BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In Re:	)	DOCKET NO. UT-980948
	)	
U S WEST?s Petition for a Declaratory Order	)	U S WEST?s OPENING BRIEF
Ending Imputation of Revenues Derived from	)	
Transferred Yellow Pages Publishing Business	)	September 20, 1999
	)	
	)	
	)	

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I. INTRODUCTION

If U S WEST believes that imputation has been sufficient, it should petition the WUTC to perform a valuation of the asset that was transferred (the publishing right) and the value that has been received from imputation to determine whether imputation should continue.[1]

Under the Commission?s Order, the imputation is not necessarily permanent, and the Commission?s prior orders show that when the Company has shown that it has received fair compensation from its affiliate for the value of the asset it transferred, imputation may cease. U S WEST 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.[1]

The Commission has before it the very petition described above. After years of disputes between various parties about the imputation of yellow pages revenues, the Supreme Court, acting on the representation of the parties in this case, provided the guidance which has been the framework for U S WEST?s petition in this proceeding.

In this brief, U S WEST will demonstrate that the record in this case is clear that it has met all the requirements for ending imputation. U S WEST will show that the transfer that took place in 1984 was the transfer of the entire yellow pages publishing business, that the value of the business at the time of the transfer was no more than $1.8 billion, and that imputation has provided fair value to Washington ratepayers for the value of the asset transferred. No more is required, and the Commission should order that yellow pages revenues will no longer be imputed to U S WEST?s revenues.

The transfer of the yellow pages publishing business in 1984 is the starting point for the questions that must be resolved in this docket. As shown through the testimony of Mr. Inouye, the Commission approved the transfer of property associated with the publishing business, but, in recognition of the fact that the entire business was transferred, the Commission reserved its decision as to a determination of fair value. The parties to this case that oppose U S WEST, and their witnesses, have repeatedly and consistently affirmed that the entire yellow pages publishing business

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[1] *U S WEST v. Utils. and Transp. Comm?n*, 134 Wn.2d 74, 102 (1997).

was transferred in 1984 for inadequate consideration, and that imputation remedies the inequities of that transaction.[2] Only now, faced with a potential end to a significant revenue stream, do these parties advance the theory U S WEST still owns the directory publishing business and that imputation was nothing more than rent. This theory is unsupported by either the facts of the 1984 transfer, the Commission orders concerning that transaction, or the representations of these parties in other contexts.

The Commission will hear from the other parties that no ?business? was ever transferred, and that PNB retained the elements that were essential to the operation of the publishing business. Nothing could be further from the truth. U S WEST?s evidence, through the testimony of Mr. Johnson and Prof. Perlman, establishes that U S WEST Direct received everything it needed to conduct the publishing business that was transferred from PNB. Those things that PNB retained, such as the right to license the PNB name, and the subscriber listing business, never would have been transferred, but would have been licensed, which is exactly what happened in this case.

Additionally, any suggestion that a formal ?sale? was required to effectively transfer the business is simply wrong. There are no legal requirements that transfers among wholly owned corporate entities be conducted as a sale transaction ? a principle that was affirmed by Judge Greene as a ?long-established? general legal principle.[3] Nor were there any Commission requirements that a formal sale take place, and no party has suggested that U S WEST failed to obtain any necessary approvals for the transfer of the business. Thus, the sale argument is inapposite.

Having established the valuation date of 1984, the next question is what the value of the

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[2] Parties who have filed testimony opposing the relief U S WEST seeks are Staff, Public Counsel, TRACER and AARP. Henceforth, when U S WEST refers to Public Counsel, that reference will also include the parties who have joined their presentations with that of Public Counsel, specifically TRACER and AARP.

[3] *United States v. AT&T*, 552 F. Supp. 131, 201(D.D.C. 1982), *aff?d sub nom Maryland v. United States*, 460 U.S. 1001, 103 S. Ct. 1240, 75 L.Ed 2d 472 (1983).

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business was at the time it was transferred. U S WEST has established, and no party has credibly disputed, that the maximum value which could reasonably be determined for the yellow pages publishing business was $1.8 billion, and the Washington portion of that value was $281 million. The valuation analysis was performed by U S WEST?s witness, Mr. Golden, an expert in the conduct of valuation studies, with particular expertise in yellow pages publishing businesses. The analysis employed reasonable assumptions that were favorable to ratepayers. U S WEST even made changes to the analysis to quantify the other parties? criticisms and found that the resulting value of the business decreased, producing a result less favorable to ratepayers.

The other parties, refusing to accept a 1984 valuation date, take the position that U S WEST must execute a sale in order to end imputation and that the appropriate valuation would be concurrent with the decision to execute such a sale. This is absurd and irrelevant. Nowhere is there support for a 1999 valuation date. The imputation of revenues has been supported and justified by references to a past transfer of assets without adequate compensation. The only past transfer was the one in 1984. One must ask, if no transfer ever took place, what transfer is being referenced by the Supreme Court in its 1997 decision?

Finally, U S WEST has established that the amount of publishing fees and imputation included in rates since 1984 has more than compensated ratepayers for the fair value of the asset transferred in 1984. Although the Supreme Court decision states that U S WEST must show that *it* has received fair value for the asset transferred, all of the parties agreed that that compensation would have to be flowed to ratepayers, and that compensation to U S WEST Communications, without compensation to ratepayers, would not satisfy the requirement that fair value be received for the asset.

Ratepayers have in fact received the equivalent of principal and interest payments on the asset transferred in 1984 through reduced rates that resulted from the Commission?s inclusion of

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directory revenues in ratemaking. Since 1984, ratepayers have received over $754 million through lower rates for telephone service because of imputed directory revenues and publishing fees. Ratepayers have not been at risk at all in this transaction, as they were always entitled to receive the value of the asset, and the interest component that U S WEST has calculated leaves ratepayers without any risk of not being compensated. Again, no party challenged U S WEST?s mathematical or methodological calculation as shown in Ms. Koehler-Christensen?s testimony. The only reasonable conclusion to be drawn on this issue is that U S WEST?s ratepayers have been fully and fairly compensated for the value of the asset transferred to U S WEST Direct in 1984, and imputation should cease.

II.BASIS FOR U S WEST?S POSITION

U S WEST?s petition is based on the express terms of the decision of the Washington Supreme Court in *U S WEST Comm., Inc., v. Wash. Util. & Transp. Comm.,* 134 Wn.2d 74, 949 P.2d 1337 (1997). That decision established that the Commission has the power to impute directory advertising revenue to U S WEST for ratemaking purposes as compensation for the past transfer of an undervalued asset to an unregulated affiliate, only so long as fair value for the transfer of the asset to the affiliate has not been received. U S WEST?s position is that fair value for the 1984 transfer of the asset, including accumulated interest, has been received and passed through to ratepayers in the form of reduced rates for telecommunications services in Washington and that the Commission?s power to impute directory revenues to U S WEST for ratemaking has ended.

U S WEST submits that the Supreme Court, writing in 1997, clearly held that imputation of directory revenue was lawful as compensation for a past transfer of an undervalued asset by PNB to an unregulated affiliate. The only valuation date on the record that is consistent with that determination by the court is January 1, 1984. Directory revenues that have been included in rates and the cumulative imputation amounts that have been reflected in rates since imputation began,

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greatly exceed the fair value of the directory publishing business on that date, including reasonable accrued interest since that date.

A. The Supreme Court?s Decision Of 12-24-97.

In *U S WEST, supra,* the Supreme Court considered U S WEST?s appeal from the Commission?s Fifteenth Supplemental Order in Docket No. UT-950200 (hereinafter ?Fifteenth Order?). U S WEST had challenged the Commission?s imputation to U S WEST, for ratemaking purposes, of approximately $80 million in annual revenue that was received by an affiliate, U S WEST Dex, for the sale of printed yellow pages directory advertising. The basis of U S WEST?s challenge was that such imputation was beyond the Commission?s statutory authority. U S WEST sought a determination by the court that would have vacated the Fifteenth Order and required the Commission to determine U S WEST?s revenue requirement without considering directory advertising revenue. This would have largely offset the rate decrease ordered by the Commission.

The Commission appeared as a respondent in the appeal to the Superior Court and the Supreme Court and submitted argument through counsel in the form of briefs to the courts (Ex. 103 at 1, 4, 5). The Commission?s arguments defended the Fifteenth Order and resisted the relief U S WEST sought (*Id.*). In defending the Fifteenth Order during the appeal, the Commission characterized certain past events, including a Commission-approved transfer of certain assets that had previously been owned by Pacific Northwest Bell Telephone Company (PNB) to U S WEST Direct (Direct) effective Jan. 1, 1984 (*Id.*). The Commission also described the conditional approvals of several Publishing Agreements between PNB and Direct. The Supreme Court ruled in favor of the Commission and it denied the relief that U S WEST had sought. The Supreme Court upheld the Commission?s statutory power under RCW 80.36.140 and RCW 80.16.020, .030 and .050 to impute directory advertising revenue to U S WEST on a narrow ground. The court?s

analysis specifically reflected the Commission?s and Public Counsel?s characterizations of the 1984 transfer of assets and approvals of publishing agreements as the transfer of a ?publishing right,? a ?valuable asset,? the ?yellow pages business? and the ?lucrative yellow pages operations.?[4] The court, writing in 1997, referred no fewer than fourteen times to the fact that this business had been transferred. In all of these references the court used the past tense in referring to the transfer of the directory business. The court stated no fewer than ten times that the transfer of this valuable asset had been for insufficient consideration. The court held, referring to RCW 80.16.030:

> We view the affiliated interest statute as giving the Commission the authority to impute income to rectify the effects of the transfer of a valuable asset by the utility to its affiliate for inadequate compensation.

U S WEST, supra, 134 Wn.2d at 95.

The court held that once U S WEST had shown that fair compensation had been received, according to the Commission?s own orders, imputation may cease. *U S WEST, supra,* 134 Wn.2d at 102.

The Supreme Court issued its decision in December 1997. By that time, according to U S WEST?s evidence in this current docket, fair compensation for the transfer of the directory business, including accumulated interest, had been provided and exceeded by imputation and publishing fees that had been flowed through to ratepayers (Ex. 503). Under the express terms of the Supreme Court?s decision that upheld the Commission?s power to impute directory revenue to U S WEST, the Commission should act to end imputation.

U S WEST?s current petition is a direct response to the Supreme Court?s decision. The rulings of the court on issues that the court decided and which are relevant to the decision on the current petition are binding on the Commission. *Tucker v. Brown,* 20 Wn.2d 740, 773, 150 P.2d 604

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[4] *U S WEST, supra,* 134 Wn.2d at 101, 95, 92, 95.

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(1944). Thus, it is said that the judgment of the court became the law of the case (*Id.*). In *Tucker, supra,* the court considered an appeal from an accounting of assets that had been held by a trustee. A prior trial and appeal had resulted in the court?s determination that the successor trustee was required to perform a full accounting of the assets that belonged to the trust. In the later accounting proceeding, the court held that the requirement to perform the accounting had become the law of the case from the prior appeal.

Similarly, in the current docket the Supreme Court repeatedly stated its holding that imputation of directory revenues was justified by the prior transfer of the valuable directory publishing business by PNB to its unregulated affiliate for inadequate compensation. That determination by the court, *i.e.*, the characterization of the manner in which the unregulated affiliate came to have possession of the directory business, and what the affiliate possessed, were necessary to the court?s decision to affirm the Commission?s imputation of directory revenues. Clearly if a transfer of an undervalued asset had not already occurred by the time the court wrote in 1997, then there would be nothing for which past imputed directory revenues (including those in the 1993-1994 test period of the Docket No. UT-950200 case), could be lawful compensation. The Supreme Court?s characterization of the event that gave possession of the business to U S WEST Dex, namely a transfer of the directory publishing business for inadequate compensation, is the law of the case. The law of the case is binding on all parties, including U S WEST, even if in prior proceedings U S WEST had espoused a different theory than that ultimately adopted by the court. U S WEST has accepted this determination, as it must, and has filed a petition consistent with the court?s decision.

B. <u>The Standards For Granting A Petition For An Accounting Order</u>.

In its Order Denying Petition to Enter Declaratory Order in this docket issued August 10, 1998, the Commission declined to issue a declaratory order pursuant to RCW 34.05.240(2). The

Commission nonetheless found that U S WEST is entitled to a prompt determination of the issue of whether fair value has been received for the ?yellow pages directory asset.? The Commission therefore directed Staff to bring a prompt petition for an accounting order to address ?the factual issues implicated in the request for a determination that fair value has been received for the asset? (*Id.* at p. 3). The factual issues that the Commission identified were (1) the appropriate period in which to value the asset; (2) the fair value of the asset; and (3) the actual amount of revenue received in satisfaction of that value (*Id.* at p. 2).[5]

In the First Supplemental Order in this docket, issued September 1, 1999, the Commission denied reconsideration on the issuance of a declaratory ruling, holding that this matter is ?more appropriate for resolution in a more formalized adjudication, which a petition for an accounting order can initiate.? There is no procedure in the Commission?s rules of procedure for obtaining an accounting order, nor is there any description of the effect of such an order anywhere in the Commission?s rules. The Commission therefore deemed Count I of U S WEST?s Petition as an application for an adjudication under WAC 480-09-400 and RCW 34.05.413(4) on the issue of whether fair value has been received for the directory asset. The Commission determined that the remaining counts were properly subjects of a declaratory ruling petition, but it declined to bifurcate the case and included the remaining counts in the adjudicative proceeding.

As an application for adjudication, this issue must be decided on the basis of the evidence in the record and on matters officially noticed in the proceeding. RCW 34.05.461(4). The Commission ruled that U S WEST has the burden of proof (Tenth Supplemental Order at p. 2). There is no statute or rule that establishes a different standard of proof than the preponderance of the evidence

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[5] U S WEST is filing separately its brief seeking a determination that the Commission is judicially and equitably estopped to determine these issues in a manner different from that which the Commission successfully argued to the Supreme Court in *U S WEST, supra.* This argument also addresses the similar point that Staff, Public Counsel, TRACER and AARP are estopped to argue inconsistently with their successful arguments to the Commission and the courts on these points.

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standard which is ordinarily applicable in civil cases.

U S WEST has introduced evidence on the three issues that the Commission identified in the Order Denying Petition. U S WEST introduced evidence that the appropriate period to value the asset was the date that the asset was transferred from regulation, January 1, 1984.[6] U S WEST introduced substantially uncontroverted evidence that on that date the fair value of the asset was no greater than $281 million.[7] U S WEST introduced substantially uncontroverted evidence that since that date, ratepayers have received the benefit of imputed directory advertising revenue exceeding $754 million and that this substantially exceeds the sum of the fair value as of January 1, 1984 plus reasonable accrued interest from that date through the date of receipt by ratepayers of the benefit of the imputed revenue.[8]

III.HISTORY OF REGULATORY AND JUDICIAL ACTION

The history of regulatory and judicial action in Washington since late 1983 with regard to directory revenues is set forth in some detail in *U S WEST, supra,* 134 Wn.2d at 88-90. Some additional elements of that history exist. The court determined at p. 88 that:

> In 1983, PNB (now U S WEST) filed an application with the Commission under RCW 80.12 (the transfer of property statute) and RCW 80.16 (the affiliated interests statute) to transfer its Washington yellow pages publishing business to Landmark Publishing Company. Because property of a utility was to be transferred and because the two companies were affiliates, the transfer required the approval of the Commission. The Commission did approve the transfer, but it did not approve the compensation to be paid under the agreement.

The court clearly characterized what was being transferred to Landmark Publishing pursuant to the application PNB filed in 1983 as the ?Washington yellow pages *publishing business*? [emphasis added].

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[6] Exs. 102-T, 107-T, 201-T, 202-T, 301-T, 303-T and supporting exhibits for all of these testimonial exhibits.
[7] Exs. 401-T at 4; 501-T at 3; neither Staff nor Public Counsel provided evidence of a different valuation as of January 1, 1984.
[8] Exs. 501-T at 9, 501-E; 503; neither Staff nor Public Counsel provided a different calculation of the cumulative impact of publishing fees and imputed directory earnings that had been flowed through to ratepayers, and interest computed on the remaining balance.

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A. Cause No. FR 83-159.

The proceeding that considered that application was Cause No. FR-83-159. The Order Granting Application in Part in Cause No. FR-83-159 issued December 30, 1983, states that PNB filed its application December 22, 1983 for an order approving a Publishing Agreement, a Memorandum of Agreement for administrative services, and the transfer of assets less related reserves and deferred items in the total amount of $23,522,946 in exchange for .21 of the sole share of Landmark Publishing Company stock. Exhibit 110 is a copy of the application. This is the application to which the Supreme Court referred at p. 88. In the Order Granting Application in Part, the Commission granted the application to transfer the assets and conditionally approved the Publishing Agreement and Memorandum of Agreement for an interim period until June 30, 1984 (Order Granting Application in Part, Cause No. FR-83-159, Ordering Paragraphs 1-3). The Commission made it clear that it neither approved or disapproved the reasonableness of any fees, charges or accounting arrangements in the Publishing Agreement or the Memorandum of Agreement (*Id.* at Ordering Paragraph 6). The Commission noted that neither the Publishing Agreement nor the Memorandum of Agreement had been finalized by the date of that Order. Exhibit 110 shows omissions of items such as dates and amounts of compensation from the Publishing Agreement.

The Fourth Supplemental Order in Cause No. FR-83-159 issued January 16, 1985, recites that orders subsequent to the December 30, 1983 order had extended the interim approval of the Publishing Agreement and the Memorandum of Agreement to December 31, 1984. Exhibit 111 is the application PNB filed October 10, 1984 for an order approving agreements for services with U S WEST Direct. In that application, PNB stated that ?PNB is no longer in the business of providing directory services? (Ex. 111 at 9). PNB further explained that the negotiations of the agreement were premised on a ?full separation? of monopoly regulated functions from competitive deregulated functions (*Id.* at 11).

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The Commission conditionally approved the now-finalized Publishing Agreement and eight separate agreements (described in Exhibit 111) that superseded the Memorandum of Agreement that had been discussed in the previous order (Fourth Supplemental Order, Cause No. FR-83-159, Ordering Paragraph 1). The Publishing Agreement was for three years, ending in 1986, with provision for two one-year extensions. It provided for specified annual payments from U S WEST Direct to PNB ?for the right to sell White and Yellow Page advertising and publish PNB?s official directories? (*Id.* at 1, 6). In this Order, the Commission neither approved nor disapproved the reasonableness of any payments that PNB would receive or make, or any profit margin PNB or USWD might derive from the agreements (*Id.* at Ordering Paragraph 8). In this Order the Commission also stated at p. 6:

> Transactions between PNB and USWD are not arms length. The Commission?s primary concern is that PNB is not undervaluing the Publishing Agreement and thereby receiving less revenue from directory than it would if it provided the service itself.

This language was recited by the Supreme Court in *U S WEST, supra,* 134 Wn.2d at 88.

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B. **Cause No. 86-156.**

The Supreme Court next described a ?later proceeding? in which the ?Commission specifically disapproved the fee to be paid to the phone company by U S WEST Direct, finding the fee for the yellow page business to be unreasonably low? (*Id.*). The ?later proceeding? was Docket No. U-86-156. The Second Supplemental Order in Docket No. U-86-156 issued October 12, 1988, recites that PNB had filed December 23, 1986 an application for an order approving ten separate agreements between PNB and USWD generally related to publishing, directory related services, unbundled directory services and administration related to support services. This application coincided with the expiration of the initial three-year term of the Publishing Agreement and eight additional agreements that had been approved in Cause No. FR-83-159. Exhibit 112 is a copy of the publishing agreement that was included in that application. The agreement was for a term of two years beginning January 1, 1987, but it specified payment from USWD to U S WEST Communications, denominated a subsidy, only for the first year, 1987 (Ex. 112 at 4, Sub-Ex. B). In the Second Supplemental Order in Docket No. U-86-156, the Commission at p. 3 described its previous action in the Fourth Supplemental Order in Cause No. FR-83-159:

> But, the Commission was unable to determine the extent to which PNB might be undervaluing its directory publishing asset and thereby transferring its directory publishing activity to US West Direct for less than full value to the detriment of PNB customers.

Thus, the Commission clearly recognized that the effect of the orders in Cause No. FR-83-159 some three years before had been the transfer of the directory publishing asset or directory publishing activity from PNB to U S WEST Direct. In this Second Supplemental Order in Docket No U-86-156, issued October 12, 1988, the Commission disapproved the amount of the publishing fee and made the findings recounted by the Supreme Court in *U S WEST, supra,* 134 Wn.2d at 88-89. Those findings included that ?the difference between the publishing fee under the publishing agreement and the reasonable value of the right to publish the ?yellow pages? constitutes

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unreasonable compensation to US West Direct? (*Id.*). U S WEST petitioned for judicial review of the Second Supplemental Order in Docket No. U-86-156, but the appeal was later dismissed based on agreement between U S WEST and the Commission that the order was not final (Fifteenth Supplemental Order, Docket No. UT-950200 at 35).

In December 1988, U S WEST Direct and U S WEST Communications reached an agreement on a month-to-month extension of the publishing agreement that had been partially approved in the Second Supplemental Order in Docket No. U-86-156. That agreement was subject to elimination of the Exhibit B payment and an eighteen-month notice of termination right for either party.

On December 20, 1988 U S WEST filed an application for an order approving the supplemental agreement. In the Third Supplemental Order in Docket No. U-86-156 issued February 7, 1989, Ordering Paragraph 7, the Commission amended the Second Supplemental Order to approve the supplemental agreement, that the Commission determined that it would review the level of the publishing fee in a full rate proceeding. In that Order, at pp. 1-2, the Commission acknowledged that it was then and had for sometime been aware of the ?undisguised policy? of U S WEST ?to reduce and finally eliminate the publishing fee in order to enhance U S WEST?s results at the expense of telephone subscribers.? The Commission expressed its disapproval of that policy in the text of the Order.

C. <u>The AFOR</u>.

The Supreme Court described the next regulatory development at *U S WEST, supra,* 134 Wn.2d at 89, as the filing in 1989 of a complaint by the Commission against U S WEST, alleging that its earnings were excessive. This complaint was settled in consolidated Dockets Nos. U-89-2698-F and U-89-3245-P through a settlement agreement. The agreement was incorporated in the Fourth Supplemental Order in those dockets, issued January 16, 1990, and resulted in a five-year

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Alternative Form of Regulation. The settlement agreement included a stipulated amount of directory imputation.[9] The settlement agreement indicated that nothing in the settlement agreement was to be taken as precedent or bind any party in a future case.[10] The five-year ?AFOR? period expired December 31, 1994.[11]

D. The Merger Case.

The Supreme Court described the next regulatory development at *U S WEST, supra,* 134 Wn.2d at 89-90, as a later (than the AFOR) proceeding involving a merger in which U S WEST ?again agreed that yellow pages directory revenues would be imputed until December 31, 1994 and then ?continue to be imputed accordingly unless and until altered by subsequent order of the Commission.?? The court found it unnecessary to decide whether this agreement waived U S WEST?s right to challenge imputation, and proceeded to hold that the Commission had the statutory authority under limited circumstances to impute directory revenues to U S WEST (*Id.* at n. 6). The merger docket was Docket No. U-89-3524-AT. In the Second Supplemental Order issued in that docket November 9, 1990, the Commission required that the Settlement Agreement that set the terms of the merger be modified to provide that directory advertising revenues would be imputed to U S WEST Communications in perpetuity. The Settlement Agreement did not otherwise address directory imputation except to state that the merger would have no effect on such imputation. U S WEST petitioned for clarification on November 19, 1990 and the Commission issued its Third Supplemental Order on November 30, 1990. The Commission modified the required change to the Settlement Agreement to state that imputation would continue until further order of the Commission. U S WEST addresses the impact of these orders in its Response to Motion for Summary Judgment, filed contemporaneously with this Brief.

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[9] Fifteenth Supplemental Order, Docket No. UT-950200 at 33.
[10] Fourth Supplemental Order, Dockets Nos. U-89-2689-F and U-89-3245-P, Appendix A at 1.
[11] Second Supplemental Order, Docket No. U-89-3524-AT at 8.

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E. **<u>Docket Nos. UT-950200 and UT-970766</u>.**

The next regulatory development came on February 17, 1995 U S WEST filed a general rate case in Docket No. UT-950200. This filing was the ?next general rate case? that went to a fully contested hearing after the Second Supplemental Order in Docket No. U-86-156. The Commission imputed directory revenue in the Fifteenth Order issued April 11, 1996. The next judicial developments followed as U S WEST appealed to the Superior Court and then to the Supreme Court, which upheld the Commission?s action. *U S WEST Comm., Inc., v. Wash. Util. & Transp. Comm.,* 134 Wn.2d 74, 949 P.2d 1337 (1997). The Supreme Court issued its opinion December 24, 1997. While the appeals were pending, U S WEST litigated an additional proceeding, the so-called ?make-whole? rate case based on the Fifteenth Order, Docket No. UT-970766, in which U S WEST in light of the Fifteenth Order, did not challenge directory imputation. The order in Docket No. UT-970766 reflected an increase in imputation from the amount included in Docket No. UT-950200 (Ex. 501-T at 13). U S WEST filed the Petition in this docket on July 10, 1998.

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A.IV. THE TRANSFER OF THE YELLOW PAGES BUSINESS

U S WEST filed its case to establish the valuation date of the directory publishing asset as of January 1, 1984, based on the fact that the Commission had previously found that on that date ?directory publishing was placed in Landmark Publishing Company.?[2] The Supreme Court upheld the Commission, referring many times in the past tense to the fact that the directory publishing business had been transferred by PNB to U S WEST Direct. *U S WEST, supra.* Staff and Public Counsel claim that the entire directory publishing business was not transferred on that date, and has never been transferred. They variously claim that only tangible assets were transferred, that intangible ?going concern? assets were ?rented? or were subject to a ?beneficial interest? even though possession may have passed to U S WEST Direct on January 1, 1984, and that ownership of the business could not have passed to U S WEST Direct on January 1, 1984 because there was no agreement of sale, complete with the accounting entries to accomplish a sale. These parties claim that imputation cannot be counted as compensation towards the fair value of the asset. Based on these claims, these parties argue that for imputation to end pursuant to the holding of the court in *U S WEST, supra,* there must be a sale transaction based upon a current valuation of the business, and a cash payment from U S WEST Dex to U S WEST Communications in the amount of that current value.

There is no evidence to support the claims of Staff and Public Counsel that the effect of the 1984 transaction that the Commission approved was to create a ?rental? of the intangible going concern value. Staff?s and Public Counsel?s (non-lawyer) witnesses were permitted to testify to legal conclusions and to speculate about the subjective intent of the Commission. None of this evidence is competent. These witnesses are not qualified to advise the tribunal on what the law is.[12]

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[12] Under RCW 34.05.452, evidence is admissible if it is the type that reasonably prudent people rely on in the conduct of their affairs, and if not inconsistent with this principle, the Washington Rules of Evidence may be a guideline. ER 702 allows expert opinion on ?scientific, technical or other specialized knowledge.? Neither Dr. Selwyn, Ms. Strain nor Mr.

These witnesses may not offer evidence on what the Commission?s subjective intent was in entering any order. *Morgan v. United States,* 304 U.S. 1, 82 L.Ed. 1129, 58 S. Ct. 773 (1938).

Staff?s and Public Counsel?s claims contradict the holding of the Supreme Court in *U S WEST, supra,* and are precluded under the law of the case and judicial estoppel.[13] Dr. Selwyn admitted that if Staff?s theory of the case is correct, then the Supreme Court was wrong in holding at 134 Wn.2d 102 that the intangible asset had been transferred (Tr. 854-856). Mr. Brosch repudiated the recommendation that Public Counsel had made and that the Supreme Court relied on, that is, for U S WEST to petition for a valuation of the asset (the publishing right) and a determination of the value that has been received from imputation to determine whether imputation should continue (Ex. 103 at 2; Tr. 692-694). Thus if the Commission is to agree with Staff and Public Counsel that the asset has not been transferred and that imputation may not count as compensation, it must tell the Supreme Court that the court was wrong in these crucial holdings.[14]

A. <u>The Yellow Pages Business Was Transferred In Its Entirety Effective 1-1-84</u>.

Under *U S WEST, supra,* 134 Wn.2d at 102, U S WEST must show that fair compensation has been received for the value of the asset it transferred. Based on the evidence, there are tangible assets that were used by PNB in publishing directories that were transferred at net book value. No party has claimed that the tangible assets were transferred at other than full value which was provided in 1984 (Tr. 1169; Ex. 610 at 64). There were also intangible assets consisting of the use of the PNB name and logo and the use of PNB subscriber listings and the noncompete agreement that were not permanently transferred and by their nature could not be permanently transferred, either in 1984 or today (Ex. 202-T at 9). PNB could not have transferred its own name to another company

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Brosch had any specialized knowledge of the law.

[13] U S WEST argues the estoppel issues separately, pursuant to the order of the Commission.

[14] If the rationale on which the Supreme Court upheld the Commission and on which a refund of over $200 million was based does not exist, then a recall of the mandate under RAP 12.9(b) would be appropriate.

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and still have done business under that name (*Id.*). PNB continued to do business under its own name after January 1, 1984. PNB could not transfer from itself the function of creating subscriber lists that are a by-product of providing local telephone service (*Id.* at 14). PNB could not have granted U S WEST Direct exclusive access to the subscriber lists because of the antitrust laws (*Id.*). PNB could not convey to U S WEST Direct the permanent right to be free of competition from PNB in the directory business everywhere in PNB?s service area because such an agreement would have been an unlawful restraint of trade. *United Dye Works v. Strom,* 179 Wash. 41, 35 P.2d 760 (1934).

However, it is consistent with the transfer of the business that there are intangibles, that is the PNB name, the subscriber lists and the right to be free of PNB?s competition, that would be licensed for a short period of time. The use of PNB?s name transitioned the ?first in the market? advantage to U S WEST Direct, but after the transition the name was not essential to carrying on the business. U S WEST, Inc. owned the U S WEST name and PNB or U S WEST Communications did not. PNB or U S WEST Communications could not authorize U S WEST Direct or U S WEST Dex to use the U S WEST name as part of a corporate name. A contractual right to be free of competition from PNB could not be enforced by U S WEST Direct beyond a limited term of years. [15]

U S WEST Direct also assumed some burdens that were costly to bear, *e.g.,* it assumed the duty to provide distribution of white page directories in satisfaction of the PNB regulatory requirement (Tr. 1130-1131).

Other intangibles that are part of the directory business could be and were transferred from PNB to U S WEST Direct (Tr. 1127). These are knowledgeable employees, proven methods of operations, and relationships with advertisers and suppliers (Ex. 201-T at 9; Ex. 301-T at 3). These

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[15] Noncompete agreements must be reasonably limited either as to geographic scope or time, in order to be lawful as partial restraints of trade. *United Dye Works v. Strom, supra*. The noncompete agreement that PNB provided was geographically unlimited because it covered all of PNB?s service territory. Some reasonable time limit would therefore be required if the agreement were to be enforced.

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relationships related to the business reputation of PNB for producing a quality directory and its status as ?first in the market? for a product that provides competitive advantages to the first provider in the marketplace. These elements could be considered ?going concern value? according to the record (Ex. 206, Tr. 1127).

B. <u>A ?Sale? As Of 1-1-84 Was Not Required</u>.

Under the law of the case, *U S WEST, supra,* the yellow pages business was transferred when the Commission conditionally approved the application that U S WEST filed in 1983 to ?transfer its Washington yellow pages publishing business to Landmark Publishing Company.? 134 Wn.2d at 88. Staff and Public Counsel argue that the business was not transferred then or at any other time because there has not been a formal agreement of sale, with a determination and payment of fair compensation. This argument presents several issues. First, is it true that an agreement of sale with determination and payment of fair compensation is the only way in which the business could be transferred? Second, is Staff?s and Public Counsel?s argument inconsistent with the history of this case? Third, is Staff?s and Public Counsel?s argument inconsistent with their own advocacy of what the imputation amounts have been?

The issue whether a formal, explicit agreement of sale is the only way in which the yellow pages business could be transferred is answered easily. Dr. Selwyn admitted that such a sale was not the only way in which the intangible assets of the directory business could have changed hands from PNB to U S WEST Direct (Tr. 832). This is really dispositive of Staff?s case. RCW 80.12.020 regulates the sale, leasing, assignment or other disposition of properties that are necessary or useful in the performance of the utility?s duties to the public. RCW 80.16.020 regulates the purchase, sale, lease or exchange or furnishing of property or ?things? between affiliates. An exchange or furnishing of property by a utility to an affiliate is within the scope of the statute. WAC 480-143-010, as it existed in 1983, addressed the same kinds of property dispositions as did RCW 80.12.020.

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WAC 480-146-090, as it existed in 1983, called for an ?Exhibit D? as part of an application for approval of an affiliated interest contract or arrangement, where the subject matter was the sale, lease or exchange of property or furnishing of property.[16] Clearly the statutes and regulations contemplate several ways in addition to a formal agreement of sale where an asset may change hands between a utility and an affiliate.

The Supreme Court held numerous times in *U S WEST, supra,* that the yellow pages publishing business was transferred by the effect of the application to approve the transfer which was conditionally approved by the Commission. The condition was the determination of fair compensation in the ?next rate case.? Another way of effecting a transfer was mentioned twice by the Supreme Court in *U S WEST, supra.* The business could be given by PNB to U S WEST Direct. Dr. Selwyn admitted that a gift is a way in which ownership can change (Tr. 836). The Supreme Court held:

> It does not matter under these statutes whether the utility paid the affiliate too much money for too little service or property, or whether (as here) *the utility gave the affiliate something of far greater value than the affiliate paid for in return.* 134 Wn.2d at 94 [emphasis added].

Later in the opinion, the Supreme court repeated this determination:

> 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.

It is clear that either an outright gift or a part gift, part sale is the construction that the Supreme Court applied to the 1984 transaction, and that either of these would transfer the rights of an owner to U S WEST Direct. The chief incidents of ownership of property are the right to its possession, use and enjoyment, and to sell or otherwise dispose of it according to the will of the owner. *Wasser & Winters Co. v. Jefferson County,* 84 Wn.2d 597, 599, 528 P.2d 471 (1974); *In re Estate of Eckert,* 14 Wn.2d 497, 128 P.2d 656 (1942). According to the uncontroverted testimony of

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[16] Copies of WAC 480-143-010 and 480-146-090 as they existed in 1983 are attached to this Brief as Appendix A.

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Max Johnson, U S WEST Direct, after January 1, 1984, had all of these incidents of ownership (Ex. 301-T at 5-12). The purpose of the current proceeding is to determine the amount of fair compensation that was not provided in 1984 and compare that to the amounts that have been received since that time.[17]

U S WEST submits that a ?sale? is not necessary under the law for a business to be transferred between affiliates.[18] However, if the Commission disagrees with this basic position, there is also authority that even if a transaction did not begin as a sale, supported by a written agreement and determination in advance of fair compensation, the law will treat the transaction as a sale if there are sufficient incidents of a sale. *Richardton Roller Mills v. Miller,* 99 Wash. 654, 170 P. 357 (1918). In *Richardton,* the court held that where a flour producer shipped a carload of flour to a person who had a contract as sales agent with the producer, but negotiations were being conducted concerning possible purchase by the agent and resale of the flour, the actions of the sales agent in selling the flour and failing to furnish invoices for such sales to the producer as agreed ?would be such an appropriation of the flour as would entitle respondent [producer] to treat the transaction as a sale, though conceding that it was not intended as a sale when the shipment was made.? 99 Wash. at 657. The court upheld judgment for the plaintiff flour producer for the price of the flour.

This case law is consistent with the determination of the Commission in the Second Supplemental Order in Cause No. U-86-156, noted by the Supreme Court in *U S WEST, supra,* 134 Wn.2d at 102, that ?if the transaction were treated as a sale of the asset and a fair price paid, then imputation of revenue would cease.? It is clearly contrary to this holding to argue, as Staff and Public Counsel do, that the 1984 transaction may not be treated as a completed transfer for the limited purposes of determining fair compensation simply because there was no formal sale

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[17] The clearest proof that U S WEST Direct had the incidents of an owner of the yellow pages business is the uncontroverted evidence that in 1997 the business was *sold*..

[18] *United States v. AT&T*, (*supra* at 201).

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agreement with determination and past payment of fair compensation. If the law were that a formal agreement of sale were necessary for the business to have been transferred, then it would have been impossible for both the Commission and the Supreme Court to have ruled that the transaction could be ?treated as a sale.? Therefore the facts of this case support the determination that the Supreme Court has already made, that the business was transferred January 1, 1984.

The record is clear that from Docket No. U-86-156 until the Supreme Court ruled in *U S WEST, supra,* PNB and then U S WEST Communications took the legal position that the Commission lacked the power to impute directory revenue to telephone operations. PNB was described in the Second Supplemental Order in Docket No. U-86-156 at 4 as arguing that ratepayers have no right to the goodwill of the directory business. U S WEST reiterated that position in Docket No. UT-950200. The Supreme Court rejected that argument in *U S WEST, supra*, and set the conditions under which imputation may end.

Staff also claimed that no transfer occurred in 1984 because Staff could not find evidence that imputations were intended as payment for the value of the yellow pages business (Ex. 701-TC at 3). Under cross examination, Ms. Strain admitted that she did not know how an installment sale would have been shown on PNB?s books in 1984 (Tr. 1160). Staff?s witness admitted that if such sale payments had been flowed through to ratepayers, the results would have been lower rates than without the payments (Tr. 1161). This is in fact what happened through imputation.

In fact, Staff?s witness admitted under cross examination that ?imputation was performed *in lieu of either a sale* in which no value was received for the assets or in lieu of publishing fees being paid that were adequate and reflected the services that were being provided? (Tr. 1203) [emphasis added]. This admission is fatal to Staff?s position that a transfer did not occur in 1984 simply because it was not called a sale and did not provide (at the time) for payment of fair compensation. Ms. Strain also admitted that the Commission often makes ratemaking decisions on affiliated interest

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transactions after the fact, and that those ratemaking decisions are not constrained by the actual accounting the utility may have done for the transaction (Tr. 1206, 1207, 1208). It is thus illogical for Staff to argue that the absence of accounting entries requires a determination that a transfer of the business did not occur January 1, 1984.

The second issue is whether Staff?s and Public Counsel?s argument that a sale was required is inconsistent with the history of this proceeding and the law of the case. The answer is that the argument is clearly inconsistent with the history and the law of the case. Throughout the opinion in *U S WEST, supra*, the court emphasized that it was concerned about the effect of the transfer of the valuable asset for inadequate compensation. The court used two definitions of ?compensation,? which included the concept of equivalent value for that which is given. 134 Wn.2d at 94, n.7. The court said that the Commission had the power under the affiliated interest statute ?to impute income to rectify the effects of the transfer of a valuable asset by the utility for inadequate consideration? (*Id.* at 95). The plain meaning of the court?s holding is that imputation is lawful if it ?rectifies? (?makes right?) the inequality of value that was created when the valuable asset of the directory business was transferred for inadequate compensation.

Staff relied on the Commission Orders, the Supreme Court?s opinion and the fact that until this current docket, U S WEST had not advanced the position before that imputation was payment over time for the value of the business, for its conclusion (Ex. 823, Tr. 905, 906). U S WEST did not advance this position before this current docket because until December 24, 1997, U S WEST?s legal position as documented in the Commission orders in Docket No. U-86-156 and Docket No. UT-950200 was that ratepayers had no legal right to the value of goodwill in the directory publishing business. The law of the state has now been pronounced by the court that ratepayers do have such a right. The court specified a way that imputation which was to provide compensation for the transfer of that asset, could end when sufficient compensation had been provided. The Supreme Court did

not hold, because it was not presented with the question, that imputation was justified as ?rent? for assets that were *not transferred.*

Public Counsel originally claimed that the Commission?s decision in Docket No. UT-950200 treated the transfer of the business and the Publishing Agreements as though they were voided by the lack of consideration (Ex. 608-TC at 32). However, under cross examination, Public Counsel?s witness admitted that the agreements were *not voided* (Tr. 625). The Supreme Court held that the power the Commission exercised under the affiliated interest statute was to ?revise and amend the terms and conditions? of the contract between the parties. *U S WEST, supra* 134 Wn.2d at 98. The revision was to ?set a fair compensation in the next rate case? (*Id.*). It is insufficient therefore to claim as Staff and Public Counsel do, that because the Publishing Agreement is not drafted as a purchase and sale agreement with specified purchase compensation, no transfer of the business occurred.[19]

Chairwoman Showalter questioned during the hearing whether there might be unstated or implicit assumptions among the parties at the time of the 1983 approval of the transfer of assets and agreements (Tr. 939) such that a formal sale agreement would not be required. Prof. Perlman testified that, consistent with the Chairwoman?s assumption, there could well be a transfer of the business between parties that had had previous dealings without any documents at all, and that in his view the Publishing Agreement reflected the transaction (Tr. 1133, 1134). Commissioner Hemstad questioned whether U S WEST?s Petition for Clarification in Docket No. U-89-3524-AT could be a ?course of conduct? that would be evidence of how any ambiguity in the agreement should be resolved (Tr. 1139). Prof. Perlman testified that events in the marketplace make it clear that a permanent transfer has taken place (Tr. 1139, 1140). There is no ambiguity in the agreement. The

[19] U S WEST does not claim that the Publishing Agreement served as the transfer document. In fact, the transfer took place on 1-1-84; the Publishing Agreement was finalized months later, and assumes a state of events in which the transfer has already occurred (Ex. 513-T at 15).

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Commission found in the Second Supplemental Order in Cause No. U-86-156 at p. 11 that ?the publishing fee as proposed appears to represent a substantial transfer of assets to US WEST Direct without adequate compensation to PNB.?

These issues have become merged in the law of the case as a result of the decision in *U S WEST, supra.* The court held that U S WEST has an obligation to give fair compensation for the transfer of the valuable regulatory asset. That obligation cannot be found in the words of the written agreements, but it exists because of the law of the case. Equally part of the law of the case is that the mechanism by which that compensation is provided is imputation, and that cumulative imputation is to be measured against the value at the time of transfer. 134 Wn.2d at 101, 102. When cumulative imputation equals the value of the asset, the authority to impute has ended (*Id.*).

The argument that no transfer of the directory business occurred in 1984 and that a lease occurred instead is also inconsistent with Staff?s and Public Counsel?s own past characterizations of the events. In Exhibit 103 at 5, Staff?s brief to the Commission in Docket No. UT-950200 is quoted. Staff there told the Commission that the Company had abandoned the valuable regulatory asset that was the yellow pages publishing function. Having told the Commission that PNB abandoned the ?valuable regulatory asset,? Staff now says that PNB transferred only the tangible assets.[20] Clearly the tangible assets are not the ?valuable regulatory asset.? Staff did not explain this contradiction in its testimony after being confronted with it by Mr. Inouye, and so the contradiction should be interpreted as a prior inconsistent admission. In the same exhibit, at p. 6, Mr. Brosch for Public Counsel is quoted as testifying that Pacific Northwest Bell transferred *?all of its directory operations, assets and liabilities* to USWD?s parent (at that time, Landmark Publishing Company) effective January 1, 1984.? At Tr. 626, Mr. Brosch reaffirmed this testimony. However,

[20] Webster?s defines ?abandon? as ?to give up absolutely.?

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Public Counsel also attempts to claim that ?intangible? assets (which would of course be included in ?all directory assets?) were not transferred. These are mutually exclusive statements, and both cannot be true.

In Idaho, Dr. Selwyn testified that a transfer of the yellow page business from regulated to unregulated status should have the exactly the same effect as an ?arm?s length cash sale? in terms of providing the gain to the ratepayers (Ex. 821 at 47). In fact, Dr. Selwyn proposed in that proceeding, in response to the company?s plan to transfer the yellow pages business to unregulated status, to ?*impute an arm?s length market value* to the yellow pages business? (*Id.*) [emphasis added]. In Idaho, Dr. Selwyn embraced the notion of imputing an arm?s length value as if an arm?s length cash sale occurred, when the only actual event was a regulatory transfer to unregulated status. Yet in Washington, where just such a transfer of the same business to an unregulated affiliate occurred in 1984, Dr. Selwyn claims that the imputation of an arm?s length value as of 1984 would be ?entirely inappropriate? because the imputation payments since 1984 were not made for the purpose of fulfilling an actual sale agreement (Ex. 823). These positions are dramatically inconsistent.

The Staff case is hopelessly confused because Dr. Selwyn did not even understand the basic premise upon which the Supreme Court upheld the Commission?s imputation. Dr. Selwyn admitted that he did not understand the statement in the Commission?s brief to the court that ?USWC has clearly provided unreasonable compensation to USWD? (Tr. At 821). The Court relied on this characterization. 134 Wn.2d at 94. Dr. Selwyn also maintained that the yellow pages business is <u>regulated</u> in Washington (Tr. 879). However, the Supreme Court quoted the Commission?s explanation that yellow pages is <u>not</u> regulated. 134 Wn.2d at 95-96.

The third issue is whether Staff?s and Public Counsel?s argument that a formal agreement of sale with fair compensation is required for the business to be transferred is inconsistent with their

characterization of the relationship as a lease. Clearly the arguments are inconsistent. There is no more formal written agreement establishing a lease than there is one establishing a sale.

There are specific characteristics of a lease. Under a lease, the owner surrenders possession of the asset for a determinate period. *Hughes v. Chehalis Sch. Dist. No. 302,* 61 Wn.2d 222, 224, 377 P.2d 642 (1963); *McLennan v. Grant,* 8 Wash. 603, 36 P. 682 (1894). Here, PNB transferred possession of the tangible assets that had been used in producing and marketing directories without any determinate period being specified. That alone negates Staff?s and Public Counsel?s lease argument. PNB also transferred its knowledgeable directory employees without there being any determinate period specified for their employment by U S WEST Direct. This too is inconsistent with an intent to leas the going concern value. While the publishing agreements were nominally for a determinate period, the uncontroverted evidence is that the effect of these agreements was to transfer the ?first in the market? advantage from PNB to U S WEST Direct (Ex. 201-T at 18). PNB would have had to struggle to win back customers, and there is no evidence that it could have won back the ?first in the market? advantage from U S WEST Direct after the term of the agreement. Also, Staff?s witness testified that it would have been ?unthinkable? for PNB to have reentered the directory business in competition with U S WEST Direct (Ex. 806-T at 9). This is additional evidence that contradicts the lease argument under the above case law.

Staff claims that what it calls a ?beneficial interest? of the directory business existed in PNB after January 1, 1984 and that because of this alleged ownership, no transfer of ownership of anything except tangible assets to U S WEST Direct occurred on January 1, 1984 (Tr. 871-872). This is a completely circular argument.[21] No statute or regulation in Washington provides for such an interest by name. This claim did not appear in Staff?s rebuttal, but was mentioned only in Dr.

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[21] Staff claims that the ?beneficial interest? meant that the intangible assets were not transferred. But Staff also claims that the reason that the intangible assets were subject to a beneficial interest was that they were not transferred.

Selwyn?s deposition. Under cross examination, Dr. Selwyn stated that what he meant by that term was the interest of ratepayers in being compensated according to *Democratic Central Committee v. Washington Metro Area Transit Comm.,* 485 F.2d 786 (D.C. Cir. 1973) (Tr. 873). Nothing in that case supports Staff?s claim. In that case, certain land that had previously been used in the regulated streetcar operation of the utility was sold pursuant to a conversion to an all-bus operation. The court held that though the operating property was nondepreciable and there was no real risk of the land going down in value, farepayers still were entitled to the capital gain during the land?s ?tenure as operating properties? because the specific facts of the conversion indicated to the court that farepayers had borne the cost of the conversion to all-bus operations that had freed the land for sale by rendering it non-operating. 485 F.2d at 822. This has nothing to do with the intangible going concern of the directory business.

According to its terms, the *Democratic Central Committee* holding applies to appreciation during the asset?s ?tenure as operating properties? (*Id.*). There is no dispute that the going concern value was never on PNB?s books.[22] Also, once the directory publishing business was transferred to U S WEST Direct, the intangibles did not become ?operating property? of PNB that was used in the production of regulated service. Nothing in *Democratic Central Committee* entitles ratepayers to appreciation in the value of assets after they have ceased being ?operating property.? These intangibles never were operating property. The court upheld the Commission?s determination that the yellow pages business is not regulated. Yet it is the increase in this going concern value *after* the transfer of the business to U S WEST Direct that Staff and Public Counsel erroneously claim belongs to the ratepayers.[23] This is of course incorrect, and is not supported by *Democratic Central*

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[22] At Exhibit 102 at 16, Mr. Inouye describes Dr. Selwyn?s deposition testimony that characterizes what was transferred as only ?book assets.?

[23] U S WEST?s position in this docket is that it has valued the goodwill that transferred to U S WEST Direct on January 1, 1984 and that through imputation and publishing fees that were flowed through to ratepayers, fair compensation for that value including accrued reasonable interest, has been given.

Committee, or any other case.

Also, *Democratic Central Committee* did not say that the utility lacked the power to sell the nonoperating property until it made the compensatory payment to ratepayers. Here, Staff claims that because the compensatory payment was not made contemporaneously, the transfer did not occur. However, nothing in the only case Staff relies upon supports this argument.

C. PNB?S Retention Of The Ownership Of Its Own Name And Trademarks, And A Licensing Of Them To U S WEST Direct, Is Consistent With A Transfer Of The Directory Publishing Business On 1-1-84.

Staff and Public Counsel claim that because PNB retained certain intangibles that had some role in the directory publishing business, PNB could not have transferred ownership of that business to U S WEST Direct in 1984 (Exs. 806-T at 6; 601-TC at 5). These intangibles consisted of the PNB name and trademarks, the right to publish the official directory and access to subscriber lists. The PNB name had appeared on the PNB directories and U S WEST Direct used this name for five years but then discontinued placing it on the directories after 1988 (Ex. 302). Neither Staff nor Public Counsel produced a witness that was qualified in the area of trademarks. Dr. Selwyn is a professional witness who generally testifies in opposition to positions of ILECs (Tr. 775) but he is not a trademark law expert (Tr. 805). Mr. Brosch admitted that he was not sure how he knew what a trademark license is (Tr. 611). Ms. Strain did not address trademark issues.

As noted above, some intangibles by their nature could not be transferred. Staff?s argument incorrectly lumps those intangibles that clearly were transferred, consisting of the business reputation and ?first in the market? advantage, with those that could not by their nature be transferred, such as the creation of subscriber lists. The former group constituted the going concern value of the business which was transferred to Direct in 1984. Transfer of the latter group of intangibles was not necessary to effectuate a transfer of the directory business (Ex. 201-T at 22).

The issue for the intangibles constituting going concern value is whether they were

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transferred to U S WEST Direct and if so, how and when? Under the law in Washington, the transfer of the goodwill of the directory business took place when the advertisers were told that U S WEST Direct was the successor to PNB and was producing the ?first in the market? directory. *Wilkinson v. Sample,* 36 Wn. App. 266, 272, 674 P.2d 187 (Div. 3 1983). Mr. Johnson testified from personal knowledge that the advertisers were informed early on that U S WEST Direct was the successor to PNB?s directory operation (Ex. 303-T at 3). Moreover, PNB withdrew from the directory business. Thus the goodwill was transferred through the mechanism that is recognized by the law in Washington. Staff?s and Public Counsel?s argument is contrary to the applicable law and the testimony of Mr. Johnson who personally participated in these events, that U S WEST Direct received and operated an ongoing business (Ex. 301-T at 3). Staff?s and Public Counsel?s argument is also unsupported by the evidence.

1. Trademark/Tradename Issues.

Prof. Perlman analyzed the trademark and trade name issues pertaining to the 1984 transfer of the yellow pages business to U S WEST Direct. Prof. Perlman is an eminent legal author and scholar on trademark issues. He has taught law in this area for more than thirty years (Ex. 201-T at 1). Under the Publishing Agreement, U S WEST Direct received the copyright for the directories, which Prof. Perlman testified is a strong indicator that U S WEST Direct owned the business (*Id.* at 16). Prof. Perlman testified in his rebuttal that this element was ?starkly inconsistent? with a characterization of the relationship as a rental or temporary transfer because PNB would have to require advertisers to change their ad copy if it were to re-enter the market and because no rational company would allow a temporary licensee of a business to acquire ownership over such an important business asset (*Id.*). Prof. Perlman was not cross-examined on this testimony.

Dr. Selwyn claimed in surrebuttal that the U S WEST Direct agreement with advertisers gave PNB the right to use advertiser?s pre-existing copy despite U S WEST Direct?s copyright (Ex. 806-

T at 17; Ex. 808). However, U S WEST established that Dr. Selwyn misread the advertiser?s agreement because PNB as an affiliate was only allowed to use the advertiser?s previously copyrighted material (Ex. 202-T at 18-19). Dr. Selwyn admitted under cross examination that he did not know how easy or hard it would have been for PNB to have re-entered the market because he did not know how much of the advertising copy was covered by the agreement on which he relied (Tr. 931). Indeed, U S WEST Direct was free to transition the going concern value of the business from PNB to itself under the Publishing Agreement and it in fact did so by changing the design of the directory covers, among other actions (Ex. 201-T at 18). Mr. Johnson gave examples of the changes over time in the directory covers which built U S WEST Direct?s brand identity (Ex. 302). The evidence is clear that everything that was necessary to operate the directory business that could be transferred was transferred January 1, 1984. Only those elements that could not by their nature be permanently transferred were retained by PNB (Tr. 1127).

Public Counsel argued in surrebuttal that paragraph 13.01 of the Publishing Agreement which required discontinuance of the use of the PNB logo on termination of the agreement meant that the transfer of the directory business was temporary (Ex. 608-T at 40). Prof. Perlman testified in rejoinder that such a provision is a standard term in a trademark license and that there is a difference between the transfer of the business and the trademark (Ex. 202-T at 3). Prof. Perlman was not cross-examined on this testimony. Public Counsel also claimed that PNB?s reservation in its application to the Commission for approval of the Publishing Agreement of the right to consider more competitive offers meant that PNB had retained the directory business (Ex. 608-TC at 40). Prof. Perlman showed that the obligation to produce and distribute white page directories is separate from the transfer of the going concern value associated with the existing yellow pages operation (Ex. 202-T at 5). The three-year Publishing Agreement was a ?window of opportunity? by which the ?first in the market? advantage passed to U S WEST Direct, even if PNB had reentered the market

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at the end of that time (*Id.* at 6).

2. Exclusive Publishing Right/Official Publisher.

Staff claimed that because PNB retained the right to confer exclusive publishing privileges, the right to use the PNB trademark and access to its own subscriber listings, it could not have transferred the directory business to U S WEST Direct on January 1, 1984 (Ex. 806-T at 4). However, Staff is simply wrong. U S WEST has established that retention of each of these items by PNB is fully consistent with a sale of the business permanently whether to a related or an unrelated party (Ex. 202-T at 8). Mr. Johnson testified that the exclusive publishing privilege was simply an agreement not to compete (Ex. 303-T at 2). Mr. Johnson also testified that the designation of U S WEST Direct as ?official? publisher in the Publishing Agreement was for PNB?s benefit because it allowed PNB to show that it was satisfying its regulatory obligation to produce white page directories (Ex. 301-T at 13). This is confirmed by current contracts with unrelated LECs that designate U S WEST Dex as the ?official? directory for the sole consideration of Direct?s publication of the LEC?s white pages (Tr. 1129-1131). None of the directories ever contained the designation ?official directory? on the cover (Ex. 302). Mr. Johnson testified that U S WEST Direct marketed its directories heavily (Ex. 303-T at 6-8). If U S WEST Direct had believed that the ?official? designation were important in the minds of advertisers, it would have used that fact in its marketing (Tr. 470).

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D. PNB At All Times Disclosed All Material Aspects Of The Transfer And The Transactions Between PNB And U S WEST Direct.

PNB followed the applicable regulations concerning disclosure of the facts surrounding its proposed transfer of the directory business to U S WEST Direct. Appendix A to this Brief contains the applicable regulations as they existed in 1983 and indeed through May of this year. The reporting that was required in 1983 concerning affiliate transactions was actually more detailed than what is required today. *Compare,* WAC 480-146-090, Appendix A, with WAC 480-146-350. WAC 480-146-090, as it existed in 1983 required an ?Exhibit D? for affiliate transactions that involved sales, exchanges, leases or furnishing of property. Exhibit 510 is the ?Exhibit D? that PNB filed concerning the transfer of the directory publishing business to U S WEST Direct.

Staff in testimony and Commissioner Hemstad in his questioning of witnesses has suggested that PNB should have disclosed the value of the business as distinguished from the value of the book assets, at the time of the original application (Tr. 1184-1185, 571). There is no legal support for this position. Regulatory accounting does not recognize book value for intangible assets such as goodwill (Ex. 509-T at 9). The utility is not permitted to earn a return on such assets. *Willcox v. Consolidated Gas Co.*, 212 U.S. 19, 53 L.Ed 382, 29 S. Ct. 192 (1909). Exhibit 510 at 7 clearly disclosed that PNB was exiting the directory publishing business. WAC 480-146-040, which was generally similar to the current WAC 480-146-260, allowed the Commission to require the applicant in a proceeding involving an affiliate transaction to provide pertinent data and information in addition to that particularly specified by statute or the regulations in Chapter 480-146 WAC. There is no evidence that the Commission was dissatisfied with the information provided or that PNB had in its possession a valuation of the business at that time that it withheld from the Commission.

Under cross examination, the Staff witness who claimed that PNB had failed to provide necessary information at the time of the original application or had misrepresented the facts,

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admitted that she was unaware of what information was required, and she did not actually contend that PNB had misrepresented the facts (Tr. 1184-6).

The Commission?s orders over the past fifteen years, and the Commission?s briefs to the Supreme Court, indicate that the Commission was clearly aware of the facts surrounding the transfer of the directory publishing business. In the Order Granting Application in Part in Cause No. FR-83-159, the Commission preserved all of its options by granting interim approval of the asset transfer and agreements for six months but indicating that it reserved judgment on ratemaking issues. That order stated at p. 2 that the new agreement between USWD and PNB was for the publication of PNB?s white and yellow page directories. In the Fourth Supplemental Order in the same cause, the Commission reviewed in detail the nine separate agreements and stated with regard to the Publishing Agreement at p. 1 that it was ?to have U S WEST Direct publish all service directories for PNB.? At p. 6 of the same order, the Commission stated that ?The Commission?s primary concern is that PNB is not undervaluing the Publishing Agreement and thereby receiving less revenue from directory than it would if it provided the service itself.? The Commission did not, as it could have done, under WAC 480-146-040, require additional information on the value of the Publishing Agreement, but it was clearly cognizant of the issue, and it approved the agreements but reserved the right to amend their terms.

In the Second Supplemental Order in Cause No. U-86-156, the Commission found at p. 12 that ?the extraction from PNB of what appears to be substantial amounts of revenue from yellow pages is in such a magnitude that [universal service] goals might well be adversely affected and deserve thorough examination.? The Commission again temporized, holding at p. 13 in Finding of Fact 5 that consideration of remedies would be in the future, notwithstanding that it found that the ?magnitude of the disparity between the publishing fee proposed by PNB and compensation which might be reasonable considering the value of the yellow pages publishing enterprise is so significant

as to possibly have significant impact upon availability and cost of telephone service.? This finding explicitly acknowledges that the issue the Commission was concerned about was the level of compensation flowing to PNB under the Publishing Agreement compared to the ?value of the yellow pages publishing enterprise.? The Commission found that there was a disparity between these two values that was of sufficient magnitude that it would ?possibly? affect universal telephone service. There is no reasonable basis to say that the Commission was not aware of the issue or that PNB or U S WEST misrepresented the nature of the transaction or failed to disclose anything that was material to the inquiry. The Commission clearly had evidence on the value of the yellow pages publishing enterprise in order for it to have entered Finding of Fact 5.

V. VALUATION

U S WEST presented the testimony and exhibits of Timothy Golden to establish the valuation of the directory publishing asset as of January 1, 1984 (Exs. 401-T - 411). Mr. Golden is a professional appraiser with fourteen years? experience and a partner at PricewaterhouseCoopers LLP. He has led a number of significant professional valuation engagements of directory publishers located throughout the world (Tr. 510; Ex. 401-T at 1-2).

Mr. Golden analyzed the value of the directory publishing business using two separate, widely accepted valuation approaches, the income approach and the market approach (Ex. 411 at 2-3). His approaches, detailed in the direct testimony, produced seven separate value estimates, which he expressed as a range of values between $1.5 billion and $1.8 billion (Ex. 411, Sch. 1). Ms. Koehler-Christensen applied normal Washington allocations to these estimates to produce a range of values for the Washington portion of the directory operation of $234.45 million to $281.34 million (Ex. 501-T at 14). In his rebuttal testimony, Mr. Golden produced alternative valuation calculations that were approximately $200 million less than his range of original conclusions when he assumed that three years of publishing fees would be paid by a hypothetical buyer (Ex. 403-T at 66).

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A. **The Proper Valuation Date Is 1-1-84.**

The central issue in this case is the identification of the proper valuation date, which is January 1, 1984. This date is the proper valuation date because on that date PNB divested the rights of an owner over this business and after that date U S WEST Direct owned those rights. Under Washington law, the ?chief incidents of ownership of property? are ?the right to its possession, use and enjoyment, and to sell or otherwise dispose of it according to the will of the owner.? *Wasser & Winters Co. v. Jefferson County, supra*; *In re Estate of Eckert, supra*. This issue is addressed in detail above.

B. **U S WEST Presented The Only Credible Valuation Study To Value The Business As Of The Date Of The Transfer.**

U S WEST presented the study performed by Mr. Golden of PricewaterhouseCoopers LLP to establish the value of the directory asset on January 1, 1984. No other party produced any estimate of the value of the directory asset on that date. Mr. Golden?s estimate was based primarily on a Discounted Cash Flow (DCF) analysis of profit stream to be produced by the publishing business over a finite projection period, plus the effect of the assumed growth of the business in perpetuity after the specific projection horizon (Ex. 401-T at 4).

Mr. Golden created two separate DCF models under the income approach. The first, or projected case was done using information that management knew or could have known in late 1983 or early 1984 for a January 1, 1984 valuation (Ex. 401-T at 5, Sch. 2a). The second, or actual case approach was done using information that became available after the fact (*Id.* at Sch. 2b). The DCF analysis produces a present value of the future profit streams (?debt free cash flow?) using the Weighted Average Cost of Capital (WACC) as the discount rate (Ex. 411 at 5). The debt free cash flows in this analysis did not assume continued payment of publishing fees above reimbursement for the cost of services provided to U S WEST Direct by PNB.

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The Capital Asset Pricing Model (CAPM) was used to estimate the cost of equity component of the WACC. Although U S WEST was publicly traded on the valuation date, Mr. Golden determined that investors would not consider its observed cost of equity as representative of the risk profile of the directory publishing business on a standalone basis (*Id.*). Mr. Golden therefore developed a cost of equity of a purchaser of the business based on an analysis of newspaper publishers, and a group of RBOCs as hypothetical purchasers to derive unlevered betas of between .75 to .90 (*Id.* at 6). Beta is a key variable in the CAPM equation that is reflective of the likely stock price volatility of the subject business. U S WEST Dex had no beta because its stock was never publicly traded. It is appropriate to adjust the observed betas of comparison companies if their leverage differs significantly from the leverage of the company that is subject to appraisal (Ex. 416). Mr. Golden used this approach and adopted a range of discount rates that is based on the higher volatility of newspaper publishers? stock prices on the upper end but tempered by the lower volatility of the stock price of an assumed RBOC purchaser of the directory publishing business on the lower end (Ex. 423).

It is critical to recognize that the market-based WACC of a hypothetical purchaser, adjusted to reflect the unique risks of the target entity, is the proper discount rate for this DCF analysis and not the authorized, book value based rate of return of the seller (Ex. 403-T at 5). Even Mr. Brosch, after offering confusing analysis in direct testimony (Ex. 601-TC at 33-34), eventually agreed with this (Ex. 608-T at 42). Dr. Selwyn did not present any evidence to support his assertion that the betas of newspapers and media companies would exceed that of U S WEST Dex (Ex. 803-C at 10). Mr. Golden presented 1984 vintage evidence which showed that large market newspaper companies were insulated from earnings volatility (Ex. 403-T at 11).

______It is important in valuing businesses to use more than one approach (Ex 419 at 56). Mr. Golden?s secondary approach was a market approach. Mr. Golden employed two different market

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analyses. The first was based on an analysis of data for seven publicly traded newspaper publishers that established a mathematical average relationship between earnings before depreciation, interest and taxes, and the sum of the market price of the companies? stock plus all of the companies? interest bearing debt (Ex. 411, Sch. 5). The second was based on an analysis of purchase transactions of small to medium sized directory publishers and printers over a two year period beginning in 1984 (*Id.* Sch. 6). For additional corroboration, Mr. Golden analyzed trends in U S WEST Direct?s growth in earnings, general inflation history and changes in investors? valuation multiples over the past fourteen years. These trends reasonably reconciled his 1984 valuation conclusions in relation to the 1997 disclosure that the directory operations previously held by U S WEST Media Group would be transferred to U S WEST Communications for a price of $4.75 billion (Ex. 411 at 9).

In his rebuttal, Mr. Golden produced an alternative value analysis that was based on a theory advocated by Staff and Public Counsel in their testimony that publishing fees would be paid by the purchaser of the directory business to the local telephone company. Assuming that such fees would be paid for the three years of the publishing agreement, these alternative calculations reduced his estimated range of values by approximately $200 million (Ex. 403-T at 65-66; Tr. 565)

Mr. Golden?s analysis is based on generally accepted methods of professional business valuation experts, and either publicly available information or information that is taken from company records and has been provided in discovery. Mr. Golden?s estimate of a January 1, 1984 total U S WEST Direct value of $1.5 billion to $1.8 billion is supported by the record. This estimate reflects the effect of publishing the white pages and yellow pages together (Tr. 564). This estimate fully reflects the effects of the agreement by PNB not to compete in the market and the value of the ?first in the market? characteristic (Tr. 566). This reflects a ?best case? view, in that any payment that the purchaser would have to have made to use any intangible assets that were retained by the

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telephone company, would reduce the value of the business (*Id.*). Ms. Koehler-Christensen?s allocation of that value to Washington to produce an estimated range of $234 million to $281 million is based on traditional imputation analysis and is also supported by the record. These estimates are the only credible estimates of the 1984 value of the directory publishing business that are in evidence.

1. Although Staff Criticized Mr. Golden?s Approach, It Conceded The Result.

Staff sought to discredit Mr. Golden?s analysis on the basis that it was performed fifteen years after the date of transfer of the asset. Mr. Golden agreed that such a long period between the valuation event and the date of the establishment of value is unusual, but stated that from the standpoint of a business valuation expert, there is nothing wrong with conducting a valuation analysis 15 years after the transaction (Tr. 512 and 579). The effect of this unusual approach was only that Mr. Golden placed more reliance on company documents and third party publications rather than interviews with company managers (Ex. 401-T at 3). Staff introduced no evidence that would show that the estimate of value that Mr. Golden produced is unreliable, simply because it was created fifteen years after the valuation date. More importantly, Staff produced no evidence of an alternative valuation of the business as of 1984.

Staff?s witness, Dr. Selwyn, admitted that the DCF methodology for valuing a business such as the directory publishing business that Mr. Golden used is ?generally sound? (Ex. 801-T at 46). Dr. Selwyn conceded that subject to what he characterized as certain input errors and the ?problematic? nature of Mr. Golden?s corroborating analyses, ?[Mr. Golden?s] DCF-based valuation method could indeed approximate the value of the yellow pages business *as it was on January 1, 1984?* (*Id.* at 47) [emphasis in original]. Nowhere in Exhibit 803-C, which was Dr. Selwyn?s analysis of Mr. Golden?s study, did Staff?s witness ever say what the mathematical effect of the so called ?input errors? was in aggregate or individually on Mr. Golden?s calculation of the

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1984 value. Mr. Golden demonstrated that quantifying all of Dr. Selwyn?s and Mr. Brosch?s criticisms (except for the level of the discount rate and the suggestion that Dr. Selwyn abandoned in his deposition that multiple discount rates should be used within the same model), would *reduce* the estimate of 1984 value produced by the Actual Case approach by $39.5 million (Ex. 403-T at 46).

The lone argument that Dr. Selwyn made on the level of the discount rate in Mr. Golden?s study was that Mr. Golden had selected a beta factor that was too high (Ex. 803-C at 9-10). Mr. Golden rebutted Dr. Selwyn?s testimony on the use of the 15% to 16% discount rate in detail (Ex. 403-T at 9-17). Mr. Golden pointed out that Dr. Selwyn introduced no evidence to support his claim that the volatility of *earnings* of newspapers would be higher than that of directory publishers (*Id.* at 11). Indeed, the evidence suggests that newspaper publishers enjoy market power for their advertising prices, which could reduce earnings volatility (*Id.* at 10). Dr. Selwyn contended that the ILEC-affiliated directory publishing business has market power which reduces tendencies toward volatile earnings. Mr. Golden also testified that *beta* measures the volatility of *stock price,* which is directly influenced by capital structure and tax rates as well as earnings performance (*Id.* at p. 13). Although he introduced surrebuttal testimony to the rebuttal evidence of other U S WEST witnesses Dr. Selwyn elected not to respond to any of Mr. Golden?s rebuttal.

The Staff witness? sole criticism of Mr. Golden?s estimated terminal year growth rate was that it differed substantially from the terminal year growth assumptions in what Dr. Selwyn erroneously termed a ?1997 valuation? that was performed in connection with the U S WEST/Media One restructuring[24] (Ex. 805-C at 9). Mr. Golden established in his rebuttal testimony that this criticism is irrelevant, because the time periods of the analyses were completely different (Ex. 403-T at 18-19). Given the changes in the U.S. economy between 1983 and 1998, the

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[24] There is no evidence that a valuation was done. The Financial Advisors announced an opinion on the fairness of a proposed price for the transaction.

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two sets of estimates of terminal year growth should certainly be different (*Id.*). Dr. Selwyn did not submit surrebuttal on this point and Mr. Golden was not cross-examined on this testimony.

Based on the record, Staff conceded that Mr. Golden?s estimate could approximate the 1984 value of the directory business, subject to alleged errors that Staff did not quantify. When Mr. Golden quantified them, these supposed errors, which were in reality matters of difference in judgment, actually reduced the estimate of value. Mr. Golden responded to Dr. Selwyn?s claims on the discount rate and terminal growth rate and Dr. Selwyn did not introduce surrebuttal. Staff has shown no errors in U S WEST?s estimate.

Staff criticized Mr. Golden?s use in the Projected Case analysis of data that, according to Dr. Selwyn, would not have been available until 1984 and claimed that the Projected Case was ?tainted? with *ex post* data (Ex. 803 at 10-11). In his deposition, Dr. Selwyn elaborated that under his theory, for a transaction to become effective on January 1, 1984, agreements and the valuation data collection effort would have to be completed as early as July 1983 (Ex. 403-T at 70). Mr. Golden established that Staff is incorrect, pointing out that pricing models are dynamic and it is typical in arms? length transactions for data that affects the price to arrive up to and after the closing date and that prices change in response to such data (*Id.*). Mr. Golden was not cross-examined on this testimony.

Staff criticized Mr. Golden?s use of the observed ratios of Business Enterprise Values to EBDIT for certain publicly traded newspaper and media companies on the basis that the companies were not comparable. Staff produced no competent evidence that use of this comparison for secondary support is inappropriate for a business valuation professional. Dr. Selwyn admitted that he had done no comparable evaluation for a business in his career (Tr. 935).

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2. Staff?s Cross Of Mr. Golden Failed To Disclose Any Errors In His Work.

In cross examination of Mr. Golden, Staff introduced Exhibit 413, consisting of *ValueLine* ?tear sheets? for October 26, 1984 for four RBOCs including U S WEST. These were the same companies that Mr. Golden used in his analysis to estimate an appropriate beta for a hypothetical RBOC purchaser of the directory business as of January 1, 1984. The exhibit showed no information on beta for these companies. Mr. Golden testified that he did not use *ValueLine?s* betas and instead used another publicly available source that his firm has found to be superior (Tr. 580).

Staff also introduced Exhibit 414, which stated that Mr. Golden did not have information on the advertising rates for the companies that he used to calculate the beta factor. Mr. Golden testified that it was appropriate to use the seven companies even though he had no information on their advertising rates because the rates were a ?fairly minute variable in a business?s overall structure? (Tr. 581). Staff also asked Mr. Golden about the relative risk of directory advertising and newspaper publishing, and Mr. Golden testified that although he could not quantify the relative risks, there were some aspects of the businesses that would make directory advertising less risky but some which would make it more risky (Tr. 517, 519). Mr. Golden testified that the RBOCs have lower betas than the newspaper publishers even though the former have more debt than the latter in part because RBOCs have a regulated source of income and are plant intensive (Tr. 521, 522). Mr. Golden also testified that based on Exhibit 415-C and assuming a market value capital structure, U S WEST Direct had a capital structure that more closely resembled that of a newspaper publisher than it did that of an RBOC (Tr. 523). As noted above, the effect of capital structure on the estimate of beta is pertinent to deriving the *purchaser?s* WACC, and in this analysis the purchaser is not U S WEST Direct. Mr. Golden?s testimony on the use of unlevered and relevered betas is consistent with the authority he cited on the point (Ex. 416). Nothing in the cross examination of Mr. Golden in any way invalidates his estimate of the 1984 value of the directory publishing business.

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3. Public Counsel Criticized Mr. Golden?s Inputs But Implicitly Endorsed The DCF Approach And Failed To Introduce Any Evidence On The Correct Valuation As Of January 1, 1984.

In Exhibit 601-T at 31-34, Public Counsel?s witness, Mr. Brosch, attacked Mr. Golden?s WACC calculation which was used in his DCF valuation on the basis that it was based on a cost of equity that was higher than that previously allowed by the Commission for U S WEST Communications, and higher than that which was implicit in the imputation calculation for U S WEST in Docket No. UT-950200, and for PNB in two previous PNB rate cases. That was the extent of Mr. Brosch?s direct testimony on that issue. In response to Mr. Golden?s rebuttal, Exhibit 403-T at 5 which noted that it is the *buyer?s* cost of capital that is relevant in a valuation, Mr. Brosch stated in Exhibit 608-T at 42 that he did not mean to imply that the buyer of the directory business would have the same cost of capital as PNB, and that he himself had used a higher ROE than would be allowed a regulated telephone company *in 1999.* There is no evidence from Public Counsel that Mr. Golden?s 1984 WACC is inappropriate for use in the valuation.

In Exhibit 601-T at 36, Mr. Brosch claimed that what he called Mr. Golden?s terminal year growth rate of 5.5% was too low because the five-year management projections that Mr. Golden relied on for his projection approach predicted double digit growth rates.[25] Mr. Brosch testified that

> a more practical approach is to discount cash flows from two time periods, an ?explicit? forecast period and a ?continuing value? associated with the period after the explicit forecast period. Mr. Golden employs a commonly accepted ?terminal year? convention to estimate the continuing value after the explicit forecast periods in his Schedules 2a and 2b (Ex. 601-T at 34-35).

In cross, Mr. Brosch repeated that the terminal year growth rate is ?applied to a period beyond the near term explicit forecast period? (Tr. 697). Mr. Golden clearly used a five year explicit forecast period for his projection approach, ending in 1988. Mr. Brosch admitted that he did not

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[25] Mr. Golden?s terminal year growth estimate was a range of between 5% and 6%, not a single number as Mr. Brosch claimed (Ex. 403-T at 19).

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know what U S WEST or U S WEST Direct management had been forecasting in December 1983 for growth for the period beyond 1988 (Ex. 610 at 136). Mr. Brosch?s testimony is simply self-contradictory. He criticized Mr. Golden for not using a growth forecast applicable to the *explicit forecast period,* as a measure of growth *beyond* that period, even though he recognized that these are two different growth estimates. Mr. Golden showed with detailed evidence why it would not have been reasonable for management to have projected a continuation of indefinite double digit growth beyond the explicit forecast period and why it is reasonable that ultimate growth would converge towards the rate of inflation (Ex. 403-T at 20-26). In his surrebuttal, Mr. Brosch attempted to salvage this position by referring to growth only *since 1990,* and concluding that added to forecasted inflation, such growth supports the 5.5% terminal growth rate for the period after 2003 he employed in his 1999 vintage value estimate (Ex. 608-TC at 45). As unreasonable as this position is for Public Counsel?s estimate of current value, as discussed below, it has no applicability to Mr. Golden?s estimate of the value of the directory business in 1984.

Public Counsel criticized Mr. Golden?s use of the December 31, 1983 tax rate in his Actual Case as well as the Projected Case. Although Mr. Golden rebutted this criticism by pointing out that no one in 1983 could have foreseen the changes in the tax law, he showed that including the actual tax rates in his Actual Case increased the value by only 3.3% (Ex. 403-T at 40). It would be unreasonable to use the tax rate changes after 1986 in the projected case, because no valuation professional in 1983 could have predicted these changes (*Id.* at 39). Mr. Brosch did not respond to this evidence in surrebuttal.

Mr. Brosch also criticized Mr. Golden?s treatment of certain capital expenditures in 1997 in his Actual Case analysis. Mr. Golden testified in rebuttal that since these expenditures were actually made to run the publishing business, the only issue is the timing of their reflection (Ex. 403-T at 42-43). Mr. Golden chose the timing that because of present value factors, made the valuation the

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highest, thereby insuring that ratepayers are not undercompensated (*Id.*).

4. Public Counsel?s Cross Of Mr. Golden Did Not Produce Evidence Of Errors.

Public Counsel established through Exhibit 419 that Schedule 6 of Exhibit 402 was a secondary approach designed to give Mr. Golden as the analyst a sense of the value of businesses that were being sold in the marketplace (Tr. 539). This is important as a secondary corroborative approach, even if the data are not adequate for the approach to have primary importance (Tr. 542). U S WEST established because of the existence of business cycles it is inappropriate to ?cherry pick? only the years where high growth occurred in estimating a terminal year growth value, and that Mr. Brosch was naive to suggest a 7% terminal growth rate (Tr. 547). Mr. Golden testified under cross from Public Counsel that the difference in values in his projected case approach that results from the difference in terminal year growth rates of 5% and 6% was $135 million (Tr. 550). Such a differential makes it important that the assumptions in the valuation be reasonable, be tested by corroborative market-based data and not be merely ?plugged in? to a model (Ex. 410 at 6). U S WEST has shown that at the upper limit of value, fair value has been paid to ratepayers.

5. Staff?s And Public Counsel?s Estimates Of The Current Value Of The Directory Publishing Business Are Flawed And Unreliable.

Mr. Golden demonstrated that when compared to the Financial Advisor?s February, 1997 disclosure of the price at which the directory operation would be fairly transferred back to U S WEST Communications, Staff?s and Public Counsel?s estimates of current value are wildly overstated. Mr. Golden calculated the implicit annual growth rates in value from the Financial Advisors? $4.75 billion estimate to those of Staff and Public Counsel that were for January 1, 1999 (Ex. 403-T at 50). Those growth rates, for an eleven-month period annualized, were between 19.7% and 62.2% for Staff and 88.7% for Public Counsel. Mr. Golden testified that the growth in directory revenue during calendar 1998 was only 7% (*Id.* at 51). Neither Staff nor Public Counsel explained

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this facially unreasonable result.

In contrast, Mr. Golden?s own estimates of 1984 value represent growth over the ensuing fourteen years to February 6, 1998 of between 8.1% and 7.2% compounded (*Id.* at p. 50). Mr. Brosch in surrebuttal stated that he rejected the Financial Advisors? estimate of real growth beyond the forecast period because of his view of historical growth (Ex. 608-TC 48). Mr. Brosch is simply unqualified to make this determination. He has never before performed a valuation study of a yellow pages business, has never taken a course in business valuation and has never consulted professionally to assist in the sale of a yellow pages business (Ex. 610 at 7-8). Mr. Brosch provided no analysis of his own until his surrebuttal to support use of the 5.5% terminal growth rate for the period after 2003. Mr. Golden applied a range of 5% to 6% for a post-1988 period based on 1984 vintage facts and circumstances, and he testified that it is inappropriate to use that range for a 1999 vintage analysis for the time after 2003 (Ex. 403-T at 53). Mr. Golden testified in rejoinder that it is arbitrary and incorrect from a valuation standpoint to ignore evidence as shown in Exhibit 406 that periodically the business cycle acts to depress growth in earnings below the rate of growth in inflation (Ex. 410 at 4-5).

Mr. Brosch claimed that one reason why his estimate of value was so much greater than that estimated by the Financial Advisors is that there were two additional years of growth (Ex. 601-TC at 52). Mr. Brosch is simply not a credible witness on this issue. The Financial Advisors? opinion was issued for February 6, 1998 (Ex. 403-T at 49). Mr. Brosch clearly stated that his estimate was for January 1, 1999 (Ex. 601-TC at 53). That is eleven months after February 6, 1998, not two years.

Mr. Brosch?s failure to perform any secondary, market based analysis, and his justification of this failure on the basis that there are supposedly no sufficiently comparable companies to analyze, are additional facts on which the Commission should find that the Public Counsel value estimate is unsupported. Mr. Golden in rejoinder pointed out that valuation professionals, and courts

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that have considered the issue, do not require perfect comparability of companies that are used for comparison purposes to support valuation analyses (Ex. 410-T at 3).

Mr. Golden demonstrated in rebuttal that Staff erred in its assumption of a fixed dollar amount each year for working capital in calculating net debt free cash flow as a step in the DCF valuation (Ex. 403-T at 55-56). The directory business could not operate if its working capital were so limited (*Id.*). This error overstated value by $200 million (*Id.*). Dr. Selwyn did not respond to this testimony in surrebuttal and Mr. Golden was not cross-examined on it. Mr. Golden also identified an error in Staff?s use of the Gordon Growth Model, by failing to use the same growth rate in the numerator as the denominator (*Id.* at Ex. 407). Dr. Selwyn did not respond to this testimony in surrebuttal and Mr. Golden was not cross-examined on it. This error overstated value by $75 million (*Id.*). Mr. Golden also pointed out that Staff erroneously characterized as ?conservative? an adjustment that approximately doubled the depreciation expense that was observed over the 1991-1998 period by irrationally employing the average of 1997 and 1998 depreciation expressed as a percentage of EBDIT (Ex. 403-T at 57). This adjustment had the result of increasing estimated value by $100 million compared to the use of the average depreciation observed over the eight-year period (*Id.*). Dr. Selwyn did not respond to this testimony in surrebuttal and Mr. Golden was only cross-examined on his understanding of Dr. Selwyn?s use of the term ?conservative? (Tr. 525, 567).

Based on the evidence, the only credible valuation for the directory business is shown by U S WEST?s testimony to be in the range of $234 million to $281 million for Washington.

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VI.IMPUTATION ISSUES

In this section, U S WEST will discuss the fact that directory revenues (and publishing fees) that have been included in rates since 1984 have fairly compensated ratepayers for the value of the asset transferred, thus meeting the final requirement for ending imputation.

As shown in Ms. Koehler-Christensen?s testimony, the value of the Washington portion of the business was no more than $281 million (Ex. 501-T/E at 3). The directory revenues and publishing fees that were included in rates since 1984 have provided over $754 million in compensation through June 1998 (*Id.* at 9). Calculating annual imputation as a principal and interest payment, with interest at U S WEST?s authorized rate of return, produces a result which shows that ratepayers were fully compensated in 1995 (Exs. 503 and 511). A modified calculation using Public Counsel?s assumptions produces a pay-off as of 1997 (Ex. 512).

Imputation is not ?rent? for untransferred assets. It was never characterized as such in any proposal submitted by any party, and no fair reading of any Commission order suggests that it is rent. Nor does the Supreme Court decision ever characterize imputation as rent for untransferred assets, because it based its decision on repeated representations by all parties that imputation represented compensation for an unfair transfer for inadequate consideration, wherein PNB ?walked away from? or ?gave away? the yellow pages publishing business asset.

A. Compensation To Ratepayers Satisfies The Requirement That U S WEST Receive Fair Value For The Asset.

As discussed above, the Supreme Court decision states that U S WEST must show that *it* has received fair value for the transfer of the yellow pages publishing asset. However, this begs the question of what U S WEST would have been required to do with that compensation once it was received. If U S WEST (*i.e.*, its shareholders) were permitted to *keep* the fair value and not pass it through to ratepayers, this case would not have been necessary, because there would have been no

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question about ratepayer compensation. Of course, that is not the case.

The answer to the question of what would have become of that compensation if it had been given directly to U S WEST Communications is that U S WEST would have been required by this Commission to flow that compensation through to ratepayers in the form of reduced rates for telephone service. Indeed, that is exactly what has happened.

Thus, it is U S WEST?s position that the value received by ratepayers for the asset meets the requirement that U S WEST show that it has received fair value for the asset. In fact, the other parties agree with this position. Public Counsel stated that it is not necessary for U S WEST to have received compensation for the asset in order for the ratepayers to be compensated (Ex. 610 at 59). Staff has also stated that it is not necessary that U S WEST actually receive the compensation in order for ratepayers to be compensated (Ex. 104, Selwyn dep. at 43).

B. It Is Appropriate To Consider The Publishing Fees And The Amounts of Imputation Embedded In Rates As Compensation For The Value Of The Asset Transferred.

As previously discussed herein, the other parties have a theory that imputation somehow is rent for assets never transferred. This theory fails on at least two bases ? first, because all of the assets necessary to operate the business were transferred, and second, because these same parties have repeatedly characterized imputation as compensation for the value of the asset transferred.

U S WEST?s calculation of imputed revenues and publishing fees as compensation for the value of the asset transferred is the only fair and reasonable outcome, given that both Public Counsel and the Commission have supported and justified imputation as a remedy for a transfer without adequate compensation.[26] Commission Staff agreed that imputation is compensation for the transfer of assets (Tr. 1202). Public Counsel has very clearly linked the amount of imputed revenues embedded in rates to compensation for the value of the asset, stating that U S WEST should petition

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[26] See, for example, the Commission?s Supreme Court Brief at 8-9, describing imputation of revenues as a remedy for the inequity of the transfer, Exhibit 103.

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the Commission to end imputation if U S WEST believes that the *imputation has been sufficient*, and that the value of the asset should be compared to the value that has been received from imputation to determine whether imputation should continue.[27] Public Counsel?s witness affirmed that imputation is compensation for the fair value of the directory business, stating ?ratepayers have been compensated . . . through the imputation process on a periodic basis for a number of years? (Ex. 610 at 59). Thus, the parties herein have properly characterized imputation as compensation for the value of the asset transferred, and it should be treated as such in this case.

Additionally, U S WEST did not simply add up the ordered imputations, but rather calculated the compensation to ratepayers based on the benefits ratepayers actually received through lower rates. All of the amounts used in the compensation calculation were actually used in rate setting, reducing telephone rates below what they otherwise would have been (Ex. 501-T at 4). This is entirely consistent with the way Public Counsel recommended that the ratepayer benefit analysis be conducted (Ex. 509-T at 17).

Finally, the ?rent? analysis is wholly unsupported, because no party advocating that theory provided any support whatsoever for the value of the assets allegedly ?rented? or the reasonableness of the amount of imputation as a rental payment (Tr. 705; Ex. 610 at 78: Ex. 104, Selwyn dep. at 88-89).

Nor is imputation compensation for ?other services? as suggested by Commission Staff (Ex. 801-T at 53; Tr. 1204-6). U S WEST has established that all of the other services it provides to U S WEST Direct are and have been separately compensated since 1987 (Ex. 509-T at 9-14). U S WEST has shown that the even assuming that the initial publishing fees (which were a lump sum) included some compensation for services rendered does not change the outcome that ratepayers

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[27] Public Counsel Response Brief to the Supreme Court at 34-35, Exhibit 103.

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have been fully compensated (Ex. 511). Furthermore, the Second Supplemental Order in Cause No. U-86-156 identified and considered many of those ?other services? now alleged to have been insufficiently compensated. That order specifically approved both the affiliated transactions *and* the amount of compensation to be paid under those agreements, nullifying the argument that imputation has served in part as compensation for those services (Ex. 509-T at 11).

C. Full Fair Value For The Yellow Pages Publishing Business Has Been Received By Ratepayers In The Form Of Lower Rates For Telephone Service Because Of Imputation.

U S WEST has established the fair value of the asset transferred, and has established that imputed revenues and publishing fees which were included in rates should be treated as compensation for the value of the asset. The next question is whether the compensation has been sufficient to constitute the full fair value of the asset. The amount of imputation and publishing fees included in rates is not disputed. No party challenged the calculations in Exhibits 503 and 511, which show that the total compensation received through mid-1997 was $754 million. In order that ratepayers not be at risk in this transaction, U S WEST calculated the compensation as a principal and interest payment on the Washington portion of the value. The interest component to ratepayers was calculated at whatever the Commission-ordered rate of return was at the time of the imputation. This is consistent with the Commission?s determinations that U S WEST?s rate of return is a fair, just and reasonable amount for shareholders to earn; U S WEST has selected the same rate as a fair, just and reasonable rate to be paid to ratepayers on their ?investment.?

1. The Washington Portion Of The Yellow Pages Business.

The yellow pages business was valued as the entire publishing operation in fourteen states. The total value was established to be in a range of $1.5 ? $1.8 billion (Ex. 401-T). It is therefore necessary, in determining whether Washington ratepayers have received fair value, to determine the Washington portion of the business for which value must be received. U S WEST determined the

Washington portion by allocating the total value using Washington?s percentage of directory revenues for 1983. This is consistent with the Commission?s historical practice of using directory revenues as the allocator for calculating the amount of imputation. It is also consistent with how the Commission allocated the gain to Washington ratepayers in the 1985 sale of Mast Publishing (Ex. 509-T at 26).

In 1983 the Washington portion of directory revenues was 15.63% of total directory revenues. Washington?s portion was thus between $234.45 and $281.34 million (Ex. 501-T at 6-7). That amount is reduced by the amount of compensation actually received in the 1984 transfer, which was $13.7 million. Thus, the amount left to be compensated after the 1984 transfer was between $220.75 and $267.64 million (*Id.* at 3).

Other parties have suggested a different percentage as an allocator. However, their recommendations are premised on the assumption that a different transfer date is also appropriate. Having determined that a 1-1-84 transfer date is correct, there is no reason to use a percentage allocator from a different year. Additionally, Public Counsel?s suggestions that growth in yellow pages revenues in Washington could have been anticipated to be higher after 1984 is based on speculation and hindsight, without any empirical support whatsoever (Ex. 610 at 145-7). It should not be used as a basis for choosing a higher allocator than the 15.63%.

2. The Interest Calculation.

The final computation to determine whether fair value has been received is the interest component. If ratepayers are entitled to compensation, then they are arguably entitled to interest on any value they do not receive in a lump sum. U S WEST calculated an interest component in the amount of value received each year through imputation and publishing fees. The interest rate used each year was the Commission-ordered rate of return. This is essentially a variable or adjustable interest rate, reflecting the Commission?s determination of the appropriate rate of return for

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U S WEST and U S WEST Direct. The use of the ordered rate of return is consistent with the Commission?s determinations that U S WEST?s rate of return is a fair, just and reasonable amount for shareholders to earn; U S WEST has selected the same rate as a fair, just and reasonable rate to be paid to ratepayers on their ?investment.?

Furthermore, U S WEST?s interest calculation gives ratepayers the same benefit they would have received if a ratebase adjustment had been made in 1984 as suggested by Staff. Not only is U S WEST?s calculation consistent with what Staff has advocated, it is a more favorable treatment for ratepayers than was approved by the Commission in the Continental Telephone sale of Mast Publishing. In that case, the gain was simply amortized over five years. No ratebase adjustment was made and ratepayers received no ?interest? adjustment (Ex. 509-T at 22-23).

Thus, it can be seen that U S WEST?s Washington ratepayers have received full and fair value for the asset transferred in 1984, through reduced rates for telephone service as a result of imputed revenues and publishing fees embedded in rates. Since ratepayers have been fully compensated for the asset, imputation should cease.

VII. OTHER ISSUES

A. A. Imputation Is A Barrier To Entry, In Violation Of Section 253 Of The Telecommunications Act Of 1996.

U S WEST believes that the Commission should consider and determine whether imputation of yellow pages revenues is now barred by Section 253 of the Telecommunications Act of 1996. Section 253 states, in pertinent part, as follows:

> (a) IN GENERAL. ? No State or local statue or regulation, or other State or local legal requirement, may prohibit or have the effect of prohibiting the ability of any entity to provide any interstate or intrastate telecommunications service.
>
> (b) STATE REGULATORY AUTHORITY. ? Nothing in this section shall affect the ability of a State to impose, on a competitively neutral basis and consistent with section 254, requirements necessary to preserve and advance universal service, protect the public safety and welfare, ensure the continued quality of telecommunications services, and safeguard the rights of consumers.

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This section expressly exerts federal authority over intrastate telecommunications. In opening all telecommunications markets to competition, as the Act was expressly intended to do, Congress did not intend to limit the Act?s reach to federal laws and regulations, or to the interstate telecommunications market. Congress recognized that states had been responsible for conferring the monopolies in local exchange service (and other services). Accordingly, Section 253 explicitly prohibits *state or local* legal requirements or decisions that create a barrier to entry for any telecommunications provider seeking to enter any telecommunications market ? interstate or intrastate.

U S WEST believes imputation is a barrier to entry into the residential telecommunications markets in Washington. Imputation of yellow pages revenues has been shown in this docket to cause residential rates to be much lower than they otherwise would be (Exs. 601-T at 9; 608-T at 23). This creates a barrier to entry into the residential market by carriers who do not have the ability to compete with that artificially low price based on recovery some of their costs through the same revenue source. In other words, if it costs U S WEST $21 per month to provide local service, and costs a competitor the exact same amount, U S WEST?s prices do not have to reflect the full $21 because of imputation, but the competitor?s prices do.

A state legal requirement need not make entry *impossible* in order to be found to have the effect of prohibiting entry. As under antitrust law, ?[a] barrier may protect a market incumbent without completely excluding entry.?[3] A state requirement may have the effect of prohibiting entry if it simply makes entry more difficult, unattractive, or overly expensive. The FCC has elaborated on this point in a proceeding intended (among other things) to encourage competitive entry in the interstate access service market. ?[B]arriers to entry,? the FCC asserted, include ?regulations that .

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. . control rates.?[28] The FCC explained that holding rates below economic costs was incompatible with its goal of promoting efficient competitive entry:

> Rates that are held below costs are equally undesirable [as rates held above costs] because they also can distort decision-making by potential competitors concerning entry and investment in the market . . . [P]otential efficient entrants may be deterred by the appearance that incumbents? costs, as reflected in artificially depressed prices, are lower than their own . . . Only when prices equal or exceed costs will potential market entrants be able to evaluate properly the financial benefits of entering these markets . . . Permitting rates to rise to cost would facilitate efficient, competitive entry.[29]

The imputation of yellow pages revenues to U S WEST?s earnings constitutes a subsidy to local service, designed to support and encourage universal service and high penetration of telephone service by keeping rates low.[30] Such a subsidy is now in violation of the express provisions of Sections 253 and 254 of the Telecommunications Act of 1996. Subsection (b) allows a Commission to impose competitively neutral universal service support requirements. Any other type of universal service requirements run afoul of both 253 and 254. As a universal service mechanism, the imputation of yellow pages revenues is not competitively neutral, as it applies only to U S WEST?s rates.

U S WEST?s pricing of its residential service is not voluntary by U S WEST, nor is it driven by the market. Rather, it is established by order of the Commission (most recently at $12.50 per month, Docket No. UT-970766, 10th Supplemental Order, January 16, 1998). U S WEST?s prices are therefore in essence created by the Commission, and those prices, set below where they otherwise would be, create a barrier to competition for those customers. These low residential rates

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[28] *Price Cap Performance Review for Local Exchange Carriers*, FCC 95-393, 1995 WL 564434 at ? 23 (Sept. 20, 1995).
[29] *Id.* ? 26.
[30] U S WEST recognizes that the Commission does not believe that local service is subsidized. However, it is clear that the $12.50 monthly rate, even with the additional $3.50 provided by the federal SLC, does not cover the cost of basic service (estimated in Docket No. UT-980311(a) to be approximately $21), or even the cost of the loop (estimated in Docket Nos. UT-960369, et al. to be approximately $18.16, including common costs). Additionally, Judge Greene clearly characterized the yellow pages revenues as a significant *subsidy* to local rates, stating that loss of the subsidy would increase rates and might impact universal service. *United States v. AT&T*, 552 F. Supp. 131, 194 (1982).

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may in fact give U S WEST an advantage in retaining its residential customer base, but it is an advantage which is prohibited by the Telecommunications Act, and which the Commission should no longer mandate.

(b) **B. Imputation Is An Unconstitutional Taking Of Property Without Just Compensation.**

U S WEST has raised, in Count IV of its petition, the issue of whether imputation constitutes a taking without just compensation which is prohibited by the Fifth and Fourteenth Amendments to the United States Constitution and Article I, Section 16 of the Washington Constitution. The Commission should grant this count as well.

When the government condemns private property to carry on the business, ?as where public-utility property has been taken for continued operation by a governmental authority,? a taking has occurred for which just compensation must be paid. *Kimball Laundry Co. v. United States*, 338 U.S. 1, 12 (1949).

Imputing yellow pages revenue to U S WEST means that rates for its regulated telephone service are set in part by reference to a non-public utility activity involving property in which telephone ratepayers have no interest and for which fair value has been received, and denies U S WEST revenue to which it would otherwise be entitled. Yellow pages publishing is not an activity associated with the furnishing of telephone service by U S WEST, but rather belongs to Dex and its shareholders. A state may not set utility rates by reference to non-public utility business involving property in which ratepayers have no interest, regardless of whether this results in an unconstitutionally confiscatory rate of return.

The test (often referred to as the ?end result? test) set forth in *Duquesne Light Co. v. Barasch*, 488 U.S. 299, 310 (1989), and similar cases has been described as standing for the proposition that U S WEST suffers a taking only if a rate order as a whole produces overall rates so

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low as to ?jeopardize the financial integrity of the [regulated] companies.? The ?end result? test of *Duquesne* and *Hope*,[4] the precursor to *Duquesne*, does not bar U S WEST?s challenge to yellow pages imputation. *Hope* and *Duquesne* recognize generally that to avoid confiscation, a public utility must be compensated for the costs of its services and, in addition, is entitled to earn a return on its investment.

Imputation fails the ?end result? test. Imputation takes property from U S WEST Dex, and denies U S WEST revenue to which it would otherwise be entitled. Without this revenue, U S WEST Communications, and U S WEST, Inc., do not earn a fair return on their investment. Additionally, even if imputation does not result in an unconstitutional taking during the time that imputation was being used to compensate ratepayers for the value of the asset, it is undeniably a taking after the value of the asset has been fully compensated, which U S WEST has shown to be the case as of 1995.

VIII. RECOMMENDED COMMISSION ACTION

A. If The Commission Finds That Fair Value Has Been Received For the Asset, Is There Any Basis Upon Which Imputation Can Be Continued?

The holding of the Supreme Court in *U S WEST, supra,* 134 Wn.2d at 102 is quite explicit:

> We note that under the Commission?s Order, the imputation is not necessarily permanent, and the Commission?s prior orders show that *when the Company has shown it has received fair compensation from its affiliate for the value of the asset it transferred, imputation may cease.* [emphasis added]

The court made this ruling in response to a challenge by U S WEST to the Commission?s legal authority to impute directory revenues at all. Therefore, under this holding, if the Commission finds that U S WEST has shown that it has received fair compensation, and for purposes of this case all parties agree that the compensation U S WEST receives should be flowed through to ratepayers, then imputation may cease. The compensation provided by imputation, according to Staff witness Strain flows from U S WEST Direct to the ratepayers via U S WEST Communications? revenue

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requirement, and so this is consistent with the formulation in the court?s opinion (Tr. 1164).

Both Ms. Strain and Dr. Selwyn suggested that notwithstanding any determination that fair value has been received for the transfer of the regulatory asset consisting of the yellow pages publishing right or function, imputation might be continued based on the ?continuing relationship? between U S WEST Dex and U S WEST Communications, or if that relationship involved further transfers of value for inadequate compensation. Ms. Strain was unable to identify any ongoing services that U S WEST Communications provides to U S WEST Dex that are priced below a reasonable value (Tr. 1204). Staff simply infers inadequate compensation from the existence of what Staff calls ?very high profits? (*Id.*). This is wrong for two reasons. First, this double counts the value that was established for the present value in 1984 of the future income streams. Second, the profits of Dex are only considered ?very high? because accounting convention does not recognize the investment in goodwill (Ex. 206).

Dr. Selwyn likewise was unable to provide evidence of any ongoing discrimination in the relationship between U S WEST Direct and U S WEST Communications that would support a continuation of imputation if the Commission finds that fair value has been received for the directory asset (Ex. 826, Tr. 916, 917). There is no legal or factual basis for the continuation of imputation. The value of the ongoing relationship has been captured in the 1984 present value of future income streams and there is no basis for that value to be compensated twice (Tr. 564, 566).

B. <u>If The Commission Finds That Valuation Date Is 1-1-84, But That Some Portion Of The Fair Value Remains To Be Paid, How Should The Commission Proceed</u>?

U S WEST has submitted evidence from which the Commission should find that ratepayers have received substantially more in imputations and publishing fees that were flowed through to rates, than the fair value of the directory business plus reasonable accrued interest. However, should the Commission find that some amount of the 1984 value plus reasonable accrued interest remains to

be paid, Mr. Inouye testified in Exhibit 102-T at 85, that any net of the cumulative value of the directory imputations that have been included in rates and the full reasonable value of the directory asset should be credited to the rate base by crediting amounts to the depreciation reserves of any classes of plant that have reserve deficiencies. If there is any net amount left after elimination of reserve deficiencies, the amount should be spread over all depreciation reserve accounts in proportion to the accounts? share of telephone plant in service. This treatment would be consistent with Staff?s recommended ratemaking treatment for a ?sale,? and it would make the depreciation reserve levels more current with respect to theoretical depreciation (*Id.*).

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IX.CONCLUSION

For the reasons set forth herein, the Commission should enter an order granting U S WEST?s petition. The Commission should determine that revenues from the yellow pages publishing business will no longer be imputed to the regulated revenues of U S WEST Communications, Inc. because fair value has been received for the transfer of the business. The Commission should further determine that imputation should end for the reasons stated in Counts II, III & IV of U S WEST?s petition.

Respectfully submitted,

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Senior Attorney

LAW OFFICES OF DOUGLAS N. OWENS

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Douglas N. Owens (WSBA 641)

Dated September 20, 1999.

[1] *Response Brief of Public Counsel and AARP in the Supreme Court, No. 64822-1. Submitted as part of Ex. 103.*

[2] Fifteenth Order at 32.

[3] Phillip E. Areeda, *et al.*, Antitrust Law, ? 420a at 57 (1995); *see Los Angeles Land Co. v. Brunswick Corp.*, 6 F.3d 1422, 1428 (9th Cir. 1993), *cert. denied*, 114 S. Ct. 1307 (1994) (?The disadvantage of new entrants as compared to incumbents is the hallmark of an entry barrier.?)

[4] *Federal Power Comm?n, et al. v. Hope Natural Gas Co.*, 320 U.S. 591, 64 S. Ct. 281, 886 L.Ed. 333 (1944).

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