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IN THE MATTER OF QWEST COMMUNICATIONS INTERNATIONAL, INC.'S, QWEST SERVICES CORPORATION'S, AND QWEST CORPORATION'S NOTICE OF SALE, REQUEST FOR WAIVER, OR APPLICATION FOR APPROVAL OF THE SALE OF THE ARIZONA OPERATIONS OF QWEST DEX, INC.	Docket No. T-01051B-02-0666

Arizona Corporation Commission
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NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Non-Proprietary Direct Testimony of Ben Johnson, Ph.D. in the above-referenced matter. The Proprietary version of the Testimony will be made available to those parties that have executed the appropriate Protective Agreements.

RESPECTFULLY SUBMITTED this 19th day of March, 2003.

Daniel W. Pozefsky
Staff Attorney

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TABLE OF CONTENTS

TESTIMONY

OF BEN JOHNSON, PH.D.

On Behalf of

THE STATE OF ARIZONA

RESIDENTIAL UTILITY CONSUMER OFFICE

Before the

ARIZONA CORPORATION COMMISSION

Docket No. T-01051B-02-0666

Introduction

Q. Would you please state your name and address?

A. Ben Johnson, 2252 Killearn Center Boulevard, Tallahassee, Florida 32309.

Q. What is your present occupation?

A. I am a consulting economist and president of Ben Johnson Associates, Inc., an economic research firm specializing in public utility regulation.

Q. Have you prepared an appendix that describes your qualifications in regulatory and utility economics?

A. Yes. Appendix A, attached to my testimony, will serve this purpose.

Q. Can you briefly explain the corporate names and acronyms that you will be using in your testimony?

A. Throughout my testimony, I will use the acronym "QCI" when specifically referring to Qwest Communications International, Inc. QCI is a publicly traded holding company that owns 100% of the stock of Qwest Corporation. I will use the acronym "QC" when referring specifically to Qwest Corporation, which is the entity that provides local exchange service in Arizona. I will use the acronym "QSC" if I am referring specifically to Qwest Services Corporation, another QCI subsidiary. I will use the term "Dex" when referring to Qwest Dex, Inc., which is another subsidiary of QCI–one whose primary function is the publication of telephone directories in QC's local exchange areas. When referring more generally or collectively to QCI and/or QC and its affiliates, I will use the term "Qwest" or "the Company."

Q. What is your purpose in making your appearance at this hearing?

A. Our firm has been retained by the Residential Utility Consumer Office ("RUCO") to assist with RUCO's participation in this proceeding. We have been asked to analyze the proposed sale of Dex to Dex Holdings LLC, along with various long term contracts which are part of this proposed sale. I will refer to the proposed sale of Dex and the associated contracts as the "proposed transaction."

Q. Would you please explain how your testimony is organized, and briefly summarize its major elements?

A. Yes. Following this introduction, my testimony has five sections. The first section contains a brief discussion of the background of this proceeding. In the second section I describe the proposed sale and summarize Qwest's claims regarding the merits of the proposed transaction. The third section examines the linkage between directory publishing and local exchange service. Historically, telephone directories that are published by, or otherwise closely associated with, an incumbent local exchange carrier generate revenues far in excess of the direct costs of publishing those directories. In this section, I explain some of the reasons why the Dex directories generate high revenues and income, all of which directly relate to QC's local exchange operations. I the fourth section I discuss the concept of imputation of directory income for regulatory purposes and the potential impact on imputation of the proposed transaction. In addition, I analyze the proposed transaction from a public interest perspective. In the fifth and final section, I present my conclusions and recommend that the Arizona Corporation Commission (the "Commission') approve the proposed transaction with certain conditions.

Q. Would you please briefly summarize your testimony?

A. Yes. The Company argues the proposed sale will enable it to avoid bankruptcy, but this temporary infusion of cash would do little more than postpone QCI's liquidity problems. Moreover, the directory publishing operations are the source of a very substantial and growing flow of cash, revenues, and profits–all of which will be lost once the sale is completed. Hence, the proposed transaction will have a substantial adverse impact on all of the major long term indicators of financial health, including earnings per share, gross profit margins, and interest coverage.

In Arizona, as in most jurisdictions, directory publishing has long been viewed as a profitable byproduct of local telephone service, serving to offset the cost of providing local telephone service. The Company has not provided adequate assurance that rates will not increase as a result of the proposed transaction. Once the directory publishing operations are no longer be located within the Qwest corporate family it will be more difficult to maintain an appropriate policy with respect to imputation of directory income. Furthermore, because of the unique structure of the proposed transaction, the relevant "value of fees and services" will be more difficult to determine.

For these and other reasons, I conclude that in the absence of adequate safeguards and assurances, the proposed transaction is not in the public interest. I recommend that the Commission reject the proposed transaction unless additional assurances and safeguards are provided. Furthermore, to ensure that all parties are treated fairly, it would be preferable for the Commission to establish an appropriate imputation amount (or formula) that will apply in future regulatory proceedings, notwithstanding any changes in circumstances that will result from completion of the proposed sale.

One way of accomplishing this is would be to establish an appropriate imputation amount (or formula) using the $43 million imputation figure referenced in the 1988 Settlement Agreement as a starting point. When this amount was initially established in Mountain Bell's 1984 rate case, it was equivalent to $2.59 per line per month. Applying this figure to the current number of switched access lines in the Company's Arizona service territory, without taking inflation into account, this is equivalent to approximately $90 million per year. Adjusting for inflation (based upon changes in the GDP Deflator from 1984 to 2001) this is equivalent to approximately $138 million as in 2001 dollars.

Without adequate safeguards and assurances, the proposed transaction is not in the public interest. Hence, if the Company is unwilling to voluntarily provide the type of assurances and safeguards I have recommended, or if it wants to reserve the right to appeal the Commission's imposition of such safeguards, the Commission should refuse to approve the proposed transaction.

Background

Q. Let's turn to the first section of your testimony. Would you please start by outlining the history of this proceeding?

A. Yes. On August 30, 2002, QCI, QSC, and QC filed a Notice of Sale, Request for Waiver or Application for Approval Pursuant to R14-2-803 wherein it sought to sell its "directory publishing assets in Arizona owned by Dex to Dex Holdings LLC (the "Buyer"), which is an entity not affiliated with Qwest. [Notice, p. 1 and p. 11.] Dex Holdings LLC is an unregulated, unaffiliated, third-party Buyer. It is owned by The Carlyle Group and Welsh, Carson, Anderson & Stowe–both private equity investment companies. [Kennard, p. 3]

> "Established in 1987, The Carlyle Group is a private global investment firm that originates, structures and acts as lead equity investor in management-led buyouts, strategic minority equity investments, equity private placements, consolidations and buildups, and growth capital financings. Since its inception, the firm has invested more than $7.2 billion of equity in 263 corporate and real estate transactions with an

> aggregate acquisition value of over $19 billion. As of September 30, 2002, the firm had more than $13.9 billion of committed capital under management." [http://www.thecarlylegroup.com/profile.htm]
>
> "Unlike other large private equity firms, our investment activities are exclusively focused in three industries: information services, communications and healthcare. Moreover, we can supply subordinated debt as well as equity to complete transactions. WCAS specializes in acquiring and building established businesses in our three targeted industries. The firm's principals have significant operating experience as well as investment experience in our industries." [http://www.welshcarson.com/site/background.cfm]

William Kennard, testifying on behalf of the Buyer, states that the two firms have experience in "owning and managing communications-related businesses" through board members who used to work in the telecommunications industry and through communications and publishing investments. [Kennard, p. 5]

In its Notice of Sale, Qwest argued that the Commission should not block the proposed transaction for any of three reasons: (1) QCI need not comply with Commission rule R14-2-803 due to a waiver it received in Commission Decision No. 58087 and reaffirmed in Decision No. 64654, (2) the Commission vacated jurisdiction over directory asset sales in a "1988 Mountain Bell Settlement Agreement," and (3) the sale is in the public interest. [Id., p. 15]

To understand these contentions it is helpful to briefly retrace the history of these assets. In October 1987, the Commission voided a 1984 transfer of directory assets by Mountain Bell to one of its subsidiaries and fined Mountain Bell for completing the transfer without prior Commission approval. [Decision No. 55755, p. 8] The parties subsequently reached a settlement resolving the issues that were in dispute. The parties agreed that Mountain Bell's transfer of directory assets would be allowed and that "the Commission will take no further action to challenge that transfer." [1988 Settlement Agreement, pp. 1-2]

The 1988 Settlement Agreement was the subject of subsequent disputes, particularly with regard to directory imputation. In setting Mountain Bell's rates after divestiture, the Commission took into account "imputed" directory publishing income of approximately $43 million. In the 1988 Settlement Agreement the parties agreed

> that in subsequent rate cases downward adjustments from the $43 million in fees received by Mountain Bell from USWD [U S West Direct–the Mountain Bell subsidiary to whom the directory assets were ultimately transferred] and included in Mountain Bell's 1984 rate case will require more than a showing by Mountain Bell that it negotiated a lesser amount with USWD. [Id., p. 2]

In a subsequent rate proceeding US West argued that

> any imputation in excess of $43 million was in conflict with the spirit and terms of the 1988 Settlement Agreement as approved in Decision 56020. According to the Company, the clear language of the Settlement Agreement only referred to a possible decrease in the $43 million imputation and made no reference to any possible increase. [Decision 58927, p. 12]

The 1988 Settlement Agreement indicated that the $43 million figure was the amount reflected in rates since the 1984 rate case, based upon the fees paid by US West Direct (USWD) to Mountain Bell. However, larger imputation amounts weren't necessarily precluded, as suggested by this language:

> in future rate cases filed by Mountain Bell, the Commission, in arriving at the test year operating income of Mountain Bell, will consider the fees and the value of services received by Mountain Bell from USWD under publishing agreements with USWD; that Mountain Bell and the Commission Staff may present evidence in support of or in contradiction to those fees and the value of those services. [1988 Settlement Agreement, p. 2]

The Commission subsequently rejected US West's argument that larger imputation amounts were precluded:

> We agree with RUCO and Staff that the Settlement Agreement does not place a cap of $43 million on the amount of imputation. It does indicate that the Commission in future cases "will consider the fees and the value of services received by Mountain Bell from USWD under publishing agreements with USWD. . . ." Subsequent to the Settlement Agreement, Direct no longer pays any publishing fees to the Company (formerly Mountain Bell). Hence, the Commission must determine what would be reasonable fees and value of services under the circumstances. [Decision 58927, p. 13]

Q. Can you briefly elaborate on the concept of "imputation"?

A. Yes. Imputation is a technique used by regulators to restate a utility's income for ratemaking purposes at a level equivalent to that which would be earned if the utility did not enter into transactions that serve to benefit an affiliated company. Without the option of using this ratemaking technique, regulators would be faced with a Hobson's choice: either attempting to block affiliated transactions that may not be fully beneficial to ratepayers, or allowing such transactions to adversely impact ratepayers.

Imputation adjustments have been widely used with respect to directory publishing, where local exchange companies have entered into agreements with affiliated publishing entities that do not provide the local exchange operations with as much income as they could earn by publishing their own directories, and/or what they could earn if they entered into an arms length contract with a completely independent publishing company. The higher level of income which could potentially be achieved by the local exchange operations is "imputed" for ratemaking purposes, thereby ensuring that ratepayers are not harmed when an affiliated company is allowed to publish the directories.

In a concurring opinion, Utah Supreme Court Justice Stewart explained that directory imputation prevent a carrier "from cherry picking the most profitable assets and diverting the profits therefrom to its shareholders." Also, "the cessation of imputation of revenues would unfairly transfer the benefit of present and future profits from the ratepayers to the shareholders." He explained that Utah is not unique in this regard:

> ...directory imputation has also been upheld when other telecommunications utilities have transferred directory publishing operations to unregulated affiliates. See, e.g., Rochester Tel. Corp. v. Public Serv. Comm'n, 660 N.E.2d 1112, 1116-18 (N.Y. 1995); State ex rel. Util. Comm'n v. Southern Bell Tel. & Tel. Co., 299 S.E.2d 763, 765-67 (N.C. 1983); Turpen v. Oklahoma Corp. Comm'n, 769 P.2d 1309, 1327-28 (Okla. 1988)." [US West v. Public Service Commission of Utah, No. 980082, January 7, 2000]

Q. What was the next major initiative pursued by Qwest following the 1988 Settlement Agreement?

A. In November 1992, U S West Communications, Inc., the parent company of Mountain Bell, filed an application for a waiver of Commission rules R14-2-803 and R14-2-805 (two of the Affiliated Interest Rules). [Decision No. 58087, p. 1] A waiver of R14-2-803 would allow US West to be exempt from filing "notice[s] of intent to organize or reorganize a public utility holding company" with the Commission under certain circumstances. [Id., p. 5] While it did not ultimately grant a waiver of rule R14-2-805, the Commission ruled that it would waive US West's reporting requirements under R14-2-803 so long as the "organizations or reorganizations" did not

> 1) result in increased capital costs to USWCI [US West]; 2) result in additional costs allocated to the Arizona jurisdiction; or 3) result in a reduction of USWCI's net operating income. [Id.]

Then, in a 1995 rate proceeding, controversy arose concerning the appropriate imputation of directory income. [Decision No. 58927, p. 1] In developing its revenue requirement and proposed rates, US West proposed a directory imputation adjustment of $42,657,000, consistent with the 1998 Settlement Agreement. [Id.] The Commission Staff disagreed with this calculation, and recommended a directory imputation amount of $60,684,000. [Id.] In resolving this dispute, the Commission ruled that "the Settlement Agreement does not place a cap of $43 million on the amount of imputation." The Commission approved the Staff recommendation. [Id.]

US West appealed this decision to the Arizona Court of Appeals. The Company charged that

> the Commission unreasonably and unlawfully (1) imputed to US West an excessive amount of operating income for directory revenues that a related company earned, (2) disallowed a portion of US West's lease expenses, and (3) disallowed a transition cost adjustment to cover US West's change from cash to accrual accounting for non-pension retirement benefits. [US West Communication, Inc. v. ACC, 185 Ariz. 277, 279 (App.1996)]

The Court agreed with US West regarding the first complaint but not the second or third. [Id.] The Court ruled that the Settlement Agreement did not preclude an upward adjustment to the imputation amount, but the adjustment must be based on the value of fees and services. [US West Communication, Inc. v. ACC, 185 Ariz. 277, 281 (App. 1996)] It ruled that the Commission's decision in that case was invalid, because it was not based on the value of fees and services:

> Accordingly, because the Commission relied on a methodology that its 1988 agreement renders invalid, and because the staff introduced no evidence that would support a greater imputation under the proper methodology, we set aside the Commission's greater imputation and direct it on remand to impute only $43 million of directory revenue. [US West Communication, Inc. v. ACC, 185 Ariz. 277, 281-282 (App.1996)]

In June 2000, the Commission authorized the merger of US West and QCI. As one result of the merger, QCI sought a reaffirmation of "the limited waiver of the Commission's

Affiliated Interest Rules previously granted [to US West] in Decision No. 58087 (November 23, 1992)." [Decision No. 64654, p. 1] The Commission granted this application, in recognition of Staff's findings that, among other things, organizations and reorganizations within QCI could be a common occurrence and that the limited waiver previously granted to US West had served as a safety net through which the Commission could focus its attention on only those changes that were of greatest consequence. [Id., p. 4]

The Company characterizes the Dex sale as a reorganization that does not meet any of the three conditions in the Decision No. 58087 that would necessitate the filing of a "notice of intent" to reorganize with the Commission. It argues that the terms of both the 1992 and 2002 waivers should be applied to the Dex sale. [Notice of Sale, p. 12] However, were the Commission to rule that the Dex sale does not fall under the scope of the 1992 and 2002 waivers, Qwest feels that it "should be granted a waiver as to this specific transaction." [Id.] The Company seeks a waiver of the following Commission Rule:

> Any utility or affiliate intending to organize a public utility holding company or reorganize an existing public utility holding company will notify the Commission's Utilities Division in writing at least 120 days prior thereto. . . [R14-2-803]

In its Notice of Sale, Qwest argues that the proposed Dex sale is in the public interest because it "will not change the provision of telecommunications service to Arizona customers." [Notice of Sale, p. 14] Qwest maintains that it will comply with all Commission rules governing the sale of utility assets where such a sale will "have a significant effect upon, or relationship to, either QC or Arizona." [Notice of Sale, p. 12] However, the Company contends it should be exempt from having to notify the Commission in writing of the organizational changes resulting from the sale, as it otherwise would be required to do under R14-2-803.

> QCI has significant first and second-tier subsidiaries, some of which have other affiliated interests. The creation, deletion and modification of the structure and interest in those affiliates is a common occurrence, which often has no effect on Arizona regulated telecommunications operations. [Id.]

In response to Qwest's Notice of Sale, Staff filed a Request For a Procedural Order which was granted by the Commission on December 20, 2002. [Procedural Order, pp. 1, 3] The procedural schedule set by the Commission was meant to strike a balance between the "aggressive" timetable proposed by Qwest and the "extended" one proposed by Staff. In accordance with this schedule, four witnesses submitted direct testimony on behalf of QC: Brian Johnson, George Burnett, Maureen Arnold, and Peter Cummings. The Buyer submitted direct testimony of one witness (William Kennard).

Summary of the Proposed Transaction

Q. Would you please describe the major components of the Dex sale?

A. Yes. This $7.05 billion transaction will be executed in two parts, referred to as the "Dexter" stage and the "Rodney" stage. [Notice of Sale, pp. 2-3]

> The first stage includes all Dex operations in Colorado, Iowa,

> Minnesota, Nebraska, New Mexico and El Paso, Texas, North Dakota and South Dakota (the "Dexter"). The second stage includes the Dex operations in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming (the "Rodney"). [Id.]

The Buyer has agreed to pay $2.75 billion for the Dexter portion of the transaction. It will pay $4.3 billion for the Rodney portion. [Qwest Form 8-K, August 8, 2002] The Dexter stage closed on November 8, 2002. [Kennard, p. 3]

> Just prior to that closing, Qwest Dex, Inc. transferred its assets and liabilities in each of those states to its newly created subsidiary, SGN LLC. At the closing, the ownership of SGN LLC transferred from Qwest Dex to Dex Media East. [Id.]

Dex Media East is a subsidiary of Dex Media, Inc. which is in turn an indirect subsidiary of the Buyer. [Id.]

Immediately prior to the closing of the Rodney stage, Dex will transfer its directory publishing assets in the Rodney states in a manner similar to its transfer in the Dexter states. The Rodney transfer differs from the Dexter transfer in that SGN LLC is replaced by GPP LLC and Dex Media East is replaced by Dex Media West. [Id.]

> Consummation of each staged closing is conditioned, among other things, on (a) the receipt of debt financing on the terms set forth in Buyer's commitment letters, (b) the separation of the Dexter and Rodney businesses, and (c) the termination or expiration of the applicable waiting period under the Hart-Scott-Rodino Act. In addition, the Rodney closing may not occur in the event that state commission, individually or collectively, order gain sharing, rate

> reduction, additional capital investments or other forms of economic loss to QCI and/or its subsidiaries (including QC) in excess of a specified level. [Notice of Sale, p. 3]

Q. Will the organizational structure of the directory publishing operations remain the same following the closing of the sale?

A. Yes and no. Mr. Kennard states little change will be seen from a labor standpoint. The management team and rank and file workers at Dex will see little to no turnover in the course of the sale. [Kennard, p. 6] The corporate structure will, however, change:

> The former Dex operations will be divided into two regions, based on the Dexter and Rodney stages of the transaction: Dex Media East will include operations specific to the Dexter states, and Dex Media West will include operations specific to the Rodney states. Many functions common to directory publishing operations in both regions will remain consolidated and will operate from within Dex Media, Inc. Even though there will be two separate companies after Rodney closes, the Buyer plans to operate as an integrated entity ... [Burnett, p. 10]

Mr. Burnett also describes three additional agreements reached by the parties to the transaction meant to overcome the difficulties associated with the organizational changes. These agreements are a Professional Services Agreement reached by SGN LLC and Dex, a Joint Management Agreement reached by SGN LLC and the Buyer, and a Transition Services Agreement reached by SGN LLC and QCI. [Id., pp. 11-13]

> For an interim period leading up to the Rodney close, this [Professional Services Agreement] requires Dex Media, Inc. to provide Dex with

> intellectual property licenses as well as certain professional services. [Id., pp. 11-12]
>
> A Joint Management Agreement provides that Dex, as well as Dex Media, Inc. and its subsidiaries, will each employ the six key management team executives, including myself, during the transition period. [Id., p. 12]
>
> [Under the Transition Services Agreement,] QCI will make available to Buyer real estate, finance and accounting, procurement, treasury and cash management, human resources, marketing and public relations, legal, corporate/executive, IT, billing and other services. [Id., pp. 12-13]

Q. Are these long term agreements?

A. No. The three agreements described above are only applicable during the transition period wherein Qwest and the Buyer wait for approval of the Dex sale in select Rodney states. Going forward, the parties entered into a different series of agreements that will help maintain or enhance the income generated by the transferred directories and related publishing activities:

> QC, the Buyer, Dex Media East and Dex Media West entered into a long term Publishing Agreement designating Dex Media East and Dex Media West as QC's official publisher in its 14-state local service region. ... Dex Media East and Dex Media West will use QC's designated branding scheme and follow QC's trademark instructions. [Id., p. 15]

Under a Directory License Agreement,

> QC will grant to the Buyer for the term of the Publishing Agreement a

> restricted license to use the directory publisher lists and directory delivery lists for the sole purpose of publishing and delivering the directories to QC's 14-state region. [Notice of Sale, pp. 4-5]

Under a Non-Directory License Agreement,

> QC will grant to the Buyer a restricted license to use the subscriber list information in its direct marketing activities for a term of five years. [Id., p. 5]

And under a Public Pay Stations Agreement,

> The Buyer will place directories in all of QC's public pay stations in the Region available for directory placement (with certain limited exceptions) for the term of the Publishing Agreement. [Id.]

Under these long term agreements, the Buyer will publish directories on behalf of QCI in the 14-state region for as much as 50 years. QCI, in turn, has agreed to not attempt to develop its own directory publishing operations and will not compete with the Buyer in the directory market for as much as 40 years. [Qwest Form 8-K, August 8, 2002]

Q. Why has QCI initiated the Dex sale and entered into these agreements with the Buyer?

A. The Company's witnesses provide one primary reason for the initiation of the sale–the need to improve QCI's financial condition. The Company's substantial cash flow generated by the proposed transactions ($7.05 billion) will allow it to pay down debt–particularly QCI's $3.4

billion Amended Credit Facility that is coming due in May 2003 and $1.155 billion in debt that will have matured by June 2003. [Johnson, pp. 9-10] Without this infusion of cash, the Company is concerned that it may be forced to default on various credit arrangements, loans, and maturing debt. [Id., p. 11]

The Dex sale was split into two stages to facilitate this rapid infusion of cash. The Company felt that it could gain relatively expeditious approval of the sale in the Dexter states, allowing it to receive the proceeds from these assets quite quickly. This provided an immediate infusion of funds and allowed QCI to negotiate credit arrangements that, in the Company's view, allowed it to avoid filing for bankruptcy. [Id., pp. 8-9] QCI has received the Dexter portion of the proceeds and used these funds to reduce the balance due on the Amended Credit Facility from $3.4 billion to $2.0 billion. [Id.] Approval from the Rodney states was anticipated to be more time consuming because these states were expected to conduct a more extensive review of the sale. [Id., p. 10]

Mr. Johnson also argues that the funds which will be provided upon closing the Rodney stage remain crucial to QCI's financial viability. Without this capital, he feels that QCI "will be in great jeopardy of not being able to pay off its maturing debt." [Id., p. 10] The Company would also "likely have insufficient cash from internal operations to meet upcoming ARCA [Second Amended and Restated Credit Agreement] payments and long-term debt maturities." [Id., p. 11]

> QCI and its subsidiaries still must make the debt maturity payments of over $6.5 billion over the next three years and over $8.5 billion over the next five years. The Rodney proceeds are still vitally needed for

> QCI and its subsidiaries to avoid defaulting under their obligations. [Id., p. 12]

Q. In the previous section, you reference the Company's claim that the Dex sale is in the public interest. How does it reach this conclusion?

A. The primary argument behind the Company's public interest analysis is similar to an argument made famous (or infamous–depending upon your perspective) by Charles Wilson, secretary of defense under President Eisenhower: "What's good for General Motors is good for the country." In their testimony, QC witnesses are basically saying, "what's good for QCI is good for Arizona." In other words, by saving QC's parent company from financial ruin, the Commission would be helping all of those Arizona citizens that rely on QC for their phone or data services, or who might be adversely affected by any disruption in Qwest's existing corporate structure. Ms. Arnold clearly makes this point.

> It has always been recognized that the financial health and viability of a public utility is a primary consideration in the public interest. ... The Commission also recognized the importance of QC's continuing financial viability by imposing several conditions on approval of the merger between QCI and [US West] designed to maintain QC's financial integrity. [Arnold, p. 14]

Mr. Johnson emphasizes the point.

> [A bankruptcy] filing could be disruptive for all the companies in the Qwest family of companies, for the employees of all those companies, for the people who rely on those companies, and, potentially, for the

service provided by some or all of those companies. [Johnson, p. 13]

QC also argues that the transaction is in the public interest in that it maintains the status quo where directory quality is concerned. Ms. Arnold contends that the Publishing Agreement outlined above will ensure that the Buyer meets all of the legal obligations that QC currently is required to meet regarding directory quality. [Arnold, p. 18] These obligations include providing a list of QC subscribers to competitive directory publishers and including in its own directories the listings for customers of competitive providers. [Id., p. 16] Further, in Arizona, "customers who purchase certain classes of service are entitled to a directory listing as part of the service." [Id.] Close consultation between the parties to resolve changes to the directory is one such proposed method of ensuring all obligations are met. [Id., p. 18]

Mr. Kennard also notes that it is in the Buyer's best interest to maintain directory quality:

> More importantly, Dex's reputation and substantial goodwill are based on the public's perception that its directories are accurate and complete and on advertisers' confidence that the directories are widely distributed. This is an asset that the Buyer will protect above all by taking great pains to ensure full and complete listings and full and widespread distribution of the directories themselves, including placement at payphone stations. [Kennard, p. 7]

Needless to say, this line of reasoning does more to rebut a potential claim that the sale could be contrary to the public interest (because quality might deteriorate) than it does to affirmatively demonstrate that the sale is in the public interest. To the extent it is "in the public interest" to maintain the existing arrangements with other carriers and the status quo level of quality, this could also be accomplished by maintaining all of the existing arrangements by rejecting the proposed sale. The Buyer does not claim it will be making any specific additions or improvements to the directories–it just provides assurances that quality will not diminish. Hence, the public interest argument largely boils down to a contention that Arizonans may suffer if QCI is forced into bankruptcy, and they will benefit if QCI's financial health is enhanced or restored.

Economics of Directory Publishing

Q. Please turn to section three of your testimony. Can you begin by discussing the origins of the RBOCs' directory publishing operations?

A. Incumbent local exchange carriers have published directories throughout this century. Although initially conceived as a method of helping customers use the telephone, directories had become an important source of revenues and profits for all local exchange carriers.

> Prior to divestiture, both the "Yellow Pages" and "White Pages" directories were prepared and distributed by the local phone company. The directory publishing assets were included in the rate base of the local phone company from which significant profits were used to reduce local telephone rates. [Decision 58927, p.10]

In the 1984 antitrust consent decree, the parties initially agreed, among other things, that the Regional Bell Operating Companies (RBOCs) would not pursue any "non monopoly" business, including the provision of directory advertising. This arrangement seemed logical, since customer premise equipment, long distance, and other relatively competitive services were transferred to, or remained with, AT&T and the most monopolistic services were transferred to, or remained with, the RBOCs. However, state regulatory agencies and consumer advocates objected to the idea of transferring this enormous stream of revenues and profits to AT&T.

Q. Was the consent decree accepted by the court?

A. Not as initially proposed. Judge Greene made several important changes in response to criticisms and comments submitted by state regulators and others. Most importantly in the context of this proceeding, he decided that the RBOCs should be allowed to retain the extremely profitable directory publishing business. Several factors contributed to this decision. For one thing, Judge Greene was not convinced that it was necessary to transfer the publishing business to AT&T in order to prevent the RBOCs from using their monopoly power in an anticompetitive manner. He noted that various aspects of the consent decree designed to restrict the RBOCs participation in non-monopolistic businesses "are based upon the assumption that the Operating Companies, were they allowed to enter the forbidden markets, would use their monopoly power in an anticompetitive manner." [*Opinion*, United States District Court for the District of Columbia, Civil Action No. 74-1698, Civil Action No. 82-0192, Misc. No. 82-0025 (PI), August 11, 1982, p. 102.] However, Judge Greene said it was not clear that publishing directories allowed the Operating Companies much opportunity to exercise anticompetitive behavior:

> This restriction lacks an appropriate basis and is not in the public

> interest. Neither of the reasons underlying the other restrictions on the Operating Companies--the need to prevent cross-subsidization and the importance of preventing competitor discrimination--has any relevance to the printed directory market.
>
> All parties concede that the Yellow Pages currently earn supra-competitive profits.... There is no warrant therefore for proceeding on the premise that the advertising prices charged by the Operating Companies are artificially low as the result of a subsidy from local exchange service." [*Id.*, pp. 113-114.]

Further, he noted, other public policy issues must be considered:

> In addition to these factors directly related to competition, there are other reasons why the prohibition on publication of the Yellow Pages by the Operating Companies is not in the public interest. All those who have commented on or studied the issue agree that the Yellow Pages provide a significant subsidy to local telephone rates. This subsidy would most likely continue if the Operating Companies were permitted to continue to publish the Yellow Pages. [*Id.*, pp. 114-115.]

Judge Greene noted that various intervenors had addressed the potential public policy effects of excluding Yellow Pages revenues from the Operating Companies' regulated operations.

> The loss of this large subsidy would have important consequences for the rates for local telephone service. For example, the State of California claims that a two dollar increase in the rates for monthly telephone service would be necessary to offset the loss of revenues from directory advertising. Evidence submitted during the AT&T trial indicates that large rate increases of this type will reduce the number of households with telephones and increase the disparity, in terms of the

> availability of telephone service, between low income and well-off citizens. This result is clearly contrary to the goal of providing affordable telephone service for all Americans. [*Id.*, p. 115.}

Therefore, Judge Greene concluded, the Operating Companies should be permitted to continue in the directory publishing business, thereby continuing to advance the policy goal of universal service through the maintenance of relatively low local exchange rates:

> "For these various interrelated reasons, the Court accordingly concludes that the prohibition, express or implied, on publication by the Operating Companies of the Yellow Pages directories is not in the public interest." [*Id.*, pp. 115-116.]

In essence, Judge Greene concluded that whatever pro-competitive advantages might be gained by separating directory publishing from the local exchange business, these advantages were outweighed by the benefits of allowing the extraordinarily high revenues and profits generated by directory publishing to continue to offset local exchange costs, thereby keeping local rates more affordable. As a result of this decision, Mountain Bell and other Bell Operating Companies were allowed to continue participating in the directory publishing business.

These historic circumstances are well worth remembering, since the Dex assets that QCI wants to sell would not belong to QCI were it not for the intervention of state regulators, consumer advocates, and others who wanted to continue the longstanding arrangements that have linked the directory publishing and local exchange businesses, ensuring that income from directory publishing helps keep local exchange prices low, thereby advancing the universal service goal.

Q. Judge Greene noted that local exchange carriers earn "supra-competitive" profits from the directory publishing business. Can you explain why these high profits exist, and why competitive pressures don't reduce them to a more normal level?

A. Yes. Telephone directories belong to a peculiar class of products that are inherently not well suited to effective competition. Other examples of successful products with similar characteristics include the VHS videotape format and the Windows computer operating system. In each of these examples, consumers find it preferable to standardize on the products or technology of one particular firm, to the exclusion of any alternatives. As a result, normal competitive conditions do not prevail.

In these situations, one choice emerges as the clear winner. Once this occurs, the winning firm gains a degree of monopoly power and protection from competitive pressures, because consumers are unlikely to subsequently switch their allegiance to different product or technology even if the price is significantly lower. Moreover, once it becomes clear which product or technology is the "winner" (preferred by or used by most consumers), other businesses tend to conform to this standard. In turn, the response of these other firms tends to allow the dominant firm to become stronger and more firmly entrenched.

To understand how this process works, consider the battle between VHS and Beta. Once a majority of consumers began to prefer the VHS format, dealers stopped carrying Beta tapes (it was cheaper to maintain an inventory of only one type of prerecorded tapes), causing even more consumers to switch to the VHS format. Eventually, it became difficult–if not impossible–to buy or rent Beta tapes in many locations, and VHS recorders became essentially the only option for most consumers. Eventually, Sony–the inventor of the Beta format and one of the most powerful consumer electronics firms in the world–was forced to abandon the fight. Sony now pays license fees to its competitors in order to sell VHS cassettes and tape recorders.

The important thing to recognize about this peculiar class of products is that individual consumers do not simply compare prices and features and select whichever combination is most to their liking. Rather, they tend to prefer whichever product is dominant, even if the price is higher and the features are less attractive. In effect, consumers treat the "winning" product as falling within a class of its own. Furthermore, there is also a tendency for other businesses to focus on whichever product is the "winner." These tendencies for both businesses and consumers to prefer the dominant product tend to be self-reinforcing, creating a "cascade" effect. Once a clear "winner" emerges and, it is very difficult, if not impossible, for new entrants to displace the winner. This creates a barrier to entry which allows the dominant firm to enjoy a high degree of monopoly power–allowing it to charge higher prices and to earn supra-competitive profits.

Upon cursory inspection, the market for these types of products may appear to be subject to normal competitive forces. There may be a variety of different substitutes (actual and potential) that could serve the same functions, and thus the dominant firm may seem to be subject to effective competition. However, upon closer inspection it becomes clear that substantial barriers to effective competition exist. Would-be competitors face the daunting task of convincing millions of consumers and hundreds or thousands of businesses to abandon the existing standard, and to start using their product instead. It can be exceedingly difficult, or impossible, to simultaneously convince enough consumers and businesses to accept the new product. In order to be truly successful, the competitor must achieve a huge critical mass, which involves capturing the loyalty or acceptance of a very high percentage of both consumers and businesses.

This unusual barrier to effective competition arises in part because successful entry involves the nexus of two distinct processes of decision-making, in part because each of these groups of decision makers prefer to settle upon a single product rather than switching back and forth amongst multiple products, and in part because each decision maker finds it preferable to select whichever product has been selected by everyone else. When a successful and well established product exists in such a market, would-be competitors find it extremely difficult to gain the necessary level of joint acceptability on a widespread basis, in order to effectively compete.

Most people want only one type of videocassette recorder (for playing all their videotapes), and they will prefer the type which is selected by everyone else, since it guarantees compatibility with their friends' equipment, and since it guarantees compatibility with the tapes which are available at rental shops. Analogously, most people want to use only one type of computer operating system (for running all their programs), since it simplifies things and minimizes learning time, and they will prefer the type which is selected by everyone else, since it minimizes problems with training new employees, ensures compatibility with popular software, and so forth. This tendency towards standardization is often reinforced by the actions of computer manufacturers (who sell computers with Windows pre-installed), software manufacturers, (who sell programs that only work with Windows), and the manufacturers of printers, monitors and other peripheral devices (who sell equipment that only works with

Windows).

This self-reinforcing phenomena largely explains the popularity of Windows (and its predecessor, MS-DOS), along with the enormous profits this "winner" is generating, and the near-impossibility of displacing it from the market place. Sellers of Unix and Linux, the most popular alternative operating systems, have had difficulty gaining more than a tiny share of the personal computer market, despite slashing their prices to near-zero levels. Just as "economies of scale" can create barriers to entry and "natural monopoly" conditions, this self-reinforcing bias in favor of the "standard" product can allow a dominant firm to earn enormous profits. The term "economies of standardization" can be used to describe this phenomena, which partially explains why Microsoft has been able to sustain and expand its monopoly position. As a result, Microsoft has been able to increase the price of Windows to record-high levels during an era when the prices of most computers and computer-related products have been declining to record-low levels.

Telephone directories are also subject to "economies of standardization." Most people only want to keep one phone directory at their bedside or on their desk, since this minimizes clutter and simplifies their life. Moreover, most people prefer using the "standard" directory, particularly if this one seems to have the best, most comprehensive listings and advertisements.

The distinctive characteristics described earlier with reference to video tapes and computer operating systems clearly apply to telephone directories. Most consumers prefer using the "standard" directory. When a competing directory is delivered to their home or business, they will often throw it away, or place it in a less frequented location in their home or office, where it receives relatively little use. It is difficult–perhaps impossible–for new entrants to dislodge the dominant directory, because the habits and preferences of hundreds of thousands of consumers and thousands of businesses must simultaneously be changed. Most businesses don't want to buy ads in multiple directories, just as most firms don't want to market video tapes or software applications using multiple formats. Most businesses don't bother advertising in a secondary directory, just as most firms don't bother selling a version of their software that works with Unix or Linux.

The "official" yellow pages sponsored by the dominant local exchange carrier offers an archetypical example of a product which is subject to severe economies of standardization. The interests of the user and the advertiser uniquely converge on whichever directory happens to be the "standard" directory (typically the one that seems to offer the most accurate and comprehensive listings and advertisements).

Even if a competing firm enters the market, most advertisers won't be inclined to abandon the "official" or "standard" directory, because they know it is popular, and that most readers only need and use one directory. Even if the price of advertising is much lower (as it typically is), most businesses won't spend much on advertising that is seen by relatively few people.

Q. You have indicated that Mountain Bell was allowed to stay in the directory publishing business partly because it generates high profits that have helped keep local exchange rates low. Are these profits related to QC's local exchange business?

A. Yes. In the case of video tapes or computer operating systems, there was initially great uncertainty concerning which firm would emerge with the successful standard. However, in the case of telephone directories, the victor was largely pre-ordained. Since the telephone company historically created and controlled all of the telephone numbers, it was in a unique position to determine which directory would be accepted as the "official" or standard set of listings.

Experience around the country demonstrates that the decisions of the local phone company, not the competitive process, determines which company publishes the most widely accepted (and most profitable) directory in each local exchange area. Business prowess, creative genius, and other factors may explain why Microsoft came to dominate the market for desktop computer operating systems. And, these types of factors may explain the difference between modest success and complete failure for firms that attempt to publish a "second" telephone directory. However, the latter firms have little hope of ever achieving the critical mass that would be necessary to displace the "standard" directory, which is almost always endorsed by, or affiliated with, the incumbent local exchange carrier.

Once the telephone company decides whether to publish a directory itself (directly or through an affiliate), or it designates another firm to publish the "official" yellow pages (in conjunction with the white page directory), that firm inevitably publishes the most universally accepted and profitable directory. Even if publishing company X has enjoyed this favorable position for more than a decade (pursuant to contract), the moment the local exchange company contracts with company Y as its "official" publisher, company X will be ignominiously shut out of its longstanding position, and company Y will immediately dominate the market. The shift in fortunes will be so massive that in some case company X will simply pick up stakes and abandon the market entirely. Even if it remains in the market, company X will generally be relegated to "also ran" status, charging lower rates and generating far lower profits, because it's directory is no longer officially endorsed by (or distributed by) the local exchange company.

Q. You have indicated that the supra-competitive profits generated by telephone directories are closely linked to the local exchange business. Are there any other linkages between the Dex directory publishing business and QC's local exchange business?

A. Yes. Accurate, up-to-date information concerning the incumbent local exchange company's customers (particularly their names and telephone numbers) lies at the core of the directory business. Yet, the development and maintenance of this information is an integral part of QC's local exchange business. Furthermore, many other aspects of the yellow page business are closely related to, or a direct function of, the local exchange business. Information obtained from customers through their application for local service and changes in the use of this service, and even the local service billing mechanisms can be used to support the yellow page business.

The incumbent carrier's management of its switching systems, including its assignment of new telephone numbers, is closely linked to the telephone directory business. The goodwill and name recognition which are created or enhanced by the incumbent carrier's dominant position in the local exchange business also enhances the value and profitability of the directory business. Relatively few people in Arizona were aware of the Qwest brand name before it merged with US West. Now that they closely associate the Qwest name with their local exchange carrier, a directory with the Qwest name on the cover is far more likely to be used, or considered to be the "official" directory than one with any other name on the cover. Even a well known brand names like AT&T, Time Warner or Conde Naste is unlikely to have as much impact on advertiser and user preferences as the Qwest brand name (or the US West brand name, or whatever name happens to be used by the dominant local exchange carrier in that particular area.)

Even if an affiliated company actually publishes the directory (e.g. Dex) customers are indirectly reassured that this directory is closely associated with the regulated public utility they depend upon for their basic local exchange service. Directories published by or on behalf of the local exchange company almost always prominently display a brand name, color scheme, logo, and other visual cues to strongly suggest this particular directory is the one that is officially sanctioned by the carrier that provides the readers with their local telephone service–the same carrier that creates and controls most of the phone numbers listed in the directory. In contrast, any alternative directories must necessarily suffer an identity problem, since they are not official publications of the local phone company, and thus inherently appear to be superfluous and unnecessary–and perhaps not as accurate or reliable.

A powerful combination of consumer habit, brand identification, and close linkages to the entity that controls most of the phone numbers gives the local exchange company's directories an "official" or "genuine" status in the minds of most consumers. This powerful competitive advantage is further reinforced by the historic circumstances of the directory publishing business–customers are accustomed to using the “official” directory published or licensed by the incumbent local telephone company.

Q. You have indicated that income from the directory publishing business has historically been used to help keep local exchange rates low. Can you briefly explain the rationale for this arrangement?

A. Yes. In most jurisdictions, directory publishing has long been viewed as an extremely profitable byproduct or extension of local telephone service. Hence, most (if not all) of the income generated from publishing directories has long been used as an offset to the cost of providing local telephone service. In Arizona, as in virtually every other state, publishing-related income is used to keep local exchange rates low and to help maintain universal service.

As I mentioned earlier, this long standing arrangement is the main reason state regulators, consumer advocates and other parties objected to placing the directory publishing business with AT&T at the time of divestiture, and it is one of the main reasons why Judge Greene decided that this business should instead be placed with US West (now Qwest) and the other RBOCs.

Of course, given the magnitude of the income streams involved, it is hardly surprising that almost immediately after divestiture many of the RBOCs attempted to change this arrangement, in hopes of increasing local rates and keeping more of the profits for their stockholders. For instance, US West placed its directory operations in a separate subsidiary, and it attempted to keep most of the directory income out of the regulatory process. In a 1986 order the Commission commented on these efforts:

> Mountain States would never have had any "Yellow Pages" assets to transfer if it and AT&T had their way. It was through the efforts of the

> Commission, among other commissions, that the BOC's rather than AT&T retained these assets. Our efforts were certainly not expended to "feather the nest" of USW. It was clearly our intent and that of the MFJ that this line of business was to remain with the BOC so as to produce a profit contribution to [benefit] local ratepayers. [Arizona Corporation Commission, Opinion and Order, Order 54843, Docket No. E-1051-84-100, January 10, 1986.]

The Buyer is willing to pay Qwest an enormous amount for its directory business, because it generates such a large income stream–a continuing flow of profits that exceed normal competitive levels by a wide margin. The very existence of this income stream, as well as its magnitude, is largely attributable to the fact that Dex's publications are the "standard" directory in each of its local exchanges. It is important to remember that most of the income Qwest is proposing to sell has (quite appropriately) been used for decades to help keep local rates at reasonable, affordable levels. Furthermore, this directory business would not even be owned by Qwest, but for the efforts of state regulators in support of this longstanding policy. Thus, it is quite appropriate that the benefits of this long standing policy should continue–as a matter of logic and equity.

Dex Sale Concerns

Q. Do you have any concerns with respect to the proposed transaction?

A. Yes. There are several problems with the Company's proposal. First, it has not presented a comprehensive and convincing case that the sale is in the public interest. Second, there is a significant risk that local exchange rates will eventually increase as a result of the sale. Hence, while the transaction may advance the interests and benefit QCI's stockholders, it would be contrary to the interests of QC's customers in the absence of adequate safeguards.

Q. Qwest claims the sale is in the public interest. Can you briefly summarize its reasoning?

A. As I explained earlier, the Company claims the proposed sale would be in the public interest because it will enable it to avoid bankruptcy. The Company provided evidence during the discovery phase of this proceeding which arguably supports this claim. In response to Staff DR No. 115, QC provided an estimate of future consolidated cash flows under three different scenarios: both phases of the Dex sale are completed; only the first phase is completed, and, neither phase is completed. Without the sale, QCI projects that by the end of the second quarter 2004, its consolidated cash balances will be *****Begin Highly Confidential** million, **End Highly Confidential***** and by the end of the 3rd quarter 2004, these cash balances will have declined to *****Begin Highly Confidential End Highly Confidential***** If only the first phase of the sale is completed, QCI projects that by the end of the 3rd quarter 2004, its consolidated cash balances will be *****Begin Highly Confidential End Highly Confidential***** If both phases are completed, the Company projects its cash balances won't decline into the negative range until sometime in *****Begin Highly Confidential End Highly Confidential*****

Q. Is QCI suffering from serious financial problems?

A. Yes. However, the problems run much deeper than short term cash flow and liquidity concerns which are the focus of Qwest's projections.

The root problem is that QCI is just one of several carriers that built enormous fiber optic networks during the tech stock "bubble." Too many networks were built, and these facilities are currently carrying traffic volumes that are a small fraction of their current capacity, and an even smaller fraction of their potential capacity (e.g. if dark portions of the network were lit and if the lit portions were upgraded to carry larger amounts of bandwidth). As a result of overbuilding, these networks aren't currently generating sufficient revenue to cover their operating costs and recover the initial investment, much less generate adequate profits.

Two of the largest carriers trapped in much the same situation–Global Crossing and Worldcom–have already entered bankruptcy. The fact that these large carriers have entered bankruptcy not only provides a vivid demonstration of the severity of QCI's problems, but these bankruptcies create an economic climate that makes QCI's own situation more difficult. The bankruptcy process will allow Global Crossing and Worldcom to reduce their debt and negotiate more favorable contracts. In turn, these competitors may emerge from bankruptcy with an enhanced ability to cut prices, survive the worldwide glut of fiber capacity, and gain market share at the expense of other carriers (like QCI).

QCI's underutilized fiber network is not the only problem it faces. For one thing, it is also heavily leveraged. According to its March 31, 2002 filing with the SEC, QCI had $21.4 billion of long term debt, $9.9 billion of current liabilities, and $2.9 billion of post-retirement and post-employment benefit obligations on a consolidated basis. In contrast, it reported consolidated current assets of just $6.6 billion–substantially less than its current liabilities. The book value of QC's property, plant and equipment was just $19.3 billion, which is substantially less than the total of its outstanding liabilities. The analogous book value for QCI's property, plant and equipment was reported to be $30.2 billion. This suggests the fiber network and other network facilities have a net book value of perhaps $11.1 billion or so. However, in the current economic climate, the fiber assets can only be sold under "fire sale" conditions. If the amounts offered for the assets of Global Crossing and other large fiber carriers are any indication, QCI might be fortunate to obtain as much as $1 billion from a distress sale of its network. Thus, it is fair to say that QCI is not in strong financial condition, and its concerns about a potential bankruptcy filing are valid.

Further aggravating these problems, existing and potential creditors and investors are reluctant to provide an infusion of additional capital, because there are serious questions about the reliability of QCI's reported financial data, and as a result it is difficult to evaluate the depth and severity of the problems it faces. The 2001 financial statements were audited by Arthur Anderson, a firm that subsequently collapsed in the wake of the Enron accounting scandal. The new auditors, KPMG haven't completed their initial audit, and there are indications they have encountered significant problems which are delaying the ability to provide accurate financial information. The potential severity of these problems is unknown, but four former Qwest executives were recently charged with accounting fraud by federal prosecutors. Moreover, QCI has not released any quarterly financial data since its March 31, 2001 filing with the SEC, and its chief executive officer (CEO) and chief operating officer have been unable or unwilling to certify the accuracy of these (or any other) financial statements pursuant to Section 302 of the Sarbanes-Oxley Act.

A recent article about Richard Notebaert (QCI's new CEO) published by USA Today provides a sense of the uncertainty which currently exists:

> "He's doing the best job he can, but he inherited a mess," says analyst Patrick Comack of Guzman & Co. "If he can turn it around, he'll look like a hero."...
>
> To reverse course, Qwest must retain more local phone customers and capture long-distance business users, says analyst Drake Johnstone of Davenport & Co.
>
> But he says the specter of more indictments could undermine Qwest's sales staff and damage its brand image.
>
> "It remains to be seen how deep the rot is," Johnstone says. "What's scary is that no one at Qwest, including Notebaert, knows."

Given these circumstances, it is fair to say that no one can accurately evaluate the likelihood of a bankruptcy filing, nor is it possible to determine whether the infusion of cash that would be provided by the Dex transaction will be sufficient to prevent a bankruptcy filing. In the short run, the infusion of cash provided by the Dex transaction would be helpful. However, the Commission's approval of the sale wouldn't necessarily ensure that the transaction will be completed. For instance, various contract provisions could enable either the Buyer or the seller to walk away from the deal under some circumstances. The Commission's decision in this proceeding will not determine whether the transaction goes forward. For instance, the Company is awaiting approval in several other states in addition to Arizona, and there is no assurance that approval will be granted in every state. Furthermore, even if every state grants approval and the deal is consummated, it may simply have the effect of delaying a future liquidity crisis. While an infusion of several billion more dollars will certainly be helpful in the short term, it won't necessarily be sufficient to overcome QCI's problems.

Q. Are QCI's financial problems a complete surprise, or could they be anticipated when QCI acquired US West?

A. Some aspects of QCI's financial problems were not widely anticipated–particularly the magnitude of the stock market bubble and the subsequent collapse of technology stock prices, as well as the possibility of accounting fraud. However, the core problems that QSI encountered could be anticipated even at that time. For example, in my testimony in Docket T-01051B-99-0497, I pointed out some of the risks:

> If [Qwest] is not successful in executing its business plan, or if competition in the long haul market continues to intensify, there is no assurance that Qwest will ever be able to generate substantial profits. It has built a modern, nationwide fiber network, but it is not unique in this regard. Unless Qwest is successful in filling this network with profitable traffic, it will never generate profits which are commensurate with the scale of its investment. In the meantime, the combined entity will have to rely upon USWCI to generate nearly all of its profits, and the majority of its discretionary cash flow. US West has used USWCI as a "cash cow." The profits generated by its dominant market position have been distributed to the parent, and subsequently reinvested in whatever ventures top management has felt hold the greatest long term potential. There is every reason to believe that this policy will continue after the merger. The difference is that the emphasis may shift even farther away form the 14 state region, because of Qwest's focus on nationwide markets. It is reasonable to assume that the cash and profits generated by USWCI will tend to flow where management believes they will be most beneficial to the merged entity's stockholders. Stated differently, USWCI's role as a subservient cash cow will probably be intensified, as the merged companies shift their

> concentration even more heavily towards growth opportunities outside the 14 state region. [Ben Johnson, Direct Testimony, p. 18]

In approving the merger, the Commission was fully aware that this transaction was primarily for the benefit of stockholders–not Arizona customers. As I explained in my testimony in that proceeding:

> The primary beneficiaries of the proposed merger will be the companies and their stockholders. Consumers outside of US West's region may also benefit, if the combined companies become more aggressive in trying to gain market share in other parts of the country.

I also pointed out that there was a risk that Qwest would divert revenues and resources away from Arizona and towards ventures in other markets, such as its fiber optic network. [Id., p. 36]

Q. Assuming the Commission rejected the Company's request in this proceeding, could the sale occur without the Arizona portion of the Dex operations?

A. I have seen nothing which would prevent this. The Purchase Agreement provides that the Buyer and seller's obligations to close the transaction are contingent upon Qwest receiving all necessary approvals. [See, e.g., ¶7.1] However, it also explicitly provides that the parties can waive this contingency. [Id.] The first half of the transaction, including the directory publishing operations in seven states, has already been closed, and approval has already been (or is likely to be) granted in some of the remaining states. Thus, there is no reason to assume that approval in Arizona is a "make or break" factor that will determine whether or not any remaining funds will be received.

Qwest and the Buyer have already invested a substantial amount of time, money and effort towards completing this sale. One can reasonably assume that the Buyer would like to obtain control over as much of Qwest's directory publishing operations as possible, and QCI certainly needs more cash. Accordingly, it is reasonable to assume that the remainder of the sale would be consummated even if it were necessary to exclude the Arizona directories. If the sales price were reduced on a pro rata basis to account for the exclusion of Dex's Arizona directories, the odds of QCI entering bankruptcy would not be significantly changed.

Q. Doesn't QC claim that the Dex sale will ensure a financially stronger and more stable operating entity?

A. Yes. The current liquidity problems would be alleviated by the Dex sale. However, this temporary infusion of cash may not be sufficient to overcome QCI's problems. Moreover, the proposed transaction could tend to weaken QCI's financial position over the longer term. The directory publishing operations are the source of a very substantial and growing cash flows, revenues, and profits–all of which will be lost once the sale is completed.

Like all incumbent LECs, the Company generates enormous financial benefits from directory publishing. Qwest Dex directories generate hundreds of millions of dollars of revenue and income each year. Yet, very little capital is required (other than the investment in the local exchange networks which make it possible to generate this income). Once this steady, growing stream of revenues, cash, and profits is lost, the Company's financial position will be substantially weakened. The proposed transaction will have a substantial adverse impact on all of the major long term indicators of financial health, including earnings per share, gross profit margins, and interest coverage. The short term effect may be to avert a liquidity crisis, but the transaction could reduce the Company's fundamental financial health over the long term.

Q. Can you now discuss your second concern, that local exchange rates may increase as a result of this transaction?

A. Yes. There will not be any immediate adverse impact, since QC is currently operating under a price cap plan. The historic relationship between directory revenues and local rates is reflected under the current price cap plan. As the Company explained, "[t]he current Price Cap Plan incorporates the level of imputation set by the Settlement Agreement." [Qwest response to Staff Dr 125, referring to the 1988 Mountain Bell Settlement Agreement] However, the Company has not provided any firm assurance that upon expiration of the current price cap plan, rates will remain unaffected by the proposed transaction. In fact, regardless of whether rates continue to be regulated through price caps, or through a more traditional form of regulation, rates could increase as a result of the proposed transaction.

First, the Commission will find it more difficult to develop and implement the appropriate imputation amount once the directory publishing operations are no longer located within the Qwest corporate family. It will be more difficult to obtain evidence concerning directory revenues and the value of the services provided by QC to the directory publishing operations, once these operations have been legally transferred outside of the same corporate family.

Second, the value of the services provided by QC (and thus arguably the appropriate imputation adjustment) could be reduced by this transaction. The contractual arrangement between the Buyer and QC is relatively unique, making it more difficult to estimate the value of the services being provided by the local exchange operations; furthermore, there are aspects of this unique arrangement that will have a tendency to reduce that value.

I am not suggesting it is unusual for a LEC to make contractual arrangements with an independent firm to publish its directories. To the contrary, it is quite common for smaller local exchange carriers to enter into joint ventures or other contractual arrangements with directory publishing firms. What is unique about the proposed Dex transaction is the duration and structure of the contractual arrangement. In a more typical arrangement (for convenience I will call it a "joint venture," although the actual legal structure can vary) the publisher sells the advertisements, and it designs, prints and distributes the actual directories. The local exchange carrier provides the telephone listings, licenses the use of its brand name and logo, and takes various steps to ensure that its local exchange customers accept these publications as the "official" directories with the best, most authoritative information. As compensation for these services, the carrier typically receives a share of the gross revenues. While the amount can vary widely, 50% or more of the gross revenues may be "retained" by or paid to the local exchange carrier.

The proposed Dex transaction is also unique in that, to the extent the Company is being compensated for these services, it is receiving this compensation as part of the cash received at the closing, rather than receiving a percentage to the directory revenues that are actually collected in future years. Again the contract is also unique because of its extremely long duration. The Buyer will receive (and will need) the active co-operation and assistance of the Company's local exchange operations in order to maintain their dominant status. In an effort to protect this status, the proposed contractual arrangements require the Company to enter into a non-compete clause for 40 years, to designate the Buyer's directories as QC's "official" directories, and to allow the Buyer to prominently display on the directories whatever brand name and logo is used by QC's local exchange operations, and to provide listing information and other forms of co-operation and assistance for 50 years. Under the proposed structure, relatively little compensation is provided on an annual basis–virtually all of the compensation is provided in advance, as part of the one-time cash payment received at the closing. While this structure helps with QCI's immediate liquidity needs, it makes it harder to value the services that are being provided by QC's local exchange operations, thereby making it harder to quantify the appropriate imputation level to use in future regulatory proceedings.

Furthermore, this unique structure may reduce the value of the services contributed by QC to this joint venture. Under normal circumstances, most of the compensation would be paid annually (rather than in advance), and the level of compensation would be directly tied to the revenues generated by the directories. Also, the contract would normally expire or be subject to cancellation after relatively few years. That more typical arrangement provides stronger incentives for the parties to closely co-operate in maximizing the income generated by the joint venture. Because of its long duration and poor incentive structure, there is reason to be concerned that the value of the services provided by QC to the Buyer (and thus, arguably the magnitude of an appropriate imputation adjustment) will be impaired over time.

Q. Doesn't the 1988 Settlement Agreement determine the level of directory revenue imputation?

A. The 1988 Settlement Agreement provides some parameters that may control future imputation adjustments, but it does not specify the precise dollar amount which will apply under any given set of circumstances (e.g. if the proposed transactions are consummated). The Company provides these explanations:

> "The sale of the directory publishing operations to an unaffiliated third party does not affect the continued applicability of that Settlement... The incorporation of imputation in future price cap plans or rate cases is governed by the terms of the Settlement Agreement." [Response to Staff DR 71]
>
> "Nothing about the sale of the directory publishing operation to a third party in and of itself should effect the 1988 Settlement Agreement." [Response to Staff DR 125]
>
> The Settlement Agreement applies, consistent with its terms, on a going forward basis whereby the value of fees and services received by Qwest from the new directory publisher would be the imputation amount. [Id.]

Q. What fees and services will Qwest receive from the Buyer?

A. As I have indicated, the fees Qwest will receive from the Buyer are largely contained within the up front $7.05 billion cash payment. It is not self evident what portion of this amount represents compensation for the services provided by QC to the Buyer and what portion represents compensation for tangible assets being sold to the Buyer. Thus, if QC believes the imputation amount to be used in future regulatory proceedings should be determined by the actual amount of the "fees and services received by Qwest from the new directory publisher" it is by no means obvious what imputation adjustment, if any, QC would propose (or accept as reasonable). Conceivably, QC would contend that no separately identifiable "fees and services" have been or will be "received by Qwest from the new directory publisher" and thus it might argue that no imputation adjustment is calculable or appropriate (or that the value of the appropriate adjustment is zero).

Conclusions and Recommendations

Q. Let's turn to the last section of your testimony. Can you begin by summarizing your concerns?

A. My biggest concern is that the proposed sale won't solve QCI's underlying problems, yet it will tend to weaken QC's financial position over the long term, leading to upward pressure on rates. Unquestionably, QCI is in serious financial trouble. By selling its directory publishing operations, and requiring its local exchange subsidiary to provide services to the Buyer for 50 years, QCI will quickly raise a substantial amount of cash. However, this transaction doesn't solve the underlying problems that QCI is confronting. The Company's own projections show that QCI's annual cash outflows exceed its inflows. It is projected to eventually run short of funds regardless of whether or not the Rodney sale is completed. [See, e.g., Response to Staff DR 115] In an effort to alleviate the current liquidity crisis, the Company is relinquishing a substantial and stable flow of cash, revenues, and profits. The long term effect will be to place downward pressure on QC's financial position, to the detriment of its customers.

Q. What options does the Commission have in this proceeding?

A. The Commission has three basic options. First, it can unconditionally approve the transaction, as requested. Second, it can refuse to approve the transaction. Third, it can pursue a middle course, by approving the transaction provided appropriate safeguards and conditions are put into place.

Q. What do you recommend?

A. I recommend the third option. The Commission should approve the transaction provided QC agrees to imposition of adequate safeguards and conditions.

To protect the public interest, the Commission should require adequate assurance that local exchange rates will not be adversely affected by the proposed sale, or by the legal or financial consequences of the sale. At a bare minimum, QC should be precluded from contending in future regulatory proceedings that imputation should be discontinued, or that the imputation amount should be reduced, as a result of the Rodney transaction. To provide customers with additional protection, and to ensure that all parties are treated fairly, it would be preferable for the Commission to establish an appropriate imputation amount (or formula) that will apply in future regulatory proceedings, notwithstanding any changes in circumstances that will result from completion of the proposed sale.

Q. Hasn't Qwest admitted that the 1988 Settlement requires imputation, and this will continue after the sale?

A. Perhaps, but the 1988 Settlement doesn't specifically contemplate the circumstances that will exist if the proposed transaction is completed. Once the Dex sale is completed, nothing will prohibit Qwest from arguing that imputation is no longer appropriate, or that the "value of fees and services" has declined due to changing circumstances. For instance, QC might argue that imputation is no longer appropriate because the publishing assets have been transferred outside its corporate family. Or, it might argue that the "value of fees and services" for imputation purposes should be limited to the (minimal) amount being paid by the Buyer to QC each year.

The Settlement Agreement referenced an imputation amount of $43 million per year, as developed in the 1984 rate case. However, the Commission has ruled that this does not represent a fixed imputation amount, regardless of changing circumstances. This ruling was affirmed in 1996 by the Court of Appeals of Arizona.

> US West argues that the quoted language sets a $43 million cap on imputed income because only downward adjustments are mentioned. We reject this interpretation. ... The apparent purpose of the disputed provision is to preclude US West and USWD from assigning an artificial value to fees and services and thereby preempting the Commission's independent assessment. The agreement authorizes the Commission staff to "present evidence in support of or in contradiction to" whatever value US West and USWD might assign to fees and services, and it entitles the Commission to adjust the presumptive $43 million imputation either upward or downward as the evidence of fees and services supports. [US West Communication, Inc. v. ACC, 185 Ariz. 277, 281 (App. 1996)]

While the Settlement Agreement leaves the door open for the Commission to determine the appropriate imputation amount as circumstances change, it also leaves the door open for the Company to argue that the imputation adjustment should be reduced, and rates increased, once the proposed transaction has been consummated.

A substantial portion of the cash received from the proposed transaction directly relates to services that have been and will be provided by QC's local exchange operations. However, given the structure of the proposed transaction, it isn't self evident what portion of the multi-billion dollar up front cash payment represents "fees and services" specifically attributable to QC's local exchange operations in Arizona. If the transaction is approved without adequate safeguards, QC could conceivably argue that imputation is no longer appropriate, or that the "value of fees and services" has dwindled to a minimal level, as evidenced by the minimal annual payments being made by the Buyer (subsequent to the initial payment).

Q. You have indicated that it would be preferable for the Commission to establish an appropriate imputation amount (or formula) that will apply in future regulatory proceedings. Why would this be appropriate?

A. Qwest owns the assets involved in the proposed transaction because of the direct intervention of this Commission and other state regulators. Furthermore, the high level of income generated by Qwest's directories is logically traceable to its local exchange operations. Accordingly, this income has long been treated as an offset to the cost of providing local exchange service, thereby helping to maintain low local exchange rates and helping advance the policy goal of universal service. This arrangement would be placed in jeopardy if Qwest is allowed to sell its existing directory publishing business and sign a 40 year non-compete clause, as proposed. The lucrative income stream that has long been used to keep local exchange rates low would no longer be available to provide that support, but would instead be bolstering the profit margin of an unregulated, non-affiliated third party.

If the Commission is inclined to approve the proposed transaction, it should insist upon appropriate safeguards to minimize the risk that customers will be adversely affected. In particular, it should explicitly establish an appropriate dollar amount (or formula) for imputation in the future. The amount of imputation should be based upon the value of fees and services without considering any diminishment in that value which results from the unique structure and characteristics of the proposed transaction. Stated another way, since the proposed transaction has been structured to maximize immediate cash flows for the benefit of QCI's stockholders; for rate purposes it is appropriate to continue to consider the level of directory imputation that Qwest would receive from its "official" directories, assuming it maximized its annual income from directories for the benefit of its local exchange operations. This imputation amount would be taken into consideration in any future price cap or rate based regulatory proceedings, as an offset to the cost of providing local exchange service.

Q. Can you illustrate this recommendation, to show how the Commission could establish an appropriate formula or imputation amount?

A. Yes. A logical starting point would be the $43 million imputation amount which was developed in the 1984 rate case. Assuming this represented a reasonable imputation value in 1984, one can reasonably conclude that the reasonable imputation amount currently would be substantially higher, due to the effects of growth and inflation. In other words, the $43 million figure should be adjusted upward to reflect growth in the number of listings included in the directories, growth in the number of copies distributed, and growth in the quantity of advertising included in the directories. The value of fees and services has logically increased, due to the effects of inflation–both in the economy generally and in the price of directory advertising specifically. One can reasonably expect that if QC were negotiating at arm's length with a third party, all of these factors would be considered, and the value of the fees and services it would receive would exceed $43 million due to the effects of growth and inflation.

The following table shows one simple way to calculate the effects of growth and inflation. I start with the $43 million imputation amount and divide by the number of switched access lines in 1984, resulting in an imputation amount per line of $31.11 per year or $2.59 per line per month. I then multiplied this amount by the number of switched access lines served by QC in Arizona as December 2001. This indicates that the $43 million imputation figure is currently equivalent to $ 89,971,955, after taking into account growth in QC's Arizona service territory, but without taking inflation into account.

Table 1

1984 Imputation	$ 43,000,000
1984 Lines	1,382,230
1984 Imputation per Line	$ 31.11
2001 Lines	2,892,059
2001 Imputation	$ 89,971,955

Q. Should inflation also be taken into account?

A. Yes. It is reasonable to assume that the "value of fees and services" has not only increased due to growth in QC's service territory (as indicated by growth in the number of switched access lines), but also due to the effects of inflation. One way of adjusting for inflation would be to analyze changes in directory advertising rates since 1984 (e.g. per listing and per column inch). However, this data isn't readily available. Accordingly, I have used a simpler approach–adjusting for inflation based upon changes in the GDP Deflator. This is the same measure of inflation which is used in the Company's price cap plan in Arizona.

Table 2

1984 Imputation per Line	$ 31.11
Change in GDPD from 1984 to 2001	53.16%
2001 Imputation per Line	$ 47.65
2001 Lines	2,892,059
2001 Imputation	$ 137,806,611

Q. Will the safeguards you have just recommended be sufficient to ensure that local exchange rates will not be adversely affected by the proposed sale?

A. Not necessarily. While these safeguards would be helpful and are worthwhile, they may not be sufficient to fully eliminate the risks to customers. Imputation is intended to protect the interests of customers; this intended result has easily been achieved where the actual income involved in the imputation process continues to flow to another affiliate (e.g. Qwest Dex) within the same corporate family. Under these circumstances, the per-books income of the local exchange carrier is understated and the per-books income of a sister company is overstated, but the parent corporations's consolidated financial statements are largely unaffected. Thus, customers could be protected while allowing publishing income to be shifted to an affiliate, provided an appropriate share of that income continued to be imputed to the local exchange operations. However, if the proposed sale is approved and consummated, the Commission will be embarking into uncharted waters. While imputation will still be appropriate, the imputed income will no longer represent a share of revenues that are being received each year by QCI or any of its subsidiaries. Instead, imputation will reflect the hypothetical level of income that would have been available to the local exchange operations if it published its own "official" directories, and had not entered into the proposed transaction.

To the extent QCI is being compensated for the services to be provided by its local exchange operations over the next 50 years, this compensation will have largely (or entirely) been received as part of the one-time up front payment received at the time the transaction is closed. Once the Dex assets are sold, the Commission will no longer be imputing to QC revenues that are currently being booked by another member of the Qwest corporate family. Instead, the Commission will be imputing compensation for services that have been and will continue to be provided by QC.

Imputation will still be appropriate, of course, since QC could be obtaining this flow of income but for QCI's decision to enter into the proposed transaction in return for a $7.05 billion cash infusion. It is appropriate to impute a higher level of income from the Buyer, since the consideration being paid directly to QC is not commensurate with the extremely valuable services and other benefits that the local exchange operations are contributing to the transaction. Among other things, the QC is providing a promise not to compete with the Buyer, the use of the brand name and logo used with its tariffed local exchange services, and designation of the Buyer's directories as QC's "official" local telephone directories in Arizona.

Q. Does this complete your direct testimony, which was prefiled on March 19, 2003?

A. Yes, it does.

Appendix A

Qualifications

Present Occupation

Q. What is your present occupation?

A. I am a consulting economist and President of Ben Johnson Associates, Inc.®, a firm of economic and analytic consultants specializing in the area of public utility regulation.

Educational Background

Q. What is your educational background?

A. I graduated with honors from the University of South Florida with a Bachelor of Arts degree in Economics in March 1974. I earned a Master of Science degree in Economics at Florida State University in September 1977. The title of my Master's Thesis is a "A Critique of Economic Theory as Applied to the Regulated Firm." Finally, I graduated from Florida State University in April 1982 with the Ph.D. degree in Economics. The title of my doctoral dissertation is "Executive Compensation, Size, Profit, and Cost in the Electric Utility Industry."

Clients

Q. What types of clients employ your firm?

A Much of our work is performed on behalf of public agencies at every level of government involved in utility regulation. These agencies include state regulatory commissions, public counsels, attorneys general, and local governments, among others.

We are also employed by various private organizations and firms, both regulated and unregulated. The diversity of our clientele is illustrated below.

Regulatory Commissions

Alabama Public Service Commission—Public Staff for Utility Consumer Protection
Alaska Public Utilities Commission
Arizona Corporation Commission
Arkansas Public Service Commission
Connecticut Department of Public Utility Control
District of Columbia Public Service Commission
Idaho Public Utilities Commission
Idaho State Tax Commission
Iowa Department of Revenue and Finance
Kansas State Corporation Commission
Maine Public Utilities Commission
Minnesota Department of Public Service
Missouri Public Service Commission
National Association of State Utility Consumer Advocates
Nevada Public Service Commission
New Hampshire Public Utilities Commission
North Carolina Utilities Commission—Public Staff
Oklahoma Corporation Commission
Ontario Ministry of Culture and Communications
Staff of the Delaware Public Service Commission
Staff of the Georgia Public Service Commission
Texas Public Utilities Commission
Virginia State Corporation Commission
Washington Utilities and Transportation Commission
West Virginia Public Service Commission—Division of Consumer Advocate
Wisconsin Public Service Commission

Wyoming Public Service Commission

Public Counsels

Arizona Residential Utility Consumers Office
Colorado Office of Consumer Counsel
Colorado Office of Consumer Services
Connecticut Consumer Counsel
District of Columbia Office of People's Counsel
Florida Public Counsel
Georgia Consumers' Utility Counsel
Hawaii Division of Consumer Advocacy
Illinois Small Business Utility Advocate Office
Indiana Office of the Utility Consumer Counselor
Iowa Consumer Advocate
Maryland Office of People's Counsel
Minnesota Office of Consumer Services
Missouri Public Counsel
New Hampshire Consumer Counsel
Ohio Consumer Counsel
Pennsylvania Office of Consumer Advocate
Utah Department of Business Regulation—Committee of Consumer Services

Attorneys General

Arkansas Attorney General
Florida Attorney General—Antitrust Division
Idaho Attorney General
Kentucky Attorney General
Michigan Attorney General
Minnesota Attorney General

Nevada Attorney General's Office of Advocate for Customers of Public Utilities
South Carolina Attorney General
Utah Attorney General
Virginia Attorney General
Washington Attorney General

Local Governments

City of Austin, TX
City of Corpus Christi, TX
City of Dallas, TX
City of El Paso, TX
City of Galveston, TX
City of Norfolk, VA
City of Phoenix, AZ
City of Richmond, VA
City of San Antonio, TX
City of Tucson, AZ
County of Augusta, VA
County of Henrico, VA
County of York, VA
Town of Ashland, VA

Town of Blacksburg, VA
Town of Pecos City, TX

Other Government Agencies

Canada—Department of Communications
Hillsborough County Property Appraiser
Provincial Governments of Canada

Sarasota County Property Appraiser
State of Florida—Department of General Services
United States Department of Justice—Antitrust Division
Utah State Tax Commission

Regulated Firms

Alabama Power Company
Americall LDC, Inc.
BC Rail
CommuniGroup
Florida Association of Concerned Telephone Companies, Inc.
LDDS Communications, Inc.
Louisiana/Mississippi Resellers Association
Madison County Telephone Company
Montana Power Company
Mountain View Telephone Company
Nevada Power Company
Network I, Inc.
North Carolina Long Distance Association
Northern Lights Public Utility
Otter Tail Power Company
Pan-Alberta Gas, Ltd.
Resort Village Utility, Inc.
South Carolina Long Distance Association
Stanton Telephone
Teleconnect Company
Tennessee Resellers' Association
Westel Telecommunications
Yelcot Telephone Company, Inc.

Other Private Organizations

Arizona Center for Law in the Public Interest
Black United Fund of New Jersey
Casco Bank and Trust
Coalition of Boise Water Customers
Colorado Energy Advocacy Office
East Maine Medical Center
Georgia Legal Services Program
Harris Corporation
Helca Mining Company
Idaho Small Timber Companies
Independent Energy Producers of Idaho
Interstate Securities Corporation
J.R. Simplot Company
Merrill Trust Company
MICRON Semiconductor, Inc.
Native American Rights Fund
PenBay Memorial Hospital
Rosebud Enterprises, Inc.
Skokomish Indian Tribe
State Farm Insurance Company
Twin Falls Canal Company
World Center for Birds of Prey

Prior Experience

Q. Before becoming a consultant, what was your employment experience?

A. From August 1975 to September 1977, I held the position of Senior Utility Analyst with Office of Public Counsel in Florida. From September 1974 until August 1975, I held the position of Economic Analyst with the same office. Prior to that time, I was employed by the law firm of Holland and Knight as a corporate legal assistant.

Q. In how many formal utility regulatory proceedings have you been involved?

A. As a result of my experience with the Florida Public Counsel and my work as a consulting economist, I have been actively involved in approximately 400 different formal regulatory proceedings concerning electric, telephone, natural gas, railroad, and water and sewer utilities.

Q. Have you done any independent research and analysis in the field of regulatory economics?

A. Yes, I have undertaken extensive research and analysis of various aspects of utility regulation. Many of the resulting reports were prepared for the internal use of the Florida Public Counsel. Others were prepared for use by the staff of the Florida Legislature and for submission to the Arizona Corporation Commission, the Florida Public Service Commission, the Canadian Department of Communications, and the Provincial Governments of Canada, among others. In addition, as I already mentioned, my Master's thesis concerned the theory of the regulated firm.

Q. Have you testified previously as an expert witness in the area of public utility regulation?

A. Yes. I have provided expert testimony on more than 250 occasions in proceedings before state courts, federal courts, and regulatory commissions throughout the United States and in Canada. I have presented or have pending expert testimony before 35 state commissions, the Interstate Commerce Commission, the Federal Communications

Commission, the District of Columbia Public Service Commission, the Alberta, Canada Public Utilities Board, and the Ontario Ministry of Culture and Communication.

Q. What types of companies have you analyzed?

A. My work has involved more than 425 different telephone companies, covering the entire spectrum from AT&T Communications to Stanton Telephone, and more than 55 different electric utilities ranging in size from Texas Utilities Company to Savannah Electric and Power Company. I have also analyzed more than 30 other regulated firms, including water, sewer, natural gas, and railroad companies.

Teaching and Publications

Q. Have you ever lectured on the subject of regulatory economics?

A. Yes, I have lectured to undergraduate classes in economics at Florida State University on various subjects related to public utility regulation and economic theory. I have also addressed conferences and seminars sponsored by such institutions as the National Association of Regulatory Utility Commissioners (NARUC), the Marquette University College of Business Administration, the Utah Division of Public Utilities and the University of Utah, the Competitive Telecommunications Association (COMPTEL), the International Association of Assessing Officers (IAAO), the Michigan State University Institute of Public Utilities, the National Association of State Utility Consumer Advocates (NASUCA), the Rural Electrification Administration (REA), North Carolina State University, and the National Society of Rate of Return Analysts.

Q. Have you published any articles concerning public utility regulation?

A. Yes, I have authored or co-authored the following articles and comments:

"Attrition: A Problem for Public Utilities—Comment." *Public Utilities Fortnightly*, March 2, 1978, pp. 32-33.

"The Attrition Problem: Underlying Causes and Regulatory Solutions." *Public Utilities Fortnightly*, March 2, 1978, pp. 17-20.

"The Dilemma in Mixing Competition with Regulation." *Public Utilities Fortnightly,* February 15, 1979, pp. 15-19.

"Cost Allocations: Limits, Problems, and Alternatives." *Public Utilities Fortnightly,* December 4, 1980, pp. 33-36.

"AT&T is Wrong." *The New York Times,* February 13, 1982, p. 19.

"Deregulation and Divestiture in a Changing Telecommunications Industry," with Sharon D. Thomas. *Public Utilities Fortnightly*, October 14, 1982, pp. 17-22.

"Is the Debt-Equity Spread Always Positive?" *Public Utilities Fortnightly,* November 25, 1982, pp. 7-8.

"Working Capital: An Evaluation of Alternative Approaches." *Electric Rate-Making,* December 1982/January 1983, pp. 36-39.

"The Staggers Rail Act of 1980: Deregulation Gone Awry," with Sharon D. Thomas. *West Virginia Law Review,* Coal Issue 1983, pp. 725-738.

"Bypassing the FCC: An Alternative Approach to Access Charges." *Public Utilities Fortnightly*, March 7, 1985, pp. 18-23.

"On the Results of the Telephone Network's Demise—Comment," with Sharon D. Thomas. *Public Utilities Fortnightly*, May 1, 1986, pp. 6-7.

"Universal Local Access Service Tariffs: An Alternative Approach to Access Charges." In *Public Utility Regulation in an Environment of Change,* edited by Patrick C. Mann and Harry M. Trebing, pp. 63-75. Proceedings of the Institute of Public Utilities Seventeenth Annual Conference. East Lansing, Michigan: Michigan State University Public Utilities Institute, 1987.

With E. Ray Canterbery. Review of *The Economics of Telecommunications: Theory and Policy* by John T. Wenders. *Southern Economic Journal* 54.2 (October 1987).

"The Marginal Costs of Subscriber Loops," A Paper Published in the Proceedings of the Symposia on Marginal Cost Techniques for Telephone Services. The National Regulatory Research Institute, July 15-19, 1990 and August 12-16, 1990.

With E. Ray Canterbery and Don Reading. "Cost Savings from Nuclear Regulatory Reform: An Econometric Model." *Southern Economic Journal,* January 1996.

Professional Memberships

Q. Do you belong to any professional societies?

A. Yes. I am a member of the American Economic Association.