BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of DRAFT FINANCIAL REPORTING RULES	Docket No. A-021178 QWEST CORPORATION'S COMMENTS ON PROPOSED RULES

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

TABLE OF CONTENTS

I. INTRODUCTION 3

II. COMMENTS 3

A. Chapter 480-146 WAC 3

B. WAC 480-120-325 4

C. WAC 480-120-331 6

D. WAC 480-120-365 6

1. WAC 480-120-365(2) 7
   a) The five business day notice requirement is unlawful, impractical and potentially very harmful to utilities. 7
   b) The requirement to file actual terms of financing before issuance imposes an unnecessary and impossible burden. 17
2. WAC 480-120-365(4) 18
3. WAC 480-120-365(6) 19

E. WAC 480-120-369 20

1. The proposed reporting requirements are unlawful under state and federal law. 20
2. The proposed reporting requirements will impose impractical burdens without corresponding benefit. 24

F. WAC 480-120-395 26

III. CONCLUSION 26

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

1 Qwest Corporation ("QC") offers the following comments in response to the Commission's December 23, 2004 notice in conjunction with the revised proposed financial reporting rules.

I. INTRODUCTION

2 QC requests that the Commission reject or modify many of the proposed rules, as they vastly exceed the Commission's authority, run afoul of both state and federal law, impose undue burden without providing corresponding benefit and are inconsistent with the increasingly competitive nature of the telecommunications industry. With regard to the telecommunications industry, the type of financial micromanagement sought by these rules can only be achieved, if at all, by legislative fiat, and perhaps then only by an act of Congress. A state commission rulemaking proceeding is not the appropriate forum for attempting to manage or restrict the financing activities and cash management of multi-state entities such as QC.

3 While its comments may be applicable to Chapters 480-70, 480-73, 480-90, 480-92, 480-100 and 480-110 as well, QC's comments only address the proposed elimination of Chapter 480-146 and the proposed revisions to Chapter 480-120, regarding telecommunications companies.

II. COMMENTS

A. Chapter 480-146 WAC

4 In and of itself, the proposed deletion of Chapter 480-146 and the dispersion of the centralized securities and affiliated-interest rules into the different industry chapters is not concerning to QC. However, to the extent doing so is an attempt to extend the Commission's authority by removing the restrictions that flow from the enabling statutes (specifically, RCW 80.08 and 80.16), QC is quite concerned. As will be discussed below, the legislature tightly prescribed the Commission's authority over securities issuances and affiliated interest transactions. Any attempt to loosen those restrictions by moving the related regulations into the general industry chapters would be unlawful.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

B. WAC 480-120-325

5 The proposed rule seeks to define "affiliated interest," "control" and "subsidiary." As discussed below, QC urges the Commission to step back from the portions of the proposed rules seeking to extend the Commission's regulatory purview to subsidiary transactions. Given that this section is only necessitated by the other rules that (unlawfully) regulate subsidiary transactions, QC suggests that this rule is unnecessary and should be deleted, along with the discussion of subsidiaries in other rules.

6 In the event the Commission proceeds in its intention to regulate subsidiary transactions, without waiver of its objection to subsidiary regulation, QC believes this rule could be significantly improved. QC notes that these definitions have changed dramatically from draft to draft, and while the Commission has added a slight measure of objectivity to the definition of "subsidiary" (i.e., that Company X cannot be Company Y's subsidiary unless Y owns at least *five percent* of the voting securities in X), the rule remains unlawfully unclear.

7 The proposed rule establishes an ostensibly-rebuttable presumption that if QC owns five percent or more of a company, QC *controls* that company and that company is, therefore, QC's subsidiary. "Control" is defined as meaning "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a company, whether through the ownership of voting shares, by contract, or otherwise.

8 While QC agrees that control should be the focus of a definition of "subsidiary," QC believes that the inclusion of "by contract, or otherwise" in the definition of "control" is vague and confusing. As a matter of law, vague rules are void and unenforceable.[1]

[1] *Pinecrest Homeowners Ass'n v. Cloninger & Assocs.*, 115 Wn. App. 611, 62 P.2d 938 (2003) (Holding that administrative regulations are unconstitutionally vague if they empower an administrative agency to make discretionary, arbitrary decisions based on standards which are vague, unarticulated, and unpublished.); *Longview Fibre Co. v. Washington*, 89 Wn. App. 627, 949 P.2d 851 (1998) ("A regulation is unconstitutionally vague if persons of common intelligence must necessarily guess at its meaning and disagree as to its application.").

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

9 The proposed definition of "control" is confusing in two principal respects. First, the phrase "by contract" is vague and potentially overbroad. Read literally, any company in which QC owns a 5% or greater ownership interest that has a contract with QC may then be deemed a subsidiary. As an illustration, assume QC and Company X (in which QC holds a 5% ownership interest) enter into a contract whereby Company X agrees to provide QC maintenance services at a QC-owned central office. Given Company X's obligation to abide by its contract with QC, it could be argued that Company X's management and policies are controlled by the contract. As such, Company X is, arguably, a subsidiary of QC. This is absolutely inconsistent with the common and legal understanding of the term "subsidiary." It is also quite problematic given the numerous additional subsidiary reporting requirements proposed in the draft rules.

10 Second, the phrase "or otherwise" is so broad and inexact that it renders the definition of "control" – and thus the definition of "subsidiary" – vague and unenforceable.

11 QC further notes that the rule purports to impose a burden on utilities to demonstrate non-control (a puzzling standard to satisfy) without any mention of a process or structure for doing so. For instance, it is unclear (again, likely unlawfully so) whether a utility is required to (and, if so, how often it is required to) petition the Commission for a finding that a company in which it owns five or more percent interest in is not under its "control."

12 QC reiterates that all parties would be far better served by the Commission adopting the generally-accepted definition of a "subsidiary." That requires no further investigation or analysis other than whether the utility owns a majority of the voting securities of the other company.[2]

---

[2] The Washington Corporations Act defines a subsidiary as "a domestic or foreign corporation that has ***a majority of its outstanding voting shares*** owned, directly or indirectly, by another domestic or foreign corporation." *RCW 23B.19.020(17) (emphasis added).*

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

13 QC recommends that the Commission delete the definition of "control" and adopt the following definition of "subsidiary":

> **"Subsidiary"** means any company in which the telecommunications company owns directly or indirectly ~~five percent or more~~ a majority of the voting securities~~, unless the telecommunications company demonstrates it does not have control~~.

C. WAC 480-120-331

14 Proposed WAC 480-120-331(2) provides that the Commission may require pertinent information *in addition to that* specified by statute or in this chapter. QC is concerned that proposed subsection (2) seeks to grant the Commission powers in excess of its jurisdiction. While QC acknowledges that the Commission has broad authority to gather information from public service companies,[3] as worded, subsection (2) appears to grant the Commission powers beyond those granted by the legislature. On its face, such a grant would be unlawful, as the Commission is limited to the powers provided by statute.[4] In light of the limits on the Commission's authority, QC recommends simply deleting subsection (2) of the proposed rule.[5]

D. WAC 480-120-365

15 Proposed WAC 480-120-365 purports to alter the current statutory requirement to file notice of securities issuances before issuance with a filing requirement that differs dramatically depending upon whether the public service company's corporate credit/issuer rating is "investment grade" or non-investment grade. Investment grade carriers will be required to file notice five business days *after* issuance, whereas non-investment grade carriers will be

[3] For example, RCW 80.04.070 provides the Commission, each Commissioner and all persons employed by the Commission "the right, at any and all times, to inspect the accounts, books, papers and documents of any public service company" and the right to examine/depose any officer, agent or employee of the public service company in relation to such accounts, books, papers or documents.

[4] See footnote 9 below.

[5] QC acknowledges that subsection (2) is a carry-forward from existing WAC 480-146-260. This fact notwithstanding, QC believes that this shuffling of the rules offers the Commission an opportunity to reassess its rules to ensure that they are lawful and do not impermissibly extend beyond the Commission's jurisdiction.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

required to file notice five business days *before* issuance.[6]

16 QC strongly opposes adoption of this proposed rule. The proposed rule – which ostensibly seeks to replace WAC 480-146-290 through 480-146-340 – far exceeds the Commission's jurisdiction and conflicts with state and federal law. In addition, the proposed rule would likely prove harmful to utilities and ratepayers without corresponding benefit.

1. WAC 480-120-365(2)

a) The five business day notice requirement is unlawful, impractical and potentially very harmful to utilities.

17 Whereas subsection (1) relaxes filing requirements for carriers with an investment grade rating, subsection (2) imposes more onerous filing requirements for non-investment grade carriers as compared to the status quo. Non-investment grade carriers must file certain information (specified in subsection (2)(a)-(c)) five business days prior to issuance[7] and additional information (any time) prior to issuance. The additional filing requirements set out in subsection (2) violate state and federal law, jeopardize carrier's ability to obtain financing on the most reasonable terms possible and serve no purpose justifying the potential harm to carriers.

(1) The five business day notice requirement violates state law.

18 The legislature did not empower the Commission to require notice five business days before a securities issuance. Instead, the legislature imposed the following requirement on public service companies.[8]

---

[6] The proposed rule does not explicitly contemplate how public service companies who are not rated by Standard & Poor's or Moody's are to report securities issuances.

[7] As a matter of law, a negotiable instrument such as a promissory note is "issued" when it is executed (signed) by the maker (in this case, QC) and delivered for purposes of giving rights on the instrument to another person. *RCW 62A.3-105.* In other words, the issuance of the debt security occurs at the closing of the transaction, when funds are exchanged and the borrower executes and delivers the debt instrument to the lender. As such, the proposed rule would require notification to the Commission five business days before closing.

[8] RCW 80.08.040.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

> Any public service company that undertakes to issue stocks, stock certificates, other evidence of interest or ownership, bonds, notes, or other evidences of indebtedness ***shall file with the commission before such issuance:***
>
> (1) A description of the purposes for which the issuance is made, including a certification by an officer authorized to do so that the proceeds from any such financing is for one or more of the purposes allowed by this chapter;
>
> (2) A description of the proposed issuance including the terms of financing; and
>
> (3) A statement as to why the transaction is in the public interest.

19 Subsection (2) of the proposed rule seeks to alter and add to this legislative requirement by requiring public service companies to provide such information *five business days* prior to issuance.

20 This proposal violates state law. The Commission is only permitted to promulgate rules when the legislature has explicitly authorized the Commission to do so.[9] Nowhere in Chapter 80.08, RCW, did the legislature authorize the Commission to expand on the statutory filing requirements and curtail public service companies' rights. The only securities-related rulemaking authority granted to the Commission by the legislature is found in RCW 80.08.090, which empowers the Commission to "establish such rules and regulations as it may deem reasonable and necessary to insure the disposition of such proceeds for the purpose or purposes specified *in its order*." The order referenced in that section relates to an order that may (but need not) be sought by a public service company under RCW 80.08.040(4). The legislature did

[9] The Administrative Procedures Act provides that a rule is invalid if it exceeds the statutory authority of the agency. *RCW 34.05.570(2)(c).* Appellate courts in Washington have explained repeatedly that administrative agencies are creatures of the legislature without inherent or common-law powers, and that they may exercise only those powers conferred on them either expressly or by necessary implication. *See, e.g., WITA v. TRACER, 75 Wash. App. 356, 363, 880 P.2d 50 (1994).* In that case, the Court of Appeals explained that, if an enabling statute does not authorize either expressly or by necessary implication a particular regulation, that regulation must be declared invalid despite its practical necessity or appropriateness. *Id.*

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

not grant the Commission rulemaking authority except in that specific context. Given that the proposed rule does not relate only to securities issuances in which the utility has requested such an order, the proposed rule unlawfully exceeds the scope of the Commission's rulemaking authority.

(2) The five business day notice requirement violates federal law insofar as it constitutes an attempt to regulate interstate commerce.

21 As will be discussed in greater detail in section II.E.1. below, this Commission is not empowered to regulate the cash management of multiple-state corporations such as QC. QC utilizes a centralized cash management structure for all of its 14-state operations. Any interference by the Commission with its ability to raise or transfer funds would constitute an unlawful attempt to regulate interstate commerce, in violation of the United States Constitution. See section II.E.1. below.

(3) The five business day notice requirement may violate federal securities law.

22 The five day notice requirement may also run afoul of federal law in that it would present securities law concerns in connection with public and private offerings that may be undertaken by QC. In a public offering, it is generally illegal for companies to make any written offers of securities other than through a prospectus that complies with the requirements of the securities laws.[10] It is very possible that the SEC could take the position that the notice being provided to the Commission under the proposed rule constitutes a written offer, especially if the notice is published or is obtainable by the public.[11] Also, with respect to private offerings, it is possible that the SEC could take the position that the notice is a public solicitation, which is impermissible in a private offering.[12]

---

[10] Section 5 of the Securities Act of 1933 (the "1933 Act").

[11] In re Carl M. Loeb, Rhoads & Co., 38 S.E.C. 843 (1959).

[12] Rule 502(c) under the 1933 Act.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

23 As QC explained in its August 25, 2004 supplemental comments, QC does not contend that this is a crystal clear, black-and-white legal issue. Federal law does not squarely resolve whether pre-filing with the Commission under proposed WAC 480-120-365(2) violates the securities laws referenced herein, although we believe that it is clear that there are no express exemptions available for compliance with state law requirements.

24 In QC's view, there are three securities law legal principles implicated by the Commission's proposed securities issuance rule. They are: "gun jumping" (registered offerings); public solicitation (Private Offerings; e.g., 144A); and insider Trading and Regulation FD (all offerings). Each will be discussed in turn below.

(a) Gun Jumping

25 "Gun jumping" is the term commonly used to refer to the act of making a premature or otherwise improper offer to sell securities in an offering that is registered with the SEC. The legal source for this restriction is Section 5 of the Securities Act of 1933 (the "*1933 Act*"), which generally makes it illegal for companies to make any written offers of securities other than through a prospectus that complies with the requirements of the securities laws.[13]

26 The SEC interprets "offers" in the broadest sense. For example, in *Carl M. Loeb, Rhoads & Co., 38 S.E.C. 843 (1959)*, the SEC held that use of a press release relating to an offering was a violation of Section 5 because it was deemed too promotional. Also, in October 1999 the SEC delayed the initial public offering of a company named Webvan Group Inc. due in part to the amount of media attention the SEC felt the company was soliciting.[14]

27 QC believes it is very possible that the SEC could take the position that the notice being

[13] Section 5 of the 1933 Act.

[14] Carrie Lee, *Heard on the Net: Webvan IPO Stirs Up Noise, But Investors Have To Wait*, Wall St. J. Interactive Ed., Oct. 7, 1999.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

provided to the Commission under the draft securities issuance rule constitutes a written offer, especially if the notice is published or is obtainable by the public and receives significant media attention. In that event, QC could in theory be subject to exposure from a violation of Section 5, as there is no exemption available for disclosures made pursuant to state statute or rule. The SEC could force a delay of the offering or bring an action against QC, and purchasers in the offering might also have actionable claims against QC.

(b) Public Solicitation

28 Rule 144A offerings are private offerings that are not registered with the SEC, thereby allowing for greater flexibility in timing and structure of the transaction. They are made possible by reliance on an exemption from the registration requirements of Section 5 of the 1933 Act that that relates to securities transactions "not involving any public offering."[15] To ensure compliance with this exemption, a company must be careful not to engage in public solicitation that would cause a transaction to be deemed a public offering.[16] If it is deemed to engage in public solicitation, it may not be able to rely on the private offering exemption from the registration requirements of Section 5, resulting in a violation of that statute.

29 Public solicitation can be deemed to occur as a result of almost any type of public statement about a transaction that exceeds strict parameters provided by the SEC in Rule 135(c) under the 1933 Act. This safe harbor rule provides that a company will not be deemed to have engaged in public solicitation if any notice it provides of the transaction contains only certain limited information, such as the name of the company and the title, amount, timing, purpose and basic terms of the offering. Rule 135(c) provides no allowance for disclosures made pursuant to a state statute or rule.

---

[15] Section 4(2) of the 1933 Act

[16] Rule 502(c) under the 1933 Act.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

30 If the Commission's rules are ever interpreted to require more than the limited information provided for in Rule 135(c), Qwest could no longer rely on the protection of the safe harbor rule and would again be exposed to claims from investors or the SEC for a violation of Section 5. This risk is only increased with any publicity of the offering that results from the Commission's inquiry.

(c) Insider Trading and Regulation FD

31 As the Commission may be aware, advance notice of a securities issuance will in most cases constitute material, non-public information, and trading while in possession of such information is generally prohibited by Rule 10b-5 under the Securities Exchange Act of 1934. If QC is able to file the requisite information on a confidential or highly confidential basis, all those at the Commission with access to this information will become insiders under Rule 10b-5. In such a case, QC would require the Commission's cooperation in maintaining the confidentiality of the information. QC would also require the Commission's assistance in prohibiting all those with access to it from trading in Qwest securities until the information is made public at the time of the transaction or from communicating such information to others to avoid making those other persons insiders.

32 If the information is not held confidential, then QC would be compelled to file a press release or make an SEC filing to release the information publicly in order to ensure compliance with the requirements of Regulation FD, which requires that material inside information be disclosed to all investors concurrently.[17] This public release would only exacerbate the practical concerns discussed below surrounding the impact that premature public disclosure of an offering could have on the success of such offering.

33 QC is extremely cautious about maintaining compliance with federal securities laws. As a

[17] Rules 100-103 under Regulation FD.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

result, even a potentially remote risk of breaching these laws is cause for real concern given the scrutiny QC is under. The lack of a black-and-white standard or prohibition only complicates mattes, as QC will never quite know what position the SEC may take. QC does not believe there can be any presumption that the SEC or the courts will defer to the Commission's rulemaking in a question of conflicting requirements that QC may face. As noted above, there is no exemption in the securities laws for compliance with state authorities. In fact, state laws that have the effect of regulating the types of securities transactions discussed herein are expressly preempted by the federal securities laws.[18]

34 In light of the above concerns, we believe that adoption of proposed WAC 480-120-365 in the form currently contemplated could place QC in the difficult situation of determining in future securities offerings whether it could safely comply with the Commission's requirements.

(4) The five business day notice requirement would create extreme practical problems for QC and similarly-situated companies.

35 Five business days notice would be extremely impractical and would severely constrain QC's financial flexibility. Even having to publicly report the higher level information required under proposed subsection (2)(a)-(c) (e.g., that QC intends to raise approximately $250 million through the issuance of bonds in order to fund network investment) will likely have a costly practical impact on QC and the terms it ultimately obtains for the bonds. In fact, it is quite conceivable that such premature disclosure could compromise such transactions altogether. This impact will affect so-called "T+3" transaction. A T+3 transaction is one in which closing occurs three business days after the transaction is priced and sized in the market. T+3 transactions are the industry standard.[19] The proposed rule makes extremely risky, if not impossible, T+3 transactions.

---

[18] Section 102 of the National Securities Market Act of 1996.

[19] T+3 transactions are the industry standard for private debt offerings. However, for public securities transactions, SEC rules *require* transactions to close on a T+3 or shorter basis. *Rule 15c6-1 of the Securities Exchange Act of 1934.*

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

36 To add more detail to this concern, requiring QC to disclose even *the existence of* a proposed T+3 equity or bond transaction five business days before closing would offer speculators, hedge funds, and other market participants the opportunity to arbitrage positions at the expense of QC. Such tactics would involve or result in the price of such bonds being sold off. The resulting change in the bond prices could easily make the deal uneconomical for QC and completely undermine the contemplated transaction. Interfering with the normal course of business of a publicly traded company affects pricing and the flexibility to refinance debt, adding unnecessary risk and cost to the transaction.

37 A very real example of this concern occurred in a recent private securities transaction, when a rumor was leaked into the market (apparently from an investment banking firm) that a debt offering was going to be announced in the next few days. The rumor did not involve any greater detail than that a debt offering was pending; neither the amount nor the estimated terms of the transaction was leaked. In fact, the information leaked in this example was less information than would be required to be filed under proposed WAC 480-120-365(2)(a)-(c). As a result of this very general leak, the spreads on the existing bonds (which are traded in the market) on the day of the leak widened by 19 to 23 basis points, as hedge funds and speculators began taking positions on the basis of the anticipated announcement. The widening of this spread affects the final pricing of the offered bonds, causing the interest rate on the bonds to be higher than anticipated. Based on a hypothetical 20 basis point increase in interest rate on a $1 billion, ten year issuance, the additional interest expense would be $20 million. This obviously is not in the best interest of the company or its ratepayers, as it greatly increases the cost of refinancing and raising capital.

38 Similarly, investment banks that arrange equity and bond transactions and counterparties on private placement deals would very likely react negatively to early disclosure requirements. Some banks would potentially refuse to work under such conditions. This would result in

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

QC's inability to complete some types of financial transactions and higher costs for transactions that QC is able to complete.

39 These precise practical problems were discussed in detail in the September 2004 comments of experts James J. Clark (of Cahill Gordon & Reindel LLP), David J. Johnson, Jr. (of O'Melveny & Myers LLP), Michele C. David (of the Bond Market Association) and George Kramer (of the Securities Industry Association). To ensure that the Commission considers these expert opinions, QC has appended these September 2004 comments hereto as Exhibits A, B and C.

40 The addition of the investment grade/non-investment grade dichotomy in proposed WAC 480-120-365 does not mitigate these practical concerns. In fact, the result of the regulatory dichotomy is to *only* subject those who will be most adversely impacted by early disclosure to the early filing requirements.[20] As discussed above, issuers who announce new financings frequently see their existing securities "sell off" during the period between announcement and pricing, which has the effect of increasing the cost of issuing new securities because the pricing of the new issued securities are referenced to the market pricing of the existing securities. Accordingly, the depth of the investment grade versus non-investment grade market would also have an impact. The pricing of non-investment grade securities is generally more sensitive to market conditions than the pricing of securities issued by investment grade companies. The investment grade market numbers in the trillions, while the non-investment grade market is in the billions.[21] The impact of a five business day notice to a non-investment grade company that is issuing in a market that is one fourth the size of investment grade could result in a much

[20] During a December 1, 2004 conference call to discuss the investment grade/non-investment grade distinction, Commission Staff informed QC that QC is the only public service company in Washington that has a non-investment-grade debt rating. Thus, QC would be the only utility in Washington with pre-issuance filing requirements under this new regulatory framework.

[21] By way of illustration, although a precise quantification is difficult to pinpoint given the dynamic nature of the markets, the Bond Market Association estimates the size of the investment grade market to be $3.725 trillion, whereas (according to Goldman Sachs) the non-investment (high yield) market is approximately $875 billion. Thus, the investment grade market is approximately 4.25 times larger.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

larger impact on pricing and market manipulation.

(5) The onerous five business day notice requirement would serve no reasonable purpose justifying the burden.

41 The five business day notice requirement is even less palatable because the filing will serve no reasonable purpose. The legislature did not give the Commission any authority to prevent, condition or delay securities issuances. And, in fact, the Commission's proposed rule asserts no such authority. Thus, at first blush, there does not appear to be any purpose for this requirement.

42 After informal discussions with Staff and individual meetings with the Commissioners during 2004, QC understands that the motivation behind the five business day reporting requirement is to provide the Commission adequate time to gather some salient facts relative to an impending securities issuance. If warranted, the Commission might confer with the public service company about the issuance, conduct a public meeting to express its concerns and to warn the company of potential rate case consequences for issuing the securities or, potentially, bring suit against the company to restrain the issuance.

43 As an initial matter, QC believes it is unreasonable to believe that any meaningful due process could occur in the five business days between notice and issuance. Furthermore, these purposes are entirely frustrated by the revisions made to the draft rule in early 2004. Earlier drafts of the rule required utilities to provide all terms of financing five business days in advance of issuance. Perhaps recognizing that such a task is impossible (see section II.D.1.b) below), the Commission revised its proposal to require more general information five business days in advance of issuance. Reading the proposed rule as currently drafted, QC could comply with its obligation by (for example) stating generally that it intends to raise approximately $250 million to $500 million in bonds at an interest rate of between 7% and 7.5% in order to fund

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

network investment – and also stating that this is a permissible purpose under RCW 80.08.030 and that the upgrading of QC's facilities is in the public interest in order to continue to provide high quality service to Washington ratepayers. While this information will likely be crippling to QC's financing efforts (for the reasons discussed above), it will provide nothing nearly specific enough from which the Commission can evaluate the propriety of the transaction and its terms. In addition, the Commission's desire to potentially air out the issue publicly prior to issuance is complicated by the insider trading restrictions discussed above. In the final analysis, there is simply no way to conclude that the benefits of the notice justify the high cost to the utility and its ratepayers in this scenario.

b) **The requirement to file actual terms of financing before issuance imposes an unnecessary and impossible burden.**

44 Proposed WAC 480-120-365 contemplates a three-tiered reporting scheme for non-investment grade carriers. Five business days before issuance, the carrier would file a description of the purposes of the issuance (including an officer's certification), a description of the issuance, *including the estimated terms of financing* and a statement as to why the transaction is in the public interest. *Proposed WAC 480-120-365(2).* At any time before issuance, the company is required to file *the terms of financing. Id.* And within sixty days after issuance, the company must file a verified statement outlining the *final terms and conditions of the transaction* and setting forth the actual proceeds from the issuance and a description of their use. *Proposed WAC 480-120-365(7).*

45 Without waiving its strenuous objections to any filing requirements five business days in advance of issuance, QC urges that the second step in this process be eliminated. No company can file or describe the final terms of issuance *prior to* the actual issuance. Until the securities are issued, for example, the precise amount of the issuance can not be ascertained. Under proposed subsection (7), the Commission will be informed of the actual final terms and

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

conditions of the issuance within sixty days after the issuance. This renders the task of identifying the actual terms of the financing before the financing transactions closing as unnecessary as it is impossible to comply with. The Commission should delete the second step from the proposed rule.

2. WAC 480-120-365(4)

46 Proposed subsection (4) creates an exemption of sorts for the filing of a Registration Statement with the SEC using a shelf registration process. QC recognizes that this proposal is a codification of the Commission's Interpretive Statement in Docket No. A-020334. While this exemption is appropriate and acknowledges the fact that the filing of a shelf registration statement does not in itself constitute a securities issuance, QC believes the rule should go further in accommodating for the nature of offerings made pursuant to shelf registration statements.

47 Rule 415 under the Securities Act of 1933 provides that securities may be registered for an offering to be made on a continuous or delayed basis in the future. This means that a filing can be made to register a dollar amount of securities that are issued at later dates without the need for further action by the SEC. For example, in 1994 and 1995, QC's predecessor maintained shelf programs for debt securities. From time to time, it would price a transaction (i.e., enter into an agreement to sell a portion of the registered securities to the underwriters on specified pricing terms) and file a prospectus supplement with the SEC. Public trading in the new securities would normally begin as soon as the markets opened after pricing. The transaction would then close a few days later, at which point QC would deliver the securities to the underwriters and the underwriters would deliver the purchase price to QC. This is a standard process for issuing securities on a delayed basis under a shelf registration program.[22]

[22] See "Corporate Finance and the Securities Laws, Second edition." Charles J. Johnson, Jr. and Joseph McLaughlin. Chapter 8: Shelf Registrations—Rule 415.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

48 Due to the fact that additional SEC intervention is not required once a shelf registration statement has been declared effective, transactions can be (and normally are) "taken down off the shelf" and priced relatively quickly to take advantage of a market window, sometimes on only one or two day's notice. As such, a company itself may not know whether a transaction will actually take place until the day of pricing. Because the pricing stage may occur fewer than five business days before issuance, the requirement that companies provide five business days notice to the Commission is impractical (if not impossible) and would cause harm to QC by removing the flexibility to take advantage of favorable conditions that may exist during only a temporary window of opportunity. While QC does not currently maintain shelf registration statements, it may do so again in the future. In addition, it could also wish to establish other types of delayed offering programs, such as medium-term-notes programs or commercial paper programs. These can also involve rapid access to the capital markets when it is advantageous to an issuer. In summary, the five business day advance notice requirement simply does not reflect the realities of the capital markets and will unnecessarily limit QC's financing options.

3. WAC 480-120-365(6)

49 QC is also concerned about the impact of new proposed subsection (6). That subsection provides that securities filings "may be submitted with portions designated confidential pursuant to WAC 480-07-160 (Confidential information)." QC appreciates the motivation behind this provision – which appears to be a direct response to QC's oft-repeated concerns about the practical impact of public disclosure. However, QC believes that this provision does not go far enough. It does not, for instance, assure utilities that *the existence* of the filing itself will be held strictly confidential. *Any* premature public disclosure of an impending QC financing transaction would adversely impact QC's financing efforts and costs of capital. This point has not been disputed by any participant in this rulemaking. The mere identification of a securities filing by QC could cause this irreparable and absolutely-avoidable harm.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

50 In addition, the proposed rule offers no assurance that, even if QC designates the entire notice as confidential, that confidentiality will be guaranteed by the Commission. As discussed above, during the progression of this rulemaking, QC has inquired of the Commission as to what it envisions that it might do should it find itself in strong disagreement with QC's impending transaction. The Commission indicated that it *may* (among other steps) take legal action if it believes such is appropriate and permissible under the circumstances. Obviously, formal legal action initiated by the Commission would shatter confidentiality and would demonstrably and adversely impact QC's financing activities.

E. WAC 480-120-369

51 Proposed WAC 480-120-369 imposes on non-investment grade companies alone an obligation to report to the Commission certain inter-company cash transfers. It also requires reporting when a non-investment grade company assumes the obligation or liability of any affiliate or subsidiary. All notices required under this section must occur five business days prior to the reportable event. QC objects to this proposed rule and urges the Commission to remove it.

1. The proposed reporting requirements are unlawful under state and federal law.

52 This proposed rule far exceeds the Commission's statutory authority. Whereas the legislature required pre-filing for securities issuances (RCW 80.08) and affiliated interest transactions (RCW 80.16) and pre-approval for transfers of property (RCW 80.12), the legislature did not impose (or authorize the Commission to impose) pre-filing requirements for cash transfers. Lacking such authority, the proposed rule is simply *ultra vires.*

53 To the extent that such authority is claimed to exist under the affiliated interest statute (RCW 80.16), this proposed rule goes well beyond that statute's purview for a number of reasons. First, it seeks to regulate cash transfers, which have never been considered to constitute

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

affiliated interest transactions in the past, and do not fit within the definition of such transactions under RCW 80.16.020.

54 Second, the proposed rule seeks to capture transfers between utilities and their subsidiaries despite the fact that RCW 80.16.010 does not cover transactions between public service companies and their subsidiaries.[23]

55 Third, even more removed from any statutory authority is the language of proposed subsection (1) that requires filing notice of cash transfers made between a public service company's subsidiary and the subsidiary's affiliates or subsidiaries. Thus, the proposed rule would impose onerous filing requirements even in situations in which the public service company (the only company over which this Commission has jurisdiction) has no involvement in the cash transfer.

56 Fourth, the rule would appear to capture some dividending of cash from a public service company to its parent.[24] This activity has never required Commission notification, and the statutes provide no support for imposition of such a requirement by the Commission. Absent express authority, commissions may not set conditions on dividends.[25] Corporate management must be able to retain its prerogative to design a dividend policy that is responsive to changes in circumstances. Without such management flexibility, corporations would be limited in their ability to raise capital, and would be unable to satisfy their obligations to shareholders.[26]

---

[23] That a subsidiary is not an affiliate under the public utilities statutes is confirmed by the proposed definitions changes in proposed WAC 480-120-325. That section proposes to define affiliates and subsidiaries separately and does not include subsidiaries within the definition of an affiliate.

[24] Proposed WAC 480-120-369(2)(d) excludes from reporting dividends only to the extent the level of dividends has not exceeded certain specified thresholds in the prior twelve months.

[25] *See Utah Power & Light Co. v. Public Service Commission,* 107 Utah 155, 152 P.2d 542 (1944) (commission has no plenary authority to govern dividends).

[26] *See Federal Power Commission v. Hope Natural Gas Compan*y, 320 U.S. 591, 605 (1942) (commissions must "enable the company to operate successfully, to maintain its financial integrity, to attract capital, and to compensate its investors for the risks assumed.").

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

Where commissions are allowed to interfere with a company's dividend policy, it has been under the express statutory authority and only for limited purposes.[27] If the legislature had intended the Commission to have authority in this area, it would have made a specific grant of such authority. However, it has not done so, perhaps recognizing that dividends are a matter that must be left to the company's business judgment and discretion.

57 Fifth, the rule appears to be an attempt to permit the Commission to engage in regulating the multi-state cash management of utilities and their affiliates and subsidiaries. Such interference is not permitted. QC financially manages its entire 14 state operation centrally. Any intrusion on QC's cash management will invariably impact cash management and cash disbursements for operations outside of Washington. Any attempt by the Commission to regulate multi-state cash management activities of QC and its family of companies would violate Title 80 RCW[28] and the commerce clause of the United States Constitution.[29] In its recent Vonage order, the FCC summarized federal precedent on the commerce clause and utilized that precedent as a basis for determining that states are preempted from applying traditional "telephone company" regulations to VoIP technology.[30] In summary, the FCC stated:[31]

---

[27] *See Ohio Central Telephone Corp. v. Public Utilities Commission of Ohio,* 189 N.E. 650, 127 Ohio St. 556 (1934) (commission has statutory authority to prohibit dividends only where payments will cause deterioration of properties and impairment of services).

[28] RCW 80.01.040 (General powers and duties of commission) empowers the Commission to regulate in the public interest, ***as provided by the public service laws***, the rates, services, facilities, and practices of all persons engaging ***within this state*** in the business of supplying utility service. *RCW 80.01.040(3).*

[29] The commerce clause grants Congress the power to regulate interstate commerce. *FERC v. Mississippi*, 456 U.S. 742, 102 S. Ct. 2126 (1982). The courts have long recognized that the commerce clause correspondingly imposes limits on the powers of the states to regulate interstate commerce. *South-Central Timber Development v. Wunnicke*, 467 U.S. 82, 104 S. Ct. 2237 (1984). That principle, commonly referred to as the dormant or negative commerce clause, "grew out of the notion that the Constitution implicitly established a national free market" from which private trade would be free from state interference. *Wyoming v. Oklahoma*, 502 U.S. 437, 469, 112 S. Ct. 789 (1992). Although incidental burdens on interstate commerce are allowable where the state's interest is of legitimate local concern, the state violates the commerce clause where "the burden imposed on [interstate] commerce is clearly excessive in relation to the putative local benefits." *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142, 90 S. Ct. 844 (1970) (setting out the "undue burden" test).

[30] *In the Matter of Vonage Holding Corporation Petition for Declaratory Ruling Concerning an Order of the Minnesota Public Utilities Commission, WC Docket No. 03-211, Memorandum Opinion and Order (rel. Nov. 12, 2004), ¶¶ 1, 38-41.*

[31] *Id., ¶38.*

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

> We note that our decision today is fully consistent with the Commerce Clause of the United States Constitution. The Commerce Clause provides that "[t]he Congress shall have Power … [t]o regulate Commerce … among the several States." As explained by the Supreme Court, "[t]hough phrased as a grant of regulatory power to Congress, the Clause has long been understood to have a 'negative' aspect that denies the States the power unjustifiably to discriminate against or burden the interstate flow of articles of commerce." Under the Commerce Clause jurisprudence, a state law that "has the 'practical effect' of regulating commerce occurring wholly outside that [s]tate's borders" is a violation of the Commerce Clause. In addition, state regulation violates the Commerce Clause if the burdens imposed on interstate commerce by state regulation would be "clearly excessive in relation to the putative local benefits." Finally, courts have held that "state regulation of those aspects of commerce that by their unique nature demand cohesive national treatment is offensive to the Commerce Clause." (citations omitted)

58 Further, commissions and courts throughout the nation have repeatedly concluded that public service commissions may not interfere with a regulated utility's management prerogatives. When imposing requirements upon utilities, the Commission must be mindful that management of the public service company belongs to the company.[32] The Commission is not a "super board of directors" for the company, nor is it a local securities and exchange commission.[33] Indeed, the U.S. Supreme Court has cautioned that "it must never be forgotten that while the state may regulate with a view to enforcing reasonable rates and charges, it is not the owner of the property of public utility companies, and it is not clothed with the general power of management incident to ownership."[34] Consequently, the Commission lacks the authority to impose its own judgments on QC's cash management, and when the Commission's actions are in excess of statutory standards, its actions are unlawful, arbitrary and capricious.[35]

---

[32] *See, e.g., Public Service Co v. Public Utilities Comm'n*, 653 P.2d 1117, 1123 (Colo. 1982).

[33] *Northern Pennsylvania Power Co. v. Pennsylvania Public Utility Commission*, 333 Pa. 265, 267, 5 A.2d 133 (1939)

[34] *Southwestern Bell Tel. Co. v. Public Serv. Comm'n.*, 262 U.S. 276, 289, 43 S. Ct. 544, 67 L.Ed. 981 (1923).

[35] RCW 34.05.570(3), (4)(c).

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

59 It would be equally off base to believe that the Commission has the authority to promulgate this rule based on RCW 80.04.080 ("Annual Reports"). That statute, which is very long, provides in its concluding sentence as follows:

> ….The commission shall have authority to require any public service company to file monthly reports of earnings and expenses, and to file periodical or special, or both periodical and special, reports ***concerning any matter about which the commission is authorized or required by this or any other law, to inquire into or keep itself informed about, or which it is required to enforce***, such periodical or special reports to be under oath whenever the commission so requires. (emphasis added)

60 With all due respect, this statute does not provide the Commission unfettered discretion to require periodical and/or special reports. The statute specifically limits the scope of such reports to matters about which the Commission is authorized or required by statute to inquire into or keep itself informed about, or laws that it is required to enforce. Neither that statute nor any other statute authorizes or requires the Commission to inquire into or keep itself informed about the cash transfers covered by the proposed rule. The affiliated interest statute does not reach cash transfers. The only somewhat-related requirements are found earlier in RCW 80.04.080 itself, which requires utilities on an annual basis to specify in a written report amounts paid for capital stock and dividends paid. This does not provide a basis for proposed WAC 480-120-369, however, because the proposed rule is far broader in scope, and in fact seeks to exclude most dividends from reporting under subsection (2)(d). As such, RCW 80.04.080 simply does not provide a legal basis for imposition of a cash transfer reporting regime.

2. The proposed reporting requirements will impose impractical burdens without corresponding benefit.

61 In addition to being unlawful, the proposed cash transfer rule remains impractical from an operational perspective. In many cases, Qwest's centralized cash management team does not

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

know the precise amount of inter-company cash transfers five business days in advance. This proposed rule will, thus, unnecessarily impede Qwest's ability to prudently and nimbly manage its cash and its multi-state operations. QC acknowledges the addition of exclusions for some dividends and for cash management and sweep accounting. QC recommends that the dividend exclusion should not be limited, however.

62 Two other practical considerations must be discussed. First, the five business day advance filing requirement is onerous and unreasonable, as it serves no purpose other than to create potential penalty liability for the utility which will be unable to comply with such a requirement.

63 Furthermore, the list of exclusions set out in subsection (2) is somewhat vague. While it is clear that some dividends (for example) need not be reported under subsection (1), it is unclear whether dividend payments from a utility to its parent are counted against the five percent cumulative trigger set out in subsection (1)(a). As noted repeatedly above, vague regulations are, as a matter of law, void and unenforceable.

64 Finally, QC will repeat its concern that this rule, with all its onerous requirements and potential for confusion, serves no beneficial purpose. The Commission has and the proposed rule claims no power to prevent or restrict inter-company cash transfers. As such, it is unclear why this rule is needed at all, and why reporting is critical *five business days before* a cash transfer that cannot be interrupted. The Commission should reject proposed WAC 480-120-369 in its entirety.[36]

[36] Without waiver of its strong opposition to the rule, QC offers one additional thought on a more minor point. If the Commission proceeds with adopting this proposed rule, QC believes that the end of the first sentence of subsection (1) should be changed from "as described in (a) *or* (b) of this subsection" to "as described in (a) *and* (b) of this subsection." As subsections (1)(a) and (b) must both be satisfied in order for a transfer to be reportable, the conjunctive "and" is more appropriate.

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

F. WAC 480-120-395

65 Proposed WAC 480-120-395 requires carriers subject to Chapter 80.16, RCW, to file an annual report summarizing transactions occurring between itself and its affiliates and itself and its subsidiaries.

66 This rule largely carries forward the annual affiliated interest reporting requirements of WAC 480-146-360, with at least one significant exception. The proposed rule seeks to require reporting of transactions between a public service company and its subsidiaries. Subsidiary regulation is not permitted under the affiliated interest statute, nor any other statute vesting the Commission with regulatory powers. That this rule was moved out from a standalone chapter implementing the affiliated interest statute (RCW 80.16) into a general industry chapter does not broaden the Commission's jurisdiction. Such a move is simply form over substance. Regardless of the name of the chapter in which the regulation resides, it is only lawful and enforceable if the legislature has granted the Commission authority. The Commission has no such authority over subsidiary transactions. QC urges the Commission to remove all references to subsidiaries and all subsidiary reporting requirements.

67 In addition, QC recommends that the Commission replace the $100,000 report threshold set out in subsection (3) with a percentage of gross revenues. This would be consistent with the analytical framework (see proposed WAC 480-120-369(1)) by replacing the fixed dollar threshold with a percentage of gross revenues. Obviously, $100,000 may be an extremely large dollar level for some small carriers, while it may represent an unreasonably low threshold for other, larger carriers. QC suggests that it would be reasonable to set the reporting threshold at 2% of the utility's prior year's revenues.

III. CONCLUSION

68 QC has participated diligently in this process, and appreciates the Commission's consideration

Qwest
1600 7th Ave., Suite 3206
Seattle, WA 98191
Telephone: (206) 398-2500
Facsimile: (206) 343-4040

of its comments. QC acknowledges that the Commission has an interest in monitoring the financial activities of the companies it regulates. QC urges the Commission, however, to be mindful of the legal and practical limitations on its authority and on the ability of this state's utilities to comply with onerous reporting requirements.

RESPECTFULLY SUBMITTED this 19th day of January, 2005.

QWEST

____

Lisa Anderl, WSBA # 13236
Adam Sherr, WSBA # 25291
Qwest
1600 7th Avenue, Room 3206
Seattle, WA 98191
Phone: (206) 398-2500
Attorneys for Qwest