BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In Re: U S WEST's Petition for a Declaratory Order Ending Imputation of Revenues Derived from Transferred Yellow Pages Publishing Business.	DOCKET NO. UT-980948

BRIEF OF COMMISSION STAFF

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I-II. INTRODUCTION / BASIS FOR STAFF'S POSITION

US West Communications, Inc. (USWC) has filed with the Commission a petition for an accounting order to end the imputation of yellow pages revenues from US West Dex to USWC. As the Commission has emphasized, imputation occurred as a direct result of US West's decision to transfer the yellow pages operations from USWC to its unregulated affiliate for grossly inadequate compensation. That much US West admits. The Company does not contend that US West Direct (the predecessor of US West Dex) ever paid PNB (the predecessor of USWC) adequate compensation[1] for the fair market value of the yellow pages business in 1984, nor that US West Direct ever set forth any schedule to make installment payments for the value of the business until PNB or USWC received the fair market value.

To the contrary, US West from 1983 through 1997 engaged in a consistent strategy to avoid paying fair compensation for the yellow pages business to USWC. The Company in 1983 initially filed an application asking the Commission to approve the transfer of the physical and tangible assets of the yellow pages business to US West Direct for approximately $23.5 million. The Commission approved this asset transfer, but not the publishing agreements filed in 1984 and later in 1987, in which US West Direct licensed significant aspects of the yellow pages business from PNB in return for the payment of publishing fees. The Commission, in a series of orders, consistently found these fees to be inadequate. But just as significantly, US West did not contend then, nor does it contend now, that these fees constituted compensation for the value of the yellow pages business. US West initially informed the Commission that the fees represented

[1]US West now argues that the imputation of yellow page revenues "counts" as an offset to the fair market value compensation owed to USWC, but that is another matter.

a “guaranteed” revenue stream that would protect the interests of ratepayers. Nonetheless, even this supposed “guarantee” expired in 1988, when US West Direct unilaterally ended the payment of publishing fees to USWC in return for nothing.

The Commission expressed its profound disapproval in 1989, and shortly thereafter, initiated a rate case against US West. In response, the Company entered into an AFOR agreement in which it agreed to the imputation of yellow page revenues for five years, according to a specified formula. Nowhere did either US West or the Commission contend that imputation--which is not a payment at all, but simply a ratemaking adjustment to the books of USWC--represented any “payment”or offset for the value of the yellow pages business. In 1990, the Commission approved the merger of PNB, Mountain Bell, and Northwestern Bell into USWC. Under the Commission’s order, which was modified at the request of US West, imputation continued under the AFOR and until further order of the Commission.

US West’s response in 1995 was to seek an end to imputation altogether. In its general rate case, Docket UT-950200, the Company argued that imputation was illegal, as a matter of law, for eighteen different reasons. It argued that yellow pages imputation constituted a “subsidy.” But US West never contended that imputation was somehow “compensation” for the value of the yellow pages business. Nor, for that matter, did US West ever argue that PNB had ever transferred the ownership of that business to US West Direct. Those issues were irrelevant to the relief that US West sought, which was an end to the imputation of revenues, because the Commission allegedly had no statutory or constitutional authority to impose such relief. In any event, the Commission held all of US West’s arguments to be without merit, and so did the state

Supreme Court, which affirmed the Commission's decision in its entirety in US West Communications, Inc. v. Utilities and Transp. Comm'n, 134 Wn. 2d 74 (1997).

Thus, from 1983-1997, several consistent themes emerge. First, US West did not contend that it transferred the yellow pages business to its affiliate for adequate compensation. Moreover, US West never contended that it made a "gift" of this business to its affiliate. (The Commission would doubtless have disapproved of the latter, and would have invalidated it for ratemaking purposes, which is undoubtedly why the Company never made this assertion). In short, US West never contended that ownership of the yellow pages business was ever transferred from USWC to its unregulated affiliate. Nor did US West ever contend that the imputation of revenues was a means of effecting such a transfer of ownership, by offsetting the revenues against the value of the asset. So these arguments were not made by either the Company or the Commission to the state Supreme Court.

But now, according to US West, all has changed. More accurately, all changed on December 24, 1997, when the state Supreme Court issued its opinion in the rate case. Because of that opinion, US West says it now must make arguments and take positions that it never made or believed in the past, that it denied in the past, and that it contradicted in the past, in order to justify the ending of yellow pages imputation. And why is that so? Because, according to US West, this is "the law of the case."[2]

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[2]US West frequently refers to "the law of the case" in its brief. Simply stated, this doctrine generally requires adherence to decisions declaring the applicable law in previous appeals of the same case. Coffel v. Clallam County, 58 Wn. App. 517, 794 P. 2d 513 (1990). As a technical matter, US West here makes reference to issues allegedly decided in a different case, the 1995 rate case. But far more important, the issues that US West repeatedly claims the state Supreme Court decided are issues that the Court, in fact, did not decide. Those issues have been

The Company argues that the state Supreme Court, having apparently decided to resolve issues that no one brought before it, has already determined that US West must prevail here. By taking the Court's opinion out of the context in which it was issued, and carefully parsing selected words from that opinion and the prior opinions of the Commission, the Company attempts to create the illusion that all one needs to do here is ratify what the state Supreme Court has already decided.

At this point, the following must be made clear: (1) The state Supreme Court was not asked to determine, and did not determine, the appropriate date to value the yellow pages publishing business, should US West Direct ever determine to treat the transfer of the business as a sale (i.e., by paying USWC adequate compensation); (2) The state Supreme Court was not asked to determine, and did not determine, that ownership of the yellow pages publishing business was ever transferred to US West Direct; and (3) The state Supreme Court was not asked by the Commission to determine, and did not determine, that the imputation of revenues constitutes an offset or "payment" in any way for the fair market value of the yellow pages business. Those are the issues to be resolved in this case. They have not yet been decided. US West's repeated references to the Court's opinion must be read with these facts in mind.

Commission Staff will show that the appropriate date to value the yellow pages business is the date that US West decides to treat its transfer of the business as a sale, when US West Dex pays, or arranges to pay, compensation to USWC for the fair market value of the business. This is what the Commission stated that the Company should do in 1988--and it is something the

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raised here for the first time, and their resolution does not depend upon any prior law of the case.

Company has still, eleven years later, not done. The state Supreme Court decision confirmed this. The 1999 Washington-apportioned value of the business, as documented by Staff, is in the range of approximately $1.04 billion to $1.37 billion.

Commission Staff will also show that US West Dex has made no payments towards the fair market value of the yellow pages business. Imputation of yellow pages revenues is not, and never has been, a means of making such payment. The state Supreme Court correctly stated that imputation arose as a result of US West Dex's failure to pay compensation to USWC. It does not follow, however, that imputation is such compensation. Indeed, imputation is not a payment at all; it is simply a ratemaking adjustment to the books of USWC for the yellow pages revenues that US West Dex continues to earn. Imputation rectifies the books as if no transfer of yellow pages operations ever occurred, so that ratepayers are not harmed by the affiliate manipulations of US West. US West has never taken a contrary view of imputation, until it filed this petition in 1998. Its argument that "the Supreme Court made us do it,"[3] is simply not tenable.

In fact, US West's entire argument to this Commission is an exercise in revisionist history. US West asks the Commission to ignore what the Company has said and done in the past regarding its handling of the yellow pages business, and to rewrite the history of imputation. The Commission should not accept US West's invitation. The Company's petition to end the imputation of yellow pages revenues is not well taken, and should be denied.

III. HISTORY OF REGULATORY AND JUDICIAL ACTION

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[3]US West contends that it reversed its long-held previous positions and characterizations of events, and decided to file the present petition to end imputation on never-before espoused grounds, because "US West has accepted this determination [of the state Supreme Court], as it must." Id. at 7-8.

A. Cause No. FR-83-159

On December 22, 1983, PNB filed an Application with the Commission seeking approval of the transfer of certain specified tangible assets pertaining to the yellow pages business. PNB specifically sought approval of the transfer of "total companywide PNB assets" of approximately $23.5 million. These consisted of cash and other assets located in Washington and Oregon; the Washington consisted of one leasehold, station equipment, office equipment, and furniture. Ex. 110 at 2. PNB stated that the reason for the proposed asset transfer was organizational: "The purpose of the transaction is a rearrangement of USW's assets to internally provide from PNB and USW's other operating telephone companies [i.e., Mountain Bell and Northwestern Bell] the initial capitalization for USW's publishing subsidiary LPC." Id. at 3.

In addition, PNB sought approval of a three-year Publishing Agreement between PNB and US West Direct. Ex. 602. Under the Publishing Agreement, PNB leased to US West Direct, among other things, the right to publish PNB's exchange service directories, the exclusive right to use PNB's tradename and trademarks on its directories, and the right to use and publish PNB's subscriber listings, in exchange for publishing fees. Ex. 602 at 10, ¶ 10.01. PNB and US West Direct acknowledged the "unique value" of the directories due to "the breadth of circulation and the right to use the name and logo of the Telephone Company [PNB]." Id. at 1. PNB's Application further informed the Commission that:

> The Publishing Agreement is a good deal for PNB and its ratepayers because the Agreement effectively preserves a significant contribution from Yellow Page revenue to PNB's earnings in the new more competitive marketplace after January 1, 1984. Further, this revenue stream is guaranteed, so that the risk and expense of this deregulated and increasingly competitive area of business are not borne in (sic) by PNB's ratepayers. (Ex 110 at 3).

The Commission approved the transfer of the $23.5 million in assets but deferred ruling on the reasonableness of any "fees, charges, or accounting allocations involved in carrying out the provisions of the agreements," and retained jurisdiction over these matters. In the Matter of the Application of PNB, Cause No. FR-83-159, Order Granting Application in Part, at 3-4 (December 30, 1983). The Commission further stated that:

> This order shall in no way affect the authority of this Commission over rates, service, accounts, valuations, estimates, or determinations of costs, or any matters whatsoever that may come before it, nor shall anything herein be construed as an acquiescence in any estimate or determination of costs, or any valuation of property claimed or asserted. (Id. at 4, ¶ 8).

PNB did no valuation study, and provided the Commission with no valuation of the yellow pages business other than the tangible assets referred to above, in connection with its Application. In any event, the Commission clearly held that this Order in no way constituted an acquiescence in any claimed valuation of property that might later come before the Commission.

In 1984, the Commission allowed PNB to enter into the Publishing Agreement with US West Direct, but again retained jurisdiction to determine the reasonableness of any payments made until a later date. The Commission determined that:

> Transactions between PNB and US West Direct 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.

In the Matter of the Application of PNB, Cause No. FR-83-159, Fourth Supp. Order, at 6, 9. (Emphasis added.) The Commission further noted that it did not wish to disrupt PNB's

organizational desires regarding the yellow pages, but at the same time was concerned that PNB maintain complete accounting records of all of its transactions with affiliated interests:

> The Commission's principal concern in this proceeding is not to make any determination at this time in respect to issues which might possibly arise in other proceedings. Rather, it is to make it possible for PNB to legally do business with its affiliates in an orderly way. But at the same time it is essential that PNB be required to maintain such accounting records as may be needed to resolve regulatory problems affecting Washington ratepayers that could conceivably arise in other proceedings to the extent that they involve transactions with affiliated interests. (Id. at 7 (emphasis added)). [4]

B. Docket No. U-86-156.

On December 23, 1986, PNB filed an Application with the Commission for the approval of ten separate agreements between PNB and US West Direct. One of these agreements was a new two-year Publishing Agreement, effective during 1987-1988, to replace the previous three-year agreement that was to expire at the end of 1986. The Commission approved the agreements, except for the amount of the publishing fee (now labeled a "subsidy" by PNB) to be paid under the Publishing Agreement. The Commission found this fee to be "unreasonably low," and held that "the difference between the publishing fee under the publishing agreement and the reasonable value of the right to publish the 'yellow pages' constitutes unreasonable compensation to US West Direct. . . . An appropriate publishing fee should be determined in the next PNB

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[4]In response to Staff's Data Request No. 36, which asked US West to provide a copy of the chart of accounts used by US West Direct at the time it recorded the transfer of assets from PNB, US West responded, "The retention period (per US West guidelines) has expired, therefore this information has not been retained by US West Dex." Ex. 304.

general rate proceeding." In the Matter of the Application of PNB, Docket No. U-86-156, Second Supp. Order, at 1-2.

The Commission then stated that if US West wanted to effect a permanent transfer of the yellow pages business, it could do so if it elected to treat the transaction as a sale:

> The public interest requires that the full reasonable value of the directory publishing enterprise be deemed available to PNB for ratemaking purposes. The remedy selected to achieve this goal should, as far as possible, reflect the true values and market realities as if the transfer had been an arms length transaction. As found in FR-83-159, these contracts do not represent such an arms length transaction. The remedies to be considered include the approval of the contracts with appropriate adjustment of the publishing fees, the return of the publishing function to PNB, or the treatment of the transaction as the sale of a capital asset.
>
> If, as the evidence appears, PNB and USWD intended a permanent transfer of the yellow pages, treatment as a sale may be most appropriate. Such treatment would allow for determination of consideration at the time of transfer that would fairly compensate PNB. PNB would assume none of the risk, and USWD would assume all of the risk attendant to the publishing enterprise. Such a result is appropriate if US West Direct seeks to ultimately acquire all of the opportunity for profit. Treatment as a sale is very likely to reflect a result that might have been achieved by the parties bargaining at arms length. Also, no further supervision by this Commission would be necessary if the transaction is treated as a sale. US West Direct would be free to manage its business without involvement in future proceedings concerning the proper levels of compensation to PNB. PNB would have the reasonable value of its asset. (Id. at 12).

At this point, several observations should be made. First, it is clear that the Commission did not view the transfer of the yellow pages assets in 1984 as accomplishing anything more than a shifting of the yellow pages operations, for organizational convenience, to a separate affiliate. The Commission clearly did not regard this 1984 "transfer" as a transfer of ownership of the entire yellow pages business to US West Direct. For, if that had been the case, then US West Direct would have already acquired all of the opportunity for profit, and would have already

borne the risk related to the yellow pages. The Commission held, rather, that if the parties were to treat the transaction as a sale, then US West Direct would obtain these attributes of ownership in the future.[5]

Second, the Commission's order was forward-looking in nature. The Commission stated that if PNB and US West Direct wished to make a permanent transfer of the yellow pages, they could accomplish this at some point in the future by treating the transaction as a sale. The clear implication was that if US West were to take such action, determination of the appropriate consideration at the time of such transfer--such permanent transfer of the business--would fairly compensate PNB. Nothing in the order suggests that the Commission viewed 1984 as a fixed

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[5]As Dr. Selwyn explained, the Commission could not have made a retroactive assignment of financial risks between PNB and USWD, because that would have required it to ignore actual outcomes subsequent to the 1984 transaction in making this assignment. TR. 948-49:

> [Y]ou can't restore the condition of risk as it pertained to the transaction in 1984, simply by erasing 15 years of history when you have knowledge of that history. . . [I]f I know which horse won the race, there's nothing that's going to get me to retroactively bet on the losers and there's nothing that's going to make someone willing to sell me the $2 ticket on the winner for $2. . . .[T]he relationship between risk and time are inherent in this kind of a transaction, and valuation necessarily considers risk. TR 948-49.

Accordingly, the Commission's observation that "PNB would assume none of the risk, and USWD would assume all of the risk attendant to the publishing enterprise" upon treatment as a sale, inescapably implies that such treatment must be forward-looking, and not retroactive to 1984 or any other past date.

This point also resolves the alleged inconsistency that US West contends to have found in Dr. Selwyn's 1996 testimony before the Idaho PUC. Brief of US West, at 25-26. In fact, there is no such inconsistency, because the Idaho case involved a proposal for a prospective transfer of the yellow pages business out of Idaho's Title 61 (regulated) status. Ex. 821, at 47. In the instant case, US West is claiming that such an ownership transfer already occurred some fifteen years ago.

valuation date that the Company had a vested "right" to invoke, should the Company ever elect to treat the yellow pages transaction as a sale.

In fact, a careful reading of the Second Supplemental Order in Docket U-86-156 reveals that the "transfer" to which the Commission referred was not a transfer of the ownership of the yellow pages business, which US West now alleges occurred in 1984, but rather, the "transfer" of the yellow pages publishing function-- a transfer for the limited duration of the 1987 Publishing Agreement in return for a publishing fee--that the Company was asking the Commission to approve. Neither the Company nor the Commission suggested that ownership of the yellow pages business had already been transferred. To the contrary, the relief the Company sought suggested the very opposite.[6]

Third, the Commission stated that US West should treat the transaction as a sale if it wished to effect a permanent transfer of the business. US West now argues, at length, that there need be no "formal sales agreement" to transfer ownership of a business from one affiliate to another. This misses the point. The Commission clearly contemplated that "treatment as a sale" would require payment from US West Direct to PNB for the "reasonable value of its asset"--reflecting "true values and market realities" as if there were an arms length negotiation between a

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[6]US West argues at page 12 of its brief, "Thus, the Commission clearly recognized that the effect of the orders in Cause No. FR-83-159 some three years [actually, 4+ years] before had been the transfer of the directory publishing asset or directory publishing activity from PNB to US West Direct." US West's contention, that the Commission viewed the "directory publishing activity" as having already been transferred outside of the publishing agreements, is simply incorrect. The Commission's Second Supplemental Order in Docket U-86-156 clearly sets forth the Commission's view that the publishing function was being transferred (i.e. leased) to US West Direct via the publishing agreements for a term of years. The Commission's concern was that the publishing fees, to be paid annually in return, were too low.

willing seller and willing buyer. In other words, if PNB ever wished to transfer ownership of the yellow pages business, it could do so once it received the fair market value in return.

Eleven years have elapsed since the date of the Second Supplemental Order in Docket U-86-156 (October 12, 1988), and USWC has yet to exercise this option.

C. The AFOR Docket and Settlement Agreement

On February 21, 1989, the Commission on its own motion initiated a complaint against US West alleging excessive earnings. This complaint was settled by the Commission's acceptance of a Settlement Agreement and a five-year alternative form of regulation (AFOR) for US West. Dockets U-89-2698-F and U-89-3245-P, Fourth Supp. Order Accepting Settlement with Modifications, Resolving Complaint and Authorizing an Alternative Form of Regulation (January 16, 1990). The Settlement Agreement provided that a portion of US West Direct's directory advertising revenues associated with Washington would be imputed to regulated revenues, in accordance with a set formula, for the entire period of the Agreement . Id., Appendix A, at 15-28. The Settlement Agreement did not state that the imputed directory revenues constituted compensation for, or an offset to, the fair market value of the yellow pages business. Nor did the Agreement provide for an end to imputation once the imputed amounts reached a specified fair market value.

D. The Merger Docket

On December 7, 1989, PNB filed an application seeking the Commission's approval of its merger with Mountain Bell and Northwestern Bell. On November 9, 1990, the Commission initially approved the merger on the condition that "US West's directory advertising revenues

associated with Washington will be imputed, in perpetuity, in accordance with the formula in the AFOR Case settlement." In re Application of PNB for Merger Approval ("Merger Case"), Docket No. U-89-3524-AT, Second Supp. Order at 10 (November 9, 1990). The Commission further noted, "The Company agrees that the merger will have no legal impact on the issue of imputation of revenues to the company for directory advertising." Id. at 5.

US West sought a "clarification" of the order and proposed an alternative resolution of the matter. The Company proposed that it be permitted to readdress imputation in the future, based only upon "future changed conditions" that could not then be predicted with certainty:

> [US West's proposed wording change] is to reflect that today's commissioners cannot bind future commissions in perpetuity, and that it is improper to suggest that US West should not be able to advocate ever to the WUTC changes in directory imputation, based on future changed conditions that no party can predict with certainty today. Because a future commission can always change the WUTC's position on this issue, without agreement from US West, fundamental fairness requires that US West at least be able to request a commission readdress this issue, if that becomes necessary due to changed conditions.

Merger Case, US West Petition for Clarification at 3 (November 19, 1990) (emphasis added).

The Commission accepted US West's proposal, noting the Company's agreement that "the issue is best laid to rest now," and provided:

> The Settlement Agreement will be modified to require that US West Communications Inc.'s directory advertising revenues associated with Washington will be imputed, in accordance with [the formula in the AFOR case settlement]. Thereafter, these revenues will continue to be imputed accordingly unless and until altered by subsequent order of the Commission.

Merger Case, Third Supp. Order Granting Petition for Reconsideration and Amending Second Supp. Order, at 1-2 (November 30, 1990).

US West did not contend, in its petition for clarification, that imputation was a means of paying compensation for the fair market value of the yellow pages business, nor that imputation should cease once a specified amount of revenues had been imputed. This would have been a condition that US West indeed could have foreseen, had the Company, or any other party, viewed the imputation of revenues as anything different from what it is: a ratemaking adjustment to USWC's books to treat the yellow pages revenues as if they were earned by USWC.

E. The US West Rate Case (Docket UT-950200)

The AFOR settlement agreement expired on December 31, 1994. In February 1995, US West filed tariff revisions designed to effect a general rate increase of $204 million over four years. The Commission suspended the revisions and set the matter for hearing, leading to the US West rate case. On April 11, 1996, the Commission, following the submission of extensive prefiled testimony, exhibits, and cross-examination of witnesses, entered an order rejecting the proposed increase and ordering the Company to reduce its rates by $91.5 million.

In the rate case, US West vigorously challenged the Commission's imputation of yellow pages revenues as illegal. The Company advanced eighteen separate arguments on this score, challenging the Commission's statutory and constitutional authority to require imputation. Ms. Koehler-Christensen was US West's only yellow pages witness in the rate case. She testified that the imputation of yellow pages was illegal because it was an impermissible "subsidy"-- a term repeated in one form or another over sixty times in her testimony. At no time did US West contend that imputation was a means of making "payments" or "offsets" for the fair market value

of the yellow pages business. Nor did Ms. Koehler-Christensen present any amortization table contending that imputation must end because the total amounts imputed exceeded this value.

The Commission rejected the Company's arguments, finding imputation to be within the Commission's statutory authority pertaining to both ratemaking and affiliated interests. US West appealed this ruling, together with other aspects of the rate case, to King County Superior Court. Judge Lasnik affirmed the Commission's decision in all respects. USWC v. WUTC, King County Cause No. 96-2-09623-7 SEA, Summary Decision and Order Affirming Commission on all Aspects in the Rate Case (November 25, 1996). US West appealed this decision to the state Supreme Court.

F. The State Supreme Court's Decision in the US West Rate Case.

US West's arguments in its present petition to end imputation are premised entirely upon the Company's contentions as to what the Supreme Court allegedly "decided" in the US West rate case. See US West Communications, Inc. v. Utilities and Transp. Comm'n, 134 Wn. 2d 74, 949 P.2d 1337 (1997). The Company states, "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." US West's Brief, at 7. It thus becomes quite important to accurately determine the issues that the Court decided.

US West argued to the Court that the imputation of yellow pages revenues was beyond the statutory authority of the Commission and, furthermore, was unconstitutional. The Commission stressed that imputation was authorized by both the affiliated interest statutes (RCW 80.16.010-.050), and the statute that precludes unreasonable practices affecting rates (RCW

80.36.170). The unreasonable practice in question, the Commission explained and the Court agreed, was the transfer of the yellow pages operations by USWC to US West Direct for inadequate consideration. US West, 134 Wn. 2d at 95.

What mattered to the Court, and what unquestionably led it to affirm the Commission's decision, was the fact USWC had not received compensation for the fair market value of the yellow pages business. As the Court pointed out, "The Commission did explain in [the Second Supplemental Order in Docket U-86-156] that a fair contract between the Company and its affiliate for the sale of the asset would put an end to any imputation of revenues." Id. at 89. The Court understood that a fair contract was one in which USWC would receive the fair market value of the business, and the Court emphasized that this critical event had not yet occurred: "No one represents to this Court that US West Direct has paid [USWC] the fair price for the yellow pages business." Id. at 94.

US West would have the Commission believe that the Court was called upon to decide the precise nature of, and more importantly, the legitimacy and significance of, its corporate manipulations of its sister affiliates. The Court was not asked to decide this question, and did not. US West attaches immense importance to the fact that the Commission and the Court both have used the term "transfer" to describe the transaction involving the yellow pages. But this term, in the abstract, conveys little meaning, and in the context of intracompany corporate shell games, even less. The Commission recently interpreted RCW 80.12.020, part of Chapter 80.12 RCW which is entitled "Transfers of Property," in the Scottish Power decision, Re Pacific Corp.,

Docket UE-981627, Second Supp. Order, 192 PUR 4th 143 (March 16,1999). The Commission looked to the terms of that statute and stated:

> We consider the ordinary meaning of these terms and see at once that the statute encompasses transfers of title (i.e., sales), transfers of rights to possess (i.e.., leases), and transfers of any designated right or set of rights (i.e., assignments) parties may wish to carve out. (Id. at 149 (emphasis added)).

The Court knew that US West, Inc., had shifted the yellow pages operations from its regulated affiliate to a nonregulated affiliate without the payment of fair compensation, thereby depriving the ratepayers of the fruits of "an asset created by ratepayer funds during the utility's de facto monopoly". US West, 134 Wn. 2d at 96. The Court did not "rule" that US West's corporate manipulations validly transferred the ownership of the yellow pages business to US West Direct, or that the Commission had ever so ruled. The precise nature of what was transferred was not decided by the Court--other than the unquestioned fact that a sale, or "treatment as a sale," had not occurred.

Nor did the Court decide the date upon which the yellow pages business should be valued, if US West were to elect to treat the transaction as a sale. Nowhere did the Court rule that 1984 is the date that must be used. It certainly did not choose that date, or any other, on the basis that PNB then conveyed ownership of the business to US West Direct by gift, as US West now contends.[7]

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[7] The Court's observation that USWC "gave away a lucrative ratepayer-funded asset to an affiliate in return for little or nothing," id. at 96, for example, is certainly not a "ruling" that US West Direct obtained ownership of the yellow pages business by gift. The Court was not commending US West for its generosity. It was criticizing US West's action, not blessing it by creating a vested right to have the business valued as of 1984, in a later proceeding of which the Court was not even made aware. Indeed, the Commission would never have countenanced a gift of the yellow pages business, for purposes of ratemaking, if that proposition had been put

Finally, the Court understood the meaning of imputation, and it did not define it as US West contends in its brief. The Court stated:

> Simply put, in determining US West's[8] net operating income, the Commission treated some of the profit made by US West Direct as if it were income received by US West. Because US West transferred its lucrative yellow pages business to its sister company, US West Direct, for inadequate consideration, the Commission imputed (for accounting purposes) the "excess revenue" (above a set return to US West Direct) to US West. US West challenges the authority of the Commission to impute such income for the purpose of setting the rates to be charged to telephone customers. (Id. at 87).

The Court noted, quite correctly, that imputation was a means to "rectify" the fact that US West had transferred the yellow pages operations for inadequate consideration, and that imputation was a "result" of this fact. Id. at 95, 96. This is quite different from holding that imputation is the consideration for the fair market value of the yellow pages business. The Court never made such a ruling. In fact, the Court explicitly recognized that imputation simply treats revenues as if they were earned by USWC, for regulatory purposes, and treats the yellow pages transaction as if it never occurred.[9]

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squarely before it. The whole point of the affiliated interest statutes is to prevent such corporate manipulations to the detriment of ratepayers. (Furthermore, if ownership had in fact been conveyed by gift, then all of the "compensation" which US West alleges was later "paid" to USWC through the imputation of yellow pages revenues would be superfluous.) Yet, US West contends that this very event occurred, and that US West Direct became the owner of the yellow pages by "gift" [or "part gift, part sale"] in 1984. US West Brief at 20.

[8]The Court's opinion refers to USWC as "US West."

[9]US West's primary authority for its newly-found imputation theory is a citation to a prior brief of Public Counsel and AARP. See US West's Brief at 1. Notwithstanding whatever reading US West may choose to give to this citation, it was not part of the Supreme Court's ruling (though the Court did refer to it in passing, see US West, 134 Wn. 2d at 101), and it does not reflect the prior rulings of the Commission. Nor, for that matter, does it reflect US West's prior long-held understanding of imputation.

IV. THE NATURE OF THE YELLOW PAGES TRANSACTIONS

A. This case involves applying the concept of ownership to non-arms length transactions between US West affiliates, in a regulatory setting in which ratepayer interests are directly affected.

US West contends that the Commission must value the yellow pages business as of January 1, 1984, because PNB allegedly transferred ownership of the business to US West Direct on that date. Although US West often uses the term "transfer" without further qualification, its analysis necessarily relies upon the concept of ownership. See Brief of US West at 2, 16, 20-21, 36; Ex. 201-T at 4 (Perlman rebuttal). Yet US West approaches the 1984 transactions as if they occurred in the marketplace, among independent participants, with no Commission regulation and no impact on ratepayers. By engaging in this artificial analysis, US West draws improper inferences from the events that occurred, ultimately concluding that 1984 is the proper valuation date because "on that date PNB divested the rights of an owner over this business and after that date US West Direct owned those rights." Brief of US West at 36.

The Commission must not forget the setting of this case in reviewing the chain of events that occurred beginning in 1983. First, the transactions here did not occur at arms-length. The Commission directly stated as much in both Cause No. FR-83-159 (Fourth Supp. Order, at 6) and Docket U-86-156 (Second Supp. Order, at 12). US West now admits this as well. US West Motion to Strike Testimony of Commission Staff and Public Counsel, at 15 n. 7 (May 20, 1999).

PNB and US West Direct, both US West affiliates, dealt with each other under the constant oversight of their common parent, US West, Inc. Whatever actions they took relative to ownership of the business were taken under the direction of US West, Inc. Mr. Inouye confirmed

that US West, Inc., not only participated in, but dictated the negotiations regarding the yellow pages, so that US West, Inc., would end up with the future benefit of the transaction. TR 492-93. Mr. Johnson further acknowledged that US West, Inc., "would step in and make a decision" to reconcile any conflict between the two affiliates; and that US West, Inc., could direct USWC [and presumably PNB] to behave in a way, with respect to its relationship with US West Direct, in a way that was best for the overall bottom line of the Company. TR 458.

Thus, observations such as Prof. Perlman's about what PNB should have done to "protect its right to reenter the directory business," lose much of their force. See Ex. 201-T at 18 (Perlman rebuttal). Prof. Perlman admitted on cross-examination that he approached the 1984 Publishing Agreement by assuming that it was a transaction between arms-length parties, TR 1135, which in fact it decidedly was not. What PNB should do to protect its "ownership" from the claims of a third party is not relevant when US West, Inc., will ultimately make the final call.

The second important factor in this case is that the transactions at issue here did not occur in a vacuum. The Commission regulated those transactions, pursuant to state statute, to ensure that the interests of US West's ratepayers were protected. While US West contends that ownership of the yellow pages business was transferred in 1984, US West presents only two ways in which this could have happened: (1) either US West paid compensation for the fair market value of the business or made arrangements to do so over a period of time (i.e., treatment as a sale); or (2) US West transferred ownership by gift. Staff can demonstrate conclusively that

compensation was not paid for the fair market value of the business. This leaves only the "gift" option, upon which US West appears to rely. See Brief of US West, at 20.[10]

But a moment's reflection shows that this alternative, and what US West infers from it, is illusory. The Commission never approved, for ratemaking purposes, a "gift" of PNB's lucrative yellow pages business to its nonregulated affiliate. It could not do so and simultaneously protect the ratepayers' interest in this business. The Commission consistently made clear that it did not wish to interfere with US West's organization or management of the yellow pages business. This is quite different from alleging that the Commission somehow approved of a transfer of ownership by gift in 1984, or that any special rights or significance should derive from this date.

Moreover, if the date of the gift becomes the date of valuation, US West's argument becomes superfluous--why is there a need to establish a valuation date for the payment of compensation, if PNB transferred of ownership of the yellow pages by gift? A gift, by definition, entails no compensation. When analyzed properly, it becomes apparent that there is no principled basis upon which to contend that the yellow pages business should be valued as of January 1, 1984. It must be valued only when the Company elects "treatment as a sale"-- the date that US West Dex pays, or arranges to pay, USWC the fair market value of the business.

B. RCW 80.12.020 and WAC 480-143-010 required PNB to state "in full detail" all of the facts and circumstances concerning its 1983 Application for the transfer of yellow pages assets to US West Direct.

On December 22, 1983, PNB filed with the Commission an "Application for an Order Approving Agreements for Services with U.S. West Direct Company and the Transfer of Assets

[10]US West states there also might have been "part gift, part sale." Id.

to Landmark Publishing Company, wholly-owned subsidiaries of US West, Inc." (Ex. 110, cover letter) PNB filed its application pursuant to the provisions of RCW Title 80, including specifically, chapters 80.12 RCW (the transfer of property statutes) and 80.16 RCW (the affiliated interest statutes). As PNB acknowledged, "The transfer requires the approval of the Commission pursuant to RCW 80.12.020." (Ex. 108, pp. 1 and 4).

RCW 80.12.020 provides:

> No public service company shall sell, lease, assign, or otherwise dispose of the whole of part of its franchises, properties or facilities whatsoever, which are necessary or useful in the performance of its duties to the public . . . without having secured from the commission an order authorizing it to do so.

The Commission has the power to enact rules to implement this statute. RCW 80.12.050. Pursuant to this authority, the Commission enacted WAC 480-143-010, which provided in part:

> Whenever a public service company desires to sell, lease, assign or otherwise dispose of the whole, or any part of its franchises, properties, or facilities whatsoever, which are necessary or useful in the performance of its duties to the public . . . such public service company shall first file with the commission a verified application requesting the commission to approve the transaction. <u>Such application must state in full detail the facts and circumstances concerning the said transaction</u>. It shall be accompanied by exhibits made a part of the verified application, containing a copy of the instruments of transfer[.]

(Emphasis added). PNB thus was obligated to state "in full detail" the facts and circumstances concerning its proposed transaction.

The Commission has also enacted rules to implement chapter 80.16 RCW. WAC 480-146-090, entitled "Form of affiliated interest application," required US West to submit with its application the following information:

A verified copy of the proposed contract, agreement, or arrangement. If unwritten, submit a summary of the provisions of any such unwritten contract, agreement or arrangement. (Emphasis added).

C. PNB's 1983 Application requested the Commission to approve the transfer of "total companywide PNB assets" of approximately $23.5 million. PNB did not inform the Commission that it intended to transfer the ownership of the entire yellow pages business to US West Direct.

What did PNB state that it wished to "transfer" to its new affiliate? In paragraph three of its 1983 Application to the Commission, the Company explained that it sought an order:

> Approving the transfer effective January 1, 1984 to Landmark Publishing Company ("LPC"), a wholly-owned subsidiary of USW and the parent of USWC, of total company wide PNB assets in the amount of $24,101,000 less all related reserves and deferred items, or a company wide adjusted net book total of $23,522,946 in exchange for .21 share of the sole share of stock of LPC. The company assets shall consist of cash, and other assets located in Oregon and Washington. The Washington assets shall consist of one leasehold, station equipment, office equipment and furniture[.] (Ex. 108, p.3 (emphasis added)).

Nowhere in PNB's Application did the Company state that it intended to transfer ownership of the entire yellow pages business to US West Direct. Nor did the Company attach any agreements, written or unwritten, that expressed that intent. WAC 480-143-010 and WAC 480-146-090 clearly contemplated the submission of such items if, in fact, the Company intended to transfer ownership of the entire business. Yet PNB included only the publishing agreement and various agreements for services.

To accomplish the result it now contends for, the Company would have had to transfer ownership of not only the physical and tangible assets, but also the intangible assets of the yellow pages business--those assets which make the business so lucrative--to PNB's affiliate, US West Direct. The Company undoubtedly must have known that the Application's reference to only the

physical assets would be, to say the least, quite uninformative. For today, the Company admits that the Washington-apportioned value of the physical assets was only $13.6 million, while the Company contends that the 1984 Washington-apportioned value of the entire business was between $234 million and $281 million--a value nearly 20 times greater.

In fact, the evidence clearly shows that PNB never intended to, and never did, transfer ownership of the entire yellow pages business to US West Direct. The Company's actions, representations, and arguments from 1983 through 1997 all indicate that ownership was not transferred. US West now contends that this all is not really important--that the Commission should pay no heed to the Company's prior inconsistent actions and statements, and that it is irrelevant that US West has previously taken positions entirely the opposite of what it now contends to be true. See US West's Brief at 7. To the contrary, this is of paramount importance, and Staff urges the Commission to take note of everything the Company has said and done up until the present, in determining what really did happen in 1984.

D. US West has previously confirmed, on numerous occasions, that in 1983-84 PNB transferred only the physical and tangible assets of the yellow pages business to US West Direct.

US West relies extensively upon the testimony of Max Johnson, who worked for US West Direct during the time that PNB filed its 1983 Application with the Commission.[11] Mr. Johnson's prefiled rebuttal testimony in this docket contains the following exchange:

> Q: Is it your recollection that what was transferred to US West Direct was a going business, as opposed to physical assets and employees?

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[11] Actually, Mr. Johnson was employed by PNB until January 1, 1984, though he states that he negotiated "as the US West Direct representative" in 1983. Ex. 301-T at 3.

A. Very definitely, a going business was transferred from PNB to US West Direct. The entire directory operation of PNB which I was responsible for running, except for the maintenance of the white pages listing operation, was transferred to US West Direct.

Q: Besides the physical assets, were business records, practices and procedures, business know how and everything else that it takes to run a successful business transferred to US West Direct in January 1984?

A: Yes, absolutely.

Ex. 301-T, at 3 (Johnson rebuttal).

This recitation of events in 1999 contrasts starkly with Mr. Johnson's clear recollection, eleven years earlier, of what actually occurred in 1983-84. In April 1988, Mr. Johnson submitted prefiled testimony directly addressing what PNB transferred to US West Direct. He made it clear that only physical and tangible assets were transferred. After stating that the purpose of his testimony was "to describe the nature of the relationship between US West Direct and Pacific Northwest Bell, and to provide a description of the directory publishing business and the environment in which US West Direct operates," he testified:

Q: Are you familiar with Cause FR-83-159?

A: Yes.

Q: Did Pacific Northwest Bell transfer anything besides physical assets to US West Direct as a part of the transaction approved by the Commission in FR-83-159?

A: The prior testimony in this docket intimates that a broad range of publishing assets were transferred. Actually the asset transfer consisted largely of cash. The PNB portion of the transfer totaled some $24.1 million of which approximately $22.2 million was in cash. The cash transferred from the three telephone companies

provided US West Direct with its cash working capital upon its formation.

Q: What was the nature of the assets transferred?

A: The publishing-related assets were transferred at their book value and included leasehold improvements, equipment, office furniture and computer software related to the Yellow Pages. Assets related to the listing business, resulting from the service order process of the telephone company (i.e., name, address, telephone number, etc.), appropriately remained with the telephone company.

Ex. 309 at 2-3 (Rebuttal Testimony of Max Johnson in Docket U-86-156).

Ms. Koehler-Christensen likewise testified, quite recently, that PNB did not transfer ownership of the entire yellow pages business to US West Direct in 1984. In her United States District Court deposition taken in April 1997, she was designated by US West as "the person who can speak for the plaintiffs concerning the transactions between or among USWDEX, USWC, USWI, and US West Media Group."[12] Ex. 519, part 2 of 2, ¶ 5 (ex. 1). Her attorney stated, "She is here to testify about the transfer . . . she is here to talk about what was transferred." Ex. 519, part 1 of 2, at 106. Ms Koehler-Christensen testified that "the assets and the operations" of PNB, Mountain Bell and Northwestern Bell were transferred to US West, Inc., and then to US West Dex's predecessor, Landmark Publishing. Id. at 107. She was then directly asked about the nature of the assets transferred in the following exchange:

Q: Can you tell me, the assets, I assume you mean tangible and intangible assets?

A: Tangible assets.

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[12]This deposition was taken in US West v. Nelson, No. C96-6025FDB (W.D. Wash. 1997), in which US West contended that imputation of yellow pages revenues violated the First Amendment. That case was dismissed for lack of jurisdiction.

Q: Were transferred to [US West,] Inc., and the quid pro quo was a share of stock or a portion of a share of stock?

A: That's my understanding.

Q: And was there anything else?

A: Not to my knowledge.

Id. at 108. Both Mr. Johnson and Ms. Koehler-Christensen were given ample opportunity to state that US West had transferred ownership of the entire yellow pages business to its affiliate, if this had been the Company's actual intent. But they testified to the contrary, because, in fact, that was not the Company's intent.

The prior testimony of Mr. Johnson and Ms. Koehler-Christensen is consistent with the views expressed by the Company in their briefing before this Commission eleven years ago. Today, US West asserts that PNB transferred the going concern value of the yellow pages business, including intangibles such as the "first in the market advantage," to US West Direct in 1984. According to US West, "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 US West Direct after the term of the [publishing] agreement." US West's Brief at 27.

This impending "struggle" for PNB to win back customers of the business it allegedly transferred away was not at all apparent to the Company, however, in 1988. In fact, US West then made clear that there was no need to worry, because nothing really had been transferred at all. In its brief to the Commission in Docket U-86-156, the Company stated:

> The staff's apparent theory is that something the staff calls "the publishing function" was transferred from PNB to US West Direct to 1984, and that on an unjust enrichment theory, PNB should be compensated by US West Direct to put

PNB in the same position it would have been in during 1987 and each succeeding year had the transfer not occurred. As noted above, the fact is that PNB could publish now if it chose, so nothing was actually transferred in 1984.

Brief of Applicant Pacific Northwest Bell Telephone Company, Docket U-86-156, at 23-24 (June 24, 1988). (Emphasis added). PNB took great pains to inform Staff, Public Counsel, and the Commission, that PNB had not transferred the publishing function to its affiliate. The Company's contention now that ownership of the entire yellow pages business was transferred to US West Direct in 1984 simply cannot be squared with the Company's prior representations.

E. USWC did not take the actions necessary to transfer ownership of the yellow pages business to US West Direct in 1984.

US West contends that in 1984, PNB transferred the ownership of the yellow pages business to US West Direct. US West relies upon this theory to argue that, for purposes of its petition to end imputation, 1984 is the proper valuation date of the business. As shown below, the facts directly contradict US West's theory. Namely:

- Neither PNB nor US West Direct performed any valuation of the yellow pages business in 1984;
- Neither PNB nor US West Direct have any documentation to support the contention that ownership of the yellow pages business was transferred in 1984;
- US West Direct did not pay PNB any compensation for the fair market value of the yellow pages business, other than $23.5 million for the physical and tangible assets. The publishing fees US West Direct paid to PNB under the 1984 and 1987 Publishing Agreements were not compensation for the fair market value of the yellow pages business, and;
- PNB leased valuable rights to US West Direct under the 1984 and 1987 Publishing Agreements, which is inconsistent with US West's contention that ownership of the yellow pages business was transferred in 1984.

1. Neither PNB nor US West Direct performed any valuation of the yellow pages business in 1984.

US West asserts that PNB transferred ownership of the entire yellow pages business to US West Direct in 1984. Yet the Company performed no valuation study of the business in 1984. Mr. Golden confirmed this in his direct testimony. He further stated that the study conducted by PricewaterhouseCoopers was "unusual," because "[m]ost valuation studies are conducted in a time period coincident to the valuation date. In the subject case, our analysis was performed 15 years subsequent to the Valuation Date." Ex. 401-T, at 3. That date was 1984 solely because US West chose it and directed Mr. Golden to use it. As he indicated on cross-examination: "I viewed my assignment as a hypothetical. It was, 'Tim, value this business enterprise as if it had been fully transferred on this particular date.'" TR 1569.

Mr. Golden admitted that he would not expect an arms-length transaction to occur without a contemporaneous valuation study:

> COMMISSIONER HEMSTAD: . . .[I]f this had been an arms-length transaction in 1983 when the negotiations went on, I assume you would agree that a buyer and a seller exercising due diligence would probably hire someone like you to evaluate or to [go] through a process of the valuation of the value of the going business where there is not a publicly traded market for the company in the stock market. Wouldn't that occur normally?
>
> THE WITNESS: Yes. (TR 569-70)

Mr. Golden further acknowledged that he had never seen a transaction involving a transfer of the business enterprise at net book value, where the business enterprise value is much, much larger. TR 570. Even if a corporation, generally speaking, can make transfers among its affiliates for

other than the fair market value, Mr. Golden agreed that where the transaction is by a regulated company and affects ratepayer interests, the situation is different:

> COMMISSIONER HEMSTAD: . . .[A] for profit, publicly traded corporation can make transfers among it affiliates at other than fair market value, and it can happen fairly commonly, but I think you would agree that where there is a ratepayer interest, in the pricing of assets, that translates into the rates to be charged[,] that's a different kind of interest than a purely shareholder interest of an unregulated for profit company.
>
> THE WITNESS: Yes. (TR 591)

In other words, PNB would have needed to know the fair market value of the yellow pages business when transferring it to US West Direct if, in fact, PNB had intended to transfer ownership of the entire business in 1984. Yet PNB performed no study at all in 1984.

2. Neither PNB nor US West Direct have any documentation to support the contention that ownership of the yellow pages business was transferred in 1984.

US West contends that the ownership of the yellow pages business was transferred in 1984. Mr. Johnson, Ms. Koehler-Christensen, and Prof. Perlman all asserted that this must have been true. Yet, one must wonder why such an alleged transaction of such tremendous magnitude was memorialized nowhere, in not a single recorded document. After all, US West contends that the Washington-apportioned value of the business in 1984 was between $234 million and $281 million. The obvious conclusion is that ownership was never transferred at all.

Mr. Johnson's testimony today is quite the opposite of his testimony in 1988. Now, he contends that ownership of the entire business was transferred. Then, he said that only the physical and tangible assets were transferred. The only way to reconcile these two versions of events is to accept for a moment Mr. Johnson's explanation that in 1988, he was referring only to

PNB's Application to the Commission in Cause FR-83-159. That dealt with tangible assets. As to the remaining assets of the business:

> My understanding was that the Commission did not have to approve the transfer of people and the other items that were included in the transfer. (TR 380)

These "other items," as it happened, were worth quite a lot, well over $200 million. In any event, Mr. Johnson later stated:

> The actual transfer of the business occurred prior to the negotiation of the Publishing Agreements, and therefore was not included in the Agreements at all. It was an entirely separate action. (TR 381)

Asked whether there was any document that memorialized this transaction, he replied, "I suspect there was someplace, but I don't have a copy of it and wouldn't know where to look for it." Id. When later asked questions about the asset transfer, counsel informed the bench that Mr. Johnson was not the appropriate witness for this issue. TR 456.

Ms. Koehler-Christensen likewise could not offer illumination on the subject. She boldly announces in her rejoinder testimony that there was no need to refer to the "permanent and irreversible" transfer of the yellow pages business in the 1984 Publishing Agreement, because by the time the agreement was signed, "the transfer was already a 'fait accompli.'" Ex. 513-T at 15. But her testimony is unpersuasive. She contends (in contrast to Mr. Johnson) that Exhibit D of PNB's 1983 Application to the Commission "clearly described the business that was to be transferred, not merely tangible assets." Ex. 509-T at 8. But she does not state specifically where this intention is referenced because, in fact, it is not referenced anywhere.[13]

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[13]US West now argues that PNB's 1983 Application "clearly shows that PNB was exiting the publishing business." Brief of US West, at 33, citing Ex. 510 at 7. But the Application states, "[C]ommencing with the Publishing Agreement, USWD assumes responsibility for the

Rather, in support of her contention, she refers to the $104.5 million in publishing fees that US West Direct agreed to pay to PNB in addition to the $13.7 million asset transfer payment. Id. at 8, n. 8. However, Mr. Inouye stated that the publishing fee amounts were not compensation for the fair market value of the yellow pages business. TR 276. They were not related to the asset transfer referenced in Exhibit D of PNB's 1983 Application. Ms. Koehler-Christensen's testimony that US West transferred ownership of the yellow pages business can refer only to some other event accomplishing this alleged transfer that is recorded nowhere.

Prof. Perlman, on the other hand, first testified that the 1984 Publishing Agreement transferred the ownership of the yellow pages business to US West Direct. Ex. 202-T at 2, 4-5.[14] He later retreated, however, and suggested there may have been some "other documents" somewhere, though he had no idea what they were, if there were any at all. In any event, they were not necessary to his conclusion that ownership of the yellow pages business was transferred in 1984. TR 1132.

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development, enhancement, maintenance, production, and administration of directory publication for PNB." Id. at 7 (emphasis added). This demonstrates that the ownership of the business was not transferred, but rather, that USWD obtained the directory publishing rights and responsibilities through the 1984 Publishing Agreement--which was for a three-year, limited duration.

[14]Prof. Perlman reviewed the 1984 Publishing Agreement, but not the 1983 or 1984 Applications of US West to the Commission in Docket FR-83-159, in reaching his conclusions. Ex. 201-T at 3 and App. B. He stated, "In my opinion the provisions of the [1984 Publishing A]greement, particularly those relating to the intangible property rights of the two parties, when examined in the context of the telephone directory business, strongly indicate that the business was transferred in 1984." Ex. 201-T at 5 (Perlman rebuttal). He later stated, " Principally, I examined the 1984 Publishing Agreement which effectuated the transfer of the directory business." Ex 202-T at 2 (Perlman rejoinder).

Yet, when asked whether this transaction, as explained by US West, was of "some considerable significance," Prof. Perlman conceded:

> A; Yes, sir, and if it were in a marketplace and if I were the counsel, it would probably be labeled a purchase and sale, and it would be a sophisticated agreement.[15] (TR 1134)

In fact, Prof. Perlman agreed that in the marketplace environment, to treat the transaction otherwise might well subject the attorney to claims of malpractice. TR 1135.

Here, however, we are asked to accept that ownership of the entire yellow pages business was transferred either by a publishing agreement that two other US West witnesses said did not transfer the business, or else by some unknown document possibly executed sometime, but unavailable now. This simply is not plausible.

a. US West's argument that ownership of the intangibles or "going concern" of the yellow pages were transferred without documentation of this intent is unpersuasive.

US West argues that the valuable intangibles of the business, referred to as the going concern value, "could be and were transferred from PNB to US West Direct." Brief of US West at 18. Nevertheless, US West says that PNB should not have been expected to disclose the total value of the business, including the intangible assets, to the Commission at the time of PNB's 1983 Application. This is because, US West argues, regulatory accounting does not recognize book value for intangible assets such as goodwill, and the utility is not permitted to earn a return on such assets. Brief of US West, at 33.

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[15] At one point, Prof. Perlman offered, "Warren Buffet bought Nebraska Furniture Mart, the largest single furniture store in the country, on a handshake, so you don't need documents," but he quickly retreated from this position, as noted above. TR 1134.

The fact that intangible assets were not recorded on the books in 1984[16] is not relevant. The relevant point, as US West well knew, was that the revenues generated from the yellow pages business-- a business developed during its long de facto monopoly--had historically contributed to PNB's overall revenue requirement. US West now says that in 1984 it engaged in an action designed to eliminate this contribution. If so, it was obligated to inform the Commission. It did not do so. To the contrary, PNB represented to the Commission that the 1984 Publishing Agreement "effectively preserves a significant contribution from Yellow Page revenue to PNB's earnings," and that this contribution was "guaranteed." Ex. 110 at 3.

US West's corollary argument, that the utility is not permitted to earn a return on the assets of the yellow pages business, is severely undercut by the decisions of the Colorado Supreme Court in Mountain States Tel. & Tel. Co. v. Public Utils. Comm'n, 763 P.2d 1020, 1027-28 (Colo. 1988), and of the Oklahoma Supreme Court in Turpen v. Oklahoma Corp. Comm'n, 769 P.2d 1309, 1327 (Okla. 1988), both cited with approval by Washington State Supreme Court in the US West rate case decision. 134 Wn. 2d at 74-75. Mountain Bell stated:

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[16]The system of accounts prescribed for use in 1984 (FCC Part 31) did not include an account for "intangible assets," though the Commission's rules contained a saving clause, WAC 480-120-016, which provided in part: "The adoption of these rules shall in no way preclude the Commission from altering or amending the same, in whole or in part . . . and further, these rules shall in no way relieve any utility from any of its duties under the Laws of the State of Washington."

On November 30, 1987, the Commission amended its accounting rules to adopt the use of an updated Uniform System of Accounts prescribed by the FCC for all Class A and Class B telecommunications companies (Cause No. U-87-1144-R, General Order No. R-278, Order Amending Rules Permanently). The updated Uniform System of Accounts includes Account 2690, Intangible Assets, which is to include, among other things, ". . . the original cost of patent rights, and such other intangible property having a life of more than one year and used in connection with the company's telecommunications operations."

> The directory publishing business was developed over the past fifty years within the protective shelter of Mountain Bell's monopoly of telephone service. The assets were included in the rate base upon which Mountain Bell was permitted to earn a return. Mountain Bell concedes that the Yellow Pages always have generated "supra competitive" profits. It is an exaggeration to say that Mountain Bell's shareholders took any significant risk in developing the directory publishing business, and we find the public interests in those assets to be beyond dispute.

763 P.2d at 1027-28. The "supra competitive" profits of the yellow pages to which the court referred could not possibly have been earned from merely the tangible assets of the business. Accord, Turpen, 769 P. 2d at 1327 (the commission has well-founded concerns when a regulated utility transfers assets to an unregulated affiliate at book value, and that unregulated affiliate uses those assets to earn revenues that benefit only the shareholders, so that the ratepayers are subsidizing the shareholders).

In addition, US West contends that the goodwill of the directory business was transferred simply by having US West Direct's sales contacts purportedly explain to advertisers that US West Direct was the "successor" to PNB. US West Brief at 12, citing Ex. 303-T at 3 (Johnson rejoinder). According to US West, this is "the mechanism that is recognized by the law in Washington." Id. at 12. As support, US West cites Wilkinson v. Sample, 36 Wn. App. 266, 272, 674 P.2d 187 (1983).

But Wilkinson stands for an entirely different principle. In that case, the purchasers bought a power cleaning service from the seller by contract. The contract set forth a total purchase price of $30,000, which was explicitly broken down as follows: $5,000 for inventory, fixtures, and equipment (i.e., the physical and tangible assets), $10,000 for a covenant not to compete, and $15,000 "for the existing business acquired." As the court explained, "In essence,

the last was simply goodwill." Wilkinson, 36 Wn. App. at 267. In addition, the contract contained a paragraph pertaining to any change in ownership of the business: "Sellers agree to notify all regular customers of the change of ownership of the business transferred in conformity with this agreement." Id. at 267-68 (emphasis added).

It is true that the Wilkinson court stated that "[w]ithout the promised notice to customers of the new ownership, there could be no transfer of the goodwill the buyers had agreed to buy." Id. at 271. But this was because the agreement between the parties required this notice, and furthermore, because the agreement itself explicitly provided for transfer of the ownership of the business. The court did not hold that the ownership of a business, or its goodwill, could be transferred by inference, simply by virtue of statements made to customers. Indeed, the very facts under which the goodwill and the business were transferred in Wilkinson--that is, an express agreement memorializing this intent--are absent here. Wilkinson does not support US West's argument, but rather, undercuts it severely.

The Commission, in fact, expressly ordered US West in 1984 to "maintain such accounting records as may be needed to resolve regulatory problems affecting Washington ratepayers that could conceivably arise in other proceedings to the extent that they involve transactions with affiliated interests." In re Application of PNB, Docket FR-83-159, Fourth Supp. Order, at 7. This, coupled with US West's knowledge that the Commission's primary concern was that PNB not undervalue the Publishing Agreement, and thereby receive less revenue from directory than it would if it provided the service itself, id. at 6, should have put the Company on notice that, if intangible assets were in fact part of the transfer in 1984, the

Commission would expect the Company to keep records regarding them, whether or not the Uniform System of Accounts at that time included an account entitled "intangible assets." US West should also have informed the Commission of its intent in this regard.

3. US West Direct did not pay PNB any compensation for the fair market value of the yellow pages business, other than $23.5 million for the physical and tangible assets. The publishing fees US West Direct paid to PNB, under the 1984 and 1987 Publishing Agreements, were not compensation for the fair market value of the yellow pages business.

US West insists that ownership of the yellow pages business was transferred to US West Direct in 1984, despite the fact that US West Direct did not pay compensation to PNB for the fair market value of the business, either in 1984 or afterwards. The only compensation that US West Direct paid was $23.6 million for the transfer of the physical and tangible assets.

The 1984 and 1987 Publishing Agreements did not provide for the payment of any compensation for the fair market value of the business. Mr. Inouye confirmed this on cross-examination:

> Well, I believe I stated that the publishing fees were intended on being some form of something. Subsidies was what it was referred to, but what I have objected to is the claim that we're taking the position that publishing fees was compensation for value. (TR 272)

He later confirmed:

> I've said that I don't believe that the people who made the decision to pay publishing fees had in mind compensation for the fair market value of the business that was being transferred. (TR 276)

This interpretation is consistent with the Publishing Agreements themselves. Paragraph 10.1 of the 1984 Publishing Agreement provided that the publishing fees were to be paid for the

following rights, which were provided to US West Direct for the limited three-year duration of the Agreement: (1) the right to use and publish subscriber listings; (2) the right to publish the exchange service directories; (3) the exclusive right to use the name, logo, trademarks, of PNB; and (4) the remaining rights and obligations recited in the Agreement. Ex. 602. Article X of the 1987 Publishing Agreement labeled the publishing fee as a "subsidy," without amplification.

US West, however, displayed a remarkable lack of knowledge as to what exactly the publishing fees, paid from 1984-88, represented. The publishing fees for 1984-86 are simply listed as lump sum amounts: $21,177,000 in 1984, $62,745,000 in 1985, and $67,548,000 in 1986. They are not broken down to indicate how much should be allocated to each of the items listed in Paragraph 10.1 of the agreement (including the unspecified "remaining rights and obligations"). Staff issued data requests to attempt to clarify the agreements, to which the Company responded: (1) US West had no information to identify the separate amounts paid under the agreements; and (2) US West had no documents, notes, or phone conversations pertaining to the negotiations that took place concerning the agreements. Exs. 306, 307.

Mr. Johnson explained that he was the "lead negotiator" for US West Direct in the Publishing Agreement negotiations. He then added that he had nothing to do with negotiating any of the fees paid in those agreements, which totaled $150 million over three years. Ex. 473. When asked whether someone simply chose the number $62,745,000 because it appeared to be correct, he replied, "it appears that that's the case," though he said there must have been "some sound basis" for it. Ex. 376. The amount of the fees themselves were negotiated above his level. Ex. 371. Mr. Johnson added, however, that US West presented no one else in this docket who

could speak regarding the issue of publishing fees, and that all the people involved in those discussions had long since retired. Ex. 394.

As to the purpose of the publishing fees, Mr. Johnson took issue with the language of the 1984 Agreement, stating that the contract signed by PNB and US West Direct mischaracterized what the publishing fees were paying for. TR 373-74. He also stated:

> From my standpoint, publishing fees were an overhead that were not payment for goods or services received, and it was my job to reduce them. (TR 371).

Accord, Ex. 303, at 14 (Johnson rejoinder). Mr. Johnson succeeded in the latter endeavor. In 1988, he sent a letter to Mr. Okamoto of US West, informing him that the publishing fees (now denominated a "subsidy" in the 1987 Publishing Agreement) would "cease to be effective." Ex. 609. The letter does not indicate that USWC received anything in return for US West Direct's ending of the publishing fees.[17]

The point is that the publishing fees, stated to be payments for the rights provided under the 1984 Publishing Agreement, were clearly not paid as compensation for the fair market value of the yellow pages business. US West's sister companies did not calculate them with this purpose in mind, and Ms. Koehler-Christensen admitted that US West did not know, in 1984, the amount of publishing fees that would be payable to PNB after 1986. Ex. 521.[18] US West

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[17]Mr. Johnson maintained, however, that this was "vigorously negotiated" between the management teams of US West Communications and US West Direct. TR 377.

[18]Prof. Perlman opined that "what seems clear to me is that the [publishing fee] payments had the effect of further compensating PNB for whatever value the directory business had above the book value of the physical assets." Ex. 201-T, at 22-23. But this is contradicted by the testimony of the other US West witnesses, and is of little value.

thought little enough of these fees that it unilaterally discontinued them in 1988. This complete lack of any payment mechanism to compensate PNB for the value of the business is wholly inconsistent with US West's contention that ownership of that business was transferred in 1984.

4. PNB leased valuable rights to US West Direct under the 1984 and 1987 Publishing Agreements, which is inconsistent with US West's contention that ownership of the yellow pages business was transferred in 1984.

Finally, US West's claim that ownership of the yellow pages business was transferred in 1984 is directly contradicted by PNB's retention of several valuable rights, leased to US West Direct for a term of years, that were crucial to the operation of the business. Dr. Selwyn expounded upon these elements in his testimony. In response, US West's witness contended that the intangible rights leased in the Publishing Agreements were "not particularly significant assets in the context of the directory business." Ex. 201-T, at 15-16 (Perlman rebuttal). The facts, however, including US West's own actions, indicate otherwise.

Dr. Selwyn explained that three elements leased to US West Direct in the 1984 Publishing Agreement were essential to the operation of a successful directory publishing operation in USWC's [or PNB's] service territory, and to the universal acceptance of the directories both by consumers and by advertisers. These elements were: (1) the exclusive right to publish PNB's directories; (2) the exclusive right to use PNB's name, logo, and trademark on US West Direct's directories; and (3) access to PNB's subscriber listings for the purpose of soliciting advertising sales. Ex. 806-T, at 4-6 (Selwyn rejoinder); Ex. 602, ¶¶ 3.01, 3.08, and 4.01 (1984 Publishing Agreement).

a. The exclusive right to publish PNB directories and PNB's agreement not to compete during the term of the Publishing Agreement

Prof. Perlman downplayed the "exclusive right" to publish, pointing out that US West cannot prevent others from publishing yellow pages directories. Ex. 202-T at 8-9 (Perlman rejoinder). This is, of course, true, but misses the point. The significance of PNB's conveyance of the exclusive right to publish was that PNB thereby agreed not to compete with US West Direct. Ex. 806-T, at 4 (Selwyn rejoinder).[19] US West Direct, thus, obtained all the advantages of being the publisher of the longtime incumbent's yellow page directories. These advantages, arising from US West Direct's linkage with PNB, are immense. Dr. Selwyn explained:

> [I]LEC directories are highly profitable precisely because the directory business is inherently monopolistic, in that advertisers and consumers alike have strong economic incentives to adopt the most comprehensive directory in which to place their listings and to use to identify suppliers of goods and services. Because ILECs such as USWC own and control the underlying databases from which advertisers can be solicited, and because they were able to develop their directory businesses over decades in which they enjoyed the status of franchise monopoly providers of local telephone service, the "official" directories of USWC and other ILECs have long dominated the yellow pages business. In fact, any number of attempts by non-ILEC entities to break into the general yellow pages business have resulted in failure.

Ex. 806-TC at 6-7 (Selwyn surrebuttal). Prof. Perlman confirmed the critical importance of the ILEC's advantages in the yellow pages business, admitting that "there is a decided competitive advantage to being the first supplier of a telephone directory in a particular market, and that

[19]Dr. Perlman agreed that PNB gave up the right to produce a competing directory for the three-year duration of the 1984 Publishing Agreement. Ex. 201-T, at 7 (Perlman rebuttal), and Ex. 202-T at 9 (Perlman rejoinder).

"[p]rior to the transaction PNB had this first supplier advantage in Washington in its service areas." Ex. 201-T, at 6-7.

This first-supplier advantage shifted to US West Direct, the exclusive publisher of PNB's yellow pages, making it the dominant yellow pages publisher. Even today, that dominance remains. As Ms. Koehler-Christensen acknowledged, "I believe that [US West] Dex is a dominant publisher in virtually all the markets in which it publishes directories." Ex. 509-T at 30 (Koehler-Christensen rebuttal). See also Ex. 516 (showing that competing directories have far less usage and a much lower customer retention rate than US West Dex's directories).

However, PNB only leased this crucial first-supplier advantage to US West Direct for the term of the publishing agreement. As Dr. Selwyn emphasized:

> If, following the expiration of the original publishing agreement, PNB decided to resume its own yellow pages publishing activity, it could easily have taken back full control of the directories simply by rescinding the three specific terms of the Publishing Agreement that enabled USWD to operate the yellow pages activity for PNB[.]

Ex. 806-TC, at 8 (Selwyn surrebuttal). This, as previously noted, is precisely what US West told the Commission in 1988: "The fact is that PNB could publish now if it chose, so nothing was actually transferred in 1984." Brief of Applicant Pacific Northwest Bell Telephone Company, Docket U-86-156, at 23-24 (June 24, 1988).

The fact that PNB merely leased the right to publish its directories for the term of the publishing agreement, and did not convey ownership of the business to US West Direct, is further confirmed by PNB's 1984 Application to the Commission. PNB stated that, despite its current relationship with US West Direct:

> However, it is always possible that at some point in the future one of the other publishing companies will make a more competitive offer which must be considered. That has not occurred to date. If PNB is offered a better financial opportunity by a different publisher, it will certainly give such an offer serious consideration. (Ex. 111 at 12).

Clearly, PNB could never have made such an offer to a different publisher if it had already relinquished ownership of the yellow pages business, as US West now contends.

b. The exclusive right to use PNB's name, trademark, and logos

The exclusive right to use PNB's name, trademark and logos was immensely important to US West Direct's yellow pages operations. Though Prof. Perlman now contends that this was not a significant issue,[20] the fact is that both parties--PNB and US West Direct--knew otherwise when they entered into the 1984 Publishing Agreement, as well as long afterwards.

In its 1984 Application to the Commission, PNB openly promoted the tremendous benefits conferred by the exclusivity of the PNB logo:

> (1) Publishing Agreement. No costs are applicable to the applicant PNB, as US West Direct is paying Pacific Northwest Bell in all agreements by negotiation on the basis of what PNB could sell directory listings for with exclusive right to publish and use the logo. Historically, PNB has sold listings at 10¢ each - but under the negotiations with US West Direct, PNB is here obtaining a $25-$35 cost per listing. If US West Direct chose to only purchase the mere listings, PNB would have to sell them for the same price paid by other publishers. We continue to sell them to other publishers at the 10¢ price. *The reason we have been successful in obtaining a very significant increase in price from US West Direct is because of the value of the exclusivity of the logo.*

[20] Ex. 201-T, at 12 (Perlman rebuttal).

Ex. 111, at 8 (underlining by US West) (italics added). PNB elaborated that the 10¢ price per listing was the market price nationally, and contrasted this with the "very aggressive negotiations PNB has had with US West Direct." Ex. 111, at 9 (underlining by US West). PNB continued:

> PNB is the owner of a valuable asset, subscriber listings developed through the performance of a monopoly function. PNB markets those functions to a competitive publisher who in turn produces the exchange White page directory and sells advertising in the Yellow page directory. The compensation for this arrangement which has been negotiated preserves a significant contribution from Yellow page revenue to PNB's earnings and is paid for the right to use the listings, the exclusive right to publish the exchange directories, and the exclusive right to produce the name, trademarks, and tradenames of PNB.
>
> PNB was able to get US West Direct to pay between $25-35 per listing, which is a price no other publisher would have paid us at this time.

Id. (underlining by US West).

In the 1984 Publishing Agreement, PNB and US West Direct both affirmed the "unique value" conferred by the PNB name and logo:

> WHEREAS, the parties recognize and agree that there is unique value in the publication of directories containing both the utility service directory information and advertising by reason of the breadth of circulation and the right to use the name and logo of the Telephone Company in connection with the publication of such directories[.] (Ex. 602 at 1).

US West's claims to the contrary today simply do not square with the evidence. Mr. Johnson went so far as to say:

> As I explained, the use of the PNB name was not for the benefit of US West Direct. We would have preferred to establish the books solely under our name to enhance our brand. It was strictly for the benefit of PNB, who wanted to ensure its corporate identity was on the directory to show that it was meeting its regulatory obligation to publish a white pages alphabetical directory.

Ex. 301-T, at 9 (Johnson rebuttal). If this were true, why then did US West Direct continue to place the PNB name on yellow pages directories that were bound separately from the white pages directories serving the same PNB territory, for five years after the 1984 directory publishing reorganization? See Ex. 806-TC at 10-11 (Selwyn surrebuttal), and 809 (copies of 1984-89 white and yellow page directory covers).

And why, moreover, did US West Direct continue to keep the PNB name prominently on the cover? Contrary to Mr. Johnson's initial claims, US West Direct did not "progressively diminis[h] the prominence of the PNB name on the covers." Ex. 303-T, at 10 (Johnson rejoinder). To the contrary, "Pacific Northwest Bell" appears prominently near the top on the June 1985 and June 1986 directories (in even larger, bolder type in 1986), while "US West Direct" is relegated to the lower, left hand corner. The PNB name remains more prominent through the May 1988-89 directory. Ex. 302. Mr. Johnson admitted this. TR 391-92.

US West commenced a five week advertising campaign in June 1988, in which it informed customers that PNB's name would be changed to US West Communications. Ex. 810. True enough, as Mr. Johnson stated, PNB's name "vanished" from all the directories soon thereafter, see Exs. 303-T, at 10 (Johnson rejoinder), and Ex. 302 (May 1989-90 directory cover). But this was only because the PNB name was being eliminated. In fact, so was PNB, whose merger into USWC was approved in 1990.

The simple fact remains that PNB's name and logo were extremely valuable well beyond January 1, 1984. And, as Dr. Selwyn demonstrated, the exclusive right to use these items was critical to the success of the yellow pages business.

c. Access to PNB's subscriber listings for the purpose of soliciting advertising sales

The 1984 Publishing Agreement also gave US West Direct, for the limited duration of that agreement, unique access to the business subscriber data controlled by PNB that is crucial to the successful solicitation of yellow pages advertising sales. Ex. 801-TC at 14 and 54, 806-TC at 6 (Selwyn rebuttal and surrebuttal). While PNB offered to sell subscriber listings to other publishers in 1984 (Ex. 513-T at 6), the business listings data that US West Direct obtained under the agreement included business "updates," i.e. additions and changes to business listings (Ex. 806-TC at 5, citing ¶ 4.01 of the agreement), whereas PNB did not begin offering daily business updates to other publishers until 1987. Ex. 513-T at 7. Moreover, the 1984 Publishing Agreement granted US West Direct real-time access to PNB databases such as the Customer Records Information Systems (CRIS) and Customer Order and Display (CORD) as another means of obtaining business subscriber information usable for advertising sales leads, which would not have been available to an unaffiliated directory publisher.[21] Ex. 602, at ¶ 4.07; TR. 919-921. Of course, US West Direct's rights to access this data extended only through the duration of the time-limited publishing agreement, and PNB retained full control of such access once the agreement expired. The fact that US West Direct obtained access to this essential information in this time-limited manner further underscores that the ownership of yellow pages business was not transferred in 1984.

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[21]The agreement also provided that PNB "agrees to furnish for the use of U S West Direct such information as is necessary regarding subscribers, operating practices, access lines, fluctuations of telephone movement and any other related information for U S West Direct to perform its obligations to publish and sell directory advertising..." (Ex. 602, at para. 3.07), which does not appear as if it would have been available to unaffiliated publishers.

E. Under the principles of Democratic Central Committee v. Washington Metro Area Transit Commission, the rate payers have retained a beneficial interest in the yellow pages operations since January 1, 1984.

US West contends that there is nothing in Democratic Central Committee v. Washington Metro Area Transit Comm'n, 485 F. Supp. 786 (D.C. Cir. 1973), to support Staff's position that ratepayers have retained a "beneficial interest" in the yellow pages operations since January 1, 1984. Specifically, US West asserts that the Court of Appeals' ruling that farepayers of the Washington Metro Area Transit system were entitled to the capital gain accruing to the assets in question was based upon "the specific facts" of the case, and had "nothing to do with the intangible going concern of the directory business." Brief of US West, at 28. US West also alleges that the ruling applies to the appreciation of assets during their "tenure as operating properties," DCC, 485 F.2d at 822, so that it cannot apply in the instant case because "[t]hese intangibles never were operating property." Id. at 28.

This is a mischaracterization of the DCC ruling, which can be confirmed by reviewing it. US West construes the scope of the DCC ruling as far more narrow than it actually is. First, the Court reviewed prior relevant rulings and determined that, for decisions outside of the D.C. Circuit, "[i]n each, the entire gain from disposition of depreciable assets was passed on to the utility's consumers, to the exclusion of its investors." DCC, 485 F.2d at 792. Second, it concluded that, "We perceive no impediment, constitutional or otherwise, to recognition of a ratemaking principle enabling ratepayers to benefit from appreciations in value of utility properties accruing while in service." Id. at 800. As Dr. Selwyn explained, Ex. 801-TC at 21-24 (Selwyn rebuttal), the Court went on to articulate two such ratemaking principles: first, the right

to receive the capital gains on utility assets is tied to the risk of capital losses; second the "principle that he who bears the financial burden of particular utility activity should also reap the benefit resulting therefrom." DCC, 485 F. 2d at 806. The latter principle is eminently applicable in the instant case, entirely apart from the specific facts of the Washington Metro Area Transit system situation that guided the Court's application of that principle in its 1973 ruling. As Dr. Selwyn observed, other state regulatory commissions already have applied that "reward follows risk principle" to determine ratepayer compensation for transfers of assets from a regulated telephone company to an unregulated affiliate. Ex. 801-TC at 23-24 (Selwyn rebuttal).

US West also errs by claiming that the Court's holding cannot apply because the intangibles relating to the directory publishing function "never were operating property." Brief of US West, at 28. US West attempts to focus the Commission's attention on the disposition of ownership of individual categories of intangible assets, such as the industry knowledge of employees who moved from PNB to USWD in 1984, but this is a red herring.

As Dr. Selwyn explained, the intangible relevant to ratemaking purposes is "the difference between the book value and the going business value of the yellow page operation" Ex. 104 (Selwyn Dep. at 73); this gain in value stems from the totality of the business operation, and cannot be reduced to or derived from an analysis of individual intangible components (Ex. 811, Selwyn Dep. at 74-75 and 87-89). US West's own valuation witness, Mr. Golden, did not attempt to measure the value of the business by aggregating the value of individual tangible and intangible assets (id., at 88). By definition, the gain in total value of a regulatory asset such as the directory operation -- which in more ordinary circumstances would be considered a "gain on

sale" of the regulatory asset -- cannot be recorded on the utility's books until a valuation had been made and/or a sale consummated.

Finally, US West contends that "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." US West Brief at 28-29(footnote omitted). Staff makes no such claim, because (as explained elsewhere in this brief) Staff's position is that ownership of the entirety of the yellow pages business was not transferred in 1984, and has not been so transferred to date.

V. VALUATION ISSUES

Staff, through its witness Dr. Selwyn, presented a calculation of the business enterprise value (BEV) of the US West yellow pages business as of January 1, 1999. Ex. 804-C, 805. This valuation study employed a projected discounted cash flow (DCF) analysis very similar to the methodology used by Mr. Golden. Ex. 804-C at 1. However, the study incorporates inputs and assumptions appropriate to a 1999 valuation, and reflect Dr. Selwyn's extensive knowledge and experience in the field of regulated telephone utilities, including valuation issues in the context of affiliate transactions. Ex. 802, Ex. 813. The model was based on Company forecasts of directory revenues and earnings before depreciation, income, and taxes (EBDIT) for the years 1999-2003, plus reasonable estimates for other cash flow variables derived from historic Company data. Ex. 804-C at 2-7. Dr. Selwyn used conservative ranges of 3.75% to 4.5% for the terminal year growth rate and 10.71% to 12.22% for the Weighted Average Cost of Capital (WACC) in his calculations. Id. at 8-9. His model produced a valuation range of $5.6-billion to $7.4-billion for US West's yellow page business as a whole, which produces a range of $1.04

billion to $1.37 billion for the Washington state portion of the yellow pages business based on a state allocation factor of 18.46%. Ex. 805, at Schedule A.

Dr. Selwyn's conclusions were challenged by Mr. Golden. Ex. 403-T. However, Mr. Golden's proposed "corrections" were incomplete: while he opines that Dr. Selwyn should have used updated values for debt and the equity risk premium, he neglects to consider the offsetting effects of an update to the level of equity, which he agrees should also be updated at the same time as the other inputs to the WACC calculation. TR. 529-531. Moreover, the overall level of the "corrections" that Mr. Golden proposes are small: the largest that he quantifies, pertaining to an alternative calculation of incremental working capital based on the method utilized by Public Counsel witness Mr. Brosch, would reduce Dr. Selwyn's estimate of the BEV by $200 million (Ex. 403-T at 56), but this is only 2.7% of the total $7.4-billion value that Dr. Selwyn calculated assuming a 10.71% WACC and 4.5% terminal year growth. Id. at 50; Ex. 805, Schedule A. Given the limited precision that is possible with any valuation analysis, which Mr. Golden acknowledges,[22] his criticisms do not detract in any material way from Dr. Selwyn's analysis and valuation results.

US West presented testimony from Mr. Golden on the valuation of the yellow pages business as of January 1, 1984. Mr. Golden's study is of little value in this case because it fixes the value of the business at the wrong time; it assumes that ownership was transferred -- a fact

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[22]Mr. Golden observes that there is a "small measure of art as well as science involved in the practice of business valuation," (Ex. 403-T at 33), and notes the "highly subjective nature of any intangible asset valuation" (id. at 65).

US West cannot prove; and it incorporates faulty assumptions and suspect data that serve to lower his value estimate.

Mr. Golden's direct testimony included a valuation study, in which he concluded that the yellow pages business' value as of January 1, 1984 was between $1.5 and $1.8 billion. Despite Mr. Golden's credentials and experience, his work in this case is, unfortunately, of limited value. He was instructed by US West to prepare only a 1984 valuation. TR. 533. He was not requested to prepare an analysis of the directory publishing business as of 1999. Ex. 422. He was instructed to assume that the whole business was transferred as of 1984. TR. 1569. He did not independently analyze the transaction to determine what occurred.

Mr. Golden employed several approaches to the valuation exercise, including a study based on actual post-1984 data,[23] but placed primary weight on the "Projected Case" income approach, stating that since there were no directly comparable guideline companies, the market approach was accorded secondary weight. Ex. 411, page 10. The income approach involved using the weighted average cost of capital as the discount rate in a discounted cash flow calculation. Mr. Golden used data pertaining to seven newspaper publishers in developing the WACC used in this approach. Ex. 411, page 5; TR. 593-4. However, he also admitted these were the same seven newspaper publishers he considered non-comparable, and therefore appropriate only for his secondary analysis, the market approach. TR. 581. Thus, to the extent that important differences exist between the yellow pages business and newspaper publishers -- and Mr. Golden

[23] Mr. Golden admits that his "Actual Case" analysis was "a fairly unique approach without a lot of precedent or guidance in business valuation literature." Ex. 403-T at 38.

admits that the differences are significant enough to limit the latter's comparability to a secondary corroboration only (TR. 582) -- the validity of his "Projected Case" results are called into question.

Mr. Golden calculated the WACC using a CAPM approach, which involved the use of "beta," a factor used to compare the riskiness of an investment in a specific industry with the investment in a broad portfolio of companies. Ex. 411, at 5. As part of his WACC calculation, Mr. Golden derived the beta for the seven newspaper publishing companies; averaged them with the betas for four Regional Bell Operating Companies (RBOCs); and then adjusted the result to reflect the debt structure of the four RBOCs, stating that higher debt levels equate to higher risk. Ex. 404, at 2. The use of a higher beta results in a higher WACC, which lowers the BEV.

Mr. Golden's authority on levered beta states, "the beta of the unlevered firm must be less than the beta of the equity <u>in an otherwise identical levered firm</u>." Ex. 404, at 5 (emphasis added). Mr. Golden relevered the beta of newspaper publishing firms to reflect debt levels of telephone companies, even though he acknowledges that a number of factors cause the nature of the businesses to be different. TR. 520-521. Mr. Golden admitted that the RBOCs had much lower betas than newspaper publishers, though they had higher debt (TR. 521), and recognized that the yellow pages business enjoys "a measure of stability because of its association with being a publisher for the Telcos." Ex. 411, at 6. Nevertheless, he failed to recognize the factors causing the RBOCs to have lower betas than the newspaper publishers in his calculation. This may be because Mr. Golden is not an expert on regulated utilities. TR. 592-3. The absurd result

is a range of betas for the yellow pages business which exceeds that of the newspaper publishers and far exceeds that of the RBOCs. Ex. 402-C, Schedule 4.

Finally, in developing a terminal year growth rate range of 5-6% for use in his model, Mr. Golden relied on hindsight, basing his estimate in part on data occurring after the January 1, 1984 date he uses for valuation. Ex. 403-T, page 23. He accorded little weight to contemporary growth rate estimates of PNB's management that were appreciably higher than 5-6%. Ex. 418. Mr. Golden's rebuttal testimony included responses to criticisms of his approach and to conclusions offered by Dr. Selwyn and Mr. Brosch in their testimonies. However, his analysis quantifying their criticisms was selective, excluding the effect of an adjustment to terminal growth rate, which he admitted would have had a significant effect on valuation. TR. 550.

VI. IMPUTATION ISSUES

A. Imputation of US West Direct's yellow pages revenues is not compensation for the fair market value of the yellow pages business. The State Supreme Court did not so hold, and US West has not argued to the contrary until now.

As the state Supreme Court held, US West Direct (and its successor, US West Dex) has never paid USWC compensation for the fair market value of the yellow pages business. Yet US West Direct, since 1984, has continued to reap the lucrative profits of this business, through publishing agreements with USWC. As a result of the fact that US West Direct has neither paid fair compensation for the business, nor paid adequate annual publishing fees to PNB or USWC since 1984, the Commission has imputed the excess profits of US West Direct to USWC. This ratemaking adjustment, which seizes no money from US West Direct, treats the 1984 transaction as if it had not occurred for ratemaking purposes, to protect the interests of the ratepayers. The

Commission has not used imputation of yellow pages revenues as a method of making installment payments toward the fair market value of the yellow pages business. The state Supreme Court has not ruled otherwise, and US West has never contended otherwise, until now. Its revisionist view of imputation is without merit.

The Court's observation that imputation arose as a result of US West's actions, and was necessary to rectify them, see USWC v. WUTC, 134 Wn. 2d at 95-96, does not mean that imputation is fair market compensation. US West has always known this. That is why US West: (1) agreed in 1989 to impute yellow pages revenues in the AFOR agreement under a formula that made no reference to compensation for assets; (2) did not argue in the 1990 merger docket that imputation should end once compensation for fair market value of the business had been paid; (3) did not argue in the 1995 rate case, among its eighteen reasons denouncing imputation, that imputation should stop for the simple reason that the fair market value of the business had already been paid for[24]; and (4) did not ask the state Supreme Court to end imputation for this reason. The Court did not hold that imputation of yellow pages revenues is compensation for assets transferred. Nor has the Commission so ruled.

B. Imputation is a ratemaking adjustment to rectify inadequate compensation arrangements in contracts between affiliates, whether for services or for asset transfers.

US West contends that imputation can only be viewed as compensation, incorporating principal and interest components, of the value of the yellow pages business it contends it

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[24]Ms. Koehler-Christensen has included amortization tables treating imputation as principal and interest payments, and concludes that the yellow pages business was paid for in early-1993. See Ex. 503, p. 1. Curiously, Ms.Koehler-Christensen, who was US West's only imputation witness in the 1995 rate case, made no mention of this "fact" at that time.

transferred in 1984. The company mischaracterizes both Commission Staff's testimony and prior Commission orders on this issue, stating that they have consistently held that imputation is "compensation for the value of the asset transferred." Brief of US West at 50.

Staff's position is, and has always been, that imputation, as used in a regulatory setting, is an adjustment made to rectify inadequate compensation arrangements contained in contracts between a utility and an affiliate. As Ms. Strain explained in her Affidavit of February 18, 1999, at 3-4 (¶¶ 6-7):

> There is a strong public policy rationale for the regulatory authority over affiliated transactions of a regulated utility, such as US West Communications. The control of affiliated companies by a common owner gives the affiliates opportunities to experience savings through economies of scale and the lack of having to compete for the affiliates's business with nonaffiliates. The owner company, through its control of the affiliates, can direct them in the pricing of services and products to each other; can control their capital structure; and can control their ability to obtain services from nonaffiliates even if the cost would be lower.
>
> This ability of the owner of an affiliated group of companies has resulted in actions being taken that shift costs to affiliates subject to rate of return regulation, and shifts profits to nonregulated affiliates in the same group. Since rate of return regulation bases rates on costs and a set return on investment, and nonregulated companies can charge prices without being limited to a set rate of return, non-arms length behavior among members of the affiliated group can maximize the profits from the group as a whole.
>
> The Commission's response when it encounters such situations is to impute (i.e., assign or attribute) revenues, profits, gains, cost savings, or capital costs, to the regulated entity. The purpose of these actions is to adjust the revenue requirement of the regulated affiliate to recognize appropriate portions of the cost savings, revenues, profits, gains on sale, or lower capital costs, that the affiliated group has experienced as a whole, or to remove excessive costs or expenses that the regulated company would not incur as a non-affiliate.

Staff's position is consistent with previous Commission findings and requirements. In the case of US West and other telephone companies regulated by the Commission, these

arrangements were contained in contracts for the provision of directory advertising services provided by affiliates to the regulated telephone company. Imputation has been ordered by the Commission in cases where ownership, and sales or transfers, of directory advertising assets were never an issue. Strain Affidavit, at 9-12. Imputation adjustments can be ordered when periodic payments for services are inadequate, or when value is not received for assets sold or transferred. Both the periodic payments for services, and value for assets sold or transferred, can be called "compensation." US West's error lies in equating imputation for the former with compensation for the latter.

The Commission stated, in In re Application of PNB, Cause No. FR-83-159, Fourth Supp. Order, at 7:

> The instant application deals with nine separate agreements and contracts between PNB and its affiliated interests U S West Direct. The existence of multiple agreements makes it very difficult for the Commission to clearly establish that PNB is receiving full value for services rendered. (Emphasis added).

This language makes it abundantly clear that the Commission was concerned with the adequacy of payment for services, not for the value of the assets transferred.

In Docket U-86-156, the Commission was never asked to decide whether the publishing agreement submitted therein was an agreement pertaining to "services" as opposed to lump sum payment for an asset. Nor did it do so. In the Second Supp. Order at 13, the Commission found that the proposed publishing fee "is a fee paid in exchange for value and not a subsidy as denominated by Pacific Northwest Bell." The Commission did not state, however, that "value" as used in this context should be equated with "lump sum payment for an asset." Rather, the

Commission throughout the order discussed the role of assets in the generation of revenues under rate of return regulation, noting in particular:

> Return on equity is the only standard which allows for appropriate evaluation of the yellow pages as an asset and in comparison with other sources of revenue to PNB. Return on equity also provides an objective and reasonable measurement of the returns to investors from the yellow pages revenues, and of the amounts that can reasonably be expected to be contributed toward the revenue requirements of the operating company. (Id. at 11).

At page 7 of the same order, the Commission discusses two ways in which affiliates can extract assets from a public utility. Both methods described involve the provision of services. The method analogous to the yellow pages situation is described as follows:

> An affiliate may also extract funds from the utility by contracting to perform a lucrative service for the utility but paying that utility far less than it would earn had it continued to perform the service for itself, or contracted at arms length by open bid for the performance of the service.
>
> Either way, assets are transferred in a manner which adversely affects the rates charged to utility customers.

These discussions make clear that the Commission contemplated that assets could be transferred through the provision of services; and it is equally clear that payments for services are not thereby transformed into payments for assets.

The Commission's discussion in both of the above orders compared the annual revenues received from yellow pages before and after the 1984 transfer of assets from PNB to US West Direct . See Cause No. FR-83-159, Fourth Supp. Order, at 6; Docket U-86-156, Second Supp. Order, at 3. This comparison would be meaningless if the Commission had been characterizing the profits before transfer as the result of annual operating revenues for services rendered by PNB to advertisers (returns on equity), and characterizing profits after the transfer as lump sum

payments for assets (returns of equity). This critical distinction is ignored by US West. As a result, US West misstates the purpose of yellow pages imputation.[25]

C. US West's characterization of imputation as compensation for the fair market value of assets transferred is inconsistent with the calculation of the gain on sale of Mast Publishing that was imputed to ratepayers.

In 1985, Contel of the Northwest's (CTNW) parent sold its subsidiary directory advertising company (Leland Mast Directory Company) to an unaffiliated third party. Strain Affidavit, at 10. Prior to that time, excess directory revenues were imputed back to CTNW in two Washington rate cases, Docket Nos. U-82-41 and U-84-18. Id.

The amount of the gain on the Mast sale imputed to CTNW was based on the sale price less the book value as reported in Moody's Public Utility Manual, from which the Washington portion was calculated. Id. It was not reduced by the dollar amounts of imputation that ratepayers had "received" in prior cases. Thus, CTNW ratepayers received compensation, through imputation, for the value of the services provided to Mast; as well as compensation, through the imputation of the Washington portion of the gain on sale, for the value of the directory publishing business when it was sold. This treatment made CTNW's ratepayers whole,

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[25] US West states in its brief at page 49 that Commission Staff agreed that imputation is compensation for the transfer of assets. See TR. 1202. However, as Ms. Strain clearly indicated, imputation can be an appropriate regulatory mechanism either where inadequate compensation was paid for assets, or where inadequate compensation was paid for services. TR 1212-1213. In this case, USWD paid USWC inadequate compensation for the valuable rights and services it received annually under the Publishing Agreements (e.g., the exclusive right to publish, the exclusive use of the logo, and the subscriber listings). It is true that if USWD were to pay USWC the fair market value of the entire yellow pages business, including all rights and services provided under the Publishing Agreements, then imputation of yellow pages revenues would cease. It does not follow, however, that the imputed revenues are "payments" or "offsets" to the fair market value of the business.

both for the inadequacy of periodic payments CTNW received for services to Mast, and for the underlying asset value realized by the parent company when the directory business was sold. Under the treatment proposed by US West, the net value of the publishing business, calculated as if it were to be sold to a third party (see Ex. 511), would be reduced by the amounts imputed to ratepayers in previous years.

D. Imputation has been ordered in cases that did not involve the transfer of ownership of assets from one affiliate to another.

In his rebuttal testimony, Mr. Inouye stated that the Commission "specifically imposed imputation to reflect funds that PNB would have received from its affiliate if reasonable consideration had been given in 1983." Ex. 102-T, page 60. This is incorrect.

In Docket U-86-156, Second Supplemental Order, the Commission presented PNB with three remedies to be considered to ensure that the full reasonable value of the directory publishing enterprise be available for ratemaking purposes: the approval of the contracts with appropriate adjustment of publishing fees; the return of the publishing function to PNB; or the treatment of the transaction as the sale of a capital asset. Id. at. 12. US West would have the Commission believe that imputation can only occur as compensation if the third remedy is adopted. The order in U-86-156 clearly did not dictate only one approach to rectify the effect of inadequate compensation from yellow pages operations. Such a conclusion would not square with the actions of this Commission with respect to yellow pages operations related to other regulated telephone utilities in Washington.

The Commission, in fact, has consistently imputed yellow pages revenues to telephone operations for ratemaking purposes in cases that did not involve the transfer of assets from the

regulated utility to a separate unregulated affiliate. In several cases involving GTE Northwest Incorporated (GTE-NW), the Commission imputed excess directory profits to the regulated utility, even though the directory affiliate was 100% owned by GTE-NW's parent corporation Strain Affidavit, at 11-12. The same was true for CTNW, as discussed above.

E. US West's newly-found theory of imputation requires one to revise the facts that have actually occurred over the past fifteen years.

As Dr. Selwyn explained, US West's revisionist theory of imputation requires one to rewrite the events of the past fifteen years. Dr. Selwyn likened the situation to that of the tenant who suddenly "discovers" that the rent he had been paying his landlord was, in reality, installment sale payments for the house:

> Consider the following analogy: A tenant lives in the same house for twenty years and has been paying rent to the landlord each month during that entire period. One day he sits down and adds up all of the rental payments he's made, and discovers that they have amounted to $200,000. He then checks back on the real estate transaction records from twenty years ago, and discovers that he could have bought an identical house right next door in 1979 for $70,000. So he calls up his landlord and says, "I actually bought the house from you twenty years for $70,000 and have made $200,000 in payments since then, so now I own it, and I'm not going to pay you any more rent.
>
> As preposterous as this may sound, it's exactly what USWC's petition amounts to.

Ex. 801-TC, at 30 (emphasis in original).

And so it is. For US West now claims that the revenues imputed to USWC, all along, have actually been installment payments toward the sale of the yellow pages business. According to US West, it matters not that neither US West, the Commission, nor anyone else, recognized this apparent "fact" in mid-1993, the date that Ms. Koehler-Christensen's exhibits now indicate that the business was "paid for." But it does matter, because this is not what

happened. The fact remains that to this day, US West Dex has not paid USWC for the fair market value of the yellow pages business.

VII. OTHER ISSUES

A. Imputation of yellow pages revenues does not violate Section 253 of the Telecommunications Act.

US West contends that the imputation of yellow pages revenues is barred by Section 253 of the Federal Telecommunications Act of 1996. The Company contends that imputation "constitutes a subsidy to local service, designed to support and encourage universal service[.]" Brief of US West, at 55. This is the same argument that US West made in the 1995 rate case -- Ms. Koehler-Christensen repeatedly made this contention in her testimony, see Ex. 518 -- and was rejected by the Commission, which expressly found that no subsidy exists, that rates cover the incremental costs of local exchange service, and that the directory imputation is not attributed or earmarked to any class of customers. Docket UT-950200, Fifteenth Supp. Order, at 36. The Company did not appeal this ruling. Moreover, the state Supreme Court held:

> The Company also argues that to price services that are subject to competition below cost by subsidizing them with revenues may violate the antitrust laws. First, the Commission concluded, and there has been no contrary showing on appeal, that price subsidies do not exist. Further, the record shows that US West has admitted that no legal action has been brought against US West or any other regional Bell telephone company alleging that the imputation of yellow pages revenues is anticompetitive or in violation of antitrust laws, in spite of the many jurisdictions imputing income. US West also argues that imputation will stifle competition. None of the parties in this case which are competitors support US West's argument that imputation will harm competition. We consider this inquiry to be a matter of policy within the discretion of the Commission.

USWC v. WUTC, 134 Wn. 2d at 99.

US West's argument is unsupported by citation to case law authority supporting its theory, nor can it point to competitors to whom imputation has acted as a "barrier" to entry. US West's argument is without merit and should be rejected.

B. Imputation of yellow pages revenues does not constitute an unconstitutional taking without just compensation.

US West also contends that imputation of yellow pages revenues is an unconstitutional "taking" of property without just compensation, because "imputation takes property from US West Dex" and "denies US West revenue to which it would otherwise be entitled." Thus, USWC and US West, Inc., "do not earn a fair return on their investment." Brief of US West, at 57.

First, the Commission made clear in the rate case that it does not seize any revenues from US West Dex, nor does it interfere with US West Dex's [or USWC's] right to conduct any business it wants. Nor does the Commission exercise jurisdiction over US West Dex's advertising. Docket UT-950200, Fifteenth Supp. Order, at 34-35. As the state Supreme Court noted, the Commission did not intend to "regulate the yellow pages business." USWC v. WUTC, 134 Wn. 2d at 96. In short, there is no taking of US West Dex's property.

Second, the Commission has not "taken" revenue from US West. The Company complains that USWC's rates are set by reference to property in which "ratepayers have no interest" and for which "fair value has been received." Brief of US West at 56. As set forth in detail in this brief, neither assertion is true. Furthermore, US West would, in any event, need to show, under the well-established "end-result" test, that the Commission's actions have produced overall rates so low that they jeopardize the financial integrity of the Company. Duquesne Light Co. v. Barasch, 488 U.S. 299, 310 (1989). US West has made no such showing. Moreover, the

Colorado Supreme Court rejected Mountain Bell's claim eleven years ago that imputation of yellow pages revenues constitutes an unconstitutional taking of property. Mountain States Tel. & Tel. Co., 763 P.2d at 1027-28. The Commission should do so here as well.

C. Public Counsel / TRACER / AARP Motion for Summary Judgment

Staff is not filing a separate answer to the Motion for Summary Judgment of Public Counsel, TRACER, and AARP. Staff however, refers the Commission to the Fifteenth Supplemental Order in Docket UT-950200, at 37 (April 11, 1996), in which the Commission rejected US West's claims that it had not waived its right to imputation by agreeing to imputation until further order of the Commission; and to the Commission's brief to the state Supreme Court in the 1995 rate case at 16, 34-35, which argued that US West should be held to its agreement that it would not challenge imputation except for "future changed conditions that no party can predict with certainty today [i.e., in 1990]." Staff submits that US West's arguments concerning imputation in this docket do not constitute such "changed conditions."

VIII-IX. RECOMMENDED COMMISSION ACTION / CONCLUSION

The Commission should deny USWC's petition to cease the imputation of directory revenues to its Washington telephone operations, and instead should order those imputations to continue until USWC actually undertakes to value the directory business at its current business enterprise value and to treat it as a sale. In the case of treatment as a sale, the amount calculated as a gain on the sale (current BEV less book value) should be recorded as a reduction to USWC's depreciation reserve accounts, both for accounting and ratemaking purposes.

Dated this ___ day of October, 1999.

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