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June 11, 2003

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REPLY TO
ATTENTION OF

Regulatory Law Office
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AZ CORP COMMISSION
DOCUMENT CONTROL

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

JUN 12 2003

DOCKETED BY *[Signature]*

Dear Ms. Lasher:

Enclosed for filing with the Arizona Corporation Commission are the original and thirteen copies of the verified Response to Questions in Commissioner Mundell's May 23, 2003 Letter, by Richard B. Lee on behalf of the Department of Defense and All Other Federal Executive Agencies in the subject proceeding. We respectfully move the inclusion of this Response into the record of this proceeding as a late filed Exhibit.

Copies of this Response have been sent in accordance with the attached Certificate of Service. Inquiries concerning this matter may be directed to the undersigned at (703) 696-1644.

Sincerely,

[Signature of Peter Q. Nyce Jr.]

Peter Q. Nyce Jr.
General Attorney
Regulatory Law Office

Enclosure

**Response to Questions In Commissioner
Mundells' May 23, 2003, Letter
by
Richard B. Lee
on behalf of
The United States Department of Defense
And
All Other Federal Executive Agencies**

- Q1. It is my understanding that the State of Washington utility commission is considering a settlement of the Qwest/Dex sale with a total value in benefits of over \$886 million for Washington ratepayers. Will the public interest be served in Arizona if this Commission considers as a condition for approval of the Qwest/Dex transaction, an increase in the amount of the total value of the Qwest/Dex sale for Arizona ratepayers from the proposed \$555.82 million to an amount that is more in line with Qwest's settlement in Washington. (Note, \$555.82 million is the present value of the proposed Arizona settlement's \$72 million per year imputation adjustment for 15 years.)**
- A1. Yes, the public interest will be served in Arizona if the Commission rejects the proposed settlement and requires an increase in the benefits to ratepayers to bring them in line with the Washington settlement.**

In my Rejoinder Testimony, I compared the ratepayer benefits of the proposed settlement to the proposals of the parties, the Utah settlement, and the current imputation.¹ Attached to this response are updates to this comparison to include the Washington settlement. On RBL-1 (Revised), I show the Washington ratepayer benefits on Line 5 and the proposed Arizona ratepayer benefits on Line 8 as stated in Commissioner Mundell's letter. On RBL-2 (Revised), I compare this data to the mid-point between Staff's original proposal (\$1,040 million) and my estimate of Qwest's calculation of the gain from the sale of Dex related to Arizona regulated telephone service (\$685 million). This mid-point (\$862 million) is slightly below the Washington settlement value (\$866 million). I believe this amount would strike a reasonable compromise between the interests of Arizona ratepayers and Qwest stockholders.

As Dex Holdings witness William E. Kennard has stated, the sale of Dex is an "extraordinary transaction."² The magnitude of the gain from the sale of Dex is great, and serves to highlight the fact that Arizona ratepayers have been receiving only a portion of the subsidy intended for them upon the break-up of AT&T. The sale of Dex to a third party provides an opportunity for the Commission to take action to ensure that Arizona ratepayers receive their fair share of this gain.

¹ Lee Rejoinder, at 3-5, RBL-1 and RBL-2.

² Tr. Vol. II, at 106.

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- Q2.** Staff's direct testimony valued the Arizona portion of the Dex sale gain at \$1,040.50 million, which is nearly double the proposed settlement value of \$555.82 million. Will the public interest be served if this Commission considers as a condition for approval of the Qwest/Dex transaction, an increase in the amount of the total value of the benefits to Arizona ratepayers from the proposed Dex sale to reflect more of Qwest's gain from the Dex sale?
- A2.** Yes, the public interest will be served in Arizona if the Commission rejects the proposed settlement and requires an increase in the ratepayer share of the gain from the sale of Dex.

In my Rebuttal Testimony I explained that the entire gain from the sale of Dex should be provided to ratepayers, since the directory operation was assigned to U S West, Qwest's predecessor, to provide a subsidy for local telephone rates.³ In my Rejoinder Testimony, however, I suggested that a reasonable compromise between the parties might be reached by splitting the difference between the positions of Staff and Qwest.⁴ As noted above and shown on RBL-2, such a compromise would result in an \$862 million benefit to Arizona ratepayers.

³ Lee Rebuttal, at 5-6.

⁴ Lee Rejoinder, at 5.

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Q3. It is my understanding that other state jurisdictions have approved Qwest's Dex sale with a requirement that there be a bill credit of approximately \$30.00 for Qwest's ratepayers in their states. Will the public interest be served if this Commission considers as a condition for approval of the Qwest/Dex transaction, a similar \$30.00 bill credit for Qwest's Arizona ratepayers?

A3. Yes, the public interest will be served if the Commission requires a small portion of the ratepayer benefits from the sale of Dex to be provided in the form of an immediate bill credit.

In my Rebuttal Testimony, I recommended that 10 percent of the ratepayer benefit be in the form of an immediate bill credit.⁵ I picked 10 percent because it is sufficiently large to provide a tangible benefit to ratepayers, but not so large as to dilute seriously the cash flow needed by Qwest to avert bankruptcy.⁶

In my Rejoinder Testimony, I noted that applying this principle to the compromise benefit I described above would result in an immediate bill credit of \$86 million.⁷ Using the Arizona access lines provided in Exhibit RUCO-1, this would equate to a bill credit of \$29.74 per line.

It should be noted that the only member of the public to comment at the hearing in this proceeding suggested that a bill credit in the range of \$30 per line would be fair to ratepayers.⁸ I agree.

⁵ Lee Rebuttal, at 8.

⁶ Id.

⁷ Lee Rejoinder, at 6.

⁸ Comment of John Poston, consumer coordinator for Arizonans for Competition in Telephone Service, Tr. Vol. II, at 68.

**Response to Questions In Commissioner
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Q4. In addition to a bill credit for customers, will the public interest be served if this Commission considers as a condition for approval of the Qwest/Dex transaction, that Qwest maintain its current rates for a period of five (5) years to stabilize rates and protect ratepayers from potential adverse effects to Qwest's financial condition resulting from the Qwest/Dex sale?

A4. No, I do not believe it would be in the public interest to freeze current rates for five years as a condition for approval of the sale of Dex.

If the Commission approves ratepayer benefits of at least the \$862 million discussed above, and includes an immediate bill credit of about \$30 per line, I believe the public interest will have been fully served in a manner appropriate to the unique circumstances associated with the sale of Dex to a third party.

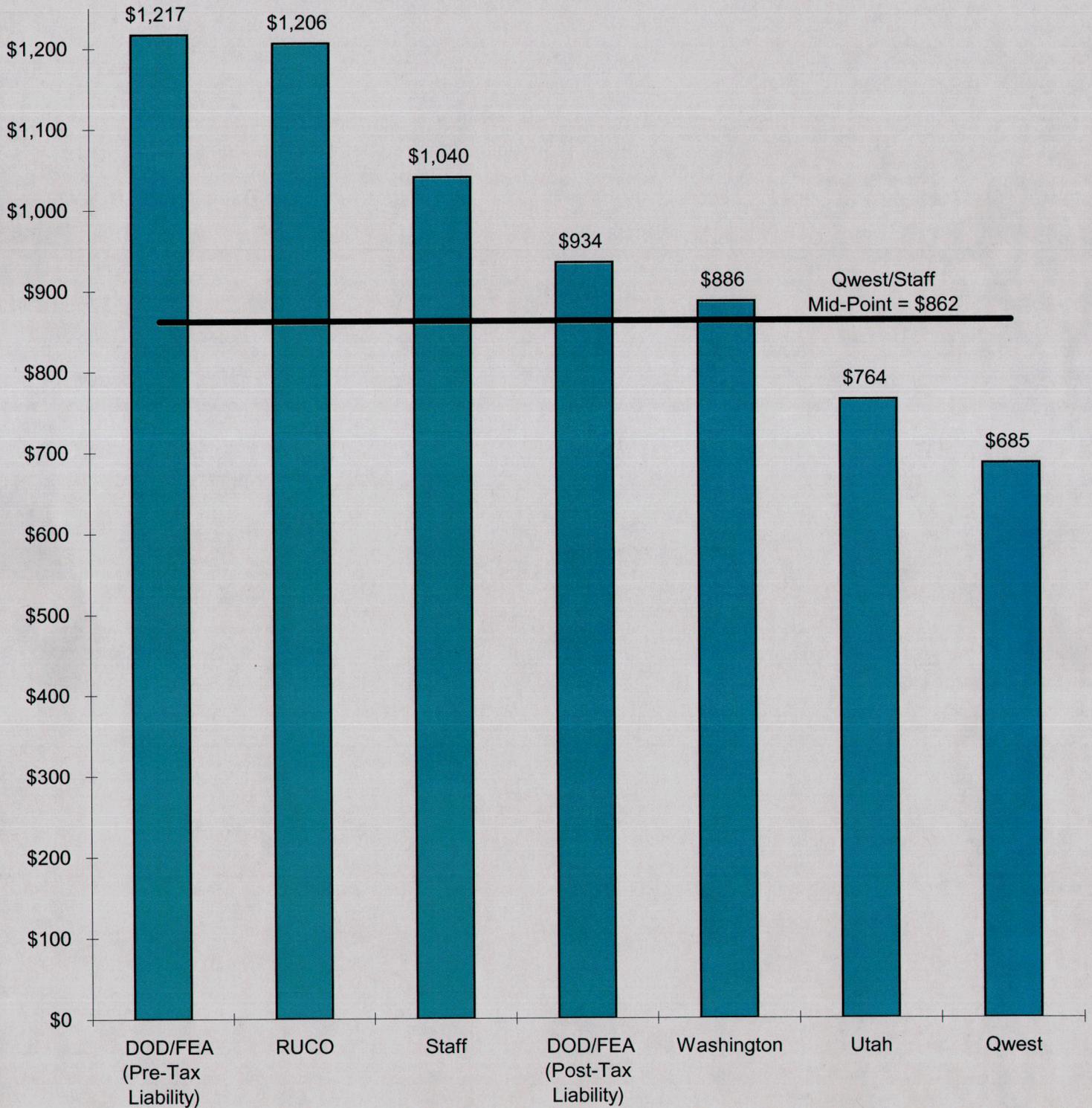
Matters relating to rate stabilization are more appropriately addressed in the upcoming price cap proceeding.

Comparison of Benefits To Arizona Ratepayers

(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 Direct, MLB-1, Page 1)	1,040
4.	DOD/FEA Proposal (Post-Tax Liability) (Attachment RBL 6)	934
5.	Washington (Mundell 5/23/03 Letter)	886
6.	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
7.	Qwest Calculation of Gain Related to Arizona Regulated Telephone Service (\$630 Stipulation / 92 percent)	685
8.	Stipulation (Mundell 5/23/03 Letter)	556
9.	Current Imputation (Brosch Direct, MLB-1, Page 1)	369

Comparison of Benefits To Arizona Ratepayers (Dollars in Millions)



AFFIDAVIT OF RICHARD B. LEE

Comes, Richard B. Lee, and being duly sworn states that the foregoing response was prepared by him or under his direction and that the statements and information contained therein are, to the best of his information and belief, true and correct.

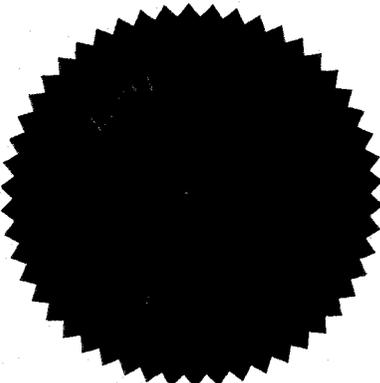

Richard B. Lee

District of Columbia

Sworn to before me by Richard B. Lee, this 10th day of June 2003.


Notary Public

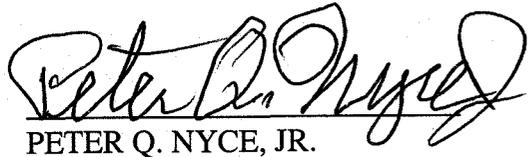
My Commission Expires: March 14th, 2006



CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing verified Response to Questions in Commissioner Mundell's May 23, 2003, Letter by 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 by E-mail and either by United Parcel Service - Next Day Air, or by first class mail, postage prepaid on June 11, 2003.

Dated at Arlington County, Virginia, on this 11th Day of June 2003.


PETER Q. NYCE, JR.

DOCKET CONTROL
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

ERNEST G JOHNSON ESQ
DIRECTOR UTILITIES DIVISION
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

SCOTT S WAKEFIELD ESQ
RESIDENTIAL UTILITY CONSUMER OFC
1110 WEST WASHINGTON ST SUITE 220
PHOENIX AZ 85007

RUSSELL P ROWE ESQ
WILLIAM C BRITTAN ESQ
CAMPBELL BOHN KILLIN BRITTAN
& RAY LLC
270 ST PAUL STREET SUITE 200
DENVER CO 80206

RICHARD R CAMERON
LATHAM & WATKINS
555 ELEVENTH STREET N W SUITE 1000
WASHINGTON DC 20004

DANIEL POZEFSKY
RESIDENTIAL UTILITY CONSUMER OFC
1110 WEST WASHINGTON ST SUITE 220
PHOENIX AZ 85007

LYN FARMER ESQ
CHIEF ALJ HEARING DIVISION
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

PHILIP J ROSELLI
WENDY MOSER
SHARON BERRY
QWEST SERVICES CORPORATION
1801 CALIFORNIA STREET, SUITE 5200
DENVER CO 80202

THOMAS H CAMPBELL ESQ
MICHAEL T HALLAM ESQ
LEWIS AND ROCA
40 NORTH CENTRAL AVENUE
PHOENIX AZ 85004

RICHARD LEE ESQ
SNAVELY KING MAJOROS O'CONNOR
& LEE, INC
1220 L STREET N W SUITE 410
WASHINGTON DC 20005

MARK BROWN
3033 N 3RD STREET
PHOENIX AZ 85012

CHRISTOPHER C KEMPLEY ESQ
MAUREEN A SCOTT ESQ
LEGAL DIVISION
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

TIMOTHY BERG ESQ
THERESA DWYER ESQ
FENNEMORE CRAIG PC
3003 NORTH CENTRAL AV SUITE 2600
PHOENIX AZ 85012

THOMAS F DIXON ESQ
WOLDCOM INC
707 17TH STREET 39TH FL
DENVER COLORADO 80202

MICHAEL W PATTEN
LAURA E SCHOELER
ROSHKA HEYMAN & DEWAULF PLC
ONE ARIZONA CENTER
400 EAST VAN BUREN STREET SUITE 800
PHOENIX AZ 85004

ALJ JANE RODDA
400 WEST CONGRESS
TUCSON AZ 85701-1347