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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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1 **I. INTRODUCTION**

2 1. AARP, the Public Counsel Section of the Washington State Attorney General's
3 Office (Public Counsel), and the Washington Electronic Business & Telecommunications
4 Coalition (WeBTEC) respectfully request that the Washington Utilities and Transportation
5 Commission (Commission) approve the proposed sale of the Qwest Dex, Inc. (Dex) business
6 from Qwest (collectively, Qwest Communications International, Inc. (QCII), Qwest Services
7 Corporation (QSC), Qwest Dex, Inc. (Dex), and Qwest Corporation (QC)) to Dex Holdings,
8 LLC (Dex Holdings) as conditioned by the Stipulation and Settlement Agreement (Stipulation).
9 *Stipulation, Ex. 2.* The Stipulation is a reasonable resolution of the issues presented here and is
10 in the public interest. This Reply Brief is filed in opposition to Commission Staff's (Staff)
11 *Opening Brief of Staff* (Staff Brief) to address the shortcomings contained therein.
12

13 **II. ARGUMENT**

14 **A. Sale of Dex is Appropriate.**

15 2. Staff dismiss concerns regarding Qwest's liquidity and the risks attendant to a
16 possible QCII bankruptcy on the basis of a rather unsubstantial analysis and without the benefit
17 of a witness with bankruptcy expertise. *Staff Brief ¶ 4. AARP, Public Counsel and WeBTEC's*
18 *Brief* reflected our legal analysis of the risks attendant to bankruptcy, as supported by the
19 evidence produced during the course of this proceeding. The Commission can minimize risks
20 associated with a financially weakened Qwest through approval of the Stipulation. The
21 Stipulation affords Qwest an opportunity to reduce debts (irrespective of root causes) while also
22 protecting the public interest through immediate and long-term annual customer credits.
23 Improved access to capital markets for Qwest is in the public interest.
24
25

1 **B. As Conditioned By the Stipulation the Dex Sale Is in the Public Interest.**

2 3. The pending sale of Dex is not a “partial transfer” of the directory publishing
3 business among affiliates, as previously reviewed by the Commission and the Courts. Instead, it
4 is a true sale of the business that triggers a need for the Commission to change its imputation
5 approach and determine the appropriate disposition of the gain, as expressly recognized in the
6 Accounting Order in Docket No. UT-980948. *Ex. 291, pp. 25-26.* The sale of Dex now before
7 the Commission is an extraordinary transaction without precedent in Washington, a liquidation
8 of a regulatory asset that warrants the unique treatment proposed in the Stipulation.
9

10 4. Staff criticize the Stipulation, in part, based upon the outcome if the Stipulation
11 is approved. *Staff Brief ¶ 11.* The Stipulation resolves the issues raised in this case in a way
12 that fairly compromises the matters in dispute. Exhibit 307C illustrates how the Settlement
13 captures **BEGIN CONFIDENTIAL** [REDACTED] **END CONFIDENTIAL** of the litigation
14 position of consumer representatives, while moving Qwest upward to **BEGIN**
15 **CONFIDENTIAL** [REDACTED] **END CONFIDENTIAL** of its ultimate litigation position.
16 The Stipulation, like virtually every settlement presented to this Commission or any tribunal, is
17 a compromise. As such, the Stipulation reflects a give and take amongst the parties to it
18 wherein not every advantage is captured, not every position is held, but a middle ground is
19 reached and all parties to the agreement are willing to support it. The one thing that is clear
20 from the Staff’s criticism of the Stipulation is the divergence of their economic analysis from
21 every other party to this proceeding. Washington’s share of the gain on the sale of Dex, as
22 measured by Qwest and Mr. Brosch, ranges from **BEGIN CONFIDENTIAL** [REDACTED]
23 [REDACTED] **END CONFIDENTIAL** while the Stipulation returns a present value of
24
25

1 **BEGIN CONFIDENTIAL** [REDACTED] **END CONFIDENTIAL**

2 respectively. *Ex. 307C.* Depending upon which gain allocation method is used and what
3 discount rate is selected, the Stipulation provides as much as **BEGIN CONFIDENTIAL**
4 [REDACTED] **END CONFIDENTIAL** The
5 Stipulation is a compromise of many disputed issues, not the least of which is how to apply the
6 legal precedents in apportioning a gain on sale.
7

8 5. Staff's Brief argues that the Stipulation fails the "no harm" test because the
9 benefits to ratepayers under the Stipulation represent less value than continued imputation. *Staff*
10 *Brief* ¶ 32, 36. However, if the Commission wishes to apply such a "no harm standard" in this
11 matter, the Stipulation provides for a larger and more certain benefit stream than does continued
12 imputation under reasonable assumptions about the future. By capturing for ratepayers an
13 extremely high percentage of the Washington share of the gain, as noted in the preceding
14 paragraph, and then converting these benefits into significant up-front cash credits along with
15 firm long-term revenue credits, ratepayers avoid the considerable uncertainties attendant to
16 future imputation. Up-front customer credits clearly represent tangible net benefits far superior
17 to any "no harm" showing that would not be feasible but for the sale of Dex and the Stipulation.
18 The near-term revenue credits of \$110 million are larger than current imputation levels and
19 cannot decline below \$103.4 million for 15 years, while there is no such certainty with respect
20 to imputation calculations in future rate proceedings. On a risk-adjusted basis, the Stipulation
21 provides more than "no-harm," it represents a net positive benefit to consumers.
22

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

1 *Staff Brief* ¶ 13. The revenue credits are no more “illusory” than imputation has been for
2 20 years. All directory profits have actually existed only on the books of an affiliated company
3 since 1984, while the telephone company had no “real directory revenues” in relation to what
4 was imputed. Thus, imputation has historically resulted in a lower earnings level for the
5 regulated entity than was deemed otherwise reasonable, simply because the parent company
6 decided to move directory income into an affiliate. Upon the sale of Dex, QCII will have the
7 cash up-front to “fund” its consolidated obligation, while continuing to accept a lower QC rate
8 of return for at least 15 more years, in the same way QC’s return has been lowered by
9 imputation for the past 20 years. Staff’s concerns on this issue are not supported by the
10 evidence before the Commission.
11

12 7. The Staff’s criticism of the revenue credit also includes unsubstantiated
13 assertions regarding QC’s ability to fund them. *Staff Brief* ¶ 84. The revenue credit can be
14 thought of as simply a continuation of past imputation, where present rates contain \$85 million
15 less revenues (or more due to line growth) than Qwest could otherwise support or “need.”
16 Nothing within the Stipulation allows Qwest to escape performance if it concludes in the future
17 that the annual revenue credits represent “an untenable position.” More likely is a scenario in
18 which rejection of the Rodney transaction accelerates QCII’s financial difficulties to the level of
19 reaching such an “untenable position.”
20

21 8. Staff also complains that the Stipulation revenue credits do not reasonably match
22 the longer contract terms within the new Publishing Agreement and Non-competition
23 Agreement. *Staff Brief* ¶ 43-46. However, the Stipulation is very deliberate in distributing
24 benefits to customers so as to maximize the value from the ratepayers’ share of the gain on sale.
25

1 By front-loading customer benefits in this era of increased competitive classification of
2 telephone services, the certainty of realization of the benefits is enhanced. If the Washington
3 share of the gain had been spread out over 40 years, as apparently preferred by Staff, the annual
4 and up-front benefit amounts would necessarily be reduced to provide the credits in distant
5 years 16-40.
6

7 **C. Adoption of Staff's Positions Regarding Alternative Economic Relief to Customers**
8 **Creates Unnecessary Risks and No Certainty of Benefits for Customers.**

9 9. Staff raise a number of concerns that imply distinctions that are irrelevant to the
10 Commission's consideration of this transaction. One such distinction is the question of whether
11 fair value is being paid to QC and not just to the parent company QCII. *Staff Brief* ¶ 3. The
12 entity distinction is unimportant, as Qwest manages cash and reports financial results on a
13 consolidated basis. *Brosch, Tr. 1276, ll. 7-14*. If Dex sale proceeds were paid to QC as Staff
14 seems to prefer, QC could then simply dividend the cash to the parent or advance the cash to the
15 parent as a loan – but it is QCII that “owns” Dex and is the logical recipient of the cash
16 proceeds upon sale. It is also QCII that will ultimately “pay” for customer credits under the
17 Stipulation because of reduced earnings and cash flow from QC customers, even though no
18 actual “payment” is required for QC to honor its Stipulation commitments to customers. Entity
19 funding distinctions raised by Staff do not address the economic realities of the consolidated
20 Qwest business, where parent company control over subsidiary dividend policy, financing
21 decisions, equity infusions and overall cash management render meaningless attempts to
22 regulate specific inter-company payments.
23

24 10. Staff's insistence that QCII and not QC should be responsible for ratepayer
25

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

9 11. Staff’s analysis of Dex sale transaction rejection relies upon assumed values
10 which are highly speculative. In one such case Staff has presented an assumed value of the
11 benefits of the directory business over 40 years. *Staff Brief* ¶ 3; *Ex. 422C*. This value is utterly
12 speculative, as no one can predict future profits of the printed directory business in Washington
13 for 40 years. The speculative nature of Staff’s analysis is revealed in its criticism of the
14 Stipulation for providing less than would be expected from an additional 40 or 50 years of
15 imputation benefits. *Staff Brief* ¶ 23. Mere trending of current imputation values into the
16 distant future fails to address continuing changes in the scope of traditional regulation of the QC
17 business through service reclassification, as well as undeniable changes in the scope of directory
18 publishing operations. The amount ratepayers can “reasonably expect to receive in benefits
19 from the yellow pages directory business” is increasingly uncertain in the future under even a
20 traditional regulation scenario, due to internet proliferation and the diversification of the Dex
21 business through secondary directories and integration of non-Qwest listings. Of course, the
22 business as usual scenario is impossible to predict if Dex is sold in all states except Washington,
23 creating a dominant regional publisher that would directly compete with any retained WA-DEX
24
25

1 yellow pages operation.

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

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

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

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

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

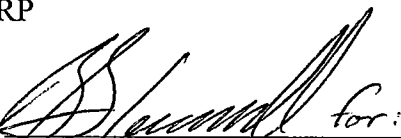
22 III. CONCLUSION

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

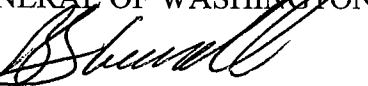
1 business for Washington ratepayers, we disagree with Staff's analysis and its opposition to the
2 Stipulation. For the reasons stated above, AARP, Public Counsel and WeBTEC respectfully
3 request that the Commission enter an order approving the Stipulation. The Stipulation is a
4 reasonable outcome for Qwest's Washington ratepayers and is consistent with the public
5 interest. Further, it offers the Commission the opportunity to lay to rest the contentious issues
6 that have surrounded this matter once and for all times, without exposing QC ratepayers to the
7 vagaries of potential bankruptcy or uncertainties about reformulation of a stand-alone
8 Washington publishing business.
9

10 DATED this 17th day of July, 2003.

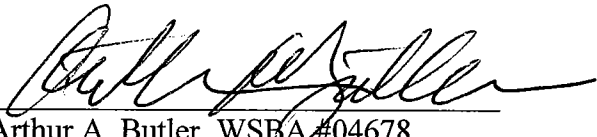
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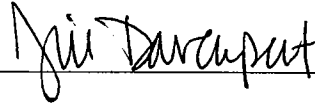
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1 I declare under penalty of perjury under the laws of the State of Washington that the
2 foregoing is true and correct.

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

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