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STATE OF WASHINGTON

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COURT OF APPEALS DIVISION II
STATE OF WASHINGTON

QWEST CORPORATION, a Colorado
corporation,

Petitioner,

v.

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,

Respondent.

NO. 34523-4-II

**RESPONSIVE BRIEF OF
WASHINGTON
UTILITIES AND
TRANSPORTATION
COMMISSION**

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I. COUNTERSTATEMENT OF ISSUES

- A. The Legislature has granted the Commission statutory authority under RCW 80.04.080 to require special or periodic reports from regulated public service companies, concerning any matter that the Commission is required or authorized to inquire into or keep itself informed about. Is WAC 480-120-369, which requires the reporting of large cash transfers made by non-investment grade, regulated companies such as Qwest, within this broad grant of statutory authority?**
- B. Is WAC 480-120-395, which requires an annual report of transactions between regulated telecommunications companies and their subsidiaries, within the broad grant of statutory authority conferred by RCW 80.04.080?**

II. COUNTERSTATEMENT OF THE FACTS

A. Introduction

This case concerns Qwest Corporation's ("Qwest") challenge to two financial reporting rules enacted by the Washington Utilities and Transportation Commission ("WUTC" or "Commission"). The first rule, WAC 480-120-369 (the "cash transfer rule"), requires that a regulated, non-investment grade telecommunications company provide five business days' notice to the Commission prior to transferring large amounts of cash from the regulated company to its affiliated interests or subsidiaries. The second rule, WAC 480-120-395, requires that a regulated telecommunications company file an annual report summarizing all

transactions (except those provided at tariff rates)¹ occurring between the company and its affiliated interests, or between the company and its subsidiaries, during the previous calendar year.² The Commission enacted these rules pursuant to the Legislature’s grant of authority, conferred under RCW 80.04.080, to require periodic or special reports “concerning any matter that the commission is required or authorized by this or any other law, to inquire into or keep itself informed about[.]”³

Despite this broad grant of statutory authority, and the fact that the rules simply require that the Commission be informed of certain highly significant financial transactions, Qwest contends that the rules are invalid because they allegedly exceed the Commission’s statutory authority.⁴ As set forth below in this brief, Qwest’s contentions are meritless. Qwest’s appeal should, therefore, be dismissed, and this Court should enter an order upholding the validity of the Commission’s financial reporting rules.

¹ Services provided under tariff are governed by RCW 80.36.100-.130.

² These rules are attached as Appendix A to this brief.

³ WAC 480-120 concerns telecommunications companies. The Commission has enacted parallel financial reporting rules for the natural gas, electric, water, and hazardous liquid pipeline industries. *See* WAC 480-90-244, -264 (natural gas); WAC 480-100-244, -264 (electric); WAC 480-110-535, -575 (water); WAC 480-73-180, -210 (hazardous liquid pipelines).

⁴ In its brief submitted to the Superior Court below, Qwest additionally contended that the Commission’s reporting rules unlawfully regulate Qwest’s cash management, interfere with Qwest’s management prerogative, interfere with the internal affairs of foreign corporations, and unlawfully regulate dividend practices. *See* CP 83-89. Qwest did not prevail on any of these claims before the Superior Court, and it has now waived them in this appeal. *Keever & Associates, Inc. v. Randall*, 129 Wn.App. 733, 741, 119 P.3d 926 (2005).

B. The Commission's Rulemaking on Financial Reporting

The Commission commenced the rulemaking that ultimately led to the enactment of various financial reporting rules, two of which are challenged by Qwest, on October 2, 2002. The Commission's concise explanatory statement sets forth the significant concerns that led it to undertake this rulemaking:

The Commission instituted this rulemaking in recognition of increasing concern with the financial viability of regulated industries and the negative financial and operational impacts of failed diversification on regulated utilities. The regulated transportation and utility business environments have undergone a number of significant developments that include corporate and industry restructuring, competition, difficulty obtaining reasonable financing, bankruptcy, financial rating downgrades, volatile commodity supply and demand, volatile pricing, and concern with the accuracy of corporate financial statements and reports. In this new environment, financings and transactions between regulated companies and their non-regulated affiliates and subsidiaries significantly impact utilities, and in turn, ratepayers. Establishing ongoing reporting requirements regarding financings and transactions between regulated companies and their non-regulated affiliates and subsidiaries will provide the Commission with more timely identification and disclosure of financial transactions that pose difficult regulatory issues.

The acquisition of Portland General Electric (PGE) by Enron and the subsequent financial difficulties experienced by Enron illustrate events that have enhanced Commission concern. Fortunately, when Enron acquired PGE, the Oregon Public Utility Commission imposed several restrictive conditions on Enron that insulated PGE from the Enron bankruptcy.

There have been a number of events in Washington State that signal the need for increased Commission awareness. Recent events include: (a) lack of notice provided to the Commission during a rate case concerning transactions with subsidiaries; (b) large cash dividends paid by regulated companies to its parent; (c) transfer of \$800,000,000 in cash from a regulated telecommunications company to its non-regulated subsidiaries; (d) questions regarding the use of proceeds from financings; and (e) dependency upon a single supplier for an essential utility service.

AR 829-30. (Concise Explanatory Statement/Open Meeting Memorandum from Open Meeting of June 28, 2004).

During the ensuing three-year period from 2002 through 2005, the Commission held three stakeholder workshops with companies in several regulated industries (including natural gas, electric, telecommunications, water, and hazardous liquid pipelines) and consumer advocacy organizations, received multiple rounds of oral and written comments from interested parties on the proposed financial reporting rules, and met informally with company representatives to discuss proposed rules. AR 2330-32. As a result of these comments and discussions, the Commission revised and modified some of the proposed financial reporting rules, and eliminated others in their entirety. (For example, the Commission substantially scaled back rules that would have required regulated companies to provide five days' advance notice when issuing securities,

after receiving comments concerning the burdens and possible adverse impacts this requirement might create for regulated companies.)

In its “Statement of the Case,” Qwest refers to the fact that the Commission did engage in a lengthy and thorough process before enacting the financial reporting rules that are the subject of this appeal. *Qwest’s Opening Brief* at 4-8. Qwest is incorrect, however, when it suggests that the Commission “declined to address the issues raised by Qwest,” or that it “did not address all of Qwest’s concerns.” *Id.* at 6, 8. In fact, the Commission did consider Qwest’s stated objections to the rules but found them to be without merit, and thus it did not adopt Qwest’s proposed revisions.

Qwest also refers to the fact that the Commission ultimately determined that the cash transfer reporting rule would apply only to non-investment grade utilities. The reason for this was not, however, as Qwest suggests, “to eliminate the opposition to the rules from the investment-grade-rated utilities and thereby reduce the number of utilities with an interest in mounting a legal challenge to the rules.” *Id.* at 7-8. Rather, the reason for this change, as set forth in detail below, was to narrowly tailor the rule’s cash reporting requirements, and apply them specifically to those utilities for which large cash transfers posed the greatest concern to ratepayers and the Commission.

C. Cash Transfer Report (WAC 480-120-369)

The Commission remains particularly concerned with large transfers of cash from regulated companies to their affiliates and subsidiaries, when such transfers are made by companies whose securities are rated less than investment grade. These companies currently include, among other companies, Qwest. (Nothing, however, precludes Qwest from upgrading its investment grade status in the future.) The Commission, in its rule adoption order, explained in detail its concerns:

Transfers of large amounts of cash from the regulated utility or its shareholders could have serious and detrimental effects on ratepayers. Regulated utilities collect cash from customers as they pay for utility services, and regulated utilities use cash to fund operations and capital investment. A large transfer of cash from the control of the regulated utility could effectively disable funding for utility operations or render the utility unable to make necessary capital investments. Either circumstance could cause an immediate harm to customers. Providing the Commission with five days' advance notice of such transfers would allow the Commission to immediately commence ratemaking or prudence proceedings, or, in particularly egregious instances, to seek to enjoin the utility from proceeding with the cash transfer altogether, if necessary to protect the interests of the ratepayers or the public interest. RCW 80.36.140 and RCW 80.28.020 authorize the Commission to determine, after hearing, that a company's "practices" or "practices affecting rates" are unreasonable, to determine the just, reasonable, and proper practices to be thereafter observed and used, and to "fix the same by order or rule."

The Commission is particularly concerned about large cash transactions by non-investment grade companies, because a parent company that is in a weak financial condition is both

more likely to take advantage of cash held by a utility subsidiary and because such a company would have greater difficulty raising capital to offset the loss of cash. Large cash transfers by non-investment grade companies are more likely to directly affect the rates or service provided to ratepayers. Providing the Commission with five days' advance notice does not unreasonably burden the company, and it affords the Commission with sufficient time to take remedial action, if necessary, in advance of any irreparable harm to ratepayers or to the public interest.

AR 2334-35 (Docket No. A-021178 and TO-030288, General Order No. R-518, Order Repealing, Amending, and Adopting Rules Permanently, ¶¶ 26-27, at 19-20 (“Adoption Order”) (March 4, 2005)).

WAC 480-120-369 requires a telecommunications company, whose corporate/issuer rating is not in one of the four highest rating categories of either Standard & Poor's L.L.C. or Moody's Investment Service, Inc. (i.e., non-investment grade), to provide the Commission with five business days' notice prior to making large cash transfers to, or assumptions of liabilities of, any of its affiliated interests or subsidiaries. Specifically, such reporting is required when the cumulative transactions in the prior calendar year exceeded five percent of the company's Washington intrastate gross operating revenue; or, if this threshold has been reached, for each subsequent transaction that exceeds one percent of the company's Washington intrastate gross operating revenue. The rule

also exempts certain companies and transactions from the reporting requirement.⁵

In the case of Qwest, the five percent of gross revenue threshold is triggered only for cumulative transactions exceeding \$42.25 million (five percent of \$845 million). AR 2475-76. Based on information provided by Qwest to the Commission, the Commission staff estimated that Qwest would be required to file, at most, eight reports per year, a level of reports that would not be burdensome and that could be sorted by hand, if needed. AR 2476.

D. Affiliated Interest and Subsidiary Transactions Report (WAC 480-120-395)

WAC 480-120-395 requires each telecommunications company subject to RCW 80.16 (the affiliated interest statutes) to file an annual report with the Commission that summarizes all transactions, except for transactions provided at tariff rates, which occurred between the company and its affiliated interests or subsidiaries during the preceding calendar year. In enacting the rule, the Commission relied upon its broad statutory

⁵ Telecommunications companies serving less than two percent of the access lines in Washington are exempted from WAC 480-120-369. In addition, the rule does not require any companies to report payments for federal and state taxes; payments for goods, services, or commodities; transactions previously approved or ordered by the Commission, other regulatory agencies, or a court; dividends, to the extent that the level of such dividends over a twelve-month period does not exceed the larger of net income during such period or the average level of dividends over the preceding three years; or sweep or cash management accounts used to transfer funds to or from a subsidiary or affiliate as part of the customary and routine cash management functions. WAC 480-120-369(2).

authority to require reports from regulated companies (RCW 80.04.080), and its broad statutory authority to examine the accounts, books, and documents of regulated companies (RCW 80.04.070). AR 2337-38 (Adoption Order, ¶ 39, at 22-23). As the Commission's concise explanatory statement further explains:

Subsidiary accounts are incorporated into the books of the parent company and therefore, activities of the subsidiary directly impact the financial viability of the parent. Cost shifting can occur among regulated parents, subsidiaries, and affiliates, thereby affecting the results of operations of the various entities.

AR 833 (Concise Explanatory Statement, at 6). The Commission, thus, included subsidiary transactions within the reporting requirement because of its concerns that these transactions “can directly and substantially affect the assets and liabilities of the regulated company, and in turn, the rates and services provided by the regulated company to its ratepayers.” AR 2337-38 (Adoption Order, ¶ 39, at 22-23). The Commission noted that no parties, including Qwest, contested the notion that “unreported transactions with a subsidiary can frustrate effective oversight of a regulated company.” AR 2333 (Adoption Order, ¶ 23, at 18).

Finally, in response to Qwest's contention that the definitions of “subsidiary” and “control” in the rule were too vague, the Commission pointed out that it used a definition of “subsidiary” that tracks the long-

established definition of “affiliated interest” in RCW 80.16.010, and that it used a definition of “control” that is substantially the same as that used by the Securities and Exchange Commission. AR 2334 (Adoption Order, ¶ 23, at 19 and n.2).⁶

E. Qwest’s Appeal

On July 8, 2005, Qwest petitioned for judicial review of the Commission’s cash transfer reporting rule, and the affiliated interest and subsidiary transactions reporting rule, contending that the Commission exceeded its statutory authority in enacting the rules. Following briefing and oral argument, the Thurston County Superior Court on February 14, 2006, issued its Order Denying Petition for Judicial Review and Declaratory Judgment. The Superior Court held that the Commission’s enactment of these rules is within its statutory authority granted by RCW 80.04.080 and that, therefore, Qwest failed to show that the Commission exceeded its statutory authority pursuant to RCW 34.05.570(2)(c).⁷ CP 283-84. Qwest filed its notice of appeal with this Court on March 9, 2006. CP 285-288.

⁶ Rule 1-02(g), “Definition of terms used in Regulation S-X” (pertaining to requirements for financial statements filed with the SEC), as found in 17 C.F.R. pt. 210.

⁷ The Superior Court also entered a separate finding that “Qwest has not shown substantial prejudice by the actions complained of, as required by RCW 34.05.570(1)(d).” CP 284. The Commission contended below, as it contends here, that the rules challenged by Qwest should be upheld because they are within the Commission’s statutory authority. The Commission did not seek a separate finding based upon RCW 34.05.570(1)(d). It does not seek such a finding on this appeal.

III. STANDARD OF REVIEW

Qwest challenges the Commission's cash transfer reporting rule (WAC 480-120-369) and affiliated interest and subsidiary transactions reporting rule (WAC 480-120-395) as allegedly exceeding the Commission's statutory authority. Judicial review of this claim is governed by RCW 34.05.570(2)(c). The burden of demonstrating that the rule is invalid is on Qwest. RCW 34.05.570(1)(a); *United & Informed Citizen Advocates Network v. Washington Utils. & Transp. Comm'n*, 106 Wn.2d 605, 610 at n. 4, 24 P.3d 471 (2001).

Qwest contends that the Commission has improperly interpreted the statutes granting it authority to enact the rules in question. While an agency's interpretation of the law is subject to de novo review, in cases such as the present one, where the agency is charged with administering a special field of law and has expertise in that field, courts will accord substantial weight to the agency's construction of statutory language and legislative intent. *Macey v. Department of Empl. Sec.*, 110 Wn.2d 308, 313, 752 P.2d 372 (1988). *Port of Seattle v. Pollution Control Hearings Bd.*, 151 Wn.2d 568, 593-94, 90 P.3d 659 (2004); *Franklin Cy. Sheriff's Office v. Sellars*, 97 Wn.2d 317, 325, 646 P.2d 113 (1982). That is the case here, since the statutes in question involve the Commission's authority to require reports of regulated companies concerning matters

about which it is authorized “to inquire into or keep itself informed about.” RCW 80.04.080. The answer to this question, in turn, depends upon what types of information will assist the Commission to carry out its statutory function of assuring that the rates of regulated utility companies are fair, just, reasonable, and sufficient, and that the services and practices of such companies are lawful and adequate. *See* RCW 80.36.140. This is clearly a matter within the Commission’s specialized expertise.

Significantly, while Qwest, on the one hand, contends that its petition is only a challenge to the rules at issue in this proceeding, which merely require the *reporting* of certain financial transactions, Qwest also devotes a portion of its brief to speculation over subsequent actions that the Commission might take against a regulated company, based upon information that is provided under the rule. *See Qwest’s Opening Brief* at 11. While (as set forth fully below) the Commission clearly has the authority to take any number of subsequent actions based upon financial information it may receive, the action taken in any specific case necessarily would depend upon the specific facts presented, the gravity of harm posed to the rates or services of the company’s ratepayers, the harm posed to the financial viability of the regulated company, or other factors.

In any event, none of these scenarios is presently before this Court. Qwest’s challenge is a facial challenge to the validity of the financial

reporting rules. To the extent that Qwest is attempting to make an “as applied” challenge to the Commission’s rules, or to some other speculative Commission action when no such action has yet occurred, Qwest’s challenge must be rejected as nonjusticiable. *ASARCO, Inc. v. Department of Ecology*, 145 Wn.2d 750, 759-60 (2002).

IV. ARGUMENT

A. The Legislature has granted the Commission statutory authority under RCW 80.04.080 to require special or periodic reports from regulated public service companies, concerning any matter that the Commission is required or authorized to inquire into, or keep itself informed about. The Commission rule requiring the reporting of large cash transfers made by non-investment grade, regulated companies is clearly within this broad grant of statutory authority.

The Commission, as a state agency, has the powers expressly granted by statute as well as those that are necessarily implied from statutory grants of authority. *Washington Pub. Ports Ass’n v. Department of Rev.*, 148 Wn.2d 637, 646, 62 P.3d 462 (2003). When construing the statutes in question, the courts will ascertain and give effect to the intent of the Legislature. *Quadrant Corp. v. State Growth Mgmt. Hearings Bd.*, 154 Wn.2d 224, 238-39, 110 P.3d 1132 (2005). Relevant statutes must be read together and harmonized so that each is given meaning and effect. *Bour v. Johnson*, 122 Wn.2d 829, 835, 864 P.2d 380 (1993). It is not presumed that the Legislature has engaged in a meaningless act. *Aviation*

West Corp. v. Department of Labor & Indus., 138 Wn.2d 413, 421, 980 P.2d 701 (1999).

RCW 80.04.080 grants the Commission broad authority to require public utilities to provide reports of their activities. Specifically:

The commission shall have authority to require any public service company to file . . . periodical or special, or both periodical and special, reports concerning any matter which the commission is authorized or required by this or any other law, to inquire into or keep itself informed about[.]
(Emphasis added.)

Qwest asserts that this statute does not specifically mention “cash transfers;” thus, Qwest argues, since there is no “express” mention of this term, there cannot be any authority to require reports of such transfers. *See Qwest’s Opening Brief* at 17-18. According to Qwest, there must be another “express” statute that specifically authorizes the Commission to inquire into this matter, or such authority cannot exist. *Id.* at 18.

But this cannot possibly be the case. Qwest’s reading of the broad authority granted under RCW 80.04.080 would render it virtually meaningless. It is true, as Qwest points out, that the Commission does have specific authority governing transfers of utility property under RCW 80.12; it has specific authority governing contracts and transactions between affiliated interests under RCW 80.16; and it has specific authority

over securities transactions under RCW 80.08. But the fact that companies must file documents with the Commission under these specific statutes – and the fact that the Commission can in some instances either void the transactions or disallow them for ratemaking purposes – does not mean that the much broader language of RCW 80.04.080 must be read only to duplicate the authority and requirements set forth in these specific statutes. The end result of this reasoning would be the ironic, and nonsensical, conclusion that the Legislature enacted a broadly worded grant of authority that has no real effect at all.

Qwest attempts to compare this case with *Washington Indep. Tel. Ass'n (WITA) v. Telecommunications Ratepayers Ass'n. for Cost-Based & Equitable Rates (TRACER)*, 75 Wn. App. 356, 880 P.2d 50 (1994), but that case is clearly distinguishable. In *WITA v. TRACER*, the court held that the Commission's general enabling statute, RCW 80.01.040(3), did not provide sufficient authority for the Commission to create a Community Calling Fund. That statute simply provides that the Commission shall “regulate in the public interest, as provided by the public service laws, the rates, services, and practices” of telecommunications companies. The court held that there must be some other statutory provision, in addition to the general enabling statute, authorizing the practice in question. *Id.* at 368. Such authority may be

express or necessarily implied from other statutes. The Commission does not disagree with this proposition.

Here, however, RCW 80.04.080 grants the Commission the authority to require reports upon any matters that it is authorized or required “by this or any other statute, to inquire into, or keep itself informed of.” The Commission has extensive duties pursuant to numerous statutes regarding the rates and services of regulated telecommunications companies. It must assure that rates charged to ratepayers are fair, just, reasonable, sufficient, and not discriminatory; it must assure that the services provided are adequate and sufficient; and it must assure that the companies’ practices are just and reasonable. RCW 80.36.140-.180. As the Commission set forth at length in its Adoption Order and Concise Explanatory Statement in this rulemaking, the receipt of information regarding large cash transfers from regulated, non-investment grade companies like Qwest is highly relevant to these duties. Put simply, the Commission needs to be kept informed of such matters so that it may take appropriate remedial action, if necessary, to protect the interests of ratepayers. The authority to require reports of cash transfers is clearly implied from its duties to properly regulate telecommunications rates and services. It is also clearly implied from the Commission’s authority, under

RCW 80.04.070, to “inspect the accounts, books, papers, and documents of any public service company.”

Qwest does not seriously dispute that this information is relevant and useful for the Commission. It does not contend that there are any reasons why such information should be intentionally withheld from the Commission, or why the legislative intent of RCW 80.04.080 should be read to require such a result. Yet that is the result that Qwest argues for — that the very Commission charged by the Legislature with overseeing its regulated rates and services does not even have the right to *know* about, let alone *inquire* about, practices that may directly impact Qwest’s ability to provide adequate services at just and reasonable rates.

It is important to again emphasize that the rule in question here requires only the *reporting* of certain large cash transfers by non-investment grade companies. Based on the information provided, the Commission might take subsequent remedial actions, if this were necessary and appropriate to protect the interests of ratepayers. Whatever action might be taken in any particular circumstances would, of course, depend upon the facts of the case.

However, the Commission might be concerned that the cash transfer will adversely affect the viability of the utility, make it difficult for the utility to obtain financing at reasonable rates, make it difficult or

impossible for the utility to make necessary improvements to its facilities, imperil the quality of services provided to ratepayers, or threaten the utility's ability to provide services at reasonable rates. This might lead the Commission to commence a prudence review (under which the reasonableness of the transfer might be examined, and a determination made as to whether this should be recognized for ratemaking purposes) or a ratemaking proceeding (under which the reasonableness of the utility's rates, including its cost of money and capital structure would be reviewed). These concerns and options were clearly stated by the Commission in its Adoption Order. AR 2335. Furthermore, such ratemaking relief is clearly within the Commission's authority. *See People's Org. for Washington Energy Res. v. Utilities & Transp. Comm'n*, 104 Wn.2d 798, 711 P.2d 319 (1985).

The Commission might also, as part of a ratemaking proceeding, impose service quality requirements to protect the ratepayers of the cash-depleted company. This type of relief has been upheld by the State Supreme Court, in a case involving Qwest's predecessor. *US West Communications, Inc. v. Utilities & Transp. Comm'n*, 134 Wn.2d 74, 112-125, 949 P.2d 1337 (1997). Or, the Commission might determine whether the cash transfer violated a previous condition limiting the use of funds (*e.g.*, as a condition of an approved merger transaction) and take

appropriate remedial action, if necessary. *See* Transcription of July 28, 2004 Commission Open Meeting, at 26-28 (Discussion between Chairwoman Showalter, Commissioner Hemstad, and Qwest's counsel).

The Commission also has the authority, pursuant to RCW 80.36.140, following a hearing, to determine whether a company has engaged in "practices" or "practices affecting rates" that are unreasonable and, if so, to fix and determine the appropriate practices "by order or rule." If a situation was particularly egregious—that is, if a regulated company as to become so cash-depleted following a large cash transfer that it could not fulfill its statutory obligation to provide adequate service at just and reasonable rates—the Commission might seek to enjoin the cash transfer altogether. Qwest appears to imply that there are no possible circumstances that could justify such remedial action. The Commission does not agree, but more significantly, that issue is not now before this Court. What is at issue now is simply the Commission's authority to require the reporting of certain cash transfers, and that authority clearly exists under RCW 80.04.080.

In this regard, the reports required by the rule do not differ from any of the other reports and documents that Qwest and other regulated companies must file with the Commission, whether they be annual financial reports (RCW 80.04.080); contracts or arrangements with

affiliated interests (RCW 80.16), securities issuances (RCW 80.08), and transfers of utility property (RCW 80.12); or other items.

Moreover, several other courts have recognized and upheld the power of states and state utility commissions to take remedial action against regulated utilities when necessary to protect the interests of ratepayers. These courts have upheld actions far more stringent than the simple reporting of a carefully circumscribed class of highly significant transactions, as the Commission rule requires. The courts have found that the authority for such actions is clearly implied from the state commission's extensive authority to regulate the rates and services of regulated utilities in the interest of the ratepayers.

The New York Court of Appeals, in *In the Matter of the Pub. Serv. Comm'n v. Jamaica Water Supply Co.*, 42 N.Y.2d 880, 366 N.E.2d 872, 397 N.Y.S. 2d 784 (N.Y. 1977), for example, upheld a lower appellate court decision that confirmed the authority of the Public Service Commission to restrict the regulated company's payment of cash dividends, pursuant to its statutory duty to ensure safe and adequate service at just and reasonable rates. The Court noted:

[T]he systematic withdrawal of earnings and the reduction therefore of the working capital of the water company had, at the time of the commission's order, imperiled the water company's capacity to maintain

adequate service, sustained only by rate increases. The order stops the drain of working capital by the water company's payment out of cash to the parent company to cover losses by the parent's other subsidiaries.

366 N.E.2d at 873. The lower appellate court similarly held:

In our opinion the general mandate of the Public Service Law to assure safe and adequate service at just and reasonable rates necessarily implies the power to control the disbursement of funds as dividends. The fact that dividends are ordinarily solely a matter of corporate affairs does not insulate them from having an impact on rates and service. The solvency of a public utility is clearly related to its status as an organization capable of providing the public service for which it is franchised.

In the Matter of the Pub. Serv. Comm'n v. Jamaica Water Supply Co., 54

A.D.2d 10, 386 N.Y.S.2d 230, 232 (N.Y. App. 1976). Thus, the New

York Public Service Commission did not simply require reports of

dividends paid out of the regulated company; it forbade such dividends

altogether.

Likewise, in *Baltimore Gas & Electric Co. v. Heintz*, 760 F.2d

1408, 1425 (4th Cir.1985), the court held:

The state may regulate the rates utilities charge consumers either directly, by requiring commission approval of a rate increase, or indirectly, by controlling certain

investments and attempts at diversification
by the utility.

*See also California Indep. Sys. Operator Corp. v. Federal Energy
Regulatory Comm'n (FERC)*, 372 F.3d 395 (D.C. Cir. 2004) (court held
that under statute authorizing FERC to regulate practices affecting rates,
while the agency does not have the power to change the composition of
the governing board of the utility, it does have the power to regulate
practices that directly affect the rate or are closely related to the rate).

The Commission's rule here requires only the reporting of certain
cash transfers. It is clearly authorized under the broad authority granted
the Commission to require special or periodic reports from regulated
utilities under RCW 80.04.080, as such reports provide information that is
highly relevant to the Commission's statutory duty and authority to
regulate, in the public interest, the rates and services of public utilities in
Washington.

Finally, the Commission takes strong exception to Qwest's
assertions that the Commission did not set forth in its Adoption Order the
statutes that are relevant to, and provide authority for, the cash transfer
reporting rule. The Commission referred at length to its authority to
assure that regulated utilities provide adequate service to the public at just
and reasonable rates, authority that is conferred pursuant to RCW

80.36.140 (for telecommunications companies) and RCW 80.28.020 (for gas, electric and water companies). The Commission then set forth, *in detail*, why having timely reports on large cash transfers by non-investment grade utilities is directly relevant to properly carrying out this authority. AR 2334-35, ¶¶ 25-27. The Commission also referred to its broad authority under RCW 80.04.070 to inspect the accounts, books and documents of regulated companies. AR 2338, ¶ 39.

RCW 80.04.080 provides that the Commission may require reports concerning any matter that it is authorized to inquire into, “by this or any other law.” The Commission has articulated the “other laws” that provide the basis for the cash transfer reporting rule. Qwest’s assertions to the contrary are simply incorrect.

B. The Commission has statutory authority pursuant to RCW 80.04.080 to require an annual report of transactions between regulated telecommunications companies and their subsidiaries.

WAC 480-120-395 requires regulated telecommunications companies to provide an annual report of all transactions, except those at tariff rates, between the regulated companies and their affiliated interests or subsidiaries. Qwest contends that the Commission does not have authority to require that it be informed of any transactions between

regulated companies and their subsidiaries. Qwest's contention is incorrect.

As previously set forth in this brief, RCW 80.04.080 grants the Commission broad authority to require reports "concerning any matter which the commission is authorized or required by this or any other law, to inquire into or keep itself informed about[.]" The Commission is charged under numerous statutes with the power and duty to assure that regulated companies continue to provide safe, adequate and proper service, at just, fair, reasonable, sufficient, and nondiscriminatory rates. RCW 80.36.140-.180. The Commission also has the authority, under RCW 80.04.070, to "inspect the accounts, books, papers, and documents of any public service company." These statutes clearly imply the authority for the Commission to be apprised of information that is relevant to these tasks.

The Commission, in its Concise Explanatory Statement, clearly set forth why it needs to be informed of transactions between regulated companies and their subsidiaries:

Subsidiary accounts are incorporated into the books of the parent company and therefore, activities of the subsidiary directly impact the financial viability of the parent. Cost shifting can occur among regulated parents, subsidiaries, and affiliates, thereby affecting the results of operations of the various entities.

AR 833 (Concise Explanatory Statement, at 6). The Commission, thus, included subsidiary transactions within the reporting requirement because of its concerns that these transactions “can directly and substantially affect the assets and liabilities of the regulated company, and in turn, the rates and services provided by the regulated company to its ratepayers.” AR 2337-38 (Adoption Order, ¶ 39, at 22-23). The Commission also noted that no parties, including Qwest, contested the notion that “unreported transactions with a subsidiary can frustrate effective oversight of a regulated company.” AR 2333 (Adoption Order, ¶ 23, at 18).

Qwest refers to the affiliated interest statutes, RCW 80.16. These statutes require that contracts and arrangements between regulated companies and affiliated interests be filed with the Commission (not simply an annual report, as is the case with subsidiary transactions). *See* RCW 80.16.020. Qwest first contends that these statutes “exclude subsidiaries.” This contention is incorrect, for the definition of “affiliated interest” in RCW 80.16.010 includes “every corporation or person with which the public service company has a management or service contract,” which covers a large number of subsidiaries.

In any event, Qwest further contends that because not every subsidiary is included within this statute, there is no authority anywhere else for the Commission to require reports of subsidiary transactions—and

that the Legislature thus intended that the Commission be kept in the dark, and uninformed, of these transactions. Qwest points to decisions in *Waste Management of Seattle, Inc. v. WUTC*, 123 Wn.2d. 621, 869 P.2d 1034 (1994), and *In re Puget Sound Energy, Inc.*, WUTC Docket No. UE-980866, Order Approving Application (Sept. 24, 1998), as somehow supporting this position. *See Qwest's Opening Brief*, at 20-21. But these decisions simply confirm that affiliates are subject to the provisions of RCW 80.16, which requires the filing of affiliate contracts and arrangements, not merely annual reports, to the Commission. The decisions cited by Qwest provide no basis for its contention that the Commission has no authority to know about, let alone inquire about, significant transactions involving subsidiaries.

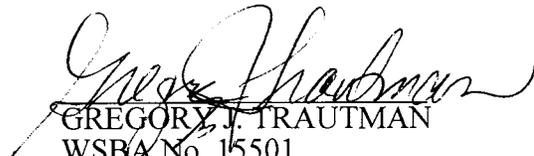
Similar to its argument concerning cash transfers, Qwest argues again that the Commission's authority to require reports under RCW 80.04.080 is limited to duplicating those situations that are already explicitly addressed elsewhere, thus, rendering the authority in RCW 80.04.080 virtually meaningless. This contention is without merit, and this Court should reject it. The Commission has the statutory authority to require regulated companies to provide annual reports of transactions with their subsidiaries.

V. CONCLUSION

Qwest's challenges to the Commission's cash transfer reporting rule, WAC 480-120-369, and the Commission's affiliated interest and subsidiary transactions reporting rule, WAC 480-120-395, are without merit, for the reasons set forth above. Qwest's appeal of the Commission's petition for judicial review should, therefore, be denied.

RESPECTFULLY SUBMITTED this 11th day of August, 2006.

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APPENDIX A

480-120-365 << 480-120-369 >> 480-120-375

WAC 480-120-369

Transferring cash or assuming obligations.

This section does not apply to a company classified as competitive pursuant to RCW 80.36.320, or to a local exchange company that serves less than two percent of the access lines in the state of Washington.

(1) At least five business days before a telecommunications company whose corporate/issuer rating is not in one of the four highest rating categories of either Standard & Poor's L.L.C. or Moody's Investors Service, Inc., or its subsidiary transfers cash to any of its affiliated interests or subsidiaries or assumes an obligation or liability of any of its affiliated interests or any of its subsidiaries, the company must report to the commission an estimate of the amount to be transferred and the terms of the transaction when the transaction will exceed thresholds as described in (a) or (b) of this subsection.

(a) The company must report if the cumulative transactions to a subsidiary or affiliated interest for the prior twelve months exceed a threshold of five percent, which is based on the prior calendar year gross operating revenue from Washington intrastate operations subject to commission jurisdiction.

(b) When the threshold in (a) of this subsection has been reached, the company must report each subsequent transaction exceeding a threshold of one percent for the prior twelve-month period, which is based on the prior calendar year gross operating revenue from Washington intrastate operations subject to commission jurisdiction.

(2) The reporting requirements in subsection (1) of this section do not include payments for:

(a) Federal and state taxes;

(b) Goods, services, or commodities;

(c) Transactions, attributed to the regulated entity, previously approved or ordered by the commission, other regulatory agencies, or the court;

(d) Dividends to the extent the level of such dividends over a twelve-month period does not exceed the larger of:

(i) Net income during such period; or

(ii) The average level of dividends over the preceding three years; or

(e) Sweep or cash management accounts used to transfer funds to or from a subsidiary or affiliate as part of the customary and routine cash management functions between or among the company and its subsidiary or affiliate.

[Statutory Authority: RCW 80.01.040, 80.04.160, 81.04.160 and 34.05.353 [used in WSR 05-06-051 filing only]. 05-06-051 and 05-08-018 (Docket No. A-021178 and TO-030288, General Order No. R-518), § 480-120-369, filed 2/28/05 and 3/28/05, effective 3/31/05.]

480-120-389 << 480-120-395 >> 480-120-399

WAC 480-120-395

Affiliated interest and subsidiary transactions report.

(1) By June 1 of each year, each telecommunications company subject to the provisions of chapter 80.16 RCW must file a report summarizing all transactions, except for transactions provided at tariff rates, that occurred between the company and its affiliated interests, and the company and its subsidiaries, during the period January 1 through December 31 of the preceding year.

(2) The information required in this subsection must be for total company, total state of Washington, and Washington intrastate. The report must include a corporate organization chart of the company and its affiliated interests and subsidiaries.

(3) When total company transactions with an affiliated interest or a subsidiary are less than one hundred thousand dollars for the reporting period, the company must provide the name of the affiliated interest or subsidiary participating in the transactions and the total dollar amounts of the transactions. When total company transactions with an affiliated interest or subsidiary equal or exceed one hundred thousand dollars for the reporting period, the company must provide:

(a) A balance sheet and income statement for such affiliated interest;

(b) A description of the products or services provided to or from the company and each such affiliated interest or subsidiary;

(c) A description of the pricing basis or costing method, and procedures for allocating costs for such products or services, and the amount and accounts charged during the year;

(d) A description of the terms of any loans between the company and each such affiliated interest or subsidiary and a listing of the year-end loan amounts and maximum loan amounts outstanding during the year;

(e) A description of the terms and total amount of any obligation or liability assumed by the company for each such affiliated interest or subsidiary;

(f) A description of the activities of each such affiliated interest or subsidiary with which the company has transactions; and

(g) A list of all common officers and directors between the company and each such affiliated interest or subsidiary, along with their titles in each organization.

(3) The report required in this section supersedes the reporting requirements contained in previous commission orders authorizing affiliated interest transactions pursuant to chapter 80.16 RCW.

(4) The company is obligated to file verified copies of affiliated interest contracts and arrangements as stated in WAC 480-120-375 (Affiliated interests -- Contracts or arrangements).

[Statutory Authority: RCW 80.01.040, 80.04.160, 81.04.160 and 34.05.353. 05-06-051 (Docket No. A-021178 and TO-030288, General Order No. R-518), § 480-120-395, filed 2/28/05, effective 3/31/05.]

No. 34523-4-II

IN THE COURT OF APPEALS
OF THE STATE OF WASHINGTON
DIVISION II

QWEST CORPORATION,
APPELLANT,

V.

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,
RESPONDENT.

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The undersigned hereby certifies that I am an employee of the Office of the Attorney General. I am a citizen of the United States and a resident of the state of Washington. I am over the age of 18 years and not a party to this action.

On August 11, 2006, I served a true and correct copy of

Responsive Brief of the Washington Utilities and Transportation Commission and this **Proof of Service** on the following parties in the manner shown below:

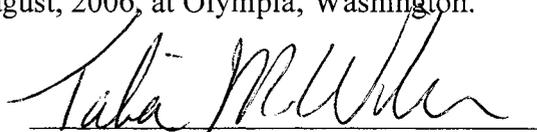
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