BEFORE THE
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

In the Matter of the Application of: QWEST CORPORATION Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a Non-Affiliate.	Docket No. UT-021120 **REPLY BRIEF OF AARP, PUBLIC COUNSEL AND WeBTEC**

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ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

I. INTRODUCTION

1. AARP, the Public Counsel Section of the Washington State Attorney General's Office (Public Counsel), and the Washington Electronic Business & Telecommunications Coalition (WeBTEC) respectfully request that the Washington Utilities and Transportation Commission (Commission) approve the proposed sale of the Qwest Dex, Inc. (Dex) business from Qwest (collectively, Qwest Communications International, Inc. (QCII), Qwest Services Corporation (QSC), Qwest Dex, Inc. (Dex), and Qwest Corporation (QC)) to Dex Holdings, LLC (Dex Holdings) as conditioned by the Stipulation and Settlement Agreement (Stipulation). *Stipulation, Ex. 2.* The Stipulation is a reasonable resolution of the issues presented here and is in the public interest. This Reply Brief is filed in opposition to Commission Staff's (Staff) *Opening Brief of Staff* (Staff Brief) to address the shortcomings contained therein.

II. ARGUMENT

A. <u>Sale of Dex is Appropriate.</u>

2. Staff dismiss concerns regarding Qwest's liquidity and the risks attendant to a possible QCII bankruptcy on the basis of a rather unsubstantial analysis and without the benefit of a witness with bankruptcy expertise. *Staff Brief ¶ 4. AARP, Public Counsel and WeBTEC's Brief* reflected our legal analysis of the risks attendant to bankruptcy, as supported by the evidence produced during the course of this proceeding. The Commission can minimize risks associated with a financially weakened Qwest through approval of the Stipulation. The Stipulation affords Qwest an opportunity to reduce debts (irrespective of root causes) while also protecting the public interest through immediate and long-term annual customer credits. Improved access to capital markets for Qwest is in the public interest.

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

B. <u>As Conditioned By the Stipulation the Dex Sale Is in the Public Interest.</u>

3. The pending sale of Dex is not a "partial transfer" of the directory publishing business among affiliates, as previously reviewed by the Commission and the Courts. Instead, it is a true sale of the business that triggers a need for the Commission to change its imputation approach and determine the appropriate disposition of the gain, as expressly recognized in the Accounting Order in Docket No. UT-980948. *Ex. 291, pp. 25-26.* The sale of Dex now before the Commission is an extraordinary transaction without precedent in Washington, a liquidation of a regulatory asset that warrants the unique treatment proposed in the Stipulation.

4. Staff criticize the Stipulation, in part, based upon the outcome if the Stipulation is approved. *Staff Brief ¶ 11.* The Stipulation resolves the issues raised in this case in a way that fairly compromises the matters in dispute. Exhibit 307C illustrates how the Settlement captures **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** of the litigation position of consumer representatives, while moving Qwest upward to **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** of its ultimate litigation position. The Stipulation, like virtually every settlement presented to this Commission or any tribunal, is a compromise. As such, the Stipulation reflects a give and take amongst the parties to it wherein not every advantage is captured, not every position is held, but a middle ground is reached and all parties to the agreement are willing to support it. The one thing that is clear from the Staff's criticism of the Stipulation is the divergence of their economic analysis from every other party to this proceeding. Washington's share of the gain on the sale of Dex, as measured by Qwest and Mr. Brosch, ranges from **BEGIN CONFIDENTIAL** [redacted] **END CONFIDENTIAL** while the Stipulation returns a present value of

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

BEGIN CONFIDENTIAL [redacted] **END CONFIDENTIAL** respectively. *Ex. 307C.* Depending upon which gain allocation method is used and what discount rate is selected, the Stipulation provides as much as **BEGIN CONFIDENTIAL** [redacted]. **END CONFIDENTIAL** The Stipulation is a compromise of many disputed issues, not the least of which is how to apply the legal precedents in apportioning a gain on sale.

5. Staff's Brief argues that the Stipulation fails the "no harm" test because the benefits to ratepayers under the Stipulation represent less value than continued imputation. *Staff Brief* ¶ *32, 36.* However, if the Commission wishes to apply such a "no harm standard" in this matter, the Stipulation provides for a larger and more certain benefit stream than does continued imputation under reasonable assumptions about the future. By capturing for ratepayers an extremely high percentage of the Washington share of the gain, as noted in the preceding paragraph, and then converting these benefits into significant up-front cash credits along with firm long-term revenue credits, ratepayers avoid the considerable uncertainties attendant to future imputation. Up-front customer credits clearly represent tangible net benefits far superior to any "no harm" showing that would not be feasible but for the sale of Dex and the Stipulation. The near-term revenue credits of $110 million are larger than current imputation levels and cannot decline below $103.4 million for 15 years, while there is no such certainty with respect to imputation calculations in future rate proceedings. On a risk-adjusted basis, the Stipulation provides more than "no-harm," it represents a net positive benefit to consumers.

6. Staff criticized the revenue credit element of the Stipulation and made a number of unsubstantiated assertions regarding the consequences to be expected therefrom.

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

Staff Brief ¶ 13. The revenue credits are no more "illusory" than imputation has been for 20 years. All directory profits have actually existed only on the books of an affiliated company since 1984, while the telephone company had no "real directory revenues" in relation to what was imputed. Thus, imputation has historically resulted in a lower earnings level for the regulated entity than was deemed otherwise reasonable, simply because the parent company decided to move directory income into an affiliate. Upon the sale of Dex, QCII will have the cash up-front to "fund" its consolidated obligation, while continuing to accept a lower QC rate of return for at least 15 more years, in the same way QC's return has been lowered by imputation for the past 20 years. Staff's concerns on this issue are not supported by the evidence before the Commission.

7. The Staff's criticism of the revenue credit also includes unsubstantiated assertions regarding QC's ability to fund them. *Staff Brief ¶ 84.* The revenue credit can be thought of as simply a continuation of past imputation, where present rates contain $85 million less revenues (or more due to line growth) than Qwest could otherwise support or "need." Nothing within the Stipulation allows Qwest to escape performance if it concludes in the future that the annual revenue credits represent "an untenable position." More likely is a scenario in which rejection of the Rodney transaction accelerates QCII's financial difficulties to the level of reaching such an "untenable position."

8. Staff also complains that the Stipulation revenue credits do not reasonably match the longer contract terms within the new Publishing Agreement and Non-competition Agreement. *Staff Brief ¶ 43-46.* However, the Stipulation is very deliberate in distributing benefits to customers so as to maximize the value from the ratepayers' share of the gain on sale.

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

By front-loading customer benefits in this era of increased competitive classification of telephone services, the certainty of realization of the benefits is enhanced. If the Washington share of the gain had been spread out over 40 years, as apparently preferred by Staff, the annual and up-front benefit amounts would necessarily be reduced to provide the credits in distant years 16-40.

C. <u>Adoption of Staff's Positions Regarding Alternative Economic Relief to Customers Creates Unnecessary Risks and No Certainty of Benefits for Customers.</u>

9. Staff raise a number of concerns that imply distinctions that are irrelevant to the Commission's consideration of this transaction. One such distinction is the question of whether fair value is being paid to QC and not just to the parent company QCII. *Staff Brief ¶ 3*. The entity distinction is unimportant, as Qwest manages cash and reports financial results on a consolidated basis. *Brosch, Tr. 1276, ll. 7-14.* If Dex sale proceeds were paid to QC as Staff seems to prefer, QC could then simply dividend the cash to the parent or advance the cash to the parent as a loan – but it is QCII that "owns" Dex and is the logical recipient of the cash proceeds upon sale. It is also QCII that will ultimately "pay" for customer credits under the Stipulation because of reduced earnings and cash flow from QC customers, even though no actual "payment" is required for QC to honor its Stipulation commitments to customers. Entity funding distinctions raïsed by Staff do not address the economic realities of the consolidated Qwest business, where parent company control over subsidiary dividend policy, financing decisions, equity infusions and overall cash management render meaningless attempts to regulate specific inter-company payments.

10. Staff's insistence that QCII and not QC should be responsible for ratepayer

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(206) 623-4711

benefits under the outcome of this proceeding is similarly misplaced. *Staff Brief ¶ 12.* Ultimately, QCII makes and receives every "payment" associated with the sale of Dex and the regulatory remedies ordered by the Commission. There is only one publicly traded consolidated Qwest business and this consolidated business will perform the Stipulation obligations (if approved) with respect to up-front and annual revenue credits, through its QC subsidiary that is the entity having customer telephone service relationships within the jurisdiction of the Commission. *Brosch, Tr. 1276, ll. 7-14.*

11. Staff's analysis of Dex sale transaction rejection relies upon assumed values which are highly speculative. In one such case Staff has presented an assumed value of the benefits of the directory business over 40 years. *Staff Brief ¶ 3; Ex. 422C.* This value is utterly speculative, as no one can predict future profits of the printed directory business in Washington for 40 years. The speculative nature of Staff's analysis is revealed in its criticism of the Stipulation for providing less than would be expected from an additional 40 or 50 years of imputation benefits. *Staff Brief ¶ 23.* Mere trending of current imputation values into the distant future fails to address continuing changes in the scope of traditional regulation of the QC business through service reclassification, as well as undeniable changes in the scope of directory publishing operations. The amount ratepayers can "reasonably expect to receive in benefits from the yellow pages directory business" is increasingly uncertain in the future under even a traditional regulation scenario, due to internet proliferation and the diversification of the Dex business through secondary directories and integration of non-Qwest listings. Of course, the business as usual scenario is impossible to predict if Dex is sold in all states except Washington, creating a dominant regional publisher that would directly compete with any retained WA-DEX

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

yellow pages operation.

12. In contrast, the Stipulation provides certainty with respect to customer benefits in an amount that represents the vast majority of any reasonable measure of value for the business. *Ex. 307C.* It is impossible to know the form in which it might be possible to keep the business, given the sale of Dex in all other states. However, it is virtually certain that "keeping" a WA-DEX stand-alone business will be less profitable than the historically integrated regional Dex business, particularly when nothing can prevent Dex Holdings from competing with such as stand-alone business. *Kennard, Tr. 324, l. 13; Burnett, Tr. 444-449.*

13. Staff's assertions regarding net present value of "future anticipated directory imputations" are inherently speculative. *Staff Brief* ¶ *33.* There are a number of significant assumptions imbedded in the Staff analysis that do not survive careful scrutiny. This is in marked contrast to the Stipulation which would provide an assured stream of benefits to ratepayers over a reasonable period of time. The only way customers can "lose" under the settlement is if, contrary to recent service reclassification actions, there are traditional rate cases occurring after 2018 that could continue to sustain large directory imputation adjustments long after the integrated Dex publishing business was sold. Unless there is traditional regulation in years 16-40 and also sustained profitability from printed directories in a stand-alone WA publishing operation, nothing will have been "forfeited" under the Stipulation. What is received under the Stipulation, during the next 15 years when traditional regulation is most likely to continue, is a significant up-front credit to customers, as well as certainty regarding revenue credits in place of a historically contentious imputation issue.

14. Staff also express a number of opinions regarding a Washington-only directory

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SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

business. *Staff Brief ¶ 8.* A stand-alone WA-DEX business would most certainly suffer from lost economies of scale since previously shared systems have either already been sold (Dexter) or would be transferred along with the other six Rodney states' publishing operations. Dex Holdings would represent an established competitor surrounding Washington's stand-alone business that can immediately exploit customer relationships to dilute the value of any retained QC publishing rights. *AARP, Public Counsel and WeBTEC Brief ¶ 25-34.* Staff's unsupported theories about retention of the WA-DEX business represent an inherently complex, high risk effort to sustain an imputation ratemaking remedy for an affiliate business relationship that simply no longer exists.

15. The fact that Dex Holdings seeks to complete this transaction does not undercut the very real risks attendant to a WA-DEX directory operation. *Staff Brief ¶ 90.* Dex Holdings is not trying to buy Washington alone, but instead as an integrated 14-state business. The record contains no valuation data for a stand-alone WA-DEX publishing business and no credible estimates of future profitability or potential imputation values from such a business. *AARP, Public Counsel and WeBTEC Brief ¶ 23-24.* Staff offers only speculation as to how a stand-alone Washington publishing business might be formulated and additional speculation that such a hypothetical publishing business might be as profitable as the existing Dex business, so as to support continuing imputation at historical levels for 40 or more years into the future.

III. CONCLUSION

16. AARP, Public Counsel, and WeBTEC recognize that this case has presented the Commission with an unusual situation regarding the relative position of the parties. While we respect Staff's desire and efforts to preserve the maximum value of the directory publishing

ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

business for Washington ratepayers, we disagree with Staff's analysis and its opposition to the Stipulation. For the reasons stated above, AARP, Public Counsel and WeBTEC respectfully request that the Commission enter an order approving the Stipulation. The Stipulation is a reasonable outcome for Qwest's Washington ratepayers and is consistent with the public interest. Further, it offers the Commission the opportunity to lay to rest the contentious issues that have surrounded this matter once and for all times, without exposing QC ratepayers to the vagaries of potential bankruptcy or uncertainties about reformulation of a stand-alone Washington publishing business.

DATED this 17th day of July, 2003.

AARP

By: [signature] for:
Ronald L. Roseman, WSBA #15396

CHRISTINE O. GREGOIRE, ATTORNEY GENERAL OF WASHINGTON

By: [signature]
Robert W. Cromwell, Jr. WSBA #24142
Assistant Attorney General
Public Counsel

WeBTEC

By: [signature]
Arthur A. Butler, WSBA #04678
Ater Wynne, LLP

ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

CERTIFICATE OF SERVICE

I hereby certify that I have this 17th day of July, 2003, served a true and correct copy of the foregoing document upon counsel of record, via the methods noted below, properly addressed as follows:

Attorneys for Qwest:

Lisa Anderl Qwest Corporation 1600 7th Ave, Suite 3206 Seattle, WA 98290	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile
Mark Reynolds Senior Director - Policy and Law Qwest Corporation 1600 7th Ave, Suite 3206 Seattle, WA 98290	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile
Adam Sherr Qwest Corporation 1600 7th Ave Seattle, WA 98290	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile
Wendy Moser Associate General Counsel Qwest Corporation 1801 California Street, Suite 4900 Denver, CO 80202	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile
Philip Roselli Qwest Corporation 1801 California Street, Suite 4900 Denver, CO 80202	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile
William Brittan Campbell, Bohn, Killin, Brittan & Ray 270 St. Paul, Suite 200 Denver, CO 80206	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

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ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

Russell Rowe Campbell, Bohn, Killin, Brittan & Ray 270 St. Paul, Suite 200 Denver, CO 80206	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

Attorneys for Dex Holdings:

Brooks Harlow Miller Nash LLP 601 Union Street, Suite 4400 Seattle, WA 98101-2352	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile
Richard Cameron Latham & Watkins LLP 555 Eleventh Street NW, Suite 1000 Washington, DC 20004	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

Attorney for Staff

Gregory Trautman Attorney General of Washington 1400 S Evergreen Park Drive SW PO Box 40128 Olympia, WA 98504-0128	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

Attorneys for Public Counsel:

Robert Cromwell Assistant Attorney General Attorney General of Washington 900 Fourth Avenue, Suite 2000, TB-14 Seattle, WA 98164	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile
Simon ffitch Assistant Attorney General Attorney General of Washington 900 Fourth Avenue, Suite 2000 Seattle, WA 98164	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile

* Non-Confidential Status

Attorneys for XO Washington, Inc.:

Rex Knowles* Director, Regulatory & External Affairs XO Oregon, Inc. 111 E Broadway, Suite 1000 Salt Lake City, UT 84111	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile
Greg Kopta* Davis Wright Tremaine LLP 1501 4th Avenue, Suite 2600 Seattle, WA 98101-1688	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile

Attorney for Department of Defense:

Stephen Melnikoff US Army Litigation Center Regulatory Law Office 901 N Stuart Street, #700 Arlington, VA 22203-1837	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

Attorney for American Association of Retired Persons:

Ronald Roseman Directing Attorney Columbia Legal Services 2011 14th Avenue E. Seattle, WA 98112	____ Hand Delivered XX U.S. Mail (first-class, postage prepaid) ____ Overnight Delivery - UPS ____ Facsimile

Attorney for Interested Person Richard Finnigan:

Richard Finnigan* Attorney at Law 2405 Evergreen Park Drive SW, Suite B-1 Olympia, WA 98502	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

Attorney for United Telephone Company of the Northwest:

Nancy Judy* Assistant Vice President, External Affairs Sprint Communications Co. LP 902 Wasco Street, M.S. A0112 Hood River, OR 97031-3105	____ Hand Delivered ____ U.S. Mail (first-class, postage prepaid) XX Overnight Delivery - UPS ____ Facsimile

* Non-Confidential Status

ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711

I declare under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

DATED this 17th day of July, 2003, at Seattle, Washington.

Jim Davenport
____

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ATER WYNNE LLP
LAWYERS
601 UNION STREET, SUITE 5450
SEATTLE, WASHINGTON 98101-2327
(206) 623-4711