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ORIGINAL

EXCEPTION

BEFORE THE ARIZONA CORPORATION COMMISSION

- MARC SPITZER  
CHAIRMAN
- JIM IRVIN  
COMMISSIONER
- WILLIAM A. MUNDELL  
COMMISSIONER
- JEFF HATCH-MILLER  
COMMISSIONER
- MIKE GLEASON  
COMMISSIONER

2003 AUG 29 A 11:11

AZ CORP COMMISSION  
DOCUMENT CONTROL

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

**DOCKETED**

AUG 29 2003

DOCKETED BY	<i>CRS</i>
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**EXCEPTIONS OF THE RESIDENTIAL UTILITY CONSUMER OFFICE**

The Residential Utility Consumer Office ("RUCO") makes the following exceptions to the recommended Opinion and Order ("ROO") on Qwest's<sup>1</sup> Application for Approval of the Sale of it's Arizona Operations of Qwest Dex, Inc. ("Dex") to Dex Holdings L.L.C. ("Dex Holdings") to an unrelated third party buyer.

**THE ROO IS NOT IN THE PUBLIC INTEREST<sup>2</sup>**

Since the filing of its application, Qwest has maintained that the Commission is

<sup>1</sup> Qwest Communications International, Inc., Qwest Services Corporation and Qwest Corporation filed the Notice of Sale. For purposes of this discussion, these Qwest entities will be referred to collectively as Qwest.

<sup>2</sup> For purposes of brevity, RUCO will not repeat its argument regarding the unfairness of the recommended settlement agreement compared to the settlement reached in Washington, a comparable state based on access lines and publishing revenues. RUCO would refer the Commission to the argument on this issue made in its Post-Hearing Brief and incorporate the same argument here.

1 bound by the terms of the May 27, 1988 Settlement Agreement ("1988 Settlement  
2 Agreement") between the Commission and Mountain States Telephone and Telegraph  
3 Company (Qwest's predecessor). Notice of Sale, at 7. In particular, Qwest posits that the  
4 Commission is limited to the \$43 million imputation figure determined in Mountain Bell's  
5 1984 rate case and referenced in the 1988 Settlement Agreement. Trans., Vol. III at 389.  
6 Staff and RUCO, on the other hand, took issue with Qwest's position in their direct  
7 testimonies and proposed imputation amounts of \$121.3 million per year under traditional  
8 regulation<sup>3</sup> and \$138 million respectively. S-1 at 3, RUCO-4 at 4-5. However, after  
9 weighing the litigation risk, Staff determined that the best course of action would be a  
10 compromise of what it originally determined was a fair imputation value and the value  
11 referenced in the 1988 settlement agreement. Trans., Vol. II at 174-176. The ROO  
12 adopted the new settlement agreement reached by Staff and Qwest, noting that the  
13 litigation risk in this case was not "insubstantial".

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17 Contrary to Qwest's argument, or the ROO's proposed Findings, the Commission  
18 should not be persuaded by the potential litigation risk. The underlying premise that the  
19 Commission is bound by the \$43 million imputation figure is flawed. By accepting this  
20 flawed premise as the basis for compromise, the ROO sells ratepayers' interests short.

21  
22 Qwest relies on the Court of Appeals Decision in *US West Communications, Inc. v.*  
23 *ACC*, 185 Ariz. 277, 915 P.2d 1232 (App. 1996) to support its conclusion that the  
24 Commission cannot increase the \$43 million imputation amount. Transcript, Vol. III at 389-  
25 390. The Court in *US West Communications, Inc.*, contrary to Qwest's argument, did not

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<sup>3</sup> Staff proposed a perpetual annual credit of \$100 million per year under price cap regulation. S-1 at 3.

1 hold that the Commission is limited to the presumptive imputed amount adopted in the  
2 1984 rate case and referenced in the 1988 Settlement Agreement.

3 In *US West Communications, Inc. v. ACC*, the Court of Appeals reviewed the  
4 Commission's Decision No. 58927 ("Decision") which approved directory imputation of  
5 \$60,684,000 based on Staff's recommendations. *US West Communications, Inc. v. ACC*,  
6 185 Ariz. 277, 279, 915 P.2d 1232, 1234. To arrive at its recommended imputation, Staff  
7 had attributed to US West all of US West Direct's ("USWD")<sup>4</sup> profits that exceeded the 11.4  
8 percent rate of return that would have been permitted had USWD remained a regulated  
9 entity. *Id.* at 280, 915 P.2d 1235.  
10  
11

12 In striking down the Decision, the Court noted that imputation method established in  
13 the 1988 Settlement Agreement was not "... the excess-profit imputation adopted by the  
14 Commission in this case but rather a method dependent upon proof of 'the fees and value  
15 of services received by Mountain Bell from USWD under publishing agreements with  
16 USWD.'" (Emphasis added) *Id.* at 281, 915 P. 2d 1236. The Court specifically stated  
17 that it was setting aside the Decision because the Commission relied on a methodology  
18 that the 1988 Settlement Agreement rendered invalid, and because Staff introduced no  
19 evidence to support greater imputation under the proper methodology. *Id.* at 281-282, 915  
20 P. 2d 1236-1237. (Emphasis added) Finally, the Court noted that the Commission can  
21 adjust the presumptive \$43 million imputation either upward or downward as long as the  
22 Commission makes the adjustment based on evidence of fees and the value of services.  
23  
24  
25 *Id.* at 281, 915 P. 2d 1236.

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<sup>4</sup> Qwest was formerly known as U.S. West Communications, Inc. Notice of Sale at 6. US West Direct was a predecessor of Dex. *Id.* at 7.

1 The Court has made it clear that the Commission is unhindered in its discretion to  
2 value for its purposes the nature of any imputation amount under consideration and reach  
3 a fair result. There is substantial evidence in the record in the immediate case to support a  
4 much greater imputation amount than recommended under the ROO using a valuation  
5 methodology.  
6

7 The particular valuation methodology suggested by RUCO considers access line  
8 growth and inflation. RUCO-6 at 3. By comparison to a valuation methodology to  
9 determine an imputation amount using the \$43 million imputation amount as a benchmark,  
10 ratepayers lose by the terms of the recommended settlement agreement. RUCO's  
11 witness, Dr. Ben Johnson, in his Rejoinder testimony, compared the annual imputation  
12 amounts under the Stipulation with imputation amounts based on the \$43 million amount  
13 ("status quo") included in Mountain Bell's 1984 rate case and the 1988 Settlement  
14 Agreement. RUCO-6 at 3, BJ Schedule 1. Dr. Johnson extended his calculations out to  
15 the years 2004 through 2048<sup>5</sup> and adjusted them for inflation and line growth. In  
16 considering the 20<sup>th</sup> year (2023), for example, under the Stipulation there is no directory  
17 income imputation. However, under the status quo, the level of imputation would amount  
18 to \$84 million based only on line growth or \$247 million if both line growth and inflation are  
19 considered. RUCO-6, BJ Schedule 1. In fact, whether adjusted for line growth and/or  
20 inflation the status quo level of imputation is at least \$11 million higher than the stipulated  
21 amount for each of the 44 years considered. Id.  
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<sup>5</sup> The difference, 45 years, is the average duration of the Non-Competition Agreement and the Publishing Agreement. RUCO-6 at 16.

1           Simply stated, Arizona consumers would be better off if the Commission were to not  
2 approve the recommended Settlement Agreement and allow for imputation under the  
3 status quo. In terms of present value, the \$72 million settlement agreement is worth  
4 approximately \$550 million. Transcript, Vol. III at 274. Adjusting the \$43 million imputation  
5 amount for line growth over 45 years results in a net present value of approximately \$850  
6 million. Transcript, Vol. III at 274, RUCO-2. Adjusting the same for both line growth and  
7 inflation, the net present value of the status quo is approximately two billion dollars.  
8 Transcript, Vol. III at 274, RUCO-2.  
9

10  
11           To solve this problem, RUCO recommends that the Commission issue an order  
12 providing the parties with the opportunity to extend the imputation period to last at a  
13 minimum forty years, the duration of the Non-Competition Agreement, or reduce the  
14 duration of the directory designation and the Non-Competition Agreement to match the 15  
15 year imputation period. RUCO-6 at 6. The focus of RUCO's concern is what will happen  
16 to consumers 20 or 30 years out. Qwest and Staff are seeking the Commission's approval  
17 to cut off after a short period of time<sup>6</sup> a very large and growing stream of cash flow.  
18 Transcript, Vol. III at 283. Traditionally, this large stream of cash is used to offset the high  
19 cost of serving rural areas and other obligations of Qwest, while also helping to keep rates  
20 affordable. Transcript, Vol. III at 283.  
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22  
23           It is unfortunate that Qwest is experiencing financial troubles. However, Arizona  
24 consumers should not be forced to give up a large stream of cash flow because of Qwest's  
25 needs elsewhere in its corporate structure.

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<sup>6</sup> When compared to the duration of the directory designation and the Non-Competition Agreement.



1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 29<sup>th</sup> day  
3 August, 2003 with:

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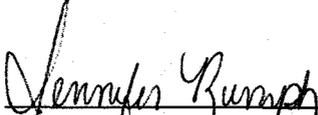
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