BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Sale of U S WEST Communications, Inc.'s Interest in Bellcore Research Communications, Inc.	)	Docket No. UT-961596
	)	ANSWER OF USWC TO STATEMENT OF FACTS OF STAFF

INTRODUCTION AND SUMMARY OF POSITION

Pursuant to RCW 34.05.240 and WAC 480-09-230(4), the Commission requested on January 15, 1997 that the parties (USWC and Staff) submit on February 18, 1997 their respective statements of fact. A review of the Staff's submission discloses there are no factual disputes between the parties – there is only a dispute on the legal conclusion to be drawn from those facts. USWC's Petition for a Declaratory Ruling is a request that the Commission declare as a matter of law that Chapter 80.12 RCW (Transfers of Property) does not apply to the transfer by USWC of its ownership interest in Bellcore to a third party. It is now appropriate that the Commission issue its declaratory order on the issue of law presented. It is the position of USWC that on the facts of

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this transaction there can be no conclusion but that an application pursuant to RCW 80.12.020 need not be filed.

The operative facts are that USWC owns a share of stock representing one-seventh of the value of Bellcore, a non-regulated research and services company from which USWC purchases services. These services in turn support the provision of regulated services by USWC. None of the assets of Bellcore or the share of stock itself have ever been in Washington ratebase, upon which USWC has earned a rate of return. Because Bellcore is an affiliate of USWC pursuant to Chapter 80.16 RCW, the company has in rate proceedings been required to prove the reasonableness of any charges for services by Bellcore, by producing the cost records and other relevant accounts of Bellcore. RCW 80.16.040 (satisfactory proof of reasonableness of charges of an affiliate). The charges for services rendered by Bellcore are equal to its costs to provide the service, plus a return or profit on its investment used to provide the service. In other words, the Commission has long held in administering Chapter 80.16 RCW that charges by any affiliate for services rendered to a regulated company will not be considered reasonable, and therefore not allowed to be included in regulated results of operations, that exceed reasonable cost plus a regulated rate of return on applicable investment; the same ceiling that would apply if the regulated company performed the services for itself, instead of hiring the affiliate.

The fact that the test for reasonableness of charges for services rendered contains an allowance for profit or return on investment does not, as the Staff summarily alleges, turn the assets of Bellcore or a share of stock representing a portion of those assets into property which is

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"necessary or useful in the performance of (its) duties to the public" and requires an order approving any transfer.

Any charge paid by USWC to another company for services rendered, will necessarily include a profit or return on investment, if that supplier intends to remain in business. Acceptance of the Staff position would produce an absurd result where the assets of any supplier of USWC would be considered 'necessary or useful" in the performance of its public service company duties. This is not a permitted reading of an unambiguous statute.

1. There Are No Disputed Facts

In its Petition, USWC stated seven operative facts in support of its position. Petition, pp. 1-2. In the affidavit of Carl Inouye, filed on February 18, 1997, these facts were restated and elaborated on. None of the statement of facts of USWC are disputed by the affidavit of Mr. Twitchell of the Staff, also filed on February 18. Staff states it is a fact that charges of Bellcore to USWC for services rendered contain a component for profit or return on investment, and that USWC rates for regulated service are based in part on USWC expenses that include Bellcore charges for services rendered, including the return component. Twitchell affidavit, pp. 2-3. USWC agrees that these statements are factual. What is incorrect is the legal conclusion Mr. Twitchell draws from the facts:

> "The Bellcore billings do include a return on investment which appears in the results of operations. As a result, Bellcore stock in effect has been included in the rate making process. . . . By including the cost and return on investment of Bellcore services in the price charged the RBOC, the share of Bellcore stock has been determined to be used and useful in the service sold." Twitchell, p. 3.

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This conclusion is unsupported by any legal analysis. The pleading of Staff's counsel, Ms. Tennyson, recites facts taken from USWC's Affiliated Interest Report filed with the Commission, which are correct, and then summarily recites the same conclusion of law:

> In summary, Commission approval of the sale of Bellcore stock by USWC is required under chapter 80.12 RCW, because by including a return on investment component in the monthly billings to USWC for utility support services the share of Bellcore stock represents ownership of property which is necessary or useful in the performance of USWC's duties to the public. Page 3.

This conclusion is not a fact and is also devoid of any legal analysis; it merely repeats the unsupported legal conclusion of Mr. Twitchell.

Nonetheless, despite the disagreement on the legal conclusion that follows from the facts, there is no factual dispute and no need for hearings to determine any disputed facts. For example, there is no factual assertion by Staff that USWC needs to retain the share of stock in order to adequately provide regulated service in Washington. Neither does the Staff argue that the Commission should forbid the sale as disposing of an asset that is necessary or useful in the provision of regulated service. Obviously, USWC can obtain services from Bellcore without owning a share of it, and the facts are undisputed that it intends to do so. The Staff takes no issue with the assertion that in a competitive nationwide market, it is inappropriate for USWC to jointly own Bellcore with its competitors. Nor is it asserted by Staff that services such as historically provided by Bellcore must be self-provisioned by USWC or obtained from an affiliate, in order for

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The Iowa Utilities Board on March 5, 1997 issued its order approving the sale without conditions (under statutes requiring pre-approval or a waiver), observing that "with the entry of other providers into the local telephone service

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the Commission to effectively review the reasonableness of the costs of the services.

2. Affiliated Interest Regulation does not Create Ratebase Assets; the Purpose is to Insure Reasonable Charges for Services Rendered.

It is black letter utility rate regulation law that any costs of the company must be prudently incurred and be reasonable, in order to be included in the regulated results of operations. In the case of services obtained from an affiliate, the only difference is that RCW 80.16.020 and .030 require contracts with affiliates to be approved before charges by the affiliate for services rendered may be included in rates, and puts the burden on the public service company to demonstrate the charges are reasonable by producing documentation specified in RCW 80.16.040. This is in recognition that contracts between affiliates may not be negotiated at arms length. Contracts with unaffiliated suppliers of goods and services need not be pre-approved, but as a practical matter must be shown by the utility to be for reasonable charges for goods or services needed by the utility to provide regulated service, in a rate increase proceeding initiated by the utility. RCW 80.04.130 (burden on utility to support a change in rates).

Thus the test whether the charges for services provided to the utility by another company are reasonable is the same whether or not the other company is affiliated: charges must be reasonable and for goods or services needed by the utility to provide regulated service, and the burden is on the utility to show the charges to be reasonable, especially if it wishes to increase regulated rates to cover the charges of the supplier. State ex rel. Pac. Tel. & Tel. Co. v.

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market, competitively neutral ownership of Bellcore is very desirable."

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Department of Public Service, 19 Wn. 2d 200 (1943); Waste Mg. v. WUTC, 123 Wn.2d 621 (1994).

One way to demonstrate reasonable charges is to show that they do not exceed the actual cost to supply the service, plus a reasonable profit, or return on investment. This is the test historically used by this and other commissions where the books and records of the supplier are available to it and the regulated utility. This is the case with affiliates of the utility where there is a contract between the affiliate and the utility. This is also the test for reasonableness of charges to interconnecting carriers required by the Telecommunications Act of 1996. 47 U.S.C. 252(d).

Where the supplier is unaffiliated, the Commission will typically look to evidence of comparable prices in the market, if it challenges the charge as appearing unreasonable. In fact, the Commission also looks at charges in the market to determine the reasonableness of affiliated charges. See 15th Supplemental Order in Docket No. UT-950200 (last USWC ratecase). Indeed, if charges of an unaffiliated supplier were shown by a utility not to exceed its own costs plus a reasonable profit, if the services were self-provisioned, it is reasonable to expect the charges would be found reasonable, absent substantial evidence that other competent suppliers who bid were below the selected supplier, and therefore what it would cost the utility to self-provision.

3. Payment for Services Rendered does not Create an Equity Position by Ratepayers in the Assets of Affiliates.

The point of this discussion is to make clear that as a matter of law and regulatory policy, it is not possible to turn a cost of service purchased from an affiliated supplier, necessary to

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support regulated service, into the equivalent of a utility rate base investment on which consumers of regulated services have paid in rates a rate of return on investment, thereby sharing the risks of the investment, entitling them to share in the profits from the sale of the investment. That of course is the real point of the Staff opposition; not to oppose the sale of the Bellcore interest because USWC needs in its view to own the share of stock in order to provide adequate telephone service, but to require an application so that any gain from the sale can be seized for the regulated consumer's benefit by using it to lower regulated rates.

This is an improper use of the transfer of assets statute. If Bellcore's assets represented by the share of stock are necessary and useful to the provision by USWC of regulated service, why has not the Staff ever asserted in prior rate and affiliated interest proceedings that the investment be added to the rate base, where all necessary and useful assets to the provision of service belong under law? See POWER v. WUTC, 104 Wn. 2d 798, 800 (1985), holding the used and useful concept does not apply to operating expenses, and that utilities are absolutely entitled to earn a rate of return on all used and useful investment dedicated to the public use.

In a situation completely analogous to the Bellcore sale, AT&T has spun off Western Electric, now Lucent, from which USWC purchased for years when it was an affiliate (and still purchases) equipment necessary and useful to provide regulated telephone service. No regulatory agency, including this one, has ever suggested ratepayers are owed something upon the sale of Lucent, because they paid in regulated prices the costs of this equipment, including a return on investment component. This is because Western Electric assets were never in ratebase, as is the

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case with Bellcore -- previously Bell Labs and Western Electric -- assets.

Staff's observation that Bellcore prices have included a return on investment component insinuates that this is an extraordinary charge that would not exist but for the affiliated relationship. If this implication is intended by Staff, it is clearly wrong. All of USWC's suppliers, present or possible, affiliated or unaffiliated, must charge prices sufficient to produce a return on investment, or go out of business. It is certain that Bellcore's new owner SAIC will charge prices to USWC sufficient to provide a return on investment. Is SAIC's investment thus still necessary and useful to the fulfillment of USWC's public service company obligations, requiring permission from the Commission if it should ever sell to another? Such an assertion would be absurd.

If instead of SAIC the services were purchased from another vendor, such as Lucent or Northern Telecom, they would certainly charge prices sufficient to provide a return on their investment. USWC cannot avoid paying in prices a return component by shopping around, except in the most extraordinary and temporary market circumstances, where vendors are attempting to buy market share by pricing under cost, and then the quality is likely to be unacceptable.

CONCLUSION

The conclusion is inescapable; the Commission should immediately issue its order declaring that under the facts and circumstances of this sale of a share of stock never included in Washington intrastate ratebase, Chapter 80.12 RCW does not apply. A hearing on this pure question of law would suit no legitimate purpose, because there is no operative fact that is in dispute or doubt. USWC requests the Commission take immediate action without further process

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or rounds of comments, and grant the petition. To do otherwise unfairly delays and may jeopardize the sale of Bellcore, when it is beyond question that the sale is appropriate and in the public interest in today's competitive environment.

DATED this 7th day of March, 1997.

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