BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Petition of Request of Sprint Nextel Corporation for an Order Declining to Assert Jurisdiction Over or, in the Alternative, Application of Sprint Nextel Corporation for Approval of the Transfer of Control of United Telephone Company of the Northwest and Sprint Long Distance, Inc. From Sprint Nextel Corporation to LTD Holding Company.	DOCKET NO. UT-051291

BRIEF OF PUBLIC COUNSEL

(PREHEARING BRIEF CONCERNING DIRECTORY IMPUTATION AND RATE REBALANCING)

JANUARY 25, 2006

I. INTRODUCTION

1. On December 23, 2005, the Washington Utilities and Transportation Commission (Commission) ordered prehearing briefing to address whether rate-rebalancing (i.e., access charge reductions with concomitant basic telephone rate increases) and the directory imputation issue, including the gain on sale of Sprint's directory business, are proper issues for adjudication in this proceeding. Order No. 5, ¶ 29.

2. In this brief, the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel) requests the Commission find that yellow pages imputation, including evaluation of the gain on Sprint's sale of its directory business, is relevant to Sprint's proposed spin-off of local phone service and should be considered in this docket.

3. Additionally, Public Counsel requests that the Commission find that rate-rebalancing is an inappropriate subject for adjudication in this proceeding, strike the testimony of witnesses regarding this issue, and exclude any such evidence offered at hearing. Should the Commission hold that rate-rebalancing is to be litigated here, Public Counsel respectfully renews its request that the Commission allow Public Counsel to file cross-rebuttal testimony on this issue.

II. BACKGROUND

A. Sprint Nextel Petition.

4. On August 26, 2005, Sprint Nextel Corporation (Sprint Nextel) requested an order from the Commission declining to assert jurisdiction over or, in the alternative, an application for approval of (1) the change of control of its incumbent local exchange carrier (ILEC), United Telephone Company of the Northwest (United), from Sprint Nextel to LTD Holding Company

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

and (2) the change of control of Sprint Long Distance, Inc. (LTD Long Distance)[1] from Sprint Nextel to LTD Holding Company.[2] LTD Holding Company (hereinafter referred to as New United for ease of reference) would be a new publicly traded company with headquarters in Overland Park, Kansas.[3] Sprint Nextel proposes to distribute the equity ownership of New United to Sprint Nextel's shareholders in a tax-free distribution. Testimony of Public Counsel Witness Michael L. Brosch, Exhibit No. ___ (MLB-1T), p. 6). Additionally, New United would initially be capitalized with substantial newly issued debt financing in an amount producing negative equity for the Company on a book basis.[4] In support of the transaction, Sprint filed testimony by Nancy L. Judy, John W. Mayo, Richard G. Pfeifer and Glenn R. Daniel.[5]

5. After the spin-off, Sprint Nextel's existing wireless and long distance network assets would continue to use existing brands, trade names and trademarks, while the post-separation New United would require re-branding, with new trade names and marks to be determined. Exhibit No. ___ (MLB-1T), p. 7-8. To enable New United to market bundled telecommunications products, the surviving Sprint Nextel entity intends to provide wholesale wireless and long distance network services to New United pursuant to contracts that include most favored nations clauses. *Id*. Existing wireless customers in United's service area would remain Sprint Nextel customers, while existing Sprint Communications long distance customers

[1] LTD Long Distance was recently formed for the purpose of providing long distance service to customers of Sprint's ILEC operations, including the customers of United, and it will be the long distance entity affiliated with LTD Holding Company. Application, p. 2, fn.3. It filed for registration with the Commission as a competitively classified company on August 18, 2005 in Docket No. UT-051259.

[2] Sprint requests that the Commission either decline to assert jurisdiction over the proposed transfer under chapter 80.12 RCW, or expeditiously approve it under RCW 80.12.040.

[3] Application, p. 2, fn.2. Applicants have not made public a name for the new operating entity that will provide service to the public.

[4] See Highly Confidential Exhibit No. __(RGP-7C) of Sprint witness Mr. Richard G. Pfeiffer and the testimony of Public Counsel witness Stephen G. Hill for more information regarding this issue. The amount is significant.

[5] On rebuttal, Sprint also filed testimony from Brian K. Staihr.

would generally be migrated into LTD Long Distance to be served by New United under the Sprint Nextel wholesale contract arrangement. *Id*.

6. Allegedly, existing assets and employees presently dedicated solely to United would not be affected by the proposal since these assets and employees will go to New United. Testimony of Sprint Nextel witness Nancy L. Judy , Exhibit No. ___ (NLJ-1T), p. 9. However, according to the Company, for shared assets, including automated systems, administrative and management personnel, New United or its subsidiary will decide whether to purchase or lease similar assets or contract for comparable services from a third party to best meet its future needs. *Id*.

B. Yellow Pages/Directory Publishing Sale.

7. On November 30, 2005, Public Counsel and Commission Staff filed testimony regarding the need to account for future revenue opportunities lost to New United due to Sprint Nextel's sale of its directory publishing ("directory") operations in 2003.[6] The concern raised by both Public Counsel and Staff is that Sprint Nextel has failed to provide for any replacement of this directory revenue imputation for United in its Application and that this revenue is necessary to accurately quantify the net cost of service incurred by United in Washington.

8. Sprint Nextel sold United's interest in directory publishing operations in 2003. Exhibit No. ___ (MLB-1T), p. 9. It divested its directory publishing subsidiaries[7] to R.H. Donnelley Corporation (RHD) and concurrently obligated United and the other Sprint-Nextel local operating companies to long-term exclusive directory publishing contracts and non-competition agreements with RHD for 50 years. *Id*. In its Application in this Docket, Sprint Nextel makes no provision for transferring any of the monetized gain on sale proceeds it captured in 2003 that

[6] Public Counsel filed direct testimony responsive to the Company's application on November 30, 2005, from Stephen G. Hill and Michael L. Brosch. Mr. Brosch filed testimony on the yellow pages imputation issue, including the sale of Sprint's directory business. Mr. Hill addressed other aspects of the spin-off

[7] Sprint Publishing & Advertising, Inc. and Cendon, L.L.C.

are associated with local telephone directory publishing rights for the benefit of United and its ratepayers or the other local telephone division operations.[8]

C. Access Charge Reductions Resulting In Higher Basic Telephone Rates.

9. A specific proposal for rate-rebalancing was raised for the first time in this case in the November 30, 2005, testimony of Staff witnesses Wilford Saunders, Timothy W. Zawislak and Betty A. Erdahl. Staff alleges that United's current access charges violate the legal standards set by the Commission in WAC 480-120-540 and two Commission decisions in Docket Nos. UT-950200 and UT-020406 because these access charges are too high. Consequently, Staff seeks to reduce access charges by an amount outlined in the Testimony of Timothy W. Zawislak Exhibit No. ___(TWZ-1T), at p. 19, and Highly Confidential Exhibit No.___ (TWZ-5HC).

10. Staff proposes substantial basic telephone rate increases to make up for the revenue lost due to lower access charges in an amount outlined in Exhibit No. ___ (TWZ-1T), at p. 14, in order to achieve revenue neutral "rate rebalancing." On average, residential customers would see a rate hike of $2.62 per line and business customers would see an increase of $4.89 per line. Rebuttal Testimony of Sprint Witness Nancy L. Judy, Exhibit No. ___ (NLJ-4), p. 8. The average dollar per month increase is misleading, however, since a significant number of local exchanges will experience rate increase far in excess of the average. *Id*. Business and residential rates in Stevenson, for example, would increase approximately $7.50 a month per line. *Id*. This is more than an 84% increase.

III. MEMORANDUM

A. The Yellow Pages Directory Issue Is Directly Related To The Transfer Of Control At Stake In This Matter.

11. This docket is intended to resolve how assets, liabilities, staffing and ongoing contractual arrangements are being divided between Sprint Nextel and New United in order to ensure that

[8] *See*, Highly Confidential Exhibit No.___(MLB-5HC) of Mr. Brosch and the Highly Confidential Testimony of Paula M. Strain , Exhibit No. ___(PMS-1THC), p. 2 regarding the amount of revenue at stake.

the spin-off is in the public interest. RCW 80.12.040; *In re Telephone Utilities of Washington, Inc., d/b/a PTI Communications,* Docket No. UT-940700; *In re U S WEST Communications, Inc*., Docket No. UT-940701, (consolidated) Third Supplemental Order, p. 5 (June 1995) (In determining whether a sale of local telephone exchanges is consistent with the public interest, the Commission will consider, among other factors, the effects of the sale on customers in the sale exchange, on remaining customers of the purchaser, on remaining customers of the seller, and on interexchange carriers).

12. It is, therefore, both necessary and appropriate to address the regulatory liability arising from the directory publishing imputation issue in this docket.[9] The specific terms of this division of resources and obligations will impact the financial ability of New United to provide safe, adequate and affordable regulated services in the future and is, therefore, inextricably linked to whether the spin-off, as proposed, is in the public interest.

13. Monopoly local phone companies initially developed directory publishing to add value to their public telephone networks, by providing printed subscriber listing information in alphabetical and classified formats. Now, the printed telephone directory has evolved to include significant commercial advertising, particularly within the classified directories where consumers seek information about desired products and services at the time they are prepared to make purchasing decisions. Advertising revenues from directories were useful to the telephone companies for decades to defray the costs of compiling and distributing the printed directories and have grown to become sizeable enough to also contribute significant profits to offset the overall costs of operating the business. These local phone companies (ILECs) have for many years used their established relationship with customers, their telephone listings data, their brand

[9] *See, In Re The Petition of U S West Communications, Inc.,* UT-980948, Fourteenth Supplemental Order (July 2000), ¶ 172:

> Imputation is the implementation of "Imputed Value," i.e., the logical or implicit value that is not recorded in any accounts… Here, imputation … revises USWC's earnings for regulatory purposes (that is, for setting rates), to reflect a portion of affiliate U S WEST Dex's earnings. It is a means by which the Commission may exercise the authority granted in chapter 80.16 RCW to protect ratepayer interests affected by affiliated transactions.

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

name and business reputation and their first mover advantage and other intangible assets to dominate the directory publishing industry.

14. Directory publishing is immensely profitable and produces substantial cash flow that would not exist but for the unique role of the ILEC. ILECs (and their consolidated holding company parent corporations) profit either directly, by selling advertising in directories they publish, or indirectly by sale of the entire directory publishing business and related official publishing rights to third parties in exchange for a one-time monetary gain.

15. The issue of ratepayer interest in the directory publishing business of ILECs has been the subject of repeated and protracted litigation in this state, most notably in cases involving Qwest and its predecessors US West and Pacific Northwest Bell. The Commission has consistently required[10] (and the Washington Supreme Court has affirmed)[11] reasonable compensation to telephone ratepayers for the value associated with publication of the official local telephone directories. This policy has required imputation of the value of directory services in (1) rate cases (as in the 1995 U S West) when improper affiliate relationships have attempted to remove directory revenues/profits from the regulated ILECs books or (2) in transfers of assets (as when Qwest sold its directory publishing business) where it became necessary for the Commission to

[10] *In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate*, UT-021120, Tenth Supplemental Order, ¶¶ 12-19 (August 2003) (Discussing the general genesis of the telephone directory and U S West/Qwest's history in particular); *In Re The Petition of U S West Communications, Inc., For An Accounting Order,* UT-980948, Fourteenth Supplemental Order (July 2000); *WUTC v. U S West Communications, Inc.*, UT-950200, Fifteenth Supplemental Order (April 1996), *aff'd, US West Communications, Inc. v. WUTC*, 134 Wn.2d 74, 949 P.2d 1337 (1997); *In re Pacific Northwest Bell Telephone Co.*, Cause No. U-89-3524-AT, Second and Third Supplemental Orders (November 1990). *See also, WUTC v. Verizon Northwest, Inc.*, Fifteenth Supplemental Order, Final Order Approving And Adopting Proposed Settlement; Rejecting Filed Rates; Accepting Proposed Settlement Rates, UT-040788, ¶ 7 (April 2005)

[11] *U S WEST Communications, Inc. v. Utilities and Transportation Commission*, 134 Wn.2d 74, 91, 949 P.2d 1337 (1997) ("We conclude the Commission has statutory authority to impute excess yellow pages revenue in calculating US West's revenue requirement under both the affiliated interests statute and under its statutory rate-making authority"). There, the Supreme Court upheld the Commission's order in the 1995 US West general rate case that yellow pages imputation continue after US West transferred its lucrative yellow pages business to its sister company, US West Direct, for inadequate compensation. *Id*. The Court also upheld the Commission's decision that imputation would cease only after there was a true sale of the business and fair compensation had been received by the Company. *Id*. at 102.

consider how the sale of the directory publishing business and the related grant of long term publishing rights should be handled.[12] In the case of Qwest, when the directory business was sold, the value was monetized in the form of a single large gain on sale.[13] Beyond Qwest, other major ILECs operating in Washington have also had their local rates determined with imputation of directory profits when unreasonable affiliate publishing arrangements required imputation adjusts.

16. Sprint Nextel received such a gain on sale in 2003[14] when it transferred United's long-term future publishing rights to a non-affiliated buyer and the Commission has never addressed what should be done with this gain.[15] Given that Sprint has been subject to directory imputation since a Commission Staff investigation into United's local rates in Docket No. U-89-3067-SI,[16]

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[12] Where the ILEC's directory publishing business has been sold, as in the case of Qwest and Sprint, exclusive official publishing and non-competition agreements grant the buyer most of these benefits and protect the buyer against competitive re-entry into directory publishing by the telephone company.

[13] Under the terms of the settlement agreement, Qwest Corporation was required to share the Washington portion of its gain on the sale of DEX with ratepayers in the form of immediate applications of credits against customer bills totaling $67 million. Qwest Corporation also was required to book revenue credits for purposes of rates, each year for fifteen years. The revenue credits were set at $110 million for four years, and $103.4 million for eleven years. The settlement parties estimated that the net present value of the ratepayers' share of the gain on sale was $942 million. *In the Matter of the Application of Qwest Corporation,* Docket UT-021120, Tenth Supplemental Order, p. 1.

[14] Sprint Nextel, as a condition of the sale, obligated United and the other Sprint-Nextel local operating companies to long-term (50 year) exclusive directory publishing contracts and non-competition agreements with RHD.

[15] None of this gain was allocated, distributed or assigned in any way to New United. Testimony of Staff Witness Paula M. Strain, Exhibit No. ___ (PMS-1), p. 2.

[16] The Company's attempt to distinguish the Commission's imputation treatment of U S West from United's imputation (by saying "there was never an MFJ order that assigned ownership of directory publishing to United, as there was in Qwest's case") is misplaced. (NLJ-4T), p. 24. United, unlike Qwest and its predecessor companies (U S West and Pacific Northwest Bell), was never a Regional Bell Operating Company. Therefore, it would not have been a party to the Modified Final Judgment ("MFJ") in *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd sub nom*, *Maryland v. United States*, 460 U.S. 1001 (1983). Under that judgment, AT&T's nationwide monopoly over local telephone service ended, and the familiar "Ma Bell" gave birth to seven regional Bell operating companies ("RBOCs"), including Pacific Northwest Bell. *In the Matter of the Application of Qwest Corporation Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate,* UT-021120, Tenth Supplemental Order, ¶ 12 (August 2003) ("The Court required that the directory publishing function be divested to the RBOCs so that, among other things, the substantial revenues derived from yellow pages advertising would continue to be accounted for in local telephone service rates"). In other words, United's directory publishing

we are perplexed by the Company's failure to seek Commission approval for the sale.[17] Before selling Dex, Qwest sought Commission approval through an application to the Commission. *See*, Qwest Application, UT-021120. While it is unclear why United failed to seek Commission approval, what is clear is that the Company should not be allowed to benefit from its non-compliance.

17. In the event a change in control is approved, failure to capture New United's portion of the directory gain proceeds for Washington customers in this docket would likely prevent any future recovery. Sprint-Nextel would be able to ignore its regulatory liability to Washington ratepayers and retain the monetized gain on sale, avoiding the Commission's reach in the future. In order to protect this value for New United's ratepayers it is therefore necessary to clearly establish this regulatory liability, in any approval of the transfer of control, to provide for future imputation or other means of recovering a reasonable amount of directory benefits, based upon the Washington share of the value of the gain that was realized by Sprint in 2003. This is an essential element of the Commission's disposition of assets and liabilities between Sprint Nextel and New United in this docket because Sprint's monetized gain on sale in 2003 represents a regulatory liability for which an accounting is required at this time.

18. To be clear, Public Counsel is not seeking a change in United's rates in this docket with respect to directory imputation. Instead, Public Counsel seeks formal recognition and quantification of the regulatory liability associated with the sale of the directory business prior to the New United spin-off. Sprint Nextel simply should not be allowed to retain all of the benefits from its 2003 sale of the directory publishing business, while burdening New United and it

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unit was always part of the local telephone company and did not need to be "assigned" as part of a court-ordered divestiture.

[17] The Company took a big risk by not seeking Commission approval. RCW 80.12.030 and RCW 80.16.020 serve to automatically void transfers governed by those chapters that are made without Commission approval. *See also,* WAC 480-120-379; *In re Puget Sound Power & Light Co*., Docket No. U-86-131, Order Denying Proposed Assignment [of BPA credits] (June 1987). As this docket reflects, the Company certainly knows how to assert that the Commission lacks jurisdiction or to request that jurisdiction be waived. Failing to consider this question here will foreclose any possibility of considering it, for the reasons discussed below.

ratepayers with the grant of official directory publishing rights to RHD without compensation for the next 50 years.

19. Thus, this issue is more than "ripe" for decision. If the spin-off is approved, Sprint Nextel would forever separate the directory gain proceeds it received from the newly created New United business that would control United prospectively. In other words, the gain would go with Sprint Nextel, while the regulatory liability associated with Commission imputation policy would affix to New United. The proposed spin-off capitalization plan contains no funding to New United from the directory sale proceeds. Indeed, it completely fails to recognize United ratepayers' claim upon directory publishing cash flows, either in future rate case proceedings or as immediate rate credits.

20. More succinctly, if the Commission attempts in future New United rate cases (as urged by Sprint Nextel) to apply its long-standing directory imputation ratemaking remedy to correct for the sale of the directory business, New United can be expected to argue several new points in opposition to such imputation that the Company cannot argue here:

1. New United did not sell the directory business; Sprint Nextel made the sale.
2. New United has no economic benefit from the sale of the business; Sprint Nextel kept the gain.
3. New United cannot afford any imputation, since it is straining to maintain credit ratings based upon its own sizable debt burden and decreased cash flows.
4. New United does not possess and has no access to any records of prior directory transactions.
5. Nothing prevents New United, as an independent successor corporation, from arguing that the Commission order, by approving the spin-off without addressing the directory issue, was dispositive of the matter.

21. Therefore, unlike the rate rebalancing issue raised by Staff, which can be addressed at a later date without any prejudice, allowing the spin-off to go forward without accounting for the sale of Sprint Nextel's directory business and the related regulatory liability to Washington

ratepayers will have irreversible repercussions that cannot adequately be addressed in a subsequent case.

B. Reducing United's Access Charges And Increasing Its Rates Commensurately Is Outside the Scope of This Spinoff Proceeding.

22. Staff alleges that United's current access charges violate legal standards set by Commission Orders issued in *WUTC v. U S WEST Communications, Inc.*, Docket No. UT-950200, A*T&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest, Inc.*, UT-020406 and *In Re Intrastate Carrier Access Charge Reform*, UT-970325 & UT-040015, adopting and amending WAC 480-120-540, respectively. It asks that the Commission take up the issue in this docket.

23. While Public Counsel does not have a position on the lawfulness of United's access charges, for the reasons discussed below, Public Counsel believes this issue is not properly before the Commission in this docket.

24. In summary:

- a complaint cases or general rate case is the proper forum for evaluating access charge levels;
- the Commission does not have a record in this docket to enable evaluation of United's access charges;
- there is no intrinsic connection between the access charge issue and the change of control issues in the docket and, hence, no need to burden this docket with this additional complex and contentious issue when it could be raised at a later time;
- there is no indication that United's access charge levels are of concern to competitive providers or that reductions will have any effect on the Washington competitive market or reduce customers' long distance rates;

- even if access charges are reduced in this docket, the issue of whether the Company can prove the need to replace the lost revenue, and the issue of which rates should be increased to do so, belongs in a general rate case.
- "rate rebalancing" in the manner proposed by Staff would constitute unlawful single issue ratemaking.
- "rate rebalancing" without notice to customers would violate due process and the Commission's own rules

1. An access charge reduction is more properly addressed in the context of a complaint case or a general rate proceeding in which cost of service is at issue.

25. The Commission has periodically addressed the correct level of access charges for Washington's incumbent local exchange carriers. For the state's large incumbents, it has addressed this issue in the context of complaint or general rate proceedings. Public Counsel is not aware of any instance of access charge reductions occurring in the context of a transfer of control docket where there was not an outstanding and unresolved complaint under RCW 80.04.110 regarding access charges.[18]

a. ATT v. Verizon a/k/a "The AT&T complaint case."

26. The AT&T Complaint Case, Docket No. UT-020406, involved a complaint filed by AT&T alleging that Verizon's access rates were in excess of its costs and therefore, it was giving itself an "undue and unreasonable preference or advantage to itself." *AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest, Inc.*, Docket No. UT-020406, Eleventh

[18] *In Re GTE Corporation and Bell Atlantic Corporation Merger*, UT-981367, for instance, there existed a separate outstanding Commission Complaint Alleging Unlawful Access Charges in UT-990672 and a separate outstanding Informal Staff Investigation of GTE Northwest's Earnings and Revenue in UT-991164. By agreement of the parties, the omnibus settlement resolved all of the issues in Docket Nos. UT-991164 (earnings), UT-990672 (access charges) and UT-981367 (merger).

Supplemental Order Sustaining Complaint, Directing Filing of Revised Access Charge Rates, ¶ 49 (August 2003). Unlike here, the record in that case involved substantial evidence, based on cost studies, that Verizon's access charges were in excess of Verizon's access costs. In fact, Verizon itself acknowledged that some of its access charges were above costs. *Id.* at ¶ 5. The Commission ultimately found that "Verizon's access rates give an undue and unreasonable preference or advantage to itself."[19]

27. Staff asserts that the AT&T complaint case requires a reduction in United's access charges. The simple rule of that case, however, is only that Verizon's access charges were too high. That result does not automatically mandate an access charge reduction for United here. Without getting to the merits of United's access charge levels, it is important to note that there a number of important differences between this docket and the AT&T complaint case. Of particular significance is the fact that no cost study is being offered by Staff or any party in this case. Since the revisions to Verizon's access charges were based on analysis of a cost study, it is hard to see how the Commission could effectively examine the issue for United without such a study.

28. It is also notable that the access charge reduction request does not arise as a result of a complaint filed by a competitive carrier (or by Staff for that matter) under RCW 80.04.110. Since the AT&T complaint case order was released there have been significant changes in the interexchange markets. These changes eliminate, for the most part, any anti-competitive impact of originating access charges on the carriers competing with United in the interexchange market. The most significant recent events are the announcements by the two leading interexchange carriers, AT&T and MCI, that they are pulling out of the mass market interexchange markets. Cable companies, wireless carriers and voice over the Internet protocol ("VoIP") providers do not pay originating access charges to United because cable and wireless carriers provide their own originating services, and customers of VoIP providers use DSL services to originate calls.

[19] Docket No. UT-020406, Eleventh Supplemental Order, ¶49.

The major user of United's originating service will be United's long distance affiliate. Therefore, high originating charges, rather than providing United with an advantage over other carriers, (the reason the Commission used to reduce Verizon's rates in UT-020406) may, if they have any impact, disadvantage United's affiliate as it competes against cable, wireless and VoIP providers.

29. The traditional arguments for access charge reduction have centered on the need to remove negative impacts on the competitive long distance market, with resulting benefits for consumers in reduced long distance rates. As noted above, however, the long distance market has changed. Staff offers no evidence that current access charges are damaging competition in United's service territory, or that reductions would translate into additional competition or any reduction in customer rates. Consequently, while there may be technical access cost issues that could be addressed in an appropriate future docket, there is no evidence that there is an urgent or compelling public interest need to take up the issues in this transfer of control docket.

b. 1995 U S West General Rate Case.

30. US West's 1995 general rate case provides an alternative example of a docket which considered access charges in a proper context. Docket No. UT-950200 involved a general rate increase request from U S West to increase its revenue by $204,613,922. *WUTC v. U S West Communications, Inc*, Docket No. UT-950200, Fifteenth Supplemental Order Denying Tariff Revisions (April 1996). The Commission denied the rate increase and instead, ordered a revenue reduction of $91.5 million. It was in the context of deciding how to allocate the revenue reduction that the Commission reduced U S West's access rates.

31. The 1995 U S West general rate case involved an exhaustive investigation of the Company's revenue requirements.[20] In fact, U S West conceded that its switched access rates

[20] In its Fifteenth Supplemental Order, at p. 8, the Commission noted that the 1995 U S West Rate Case was "among the longest proceedings the Commission ha[d] heard in years." There were 52 expert witnesses and nearly 800 exhibits, comprising over 10,000 pages of prefiled written testimony and documentation. *Id.* Transcript testimony ran 4,200 pages due to the more than 23 days of hearing. *Id.* In addition to the Company, Commission

greatly exceeded its own direct cost calculations. *Id*. at pp. 110-111. Significantly, the Commission found that the markup over incremental costs for switched access was higher than for other services that used the company's local loop and network facilities, namely toll and local exchange services. *Id*. at p. 112. The Commission also noted that since it was decreasing retail toll rates, high access charges might adversely affect toll competitors that had to respond to the toll rate reduction. *Id*. at pp. 107-108.

32. Therefore, the Commission reduced U S West's access rates by $29 million with an additional $5.3 million reduction phased in over the next two years. *Id*. at p. 111. The Commission also found that extensive changes in the structure of access charges were in order. These changes included adoption of the local transport restructure, setting transport rates equal to comparable dedicated access rates, rejecting the proposed residual interconnection charge (RIC), and eliminating the carrier common line charge (CCLC). *Id*.

33. None of the conditions that led the Commission to reduce access rates in Docket No. UT-950200 exists in this proceeding. First, there has not been an exhaustive investigation of the carrier's revenue requirement that suggests that the revenue requirement should be reduced. Second, there is no evidence that United's markup over incremental costs for switched access is higher than for other services that used the company's local loop and network facilities, namely toll and local exchange services. There are no incremental cost studies in the record. There are no toll reductions in the instant docket that would adversely affect other interexchange carriers. Most importantly, there has been no showing that United's other local exchange rates should be increased – a showing that is required to be made in a general rate case proceeding.

Staff, and Public Counsel, fourteen party intervenors participated. *Id*. In the end the Company's cost studies for local exchange service were rejected in favor of the Hatfield Model cost study. *Id*. at 135.

2. Even if access charge reductions are ordered, this is not the appropriate proceeding in which to consider a basic telephone rate increase as a result of rate rebalancing.

34. In its Application, Sprint Nextel did not request a rate increase for the spin-off and none of its prefiled testimony even remotely suggests one. To the contrary, Nancy L. Judy took the position that if the transaction is allowed, "United will continue to offer the same services, and at the same rates, terms and conditions that it does today." Exhibit No. ___ (NLJ-1T), p. 10. Rather, a specific proposal for rate-rebalancing was made, for the first time, in the November 30, 2005, testimony of Staff witnesses Wilford Saunders, Timothy W. Zawislak and Betty A. Erdahl.

a. The Commission has held in a similar setting that basic telephone rates are appropriately set in general rate proceedings.

35. When presented with a similar situation in the AT&T complaint case, the Commission ruled that local basic service rates should be set through a general rate case.[21]

(1) The Commission has held that rates should be set in a general rate case.

36. In the AT&T complaint case, Verizon attempted to link access charge reductions (the subject of the complaint) with concomitant basic service rate increases. The Commission strongly rejected this effort. *See*, Docket No. UT-020406, Fifth Supplemental Order, ¶¶ 23-24 (February 2003), saying:

> If Verizon believes that changes in its rates may be necessitated by the outcome of the complaint it has options regarding how it may choose to proceed. It may seek to negotiate an implementation plan with the parties. It may ask the Commission to hold a second stage of hearings in which it determines implementation issues. If Verizon wants to obtain the earliest possible resolution of any "rate leveling" issues, it may file a general rate increase request at any time. Such a filing would provide due process notice to persons effected by rate changes, and would allow Verizon's rate tariffs to be modified, if justified by the evidence.

[21] It should be noted that Staff states that it does not propose a general rate case at this time. Testimony of Betty A. Erdahl, Exhibit No. ___ ("BAE-1T"), pp. 18-19.

37. Ultimately, Verizon filed a general rate case to address this and other revenue issues in Docket UT-040788.

38. Thus, while the record in the AT&T Complaint case included Verizon cost studies to analyze access rates, the Commission refused to consider raising local rates as part of that proceeding on the basis that a general rate case is the proper forum for a comprehensive review of local rates and the proper manner to provide due process notice to affected customers.[22] In its Eleventh Supplemental Order the Commission further expanded on its reasoning for rejecting ratemaking outside of the general rate case context, saying: "the status of the Company's earnings is not relevant to the issues raised by the complaint" and "a rate proceeding initiated by Verizon will afford a much greater opportunity to explore the issues that this decision has acknowledged and any others that may require attention." Docket No. UT-020406, Eleventh Supplemental Order, ¶ 140.[23] Therefore, even if the Commission holds that the reduction of access charges is within the scope of this docket, the setting of basic service rates is not.

(2) The Commission rules governing the process by which rates should be set provide a template for the type of record required.

39. The Commission promulgated rules of procedure for determining the appropriate level of rates for telecommunications companies in WAC 480-07-500 to-660. While the rules apply to

[22] The Commission also rejected any attempt by Verizon to account for additional access lines, saying: "We believe that doing so is improper in this proceeding, because we earlier ruled, and reaffirm in this order, that we will not consider Verizon's revenue needs in this docket." *Id*. at ¶ 65. The Commission also rejected Staff and Verizon's attempt to put on evidence regarding the Company's earnings.

[23] When, following the access charge decision, Verizon eventually filed a rate case, it included a request for interim or emergency rate relief in the precise amount of the access charge reduction. *WUTC v. Verizon*, UT-040788, Order No. 11, ¶¶ 13, 19. Verizon argued, inter alia, that it was entitled to rebalancing because the access charge reduction had caused it gross hardship and inequity. The Commission rejected the request, after reviewing "all financial indices as they concern the applicant, including rate of return, interest coverage, earnings coverage, and the growth, stability, or deterioration of each, together with the immediate and short-term demands for new financing and whether the grant or failure to grant interim relief will have such an effect on financing demands as to substantially affect the public interest." *Id.*, ¶113, et seq. The order is instructive in at least two relevant respects. First, unlike this case, the Commission had before it a substantial record regarding Verizon's financial condition and still rejected the request to replace lost access revenues, requiring Verizon to put on its full rate case. Second, the Commission found no legal obligation for it to allow Verizon to maintain a given level of rates. *Id.*, ¶99.

rate cases initiated by regulated utilities, they provide a framework for the type of information that is necessary to provide an adequate record for ratemaking. This information includes:

> (a) A detailed portrayal of the development of the company's requested rate of return.
>
> (b) A detailed portrayal of restating actual and pro forma adjustments that the company uses to support the filing, specifying all relevant assumptions, and including specific references to charts of accounts, financial reports, studies, and all similar records relied on by the company in preparing its filing, supporting testimony, and exhibits. If the company proposes to calculate an adjustment in a manner different from the method that the commission most recently accepted or authorized for the company, it must also present a work paper demonstrating how the adjustment would be calculated under the methodology previously accepted by the commission, and a brief narrative describing the change. Commission approval of a settlement does not constitute commission acceptance of any underlying methodology unless so specified in the order approving the settlement.
>
> * * *
>
> (c) A detailed portrayal of revenue sources during the test year and a parallel portrayal, by source, of changes in revenue produced by the filing, including an explanation of how the changes were derived.
>
> (d) If the public service company has not achieved its authorized rate of return, an explanation of why it has not and what the company is doing to improve its earnings in addition to its request for increased rates.
>
> (e) A representation of the actual rate base and results of operation of the company during the test period, calculated in the manner used by the commission to calculate the company's revenue requirement in the commission's most recent order granting the company a general rate increase.
>
> (f) Supplementation of the annual affiliate and subsidiary transaction reports as provided in rules governing reporting requirements for each industry, as necessary, to include all transactions during the test period. The company is required to identify all transactions that materially affect the proposed rates.

WAC 480-07-510.

40. Significantly, the Commission also requires that a cost study be in the record, including "all cost studies conducted <u>in the last five years</u> for any of the company's services" with a

description of the methodology used in the studies. *Id*. (emphasis added). Here, it is obvious that the documentary record does not meet all of the requirements of WAC 480-07-510.

b. A public service company does not have the permanent right to a specific level of revenue.

41. A "company is not entitled to a level of revenue." *AT&T Communications of the Pacific Northwest, Inc. v. Verizon Northwest, Inc*., UT-020406, Eleventh Supplemental Order Sustaining Complaint, Directing Filing of Revised Access Charge Rates, p. 7 (August 12, 2003).[24] Instead, a company "is entitled to the opportunity to earn at a level allowing it to meet its reasonable expenses, including the cost of capital needed to support its operations." *Id*. Moreover, the "appropriate means to demonstrate the need for a general increase in its rates and charges is a general rate increase proceeding." *Id*.

42. For the Commission to increase rates based purely on a company's historic revenue requirement, as the Staff suggests, ignores the clear statutory requirement to ensure that rates are fair, just, reasonable, or sufficient under RCW 80.36.080 and RCW 80.36.140.

c. The doctrine of single issue ratemaking prohibits a rate increase in this proceeding.

43. Allowing a rate increase in this docket would also violate the prohibition against single issue ratemaking. One reason that state utility commissions are loathe to engage in single-issue ratemaking is because it requires that regulators consider changes in isolation, thereby ignoring potentially offsetting considerations and risking understatement or overstatement of the overall revenue requirement. *City of Chicago v. Ill. Commerce Commn.*, 281 Ill.App.3d 617, 627 (1996). This principle has been annunciated in several Commission decisions. *See e.g., MCI Telecommunications Corporation v. GTE Northwest, Inc*., UT-970653, Second Supplemental Order Dismissing Complaint, p. 5 (October 1997).

[24] *See also, WUTC v. U S West Communications, Inc.,* UT-970766, Fourteenth Supplemental Order: Commission Order on Reconsideration Service Quality and Directory Assistance Revenue Issues, p. 6 (March 1998) (rejecting a request by Qwest to seek revenue increases at a later date if current directory assistance revenue estimates were not met).

44. In *MCI v. GTE*, the Commission held that it "generally will not engage in single issue or 'piecemeal' ratemaking." *Id*. To the contrary, the Commission has said that questions of whether rates and charges are fair, just, reasonable, and sufficient under RCW 80.36.140 should be resolved by a comprehensive review of a company's rate base and operating expenses, determining a proper rate of return, and allocating rate changes equitably among ratepayers. *Id*., citing *In re U S West Communications, Inc*., Docket No. UT-920085, Third Supplemental Order (April 1993).

45. By seeking to raise basic telephone rates (if the Commission decides to lower United's access charges), Staff has sought to present just the type of limited rate case the Commission has rejected. "Such limited rate cases likely would result in unfair and unequal allocation of rates among the company's ratepayers, and would not be a productive use of the Commission's resources." *MCI v. GTE,* Docket No. UT-970653 at p. 6. The proper context for consideration of cost shifting, rate spread and similar issues is in a general rate case where all revenues and costs are before the Commission.[25]

46. In the instant case, Staff proposes to redistribute revenues from access charges to residential and business rates outside the context of a general rate case. Thus, there is no examination of United's costs and revenues and no review of the appropriate rate design and rate spread among customer classes. Therefore, even if lower access charges are held to be within the scope of this docket, any revenue shortfalls should be addressed in a separate proceeding that considers all of these factors. To do otherwise is clearly improper single issue rate making.

[25] *See also, WUTC v. U S West Communications, Inc.*, Docket No. UT-980340, Final Order Granting Summary Determination; Ordering Implementation of 1+ Toll Dialing Parity, p. 11 (October 1998) (Where U S West sought rate rebalancing before it would implement dialing parity, the Commission granted Staff's motion seeking summary determination and ordered U S West to implement dialing parity without the requested rate rebalancing, saying "We agree with the Commission Staff that any demonstrated revenue deficiency experienced by U S WEST associated with lost market share for toll services should be brought before the Commission in a separate proceeding.").

d. Customers are entitled to notice and an opportunity to be heard prior to a Commission decision raising rates.

(1) State statutes requires notice to United's customers of any rate increase.

47. Title 80 RCW provides for two basic paths to initiate a change in telecommunications rates. Each provides for certain procedural protections. Neither statutory path is present in this case. The first path involves proposed changes by telecommunications carriers. Telecommunications companies have an obligation to have their tariffs on file with the Commission and may not charge more for any service rendered than the tariff on file and in effect at that time. RCW 80.36.100; RCW 80.36.130. To change a tariff, a company must publish and file a notice with the Commission. RCW 80.36.110. The notice must plainly state the changes proposed to be made in the tariff schedule then in force, and the time when the change will go into effect. *Id*. A proposed tariff change may not go into effect for at least 30 days after filed with the Commission. *Id*. The Commission may suspend any changes within 30 days of the filing, hold a hearing to consider the proposed change, and prescribe a different rate if it concludes that the change is unjust, unfair, or unreasonable. *Id*.; RCW 80.04.130; RCW 80.36.140. *Washington Independent Telephone Ass'n v. Washington Utilities and Transp. Com'n*, 148 Wn.2d 887, 893, 64 P.3d 606 (2003).[26] If suspended, the Commission has an additional 10 months to review the merits of the request. RCW 80.04.130.

48. The second path is the filing of a complaint against rates pursuant to RCW 80.04.110 on the Commission's own motion or on motion of another of the broad class of complainants listed in the statute. The filing of such a complaint triggers notice and other procedural rights and protections including those provided for in RCW 80.04.120 and the Commission's procedural

[26] The rates of telecommunications companies may be altered by the Commission only by order after hearing and findings, not by rule. RCW 80.36.140; *Washington Independent Telephone Ass'n v. Washington Utilities and Transp. Com'n*, 110 Wn. App. 147, 157, 39 P.3d 342 (2002), *reversed on other grounds*, 148 Wn.2d 887, 911 (rule did not actually set rates).

rules regarding adjudications. WAC 480-07-300 et seq. No such complaint has been filed in this case putting rates at issue.

(2) Commission rules require notice to United's customers.

49. WAC 480-120-194 also requires customer notice regarding a proposed rate increase 30 days prior to taking effect.[27] Notice must mailed to each customer that would be affected by the proposed change and must include, *inter alia*, a comparison of current and proposed rates by service, an example showing the monthly increase of the average customer's bill based on the proposed rates, the requested effective date and, if different, the implementation date, a description of how customers may contact the company if they have specific questions or need additional information about the proposal and language informing the public of how to comment on the proposal, including (1) how to participate in the Commission's process by mailing or faxing a letter, or submitting an e-mail and (2) how to contact the Commission for process questions or to be notified of the scheduled open meeting at which the proposal will be considered by the Commission. *Id.* [28]

50. In the instant case, none of these requirements have been met and Sprint acknowledges the practical problems associated with trying to fulfill these requirements 30 days prior to the effective date of a rate increase. According to the Company in Exhibit No. ___(NLJ-4T), p. 9:

> Typically, these notices are contained in billing statements that take 30 days to cycle through. Therefore, it would take at least two months to ensure that all customers received at least 30 days notice of the rate increase. This factor alone would make it impossible for United to implement new rates within 30 days after the separation closes…. Further, if the Commission were to require United

[27] Notice must be verified by the company in accordance with WAC 480-120-198.

[28] Additionally, the rule requires that the copies of the published notice (1) be delivered to community agencies and organizations in the geographic area where the company offers service for posting and publication by the agency or organization, (2) be printed as a paid advertisement in the daily newspaper of general circulation with the greatest number of subscribers in each geographic area or each of the areas affected by the proposed tariff, (3) be provided to the news editor of every newspaper, television station, and radio station, in the geographic area within which it offers service and (4) be posted on an Internet web site accessible to the public using generally available browser software.

to notify customers of the rate changes concurrent with the name change…it could delay the separation.

(3) Due process requires notice to United's customers.

51. "Procedural due process at a minimum requires notice and an opportunity to be heard." *Rivett v. City of Tacoma*, 123 Wn.2d 573, 583, 870 P.2d 299 (1994). The Commission has expressed a preference for litigating rate increases in general rate cases because doing so protects the due process rights of customers. *AT&T v. Verizon,* Docket No. UT-020406, Fifth Supplemental Order, ¶¶ 23-24 (February 2003) (Verizon "may file a general rate increase request at any time. Such a filing would provide due process notice to persons effected by rate changes, and would allow Verizon's rate tariffs to be modified, if justified by the evidence").

52. It is undisputed no notice or opportunity to comment has been given to ratepayers in this case.[29] This lack of notice is underscored by the fact that the Petitioner who initiated the Application in this case provided no notice that rate relief would be requested. The Petitioner's testimony actually states that it would maintain current rates and services. Exhibit No. ___ (NLJ-1T), p. 10. The rate change is proposed only in responsive testimony by Staff. Exhibit No. ___(TWZ-1T), p. 12.

53. It may be argued that if the Commission grants the Staff's requested rate increase that notice could be provided at that time. After-the-fact notice, however, is inadequate to cure the defect. Moreover, it is clearly antithetical to the notion that due process requires a hearing before deprivation occurs. *Cleveland Bd. of Educ. v. Loudermill,* 470 U.S. 532, 542, 105 S. Ct. 1487 (1985); *Devine v. Dept. of Licensing,* 126 Wn. App. 941, 949-50, 110 P.3d 237 (2005). As the finder of fact, the Commission would have already determined that the rates were fair, just, reasonable, and sufficient without notice and an opportunity for ratepayers to be heard.

54. Therefore, the only way to cure the statutory, regulatory and constitutional procedural problems attendant to Staff's proposed rate increase is to remove that issue from the scope of this

[29] Indeed, to Public Counsel's knowledge, no notice of any kind has yet been provided to United customers of the impending spin-off.

case. The best approach, as the AT&T complaint matter shows, is for Staff to bring a separate complaint proceeding, if appropriate, regarding United's access charges. If that results in a finding that reduces United's revenues, United can, if it deems it necessary, file a general rate case to seek relief.

e. Since the FCC is considering exercising ratemaking authority over state access charges, increased rates may not be necessary and may actually foreclose an opportunity to receive Federal Universal Service Funds and/or result in double recovery by the company.

55. On March 3, 2005, the Federal Communications Commission (FCC) issued a Further Notice of Proposed Rulemaking Proposed Rulemaking in the Matter of Developing a Unified Intercarrier Compensation Regime (FNPRM) soliciting comments on a variety of issues. CC Docket No. 01-92, FCC 05-33. Comments were filed on May 23, 2005.

56. The FCC has concluded that there is an urgent need to reform the existing intercarrier compensation rules. *Id*. at ¶ 37. The question remains how to do that. There are at least three comprehensive plans proposed to the FCC by major advocacy groups. Each of these plans would impact Washington differently, but there are particular likely effects that we believe the Commission should consider.

57. First, there is the possibility that United will double recover revenues. This would occur if the Commission ordered access charge reductions and allowed United to recover the decreased revenues through higher basic phone rates, as Staff proposes, and the FCC subsequently acted to reduce access charges by creating a federal support mechanism. United would enjoy a windfall because it would be collecting significantly higher basic telephone rates to offset non-existent revenue losses.

58. Second, there is a possibility that the FCC will implement a plan whereby federal support is based on the current cost of access charges. If the Commission reduces state access rates for a year that turns out to be the base year for the FCC proceeding, then the total allowed revenue decreases. With a lower total allowed revenue, it is unlikely that United would be able to receive

these new funds. Thus, if the Commission initiates access reductions before the FCC, it is possible that local basic phone rates will increase and United will not receive any funding from the federal universal service fund.

59. Therefore, it is essential that the FCC be allowed to complete its process first.

3. Should the Commission hold that rate rebalancing is proper in this docket, Public Counsel has statutory and constitutional due process rights to introduce direct evidence rebutting Staff's testimony on the rate rebalancing issue.

60. In the event that the Commission determines to take up access charges and rate rebalancing in this proceeding, Public Counsel respectfully requests that the Commission revisit the issue of whether Public Counsel will be permitted to file rebuttal testimony on these issues. Public Counsel acknowledges the Commission's rulings to date, however, it is our position that, if this matter is to be taken up and decided, that both the Administrative Procedures Act and constitutional due process require that we be permitted to file testimony.

61. RCW 34.05.449(2) concerns the procedures for ensuring a complete adjudicative record. It says:

> To the extent necessary for full disclosure of all relevant facts and issues, the presiding officer *shall* afford to all parties the opportunity to respond, present evidence and argument, conduct cross-examination, and *submit rebuttal evidence, except as restricted by a limited grant of intervention or by the prehearing order.*

(Emphasis added). Public Counsel was not subject to a limited grant of intervention and the discussion in the prehearing conference and order regarding whether Staff would even raise the issue of rebalancing was unclear. The order did not restrict or permanently preclude cross-rebuttal by its terms, but simply did not address the issue. *See*, Public Counsel's Motion for Reconsideration of Order No. 4, ¶ 5-6 (December 16, 2005).

62. Moreover, Washington case law establishes that a party to an administrative proceeding has the right to present rebuttal evidence. *Surina v. Department of Labor and Industries,* 34

Wn.2d 839, 842, 210 P.2d 403 (1949). There, the Court remanded the case to L&I, directing it to reopen the record for the sole purpose of receiving and considering the prohibited rebuttal testimony. *Id. at 842-43.*

63. In addition to the requirements of the APA, Public Counsel also has a constitutional due process right to file responsive testimony on an issue directly affecting the interests of the customers it represents. *See e.g., WUTC v. Pacific Northwest Bell Telephone Co. d/b/a U S West Communications,* Docket No. U 89-2698-F, Docket No. U 89-3245-P (Consolidated) Fourth Supplemental Order (January 1990), p. 22 (Due process is ensured by a full and complete record, including reasonable discovery, full cross examination of witnesses, the opportunity for all persons to testify and present evidence). This right was not waived by awaiting the filing of Staff's proposal, and is not preserved by only permitting cross-examination and briefing.

64. If the Commission decides to consider access charge reductions and rate rebalancing in this docket, Public Counsel has testimony prepared on the issues which it can file immediately upon receipt of a Commission order granting it leave to do so.

IV. CONCLUSION

65. For the foregoing reasons Public Counsel requests that the Commission issue an order (1) limiting the scope of the proceeding to exclude the consideration of access charge reductions and concomitant rate increases, strike the testimony of witnesses regarding this issue, and exclude any such evidence offered at hearing and (2) affirming the appropriateness of including consideration of the directory imputation issue, including disposition of Sprint's gain from the

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ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

sale of its directory business, in the instant docket.

Dated this 25th day of January, 2006.

ROB MCKENNA
Attorney General

_____

Simon J. ffitch
Assistant Attorney General
Judith Krebs
Assistant Attorney General
Public Counsel

ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

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ATTORNEY GENERAL OF WASHINGTON
Public Counsel
900 4th Ave., Suite 2000
Seattle, WA 98164-1012

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