

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Complainant,

v.

QWEST CORPORATION,

Respondent.

DOCKET NO. UT-032162

SETTLEMENT AGREEMENT

Both parties in this proceeding enter into the following agreement to resolve all issues in the above docket.

I. PARTIES

1.1 The Parties to this Agreement are the Staff of the Washington Utilities and Transportation Commission (Staff) and Qwest Corporation (Qwest) (collectively, “the Parties”).

II. BACKGROUND

2.1 On August 10, 2004, the Commission issued a complaint alleging that Qwest violated various provisions of state law by filing late reports with the

Commission, filing inaccurate reports with the Commission, and maintaining inaccurate accounts.

A. Failure to File Timely Reports

2.2 Qwest notified the Commission that it could not file its 2002 annual report or its quarterly reports for the fourth quarter of 2002 and the first quarter of 2003 by their due dates, as a result of the ongoing restatement of the Company's 2000 and 2001 financial statements. Qwest also stated that it would not file its 2002 affiliated interest report by June 1, 2003. Qwest requested and received a temporary exemption from the Commission's filing requirements.¹ Under the terms of the extension, Qwest was to file its 2002 annual report, its fourth quarter 2002 report, and its first quarter 2003 report by August 1, 2003, and its 2002 affiliated interest report by September 1, 2003.

2.3 Qwest requested a second extension of time to file its 2002 annual report, fourth quarter 2002 report, first quarter 2003 report, and 2002 affiliated interest report. The Commission denied Qwest's second request and required Qwest to file the reports by August 1, 2003, and September 1, 2003.²

2.4 Qwest failed to file its 2002 annual report, fourth quarter 2002 report, and first quarter 2003 report by August 1, 2003. Qwest filed its 2002 annual report

¹ *In re Qwest Corporation*, Docket No. UT-030495, Order No. 01, ¶ 15 (April 23, 2003).

² *In re Qwest Corporation*, Docket No. UT-030459, Order No. 02, ¶¶ 14-15 (July 23, 2003).

144 days late on December 23, 2003. Qwest filed its fourth quarter 2002 report 151 days late on December 22, 2003. Qwest filed its first quarter 2003 report 272 days late on April 29, 2004.

2.5 Qwest failed to file its 2002 affiliated interest report by September 1, 2003. While Qwest filed a portion of the report on time, it filed other portions (Attachment B and Confidential Attachment D) of the reports in December 2003.

2.6 Qwest also failed to file two subsequent quarterly reports on time. Qwest's second quarter 2003 report was due on September 28, 2003, but the report was filed 214 days late on April 29, 2004. Qwest's third quarter 2003 report was due on December 29, 2003, but was not filed until April 29, 2004. The third quarter 2003 report was 122 days late.

B. Filing Inaccurate Reports Needing Later Revision

2.7 The restatement of Qwest's 2000 and 2001 financial statements revealed that Qwest's reports covering this time period were not accurate as filed. In total, 12 reports were filed that were later revised following the completion of Qwest's extensive restatement process. Eight of those reports were quarterly reports: Qwest revised four quarterly reports from 2000 and four quarterly reports from 2001. Two of the 12 reports were annual reports: Qwest revised annual reports from 2000 and

2001. Two of the 12 reports were affiliated interest reports: Qwest revised affiliated interest reports from 2000 and 2001.

2.8 These reports contained inaccuracies due to certain misinterpretations or misapplications of Generally Accepted Accounting Principles (“GAAP”) by Qwest (see Paragraph 2.10 below). The reports were consistent with the Company’s accounting records, which were inaccurate due in part to certain material weaknesses and significant deficiencies in the Company’s accounting procedures.

C. Maintaining Inaccurate Accounts Requiring Revision

2.9 Pursuant to RCW 80.04.090, the Commission has the authority to prescribe the form of all accounts kept by a regulated company. WAC 480-120-302 requires Qwest to use the *Uniform System of Accounts (USOA) for Class A and Class B Telephone Companies*, which is published by the Federal Communications Commission. The USOA requires that companies’ financial records be kept in accordance with GAAP to the extent permitted by the USOA. 47 CFR § 32.12(a).

2.10 In its Form 10-K for the fiscal year ended December 31, 2002, filed with the Securities and Exchange Commission on January 13, 2004 (“10-K”), Qwest disclosed that it had identified a number of internal control deficiencies that constituted "material weaknesses" or "significant deficiencies" (as defined under

generally accepted auditing standards) during the 2000, 2001, and 2002 fiscal years. Qwest has made numerous changes to its controls and procedures and to its executive team since the time of the violations alleged in the complaint. These changes are discussed in Item 9A of the 10-K. In Note 3 to the 10-K, Qwest disclosed that it had determined that, in certain cases, it had misinterpreted or misapplied GAAP in its 2000 and 2001 consolidated financial statements and, accordingly, it had restated its 2000 and 2001 consolidated financial statements. Items 9 and 9A and Note 3 of the 10-K are excerpted and attached as an appendix to this Agreement.

2.11 As a result of the misinterpretations or misapplications of GAAP disclosed in the 10-K, Qwest failed to maintain accounts in a manner that complied with the USOA. Qwest restated its accounts as of January 13, 2004.

III. SPECIFIC TERMS

3.1 The Parties agree that all claims against Qwest in this proceeding should be resolved by Qwest's acceptance of the following admissions, penalties, and commitments:

3.2 Qwest admits the following:

- Qwest violated the Commission's Order No. 02 from Docket No. UT-030495 dated July 23, 2003, RCW 80.04.080, and WAC 480-120-304(1) by failing to file its 2002 annual report until December 23, 2003.

- Qwest violated the Commission's Order No. 02 from Docket No. UT-030459 dated July 23, 2003, RCW 80.04.080, and WAC 480-120-304(2) by failing to file its fourth quarter 2002 report until December 22, 2003, and its first quarter 2003 report until April 29, 2004.
- Qwest violated RCW 80.04.080 and WAC 480-120-304(2) by failing to file its second and third quarter 2003 reports until April 29, 2004.
- Qwest violated the Commission's Order No. 02 from Docket No. UT-030459 dated July 23, 2003, RCW 80.04.080, and WAC 480-146-360 by failing to file portions of its 2002 affiliated interest report until December 2003.
- As a result of the certain misinterpretations or misapplications of GAAP disclosed in the 10-K, Qwest failed to maintain accounts in accordance with the USOA, as required by WAC 480-120-302 or *former* WAC 480-120-031.

3.3 Because Qwest admits that its failure to maintain accurate accounting records in accordance with the USOA constitutes a violation of state law, Staff believes that the Commission should make no finding that Qwest violated state law by filing inaccurate reports (as alleged in the Fifth Cause of Action in the complaint).

The Parties agree that no penalty should be assessed under the Fifth Cause of Action and that cause of action should be dismissed.

3.4 Qwest will pay a penalty of \$48,000 for the violations incurred as admitted above. Qwest must pay this amount within 15 days of the Commission's order approving and adopting this Settlement Agreement.

3.5 Qwest will comply with all applicable Commission rules and statutes, including those regarding filing annual financial reports by May 1 of each year as required by RCW 80.04.080, WAC 480-120-302, and WAC 480-120-304(1); filing quarterly financial reports no later than 90 days after the close of the quarter being reported as required by RCW 80.04.080, WAC 480-120-302, and WAC 480-120-304(2); filing affiliated interest reports by June 1 of each year as required by RCW 80.04.080 and WAC 480-146-360; and keeping accounts as required by RCW 80.04.090 and WAC 480-120-302.

3.6 Qwest further commits that the financial reports it files and the accounts it maintains will be accurate in all material respects, and when inaccuracies occur, that it will promptly correct any material inaccuracies.

3.7 The Parties acknowledge and agree that while neither RCW 80.04.090 nor WAC 480-120-302 explicitly imposes an accuracy requirement or defines

standards for determining whether a report or account is “accurate” or “inaccurate” or whether any “inaccuracy” is material, reports filed with the Commission and accounts maintained by a public service company should be accurate in all material respects. Nonetheless, every restatement of an account or correction of a report is not *per se* a violation, as it is generally understood that even when companies act in good faith they will make errors. Accounting standards allow for, and in some cases even require, such restatements. When material inaccuracies are discovered, they should be promptly corrected.

IV. GENERAL TERMS

4.1 This Agreement does not preclude the Commission from pursuing penalties for violations of Commission rules and statutes unrelated to the subject matter of this Agreement or for subsequent violations of the rules and statutes stated above.

4.2 The Parties agree that this Settlement Agreement resolves the contested issues between them in this proceeding. Parties understand that the Specific Terms of the Agreement do not apply unless the Commission approves them.

4.3 The Parties have entered into this Agreement voluntarily to avoid further expense, inconvenience, uncertainty, and delay of litigation.

4.4 The Parties agree to cooperate in submitting this Agreement promptly to the Commission for adoption, in compliance with WAC 480-07-730. The Parties agree to use their best efforts to secure Commission approval of the Specific Terms of this Agreement in proceedings before the Commission through testimony or briefing. No party to this Agreement or its agents, employees, consultants, or attorneys will engage in advocacy contrary to the Commission's adoption of this Agreement.

4.5 Nothing in this Agreement shall limit or bar a party's ability to pursue legal enforcement of the Specific Terms and General Terms of the Agreement. Should legal enforcement be necessary, the party against whom action is taken will be liable for costs to the moving party, if such action is successful.

4.6 The Parties recognize that this Agreement represents a compromise of the positions the Parties may otherwise assert in this proceeding. As such, conduct, statements, and documents disclosed during negotiations of this Agreement shall not be admissible as evidence in this or any other proceeding, except in any proceeding to enforce the terms of this Agreement or any Commission Order adopting those terms.

4.7 This Agreement shall not be construed against either party because it was the drafter of the Agreement.

4.8 The Parties have negotiated this Agreement as an integrated resolution of the issues. This Agreement supersedes all prior oral and written agreements on issues addressed herein. The Parties recommend the Commission adopt this Agreement in its entirety.

4.9 The Parties may execute this Agreement in counterparts and as executed shall constitute one agreement. Copies sent by facsimile are effective as original documents

4.10 The Parties shall take all actions necessary and appropriate to carry out this Agreement.

4.11 In the event that the Commission rejects all or any portion of the Specific Terms of this Agreement or conditions approval of the Specific Terms on material revisions to its terms and conditions, each party reserves the right to withdraw from this Agreement by written notice to the other party and the Commission. Written notice must be served within 10 days. In such event, neither party will be bound or prejudiced by the terms of this Agreement, and both parties shall be entitled to seek reconsideration of the Order rejecting all or part of the Agreement. Additionally, the Parties will jointly request a prehearing conference be

//

//

reconvened for purposes of establishing a procedural schedule to complete the case,
if needed.

CHRISTINE O. GREGOIRE
Attorney General

QWEST CORPORATION

LISA WATSON, WSBA #31549
Assistant Attorney General
Counsel for Staff of the
Washington Utilities and
Transportation Commission
(360) 664-1186
Date Signed: _____

LISA A. ANDERL, WSBA #13236
ADAM L. SHERR, WSBA #25291
Counsel for Qwest Corporation
(206) 398-2500
Date signed: _____