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Subject: 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 Sale Of The Arizona Operations Of Dex, Inc.
Arizona Corporation Commission, Docket No. T-01051B-02-0666

Arizona Corporation Commission
Docket Control
Attn: Ms. Viki Lasher
1200 West Washington Street
Phoenix, Arizona 85007

Arizona Corporation Commission
DOCKETED

MAY 09 2003

DOCKETED BY *CR*

Dear Ms. Lasher:

Enclosed for filing with the Arizona Corporation Commission are the original and thirteen copies of the expurgated version of the Rejoinder Testimony of Mr. Richard B. Lee on behalf of the Department of Defense and All Other Federal Executive Agencies in the subject proceeding.

Copies of the expurgated Rejoinder Testimony have been sent in accordance with the attached Certificate of Service. Copies of the Confidential version of Mr. Lee's Attachment 3 to his Rejoinder Testimony have been sent only to Parties who have executed the appropriate Protective Agreement. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,
Peter Q. Nyce Jr.
Peter Q. Nyce Jr.
General Attorney
Regulatory Law Office

Enclosure

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER

Chairman

JAMES M. IRVIN

Commissioner

WILLIAM A. MUNDELL

Commissioner

JEFF HATCH-MILLER

Commissioner

MIKE GLEASON

Commissioner

IN THE MATTER OF QWEST COMMUNICATIONS) Docket No. T-01051B-02-0666
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.)

REJOINDER TESTIMONY

of

RICHARD B. LEE

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE

And

ALL OTHER FEDERAL EXECUTIVE AGENCIES

ROBERT N. KITTEL, CHIEF

Regulatory Law Office

Office of the Judge Advocate General

U.S. Army Litigation Center

901 N. Stuart Street, Suite 713

Arlington, Virginia 22203-1837

by

Peter Q. Nyce, Jr.

General Attorney

May 9, 2003

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I. INTRODUCTION

1

2

3 **Q. PLEASE STATE YOUR NAME, POSITION AND BUSINESS ADDRESS.**

4 A. My name is Richard B. Lee. I am Vice President of the economic consulting firm of
5 Snavelly King Majoros O'Connor & Lee, Inc. ("Snavelly King"). My business address is
6 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

7 **Q. ON WHOSE BEHALF ARE YOU APPEARING IN THIS DOCKET?**

8 A. I am appearing on behalf of the Department of Defense and all other Federal Executive
9 Agencies ("DOD/FEA").

10 **Q. ARE YOU THE SAME RICHARD B. LEE WHO SUBMITTED REBUTTAL
11 TESTIMONY IN THIS PROCEEDING ON MARCH 4, 2003?**

12 A. Yes, I am.

13 **Q. DID YOUR REBUTTAL TESTIMONY CONTAIN A DESCRIPTION OF YOUR
14 BACKGROUND AND EXPERIENCE?**

15 A. Yes, it did.

16 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR DIRECT
17 SUPERVISION?**

18 A. Yes, it was.

19 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

20 A. In this testimony, I will explain my opposition to the Settlement Agreement proposed by

1 the Arizona Corporation Commission Staff ("Staff") and Qwest Corporation ("Qwest").¹

2 I will also respond to the surrebuttal testimonies of Qwest witnesses Ann Koehler-
3 Christensen and Phillip E. Grate.

4 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

5 A. I oppose the proposed Settlement Agreement because I do not believe it provides
6 adequate compensation to local ratepayers for the sale of Qwest Dex, Inc. ("Dex") by
7 Qwest's parent company, Qwest Communications International, Inc. ("QCI"). I also find
8 the criticisms of my Rebuttal Testimony to be without merit.

9
10 **II. THE PROPOSED SETTLEMENT IS NOT IN THE PUBLIC INTEREST**

11
12 **Q. DO YOU OPPOSE SETTLEMENT AGREEMENTS IN REGULATORY**
13 **PROCEEDINGS AS A MATTER OF PRINCIPLE?**

14 A. No. Settlement Agreements can be in the public interest when they represent an
15 appropriate balancing of benefits and risks for both the company and ratepayers.
16 Settlement Agreements generally represent a compromise on the part of the parties
17 involved. Each party balances the benefits it receives from the Settlement Agreement
18 against the risk that these benefits will be less if a settlement is not reached and litigation
19 is pursued.

¹ Stipulation dated April 10, 2003.

1 Q. HAVE YOU EVER TAKEN A POSITION ON A SETTLEMENT AGREEMENT
2 IN ARIZONA?

3 A. Yes. In Docket No. T-01051B-97-0689 on behalf of DOD/FEA, I opposed a Proposed
4 Agreement between Staff and U S West concerning depreciation.² That Proposed
5 Agreement was not approved by the Commission. In Docket T-01051B-99-0105, on
6 behalf of DOD/FEA, I supported a proposed Settlement Agreement between Staff and
7 Qwest concerning rate case issues and a Price Cap Plan.³ That Proposed Settlement
8 Agreement was approved by the Commission.

9 Q. WHY DO YOU OPPOSE THE PROPOSED SETTLEMENT AGREEMENT IN
10 THIS PROCEEDING?

11 A. I do not believe the proposed Settlement Agreement provides adequate compensation to
12 local ratepayers for the sale of Dex. From a ratepayer's perspective, I do not believe the
13 Settlement Agreement provides an appropriate balancing of litigation risk versus
14 settlement benefits.

15 Q. WHAT HAS LED YOU TO THIS BELIEF?

16 A. My belief is based on my review of Attachment RBL1 to this testimony. That attachment
17 lists the ratepayer benefits, on a present value basis, of the various proposals of the
18 parties and calculations I have made, as follows:

19 Line 1: The present value of my proposal on behalf of DOD/FEA reflecting a

² Testimony on the Proposed Agreement Between the Commission Staff and U S West, October 30, 1998.

³ Testimony on the Agreement Between the Commission Staff and Qwest, November 13, 2000.

1 regulatory liability on a pre-tax basis (\$1,217 million).

2 Line 2: The present value of the proposal of the Residential Utility Consumer
3 Office ("RUCO") as quantified by Qwest (\$1,206 million).

4 Line 3: Staff's proposal (\$1,040 million).

5 Line 4: The present value of my proposal on behalf of DOD/FEA reflecting a
6 regulatory liability on a post-tax basis (\$934 million).

7 Line 5: My calculation of the benefit Arizona ratepayers would receive from the
8 settlement reached in Utah were it to be increased in proportion to the greater
9 booked Dex revenues in Arizona (\$764 million).⁴

10 Line 6: The gain from the portion of Dex's business related to Qwest's regulated
11 telephone service according to Qwest witness Grate's statement that the present
12 value of the Stipulation is 92% of this amount (\$685 million).⁵

13 Line 7: The ratepayer benefit pursuant to the Stipulation (\$630 million).

14 Line 8: The present value of the current \$43 million imputation as calculated by
15 Staff (\$369 million).

16 **Q. WHAT DO YOU CONCLUDE FROM YOUR REVIEW OF ATTACHMENT**
17 **RBL1?**

18 **A.** I conclude that the Stipulation does not represent a reasonable compromise between the
19 parties to this proceeding. Qwest's calculation of the total Arizona gain from the sale of

⁴ See Qwest Response to STF 2-69, Attachment A, Page 2, for booked Dex revenues.

⁵ Grate Surrebuttal, at 5 (\$630/ .92 = \$685).

1 Dex (Line 5) is much less than that of the other parties (Lines 1, 2 and 3), largely because
2 Qwest contends that the gain associated with Secondary Directories and non-Qwest
3 listings should be “carved out” of the ratepayer benefit calculation. This is a highly
4 controversial contention, as I will discuss below. At any rate, the Stipulation benefit
5 (Line 6) does not represent a compromise on this issue – the Stipulation benefit is even
6 less than Qwest’s calculation of gain. I cannot, in good conscience, recommend that
7 DOD/FEA support a settlement that represents a capitulation instead of a compromise.

8 **Q. WHAT WOULD YOU CONSIDER A REASONABLE COMPROMISE?**

9 A. If Staff and Qwest had proposed to split the difference between their positions, I would
10 have seriously considered supporting their settlement. As shown on Attachment RBL2,
11 this would have resulted in a \$862 million ratepayer benefit and an apparent balancing of
12 interests.

13 **Q. DO YOU HAVE ANY OTHER CONCERNS ABOUT THE PROPOSED**
14 **SETTLEMENT AGREEMENT?**

15 A. Yes, I do. In my Rebuttal Testimony, I recommended an immediate bill credit as well as
16 an annual imputation for 15 years.⁶ The Stipulation calls for an annual imputation for 15
17 years, but no immediate bill credit. I am concerned that local service ratepayers may
18 never actually see a benefit from the sale of Dex without an immediate bill credit. In
19 Utah, Qwest agreed to a \$22 million bill credit in addition to a continuation of
20 imputation.

⁶ Lee Rebuttal, at 7-8.

1 Q. WHAT WOULD YOU CONSIDER A REASONABLE BILL CREDIT?

2 A. In my Rebuttal Testimony, I recommended that the bill credit represent 10 percent of the
3 present value of total ratepayer benefits.⁷ If one were to assume a total settlement of
4 \$862 million, as above, the immediate bill credit would be \$86 million, and the
5 imputation for 15 years would be \$95 million annually.⁸

6 Q. WOULD AN \$86 MILLION BILL CREDIT SERIOUSLY UNDERMINE
7 QWEST'S NEED FOR CASH TO AVERT BANKRUPTCY?

8 A. No. In speaking to institutional investors, Oren G. Shaffer, QCI's Chief Financial
9 Officer, noted that QCI had allocated \$500 million as the potential cost of getting
10 regulatory approval of the Dex sale.⁹ He went on to state:

11 The only reason I'm making a point about this is
12 that, as I said, we're down to where we have two
13 states left that we're negotiating with. It cost us \$22
14 million to settle out Utah. So, I think it's a fair
15 assumption that I've over – I've over estimated the
16 kind of regulatory costs that this thing's going to
17 take to complete....¹⁰

18
19 The two states referenced are Arizona and Washington.

⁷ Id.

⁸ Given a discount rate of 9.61 percent and a half-year convention.

⁹ Transcript of Mr. Shaffer's statements at the Janco Partners 8th Annual Institutional Investor Media and Telecommunications Conference, March 13, 2003, at paragraph 24. See Qwest Response to DOD/FEA 2-1.

¹⁰ Id., at paragraph 25.

1 **III. REJOINDER TO ANN KOEHLER-CHRISTENSEN**

2
3 **Q. WHAT ARE MS. KOEHLER-CHRISTENSEN'S CRITICISMS OF YOUR**
4 **TESTIMONY?**

5 A. Ms. Koehler-Christensen contends that I incorrectly assume that Qwest customers have a
6 claim to all of the gain from the Dex sale, even though "a significant portion of that gain
7 is attributable to business activity completely independent from Dex's publication of
8 directories on behalf of Qwest."¹¹ Ms. Koehler-Christensen contends that much of New
9 Ventures activities are not related to directory publishing and thus the gain from them
10 should not accrue to ratepayers.¹² Although she concedes that Secondary directories and
11 non-Qwest listings are related to directory publishing, she contends they are not related to
12 the directory publishing performed by Dex on behalf of Qwest, and thus the gain from
13 them should not accrue to ratepayers.¹³

14 **Q. DO YOU BELIEVE THERE IS MERIT TO MS. KOEHLER-CHRISTENSEN'S**
15 **CRITICISMS WITH RESPECT TO SECONDARY DIRECTORIES AND NON-**
16 **QWEST LISTINGS?**

17 A. No. As I explained in my Rebuttal Testimony, the directory publishing business, in total,
18 was assigned to Qwest's predecessor, U S West, upon AT&T's divestiture in 1984 to

¹¹ Koehler-Christensen Rebuttal, at 3.

¹² Id., at 17.

¹³ Id.

1 generate "a substantial subsidy for local telephone rates."¹⁴ Now Qwest's directory
2 publishing business, in total, is being sold at a substantial gain. The "carve-outs"
3 proposed by Ms. Koehler-Christensen represent nothing more than an attempt to retain a
4 significant portion of this gain for stockholders at the expense of ratepayers. Changes in
5 the directory publishing business, such as Secondary directories and non-Qwest listings,
6 are to be expected over time, and don't represent a legitimate reason for reducing the
7 subsidy for local telephone rates.

8 **Q. DO YOU BELIEVE THERE IS MERIT TO MS. KOEHLER- CHRISTENSEN'S**
9 **CRITICISM WITH RESPECT TO NEW VENTURES?**

10 A. No. New Ventures is an integral part of the directory publishing business being sold,
11 even though it involves "non-traditional" activities. Confidential Attachment RBL3 to
12 this Rejoinder Testimony provides a number of excerpts from the Confidential
13 Descriptive Memorandum provided to prospective buyers of Dex.¹⁵ These excerpts
14 demonstrate the importance of New Ventures to the Dex sale and the close relationship of
15 these activities to Dex's core directory publishing operation. As noted in Qwest's
16 response to STF 1-26, potential buyers were not allowed to bid on Dex without the New
17 Ventures activities. There is no legitimate reason to "carve-out" any of the gain from the
18 sale of Dex for New Ventures activities.

¹⁴ Lee Rebuttal, at 5, *citing* United States v. American Tel. and Tel Co. et al., 552 F. Supp. 131, at 224 (1982) ("MFJ").

¹⁵ Response to STF 1-26, Attachment A.

1 **IV. REJOINDER TO PHILIP E. GRATE**

2
3 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S CRITICISMS OF YOUR**
4 **PROPOSAL ON BEHALF OF DOD/FEA?**

5 A. Mr. Grate suggests six reasons for finding my proposal "unreasonable."¹⁶ I will respond
6 to each in turn and explain why each criticism lacks merit.

7 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S FIRST CRITICISM?**

8 A. Mr. Grate states that I chose to disregard the 1988 Settlement "without offering any real
9 justification."¹⁷ Contrary to Mr. Grate's assertion, I explained in my Rebuttal Testimony
10 that the 1988 Settlement Agreement (in plain language) addressed only the "transfer" of
11 Yellow Pages assets from one affiliate to another within U S West.¹⁸ Since there was no
12 value placed on the directory enterprise as a business, the 1988 Settlement Agreement
13 depended upon affiliate transaction analyses related to "fees" and "the value of service."

14 The sale of Dex to an unrelated third party presents an entirely new and different
15 situation. On the one hand, affiliate transaction rules will cease to apply once the sale
16 occurs, since Dex will no longer be an affiliate. On the other hand, there will be a
17 specific value attributable to the directory enterprise by virtue of its sale. I have accepted

¹⁶ Grate Surrebuttal, at 38-40.

¹⁷ Id., at 38.

¹⁸ Lee Rebuttal, at 6.

1 Qwest's estimate of this value for purposes of this testimony.

2 An examination of Attachment RBL1 to this testimony dramatically illustrates
3 how totally inadequate the subsidy of local rates has been pursuant to the 1988 Settlement
4 Agreement. The present value of my proposal (Line 1) is over three times the present
5 value of the current imputation (Line 8). Staff's proposal (Line 3) is nearly three times
6 the present value of the current imputation. I have not proposed a "true-up" to reimburse
7 local service ratepayers for the extra payments they have made in past years due to this
8 inadequate subsidy. But I do believe local service ratepayers should be credited with the
9 full value of the directory gain now that this amount is known.

10 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S SECOND CRITICISM?**

11 A. Mr. Grate criticizes my proposal to provide local service ratepayers all of the Arizona
12 portion of the gain on the sale of Dex without regard to income taxes.¹⁹ He contends that
13 under federal tax law and correct accounting principles, QCI will pay tax on the gain.
14 Mr. Grate would have the Commission concentrate on the trees and ignore the forest.

15 Regulation is as much art, as science. As Mr. Grate recognizes, the ratemaking
16 process involves a balancing of investor and consumer interests.²⁰ As I explained in my
17 Rebuttal Testimony, the net operating losses attributable to QCI's nonregulated

¹⁹ Grate Surrebuttal, at 38.

²⁰ Grate Surrebuttal, at 7, citing Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transit Commission, 458 F. 2d 786, 806 (D.C. Cir. 1973) ("DCC").

1 operations, when fully determined, will exceed the one-time gain from its sale of Dex.²¹

2 Mr. Grate does not dispute this assertion.²²

3 In preparing its tax return, therefore, Qwest will calculate the tax due on the gain
4 from the sale of Dex. It will then offset these taxes with the tax effect of its net operating
5 losses, and determine that it does not owe any net taxes.

6 As I see the situation, the huge losses from QCI's nonregulated operations have
7 forced the sale of Dex. Ironically, these very losses will, in effect if not "technically,"
8 allow QCI to retain the entire gain from the sale of Dex. I believe an informed balancing
9 of investor and consumer interest can only conclude that this entire gain should accrue to
10 the benefit of local service ratepayers, without a deduction for "phantom" taxes.

11 **Q. WHAT WOULD BE THE EFFECT ON YOUR PROPOSAL IF THESE**
12 **"PHANTOM" TAXES ARE DENIED TO RATEPAYERS?**

13 A. On Attachment RBL5, I calculate the present value of my proposal as \$1,217.3 million.
14 On Attachment RBL4, I recalculate my proposal assuming that the Arizona Regulatory
15 Benefit is determined on a Post-Tax basis. Using the rounding convention I adopted in
16 my original proposal the immediate bill credit (Line 4) becomes \$98 million (instead of
17 \$97 million) and the Annual Amortization (Line 6) remains \$58 million. The Initial
18 Regulatory Liability (Line 5), however, drops from \$873 million to \$528 million.

19

²¹ Lee Rebuttal, at 10.

²² See Qwest response to STF 2-118 for QCI's net operating losses as of 12/31/01.

1 On Attachment RBL6, I calculate that the present value of my proposal would
2 drop to \$934.2 million under this assumption.

3 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S THIRD CRITICISM?**

4 A. Mr. Grate endorses Ms. Koehler-Christensen's position that I should "carve-out" a
5 substantial portion of the gain on the sale of Dex because it is not related to the provision
6 of Qwest's regulated telephone service. As I explained above, this criticism is without
7 merit.

8 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S FOURTH CRITICISM?**

9 A. Mr. Grate objects to my attribution of 100 percent of the Arizona portion of the gain to
10 ratepayers and none to shareholders.²³ He contends that under the principles of *DCC*, all
11 of the gain belongs to the owners. He contends that the vacation of the *MFJ*, which
12 controlled the 1984 AT&T divestiture, is somehow relevant to this proceeding.

13 Mr. Grate's reliance on *DCC* is misplaced. As I noted above, *DCC* recognizes
14 that regulation involves a balancing of investor and consumer interests. Mr. Grate
15 emphasizes the following sentence from *DCC*:

16 In particular instances, however, the direction in
17 which the equities lie is so vividly marked by the
18 circumstances of the case that the allocation
19 properly to be made emerges plainly.²⁴
20

21 Interestingly, Mr. Grate and I are in apparent agreement that "The equities are vividly

²³ Grate Surrebuttal, at 39.

²⁴ Grate Surrebuttal, at 17, citing *DCC*, at 807. (The correct cite is 821).

1 marked by the circumstances in Arizona.”²⁵

2 As I explained in my Rebuttal Testimony, the *MFJ* assigned the directory
3 publishing business to U S West and the other Bell operating companies in order to
4 generate “a substantial subsidy for local telephone rates.”²⁶ At midnight on December
5 31, 1983, U S West became the sole owner of AT&T’s directory operation in its region,
6 and since then local service ratepayers have been entitled to the subsidy generated by this
7 operation. The termination of the *MFJ* as of February 6, 1996, was purely ministerial and
8 had absolutely no effect on the assignment of directory operation over a decade before.²⁷
9 Mr. Grate’s point, in other words, is a red herring.

10 **Q. WHAT IS YOUR RESPONSE TO MR. GRATE’S FIFTH CRITICISM?**

11 A. Mr. Grate refers to the \$97 million initial bill credit I have proposed as a “windfall” to
12 ratepayers, because if Dex were not sold, ratepayers would not receive any such credit.²⁸
13 I find this comment disingenuous. I suggest it is QCI that is receiving a multi-billion
14 cash “windfall” by selling Dex, which is only available for QCI to sell because it was
15 assigned to U S West to subsidize local service rates.

²⁵ Id.

²⁶ Lee Rebuttal, at 5, citing *MFJ*, 552 F. Supp. at 224.

²⁷ See Order in Civil Action No. 82-0192, United States of America v. Western Electric Company, Inc. et al., United States District Court for the District of Columbia, April 11, 1996.

²⁸ Grate Surrebuttal, at 39.

1 Q. WHAT IS YOUR RESPONSE TO MR. GRATE'S FINAL CRITICISM?

2 A. Mr. Grate criticizes my proposal to establish a rate base regulatory liability for the 90
3 percent of the ratepayer benefit which is not provided as an immediate bill credit.²⁹ He
4 states that the "intangible assets" that allowed ratepayers to receive a subsidy from
5 directory advertising were never included in Qwest's rate base. This is another red
6 herring. QCI will receive billions in cash upon the sale of Dex. My proposal is simply to
7 provide Arizona local service ratepayers a small portion of their share of this cash as an
8 immediate bill credit, and to consider the balance as "cost-free capital" (similar to
9 deferred taxes) to be amortized over 15 years. How the subsidy from directory
10 advertising has been treated in the past is absolutely irrelevant to what should be the
11 treatment upon the sale of Dex.

12

13

V. CONCLUSION

14

15 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

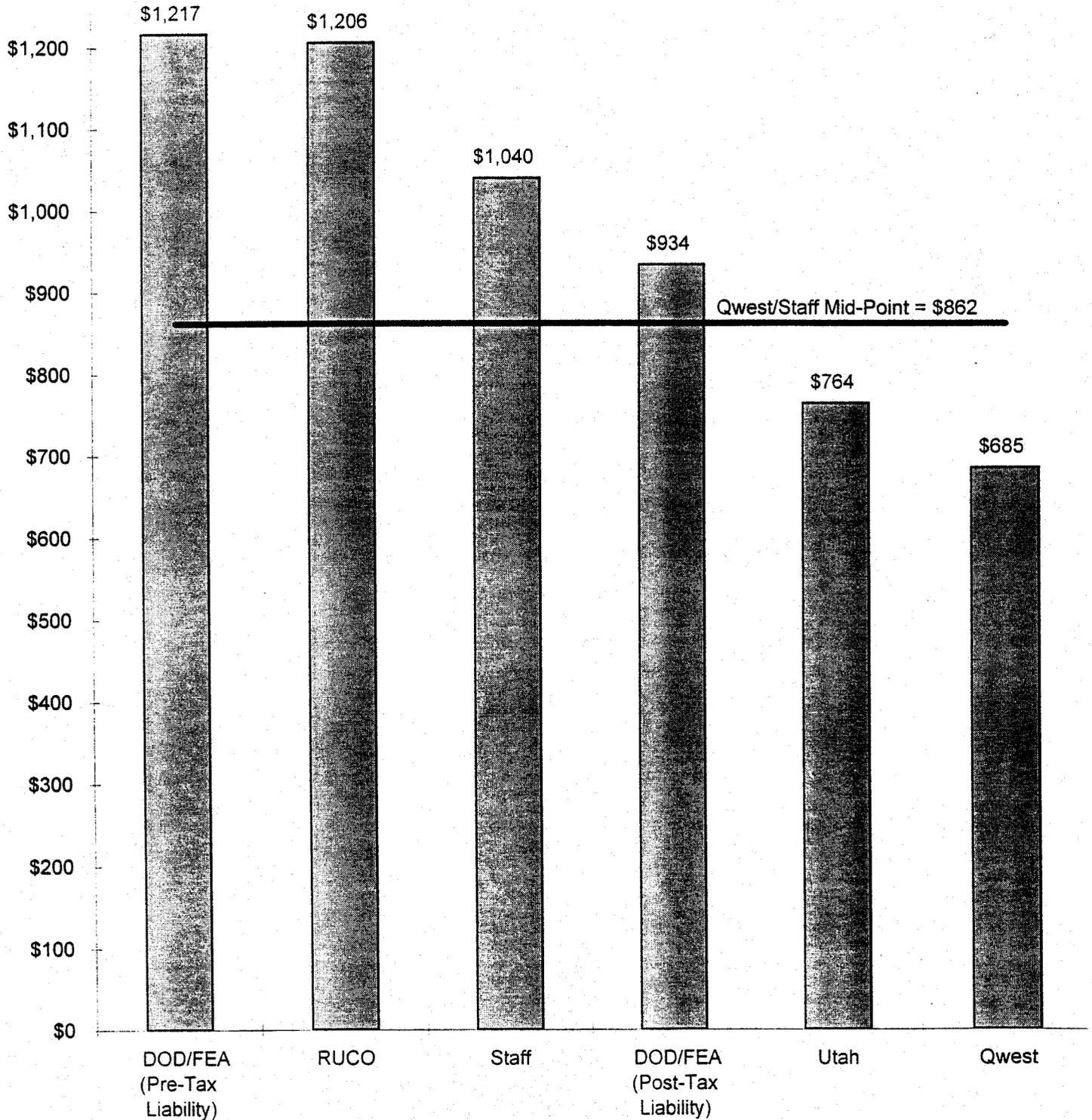
16 A. Yes, it does.

²⁹ Id., at 40.

Comparison of Ratepayer Benefits
(Dollars in Millions)

1.	DOD/FEA Proposal (Pre-Tax Liability) (Attachment RBL 5)	\$ 1,217
2.	RUCO Proposal (Grate Surrebuttal, PEG-S4, Page 3)	1,206
3.	Staff Proposal (Brosch Rebuttal, MLB-1, Page 1)	1,040
4.	DOD/FEA Proposal (Post-Tax Liability) (Attachment RBL 6)	934
5.	Utah Equivalent (\$22 plus present value of \$30.1 for 20 years, 9.61 discount factor, half year used, adjusted for Arizona Dex revenues.)	764
6.	Qwest Calculation of Gain Related to Arizona Regulated Telephone Service (\$630 Stipulation / 92 percent)	685
7.	Stipulation (Grate Surrebuttal, PEG-S4, Page 2)	630
8.	Current Imputation (Brosch Rebuttal, MLB-1, Page 2)	369

Comparison of Ratepayer Benefits (Dollars in Millions)



Arizona Corporation Commission
Docket No. T-01051B-02-0666
DOD/FEA – RBL 3
Testimony of Richard B. Lee
May 9, 2003

**Excerpts From Dex Confidential Descriptive Memorandum, Lehman Brothers,
April 2002 as Provided in Response to STF 1-26**

Confidential Information
Subject To Protective Agreement

Recommended Regulatory Treatment of DEX Sale
(Dollars in Millions)

	<u>Post-Tax</u> a	<u>Pre-Tax</u> $b=a / (1.0 - .4)$
1. Gain on Sale	\$ 3,793	\$ 6,322
2. Arizona Share	15.47%	N/A
3. Arizona Regulatory Benefit (L1 x L2)	\$ 587	\$ 978
4. Bill Credit (L3 x 10%)	\$ 59	\$ 98
5. Initial Regulatory Liability (L3 - L4)	\$ 528	N/A
6. Annual Amortization (L5/15)	\$ 35	\$ 58

Source: Lines 1 and 2, Grate Surrebuttal, PEG-S4, Page 1.
Tax Rate = .4 per Grate Surrebuttal, PEG-S4, Page 1.

Present Value of DOD/FEA Proposed Customer Credits
Pre-Tax Regulatory Liability
(Dollars in Millions)

<u>Year</u>	<u>Pre-Tax Reg. Liability</u> a	<u>Earnings</u> b=.0961 (a-.5d)	<u>Rev. Credit</u> c=b/.6	<u>Annual Amort.</u> d	<u>Total Credit</u> e=c+d	<u>Discount Factor</u> f	<u>Present Value</u> g=e*f
0	-	-	-	-	\$ 97.0	1.00000	\$ 97.0
1	\$ 873.0	\$ 81.1	\$ 135.2	\$ 58.0	193.2	0.95074	183.7
2	815.0	75.5	125.9	58.0	183.9	0.85937	158.0
3	757.0	70.0	116.6	58.0	174.6	0.77679	135.6
4	699.0	64.4	107.3	58.0	165.3	0.70214	116.1
5	641.0	58.8	98.0	58.0	156.0	0.63466	99.0
6	583.0	53.2	88.7	58.0	146.7	0.57367	84.2
7	525.0	47.7	79.4	58.0	137.4	0.51854	71.3
8	467.0	42.1	70.2	58.0	128.2	0.46871	60.1
9	409.0	36.5	60.9	58.0	118.9	0.42367	50.4
10	351.0	30.9	51.6	58.0	109.6	0.38295	42.0
11	293.0	25.4	42.3	58.0	100.3	0.34615	34.7
12	235.0	19.8	33.0	58.0	91.0	0.31288	28.5
13	177.0	14.2	23.7	58.0	81.7	0.28282	23.1
14	119.0	8.6	14.4	58.0	72.4	0.25564	18.5
15	61.0	2.9	4.9	61.0	65.9	0.23107	15.2
Total							\$ 1,217.3

Sources: Col. b factor = Rate of Return, Docket No. T-1051B-99-105
Col. c factor = 1.00 - .4 tax rate
Col. e, Year 0 = Lee Rebuttal, Attachment 4, Line 4
Col. a, Year 1 = Lee Rebuttal, Attachment 4, Line 5
Col. a, Other = Previous year - Col. d
Col. d = Lee Rebuttal, Attachment 4, Line 6
Col. f = Col. b factor, Half Year Used

Present Value of DOD/FEA Proposed Customer Credits
Post-Tax Regulatory Liability
(Dollars in Millions)

<u>Year</u>	<u>Post-Tax Reg. Liability</u> a	<u>Earnings</u> b=.0961 (a-.5d)	<u>Rev. Credit</u> c=b/.6	<u>Annual Amort.</u> d	<u>Total Credit</u> e=c+d	<u>Discount Factor</u> f	<u>Present Value</u> g=e*f
0	-	-	-	-	\$ 98.0	1.00000	\$ 98.0
1	\$ 528.0	\$ 48.0	\$ 79.9	\$ 58.0	137.9	0.95074	131.1
2	493.0	44.6	74.3	58.0	132.3	0.85937	113.7
3	458.0	41.2	68.7	58.0	126.7	0.77679	98.4
4	423.0	37.9	63.1	58.0	121.1	0.70214	85.0
5	388.0	34.5	57.5	58.0	115.5	0.63466	73.3
6	353.0	31.1	51.9	58.0	109.9	0.57367	63.0
7	318.0	27.8	46.3	58.0	104.3	0.51854	54.1
8	283.0	24.4	40.7	58.0	98.7	0.46871	46.3
9	248.0	21.0	35.1	58.0	93.1	0.42367	39.4
10	213.0	17.7	29.5	58.0	87.5	0.38295	33.5
11	178.0	14.3	23.9	58.0	81.9	0.34615	28.3
12	143.0	11.0	18.3	58.0	76.3	0.31288	23.9
13	108.0	7.6	12.7	58.0	70.7	0.28282	20.0
14	73.0	4.2	7.0	58.0	65.0	0.25564	16.6
15	38.0	1.8	3.0	38.0	41.0	0.23107	9.5
Total							\$ 934.2

Sources: Col. b factor = Rate of Return, Docket No. T-1051B-99-105
Col. c factor = 1.00 - .4 tax rate
Col. e, Year 0 = RBL 4, Line 4, Col. b
Col. a, Year 1 = RBL 4, Line 5, Col. a
Col. a, Other = Previous year - RBL 4, Line 6, Col. a
Col. d = RBL 4, Line 6, Col. b
Col. f = Col. b factor, Half Year Used

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing expurgated Rejoinder Testimony of Mr. Richard B. Lee on behalf of the United States Department of Defense and All Other Federal Executive Agencies was sent to the parties on the attached service list either by United Parcel Service - Next Day Air, or by first class mail, postage prepaid on May 8, 2003. Copies of the Confidential version of Mr. Lee's "Attachment 3" to his Rebuttal Testimony have been sent only to Parties who have executed the appropriate Protective Agreement.

Dated at Arlington County, Virginia, on this 8th Day of May 2003.


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