BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In Re Petition of U S WEST COMMUNICATIONS, INC., for an Accounting Order	DOCKET NO. UT-980948 MEMORANDUM IN SUPPORT OF MOTION OF COMMISSION STAFF FOR PARTIAL SUMMARY DETERMINATION DISMISSING COUNT III OF US WEST COMMUNICATIONS, INC.=S PETITION FOR A DECLARATORY ORDER ENDING IMPUTATION

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I. INTRODUCTION

US West, Communications, Inc. (USWC) contends, in Count III of its Petition for a Declaratory Order Ending Imputation, that the Commission=s imputation of excess yellow pages revenues, above and beyond USWC=s authorized rate of return, is an Aunconstitutional infringement on speech@ which violates both the free speech and press clauses of the First Amendment and Article 1, Section 5 of the Washington Constitution.[1] In particular, USWC contends that yellow pages publication is an expressive activity Awhich involves the exercise of creativity and editorial discretion;@ and that imputation of yellow page revenues Adirectly and substantially infringes on this editorial discretion and on the constitutional rights of US WEST [i.e., USWC], US WEST, Inc., and DEX [i.e., US West, Dex, Inc].@ US West Petition for a Declaratory Order Ending Imputation at 10, paragraph 33.[2] This contention is without merit and should be dismissed.

[1]US West contends that the practice of imputation violates both the First Amendment to the United States Constitution and Article 1, Section 5 of the Washington Constitution. The analysis under the state constitution does not differ from First Amendment analysis. First, as set forth below, imputation is a well-established regulatory practice that is not speech-related. Second, even if imputation were deemed somehow to constitute a regulation affecting speech, the publication of the yellow pages is clearly commercial speech and, as such, is subject to the same protection under Article 1, Section 5 of the Washington Constitution as under the First Amendment. Ino Ino, Inc. v. City of Bellevue, 132 Wn. 2d 103, 116, 937 P.2d 154 (1997); National Fed=n of Retired Persons v. Insurance Commn=r, 120 Wn. 2d 101, 119, 838 P.2d 680 (1992).

[2]This is the only reference to USWC=s First Amendment claim in this docket. USWC has submitted nothing in its direct testimony addressing any factual matters related to its imputation claim. However, the Commission should note that this is not the first time that US West has argued that the practice of imputation infringes freedom of speech or the press. Two years ago, USWC, US West, Inc., and US West Dex jointly sued the Commission in federal District Court and raised a First Amendment claim. US West, Inc., et. al v. Nelson, et. al, No. C96-6025FDB (W.D. Wash 1997). In conjunction with this claim, the companies on April 15, 1997 filed a memorandum in support of their

Properly stated, the issue presented is:

> Where the Commission has engaged in a common and well-established regulatory practice, namely, imputation of revenues to protect captive ratepayers from the inequitable effects of affiliated transactions, is there a violation of the First Amendment merely because the imputation in question concerns US West=s lucrative yellow pages advertising business?

The answer to this question is clearly Ano.@[3]

This case has nothing to do with the infringement of cherished First Amendment rights. It has to do with the Commission=s authority -- indeed, its statutory obligation -- to regulate the affiliated transactions of public utilities, and to protect the Company=s Washington ratepayers from unreasonable practices, which, in this case was the conveyance of a corporate asset (the directory publishing operation) to an unregulated affiliate without payment of fair market value. The imputation of affiliate

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motion for summary judgment. See Attachment A to the Affidavit of Gregory J. Trautman (cited hereafter as AUS West federal District Court memo@). On May 5, 1997, prior to the date on which a responsive memorandum was due, the federal District Court dismissed US West=s lawsuit for lack of jurisdiction under the Johnson Act. Id., Order Dismissing Action (May 5, 1997). See Attachment B to the Affidavit of Gregory J. Trautman. The 9th Circuit Court of Appeals affirmed the federal District Court dismissal. US West, Inc., et. al v. Nelson, et. al, 146 F. 3d 718 (9th Cir. 1998). US West=s prior memorandum nevertheless is instructive, as it sets forth, in far greater detail than does USWC=s present petition, the nature of the Company=s First Amendment arguments, and Staff refers to this prior Company memorandum in various parts of this brief. We also provide relevant excerpts from the factual record in the District Court case. See Attachments C and D to the Affidavit of Gregory J. Trautman.

[3]In its federal District Court First Amendment memorandum, US West contended:

AThis motion presents a clean, straightforward legal issue:

> May the State impose a special economic burden, affecting only a handful of publishers, because of the content of their publications?@

US West federal District Court memo, at 1. US West subsequently argued that imputation Atargets a tiny subset of the press,@ is a Acontent-based regulation of speech,@ and allows the Commission the Aunbridled discretion@ to Aburden speech.@ Id. at 1, 19.

US West=s argument wholly mischaracterizes the nature of imputation, and thus misstates the issue at hand. As Staff=s brief fully demonstrates, imputation does not impose a special economic burden, it does not affect only a handful of publishers, and it assuredly is not a content-based regulation of speech which targets a tiny subset of the press. Imputation is a long-established, generally applicable regulatory mechanism to protect ratepayers from the inequitable effects of a regulated company=s transactions with its affiliates.

revenues is a long-established mechanism for helping to carry out the Commission=s regulatory obligations. It helps to replicate what would happen in the competitive market, something which US West has attempted to avoid through the manipulation of its assets among its numerous affiliates.

Imputation is not an Ainfringement of speech.@ It has nothing to do with expressive activity, the exercise of creativity, or editorial discretion. Imputation does not regulate speech in any way. Under well-established Supreme Court precedent, generally applicable practices which do not target, and at most (if at all), only incidentally affect speech are entirely consistent with the First Amendment. Leathers v. Medlock, 499 U.S. 439, 447 (1991); Cohen v. Cowles Media Co., 501 U.S. 663, 669 (1991).

Moreover, imputation in this case has no effect on US West Dex, which is the entity engaged in the yellow pages business. Imputation neither takes any money from US West Dex, lowers its profits, nor regulates it in any fashion. Imputation merely assigns, or attributes, revenues to the financial books of USWC for ratemaking purposes. US West=s attempt to clothe its affiliate manipulations in First Amendment garb should be seen for what it is: an attempt to avoid the legitimate and necessary oversight of its regulated entity, USWC. The First Amendment was not enacted with this purpose in mind.

II. BACKGROUND

A. The Commission=s Role in Setting Rates of Regulated Public Utilities.

In order to place the Company=s First Amendment claim in proper context, it is necessary to fully set forth the basis and purpose of imputation, not only as it applies specifically in this case, but as it applies generally to all companies subject to Commission jurisdiction. The Commission regulates the

rates and practices of public utilities, including telephone companies such as USWC, which provide intrastate telecommunications service in Washington. Because the regulated utilities are de jure[4] or de facto monopolies, the Commission=s regulation of rates serves as a surrogate for competition. USWC=s rates are set periodically in general rate cases where its costs and revenues for a test year are calculated and adjusted to produce a total intrastate revenue requirement sufficient to allow USWC the opportunity to earn a fair rate of return on its investment. See, e.g., People=s Organization for Washington Energy Resources v. Utilities & Transportation Comm=n, 104 Wn.2d 798, 711 P.2d 319 (1985) (APOWER@). The rates of USWC recently were set by the Commission in the 1995-96 Rate Case, WUTC v. US West Communications, Inc., Docket No. UT-950200, Fifteenth Supplemental Order, 169 PUR 4th 417 (April 11, 1996), and again in the 1997 Rate Case. WUTC v. US West Communications, Inc., Docket No. UT-970766, Tenth Supplemental Order (January 16, 1998).

[4]We recognize that in the context of telecommunications companies, since at least 1994, de jure monopolies have not been recognized. In Re Electric Lightwave, Inc., 123 Wn. 2d 530, 869 P. 2d 1045 (1994).

In determining a company=s revenue requirement, the Commission does not simply accept the revenues and expenses set forth by the regulated utility on its balance sheet. It makes adjustments to reflect either actual changes in revenues or expenses or to implement necessary regulatory policies. See, e.g., POWER, 104 Wn.2d at 810.[5] The yellow pages adjustment, confirmed most recently in the Commission=s 1996 Rate Order, implements the obligation of the Commission to serve as a surrogate for competition where the regulated company has entered into non-arms-length transactions with its affiliates.

B. Imputation Is a General Policy Applied to All Utilities to Protect Ratepayers from the Inequitable Effects of a Regulated Utility=s Transactions with Its Corporate Affiliates.

This case presents no question concerning the Commission=s statutory authority to apply the practice of imputation to USWC. The Washington State Supreme Court upheld that authority in affirming the Commission=s 1995-96 Rate Case order. US West Communications, Inc., v. Utilities and Transp. Comm=n, 134 Wn. 2d 74, 949 P. 2d 1337 (1997).[6]

[5]The specific types of ratemaking adjustments are set forth in the Commission=s regulations. WAC 480-09-330. Several examples are provided in the Affidavit of Paula M. Strain (Strain Aff.) **&&**3, 8.

[6]Moreover, every state court and state commission to consider the statutory authority issue has upheld imputation. See cases and decisions cited in US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 99-101 and fns. 8-9.

The purpose of imputation is founded in the broad authority which the Legislature has granted the Commission to supervise the terms and conditions of contracts between a regulated entity and its affiliates, and to disallow, for ratemaking purposes, unreasonable compensation made pursuant to such contracts. RCW 80.16.010-.050; US West v. Utilities and Transp. Comm=n, 134 Wn. 2d at 92-95.[7] As the state Supreme Court explained:

> The general rationale for the Commission=s authority to review transactions between affiliated companies is fear of collusion in the absence of arm=s length dealings. It does not matter under these statutes whether the utility paid the affiliate too much money for too little service or property, or whether (as here) the utility gave the affiliate something of far greater value than the affiliate paid for in return. The effect in either situation is to give to the shareholders of the affiliate something of value at the expense of the ratepayers of the utility.

Id. at 94 (citation omitted).

The control of affiliated companies by a common parent[8] gives the companies numerous opportunities to unreasonably maximize overall corporate profits at the expense of captive ratepayers. The parent company can direct affiliates in the pricing of services and products relative to each other; can control their capital structures; can limit their ability to obtain services from nonaffiliates even if the cost would be lower; and can oversee the sale of assets to affiliates for far less than their market value. Affidavit of Paula M. Strain (Strain Aff.) &&5-8; see generally 1 A. Priest, Principles of Public Utility Regulation, 89-94 (1969).

[7]The use of imputation is also authorized as part of the Commission=s duty and authority to set reasonable rates. RCW 80.36.080-.140; US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 96.

[8]Here, USWC and US West Dex are both controlled by their parent company, US West, Inc. See Part II (F), infra.

In numerous cases the Commission has encountered company actions which either shift costs to the regulated affiliates, or which shift profits to the nonregulated affiliates. Since rate of return regulation bases a regulated company=s (e.g., USWC=s) rates on costs plus a set return on investment, whereas nonregulated companies (e.g., US West Dex) may charge prices without being limited to a set rate of return, non-arms length transactions among members of the affiliated family can maximize profits for the corporate family as a whole. This profit maximization is accomplished at the direct expense of the captive regulated ratepayers, who are asked to pay unreasonably high rates either because of costs that are loaded upon them, or profits that are transferred away. The Commission=s response to such situations is to adjust the revenue requirement of the regulated affiliate to recognize portions of the cost savings, revenues, profits, gains on sale, or lower capital costs, that the affiliated family has experienced as a whole. This is done through the Aimputation,@ or assignment, of such items to the regulated entity from the group. Strain Aff. &&7-8.[9]

[9]The Commission has expertise and experience in the ratemaking process. In the federal District Court case, counsel for plaintiffs acknowledged this by stating: AThe Commission clearly knows how the ratemaking process works. You can prove that fact beyond any dispute, and we=d stipulate to it.@ Deposition of Ernest J. Sampias at 41 (Sampias Dep.) (See Attachment D to the Affidavit of Gregory J. Trautman).

Significantly, imputation is not a procedure in any way unique to the regulation of telecommunications providers, or of USWC in particular.[10] The Commission has employed imputation in numerous cases involving electric companies, gas companies, and telephone companies other than USWC. Strain Aff. &8. Imputation has been applied to public utilities whose activities involve nothing even remotely resembling Aspeech@. It neither Atargets@ speech, or is based in any way on the content of speech. It has nothing to do with the exercise of free speech. It is a well-established and accepted general regulatory policy. Indeed, one predecessor to USWC, Mountain Bell, has described the practice as a Acommon regulatory tool.@[11]

C. The Commission Has Imputed Excess Yellow Pages Revenues to USWC to Properly Compensate Ratepayers for USWC=s Decision to Transfer Its Lucrative Yellow Pages To US West Dex Without Receiving Fair Market Value.

[10]US West, in its First Amendment summary judgment memorandum before the federal District Court, argued repeatedly that imputation Atargets@ speech-related activities, particularly those of telecommunications companies. See US West federal District Court memo at 1, 9, 10, 12. As set forth above, this assertion is simply without merit.

[11]Mountain Bell urged the Colorado Public Utilities Commission to impute yellow pages revenues from its unregulated directory operations to its regulated affiliate, rather than force the regulated affiliate to reacquire the yellow pages operations altogether. US West=s predecessor urged that the Aimputation of revenues, which it describes as a common regulatory tool, is a preferable or superior approach.@ Mountain States Tel. & Tel. Co. v. Public. Util. Comm=n of Colorado, 763 P.2d 1020, 1029 (1988)(emphasis added).

In its First Amendment memorandum to the federal District Court, US West contended that the purpose of imputation is simply to Araise revenue@ and Asubsidize local telephone rates.@[12] In the 1995-96 Rate Case, the Commission emphatically found, after reviewing extensive testimony and cost studies, that this is not the case.[13] The state Supreme Court affirmed this finding.[14] US West essentially has misstated, and in fact, wholly ignored the underlying basis and necessity for imputation.

As the state Supreme Court noted, US West=s yellow pages business was developed as a result of its long, de facto monopoly in the local telephone business. US West, through its predecessor, PNB, did not develop this lucrative business by its initiative, management skill, investment, or risk-taking in a competitive market. Rather, it did so because it was the sole provider of local telephone service, and as such, owned the underlying customer data bases and had established business relationships with virtually

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[12]See US West federal District Court memo at 14, 16, 18, 19.

[13]The Commission could not be clearer on this point:

> USWC argues that under the Telecom Act, universal service may only be subsidized on an equitable and nondiscriminatory basis, and imputing income to USWC is improper because there is no evidence subsidies are needed by all customers including those who may be millionaires.
>
> The Commission rejects this argument. The proposal is not a universal service subsidy. It is a ratemaking adjustment. Its purpose is to reflect funds that would be available to the Company, but for Company action. In any event, the Commission finds in this Order that existing rates for local exchange service do cover incremental costs of providing that service, which thus needs no Asubsidy,@ and the Commission does not attribute or Aearmark@ the directory imputation directly to any class of customers. Therefore the subsidy argument is inapposite.

WUTC v. US West Communications, 169 PUR 4th 417, 445 (1996), aff=d, US West Communications, Inc., v. Utilities and Transp. Comm=n, supra. The Commission amplified its finding that there is no subsidy at several other points in its Order. 169 PUR 4th at 427, 481, 487-88.

[14] US West did not challenge the Commission=s finding in its state Supreme Court appeal. The Court subsequently ruled in affirming the Commission, "[T]he Commission concluded, and there has been no contrary showing on appeal, that price subsidies do not exist.@ US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 99.

all the of the potential yellow pages advertisers. The yellow pages business has enjoyed its continuous high profits because of its close association with the Company=s regulated telecommunications services. It is thus quite unlike businesses of unregulated affiliates which were developed in the competitive marketplace. As the Court further found, the billing and collection service provided to US West Dex by USWC is a valuable business advantage to US West Dex; and in contrast with potential publishing competitors, US West Dex=s publishing enjoys a unique and direct benefit by being associated with the Company=s regulated telecommunications services. US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 99-100.

The history of the yellow pages business reflects these facts. Upon the divestiture of AT&T in 1982, Judge Greene held that the Bell Operating Companies (including Pacific Northwest Bell, a predecessor of USWC) would be allowed to retain publication of the yellow pages businesses. United States v. Amer. Tel. & Tel. Co., 552 F. Supp. 131, 193-94 (D.D.C. 1982). However, only two years later, Judge Greene observed with dismay that the intent of the 1982 order had been circumvented by the acts of regional holding companies such as US West.[15]

[15]The court assumed that the yellow pages revenues would continue to be included in the rate base of the operating companies:

> Yet the Regional Holding Companies, or some of them, have breached that understanding. Instead of funneling Yellow Pages revenues to the Operating Companies, they have created separate subsidiaries to handle their directory publishing operations which do not feed the revenues from these operations into the rate base.

United States v. Western Elec. Co., Inc., 592 F. Supp. 846, 866 (D.D.C. 1984) (footnote omitted; emphasis in original.)

PNB sought authority to transfer its yellow pages business to nonregulated affiliates of PNB soon after the AT&T divestiture. The Company requested the Commission to approve, pursuant to chapters 80.12 RCW (the transfer of assets statutes) and 80.16 RCW (the affiliated interest statutes), the transfer the assets from PNB to US West Dex.[16] In a separate publishing agreement, the Company proposed to pay only a Apublishing fee@ from US West Dex to PNB. The Commission approved the transfer of assets but did not approve the fee proposed to be paid under the publishing agreement. In re PNB Tel. Co., WUTC No. FR-83-159, at 3 (Order Granting Application in Part, Dec. 30, 1983).

In a subsequent proceeding, the Commission again disapproved the proposed publishing fee to be paid to PNB, and reserved authority to determine the appropriate compensation to PNB, for ratemaking purposes, pursuant to its continuing statutory jurisdiction under RCW 80.16.050 over the terms of affiliated interest contracts. The Commission clearly noted its concern that PNB not transfer the yellow pages business to its own affiliate for an inadequate price, to the substantial harm of the ratepayers. The Commission stated, A[t]he public interest requires that the full value of the directory publishing enterprise be deemed available to PNB for ratemaking purposes.@ In re PNB Tel. Co., 96 PUR 419, 427 (WUTC No. U-86-156, 2d Supp. Order, Oct 12, 1988).

US West Dex paid only a separate publishing fee from 1984 to 1988, a fee which the Commission expressly found Aunreasonably low.@ In re PNB Tel Co., 96 PUR 4th at 421. Since 1988, US West Dex has paid no fee at all. USWC and US West Dex simply amended their agreement

[16]PNB transferred the assets to Landmark Publishing, the predecessor of US West Direct, which is in turn the predecessor to US West Dex. For reference purposes, these entities are referred to as US West Dex in this brief.

to end the publishing fee. Such a voluntary relinquishment of a sizeable annual payment, while understandable among a corporate family of companies, would never occur in the competitive marketplace.

In 1989, the Commission filed a complaint against PNB alleging excessive earnings. In a settlement of the rate complaint, PNB agreed as part of a comprehensive five-year Aalternative form of regulation@ (AFOR) to impute, or assign, a level of yellow page revenues as part of its revenue requirement, to pay for the cost of regulated services. Washington Util. & Transp. Comm=n v. Pacific Northwest Bell Tel. Co., WUTC Nos. U-89-2698-F, U-89-3245-P, App. A, at 14-17 (4th Supp. Order, Jan. 16, 1990). When PNB merged into US West in 1990, the Company agreed to continued imputation until the end of 1994.[17] Despite this history of acquiescence by USWC to the imputation of excess yellow pages revenues, the Company now challenges this regulatory policy as a violation of its First Amendment rights.

D. The Commission Has Not Singled Out USWC for the Imputation of Excess Yellow Pages Revenues.

In its memorandum to the federal District Court, US West claimed, without benefit of any evidence, that A[i]mputation as applied to USWC is strictly a burden on plaintiffs,@ and that no other telephone service provider is subject to the same standard as is applied to US West.[18] This claim is

[17]The Commission=s order, modified in accordance with the Company=s request, further stated: AThereafter, these revenues will continue to be imputed accordingly unless and until altered by subsequent order of the WUTC.@ In re Application of PNB for Merger, WUTC No. U-89-3524-AT, at 2, 1990 Wash. UTC LEXIS 125 (3d Supp. Order, Nov. 30, 1990).

[18]US West federal District Court memo at 3, 4, 9.

simply false. The Commission has not singled out USWC for the imputation of yellow page revenues. The Commission has applied imputation principles to both General Telephone of the Northwest and to Continental Telephone Company.[19]

E. Imputation Does Not Involve Any Taking of Revenues from US West Dex, Nor Does It Regulate the Operations of US West Dex In Any Way.

It is significant to note that, among the US West family of companies, the only party to this proceeding is USWC. US West Dex is not a party. USWC complains that the practice of imputation violates the right of free speech, because it allegedly infringes on the editorial discretion involved in publishing the yellow pages. Yet the only company engaged in the publication of yellow pages is US West Dex. And, as the Commission repeatedly found in the 1995-96 Rate Case, yellow pages imputation in no way affects the activities of US West Dex.

Imputation, as applied here, involves simply the assignment, or attribution, of revenues to the financial books of USWC, the regulated entity, for ratemaking purposes. In other words, the excess yellow pages profits of US West Dex, over and above costs plus a fair rate of return, are counted toward USWC=s revenue requirement paid for by ratepayers. However, no money is ever taken from US West Dex, no revenues are seized; the Commission neither lowers the profits of US West Dex,

[19]General Telephone Company of the Northwest, Inc. (GTE-NW) has for years published yellow pages through its affiliate, General Telephone Directory Company (GTD). The Commission consistently has applied the same principle to GTE-NW as it does to US West -- namely, that GTD is entitled to receive its costs plus a fair rate of return. Excess profits above this amount are imputed to GTE-NW. It is true that the amounts which need to be imputed are considerably lower -- but this is because GTE-NW retains many of the profits within the regulated entity, rather than spinning them off to GTD, its directory publishing affiliate, for no consideration, as has USWC. Strain Aff. &&16-19.

The Commission applied the same imputation standards to Continental Telephone Company of the Northwest when it provided the yellow pages through its directory affiliate, Leland Mast Directory Company. Continental=s parent company then sold its directory affiliate to Southwestern Bell for $120 million. Imputation of yellow pages profits thus ended, because Continental elected to sell this lucrative asset, in the open marketplace, to a private competitor for fair market value. Strain Aff. &&10-15. In contrast to USWC, Continental did not give away its asset to its affiliate for grossly inadequate consideration.

requires transfers of cash or stock from US West Dex, nor otherwise regulates US West Dex in any fashion. 169 PUR 4th at 443-44; see Strain Aff. &3. The directory publishing affiliate is free to publish what it chooses, as often as it chooses, and for as much profit as it chooses. As the Commission explained:

> The Commission does not disagree with the proposition that a regulated utility has the right to conduct a nonregulated business. The proposed imputation does not interfere with USWC=s right to conduct any business it wants, nor does it interfere with its affiliate=s right to conduct any business.

169 PUR 4th at 444.

Finally, the Commission expressly rejected the argument that imputation regulates advertising: AThe Commission exercises no jurisdiction over advertising, which is not regulated in any way by this proposal. Only the utility [UWSC] is regulated or affected, pursuant to statutory and Constitutional authority.@ Id. The state Supreme Court acknowledged these facts in its decision affirming the Commission. US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 95-96, 102.

The federal District Court made this very observation in its order dismissing US West=s First Amendment claim under the Johnson Act. Judge Burgess exposed the fallacy inherent in the Company=s argument in the following query:

> I am not entirely sure I understand the plaintiffs= First Amendment claim. If US West Dex, the Yellow Pages publisher, is indeed a separate entity (a point that is rather important to the plaintiffs= theory), the imputation of Yellow Pages profits to *US West Communications* would not impact the speech of *US West Dex*. The injury alleged would run to US West Communications, which is not engaged in publications, and therefore would not offend any of its free speech rights.

US West, Inc. v. Nelson, Order Dismissing Action, at 1 fn. 1, No. C96-6025FDB (W.D. Wash, May 5, 1997), aff-d, US West, Inc. v. Nelson, 146 F.3d 718 (9th Cir. 1998).

F. USWC and US West Dex Are Close Members of the US West Family of Companies.

USWC and US West Dex are both subsidiaries of the same parent company, US West, Inc. As part of a corporate reorganization on June 12, 1998, US West was restructured into two independent companies. The businesses of the US West Communications Group and the domestic directories business of the US West Media Group were brought together under the new US West, Inc.

As the state Supreme Court expressly recognized in its decision upholding imputation, USWC and US West Dex are sister affiliates that have operated at less than arms length in their business dealings with one another. US West v. Utilities and Transp. Comm-n, 134 Wn. 2d at 87, 92-95, 99-100. This continues to be true today. US West, Inc., the parent company, has publicly-traded stock on the New York Stock Exchange; neither USWC nor US West Dex, the sister affiliates, are publicly traded. Moreover, US West-s investor informational materials proclaim the new US West [i.e., US West, Inc., comprising both USWC and US West Dex] to be a Asingle company@ speaking with a single voice, having a single vision, and offering a single strategic focus. The company states that bringing US West Dex under the banner of the new US West will Aadd synergy@ for customers and shareowners. Strain Aff. && 25-26.

This close relationship between USWC and US West Dex provides both the reason why the companies are so interested in the dealings of the other and why it is paramount that the Commission be enabled to use ratemaking adjustments such as imputation to protect ratepayers from the inequitable effects of such transactions.

G. The Yellow Pages Are Overwhelmingly Commercial In Nature.

In its memorandum before the federal District Court, US West provided a remarkably skewed version of what the yellow pages actually comprise. According to the Company, A[f]irst and foremost, directories are a resource -- not unlike encyclopedias, dictionaries, or other reference works.@ The Company strained to point out that within the hundreds upon thousands of pages of business and commercial advertisements are scattered listings of Ageneral informational@ or Acommunity services@ information.[20] Yet the evidence proffered by the Company itself revealed the yellow pages to be overwhelmingly commercial. No one would ever mistake the yellow pages for the Encyclopedia Britannica.

[20]US West federal District Court memo at 2, 5.

The Company=s Seattle yellow pages directory that it filed as an exhibit with the federal district Court[21] is, by sheer page content, over 97% commercial. Business listings and advertisements are the yellow pages= reason for existence. The prices for advertisements are steep,[22] and US West=s yellow pages operations are highly profitable in all states.[23]

US West Dex also has several commercial advantages over its potential competitors. While some other directories have been published, US West Dex enjoys a unique and direct benefit by being associated with the Company=s regulated services, in contrast to potential publishing competitors. US West has further admitted that there is only Alimited competition@ between US West Dex=s directories and other directories.[24] As the state Supreme Court summed up, AThe fact is that the Company is different from other companies competing for the business.@ US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 99-100.

US West contends in its petition that yellow pages publishing involves the exercise of creativity and editorial discretion. US West=s Petition for a Declaratory Order Ending Imputation, at 10, paragraph 33. However, the arrangement of listings and advertisements in the yellow pages is set entirely by predetermined rules, and computers are used to set the layouts. Listings are arranged alphabetically. Display advertising is arranged first by size of advertisement, and then by seniority of firms doing business with US West. Although US West Dex personnel help to develop individual ads,

[21]Declaration of Ernest J. Sampias Re: Summary Judgment, at 2. See Attachment C to the Affidavit of Gregory J. Trautman.

[22]A one-eighth page ad in the Olympia-Lacey-Tumwater directory may cost $500 per month, and a comparable ad in Seattle would cost even more. Sampias Dep. at 102-03.

[23]Sampias Dep. at 142.

[24]Sampias Dep. at 16-24. US West=s witness further admitted that he was not familiar with the term Aeffective competition,@ id. at 84-85, and thus could not testify to the existence of any such competition.

there is little, if any, room for editorial judgment or creativity in the selecting, arranging, and presentation of the yellow page advertisements. See Deposition of Ernest J. Sampias at 103-07.

III. ARGUMENT

A. Partial Summary Determination Should Be Granted Because There Are No Issues of Material Fact and Imputation Does Not Violate the First Amendment As A Matter of Law.

US West=s First Amendment claim is set forth entirely within Count III of its petition for a declaratory order. US West has not submitted any factual testimony pertaining to this claim in its direct testimony filed October 15, 1998. Nor has US West indicated that its claim is dependent upon any particular factual matters. The relevant factual matters pertaining to the practice of imputation are set forth in this memorandum and accompanying affidavits. Where the nonmoving party does not controvert the relevant facts supporting a summary judgment motion (or a summary determination motion pursuant to WAC 480-09-426), those facts are considered to have been established. Central Washington Bank v. Mendelson-Zeller, Inc., 113 Wn. 2d 346, 354, 779 P.2d 697 (1989). As there are no issues of material fact, partial summary determination should be granted because, as set forth below, the practice of imputation is clearly constitutional as a matter of law. See Weyerhaeuser Co. v. Aetna Cas. and Sur. Co., 123 Wn. 2d 891, 897, 874 P.2d 142 (1994).

B. Imputation Is A Generally Applicable Regulatory Policy Not Directed at Speech In Any Way and Is Fully Consistent With The First Amendment.

The Commission has applied imputation to address the inequities of various corporate affiliated transactions, as well as inequities not involving affiliated interests. It protects ratepayers from company

maneuvers in which assets are transferred to and from affiliates at less than arms-length. Imputation has been applied to transactions involving all regulated industries, including electric and gas utilities. It has been applied to telecommunications companies other than US West. It is a policy which has absolutely nothing to do with the exercise of free speech. It is a long-established, generally applicable principle of regulation. Strain Aff. &&6-23.

US West=s entire First Amendment argument, as presented to the federal District Court, rested upon the unsupported assertion that imputation is a policy which specifically targets and burdens the exercise of speech. The cases that it cited all assume this unfounded premise. US West does not contend, nor can it, that generally applicable practices which do not target and at most only tangentially affect speech are wholly consistent with the First Amendment. The Supreme Court has repeatedly so held in a long line of cases involving generally applicable legal requirements imposed on businesses engaged in First Amendment activity. These include cases concerning taxes, labor laws, antitrust laws, securities laws, procedural laws and even the common law. This longstanding precedent, directly applicable here, effectively disposes of all of US West=s claims.

In Leathers v. Medlock, 499 U.S. 439, 447 (1991), the Supreme Court upheld Arkansas=s extension of its sales tax to cable television services, while exempting print media from that tax: AWe have said repeatedly that a State may impose on the press a generally applicable tax.@[25] Similarly, the

[25] The court cited Jimmy Swaggart Ministries v. Board of Equalization of Cal., 493 U.S. 378, 387-388 (1990); Arkansas Writers= Project, Inc. v. Ragland, 481 U.S. 221, 229 (1987); Minneapolis Star & Tribune Co. v. Minnesota Comm=r of Revenue, 460 U.S. 575, 586 and n. 9 (1983). The Court then explained why the tax at issue did not violate the First Amendment:

Court has held that other generally applicable laws and practices may be applied to speech and press activities.[26] Indeed, in Cohen v. Cowles Media Co., 501 U.S. 663, 669 (1970), the Supreme Court referred to the Awell-established line of decisions holding that generally applicable laws do not offend the First Amendment simply because their enforcement against the press has incidental effects on its ability to gather and report the news.@

The imputation of excess yellow pages revenues fits squarely within the parameters of Leathers and the similar cases listed above. (Those cases involved pure speech, not merely commercial speech which is entitled to lesser protection.)

> [The Arkansas sales tax] applies to receipts from the sale of all tangible personal property and a broad range of services, unless within a group of specific exemptions. Among the services on which the tax is imposed are natural gas, electricity, water, ice, and steam utility services; telephone, telecommunications, and telegraph service. . . . The tax does not single out the press and does not therefore threaten to hinder the press as a watchdog of government activity. . .
>
> Furthermore, there is no indication in this case that Arkansas has targeted cable television in a purposeful attempt to interfere with its First Amendment activities. Nor is the tax one that is structured so as to raise suspicion that it was intended to do so. Unlike the taxes involved in Grosjean [v. American Press Co., 297 U.S. 233 (1936)] and Minneapolis Star, the Arkansas tax has not selected a narrow group to bear fully the burden of the tax.
>
> The tax is also structurally dissimilar to the tax involved in Arkansas Writer=s. In that case, only Aa few@ Arkansas magazines paid the State=s sales tax. . . .[Here], Arkansas= extension of its sales tax to cable television hardly resembles Aa penalty for a few@.

Leathers, 499 U.S. at 447-48.

[26] Cohen v. Cowles Media Co., 501 U.S. 663, 670 (1991) (application of doctrine of promissory estoppel to the press); Mabee v. White Plains Publishing Co., 327 U.S. 178, 184 (1946) (application of the Fair Labor Standards Act to publishing business); Associated Press v. National Labor Relations Bd., 301 U.S. 103, 130-33 (1937) (application of National Labor Relations Act to employment of reporters and editors); Associated Press v. United States, 326 U.S. 1, 19-20 (1945) (application of antitrust laws to news gathering and disseminating organizations); Oklahoma Press Publishing Co. v. Walling, 327 U.S. 186, 192-94 (1946) (requiring newspapers to comply with minimum wage and overtime restrictions applicable to other enterprises); Herbert v. Lando, 441 U.S. 153, 169-70 (1979) (no exemption for the media from the general rules of pretrial discovery); Zurcher v. Stanford Daily, 436 U.S. 547, 554 (1978) (no immunity for the press from search warrants); Securities and Exchange Comm=n v. McGoff, 647 F.2d 185 (D.C. Cir. 1981) (no exemption for the press from application of Securities and Exchange Commission laws).

By contrast, the cases cited by US West in its federal District Court memorandum are distinguishable in that they involve laws which specifically target speech.[27] In Minneapolis Star, 460 U.S. 591-92, the Supreme Court struck down a special-use tax that singled out for special treatment not just the press, but a small subset of the press. In Arkansas Writers= Project, 481 U.S. 221, the Court invalidated a tax which treated some magazines less favorably than others. In United States v. National Treasury Employees Union, 513 U.S. 454 (1995) the Court struck down a ban on honoraria for federal government employees who gave off-duty speeches. And in Simon & Schuster, Inc. v. Members of the New York State Crime Victims Bd., 502 U.S. 105 (1991), the Court held unconstitutional the ASon of Sam@ law that required an accused or convicted criminal=s income from publications describing their crime to be deposited in an escrow account, with the funds distributed to the victims of the crime.[28]

US West=s contention that imputation is unconstitutional is without merit for the simple reason that imputation is not a speech-related regulation at all. It is a policy which addresses the corporate transactions of regulated companies and their affiliates.

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[27]The Washington Supreme Court upheld a use tax imposed on Sears catalogues even though a specific statute singled out commercial catalogue distribution for the tax. Sears & Roebuck Co. v. Department of Revenue, 97 Wn.2d 260, 262, 643 P.2d 884, appeal dismissed, 459 U.S. 803 (1982). Despite the fact that catalogues were targeted in the statute, the Washington court held that it was part of a Ageneral use tax statute,@ and therefore, no constitutional issue was presented. Id. at 263.

[28]Other cases cited by US West are likewise distinguishable. See City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410 (1993) (Court struck down ban on news racks that distributed Acommercial handbills@); 44 Liquormart, Inc. v. Rhode Island, 134 L. Ed. 2d 711 (1996) (Court held unconstitutional Rhode Island=s prohibition against advertisements that provided information about the retail prices of alcoholic beverages); Rubin v. Coors Brewing Co., 131 L. Ed. 2d 532 (1995) (Court struck down law prohibiting the publication of the alcoholic content of malt beverages); Riley v. National Fed=n of the Blind of North Carolina, Inc., 487 U.S. 781 (1988) (Court invalidated law which placed fee restrictions and license requirements on fundraisers engaged in solicitation, and required disclosure of certain information); Denver Area Educ. Telecomms. Consortium, Inc. v. FCC, 135 L. Ed. 2d 888 (1996) (Court struck down laws regulating the broadcasting of Apatently offensive@ sex-related material on cable television); Village of Schaumburg v. Citizens for a Better Environment, 444 U.S. 620 (1980) (Court invalidated municipal ordinance which prohibited solicitation of contributions by certain charitable organizations).

C. The Imputation of Excess Yellow Pages Revenues Is Constitutional Even If It Were Viewed as a Regulation Affecting Commercial Speech.

Assuming for the purpose of argument that the Commission=s imputation of excess yellow pages revenues is a speech-related regulation, it is constitutional under the standards governing the regulation of commercial speech. Imputation in this case directly advances a substantial governmental interest, and regulates no more than is necessary to serve that interest. Rubin v. Coors Brewing Co., 131 L. Ed.2d 532, 539 (1995).

1. Imputation of Yellow Pages Revenues Imposes No Burden on the Exercise of Free Speech.

US West cannot show that the imputation of yellow pages revenues even implicates any right to speech. The only corporation that conceivably possesses a First Amendment interest is US West Dex, the directory publishing affiliate, which is not a party to this action. Yet imputation does not affect US West Dex at all. Imputation simply assigns revenues to the books of the regulated entity, USWC, for ratemaking purposes. The Commission does not extract any money from US West Dex, nor does it interfere in the publishing operations of US West Dex in any way.

In its federal District Court memorandum, the Company contended that:

> USWC cannot raise revenues in the amounts imputed to it. US West, as a USWC shareholder, has thereby suffered lost value in its shares of USWC stock. As a consequence, [US West Dex=s] profits have less value to US West, effectively penalizing US West because of [US West Dex=s] publishing activities.[29]

[29]US West federal District Court memo at 3.

Nothing in these allegations shows that US West Dex is affected in any way by imputation, because, in fact, it is not. US West Dex is free to publish its yellow pages as it chooses and to make whatever profits it can make.

2. The Yellow Pages Are Overwhelmingly Commercial Speech.

Even assuming that imputation is somehow a regulation affecting speech, the speech in question here is commercial speech. The example of the yellow pages filed by US West in its federal District Court memorandum reveals that the yellow pages are over 97% commercial in nature. They consist overwhelmingly of business listings and advertisements whose purpose is Aproposing a commercial transaction.@ See City of Cincinnati, 123 L. Ed. 2d at 111; Ohralik v. Ohio State Bar Ass=n, 436 U.S. 447, 455-56 (1978). Even if, as US West argued to the District Court, yellow page readers may be actively seeking out an advertisement or a transaction,[30] the listings and advertisements are no less commercial. They provide the consumer with the additional information necessary to complete the transaction: what product or service is being sold, where to get it, when to get it, and who will sell it. A few scattered pages of Acommunity service@ information does not elevate the yellow pages as a whole to the level of pure, fully protected speech. The court must examine Athe nature of the speech taken as a whole.@ Riley, 487 U.S. at 796, which is undisputedly commercial.

Nor does the compilation of the yellow pages entail the Aeditorial discretion@ alleged by US West that raises it to the level of fully protected speech. See Denver Area Educ. Telecomms. Consortium, 135 L. Ed. 2d at 899. This discretion must be one that far exceeds the use of US West=s

[30]US West federal District Court memo at 5-6.

computer database to arrange advertisements into predetermined categories and layouts. Cf. Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241, 258 (editorial judgment of newspapers involves choices regarding the treatment of public issues and public officials); Hurley v. Irish-American Gay, Lesbian and Bisexual Group of Boston, 132 L. Ed. 2d 487, 503-06 (1995) (editorial judgment involved determining what political and social messages parade organizers wished parade to send).

3. The Imputation of Yellow Pages Revenues Directly Advances a Substantial Governmental Interest and Is No More Extensive Than Necessary to Serve That Interest.

Again, assuming that yellow pages imputation is a speech-related regulation, a regulation of commercial speech is constitutional if it directly advances a substantial governmental interest and is no more extensive than necessary to serve that interest. Rubin, 131 L. Ed. 2d at 539. There must be a Areasonable fit@ between means and ends. 44 Liquormart, Inc., 134 L. Ed. 2d at 730. Imputation clearly meets these requirements.

First, the interest involved is substantial, indeed compelling. Imputation serves to protect captive ratepayers from the inequitable effects of transactions between a regulated company and its affiliates. Here, USWC transferred a lucrative money-producing asset to its affiliate for grossly inadequate consideration. The Commission not only has the authority to make ratemaking adjustments of this type, it has the statutory duty to do so. Chapter RCW 80.16 (the affiliated interests statutes). The Commission also has the duty to take account of unreasonable practices which affect the rates to be paid by US West=s captive ratepayers, pursuant to RCW 80.36.080 and -.140. The State Supreme

Court upheld both of these statutory bases for imputation. It further cited with approval the Commission=s explanation of why imputation is necessary:

> Utilities may have the power to subdivide the integrated utility operations and divest for their own organizational goals or profit objectives any discrete, divisible, and potentially profitable aspect of that operation. Imputation is entirely consistent with the purpose of regulation as a tool to minimize adverse effects on such division and divestiture when those circumstances occur.

US West Communications, Inc. v. Utilities and Transp. Comm=n, 134 Wn. 2d at 96.

US West asserted in its federal District Court memorandum: AThe >state interest= in imputation is to subsidize telephone service. In essence, imputation is a tax to raise revenue.@[31] This unsupported assertion is without merit. In fact, the Commission determined, after reviewing hundreds of pages of testimony and cost studies in the US West rate case, that local telephone service is not Asubsidized@ in any fashion, and that the price for such service fully covers its costs. WUTC v. US West Communications. Inc., 169 PUR 4th at 481, 487-88. This finding was affirmed by the state Supreme Court. US West v. Utilities and Transp. Comm=n, 134 Wn. 2d at 98. Moreover, imputation is not a Atax@ on anyone. It takes no money from US West Dex; to the extent revenues are imputed to USWC, this simply helps makes ratepayers whole in the light of USWC=s decision to give away one of its assets.

[31] US West federal District Court memo at 14.

Having misstated the purpose of imputation, US West then leaps to the unfounded conclusion that imputation does not directly advance that purpose. US West suggested to the federal District Court that the Commission should simply impose a general tax on all businesses.[32] This would not address the issue presented here in any way. At issue is USWC=s dealings with its affiliates. To tax other companies for the corporate practices of US West would not only be pointless, it would be patently illegal. What the Commission has chosen is simply a regulatory method that has been applied numerous times before to address similar practices of other corporations. There clearly is a Areasonable fit@ between imputation and the purpose it is designed to achieve.[33]

[32]US West federal District Court memo at 16, 19.

[33]As set forth previously, one alternative remedy that was applied by the Colorado Supreme Court was to direct the regulated telephone company (Mountain Bell) to reacquire the yellow pages assets. That is certainly a more stringent remedy than the imputation which the Commission has implemented, and which US West=s predecessor deemed a Acommon regulatory tool.@ Mountain States Tel. & Tel. Co., 763 P.2d at 1029.

4. Imputation Is Not a Content-Based Restriction on Speech and Is Constitutional Under the Same Intermediate Scrutiny Standard That Applies to Regulation of Commercial Speech.

The First Amendment operates most stringently upon regulations which stifle or restrict speech because of its content. Turner Broadcasting System, Inc., v. Federal Communications Comm=n, 512 U.S. 622, 129 L. Ed. 2d 497, 517 (1994). Regulations are deemed content-neutral if they operate upon speech irrespective of the particular ideas, views, or messages expressed. Id. at 518, 520. See, e.g., City Council of Los Angeles v. Taxpayers for Vincent, 466 U.S. 789, 804 (1984) (ordinance prohibiting the posting of signs on public property is content-neutral because it is silent concerning any speaker=s point of view); Heffron v. International Society for Krishna Consciousness, Inc., 452 U.S. 640, 649 (1981) (regulation requiring that sales and solicitations take place at designated locations applies evenhandedly to all who wish to distribute and sell written materials or to solicit funds).

Even if imputation were viewed as a regulation affecting speech, it is clearly a content-neutral regulation. Imputation operates irrespective of any ideas, viewpoints, or messages conveyed through the yellow pages. US West Dex remains free to publish whatever it wishes. Imputation does not, as US West contended, Asingle out yellow page directories,@ nor is it in any way Abased on the telephone information content of the directories.@[34]

[34]US West federal District Court memo at 12.

As a content-neutral regulation, imputation is governed by the intermediate scrutiny of United States v. O'Brien, 391 U.S. 367, 377 (1968), which will sustain the regulation if:

> [I]t furthers an important or substantial government interest; if the government interest is unrelated to the suppression of free expression; and if the incidental restriction on First Amendment freedoms is no greater than is essential to the furtherance of that interest.

Imputation plainly meets this test, which is virtually identical to that applied to regulations of commercial speech. It is fully consistent with the First Amendment.[35]

D. Imputation Does Not Vest the Commission with Unbridled Discretion to Unconstitutionally Burden Speech.

[35] Even if imputation were viewed as a regulation burdening pure, fully protected speech, it is constitutional. The overriding interest in protecting captive ratepayers from the inequitable effects of corporate affiliate manipulations is a compelling interest, and imputation is the least restrictive means of achieving this end.

Finally, US West contended in its federal District Court memorandum that imputation vests the Commission with the unbridled discretion to burden speech.[36] This contention is without merit. The authority to impute excess yellow page revenues is constrained by numerous factors, namely: (1) the Administrative Procedure Act, chapter RCW 34.05, which requires that US West be afforded a hearing, that any imputation be based upon substantial evidence in the record, and that the Commission not act arbitrarily and capriciously; (2) the Commission=s obligation pursuant to RCW 80.36.080 to ensure that the rates and charges of telecommunications companies be fair, just, reasonable and sufficient; and (3) the constitutional prohibition against rates that are confiscatory. Moreover, the Commission has applied imputation to USWC in the same manner as it has to other regulated companies: it allows for the recovery of costs plus a fair rate of return.

US West cited cases to the federal District Court that are completely inapposite to the situation here. See Forsyth County v. Nationalist Movement, 505 U.S. 123 (1992) (Court invalidated ordinance empowering administrator with unbridled, unreviewable discretion to adjust public-speech permit fee based on amount of hostility likely to be created by speech=s content, in an over 99% white county with a long history of racial turmoil, lynchings, and Ku Klux Klan participation); Shuttlesworth v. Birmingham, 394 U.S. 147 (1969) (Court invalidated ordinance empowering city officials to deny a public demonstration permit if required to by Apublic welfare, peace, safety, health, decency, good order, morals, or convenience@); Niemotko v. Maryland, 340 U.S. 268 (1951) (Court overturned disorderly conduct conviction of Jehovah=s Witnesses where their use of a public park was not even

[36]US West federal District Court memo at 19-21.

prohibited by any statute or ordinance but only by an amorphous local practice conferring all permitting authority, without standards or limitations, on the park commissioner and city council).

Imputation is entirely consistent with the First Amendment; it does not invest the Commission with the unbridled discretion to impermissibly burden speech. It is a well-established, regulatory practice to protect ratepayers from the inequitable effects of intracompany affiliate transactions, and is clearly constitutional.

IV. CONCLUSION

For the foregoing reasons, Staff requests that the Commission grant its motion for partial summary determination dismissing Count III of US West=s Petition for a Declaratory Order Ending Imputation.

DATED this 18th day of February, 1999.

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