BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In Re:	)	DOCKET NO. UT-980948
	)	
U S WEST's Petition for a Declaratory Order	)	REPLY BRIEF OF U S WEST
Ending Imputation of Revenues Derived from	)	
Transferred Yellow Pages Publishing Business	)	November 5, 1999
	)	
	)	
	)	

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U S WEST submits its reply to the briefs of Staff and Public Counsel. U S WEST will follow generally the format of the opening brief as to the order of issues, although it will not address each of the issues discussed in the opening brief.

I. INTRODUCTION/OVERVIEW OF THE CASE

The basis of Staff's and Public Counsel's positions, as discussed in their briefs, is that there is something inherently wrong and unacceptable about transactions between affiliated companies, where at least one company is regulated, unless those transactions closely resemble transactions between unaffiliated companies. Thus, Staff and Public Counsel build their cases on the notion that presumes that an affiliated interest transaction is invalid and ineffective unless it looks like a transaction that would occur between unaffiliated entities. This notion is simply unsupported by the law. The statutes, as interpreted by the Supreme Court in *U S WEST Comm., Inc. v. Wash. Util. & Transp. Comm.,* 134 Wn.2d 74 (1997), do not presume that a transaction between affiliates is invalid unless it looks like a transaction that would occur between unaffiliated companies. They merely empower the Commission to modify the terms of the transaction where necessary to protect interests of ratepayers.[1]

RCW 80.12.030, the statute under which the Supreme Court upheld the Commission's power to impute, as interpreted by that court, applies when "(as here) the utility gave the affiliate something of far greater value than the affiliate paid for in return. The effect . . . is to give the shareholders of the affiliate something of value at the expense of the ratepayers of the utility" (*Id.* at 94). The court issued this holding in rejecting U S WEST's argument that because U S WEST Communications' accounts did not reflect payments to U S WEST Direct for services,

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[1] Both Staff's and Public Counsel's briefs resort to pejorative and emotional attacks on U S WEST and its motives in bringing this proceeding. U S WEST will not respond to those attacks, other than to note that the argument in Public Counsel's brief at p. 2 really is an argument that imputation should never be ended, even when it would be agreed that the fair price for the directory business has been paid.

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imputation

was not authorized under RCW 80.12.030. Thus the court held that it would examine the substance rather than the form of the transaction to see whether the effect was within the "general rationale" of the Commission's authority to review transactions between affiliates which is "fear of collusion in the absence of arm's length dealings." *Id.*

A corollary point in Staff's and Public Counsel's basic positions is the view that where a business involves the use of several types of assets, including several different types of intangible assets, if the seller or transferor of the business retains ownership of *any* of the intangible assets, such as a trademark, then the entire business has not been sold or transferred at all. This is simply an outlandish view of the role of intellectual property rights, including trademarks, and it has no support in the evidence, in the law, or in common sense.

Staff's and Public Counsel's arguments are especially notable in what they do not address. Neither of these parties addresses, at all, Prof. Perlman's determinative (and not cross examined) testimony that the assignment in the Publishing Agreement of the copyright in the Yellow Page directories to U S WEST Direct and later Dex, effectively transferred the ownership of the business to U S WEST Direct (Ex. 201-T at 4, 5, 16). Neither of these parties attempts to explain Dr. Selwyn's admission that if Staff's (and by extension Public Counsel's) theory of this case is correct, then the Supreme Court was wrong in holding that the value of the directory publishing business had already passed to U S WEST Direct at some time before December 24, 1997 (Tr. at 854-856). Neither of these parties attempts to explain why it is impermissible for a regulated company to transfer a business to an affiliate in a transaction that requires compensation to protect ratepayer interests, and to have the Commission later determine that the actual compensation was inadequate and determine the required compensation in order to protect those interests.

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Instead of addressing these issues, Staff and Public Counsel have devoted their briefs largely to non-determinative, irrelevant issues. These include the argument that because Pacific Northwest Bell supposedly did not specifically ask to transfer the directory intangibles, no transfer of ownership occurred; the claim that U S WEST has changed its position on what imputation is; and, the claim that because U S WEST Direct did not pay PNB in cash, the conditions of the Supreme Court opinion for the end of imputation have not been met.

U S WEST submits that the Commission's orders demonstrate that it was fully aware of the nature of the transaction in 1984, and that everything that was necessary to operate the directory business was transferred to U S WEST Direct, with the knowledge of the Commission. The Commission in 1984 deferred determining the reasonableness of the compensation until a formal proceeding dealing with PNB's results of operations for rate making purposes. In Docket No. U-86-156 the Commission elaborated that in the next rate case the full value of the business that had been transferred should be available for ratemaking. Subsequently in Docket No. UT-950200, the parties litigated the Commission's authority to impute directory revenues.

The Commission won its case in the Supreme Court on the theory that imputation was authorized because it rectified the effects of the *past* transfer of the valuable directory publishing business to an unregulated affiliate for inadequate compensation. That same past transfer that brought victory to the Commission on the question of its authority to impute means that consistency and justice require the Commission to treat the transfer for valuation purposes as having occurred in the past. The only past date that any party has suggested on this record for the transfer is 1984.

The directory business has been paid for through publishing fees and imputation that reduced rates. U S WEST's undisputed evidence shows that U S WEST has more than paid the 1984 fair market value plus reasonable interest since 1984 until the imputation amounts equaled

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this value. This outcome is the same from the standpoint of passing compensation *to ratepayers* as if a cash payment had been made from U S WEST Direct to U S WEST Communications. The business should not be paid for twice. U S WEST has more than satisfied its obligation to pay the ratepayers, in the form of reduced rates, for their interest in the directory business at the time of that past transfer.

II. BASIS FOR U S WEST'S PETITION

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

Staff argues that U S WEST did not contend prior to this case that the yellow pages business was transferred from U S WEST to its unregulated affiliate for inadequate compensation (Brief at 3). It then concludes that "these arguments were not made by either the Company *or the Commission* to the state Supreme Court" (emphasis added). This is simply untrue. The Commission definitely argued to the Supreme Court that U S WEST transferred the directory business to its affiliate for inadequate compensation, and that this past transfer justified imputation (Ex. 103 at 1-2). In fact, the Commission stated no fewer than eight times in its brief to the Supreme Court that the *business* had been transferred (*Id.*) The Supreme Court understood this and it recited the Commission's core argument at 134 Wn.2d 91: Imputation was proper according to the Commission "because the utility *has transferred away* a valuable asset to an affiliated company without obtaining fair value" (emphasis added). The Commission stated no fewer than six times in its Fifteenth Supplemental Order in Docket No. UT-950200, which was the subject of that appeal, that the business had been transferred or divested, or that U S WEST had "lost" the regulatory asset.

Staff argues that the Supreme Court was not asked to decide that *ownership* of the directory business had been transferred. Public Counsel echoes this claim at p. 19. This is actually a function of the Commission's litigation posture in the Supreme Court, not

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U S WEST's. U S WEST had opposed imputation as beyond the Commission's authority under any conditions. The Commission justified its imputation to the court by showing only that the directory business had been transferred, and it did not argue any more specifically about what interest in that business had been transferred, except that it advised the court that what U S WEST Direct received was "an entire enterprise" (Ex. 103 at 2). That is the issue on which the court ruled. Therefore, the value that is material for this docket is the value of the interest that the Commission told the court was transferred. It is that value that the court held when paid, would justify the end of imputation. *U S WEST, supra,* 134 Wn.2d at 102. Nowhere do Staff and Public Counsel attempt to reconcile this explicit representation to the court by the Commission of the extent of the asset that was transferred, i.e. an "entire enterprise," with Staff's and Public Counsel's claim in this docket that intangibles were only "rented" or that the publishing function was "outsourced."

Staff also argues that the Supreme Court did not determine the appropriate date to value the yellow pages publishing business (Brief at 4). U S WEST has never contended that the Supreme Court did make such a determination. However, what was crucial to the court's ruling was the finding that a *past* transfer of the directory publishing business requiring adequate compensation *had occurred* and that past transfer for inadequate compensation was the justification for the WUTC's imputation of directory revenues to U S WEST. On this record, the only past date that has been suggested by any party on which the transfer could have occurred is January 1, 1984.

There are actually two elements to the court's finding. One is that a transfer that required compensation to protect ratepayers' interests occurred prior to 1997, and the second is that the compensation that was actually provided at the time of the transfer had not been shown to be adequate to protect those interests. These coinciding factors, according to the court, were the

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reasons that the WUTC was empowered under the statutes to impute directory revenues. If, as Staff and Public Counsel now claim, the transfer has not yet occurred, the court could not have made its findings. The lack of a past transfer negates the first prong of the court's determination. Also, if the transfer has not yet occurred, it would not be possible to determine that the compensation received had been inadequate. Dr. Selwyn admitted that Staff's current position could not be reconciled with the Supreme Court's opinion (Tr. at 854-856). Staff's and Public Counsel's briefs do not respond to this issue, although U S WEST pointed it out at p. 16 of its opening brief.

III. THE TRANSFER OF THE YELLOW PAGES PUBLISHING BUSINESS

A. The Yellow Pages Business Was Transferred in its Entirety Effective 1-1-84.

Staff argues that "[u]nder the Publishing Agreement, PNB *leased* to U S 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" (Brief at 6) (emphasis added). Staff cites Ex. 602 at 10, ¶10.01 for the source of this statement. Ex. 602 is the publishing agreement that was conditionally approved in the Fourth Supplemental Order in Cause No FR-83-159.

Nowhere in ¶10.01, or any other paragraph, does the publishing agreement use the term "lease" to describe the relationship between PNB and U S WEST Direct. Prof. Perlman described the arrangement for the right to publish directories as a noncompete agreement which gave U S WEST Direct the opportunity to migrate the "first supplier advantage" to itself (Ex. 201-T at 7). Staff 39 concedes that this was the nature of that provision, and that the first supplier advantage was indeed transferred (Brief at 39). Prof. Perlman described the arrangement for the exclusive right to use trademarks as a license, although he pointed out that the significance of a trademark is in a purchaser's selection among competing vendors, which has

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limited applicability to the directory business (Ex. 201-T at 12). This testimony was not rebutted. Staff's argument in its brief that these items and unidentified other items were "leased" under the agreement is unsupported by Staff's own evidence or the wording of the Agreement.

Public Counsel argues that the publishing agreement, according to Public Counsel an "integral part of the restructuring of publishing operations in 1984," resulted in "essential elements" of the publishing business being retained by USWC and only licensed or "rented" to the affiliate (Brief at 3). The essential elements of the publishing business were actually the cash, the relationships with advertisers and suppliers, and, most importantly, the employees (Ex. 201-T at 9). It is undisputed that these were all transferred.

Public Counsel also argues that the 1984 transaction "did not constitute a complete and permanent transfer of ownership so as to warrant treating imputation as if it were installment payments on a 1984 sale." Public Counsel does not explain why its witness, Mr. Brosch, testified under oath in Docket No. UT-950200 that "Pacific Northwest Bell transferred *all of its directory operations, assets and liabilities* to USWD's parent (at that time, Landmark Publishing Company) effective January 1, 1984 and entered into a three-year publishing agreement effective through 1986" (Ex. 103 at 6) (emphasis added). Public Counsel also does not explain why its witness testified in that same docket that "[t]he imputation of directory revenues is only necessary because of the parent entity's decision to *remove the directory publishing business* from the telephone company's operations and financial results at divestiture." *Id.* (emphasis added).

This was Mr. Brosch's prefiled direct testimony, not any off-the-cuff response to a cross examination question. Mr. Brosch testified that the parent entity decided at divestiture "to remove the directory publishing business from the telephone company's operations and financial results." Public Counsel won in court on the theory that the business was "removed." Public

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Counsel seeks now to "double dip" by arguing that the business was not removed. U S WEST raised this contradiction in Mr. Inouye's rebuttal testimony. Public Counsel's surrebuttal testimony in this docket, and its brief, do not attempt to explain the contradiction. This prior testimony by Public Counsel's witness was part of the record on which the Supreme Court made its decision to uphold the Commission's power to impute.

Public Counsel also argues that "[r]atepayers were not guaranteed receipt of any business valuation as of 1984 (as now asserted by USWC), but instead have remained at risk for the variability in directory revenues and income since the 1984 transaction through the imputation process" (Brief at 5). Public Counsel's brief does not explain how such an "at risk" relationship could exist in the face of Public Counsel's statement in its brief to the Supreme Court which was recited by the Court in *U S WEST, supra* at 134 Wn.2d at 101:

> Public Counsel and AARP argue that if US West believes the imputation has been sufficient, *it should petition the Commission to perform a valuation of the asset that was transferred (the publishing right) and to determine the value that has been received from imputation to determine whether imputation should continue.*

(emphasis added). Public Counsel plainly advocated exactly and specifically what U S WEST is doing in this current docket. Public Counsel plainly told the Supreme Court that once the cumulative imputation amounts equaled the value of the asset that was transferred, it would be proper for imputation to end. Public Counsel clearly told the court that the ratepayers' entitlement was to the value "of the asset that was transferred." There is no ongoing "at risk" relationship based on variability in the annual imputation amounts that are used cumulatively to determine when that value has been received by ratepayers. This is not "reconstruction of history" by U S WEST, as Public Counsel argues at p. 47; it is Public Counsel's own voluntary statement to the Supreme Court and on which the Supreme Court relied in indicating that there was a means by which imputation would end. *U S WEST, supra,* 134 Wn.2d at 102.

Public Counsel, now apparently embarrassed by this statement, attempts at p. 58 of its current

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brief to minimize the statement's significance, calling it "an aside" and saying that U S WEST takes the statement "out of context." Public Counsel's argument about context is without any evidentiary support; Public Counsel had the opportunity to introduce other portions of its brief to the court, and it did not do so. U S WEST introduced pages 34 and 35 of Public Counsel's brief to the Supreme Court in Ex. 103, which is where the quotation appears. The Commission can see for itself that U S WEST has not taken the statement out of context.

An "aside" is a theatrical device, and Public Counsel does not explain how the device of an aside, which is usually used when a speaking character wishes to make a matter clear to the audience, is unreliable in this case when made to the audience of the Supreme Court, assuming that the characterization as an "aside" is correct. Public Counsel's statement, even as an "aside" is still presumably correct and reliable if that statement is made in a brief to the Supreme Court. Public Counsel made a clear statement about how imputation would end, which Public Counsel told the Supreme Court was an "invitation" to U S WEST (Ex. 103 at 2). The Supreme Court discussed the precise mechanism in connection with its holding at 134 Wn.2d at 102 that "when the Company has shown that it has received fair compensation from its affiliate for the value of the asset it transferred, imputation may cease."

Public Counsel's current brief argues that its prior statement to the Supreme Court did not "agree not to dispute the issues raised" in such a filing by U S WEST, "including the effect of imputation." The effect of imputation is central to the statement in the Public Counsel brief to the Supreme Court. If Public Counsel now contends that the "value that had been received from imputation" should not be counted in determining whether the "valuation of the asset that had been transferred" has been received, then it is contradicting a material statement of fact and law that it made to the Supreme Court, and on which that court relied in ruling in Public Counsel's favor.

B. <u>Staff's And Public Counsel's Briefs Contradict The Commission's Order In The Rate Case,</u>

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Staff's Brief In That Case And The Second Supplemental Order In Docket No. U-86-156.

Staff argues that the Commission "clearly did not regard this 1984 'transfer' as a transfer of ownership of the entire yellow pages business to U S WEST Direct" (Brief at 9). As discussed above, this argument directly contradicts the Commission's specific representation to the Supreme Court in its brief, that U S WEST Direct received "an entire enterprise" (Ex. 103 at 1). It also contradicts other language in the Commission's Fifteenth Supplemental Order in Docket No. UT-950200. At pp. 39 and 41 of that order, the Commission said that its power was to protect consumers if a utility were to "divest" a discrete and profitable aspect of its operation, and that the "divestiture" of a "money producing element" without a return benefit was imprudent. Webster's defines "divestiture" as "the act of divesting" and "divest" as "to strip; to deprive; to dispossess." These determinations by the Commission indicate that the imputation was based on the Commission's perception of the passage of the full ownership interest in the directory business to U S WEST Direct in 1984.

Staff also ignores the Commission's use of verb tenses in the passage that Staff quotes from the Second Supplemental Order in Docket No. U-86-156. The Commission said:

> "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 [i.e. as a sale] would allow for determination of consideration *at the time of transfer* that would fairly compensate PNB . . . Treatment as a sale is very likely to reflect a result that *might have been achieved* by the parties bargaining at arms length.

(emphasis added). The Commission, writing in 1988, used the past tense in referring to the determinative fact of the intent of PNB and USWD. The only past date for a transfer and associated intent, viewed from 1988, was when the business was transferred in 1984. The phrases "intended a permanent transfer," and "consideration at the time of transfer," coming in successive sentences in the same paragraph, clearly refer to the same transfer at the same point in time, namely a point in the past. The Commission also used the past tense in referring to the likely dollar outcome of treatment as a sale as the result that "might have been achieved" by arms length bargaining. This indicates that even if the determination of the dollar outcome of

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treatment as a sale is done in the future, viewed from 1988, the proper measurement is what arms length bargaining "might have achieved" in the past, viewed from 1988. Again, the only possible past date viewed from 1988 for such hypothetical bargaining is 1984.

Staff's confusion on the timing of the remedy leads it to erroneously argue that the permanent transfer had not yet occurred by the time of the Second Supplemental Order in Docket No. U-86-156. The Commission ordered no remedy in the Second Supplemental Order. It specifically held that remedies were for the future in a general rate case (Second Supplemental Order, Docket No. U-86-156 at 14, first ordering paragraph). Such an order only makes sense if the Commission recognized at the time that something of value beyond simply the hard assets had been transferred. Staff's argument at p. 10 of its brief that the Commission in that Order in Docket No. U-86-156 was considering only a temporary transfer of the "publishing function" for the duration of the new publishing agreement that was before it in that case, is at war with the Commission's use of the past perfect tense to describe the transfer that required the "full reasonable value" of the "directory publishing enterprise" to be made available to PNB for ratemaking purposes.

Staff carefully avoids quoting the precise language of the order and incorrectly paraphrases "as if the transfer had been an arms length transaction" (the Commission's words) to "as if there were an arms length negotiation" (Staff's words) to argue that the Commission's "treatment as a sale" formulation means that ownership of the yellow pages business cannot transfer without *advance* payment of fair market value. Staff has essentially made this up. The Commission's words speak for themselves and they do not support Staff's argument. The Commission's use of the past perfect tense subjunctive mood is not the same as the present tense subjunctive mood that Staff's argument uses.

In any case, the Commission told the Supreme Court in its brief that U S WEST Direct received "an entire enterprise" in exchange for virtually nothing, and that imputation compensated for the "gross inadequacy" of the compensation (Ex. 103 at 1). The Supreme Court agreed. If the Commission is to

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make a finding in this docket in agreement with this Staff argument, it must advise the Supreme Court that the Commission's prior representation was incorrect and there would be grounds for reopening that case.

Staff's argument is also flatly contradictory to Staff's argument in its brief to the Commission in Docket No. UT-950200, when it advised the Commission that PNB had "walked away from" and "abandoned" the yellow pages publishing function (Ex. 103 at 5). Webster defines "abandon" as "to give up absolutely," and to "renounce utterly." Staff in its current brief does not explain how it is possible to "give up absolutely" or "renounce utterly" and "walk away from" an asset and yet still own it after the expiration of a "lease," as Staff now claims is the nature of the transfer to U S WEST Direct. U S WEST confronted Staff with this inconsistency in Mr. Inouye's rebuttal testimony but Staff's brief and testimony ignored the contradiction. At p. 11, n. 6, Staff argues that the Second Supplemental Order in Docket No. U-86-156 expressed the Commission's view that the publishing function was being leased to U S WEST Direct in the publishing agreements. This argument is flatly untrue. Nowhere in that order did the Commission use the terms "lease" or "rent" to describe the interest that U S WEST Direct had in the directory publishing business.

Public Counsel's brief at p. 4, without addressing the above language on the timing of remedies, argues that the Commission's description in the Second Supplemental Order in Docket No. U-86-156 of three possible remedies, one of which was "treatment as a sale," means that the treatment cannot refer to the 1984 transaction. Public Counsel's current argument contradicts its representation to the Commission in its brief in Docket No. UT-950200 when it said "USWC spun off Yellow Pages and is not receiving fair value for it. The imputation of revenues serves to account for *this 'imprudent sale'*" (Ex. 103 at 3) (emphasis added). In 1996, therefore, Public Counsel told the Commission that the 1984 transaction was an imprudent "sale." Now, in 1999, with only the Supreme Court case having intervened, Public Counsel says that the same transaction could not have been a sale and did not transfer

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ownership. The Commission and the Supreme Court *agreed* with Public Counsel's position in Docket No. UT-950200 in upholding the Commission's power to impute directory earnings to U S WEST Communications.

Public Counsel says that the 1984 event was an "attempted transfer of the Yellow Pages Business" (Brief at 5). Public Counsel's witness told the Commission under oath in Docket No. UT-950200 that the 1984 event "*transferred* [PNB's] directory publishing assets and operations to a separate affiliate" (Ex. 103 at 6) (emphasis added). Public Counsel has not attempted to explain this inconsistency. Public Counsel's current characterization of the transaction should be rejected.

C. <u>The Settlement Agreements In The AFOR And Merger Cases Are Irrelevant</u>.

Staff argues that the settlement agreements in the AFOR docket and the Merger Case did not state that imputation was compensation for the transfer of the yellow pages business (Brief at 11-13). This is of course true but irrelevant. The fact that settlement agreements, which stated that they are not binding on any party in future cases, did not say that imputation compensates for the transfer of directory publishing, does not mean that that is not the effect of imputation. The Commission advised the Supreme Court in its brief that imputation was to "remedy the inequity" of U S WEST's past transfer of the "lucrative yellow pages publishing business" in a not-at-arms-length transaction for which U S WEST received "virtually nothing" (Ex. 103 at 1). The court clearly relied on this representation. *U S WEST, supra*, 134 Wn.2d at 94.

D. <u>Staff And Public Counsel Misstate The Petition For Clarification In The Merger Case</u>.

Staff claimed that U S WEST in its Petition for Clarification in the Merger Case proposed that imputation be readdressed in the future "*only* upon 'future changed conditions'" (Brief at 12) (emphasis added). This is flatly untrue. The Petition for Clarification does not include the "only" qualifier. The Petition for Clarification states that "at least" U S WEST should be able to address imputation based on future changed conditions. "At least" means that there are other bases for readdressing imputation

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besides future changed conditions. U S WEST has a statutory right under RCW 80.04.200 to readdress any Commission order by which it is aggrieved based on changed conditions "or for any other good and sufficient cause which for any reason was not considered and determined in such former hearing" after two years, or six months if the order was not reviewed. U S WEST did not waive this right. In any case, no such limiting condition was included in the Third Supplemental Order in Docket No. U-89-3524-AT. In fact conditions have changed in ways that no one could have predicted at the time of the Merger Case Order, as argued in U S WEST's response to the Motion for Summary Determination.

E. The Law Of The Case Applies Because The Supreme Court Relied On The Representations Of The Commission And Public Counsel That "The Utility Has Transferred Away A Valuable Asset To An Affiliated Company;" No More Specificity Is Required For The Doctrine To Apply.

Staff sets up a straw man argument in order to attempt to escape the law of the case doctrine. Staff attributes to U S WEST an argument 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."[2] Staff then proceeds to quote from the Commission's recent decision in the *Scottish Power* case to make the point that the transfer of property statutes contemplate different types of transfers.

U S WEST has not made the argument that Staff attributes to it. U S WEST has relied on the language of the Supreme Court:

> They [including the Commission and Public Counsel] contend the Commission properly imputed the excess revenue from the yellow pages business to US West because *the utility has transferred away a valuable asset to an affiliated company without obtaining fair value,* and that the imputation serves to correct US West's revenues to produce rates that are fair and reasonable. *U S WEST, supra,* 134 Wn.2d at 91 (emphasis added).

The Court recited the core argument of the Commission in support of its decision to impute. The Court did not attribute to the Commission any different or more detailed description of the legitimacy

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[2] Public Counsel's brief makes the same claim.

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and significance of "corporate manipulations" than this phrase: "the utility has transferred away a valuable asset to an affiliated company without obtaining fair value." U S WEST has not suggested that the Court made any more detailed a determination than that, nor is such a determination necessary to decide in this case what value to assign to the "valuable asset." The Court upheld the power to impute based on the Commission's argument that U S WEST "transferred away" the valuable asset without required compensation and the asset that was "transferred away" is the same asset that must be valued in order that imputation may end. *U S WEST, supra,* 134 Wn.2d at 102.

F. Staff's Brief Applies Inconsistent And Mutually Exclusive Standards To The Question Of Whether Ownership Of The Directory Business Transferred In 1984.

Staff argues that the court did not determine that U S WEST obtained ownership of U S WEST Direct by gift and attributes a critical motive to the Supreme Court's statement that U S WEST "gave away a lucrative ratepayer-funded asset to an affiliate in return for little or nothing." Staff claims that the Commission would not have countenanced a gift of the yellow pages business "for purposes of ratemaking." Staff claims that if the yellow pages had been conveyed by gift, then the subsequent compensation by imputation would be superfluous. The Court's description that U S WEST "gave away" the asset is consistent with the conveyance of ownership by gift. It is also consistent with Staff's statement in its brief to the Commission in Docket No. UT-950200 that U S WEST "abandoned" the asset (Ex. 103 at 5). However, whether there was a "gift" or not is in fact irrelevant. There clearly was a transfer of ownership, and the ratemaking impacts of the transfer for inadequate compensation are what the current docket is about.

The court held that the Commission had the power to impute to "rectify the effects of the transfer of a valuable asset by the utility to its affiliate for inadequate compensation" *U S WEST, supra,* 134 Wn.2d at 95. Staff's brief again avoids quoting the Supreme Court's language and misleadingly paraphrases it at p. 17 by stating that "[t]he Court noted, quite correctly, that imputation was a means to

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‘rectify’ the *fact that* U S WEST had transferred the yellow pages operations for inadequate compensation” (emphasis added). Staff then uses this formulation to argue that “This is quite different from holding that imputation is the consideration for the fair market value . . .” (Staff’s emphasis).

Contrary to Staff’s arguments, the Court’s holding was that imputation is specifically to “rectify the *effects of*” the transfer of the asset for inadequate compensation. 134 Wn.2d at 95 (emphasis added). Obviously the effect of the transfer of the asset for inadequate compensation is that the utility has a deficit in its asset accounts compared to the situation that would exist if adequate compensation had been received at the time of the transfer. The adequate compensation, as Staff appears to agree, is the fair market value at the time of transfer. The verb to “rectify” according to Webster means to “make or set right; to correct from a wrong, erroneous or false state.” Thus to “*rectify the effects”* of an asset deficit caused by a transfer for inadequate compensation is to eliminate the lack of adequate compensation which constitutes the incorrect state of the asset accounts. Thus the dollars imputed must be the increments of compensation, if they are to "rectify the effects” of inadequate compensation.

Staff’s brief at p. 18 argues that U S WEST’s analysis is “artificial,” in that it necessarily relies on the concept of ownership, but it supposedly treats the transactions as if they were between independent participants without Commission regulation and without impact on ratepayers. Staff has the matter completely backwards. U S WEST’s case was premised on the Supreme Court’s decision that upheld the Commission’s imputation of directory revenue based only on the fact that U S WEST “transferred away” its valuable directory asset for inadequate compensation. This was explicitly in recognition of the Commission’s regulatory authority. Staff and Public Counsel introduced responsive testimony in which they argued for the first time that a sale was necessary to have transferred ownership in order for the January 1, 1984 valuation to be appropriate. Staff and Public Counsel go on to challenge that such ownership had actually transferred, based on the lack of things such as arms length agreements of sale and valuations that would be found in similar transactions between unaffiliated entities.

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U S WEST moved to strike this testimony and its motion was temporarily denied so U S WEST submitted rebuttal on these issues.[3]

Staff's argument at p. 19 of its brief is that because U S WEST, Inc. controlled both PNB and U S WEST Direct, the Commission should ignore the actual agreements between the parties. This is in irreconcilable conflict with Staff's position that the directory business did not transfer because there were no written agreements of sale complete with terms and valuation and payment of cash. Staff does not explain why it would be appropriate, given the same control by U S WEST, Inc. over the two parties, to rely on such agreements if they existed, when Staff urges the Commission not to rely on the actual agreements.

Staff seeks to argue both sides of the same question. Staff effectively said in its testimony that there are no indicia in the existing agreements of an intent to transfer the business, such as one would expect in agreements between unaffiliated entities. When Prof. Perlman showed that the agreements would be consistent with an intent to transfer the business, even among unaffiliated entities (Ex. 201-T at 22), Staff claimed in its brief that the affiliated relationship makes his testimony irrelevant because the parties would not necessarily operate under the agreements as written. Apparently, it is Staff's position that no actual or hypothetical written agreement would allow the Commission to decide whether the business had been transferred.

U S WEST submits that the best evidence of the transfer (aside from the Commission's and Supreme Court's own prior findings that the business was transferred) is for the Commission to look at how the business has operated since 1984. Using this test, the business was clearly transferred Jan. 1, 1984 (Tr. at 1139, 1140). The business no longer bears the telephone company name or logo, U S WEST Direct has the copyright, and the business is vastly changed from the business that PNB operated (*Id.*). The business was actually resold *back* to U S WEST Communications Group, Inc., in

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[3] U S WEST has renewed its motion to strike this testimony.

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1998, and Staff has not explained how that could have happened if, as Staff claims, PNB always owned the business. Obviously it could not have happened. U S WEST did not pay billions in real dollars to the stockholders of MediaOne Group, just for fun or to achieve some regulatory outcome in Washington. It had to pay those dollars in order to reacquire the directory publishing business.

Staff's arguments are contradicted by its own testimony and the Commission's order in the rate case. Staff argues that the only ways in which the business could have transferred in 1984 are (1) an initial payment in cash or "making arrangements" to pay a lump sum over time, or (2) a gift. Staff argues that neither of these happened and therefore the business did not transfer. Staff claims that neither of these happened because Staff supposedly "can demonstrate" that fair market value was not paid and the Commission did not approve a gift.

This entire argument is of course inconsistent with the Commission's Fifteenth Supplemental Order in Docket No. UT-950200 and its brief to the Supreme Court and Staff's brief to the Commission in Docket No. UT-950200 (Ex. 103 at 1, 2, 5). The first point is contradicted by Staff witness Strain who admitted that publishing fees and imputation were compensation towards fair market value (Tr. at 1167). Prof. Perlman also testified that publishing fees and imputation were payments for the value of the business (Ex. 201-T at 22-23). In the Fifteenth Supplemental Order in Docket No. UT-950200 at p. 32 the Commission *found* that publishing fees were compensation towards the value of the business.

The point of the regulatory statutes is to protect ratepayer interests by making financial adjustments that may be long after the fact of actual or accounting developments (Tr. at 1208). As long as the adjustments are made, and here they have been made in the form of imputing revenues to compensate for the value of the transferred asset, it is of small importance whether the change of ownership is classified as a sale, a transfer, a gift or a part gift part sale. The Supreme Court looked at the substance rather than the form of the transaction to uphold the Commission's power to impute under RCW 80.12.030. U S WEST pointed these alternatives out because the Staff argued in testimony that

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the only way that the ownership of the business could have transferred is a sale based on arms length negotiations with a contemporaneous exchange of equal compensation. U S WEST showed that such a sale is not the only way, even assuming that the appropriate benchmark is the types of transactions that exist between unaffiliated entities (an assumption with which U S WEST disagrees).

G. <u>PNB At All Times Disclosed All Material Aspects Of The Transfer And The Transactions Between PNB And U S WEST Direct.</u>

At pp. 20-23 of its brief, Staff claims that U S WEST's applications under RCW 80.12.020 and Chapter 80.16 RCW failed to disclose any intent to transfer ownership of the "intangible assets of the yellow pages business—those assets which make the business so lucrative," and claims that U S WEST "undoubtedly" must have known that its application's reference only to physical assets would be "uninformative." This claim cannot be reconciled with Staff's own brief to the Commission in Docket No. UT-950200, in which Staff demonstrated that it was well aware that U S WEST had "walked away from" and "abandoned" the "valuable regulatory asset" that was the Yellow Pages publishing function (Ex. 103 at 5). This claim is also flatly inconsistent with the stated position of Staff in Docket No. U-86-156 as recounted by the Second Supplemental Order at pp. 4-5:

> The Commission Staff alleged that applicant has advocated a transfer of the *lucrative yellow pages publishing function* to US West Direct, an unregulated affiliate, at terms disadvantageous to itself and its customers. Staff asserted that this position emphasizes that the real party in this proceeding is US West Direct, and demonstrates the absence of arms-length bargaining *attending the asset transfer.*

(emphasis added). So in 1988, Staff was not "uninformed" about the nature of the transfer, and it alleged that it was the "lucrative" yellow pages publishing function, not just the physical assets, that was being transferred.

Finally, in Cause No. FR-83-159, the Commission did not act as if it were "uninformed" by the application. It deferred deciding on the reasonableness of the compensation associated with the affiliated transactions, showing a clear understanding that more than just the physical assets were

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transferred. Staff has not explained why, if the Commission had truly been under the impression that only physical assets were being transferred in exchange for a fraction of a share of stock in Landmark Publishing, it deferred deciding on the reasonableness of the compensation. No party has ever contended that the physical assets were undervalued.

At p. 23 of its brief, Staff argues that the Commission should heed U S WEST's prior positions which Staff contends show that U S WEST never intended to, nor did, transfer ownership of the entire yellow pages business to U S WEST Direct. This presents the issue that U S WEST argued in its Motion to Strike. Certainly U S WEST in the past, argued positions that are contrary to what the Supreme Court decided in *U S WEST, supra*. U S WEST's presentation in this case is based on the fact that U S WEST *lost those arguments in court in 1997 and the Commission won them.* U S WEST is litigating this case based on the determinations that made the Commission victorious in court. Aside from some unexpressed intent that U S WEST should be punished for having held litigation positions in the past that the Court ultimately overruled, the Staff does not say for what purpose the Commission should heed those prior positions. As U S WEST has argued in its Motion to Strike, Staff and Public Counsel seek to argue the *reverse* of the positions that brought Public Counsel and the Commission victory in court, and this is precluded by the doctrines of judicial estoppel and equitable estoppel.

Staff at p. 23 quotes Mr. Johnson's testimony in this case that a going business was transferred to U S WEST Direct in 1984, and contrasts it to his testimony in Docket No. U-86-156 in which he rebutted the testimony of the Staff that the "publishing function" had been transferred. Staff at p. 26 quotes from U S WEST's brief in Docket No. U-86-156, to the same effect.[4] Staff also quotes from a deposition by Ms. Koehler-Christensen in Ex. 519 attempting to show that the company's view in April 1997 was that only tangible assets were transferred. All of these items predate the Supreme Court's

[4] This is a document which is not in evidence, and on which it would be illegal for the Commission to make a finding. See RCW 34.05.461.

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December 1997 decision that upheld the Commission's determination that the "publishing function" had indeed been transferred, as an "entire enterprise," for inadequate compensation.

Mr. Johnson's testimony on this record conforms to the law and the facts pertinent to the transaction as announced by the Supreme Court, as does Ms. Koehler-Christensen's testimony. In fact, Mr. Johnson's testimony from U 86-156 is entirely consistent with U S WEST's view of this case. In 1988, Mr. Johnson clearly told the Commission that both USWC and USWD were subsidiaries of U S WEST, stating: "PNB is not in the directory business today. . . . USWD is a totally separate company. PNB is a totally separate company. PNB has no ownership interest in USWD" (Ex. 309 at 7, 10). U S WEST's brief in Docket No U-86-156, even if it were proper as a basis to use for a finding in this case, which it is not, does not demonstrate anything. The views in that brief were rejected by the Supreme Court and U S WEST's current case is consistent with that decision by the Supreme Court. Staff's argument, that U S WEST's current contention that ownership of the entire yellow pages business was transferred to U S WEST Direct in 1984 "cannot be squared" with prior company representations, is wrong. It is easily squared by reference to the doctrines of *stare decisis* and the law of the case, and U S WEST pointed this out in its opening brief.

Staff's brief at p. 27 argues that four alleged "facts" contradict U S WEST's case that ownership of the directory business passed to U S WEST Direct in 1984.[5] The first of these "facts" is that no valuation of the business was performed in 1984. Staff claims that based on Commissioner Hemstad's statement during his examination of Mr. Golden at Tr. 591, "PNB
would have needed to know the fair market value of the yellow page business when transferring it." This makes no sense in light of what actually happened, which was that in all of its orders in Cause No. FR-83-159 and Docket No. U-86-156, the Commission deferred any decision on valuation or any

[5] Staff does not mention the Commission's representation in its brief to the Supreme Court that U S WEST Direct received "an entire enterprise" (Ex. 103 at 1-2).

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ratemaking effect of the transfer until there should be a rate case. There was no rate case in 1984. Staff does not explain what the Commission would have done with the valuation information in 1984, in light of the Commission's deferral of that issue.

The second supposed "fact" is that there is no documentation to support the contention that ownership of the yellow pages business was transferred in 1984. This contention is unfathomable given the eight separate statements in the Commission's brief to the Supreme Court that say that the business was transferred, the fourteen separate statements in the Supreme Court's opinion that say that the business was transferred and Staff's own brief to the Commission in Docket No. UT- 950200 that says PNB "abandoned" the "valuable regulatory asset" (Ex. 103 at 1-2, 5). This is the key area of Staff's brief in which Staff's "heads I win, tails you lose" approach to affiliate transactions manifests itself. Staff argues that the transaction should be scrutinized carefully because it involves an affiliate and a regulated company, and yet the evidence that it uses in its brief to support the claim that documentation is lacking, is all explicitly based on Commissioner Hemstad's hypothetical question to Prof. Perlman that involves getting "out from under the environment of a *related entity."* Tr. at 1133 (emphasis added). Thus all of the testimony that Staff cites at p. 31 of its brief including the references to "if [the transaction] were in a marketplace" that to not have a "sophisticated" agreement would subject counsel to claims of malpractice, is based on the hypothetical that Commissioner Hemstad established at Tr. 1133, of non related companies. Prof. Perlman testified earlier that transactions between related companies do not partake of this level of formality (Tr. at 1133). This testimony is unrebutted.

Staff also ignores the history of this case.[6] Until fourteen months before divestiture, the directory business was destined for AT&T according to the proposed Modification of Final Judgment. Judge Greene issued his opinion changing that in 1982. *United States v. Western Electric,* 552 F. Supp. 131

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[6] Staff misstates the record. The evidence is that Mr. Johnson suspected that there were documents memorializing the transfer of the business but he did not have them and due to the passage of time under applicable retention policies, non documents could be found. This is not evidence that no documents relating to this transfer existed.

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(D.D.C. 1982). PNB filed its Dec. 20, 1983 application, which was incomplete, a few days before divestiture, and the Commission ten days later approved the asset transfer application and conditionally and temporarily approved the publishing agreement.[7] The agreement that the Commission initially approved was not signed and did not have dollar amounts. In January 1985 the Commission approved the completed application in part, having previously extended the interim approval.[8] The agreement that the Commission finally approved in part was signed in June of 1984. All during this time, the production of directories did not cease just because regulatory requirements were still being dealt with. Instead, PNB directory employees transferred to the new company and began building a new business and publishing directories. Mr. Johnson testified that he was working for the organization that became U S WEST Direct but was being paid by PNB until the divestiture occurred (Tr. at 426). Staff's argument that it is "not plausible" that the business transferred without "sophisticated agreements," fails to take into account the historical events and the relationships of the corporate entities involved. Staff's argument assumes that there must have been legal requirements to protect the interests of the parties that are based on an arms' length relationship when the whole basis of this case is the fact as found by the Commission and the Supreme Court, that the parties did not deal at arms' length. In fact, the people involved worked out the essentials of the transaction before U S WEST Direct even existed as an entity that was capable of signing an agreement (Tr. at 451).

U S WEST submitted documentation in the form of its applications and the orders approving the applications. What the Staff fails to explain in its argument is that there was no more written contract or agreement of sale for the transfer of the tangible assets than there was for the intangible assets. Yet Staff does not claim that ownership of the tangible assets was not transferred.

Staff's brief at p. 29 glosses over an important issue in accusing Mr. Johnson of testifying

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[7] Order Granting Application in Part, Cause No. FR-83-159.
[8] Fourth Supplemental Order, Cause No. FR-83-159.

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inconsistently. Mr. Johnson stated that his understanding was that the Commission did not have to approve the transfer of people and other items, and that the actual transfer of the business was separate from the Agreements. Much of the intangible value of the directory business was the reputation of the employees who put the directories out, their knowledge of the directory business and its practices and their relationships with advertisers and suppliers (Ex. 102-T at 9). Since employees are not property, franchises or facilities, they may not be "sold." The Commission has never held that a transfer of employees between affiliates is subject to RCW 80.16.020. It is undisputed that the employees were transferred to U S WEST Direct. Staff's argument fails to recognize that U S WEST documented in Sub-Ex. D, p. 8 of its application, Ex. 110, that U S WEST Direct would be responsible for these employees.

Staff mischaracterizes Mr. Inouye's testimony in arguing that Mr. Inouye stated at Tr. 276 that the publishing fee amounts were not compensation for the fair market value of the publishing business (Staff Brief at 30). What Mr. Inouye stated at Tr. 276 is that he did not believe that the negotiators of the agreement had in mind compensation for the fair market value of the business. At Tr. 278, Mr. Inouye was asked: "I'm talking about compensation for the business that was transferred. Was that [publishing fees] meant to be compensation for any portion of that?" Mr. Inouye answered: "I believe so." So although Mr. Inouye testified that he did not believe the negotiators had a specific fair market value in mind at the time, his testimony is that they intended publishing fees to compensate in some way for the value of the business that was transferred. The Commission found that publishing fees were part compensation for the transfer of the business at p. 32 of the Fifteenth Supplemental Order in Docket No. UT-920500. Staff also ignores Prof. Perlman's testimony at Ex. 201-T at 22-23 that publishing fees and imputation were effective compensation toward the value of the publishing business that was in excess of the book value of the assets transferred.

Staff's third "fact," that nothing was paid to PNB but the $23.5 million for the tangible assets, is

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not a fact but is a false statement. The publishing fees were "compensation in some form" for the business (Tr. at 273). U S WEST has only argued that publishing fees for one year, 1985, when such fees were used in ratemaking, represent actual payment towards the overall value of the business at the time of transfer. In any case, as stated above, the Commission has already determined that publishing fees were compensation toward the value of the business.

Staff's brief also ignores the fact that over the years approximately three quarters of a billion dollars in imputed directory revenues have been used to reduce rates. This mechanism, although indirect, is effectively a payment to U S WEST Communications from U S WEST Direct.

Staff's fourth "fact," that PNB "leased" publishing rights to U S WEST Direct, is also false both as to its premise and its conclusion. As discussed above, the claim that PNB "leased" rights to U S WEST Direct is only in Staff's mind; it does not appear in any of the documents. Indeed, it is contradictory that Staff claims that U S WEST cannot support its view of the transaction with documentation, yet the documents do not support Staff's claim that rights were "leased." Also, the conclusion that Staff draws, namely that the existence of supposedly "leased" rights is inconsistent with the transfer of the ownership of the business in 1984, is contradicted by Prof. Perlman's testimony, Ex. 201-T and Staff's own evidence. Prof. Perlman established that it is not necessary to transfer all intangibles in order to transfer a business (Ex. 201-T at 9). Prof. Perlman testified that the effect of the exclusive right to publish was to create a window of opportunity to transfer the "first supplier advantage" to U S WEST Direct (Ex. 201-T at 7). Staff claims that the "exclusive right" which Staff concedes is only an agreement not to compete, was "leased" and that this is inconsistent with the transfer of the business in 1984. Yet Staff concedes in the next breath at p. 40 of its brief that "the first supplier advantage *shifted to U S WEST Direct"* and that "[e]ven today, that [first supplier] dominance remains" (emphasis added). Staff has thus acknowledged that the important function of the "exclusive right" was to enable the transfer of the first supplier advantage, and that once that function had been performed

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which Staff admits it has, the "exclusive right" had no function any longer.

Staff, having conceded the issue, nonetheless attempts to argue inconsistently that PNB could have nullified the effect of the transfer of the first supplier advantage by simply rescinding the "exclusive right." There is no evidence to support this. Mr. Johnson testified that U S WEST Direct engaged in heavy brand marketing to transfer advertiser allegiance to its brand (Tr. at 413, 466, 467). Staff introduced no evidence from interviews with advertisers to support the claim that they would have returned to PNB in the face of competition from U S WEST Direct (Tr. at 927).

Staff argues that the exclusive use of the PNB logo was "immensely important," that it was leased, and therefore the directory business was only leased. Staff relies on language from PNB's 1984 application, which does not describe the relationship as a lease. Staff fails to explain why, under its theory that the business could not be effectively operated without the use of the PNB logo, U S WEST Direct ceased using that logo as soon as it legally could do so when the second extension of the publishing agreement expired in 1989 and yet U S WEST Direct prospered after that time. Staff argues that *in 1990,* the PNB name disappeared and the U S WEST Communications name took its place, but that does not support Staff's argument. The U S WEST Direct business did not fail or even falter because it no longer used the PNB logo. After U S WEST Direct stopped using the PNB name, some directories were issued by Direct in PNB exchanges while PNB was still using the PNB name (Tr. at 393).

Staff's brief asks rhetorically why U S WEST Direct put the PNB name on separately bound yellow page directories without acknowledging that Mr. Johnson answered this question on the record. The agreement as interpreted by U S WEST Direct required the use of the PNB name on all directories, separately or cobound (Ex. 303-T at 10). Also, the U S WEST Direct advertising agency recommended a standard cover for all books (Tr. at 460).

Staff's brief also argues that the agreement gave access to subscriber listing information that was

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according to Staff "crucial" for successful solicitation of advertising sales. Mr. Johnson testified, as the person who operated the business, that the subscriber listings had nothing to do with soliciting customers for advertising (Ex. 303-T at 3). Service order data was useful for identifying prospective new customers, but any publisher could obtain this same information from PNB (*Id.*). This testimony is unrebutted and was not cross examined. Since the supposedly "crucial" information was freely available to all competitors, that does not support a finding that the fact that PNB could not separate the function of providing service order information from the provision of local telephone service, means that the directory publishing business was "rented."

Staff incorrectly argues that U S WEST has misconstrued *Democratic Central Committee v. Washington Metro Area Transit Comm.,*485 F.2d 786 (D.C. Cir. 1973). Staff's claim that "reward follows risk" actually supports U S WEST's position because the Supreme Court has held that ratepayers are entitled to compensation for the asset that was transferred. *U S WEST, supra,* 134 Wn.2d at 102. Fluctuations in the annual amount of directory revenues and expenses after the transfer do not affect the amount to which ratepayers are entitled, and ratepayers therefore have borne no risk. Such fluctuation only affects how rapidly ratepayers are compensated. *Democratic Central Committee* relates to operating property that has been taken out of service, not to the going concern value of an operating business. Aside from this, it is simply bootstrapping to argue that imputation which is ordered by the Commission as a "remedy" for the "inequity" of a transfer for "grossly inadequate compensation," is itself the basis on which to find that ratepayers have been "at risk" to justify a finding that the transfer never occurred. Also, Staff does not deny that the intangibles were never operating property, and that *Democratic Central Committee, supra*, relates only to compensation to ratepayers from dispositions of operating property. However Staff argues that the whole may be greater or different from the sum of the parts, and implies without actually saying so that somehow the difference between going business value and book value was "operating property." This is incorrect. Only the book tangible assets consisting of

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the few items of furniture and a leasehold were ever "operating property." If there had been an account for the intangible going concern value of the business, it would have been excluded from the rate base.[9] It would not have been included in any valuation under RCW 80.04.250 of the assets that are used and useful in providing telephone service, which is the practical definition of operating property.

In sum, all the evidence points to a transfer of the publishing business in 1984, with PNB retaining the function of providing listing to all publishers. There is no evidence of a lease at all, and it is clear that "ownership" was transferred.

IV. VALUE OF THE BUSINESS

A. U S WEST Presented the Only Credible Valuation Study to Value the Business as of the Date of the Transfer.

At p. 47 of Staff's brief, Staff argues that Mr. Golden's criticism of Dr. Selwyn's 1999 valuation was incomplete in that Mr. Golden supposedly neglected to consider in his rebuttal the *offsetting* effect of an update to the level of equity, when the values for debt and equity risk premium are updated. This argument is unsupported by any evidence. Counsel for Staff asked Mr. Golden on the record whether he could accept that the effect of updating the level of equity in conjunction with the other adjustments would produce a higher valuation than Dr. Selwyn's Appendix 2 schedule, and Mr. Golden testified that there were too many interrelated variables to make such a generalization (Tr. at 530). Staff witness did not submit surrebuttal on this issue, and so Staff's claim that the effect of updating the equity would *offset* the other adjustments is simply unsupported by any evidence. Staff's brief, in claiming that U S WEST's criticisms do not detract in any "significant way" from Staff's valuation inexplicably ignores U S WEST's discussion at pp. 45-46 of its opening brief of the 19.7% to 62.2% annual growth rate that is implied between the Financial Advisor's disclosure estimate of February, 1998 and Staff's

[9] Staff's citations at p. 53 fail to distinguish between the minuscule operating assets of the directory business and the going concern value. If U S WEST had been permitted to earn a return on the going concern value, then the return actually earned by the business could not have been "supra competitive" (Ex. 206).

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estimate for January 1, 1999. U S WEST pointed out in its opening brief that the underlying revenues grew in calendar 1998 by only 7%. This is a facially unreasonable result.

Staff's brief at p. 49 criticizes Mr. Golden's use of the newspaper publishers' data to develop unlevered betas for use in determining the Weighted Average Cost of Capital in his DCF study. Staff says these results are "call[ed] into question" based on Mr. Golden's use of these publishers as appropriate for the secondary analysis because they were not comparable to directory publishers. There is no evidence to support a direct challenge to Mr. Golden's work and so Staff's brief resorts to the rhetorical device of the passive voice in which the results have been "called into question" by someone unknown. Staff did not field an expert who was qualified in business valuations, and Mr. Golden's testimony that the newspaper publishers' data was sufficiently reliable to use to determine unlevered betas, is uncontradicted. Mr. Golden supported his opinion with data (Ex. 403-T at 10). Staff argues at p. 50 of its brief that Mr. Golden "failed to recognize the factors causing the RBOCs to have lower betas than newspaper publishers." Staff has not shown on the record what "recognition" of these factors would be appropriate, that Mr. Golden did not do. In fact Mr. Golden appropriately treated the differences by creating a range that reflected the higher stock price volatility of a newspaper publisher and the high debt leverage of an RBOC. Staff also mistakes the purpose of the exercise which is to determine the WACC of the purchaser of the business, not "the yellow pages business" itself.

Staff's brief also mischaracterizes the record by claiming that Mr. Golden accorded little weight to "contemporary growth rate estimates of PNB's management" in developing his terminal year growth rate. Mr. Golden pointed out in his rebuttal that the "contemporary growth rate estimates" of management that Staff refers to were not for the terminal growth period (Ex. 403-T at 20). The terminal growth period is the long term (*Id.*). Mr. Golden considered contemporaneous evidence including over forty articles from this period discussing the onset of directory competition (Ex. 409). Mr. Golden used this information in constructing the "real" growth element of long term growth (Ex. 403-T at 25-26). It

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would have been improper to consider these "contemporary estimates" that were for the short term as terminal growth rate estimates.

Public Counsel's brief alludes at p. 38 to Mr. Brosch's regulatory experience and mentions his $8.5 billion estimate of the directory value as of January 1, 1999. Mr. Brosch testified in his deposition that he did not recall previously doing a valuation of a yellow pages operation and had never taken courses in business valuation (Ex. 403-T at 63). Public Counsel's brief does not respond to U S WEST's argument at pp. 45-46 of its opening brief that the astounding eleven month growth rate that is implicit in Mr. Brosch's estimate, using the Financial Advisors' disclosure estimate as a base, is 88.7% annualized, and that Mr. Brosch did not respond in surrebuttal to Mr. Golden's testimony that such a difference is unreasonable on its face, other than to misstate the period of time involved in the growth.

Public Counsel's brief argues that one should not use costs of capital as they existed in 1984 because they are high relative to current costs. But Public Counsel, other than making the obvious mathematical point that using current costs tends to increase the valuation using the DCF approach, does not explain why current costs would be right to use in setting a 1984 valuation when capital costs in fact, were higher. Public Counsel also incorrectly asserts at p. 40 that the decline in realized earnings from directory in 1987 was an "accounting aberration." This is not supported by the record. Mr. Golden testified that this was the result of the onset of competition (Ex. 403-T at 21-24). Public Counsel's view that "bad times" should be excluded from consideration is without any support from a qualified valuation professional. Mr. Golden testified that such a professional would not assume in setting a cost of capital that times for a business would always be rosy. Public Counsel's and Staff's criticisms of U S WEST's valuation are without substance and they should be rejected.

V. IMPUTATION HAS GIVEN RATEPAYERS FAIR VALUE FOR THE ASSET

A. It Is Appropriate To Consider The Publishing Fees And The Amounts of Imputation

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Embedded In Rates As Compensation For The Value Of The Asset Transferred.

Staff's brief at p. 50 attributes to the Supreme Court a "holding" that the court never made, namely that U S WEST Direct and/or Dex have never paid USWC compensation for the fair market value of the yellow pages business. The court did not so hold. The court stated in *U S WEST, supra,* at 134 Wn.2d 94 that "*No one represents to this court* that US West Direct has paid US West the fair price for the yellow pages business. US West Direct paid a publishing fee to PNB from 1984 to 1988-but a fee the Commission found to be unreasonably low. It is undisputed that no fee has been paid to US West since 1988" (emphasis added). This is quite different from Staff's attempted revision. The court clearly left open the possibility that someone would later make a representation that the fair price had been paid to U S WEST Communications, and it clearly included in the ambit of such a representation, the publishing fees that the Commission had found to be unreasonably low. Thus the court's actual holding is that publishing fees, while not sufficient in themselves to equal fair market value, are payment toward that value. U S WEST is now making the representation that full payment has been made that was lacking on the record that was before the court.

Staff's brief at p. 51, without any citation to the record, presumes to state that "U S WEST has always known" that imputation is not compensation for the value of the directory business and that such knowledge is supposedly why U S WEST did or did not do four certain things, including why it entered into two settlement agreements, which are Staff's first and second points. However, there is no evidence to support Staff's argument, and it is egregious for Staff to claim that the absence of something in two settlement agreements, is somehow an admission against interest. This argument offends both the policy of the law that favors settlements and the provisions in both settlement agreements, which were signed by Staff, that indicate that the agreements do not bind any party in any other proceeding in the future. This Staff argument clearly chills entering into any settlement with Staff on any contested matter in the future.

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Staff's third and fourth items, that U S WEST would have litigated in the rate case and the appeal the issue of past imputations cumulating to the 1984 value of the asset, assume that U S WEST would have been prescient enough to have known while litigating Docket No. UT-950200 that in the Fifteenth Supplemental Order in that docket, the Commission would hold at p. 38 that imputation would not be "never ending," and that the Supreme Court would later uphold imputation on that basis as compensation for the transfer of the valuable regulatory asset. Obviously, not having been prescient enough to know the third item, U S WEST did not make a record on which it could have argued the fourth to the court. U S WEST is making that showing and argument now, as the court clearly contemplated.

B. <u>There Is No Evidence To Support Staff's Claim In Its Brief That Imputation Is To Compensate For Underpriced Intercompany Services.</u>

Staff's brief at p. 53 contradicts the Commission's entire argument in its order and brief to the Supreme Court on the purpose and justification for imputation, and the holding of the court in response. The Commission told the Supreme Court that imputation was proper "because the utility has transferred away a valuable asset to an affiliated company without obtaining fair value," 134 Wn.2d at 91, and the court held that RCW 80.16.020 authorized imputation "to rectify the effects of the *transfer of a valuable asset* by the utility to its affiliate for inadequate compensation" *Id.* at 95, (emphasis added). Staff now claims that imputation is not for the transfer of an asset at all. According to Staff, imputation is really because there are underpriced *services* that are being provided apparently by U S WEST Communications to Dex. The court did not uphold imputation on this theory, and there is no evidence of any underpriced service on the record.

The only Staff witness to address this issue admitted under cross examination that she did not know of any underpriced services (Tr. at 1206). Staff does not attempt to reconcile this new argument with its statement in its brief to the Commission in Docket No. UT-950200 that it was the

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"abandonment" of the "valuable regulatory asset" that called for ratepayer compensation (Ex. 103 at 5). Those arguments cannot be reconciled. Staff fails to distinguish the Commission's holding in the Second Supplemental Order in Docket No. U-86-156 that the publishing fee is "in exchange for value."

Staff also, apparently embarrassed by its witness' admission that imputation is indeed compensation for the transfer of assets, improperly attempts to rewrite the transcript in its brief. At Tr. 1202, Ms. Strain was asked:

> Q. Is it correct that the Commission has imputed revenues to U S WEST Communications in lieu of adequate compensation for the transfer of assets?

Her answer was:

> Well, I'd say it's for the transfer of assets *as well as* for inadequate compensation on an ongoing basis. I thing what was really happening here is that on an ongoing basis, year-by-year, there was an [sic] adequate compensation under the Publishing Agreements, and imputation was performed as a mechanism to remedy that inadequate compensation. (emphasis added)

Staff claims in its brief at n. 25 that this answer, which clearly used the conjunctive phrase "as well as," instead means the *disjunctive* as if the witness had said "or," based solely on testimony at Tr. 1212-1213. However, at Tr. 1212-1213 Ms. Strain was asked a *hypothetical question.* At Tr. 1202, U S WEST asked the witness a fact question, not a hypothetical question. Staff's brief misstates its own witness' testimony, and this argument should not be given any weight by the Commission.

C. <u>Mast Publishing And GTE-NW Imputations Are Irrelevant To This Case</u>.

Staff's brief argues at pp. 55-56 that U S WEST's characterization of imputation as compensation for the value of the asset contradicts prior treatment of imputation in connection with the sale of Mast Publishing and several cases involving GTE-NW.[10] Mast Publishing and GTE-NW are irrelevant to this case. There is no evidence that CTNW or GTE-NW challenged the Commission's authority to impute revenues as U S WEST did, there is no Supreme Court decision establishing the

[10] Public Counsel echoes this argument.

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Commission's authority to impute for those companies and there is no evidence of a transfer of Mast Publishing to an affiliate by CTNW or a similar transaction involving the publishing affiliate of GTE-NW at an inadequate price as the Commission found occurred with PNB and U S WEST Direct.

D. <u>The Staff's *Ad Hominem* Attack Based On An Analogy To A Landlord-Tenant Dispute Assumes The Premise That The Staff Cannot Prove Logically With Evidence.</u>

Staff's use of the landlord-tenant analogy at p. 57 of its brief dodges the issues. If Staff is granted the major premise that the 1984 transaction was a lease, then it is easy to prove that the periodic receipts of consideration in imputation were lease payments. The problem with Staff's analogy is that it is a poor substitute for rational analysis of the evidence. U S WEST has shown with evidence that the significant parts of the directory business, most importantly the employees who knew the business and had the contacts with advertisers, were permanently transferred (Ex. 201-T at 9). Their jobs at PNB were eliminated. There was no obligation on U S WEST Direct to turn over customer lists or other competitively sensitive information to PNB at the end of the publishing agreement, as would be expected if the arrangement were temporary (Ex. 202-T at 16) It is not necessary to transfer all intangibles in order to effectuate a sale or transfer of a business, and all that was necessary to operate the publishing business was in fact transferred. Staff's *ad hominem* attacks do not show that U S WEST has attempted to "revise history." The Commission in its orders in Cause No. FR-83-159 and Docket No. U-86-156 indicated its awareness that a valuable asset was being and had been transferred, respectively and that the determination of the dollar amount of compensation that was due to ratepayers would be done in a future rate case. This is consistent with U S WEST's position in the current case, and it is inconsistent with Staff's and Public Counsel's argument that the Commission contemplated a rental arrangement.

E. <u>Case Law Cited In Public Counsel's Brief On How The Commission Has Treated Transfers Of Operating Property, Supports U S WEST's Position That A Transfer To An Affiliate Is Sufficient To Establish The Time At Which Valuation Should Occur</u>.

Public Counsel cited in its brief *WUTC v. Puget Sound Power & Light Co.,* Docket Nos. U-89-

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2688-T, Third Supplemental Order, January 17, 1990 as an example of how the gain on sale had been treated in the past by the Commission. This case supports U S WEST's argument in the current case that a "sale" to an affiliate is not necessary to establish the time when the transferred assets' value should be established for purposes of passing the gain to the ratepayers. At p. 52 of that order, the Commission noted that the staff adjustment had included "property sold *or transferred* from 1974 through March 31, 1989." The test period in that case was the twelve months ended September 30, 1988. The Commission upheld Staff's adjustment which as noted above was based on including the values of properties that had been transferred many years before the date of the hearing. The Commission required at p. 52 of the order that the total gain on the property be amortized over fifteen years, rather than five as Staff had recommended, because this "more accurately reflect[ed] the time over which the company realized the gains." The Commission recognized that the gains were *realized* at the time of sale *or transfer to an affiliate*, which is what U S WEST argues in this current docket. Even though the gains were realized in years prior to the rate case as properties were transferred to affiliates, they were given ratemaking effect in that 1989 rate case. This case clearly supports U S WEST's view and contradicts the claim of Staff and Public Counsel that an arms-length "sale" must occur before there is an event involving a transfer of property to an affiliate that allows valuation of the asset and determination of gain to occur.

VI. <u>CONCLUSION</u>

U S WEST has shown in this reply brief that the arguments of Staff and Public Counsel for the continuation of directory imputation are based fundamentally on a result-oriented and emotional approach that sets at naught the decision of the Supreme Court in *U S WEST, supra.* U S WEST has shown that this Commission's repeated representations to the court about the nature and effect of the 1984 transfer of the directory business, on which the court relied, are absolutely irreconcilable with the positions that Staff and Public Counsel now take on the same issue.

The court upheld the Commission's imputation power on a narrow basis: to remedy the effects of

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the fact that the utility had transferred away a valuable asset to an affiliated company without obtaining fair value. *U S WEST, supra,* 134 Wn.2d at 91. That was the way the Commission put the issue to the court. The attempts by Staff and Public Counsel to engage in hairsplitting to deny what this Commission has consistently said for at least eleven years, namely that the directory business was transferred in 1984 for inadequate compensation, should be given short shrift by this Commission. The fact that U S WEST in the past argued positions that the Supreme Court rejected, is immaterial. This case is based on the Commission's victorious position in the Supreme Court.

Toward the end of the hearings in this matter, there were discussions about a "parallel regulatory universe." However, that is not where this case resides. This case resides in the real world in which the Commission's decision as upheld by the court, caused a refund of over $200 million. Imputation has provided ratepayers compensation in excess of three quarters of a billion of real dollars in reduced rates. The inevitable consequence of the upholding of that decision based on the rationale that a past transfer requires imputation to "rectify the effects" of inadequate compensation is that the compensation is capable of being fixed as of the transfer date in 1984 and that imputation since that time counts against the value. U S WEST has presented the only evidence of the value of the directory business as of 1984 and its evidence that imputation that was actually included in rates cumulates to exceed that value plus reasonable interest is essentially unchallenged. U S WEST has accepted the invitation of Public Counsel, as described by the court in *U S WEST, supra,* and it has met its burden. The Commission should find that fair

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compensation has been received by ratepayers and that such receipt meets the requirement of the Supreme Court's opinion in *U S WEST, supra,* for the end of imputation.

Respectfully submitted,

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____
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