&T and its former subsidiaries, on December 22, 1983, PNB applied to the Commission for approval of the transfer of certain assets to its affiliate Landmark Publishing Company and of agreements under which Landmark would publish directories for PNB. PNB asked that the transfer of the assets, associated with its Washington Yellow Pages business, and valued at about $13.7 million, be effective January 1, 1984.[10] Because chapters 80.12 RCW (transfer of property) and 80.16 RCW (affiliated interests) require full disclosure and prior approval of all property transfers and all affiliated interest transactions, the Company was required to and did apply for approval of the transaction.

25 The Application specifically sought approval of three aspects of the agreement: (1) a publishing agreement between PNB and Landmark by which Landmark agreed to publish directories and Yellow Pages advertising for PNB; (2) a memorandum of

understanding for administrative services; and (3) the transfer of certain assets (cash and a leasehold, principally):

> . . . total company wide PNB assets in the amount of $24,101,000 . . . in exchange for .21 share of the sole share of stock of LPC. . . . The Washington assets shall consist of one leasehold, station equipment, office equipment and furniture. PNB will then transfer the LPC stock to U S WEST as a stock dividend payable

[10] This allowed the Commission five business days to evaluate the matter and to prepare and enter its order.

January 3, 1984.

Application, Cause No. FR-83-159, at pages 2 -3. The cash was to satisfy the working capital requirements of the directory publishing operation.

26 The application specified that the publishing agreement would govern the terms by which Landmark would publish directories and Yellow Pages for PNB. PNB represented:

> The Publishing Agreement is a good deal for PNB and its ratepayers because the Agreement effectively preserves a significant contribution from Yellow Pages revenue to PNB's earnings in the new more competitive marketplace after January 1, 1984. Further, **this revenue stream is guaranteed**, so that the risk and expense of this deregulated and increasingly competitive area of business are not borne in *[sic]* by PNB's ratepayers. *[Emphasis in original.]*
>
> The purpose of the transaction is a rearrangement of USW's assets to internally provide from PNB and USW's other operating telephone companies the initial capitalization for USW's publishing subsidiary LPC. . . . This transaction does not negatively impact PNB's ratepayers since the leasehold, cash and other property to be transferred will be removed from the rate base.

Id., at page 3.

27 The Commission approved the transfer within the few days required by the timing of the application – but only on an interim basis. *In re PNB Tel. Co., Order Granting Application in Part, No. FR-83-159, (December 30, 1983), p. 2.* The Commission determined that the transactions between PNB and U S WEST Direct were not arms' length dealings, and stated its concern that PNB not undervalue the advertising revenues in the publishing agreement with its affiliate. The Commission reserved the right to determine reasonable revenues and expenses, together with their proper regulatory treatment, in any formal proceeding before the Commission dealing with the results of U S WEST's operation for ratemaking purposes. The Commission directed PNB to record and maintain all records needed to perform the eventual valuation.

2. *Publishing Agreement, Cause No. FR-83-159*

28 The 1983 Application included a Memorandum of Agreement (MOA) between PNB and Landmark, and a Publishing Agreement. In 1984, the Company sought authorization under the original docket to replace the MOA with nine contracts and a Publishing Agreement having a three-year term, with provision for two additional one-year extensions. The MOA stated the fees Landmark was required to pay to PNB: $21.18 million (1984), $62.7 million (1985), and $67.55 million (1986).

29 The Commission approved the Publishing Agreement and the contracts, but again reserved ruling on the reasonableness of the specified fees Landmark was to pay PNB until a future time. *Fourth Supplemental Order, Cause No. FR-83-159 (January 16, 1985).* The Commission also found again that the transactions between PNB and U S WEST Direct were not arms' length. The Commission's principal stated concern in approving the arrangement was to make it possible for PNB to do business with its affiliates legally and in an orderly way. The Commission was not able to determine the extent to which PNB was receiving full value for allowing Landmark to publish the directories, and expressly did not approve the reasonableness of the publishing fees nor any profit margin derived from them.

C. Revised Publishing Agreements

1. Revised Publishing Agreements, Cause No. U-86-156

30 On December 23, 1986, PNB filed an application seeking approval of ten separate agreements between PNB and U S WEST Direct[11] relating to various services to be provided by PNB. These included a new two-year publishing agreement for 1987 and 1988, which reduced the publishing fee to $41.6 million for 1987. *Ex. 112 at p. 14.* The fee for 1988 was to be renegotiated between the parties, and was ultimately set at $33.9 million. *Ex. 112 at 4. See also, Second Supplemental Order, Docket No. U-86-156 (October 12, 1988), at p. 6.*

31 The Commission again temporarily approved the agreements to permit the continued publication of directories, pending full review in the next PNB general rate proceeding, but it specifically found the amount of the publishing fees contained in the publishing agreement to be inadequate and improper for ratemaking purposes. *Id. at pp. 13-14.*

32 In that order, the Commission repeatedly acknowledged the temporary nature of the publishing arrangement when it noted that "the subject of the application under review in this proceeding is a group of ten agreements which govern the publication of telephone directories on behalf of PNB by U S WEST Direct." *Id. at p. 2.* [emphasis added] The Commission concluded that the publishing fee that PNB proposed to the Commission was "unreasonable and not in the public interest pursuant to RCW 80.16.020." The Commission ruled that appropriate compensation for PNB for allowing its affiliate to publish directories would be determined in the next Company general rate case.

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[11] U S WEST Direct was a subsidiary of Landmark Publishing Co. It has been succeeded by U S WEST Dex.

33 The Commission listed three possible remedies that it would consider: (1) approval of the contracts with an appropriate adjustment to the publishing fees – affirming that PNB retained the rights to publish the Yellow Pages; (2) return of the publishing function to PNB; and (3) treatment of the transaction as the sale of a capital asset.

34 Near the end of 1988, after only five years of the "guaranteed" revenue stream it had committed to the Commission, PNB agreed to the termination of publishing fees without Commission approval and without any further financial consideration from its affiliate. In a letter dated December 12, 1988, U S WEST Direct's Vice President-Marketing, Max G. Johnson, wrote Dennis Okamoto, then Vice President-Treasurer of PNB, advising him that "the intercompany 'subsidy' payment [publishing fee] will cease to be effective 12/31/88." Ex. 609. Mr. Okamoto agreed to this action.

2. Further Revised Agreements, Cause No. U-86-156

35 USWC subsequently applied for an order approving a newly revised, extended publishing agreement. The Commission again partially and conditionally approved the agreement, subject to a future review of the appropriate level of publishing fees in a full rate case setting. *Third Supplemental Order, In re Application of PNB, Cause No. U-86-156 (February 7, 1989).* Although it approved the publishing agreement, the Commission expressly stated its disapproval of the Company's "undisguised policy" of acting to "reduce and finally eliminate the publishing fee in order to enhance U S WEST's results at the expense of telephone subscribers." *Id. at pp. 1-2.*

D. Rate Complaint Case and AFOR, Cause Nos. U-89-2698-F, U-89-3245-P

36 In February 1989, the Commission filed a complaint against PNB alleging excessive earnings. As part of a settlement of the rate complaint and adoption of an alternative form of regulation (AFOR), PNB agreed by stipulation to imputation of a portion of Yellow Pages income as fulfilling a part of the Company's revenue requirement for regulated services. *WUTC v. Pacific Northwest Bell Tel. Co., WUTC Cause Nos. U-89-2698-F and U-89-3245-P, Appendix A, at pp. 14-17 (Fourth Supplemental Order, January 16, 1990).*[12]

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[12] The Commission ordinarily does not infer very much from settlement agreements. In Docket No. UT-950200, however, USWC charged that it was improperly coerced into accepting imputation. The Superior and Supreme Courts affirmed the order in which the Commission found no basis for USWC's contention. USWC's choice to accept imputation was entirely voluntary, a fact that is reflected in the pleadings and order of the merger docket, discussed at more length elsewhere in this Order.

E. The USWC Merger, Docket No. U-89-3524-AT

1. Second Supplemental Order

37 In December, 1989, PNB sought the Commission's approval of the merger of PNB, Mountain Bell, and Northwestern Bell Telephone Company into U S WEST Communications, Inc.[13] The Company entered a settlement agreement with other parties proposing to continue until the end of 1994 the imputation the Company had just accepted.

38 Commissioner A. J. Pardini dissented from the Commission's approval of the merger settlement, in part because the proposed settlement "forfeits an opportunity to, once and for all, resolve the issue of U S WEST's directory publishing revenues." *Second Supplemental Order, Docket No. U-89-3524-AT (November 9, 1990), Separate Opinion, Commissioner A. J. Pardini (dissenting), at p. 3 (unnumbered page).* The dissent quoted Judge Greene's discussion of directory publishing revenues, which we have described above.

39 The Commission's majority opinion took note of the dissent and observed, "The Commission has always intended that the revenue stream from directory services be considered income due the operating company." *Second Supplemental Order, Docket No. U-89-3524-AT (November 9, 1990), at p. 8.* The Commission conditioned merger approval upon modification of the Settlement Agreement so that advertising revenues would be imputed "into perpetuity." *Id., at pp. 8, 10.*

2. Third Supplemental Order

40 PNB sought clarification of the Second Supplemental order, arguing that the merger and imputation were unrelated issues, and that the condition of imputation could be construed as an inappropriate and unilateral change to the Settlement Agreement. *Petition for Clarification, Docket U-89-3524-AT (November 20, 1990), at p. 2.* U S WEST proposed an alternative condition, replacing "in perpetuity" with "until changed by WUTC order." The rationale for this change was, "to reflect the reality that today's commissioners cannot bind future commissions in perpetuity, . . . [and because] fundamental fairness requires that U S WEST at least be able to request a commission to readdress this issue, if that becomes necessary due to changed conditions." *Id. at p. 3.*

41 The Commission accepted USWC's proposal, and the Commission's Third Supplemental Order stated that the Settlement Agreement would be modified to require that directory advertising revenues "will continue to be imputed accordingly

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[13] Second Supplemental Order, Docket No. U-89-3524-AT (November 9, 1990), at p. 1.

unless and until altered by subsequent order of the Commission." *Third Supplemental Order, Docket No. U-89-3524-AT, at p. 2 (November 30, 1990).*

F. 1995 General Rate Case, Docket No. UT-950200

42 On February 17, 1995, following completion in 1994 of the five-year AFOR, USWC filed a general rate increase for telephone services of approximately $204 million a year. In calculating that revenue requirement, USWC proposed that imputation be discontinued. The Company there argued for the first time that imputation was illegal and advanced eighteen separate arguments for that conclusion.

43 The Commission rejected each of the Company's arguments against the imputation of Yellow Pages revenues. *Washington Utilities and Transportation Commission v. U S WEST Communications, Inc., Docket No. UT-950200, Fifteenth Supplemental Order, at pp. 30-39 (1996).*

44 USWC appealed the Commission's decision to the King County Superior Court and then to the Washington State Supreme Court which affirmed the Commission in all regards. Both the Superior Court and the Supreme Court upheld the Commission's Yellow Pages decision, ruling that the Commission acted lawfully to impute excess Yellow Pages revenue when calculating USWC's revenue requirement under both the affiliated interest laws (chapter 81.16 RCW) and statutory ratemaking authority (RCW 80.36.140). *134 Wn.2d 48, at p. 91.*

45 The Supreme Court decision specifically noted the Commission's continuing supervisory control over transactions among affiliates (RCW 80.16.050) and the power to disallow unreasonable compensation to an affiliated company for ratemaking purposes (RCW 80.16.030). *134 Wn.2d at p. 93.* The Court ruled that the Commission was within its statutory authority to disallow for ratemaking purposes the unreasonably low compensation USWC received from its affiliate, U S WEST Direct, for the profitable Yellow Pages operations. The Court stated:

> No one represents to this Court that U S WEST Direct has paid U S WEST the fair price for the Yellow Pages business. . . . The imputing of revenue is the result of the fact that the Company gave away a lucrative ratepayer-funded asset to an unregulated affiliate in return for little or nothing.

134 Wn.2d at pp. 94, 96. The Court observed that USWC could "apply for an end to imputation when it can show that it has received fair value for the asset." *134 Wn.2d at p. 102.*

G. USWC's Current Request

46 In this Docket, USWC again asks the Commission to put an end to imputation.[14] It argues that the Supreme Court decision ruled that a permanent transfer of the entire Yellow Pages business occurred on January 1, 1984, and that the imputation and publishing fees constitute full payment by USWC to ratepayers for the loss of the business that was transferred to Landmark without compensation.

III. PROCEDURAL MOTIONS

47 Three pending motions have been deferred for resolution until after conclusion of the evidentiary hearing. The first is a motion by U S WEST, earlier denied but renewed at the conclusion of the hearing, that would have us exclude certain responsive evidence filed by Public Counsel and Commission Staff on the basis of judicial estoppel. USWC contends that Commission Staff and Public Counsel made certain factual representations and prevailed on prior judicial review, and because of that they cannot in this proceeding make different representations. The second is a motion by Public Counsel and intervenors that asks the Commission to deny USWC's accounting petition on the basis that it fails to comply with the requirements or intentions of prior Commission orders regarding modification of imputation. The third is a Commission Staff motion for a ruling denying the element of USWC's petition arguing that imputation violates USWC's constitutional right of free speech. We will address each motion individually.

A. USWC's Motion to Strike Portions of the Testimony of Staff and Public Counsel

48 U S WEST argues that Commission Staff and Public Counsel are judicially and equitably estopped from characterizing the 1984 transfer of the directory publishing business from Pacific Northwest Bell to Landmark Publishing Co. as a renting of intangible assets or the "outsourcing" of the directory publishing function. It alleges that in arguments before the state Supreme Court, Public Counsel and the assistant attorney general representing the Commission on appeal of the rate case order, characterized the transaction as the transfer of the directory publishing business and the transfer of "an entire enterprise." U S WEST argues that the Court accepted the argument and, thus, Commission Staff is now estopped from making any argument (and the Commission is estopped from making any finding) that less than the entire enterprise was transferred in this case. USWC contends that the testimony of Staff and Public Counsel's witnesses supports USWC's argument that those parties now seek to reverse or contradict prior arguments made to the Supreme Court.

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[14] USWC does not petition to modify the merger order in which the imputation obligation is fixed, and it does not apply for approval of a sale or other divestiture of the asset or for any modification of the publishing agreement.

49 Commission Staff and Public Counsel respond that they have not taken "clearly inconsistent" positions in judicial proceedings involving the same question (an essential element required for the application of judicial estoppel). They argue that the word "transfer" can and often does encompass a much broader set of transactions than the transfer of ownership and title to property, including but not limited to rental or outsourcing arrangements. Although the parties to the prior proceedings asserted that a "transfer" of assets took place, they did not analyze the precise nature of that transfer as suggested by U S WEST. Staff and Public Counsel contend that such an analysis did not occur because the precise legal nature of the transfer was not at issue in the rate case.

50 Commission Staff and Public Counsel also respond that the allegedly inconsistent statements attributed to them – characterizing the legal nature and effect of the transfer of the Yellow Pages business – are conclusions of law, not assertions of fact, and argue that the doctrine of judicial estoppel applies only to bar inconsistent positions as to facts. U S WEST contends that the positions the respondents and the Commission took before the Court were factual assertions that U S WEST had transferred away a valuable asset to an affiliated company without obtaining fair value. U S WEST argues that Staff and Public Counsel must be estopped from denying the "fact" that the valuable asset was transferred away.

51 **The Commission denies U S WEST's motion.** First, the exact nature of the ownership of the directory function, and the exact nature of the transactions among USWI and its subsidiaries, were not at issue in the rate case proceeding. The only issue there was whether the Commission – given that USWC, for whatever reason, no longer recorded as its own the revenues of the U S WEST conglomerate's Yellow Pages business – had the power to impute revenues to the regulated entity. The Court answered that question in the affirmative. The business – that is, the directory and yellow pages publishing function – was conducted by Landmark after January 1, 1984 and not by PNB. The Court's decision could not approve imputation without first granting judicial recognition that in that circumstance, a sufficient transfer occurred to invoke the pertinent statutes. The Court's decision, however, did not require and did not produce a finding of complete, total, and irrevocable transfer of all rights as of any particular moment.

52 The Court did not make a finding, or remand to the Commission for a finding, that a complete transfer occurred. Passages in the decision appear to characterize the transfer as completed. On balance, however, we do not believe that the decision resolved the issue we now face, or that it prevents us from examining the issue. The Court observed at page 98 that USWC "has always been free to sell" the directory business "for a fair value" and it held at page 102 that "USWC may petition the Commission for an end to imputation if and when it can show *it has received* fair value for the transfer of the asset." *[emphasis added]* USWC argues that the decision rules that a complete and final transfer occurred in 1984. If the Court had ruled that

USWC had made a permanent and complete transfer of the business, it would be inconsistent to say that the Company always had the right to sell, or that it may in the future receive fair value for the business.

53 U S WEST's position also has telling legal and regulatory implications. U S WEST in making this motion would shift the obligation and the right of fact finding from the administrative agency to the parties in any given docket, and from the order itself to the briefs, as the effect of the motion would be to rely on parties' briefs for statements of fact, not on agency orders or judicial decisions. The principle that the Company argues states that parties who advance facts in one proceeding may not contest those facts in later litigation. The case that USWC cites for its argument is not directly analogous to the present situation, in that the result argued there in briefs was clearly a central element clearly resolved in the earlier litigation.[15] Here, that is not the case, as the argued matter is not necessary to the result, had no factual basis in the prior litigation, was not clearly resolved in the cited decision, and arose under the state Administrative Procedure Act.

54 In the rate case, we see no factual or legal presentations of the sort received in this docket. There, the Commission made no finding of fact in the underlying administrative order that a complete and permanent transfer occurred on January 1, 1984. We see no findings of fact in the Supreme Court decision and no remand to the Commission so that appropriate findings could be made. USWC's argument rests on the premise that the Court found USWC's interpretation of the representations of Commission Staff and Public Counsel, on brief to be facts. U S WEST's position would give the power to make findings of fact to the parties to judicial review and to the Supreme Court, contrary to the requirements of RCW 34.05.461 and RCW 34.05.558.

55 We also see the definition of the relationship not as a matter of fact, but as a conclusion of law based on the application of narrow principles of law to specific facts. As Commission Staff and Public Counsel point out, the facts have been repeatedly recited in numerous contexts, including Commission orders. What is at issue is the interpretation of those facts. *Community College v. Personnel Board, 107 Wn.2d 427, 434-35, 730 P.2d 653 (1986).* The legal component is then reviewed under the "error of law" standard. U S WEST's challenge is addressed to an argument of law, not fact, in the manner of an agency's application of law to the facts of a case. See, *Franklin County v. Sellers, 97 Wn.2d 317, 646 P.2d 113 (1982).* It is therefore not subject to the principle that USWC posits.

56 Finally, the Company argument should be rejected on policy grounds, as well. The Commission grants parties some latitude to repeat positions previously denied or to back away from positions previously approved. Agencies are not bound so tightly by

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[15] *Tucker v. Brown*, 20 Wn.2d 740, 150 P.2d 604(1944).

the bonds of precedent as are the courts, and have a greater latitude in fashioning responses based on current circumstances. *Atchison, Topeka & Santa Fe Railway Co. v. Wichita Board of Trade, 412 U.S. 800, 808-09, 37 L. Ed. 2d 350, 93 S. Ct. 2367 (1973).* This result is consistent with an evolving regulatory environment in which an administrative decision might be rendered outdated by rapidly occurring events. *See, In re Burlington N. R.R. Co., 1994 Minn. App. 1001, 522 N.W.2d 371, 377 (1994).* Granting the Company's motion could require the Commission to accept similar arguments in this or other dockets, requiring the exclusion of relevant testimony, and could pose negative consequences for the Commission's and parties' ability to deal with future circumstances.

57 The Commission denies the motion.

B. Public Counsel, TRACER, and AARP Motion for Summary Judgment.

1. Changed Conditions

58 Public Counsel, TRACER, and AARP ("Movants" for purposes of this discussion) ask for a summary determination that there is no basis upon which U S WEST's petition can be granted, and that it should therefore be denied. Movants rely on the Commission's Second and Third Supplemental Orders in Commission Cause No. U-89-3524-AT — the merger proceeding in which Pacific Northwest Bell, Northwestern Bell, and Mountain States telephone companies asked permission to form U S WEST Communications, Inc.

59 The Movants argue as follows. The Commission's Second Supplemental Order in the merger proceeding approved the merger on the stated condition that directory revenues be imputed "in perpetuity." U S WEST's subsequent Petition for Clarification stated its acknowledgment that the issue of imputation for ratemaking purposes was "best laid to rest." U S WEST proposed that the condition be clarified to state that revenues be imputed until changed by Commission order because "future changed conditions" could make changes to imputation necessary. Movants argue that the Third Supplemental Order responded to U S WEST's concerns, acknowledged the problem, and amended the condition as U S WEST requested. Thus, Movants argue, U S WEST must establish "future changed conditions" as a prerequisite to seeking a change in directory revenue imputation.

60 U S WEST responds that its reference to "changed conditions" in its Petition for Clarification does not foreclose other bases for ending imputation. U S WEST asserts that the Commission's Third Supplemental Order did not impose any prerequisite to consideration of the issue in the future, and argues that it is not required to show changed conditions. However, U S WEST goes on to argue that unforseen changed

conditions do exist.[16]

61 The merger order should be given significant weight. It demonstrates the importance that the Commission attached to the continuation of imputation as an ongoing condition, necessary in order to realize the benefits the Company expected from the merger. It demonstrates equally well the Company's agreement to imputation for the indefinite future, expressed in an order that they did not appeal and that they agreed would "put the matter to rest."

62 We are concerned, however, that granting the motion could, (like the original order demanding imputation into perpetuity), restrict unduly the flexibility of this or a future Commission to address matters on a future record in light of future circumstances. The burdens imposed by RCW 80.04.200 on parties seeking a modification of an order are significant, but parties should not be deemed legally foreclosed from seeking modification, nor the Commission from granting it when circumstances warrant.

2. *Equitable Estoppel*

63 Movants also argue that U S WEST is equitably estopped from claiming that imputation of revenue constituted payments for the value of the Yellow Pages business, because the claim is inconsistent with U S WEST's position in the merger case[17] that imputation is an acceptable condition for approval of the merger. U S WEST responds that neither Public Counsel nor TRACER acted to their detriment in reliance on U S WEST's "commitment" and thus a necessary element of equitable estoppel is not met.

64 The Commission has discussed the application of equitable estoppel in the regulatory context in several prior orders.[18] The application of equitable estoppel requires the following:

> "(1) [A] party's admission, statement or act inconsistent with its later claim; (2) action by another party in reliance on the first party's act, statement or admission; and (3) injury that would result

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[16] We deal with this argument below.

[17] Cause No. U-89-3524-AT

[18] *See*, for example, *WUTC v. U S WEST, Docket No. U-89-3245-P (1989)*; *WUTC v. Whidbey Tel. Co., Cause Nos. U-85-50, U-85-51, and U-86-30 (1986); Order M.V. No. 133363, Seafair Moving & Transfer, Inc., Hearing No. P-69394 (1986); Order M.V. No. 128063, Paul E. and P. Randal Savage, Hearing No. P-66336 (1983).*

> to the relying party from allowing the first party to contradict or repudiate the prior act, statement or admission."

Mikhail Kramarevcky v. Department of Soc. & Health Servs., 122 Wash. 2d 738, 743 (1993), citing Robinson v. Seattle, 119 Wash. 2d 34, 82, 830 P.2d 318, cert. denied, 121 L. Ed. 2d 598, 113 S. Ct. 676 (1992).

65 Here, we find no reliance or injury in the nature of the reliance and injury discussed in the cases. While an order was entered based on the representation (U S WEST's agreement to imputation), that fact gives rise to a question of process as to the proper manner to change the order rather than a question of estoppel. *See, WUTC v. General Tel. Co. of the Northwest, Inc., Cause No. U-81-61 (1982).* Principles of equitable estoppel do not apply.

3. Waiver

66 Movants also argue that U S WEST waived any right to challenge imputation on grounds other than "future changed conditions" because the Company accepted the merger settlement and did not appeal the final order in that case. U S WEST reiterates its arguments that it is not limited to relief based on changed conditions, but if it were, changed conditions exist. U S WEST also argues that there was no explicit requirement that its entitlement to challenge imputation be limited to "changed conditions," and that waiver cannot be based on an implicit condition.

67 Here, U S WEST's arguments are consistent with our views on the need for regulatory flexibility, stated above, and are persuasive. We see nothing in the earlier actions that would constitute a waiver of alternative approaches in the context of this proceeding. To find waiver, we believe that we must also find either an explicit representation or a factual setting the equivalent of an explicit representation. USWC agreed to the result and waived the immediate judicial review of that order. We see nothing in this situation that expresses USWC's waiver of all alternative legal positions for all time to come. The prior order did not specify changed conditions as the only means by which to secure a change in the ordered imputation, although that is the principal ground for reopening an order under RCW 80.04.200. The order did not limit grounds for review of the order to changed circumstances.

4. Collateral Attack on Prior Order

68 Movants argue that U S WEST's Petition for an Accounting Order constitutes an improper collateral attack on the Commission's Third Supplemental Order in the merger case. U S WEST argues that the Third Supplemental Order only requires that imputation continue until subsequent order of the Commission, and that there is nothing improper in U S WEST's request that the Commission enter such a "subsequent order" at this time.

69 We reject Movants' argument for purposes of this proceeding. USWC is not attempting to negate the entire merger order. Instead, it is seeking a review of the framework for imputation that is established in that order, after the passage of a considerable period of time.

5. Conclusion

70 U S WEST is not legally barred, by any of the legal principles advanced by Movants, from seeking a change to the Commission's imputation practices. This ruling is consistent with RCW 80.04.200, authorizing rehearing of Commission orders. The underlying principle that the Commission finds pertinent is that a regulatory agency must, within the bounds of the law, retain the flexibility to regulate reasonably, in the public interest, pursuant to the public service laws, over time. *See, Farm Supply v. Util. & Transp. Comm'n, 83 Wn.2d 446, 452, 518 P.2d 1237 (1974)*; *see, also, Util. & Transp. Comm'n v. United Cartage, 28 Wn.App 90, 621 P.2d 217 (1981), cert. denied, 95 Wn.2d 1017 (1981).* We are concerned that the Movants' interpretation of the principles they advocate would unnecessarily restrict the Commission's flexibility in a given case to address matters of public concern reasonably, lawfully, and consistent with the public interest. We therefore deny the motion.

C. Commission Staff Motion for Partial Summary Determination

71 U S WEST contends that the practice of imputation violates free speech protections found in the First Amendment of the United States Constitution and Article 1, Section 5, of the Washington Constitution. It argues that Yellow Pages publication is an expressive activity protected by the Speech and Press Clauses of the First Amendment of the United States constitution, which applies to the State of Washington through the Due Process Clause of the Fourteenth Amendment. It also argues that the activity is protected by Article 1, Section 5, of the Washington Constitution. The essence of its contention is that Yellow Pages publishing involves the exercise of creativity and editorial discretion, and that imputing directory revenue directly and substantially infringes on this editorial discretion and on the constitutional rights of U S WEST Communications, Inc., U S WEST, Inc., and U S WEST Dex.

72 Commission Staff moves to dismiss this count of USWC's petition. Staff contends that there is no issue of material fact; that on the recited facts there is no violation of constitutional protections as a matter of law; and that even if imputation were seen as affecting commercial speech – which Commission Staff does not concede – there is no violation of constitutional protections.

73 According to Commission Staff, the issue, properly stated, is:

Where the Commission has engaged in a common and well-established regulatory practice, namely, imputation of revenues to protect captive ratepayers from the inequitable effects of affiliated transactions, is there a violation of the First Amendment merely because the imputation in question concerns U S WEST's Yellow Pages advertising business?

1. Standing

74 Commission Staff argues that USWC has no standing to raise this issue, in that it suffers no harm from imputation and that only U S WEST Dex as publisher would have the right to present it. USWC responds that it does have the necessary standing, but cites no authority for the proposition. While we find that Staff is correct and standing does not exist, we will address other elements of the issue because of its significance.

2. Burden on Speech

75 Commission Staff argues that imputation has nothing at all to do with speech. Rather, Staff contends that it is a general policy applied to all utilities to protect ratepayers when a regulated utility's transactions with its unregulated corporate affiliates produce results that are inequitable to the interests of ratepayers. In numerous cases, Staff continues, the Commission has applied imputation to various companies' affiliate transactions that either shift costs to the regulated affiliate or shift profits to a non-regulated affiliate. Imputation neither "targets" speech, nor is it based in any other way on the content of speech. Imputation does not in any way affect any activity of U S WEST Dex. Imputation, as applied in this case, simply involves an accounting adjustment to the financial books of U S WEST, Inc., the regulated entity, for ratemaking purposes, that happens to be measured by reference to Yellow Pages earnings. The Commission does not touch the other company's earnings or the disposition of its income in any way at all.

76 U S WEST argues the Commission's imputation of Yellow Pages advertising revenues to USWC does burden speech because the imputation formula is not a generally applicable regulation — it is an individually fashioned remedy. U S WEST argues that the Commission has some authority to engage in individualized regulation but it may not exercise that authority where First Amendment interests are at stake. It concludes that individualized imputation violates the First Amendment in this case. It argues that even though Dex and the parent, U S WEST, Inc., are not parties, their free speech interests must be considered. It contends that the imputation of Dex revenues acts per se as a disincentive to publishing by providing a disincentive to maximize profitability.

77 Commission Staff responds that the imputation of Yellow Pages earnings imposes no burden on any exercise of free speech. Staff contends that imputation of excess

Yellow Pages revenue would be constitutional even if it were viewed as a regulation affecting commercial speech. The Staff argues that Yellow Pages are overwhelmingly commercial speech. The imputation of Yellow Pages revenues directly advances a substantial government interest – compliance with the laws requiring that charges to ratepayers be fair, just, reasonable, and sufficient – and the imputation is no more extensive than necessary to serve that interest.

78 The Commission finds that imputation, both in principle and as applied here, has nothing to do with and does not affect the exercise of free speech, commercial or otherwise. Imputation is strictly a mechanism by which the Commission balances the financial interests of regulated utilities' stockholders and ratepayers. USWC's contention fails first because the Company has no standing to raise the issue, second because imputation has no effect on speech, and third because the imputation mechanism is clearly a principle of general application. It is applied irrespective of the underlying activity to correct situations in which the Commission finds that a regulated company has given an ongoing benefit to its owners to the detriment of its ratepayers. *See, e.g., Fourth Supp. Order Accepting Settlement Agreement, WUTC v. Washington Natural Gas Co., et al., Docket Nos. UG-931405; UG-931442 (1994).*

79 The existence of imputation and/or the details of its application in defining the income of USWC have no impact whatever on the sibling or on the activity generating the revenues that define the level of imputation. Neither do they have anything to do with how that activity is conducted. We find no connection at all between imputation and speech. Imputation addresses neither the content of underlying speech nor even the existence of speech, and it neither impinges on speech nor affects it in any way.

80 Imputation is a mechanism by which USWC's operating results are restated to reflect earnings as if the Yellow Pages directory business were retained within the company's Washington operations. That was where the directory business was traditionally conducted, as confirmed by Judge Greene in the passage cited above. During the entire history of that operation, free speech issues were never raised. The creation of an affiliated-interest relationship in itself could hardly create a free speech claim that did not previously exist.

81 As we discuss at greater length, below, imputation is strictly a mechanism by which the Commission acts to protect ratepayer interests when the regulated company acts in a manner detrimental to those interests. Imputation in this case has been no more extensive than necessary to serve that interest. The Commission uses imputation to implement the public service laws requiring that rates be fair, just, reasonable, and sufficient, for both ratepayers and regulated companies. The public service laws, in turn, reflect and implement constitutional principles that define and balance the rights and responsibilities of companies that choose to enter regulated businesses.

3. Discretion

82 USWC contends that because the application of imputation and its details are a matter within the Commission's discretion, risks to speech are particularly dangerous and Commission action must be foreclosed. Again, we disagree with the Company. Even if imputation affected speech, which it does not, the areas of the Commission's discretion are narrowly circumscribed and extend only so far as the Commission must act to protect the financial interests of ratepayers. The Commission has and exercises jurisdiction only to the extent that is necessary to produce rates that are fair, just, reasonable, and sufficient. RCW 80.36.080. Imputation does not vest the Commission with unbridled discretion to burden speech unconstitutionally but only with reasonable discretion to exercise financial regulation to the extent necessary under the Constitution to produce rates that are fair, just, reasonable, and sufficient.[19]

4. Washington Constitution

83 Finally, USWC argues that the Washington Constitution's free speech provision is more broadly protective of speech than the First Amendment, and it applies here to prevent imputation. Commission Staff responds that the State Constitution gives commercial speech no greater protection than the Federal constitution provides. Staff argues that USWC fails to demonstrate that USWC has standing to raise the issue, that speech is affected at all, or that courts have decided cases addressing comparable situations.

84 We reject the Company's contentions. We find no cases interpreting the Washington Constitution in a manner analogous to that before us to prevent the exercise of regulatory power. The only significant element appears to be that an unregulated entity operates a directory advertising business, which we find insufficient to call forth the constitutional provisions.

5. Conclusion

85 We grant Staff's motion for partial dismissal. We find in the evidence no burden on speech in the Commission's use of imputation in order to correct U S WEST's affiliated-interest transaction.

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[19] *Bluefield Water Works & Improvement Co. v. Public Service Comm'n of West Virginia,* 262 U.S. 679, 43 S. Ct. 675, 67 L. Ed. 1176 (1923). *Federal Power Commission, et al v. Hope Natural Gas Co.,* 320 U.S. 591, 64 S. Ct. 281, 88 L. Ed. 333 (1944).

IV. PARTIES' ARGUMENTS ON THE MERITS

A. U S WEST Communications, Inc.

1. The Supreme Court Decision

86 On the merits of this proceeding, U S WEST argues that the Washington State Supreme Court decision[20] determined that a complete transfer occurred on January 1, 1984, and decided that U S WEST is entitled to the end of imputation when it demonstrates that the value of imputation is equivalent to the value of the yellow pages directory business as of that date. USWC repeats arguments that it made in support of its motion to strike certain of its opponents' testimony. USWC contends that the Court's decision is based on parties' representations that the entire Yellow Pages directory business was permanently transferred on January 1, 1984, that the decision accepts that interpretation, and that this interpretation thus became "the law of the case." USWC bases its arguments on express language within the decision and notes that in fourteen separate instances the Court stated that the business had been "transferred" and that in ten instances the Court states that the transfer was for insufficient consideration. The Company also notes that the Court states that the Commission has the power to rectify the inadequacy of the compensation.

87 USWC concludes from these statements that the Court finds as a fact necessary to the decision's result that a complete and permanent transfer occurred in 1984. USWC also concludes that the Commission's power to "rectify" the disadvantage to ratepayers is limited, in light of such a finding, to securing compensation for ratepayers for the value of the asset that was transferred. The Company ends its argument by stating that, because it proved the value of the business on that date, and because it proved that the amount imputed for the benefit of ratepayers exceeds that value, it has demonstrated that imputation must cease.

2. The Transfer of the Yellow Pages Business

88 USWC acknowledges that no documents support its view that a complete transaction occurred, but contends that no documentation is necessary to support a complete transaction among affiliates. It also contends that there is no fact of record to support the argument of Commission Staff and Public Counsel that the 1984 transaction was actually a lease of the intangible going-concern value.

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[20] *U S WEST Comm., Inc. v. Wash. Util. & Transp. Comm.*, 134 Wn.2d 74, 949 P.2d 1337 (1997).

89 USWC argues, by analogizing to arms' length transactions, that the 1984 transaction was in fact complete. It admits that it did license many of the intangibles associated with the directory operation, but argues that it could not have transferred intangibles such as a right to be permanently free from competition or exclusive access to subscriber lists without illegally restraining trade. It argues that it could not transfer its own name to Landmark permanently and still retain the name for its own operations. The remaining intangibles, such as skilled employees and relationships with advertisers, do constitute part of the "going concern value."

90 USWC argues that the Court has found that a complete and permanent transfer occurred as a gift or as part sale, part gift. The Company argues that a sale is not required to accomplish a permanent transfer, citing *Richardson Roller Mills v. Miller, 99 Wash. 654, 170 Pac. 357 (1918)*, involving an arms' length transaction.

91 USWC argues that a sale occurred because Commission Staff admitted that the effect of imputation – reducing rates for ratepayers in a manner determined by the Commission – is the same as the effect of payments in a sale. It argues that Commission Staff made a crucial admission in acknowledging that imputation was undertaken in lieu of either a sale or publishing fees.

92 USWC contests Commission Staff's and Public Counsel's argument that the failure to design the 1983 intercompany transaction documents as a sale implies it was not a sale. USWC asserts that Staff's and Public Counsel's view is inconsistent with the law of the case decreed by the Supreme Court. USWC cites Prof. Perlman's testimony to the effect that among affiliates, no documentation may be needed at all to effect a permanent transaction. USWC argues that to the extent there was ambiguity in the written agreements, that has been resolved by the parties' subsequent actions (i.e., that the parties' later behavior demonstrates their intention to make a permanent transfer in 1984).

93 USWC argues that the transaction could not be a lease, which is for a defined period, because the assets (largely cash) and intangibles (such as employees) were transferred without a determinate period. USWC argues that the Company never held a beneficial interest on behalf of ratepayers and that the Company's position is supported by the *Democratic Central Committee* case.[21]

94 USWC also argues that licensing its name and trademarks are consistent with a sale, not a lease. It cites *Wilkinson v. Sample, 36 Wn.App. 266, 674 P.2d 187 (1983)*, involving an arms' length transaction, for the proposition that goodwill is transferred

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[21] *Democratic Central Committee v. Washington Metro Transit Comm.*, 485 F.2d 786 (D.C. Cir., 1973).

merely by the new owner announcing the succession to customers, which Landmark did.

95 USWC argues that at all times it provided all information pertinent to the transfer that was required by law. It had no duty to disclose the value of the ongoing business concern, it says, because that is not subject to regulatory accounting. It argues that none of the Commission's orders is inconsistent with the result that USWC advocates.

3. Valuation

96 USWC argues that it has supplied in the testimony of Mr. Golden the only credible evidence of record to value the business as of the time of the of transfer. It argues that it has incorporated several suggestions from Commission Staff and Public Counsel in its valuation and that Staff has conceded the validity of the result. USWC argues that Public Counsel criticized the result, but offered no alternative.

4. Imputation Issue

97 USWC argues that the accumulated value of imputation to Washington ratepayers exceeds the value, with interest, of the directory business as of the time of the transfer in 1984. The company calculates that the accumulated value of imputation exceeded USWC's calculation of the 1984 value of the business at some time during 1995. Modified to accept Public Counsel's suggestions, the accumulated value of imputation exceeded the value of the business in 1997. In any event, USWC argues that this compensation to ratepayers satisfies the requirement that USWC receive fair value for the asset.

98 The transfer cannot be considered a temporary or lease transaction, USWC contends, stating that both Commission Staff and Public Counsel concede that imputation compensates ratepayers for the value of the asset. Therefore, the Company contends, imputation must cease.

5. Other Issues

99 USWC contends that imputation is forbidden by Section 253 of the Telecommunications Act of 1996 because it artificially lowers rates and thus constitutes a barrier to competitive entry. The FCC has ruled that regulations that hold rates below cost are such a barrier and are impermissible.

100 Finally, USWC contends that imputation is an unconstitutional taking of property without just compensation. It cites *Kimball Laundry Co. v. United States, 338 U.S. 1, 93 L.Ed. 1765, 69 S.Ct. 609 (1949).* The Company argues that the application of imputation takes property from U S WEST Dex and denies USWC, the opportunity to

earn a fair return. Even if imputation is found not to violate the Constitution per se, USWC argues, allowing imputation to continue after ratepayers have been compensated does constitute a violation.

6. Recommended Commission Action

101 USWC asks that the Commission enter an order ending imputation because there is no basis on which imputation can be continued. If the Commission finds that the valuation date is January 1, 1984, but that some portion of the fair value remains uncompensated, USWC suggests that the portion should be credited to rate base by crediting depreciation accounts.

B. Commission Staff

102 Commission Staff disputes USWC's arguments and contends that the Commission should continue to impose imputation. Staff contends that USWC has engaged in a consistent strategy to avoid paying fair compensation for the Yellow Pages business. Staff argues that the Commission approved the transfer of tangible assets, but did not approve the publishing agreements or the level of publishing fees. USWC agreed to imputation in the AFOR and merger dockets, but only challenged the Commission's right to impose imputation in the 1995 rate case, UT-950200. Never in the past has USWC argued or the Commission found that USWC transferred the complete ownership of the Yellow Pages business to Landmark, and never has USWC before this docket contended that imputation was compensation for the value of the Yellow Pages business.

103 USWC is attempting to create the illusion, Staff argues, that the Commission merely must ratify the Supreme Court decision to grant the Company's request. However, Staff contends that doing so is improper because the Court did not determine the ownership of the asset, it did not determine the date on which to make a valuation, and it did not determine that imputation constitutes payment for the transfer of the Yellow Pages business.

104 The proper date to make a valuation, according to Commission Staff, is the date on which USWC decides to treat the transaction as a sale and receives fair market value for the Yellow Pages business.

105 Commission Staff argues that while the Court did find imputation proper as a result of inadequate compensation in the transaction in question, the Court did not hold that imputation constitutes compensation for the value of the asset. It is not a payment at all, but merely an adjustment to the books of the regulated company. USWC's arguments are an exercise in revisionist history, Staff argues, seeking to rewrite the events of the past in order to excuse USWC from the imputation of Yellow Pages excess return.

1. History

106 Commission Staff contends that under the original publishing agreement in Cause No. FR-83-159, PNB in effect leased to Landmark the right to publish PNB's directories in exchange for publishing fees, providing a guaranteed revenue stream to PNB. PNB did no valuation study and provided the Commission with no valuation of the business. The Commission allowed the transfer of the tangible assets (principally cash) but reserved judgment on the financial aspects of the arrangement, requiring PNB to maintain pertinent financial records.

107 In Cause No. U-86-156, brought on by USWC's request for approval of ten separate agreements between USWC and U S WEST Direct (including a new Publishing Agreement), the Commission found the fee unreasonably low compared to the estimated reasonable value of the right to publish the Yellow Pages. The Commission ruled that the full value of the publishing enterprise must be available to PNB for ratemaking purposes. Remedies include, the Commission said, invalidation of the agreements and return of the Yellow Pages to PNB, determining an appropriate publishing fee, or treatment as the sale of a capital asset.

108 Commission Staff contends that the Commission Order in Cause No. U-86-156 was clear in finding that the initial 1984 transaction merely empowered Landmark to conduct the publishing operation on PNB's behalf. The Order was forward-looking, and stated some possible future consequences including treatment as a sale – should PNB elect that treatment. USWC has not yet made that election.

109 Commission Staff calls attention to the Company's agreement to imputation in the AFOR and rate complaint docket. Staff also notes that PNB agreed to imputation in the merger settlement. The Commission directed that imputation continue until further order of the Commission. Commission Staff describes the 1995 rate case, noting the Company's challenge of imputation in that docket, and analyzes the 1997 Supreme Court decision.

110 Commission Staff argues that the Court was not asked to and did not decide whether there had been a permanent transfer, and, if so, to determine the date of valuation. The Court noted correctly that the purpose of imputation is to treat Yellow Pages revenues and expenses as though the Yellow Pages transaction had never occurred.

2. The Nature of Yellow Pages Transactions

111 Commission Staff argues that the Yellow Pages transactions were interaffiliate transfers made without true negotiation, and were not arms' length transactions. Staff argues that it is improper, therefore, to apply standards of arms' length transactions to interpret or define the relationships among the participants. Also, it is improper to

call the transactions a "gift" of a lucrative asset when the Commission did not approve a gift. Staff concludes that there is no principled way to argue that the Yellow Pages business should be valued as of January, 1984. Rather, Staff contends, it should be valued at the time the Company elects treatment as a sale and demonstrates payment by U S WEST Dex of the fair market value at that (future) time.

3. Inadequate Disclosure

112 Commission Staff argues that if the Company were transferring the entire Yellow Pages business, it failed to disclose that intention. In that, the Company violated RCW 80.12.020, which forbids the disposition of properties without Commission approval and the Company violated WAC 480-143-010, which requires an application for authority to transfer property to "state in full detail" the facts and circumstances of the proposed transaction. Commission rules also require the submission of a full description of any unwritten provisions. The Company did not disclose that it was going to cede all rights in the Yellow Pages publishing business and did not submit to the Commission any document that so stated.

4. Prior Representations

113 Commission Staff points out that U S WEST has confirmed numerous times in other proceedings that it transferred only the physical and tangible assets in the 1984 transaction. Staff notes that USWC argued to the Commission on brief in Cause No. U-86-156 , the proceeding in which the Commission considered revised publishing agreements, that because PNB could resume Yellow Pages publication at any time, *nothing* was transferred.

5. Necessary Steps Omitted

114 Commission Staff argues that no transfer occurred because PNB failed to take a number of steps that would have been necessary to transfer ownership of the Yellow Pages business in 1984. It conducted no valuation of the Yellow Pages business, and it prepared no documentation to support a full transfer of ownership. Staff states that Landmark paid no compensation for the fair market value of the business, and PNB leased valuable rights to Landmark under the publishing agreement in a manner inconsistent with the theory of a sale.

6. Beneficial Interest

115 Commission Staff argues that the theory of the *Democratic Central Committee* case, above, requires a beneficial interest in the Yellow Pages operations to be preserved for ratepayers. Because Yellow Pages operations affected the Company's operations, ratepayers were exposed to risk of loss. Staff contends that it is improper to focus on

the nature of the individual components, as USWC urges. Staff suggests that it is necessary instead to look at the business operations as a whole as an asset of PNB, as USWC's witness Mr. Golden did. Commission Staff argues that there is no barrier to recognition of capital appreciation, as USWC contends, as of January 1, 1984, because there was no transfer of the business effective at that time. Indeed, no transfer of the business has yet occurred.

7. Valuation Issues

116 Commission Staff presented a calculation of the business value as of January 1, 1999, through witness Dr. Lee Selwyn. The methodology the Staff witness used is comparable to Mr. Golden's, and returned a total valuation of $5.6 to $7.4 billion overall, or $1.04 to $1.35 billion on a Washington-separated basis.

8. Imputation Issues

117 Commission Staff contends that imputation is not compensation for the capital value of the business. Staff argues that U S WEST Direct has not paid anything for the fair market value of the business. Moreover, Staff argues, it is inconceivable that USWC could have believed that imputation constitutes payment for an asset, when the Company agreed to imputation in a way that did not specify a formula to amortize value; when it did not argue in the merger docket that imputation must end once amortization was complete; when it did not argue in the 1995 rate case that imputation should stop because it had paid for the fair market value of the business; and when it did not ask the Supreme Court to end imputation because the business had been paid for.

118 Staff argues that imputation is a means to rectify inadequate compensation arrangements and not for amortization of a capital asset. Prior Commission orders, Staff says, demonstrate that the Commission was concerned with, and later used imputation to rectify, inadequate compensation to PNB from Landmark for the publishing agreement and for services rendered. Staff points out that in a 1985 transaction, the parent of Continental Telephone of the Northwest sold its directory subsidiary, Mast Directory Company, to an unaffiliated interest. Prior to the sale, excess directory revenues were imputed to CTNW in the manner used for PNB despite the permanent placement of Mast as a separate subsidiary. The Commission computed the gain on the sale for regulatory treatment without reference to any capital offset from imputation, because imputation is not a regulatory means to recognize capital transactions.[22] In another example, excess directory earnings of an

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[22] *WUTC v. Continental Telephone of the Northwest, Inc.,* Cause No. U-82-41, Second Supp. Order, (August 12, 1983).

affiliate were imputed to GTE-NW even though the commonly owned directory company merely owned, and was not acquiring or divesting, the directory business.[23]

9. Other Issues

119 Commission Staff argues that there is no violation of Section 253 of the Telecommunications Act of 1996 because the Commission found in UT-950200 that no subsidy exists from imputation. The State Supreme Court affirmed that finding and noted that no competitor, who would presumably be hindered under USWC's theory had supported the Company.

120 Staff argues that Yellow Pages imputation is not an unconstitutional taking without just compensation. The Commission seizes no revenues from the affiliate, does not regulate the affiliate, and does not interfere in any way with the affiliate's conduct of business. Neither has the Commission "taken" revenue from USWC, Staff argues. Staff contends that USWC is wrong in its contentions that rates under imputation are set by reference to property in which "ratepayers have no interest" and for which "fair value has been received." Neither, Staff notes, has USWC demonstrated that the resulting overall rates are so low as to jeopardize the financial integrity of the Company, a requirement for a finding of unconstitutional taking under *Duquesne Light Co. v. Barasch, 488 U.S. 299 (1989).*

C. TRACER, AARP and Public Counsel.[24]

121 TRACER's brief begins with the observation that USWC's case rests entirely on a misreading of language in the decision of the Washington State Supreme Court and an attempt to revise history.

122 TRACER argues that the 1984 transaction was not a complete and permanent transfer of ownership of the directory publishing business. TRACER points out that at the time of the transaction there was no valuation, no buyer or seller, no consideration for the going-concern value of the business, no application for approval of the transfer, and no Commission disposition of the gain. In the absence of an application from PNB for approval of a sale transaction, the Commission implemented imputation. TRACER argues that USWC should not be allowed to characterize the transaction

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[23] *WUTC v. General Telephone of the Northwest, Inc.,* Cause No. U-84-18, Second Supp. Order, (January 15, 1985).

[24] Intervenors TRACER and AARP coordinated their efforts with Public Counsel to produce a joint brief. For convenience, we will refer to their combined brief in this docket using only TRACER's name. We acknowledge the considerable effort of each of the contributing parties. In many respects this brief parallels that of Commission Staff, and this Order for the sake of brevity and clarity will not repeat parallel arguments.

retroactively as a sale. TRACER contends that the imputation adjustments and publishing fees were not installment payments on a hypothetical sale, because no true sale occurred, no consideration was paid or received for the value of the business, no amortization schedule was established, no gain was available for Commission distribution, and publishing fees were never referred to as consideration. TRACER contends that ratepayers are entitled to the gain on the sale of the Yellow Pages business because they have continued to be at risk and are entitled to share in the growth of the value of the business. Finally, TRACER contends that imputation may cease only when the full current market value of the Yellow Pages business is determined, received by USWC, and credited to ratepayers.

1. History

123 TRACER's thorough recitation of the history of the transaction and the significant orders parallels that of Commission Staff and will not be repeated at length. TRACER notes that the Second Supplemental Order in Cause No. U-86-156 speaks prospectively about characterization of the transaction as a sale, saying "*if* U S WEST Direct seeks to ultimately acquire all of the opportunity for profit. . . " (emphasis added). Only at the time of an application, valuation, and credit to ratepayers, TRACER contends, may conditional treatment as a sale begin.

124 TRACER calls attention to language in the Supreme Court decision, observing that "The record shows the Company has always been free to sell the business for a fair value." TRACER argues that this observation, and the Court's observation that imputation may cease when the Company receives fair value for the business from its affiliate, demonstrate the fallacy in the Company's contention that the Court found a complete transfer to have occurred.

125 TRACER describes the details of the 1983 application packet and concludes that the 1984 transactions did not constitute and were never intended to constitute a permanent transfer of ownership of the directory business. TRACER notes that USWC's argument that the 1984 transaction was all or part gift causes the Company a problem because the Company has never asked the Commission to approve a transfer of the entire business operation without consideration, as it must under RCW 80.12.020. TRACER observes that the Company's version of history is incompatible with the requested and actual regulatory treatment, and concludes that no transfer of ownership occurred.

2. Valuation

126 TRACER argues that the central issue in valuation is selection of the proper time period. TRACER argues that there is no basis to conduct the valuation as of January 1984, because no change in ownership was disclosed, was approved, or occurred. TRACER cites to asserted errors in the methodology of Mr. Golden's proffered

valuation, but also argues that the basic premises of a sale as of that date were not met and that the extraordinary appreciation of the Yellow Pages business value since then offers strong motivation to the Company for insisting upon the 1984 date and valuation.

3. Imputation Issues

127 TRACER cites to the Commission's order in Docket No. UT-950200 and the Commission's observation there that it and other Commissions have used imputation to prevent regulated companies from transferring profitable assets to unregulated affiliates while saddling captive utility customers with the expenses of operation but reduced offsetting revenues from related services. TRACER concludes that imputation is not an installment payment for the transfer of the fair value of the publishing business. Similarly, TRACER finds no reason to consider publishing fees as payment for the value of the business as opposed to their stated purpose. TRACER also notes that USWC has never availed itself of the opportunity to secure treatment as a sale.

128 TRACER defends the accuracy of a "rental" analogy, and notes that even USWC's witness Golden uses the term "rent" in conjunction with the payment for temporary use of intangible assets. TRACER argues that ratepayers continue to bear the risks of the publishing function because they have remained at risk for the risks and costs of the publishing business under imputation. Ratepayers, argues TRACER, are entitled to the gain on sale when they have borne the risks. TRACER cites to Washington decisions, including one on the distribution of gain by USWC on the sale of Bellcore and another on the sale by Puget Sound Power and Light of certain assets in Cause No. U-85-53 (1986). TRACER disputes USWC's interpretation of TRACER's brief to the Washington State Supreme Court in the appeal of the Commission's orders in the rate case, and disputes USWC's interpretation of the testimony in this docket of Public Counsel and Intervenor witness Mr. Brosch.

4. Other Issues

129 On the same basis as Commission Staff, TRACER opposes USWC's contention that imputation is impermissible under the Telecommunications Act of 1996. TRACER also opposes USWC's contention that imputation constitutes an impermissible taking, arguing that imputation does not affect the publishing business in any way and citing a Colorado court decision holding that imputation in that state did not constitute an impermissible taking.[25]

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[25] *Mountain States Telephone and Telegraph Co. v. Public Utilities Commission*, 763 P.2d 1020 (Colo., 1988), cited with approval in the 1997 Washington State Supreme Court decision, 134 Wn.2d at p. 100.

V. DISCUSSION AND COMMISSION DECISION

130 The Commission has set out above a summary of the parties' arguments. In this segment of the order, we state our decision on the issues presented to us and our reasoning for those decisions.

A. Basis for USWC's Position

1. The Supreme Court Decision

131 U S WEST makes a number of representations about the meaning of the 1997 State Supreme Court decision affirming the Commission's rate case order. Consequently, we have read the decision closely and carefully.

132 USWC argues that the Court ruled, at least implicitly, that the January 1, 1984, transaction was complete and final; that a valuation must take place as of that date; that the purpose of imputation is to offset or pay for the capital value of the business; and that if the value of imputation exceeds the 1984 valuation of the directory business, imputation must cease.

133 USWC's argument is not without shortcomings. USWC takes its position despite the apparent context, holding, and language of the judicial decision to the contrary; despite the lack of administrative or judicial findings of fact supporting the theory; despite the Company's prior representations, actions, and litigation positions to the contrary; despite witnesses' prior sworn statements to the contrary; despite the prior Commission orders to the contrary; and despite the inherent admission that if its position were true it would be admitting its failure to disclose the total disposition of a lucrative asset to an affiliated interest, contrary to the requirements of chapters 80.12 and 80.16 RCW.

134 USWC and its witnesses acknowledged freely that the Company never in the past contended facts and legal relationships that it now argues control the transaction. Its positions are contrary to its prior representations to the Commission,[26] contrary to

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[26] Brief of Applicant Pacific Northwest Bell Telephone Company, Docket U-86-156, at 23-24 (June 24, 1988).

prior Commission orders,[27] contrary to the prior sworn statement of a USWC witness,[28] and contrary to the holdings and observations of the Supreme Court decision.[29] USWC explains all of these inconsistencies by saying that it is only following the mandate of the state Supreme Court and what USWC calls "the law of the case."

135 We do not find that the Court's decision supports USWC's interpretation of the Court's decision. The Court ruled that the Commission acted properly within its discretion in using imputation as a means to rectify injury to ratepayers from an affiliated interest transaction. While the Court did refer to the transaction in some instances in the past tense – a transaction must have occurred to invoke the relevant statutes – it made no rulings on the timing or nature of any complete transfer of all rights to the Yellow Pages business or the proper valuation of that business because the issues were not presented.

2. USWC's Interpretation of the Supreme Court Decision

136 USWC argues that if there had been no "transfer," then the premise of the Court decision was wrong. USWC argues that the Court therefore ruled that a complete and final transfer occurred on January 1, 1984, that a valuation must be made as of that date, and that because the amounts of imputation now total more than the 1984 valuation, imputation is now illegal. The Commission disagrees.

137 USWC's first fundamental fallacy is to state that the Court's acknowledgment of a transfer of rights and benefits sufficient to invoke regulatory review and action was in fact a holding that a complete, total, and final transaction occurred as of a specific date. The Commission did not make a finding to that effect in the order appealed from nor in any prior case, and in fact over time made unambiguous holdings to the contrary, in orders that were never appealed. No record was made in the rate case to support such a finding. No party argued as much to the Court. The Court did not make a finding of fact to that effect nor did it remand the issue to the Commission for

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[27] *In the Matter of the Application of Pacific Northwest Bell Company, Order Granting Application, Cause No. FR-83-159 (December 30, 1983); In the Matter of the Application of Pacific Northwest Bell Company, Second Supplemental Order, Docket No. U-86-156 (1988); Washington Utilities and Transportation Commission v. U S WEST Communications, Inc., Fifteenth Supplemental Order, Docket No. UT-950200, (1996).*

[28] Rebuttal Testimony of Max Johnson in Docket U-86-156; testimony of Ms. Koehler-Christiansen, transcript p. 1001

[29] *U S WEST v. Utils. and Transp. Comm'n, 134 Wn.2d 74, 89, 98, 102 (1997).*

an appropriate finding under RCW 34.05.558. The Court simply did not make the ruling that U S WEST contends the Court made.

138 Some of the confusion – or at least the missed communication – among the parties results from the difference in meaning, interpretation, and inference that the parties assign to the term "transfer."

139 USWC notes the term "transfer" in the parties' arguments on review of the Commission's Order in Docket No. UT-950200, and the Supreme Court's use of the term in its decision at 134 Wn.2d 49, and reads it to mean a complete, total, permanent transfer of all aspects of the Yellow Pages directory business.

140 All parties in the rate case acknowledged that after January 1, 1984 Landmark published the PNB directories and kept the proceeds from Yellow Pages advertising sales. All parties acknowledge the existence of contracts between PNB and Landmark regarding publication. The Commission ruled in orders that were not appealed that the consideration PNB received from Landmark was inadequate. No more was necessary to invoke the relevant statutes authorizing imputation and no more was necessary to decide the issues in the our order UT-950200 and its judicial review. While the parties in argument and the Court in ruling on the transaction did on occasion use the past tense, that was neither the argument nor the ruling that the transaction is complete and permanent for all purposes or that it was completed at any particular time.

141 The 1984 transaction in which certain assets changed ownership and in which responsibility for publication of the White and Yellow Pages directories moved from PNB to Landmark was a transfer, whether or not permanent, of the business operations. It was a sufficient transfer – shifting as it did the right to publish and to collect advertising revenues – to invoke the provisions of chapters 80.12 and 80.16 RCW. The term "transfer" need not, and did not, for the Commission or other parties, mean total and permanent transfer of the entire business. USWC's use of the term is not consistent with others' use.

142 In its appeal of the Orders in UT-950200, USWC did not challenge any lack of findings by the Commission as to whether the transfer was complete and final. It did not argue to the Court, so far as this record reveals, that the Commission's decision failed to make necessary findings or that the Court should remand the matter back to the Commission for necessary findings.

143 Courts can rule only on issues that are before them. The issue that USWC presented to the Court, on its challenge of the Commission Order in Docket No. UT-950200, was whether the Commission's use of imputation is legal to rectify adverse effects on ratepayers from what all parties acknowledged to be an affiliated interest transaction involving inadequate compensation. The Court ruled that the Commission's use of

imputation is legal under the pertinent statutes in those circumstances. It rejected, or found it unnecessary to reach, each of the 18 reasons that USWC posited as making imputation illegal.

144 USWC's theory of the decision appears to be inconsistent with significant portions of the Court's ruling. It is inconsistent with the Court's observation at page 98 that "[t]he record shows that the Company has always been free to sell the business for a fair value," because use of the present perfect progressive tense implies an ongoing, continuing ability to sell rather than a past, consummated sale.[30] The Court's observation at p. 102 that the Company is free to ask the Commission for an end to imputation "when it can show that it [USWC] has received fair value for the transfer of the asset" (emphasis added) is inconsistent with USWC's contention that it is ostensibly entitled to that result when it can show that it has provided a value to ratepayers.

145 USWC does not present evidence that it has received fair value for the asset. Instead it argues that the Court's decision makes the imputation of Yellow Pages revenues illegal because the value of the asset was "paid off" by imputation to USWC's earnings.[31]

146 USWC's theory is misguided. It is inconsistent with the factual record in this and prior dockets; it is inconsistent with the regulatory record; and it is inconsistent with the Supreme Court decision that it ostensibly seeks to implement.

B. The transfer of the Yellow Pages Business

147 U S WEST argues that the transaction was complete and final on Janauary 1, 1984. We find that it was not. We find that the 1984 transaction was represented to be, and actually was, a transfer in which Landmark began publishing directories and engaging in the Yellow Pages business "for" PNB[32] and agreed to make a guaranteed stream of payments for that privilege. That is what this record reveals, and that is what the Commission finds. Only in that context can the documentation presented by PNB,

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[30] William A. Savin, The Gregg Reference Manual, (7th Ed. 1999).

[31] USWC argues that the Company always took the position that imputation is illegal. USWC Opening Brief, at p. 26. A glance at prior Commission orders reveals that this statement is not supportable. In particular, in the merger dockets the Company accepted imputation on a continuing basis. This is inconsistent with the Company's new theory of illegality. In pleadings related to the merger order, the Company admitted that "it is time to put the issue (of imputation) to rest." It consented to the ongoing imputation as an integral element of the merger transaction, and it did not appeal the order.

[32] Order of Dec. 30, 1983 in Cause No. FR-83-159.

the unappealed decisions of the Commission, and the Supreme Court decision be understood to make sense.

1. Indicators of Arms' Length Transactions

148 USWC argues that the transaction must be treated as a sale or other permanent transfer if there are certain indicia of a permanent transfer, according to the legal standards applied to arms' length transactions. Examples include the transfer of goodwill, copyright licensing, and use of trademarks.

149 The analogy and the citations are invalid, because this is not an arms' length transaction. Mr. Inouye confirmed at TR 492-3 what has been clear from the outset of this transaction in 1983 — that USWI controlled the negotiations regarding the Yellow Pages. Indeed, it was only sound business that USWI control the transaction in every regard. It did so in an attempt to shift the income of the lucrative directory publishing business from PNB, where it was a benefit shared by ratepayers and stockholders, to an unregulated subsidiary where the benefit could be enjoyed exclusively by shareholders. To the extent that witnesses represented that this was not the case, and that dealings between the companies *were* at arms' length, their testimony is not credible.

150 The Company repeatedly analogizes for selected purposes to standards applicable to third-party or arms' length transactions. The Commission gives those standards no weight in this context, as they are inapposite to this series of transactions. Every one of the incidents of this transaction was subject to the ultimate discretion, direction, and control of USWI and could be molded to resemble or not resemble an arms' length transaction at USWI's direction. USWC clearly concedes this when it strongly argues the reverse of this issue, for example, when it points out that the transaction needs no documentation because it is a transaction between affiliates, or when it states that it needs none of the indicia of a third-party transaction because affiliates are free to make gifts to one another.

151 Finally, some of Mr. Johnson's testimony relating to trademarks is not credible. We find no indication that the logo of U S WEST Communications, Inc., connotes in the popular view an entirely different company from that connoted by any other U S WEST corporate family logo.[33] We find it not credible that consumers see the U S WEST Communications logo, with its stylized U S WEST lettering, see the identical U S WEST lettering with the name "Dex," and view them as totally distinct and unrelated companies as opposed to related products under a single umbrella. In any event, the substitution of the U S WEST logo for that of PNB was a choice made by

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[33]Mr. Johnson, TR pp. 410-421.

U S WEST, Inc. and PNB and should not be used to justify the evaporation of any publishing rights or financial benefits previously held by PNB.

2. *Gift Theory*

152 All parties acknowledge the lack of contemporaneous adequate compensation for the transfer of the assets.[34] The Commission ruled on more than one occasion, without contest or appeal, that the compensation provided for the publishing agreements was inadequate or nonexistent. USWC argues that because the Court said that USWC "gave away" the asset for little or no return, it ruled that the transaction constituted a completed gift of the entire directory business on January 1, 1984. Therefore, the Company argues, the transaction was a fully executed gift of the entire Yellow Pages publishing business and no formal evidence of sale transfer is needed.

153 There was no gift because a gift requires donative intention.[35] Here, as the Commission has repeatedly noted, the intention was to enrich stockholders at the expense of ratepayers. It was not a permanent transfer of the entire publishing business, because the approved transaction was neither designed nor presented to effect a permanent transfer, nor did it effect a permanent transfer.

154 Moreover, the transaction is not a completed transfer of the entire publishing business because PNB did not receive Commission authorization under Chapters 80.12 and 80.16 RCW to give away the exceptionally valuable asset. A no-compensation transfer of the entire business would clearly have been subject to disclosure and Commission approval under both the transfer of property and the affiliated interest statutes. While the no-compensation nature of the asset transfer was disclosed, we find that USWC presented the transfer of the publishing business function as an outsourcing or a lease, with compensation over its term, in a way that clearly precludes treatment as a gift.

155 As we repeatedly note, the limited transfer of the publishing function that PNB described to the Commission and then effected in the 1984 transaction neither demands nor implies the relinquishment of all rights in a permanent transfer.

3. *Regulatory Consequences*

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[34] Consideration for the asset transfer was nonexistent. PNB immediately transferred to U S WEST (the parent company) the entire 21/100 share in Landmark that it received for the capital assets and so far as the record shows derived no benefit from that transfer. *See, Cause No. FR-83-159 (Order of Dec. 30, 1983), and Second Supplemental Order, Cause No. U-86-156, pp. 11-12 (1987).*

[35] *Oman v. Yates*, 70 Wn.2d 181, 422 P.2d 489 (1967); *Tucker v. Brown*, 199 Wash. 320, 92 P.2d 221 (1939); *Dingley v. Robinson*, 149 Wash. 301, 270 Pac. 1018 (1928).

156 For regulatory purposes, as suggested by Commission Staff and other parties, we must look to the regulatory interpretation of the actions that the regulated company took and that it disclosed to the Commission. From a regulatory perspective, the following occurred or failed to occur.

157 PNB did not represent in its December, 1983, application that it was intending to part permanently with all aspects of ownership of the Yellow Pages business. Instead, it clearly stated that "This application concerns the implementation of the new Publishing Agreement between PNB and USWDC *for the publication of PNB's White and Yellow Page directories.*" Application, Cause No. FR 83-159, p. 3. (emphasis added) The application by its own terms was for an agreement for publication, and not for the transfer of a valuable business.

158 The relationship that was thereby created for regulatory purposes – the relationship that the Commission approved – was not a sale or other permanent transfer. Instead, it was the transfer of certain assets along with a license and series of agreements for services for a term of years. PNB's representation to the Commission was of a temporary outsourcing (in common parlance, as Mr. Selwyn notes, a "lease") of the publishing function, under a publishing agreement, in exchange for a fee. Only in this context do the contemporaneous representations, the contemporaneous regulatory treatment, and the relevant orders all make sense.

159 The Commission recognized the impermanence of the authorized relationship in a later order, telling PNB that it should make an election about the transfer. The Commission listed three possible means to treat the transaction:

> The remedies to be considered include the approval of the contracts with appropriate adjustment of publishing fees, the return of the publishing function to PNB, or the treatment of the transaction as the sale of a capital asset. If, as the evidence appears to show, PNB and USWD intended a permanent transfer of the Yellow Pages, treatment as a sale may be most appropriate. Such treatment would allow for determination of consideration at the time of transfer that would fairly compensate PNB. PNB would assume none of the risk, and USWD would assume all of the risk attendant to the publishing enterprise. *Such a result is appropriate if U S West Direct seeks to ultimately acquire all of the opportunity for profit.* Treatment as a sale is very likely to reflect a result that might have been achieved by parties bargaining at arms' length.

Docket No. U-86-156, Second Supplemental Order, at p. 12 (emphasis added). It is clear from this discussion that the Commission had not authorized a permanent transfer. None of the discussion would make sense if a permanent transfer had been approved. USWC neither sought clarification nor appealed the order or its description of the transaction. Nor did it ever come back to the Commission with a request to treat the transaction as a sale.

160 U S WEST states that it always provided full disclosure about the transaction. *USWC Brief, p. 33.* In light of the record and USWC's earlier positions, this statement is difficult to understand. If it intended a transfer of the entire business, not only did it not tell the Commission it was transferring the entire business (nor the value of the ongoing business ostensibly transferred), its application stated that it was arranging for publication, and it subsequently represented through the sworn statements of witnesses (Ms. Koehler-Christianson[36] and Mr. Johnson[37]) and legal positions[38] that no transfer of intangible assets occurred. Mr. Inouye states at transcript pages 263-264 and Ms. Koehler-Christianson acknowledges at transcript page 1001 that the changes in their statements are the result of the Company's desire to support the existence of a completed, permanent transfer that the Company contends is demanded by its interpretation of the Court's decision.

161 U S WEST's statements now about the facts and the meaning of its own actions are so clearly contrary to the events and representations at the time that they cast serious doubt on the credibility of the Company's case. If we are to believe that it did in fact transfer all rights to the business, it never once told the Commission that it was effecting the complete and total transfer of an immensely valuable asset, contrary to its obligation under law to seek approval for such a transaction. The Company failed to maintain the documentation ordered by the Commission that is essential to the valuation of the asset that it now seeks us to make. Again and again, the contemporaneous information that PNB and USWC provided and its arguments are inconsistent with the facts and the positions that USWC now espouses.

162 In summary, USWC asks the Commission to look at legal documents prepared by the Company's own lawyers in response to its legal obligation to define and disclose every relevant aspect of the transaction, and then to disregard the language of those documents, and to infer an intention that is not evident within the documents. We cannot find on the facts in this record that a transfer of the business occurred in 1984.

4. Regulatory Treatment

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[36] Ms. Koehler-Christianson, Tr. 1001; Ex. 519, part 1 of 2, at 107-8 (referring to testimony in deposition in USWC's federal proceeding challenging imputation on First Amendment grounds).

[37] *See,* Tr. 378-79; Ex. 309 at 2-3 (referring to Rebuttal Testimony of Max Johnson in Docket U-86-156).

[38] "As noted above, the fact is that PNB could publish now if it chose, so nothing was actually transferred in 1984." Brief of Applicant Pacific Northwest Bell Telephone Company, Docket U-86-156, at 23-24 (June 24, 1988).

163 Regulatory requirements are the most telling argument regarding the transfer of the business. USWC has never asked the Commission to approve the permanent transfer of the entirety of the Yellow Pages business to Landmark or any other entity. As we have noted above, under RCW 80.12.020, USWC had no authority to dispose of property without receiving Commission authority to do so, and under RCW 80.16.020 it had no authority to consummate a transaction with an affiliate without receiving Commission authority to do so.

164 Chapter 80.12 RCW severely restricts public utilities' ability to transfer property without prior Commission approval. RCW 80.12.020 says, in part,

> No public service company shall sell, lease, assign or otherwise dispose of the whole or any part of its . . . properties . . . without having secured from the commission an order authorizing it to do so.

165 The consequence of failure to do this is made clear in RCW 80.12.030:

> **Disposal without authorization void.** Any . . . sale, lease, assignment, or any other disposition, merger, or consolidation made without the authority of the Commission shall be void.

166 RCW 80.16.020 requires a regulated company to

> file with the commission a verified copy, <u>or a verified summary if unwritten</u>, of a contract or arrangement providing for the . . . purchase, sale, lease, or exchange of <u>any property, right, or thing</u> . . .. The filing must be made prior to the effective date of the contract or arrangement. Modifications or amendments to the contracts or arrangements must be filed with the commission prior to the effective date of the modification or amendment.

(Emphasis added.)

167 The 1983 application was for approval of the transfer of certain assets worth $13.7 million (for which the Company received nothing) and the approval of publishing agreements under which Landmark agreed to publish directories including company listings and Yellow Pages for PNB and to pay PNB a guaranteed stream of income.

168 The Company in this docket does not ask the Commission to approve the transfer of the entirety of the Yellow Pages business to Landmark. Instead, it merely asks the termination of imputation – allegedly pursuant to order of the Washington State Supreme Court. The Company's current request for regulatory treatment retroactive to 1983 is incompatible with regulatory requirements. The Company never asked the Commission to treat the transfer as a sale or any other completed transaction or otherwise give regulatory approval or regulatory permission for a permanent transfer

(which would require a modification or amendment of the original approved agreement under the terms of the statute) even after the Commission invited it to do so. It never asked the Commission to distribute the realized gain from a sale. It never kept the necessary records that the Commission directed it to keep.[39] USWC has not received authority to transfer the business asset. We find that for regulatory purposes any arrangement or disposition that purported to effect a transfer other than the limited transaction approved in 1983 is void. RCW 80.12.030

169 We conclude that USWC retains the asset, both by the factual history of the transaction and as a matter of law. We will continue to regulate USWC as though it retains all rights to the asset. No complete transfer occurred in 1984, and we have no evidence of any later sale or other disposition to which PNB or USWC was a party. Neither PNB nor USWC applied for approval of such a transaction, and we have not approved such a transaction. Any such transaction would therefore be void in any event. The Commission has continuing jurisdiction over any such arrangement, dating back to the original application. The Commission can, but is not required to, institute an investigation. "At any time after receipt of the contract or arrangement," the Commission may disapprove such a contract or arrangement if the Commission finds that the public service company has failed to prove that contract or arrangement is reasonable and consistent with the public interest. RCW 80.16.020.

5. Consequences of a Transfer

170 The first fundamental fallacy in USWC's position is that a transfer occurred. Its second fundamental fallacy is its assumption that proof of a transfer removes imputation as an appropriate remedy for the inter affiliate transaction. It is clear that this is not the case.

171 The Commission's Order of October 12, 1980 in Cause No. U-86-156 sets out three potential means of rectifying the consequences of the transaction. That list is not exclusive.

172 Imputation is the implementation of "Imputed Value," i.e., the logical or implicit value that is not recorded in any accounts. *ATTORNEYS' DICTIONARY AND HANDBOOK OF ECONOMICS AND STATISTICS, by Les Seplaki, New York: Professional Horizons Press, 1991, p. 121.* It is the ascription or attribution to another. *Webster's II New Riverside University Dictionary, Boston, 1984.* Here, imputation is the ascription or attribution of income, not recorded otherwise on any of USWC's accounts, implemented by an accounting adjustment. It revises USWC's earnings for regulatory purposes (that is, for setting rates), to reflect a portion of

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[39] *In the Matter of the Application of PNB,* Cause No. FR-83-159, Fourth Supp. Order, at 7 (January 16, 1985).

affiliate U S WEST Dex's earnings. It is a means by which the Commission may exercise the authority granted in Chapter 80.16 RCW to protect ratepayer interests affected by affiliated transactions.

173 There is no principle of law or policy that constrains the Commission from using imputation on an ongoing basis when the affiliate of a regulated telecommunications company owns and operates a directory publishing business that serves the regulated company. The Commission has used imputation in such settings. *See, Second Supplemental Order, WUTC v. Continental Telephone Company of the Northwest, Inc., Docket No.* U-82-41 *(August 1983); Second Supplemental Order, WUTC v. General Telephone Company of the Northwest, Inc., (January 1985).* Imputation is thus an alternative to a distribution at the time of a transfer, when the transfer is to an affiliate. Its application to U S WEST has been to substitute the earnings imputation, for ratemaking purposes, for the actual payments (if any) by Dex for rights or services that USWC provides and that allow Dex to publish directories containing Yellow Pages advertising on behalf of USWC. That repricing of affiliated payments offsets the loss to ratepayers of the benefit they would have received if PNB had not transferred the business operation. The loss to ratepayers occurs on an ongoing basis, and the offsetting benefit from imputation of "excess" earnings compensates ratepayers for the immediate period's loss, not for the capital value that might be distributed in the event of a sale to a third party in an arms' length transaction. Imputation is not a substitute for, nor is it a means to implement, the amortization of any value to be distributed.

174 The Court appears to have understood this perfectly, for it stated that USWC could ask for an end to imputation when *it received* consideration for the asset, not when it *paid* or when *ratepayers received* consideration for the asset.

175 The Commission does not rule out any Yellow Pages treatment, nor does it predict what the Commission will do given the facts of any possible future record. The Company may come forward in a proper procedural setting to ask for a change in imputation. If that occurs, the Commission will receive evidence, hear arguments, and make a responsible decision, under law, on the facts of record.

6. Conclusion

176 U S WEST's arguments about the actual nature and timing of the transaction are factually incorrect. The transaction and the pertinent documentation that PNB represented to the Commission, and that the Commission approved, was for the transfer of certain assets and the temporary outsourcing of the directory publishing business in exchange for a guaranteed stream of payments from the temporary publisher for the right to conduct the publishing business. The Commission has approved no other transaction and it expressly refused to approve the adequacy of the publishing fees. For regulatory purposes, no other transaction has occurred.

177 When we examine the evidentiary record, we see no objective indicators demonstrating that the publishing business was formally transferred. We see none of the indicators of an arms' length transaction – even of a receipt for a transaction without consideration – that might constitute a part of the evidence that the transaction occurred as USWC contends. We see no request for other regulatory approval, and no summary of any unwritten agreements. We conclude on the facts of record that no permanent transfer occurred, factually or legally.

C. Valuation

178 USWC argues that because the complete and permanent transaction was consummated on January 1, 1984, the value of the transferred asset must be valued as of that date. We have found that the transaction did not occur on that date and that there is neither evidence of a transaction at any other date nor of regulatory approval of a transaction for regulatory purposes. Consequently, we need not discuss the issue of valuation and we cannot without a transaction to approve determine whether valuation is needed or what is the proper date for valuation of the ongoing business.

179 The Commission will continue to use imputation to preserve and balance the positions of stockholders and ratepayers until the Company demonstrates a change in conditions that warrants a change in imputation.

180 The Commission will then have the opportunity to determine whether to end imputation and, if so, determine the appropriate disposition of any gain.

D. Other Issues

1. Publishing Fees as Payment for an Asset

181 USWC urges that the publishing fees should be considered payment for the capital asset that has been transferred. It is clearly improper to do so. We find and conclude above that the purpose of the 1984 transaction, as expressed in the supporting documents and in Commission orders, was to authorize and require Landmark to publish directories and conduct the classified advertising business for PNB for a limited period in exchange for the publishing fees. The fees were established and represented as compensation for the rights to perform that activity and for other services rendered by PNB.

2. Barrier to Entry

182 USWC contends that imputation is a barrier to entry forbidden by Section 253 of the Telecommunications Act of 1996 because it subsidizes rates and makes it more difficult for competitors to enter the market. The Commission disagrees.

183 The question of subsidy was resolved by the Supreme Court when it upheld imputation against USWC's challenge in the rate case. *134 Wn.2d at p. 83.* No competitors challenge imputation or contend that it constitutes a barrier. There is no evidence, as opposed to the mere allegation, that imputation constitutes a barrier to competition. The Commission rejects this challenge.

3. Unconstitutional Taking

184 USWC again contends that imputation is unconstitutional, this time as a taking of Landmark's revenues without compensation under the Fifth and Fourteenth Amendments to the United States Constitution and Article I, Section 16 of the Washington State Constitution. We reject the argument.

185 First, neither USWI nor Landmark is a party, and USWC does not have standing to raise the issue as to the rights of others.

186 Moreover, as we have previously held and the State Supreme Court affirmed, revenues of the nonregulated company, Landmark, are not affected. Imputation is established for a limited purpose, authorized by statute, and for a purpose that has been found fully lawful by the United States Supreme Court.[40]

E. Conclusion

187 USWC's petition for an accounting order is premised on a selective reading of the Washington State Supreme Court's decision and on alleged facts that are contrary to the facts that we find on this record. Imputation is merely a means to preserve the relative benefits of Yellow Pages operation to ratepayers and stockholders that existed prior to the Commission's authorization of the temporary transfer of the publishing function from PNB to Landmark in January1984. Imputation also operates to reprice the ongoing affiliated transactions in an equitable manner. There is no evidence of an actual transfer from PNB or USWC to Landmark, and there has been no regulatory approval of any permanent divestiture of ownership of the publishing function from PNB or its successor, U S WEST Communications, Inc. The Commission denies USWC's petition for an accounting order ending imputation.

VI. FINDINGS OF FACT

188 Having discussed above all matters material to our decision, and having stated general findings and conclusions, the Commission now makes the following summary findings of fact. Those portions of the preceding discussion that include findings

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[40] *United Fuel Gas Co. v. Railroad Comm. of Kentucky*, 278 U.S. 300, *Supra.*

pertaining to the ultimate decisions of the Commission are incorporated by this reference.

189 1. The Washington Utilities and Transportation Commission is an agency of the State of Washington that is vested by statute with the authority to regulate telecommunications companies offering service to the public for compensation.

190 2. U S WEST Communications, Inc., is a subsidiary of U S WEST, Incorporated. USWC is engaged in providing telecommunications services to the public of the state of Washington. It is the successor in interest to Pacific Northwest Bell Telephone Company, which disappeared as a separate entity upon its merger with two other local exchange telecommunications companies to form U S WEST Communications, Inc.

191 3. Landmark Publishing Company is a subsidiary of U S WEST, Incorporated. Landmark is the owner of U S WEST Dex, formerly called U S WEST Direct, a subsidiary engaged in the business of publishing telephone directories.

192 4. On December 22, 1983, PNB filed an Application for authority under Chapter 80.12 RCW to transfer as of January 1, 1984, Washington assets valued at $13.7 million to Landmark Publishing Co., in exchange for a 21/100 share in Landmark. The application disclosed that PNB would immediately transfer that compensation to its parent, U S WEST.

193 5. The Application also sought approval of the asset transfer as an affiliated interest transaction under Chapter 80.16 RCW along with approval to enter a publishing arrangement in which Landmark would publish PNB's directories, including Yellow Pages advertising, under contract, in exchange for a guaranteed stream of payments.

194 6. The Commission allowed the transaction to proceed, reserving the right to determine the ratemaking effect of the transaction at a later time. Assertions that the transaction was intended to effect a complete transfer of the directory publishing business, and that it did so, are not credible.

195 7. In 1988, U S WEST Dex proposed and PNB consented to the termination of the publishing fee that was an element of the 1984 transaction.

196 8. The Yellow Pages directory publishing business as of Dec. 31, 1983, was a valuable asset of Pacific Northwest Bell Telephone Co..

197 9. Neither PNB nor USWC has sought, and the Commission has not granted, regulatory approval for any transaction involving Yellow Pages publishing except the one described in the application in Cause No. U-83-159.

198 10. U S WEST in 1989 accepted the imputation of Yellow Pages publishing excess earnings until the practice is changed or terminated by later Commission order.

VII. CONCLUSIONS OF LAW

199 1. The Washington Utilities and Transportation Commission has jurisdiction over the subject matter of this proceeding and the parties to the proceeding.

200 2. Chapter 80.12 RCW requires regulated public utilities to secure prior Commission approval of any sale or other disposal of an asset and provides that any sale or disposition without such approval is void.

201 3. Chapter 80.16 RCW requires regulated public utilities to secure prior approval for certain transactions with affiliates, and provides that the Commission has continuing jurisdiction over such transactions.

202 4. The transaction that the Commission approved in 1983 in Cause No. U-83-159 was a temporary transfer from PNB to Landmark of the right to publish directories on behalf of PNB that include Yellow Pages advertising, coupled with PNB's agreement to provide certain services to Landmark.

203 5. Neither PNB nor USWC has sought, and the Commission has not granted, regulatory approval for any transaction involving Yellow Pages publishing except the one described in the application in Cause No. U-83-159.

204 6. The transaction involving the Yellow Pages publishing function that the Commission approved in Cause No. U-83-159 did not vest Landmark with the complete and total permanent right to engage in the publishing business theretofore operated by PNB.

205 7. The Commission is not required by virtue of the Supreme Court decision of December 24, 1997, to terminate imputation to USWC of excess earnings from Yellow Pages publishing.

206 8. No facts appear of record that would render termination of the imputation to USWC of excess directory earnings consistent with the public interest.

207 9. The application for an accounting order terminating imputation should be denied.

VIII. ORDER

208 The Commission denies U S WEST's request for an accounting order.

209 Dated and effective at Olympia, Washington this __ day of July, 2000.

WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

MARILYN SHOWALTER, Chairwoman

RICHARD HEMSTAD, Commissioner

WILLIAM R. GILLIS, Commissioner

NOTICE TO PARTIES: This is a final Order of the Commission. In addition to judicial review, administrative relief may be available through a petition for reconsideration, filed within 10 days of the service of this Order pursuant to RCW 34.05.470 and WAC 480-09-810, or a petition for rehearing pursuant to RCW 80.04.200 or RCW 81.04.200 and WAC 480-09-820(1).

197 9. Neither PNB nor USWC has sought, and the Commission has not granted, regulatory approval for any transaction involving Yellow Pages publishing except the one described in the application in Cause No. U-83-159.

198 10. U S WEST in 1989 accepted the imputation of Yellow Pages publishing excess earnings until the practice is changed or terminated by later Commission order.

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Attachment 2

Information on Phone Directories Company
From PDC Web Site

ECONOMICS AND
TECHNOLOGY, INC.

About Us
Products
Customer Service
Online Directories
Locations

ABOUT PHONE DIRECTORIES - History

The Place To Go For Your Business To Grow

In an effort to give a choice in products back to the consumer, Phone Directories Company (PDC) began publishing independent phone directories in 1973. At that time, our offices were located in Price, Utah. Shortly after the birth of this family owned and operated company, PDC moved to Colorado.

In 1978, the company moved again. The headquarters were then located in Orem, Utah where PDC now resides. Years of steady growth during that time period brought about a high level of respect from the business community. This respect grew and PDC began to expand nationwide.

PDC then made a shift in 1985. The owners relocated the company to their basement and made the decision to take only their top eight employees with them. To help with the transition, the forward-thinking owners provided options to their employees that were ahead of their time. Day care was provided for the convenience of the employees. Realizing that not everyone works on the same schedule, the owners also allowed employees to work on flextime schedules. The team responded to these conveniences, and the company grew.

After two years in the basement and some streamlining, revenues began to rise. This increase in revenue helped the company grow in directions ownership had envisioned for years. This growth has moved us away from the basement into our current Orem, Utah facility. Our 30,000 square foot building houses more than 300 employees.

PDC is currently one of North America's largest independent telephone directories publishers. We distribute telephone books to more than 130 markets throughout the U.S. and Canada. The total number of books distributed in 1998 totaled more than 3.0 million.

PDC is a leader in providing an innovative source of information for the businesses and communities it serves. It is our goal to become the standard of excellence in the phone directory industry by providing quality phone directories uniquely tailored to the customer's needs.

Attachment 3

Information on Arizona Yellow Pages Market
From Yellow Pages Publishers Association Web Site

ECONOMICS AND
TECHNOLOGY, INC.

DIRECTORY INDEX

Directories by State	Code	Pub Code	Pub Initials	Close Date	Pub Date	Issue Length	WP Close Date	Pop (000)	#Co	Distribution	PPub Date	PIssue Length	Split Run
ARIZONA (AZ)													
Ahwatukee	003061	0760	SWG	03/14/01	05/01			52	3	34,736	05/00		
Apache Junction	003034	0754	SD	07/01/01	11/01			25	3	37,370	11/00		
Apache Junction	003037	0833	PDC	05/30/01	11/01		05/30/01	40	2	25,000	11/00		
Bellaire-West Univ	101902	0754	SD	05/05/01	09/01		05/05/01	90	2		09/01		
Carefree-Cave Creek	003116	0754	SD	09/20/00	03/01		09/20/00	38	2	30,000	03/00		
Casa Grande	003120	0738	USW	11/13/00	01/01		12/04/00	73	2	41,827	01/00		
Casa Grande	003123	0833	PDC	03/06/01	08/01		03/06/01	75	2	24,500	07/00	13	
CaveCreek-Crfree-Ant	101702	0786	NDC	08/04/01	11/01		08/04/01	28	3		11/00		
Chandler-Gilbert	003134	0754	SD	12/10/00	04/01			75	3	75,520	03/00	13	
Clifton-Safford	003670	0738	USW	09/01/00	11/00		09/22/00	32	2	17,436	11/99		
Cochise County	003145	0738	USW	08/30/01	12/01		09/20/01	111	2	75,526	12/00		
Flagstaff	003271	0833	PDC	04/12/01	08/01		04/12/01	95	2	51,500	08/00		
Flagstaff	003270	0738	USW	02/01/01	04/01		02/22/01	154	2	126,848	04/00		
Flagstaff-N Arizona	101505	0915	JHZ	09/20/00	12/00			165	3	80,000	12/00		
Fountain Hills	003287	0754	SD	11/15/00	03/01		11/15/00	29	2	12,000	03/00		
Gila River	100517	0621	CDK	05/25/01	09/01		05/25/01	10	2	4,500	09/00		
Globe	003320	0738	USW	01/03/01	03/01		01/24/01	70	2	20,715	03/00		
Green Valley	003351	0760	SWG	11/19/00	02/01			38	3	25,415	02/00		
Kearns Canyon	003391	0558	LMB	05/19/01	09/01		05/26/01	9	2	3,566	09/00		
Kingman	003406	0833	PDC	06/30/01	11/01		06/30/01	15	2	28,500	11/00		
Lower Colorado Riv	003067	0833	PDC	05/23/01	10/01		05/23/01	150	2	41,500	10/00		
Mesa	100088	0786	NDC	01/22/01	04/01		01/22/01	307	3	185,000	04/00		
Mesa	003418	0754	SD	04/01/01	07/01		04/01/01	384	3	115,000	07/00		
Mohave County	003431	0738	USW	06/09/01	09/01		06/30/01	107	2	105,516	09/00		
Mohave County	003395	0558	LMB	08/11/01	12/01		08/18/01	145	4	142,697	12/00		
NE Arizona-Holbrook	003361	0833	PDC	02/03/01	07/01		02/03/01	60	2	38,000	06/00	13	
Nogales Santa Cruz	003476	0833	PDC	11/03/00	04/01		11/03/00	38	2	21,500	03/00	13	
Nogales-Green Valley	003470	0738	USW	08/15/01	11/01		09/05/01	60	2	37,031	11/00		
Page Lk Powell Kane	003504	0833	PDC	03/05/01	07/01		03/05/01	20	2	19,900	07/00		

DIRECTORY INDEX

Directories by State	Code	Pub Code	Pub Initials	Close Date	Pub Date	Issue Length	WP Close Date	Pop (000)	#Co	Distribution	PPub Date	PIssue Length	Split Run
Page-Lake Powell	003507	0790	WVA	03/01/01	05/01			6	2	22,000	05/00		
Paradise Valley	003511	0754	SD	11/15/00	03/01		11/15/00	20	2	12,000	03/00		
Parker	003520	0682	VZ	01/19/01	05/01		02/09/01	12	2	38,085	05/00		
Payson	003545	0738	USW	01/04/01	03/01		01/25/01	19	2	18,284	03/00		
Payson	003547	0833	PDC	12/26/00	06/01		12/26/00	50	2	21,500	05/00	13	
Phoenix E Valley(W)	003420	0738	USW	06/20/01	09/01		07/11/01	755	3	442,572	09/00		
Phoenix E Valley(Y)	003421	0738	USW	06/20/01	09/01		07/11/01	755	4	442,572	09/00		
Phoenix North	101637	0786	NDC	07/14/01	10/01		07/14/01	275	3		10/00		
Phoenix On The Go	100152	0738	USW	03/12/01	06/01		04/02/01	500	3		06/00		
Phoenix(W)	003569	0738	USW	11/27/00	03/01		12/18/00	2312	3	1,015,247	03/00		
Phoenix(Y)	003570	0738	USW	11/27/00	03/01		12/18/00	2401	4	1,336,405	03/00		
Phoenix-Gr Nw Valley	003800	0738	USW	06/07/01	09/01		06/28/01	758	3	384,802	09/00		
Phoenix-Gr Sw Valley	003070	0738	USW	06/07/01	09/01		06/28/01	78	3	33,710	09/00		
Phoenix-Scottsdale	003745	0738	USW	06/07/01	09/01		06/28/01	338	3	238,602	09/00		
Prescot & TriCity AW	100360	0915	JHZ	02/24/01	06/01		02/24/01	80	3	52,000	06/00		
Prescott	003620	0738	USW	01/23/01	04/01		02/13/01	77	2	68,214	04/00		
Prescott-Verde Vly	003622	0833	PDC	02/09/01	07/01		02/09/01	109	2	55,000	06/00	13	
Scottsdale C Phoenix	100086	0786	NDC	10/06/00	01/01		10/06/00	301	3	165,000	01/00		
Scottsdale North	100085	0786	NDC	09/08/00	12/00		09/08/00	192	3	60,000	12/99		
Sedona-Verde Valley	003747	0833	PDC	03/28/01	08/01		03/28/01	25	2	36,300	08/00		
Show Low	003370	0558	LMB	12/15/00	04/01		12/29/00	70	3	77,426	04/00		
Sierra Vista	003754	0833	PDC	09/29/00	02/01		09/29/00	48	2	33,000	02/00		
So Central Arizona	003756	0833	PDC	03/26/01	08/01		03/26/01	43	2	25,000	08/00		
Southeastern Arizona	003758	0833	PDC	10/18/00	03/01		10/18/00	45	2	33,000	02/00	13	
Sun City-Visto-SdlBk	003765	0760	SWG	02/28/01	05/01			7	2	8,119	05/00		
Sun Cty-Sun Cty West	003763	0760	SWG	08/14/01	11/01			90	3	62,466	11/00		
Tempe	100087	0786	NDC	03/12/01	06/01		03/12/01	319	3	215,000	06/00		
Tempe	003766	0754	SD	05/01/01	09/01			238	3	84,000	09/00		
Tucson Central	003776	0738	USW	10/12/00	01/01		11/02/00	354	2	102,286	01/00		
Tucson East	003777	0738	USW	10/11/00	01/01		11/01/00	446	2	181,265	01/00		
Tucson North-Nw	003778	0738	USW	10/11/00	01/01		11/01/00	298	2	153,639	01/00		
Tucson Regional	003597	0835	WPZ	11/15/00	02/01			750	4	316,000	02/00		
Tucson(W)c	003773	0738	USW	05/01/01	08/01		05/22/01	722	3	464,541	08/00		
Tucson(Y)	003771	0738	USW	05/01/01	08/01		05/22/01	722	4	464,541	08/00		
White Mountain	003806	0833	PDC	02/08/01	07/01		02/08/01	42	2	36,000	06/00	13	
Wickenburg	003820	0738	USW	11/20/00	02/01		12/11/00	15	2	11,773	02/00		
Window Rock	003865	0558	LMB	09/15/00	01/01		09/29/00	155	2	29,768	01/00		
Winslow	003870	0738	USW	02/07/01	04/01		02/28/01	23	2	13,591	04/00		
Yuma	003920	0738	USW	12/18/00	02/01		01/08/01	136	2	102,999	03/00	11	
Yuma Metro	003921	0833	PDC	06/03/01	10/01		06/03/01	86	2	65,000	10/00		

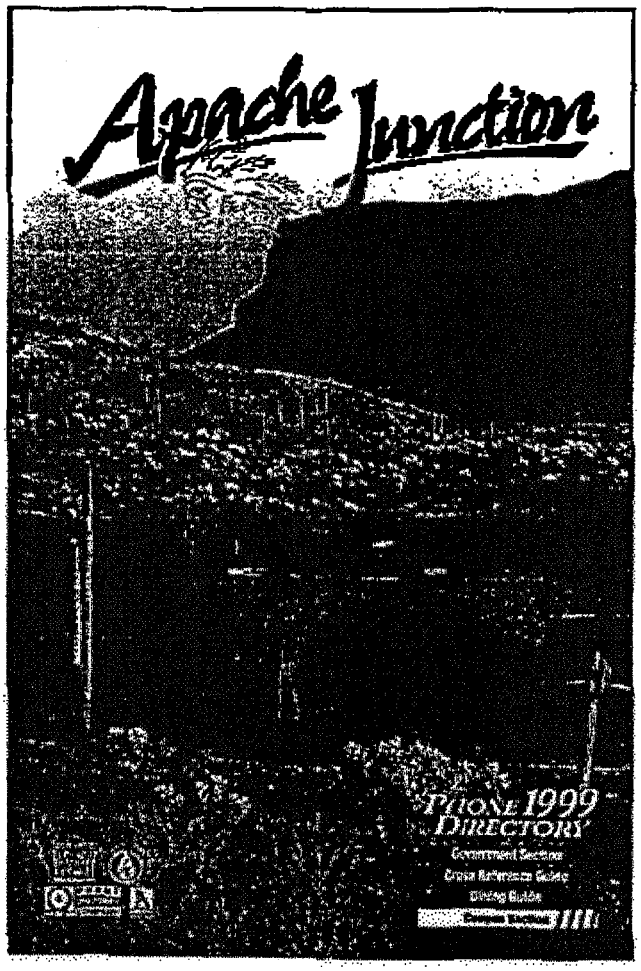
Attachment 4

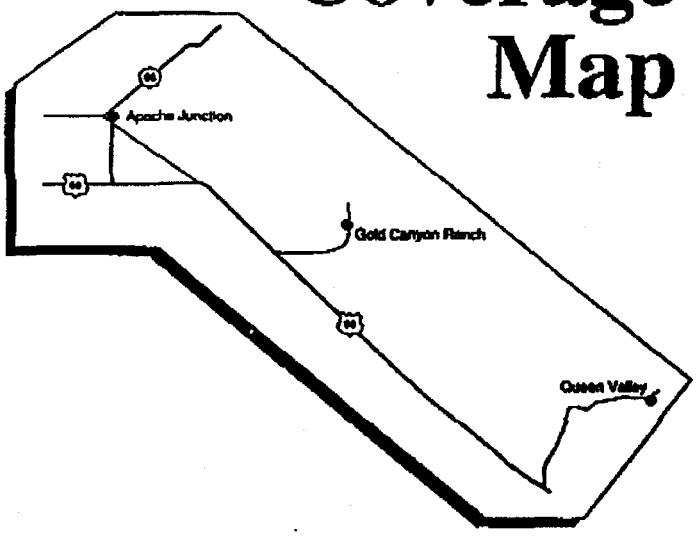
Phone Directories Company
Information Sheets on its Arizona Directories

ECONOMICS AND
TECHNOLOGY, INC.

PHONE DIRECTORIES COMPANY

Apache Junction Phone Directory Coverage Map





Directory YPPA #:	003037
State(s) & Area Code(s):	AZ (520, 602)
Counties:	Pinal
Directory Area Population:	18,500
Approximate Directory Circulation:	25,000
Produced Since:	1998
Directory Code:	AJC

This Directory Serves Your Local Market Area - Covering All Or Portions Of The Following Utility Directories:

Globe.....USW Phoenix East Valley...USW

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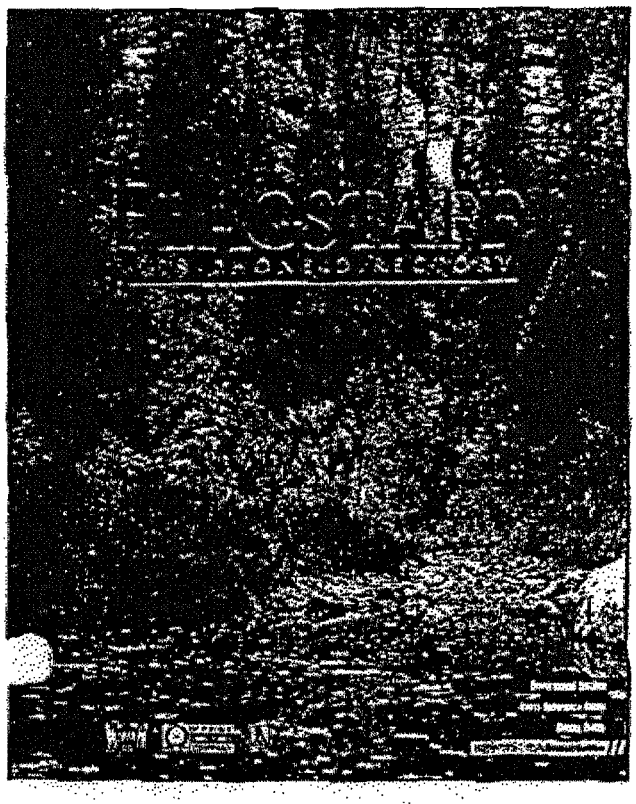
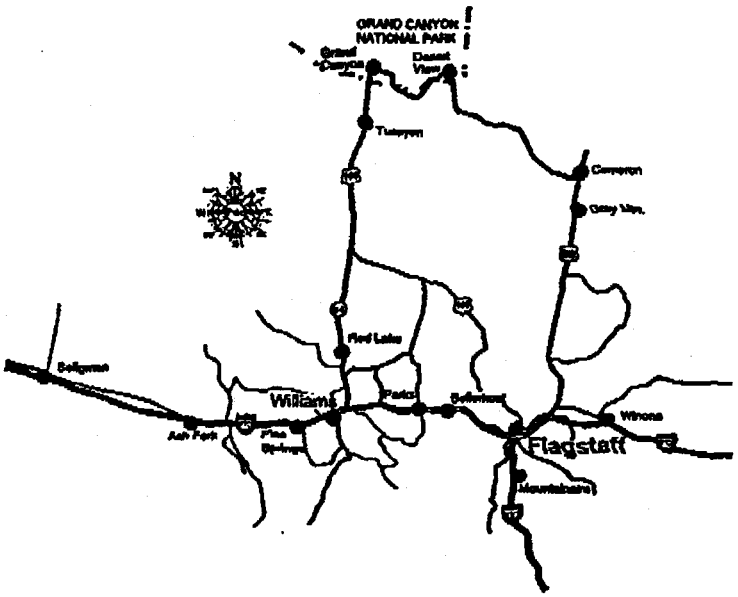
A UTAH and ALASKA CORPORATION
PO BOX 887 PROVO, UT 84603-0887
(801) 225-0801 • FAX (801) 225-0991

PHONE DIRECTORIES COMPANY

Flagstaff Directory Area Coverage Map





This Directory Serves Your Local Market Area - Covering All Or Portions Of The Following Utility Directories:

Flagstaff.....USW

Directory YPPA #: 003271
State(s) & Area Code(s): AZ (520)
Counties: Coconino
Yavapi
Directory Area
Population: 54,600
Directory Circulation: 50,000
Produced Since: 1994
Directory Code: FLG

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A UTAH and ALASKA CORPORATION
PO BOX 887 PROVO, UT 84603-0887
yellow pages (801) 225-0801 • FAX (801) 223-1285

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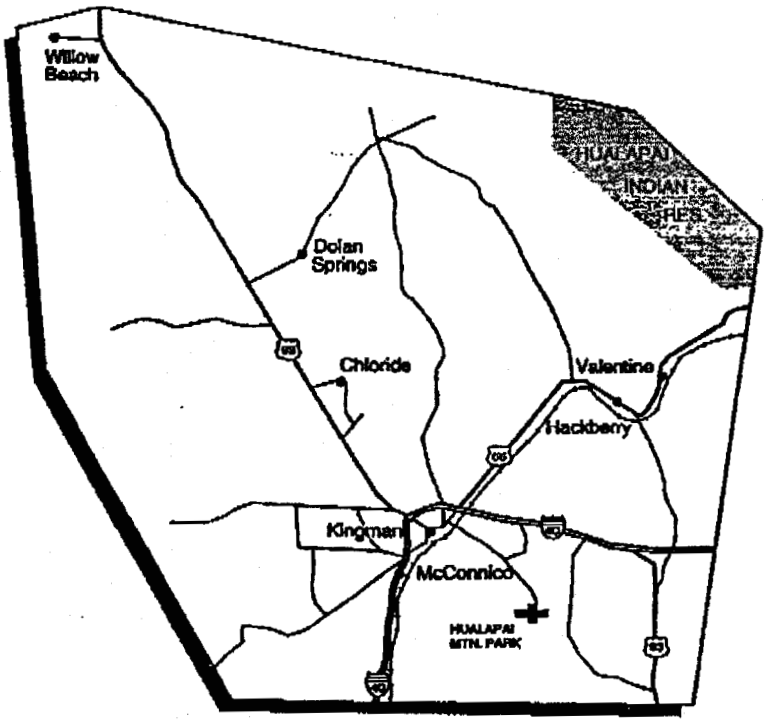
Kingman Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Mohave Co.....LMB
Mohave Co.....USW

Directory YPPA #: 03406
State(s) & Area Code(s): AZ (520)
Counties: Mohave
Directory Area Population: 14,697
Directory Circulation: 28,500
Produced Since: 1994
Directory Code: KIN

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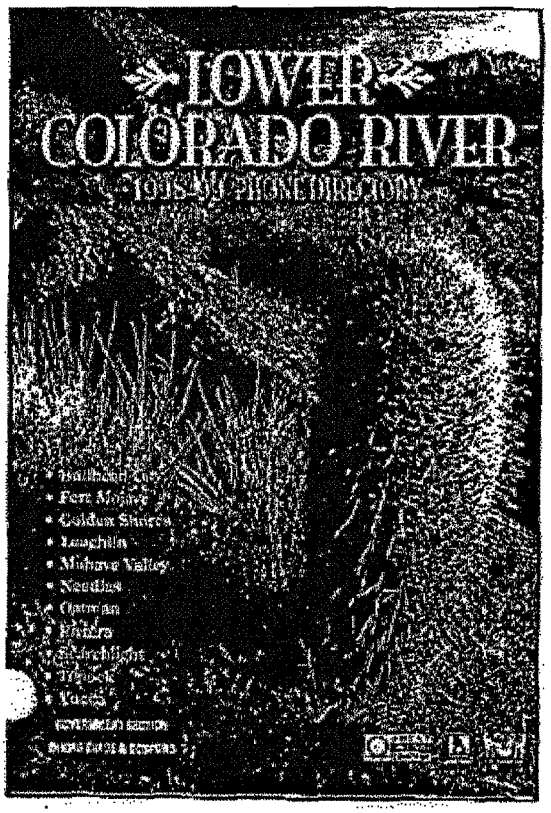
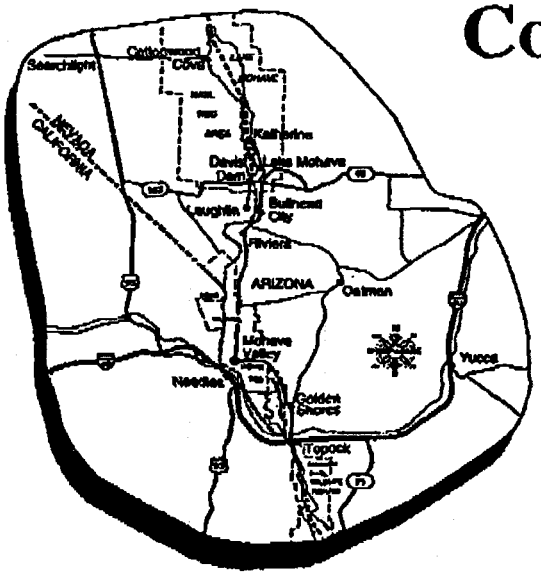
Lower Colorado River Directory Area Coverage Map





This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Laughlin	RHD/CNT
Mohave Co	LMB
Mohave Co D	USW
Needles	GTD

Directory YPPA #:	003067
State(s) & Area Code(s):	AZ (520)
	CA (619)
	NV (702)
Counties:	AZ - Mohave
	CA - San Bernardino
	NV - Clark
Directory Area Population:	41,575
Directory Circulation:	41,000
Produced Since:	1994
Directory Code:	LCR

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A Utah and Alaska Corporation
P.O. Box 887 Provo, UT 84603-0887
Toll Free: 1-800-553-0801
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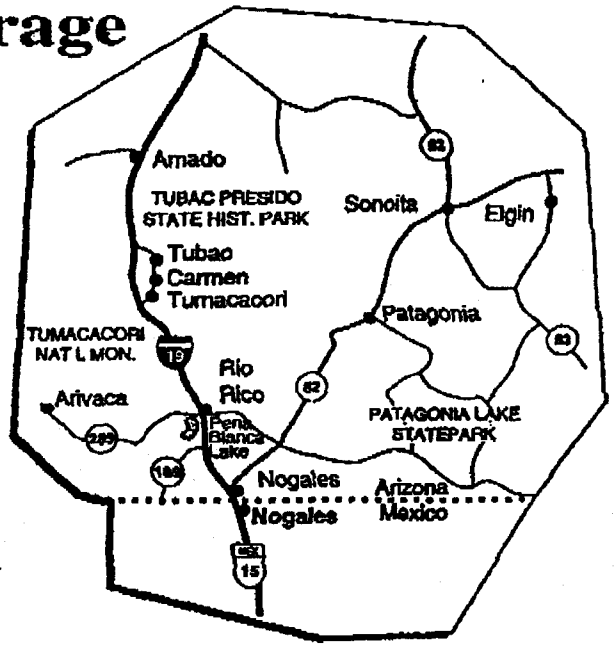
(801) 225-0801 • FAX (801) 225-0991

PHONE DIRECTORIES COMPANY

Nogales Directory Area

Coverage Map



This Directory Serves Your Local Market Area - Covering All Or Portions Of The Following Utility Directories:

Nogales - Green Valley...USW
Sonora Nogales.....Mexico

Directory YPPA #:	03476
State(s) & Area Code(s):	AZ (520) Mexico
Counties:	AZ - Pima & Santa Cruz Mexico - Sonora
Directory Area Population:	32,000
Directory Circulation:	21,500
Produced Since:	1986
Directory Code:	NOG

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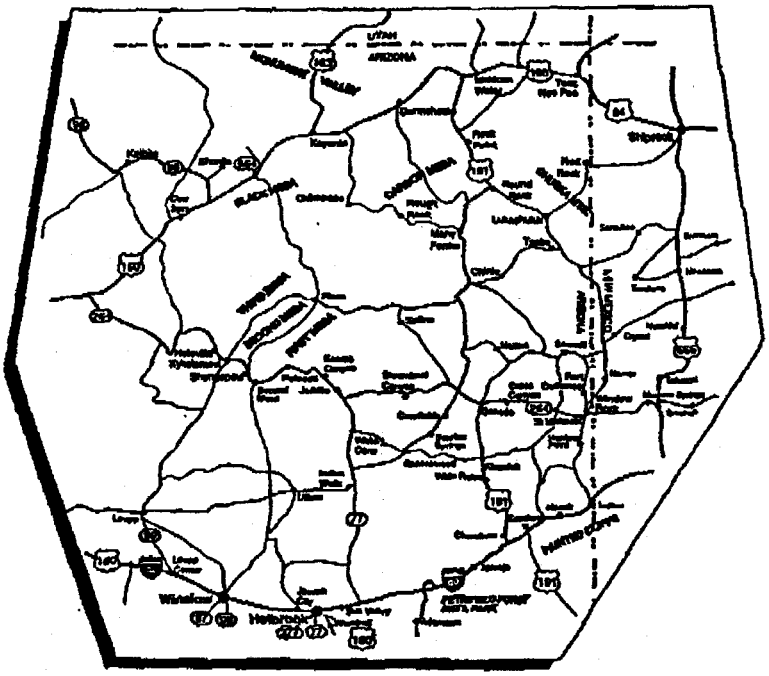
Northeast Arizona Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Gallup	USW
Canyon	LEM
Window Rock	GTE
Show Low	ADS
Winslow	USW

Directory YPPA #:	003361
State(s) & Area Code(s):	AZ (520)
Counties:	AZ - Navajo Coconino Apache NM - McKinley San Juan
Directory Area Population:	60,381
Directory Circulation:	38,000
Produced Since:	1988
Directory Code:	HOL

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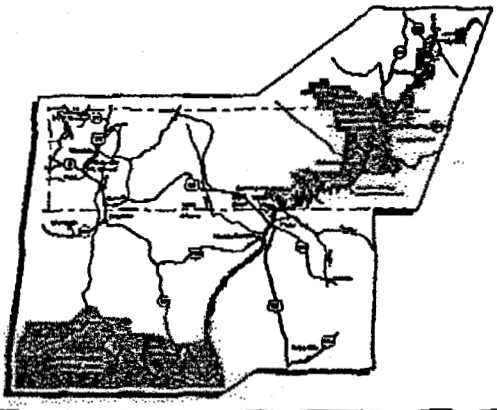
Page/Kane County Directory Area Coverage Map



Directory YPPA #:	003504
State(s) & Area Code(s):	AZ (520)
	UT (801)
Counties:	AZ - Mohave
	Navajo
	Coconino
	UT - Kane
	Garfield
	San Juan
Directory Area Population:	19,893
Directory Circulation:	19,900
Produced Since:	1986
Directory Code:	PAG

This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Flagstaff.....USW
Moab.....LEM
Southern Utah.....USW
Window Rock.....GTE

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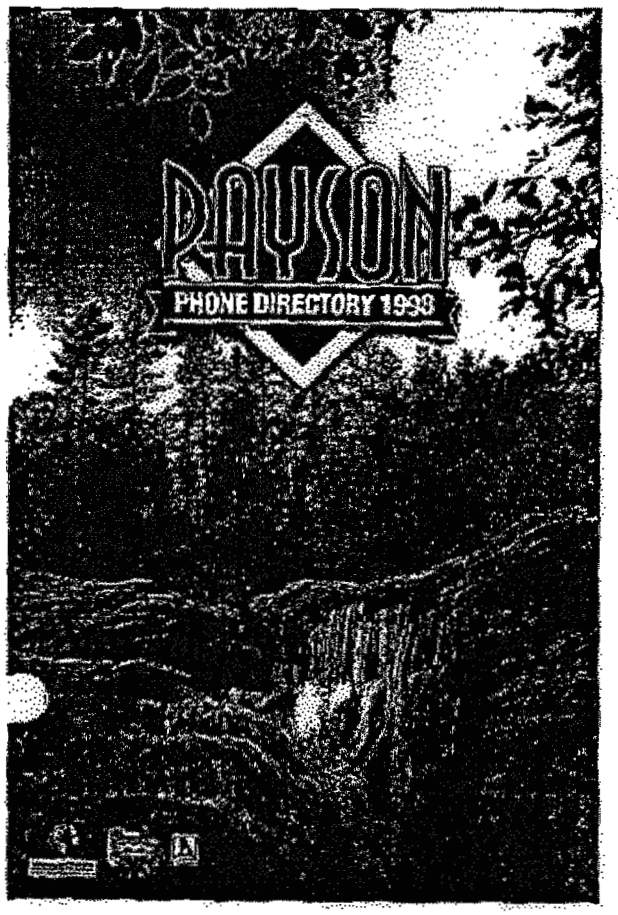
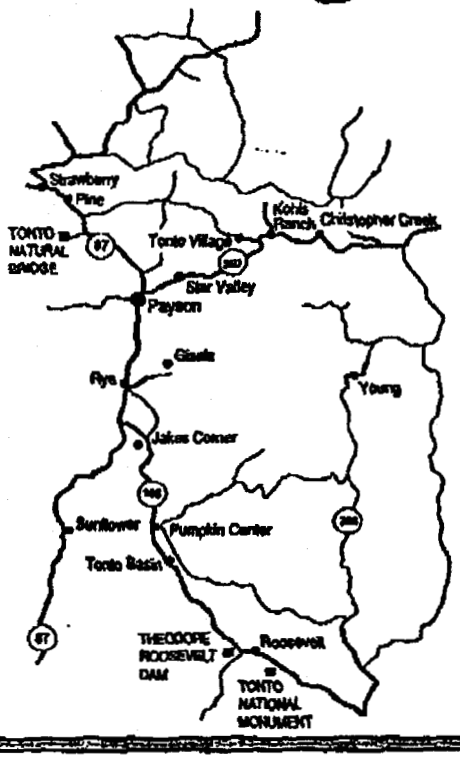


Payson Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Payson.....USW

Directory YPPA #:	003547
State(s) & Area Code(s):	AZ (520)
Counties:	Gila
Directory Area Population:	13,097
Approximate Directory Circulation:	21,500
Produced Since:	1995
Directory Code:	PAY

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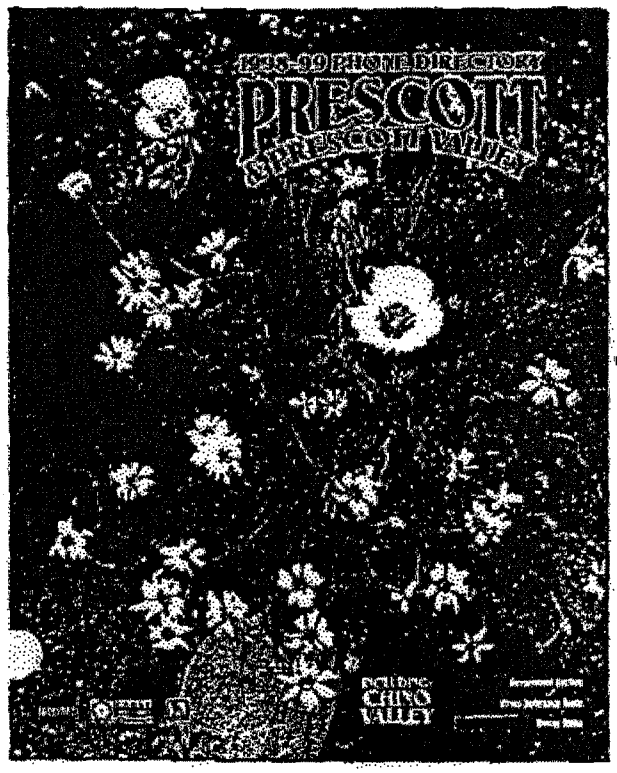
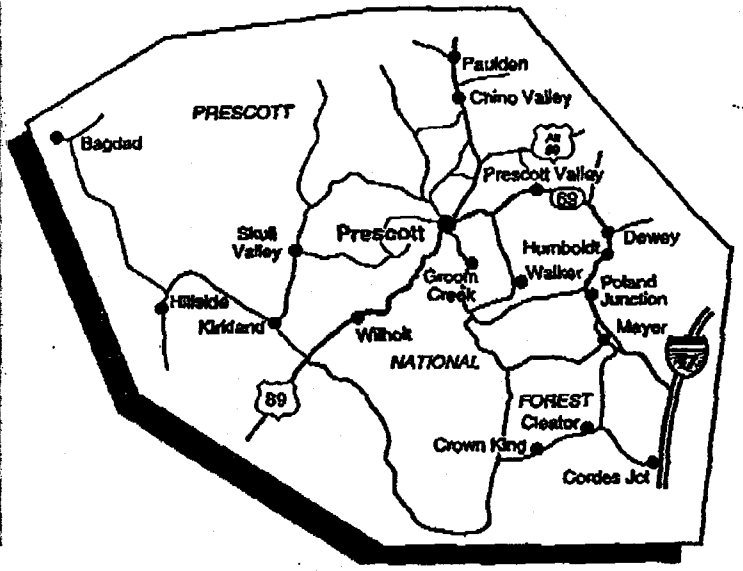
Prescott Directory Area Coverage Map





This Directory Serves Your Local Market Area - Covering All Or Portions Of The Following Utility Directories:

Prescott.....USW

Directory YPPA #:	003622
State(s) & Area Code(s):	AZ (520)
Counties:	Yavapai
Directory Area Population:	87,488
Approx. Directory Circulation:	55,000
Produced Since:	1992
Directory Code:	PRE

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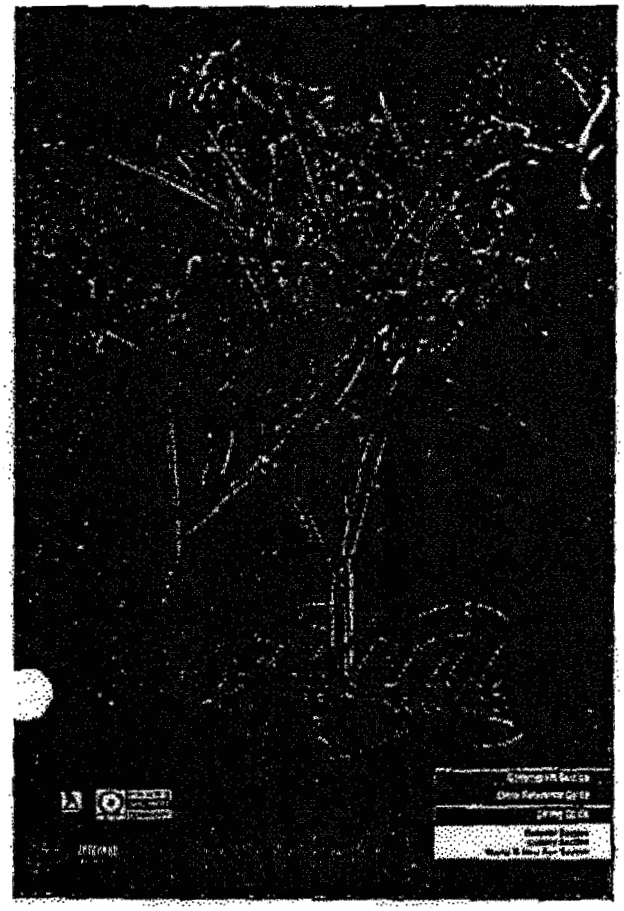
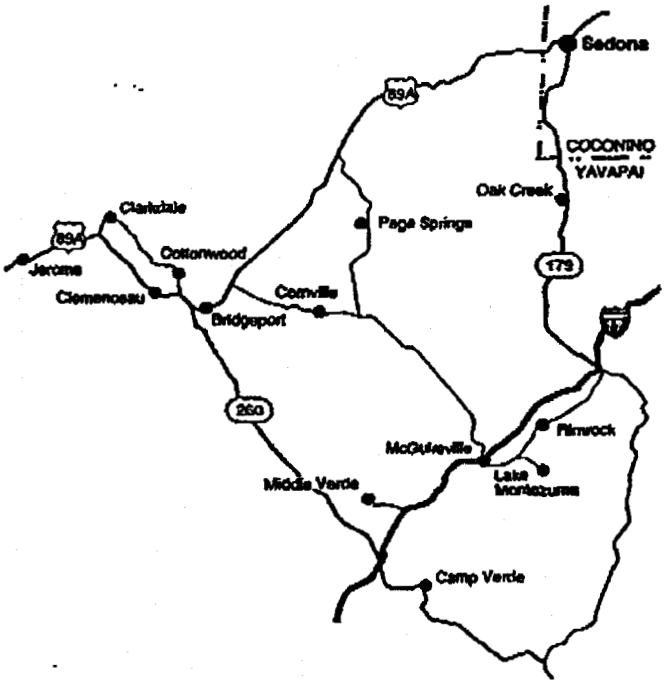
Sedona Directory Area Coverage Map





This Directory Serves Your Local Market Area - Covering All Or Portions Of The Following Utility Directories:

Flagstaff.....USW

Directory YPPA #:	003747
State(s) & Area Code(s):	AZ (520)
Counties:	Coconino Yavapi
Directory Area Population:	22,808
Directory Circulation:	40,000
Produced Since:	1977
Directory Code:	SED

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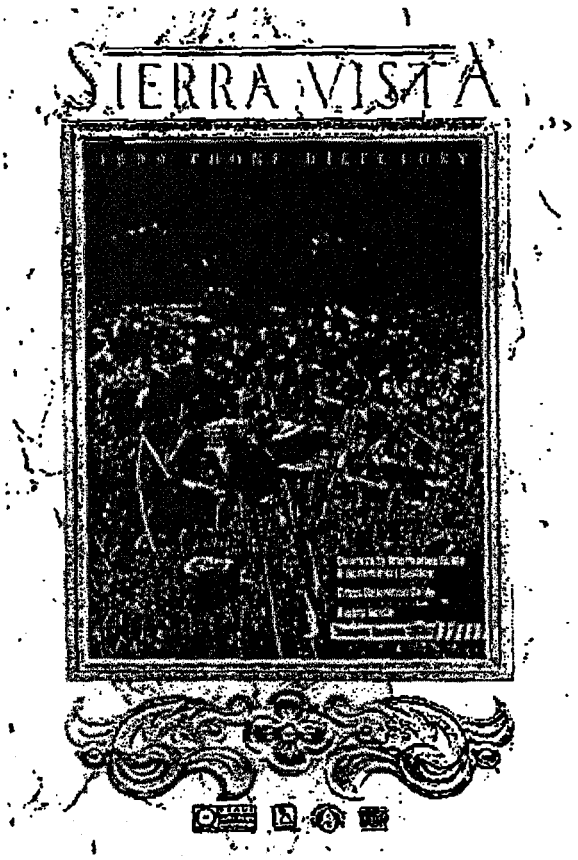
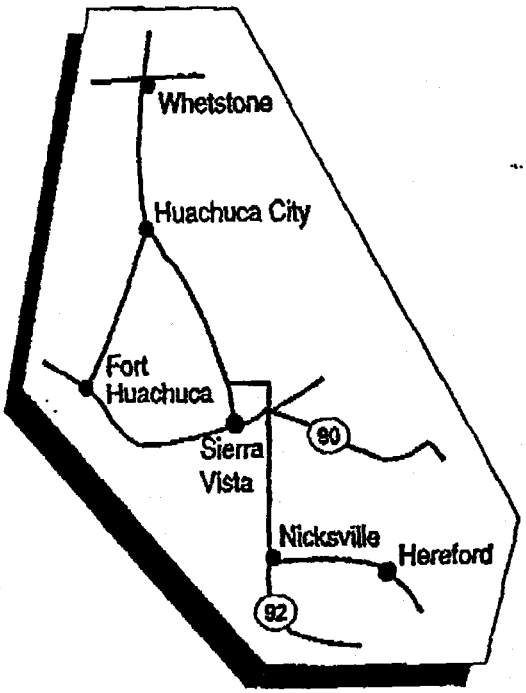
Sierra Vista Directory Area Coverage Map





This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Cochise County...USW

Directory YPPA #:	003754
State(s) & Area Code(s):	AZ (520)
Counties:	Cochise
Directory Area Population:	36,921
Approximate Directory Circulation:	33,000
Produced Since:	1982
Directory Code:	VIS

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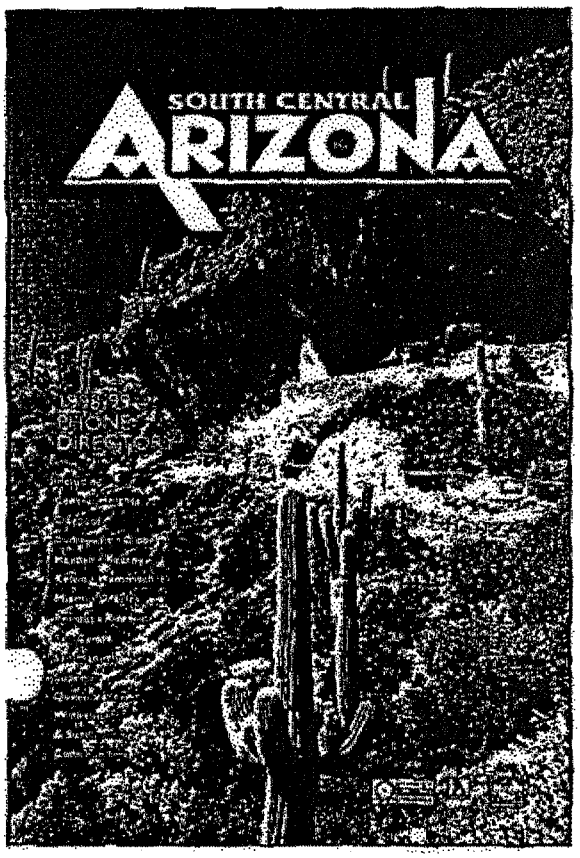
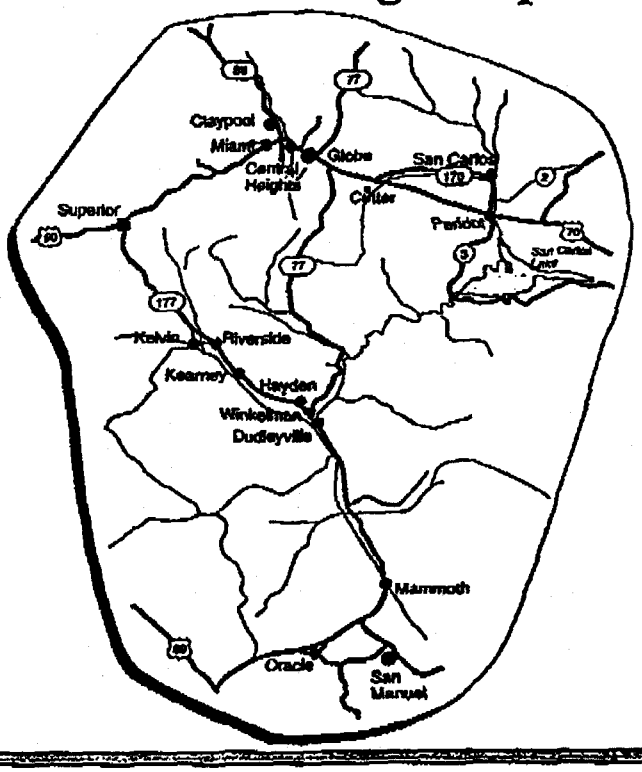


South Central Arizona Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Casa Grande	USW
Globe	USW
San Manual	USW

Directory YPPA #:	003756
State(s) & Area Code(s):	AZ (520)
Counties:	Pinal Gila
Directory Area Population:	42,594
Approximate Directory Circulation:	25,000
Produced Since:	1995
Directory Code:	SCA

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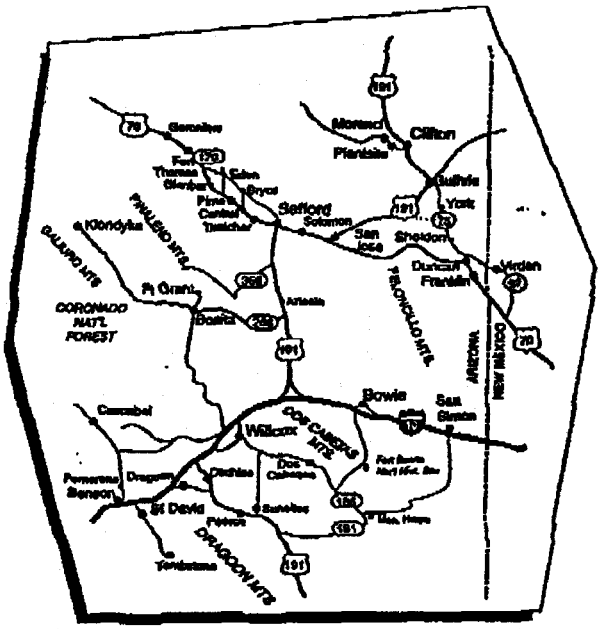
South East Arizona Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Cochise County.....USW
Safford.....USW

Directory YPPA #:	003758
State(s) & Area Code(s):	AZ (520) & NM (505)
Counties:	AZ - Graham Cochise, Greenlee, Gila NM - Hidalgo
Directory Area Population:	44,900
Approximate Directory Circulation:	33,000
Produced Since:	1985
Directory Code:	SAZ

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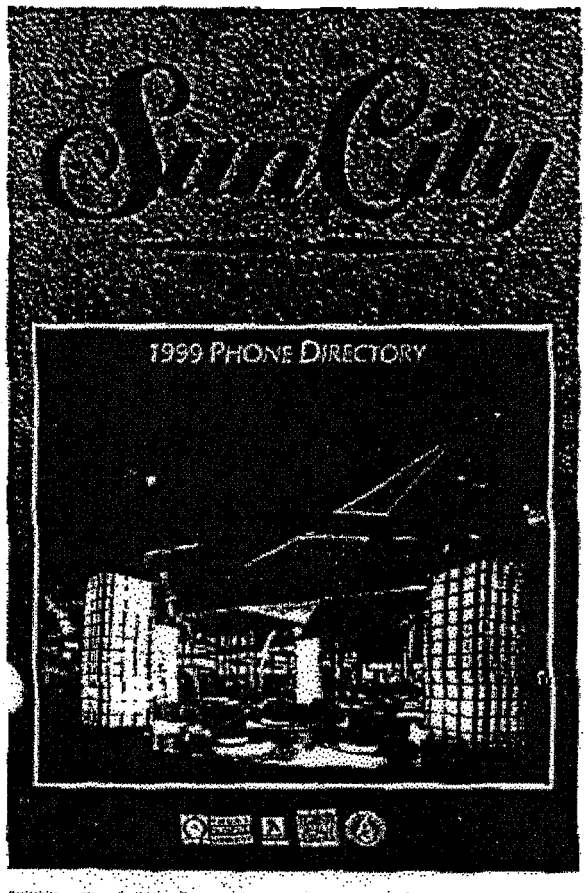
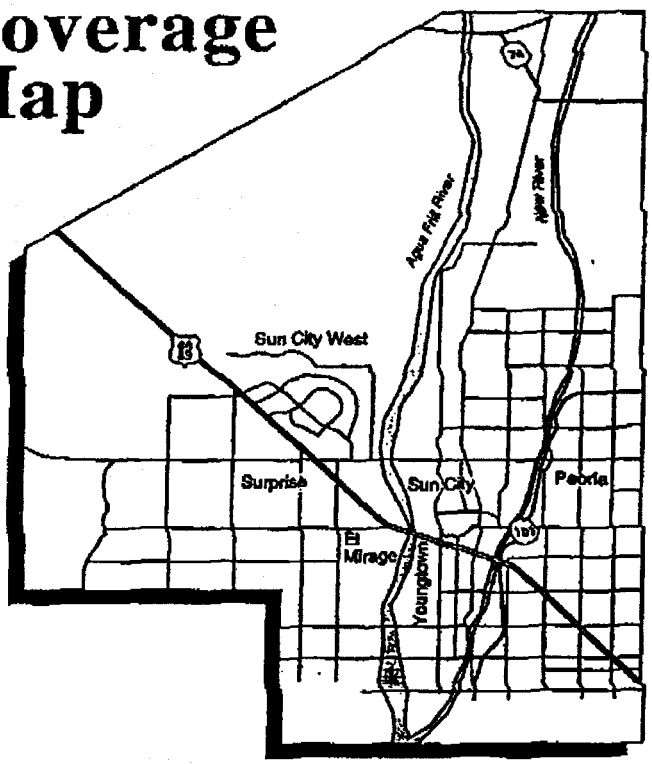


Sun City / Sun City West Directory Area Coverage Map



This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Greater Northwest Valley...USW

Directory YPPA #: 003764
State(s) & Area Code(s): AZ (602)
Counties: Maricopa
Directory Area Population: 123,762
Approximate Directory Circulation: 56,500
Produced Since: 1996
Directory Code: SWP

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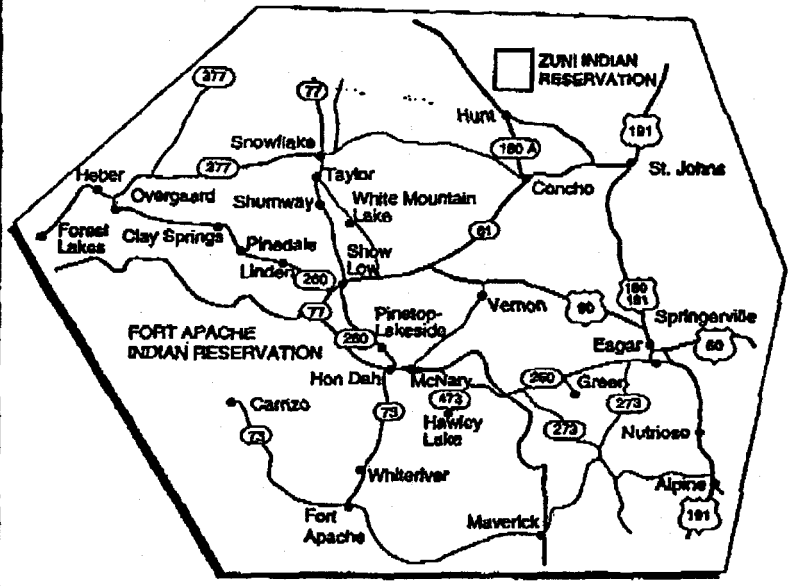
White Mountain Directory Area Coverage Map



This Directory Serves Your Local Market Area

Directory YPPA #: 003806
State(s) & Area Code(s): AZ (520)
Directory Circulation: 36,000
Directory Code: WHI

Phone Directories Co. Inc.
A UTAH and ALASKA CORPORATION
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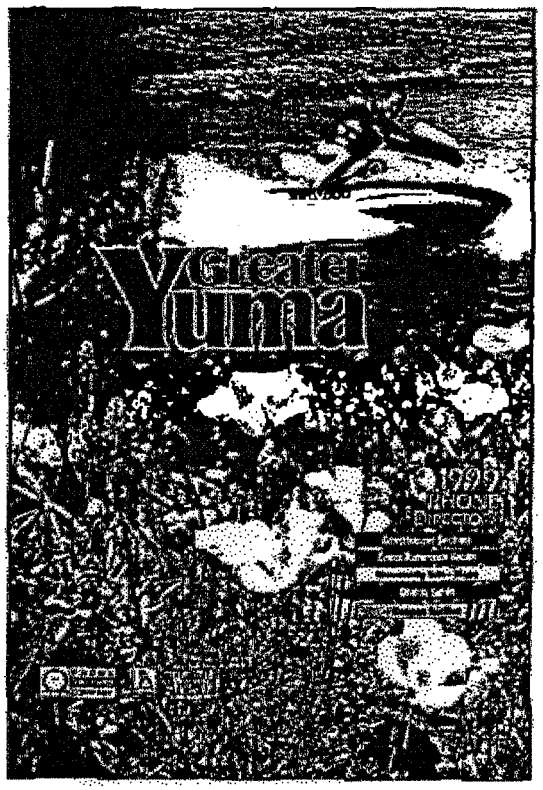
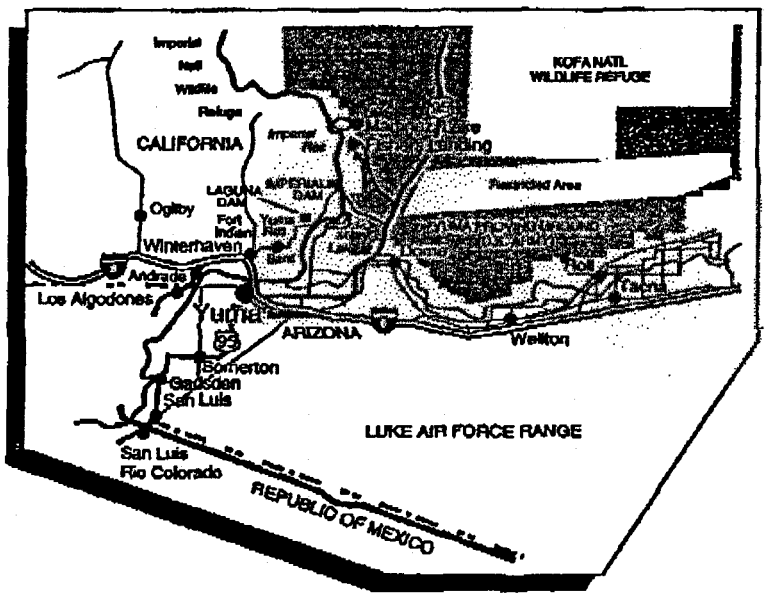
Yuma Directory Area Coverage Map





This Directory Serves Your Market Area - Covering All Or Portions Of The Following Utility Directories:

Imperial Co.....PAC
Yuma.....USW
Mexicali.....Telnor

Directory YPPA #:	003921
State(s) & Area Code(s):	AZ (520)
	CA (619)
Counties:	AZ - Yuma
	CA - Imperial
	Mexico
Directory Area Population:	84,706
Directory Circulation:	65,000
Produced Since:	1994
Directory Code:	YUM

Phone Directories Co. Inc.
A UTAH and ALASKA CORPORATION
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Attachment 5

Cover pages of US West/DEX Yellow Pages Directories

(Qwest Response to UTI-43-011)

ECONOMICS AND
TECHNOLOGY, INC.

Arizona
Docket No. T-1051B-99-105
UTI 43-011

INTERVENOR: Arizona Corporation Commission Staff (Utilitech)

REQUEST NO: 011

At page 14 of her supplemental direct testimony, Ms. Koehler-Christensen refers to the covers of Dex directories. Please provide copies of the front and back covers of the five largest white and yellow pages directories published in Arizona by Dex, before and after the policy change referenced at line 8.

RESPONSE:

Attachment A provides copies of the current front covers on DEX's five largest directories in Arizona. Directories published before this policy change are in archives and copies of the front covers will be provided as soon as they can be retrieved. This is estimated to be approximately one week. Back covers of DEX directories are paid advertising and are not relevant to this request.

Ann Koehler-Christensen
Manager
1600 7th Avenue, Rm. 3008
Seattle, WA

ARIZONA
DOCKET NO. T-01051B-99-105
UTI 43-011
ATTACHMENT A

USA
36USC380
ial Sponsor of the
U.S. Olympic Team

Phoenix Metro

March 2000/2001

Area Codes 480, 520, 602, 623

USWEST Dex®

Your Directory Expert

The Greater Metro Edition

Residential White Pages For The Entire Phoenix Area

Internet Pointer
Look for this familiar symbol throughout the directory to locate Internet addresses

Phone Service Pages
See the Business White Pages

Government Pages
See the Business White Pages

Complete Listings
Listings for all local telephone companies including:
U S WEST, 1-800-RECONEX, AT&T, GST Telecom, MCI
See page one for details.

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The U S WEST Dex White Pages are printed with a minimum of 40% postconsumer material

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Turn on your Yellow Pages

USA

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Phoenix Metro A-L

March 2000/2001

Area Codes 480, 520, 602, 623

USWEST Dex®

Your Directory Expert

The Greater Metro Edition

Yellow Pages For The Entire Phoenix Area

Internet Pointer
Look for this familiar symbol throughout the directory to locate Internet addresses

Audio Information
Look for this symbol for free 24-hour audio information

Complete Listings
Listings for all local telephone companies including:
U S WEST, 1-800-RECONEX, AT&T, GST Telecom, MCI
See page one for details.

Internet Guide
Preceding the Internet headings in The Yellow Pages

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USA

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Tucson
and Surrounding Area
August 1999/2000

Area Code 520

USWEST Dex®

Your Directory Expert

The White Pages

Phone Service Pages
Information, tips & area codes

Government Pages
City, county, state & federal agencies

Business Listings
Following the residential listings

Complete Listings
Listings for all local telephone companies including:
U S WEST, 1-800-RECONEX, e.spire Communications, GST Telecom, Tohono O'odham Utility Authority

See page one for details.

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and Surrounding Area
August 1998/1999

Area Code 520

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The Yellow Pages

Audio Information
Look for this symbol for free
24-hour audio information

Community Pages
Events, maps & ZIP codes

Complete Listings
Listings for all local telephone companies including:
U S WEST, Arizona Telephone Co., e.spire Communications, Inc., MCI, Tohono O'Odham Utility Authority

See page one for details.

http://uswestdex.com
Visit our Internet Yellow Pages for complete business listings

New! Internet Guide
See the "Internet Products & Services" heading in the Yellow Pages

T Dex, Inc. 1997

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East Valley

Mesa • Tempe • Chandler

Ahwatukee, Apache Junction, Chandler Heights, Gilbert, Guadalupe, Higley, Palm Springs, Queen Creek, Sun Lakes, Superstition

September 1999/2000

Area Codes 480, 520, 602, 623

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The White Pages

Phone Service Pages
Information, tips & area codes

Government Pages
City, county, state & federal agencies

Business Listings
Following the residential listings

Complete Listings
Listings for all local telephone companies including:

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East Valley

Mesa • Tempe • Chandler

Ahwatukee, Apache Junction, Chandler Heights, Gilbert, Guadalupe, Higley, Palm Springs, Queen Creek, Sun Lakes, Superstition

September 1999/2000

Area Codes 480, 520, 602, 623

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The Yellow Pages

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See page one for details.

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Visit uswestdex.com to get the most accurate business information for your area

Phoenix Coyotes Schedule
See fold-out tab for hockey information

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AZ CORP COMMISSION
DOCUMENT CONTROL

BEFORE THE ARIZONA CORPORATION COMMISSION

IN THE MATTER OF THE APPLICATION OF U S WEST COMMUNICATIONS, INC., A COLORADO CORPORATION, FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR VALUE OF THE COMPANY FOR RATEMAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON AND TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH RETURN	Docket No. T-1051B-99-105

SURREBUTTAL TESTIMONY OF

SUSAN M. GATELY

ON BEHALF OF

AT&T COMMUNICATIONS

OF THE MOUNTAIN STATES, INC.

SEPTEMBER 8, 2000

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Background

Q. Please state your name, position, and business address?

A. My name is Susan M. Gately. I am the Senior Vice President of Economics and Technology, Inc., (ETI), One Washington Mall, Boston, Massachusetts. Economics and Technology, Inc is a research and consulting firm specializing in telecommunications economics, regulation, management, and public policy.

Q. Have you previously submitted testimony in this proceeding?

A. Yes. On August 8, I submitted prefiled Direct Testimony on behalf of AT&T Communications of the Mountain States, Inc. ("AT&T")

Q. What is the purpose of your testimony at this time?

A. I will respond to certain criticisms levied against my Direct Testimony contained in the reply testimony of Qwest witnesses Mr. Redding and Ms. Koehler-Christensen.

Summary of Testimony

Q. Please summarize the primary aspects of US West's filing that you address in your testimony.

A. My testimony primarily addresses the attempts by Qwest witnesses George Redding and Ann Koehler-Christensen to discredit the revenue requirement reductions proposed in my Direct Testimony of August 8, 2000. Specifically, I demonstrate that neither Mr.

Redding nor Ms. Koehler-Christensen offers any evidence what so ever in rebutting my proposed revenue requirement adjustments associated with Local Number Portability (LNP), interconnection, sale of exchanges, accrual treatment of PBOB expenses, imputation of yellow pages revenue, and the FCC's CPR Audit finding. As I demonstrate below, the bulk of the rebuttal is limited to statements that the Qwest witnesses do not agree with the adjustments that have been proposed.

QWEST has made no attempt to demonstrate that all of the costs associated with the deployment of the federally mandated LNP implementation have been removed from its intrastate revenue requirement.

Q. Have you reviewed Qwest witness George Redding's rebuttal of your proposed adjustments related to LNP expenses?

A. Yes, I have.

Q. Is he correct in asserting that your proposed rate base and expense disallowances relative to LNP implementation are "completely erroneous."

A. No. Mr. Redding has responded to my proposed LNP disallowance in much the same way he responds to my other proposed revenue requirement adjustments– with a broad wave of the hand saying little more than "she's wrong." Aside from disagreeing with my finding, Mr. Redding has done nothing to clarify the situation. He reiterates a statement from his Direct Testimony that "the elements covered by the surcharge were ordered to be removed from the separations process, and, thereby, from regulated results" (a statement I, in fact, acknowledged in my Direct Testimony), but has offered

no new insight into the situation, nor answered any of the specific allegations raised in my Direct Testimony.

Specifically, Mr. Redding has offered no explanation as to why the adjustment for LNP capital expenses through year end 1998 was limited to $55.5-million[1] rather the $221-million in LNP related capital expenses Qwest reported in response to Data Request UTI-13-023. The fact remains that in its initial filing, Qwest indicated that through the end of 1998 it had incurred some $341-million in LNP-related costs ($221-million in capital, $120-million in expense)[2] Given an opportunity to provide a reasonable explanation as to why the full amount identified in UTI-13-023 was not removed from separations, Mr. Redding simply ignores the issue.

My proposed adjustment does nothing more than ensure that the full amount of LNP capital investment and expenses identified by Qwest in its own responses to UTI-13-023 and AT&T 11-104 through 11-107, are removed from Qwest's intrastate revenue requirement.

Q. Is Mr. Redding correct in his interpretation of the FCC's May 1998 LNP Order that any "items that were not included under the FCC LNP surcharge were to be recovered in the normal course of business?"

---

1. Qwest response to AT&T 11-107.
2. Qwest response to UTI 13-023.

A. No. Mr. Redding's quote from the FCC here is taken completely out of context. The quote comes from the May, 1998 Order setting forth the LNP implementation schedule and the structure of the federal LNP cost recovery mechanism. Mr. Redding quotes from paragraph 144 of that Order, a paragraph that deals specifically and exclusively with the five-year implementation and amortization schedule for LNP capital investments. Put in the proper context, the quote reads as follows:

> 144. We choose the five-year period for the end-user charge because it will enable incumbent LECs to recover their portability costs in a timely fashion, but will also help produce reasonable charges for customers and avoid imposing those charges for an unduly long period. ... After a carrier establishes its levelized end-user charge in the tariff review process we do not anticipate that it may raise the charge during the five-year period unless it can show that the end-user charge was not reasonable based on the information available at the time it was initially set. Furthermore, once incumbent LECs have recovered their initial implementation costs, number portability will be a normal network feature, and a special end-user charge will no longer be necessary to ensure that incumbent LECs recover their number portability costs on a competitively neutral basis. Carriers can recover any remaining costs through existing mechanisms available for recovery of general costs of providing service.[3]

Clearly the FCC's directive that carriers could recover "any remaining costs" through existing mechanisms refers to costs that may be incurred in the normal course after number portability is implemented. Qwest's attempt to recover costs incurred for its initial, federally mandated implementation of number portability during the period 1996 through 1999 from intrastate rates in Arizona is not authorized by this FCC Order.

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3. *In the Matter of Telephone Number Portability*, CC Docket 95-116 and RM8355, released May 12, 1998 at 144.

Q. To the extent that certain of Qwest's LNP implementation related costs are not being recovered via the FCC's end user LNP surcharge, is it appropriate for Qwest to now recover those costs from the intrastate jurisdiction?

A. There is no basis for Qwest to recover interstate LNP implementation costs from the intrastate jurisdiction. Clearly, whether and how a carrier is allowed to recover interstate capital investment and operating expenses in no way impacts the interstate nature of those costs. Moreover, Qwest made a choice to recover interstate LNP implementation costs via the LNP cost-recovery mechanisms of end user and query charges, a choice that was entirely optional. The FCC stated " We will allow but not require incumbent LECs subject to rate-of-return or price-cap regulation to recover their carrier-specific costs directly related to providing number portability through a federal charge assessed on end-users"[4] In many ways, the final determination of the rate levels that came out of the FCC's inquiry into LNP end user and query charges proposed by Qwest and the other ILECs was more in the nature of a settlement on an acceptable rate than a formal determination of actual costs. There is no basis in that FCC determination to support a finding by this Commission that Qwest is entitled to any recovery from Arizona rate payers in addition to the end user and query charges set forth in Qwest's federal LNP tariff.

Q. Can you provide an example?

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4. *Id.*, at paragraph 135.

A. Yes. The excerpt below taken from the FCC's July 16, 1999 Order allowing Qwest's LNP tariff to go into effect provides just such an example. The excerpt reveals that the FCC was initially troubled by US West's use of a 1.89 overhead factor in the development of the LNP query charges. During the course of the investigation, US West convinced the FCC that the expenses being recovered by the 1.89 factor were in fact legitimately interstate costs associated with the implementation of LNP service. In the interest of getting the proposed price levels to a range that the FCC would feel comfortable approving, however, US West removed .89 of the 1.89 overhead factor from the development of the rates.

> Based on extensive discussions, reflected in *ex parte* submissions on the record, U S WEST has addressed our concerns with respect to the use of the 1.89 overhead factor. In an *Ex Parte* submission, however, U S WEST has agreed to remove the costs generated by the 1.89 factor from its query service rates. *[footnote omitted]* As reflected in its revised filing, the removal of the 1.89 factor lowers U S WEST's query services rates by 89% and makes them comparable to rates charged by other incumbent LECs for query services.*[footnote omitted]* We are, therefore, satisfied that U S WEST's recovery of its incremental overhead costs is reasonable.[5]

No determination was made that the overhead costs that would have been recovered by the 1.89 overhead factor were not appropriately interstate in nature, and there was certainly no determination made that those costs should be recovered from intrastate rates. Yet given Mr. Redding's repeated assertions that "all elements covered by the surcharge" have been removed (implying that that is all that needed to be removed), it

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5. *In the Matter of Long Term Number Portability Tariff Filings – US West, Inc.*, CC Docket 99-35, Memorandum Opinion and Order released July 16, 1999 at paragraph 82.

appears quite likely that those overhead expenses (clearly not being recovered via interstate charges by agreement of the FCC and Qwest), as well as others that were dropped during the movement towards "reasonable" LNP rates, are embedded in the intrastate revenue requirement results presented by Mr. Redding.

Q. Did the FCC Order approving the LNP rates based upon Qwest's revised LNP estimates transfer responsibility for the difference between the approved recovery amounts and those originally proposed to the intrastate jurisdiction?

A. No, absolutely not. The conclusory paragraph prior to the ordering clauses of the July 16, 1999 FCC Order rejecting US West's initial tariffs and approving its revised filing is quite clear – the *costs* (not just the rate levels) claimed by US West for LNP implementation were "unjust", "unreasonable" and "unlawful."

> Based on the entire record before us, we find that certain costs claimed in U S WEST Long-Term Number Portability Transmittal Nos. 965 and 975, filed January 26, 1999 and March 9, 1999, with effective dates of February 10, 1999 and March 24, 1999, respectively, are unjust and unreasonable and, accordingly, unlawful under section 201(b) of the Act.*[footnote omitted]*[6]

The FCC has refused to allow Qwest recovery of these costs on its watch, so Qwest is now attempting to recover them from intrastate prices in Arizona.

6. Id., at 100.

Q. Should this Commission heed Mr. Redding's assurances that all of the LNP-associated costs have been removed from the Arizona intrastate revenue requirement?

A. No, it should not.

Mr. Redding is wrong that the logic underpinning the Utah PSC's exclusion of interconnection costs from the general revenue requirement is not relevant to the current situation in Arizona.

Q. Have you reviewed Qwest witness George Redding's rebuttal of your proposal to exclude interconnection costs from the development of the intrastate revenue requirement?

A. Yes, I have.

Q. Do you agree with Mr. Redding's claim that you did not "tell the rest of the story" in describing the disallowance ordered by the Utah Commission?

A. No, I do not. Once again Mr. Redding has made only the most superficial of responses to the adjustment proposed in my Direct Testimony, in this case bizarrely mischaracterizing it. Contrary to Mr. Redding's assertions, the reference in my testimony to the Utah PSC Order of December 1997 quite clearly *highlights* the "rest" of the story. Quoting from that testimony: "In a recent case, the Utah Public Service Commission disallowed recovery of U S West's interconnection costs through general intrastate rates since these

costs were the subject of separate proceedings designed to evaluate costs and pricing evidence directly related to the services U S West provides to its competitors."[7]

Q. Do you agree with Mr. Redding that the absence of an ongoing proceeding investigating interconnection costing and pricing is justification for leaving interconnection costs buried as part of the general intrastate revenue requirement?

A. Absolutely not. The *timing* of such an inquiry into the costs and prices associated with the provision of services to competitors (whether concluded, ongoing, or yet to be initiated) is irrelevant to whether those costs should be included in the determination of revenue requirement (hence prices) associated with the provision of service to the general body of Qwest's non-interconnection service customers.

Q. Would you make any revision to your proposed downward adjustment of $74-million to Qwest's intrastate revenue requirement based upon the exclusion of interconnection investment and operating expenses?

A. No. I would not. As I discussed in my Direct Testimony, according to its response to UTI 13-022, U S WEST has included all of its interconnection costs in the jurisdictional separations process since it intends to recover them in the normal course of business. This means that the $1.547-billion in capital costs and expenses incurred by U S WEST

7. Gately Direct, at 19.

from 1996 through 1999[8] would be subject to the state allocation process used to allocate company-wide expenses to Arizona operations. It is inappropriate for recovery of extraordinary and non-recurring start-up costs designed to facilitate competition in accordance with the Act to be included in the *general rate structure* of the incumbent LEC if it is seeking recovery of those costs elsewhere.

Interconnection costs are recoverable in amounts assessed competitors pursuant to negotiated or arbitrated interconnection or resale agreements and in interconnection cost dockets setting unbundled network element ("UNE") prices. These are the only proceedings that allow a commission to fully evaluate the appropriateness of these very substantial costs. Buried within U S WEST's overall rate base and revenue requirement in this proceeding, the Arizona portion of the $1.5 billion overall interconnection expense will be recovered without an appropriate level of review and approval. This could result in double recovery – once from competitors and once from retail and wholesale customers.

Q. Did Mr. Redding or any other Qwest witness rebut the development of the dollar amount of the interconnection adjustment made in your Direct Testimony?

A. No, aside from Mr. Redding's assertion that the adjustment wasn't appropriate because there is not an interconnection cost and pricing investigation presently ongoing in

8. *See* U S WEST's response to AT&T 10-087.

Arizona, there was no rebuttal of the calculation of the $74-million adjustment.

Unless and until this Commission revises the conditions it presently requires before allowing utilities to adopt the accrual method of accounting for PBOPs, Qwest's proposed $29-million revenue requirement increase associated with adoption of such accounting treatment should be rejected.

Q. Have you reviewed Mr. Redding's rebuttal of your proposed rejection of the revenue requirement adjustment made by US West for adoption of the accrual method of accounting for PBOPs?

A. Yes, I have. Mr. Redding characterizes my proposal that US West's proposed revenue requirement adjustment be rejected because it has failed to meet the conditions mandated by the Commission for adoption of the accrual method of accounting as "patently ridiculous," suggesting that since no other party had opposed this element of the Company's proposal it must be fine.

Q. Do you agree with Mr. Redding?

A. No. Without question, Qwest has not met the Commission's required ten conditions. On that basis, the revenue requirement adjustment should be rejected. My testimony does not go to the nature or merits of US West's suggested "modification" to the conditions required by the Commission. Should the Commission decide to change its standards (adopting what Mr. Redding describes as a "modification"), then Qwest's proposed adjustment would be appropriate. Should the Commission decide to enforce its existing requirements, then the adjustment should be rejected. Based upon the Commission's standards as they have been enumerated to date, Qwest's revenue requirement should be reduced by the $29-million identified in my Direct Testimony.

Mr. Redding's rebuttal mischaracterizes my recommendation relative to an additional revenue requirement reduction associated with the sale of exchanges in Arizona.

Q. Have you reviewed Mr. Redding's rebuttal to that portion of your Direct Testimony dealing with adjustments related to Qwest's sale of exchanges in Arizona?

A. Yes, I have, and I'm afraid that Mr. Redding has entirely missed the point of my discussion.

Q. In what way has Mr. Redding misinterpreted your position?

A. Mr. Redding has read my criticism of the "net operating income" portion of Qwest's development of its "sale of exchanges" revenue requirement adjustment as applying to the whole of Qwest's "sale of exchanges" adjustment. In rereading my Direct Testimony from Mr. Redding's view, I can see that my choice of words was not the clearest in initially describing the problem I was attempting to correct, although a full reading of the section should have clarified the situation. In describing an unexpected outcome of "a revenue requirement increase" flowing from and alleged loss of net income, my discussion was limited to the revenue requirement impact of the net operating income changes taken alone, not the bottom line impact of all of the changes associated with Qwest's sale of exchanges.

Q. Did Mr. Redding dispute or discuss your criticism of the manner in which U S West developed its alleged "net operating income" results for the sold exchanges?

A. No, he did not.

Q. Did Mr. Redding specifically rebut your suggestion at page 39 that the Commission either reduce U S West's revenue requirement by $7-million or require U S West to make a more reasonable assessment of the expenses associated with the sale of the exchanges?

A. No. His rebuttal of my Direct Testimony proposing an adjustment incorporating the revenue requirement impact of eliminating the alleged shortfall in net operating income resulting from the sale of exchanges was limited only to the phraseology in the initial question and answer in that section – not to the merits of the proposed adjustment. Other than a blanket statement at the beginning of his rebuttal that he is "in complete disagreement" with all of my proposed adjustments, he did not specifically address my proposed $7-million adjustment (which would have increased the overall revenue requirement reduction resulting from the sale of exchanges in Arizona from the $11.7-million proposed by Qwest, to closer to $19-million).

Ms. Koehler-Christensen offers no evidence in rebuttal to my Yellow Pages imputation revenue requirement reduction recommendation.

Q. Have your reviewed Ann Koehler-Christensen's rebuttal of your proposed Yellow Pages imputation adjustment?

A. Yes, I have. Ms. Koehler-Christensen takes issue first with the base amount of the yellow pages revenue being imputed (developed in the Direct Testimony of Dr. Selwyn), and second with the application of U S West's gross revenue conversion factor to the imputed amount. Dr. Selwyn's Surrebuttal testimony deals with Ms. Koehler-Christensen's rebuttal of the imputation amount. I will address her critique of the application of the gross revenue conversion factor to the imputation amount below.

Q. What evidence does Ms. Koehler-Christensen offer to rebut the application of Qwest's gross revenue conversion factor to the imputed yellow pages revenues?

A. Ms. Koehler-Christensen offers no evidence disputing the development of a bottom-line revenue requirement reduction based upon the application of the company's "gross revenue conversion factor" to the yellow pages imputation amount recommended by Dr. Selwyn, she simply says its is wrong. She offers no explanation as to why it is wrong – but maintains that it makes "no allowance for a reasonable return" and "increases the already ridiculously high net income number."

Q. Do you agree with Ms. Koehler Christensen relative to the application of the gross revenue conversion factor to the imputed yellow pages recommendation?

A. No, I do not.

Q. Should the ACC be distracted from the issue at hand – the imputation of the full amount of revenues recommended by Dr. Selwyn in his testimony – by the question of whether the gross revenue conversion factor should be applied to that revenue imputation?

A. No. It is not necessary to make a determination as to whether the gross revenue conversion factor applies to the imputed Directory Assistance revenues at this time. Application of the gross revenue conversion factor will, at the end of the day, be determined based upon whether the revenue being imputed is on a pre- or post- tax basis. In point of fact, the gross revenue conversion factor will not be applied not to each adjustment that the ACC makes to Qwest's proposed revenue requirement, but the bottom shortfall or overage culminating from all of the adjustments taken together.

The ACC should act expeditiously to end the extraction of revenues from Arizona ratepayers for plant that the FCC CPR audits found to be "missing."

Q. Have you reviewed Qwest witness George Redding's rebuttal of your recommended revenue requirement reduction flowing from the findings of the Audit Division of FCC in its audit of the Continuing Property Records (CPRs) of the RBOCS as of June 30, 1997?

A. Yes, I have, and I'm somewhat baffled that Mr. Redding has chosen to rebut my six-page summary and revenue requirement calculation without responding to Dr. Selwyn's lengthy Direct Testimony on the relevance of the CPR Audits to Arizona intrastate ratemaking.

Q. Does Mr. Redding rebut any of Dr. Selwyn's Direct Testimony, or his recommendations relative to the audit results?

A. No. No where does Mr. Redding, or any other Qwest witness, rebut the thirty pages of Direct Testimony Dr. Selwyn submitted on this issue. Nor, apparently, does Qwest dispute the similarities Dr. Selwyn has identified between the findings of the FCC's Audit Division in the CPR Audits and results found in Arizona by Qwest's own auditors in an unrelated audit it undertook of plant in Arizona.

Q. Mr. Redding testifies that Qwest has filed a "strong" protest related to the Audits. Do you consider the fact that Qwest's protest reason enough not to adopt your proposed downward adjustment to Qwest's intrastate revenue requirement?

A. No, I certainly do not. All of the RBOCs, Qwest included, have a long history of

protesting and appealing virtually every regulatory opinion that is released that results in an action or finding they view unfavorably. The filing of a protest as a reaction to the CPR Audit results was perfectly in keeping with historical behavior, and frankly, should have been entirely expected. Looking back over the twenty years that I have been involved participating in the regulatory process in this industry I can not recall a single incident where the initial reaction of an RBOC accused of regulatory misbehavior was to do anything but claim either that the behavior didn't matter, or that the regulator was wrong.

Q. Is it true that the FCC has not taken any regulatory action relative to the Audits beyond the docketing of the results?

A. The FCC has yet to enact any major regulatory action in response to the findings of its Audit Division. The procedural history of the Audit at the FCC is fairly well documented throughout pages 62 - 91 of Dr. Selwyn's Direct Testimony. One has to be careful, however, not to read too much into the FCC's inaction up until this time. The audit finding clearly represent quite a thorny, and somewhat embarrassing, problem for the FCC: after all, this inflation of the rate base with *phantom* plant occurred as an abuse of its regulatory rules, *under its regulatory watch*, over the course of decades.

The write-down of more than $1-billion of the $5-billion in undocumentable plant falls under the FCC's sole regulatory jurisdiction – a write down of this magnitude by a single regulator would require a level of political backbone that the FCC may not possess.

Q. Has there been much recent public discussion of the CPR Audit results?

A. No, the most recent tactic by the RBOCs has been an attempt to simply make the whole problem go away by including language that would "close" the audit as a part of a larger package of regulatory changes.[9] (Similar to the kinds of tag line items of legislation frequently found tacked onto legislative budget appropriations bills).

Q. Mr. Redding states that it is impossible to make an accurate revenue requirement adjustment based upon the CPR Audit findings, characterizing it "not as an audit of Qwest's books with respect to plant. It was a review of the individual property records." Do you agree?

A. I vehemently do not agree. Mr. Redding's attempt to dismiss the individual property records as having nothing to do with Qwest's "books" is laughable. The individual property records are part of the paper trail to Qwest's books – if one is flawed, so is the other. Mr. Redding is attempting to characterize the Audit results in precisely the manner warned against by Dr. Selwyn in his Direct Testimony (at 84 – 85) Rather than simply paraphrasing, I've taken the following quote directly:

> Viewed at its most superficial level, it might be argued (and in fact the RBOCs have advanced precisely this claim) that the FCC audits demonstrate little more than the failure of the RBOCs (including US West) to maintain accurate regulatory accounting records. From this perspective, the explanation for the FCC auditors' inability to find particular assets is not that the assets are no

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9. [9] FNPRM *In the Matter of the 1998 Biennial Regulatory Review—Review of Depreciation Requirements for Incumbent Local Exchange Carriers, Ameritech Corporation Telephone Companies' Continuing Property Records Audit, et al, GTE Telephone Operating Companies Release of Information Obtained During Joint Audit*, CC Dockets 98-137, 99-117 and 98-26 at 15.

> longer useful (or perhaps may never even have been purchased), but rather that the RBOCs simply failed to track the movement of assets following the initial CPR entry. Such a notion undermines, at its most fundamental level, the very foundations of regulatory accounting and reporting: If the books and records are inconsistent with reality, blame the bookkeepers, not RBOC management. If audit results may be so lightly dismissed as merely reflecting sloppy recordkeeping rather than a systematic policy of exaggerating the basis for establishing the telephone company's rate level, there would seem to be little purpose in maintaining such records — or the regulatory machinery to review them — in the first place.
>
> But the purpose of a regulatory recordkeeping and reporting requirement is more than an exercise in testing the accuracy of the process: Rates and rate levels are linked, directly or indirectly, to the net book value of the regulated company's rate base. RBOCs confront a substantial financial incentive to overstate that value. Whether accomplished through deliberate deception or through recordkeeping practices that have the same practical effect, the result is just as unacceptable. Indeed, there would be no purpose in auditing BOC records if, in the end, the inconsistencies are dismissed as irrelevant.

Q. Should the Arizona Corporation Commission heed Mr. Redding's proposal that the Commission not take any action relative to the finding of the FCC Audit Division staff until the FCC has done so?

A. Absolutely not. The longer the inflated investment is allowed to remain on Qwest's books, the greater the damage to Qwest's intrastate ratepayers in Arizona. As Dr. Selwyn describes in great detail in pages 62 - 91 of his Direct Testimony, the FCC Audit Bureau's results are noteworthy and solid. The Audit was conducted using valid statistical sampling techniques, Qwest staff accompanied and assisted the FCC Audit Division during the audit tours, and Qwest was given an opportunity to respond to the Audit and request rescoring for items of equipment that it believed were inappropriately scored.

At an absolute minimum, this Commission should limit the extraction of additional revenue from Arizona ratepayers to fund and provide return on a rate base that is inflated by approximately 20% by reducing the rate base to eliminate the phantom plant immediately. Even so, while this approach can work to establish valid rates from the decision date forward, it will still do little or nothing to penalize the utility for its misreporting, nor capture for ratepayers any portion of the excessive amounts that they have paid in past years. The Arizona Corporation Commission should take responsibility for the misreporting that has occurred to date and put an end to the situation as soon as possible.

Q. Does this conclude your testimony?

A. Yes, it does.