

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

LeRoy Koppendrayer
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Chair
Commissioner
Commissioner
Commissioner

In the Matter of Inquiry into Potential Effects of
the Financial Problems at Qwest on the
Company, its Minnesota Customers, and
Potential Mitigation Measures

ISSUE DATE: September 3, 2003

DOCKET NO. P-421/CI-02-1391

ORDER ACCEPTING REPORT AND
CLOSING DOCKET

PROCEDURAL HISTORY

On August 9, 2002, following public announcements made by Qwest regarding accounting errors, employee layoffs and reduced earnings, the Commission issued a notice of its intent to meet on August 15, 2002 to inquire into 1) the potential effects of Qwest's financial problems on the Company, its Minnesota customers and employees, and 2) potential mitigation measures.

The Commission requested attendance at the meeting by Qwest representatives qualified to provide information regarding the Company's accounting errors, announced layoffs, current earnings, and credit ratings. The notice also listed the Commission website where briefing papers prepared by Commission staff for this matter could be found. The Commission sent this notice to all parties on the service list for Qwest's Alternative Form of Regulation (AFOR) Docket (P-421/AR-97-1544) and Merger Docket (P-33009,3052,5096,421,3017/PA-99-1192).

On August 14, 2002, the Commission received a letter from the American Association of Retired Persons (AARP) urging the Commission to open an investigation into Qwest's financial problems to ensure that the reliability of telephone service in the state will not be affected. The Commission received no additional filings in response to its meeting notice.

On August 15, 2002, the Commission met to consider this matter. At the hearing, the Commission heard from representatives of Qwest, a coalition of competitive local exchange carriers (CLECs), Citizens Telecommunications Company and Frontier Communications, Inc., Onvoy Communications, Inc., the Minnesota Department of Commerce (the Department), and the Residential and Small Business Utilities Division of the Office of the Attorney General and one retail customer of Qwest.

On September 9, 2002, the Commission issued an Order directing the Minnesota Department of Commerce (the Department) to gather additional information related to 1) the potential effects of Qwest's financial problems on the Company, its Minnesota customers and employees, and 2) potential mitigation measures. Specifically, in addition to the issues the Department was currently monitoring, the Commission directed that the Department develop the following issues, as well:

- 1) compliance status with respect to the commitments made pursuant to the Alternative Form of Regulation (AFOR) approved by the Commission for the Company;
- 2) appropriate allocation of proceeds from the anticipated sale of Qwest DEX, an affiliate of Qwest Corporation that publishes widely used telephone directories (yellow and white pages); and
- 3) Qwest's plan to maintain effective contact with its wholesale customers (CLECs) during and beyond Qwest's transition to a reduced workforce.

On June 26, 2003, the Department submitted its report on Qwest's financial condition and other areas of its investigation.

On June 30, 2002, the Commission issued a Notice soliciting comments on the Department's report.

On July 14, 2003, Qwest filed comments in response to that Notice. No other party filed comments.

The Commission met on August 19, 2003 to consider this matter.

FINDINGS AND CONCLUSIONS

I. THE DEPARTMENT'S RECOMMENDATIONS

The Department submitted a comprehensive review and analysis of the issues identified in the Commission's Order. Some of the more important parts of its review are as follows.

On the subject of whether creditors of Qwest Communications International, Inc. or any of the Qwest family of corporations have a claim against the assets or Qwest Corporation (the Regional Bell Operating Company or RBOC providing local, regulated service in Minnesota, the Department noted that procedures are in place, through compliance with FCC and Commission requirements related to cost allocations and account separations, to protect Minnesota ratepayers for charges that are not a part of Qwest - Minnesota's intrastate operations.

On the issue of which Qwest entity is responsible for the recently reported loan from an associate of Bank of America, the Department indicated that it was satisfied that Qwest Services Corporation's (QSC's) credit agreement does not pledge any QC assets as part of the loan agreement. QSC's obligations are secured by a first pledge on the capital stock of QC, a second pledge on the capital stock of QwestDex, and certain assets of QwestDex. The Department noted that should creditors seek to enforce a pledge upon the stock of QC, prior Commission approval is required before a change of ownership could occur. The Department also concluded that the Commission has the authority to review the pledge of regulated assets if the transaction impacts the rates and services offered to Minnesota consumers, and that a review of the reasonableness of Qwest's debt restructuring should be addressed at QC's next ratemaking proceeding.

Regarding the status of compliance with the terms of the U S WEST/Qwest merger agreement, the Department noted that its Comments in Docket No. 421/AR-97-1544 (the AFOR case) and Docket No. P421 et al/PA-99-1192 (the Merger case) relating to Qwest's previous year's performance concluded that Qwest is in substantial compliance with the AFOR and Merger requirements. The Department also noted that Qwest reported compliance for wholesale services as required under the Merger Agreement.

In addition, the Department reported the status of the shareholder suit reported August 15, 2003, announced resolution of the conflict of interest concern identified in earlier comments, and reported on the status of the Company's AFOR and its plan to maintain effective contact with its wholesale customers during and beyond Qwest's transition to a reduced workforce.

The Department recommended that the Commission determine that it would not be appropriate for QC-Minnesota ratepayers to pay for a higher cost of capital or other costs resulting from Qwest's financial problems. In addition, the Department recommended that if QC's AFOR expires and a rate making proceeding is initiated, QC should be required to

1. identify all issuances of debt and associated cost in a manner that will facilitate a potential adjustment to mitigate the impacts of adverse market factors due to Qwest's financial situation;
2. provide a discussion and analysis of the effects at that time of Qwest's financial situation on QC's cost of common equity;
3. report any significant financial event for QC and provide copies of any reports made to the SEC or any other federal agency on a going forward basis;
4. maintain service quality at or above levels that existed at the time of the Qwest merger and the QC-MN AFOR plan by meeting or exceeding all service quality standards set for QC-MN; and
5. include an imputation for QwestDex revenues in the jurisdictional revenue requirement calculation.

II. THE COMMISSION'S ANALYSIS AND ACTION

The Department's report has satisfactorily addressed the concerns raised at the Commission's meeting on August 15, 2002.

The Department identified five issues that it believed should be addressed at a ratemaking proceeding and Qwest has agreed that these financial matters should be addressed in a ratemaking proceeding. The Department recommended that if Qwest initiates a rate case proceeding it should be required to address those five issues.

Due to the possibility of changed circumstances between now and Qwest's next rate case, the Commission declines to determine at this time whether Qwest will be required to address in that future rate case the issues identified by the Department in its Report. Instead, the Commission will simply accept the Department's Report. By accepting the Department's report, the Commission certainly takes note of the Department's recommendation, however. In addition, as a permanent part of the record in this docket, the Report will remain available for reference and examination at a future date. Finally, in accepting the Department's Report, the Commission expresses appreciation for the Department's work and retains the discretion to revisit the Department's Report and recommendations when Qwest's rate case actually arises, when the circumstances existing at that time can better inform the Commission as to what issues it is appropriate to require be examined in the rate case.

ORDER

1. The Commission accepts the Department's Report, determines that no further action is needed at this time, and closes the docket.
2. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Burl W. Haar
Executive Secretary

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