BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of DRAFT FINANCIAL REPORTING RULES	Docket No. A-021178 QWEST CORPORATION'S COMMENTS ON PROPOSED RULES

1 Qwest Corporation ("QC") offers the following comments in response to the Commission's April 28, 2004 Notice of Opportunity to Comment in conjunction with the draft financial reporting rules.

I. INTRODUCTION

2 On December 3, 2003, the Commission Staff circulated a draft set of financial reporting rules and sought public comment by January 18, 2004. Staff's proposal deleted WAC Chapter 480-146 (Securities and Affiliated Interests) and inserted into each industry-specific chapter reporting rules regarding securities issuances, affiliated interest transactions, property transfers, subsidiary transactions and cash transfers. QC filed extensive comments during that comment cycle objecting in several respects to many of the new reporting requirements on legal, practical and policy grounds. QC will not repeat in its entirety its January 18 comments, but instead attaches them hereto as Attachment A and incorporates them herein by this reference. QC requests that the Commission review QC's earlier comments, as many (if not all) of the arguments made by QC remain applicable to Staff's most recent draft.

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3 In March 2004, Staff met informally with QC to talk through many of the outstanding issues. On April 28, 2004, Staff circulated a new draft of the financial reporting rules. Staff has requested comments by May 18, 2004.

4 The current draft removes several of the new reporting requirements objected to by QC. These include, for example, the requirement to file affiliated interest transaction notifications five business days in advance of effective date of the transaction, and a requirement to summarize each intercompany cash transfer in the utility's annual affiliated interest transaction report. Nevertheless, QC continues to object to many of the proposed rules insofar as they exceed the Commission's authority, conflict with other legal obligations utilities face and impose undue burdens on utilities, while serving no apparent purpose. QC respectfully renews its request that the Commission reject or modify the proposed rules discussed below.

II. COMMENTS

A. Chapter 480-146 WAC

5 See QC's January 18, 2004 comments, ¶ 4. In summary, QC sees no significance or harm to transitioning affiliated interest and securities filing rules from a stand-alone chapter (Chapter 480-146, WAC) to specific industry chapters, *so long as* this reorganization is not used as cover for expanding reporting requirements beyond the Commission's statutory purview.

B. WAC 480-120-015

6 Staff's April 28 draft proposed to modify WAC 480-120-015 as follows:

> **WAC 480-120-015 Exemptions from rules in chapter 480-120 WAC.**
> ~~(1) The commission may grant an exemption from the provisions of any rule in this chapter, if consistent with the public interest, the purposes underlying regulation, and applicable statutes.~~
>
> ~~(2) To request a rule exemption, a person must file with the commission a written request identifying the rule for which an exemption is sought, and provide a full explanation of the reason for requesting the~~

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~~exemption. In addition to any other reason, parties may allege force majeure was the factor leading to the request for waiver.~~

~~(3) The commission will assign the request a docket number, if it does not arise in an existing docket, and will schedule the request for consideration at one of its regularly scheduled open meetings or, if appropriate under chapter 34.05 RCW, in an adjudication. The commission will notify the person requesting the exemption, and other interested persons, of the date of the hearing or open meeting when the commission will consider the request.~~

~~(4) In determining whether to grant the request, the commission may consider whether application of the rule would impose undue hardship on the requesting person, of a degree or a kind different from hardships imposed on other similarly situated persons, and whether the effect of applying the rule would be contrary to the purposes of the rule.~~

~~(5) The commission will enter an order granting or denying the request, or setting it for hearing, pursuant to chapter 480-09 WAC.~~

The commission may grant an exemption from the provisions of any rule in this chapter consistent with the standards and according to the procedures set forth in WAC 480-07-110 (Exceptions from and modifications to the rules in this chapter; special rules.)

7 This draft is very similar to Staff's December 2003 draft. QC believes that the cross-reference to WAC 480-07-110 is confusing and unnecessary. WAC 480-07-110 provides no procedural guidance whatsoever.[1] Hence, the phrase "and according to the procedures set forth in WAC 480-07-110" is confusing and should be removed. QC recommends that the rule be left as currently in effect (with the exception of updating the references to WAC 480-09 to reflect the Commission's transition to WAC 480-07) or truncated as follows:

WAC 480-120-015 Exemptions from rules in chapter 480-120 WAC.
~~(1)~~ The commission may grant an exemption from the provisions of any rule in this chapter, if consistent with the public interest, the purposes underlying regulation, and applicable statutes.

~~(2) To request a rule exemption, a person must file with the~~

[1] WAC 480-07-110(1) provides merely, "[t]he commission may modify the application of these rules in individual cases if consistent with the public interest, the purposes underlying regulation, and applicable statutes."

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~~commission a written request identifying the rule for which an exemption is sought, and provide a full explanation of the reason for requesting the exemption. In addition to any other reason, parties may allege force majeure was the factor leading to the request for waiver.~~

~~(3) The commission will assign the request a docket number, if it does not arise in an existing docket, and will schedule the request for consideration at one of its regularly scheduled open meetings or, if appropriate under chapter 34.05 RCW, in an adjudication. The commission will notify the person requesting the exemption, and other interested persons, of the date of the hearing or open meeting when the commission will consider the request.~~

~~(4) In determining whether to grant the request, the commission may consider whether application of the rule would impose undue hardship on the requesting person, of a degree or a kind different from hardships imposed on other similarly situated persons, and whether the effect of applying the rule would be contrary to the purposes of the rule.~~

~~(5) The commission will enter an order granting or denying the request, or setting it for hearing, pursuant to chapter 480-09 WAC.~~

C. <u>WAC 480-120-325</u>

8 In its December 2003 draft, Staff proposed to expand the definitions section found at WAC 480-120-021 to define a "subsidiary" as "any company in which the Class A company owns directly or indirectly five percent or more of the voting securities." QC commented that a 5% threshold was contrary to the common understanding and definition of "subsidiary," a term which implies control by the parent company. A 5% threshold, QC argued, was not necessarily enough to constitute any degree of control. QC also suggested removal of the reference to "Class A" companies. See QC's January 18, 2004 comments, ¶¶ 5-7.

9 In its April 28 draft, Staff changed direction and proposed to leave WAC 480-120-015 as is, but to add a new section (WAC 480-120-325), as follows:

> **<u>WAC 480-120-325 Definitions.</u>** <u>The definitions in this section apply to Part VIII of this chapter.</u>
>
> **<u>"Affiliated interest</u>**<u>" means a person or corporation as defined in RCW</u>

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80.16.010.

"Control" means the ability, directly or indirectly, to control management or policies of a company, whether through the ownership of voting shares, by contract, or otherwise.

"Subsidiary" means any company that the telecommunications company directly or indirectly controls.

10 QC agrees with the removal of the reference to "Class A" companies, but believes that the new definition of "subsidiary" is vague and contrary to the common understanding of the term. Staff's definition of "subsidiary" relies entirely on its definition of "control." While QC agrees that control should be the focus of a definition of "subsidiary," QC believes that the inclusion of "by contract, or otherwise" in the definition of "control" is vague and confusing. As a matter of law, vague rules are void and unenforceable.[2]

11 The proposed definition of "control" is confusing in three respects. First, it uses the word "control" to define "control." If it were the case that Staff wanted to narrow the definition of "control" for purposes of Chapter 480-120 by adding limiters such as "by contract" or "by ownership of voting shares," the use of the term "control" to define "control" would make sense as a starting point. However, the inclusion of "or otherwise" renders any attempted limitation moot, and leaves the definition too imprecise to be enforced or understood.

12 Second, the phrase "by contract" is vague and potentially overbroad. Read literally, any company that has a contract with QC may then be a subsidiary. As an illustration, assume QC and Company X enter into a contract whereby Company X agrees to provide QC janitorial services in a QC-owned building. Given Company X's obligation to abide by its contract with QC, it could be argued that

[2] Pinecrest Homeowners Ass'n v. Cloninger & Assocs., 115 Wn. App. 611, 62 P.2d 938 (2003) (Holding that administrative regulations are unconstitutionally vague if they empower an administrative agency to make discretionary, arbitrary decisions based on standards which are vague, unarticulated, and unpublished.); Longview Fibre Co. v. Washington, 89 Wn. App. 627, 949 P.2d 851 (1998) ("A regulation is unconstitutionally vague if persons of common intelligence must necessarily guess at its meaning and disagree as to its application.").

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Company X's management and policies are controlled by the contract. As such, Company X is, arguably, a subsidiary of QC. This is absolutely inconsistent with the common and legal understanding of the term "subsidiary." It is also quite problematic given the numerous additional subsidiary reporting requirements proposed in the draft rules.

13 Finally, the phrase "or otherwise" is so broad and inexact that it renders the definition of "control" – and thus the definition of "subsidiary" – vague and unenforceable.

14 As QC pointed out in its January 18 comments, the Commission would be wise to look to the Legislature's definition of "subsidiary" in the Washington Corporations Act – a domestic or foreign corporation that has ***a majority of its outstanding voting shares*** owned, directly or indirectly, by another domestic or foreign corporation.[3] That definition is objectively precise, consistent with the public's understanding of the term and will permit companies to comply with Commission directives (assuming any are adopted by the Commission) relating to subsidiaries. Again, QC recommends adoption of the following definition of "subsidiary" either in WAC 480-120-021 or -325.

> "Subsidiary" means any company in which the public service company owns directly or indirectly a majority of the voting securities.

D. WAC 480-120-331 (formerly WAC 480-120-X01)

15 See QC's January 18, 2004 comments, ¶¶ 13-14. QC is mindful that subsection (2) – empowering the Commission to require pertinent information in addition to that specified by statute or in WAC Chapter 480-120 – is a carry-forward from WAC 480-146-260. Nevertheless, QC remains concerned that subsection (2) explicitly grants the Commission power exceeding its statutory jurisdiction. As such, QC again recommends that subsection (2) be deleted from this rule.

[3] RCW 23B.19.020(17) (emphasis added).

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E. WAC 480-120-365 (formerly WAC 480-120-X03)

16 Proposed WAC 480-120-365 provides as follows:

> **WAC 480-120-365 Issuing securities.** (1) At least five business days, as defined in WAC 480-07-120 (Office hours), before a telecommunication company subject to the provisions of chapter 80.08 RCW undertakes to issue stocks, stock certificates, other evidence of interest or ownership, bonds, notes, or other evidences of indebtedness, or assumes any obligation or liability as guarantor, the company must file with the commission:
>
> (a) A description of the proposed issuance;
>
> (b) An estimate of the anticipated proceeds from the issuance;
>
> (c) A description of the purposes for which the issuance will be made, including a certification by an officer authorized to do so, that the proceeds from any such financing is for one or more of the purposes allowed by RCW 80.08.030; and
>
> (d) A statement as to why the transaction is in the public interest.
>
> (2) Before issuance of the proposed security, the company must file with the commission the terms of financing.
>
> (3) A commission order is not required for such a filing. The company may request a written order affirming that the company has complied with the requirements of RCW 80.08.040. The company must submit the request for a commission order, along with the information required in subsection (1) of this section, at least fifteen business days before the requested effective date for the order. The company must file the information required in subsection (2) of this section with the commission before the commission enters a written order.
>
> (4) Filing a Registration Statement with the Securities and Exchange Commission using a shelf registration process does not constitute undertaking the issuance of a security, and therefore a filing with the commission is not required under the provisions of RCW 80.08.040. A shelf registration filing is defined under the General Rules and Regulations promulgated under the Securities Act of 1933, Rule 415 - Delayed or Continuous Offering and Sale of Securities.
>
> (5) An authorized representative must sign and date the filing and include a certification or declaration that the information is true and correct under penalty of perjury as set forth in RCW 9A.72. The certificate or

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declaration must be in substantially the following form:

"I certify (or declare) under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct."

(6) Within sixty days after the issuance of any securities, except for dividend reinvestment and employee benefit plans, a company must file with the commission a verified statement:

(a) Outlining the final terms and conditions of the transaction; and

(b) Setting forth actual proceeds from the issuance and the disposition of proceeds stating the final amount to be used for each purpose allowed by RCW 80.08.030.

17 QC acknowledges that Staff's current draft contains some improvements over the December 2003 draft. Most notably, Staff has pushed back the filing timeline for the specific financing terms from five business days before issuance of the securities to any time before issuance. Staff also removed the requirement that the utility provide the "specific purpose" for which the securities issuance is being made.[4]

18 That said, QC continues to strongly oppose adoption of this proposed rule, which exceeds the Commission's jurisdiction, is vague, is potentially in conflict with federal law and imposes impractical burdens and costs without any corresponding benefit.

1. The five business day filing requirement (proposed WAC 480-120-365(1))

19 By far, the most troubling component of this rule continues to be Staff's insistence that utilities make filings *five business days* before issuance of securities. Actually, in the current draft, Staff has modified the rule to require a filing at least five business days prior to the date a telecommunications

[4] RCW 80.08.030 sets out the permissible purposes for which a utility can issue securities, including (for example) the acquisition of property and the issuance of stock dividends. Based on its informal discussions with Staff, QC understands that the requirement (under proposed WAC 480-120-365(1)(c)) to provide a "description of the purpose for which the issuance will be made" is intended to simply require the utility to identify to which purpose(s) under RCW 80.08.030 the securities issuance is related.

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company "undertakes to issue" securities. As an initial matter, the phrase "undertakes to issue" is impermissibly vague,[5] especially as it is being used to trigger a filing requirement.[6] It could be read to require filing five business days prior to QC even beginning the process of investigating or soliciting information about a possible securities issuance. It could also be interpreted to refer to the moment that QC enters into a contract to issue securities. Depending on how this rule is applied, such a requirement could impose a metaphysically and practically impossible standard to abide by or enforce. Clarification of "undertakes to issue" is needed.

20 Even if QC and the Commission ultimately interpret "undertakes to issue" as being synonymous with "issues," the five day requirement is unlawful for the reasons discussed in QC's earlier comments. See QC's January 18, 2004 comments, ¶¶ 17-19. In summary, the Commission is only permitted to promulgate rules and impose requirements on the companies it regulates if the legislature has explicitly authorized the Commission to do so. Here, the legislature only authorized the Commission to receive and require securities filings [any time] before the issuance. *RCW 80.08.040*. It did not grant the Commission any rulemaking authority with regard to securities filings, except as found in RCW 80.08.090 – pertaining to requiring post-issuance accountings after issuance of an order pursuant to RCW 80.08.040(4).[7] Unilaterally limiting public service companies' rights by adding an inconsistent, earlier filing requirement is not a tool at the Commission's disposal. Such a requirement can only be imposed by the legislature.

21 Furthermore, the five business day requirement may also run afoul of federal securities law, placing QC and other utilities in the impossible position of having to choose whether to comply with federal securities law or the Commission's reporting rule. See QC's January 18, 2004 comments, ¶ 20. In

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5 As noted above, vague regulations are void and unenforceable as a matter of law. See footnote 1.

6 While the statute, RCW 80.08.040, uses the phrase "undertakes to issue," the legislature was careful not to use it when establishing a time-sensitive filing requirement. Instead, the legislature, when defining the trigger for making a filing, used the word "issuance."

7 Such an order is not issued in connection with each securities issuance. It is done only upon the request of a utility issuing securities. *RCW 80.08.040*.

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its earlier comments, QC noted that the five day notice requirement may present securities law concerns in connection with public and private offerings. QC noted that, in a public offering, it is generally illegal for companies to make any written offers of securities other than through a prospectus that complies with the requirements of the securities laws.[8] QC also noted that it is very possible that the SEC could take the position that the notice being provided to the Commission under the proposed rule constitutes a written offer, especially if the notice is published or is obtainable by the public.[9] The SEC generally strictly enforces this prohibition.[10] Also, with respect to private offerings, it is possible that the SEC could take the position that the notice is a public solicitation, which is impermissible in a private offering.[11]

22 The SEC has by rule created safe harbors to allow certain types of written notices of anticipated securities offerings.[12] These safe harbors generally allow the release of specified and limited information, the extent of which is dependent on the timing of the notice (pre- or post-filing of a registration statement) and the nature of the offering (registered or private). QC acknowledges that the Commission's revised proposed rules require less detailed information to be provided in the advanced notice than under its December 2003 proposal. As a result, the safe harbors are more likely to apply. However, QC remains concerned that the proposed rules will require (or will be interpreted to require) information in addition to that permitted under the safe harbors. For example, none of the safe harbors contemplates inclusion of a statement as to why the offering is in the public interest, as is required by proposed WAC 480-120-365(1)(d). Due to the strict enforcement by the SEC of its rules in this area, the Commission's rules (or its enforcement of them) may still risk subjecting QC to securities law exposure under federal law.

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8 Section 5 of the Securities Act of 1933 (the "1933 Act").

9 In re Carl M. Loeb, Rhoads & Co., 38 S.E.C. 843 (1959).

10 For example, in *Franklin, Meyer & Barnett, 37 S.E.C. 47 (1956)*, a broker-dealer was deemed to have violated Section 5 by sending a business card upon which he wrote "Phone me as soon as possible as my allotment is almost complete on this issue."

11 Rule 502(c) under the 1933 Act.

12 Rules 134, 135 and 135(c) under the 1933 Act.

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23 A further complication stemming from federal securities law is the question of insider status which may be created by virtue of QC sharing this information with the Commission. As the Commission may be aware, advance notice of a securities issuance will in most cases constitute material, non-public information under federal law. If QC is able to file the requisite information on a confidential or highly confidential basis, all those at the Commission with access to this information will become insiders under federal and state securities laws. In such a case, QC would require the Commission's cooperation in maintaining the confidentiality of the information and prohibiting all those with access to it from trading in Qwest securities until the information is made public at the time of the transaction. Commission employees would also need to be prohibited from communicating such information to others to avoid making those other persons insiders. If the information is not held confidential, then Qwest would be compelled to file a press release or make an SEC filing to release the information publicly. This public release would only exacerbate the practical concerns discussed immediately below.

24 In addition to the questions of lawfulness addressed above, QC reiterates the impracticality of this proposed rule. Backing off from a requirement that the specific financing terms be filed five business days in advance is certainly a step in the right direction, but it is not sufficient. Even having to publicly report the higher level information required under proposed subsection (1)(a)-(d) (e.g., that QC intends to raise approximately $250 million through the issuance of bonds in order to fund network investment) will likely have a costly practical impact on QC and the terms it ultimately obtains for the bonds. In fact, it is quite conceivable that such premature disclosure could compromise such transactions altogether. For example, requiring QC to disclose even the existence of a proposed equity or bond transaction five business days before closing would offer speculators, hedge funds, and other market participants the opportunity to arbitrage positions at the expense of QC. Such tactics would involve or result in the price of such bonds being sold off. The resulting change in the bond prices could easily make the deal uneconomical for QC and completely undermine the contemplated

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transaction. Interfering with the normal course of business of a publicly traded company affects pricing and the flexibility to refinance debt, adding unnecessary risk and cost to the transaction.

25 A very real example of this concern occurred in a recent private securities transaction, when a rumor was leaked into the market (apparently from an investment banking firm) that a debt offering was going to be announced in the next few days. The rumor did not involve any greater detail than that a debt offering was pending; neither the amount nor the terms of the debt was leaked. In fact, the information leaked in this example was less information than would be required to be filed under proposed WAC 480-120-365(1)(a)-(d). As a result of this very general leak, the spreads on the existing bonds (which are traded in the market) on the day of the leak widened by 19 to 23 basis points, as hedge funds and speculators begin taking positions on the basis of the anticipated announcement. The widening of this spread affects the final pricing of the offered bonds, causing the interest rate on the bonds to be higher than anticipated. Based on a hypothetical 20 basis point increase in interest rate on a $1 billion, ten year issuance, the additional interest expense would be $20 million. This obviously is not in the best interest of the company, its ratepayers or the Commission, as it greatly increases the cost of refinancing and raising capital.

26 The five day notice requirement is less palatable because the onerous, likely-harmful public filing required by the rule will serve no reasonable purpose. As QC noted in its January 18 comments, the legislature did not give the Commission any authority to prevent, condition or delay securities issuances. Thus, at first blush, there does not appear to be any purpose for this requirement.

27 After informal discussions with Staff, QC understands that Staff's purpose of the five business day reporting requirement is to provide the Commission adequate time to gather the salient facts relative to a securities issuance and, if warranted, hold a special public meeting to express its concerns and to warn QC of potential rate case consequences for issuing the securities. As an initial matter, QC believes it is absurd to believe that any meaningful due process could occur in the five business days

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between notice and issuance.

28 Furthermore, the purpose articulated by Staff is entirely frustrated by the revisions it made to the rule. In the current draft, Staff moved away from its earlier intention to require utilities to file the actual details – the terms of the financing – five business days before the issuance. Under subsection (2), these specifics need not be filed until the instant before QC issues the securities. Reading the proposed rule as currently drafted, QC could comply with its obligation by stating generally that it intends to raise approximately $250 million in bonds in order to fund network investment – and also stating that this is a permissible purpose under RCW 80.08.030 and that the upgrading of QC's facilities is in the public interest in order to continue to provide high quality service to Washington ratepayers. *Proposed WAC 480-120-365(1).* While this information will likely be crippling to QC's financing efforts (for the reasons discussed above), it will provide nothing nearly specific enough from which the Commission can evaluate the propriety of the transaction and its terms. In addition, Staff's desire to air out the issue publicly prior to issuance is complicated by the insider trading restrictions discussed above. In the final analysis, there is simply no way to conclude that the benefits of the notice justify the high cost to the utility in this scenario.

2. The shelf offering exclusion (proposed WAC 480-120-365(4))

29 Proposed subsection (4) of the securities issuance rule states:

> (4) Filing a Registration Statement with the Securities and Exchange Commission using a shelf registration process does not constitute undertaking the issuance of a security, and therefore a filing with the commission is not required under the provisions of RCW 80.08.040. A shelf registration filing is defined under the General Rules and Regulations promulgated under the Securities Act of 1933, Rule 415 - Delayed or Continuous Offering and Sale of Securities.

30 QC recognizes that this proposal is a codification of the Commission's Interpretive Statement in

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Docket No. A-020334. While this addition to the proposed rules is appropriate and acknowledges the fact that the filing of a shelf registration statement does not in itself constitute an undertaking to issue securities, QC believes the rule should go further in accommodating for the nature of offerings made pursuant to shelf registration statements.

31 Rule 415 under the Securities Act of 1933 provides that securities may be registered for an offering to be made on a continuous or delayed basis in the future. This means that a filing can be made to register a dollar amount of securities that are issued at later dates without the need for further action by the SEC. For example, in 1994 and 1995, QC (then known as U S WEST Communications, Inc.) maintained shelf programs for debt securities. From time to time, it would price a transaction (i.e., enter into an agreement to sell a portion of the registered securities to the underwriters on specified pricing terms) and file a prospectus supplement with the SEC. Public trading in the new securities would normally begin as soon as the markets opened after pricing. The transaction would then close a few days later, at which point QC would deliver the securities to the underwriters and the underwriters would deliver the purchase price to QC. This is a standard process for issuing securities on a delayed basis under a shelf registration program.[13]

32 Due to the fact that additional SEC intervention is not required once a shelf registration statement has been declared effective, transactions can be (and normally are) "taken down off the shelf" and priced relatively quickly to take advantage of a market window, sometimes on only one or two day's notice. As such, a company itself may not know whether a transaction will actually take place until the day of pricing. Because the pricing stage may be interpreted as an "undertaking to issue" securities, the requirement that companies provide notice to the Commission five business days in advance is impractical (if not impossible) and would cause harm to QC by removing the flexibility to take advantage of favorable conditions that may exist during only a temporary window of opportunity.

[13] See "Corporate Finance and the Securities Laws, Second edition." Charles J. Johnson, Jr. and Joseph McLaughlin. Chapter 8: Shelf Registrations—Rule 415

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While QC does not currently maintain shelf registration statements, it may do so again in the future. In addition, it could also wish to establish other types of delayed offering programs, such as medium-term-notes programs or commercial paper programs. These can also involve rapid access to the capital markets when it is advantageous to an issuer. In summary, the five business day advance notice requirement simply does not reflect the realities of the capital markets and will unnecessarily limit QC's financing options.

F. WAC 480-120-369 (formerly WAC 480-120-X04)

33 Proposed WAC 480-120-369 provides as follows:

> **WAC 480-120-369 Transferring cash or assuming obligation.** (1) At least five business days, as defined in WAC 480-07-120 (Office hours), before a Class A company or any subsidiary of such a company transfers cash to any of its affiliated interests or subsidiaries or assumes an obligation or liability of any of its affiliated interests or any of its subsidiaries, the company must report an estimate of the amount to be transferred and the terms of the transaction to the commission if:
>
> (a) A single transaction amount exceeds five percent of prior calendar year gross operating revenue; or
>
> (b) Such transaction, together with all transactions with such subsidiary or affiliated interest over the preceding twelve months, exceeds five percent of prior calendar year gross operating revenue.
>
> (2) The reporting requirement in this section does not include payments for:
>
> (a) Federal and state taxes;
>
> (b) Goods, services, or commodities;
>
> (c) Transactions, attributed to the regulated entity, previously approved or ordered by the commission, other regulatory agencies, or the court;
>
> (d) Dividends to the extent the level of such dividends over a twelve-month period do not exceed the larger of:
>
> (i) Net income during such period; or

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(ii) The average level of dividends over the preceding three years; or

(e) Payments for sweep or cash management accounts. The foregoing provisions will have no application to sweep and cash management account transfers used to transfer funds to or from a subsidiary or affiliate as part of the customary and routine cash management functions between or among the utility and its subsidiary or affiliate.

(3) This section does not apply to companies classified as competitive pursuant to RCW 80.36.320.

34 This rule is flawed and unlawful. It remains the most distressing and troublesome from QC's perspective, as it far exceeds the Commission's statutory authority. As QC discussed at length in its January 18 comments, the legislature did not empower the Commission to regulate cash transfers as it did affiliated interest transactions, property transfers and securities issuances. Neither did the legislature authorize the Commission to require reporting of transactions (affiliated interest, or otherwise) between utilities and their subsidiaries. See QC's January 18, 2004 comments, ¶¶ 36-42. This proposed rule appears to be an attempt to interfere with QC's cash management prerogatives; this is not a role the Commission is permitted to play. *Id.* ¶¶ 28-29.

35 Worse yet, reporting is required under subsection (1) of cash transfers between a utility's unregulated subsidiaries and affiliates, even if the regulated utility (in this case, QC) has no involvement whatsoever in the transaction. QC fails to understand what conceivable legal basis Staff could have for a rule that would entitle the Commission to monitor the cash transfers between two unregulated affiliates of QC.

36 Based on its informal discussions with Staff, QC understands that Staff bases its ability to regulate cash transfers not on the RCW 80.16 (governing affiliated interest transactions), but on RCW 80.04.080 ("Annual Reports"). That statute, which is very long, provides in its concluding sentence as follows:

….The commission shall have authority to require any public service company to file monthly reports of earnings and expenses, and to file periodical or

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> special, or both periodical and special, reports ***concerning any matter about which the commission is authorized or required by this or any other law, to inquire into or keep itself informed about, or which it is required to enforce***, such periodical or special reports to be under oath whenever the commission so requires. (emphasis added)

37 With all due respect, this statute does not provide the Commission unfettered discretion to require periodical and/or special reports. The statute specifically limits the scope of such reports to matters about which the Commission is authorized or required by statute to inquire into or keep itself informed about, or laws that it is required to enforce. *RCW 80.04.080*. Neither that statute nor any other statute authorizes or requires the Commission to inquire into or keep itself informed about the cash transfers covered by the proposed rule. As Staff apparently acknowledges, the affiliated interest statute does not reach cash transfers. The only somewhat-related requirements are found earlier in RCW 80.04.080, which requires utilities on an annual basis to specify in a written report amounts paid for capital stock and dividends paid. Staff cannot be using this as the basis for proposed WAC 480-120-369, however, because the rule is far broader in scope, and in fact seeks to exclude most dividends from reporting under subsection (2)(d). As such, RCW 80.04.080 simply does not provide a legal basis for imposition of a cash transfer reporting regime.

38 In addition to being unlawful, the proposed cash transfer rule remains impractical from an operational perspective. In many cases, Qwest's centralized cash management team does not know the precise amount of inter-company cash transfers five business days in advance. This proposed rule will, thus, unnecessarily impede Qwest's ability to prudently and nimbly manage its cash and its multi-state operations. See QC's January 18, 2004 comments, ¶ 43. QC acknowledges the addition of exclusions for some dividends and for cash management and sweep accounting. QC recommends that the dividend exclusion should not be limited, however.

39 Two other practical considerations must be discussed. First, the five business day advance filing

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requirement is onerous and unreasonable, as it serves no purpose other than to create potential penalty liability for the utility which will be unable to comply with such a requirement. Second, assuming *arguendo* that a cash transfer rule is adopted by the Commission over industry objection and is sustained when challenged in court, the rule could be improved by adding a second trigger to subsection (1)(b). As presently drafted, subsection (1)(b) requires the filing, on five business days notice, of ***all*** cash transfers other than those exempted under subsection (2) once the total value of the cash transfers between a Class A company and a particular subsidiary or affiliate exceeds five percent of the prior year's gross revenues. A second trigger should be added to subsection (1)(b) to ensure that only large cash transfers are reportable once the cumulative trigger presently described in subsection (1)(b) is satisfied. If that is not done, the Commission may find itself inundated with reportable cash transfers, assuming the utilities and their affiliates and subsidiaries are able to comply with the onerous filing requirements. For example, without waiver of its strenuous objections to the adoption of any rule requiring reporting of cash transfers, QC notes that the Commission could revise subsection (1) as follows:

> (1) ~~At least five business days, as defined in WAC 480-07-120 (Office hours)~~ Within 20 business days after ~~before~~ a Class A company~~, or any subsidiary of such a company,~~ transfers cash to any of its affiliated interests or subsidiaries or assumes an obligation or liability of any of its affiliated interests or any of its subsidiaries, the Class A company must report an estimate of the amount to be transferred and the terms of the transaction to the commission:
>
> (a) If the ~~A~~ single transaction amount exceeds five percent of prior calendar year gross operating revenue; or
>
> (b) ~~Such transaction, together with all transactions with such subsidiary or affiliated interest over the preceding twelve months, exceeds five percent of prior calendar year gross operating revenue.~~ If the single transaction amount exceeds three percent of prior calendar year gross operating revenue and the cumulative cash transactions between the Class A company and the particular subsidiary or affiliated interest for the prior twelve months exceed five percent of prior calendar year gross operating revenue.

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40 Furthermore, the list of exclusions set out in subsection (2) is somewhat vague. While it is clear that some dividends (for example) need not be reported under subsection (1), it is unclear whether dividend payments from a utility to its parent must be counted against the five percent cumulative trigger set out in subsection (1)(b). As noted repeatedly above, vague regulations are, as a matter of law, void and unenforceable.

41 Additionally, the rule is internally inconsistent in that subsection (1) imposes requirements on all Class A companies, while subsection (3) exempts all competitively-classified companies. As the Commission recently determined that all companies (including CLECs) with over 2% of the state's access lines are Class A companies,[14] this inconsistency should be resolved. QC believes that increased regulation, especially in the arena of cash management, is inappropriate for all companies. However, to the extent the Commission believes it is appropriate, necessary and lawful to require reporting of cash transfers, it should impose this requirement evenhandedly on all local exchange carriers.

42 Finally, QC will repeat its concern that this rule, with all its onerous requirements and potential for confusion, serves no beneficial purpose. The Commission has and the proposed rule claims no power to prevent or restrict inter-company cash transfers. As such, it is unclear why this rule is needed at all, and why reporting is critical *five business days before* a cash transfer that cannot be interrupted. The Commission should reject proposed WAC 480-120-379. Again, as with Staff's desire to expand the Commission's authority around securities issuances, the appropriate venue for such an expansion is the legislature, not unilateral, *ultra vires* actions in a rulemaking.

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[14] *In the Matter of Comcast Phone of Washington, LLC Application For Mitigation Of Penalties Or For Stay; In the Matter of Comcast Phone of Washington, LLC Petition For An Interpretive And Policy Statement Or Declaratory Ruling, Docket Nos. UT-031459 and UT-031626 (consolidated),* Order No. 4 -- Final Order Affirming and Adopting Initial Order Granting Mitigation, On Condition; Denying Exemption from Rule (Mar. 17, 2004), ¶ 38 ("We conclude, as a matter of law, that CLECs such as Comcast that have more than 2 percent of the access lines within the state of Washington are Class A companies within the meaning of WAC 480-120-439 and are subject to the reporting requirements of the rule.").

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G. WAC 480-120-395

43 This rule largely carries forward the annual affiliated interest reporting requirements of WAC 480-146-360. In a couple of significant ways, it purports to increase reporting requirements, and QC asks the Commission to reject or modify the annual reporting requirements.[15] First, the rule seeks to require reporting of transactions between a public service company and its subsidiaries. Subsidiary regulation is not permitted under the affiliated interest statute, nor any other statute vesting the Commission with regulatory powers. This appears to be an example of Staff attempting to expand the Commission's regulatory authority by simply moving the regulation from the affiliated interest rules chapter to the general industry chapter. This is form over substance. Regardless of the name of the chapter in which the regulation resides, it is only lawful and enforceable if the legislature has granted the Commission authority. The Commission has no such authority over subsidiary transactions.

44 With regard to the $100,000 report threshold set out in subsection (3), QC recommends that the Commission use a consistent analytical framework (see proposed WAC 480-120-369(1)) by replacing the hard-and-fast dollar threshold with a percentage of gross revenues. Obviously, $100,000 may be an extremely large dollar level for some small carriers, while it may represent an unreasonably low threshold for other, larger carriers. Qwest suggests that it would be reasonable to set the reporting threshold at 2% of the utility's prior year's revenues.

III. CONCLUSION

45 Again, QC appreciates the opportunity to comment on the proposed rules. QC acknowledges that the development of financial reporting rules is a difficult task, and that the Commission has an interest in monitoring the financial activities of the companies it regulates. QC urges the Commission, however, to be mindful of the legal and practical limitations on its authority and on the ability of this

[15] QC does acknowledge that Staff removed from the list of reportable items a description of every cash transfer made during the prior year. That requirement was contained at propose WAC 480-120-X08(2)(e). QC believes the removal of that requirement is a very positive development, and appreciates Staff's responsiveness to QC's concerns.

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state's utilities to comply with onerous reporting requirements.

RESPECTFULLY SUBMITTED this 18th day of May, 2004.

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