

Agenda Date: September 25, 2008
Item Number: A3

Docket: UT-081501
Company Name: Qwest Corporation

Staff: Betty Erdahl, Regulatory Analyst – Telecommunications

Recommendation

Approve the sale of Qwest Corporation's (Qwest's) headquarters building and the land located at 1600 – 7th Avenue, Seattle, Washington, subject to conditions agreed to by Qwest. These conditions are as follows: Direct \$12.97 million of the sale proceeds to the benefit of Washington customers in the form of (1) a \$10.32 million investment in fiber-to-the-node (FTTN) and a \$2.45 million investment in digital subscriber line (DSL), both within three years of the closing of the sale; and (2) make a \$200,000 contribution to Community Voice Mail within one month of the closing of the sale. Attachment A to this memo provides a summary of communities that will receive FTTN or DSL as a result of Qwest's commitments.

Discussion

On August 13, 2008, Qwest filed an application with the commission pursuant to RCW 80.12 and WAC 480-143 requesting an order approving the sale of the land and building located at 1600 – 7th Avenue, Seattle Washington to INGCAL 7th AVENUE LLC. Qwest filed an amendment to the agreement on September 12, 2008. The company's September 16, 2008, letter confirms that this newly-submitted amendment does not make any material changes to the underlying purchase and sale agreement that the parties considered in reaching their earlier agreement on the issues.

Under RCW 80.12.020 and WAC 480-143-120, a public service company must secure commission approval prior to completing the sale of a property necessary or useful in the performance of its duties to the public. WAC 480-143-120 requires that applications include details of the sale as well as the company's current financial statement and copies of all transfer instruments. WAC 480-143-170 requires that the transaction be in the public interest and that, if it is not, the commission shall deny the application.¹

Qwest's application is complete, as it contains the documentation required by WAC 480-143-120. This documentation is a detailed explanation of the sale, the company's current financial statement, a signed purchase and sales agreement, a lease-back agreement and a copy of the proposed journal entries. The application also includes a detailed discussion of commitments that Qwest has made in order to ensure that the transfer is consistent with the public interest.

The office building that Qwest seeks approval to transfer has been owned and occupied by Qwest since 1976 and has been used by Qwest in providing telecommunications service in

¹ Although Qwest is currently under an Alternative Form of Regulation (AFOR) which limits the applicability of RCW 80.12 to transactions exceeding \$15,600,000 (*see* Order 06, ¶ 50, Docket UT-061625), the value of this transaction is greater than \$15,600,000, therefore, RCW 80.12.020 and associated commission rules are applicable.

Washington, as well as other states. The building has 32 floors; however, as Qwest's Washington work force has been reduced, Qwest's need for space has substantially diminished. Thus, Qwest put the property up for sale and has entered into a sales agreement with the buyer for an amount of money specified in Qwest's confidentially filed Reinstatement of and Second Amendment to Agreement for Sale and Purchase of Real Property. Following the transfer, Qwest will lease back from the new owner the space necessary to continue providing service to the public.

Because of Qwest's need to obtain a finding from the commission that the transaction is in the public interest, representatives of Qwest, commission staff (staff), the office of Public Counsel of the Attorney General's Office (PC), and the Department of Defense and all other Federal Executive Agencies (DOD/FEA) held extensive discussions prior to Qwest's filing its application on August 13, 2008.² These discussions focused on two central public interest requirements: (1) the amount of the sale proceeds that Qwest should share with Washington customers, and (2) the manner in which this gain on sale should be distributed back to customers.

Share of Gain on Sale

Staff and PC argued that because the property being sold had been in Qwest's rate base for almost 32 years prior to the recent implementation of the Alternative Form of Regulation (AFOR),³ Washington customers have, in part, paid for these assets through rates that Qwest charged while the company was under rate base, rate of return regulation. Therefore, in order for the sale to be in the public interest, directing a portion of the gain on sale (i.e., the appreciation of the building above net book value) back to Washington customers is justified based on the equitable sharing principles of *Democratic Central Committee v. Washington Metropolitan Transit Comm'n*.⁴

² Qwest filed an application for approval of the same transaction on May 28, 2008. The filing was assigned docket number UT-080923. Qwest withdrew that application while settlement discussions were ongoing with the parties that expressed an interest in that filing, i.e., staff, Public Counsel and the Department of Defense and all other Federal Executive Agencies.

³ See Order 06, Order Accepting Settlement and Approving Alternative Form of Regulation, on Conditions, Docket UT-061625 (July 24, 2007).

⁴ 458 F. 2d 786 (D.C. Cir. 1973), *reh den, cert den*, 415 US 935 (1973); As this commission stated in its Second Supplemental Order, Order Approving Sale with Conditions (Centralia Coal), at ¶ 48, Docket Nos. UE-991255, UE-991262, UE-991409 (March 2000):

A number of Commissions have applied the equitable-sharing principles of *Democratic Central* to justify a sharing of gain. See, for example, *Power & Light Co. v. State Corp. Comm'n of Kansas*, 5 Kan. App. 514, 529, 620 P.2d 329 (1980) (where the court, on review, reversed the Kansas commission's decision granting 100% of the gain from sale of a utilities headquarters building, and instructed the commission on remand to take into account the equities due to both the ratepayers and stockholders); *In the Matter of the Application of Southern California Gas Company for Authority pursuant to Public Utilities Code Section 851 to sell and lease back its Headquarters Property in Los Angeles, California* Decision No. 90-11-031, Application No. 87-07-041, 118 P.U.R.4th 81 (where the California commission ordered a sharing between shareholders and ratepayers of the gain on the sale of a company's headquarters building);

As a way to “size” the amount of the proceeds that would be shared with Washington customers, staff employed the methodology the commission endorsed in Dockets UE-991255, et al. (Centralia Coal). In that case, the commission approved the sale of the Centralia coal-fired power plant by co-owners Avista, PacifiCorp and Puget Sound Energy (PSE), based on conditions designed to ensure the equitable sharing of the gain on sale.⁵ Without endorsing staff’s position or the use of the Centralia Coal methodology, Qwest, PC and DOD/FEA have agreed that sharing the proceeds with Washington customers in the amount of \$12.97 million, which is consistent with use of Centralia Coal’s methodology and is shown in Confidential Attachment B in Qwest’s application, is an amount of money sufficient to meet part of the public interest criteria. Negotiations then turned to how the proceeds would be used to benefit Washington customers.

Manner of Distribution

Qwest is in the first year of its four-year alternative form of regulation, and most of its services are no longer subject to tariff regulation. As such, Qwest is unlikely to have a rate case in the near term, if ever, in which to share the gain realized on the sale of its office building with Washington customers. An immediate distribution of the customers’ share of the gain is therefore necessary.⁶

The parties discussed various options regarding how the \$12.97 million should be distributed to Washington customers. These options included the reinstatement of free Directory Assistance (DA) usage, a monthly customer bill credit, a reduction in Qwest’s interim terminating access

Central Maine Power Company, Docket No. 99-155, Maine Public Utilities Commission, Public Utilities Reports Fourth, Slip Opinion, August 02, 1999 (where the Maine commission “ruled” that the ratepayers were entitled to recover the gains on the sale of right-of-way property, but then shared the gains 90/10 between ratepayers and shareholders). See also David W. Wirick, *State Public Service Commission Disposition of the Gain on Sale of Utility Assets*, National Regulatory Research Institute 94-17(1994).

⁵ In UT-991255, the commission used a methodology that calculated the amount of proceeds from a sale that would be directed back to customers. In general terms, this methodology assigns, net of taxes, the asset’s accumulated depreciation to customers, the asset’s net book value to the company and splits the asset’s appreciation evenly between customers and the company. Centralia Coal at ¶ 65. Regarding Qwest’s property sale, in order to arrive at the amount directed back to Washington customers, the sale price and other critical inputs were adjusted by a rent compensation factor and an interstate separations factor.

⁶ The commission in the Centralia Coal case provided that the return of the customers’ share of gain from the sale of Centralia facilities could be accomplished in then-ongoing rate proceedings for PacifiCorp and Avista. PSE could not accomplish the return of benefits so directly because PSE did not have an ongoing rate case before the commission and PSE could not file a request for a rate increase until the rate plan governing its rates concluded. The commission, therefore, found that approval of PSE’s sale should be conditioned on PSE’s deferral of the gain until its next general rate proceeding, with the deferral accruing interest to ensure that ratepayers receive the full value, including time value, of their share of the gain. Rather than use this deferral accounting approach, PSE agreed to an immediate pass-through of the customers’ share of gain. See Fifth Supp. Order, Order Granting Puget Sound Energy, Inc., Petition for Centralia Transaction Credit, at ¶¶ 27, 28, Docket UE-991409 (Aug. 2000).

charge (ITAC), and expansion of high speed internet services such as DSL or FTTN⁷ to communities that currently do not have these services.

Over the course of the discussions the parties considered expanding high speed internet services, either DSL or FTTN, to locations which did not currently have them and were not part of Qwest's expansion plans. In addition to the deployment of DSL and FTTN, Qwest agreed to provide a contribution to Community Voice Mail (CVM).⁸ These three elements when taken together are in the public interest because they provide long term benefits in a direct and timely manner to business and residential customers in rural or suburban locations where expansion of high speed internet service would either be slow or non-existent and are in addition to Qwest's current deployment plans.⁹ In addition, the contribution to CVM provides needed support to a program that assists members of our society who have the fewest resources and the least access to telecommunications services.

Other options were not included because the benefits were relatively small, short term, uneven or hardly recognizable to the majority of customers. A monthly bill credit was rejected because it would be relatively small and would only result in short term benefits. Reinstatement of the free DA call allowance was not pursued because the benefits would be small and recognized only to those who use DA when there are other available options over the Internet or with a telephone directory. Reducing Qwest's ITAC was not included because, while a reduction would reduce access costs for interexchange carriers, there is no guarantee that the reduction in access costs would be passed on to end users in the form of lower per minute rates.

Conclusion

Staff, PC and DOD/FEA believe that the commitment made by Qwest to return \$12.97 million to Washington via a combination of investments in advanced services and a contribution to CVM ensure that the sale of the land and building owned by Qwest at 1600 - 7th Ave, Seattle, Washington is in the public interest.¹⁰ These commitments are the result of negotiations between the parties that considered both Qwest's legacy rate-of-return obligations and the new circumstances presented by Qwest's AFOR. In its AFOR order, the commission recognized that Qwest faces a changed telecommunications market and that rate of return regulation could be

⁷ FTTN provides high speed internet service at speeds between 1.5 Mbps and 20 Mbps; whereas DSL provides service speeds that typically range from 256 kbps to 1.5 Mbps.

⁸ Community Voice Mail is a program that provides voicemail service to those who are homeless and without the ability to have voicemail service that allows them to receive messages from social service organizations, employers, family members or others.

⁹ See Certification attached in Qwest Application submitted by Robert W. Greenwood, Qwest VP of Network Operations and Engineering.

¹⁰ Both PC and DOD/FEA have filed letters in this docket indicating they believe that the public interest requirement of WAC 480-123-170 has been met by the commitments Qwest has made in its application.

replaced, at least for a trial period, by an AFOR that balances the interests of the company and its customers.

Staff believes that Qwest's commitment reflects these considerations and recommends that the commission approve Qwest's application for the transfer and sale of the property located at 1600 – 7th Avenue, Seattle, Washington.

Attachment