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Transcript Exhibit(s)

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*Admitted with June 3, 2003
transcript (volume II)*

EXHIBIT

DH-1

Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS:
MARC SPITZER, CHAIRMAN
JIM IRVIN
WILLIAM A. MUNDELL
JEFF HATCH-MILLER
MIKE GLEASON

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

DIRECT TESTIMONY OF
WILLIAM E. KENNARD
ON BEHALF OF
DEX HOLDINGS LLC

JANUARY 28, 2003

Direct Testimony of
William E. Kennard

I.
INTRODUCTION AND BACKGROUND

Q. PLEASE STATE YOUR NAME FOR THE RECORD.

A. William E. Kennard.

Q. WHO IS YOUR EMPLOYER AND WHAT IS YOUR CURRENT POSITION?

A. I am Managing Director of the Telecommunications and Media Group of The Carlyle Group ("Carlyle"). My business address is 1001 Pennsylvania Avenue, N.W., Washington, D.C. I have held this position since May 2001.

Q. PLEASE DETAIL YOUR WORK EXPERIENCE.

A. In November 1997, President Bill Clinton appointed me as Chairman of the Federal Communications Commission ("FCC"). I served in that position through January 2001. As Chairman, I led the FCC's implementation of the Telecommunications Act of 1996, the first comprehensive overhaul of the nation's telecommunications laws since the New Deal era when the FCC was created. I guided the FCC's adoption of procompetitive rules that advanced the central goal of the 1996 Act, which is to bring consumers the benefits of competition in all areas of the telecommunications industry, including competition between and among incumbent local exchange carriers ("ILECs"), interexchange carriers, new entrants, and others.

Before serving as FCC Chairman, I served as the FCC's General Counsel from December 1993 until October 1997. As the FCC's chief legal officer, I was responsible for advising the FCC on all matters involving the interpretation and application of the Communications Act of 1934, as amended, as well as other enacted or proposed legislation or regulations affecting the responsibilities and jurisdiction of the FCC and defending its many orders in court. Before joining the FCC, I was a partner in the

Washington, D.C. law firm of Verner, Liipfert, Bernhard, McPherson & Hand. From July 1983 through April 1984, I was the Assistant General Counsel of the National Association of Broadcasters. From September 1982 to July 1983, I was an associate attorney at the Verner, Liipfert firm. I received a one-year legal fellowship from the National Association of Broadcasters between September 1981 and September 1982.

Q. WOULD YOU PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND BRIEFLY?

A. I received my Juris Doctor degree from the Yale Law School in May 1981. I received an A.B. with distinction in communications from Stanford University in 1978.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS?

A. Yes. I am admitted to the bar in the state of California and in the District of Columbia.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I will address three areas. First, I will show that the Buyer is exceptionally well qualified to own and operate Dex. Second, I will discuss the reasons why the Buyer will have incentives to ensure that it provides the full range of high-quality services necessary for Qwest Corporation to meet its directory publishing obligations. Third, I will address certain reasons why the proposed sale of Qwest Dex as provided in the Rodney Agreement and related transaction documents is in the public interest.

Q. DO YOU INTEND TO ADDRESS THE FINANCIAL IMPACTS OF THE TRANSACTIONS TO QWEST?

A. No. I believe that Qwest is in a better position to address the financial impacts of this transaction to itself. Moreover, I understand that Qwest will address this issue in this proceeding.

Q. PLEASE DESCRIBE THE PROPOSED SALE VERY BRIEFLY AS BACKGROUND TO YOUR TESTIMONY.

A. The sale is structured to take place in two parts. In the first phase of the transaction, under the Dexter Agreement, Dex Media East, LLC, a subsidiary of Dex Media, Inc. ("Dex Media"), and an indirect subsidiary of Dex Holdings LLC (the "Buyer"), acquired the operations of Qwest Dex in the eastern portion of Qwest's local exchange operating territory, including the states of Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota, and South Dakota. That phase of the sale closed on November 8, 2002. 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. The Rodney Agreement provides for a similar course of events to take place just prior to and at the closing of the Dex Media West phase of the transaction. At the Dex Media West closing, Qwest Dex, Inc. will transfer its remaining assets and liabilities, including those in Washington, Arizona, Idaho, Montana, Oregon, Utah, and Wyoming, to GPP LLC, a separate newly-created subsidiary of Qwest Dex, Inc., and transfer ownership of GPP LLC to Dex Media West, LLC, also a subsidiary of Dex Media and an indirect subsidiary of Dex Holdings LLC.

II.
BUYER'S QUALIFICATIONS/REGULATORY COMPLIANCE

Q. PLEASE IDENTIFY THE BUYER.

A. Dex Holdings LLC, the Buyer, is a Delaware limited liability company recently formed for the purpose of purchasing the Dex publishing business. The Buyer is owned by The Carlyle Group ("Carlyle") and Welsh, Carson, Anderson & Stowe ("WCAS") (collectively, the "Owners"). The Owners are established private equity investment companies.

Q. WOULD YOU ALSO PROVIDE SOME BACKGROUND REGARDING THE OWNERS?

A. Carlyle 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 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. We are headquartered in Washington, DC, and serve a diverse base of more than 550 investors in 55 countries worldwide. Carlyle has deep knowledge and experience across disciplines and industries that give it a competitive edge in all the markets in which it operates.

WCAS is one of the oldest and largest private equity investment firms in the United States. Founded in 1979, it has raised 12 investment partnerships with total capital of $12 billion. Its investment activities are exclusively focused in three industries: communications, information services, and healthcare. WCAS has completed over 100 buyouts and over 650 add-on acquisitions since its founding. Combined, Carlyle and WCAS have over $25 billion of committed capital under management. The Buyer's ability to raise the large amounts of capital needed to purchase, fund, and operate Dex has already been demonstrated in funding and closing the Dexter portion of the transaction, which required $2.75 billion in debt and equity capital.

Q. WHAT EXPERIENCE DO THE OWNERS HAVE IN OWNING AND MANAGING COMMUNICATIONS-RELATED BUSINESSES?

A. Carlyle and WCAS are among the largest and most successful private equity investment firms in the world. Their successes in communications investing result from investment professionals who have deep understanding of and respect for the unique responsibilities of owning regulated businesses. At Carlyle, one of my partners is James A. Attwood, who formerly served as Verizon's Executive Vice President for Strategy and served in that same capacity for GTE. Mr. Attwood is Co-Chairman of the Board of Directors of the Buyer. I also serve on the Buyer's board as a director and member of the Audit Committee. Other senior partners of Carlyle include former Secretary of State, Secretary of the Treasury, and White House Chief of Staff James A. Baker III and former Securities and Exchange Commission Chairman Arthur Levitt. At WCAS, Anthony J. De Nicola serves as Co-Chair of the Buyer's board of directors and brings several years of experience in overseeing WCAS's communications investments. WCAS's portfolio companies in telecommunications include Centennial Communications (a provider of rural wireless services), Valor Telecommunications (a rural wireline provider), and Amdocs (a provider of OSS and billing software to the communications industry). Carlyle also has extensive experience as a successful investor in communications and publishing. Its ownership experience includes Pacific Telecom (submarine fiber-optic cable), Neptune Communications (high-speed undersea fiber-optic networks), Genesis Cable (a U.S. cable television operator), Prime Cable (cable television operator in Montgomery County, Maryland, and Arlington County, Virginia), Entertainment Publications, Inc. (promotional coupon publishing and advertising), Taiwan Broadband (largest cable television provider in Taiwan), eAccess Broadband Services (Japanese ADSL provider), and Videotron Telecom Ltée (Canadian facilities-based CLEC).

III.
BUYER'S PLANS TO PROVIDE HIGH-QUALITY SERVICES TO QWEST CORPORATION

Q. HOW CAN THE COMMISSION BE CERTAIN THAT QWEST CORPORATION WILL BE ABLE TO CONTINUE TO MEET ALL OF ITS REGULATORY OBLIGATIONS AND OTHER RESPONSIBILITIES REGARDING LISTINGS AND DIRECTORY PUBLICATION AND DISTRIBUTION AFTER DEX IS SOLD?

A. There are several reasons. First, no change in the management of Dex is contemplated as a result of this transaction. The current management will stay on and is very experienced in publishing and distributing directories in compliance with regulatory requirements. The testimony filed in this docket by George Burnett, the Chief Executive Officer of Dex, describes his qualifications as well as some of the accomplishments of Dex. Second, as I described earlier, both of the Owners have extensive experience in managing communications-related businesses, and understand the important position that the Commission's directory publishing requirements occupy. Finally, the penalty for the Buyer's failure to perform the publishing agreement at a level sufficient to meet Qwest's regulatory responsibilities would be severe – potential termination of the publishing agreement.

Q. YOU DISCUSSED THE LEADERSHIP OF DEX, DEX HOLDINGS, AND ITS OWNERS AFTER THE TRANSACTION. WHAT ABOUT THE RANK AND FILE WORKERS AT DEX?

A. One of the critical assets that we are acquiring is the existing management and staff at Dex. We do not want to jeopardize those human assets by engaging in shortsighted and imprudent cost-cutting measures, because the value of that human capital cannot be overstated. Dex is already one of the most efficient directory publishers in the country. In addition, we plan to accept the collective bargaining agreements with the two unions that represent Dex workers. In fact, Qwest Dex and Dex Media recently agreed with the International Brotherhood of Electrical Workers ("IBEW") to extend the current agreement from May 2003 to May 2006. The agreement, which has been ratified by the IBEW, is binding on Dex Media and provides that there will be no material changes in compensation or benefits through the end of the extended term. Further, for the Communications Workers of America and other non-IBEW employees, Dex Media will keep in place, or put in place, pension, medical, life, and other benefit plans that are comparable to Qwest's current plans.

Q. WHAT ARE THE BUYER'S PLANS FOR QWEST DEX?

A. Dex Media East has already acquired Qwest's directory business in the eastern half of the Qwest states. The best way to characterize how things are working is "business as usual." The same will hold true after Dex Media West acquires the remaining Dex operations in the western region. We plan to continue to publish the high quality white and yellow pages that are familiar to Qwest's local exchange customers and other directory users. We do not plan any major changes to the directories. Qwest subscribers and other directory users will continue to see the same familiar look and contents of the product. Dex Holdings' operating subsidiaries will continue to include the government listings, community information, and other features on which directory users have come to rely. While we plan to continue to refine and improve the Dex directories and to pursue expansion in related areas, such as Internet directory publishing, changes will be incremental, not radical.

Q. WHAT ENSURES THAT DEX WILL CONTINUE TO MEET REGULATORY REQUIREMENTS AND QWEST'S OTHER DIRECTORY RESPONSIBILITIES?

A. The Buyer is contractually bound to provide services necessary to enable Qwest to satisfy its directory publishing obligations, including obligations that exist under its inter-connection agreements with CLECs. 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. Thus, Dex will continue to include CLEC listings on the same basis as Qwest's own, and will ensure that every customer within the coverage area of the directory is able to obtain a copy of the directory, without regard for the identity of the subscriber's local exchange carrier ("LEC").

Q. WHAT IS THE BUYER'S PLAN REGARDING PUBLISHING SCHEDULES?

A. We do not plan to change publishing intervals. Most directories are published annually. We plan to continue with the current intervals, unless the public interest requires a change.

Q. WHAT WOULD BE AN EXAMPLE OF A NECESSARY CHANGE TO A PUBLISHING SCHEDULE?

A. If the area covered by a directory were undergoing a massive numbering change or the introduction of a new NPA, then it might be prudent to either delay or advance the publication of the directory or directories for that area.

Q. WHAT IS THE LIKELY COMPETITIVE IMPACT OF THE DIRECTORY PUBLISHING AGREEMENT BETWEEN QWEST AND DEX HOLDINGS?

A. The publishing agreement and related documents ensure that no LEC will have any competitive advantage or be subject to any disadvantage. The agreements provide that all of the obligations that would have applied to Qwest Dex will continue to be met pursuant to the publishing agreement between Dex Holdings and Qwest Corporation. Included in those obligations are provisions to ensure that both Qwest's and CLECs' customers are properly listed. In the CLECs' case, the publishing agreement ensures that the Buyer will take actions necessary to ensure that Qwest Corporation meets its obligations in its interconnection agreements with CLECs. Again, not only will Qwest's local exchange customers not notice a change upon closing of the sale, CLECs likewise will experience no material change in how their local exchange customers' listings are handled. As an independent publisher, we have an incentive to be even-handed in our treatment of all carriers.

Q. ARE THERE OTHER PUBLIC INTEREST BENEFITS OF THIS TRANSACTION?

A. Yes. I see benefits flowing merely from the fact that the new owner is not affiliated with an incumbent LEC. As the Buyer innovates and responds to increasing competition in the directory business, it will look at the business from the consumer's perspective and that of its advertising customers, rather than the perspective of a telecommunications provider. Today, Dex operates as part of an overall enterprise that includes local exchange, interexchange, and other operating entities. That enterprise is financially obligated to use the Dex profits to service a substantial debt load and to subsidize local exchange rates.

As an independent entity, Dex will have the ability to use the profits from its directory publishing business to research and develop new and improved products, maximizing the value of the directory publishing assets and providing new services to consumers and advertisers alike. In the past few years, we have all seen how the value of noncore assets can be maximized and services provided more efficiently and in a more competitively neutral way when those assets are divested from large ILECs. For example, we have seen these benefits in the wireless tower, billing services, and customer care sectors.

IV. CONCLUSION

Q. COULD YOU SUMMARIZE YOUR TESTIMONY FROM THE PERSPECTIVE OF A REGULATORY REVIEW OF THE PROPOSED SALE UNDER A "PUBLIC INTEREST" STANDARD?

A. I appreciate that the Commission wants to make sure that it is doing everything that it can to protect the interests of Qwest's local exchange customers. But the Commission has every reason to find the transaction to be in the public interest and no reasons, other than speculative ones, to find that it is not. The Buyer is well qualified to own Dex and is well positioned to invest in this business and improve its products and services. The Buyer will thus be able to maximize the value of the Dex assets and to do so in a way that is competitively neutral and thereby further other important policy goals. For these reasons, this transaction is the right thing at the right time from a public interest standpoint. The directories will only get better. All regulatory requirements for publishing and distributing directories will be met, and there is no reason to believe that Qwest and its local exchange customers would be better off financially if Qwest retained Dex.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. Thank you.

EXHIBIT
Q-1
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

TESTIMONY OF

PETER C. CUMMINGS

ON BEHALF OF

QWEST CORPORATION

JANUARY 28, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, ADDRESS AND EMPLOYMENT.

A. My name is Peter C. Cummings and my business address is 1600 Bell Plaza, Room 3005, Seattle, Washington, 98191. I am employed by Qwest Corporation as Director - Finance.

Q. WHAT ARE YOUR JOB RESPONSIBILITES AT QWEST?

A. My responsibilities include financial analysis of capital costs and capital structure of Qwest Corporation. I develop cost of capital estimates for company cost studies, capital budgeting and economic analysis, and I testify on financial issues.

Q. PLEASE REVIEW YOUR WORK EXPERIENCE.

A. I began my career at Northwestern Bell in 1969 and have held positions in Operator Services, Marketing, and Finance departments. For the last 16 years, my job responsibilities have been focused on cost of capital and rate of return.

Q. PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND OTHER QUALIFICATIONS.

A. I received my B.A. degree from Bemidji State College in Minnesota. I have a Master of Public Administration Degree from the University of Oklahoma and a Master of Business Administration Degree from Creighton University in Omaha, Nebraska. I am a Chartered Financial

Analyst and a member of the Association for Investment Management and Research, the Financial Management Association, and the Seattle Society of Financial Analysts.

Q. HAVE YOU EVER TESTIFIED IN REGULATORY PROCEEDINGS?

A. Yes, many times. I have testified before the Federal Communications Commission and before state commissions in Arizona, Colorado, Idaho, Iowa, Minnesota, Montana, Nebraska, New Mexico, North Dakota, Oregon, South Dakota, Utah, Washington, and Wyoming. I have testified primarily in rate cases and wholesale cost dockets on rate of return, capital structure, and other financial issues. I also provided testimony in support of the U S WEST/Qwest merger and in other special-purpose dockets.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?

A. My testimony is filed in tandem with that of Qwest witness Brian G. Johnson. The purpose of our testimony is to explain why the sale of Dex is critical to the continued financial viability of QC, and Qwest Communications International Inc. ("QCI"), QC's ultimate parent corporation. Mr. Johnson and I focus on the months prior to the announcement of the Dex sale transaction, conditions leading up to the decision to sell Dex, and the significance of the closing of the transaction.

In so doing, our testimony demonstrates that the sale of Dex is in the public interest.

My testimony focuses on Qwest's historical situation and current financial obligations and challenges. Mr. Johnson's testimony touches on those same subjects, but focuses to a greater extent on Qwest's strategic goals and the options Qwest evaluated and pursued to address its financial difficulties.

Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?

A. My testimony addresses the following issues:

Section III: I provide a general description of QCI and QC financing. I describe how corporations, including QCI and QC, generate cash necessary to operate their businesses, through equity or debt financing, operating revenues, and occasional asset sales. I then discuss the importance of cash, or liquidity, to the business.

Section IV: I discuss how a number of events led to significant concerns about QCI's liquidity, its ability to service its debt load, and QCI's decision to sell Dex. QCI's declining revenues and a series of missed Wall Street expectations beginning in late 2001 resulted in QCI and QC being unable to access the commercial paper market. This required them to fully draw down and amend a $4 billion syndicated credit facility by February 2002. This in turn led credit rating agencies to downgrade both QCI's and QC's debt ratings, ultimately to "junk" status. Beginning in 2001, QCI's stock price began a steep decline, from $40 per share in January 2001, to the teens by year-end 2001. The stock price ultimately sank as low as $1.07 in August 2002. This discussion provides the necessary background for Mr. Johnson's testimony regarding QCI's decision to sell Dex, his summary of the Dex sale transaction and his discussion of the critical need to close both phases of the sale transaction.

I discuss the Second Amended and Restated Credit Agreement (the "ARCA") and the results of QCI's December 2002 private debt exchange as they relate to the Dex transaction. The ARCA is a re-negotiation of the $4 billion Amended Credit Facility, which was set to mature in May 2003. The ARCA, which would likely not have been possible without the Dex transaction, greatly improved Qwest's short-term liquidity position and eased critical financial covenants under which Qwest was very likely to default. The just-completed private debt exchange also relates to and improved Qwest's liquidity situation. Along with the sale of Dex, the ARCA and the private debt exchange demonstrate Qwest's diligent efforts to de-lever its balance sheet, improve its liquidity position and stabilize its financial situation in order to avoid bankruptcy.

Section V: I examine the impact of the Dex sale on QC capital costs. The capital markets' reaction to the close of the first phase of the Dex sale has resulted in higher stock prices for QCI and lower bond yields for QC reflecting a lower cost of capital. With investor expectations already incorporating completion of the entire Dex sale, I expect the close of the second phase of the Dex sale to have a neutral to slightly positive impact on QC capital costs.

III. GENERAL DESCRIPTION OF QCI AND QC FINANCING

Q. PLEASE DISCUSS HOW QC IS RELATED TO QCI.

A. QC is a regulated local exchange carrier, and provides basic local exchange, IntraLATA toll and other telecommunications services to customers in Arizona and 13 other states. QC is a subsidiary of Qwest Services Corporation ("QSC"), which in turn is a subsidiary of the parent holding company, QCI. QSC also owns Qwest Dex Holdings, Inc., which in turn owns Dex. An organizational chart depicting this structure is attached as Exhibit PCC-1.

Q. EXPLAIN THE IMPORTANCE OF CASH TO QCI AND QC.

A. Cash is a corporation's lifeblood. QCI and QC use cash to pay expenses (interest payments, vendor expenses, payroll, taxes, etc.), make capital investments, and repay debt obligations as they mature.

Q. WHAT ARE THE SOURCES OF CASH AVAILABLE TO QCI AND QC?

A. QCI and QC can generate cash from three basic corporate activities: operating activities, financing activities and investing activities. Cash from operating activities, as its name suggests, is cash generated by the day-to-day operations of the business. Cash from financing activities comes from sales of equity and debt. These are the primary sources of cash for

QC and QCI. Cash from investing activities comes from investment returns and sales of assets.

Q. PLEASE DESCRIBE "CASH FROM OPERATIONS."

A. Cash from operations is obtained from the operations of the company, generally through the sale of telecommunications products and services. This source of cash is generally recurring in some pattern such as monthly, quarterly, or annually and is primarily used to pay ongoing operating expenses such as wages, vendor invoices, taxes, etc.

Q. PLEASE DESCRIBE CASH FROM THE SALE OF EQUITY.

A. Cash from the sale of equity is derived from the sale of stock in the corporation. The sale of stock normally happens at the start-up of a corporation. The corporation may issue additional stock as the firm grows to pay for additional plant and investment. While cash can be used to pay for any product or service, cash from equity often provides the cash for necessary start-up expenses and investments incurred before revenues are sufficient to pay for the ongoing operations of the firm. QCI is the Qwest entity whose stock is publicly traded on the New York Stock Exchange. The equity recorded on QC's books came from equity investment by QCI and its predecessor companies.

Q. PLEASE DESCRIBE CASH FROM THE SALE OF DEBT.

A. Debt can generally be divided into three categories: short, intermediate, and long term. The distinction between intermediate and long term debt maturity is rather arbitrary and deals with both the time to maturity and the interest rate paid by the entity issuing the debt. The interest rate generally increases as the length of the debt maturity increases. The cash raised by selling debt can be used to pay operating expenses, make investments, and to pay-off or reduce other debt, generally of a shorter maturity. Intermediate and long-term debt is often associated, like equity, with the financing of capital investments. Short-term debt is debt due within one year and includes maturing intermediate and long term debt issues, bank loans, and commercial paper.

Q. EXPLAIN THE TERM "COMMERCIAL PAPER."

A. Commercial paper is an unsecured, short-term security issued by companies that provides ready access to cash. Commercial paper, due to its very short maturities, carries low interest rates. It is the corporate equivalent of short term U.S. Treasury Bills. Commercial paper is frequently paid off and reissued as the needs of the business dictate. Corporations that issue commercial paper are required to maintain bank loan lines of credit, or credit facilities, as a backup to their commercial paper programs. The bank loan credit facilities generally carry higher interest rates than commercial paper issues.

Q. PLEASE DESCRIBE CASH FROM THE SALE OF ASSETS.

A. A company can also raise cash by selling assets. A company may sell assets when it no longer needs them, when it reorganizes its business, or when, as with the sale of Dex, it has a greater need for the immediate cash from the sale than the cash flow that can be obtained over time from the asset itself.

Q. WHAT IS CASH FLOW?

A. Cash flow is the difference between all inflows of cash (such as revenues) and all outflows of cash (such as cash expenses). A company can improve cash flow by increasing cash proceeds flowing into the business, decreasing cash flowing out of the business, or both.

Q. WHAT IS FREE CASH FLOW?

A. Free cash flow is cash generated by operating activities, less cash used for capital expenditures. The cash flow remaining is free cash flow. Free cash flow is the net cash from operations that is available for payments to capital providers (e.g., payment of maturing debt and dividends to shareholders).

Q. WHEN ANALYSTS DISCUSS LIQUIDITY, WHAT ARE THEY TALKING ABOUT IN RELATION TO CASH, CASH FLOW, AND FREE CASH FLOW?

A. Liquidity refers to the availability of sufficient cash to operate the business, including cash to satisfy short-term obligations (expenses) and long term obligations (debt maturity). A textbook definition of liquidity is cash and cash equivalents that can be readily accessed to meet payment obligations when they come due. Cash equivalents would include assets that can be readily converted to cash such as exchange-traded common stock, investments in other companies, accounts receivable, short term investments, and readily marketable assets such as real estate.

IV. THE FINANCIAL SITUATION OF QCI AND QC

Q. PLEASE DESCRIBE THE PRE-SALE FINANCIAL SITUATION OF QCI AND QC.

A. It is necessary to review the events in the months leading up to the Dex sale transaction in August 2002 in order to understand the financial situation that led QCI to consider selling Dex. In January 2002, QCI had declining EBITDA, declining revenues, and over $25 billion in debt on its balance sheets.[1] QCI's fourth quarter financial report stated:

> "Reported revenue for the quarter was down approximately six percent to $4.70 billion, down 314 million from $5.02 billion in the same period last year."
>
> "For the quarter, pro forma normalized earnings before interest, taxes, depreciation and amortization (EBITDA) was $1.61 billion compared with pro forma normalized EBITDA for the same period last year of $1.99 billion."

QCI's stock price had steadily declined from the mid-$40's in January 2001 to the mid-teens by January 2002. *See* Exhibit PCC-2 (QCI stock price chart). There was concern in the financial markets and a high-level of scrutiny from investment analysts regarding QCI's financial condition. By the beginning of 2002, it was apparent that the economic downturn

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[1] *See* QCI Form 8-K, Jan. 29, 2002 (4th Quarter Financial Results Announcement). I reference a number of QCI SEC filings throughout my testimony. These are available at http://www.sec.gov, and through the Qwest Investor Relations section of the Qwest website at http://www.qwest.com.

coupled with reduced demand and overcapacity in the telecommunications industry placed QCI at serious risk of being unable to generate sufficient cash flow to service its debt obligations.

Q. WHAT STEPS DID QCI TAKE IN RESPONSE TO ANALYSTS' CONCERNS?

A. As part of its earnings announcement on January 30, 2002, QCI stated that it was evaluating various plans to generate additional cash to reduce the debt on its balance sheet, sometimes referred to as "de-levering" the balance sheet.[2] QCI stated that it was considering a number of alternatives to address these issues, including: "issuing equity-based securities, [and] sales of assets or of securities associated with those assets, including, among others, wireless, access lines, directories, its applications service provider business and other non-core assets."[3]

Q. DID QCI'S AND QC'S FINANCIAL SITUATION IMPACT THEIR ABILITY TO OBTAIN FINANCING?

A. Yes. QCI's and QC's steadily worsening financial situation did impact their ability to obtain financing. This first became an issue with regard to their ability to refinance, or "roll over" their commercial paper. As I previously explained, commercial paper is an unsecured, short-term security that provides ready access to cash. Commercial paper carries low interest rates, and has therefore historically been a critical component

2 *See* QCI Form 8-K, Jan. 29, 2002.

3 *Id.*

of QCI's and QC's financing portfolio. Beginning in early 2002, it became increasingly difficult for QCI and QC to roll over their commercial paper. Eventually, QCI and QC were forced from the commercial paper market because investors were not willing to reinvest in new QCI or QC commercial paper. By mid-February 2002, they were effectively shut out of the commercial paper market, requiring them to fully draw down the existing $4 billion syndicated bank credit facility ("Credit Facility") that backed up their commercial paper program, in order to repay their existing commercial paper indebtedness.[4]

Q. HOW DID THE BOND RATING AGENCIES REACT TO QCI AND QC NOT HAVING ACCESS TO THE COMMERCIAL PAPER MARKET?

A. When QCI and QC became unable to access the commercial paper market, the bond rating agencies reacted with downgrades of both QCI's and QC's long-term and short-term debt ratings. Moody's Investor Service lowered QCI's long-term and QC's long-term and short-term ratings, commenting that:

> Qwest's difficulty in rolling its commercial paper has required the company to utilize its $4.0 billion bank facility. Without access to commercial paper, the company's alternate liquidity has been reduced by the drawdown on its bank facility. This lack of alternate liquidity considerably limits the company's financial flexibility and poses a risk to damage Qwest's overall competitive profile if not resolved expeditiously.[5]

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4 "On February 14, 2002, Qwest issued a press release announcing that it had taken steps to address short-term liquidity pressures in the commercial paper market by drawing down on its $4 billion credit facility." QCI Form 8-K, Feb. 15, 2002.

5 Moody's Investor Service Rating Action, February 14, 2002, "Moody's Lowers Ratings of Qwest Communications International and Subsidiaries, Keeps All Ratings On Review For Possible Further Downgrade."

Standard & Poor's similarly lowered its long-term ratings on both QCI and QC. Fitch Ratings also downgraded both QCI and QC, commenting:

> The downgrades reflect Fitch's view that the liquidity of the company has been materially reduced following the draw down of its previously untapped $4 billion bank facility on February 13 and 14. ... To resolve the rating outlook that exists at the current "BBB" level, Fitch will continue to monitor Qwest's operating performance in the currently weak environment for telecom services, as well as evaluate measures Qwest may undertake to strengthen its balance sheet. Such measures may include the sale of non-core assets and/or the issuance of equity-like securities.[6]

Q. EXPLAIN WHAT THESE CREDIT AGENCY RATINGS MEAN, AND THE SIGNIFICANCE OF THESE DOWNGRADES.

A. Bond ratings are indicators of credit quality. The interest rate cost to the company issuing the bonds increases as its bond rating decreases. The February 14, 2002 rating downgrades recognized the additional risk inherent in QCI and QC bonds due to their exit from the commercial paper market and draw down of the Credit Facility, but kept the ratings within the investment grade category. Bonds rated within the "BBB" (S&P and Fitch) or "Baa" (Moody's) rating categories and above are considered investment grade bonds. Bonds rated in the "BB" and "Ba" rating categories and below are considered high yield or "junk". A further series of downgrades, which I discuss later in my testimony, ultimately left both QCI and QC with junk ratings. I have attached as Exhibit PCC-3 a chart depicting the chronology of the credit rating agency actions.

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6 Fitch Ratings, February 14, 2002, "Fitch Ratings Downgrade Qwest; Maintains Negative Outlook."

Q. WHAT OTHER EVENTS IN THIS TIME FRAME CONTRIBUTED TO QCI'S FINANCIAL CONCERNS?

A. On March 11, 2002, QCI received an informal inquiry from the Denver Regional Office of the SEC relating to matters involving Qwest's accounting policies, practices and procedures in 2000 and 2001.[7] The announcement of the informal investigation likely created doubts in the minds of investors about how to evaluate QCI, because the inquiry raised questions as to QCI's prior financial results and future earnings. On April 3, 2002, the SEC issued a formal order of investigation. Because of the SEC investigation, QCI could not issue new stock or bonds to the public in a registered offering, as its financial records could no longer be verified in the registration document required to issue such securities.

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[7] "On March 11, 2002, Qwest Communications International Inc. ("Qwest") issued a press release disclosing an informal inquiry from the Securities and Exchange Commission." QCI Form 8-K, March 11, 2002. A copy of the press release is attached to the 8-K and reads in part: "Qwest Communications International Inc. today said it received an informal inquiry from the Denver regional office of the Securities and Exchange Commission (SEC) requesting voluntary production of documents. Qwest intends to respond fully to this request, which was received in a letter Friday, March 8, 2002. The matters identified by the SEC as the focus of the informal inquiry have previously been the subject of disclosure by Qwest and have been widely reported in the investment community and in the media. The matters relate to three areas of Qwest's accounting policies, practices and procedures in 2000 and 2001, including revenue recognition and accounting treatment of (i) sales of optical capacity assets (often referred to as Indefeasible Rights of Use or "IRUs"), particularly sales to customers from whom the company agreed to purchase optical capacity; (ii) the sale of equipment by Qwest to customers from which Qwest bought Internet services or to which Qwest contributed equity financing, including equipment sales to KMC and Calpoint; and (iii) Qwest Dex, particularly changes in the production schedules and lives of some directories. The SEC informed Qwest that this informal inquiry is not an indication that it or its staff believes any violation of law has occurred, nor should Qwest consider the inquiry an adverse reflection on any entity or security."

Q. WHAT WERE QCI AND QC DOING IN RESPONSE TO BEING SHUT OUT OF THE COMMERCIAL PAPER MARKET?

A. On March 12, 2002, QC completed a $1.5 billion offering of 8.875% 10 year bonds. QC used a portion of the proceeds to pay off its share of the indebtedness on the $4.0 billion Credit Facility, leaving QC with no further obligations under the Credit Facility. On March 15, 2002, QCI announced an amendment to the Credit Facility.[8] The amendment relaxed the financial covenants associated with the Credit Facility, permitting QCI to maintain a ratio of consolidated debt to consolidated EBITDA for the trailing four quarters of not more than 4.25x at March 31, June 30 and September 30, 2002, and a ratio of 4.0x at December 31, 2002 and March 31, 2003. The previous debt coverage ratio limit had been 3.75x. The amendment also reduced the amount of funds available under the Credit Facility to $3.4 billion, and required QCI to use a portion of net proceeds from future sales of assets and capital market transactions, including the issuance of debt and equity securities, to prepay the Credit Facility until the outstanding balance was $2 billion or less. The Credit Facility was originally scheduled to mature on May 3, 2002, but QCI exercised its option to extend the maturity to May 3, 2003.[9] Hereinafter, I refer to the

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[8] "On March 15, 2002, Qwest Communications International Inc. ("Qwest") amended its $4 billion unsecured bank agreement." QCI Form 8-K, March 18, 2002. A copy of a press release is attached to the 8-K and states: "Qwest Communications International Inc. (NYSE: Q) today announced it has amended its $4 billion unsecured bank credit agreement. The company believes that available cash and borrowings available under the bank facility will be sufficient to pay debt maturing in the next twelve months and to fund its capital and operating expenditures during that period. Qwest continues to expect to become cash flow positive in the second quarter of 2002. . .

[9] *Id.* "As part of the amendment, Qwest is permitted to maintain a ratio of debt to Consolidated EBITDA (as defined in the agreement) for the trailing four quarters of not more than 4.25 at March 31, June 30 and September 30, 2002 and 4.0 at December 31, 2002 and March 31, 2003. The

Credit Facility, as amended on March 15, 2002, as the "Amended Credit Facility."

Q. DID THIS ADDITIONAL FINANCING RESOLVE QCI'S FINANCIAL CONCERNS?

A. Only for the very short term, meaning through the second quarter of 2002. QCI still carried a debt load in excess of $26 billion and was continuing to see declining revenues, resulting in decreasing EBITDA. On April 18, 2002, QCI announced a downward revision to its 2002 financial guidance, citing continuing weakness in both the telecommunications sector and the regional economy, and announced that, "It has decided to proceed with seeking proposals from potential buyers for its Dex (directories) and Wireless businesses and is also working on selling its Qwest Cyber Solutions business and other assets, including access lines and wireless towers."[10] On April 30, 2002, QCI announced first quarter financial results:[11]

> "Reported revenue for the quarter was down approximately 13.5 percent to $4.37 billion from $5.05 billion in the same period last year, primarily due to the absence of optical capacity asset sales and certain Internet equipment sales."

> "For the quarter adjusted EBITDA (adjusted earnings before interest, taxes, depreciation and amortization) was $1.45 billion compared with adjusted EBITDA for the same period last year of $2.0 billion."

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previous debt coverage ratio limit was 3.75. The bank facility matures May 3, 2002, but the company presently expects to exercise its option to extend the maturity to May 3, 2003, as permitted by the agreement."

[10] *See* QCI Form 8-K, April 19, 2002

[11] *See* QCI Form 8-K, May 1, 2002.

> "For 2002, it expects recurring revenues for local service to decline by 3% to 4% compared with 2001. . . It expects net debt at the end of 2002 of just over $25 billion."

The credit rating agencies again reacted, downgrading QCI's and QC's bond ratings in April 2002. A series of further downgrades finally dropped QCI's and QC's bond ratings into junk status. *See* Exhibit PCC-3 (chronology of credit rating agency action). QCI's stock price also continued to decline. *See* Exhibit PCC-2 (QCI stock price chart).

Q. EXPLAIN THE SIGNIFICANCE OF "JUNK" CREDIT RATING STATUS.

A. On May 22, 2002, Standard & Poor's downgraded both QCI and QC from investment grade "BBB-" to the non-investment grade ("junk") bond rating of "BB+". Moody's and Fitch soon followed with downgrades to junk grade ratings as shown in Exhibit PCC-3. The significance of junk ratings for corporate bond issuers is that they have to pay significantly higher interest rates than investment grade issuers, reflecting their companies' higher risk. Additionally, the market for junk bonds is smaller than the investment grade market. Many institutional investors are prohibited from acquiring or retaining junk bonds in their portfolios, or are limited in the quantity they may acquire or retain. Having their credit ratings downgraded to junk status further reduced QCI's and QC's ability to raise cash through debt financing.

Q. MR. JOHNSON REFERS TO THE ARCA. WHAT ARE THE KEY TERMS OF THE ARCA?

A. The Second Amended and Restated Credit Agreement ("ARCA") refinanced approximately $3.354 billion of indebtedness then existing under the Amended Credit Facility.[12] QSC assumed all of the currently outstanding debt under the Amended Credit Facility. Qwest Capital Funding ("QCF") and QC, which were the borrowers under the Amended Credit Facility, are not obligated under the ARCA as borrowers. The ARCA provided additional security for the bank lenders and established a new maturity date of May 3, 2005, requiring intermediate payments before that date with specific payments tied to the sale of Dex and other asset sales. The ARCA also relaxed the debt to EBITDA ratio covenants under the Amended Credit Facility, providing that QCI must maintain a 6.0x debt to EBITDA ratio, and QC must maintain a 2.5x debt to EBITDA ratio.

Q. GIVEN THAT THE ARCA IS IN PLACE, DOES QCI STILL NEED TO PROCEED WITH THE DEX SALE?

A. Yes. While the ARCA provided additional headroom on QCI's financial covenants, and extended the maturity dates under the Amended Credit Facility, it did not provide any new cash to make payments, and that remains a critical issue. Absent the Dex sale, QCI would lack the necessary cash to make the required payments under the ARCA, and other upcoming maturities, including the Dex Term Loan. The chart below

[12] "On September 4, 2002 Qwest Communications International Inc. ("Qwest") announced that it had reached unanimous agreement with the 29 lenders in its syndicated credit facility to amend Qwest's $3.4 billion credit facility. " QCI Form 8-K, September 5, 2002.

depicts, as of November 1, 2002 (prior to the close of "Dexter" – the first stage of the Dex sale), the debt maturities of QCI subsidiaries, including QC, through the end 2007:

TABLE A:

QCI Consolidated Debt Maturities ($ millions)

	2002	2003	2004	2005	2006	2007	TOTAL
QC		1,155	850	441		160	2,606
QSC	1,354*	1,500*		1,250			4,104
QCF			1,250	500	1,250		3,000
QCI						11	11
QCC						350	350
TOTAL	1,354	2,655	2,100	2,191	1,250	521	10,071

* Includes Dexter close and assumes Rodney phase of Dex sale closes as scheduled.

Q. DID QCI USE THE PROCEEDS OF THE DEXTER CLOSING TO REPAY A PORTION OF ITS INDEBTEDNESS?

A. Yes. Pursuant to the terms of the ARCA, QCI paid $1,354 million from the Dexter proceeds to reduce the QSC borrowings under the ARCA to $2.0 billion. Unless QC is able to refinance its $1,155 million of debt maturing in the first half of 2003, which is unlikely due to the continuing SEC investigation, the Dexter proceeds will also be used to repay QC debt obligations.

Q. AFTER COMPLETING THE FIRST STAGE OF THE DEX SALE AND APPLYING THE PROCEEDS TO DEBT REDUCTION, IS IT STILL NECESSARY TO SELL THE REMAINDER OF DEX?

A. Yes. Completion of both phases of the Dex sale is critical to providing the cash for Qwest to de-lever its balance sheet and meet its debt service obligations. The entire Dex sale is absolutely necessary, as demonstrated by QCI's previous disclosure that, even if QCI does realize the proceeds from both phases of the Dex sale, it still may be unable to meet its debt service obligations through 2005:

> "After giving effect to the first stage of the sale of Dex and the repayment of certain Qwest Corporation Notes in October 2002, our consolidated debt was $24.5 billion as of September 30, 2002. Thus, despite these recent measures, there is substantial risk that our free cash flow from operations as presently conducted and the cash proceeds from the sale of the remainder of our Dex publishing business will be insufficient to meet our debt service obligations after 2005. Even if we are successful in our de-leveraging efforts, we may be unable to meet our debt service obligations through 2005 (which include $6.9 billion of debt maturities) without obtaining additional financing if we are unsuccessful in improving our operations as we expect, if the declines in our revenues and profits are worse than we expect, if economic conditions do not improve, or if the sale of the Dex West business does not occur." [13]

Q. PLEASE DESCRIBE QCI'S RECENTLY COMPLETED DEBT EXCHANGE AND EXPLAIN HOW IT AFFECTS THE MATURITY SCHEDULE OF OUTSTANDING DEBT?

A. On November 20, 2002, QCI announced an offer to exchange approximately $12.9 billion aggregate principal amount of outstanding

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[13] *See* QCI Form 8-K, Nov. 14, 2002.

debt securities of QCF through a private placement for new debt securities.[14] On December 23, 2002, QCI announced that, as of the December 20, 2002 offer expiration date, $5.2 billion in total principal amount of QCF notes had been validly tendered and accepted for exchange for $3.3 billion of new QSC notes. The result of that exchange was to reduce QCI's total debt by over $1.9 billion and to extend some near-term maturities.[15] The exchange converts $735m of QCF debt previously set to mature in 2004, 2005, and 2006 into $547m of new QSC debt set to mature in 2007.

Q. DOES THE DEBT EXCHANGE REDUCE THE NEED TO COMPLETE THE SALE OF DEX?

A. No. The debt exchange provided some additional financial flexibility in the near term, but completion of the sale of Dex remains the key component in QCI's business plan to stabilize its financial position over the near and intermediate term. The Wall Street Journal described the exchange as "at

[14] *See* QCI Form 8-K, Nov. 20, 2002. A press release attached to the 8-K notes: "Qwest Communications International Inc. (NYSE: Q; QCII) announced today that it has commenced a private offer to exchange $12,902,653,000 aggregate principal amount of outstanding debt securities of Qwest Capital Funding, Inc. (QCF), a wholly-owned subsidiary of QCII, in a private placement for new debt securities. The new securities include up to $4,000,000,000 of new senior subordinated secured notes of Qwest Services Corporation (QSC), a wholly-owned subsidiary of QCII."

[15] *See* QCI Form 8-K, Dec. 23, 2002. A press release attached to the 8-K states: "Qwest Communications International Inc. (QCII) (NYSE: Q) today announced the successful results of its offer to exchange $12.9 billion aggregate principal amount of outstanding debt securities of Qwest Capital Funding, Inc. (QCF), a wholly-owned subsidiary of QCII, in a private placement for new debt securities. As of the expiration of the offer on Friday, December 20, 2002, approximately $5.2 billion in total principal amount of the QCF notes had been validly tendered and accepted for exchange. This will reduce Qwest's total debt by over $1.9 billion-from approximately $24.5 billion to approximately $22.6 billion-and extend some near-term maturities."

the low end of the deal's expected range" and went on to note QCI's continuing problems:[16]

> "Qwest, based in Denver, will cut its debt to $22.6 billion from $24.5 billion through the debt exchange. The company has been racing to reduce a debt load that investors fear could force it into bankruptcy law protection. At the same time, Qwest has been struggling with a flagging core business, investigations into its accounting, and collapse of its stock price."

Standard & Poor's rated the new bonds equivalent to the old bonds and commented further saying that, "near-term liquidity still remains a source of concern, particularly if closing of the $4.3 billion second phase of the company's directories sale is delayed beyond 2003."[17] After the debt exchange, the near-term schedule of debt maturities for QCI and its subsidiaries is as follows, as of January 2003:

TABLE B:

QCI Consolidated Debt Maturities ($ millions)

	2003	2004	2005	2006	2007	TOTAL
QC	1,155	850	441		160	2,606
QSC	1,500*		1,250		547	3,297
QCF		963	421	881		2,265
QCI					11	11
QCC					350	350
TOTAL	2,655	1,813	2,112	881	1,068	8,529

* Includes Dexter close and assumes Rodney phase of Dex sale closes as scheduled.

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[16] *See* The Wall Street Journal, December 24, 2002, page C-5. (Attached as Exhibit PCC-4)

[17] *See* Standard & Poor's Press Release December 26, 2002. (Attached as Exhibit PCC-5).

After the debt exchange, QCI has more than $8.5 billion of debt maturing in the next five years and more than $6.5 billion maturing in the next three years. The cash to be provided by the sale of Dex remains critical to reducing the company's high level of debt.

V. IMPACT OF THE DEX SALE ON QC CAPITAL COSTS

Q. WHAT IMPACT WILL THE SALE OF DEX HAVE ON CAPITAL COSTS FOR QC?

A. The capital market reaction to the announcement of the Dex sale and completion of the first phase (Dexter) has been positive for the company, resulting in lower capital costs. QC's cost of capital reflects the risk of the company and is determined by the actions of buyers and sellers of debt and equity securities in the capital markets. The market reaction to the announcement of the sale of Dex and the completion of the first phase of the sale has been an increase in the price for QCI stock and a decrease in the investor required bond yield for QC bonds, reflecting a lower cost of capital.

I expect completion of the second phase of the Dex sale (Rodney) will have a neutral to slightly positive impact on QC's cost of debt and equity capital because investor expectations already reflect completion of the entire sale. Stated another way, if the second phase sale was delayed significantly or not completed at all, I would expect an increase in capital costs for QC.

Q. WHAT EVIDENCE DO YOU HAVE THAT THE DEX SALE HAS LOWERED CAPITAL COSTS?

A. Exhibit PCC-2 shows the daily stock prices for QCI. Higher stock prices equate to lower capital costs. A share of stock sold to the public for $10 is worth more to the company than a share of stock sold at $9. During the month before the 8/20/2002 announcement of the Dex sale, QCI stock traded at prices under $2.00 per share. Since that date, QCI stock price has steadily increased, generally trading above $4.00 per share since the 11/8/2002 Dexter sale close and ending the year 2002 at $5.00 per share.

Exhibit PCC-6 shows the third and fourth quarter 2002 estimates of QC's borrowing costs – the estimated costs of issuing new debt securities. Over this time period spanning the Dexter sale close, the bond ratings are consistent and U.S. Treasury benchmark interest rate yields are up slightly. The credit spreads for QC are significantly lower resulting in lower borrowing costs for QC. The following extract from Exhibit PCC-6 shows the decrease in borrowing costs for typical long term financing. Driven by the lower credit spreads, the all-in cost for 10 year bonds declined 1.683% from 11.177% to 9.494%. The cost for 30 year bonds declined 1.187% from 10.5755% to 9.3885%.

QC Borrowing Costs 3Q 2002

Term (years)	Benchmark Yield	Credit Spread	Reoffer Yield	Underwriting Commission	All-in Cost
10 yr	3.590%	7.542%	11.132%	0.0450%	11.1770%
30 yr	4.668%	5.820%	10.488%	0.0875%	10.5755%

QC Borrowing Costs 4Q 2002

Term (years)	Benchmark Yield	Credit Spread	Reoffer Yield	Underwriting Commission	All-in Cost
10 yr	3.814%	5.635%	9.449%	0.0450%	9.4940%
30 yr	4.779%	4.522%	9.301%	0.0875%	9.3885%

Q. HOW DO THE BOND RATING AGENCIES VIEW THE DEX SALE?

A. The bond rating agencies view the sale of Dex as a critically important element in QCI's strategy to reduce debt and improve liquidity. After the close of the Dexter phase of the Dex sale, Standard & Poor's said,

> The ratings and outlook for Qwest already incorporated the receipt of these proceeds by year-end 2002. However, the company still faces the challenge of obtaining state regulatory approvals for the close of the western region, and the close of this $4.3 billion transaction is expected to occur in 2003. These additional proceeds are critical in enabling the company to meet upcoming maturities on both the bank debt and

> public debt, which total about $7 billion from 2003 through 2005, of which about $4.8 billion is due through 2004, after the $1.4 billion pay-down of the $3.4 billion bank loan.[18]

Moody's Investors Service believes it is critical that the Dex sale proceed on course:

> Moody's believes it is critical that the Dex sale proceed on course, and if it does, Qwest could have over $4 billion of cash (net of mandatory bank debt repayments from the Dex sale) and available bank facilities (assuming compliance with the new covenants) to deal with capital needs to cover operating shortfalls and maturing long term debt.[19]

Fitch focuses on the company's liquidity and ability to manage debt maturities:

> From Fitch's perspective the company's ability to manage its maturity schedule and liquidity is a key rating consideration given the company's lack of capital market access to refinance maturities and limited pool of assets available for sale in a timely manner. Fitch acknowledges that the Dex sale coupled with the amended credit facility provides the company with a level of near term liquidity stability, however continued deterioration of the company's core operations pressure the company's credit profile and capacity to generate free cash flow and compromise the company's ability to meet debt service requirements.[20]

[18] Standard & Poor's Press Release, "S&P Comments on Qwest Communications International" November 12, 2002.

[19] Moody's Investor Service Press Release, "Moody's Downgrades Ratings Of Qwest Capital Funding And Qwest Communications International, But Not The Ratings Of Qwest Corporation And Its Subsidiaries; All Ratings Remain On Review For Possible Downgrade." September 5, 2002.

[20] Fitch Ratings Press Release, "Fitch Ratings Comments on Qwest Debt Exchange." November 20, 2002.

The key message is that completion of the Dex sale is factored into the current ratings. The sale of Dex and other things need to happen to improve the bond ratings and, absent the sale of Dex, the ratings are likely to be downgraded.

VI. CONCLUSION

Q. COULD YOU PLEASE SUMMARIZE YOUR TESTIMONY?

A. Yes. Qwest is facing very difficult financial times. Falling revenues, decreased cash flows, high debt, outside investigations, a collapsed stock price, and a lack of access to the commercial paper market left the company in a critical liquidity situation and approaching bankruptcy by early 2002. As Mr. Johnson describes in his testimony, Qwest concluded that the sale of assets, specifically Dex, was necessary to its strategy of de-levering its balance sheet and stabilizing its liquidity situation. The Dex transaction was also critical to allowing Qwest to successfully negotiate the ARCA. Absent the ARCA, Qwest would almost certainly have been facing bankruptcy given the payment obligation of $3.4 billion in May 2003 and its inability to meet the debt covenants specified in the Amended Credit Facility.

The sale of Dex (both phases) remains critical to Qwest's ability to avoid bankruptcy in the short and intermediate term. The closing of the Rodney stage, while vital to Qwest's strategy, may still not be sufficient in and of itself to allow Qwest to meet its upcoming debt maturities. Whether the Rodney proceeds prove to be sufficient they are clearly necessary in Qwest's efforts to avoid bankruptcy.

Q. DOES THIS CONCLUDE YOUR TESTIMONY.

A. Yes, it does.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBITS OF

PETER C. CUMMINGS

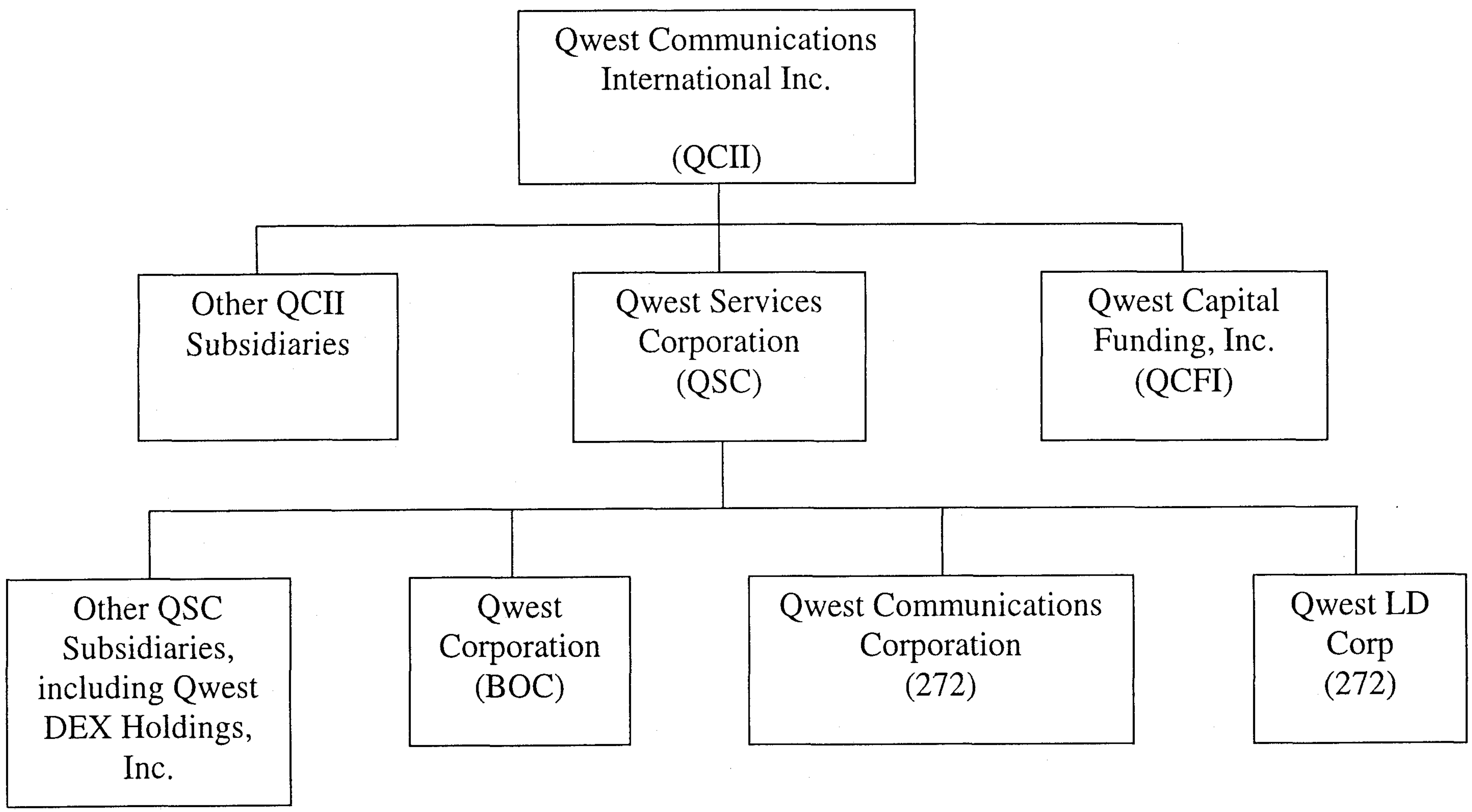
ON BEHALF OF

QWEST CORPORATION

JANUARY 28, 2003

Arizona Corporation Commission
Qwest Corporation – PCC-1
Exhibits of Peter C. Cummings
Docket No. T-01051B-02-0666
January 28, 2003

QWEST CORPORATE STRUCTURE



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Exhibits of Peter C. Cummings
Docket No. T-01051B-02-0666
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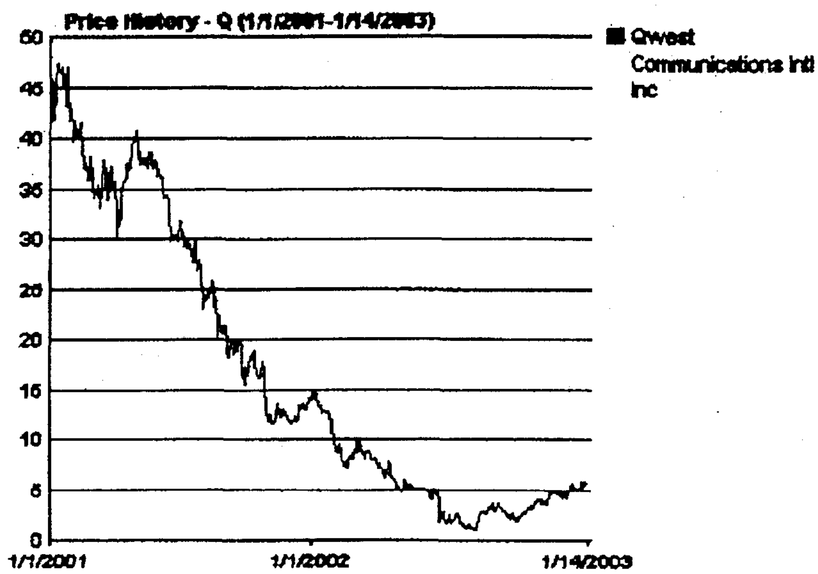

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Qwest Communications Intl Inc

Date	High	Low	Close	Volume
1/14/2003	6.140	5.870	6.020	9,365,900
1/13/2003	6.100	5.760	5.860	5,854,300
1/10/2003	5.860	5.580	5.750	5,913,900
1/9/2003	5.790	5.550	5.750	6,355,800
1/8/2003	5.900	5.490	5.510	10,187,100
1/7/2003	6.150	5.880	5.930	11,059,800
1/6/2003	5.990	5.410	5.930	14,019,300
1/3/2003	5.490	5.240	5.380	5,535,800
1/2/2003	5.410	5.040	5.350	7,868,700
12/31/2002	5.100	4.900	5.000	6,027,200
12/30/2002	5.190	4.820	5.100	7,699,100
12/27/2002	5.300	5.020	5.090	4,980,700
12/26/2002	5.540	5.200	5.340	5,245,500
12/24/2002	5.900	5.400	5.410	8,859,200
12/23/2002	5.710	5.290	5.690	13,446,500
12/20/2002	5.460	5.060	5.300	18,268,200
12/19/2002	5.110	4.800	5.070	10,044,200
12/18/2002	5.310	4.750	4.850	20,333,100
12/17/2002	5.000	4.400	5.000	10,748,500
12/16/2002	4.420	4.090	4.420	5,390,000
12/13/2002	4.370	4.150	4.280	4,700,800

12/12/2002	4.640	4.330	4.390	4,107,300
12/11/2002	4.680	4.510	4.640	6,006,700
12/10/2002	4.760	4.160	4.720	6,175,200
12/9/2002	4.330	3.920	4.260	7,222,300
12/6/2002	4.540	4.250	4.340	5,605,300
12/5/2002	4.760	4.400	4.430	5,701,200
12/4/2002	4.700	4.430	4.570	4,332,600
12/3/2002	4.770	4.530	4.620	4,050,400
12/2/2002	5.090	4.580	4.660	6,820,500
11/29/2002	4.980	4.800	4.840	2,302,200
11/27/2002	5.170	4.830	4.830	7,234,500
11/26/2002	5.120	4.600	4.960	11,316,500
11/25/2002	5.000	4.490	4.990	10,572,900
11/22/2002	4.750	4.420	4.620	7,253,200
11/21/2002	4.880	4.450	4.640	12,011,200
11/20/2002	4.970	4.250	4.330	39,355,800
11/19/2002	3.900	3.430	3.900	7,976,200
11/18/2002	3.760	3.430	3.630	7,312,800
11/15/2002	3.830	3.520	3.790	8,701,400
11/14/2002	4.000	3.710	3.710	7,798,300
11/13/2002	3.980	3.710	3.880	5,310,400
11/12/2002	3.910	3.730	3.870	6,624,600
11/11/2002	3.980	3.680	3.710	6,674,800
11/8/2002	4.320	3.980	4.000	10,107,700
11/7/2002	4.230	3.880	4.150	13,487,200
11/6/2002	4.100	3.850	4.090	10,092,400
11/5/2002	4.050	3.730	3.840	9,790,900
11/4/2002	3.940	3.650	3.900	14,086,900
11/1/2002	3.600	3.000	3.590	8,255,000
10/31/2002	3.420	3.190	3.390	9,960,300

10/30/2002	3.490	3.060	3.390	11,608,100
10/29/2002	3.440	3.020	3.180	7,211,000
10/28/2002	3.550	3.300	3.460	6,550,100
10/25/2002	3.330	3.170	3.260	4,380,100
10/24/2002	3.520	3.130	3.230	8,751,300
10/23/2002	3.210	2.980	3.210	10,488,200
10/22/2002	3.350	2.930	3.150	14,627,100
10/21/2002	3.030	2.770	3.000	7,916,200
10/18/2002	3.070	2.650	2.740	7,724,300
10/17/2002	2.960	2.770	2.850	5,831,900
10/16/2002	2.840	2.650	2.720	5,818,200
10/15/2002	2.850	2.590	2.790	7,687,800
10/14/2002	2.550	2.400	2.550	3,290,700
10/11/2002	2.530	2.350	2.430	5,892,500
10/10/2002	2.450	1.910	2.380	7,670,700
10/9/2002	2.020	1.820	1.980	10,401,800
10/8/2002	2.180	1.950	1.950	6,464,000
10/7/2002	2.200	1.960	2.050	7,095,500
10/4/2002	2.400	2.170	2.180	5,421,500
10/3/2002	2.680	2.300	2.340	7,689,700
10/2/2002	2.800	2.410	2.460	6,837,700
10/1/2002	2.720	2.300	2.690	6,569,200
9/30/2002	2.360	2.100	2.280	8,612,500
9/27/2002	2.550	2.250	2.260	5,527,900
9/26/2002	2.590	2.390	2.450	7,627,400
9/25/2002	2.750	2.460	2.520	11,194,800
9/24/2002	2.820	2.560	2.610	9,865,400
9/23/2002	2.950	2.400	2.790	7,469,700
9/20/2002	2.970	2.670	2.850	10,928,500
9/19/2002	2.940	2.460	2.850	19,564,500

9/18/2002	3.130	2.820	2.970	14,813,500
9/17/2002	3.420	3.040	3.150	11,356,700
9/16/2002	3.600	3.270	3.310	6,826,900
9/13/2002	3.770	3.310	3.490	13,943,600
9/12/2002	3.630	3.240	3.600	21,317,000
9/11/2002	3.250	3.060	3.180	5,247,000
9/10/2002	3.310	2.960	3.040	16,556,500
9/9/2002	3.250	2.870	3.170	13,853,500
9/6/2002	3.210	2.900	3.000	14,341,600
9/5/2002	3.560	3.130	3.200	28,906,800
9/4/2002	3.770	3.280	3.600	25,357,100
9/3/2002	3.310	3.100	3.260	14,526,400
8/30/2002	3.400	3.020	3.280	10,293,400
8/29/2002	3.300	2.950	3.180	12,683,200
8/28/2002	3.260	2.760	3.010	22,568,700
8/27/2002	2.770	2.650	2.770	8,654,800
8/26/2002	2.720	2.430	2.670	11,376,500
8/23/2002	2.790	2.650	2.690	9,345,100
8/22/2002	3.050	2.770	2.910	15,353,100
8/21/2002	3.010	2.600	2.940	32,051,000
8/20/2002	2.950	2.650	2.950	60,456,700
8/19/2002	2.290	1.960	2.240	19,293,300
8/16/2002	1.980	1.540	1.930	24,477,500
8/15/2002	1.630	1.350	1.530	16,122,900
8/14/2002	1.550	1.120	1.500	20,505,500
8/13/2002	1.170	1.100	1.110	10,416,800
8/12/2002	1.250	1.110	1.120	15,634,400
8/9/2002	1.290	1.130	1.240	15,600,700
8/8/2002	1.390	1.080	1.200	25,302,900
8/7/2002	1.400	1.070	1.200	43,506,900

8/6/2002	1.920	1.250	1.350	18,760,100
8/5/2002	1.790	1.580	1.690	16,291,700
8/2/2002	1.600	1.420	1.580	18,488,300
8/1/2002	1.600	1.320	1.500	38,184,800
7/31/2002	1.600	1.200	1.280	34,253,400
7/30/2002	1.420	1.250	1.290	27,587,900
7/29/2002	1.770	1.110	1.490	46,513,800
7/26/2002	1.740	1.480	1.500	13,592,200
7/25/2002	1.750	1.560	1.610	10,280,400
7/24/2002	1.900	1.400	1.700	23,566,900
7/23/2002	2.390	1.700	1.750	18,893,300
7/22/2002	2.730	2.250	2.310	19,273,000
7/19/2002	2.700	2.280	2.490	26,681,800
7/18/2002	3.000	2.290	2.740	26,429,700
7/17/2002	2.400	2.180	2.390	13,064,000
7/16/2002	2.190	1.900	2.150	24,633,400
7/15/2002	2.110	1.850	2.000	15,558,200
7/12/2002	2.060	1.800	1.930	15,997,300
7/11/2002	2.090	1.550	1.870	29,885,500
7/10/2002	2.010	1.520	1.770	63,059,200
7/9/2002	2.750	2.140	2.600	20,264,600
7/8/2002	2.120	1.900	2.100	13,510,000
7/5/2002	1.900	1.520	1.820	8,835,000
7/3/2002	1.900	1.490	1.700	30,997,800
7/2/2002	2.300	1.920	1.930	27,836,500
7/1/2002	2.940	2.100	2.300	20,382,800
6/28/2002	3.120	2.420	2.800	28,012,800
6/27/2002	2.810	1.830	2.760	41,227,300
6/26/2002	3.000	1.200	1.790	86,027,400
6/25/2002	4.670	4.150	4.190	6,501,300

6/24/2002	4.650	4.300	4.420	10,461,400
6/21/2002	4.740	4.500	4.590	5,909,300
6/20/2002	4.980	4.710	4.720	8,477,400
6/19/2002	5.120	4.950	4.980	7,904,100
6/18/2002	5.290	5.030	5.140	15,863,300
6/17/2002	5.120	4.790	5.000	22,732,200
6/14/2002	4.210	4.000	4.150	9,808,800
6/13/2002	4.330	4.140	4.270	6,254,600
6/12/2002	4.710	4.000	4.290	8,308,800
6/11/2002	4.850	4.550	4.550	9,290,700
6/10/2002	5.000	4.740	4.770	5,996,300
6/7/2002	4.960	4.800	4.940	3,493,900
6/6/2002	5.130	4.900	5.000	4,398,000
6/5/2002	5.170	5.020	5.060	3,729,000
6/4/2002	5.160	4.990	5.080	4,985,600
6/3/2002	5.250	5.040	5.100	6,778,300
5/31/2002	5.260	5.150	5.160	6,447,000
5/30/2002	5.260	4.850	5.200	7,793,200
5/29/2002	5.380	5.060	5.060	4,192,300
5/28/2002	5.300	5.030	5.200	3,809,800
5/24/2002	5.300	5.000	5.110	5,771,300
5/23/2002	5.100	4.600	5.100	14,024,500
5/22/2002	5.160	4.960	5.030	6,696,500
5/21/2002	5.420	4.880	5.030	9,528,700
5/20/2002	5.400	5.170	5.290	4,945,400
5/17/2002	5.480	5.020	5.170	6,759,200
5/16/2002	5.680	5.390	5.530	4,334,400
5/15/2002	5.550	5.270	5.390	6,138,100
5/14/2002	5.600	5.100	5.500	9,507,000
5/13/2002	5.210	4.910	5.030	6,835,400

5/10/2002	5.610	4.950	5.040	14,339,800
5/9/2002	6.060	5.780	5.900	9,312,900
5/8/2002	6.250	5.500	6.170	18,032,100
5/7/2002	5.390	4.870	5.160	27,306,800
5/6/2002	5.190	4.780	4.860	8,124,400
5/3/2002	5.210	5.010	5.050	9,005,000
5/2/2002	5.400	4.960	5.090	13,409,600
5/1/2002	5.450	4.940	5.290	18,168,100
4/30/2002	5.400	4.350	5.030	34,168,500
4/29/2002	5.750	4.800	4.960	25,640,900
4/26/2002	6.100	5.720	5.750	7,878,600
4/25/2002	6.270	6.050	6.110	4,930,500
4/24/2002	6.410	6.150	6.170	5,886,100
4/23/2002	6.730	6.270	6.400	9,239,500
4/22/2002	6.550	5.990	6.400	18,585,300
4/19/2002	7.060	6.450	6.600	24,051,500
4/18/2002	8.190	7.530	7.570	12,917,600
4/17/2002	8.200	7.530	7.900	15,483,300
4/16/2002	7.750	6.900	7.470	19,338,900
4/15/2002	7.140	6.670	6.680	4,261,600
4/12/2002	6.980	6.310	6.900	8,933,500
4/11/2002	6.410	5.930	6.350	9,281,400
4/10/2002	7.000	6.170	6.260	18,919,700
4/9/2002	7.350	7.000	7.010	6,175,500
4/8/2002	7.590	7.180	7.210	8,183,300
4/5/2002	7.450	7.250	7.340	9,057,500
4/4/2002	7.550	7.070	7.260	10,286,000
4/3/2002	7.910	7.530	7.550	6,972,400
4/2/2002	7.960	7.600	7.630	13,010,700
4/1/2002	8.200	7.970	8.000	9,392,200

3/28/2002	8.480	7.920	8.220	7,539,000
3/27/2002	8.240	7.960	7.980	10,173,300
3/26/2002	8.460	8.090	8.090	8,289,700
3/25/2002	8.710	8.210	8.210	4,772,100
3/22/2002	8.620	8.310	8.500	7,859,800
3/21/2002	8.970	8.500	8.690	9,828,400
3/20/2002	9.140	8.790	8.900	8,960,900
3/19/2002	9.280	8.900	8.940	7,792,900
3/18/2002	9.660	8.800	9.010	11,563,900
3/15/2002	8.900	8.300	8.680	8,911,100
3/14/2002	8.700	8.190	8.250	13,140,900
3/13/2002	8.960	8.480	8.700	13,419,700
3/12/2002	9.250	8.760	8.950	16,887,900
3/11/2002	9.640	8.800	9.460	14,890,800
3/8/2002	10.200	9.550	9.710	10,366,400
3/7/2002	9.940	9.400	9.820	19,450,100
3/6/2002	10.290	8.520	10.080	15,489,400
3/5/2002	9.150	8.200	8.850	16,201,500
3/4/2002	9.410	8.780	9.150	13,187,300
3/1/2002	9.500	8.500	8.990	9,299,100
2/28/2002	8.710	8.300	8.700	7,421,500
2/27/2002	8.700	8.210	8.300	9,644,900
2/26/2002	8.560	8.140	8.250	17,076,000
2/25/2002	8.540	7.950	8.300	8,160,300
2/22/2002	8.530	7.800	8.270	14,380,300
2/21/2002	8.580	7.250	8.430	26,032,500
2/20/2002	7.790	6.910	7.640	18,117,600
2/19/2002	7.850	7.070	7.270	16,670,400
2/15/2002	7.560	6.540	7.560	58,069,000
2/14/2002	8.050	7.270	7.490	59,351,100

2/13/2002	8.920	8.470	8.590	27,375,900
2/12/2002	9.260	9.110	9.210	28,318,000
2/11/2002	9.550	8.870	9.360	25,152,300
2/8/2002	9.690	8.770	9.600	13,215,300
2/7/2002	9.600	8.750	8.750	16,432,500
2/6/2002	9.180	8.850	9.020	22,655,400
2/5/2002	9.640	8.610	9.240	22,266,400
2/4/2002	10.010	8.510	8.960	26,914,300
2/1/2002	10.460	9.850	10.000	24,717,800
1/31/2002	11.550	10.290	10.500	17,068,300
1/30/2002	11.730	10.400	10.750	29,282,800
1/29/2002	12.010	11.410	11.760	15,138,600
1/28/2002	13.000	11.870	12.350	6,494,300
1/25/2002	13.050	12.310	12.590	7,271,000
1/24/2002	13.040	12.750	13.000	4,185,100
1/23/2002	12.850	12.290	12.850	6,417,700
1/22/2002	13.130	12.640	12.650	4,833,100
1/18/2002	12.880	12.540	12.880	4,780,800
1/17/2002	13.250	12.750	12.810	9,870,500
1/16/2002	13.590	13.110	13.150	3,856,000
1/15/2002	13.690	13.350	13.550	3,519,200
1/14/2002	13.810	13.230	13.340	6,420,800
1/11/2002	14.140	13.640	13.670	9,575,300
1/10/2002	14.350	13.450	13.760	9,692,900
1/9/2002	14.880	14.130	14.380	10,526,500
1/8/2002	14.700	14.360	14.560	5,995,600
1/7/2002	14.950	14.350	14.460	7,894,800
1/4/2002	15.190	14.660	14.930	8,572,300
1/3/2002	14.850	14.050	14.600	9,181,200
1/2/2002	14.250	13.590	14.020	6,250,300

12/31/2001	14.500	13.900	14.130	5,078,800
12/28/2001	14.270	13.400	14.240	8,812,200
12/27/2001	13.700	13.300	13.700	7,224,900
12/26/2001	13.540	13.190	13.300	5,684,600
12/24/2001	13.640	13.190	13.190	4,436,900
12/21/2001	15.000	13.020	13.400	14,922,300
12/20/2001	13.760	13.100	13.600	12,174,400
12/19/2001	13.600	12.800	13.350	7,864,400
12/18/2001	13.740	13.130	13.270	14,305,300
12/17/2001	13.770	12.220	13.440	21,961,500
12/14/2001	12.470	11.500	12.330	18,913,800
12/13/2001	12.270	11.500	11.800	29,824,500
12/12/2001	12.320	11.950	12.100	10,661,800
12/11/2001	12.620	11.640	12.380	13,497,700
12/10/2001	12.020	11.640	11.950	11,014,000
12/7/2001	11.990	11.520	11.770	13,702,000
12/6/2001	12.220	11.910	11.920	14,861,000
12/5/2001	12.080	11.500	11.900	12,815,700
12/4/2001	11.950	11.600	11.660	9,667,100
12/3/2001	12.070	11.770	11.880	7,331,800
11/30/2001	12.190	11.800	11.900	12,648,900
11/29/2001	12.480	12.150	12.200	8,612,800
11/28/2001	12.910	12.250	12.350	11,703,900
11/27/2001	13.400	12.700	12.770	7,607,800
11/26/2001	13.300	12.800	13.190	8,594,700
11/23/2001	12.760	12.140	12.650	2,520,900
11/21/2001	12.650	12.340	12.450	5,862,100
11/20/2001	13.260	12.600	12.840	6,589,400
11/19/2001	13.500	12.850	13.200	9,071,700
11/16/2001	13.700	12.900	13.200	6,688,900

11/15/2001	13.750	12.710	13.700	13,832,400
11/14/2001	12.720	12.260	12.650	12,609,600
11/13/2001	12.180	11.560	12.060	11,906,300
11/12/2001	11.650	11.270	11.540	6,901,400
11/9/2001	12.010	11.480	11.850	8,242,500
11/8/2001	12.220	11.710	11.940	9,908,200
11/7/2001	11.740	11.080	11.510	21,666,800
11/6/2001	12.400	11.510	11.790	12,880,300
11/5/2001	12.540	11.990	12.500	13,803,400
11/2/2001	12.500	11.490	11.970	19,447,700
11/1/2001	12.600	11.550	12.000	24,559,400
10/31/2001	14.900	12.500	12.950	38,800,300
10/30/2001	16.750	15.950	16.000	5,446,900
10/29/2001	17.410	16.650	16.900	4,045,200
10/26/2001	17.940	17.400	17.750	4,144,200
10/25/2001	17.650	16.400	17.510	5,776,100
10/24/2001	16.850	16.280	16.810	6,667,000
10/23/2001	16.690	16.130	16.340	8,507,800
10/22/2001	16.450	15.950	16.110	5,957,900
10/19/2001	16.710	15.950	16.170	11,719,100
10/18/2001	16.730	16.260	16.700	7,778,900
10/17/2001	17.930	16.480	16.600	10,812,000
10/16/2001	18.900	17.500	17.830	9,576,700
10/15/2001	18.980	18.570	18.900	3,362,100
10/12/2001	19.090	18.450	18.800	6,320,600
10/11/2001	19.950	18.350	18.600	8,468,100
10/10/2001	18.610	18.100	18.480	8,629,800
10/9/2001	18.650	17.050	18.260	11,446,000
10/8/2001	17.450	16.550	17.430	7,837,900
10/5/2001	17.000	16.220	16.960	6,850,800

10/4/2001	17.030	16.100	16.550	10,500,200
10/3/2001	17.280	15.000	17.200	22,150,700
10/2/2001	16.150	15.260	15.600	21,357,400
10/1/2001	16.850	16.160	16.500	10,044,500
9/28/2001	17.350	16.120	16.700	24,327,600
9/27/2001	19.350	16.490	16.500	29,160,600
9/26/2001	20.060	18.900	19.400	8,959,200
9/25/2001	20.150	19.450	19.860	6,367,900
9/24/2001	21.000	19.700	20.030	7,032,300
9/21/2001	19.230	17.000	19.000	10,621,700
9/20/2001	20.340	18.600	19.560	7,234,900
9/19/2001	20.240	19.250	20.150	9,486,900
9/18/2001	20.090	18.780	19.650	9,273,000
9/17/2001	20.500	18.500	18.570	10,515,400
9/10/2001	20.000	16.280	19.900	23,926,700
9/7/2001	19.300	17.890	18.140	31,493,600
9/6/2001	19.600	19.000	19.260	16,096,200
9/5/2001	20.600	19.100	20.250	10,842,000
9/4/2001	21.870	20.650	20.850	4,865,500
8/31/2001	21.680	20.700	21.500	7,165,700
8/30/2001	21.100	20.400	20.650	6,748,000
8/29/2001	21.250	20.810	20.920	7,755,200
8/28/2001	21.630	20.750	20.980	7,671,600
8/27/2001	22.110	21.500	21.700	9,393,400
8/24/2001	22.270	20.620	22.270	14,439,900
8/23/2001	21.900	20.010	20.470	24,109,800
8/22/2001	23.150	21.540	22.100	15,020,000
8/21/2001	24.000	23.140	23.220	4,895,300
8/20/2001	24.200	23.430	24.100	6,110,300
8/17/2001	25.000	23.170	23.350	9,384,700

8/16/2001	25.300	24.350	25.200	6,282,300
8/15/2001	26.080	25.230	25.240	7,672,500
8/14/2001	26.050	24.800	26.000	12,908,400
8/13/2001	24.740	24.300	24.660	5,466,900
8/10/2001	24.800	23.850	24.770	5,757,300
8/9/2001	24.350	23.640	24.290	8,876,200
8/8/2001	25.000	23.500	24.200	12,348,300
8/7/2001	24.490	23.570	24.000	12,083,700
8/6/2001	24.940	23.800	24.290	11,597,000
8/3/2001	24.470	22.800	24.400	14,680,000
8/2/2001	25.500	22.870	23.100	25,647,500
8/1/2001	26.200	24.800	25.210	13,648,600
7/31/2001	27.000	25.800	26.000	11,799,400
7/30/2001	27.740	26.830	27.200	5,094,000
7/27/2001	28.220	27.130	27.900	4,614,400
7/26/2001	28.130	27.380	28.010	6,043,900
7/25/2001	27.590	27.000	27.400	6,794,600
7/24/2001	27.880	26.580	27.050	7,273,200
7/23/2001	29.500	28.110	28.550	5,138,900
7/20/2001	30.220	28.250	30.000	10,541,500
7/19/2001	28.700	28.000	28.230	6,654,100
7/18/2001	28.600	27.420	27.810	8,879,000
7/17/2001	29.010	27.750	28.960	6,187,700
7/16/2001	29.950	28.850	29.220	3,495,600
7/13/2001	29.960	29.120	29.520	2,680,100
7/12/2001	30.000	29.000	29.950	4,414,800
7/11/2001	29.980	28.800	29.140	5,392,200
7/10/2001	30.730	29.350	29.840	4,748,000
7/9/2001	30.170	29.000	29.990	3,373,000
7/6/2001	30.110	29.000	29.400	3,523,800

7/5/2001	31.100	30.000	30.100	3,129,400
7/3/2001	30.990	30.650	30.810	1,746,600
7/2/2001	31.450	30.900	31.150	4,997,500
6/29/2001	31.950	29.900	31.870	8,834,400
6/28/2001	30.830	29.750	29.970	5,504,800
6/27/2001	30.610	29.490	30.070	4,168,000
6/26/2001	30.470	29.530	30.030	3,457,200
6/25/2001	30.590	29.800	30.040	4,128,400
6/22/2001	30.810	30.130	30.500	6,920,600
6/21/2001	31.690	30.150	30.500	14,262,500
6/20/2001	30.300	28.390	30.020	26,166,400
6/19/2001	32.400	30.950	31.270	16,393,700
6/18/2001	32.500	29.600	29.820	11,798,300
6/15/2001	33.870	32.600	33.000	6,130,600
6/14/2001	34.470	33.960	34.100	3,227,500
6/13/2001	34.560	34.040	34.400	2,497,400
6/12/2001	35.050	33.220	34.360	5,004,400
6/11/2001	34.650	33.450	34.250	4,171,300
6/8/2001	34.700	33.760	34.260	5,267,900
6/7/2001	36.850	34.890	35.000	5,966,400
6/6/2001	36.630	35.860	36.210	3,040,000
6/5/2001	36.500	35.600	36.230	4,701,600
6/4/2001	37.150	35.860	36.150	3,481,500
6/1/2001	37.110	35.640	36.910	4,377,500
5/31/2001	37.400	36.080	36.740	3,856,100
5/30/2001	37.150	36.090	36.290	3,272,900
5/29/2001	38.290	36.950	37.290	3,492,300
5/25/2001	38.080	37.080	37.750	3,877,900
5/24/2001	38.100	36.900	37.070	4,466,200
5/23/2001	38.750	37.450	37.600	5,043,800

5/22/2001	38.990	38.300	38.530	4,453,100
5/21/2001	38.750	38.050	38.670	5,140,500
5/18/2001	38.720	37.420	38.600	7,417,200
5/17/2001	37.950	36.400	37.820	9,746,300
5/16/2001	37.920	36.250	37.000	12,534,900
5/15/2001	38.200	37.440	37.650	6,812,500
5/14/2001	38.150	36.990	37.930	3,415,700
5/11/2001	37.870	36.600	37.420	2,656,100
5/10/2001	38.390	37.700	37.960	3,936,500
5/9/2001	38.100	37.100	38.000	5,222,300
5/8/2001	38.900	37.300	37.550	6,827,400
5/7/2001	38.870	37.530	38.640	5,392,300
5/4/2001	38.130	37.140	37.540	9,234,600
5/3/2001	39.500	38.230	38.450	6,002,400
5/2/2001	40.580	39.200	39.440	5,241,100
5/1/2001	41.200	40.400	40.810	5,766,100
4/30/2001	41.830	39.840	40.900	7,887,500
4/27/2001	39.900	39.120	39.800	4,482,300
4/26/2001	39.300	38.490	39.250	7,916,800
4/25/2001	39.710	37.300	38.900	7,784,100
4/24/2001	38.500	37.000	37.300	6,658,700
4/23/2001	37.400	36.160	37.120	7,079,300
4/20/2001	38.350	37.110	37.400	6,462,300
4/19/2001	37.670	36.350	36.900	7,148,500
4/18/2001	38.540	36.170	37.510	7,391,500
4/17/2001	36.370	35.200	36.240	4,369,100
4/16/2001	35.770	35.250	35.700	3,709,600
4/12/2001	36.100	34.260	35.700	6,226,400
4/11/2001	36.250	35.050	35.700	8,007,700
4/10/2001	35.890	32.650	34.800	9,762,400

4/9/2001	32.680	31.700	32.190	4,789,900
4/6/2001	32.100	31.000	31.400	4,356,900
4/5/2001	32.910	30.550	32.850	11,519,500
4/4/2001	33.300	30.000	30.110	10,913,200
4/3/2001	35.950	32.570	32.720	6,995,500
4/2/2001	35.990	35.000	35.700	4,520,500
3/30/2001	35.590	33.720	35.050	7,564,500
3/29/2001	35.950	34.000	35.160	4,817,400
3/28/2001	36.850	34.700	34.980	3,606,800
3/27/2001	37.600	35.750	37.190	4,746,900
3/26/2001	36.500	35.320	36.350	3,284,000
3/23/2001	35.650	33.850	35.250	4,969,100
3/22/2001	34.250	32.240	34.000	7,353,000
3/21/2001	36.950	33.980	34.230	8,476,600
3/20/2001	37.500	36.380	36.380	5,202,500
3/19/2001	37.420	36.650	37.000	3,867,900
3/16/2001	37.900	36.690	36.840	7,760,500
3/15/2001	38.060	36.190	37.920	5,631,900
3/14/2001	36.230	34.540	35.440	8,390,300
3/13/2001	34.870	33.000	34.780	4,429,700
3/12/2001	33.950	32.750	33.250	5,048,500
3/9/2001	34.660	33.590	33.800	3,445,700
3/8/2001	36.020	34.840	35.290	4,233,000
3/7/2001	35.200	34.430	34.520	2,923,600
3/6/2001	35.690	34.800	34.940	4,231,000
3/5/2001	34.850	33.600	34.300	4,136,500
3/2/2001	35.160	33.200	34.730	6,995,800
3/1/2001	35.920	34.370	34.860	6,789,200
2/28/2001	38.150	36.610	36.970	3,810,200
2/27/2001	38.520	37.290	37.450	4,567,000

2/26/2001	38.890	36.280	38.270	7,003,700
2/23/2001	36.130	33.880	35.900	6,059,400
2/22/2001	37.650	35.590	36.490	6,953,200
2/21/2001	37.750	36.530	37.500	4,705,600
2/20/2001	38.240	36.800	36.850	5,714,300
2/16/2001	39.260	36.580	37.100	8,749,000
2/15/2001	40.810	39.530	39.700	5,487,800
2/14/2001	41.610	38.820	39.080	6,137,400
2/13/2001	41.860	40.800	41.690	5,152,300
2/12/2001	41.400	40.010	40.900	3,922,500
2/9/2001	41.000	40.030	40.430	4,516,600
2/8/2001	41.000	40.310	41.000	4,315,400
2/7/2001	41.510	39.760	40.440	5,307,100
2/6/2001	41.890	40.800	41.180	4,864,700
2/5/2001	40.990	39.650	40.900	5,831,200
2/2/2001	41.850	39.680	39.760	6,190,700
2/1/2001	42.350	40.000	41.800	10,460,600
1/31/2001	42.980	42.000	42.120	3,928,000
1/30/2001	43.510	42.600	42.800	4,745,000
1/29/2001	43.700	42.640	43.560	5,437,100
1/26/2001	43.813	41.750	41.875	9,487,500
1/25/2001	45.750	43.000	44.375	10,856,100
1/24/2001	47.250	44.500	47.063	10,141,900
1/23/2001	44.875	43.500	44.625	6,046,700
1/22/2001	46.250	42.563	43.313	6,456,100
1/19/2001	46.875	45.813	46.500	5,900,000
1/18/2001	46.375	45.313	45.750	4,046,100
1/17/2001	47.563	44.188	45.438	9,564,800
1/16/2001	47.938	46.500	47.000	4,751,700
1/12/2001	48.188	46.438	46.625	4,688,000

1/11/2001	47.500	45.313	47.500	8,221,800
1/10/2001	45.750	44.063	45.688	5,305,800
1/9/2001	44.875	42.375	44.875	5,011,200
1/8/2001	44.000	41.500	42.000	4,988,200
1/5/2001	46.125	42.875	43.563	6,709,900
1/4/2001	47.000	44.625	46.000	9,744,000
1/3/2001	43.750	39.375	43.500	9,959,100
1/2/2001	40.813	38.438	39.688	5,398,800

[redacted]

CSI Data Source: CSI
http://www.csidata.com

DATE	MOODY'S	STANDARD & POOR'S	FITCH
	Qwest Communications International Inc. Long Term Bond Ratings		
7/24/01		Affirms BBB+ Outlook Stable	
9/10/01			Affirms BBB+ Outlook Stable
12/13/01	Affirms Baa1 Outlook Negative		Affirms BBB+ Outlook Negative
1/16/02	On Review For Possible Downgrade		
2/14/02	Downgrade to Baa2 Outlook Negative	Downgrage to BBB Outlook Negative	Downgrage to BBB Outlook Negative
3/5/02	Downgrade to Baa3 Outlook Negative		
3/7/02		Affirms BBB Outlook Negative	
4/19/02		Downgrade to BBB- Outlook Negative	Downgrade to BBB- Outlook Negative
5/22/02		Downgrade to BB+ Outlook Negative	
5/30/02	Downgrade to Ba2 Outlook Negative		
7/3/02	On Review For Possible Downgrade		
7/10/02	Downgrade to B2 Outlook Negative		Downgrade to B Outlook Negative
7/17/02		Downgrade to B+ Outlook Developing	
8/12/02			Downgrade to CCC+ Outlook Negative
8/27/02		Downgrade to B- Outlook Negative	
9/5/02	Downgrade to Caa1 Outlook Negative	Affirms B- Outlook Developing	
11/20/02		Downgrade to CC Outlook Developing	Affirms CCC+ Outlook Negative
12/26/02	Affirms Caa1 On review for downgrade	Reassigned B- Outlook Developing	
	Qwest Corporation Long Term Bond Ratings		
7/24/01		Affirms BBB+ Outlook Stable	
9/10/01			Affirms A Outlook Stable
12/13/01	Affirms A2 Outlook Negative		Affirms A Outlook Negative
1/16/02	On Review For Possible Downgrade		
2/14/02	Downgrade to A3 Outlook Negative	Downgrade to BBB Outlook Negative	Downgrade to BBB+ Outlook Negative
3/5/02	Downgrade to Baa2 Outlook Negative		
3/7/02			Affirm BBB+ Outlook Negative
4/19/02		Downgrade to BBB- Outlook Negative	Downgrade to BBB Outlook Negative
5/22/02		Downgrade to BB+ Outlook Negative	
5/30/02	Downgrade to Baa3 Outlook Negative		
7/3/02	On Review For Possible Downgrade		
7/10/02	Downgrade to Ba3 Outlook Negative		Downgrade to B Outlook Negative
7/17/02		Downgrade to B+ Outlook Developing	
8/12/02			Affirms B Outlook Negative
8/27/02		Downgrade to B- Outlook Negative	
9/5/02	Affirms Ba3 Outlook Negative	Affirms B- Outlook Developing	
11/20/02		Affirms B- Outlook Developing	Affirms B Outlook Negative
12/26/02	Affirms Ba3 On review for downgrade	Affirms B- Outlook Developing	

Arizona Corporation Commission
Qwest Corporation – PCC-4
Exhibits of Peter C. Cummings
Docket No. T-01051B-02-0666
January 28, 2003

DEALS & DEAL MAKERS

Qwest's Bond Swap Cuts Debt, But Some Holders Oppose It

By SHAWN YOUNG

Qwest Communications International Inc. said it has reduced its debt by \$1.94 billion by swapping some bonds for new bonds that have a lower face value but a higher interest rate and longer maturities.

The debt reduction from the bond swap, which some bondholders claimed was coercive and a violation of securities laws, was at the low end of the deal's expected range. But the exchange still gives Qwest as much as three extra years to repay some of its more burdensome debts, easing the local and long-distance phone company's financial pinch.

Qwest, based in Denver, will cut its debt to \$22.6 billion from \$24.5 billion through the debt exchange. The company has been racing to reduce a debt load that investors fear could force it into bankruptcy-law protection. At the same time, Qwest has been struggling with a flagging core business, investigations into its accounting and the collapse of its stock price. Qwest has said it overstated revenue from 2000 and 2001 by about \$1.9 billion, and plans to restate about \$1.5 billion in earnings from that period.

In 4 p.m. New York Stock Exchange trading, Qwest shares were up 39 cents, or 7.4%, at \$5.69. The stock traded as high as \$64 at its peak in early 2000, but Goldman, Sachs & Co. analyst Frank Governali and some other analysts said it is still overpriced at its current level.

The debt swap, which was available only to institutional investors, had the potential to cut Qwest's debt by between \$1.8 billion and \$2.6 billion, depending on how many bondholders chose to participate and which bonds they held. Although the exchange was at the range's low end, the swap moves \$735 million in debt that was due to mature in 2004, 2005 and 2006 back to 2007, Mr. Governali said. Investors were particularly concerned about Qwest's ability to handle those payments. The swap will increase Qwest's interest expense, which was \$1.44 billion in 2001, by about \$68 million a year.

"The successful results of this private exchange offer mark another significant step in our plans to improve liquidity ... and strengthen our balance sheet, which we have undertaken to benefit all of the company's constituencies," said Chief Financial Officer Oren Shaffer in a statement. "We continue to make progress on improving Qwest's financial position to ensure the long-term success of the company." The company's debt-reduction efforts so far have included a deal to sell its phone-directory business for \$7 billion.

Mr. Shaffer assumed his post in July as part of a shakeup that has changed nearly all of Qwest's top officers. He previously worked for Qwest Chairman and Chief Executive Richard Notebaert, who was appointed in June, at Ameritech Corp., the Baby Bell that served the Midwest until it was bought by SBC Communications Inc. in 1999.

Qwest had offered holders of \$12.9 billion in bonds issued by its Qwest Capital Funding subsidiary as much as \$4 billion in new notes from its Qwest Services Corp. subsidiary and \$6.6 billion in Qwest notes. The offer expired last week, and the exchange for noteholders who accepted will take place Thursday.

A group of unhappy bondholders had sued to block the exchange but dropped their complaint last week after a judge refused to issue a restraining order that would have delayed the swap.

Their complaint claimed that the offer sought to strip noteholders of more than \$2.25 billion in value and was coercive because the new notes have a higher priority for repayment than the old ones, which penalizes bondholders who don't participate. The bondholders also complained that Qwest's current lack of audited financial statements made it difficult for them to assess the offer.

Brad Scheler, a partner at Fried, Frank, Harris, Shriver & Jacobson, the New York law firm representing the bondholders, said last week that the bondholders could seek damages related to the offer after it expires.

Meanwhile, the Federal Communications Commission yesterday cleared the way for Qwest to sell long-distance phone service in nine of its 14 states. The approvals by the FCC are the first for Qwest, which had withdrawn applications for Colorado, Idaho, Iowa, Nebraska, North Dakota, Montana, Utah, Washington and Wyoming in September ahead of almost-certain rejection by regulators. Qwest is the regional Bell serving 14 Western and Mountain states, and outside that region is the country's fourth-largest long-distance carrier.

The FCC had been set to reject the applications over concerns about Qwest's accounting scandal. But Qwest refiled its application after updating the affiliate's financial statements and putting new controls in place to ensure that both Qwest and the long-distance subsidiary complied with accounting principles, leading to yesterday's FCC approval.

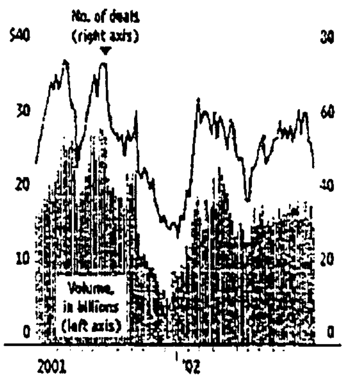
—Yochi J. Dreazen contributed to this article.

Syndicated-Loan Mar[k]

Syndicated loans are corporate loans that "syndicate," of banks and/or institutional [i]nvestment grade or unrated loans priced [a]t Libor plus 1.50 percentage points (150 [...] grade or unrated loans priced at or above [...]

Forward Calendar

A leading indicator of activity, showing new leveraged deals mandated or in the market.



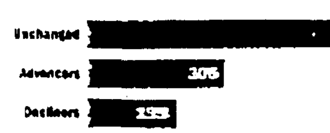
Notes: Final figure on forward calendar (left) is as of Dec. 20; [...]

Sources: Banc of America Securities LLC; Loan Pricing Corp.

The Week's Biggest Mover[s]

Biggest gainers and losers among widely-[...] in the week ended Friday. Listed are the [...] least five bids. All loans listed are 5-term.

	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Level 3 Comm.	Caa1/N.R.	L+425	Jan. 15,'08	74.75	[illegible]
[illegible]	N.R./N.R.	L+212.5	April 01,'06	27.50	[illegible]
[illegible]	B3/CCC-	L+300	March 31,'08	[illegible]	[illegible]
[illegible]	N.R./N.R.	L+300	Sept. 30,'09	[illegible]	[illegible]
[illegible]	B3/B-	L+450	June 30,'06	[illegible]	[illegible]
[illegible]	N.R./N.R.	L+500	Dec. 31,'05	[illegible]	[illegible]
[illegible]	Caa2/N.R.	L+525	March 31,'05	[illegible]	[illegible]
Global Crossing	N.R./N.R.	L+300	July 06,'06	[illegible]	[illegible]
[illegible]	B1/B-	L+275	[illegible]	[illegible]	[illegible]
United Rentals	Ba1/BB+	L+300	[illegible]	[illegible]	[illegible]
[illegible]	N.R./N.R.	L+325	[illegible]	[illegible]	[illegible]
Land O'Lakes	B1/BB	L+250	Oct. 11,'08	[illegible]	[illegible]
[illegible]	[illegible]	L+400	[illegible]	[illegible]	[illegible]



Note: These are the averages of indicative bid prices [...] percentage of the par, or face, value. Coupon, [...] London Interbank Offered Rate. All ratings are for [...] noted with an [...]. These prices do not represent act[ual] [...] estimated values provided by dealers.

STANDARD & POOR'S

CLOSE

Fixed Income

Print EMAIL THIS ARTICLE

Qwest Communications International Inc. Assigned New Ratings; Outlook Is Developing

Analyst:
Catherine Cosentino, New York (1) 212-438-7828

Publication date: 26-Dec-02, 16:50:58 EST
Reprinted from RatingsDirect

NEW YORK (Standard & Poor's) Dec. 26, 2002--Standard & Poor's Ratings Services said today that it reassigned its 'B-' corporate credit rating to diversified telecommunications carrier Qwest Communications International Inc. (Qwest).

Standard & Poor's also assigned a 'CCC+' rating to three senior subordinated secured notes, representing $3.3 billion in total debt issued under a 144A offer by Qwest Services Corp. in connection with its debt exchange offer concluded with Qwest Capital Funding Inc. debt holders. These notes are guaranteed by Qwest and Qwest Capital Funding Inc. and have a junior lien on the $2 billion bank loan collateral pool. The collateral for the $2 billion bank loan includes a first lien on the stock of the local telephone operating company Qwest Corp. and a second lien on the stock and certain assets of the Qwest directories business.

Qwest and Qwest Services Corp. have agreed to enter into a registration rights agreement pursuant to which they will agree to file an exchange offer registration statement and, under some circumstances, a shelf registration statement, with the SEC with respect to the new notes. However, Qwest's ability to register these notes is hampered by the current SEC investigation, which is likely to preclude any registration from becoming effective at this time.

Furthermore, Standard & Poor's assigned a 'CCC+' rating to the untendered senior unsecured debt remaining at Qwest Capital Funding Inc., which represents about $7.7 billion of debt.

The outlook is developing.

"The 'B-' corporate credit rating is the same as prior to the debt exchange offer. As a result of the exchange, the company's consolidated debt has been reduced by a relatively modest $1.9 billion, versus the company's total pre-exchange debt balances of about $24.5 billion," said Standard & Poor's credit analyst Catherine Cosentino. "Moreover, the 'B-' rating reflects the high degree of risk that continues to surround Qwest due to the ongoing Department of Justice criminal and SEC investigations, as well as the existence of various shareholder lawsuits."

Standard & Poor's also said that near-term liquidity still remains a source of concern, particularly if closing of the $4.3 billion second phase of the company's directories sale is delayed beyond 2003. Even with the debt exchange, which resulted in a reduction of about $287 million in maturities in 2004, Qwest has consolidated maturities from 2003 through 2005 of about $6.7 billion, of which about $4.5 billion is due through 2004.

Complete ratings information is available to subscribers of RatingsDirect, Standard & Poor's Web-based credit analysis system, at www.ratingsdirect.com. All ratings affected by this rating action can be found on Standard & Poor's public Web site at www.standardandpoors.com; under Fixed Income in the left navigation bar, select Credit Ratings Actions.

QCORP BORROWING COSTS

Spot Date	9/30/02
Credit Spreads as of	9/30/02
Senior Debt Rating	Ba3/B-

Domestic Long-Term Debt

Term (Years)	Settlement Date	Maturity Date	Benchmark Yield[1]	Credit Spread[2]	Reoffer Yield	Underwriting Spread[3]	All-In Cost
1	09/30/02	09/30/03	1.562%	1,235.3	13.915%	0.1000%	14.0150%
2	09/30/02	09/30/04	**1.683%**	1,054.5	12.228%	0.2000%	12.3280%
3	09/30/02	09/30/05	1.975%	1,048.9	12.464%	0.2500%	12.5473%
4	09/30/02	09/30/06	2.268%	1,005.0	12.317%	0.3000%	12.3922%
5	09/30/02	09/30/07	**2.560%**	961.0	12.170%	0.3500%	12.2403%
7	09/30/02	09/30/09	2.972%	873.2	11.704%	0.4000%	11.7611%
10	09/30/02	09/30/12	**3.590%**	754.2	11.132%	0.4500%	11.1770%
20	09/30/02	09/30/22	4.129%	668.1	10.810%	0.8750%	10.8975%
25	09/30/02	09/30/27	4.399%	625.1	10.649%	0.8750%	10.7365%
30	09/30/02	09/30/32	**4.668%**	582.0	10.488%	0.8750%	10.5755%

Notes:
[1] Source is Bloomberg, with interpolation.
[2] Source is SalomonSmithBarney, with interpolation.
[3] Merrill Lynch "global" fees.

QCORP BORROWING COSTS

Spot Date	12/31/02
Credit Spreads as of	12/31/02
Senior Debt Rating	Ba3/B-

	Domestic Long-Term Debt						
Term (Years)	**Settlement Date**	**Maturity Date**	**Benchmark Yield[1]**	**Credit Spread[2]**	**Reoffer Yield**	**Underwriting Spread[3]**	**All-In Cost**
1	12/31/02	12/31/03	1.335%	915.6	10.491%	0.1000%	10.5910%
2	12/31/02	12/31/04	**1.598%**	803.9	9.637%	0.2000%	9.7370%
3	12/31/02	12/31/05	1.977%	766.6	9.643%	0.2500%	9.7263%
4	12/31/02	12/31/06	2.355%	695.4	9.309%	0.3000%	9.3840%
5	12/31/02	12/31/07	**2.734%**	624.1	8.975%	0.3500%	9.0450%
7	12/31/02	12/31/09	3.166%	599.9	9.165%	0.4000%	9.2217%
10	12/31/02	12/31/12	**3.814%**	563.5	9.449%	0.4500%	9.4940%
20	12/31/02	12/31/22	4.297%	507.9	9.375%	0.8750%	9.4625%
25	12/31/02	12/31/27	4.538%	480.0	9.338%	0.8750%	9.4255%
30	12/31/02	12/31/32	**4.779%**	452.2	9.301%	0.8750%	9.3885%

Notes:
[1] Source is Bloomberg, with interpolation.
[2] Source is SalomonSmithBarney, with interpolation.
[3] Merrill Lynch "global" fees.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AFFIDAVIT OF PETER C. CUMMINGS
STATE OF WASHINGTON COUNTY OF KING	) :	SS

Peter C. Cummings, of lawful age being first duly sworn, depose and states:

1. My name is Peter C. Cummings. I am Director–Finance– for Qwest Corporation in Seattle, Washington. I have caused to be filed written direct testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Peter Cummings

Peter C. Cummings

SUBSCRIBED AND SWORN to before me this 24th day of January, 2003.

LORI L. WHITE
NOTARY PUBLIC
STATE OF WASHINGTON
COMMISSION EXPIRES 7-10-03

Lori L. White

Notary Public

My Commission Expires: 7/10/03

BEFORE THE ARIZONA CORPORATION COMMISSION

EXHIBIT
Q-2
Admitted

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

TESTIMONY OF

BRIAN G. JOHNSON

ON BEHALF OF

QWEST CORPORATION

JANUARY 28, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME, ADDRESS AND EMPLOYMENT.

A. My name is Brian G. Johnson. My business address is 7074 Rocky Point Road, Polson, Montana, 59860. Qwest has retained me as a consultant to assist in the regulatory process related to the sale of the Qwest Dex, Inc. ("Dex") directory publishing assets and business. I am submitting this testimony in support of Qwest Corporation's ("QC") application in this matter.

Q. PLEASE REVIEW YOUR WORK EXPERIENCE AND EDUCATION.

A. From 1970 to 1999, I was employed by QC's predecessors: The Mountain States Telephone and Telegraph Company, and U S WEST Communications, Inc. Throughout my 29 years with these companies, I served in various capacities including Assistant Treasurer, State Regulatory Director for the state of Colorado, and Executive Director of Corporate Public Policy.

As Assistant Treasurer, I was responsible for overseeing the financing for the Mountain States Telephone and Telegraph Company. As a result, I am familiar with financial filings, documents, terms, practices and policies. As the Colorado State Regulatory Director, I was responsible for numerous regulatory and legislative issues, including rate cases and alternative forms of regulation filings, tariff filings, depreciation cases, and rulemakings. My role as Executive Director of Corporate Public Policy required me to develop strategy and company policy, as well as serve as the company spokesperson for these policies before individual commissions and the Regional Oversight Committee. Part of my responsibilities included the oversight of regulatory issues associated with retail product and marketing initiatives, including all aspects of rate cases. I am familiar with the history of Dex and its predecessors, and with the interrelationships between Dex and the regulated local exchange provider, today known as QC.

I summarize my education and work experience in Exhibit BGJ-1.

II. PURPOSE OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?

A. My testimony is filed in tandem with that of Peter C. Cummings. The purpose of our testimony is to explain why the sale of Dex is critical to the continued financial viability of QC, and Qwest Communications International Inc. ("QCI"), QC's ultimate parent corporation. Mr. Cummings and I focus on the months prior to the announcement of the Dex sale transaction, conditions leading up to the decision to sell Dex, and the significance of the closing of the transaction. In so doing, our testimonies demonstrate that the sale of Dex is in the public interest.

Mr. Cummings' testimony focuses on Qwest's[1] historical situation, and current financial obligations and challenges. My testimony touches on those same subjects, but focuses to a greater extent on Qwest's strategic goals and the options Qwest evaluated and pursued to address its financial difficulties.

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1 When the term Qwest is used it refers to the global group of Qwest entities and not specifically to the parent corporation or an individual entity.

Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?

A. My testimony addresses the following issues:

Section III: Following on Mr. Cummings' general description of how QCI and QC finance their operations and his discussion of the numerous events leading to concerns about QCI's liquidity and its ability to service its debt, I discuss QCI's decision to sell Dex. With QCI's heavy debt load and significant liquidity issues, the specter of bankruptcy was very much a reality. The options available to QCI were extremely limited, but I explain what they were and why QCI chose to sell Dex. I also explain the critical role of the Dex transaction in facilitating the renegotiation of QCI's syndicated credit facility, without which QCI likely would have defaulted on covenants relating to QCI's debt to EBITDA (earnings before interest, taxes, depreciation and amortization) ratio, leading to a possible bankruptcy.

Section IV: I provide a high level summary of the Dex sale transaction, and discuss the decision to complete the sale in two phases. I discuss the critical need to close both phases of the sale transaction, as well as the intended uses of the proceeds from the transaction.

Section V: I conclude my testimony by demonstrating that the Dex sale transaction is in the public interest, from the perspective of the financial well-being of both QCI and QC, and recommending that this Commission approve the transaction on an expeditious basis.

III. THE DECISION TO SELL DEX

Q. WHAT IS THE SIGNIFICANCE OF QWEST'S FINANCIAL DOWNTURNS IN 2002?

A. As Mr. Cummings describes more fully in his testimony, by 2002 QCI was in a situation where it needed to improve liquidity and reduce debt, and it needed to do so quickly. In the Amended Credit Facility, QCI had been able to marginally improve the covenants relating to its debt to EBITDA ratios. The continuing decline of EBITDA, however, made it very possible that QCI would soon be in violation of those covenants, even with the slightly relaxed debt to EBITDA ratio requirements.

Further, QCI had ever dwindling options to raise cash necessary to make upcoming required payments under the Amended Credit Facility in 2003. QCI was required to repay in full its borrowing under that facility, $3.4 billion, in May 2003. QC also had $1.1 billion of other debt maturing by June 2003. QCI and QC were locked out of the commercial paper market. Their ability to issue intermediate and long term debt was increasingly hampered by the decline, ultimately into junk status, of their credit ratings. Even had they been able to issue replacement debt, it would likely have been on much more onerous terms, given their credit ratings, and it would not have reduced the risk associated with the debt to EBITDA ratio covenants. QCI's dwindling stock price made a public stock issue impractical; the SEC investigation made a public stock issue impossible. By April 2002, having explored numerous options, QCI decided to move ahead with a possible sale of Dex, and solicited proposals from potential purchasers.

Q. WHAT WERE THE DIFFERENT OPTIONS AVAILABLE TO QCI TO RAISE CASH TO IMPROVE ITS LIQUIDITY AND REDUCE ITS DEBT LOAD?

A. Increased revenue from internal operations was not an option, due to declining demand for telecommunications products and services, decreasing sales in the context of high fixed costs, increased competition and loss of access lines, and excess capacity in the fiber market.

Further reducing operational expenses was also not a viable option to significantly increase cash flow. QCI had already reduced its employee levels and expenses significantly in 2001, and continued to reduce expenses in 2002. The additional reductions could help improve cash flow and free cash flow, but not nearly to the degree necessary to meet maturing debt obligations.

Issuing additional equity or debt also proved infeasible. QCI did file an S-3 Registration Statement with the SEC on February 5, 2002 for issue of up to $2.5 billion of common stock or debt securities. However, the SEC investigation initiated on March 11, 2002 precluded any public stock sale. In any event, the severe drop in QCI's stock price made a stock issue impractical. The declining credit ratings of both QCI and QC and the severe drop in market prices for the company's bonds made further debt offerings equally impractical.

The other option to raise sufficient cash was a potential sale of assets, including the wireless business, wireless towers, access lines, or Dex. The sale of wireless assets could raise cash quickly, but not in sufficient amounts to satisfy QCI's short- and intermediate-term cash needs. Access line sales could raise sufficient cash, but would likely require several years to complete, based on QC's past experience.

QCI determined that the sale of Dex was the most promising and appropriate strategy for raising necessary cash on a short timeline. The sale of Dex would also provide enough proceeds to perhaps persuade the bank members of the Amended Credit Facility to negotiate an extension of the repayment dates and further relax the debt to EBITDA ratio covenants, which was an equally important consideration. After significant due diligence by potential purchasers and negotiations with potential purchasers, QCI reached an agreement on August 19, 2002 to sell Dex. I further describe the sale transaction in Section IV of my testimony.

Q. YOU STATED THAT THE DEX SALE WAS IMPORTANT TO QCI'S EFFORTS TO FURTHER AMEND ITS AMENDED CREDIT FACILITY. WHY WOULD THIS BE NECESSARY, GIVEN THAT QCI HAD JUST NEGOTIATED AN AMENDMENT IN MARCH 2002?

A. QCI's continued declining EBITDA and lack of cash to reduce its $26 billion debt load still left QCI in jeopardy of violating its debt-to-EBITDA ratio covenants even though these had been slightly relaxed by in the Amended Credit Facility . In fact, by August 19, 2002, QCI had disclosed that, unless it was able to renegotiate the Amended Credit Facility or obtain waivers from the banks relating to the debt-to-EBITDA ratio covenants, it would be in violation of those covenants, and therefore in default by the end of the third quarter, 2002.[2] In addition, the entire $3.4 billion indebtedness under the Amended Credit Facility was coming due in May 2003, and QC also had $1.1 billion of other debt maturing by June 2003. There was simply insufficient cash to meet these obligations when they came due, necessitating an extension of the maturity date under the Amended Credit Facility.

Q. WAS QCI ABLE TO NEGOTIATE FURTHER AMENDMENTS TO THE AMENDED CREDIT FACILITY?

A. Yes. As discussed in greater detail by Mr. Cummings, the resulting credit agreement is referred to as the Second Amended and Restated Credit Agreement ("ARCA"), which QCI announced on September 4, 2002.[3] QCI also negotiated a $750 million term loan (the "Dex Term Loan"), due in full upon completion of the second phase of the Dex sale transaction, expected in 2003, but in no event later than September 2004.

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[2] "Based on our expectations for the remainder of 2002, we must complete the amendment of the syndicated credit facility or obtain waivers from the banks prior to September 30, 2002. Unless we accomplish one of these alternatives, we anticipate we will fail to satisfy the financial covenants under the syndicated credit facility as of the end of the third quarter." QCI Form 8-K, Aug. 19, 2002.

[3] "On September 4, 2002 Qwest Communications International Inc. ("Qwest") announced that it had reached unanimous agreement with the 29 lenders in its syndicated credit facility to amend Qwest's $3.4 billion credit facility. " QCI Form 8-K, Sept. 5, 2002.

Q. WHAT WOULD HAVE HAPPENED HAD QCI NOT BEEN ABLE TO NEGOTIATE THE ARCA?

A. Absent a renegotiation of the Amended Credit Facility or a waiver relating to the debt-to-EBITDA ratio covenants, QCI would have violated those covenants by the end of the third quarter, 2002.[4] This would have put QCI in default under the terms of the Amended Credit Facility, which likely would have driven QCI into bankruptcy. Setting aside the issue of these financial covenants, QCI would almost certainly have lacked sufficient cash to make the $3.4 billion payment on the Amended Credit Facility required in May 2003. Again, this could have potentially driven QCI into bankruptcy. Bankruptcy, however, is not a business plan, and QCI had no intention of pursuing that option until and unless it exhausted all other alternatives. Accordingly, QCI continued to move forward with its plan to sell Dex and renegotiate the Amended Credit Facility.

Q. WOULD QCI HAVE BEEN ABLE TO NEGOTIATE THE ARCA ABSENT THE DEX SALE TRANSACTION?

A. No. The Dex sale transaction effectively facilitated QCI's ability to negotiate the terms and conditions in the ARCA. The banks recognized that, absent the sale of Dex, QCI had insufficient cash to make the $3.4 billion payment that would have been due on May 3, 2003. The ARCA requires interim payments in the event of asset sales, specifically including the sale of Dex. In particular, the close of the Dexter phase of the Dex sale transaction required a $1.354 billion pay down of the ARCA, and the close of the Rodney phase of the Dex sale transaction requires a further $750 million pay down of the ARCA. In addition,

[4] QCI Form 8-K, Aug. 19, 2002.

QCI is required to fully pay the $750 million Dex Term Loan upon the close of Rodney. Providing for these interim pay downs of QCI's $3.4 billion indebtedness, using Dex sale proceeds, was critical to QCI's ability to negotiate relaxed financial covenants and an extension in the maturity date to May 3, 2005. Absent the Dex sale agreement, it is very unlikely that QCI would have been able to negotiate the ARCA, which, as I previously described was absolutely critical to avoiding bankruptcy

IV. DEX SALE TRANSACTION

Q. PLEASE REVIEW THE MAJOR ASPECTS OF THE DEX SALE TRANSACTION.

A. On August 19, 2002, QCI reached an agreement to sell Dex for $7.05 billion to a new entity ("Buyer") formed by a consortium of private equity firms, including The Carlyle Group and Welsh, Carson, Anderson & Stowe. The sale is in two stages. The first stage (Dexter) included Dex operations in Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota and South Dakota, and closed on November 8, 2002. The second stage (Rodney) includes Dex operations in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming, and is expected to close in 2003.

Q. WHY WAS THE SALE TRANSACTION STRUCTURED TO CLOSE IN TWO PHASES?

A. The primary reason for a two-phased transaction was the need to quickly improve QCI's financial condition with an infusion of cash. QCI's $3.4 billion

Amended Credit Facility was coming due in May 2003. As Mr. Cummings' debt maturity charts show, QC also had $1.155 billion of debt maturing by June 2003. There was a concern about the ability to close the entire transaction in time to meet these repayment needs because of the belief that some states, including Arizona, would likely require a regulatory review of the transaction and such a review might not be completed in the necessary timeframe. A staged close would also allow Buyer to acquire a portion of the Dex operations and begin business sooner, recognizing that the regulatory process in certain Rodney states could delay the ability to close in those states.

Q. HOW WAS THE DEX SALE ARRANGED?

A. Qwest solicited potential purchasers for Dex worldwide from April to July 2002 and conducted a rigorous and widely-publicized auction for Dex in July and August 2002 to elicit the highest price for the asset. Qwest then received two fairness opinions with respect to the transaction from its respected financial advisors for the transaction to the effect that, subject to the assumptions, qualifications and terms contained in those opinions, the consideration to be received by Qwest in the transaction is fair to the Company from a financial point of view.

Q. WITH THE NEGOTIATION OF ARCA AND THE CLOSING OF DEXTER, IS THERE STILL A NEED TO COMPLETE THE RODNEY PHASE OF THE TRANSACTION?

A. Yes. Unless QCI completes the Rodney portion of the Dex sale transaction, it will be in great jeopardy of not being able to pay off its maturing debt. A portion of the Dexter proceeds have been used to pay the first installment of the ARCA loan, reducing QCI's indebtedness under the ARCA from $3.4 billion to $2.0 billion. See Mr. Cummings' debt maturity charts. However, QCI's financial position remains precarious. Without the proceeds from the second phase of the Dex sale, the only other source of cash is cash flow from internal operations. Even if it were to drastically reduce its capital budgets and operating expenditures, QCI would likely have insufficient cash from internal operations to meet upcoming ARCA payments and long-term debt maturities.

After the recent closing of the Dexter phase of the transaction, Standard and Poor's commented to the same effect:

> [T]he company still faces the challenge of obtaining state regulatory approvals for the close of the western region, and the close of this $4.3 billion transaction is expected to occur in 2003. These additional proceeds are critical in enabling the company to meet upcoming maturities both on the bank and public debt, which total about $7 billion from 2003 through 2005, of which about $4.8 billion is due through 2004, after the $1.4 billion pay-down of the $3.4 billion bank loan.[5]

Q. DID THE DECEMBER 2002 PRIVATE DEBT EXCHANGE ALLEVIATE ENOUGH FINANCIAL PRESSURE TO ALLOW QCI TO MEET ITS REPAYMENT OBLIGATIONS AND SURVIVE WITHOUT THE CLOSING OF RODNEY?

A. It did not. While QCI was pleased that a portion of eligible bondholders took advantage of the exchange offer, the results of the offer have no significant bearing on most of QCI's and QC's repayment obligations. As Mr. Cummings'

[5] Standard and Poor's Press Release, December 26, 2002. See Exhibit PCC-5.

Table B shows, QCI and its subsidiaries still must make 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.

V. THE SALE OF DEX IS IN THE PUBLIC INTEREST

Q. DESCRIBE WHY YOU BELIEVE THE SALE OF DEX IS IN THE PUBLIC INTEREST.

A. The sale of Dex is in the public interest because it goes a long way toward improving QCI's financial stability over the next several years, addressing critical liquidity concerns, and allowing QCI time to execute on its business plan. With the completion of the sale of Dex, QCI can focus on core telecommunications services and continue to maintain high levels of service quality. The sale of Dex averts what most considered a pending bankruptcy, which otherwise would have been a "lose-lose" solution for customers, employees and shareholders of the Qwest family of companies. Consequently, if the Commission finds that it is required to approve this transaction, I recommend that it do so as expeditiously as possible, consistent with the public interest. Time is of the essence to the parties in completing the transaction.

Q. ARE THERE ANY OTHER FACTORS THE COMMISSION SHOULD CONSIDER IN MAKING A PUBLIC INTEREST DETERMINATION?

A. Yes, there are. Earlier in my testimony I mentioned the issue of bankruptcy. The Commission should be concerned about this issue, and should conclude that to the extent that the Dex transactions reduce the possibility of such a filing, that factor weighs heavily in favor of a finding that the transactions are in the public interest.

Q. IF QCI, BUT NOT QC, WERE TO FILE FOR BANKRUPTCY, WHY SHOULD THE COMMISSION BE CONCERNED?

A. Such a filing could be disruptive for all the companies in the Qwest family of companies, for the employees of all of those companies, for the people who rely on those companies, and, potentially, for the service provided by some or all of those companies. Additionally, the Commission should be concerned because QCI is the parent company for both QC and Dex. Thus, even if QC were not the party directly seeking bankruptcy protection, QC and Dex, and their operations, would be subject to the jurisdiction of the bankruptcy court. They are assets of QCI, and as such could be sold or otherwise disposed of to satisfy the interests of the creditors of QCI. Under those circumstances, I am advised and believe that the bankruptcy court and the trustee in bankruptcy would give little, if any, consideration to ratepayer interests in connection with the disposition of the proceeds from any such sale.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. The Dex sale is a critical component of QCI's financial viability over the next few years. QCI needs the proceeds from the sale to provide enough cash to pay down maturing debts and continue operations over the next several years. Failure to rectify QCI's precarious financial position would have serious impacts on QC to the detriment of its customers, shareholders and employees.

BEFORE THE ARIZONA CORPORATION COMMISSION

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

EXHIBITS OF

BRIAN G. JOHNSON

ON BEHALF OF

QWEST CORPORATION

JANUARY 28, 2003

Education and Employment

Education

M.A. Economics, University of Montana, 1970
B.A. Economics, University of Montana, 1966

Employment

2002	Private Consultant
1997	Executive Director – Public Policy – US WEST
1993	Director - Colorado Regulatory Affairs – US WEST
1990	Director - Regulatory Finance – Mountain Bell
1987	Assistant Treasurer - Financial Planning - Mountain Bell
1984	District Staff Manager - Corporate Accounting and Financial Analysis- Mountain Bell
1979	District Manager - Payroll, Personnel and Cost Accounting – Mountain Bell

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AFFIDAVIT OF BRIAN G. JOHNSON
STATE OF COLORADO COUNTY OF DENVER	: SS

Brian G. Johnson, of lawful age being first duly sworn, depose and states:

1. My name is Brian G. Johnson. I am a consultant – for Qwest Corporation in Denver, Colorado. I have caused to be filed written direct testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Brian G. Johnson

Brian G. Johnson

SUBSCRIBED AND SWORN to before me this 24 day of January, 2003.

Tina M. Colvin

Notary Public

My Commission Expires: July 12, 2006

EXHIBIT
Q-4
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

TESTIMONY OF

MAUREEN ARNOLD

ON BEHALF OF

QWEST CORPORATION

JANUARY 28, 2003

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I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Maureen Arnold. My business address is 3033 N. 3rd Street, Phoenix, Arizona.

Q. WHAT IS YOUR POSITION WITH QWEST AND WHAT ARE YOUR RESPONSIBILITIES?

A. As the Director of Regulatory Matters, I am responsible for all regulatory activity for the state of Arizona.

Q. WHAT IS YOUR WORK EXPERIENCE AND EDUCATIONAL BACKGROUND?

A. In 1972 I began my career with C&P Telephone in Washington, D.C. I transferred to Albuquerque, New Mexico in 1975 and began working for Mountain Bell (now Qwest Corporation). I held various positions in the customer services area until 1985. Since 1985, I have held several positions in Regulatory Affairs in New Mexico and Arizona. I have been in Arizona Regulatory Affairs since 1993. I have a Bachelor of Science Degree from the University of New Mexico and a Masters of Business Administration from Webster University.

Q. HAVE YOU PREVIOUSLY APPEARED BEFORE THIS COMMISSION AS A WITNESS IN REGULATORY PROCEEDINGS?

A. Yes. I testified in Docket No. T-01051B-99-0105 (Rate Case), Docket No. U-3021-96-448 et. al. (Interconnection Service Measurements), Docket No. T-1051-97-0689 (Qwest Depreciation Rates), Docket No. T-01051B-99-0737 (Sale of Assets to Citizens), and Docket No. T-01051B-99-0497 (Qwest Merger).

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY IN THIS DOCKET?

A. The purpose of my testimony is to address the public policy and regulatory issues surrounding Qwest Communications International Inc.'s ("QCI") sale of the directory publishing assets and business of Qwest Dex, Inc. ("Dex"). My testimony will provide an overview of the transaction and also describe the relevant regulatory history in Arizona relating to directory publishing. I will further demonstrate that, if the Commission deems it necessary to approve the sale, it should do so as expeditiously as possible, as consistent with the public interest, and without conditions that would defeat the purpose of the transaction.

Q. WHAT ISSUES WILL YOU ADDRESS IN YOUR TESTIMONY?

A. My testimony addresses the following issues:

- the structure of the transaction;

- the relevant regulatory history relating to directory publishing issues;
- the necessity of the sale in light of QCI's precarious financial condition and the impact of QCI's financial condition on Qwest Corporation ("QC");
- QC's current responsibilities with regard to directory publishing and how those obligations will continue to be met after the sale;
- the effect of the sale on QC's rates.

Q. PLEASE IDENTIFY THE OTHER QC WITNESSES AND THE TOPICS THEY WILL ADDRESS.

A. Brian G. Johnson and Pete Cummings will testify as to the financial necessity of the sale. George A. Burnett will testify as to operational facts of the transaction and the nature of Dex's business.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. On August 19, 2002, QCI agreed to sell Dex's directory publishing business to an entity formed by the private equity firms of The Carlyle Group and Welsh, Carson, Anderson & Stowe ("Buyer"). The total purchase price for the transaction is $7.05 billion. The sale is divided into two stages. The first stage, called Dexter, included Dex operations in Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota and South Dakota. Of the total purchase price, $2.75 billion was allocated to the Dexter stage, which closed on November 8, 2002. The remaining $4.30 billion, subject to adjustments I describe herein, is allocated to the second stage of the transaction, called Rodney, which is scheduled to close in 2003 and includes the remaining Dex operations in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming.

This transaction does not fall within the scope of Arizona's asset transfer statute, A.R.S. § 40-285, as that statute pertains only to the transfer of assets owned by a regulated public service corporation. Neither Dex, nor QCI, Dex's ultimate parent, are regulated public service corporations as defined by Article 15, Section 2 of the Arizona Constitution. In a 1988 Settlement Agreement between the Commission and The Mountain States Telephone and Telegraph Company ("Mountain Bell"), Qwest's predecessor, the Commission acknowledged that the directory publishing assets that are the subject of this transaction had been conveyed from Mountain Bell to U S WEST Direct (Dex's predecessor). The Commission accepted that transfer as valid and agreed that it would take no further action to challenge the transfer. Accordingly, since that Settlement Agreement became effective on June 13, 1988, the directory publishing assets that are the subject of this transaction have not been assets of the regulated public service corporation.

Further, to the extent that this transaction would be deemed to fall within the scope of Arizona's affiliate interest rules applicable to QC (A.A.C. R14-2-801 – 806), it should be subject to the standing waiver of those rules granted by the Commission in ACC Decision No. 58087 and reaffirmed in ACC Decision No. 64654. I will demonstrate that this transaction falls within the scope of that waiver because: 1) it will not result in increased capital costs to QC; 2) it will not result in additional costs allocated to the Arizona jurisdiction; and 3) it will not result in a reduction of QC's net operating income.

Because the Commission may nonetheless decide that it does need to approve this transaction, I then demonstrate that the sale of Dex is in the public interest for at least three compelling reasons. First, it is essential that QC remain a financially strong company in order to maintain its network and provide quality service to its retail and wholesale customers in Arizona. QC's financial viability is directly affected by the financial viability of QCI. As explained by Mr. Johnson and Mr. Cummings, the sale of Dex is a major component of QCI's effort to restructure its debt and de-lever its balance sheet, and is necessary to avoid bankruptcy and address QCI's and QC's liquidity needs.

Second, QC currently has a variety of regulatory obligations related to directories. Today, these obligations are largely met through a Publishing Agreement with Dex. As part of the Dex sale transaction, the Buyer has entered into a new Publishing Agreement with QC under which QC's obligations will continue to be fulfilled. Mr. Burnett explains this in greater detail in his testimony.

Third, the 1988 Settlement Agreement ensures that the benefit of directory imputation included in current rates will remain in place, and will insulate ratepayers from any adverse rate affects based on the sale of Dex. QC's rates will not increase as a consequence of this sale.

III. THE TRANSACTION

Q. PLEASE PROVIDE AN OVERVIEW OF THE STRUCTURE OF THE TRANSACTION.

A. As explained in more detail by Mr. Burnett, the Buyer has all requisite technical, managerial and financial qualifications to serve as QC's official directory publisher. The sale will be completed in two stages for a total sale price of $7.05 billion. The first stage of the sale (Dexter) included all Qwest Dex operations in Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota and South Dakota for an agreed purchase price of $2.75 billion. This stage of the sale closed on November 8, 2002.

The second stage of the sale (Rodney) includes all Dex operations in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming for an agreed purchase price of $4.30 billion and is scheduled to close in 2003. The purchase price for Rodney is subject to adjustment based upon the Dexter adjusted EBITDA number and the working capital of Rodney at the time of closing. The second stage is contingent upon the receipt of any necessary state regulatory approvals (assuming the conditions of such approvals do not exceed the terms set forth in the purchase agreement) and on the Buyer's ability to receive debt financing for the transaction and to secure additional equity financing. The two-stage approach has allowed the Buyer to gain control of a portion of the assets and to begin operations quickly. It has also allowed QCI to receive a portion of the sale proceeds in 2002, in furtherance of the company's debt restructuring and de-levering strategy.

Q. WHAT IS THE RELATIONSHIP BETWEEN QCI, QC AND DEX?

A. QCI is QC's ultimate parent, or holding company. QCI owns Qwest Services Corporation ("QSC"), which in turn owns QC. QSC also owns Qwest Dex Holdings, Inc., which in turn owns Dex. Mr. Cummings has included an organizational chart in his testimony. QC is the incumbent local exchange carrier in many parts of the state of Arizona and the Commission regulates many aspects of its business. Dex is an integrated directory publishing operation and is not regulated by the Commission. Although QCI indirectly owns both QC and Dex, the two companies are otherwise financially separate and operationally independent.

IV. OVERVIEW OF REGULATORY HISTORY RELATING TO DIRECTORY PUBLISHING OPERATIONS AND 1988 SETTLEMENT AGREEMENT

Q. PLEASE DESCRIBE THE BACKGROUND OF THE 1988 SETTLEMENT AGREEMENT BETWEEN THE ARIZONA CORPORATION COMMISSION AND MOUNTAIN BELL.

A. Prior to 1983, Mountain Bell, QC's predecessor, was a Bell Operating Company and a subsidiary of the American Telephone and Telegraph Company ("AT&T"). With the divestiture of AT&T in 1984, the Plan of Reorganization separated the Bell Operating Companies including Mountain Bell from AT&T. Seven regional holding companies were created and ownership of the twenty-two Bell Operating Companies was divided among the seven regional holding companies. As a result of this process, Mountain

Bell became a wholly owned subsidiary of U S WEST, Inc., one of the seven newly created regional holding companies.

Prior to the divestiture, each Bell Operating Company published white pages and yellow pages directories for its service areas. At divestiture, the district court assigned the directory publishing assets and business to the Bell Operating Companies.

In 1984, Mountain Bell transferred its directory publishing assets and business to U S WEST Direct ("USWD"), a subsidiary of U S WEST, Inc. This Commission issued an order to show cause requiring Mountain Bell to appear and demonstrate why it had not violated Arizona law in transferring the directory publishing assets without Commission approval. Following a hearing, the Commission issued an order declaring the transfer to be invalid. Mountain Bell appealed that order to the Superior Court. In 1988, the Commission and Mountain Bell reached a settlement of that litigation which was incorporated into the Settlement Agreement I have previously described.

Q. PLEASE DESCRIBE THE TERMS OF THE SETTLEMENT AGREEMENT.

A. The Settlement Agreement is attached to Qwest's Application filed in this Docket. It provides that the parties would accept the transfer of the directory publishing assets from Mountain Bell to USWD as valid and the Commission would take no further action to challenge the transfer. The Settlement Agreement further provides that in future rate cases, the Commission, in arriving at Mountain Bell's test year operating income, will consider the fees and value of the services received by Mountain Bell from USWD. The Commission approved the Settlement Agreement on June 13, 1988, in Decision No. 56020.

Q. HOW WAS THE SETTLEMENT AGREEMENT TREATED IN MOUNTAIN BELL'S 1993 RATE CASE?

A. On July 15, 1993, USWC applied for an increase in its intrastate rates. In calculating the revenue requirement contained in its rate application, the Company imputed $43 million in directory revenues pursuant to the Settlement Agreement. In its filing, Staff proposed an adjustment to impute additional directory revenues of $17.6 million for a total proposed directory revenue imputation adjustment of more than $60 million. In proposing this adjustment, Staff imputed profits associated with USWD's "Yellow Pages" operations in excess of the rate of return it proposed for USWC's regulated operations. The Commission ultimately adopted a revenue requirement that included Staff's proposed directory revenue imputation adjustment. (See Decision No. 58927).

USWC appealed the Commission's order to the Arizona Court of Appeals. On February 8, 1996, the Court of Appeals issued an opinion determining that the Commission's directory adjustment violated the Settlement Agreement and that the Commission was limited to imputing the fees and value of services received by USWC from USWD. The Court of Appeals also indicated that it was inappropriate for the Commission to treat USWD's assets as if they were still a part of the regulated utility. The Court found that the Commission had "unequivocally agreed in 1988 to accept the transfer of directory publication to an unregulated subsidiary."[1]

Q. HAS THE SETTLEMENT AGREEMENT BEEN APPLIED IN RATE CASES SUBSEQUENT TO THE 1996 COURT OF APPEALS DECISION?

A. QC and its predecessors have filed only one rate case since 1996, on January 8, 1999, which resulted in a Commission order on March 30, 2001 approving a settlement agreement between Commission Staff, QC and other parties. At the hearing, Staff testified in support of the settlement and indicated that a directory revenue imputation of $43 million was considered in arriving at the revenue requirement under the settlement.[2]

Q. BASED ON THIS HISTORY, AND THE 1988 SETTLEMENT AGREEMENT, CAN THE DIRECTORY PUBLISHING ASSETS THAT ARE THE SUBJECT OF THIS TRANSACTION BE CONSIDERED REGULATED PUBLIC SERVICE CORPORATION ASSETS?

A. I don't believe so. As I indicated, in the Settlement Agreement the Commission accepted as valid the transfer of these directory-publishing assets from Mountain Bell to UWSD, and agreed to take no further action to challenge that transfer. This means that, upon the Commission's approval of the Settlement Agreement in June 1988, these directory publishing assets were no longer the assets of Mountain Bell, QC's predecessor and the

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[1] *US West Communications, Inc. v. Arizona Corporation Comm'n*, 185 Ariz. 277, 915 P.2d 1232 (App. 1996).

[2] Docket No. T-01051B-99-0105, Tr. 12/01/2000 at 507.

regulated public service corporation at that time. Accordingly, today, these assets are not the assets of QC, the regulated public service corporation. Based on my understanding of A.R.S. § 40-285, this transaction should therefore not require Commission approval pursuant to that statute, which applies to transfers of regulated public service corporation assets.

Q. DOES THIS TRANSACTION FALL WITHIN THE SCOPE OF THE LIMITED WAIVER OF ARIZONA'S AFFILIATE INTEREST RULES, GRANTED IN ACC DECISION NO. 58087 AND REAFFIRMED IN ACC DECISION NO. 64654?

A. I believe that it does. In Decision No. 58087, this Commission determined that USWCI, its parents and affiliates are only required to file a notice of intent to organize or reorganize when the organization or reorganization is likely to: (1) result in increased capital costs to USWCI; (2) result in additional costs allocated to the Arizona jurisdiction; or (3) result in a reduction of USWCI's net operating income. This waiver was recently reaffirmed for Qwest in ACC Decision No. 64654.

Q. ARE THOSE CRITERIA FOR APPLICATION OF THE WAIVER SATISFIED HERE?

A. Yes. First, this transaction will not result in increased capital costs to QC. In fact, as Mr. Cummings explains in his testimony, the Dexter sale reduced the cost of capital for QC and the expected completion of the Rodney sale will maintain or slightly improve the capital cost reduction. Second, this transaction will not result in the allocation of any additional costs to the

Arizona jurisdiction since no DEX costs have ever been allocated to Arizona regulated results of operations. Third, the transaction will not result in a reduction of QC's net operating income. These are not QC assets or revenues, and QC's net operating income is not affected. To the extent that one might consider Dex revenues to be part of QC's net operating income as a consequence of imputation, the Commission should note that this transaction does not alter in any way the imputation specified in the Settlement Agreement. QC will continue to abide by the Settlement Agreement after the transfer is completed, and continue to impute directory revenues in accordance with the Settlement Agreement. Therefore, even if imputed directory revenues were considered to be part of QC's net operating income, the third criterion for the limited waiver is still satisfied, as the amount of directory revenues imputed to QC remains governed by the Settlement Agreement, and is not impacted by the sale.

Q. IF THE COMMISSION, NONETHELESS, BELIEVES THAT IT IS REQUIRED TO APPROVE THIS TRANSACTION, SHOULD IT DO SO?

A. Yes, if the Commission still believes that it is required to approve this transaction it should do so expeditiously, as consistent with the public interest. The sale of Dex is consistent with the public interest in at least three compelling ways.

First, it is essential that QC remain a financially strong company in order to maintain its network and provide quality service to its retail and wholesale customers in Arizona. QC's financial viability is directly affected by the financial viability of QCI. As explained by Mr. Johnson and Mr. Cummings, the sale of Dex is a major component of QCI's effort to restructure its debt and de-lever its balance sheet and is necessary to avoid bankruptcy and address QCI's and QC's liquidity needs.

Second, QC currently has a variety of regulatory obligations related to directories. Today, these obligations are largely met through a Publishing Agreement with Dex. As part of the Dex sale transaction, the Buyer has entered into a new Publishing Agreement with QC under which QC's obligations will continue to be fulfilled. Mr. Burnett explains this in greater detail in his testimony.

Third, the 1988 Settlement Agreement ensures that the benefit of directory imputation included in current rates will remain in place, and will insulate ratepayers from any adverse rate effects based on the sale of Dex. QC's rates will not increase as a consequence of this sale.

I discuss each of these critical public interest considerations in turn.

V. PUBLIC INTEREST ANALYSIS

Q. HAS THE COMMISSION RECOGNIZED THAT THE FINANCIAL INTEGRITY OF QC IS AN IMPORTANT PUBLIC INTEREST CONSIDERATION?

A. Yes. It has always been recognized that the financial health and viability of a public utility is a primary consideration in the public interest. In fact, the Arizona Constitution requires the Commission to establish rates for the companies it regulates based on the fair value of their rate base in order to ensure that they have the opportunity to earn a fair rate of return.[3] The Commission also recognized the importance of QC's continuing financial viability by imposing several conditions on approval of the merger between QCI and USW designed to maintain QC's financial integrity.[4]

Q. WHY IS IT IMPORTANT THAT QC HAVE CONTINUING ACCESS TO CAPITAL MARKETS?

A. QC needs access to capital markets to ensure that it can continue to meet growth, provide new services and maintain a reliable local network. This, in turn, directly benefits the public interest and Arizona ratepayers by ensuring their access to a robust local network through a sound local telephone company.

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[3] *Scates v. Arizona Corporation Commission*, 118 Ariz. 531, 578 P.2d 612 (App. 1978).

[4] Decision No. 62672 at pages 16-17.

Q. WHAT IS THE RELATIONSHIP BETWEEN QC'S FINANCIAL VIABILITY AND QCI'S FINANCIAL CONDITION?

A. All of QCI's subsidiaries, including QC, gain access to equity markets through QCI. In addition, even though QC issues its own debt, its access to and cost of debt is affected by the debt rating of QCI. Mr. Cummings explains the relationship between QCI and QC bond ratings and costs of debt in his testimony. Thus, it is imperative that QCI maintain its financial integrity to the direct benefit of QC and its customers.

Q. WHAT DOES THE SALE OF DEX HAVE TO DO WITH QCI'S FINANCIAL VIABILITY?

A. As explained by Mr. Johnson, QCI decided to sell Dex as a critical component of its strategy to preserve and strengthen the financial integrity of QCI. If QCI had been unable to sell Dex, the specter of bankruptcy for QCI would have been very real. This alone is a compelling reason to find that the sale of Dex serves the public interest, as it allows QCI to avoid bankruptcy.

Q. WILL QC CONTINUE TO MEET ITS LEGAL OBLIGATIONS RELATED TO DIRECTORIES?

A. Yes. QC does have certain obligations related to directories under federal and state law, and QC's new Publishing Agreement with Buyer ensures that QC will continue to fulfill these obligations after the sale is completed.

Q. WHAT ARE QC'S OBLIGATIONS RELATED TO DIRECTORIES UNDER FEDERAL LAW?

A. Under Section 222 of the Federal Telecommunications Act of 1996, like every provider of local telecommunications services, QC is required to provide certain Subscriber List Information ("SLI") to all competing directory publishers on a reasonable and nondiscriminatory basis.[5]

In addition, Section 271 of the federal Act imposes certain requirements on QC for access and interconnection that specifically include "[W]hite pages directory listings for customers of the other carrier's telephone exchange service."[6] This requires QC to include its competitors' customer listings in any directories that QC or its affiliates publish.

Q. DOES QC HAVE OBLIGATIONS RELATED TO DIRECTORIES UNDER ARIZONA LAW?

A. Yes. The Commission's interconnection rules require that local exchange service providers must provide nondiscriminatory access to SLI.[7] In addition, the Commission's universal service rules define basic telecommunication service as including access to a white page or similar directory listing.[8] Under Qwest's Arizona tariffs, customers who purchase certain classes of service are entitled to a directory listing as part of the service.

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[5] 47 U.S.C. § 222(e).

[6] 47 U.S.C. § 271 (c)(2)(B)(viii).

[7] A.A.C. R14-2-1306

[8] A.A.C R14-2-1201

Q. HOW DOES QC CURRENTLY FULFILL ITS DIRECTORY OBLIGATIONS ARISING UNDER FEDERAL AND STATE LAW?

A. QC currently fulfills its directory publishing obligations in three ways:

- through a Publishing Agreement with Dex whereby Dex publishes and distributes White Page directories for QC;
- through its interconnection agreements with competitive carriers that either extend to directories or facilitate competitors' contact with Dex; and,
- by integrating listings from competitive carriers and including them in the information that QC transmits to Dex for publishing.

QC will continue to fulfill these obligations in the same way with the Buyer after the sale of the business and assets of Dex. In addition, as described by Mr. Burnett, QC will remain in control of its SLI as it does today, so that customers' privacy is protected.

Q. PLEASE DESCRIBE THE CURRENT DIRECTORY PUBLISHING AGREEMENT.

A. Currently, QC fulfills its obligations to publish and distribute White Pages directories in Arizona through a Publishing Agreement with Dex. In this contractual relationship, QC licenses its SLI to Dex. In turn, Dex compiles, publishes and distributes white page directories. In addition, Dex replaces directories as necessary and re-publishes directories at certain set intervals, usually annually.

Q. HOW WILL THIS PUBLISHING AGREEMENT CHANGE AFTER THE SALE?

A. There will be no essential change in these directory-publishing arrangements after the sale. Buyer has entered into a new Publishing Agreement with QC modeled on the current QC-Dex Publishing Agreement. Buyer has agreed that for the 50-year duration of that Publishing Agreement, it will compile the directories from SLI provided by QC and publish and distribute White Pages directories in the exchanges served by QC.

In addition, the new Publishing Agreement defines the legal obligations of the Buyer to assist QC in fulfilling its obligations. These provisions ensure that QC will continue to be able to satisfy its directory publishing obligations after the sale is completed. The new Publishing Agreement contains consultation provisions whereby the Buyer has agreed to consult with QC on any proposed material changes to a White Pages directory. There are also provisions allowing QC to terminate the agreement if it cannot fulfill its obligations through the agreement. Under Section 6.2(b) of the Publishing Agreement, if the Buyer breaches the agreement "in a manner that results in a material and continuing failure to discharge the Publishing Obligation with respect to any Primary Directory," QC may terminate the agreement with respect to that directory and fulfill its regulatory directory publishing obligations itself. Finally, per the terms of the Publishing Agreement, the Buyer's successors in interest, if any, will be legally bound to meet the obligations imposed upon the Buyer under the agreement. As a consequence, through the Publishing Agreement, QC has ensured continuous performance and fulfillment of its directory publishing obligations.

In addition, and important to Arizona telephone customers, QC will retain control of its own SLI post-sale, as it does today, ensuring that customers' privacy continues to be protected.

Q. HOW DOES QC CURRENTLY MANAGE OTHER PROVIDERS' INFORMATION IN THE DIRECTORY PUBLISHING CONTEXT?

A. QC integrates the subscriber lists of other providers into its SLI and transmits that information to Dex. Other providers' SLI is not differentiated from its own in any way.

Q. WILL QC CONTINUE TO INTEGRATE OTHER PROVIDERS' SLI AFTER THE SALE?

A. Yes. The only difference is that it will be transmitted to a Dex that is under new ownership. In addition, just as Dex does now, the Buyer will also be free to continue to independently negotiate with other providers to obtain their SLI.

Q. WHAT IMPACT WILL THE SALE OF DEX HAVE ON QC'S RATES?

A. None. Based on the Settlement Agreement, Arizona ratepayers will continue to receive the benefit of directory revenue imputation, and are insulated from any rate impact based on this transaction.

Q. DOES THE SETTLEMENT AGREEMENT CONTINUE TO APPLY EVEN THOUGH THE DIRECTORY PUBLISHING BUSINESS IS BEING SOLD TO A THIRD PARTY?

A. Yes. While I cannot render a legal opinion, nothing in my review of the agreement forbids a further transfer of the directory publishing business. The Agreement appears to me to be clear that, from the date of its approval, the Commission accepted as valid Mountain Bell's transfer of the directory operations to an unregulated subsidiary and the parties agreed to imputation under the terms of the agreement in future rate cases. QC and the Commission have treated the Settlement Agreement as binding since 1988 despite significant corporate changes in the telephone company.

VI. CONCLUSION

Q. WHAT IS YOUR CONCLUSION?

A. I conclude that the sale of the business and assets of Dex is in the public interest. The sale is a necessary component of QCI's overall debt restructuring and de-levering strategy, and will help ensure QC's ongoing access to capital markets that is necessary for the creation and maintenance of Arizona's robust local telecommunications network. The publishing agreement between QC and buyer ensures that QC will continue to meet its directory publishing obligations. Finally, the 1988 Settlement Agreement ensures that this transaction will not impact QC rates, and provides for continued imputation to the benefit of ratepayers.

Because the sale is in the public interest, if the Commission determines that it is required to approve the sale, it should approve the sale as expeditiously as possible, without imposing any conditions on approval that would defeat the purpose of the transaction.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AFFIDAVIT OF MAUREEN ARNOLD
STATE OF ARIZONA COUNTY OF MARICOPA	) :	SS

Maureen Arnold, of lawful age being first duly sworn, depose and states:

1. My name is Maureen Arnold. I am Director of Regulatory Matters for Qwest Corporation in Phoenix, Arizona. I have caused to be filed written direct testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Maureen Arnold

Maureen Arnold

SUBSCRIBED AND SWORN to before me this 28th day of January, 2003.

Josie Maldonado

Notary Public

My Commission Expires: 9/18/04

"OFFICIAL SEAL"
Josie Maldonado
Notary Public-Arizona
Maricopa County
My Commission Expires 9/18/2004

EXHIBIT
Q-5
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

SURREBUTTAL TESTIMONY OF

MAUREEN ARNOLD

ON BEHALF OF

QWEST CORPORATION

APRIL 18, 2003

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Maureen Amold. My business address is 4041 N. Central Ave., Phoenix, Arizona.

Q. ARE YOU THE SAME MAUREEN ARNOLD WHO FILED DIRECT TESTIMONY FOR QWEST IN THIS DOCKET?

A. Yes.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF QWEST'S SURREBUTTAL TESTIMONY IN THIS DOCKET?

A. The purpose of my testimony is to support the settlement stipulation dated April 10, 2003, between Staff and Qwest (the "Stipulation"). I explain why the settlement set forth in the Stipulation is in the best interests of both Qwest shareholders and Arizona ratepayers. I will also respond to certain statements made by Dr. Johnson on behalf of the Residential Utility Consumer Office (RUCO) and Mr. Lee on behalf of the Department of Defense (DOD).

Qwest will also present the testimony of Peter C. Cummings, Phillip Grate and Ann Koehler-Christensen. Mr. Cummings responds to Dr. Johnson's testimony suggesting that this Commission's approval of the proposed transfer is both not necessary to preserve the financial position of QC and its parent and is not sufficient to meet these goals. Mr. Grate and Ms. Koehler-Christensen rebut those portions of Mr. Lee's and Dr. Johnson's testimony that deal with any ratepayer interest in the directory operations, and correct Mr. Lee's calculation and allocation of the Arizona portion of the gain from the sale.

While Qwest felt it was important to respond to these portions of Mr. Lee's and Dr. Johnson's testimony, the appropriate focus of this proceeding at this point is whether the Stipulation reached by Qwest and Staff is in the public interest. Qwest urges the Commission to adopt the Stipulation as in the public interest. Importantly, in the event the Commission does not approve and adopt the Stipulation, then its consideration of Qwest's Application is governed by the terms of the 1988 Settlement Agreement between the Commission and Mountain Bell, Qwest's predecessor. Neither Mr. Lee nor Dr. Johnson offer any rational reason why that would not be the case—other than the fact that they would clearly prefer that the 1988 Settlement Agreement not control the issues in this case, given that their proposals are starkly inconsistent with that Agreement. For that reason, Mr. Lee's testimony concerning the ratepayer's interest in the gain from the sale and Dr. Johnson's calculation of increased imputation are essentially irrelevant to the consideration of this Application. In any event, Mr. Grate's and Ms. Koehler-Christensen's testimony demonstrates that Mr. Lee's calculation of the regulatory gain on this transaction is not only irrelevant, but also erroneous.

III. THE STIPULATION IS IN THE PUBLIC INTEREST

Q. PLEASE DESCRIBE GENERALLY THE STIPULATION BETWEEN QWEST AND STAFF?

A. The Stipulation was the product of extensive negotiations between Staff and Qwest and provides in pertinent part, contingent on the Commission approving and adopting the Stipulation, that: (1) the parties agree that the Application filed by Qwest should be approved by the Commission; (2) the 1988 Settlement Agreement between Mountain Bell and the Commission is superceded; and (3) starting on July 1, 2003, for a period of fifteen years, directory revenues in the amount of $72 million will be imputed to Qwest in any rate case, earnings or price cap review proceedings or other rate proceeding. After that 15 year period, imputation ceases.

Q. DO YOU BELIEVE THAT THE STIPULATION IS IN THE PUBLIC INTEREST?

A. Yes. There are several obvious benefits to the Stipulation. First, the level of imputation increases from a presumptive level of $43 million as set by the 1988 Settlement Agreement to a definite amount of $72 million. This change will have a significant impact on the rates paid by Qwest customers in Arizona for the next 15 years. Qwest's revenue requirement, and therefore its rates, will be lower than they otherwise would be absent the stipulation. Second, the approval of the Application is necessary in order to close the Rodney portion of the directory sale and will help Qwest meet its immediate financial needs. Mr. Cummings addresses this benefit of the Stipulation in his testimony. Third, the replacement of the cumbersome methodology of imputing the fees and value of service received by Qwest from Dex with a specific negotiated sum removes uncertainty and complexity from future rate proceedings.

Q. SHOULD THE COMMISSION APPROVE THE STIPULATION?

A. Yes.

IV. IN THE EVENT THE COMMISSION DOES NOT ADOPT THE STIPULATION BETWEEN QWEST AND STAFF, THEN THE PRIOR 1988 SETTLEMENT AGREEMENT SETS THE PARAMETERS OF THE COMMISSION'S CONSIDERATION OF QWEST'S APPLICATION

Q. YOU MENTION THAT ONE OF THE BENEFITS OF THE STIPULATION IS THE INCREASE IN ANNUAL IMPUTATION AMOUNT FROM $43 MILLION TO $72 MILLION. IS THAT REALLY A BENEFIT OF THE STIPULATION?

A. Yes. The 1988 Settlement Agreement remains in effect, pending the Commission's decision on whether to approve and adopt the Stipulation between Qwest and Staff, and applies to the Commission's consideration of Qwest's Application. Absent the adoption of the Stipulation, the Commission may not change the imputation methodology established by the 1988 agreement.

Q. WHY DO YOU BELIEVE THAT THE 1988 AGREEMENT APPLIES TO THIS APPLICATION ?

A. While both Dr. Johnson and Mr. Lee suggest that the Commission can simply ignore the 1988 Settlement Agreement and impose additional conditions on this transaction, they provide no persuasive basis for this conclusion. They argue that the 1988 Settlement Agreement applies to the earlier transfer of the directory publishing business to Dex and *not to this transfer to an* unaffiliated third party. What they ignore is that the results of the earlier transfer from Mountain Bell to Dex and the terms of the 1988 Agreement provide the starting point for any analysis of this transaction.

Prior to 1984, Mountain Bell owned the directory publishing operations. In the 1988 Agreement, the Commission agreed to accept as valid and not challenge the transfer from Mountain Bell to U S WEST Direct, Dex's predecessor. Once the directory publishing operations were transferred to the directory publishing affiliate (then U S WEST Direct, now Dex) and the Commission had accepted the validity of that transfer, those operations were no longer owned by an entity regulated by this Commission. No Arizona statute requires Commission approval for the transfer of a business or assets that are not owned by a public service corporation. Similarly, the Commission's Affiliate Rules do not apply to a transfer of assets by an unregulated affiliate of a public service corporation. Any review by the Commission of the transaction under the Affiliate Rules must be governed by the Commission's prior recognition that Dex owns the directory publishing assets and Qwest Corporation does not.

Any claim that the Commission can unilaterally change the imputation methodology set in the 1988 Agreement or now impose conditions on the transfer of the assets from Dex to the Buyer amounts to an indirect challenge to the validity of the original transfer from Mountain Bell to Dex. It is my understanding that the Arizona Court of Appeals said that the Commission could not challenge the 1984 transfer directly or indirectly.

Unless the 1988 Agreement is superceded by the Stipulation between Qwest and Staff in this proceeding, imputation in future rate proceedings remains governed by the formula set in that agreement—the fees and value of services received by Qwest from Dex.

V. REBUTTAL OF RUCO WITNESS BEN JOHNSON

Q. DO YOU AGREE WITH MR. JOHNSON'S STATEMENT ON PAGE 21 THAT THE ONLY PUBLIC INTEREST BENEFIT FOR THE SALE OF DEX IS THAT ARIZONANS MAY SUFFER IF QCI IS FORCED INTO BANKRUPTCY?

A. No. The potential difficulties for Arizona ratepayers if QCI (or Qwest) is forced into bankruptcy should not be underestimated. Avoiding a potential bankruptcy, however, is not the only benefit of the sale. As the Stipulation provides, another obvious benefit is increased and certain imputation. That benefit, of course, is contingent upon the Commission adopting and approving the Stipulation, per its terms. Further, the Stipulation secures the benefits of increased imputation for future rate proceedings in Arizona.

Q. DO YOU AGREE WITH DR. JOHNSON THAT LOCAL EXCHANGE RATES MAY INCREASE AS A RESULT OF THE SALE OF THE DIRECTORY PUBLISHING OPERATIONS?

A. No. Dr. Johnson seems to be concerned that after the transfer Qwest will argue for a lower level of imputation. The Stipulation precludes any such argument and obviates that concern. Indeed, the Stipulation increases the amount of directory revenue imputation beyond that set in the 1988 Settlement Agreement. Based on the Stipulation, Qwest is obligated to impute this additional revenue beginning with its 2003 filing for review of the Price Cap Plan. Far from increasing rates, this increased imputation will have the effect of reducing Qwest's revenue requirement, thereby lowering the rates Qwest would otherwise be able to charge.

Q. ON PAGE 4 OF HIS TESTIMONY, DR. JOHNSON STATES THAT "THE COMPANY HAS NOT PROVIDED ADEQUATE ASSURANCES THAT RATES WILL NOT INCREASE AS A RESULT OF THE PROPOSED TRANSACTION." DO YOU AGREE WITH THAT ANALYSIS ?

A. No, I do not. The Stipulation provides for increased imputation for fifteen years. This ensures that the transfer of directory assets will have no adverse impact on the rates charged by Qwest. Indeed, as previously described, the increased imputation will cause Qwest's rates to be lower than they otherwise would be, absent the Stipulation.

Q. SIMILARLY, ON THE SAME PAGE DR. JOHNSON STATES "ONCE THE DIRECTORY PUBLISHING OPERATIONS ARE NO LONGER BE (SIC)

LOCATED WITHIN THE QWEST CORPORATE FAMILY IT WILL BE MORE DIFFICULT TO MAINTAIN AN APPROPRIATE POLICY WITH RESPECT TO IMPUTATION OF DIRECTORY INCOME." DO YOU AGREE WITH THIS STATEMENT ?

A. The Stipulation again takes care of this concern because it provides for specific, certain imputation of $ 72 million for the next 15 years.

Q. ON THE SAME PAGE, DR. JOHNSON SAYS "FURTHERMORE, BECAUSE OF THE UNIQUE STRUCTURE OF THE PROPOSED TRANSACTION. THE RELEVANT 'VALUE OF FEES AND SERVICES' WILL BE MORE DIFFICULT TO DETERMINE." DO YOU AGREE WITH THIS STATEMENT?

A. No, again one of the benefits of the Stipulation is the replacement of the less-defined concept of "fees and value of services" with a defined amount of $ 72 million.

VI. CONCLUSION

Q. DOES THIS CONCLUDE YOUR SURREBUTTAL TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AFFIDAVIT OF MAUREEN ARNOLD
STATE OF ARIZONA COUNTY OF MARICOPA	) :	SS

Maureen Arnold, of lawful age being first duly sworn, depose and states:

1. My name is Maureen Arnold. I am Director of Regulatory Matters for Qwest Corporation in Phoenix, Arizona. I have caused to be filed written surrebuttal testimony in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Maureen Arnold

Maureen Arnold

SUBSCRIBED AND SWORN to before me this 18th day of April, 2003.

Claire L Volpe

Notary Public

My Commission Expires: 6·30·03

OFFICIAL SEAL
CLAIRE L. VOLPE
NOTARY PUBLIC - ARIZONA
PIMA COUNTY
My Comm. Expires June 30, 2003

EXHIBIT
Q-6
Admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

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

TESTIMONY

OF

MAUREEN ARNOLD

IN SUPPORT OF STIPULATION

ON BEHALF OF

QWEST CORPORATION

APRIL 28, 2003

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Maureen Arnold. I am employed by Qwest. My business address is 4041 N. Central Ave., Phoenix, Arizona.

Q. ARE YOU THE SAME MAUREEN ARNOLD WHO FILED DIRECT AND SURREBUTTAL TESTIMONY FOR QWEST IN THIS DOCKET?

A. Yes.

II. QWEST'S SUPPORT OF STIPULATION

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of my testimony is to state why Qwest believes the Stipulation between the Commission Staff and Qwest is in the public interest and should be adopted by this Commission. I incorporate into this testimony portions of my Surrebuttal Testimony filed on April 18, 2003 that address the Stipulation.

Q. PLEASE DESCRIBE THE STIPULATION BETWEEN QWEST AND STAFF.

A. The pertinent parts of the Stipulation provide that (1) the parties agree that the Application filed by Qwest should be approved by the Commission; (2) the 1988 Settlement Agreement between Mountain Bell and the Commission is superceded; and (3) starting July 1, 2003, for a period of fifteen years, directory revenues in the amount of $72 million a year will be imputed to

Qwest in any rate case, earning or price cap review proceedings or other rate proceeding. The imputation ceases after the 15 year period.

Q. IS THE STIPULATION IN THE PUBLIC INTEREST?

A. Yes, it is. First, the level of imputation increases from a presumptive level of $43 million as set by the 1988 Settlement Agreement to a definite amount of $72 million. This change will have a significant impact on the rates paid by Qwest-Arizona customers for the next 15 years. Qwest's revenue requirement, and therefore its rates, will be lower than they otherwise would be absent the Stipulation. Second, the approval of the Application is necessary in order to close the Rodney portion of the directory sale and will help Qwest meet its immediate financial needs. Third, replacing the methodology of imputing the fees and value of services received by Qwest from Dex with a flat amount removes uncertainty and complexity from future rate proceedings.

Q. IS THE INCREASE FROM A PRESUMPTIVE $43 MILLION TO A DEFINITE $72 MILLION REALLY A BENEFIT TO THE STIPULATION?

A. Yes. The 1988 Settlement Agreement remains in effect, pending the Commission's decision to adopt and approve the Stipulation and approve Qwest's Application. Absent those events, the Commission may not change the imputation methodology established by the 1988 Agreement, which is based on the fees and value of services Qwest receives from Dex.

Q. WHY DO YOU BELIEVE THE 1988 AGREEMENT APPLIES TO THIS APPLICATION?

A. Prior to 1984, Mountain Bell owned the directory publishing operations. In the 1988 Agreement, the Commission agreed to accept as valid and not challenge further the transfer from Mountain Bell to U S WEST Direct, Dex's predecessor. Once the directory publishing operations were transferred to the directory publishing affiliate (then U S WEST Direct, now Dex) and the Commission accepted the validity of that transfer, those operations were no longer owned by an entity regulated by this Commission. No Arizona statute requires Commission approval for the transfer of a business or assets that are not owned by a public service corporation. Any review by the Commission of the transaction under the Affiliate Rules must be governed by the Commission's prior recognition that Dex owns the directory publishing assets and Qwest Corporation does not.

Any claim that the Commission can unilaterally change the imputation methodology set in the 1988 Agreement or now impose conditions on the transfer of assets for Dex to the buyer amounts to an indirect challenge to the validity of the original transfer from Mountain Bell to Dex. It is my understanding that the Arizona Court of Appeals said that the Commission could not challenge the 1984 transfer directly or indirectly.

Unless the 1988 Agreement is superceded by the Stipulation between Qwest and Staff in this proceeding, imputation in future rate proceedings remains governed by the formula set that agreement—the fees and value of services received by Qwest from Dex.

III. CONCLUSION

Q. SHOULD THE COMMISSION APPROVE THE STIPULATION?

A. Yes.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

BEFORE THE ARIZONA CORPORATION COMMISSION

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 AFFIDAVIT OF MAUREEN ARNOLD
	) :	SS
STATE OF ARIZONA COUNTY OF MARICOPA	)	

Maureen Arnold, of lawful age being first duly sworn, depose and states:

1. My name is Maureen Arnold. I am Director of Regulatory Matters for Qwest Corporation in Phoenix, Arizona. I have caused to be filed written testimony in support of stipulation in Docket No. T-01051B-02-0666.

2. I hereby swear and affirm that my answers contained in the attached testimony to the questions therein propounded are true and correct to the best of my knowledge and belief.

Further affiant sayeth not.

Maureen Arnold

Maureen Arnold

SUBSCRIBED AND SWORN to before me this 18th day of April, 2003.

Josie Maldonado

Notary Public

My Commission Expires: 9-18-04

"OFFICIAL SEAL"
Josie Maldonado
Notary Public-Arizona
Maricopa County
My Commission Expires 9/18/2004

EXHIBIT
S-1
ADMITTED

NON-CONFIDENTIAL

DIRECT

TESTIMONY

OF

MICHAEL BROSCH

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

MARCH 28, 2003

BEFORE THE ARIZONA CORPORATION COMMISSION

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

DIRECT TESTIMONY

OF

MICHAEL BROSCH

ON BEHALF OF THE UTILITIES DIVISION STAFF

MARCH 28, 2003

Non-Confidential Version

Executive Summary of Testimony

Utilitech was retained by the ACC Utilities Division Staff to review and analyze the Application of Qwest in this matter regarding the proposed sale of the Dex directory publishing business. I am a principal of Utilitech and have previously represented the Staff in rate cases and other proceedings involving Qwest and its predecessors over the past 15 years, including analysis of directory publishing issues and the calculation of imputation adjustments associated with directory publishing. I have also testified regarding the sale of Dex transaction in pending proceedings in Utah and Washington.

The sale of Dex represents an extraordinary transaction intended to monetize and liquidate a major segment of Qwest's business, the directory publishing business that has historically been recognized above the line in establishing telephone service rates. The sale of the Dex income stream creates a substantial risk that the large gain on sale and cash proceeds from the transaction will be used to satisfy immediate creditor demands arising primarily from the non-regulated portions of Qwest's business, while the loss of the future income stream produced by directory publishing leaves the overall and regulated business financially weakened. Notably, the Dex sale eliminates an affiliate relationship that has been challenging to regulators for many years, substituting new long-term agreements with the Buyer of Dex that convey valuable assets of the telephone company on a long term basis, even though the QCI parent entity receives all of the proceeds from the sale of Dex.

The sale of Dex terminates the 1988 Settlement Agreement that has provided for directory imputation in Arizona in the past, based upon the fees and value of services received under affiliate publishing agreements. The sale of Dex will eliminate the affiliate publishing arrangement with USWD (now Dex) that was the basis of the 1988 Settlement Agreement. The Dex sale will also frustrate any future ability of the Arizona Corporation Commission to consider directory publishing financial results in evaluating the value of fees and services. While the 1988 Settlement Agreement pertained to and resolved a disputed specific transfer of certain assets among corporate affiliates that occurred in 1984, the Settlement Agreement did not contemplate the true sale of the publishing business enterprise to a non-affiliate at market value. It therefore is now necessary to provide for adjusted Arizona revenue credits from the sale proceeds to replace the inadequate levels of compensation provided for in the 1988 Settlement Agreement.

In addition, it must be recognized that the sale of Dex yields a very large gain that represents the full value of the business enterprise being transferred, including the fees and services being transferred by Qwest Corporation under new Publishing and Noncompetition Agreements. This gain should not be attributed only to shareholders, as suggested in the Company's prefiled testimony. Instead, the intrastate Arizona portion of the realized gain on sale of Dex should be accounted for as fees and value of services under the principles of the expiring Settlement, and used to increase the imputation amount embedded within customers' rates. This prospective adjustment will cause future QC revenue requirements to reflect an accurate accounting for the Arizona portion of the gain. If traditional regulation is employed upon expiration of the Arizona Price Cap Plan, I recommend a fixed annual revenue credit of $121.3 million per year for each of the next 20 years, in place of the $43 million value under the prior agreement. On the other hand, if price cap regulation is continued after the initial term of the Arizona Price Cap Plan, a perpetual annual revenue credit of $100 million per year should be ordered. Alternatively, if the Commission disagrees with Staff about the termination of the

1988 Settlement Agreement and decides to not increase annual revenue credits in lieu of imputation above the $43 million annual amount, a large one-time customer bill credit of no less than $593 million should be employed to immediately return the full value of fees and services to customers.

These credits and long-term benefits to customers will recognize that historically Dex has been treated as a source of revenue credits in Arizona and that ratepayers have a vested interest in the fees and value associated with the directory business. The calculations supporting these recommendations are set forth in Confidential Exhibit MLB-1 and are explained in the "Gain on Sale Allocation to Arizona" section of my testimony.

My testimony also rebuts certain assertions by Company witnesses Arnold and Burnett regarding the impact of the Dex sale upon Qwest Corporation risks and costs and the sources of value that are being sold with the Dex business. In particular, I explain why the 1988 Settlement Agreement is not applicable upon sale of Dex.

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PREPARED TESTIMONY OF
MICHAEL L. BROSCH

Introduction and Qualifications

Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. By whom are you employed?

A. I am a principal in the firm Utilitech, Inc., a consulting firm engaged primarily in utility rate and regulation work. The firm's business and my responsibilities are related to special services work for utility regulatory clients. These services include rate case reviews, cost of service analyses, jurisdictional and class cost allocations, financial studies, rate design analyses and focused investigations related to utility operations and ratemaking issues.

Q. On whose behalf are you appearing in this proceeding?

A. I am appearing on behalf of the Arizona Corporation Commission Utilities Division Staff ("Staff"). Utilitech entered into a contract with the State of Arizona to review and respond to the Notice and Application of Qwest Corporation ("Qwest or QC") for Waiver or Approval of the Sale of the Arizona Operations of Qwest Dex, Inc. ("Dex").

Q. Will you summarize your educational background and professional experience in the field of utility regulation?

A. I graduated from the University of Missouri, Kansas City, in 1978 with a Bachelor of Business Administration Degree, majoring in accounting. I hold a CPA Certificate in the State of Missouri and in the State of Kansas. I am a member of the American Institute of Certified Public Accountants, the Missouri Society of Certified Public

Accountants, and the Kansas Society of Certified Public Accountants. Since completion of formal education, my entire professional career has been dedicated to utility operations and regulation consulting.

From 1978 to 1981, I served as a public utility accountant with the Staff of the Missouri Public Service Commission. While employed by the Missouri Commission, I participated in rate case examinations involving electric, gas, water, steam, transit, and telephone utilities operating in Missouri. In December 1981, I accepted employment with Troupe Kehoe Whiteaker & Kent, a Kansas City CPA firm, in its public utility department. While with Troupe Kehoe Whiteaker & Kent, I was involved in the review, analysis, and presentation of a wide range of utility rate case issues and various other utility management advisory functions for both utility company and regulatory agency clients. In May 1983, I commenced employment with Lubow, McKay, Stevens and Lewis, an accounting and public utility consulting firm. While employed by that firm, I was involved in numerous regulatory proceedings and directed work related to various special projects.

In June 1985, Dittmer, Brosch and Associates, Inc. (now Utilitech, Inc.) was organized. The firm specializes in public utility regulatory and management consulting in the electric, gas, telecommunications, water, and waste water industries. As a principal of the firm, I am responsible for the supervision and conduct of the firm's various regulatory projects. A majority of the firm's business involves representation of utility commission staff and consumer advocate interveners in utility rate proceedings and special or focused investigations. In 1992, the firm was renamed Utilitech, Inc.

I have testified before utility regulatory agencies in Arizona, Arkansas, California, Florida, Hawaii, Illinois, Indiana, Iowa, Kansas, Michigan, Missouri, New Mexico, Ohio, Oklahoma, Utah, Washington and Wisconsin in regulatory proceedings involving electric, gas, telephone, water, sewer, transit, and steam utilities.

Q. Have you previously participated in Qwest or U S West Communications ("USWC") regulatory proceedings?

A. Yes. My firm has represented various clients in prior Qwest/USWC proceedings in several states. In Arizona, I participated in the last four Arizona general rate cases involving Qwest/USWC on behalf of the Arizona Corporation Commission ("ACC") Staff and supported the Staff in negotiating a Price Cap Plan in settlement of the most recent rate case.[1] In Washington, I assisted the Attorney General's Office, Public Counsel Section, in negotiation and subsequent review of that State's Alternative Form of Regulation (AFOR) plan.[2] I was also a witness in the two subsequent Washington general rate cases involving USWC and in a 1998 proceeding dealing exclusively with directory imputation issues.[3] In New Mexico, I served as a witness for the Commission Staff in the most recent USWC rate case.[4] In Utah, I served as witness for the Committee of Consumer Services in USWC's last general rate case and sponsored the directory imputation amount approved by the Commission in that Docket.[5] I also represented consumer advocate clients in Utah, Iowa and Washington in regulatory proceedings associated with the

1 ACC Docket Nos. E-1051-88-146, E-1051-91-004, E-1051-93-183, and E-1051B-99-105
2 WUTC Docket Nos. U-89-2698-F and U-89-3245-P
3 WUTC Docket Nos. UT-950200, UT-970766 and UT-980948.
4 PRC Case No. 3008.
5 Utah Docket No. 97-049-08

acquisition of USWC by Qwest.[6] I am also presently involved in the Dex Sale Dockets pending in Utah and in Washington.

Q. What is the purpose of your testimony in this Docket?

A. My testimony is intended to describe and sponsor, on behalf of the Staff, an explanation of how the sale of Dex will impact QC and recommendations regarding certain conditions and ratemaking treatment that should be imposed if the sale of Dex is approved by the Commission. Without such conditions and the proposed ratemaking treatment, the proposed sale of Dex is not in the public interest and should not be approved.

Q. How is the balance of your testimony organized?

A. My testimony is arranged by major topical area. A Table of Contents appearing at the beginning of the testimony sets forth this organization.

The Dex Sale Transaction

Q. Please describe the pending transaction to sell Qwest Dex.

A. Qwest Communications International, Inc. ("QCI"), the ultimate parent company owning Qwest Corporation, Qwest Dex and numerous other subsidiaries[7], has contracted to sell its entire interest in Qwest Dex, Inc. to a consortium of buyers including the Carlyle Partners III, CP III Coinvestment, L.P., and Welsh Carson, Anderson & Stowe IX, L.P. (hereinafter, "Buyer"). The sale of Dex is to occur in two stages, generally including the eastern portion of Qwest's local service territory in a "Dexter" transaction that has already closed, with a second stage "Rodney"

6 Utah Docket No. 99-049-41, Iowa Case No. SPU-99-27, Washington Docket No. UT-991358.

7 A Qwest Corporate Structure chart appears as Appendix A, attached to the Company's Notice of Sale, Request for Waiver or Application for Approval in this Docket.

transaction scheduled to close later in 2003. Consideration to be received by QCI is total cash of up to $7.05 billion, unless the Buyer requests QCI to retain an equity position of up to $217 million and/or provide debt financing to the Buyer to not exceed $300 million.

To transfer the value of the Dex business as a going concern, numerous commercial agreements are incorporated into the Dexter and Rodney Purchase Agreements. These include a Publishing Agreement, a Directory List License Agreement, a Billing & Collection Agreement, a Noncompetition Agreement, a Trademark License Agreement and several other conveyance and service arrangement contracts. Collectively, these documents are intended to convey the entire Dex business to the Buyer in a manner that transfers the personnel, management, physical assets and automated systems, as well as rights to use significant intangible assets of Qwest without disruption of the business or dilution of the considerable going concern value of Dex.

Q. Why is it appropriate to characterize the sale of Dex as an extraordinary event?

A. The proposed sale represents the liquidation of a major segment of the consolidated Qwest business, the directory publishing segment that has historically been treated as a regulatory asset.[8] A portion of the operating revenues, expenses and resulting income of this business segment have consistently been recognized within jurisdictional income for ratemaking purposes in Arizona and other states. In this sense, QC customers have a continuing claim upon the value of the directory

8 Prior to 1984, directory publishing was performed within Mountain Bell, with the publishing revenues and expenses recorded in above-the-line accounts. Starting in 1984, directory publishing was performed by a corporate affiliate pursuant to a Publishing Agreement and other affiliate contracts. In Arizona, litigation surrounding the transfer of assets and the affiliate Publishing Agreement was resolved in the 1988 Settlement Agreement that preserved above the line recognition of directory publishing income, subject to a showing of the value of fees and services to deviate from a $43 million imputation value.

publishing operation, even though a formal accounting for this claim has not been required.[9] Never before has the directory publishing business of the incumbent local exchange carrier ("ILEC") in the Arizona Qwest territory not been under common ownership and control with the ILEC.

Q. Isn't it true that the directory publishing business owned by Qwest and its predecessors has been transferred among affiliated entities in prior years?

A. Several internal reorganizations of the Qwest directory business have occurred in the past. These include the transfer of cash and certain directory assets into the new publishing affiliate in late 1983, the formation of U S West Communications and Media Group tracking stocks in 1995, with Dex being included as part of the Media Group, the 1998 spinoff of Media Group with Dex being purchased back by New U S West and then the merger with Qwest in July 2000.[10] However, there has never before been a true sale of Dex at market value to a non-affiliated entity reflecting an arm's-length transaction and objective valuation of the directory publishing business enterprise. The sale of Dex therefore represents the extraordinary liquidation of a part of Qwest's Arizona jurisdictional income stream that will no longer be available to support the Company's financial health or to contribute to its jurisdictional income for regulatory purposes.

Q. How was the Dex purchase price of $7.05 billion determined?

A. The purchase price was the result of negotiations between Qwest and the Buyers and appears to be reflective of the financial distress being experienced by Qwest as

9 This customer claim upon the value associated with directory publishing was not required to be recorded as either a regulatory asset or regulatory liability pursuant to Statement of Financial Accounting Standard No. 71.

10 Qwest response to Data Request STF 1-02.

a result of its debt burden and lack of liquidity to service its debts.[11] The negotiated $7.05 billion purchase price is (START CONFIDENTIAL) [redacted]. (END CONFIDENTIAL) I will explain the concerns with the purchase price later in the "Gain on Sale Allocation to Arizona" section of my testimony.

Q. Even at the $7.05 billion price that you characterize as reflective of Qwest's financial distress, will the Company realize a large gain on sale that should be addressed by the Commission in this proceeding?

A. Yes. According to estimates prepared in the confidential response to Staff Data Request 2-68, the pretax gain on sale expected to result from the Dex sale is approximately (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) billion. After consideration of income taxes and the various allocations required to determine an Arizona share of this gain, I believe that Arizona customers are entitled to a present value net benefit of no less than (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) million in after-tax dollars, which is equivalent to (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) in revenue requirements. The detailed calculation of this gain allocation is set forth in Confidential Exhibit MLB-1 attached to this testimony and is described in the "Gain on Sale Allocation to Arizona" section of my testimony. The form in which Arizona's share of this gain should be attributed to customers is discussed in the "Recommended Conditions Upon Approval" section of this testimony.

11 On December 23, Qwest announced a successful private debt exchange that will reduce total outstanding debt from approximately $24.5 billion to $22.6 billion and will extend some near-term maturities. In the Qwest Press Release announcing the debt exchange, the Company stated, "Over the past six months, Qwest's new leadership team has accomplished a number of steps to reduce debt and improve liquidity, including closing the sale of the first phase of its directory publishing business, QwestDex; amending the company's credit facility; and completing a new term loan."

Q. How does Qwest plan to utilize the cash proceeds from the sale of Dex?

A. The net cash realized from the Dex sale, to the extent not mandated for attribution to Qwest Corporation customers by order of regulators, is intended to be directed toward the repayment of debt. The Company restructured its debt around an amended credit facility and term loan associated with the Dex sale transactions. Sections III and IV of Mr. Johnson's testimony and Section IV of Mr. Cummings' testimony describe the financial circumstances of the Company and the importance of the Dex sale in improving corporate liquidity. The recommendations contained herein give careful consideration to the Company's planned repayment of debt as well as customers' entitlement to participation in the realized gain associated with the sale of Dex.

Q. Will Qwest be required to pay income taxes on the gain it realizes from the sale of Dex?

A. Certain of the financial analyses prepared by Qwest's financial advisors in the transaction suggest that the (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL), will offset the income tax liability otherwise payable on the Dex sale gain.[12] In response to Data Request STF 2-118, the Company estimated its consolidated NOL carryforward position to be approximately $5.82 billion as of December 31, 2001. However, since Qwest Corporation's regulated ILEC business and the directory publishing business have

12 STF 2-57, Attachment B, Merrill, Lynch Transaction Overview at page 2, (START CONFIDENTIAL) [redacted]

been consistently profitable, such NOL income tax benefits arise from non-regulated business segments and should not be attributed to any gain considered for crediting to telephone customers.

Regarding income tax liability, the key point is that the sale of Dex creates an opportunity for QCI to realize a cash benefit for its NOL carryforward position that is being retained for its shareholders because my recommendations provide for income taxes at statutory tax rates as if the entire gain on sale is taxable. Stated differently, the calculated income tax expenses allowed in Confidential Exhibit MLB-1 on the Dex sale gain will not be immediately paid to the government, but will instead allow the parent company, Qwest Communications International, Inc. ("QCI"), to convert its NOL position into additional cash for use in repayment of debt.

Q. Would the Company be selling the Dex business if not for the poor financial performance of its non-regulated businesses?

A. No. As explained in the testimony of Qwest witness Mr. Cummings, "The sale of Dex (both phases) remains critical to Qwest's ability to avoid bankruptcy in the short and intermediate term."[13] Notably, the financial difficulties and liquidity concerns explained by Mr. Cummings and Mr. Johnson came in with the Qwest acquisition and have not been shown to be related to the financial performance of the traditional "U S West" ILEC business.

[redacted] (END CONFIDENTIAL).

13 Direct testimony of Peter Cummings, page 10.

Q. What characteristics of the Dex business make it so valuable to the Buyer?

A. Dex is a unique business enterprise encompassing the incumbent directory publishing position in the 14 states served by Qwest Corporation. Because of its position, Dex produces a consistently strong and growing stream of income and cash flow while requiring minimal capital expenditures. These characteristics are of sufficient value to yield over $7 billion in a distress sale of the business because the Buyers will enjoy this income stream upon sale of Dex. Unfortunately, QCI will sorely miss the income and cash flow produced by Dex after the sale, but the Company had little choice but to monetize this asset to meet the demands of its creditors.

Q. How do the commercial agreements that are incorporated into the Dex Purchase Agreement influence the value of the business?

A. The commercial agreements are essential to convey the full value of the business to the Buyers because, without such agreements, Dex cannot function as a going concern in its present form. The new Publishing Agreement designates the Buyer as the "exclusive official publisher of all Directory Products" in the regions served by Qwest Corporation for the next 50 years, as well as a limited grant of "branding rights" to use the Dex names and marks and designation of the Buyer to receive all business referrals for directory advertising from within the Qwest Corporation region.[14] To preserve the public identity of the transferred business, a Trademark License Agreement grants the Buyer the right to use the "Qwest Dex" name in the conduct of the business.[15] Access to listings data, expanded use of listings, payphone placement rights, certain transition services and billing and collection

14 Exhibit D, Publishing Agreement, at paragraph 4.2.
15 Exhibit J, Trademark License Agreement, paragraph 2.1 and Appendix A.

services are provided for in other commercial agreements, which preserve the existing interfaces between Dex and the telephone company.[16] Without these agreements, the value of the Dex business enterprise would be substantially diminished.

Q. Is there a completely new agreement associated with the Dex sale that did not exist previously, when Dex was a wholly-owned affiliate of the telephone company?

A. Yes. A new Noncompetition Agreement appears as Exhibit M to the Dex Purchase Agreements. Th . Noncompetition Agreement obligates Qwest and its subsidiaries to not "publish, market, sell or distribute any Directory Products" in competition with the Buyers interests for a period of forty years, as long as the Buyer performs in accordance with the terms of the Publishing Agreement.[17] This new Agreement has the effect of precluding Qwest or its telephone operating subsidiary from re-entering the directory publishing business to attempt a take back of the directory advertising profits typically earned by the incumbent telephone holding company. Notably, there was no need for a Noncompetition Agreement between Dex and its telephone operating affiliate prior to the transaction because the common parent entity was able to direct the telephone company to not compete with Dex.

Q. How is the current proposed sale of Dex different from the 1984 transaction that created Dex's predecessor as a separate corporate entity?

A. The creation of U S West Direct in 1984 involved a non-arm's length transfer between corporate affiliates of employees, working capital and limited physical assets at book value, so as to move the directory publishing business outside of the

16 See Exhibits E, F, I, K and G respectively.

17 Exhibit M, Noncompetition Agreement, paragraphs 2.1 and 6.3. This Agreement also provides for non-

telephone company (at that time Mountain Bell). There was no consideration given for the fair market value of the directory publishing business enterprise in 1984 and there was no payment made to the telephone company for the fair value of the business at that time. The considerable intangible assets associated with the directory business that were to be used by U S West Direct in the conduct of the business were not permanently transferred to the publishing affiliate in 1984. Instead, for a limited period of time, a publishing fee was paid by U S West Direct to Mountain Bell to partially compensate for the valuable official publishing rights, trade names and marks, incumbent publisher position and other benefits associated with affiliation with Mountain Bell. Later, these publishing fees were ceased by agreement to amend the publishing agreement between the telephone and publishing affiliates, to the extreme detriment of the telephone company, forcing regulators in Arizona and other states to impute directory profits into the telephone company income statement to correct for inappropriate compensation from the directory publishing affiliate.

In contrast to the contrived affiliate transactions of prior years, the pending Dex sale is a true sale of the directory business for a negotiated cash price determined through interaction of informed parties in possession of relevant valuation information. The $7.05 billion sale price is at the low end of the market value of the Dex income stream[18] and is based in large part upon the continued use of the official directory status of Qwest's directories in the new Publishing Agreement, as well as Noncompetition Agreement and the use of other Qwest intangible assets granted to the Buyer in the various commercial agreements. For

solicitation of employees and Dex senior management for a period of two years at Article 4.

18 See valuation summary pages from the confidential response to Data Request STF 2-58, Attachments B and C, specifically the Dex valuation summary charts prepared by Merrill Lynch and Lehman Brothers, as presented to the Qwest Board of Directors August 19, 2002.

the first time since the directory business was removed from the telephone company by affiliate transaction in 1983, regulators are now able to review a market valuation of the directory publishing rights associated with the incumbent local exchange telephone business and determine an appropriate regulatory treatment for the Dex transaction.

Q. Are there practical regulatory problems created by the sale of Dex if it is approved by the Commission?

A. Yes. The current liquidity problems faced by QCI are mitigated in the short term by using the Dex sale cash proceeds to satisfy creditors. However, as noted elsewhere in my testimony, the substantial annual Dex income and free cash flows will no longer be available to QCI to meet ongoing capital requirements in the longer term. The regulated telephone service business is inherently capital intensive, such that service quality is dependent upon continuing access to capital on reasonable terms. Absent an improvement in QCI operating and cash flow results beyond 2004, it is conceivable that the Dex sale represents only a temporary solution to more chronic problems impacting the Company's access to capital on reasonable terms. Therefore, one problem faced by the Commission is the continued weak and potentially worsening long-term financial condition of QCI after the Dex income stream is monetized.[19]

Another problem created by the pending Dex sale is the loss of access to financial data for Dex to aid in evaluating the value of fees and services pursuant to the Settlement Agreement. In the most recent Arizona rate case, the Company

19 In the highly confidential response to Staff Data Request 2-155S1, the Company provided projections of its cash flow and cash balances after meeting debt service and after the sale of Dex and the results indicate (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL).

sought complete elimination of the $43 million imputation value by asserting certain claims regarding the "value of fees and services" provided by Dex and quantified from Dex financial information. My testimony, in opposition to Qwest's witness, explained the reasonableness of more than $43 *million in* imputation under the Settlement Agreement, relying upon available Dex financial data. Ultimately, the negotiated resolution of the rate case left the embedded $43 million of imputation unchanged. However, any future rate case reconsideration of "the value of fees and services" would be frustrated by the absence of any Dex financial data needed for such analyses. This is why a permanent resolution of imputation issues is required in connection with any sale of the Dex business enterprise.

Finally, the sale of Dex and the large gain on sale to be realized by QCI from the transaction requires regulatory attention to replace or restate the 1988 Settlement Agreement that is no longer applicable upon sale of Dex. The $43 million directory imputation value that is embedded within the Arizona revenue requirement is insufficient to fully recognize the Arizona value of fees and services being realized in the form of Dex sale gains.

The 1988 Arizona Settlement Agreement

Q. According to the Testimony of Ms. Maureen Arnold, the ACC has already approved the transfer of the directory business in the 1988 Settlement Agreement and the Court of Appeals has found the Commission "unequivocally agreed in 1988 to accept the transfer of directory publication to an unregulated subsidiary." Do you agree with this characterization?

A. No. The 1988 Settlement Agreement was entered into to resolve litigation surrounding an earlier and quite different transaction between corporate affiliates.[20] A true and complete sale of the directory publishing business was not contemplated or addressed by the 1988 Settlement Agreement. In contrast, the pending Dex sale is a true sale of the business to a non-affiliate for cash consideration at a market determined price. Before the Dexter/Rodney transactions, a permanent and complete transfer or sale of the directory publishing business had never occurred.

The issues resolved by the 1988 Settlement Agreement were also tied to an ongoing affiliate business relationship for which specific settlement provisions were implemented that will no longer apply. The 1988 Settlement Agreement specifically references the affiliate publishing agreement with USWD and fees payable under such agreements – but these agreements will no longer exist after Dex is sold.

Q. How was the directory asset transfer, that was initially voided in ACC Decision No. 55755 and that is referenced in the 1988 Settlement Agreement, different from the sale of the directory publishing business that is now pending with the Buyer of Dex?

A. Decision No. 55755 voided the inappropriate transfer of certain Yellow Pages assets from the telephone company to a corporate affiliate. The Commission was not dealing with a bona-fide sale of the business or with reasonably compensatory proceeds from such a true sale. Instead, a valuable publishing operation was illegally transferred to an affiliate for inadequate compensation, causing the Commission to conclude, "We believe it is in the best interest of the public for

20 Paragraph 3 of the Settlement Agreement resolves issues arising from "the transfer of Yellow Pages assets from Mountain Bell to USWD", including the dismissal of Action No. CV 87-33850, the Commission taking "no further action to challenge that transfer, and prescription of imputation methods applicable to "publishing agreements with USWD".

Mountain Bell to assume control over its Yellow Pages asset."[21] As noted by Ms. Arnold, the Company appealed Decision No. 55755 to the Superior Court and this appeal was resolved through the 1988 Settlement Agreement. Because there was no true sale of the directory business in 1984 with reasonable, market-based compensation to benefit the telephone company and its ratepayers, the 1988 Settlement Agreement required an ongoing compensation payment be imputed in the annual amount of $43 million, subject to adjustment for changes in "fees and value of services". Recognizing the risk that publishing fees being paid pursuant to affiliate contracts could be easily modified or reduced, the Settlement Agreement also required "…more than a showing by Mountain Bell that it negotiated a lesser amount with USWD" before the $43 million value could be adjusted downward.

Q. You have explained that the 1988 Settlement Agreement pertained to an earlier affiliate transfer of assets and required $43 million in annual compensation to the telephone company, irrespective of negotiated terms within affiliate publishing agreements. Please summarize the reasons why you believe the 1988 Settlement Agreement does not apply to the pending Dex sale transaction.

A. The reasons why the 1988 Settlement Agreement does not apply to the pending sale of Dex include the following:

- The 1988 Settlement Agreement applied to a specific transfer of assets between corporate affiliates, referred to as "that transfer" at paragraph 3(b). It did not apply to the complete sale of Dex to a non-affiliate or to long term assignment of official publisher status with a Noncompetition covenant.
- The 1988 Settlement Agreement is to be administered by reference to "fees and the value of services received by Mountain Bell from USWD under

21 ACC Decision No. 55755 (10/8/87), page 6.

publishing agreements with USWD", but there will no longer be any publishing agreements "with USWD" or any comparable affiliate.

- The 1988 Settlement Agreement provides "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", but the source of such value evidence currently resides within Dex and will no longer be available for such an evidentiary showing after the business is sold to a third party.
- Paragraph 3(d) of the Settlement Agreement requires that, "the Commission will be provided with reasonable access to the financial records of USWD for the purpose of verifying the amount of fees received by Mountain Bell from USWD under publishing agreements with USWD and the value of services provided by/to Mountain Bell to/by USWD." After the business is sold, there will be no "reasonable access" to financial records of USWD or any other affiliate publisher.
- The same paragraph 3(d) provides that "if the records of USWD are not maintained on a basis comparable to that of a regulated utility, Mountain Bell agrees that the Commission will be provided with any available accounting records reconciling or relating the fees and the value of services received by Mountain Bell from USWD under publishing agreements with USWD to the accrual basis of accounting." It is at least impractical and likely impossible to maintain sufficient access to the Buyer's accounting records for Qwest, as successor to Mountain Bell, to comply with this obligation.

For these reasons, it is my belief that the 1988 Settlement Agreement is not applicable to the pending sale of Dex or in rate proceedings after such a sale.

Q. Paragraph 3(b) of the 1988 Settlement Agreement states, "For purposes of this settlement (and not as an admission by Mountain Bell that the Commission has jurisdiction over the Yellow Pages asset transfer or an admission by the Commission that it does not have jurisdiction over the Yellow Pages asset transfer) the parties agree that the transfer of Yellow Pages assets from Mountain Bell to USWD will be accepted by the parties as valid and the Commission will take no further action to challenge that transfer." What transaction is being referenced as "that transfer"?

A. Within the Settlement Agreement, preceding paragraphs 1, 2 and 3(a) all clearly relate to the transfer of assets between affiliates occurring at divestiture, as addressed in Decision No. 55755 and Action No. CV 87-33850. It is unreasonable to construe this Decision to anticipate future sale events involving the entire directory publishing business and all rights to participate in such business to be "that transfer". The pending sale of Dex is not "that transfer" being referenced within the 1988 Settlement Agreement. What is being sold with Dex at this time is not the cash and tangible assets that were transferred into the affiliate in late 1983, but rather the valuable official publishing rights, Noncompetition Agreement and other intangible assets that represent the going concern value of the business.

Q. For what reasons did the Commission reject the initial transfer of assets to USWD?

A. ACC Decision No. 55755 concluded that, "Telephone directories, including the 'Yellow Pages' are necessary or useful in the performance of telephone service to the public" and that "Mountain Bell violated A.R.S. § 40-285 by its disposition of 'Yellow Pages' directory publishing assets without Commission approval."[22] Decision No. 55755 at page 6 required Mountain Bell to reassume control over

22 Id. Conclusions of Law 3 and 5.

directory publishing and envisioned an interim period during which a rate case may occur, with the following instruction for directory imputation in this period:

> Pending completion of the reassumption of control by Mountain Bell over the Yellow Pages, we believe it is in the best interests of the public to impute the amount of net revenues at Mountain Bell's next rate case based on the following:
> (1) The entire Arizona related profits of Direct or $43 million as adjusted for inflation since the last Test Year, whichever number is higher, and;
> (2) The above net revenues will be presumed correct but will be adjusted if Mountain Bell can convince the Commission otherwise. Clearly, however, it will take a greater showing by Mountain Bell than an amount based upon a negotiated agreement with Direct.

When the appeal of Decision No. 55755 was resolved in the 1988 Settlement Agreement, an effort was made to maintain this presumptively correct $43 million value subject to a showing in support of any different amount.

Q. Paragraph 3[c] of the 1988 Settlement Agreement refers to "fees received from USWD under publishing agreements with USWD". What were these "fees"?

A. The initial affiliate Publishing Agreement between U S West Direct and Mountain Bell provided for large annual payments to the telephone company of "publishing fees" to compensate for the valuable right to serve as the official publisher of directories on behalf of the incumbent Bell telephone company. The payment of these fees might have pacified regulators that loss of the directory publishing assets would not harm telephone ratepayers. In fact, the 1988 Settlement Agreement in Arizona attempted to make permanent a $43 million minimum receipt of such "fees" by Mountain Bell through agreement that, "in subsequent rate cases downward adjustments from the $43 million in fees received by Mountain Bell from USWD 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". The parties acknowledged the non-arm's length nature of affiliate publishing agreements and feared U S West's ability to unilaterally reduce publishing fees to the detriment of Mountain Bell and its ratepayers.

Q. Did U S West unilaterally reduce publishing fees payable to Mountain Bell under affiliate publishing agreements?

A. Yes. The affiliate Publishing Agreement was amended in 1988 to eliminate the payment of fees. This act was blatantly imprudent on the part of telephone company management and revealed the transfer of directory assets to be a regulatory strategy to secure most or all of the directory publishing profits for shareholders instead of ratepayers. In Arizona, directory imputation levels remained in dispute in subsequent rate cases in spite of the existence of the 1988 Settlement Agreement.

Q. Was the $43 million imputation value provided for in the 1988 Settlement Agreement adequate consideration for ratepayers?

A. No. The 1988 Settlement Agreement has been a persistently bad deal for ratepayers. The Settlement Agreement failed to provide for any growth in directory publishing revenues or profits, effectively leaving all of such growth for the sole benefit of shareholders. My testimony in the 1993 USWC rate case supported an increase in imputation from $43 million to about $60 million and the Commission's Decision No. 58927 approved this increased imputation. However, as noted at page 9 of Ms. Arnold's testimony, USWC successfully appealed the Commission's Order based upon the 1988 Settlement Agreement requirement that imputation was limited to "fees and the value of services received by USWC from USWD under publishing agreements with USWD". The Commission was forced to increase rates to reflect reduced imputation back to the $43 million level, even though it had found higher imputation to be more reasonable.

Q. After using the 1988 Settlement Agreement to appeal the 1993 ACC rate order and reduce imputation to $43 million, was the Company content to leave imputation at the negotiated $43 million level in its 1999 rate filing?

A. No. In its very next rate case in 1999, the Company advocated reduction of imputation from the Settlement Agreement level of $43 million to zero.[23] My testimony in that Docket explained that a more equitable imputation for ratepayers would be no less than $93.1 million,[24] but in deference to the 1988 Settlement Agreement, Staff advocated only $43 million be included in determining revenue requirements. The 1988 Settlement Agreement has consistently understated the amount of imputation that customers should have received, given the substantial growth in the value of the official directory publishing rights within the USWC/QC ILEC service territory.

Q. Has Qwest offered any firm commitment to continue imputation at the $43 million level after Dex is sold in the pending transactions?

A. No. After arguing that the ACC has no jurisdiction over this transaction because of the Settlement Agreement at pages 10 and 11 of her testimony, Ms. Arnold concludes her Direct Testimony at page 20 with the statement, "Finally, the 1988 Settlement Agreement ensures that this transaction will not impact QC rates, and provides for continued imputation to the benefit of ratepayers." However, the

23 Docket No. T-1051B-99-105, Testimony of Anne Koehler-Christensen, pages 1 through 15.
24 ACC Docket No. T-1051B-99-105, Direct Testimony of Brosch, page 48.

Company's own interpretation of the Settlement Agreement in the 1999 rate case did not "provide for continued imputation" while Dex was under common ownership. It is difficult to place much faith in the 1988 Settlement Agreement to "ensure" anything about future imputation, since the Company has already argued that no imputation is required under the same agreement. It should be noted that Qwest's witnesses offer no firm commitment to impute $43 million or any other value in future QC rate cases in Arizona.

Q. Was a long-term Noncompetition Agreement granted by Mountain Bell in favor of the new publishing affiliate in 1984, as part of the disputed asset transfer that was ultimately resolved in the 1988 Settlement Agreement?

A. No. In stark contrast to the divestiture era transfer of tangible directory publishing assets, the pending transaction to sell Dex involves a long-term Noncompetition Agreement. Through this Agreement, QC will surrender its right to re-enter the publishing business or to negotiate a publishing fee from another publisher in return for the grant of the "official publisher" privilege for a period of 50 years. The existence of such a covenant indicates how different the pending transaction is to the shuffling of assets and personnel among affiliates that was reluctantly accepted by the Commission in the 1988 Settlement Agreement. In 1984, Mountain Bell was not contractually precluded from re-entering the directory publishing business or demanding even larger publishing fees for the value of the official publisher designation.

Q. At page 10 of her testimony, Ms. Arnold argues that, in the 1988 Settlement Agreement "...the Commission accepted as valid the transfer of these directory-publishing assets from Mountain Bell to UWSD [sic], and agreed to take no further action to challenge that transfer." Did the Commission permanently resolve the issue of ratepayer entitlement to economic participation in the financial benefits associated with the directory publishing business in the 1988 Settlement Agreement?

A. No. The 1988 Settlement Agreement resolved issues surrounding an earlier transfer of certain assets between affiliates that it had previously rejected and was the subject of litigation. The Settlement Agreement left open for reconsideration the value of fees and services under affiliate publishing arrangements that might justify adjustments to a presumed reasonable imputation value fixed at $43 million per year.

Q. At page 10 of her testimony, Ms. Arnold states, "As I indicated, in the Settlement Agreement the Commission accepted as valid the transfer of these directory-publishing assets from Mountain Bell to UWSD [sic], and agreed to take no further action to challenge that transfer. This means that, upon the Commission's approval of the Settlement Agreement in June 1988, these directory publishing assets were no longer the assets of Mountain Bell, QC's predecessor and the regulated service corporation at that time." Are the "assets" being described by Ms. Arnold the primary assets now being conveyed to the Buyer of the Dex business?

A. No. The Mountain Bell directory publishing assets in Arizona that were transferred as of January 1, 1984 included $56.3 million in cash and $8.3 million of fixed assets including a building, PBX, motor vehicles, furniture and computers, less $2.0 million in accounts payable assumed by the affiliate.[25]

The cash balance transferred to the publishing affiliate 20 years ago cannot be sourced into the present transaction, because cash assets of Dex are retained

25 Qwest response to STF 4-156.

by the seller.[26] The book value of all other tangible assets being transferred to the Buyer represent only (START CONFIDENTIAL)[redacted], (END CONFIDENTIAL) which is less than (START CONFIDENTIAL) [redacted](END CONFIDENTIAL) percent of the total purchase price, as shown at Exhibit MLB-1, line 2. Thus, it is unlikely that any of the tangible directory assets that were transferred out of Mountain Bell in late 1983 are significant to the Dex business being sold 20 years later. The more important elements of value now being sold are the intangible assets associated with the ILEC official publishing rights, the goodwill and going concern value of the business and its customer relationships, the long-term Noncompetition Agreement and the Qwest Dex trade names and marks.

Q. Were any of these intangible assets sold by Mountain Bell to USWD in 1983 when the tangible physical directory assets were transferred?

A. No. There was no sale or permanent transfer of intangible assets associated with the right to serve as official publisher. Instead, the Publishing Agreements commencing in 1984 conveyed a right to use these intangible assets during the term of the Agreements, in effect renting them as part of the official publisher status that was granted to USWD. The problem with the previous Publishing Agreements was the failure to adequately compensate the telephone company for the valuable official publisher status. Similarly, the new Publishing Agreement with the Buyer of Dex grants the official publisher franchise associated with the Qwest Corporation ILEC Dex territory, again with no ongoing compensation to the telephone company for the value of that franchise. The only reasonable conclusion to be drawn from these facts is that the $7.05 billion sale price of the business, less the relatively

26 Rodney Contribution Agreement (Exhibit B) at Schedule 2.2 lists "excluded assets" and numbered item 4. therein is "Cash and cash equivalents".

modest amount of tangible assets contributed by the Seller, represents the overall present value of fees and services being conveyed in the transaction pursuant to the commercial agreements.

Q. In the event the Commission does not agree with you and instead decides to apply the principles within the 1988 Settlement Agreement to the pending transaction, should the $43 million in imputation be adjusted to reflect the value of fees and services associated with the Dex sale transaction?

A. If the 1988 Settlement Agreement were deemed applicable to the pending Dex sale, the $43 million imputation value should be increased significantly and made permanent at a new higher level reflective of the value of fees and services within the new Publishing, Noncompetition and other commercial agreements to be made effective between QC and the Buyer of Dex. The "value of fees and services" principle embedded within the Settlement Agreement can be employed to observe that the $43 million level of imputation is woefully inadequate relative to the value actually being paid for Dex and its exclusive ongoing "official publisher" relationship with the regulated telephone company.

Ratepayers Retain a Valid Claim Upon Dex

Q. Has Qwest offered any analysis to support its apparent conclusion that shareholders, rather than ratepayers, are entitled to retain the multi-billion dollar gain to be realized as a result of selling Dex?

A. No. The directory business of Qwest (and its predecessors) in Arizona has consistently been operated in coordination with the regulated telephone operations under common ownership, so as to capture the tremendous economic benefits of publishing directories in conjunction with (and as an offset to the costs of) providing telephone services. Like the other regional Bell holding companies, directory publishing grew up within the telephone business because the Bell companies were recognized by advertisers as publishers of the most complete "official" directories in their territories. In this section of my testimony, I will explain the synergies and linkages between the telephone company and the publisher of official directories for the telephone company that caused Dex business revenues and profits to be imputed by this and other regulatory commissions.

Q. In your opinion, are Dex directory operations integrally linked to the provision of local phone services, such that directory publishing income is rightfully credited or imputed into the telephone company's revenue requirements?

A. Yes. The linkages between the white and yellow page directories of Dex and the telephone services of Qwest Corporation continue to include:

1) Listings that represent the primary information content of the directories are created in operation of the local phone business. This makes the telephone company the best source for the most current and complete listings information. To advertise in the Dex yellow pages you must have business telephone service.[27]

2) Usage of the white and yellow pages is driven by telephone customers' desire to make more effective use of local telephone services to reach businesses they wish to communicate with.

3) The usefulness of local telephone service is enhanced by the availability of both alphabetical and classified directories.

4) In the case of Dex directories, much of the revenues earned from yellow pages advertising are billed on local phone bills of

27 Per Qwest web site description of Qwest Dex yellow page advertising. See http://www.qwest.com/pcat/large_business/product/1,1354,55_4_24,00.html

QC telephone customers and are collected and processed by QC remittance centers.

5) Qwest payphones, even though now deregulated, have been contracted to be provided with Dex directories. This advances the public perception that Qwest Dex directories are part of the ILEC services and are the official directories.

6) Directories of telephone affiliates are published with prominent placement of identifying tradenames and trademarks linking them to the telephone company.

7) The public is likely to perceive Dex directories to be endorsed by the telephone company and thereby the "official" book that is accurate, current and comprehensive with respect to the phone number listings controlled and assigned by Qwest. (See point 1)

8) Qwest refers customer inquiries regarding directory advertising to Dex, where such referrals may lead to incremental sales of advertising.

Simply stated, Dex publishes the "official" phone books for Qwest, and these directories offer significant value to advertisers as well as supra-competitive profits to the publisher. For all of these reasons, the traditional regulatory practice for many years, as codified in the FCC's Uniform System of Accounts and recognized by this Commission for many years, is to treat directory advertising and other directory publishing revenues as above-the-line for ratemaking purposes.[28]

28 As noted in prior testimony, the amount of directory publishing revenues to be treated above-the-line in Arizona has continued to be a contentious issue, even though ostensibly resolved by the 1988 Settlement Agreement.

Q. Many of the linkages between the telephone company and the directory operations that you describe appear to represent intangible goodwill assets enjoyed by the publisher from its relationship with the telephone company. Is this goodwill value recognized anywhere on the books of Dex or the telephone company?

A. No. Going concern or goodwill is not an investment that required contributions of cash or other assets by Qwest or QCI, but instead this value has arisen from doing business successfully over a period of time. For this reason, there are no recorded goodwill assets on the Dex or QC balance sheet associated with this value. In the pending transaction, $7.05 billion is being paid to acquire the Dex going concern business, its goodwill, and its consistently large income stream. The origin of this goodwill and income stream arises from linkages into the telephone company that have existed for decades, linkages that are carefully preserved in the many commercial agreements that are made a part of the transaction.

Q. Is the relationship between QC and Dex unique, or do the other three regional "Bell" holding companies also publish telephone directories that tend to be more profitable than the directory operations of non-ILECs?

A. According to information contained in a confidential Qwest Dex Strategy White Paper provided in response to Staff Data Request No. 2-84 at page 5, the Regional Bell Operating Companies ("RBOCs") have very attractive revenue and Earnings Before Interest, Taxes, Depreciation and Amortization ("EBITDA") characteristics:

(START CONFIDENTIAL) [redacted]

[redacted]

[redacted] (END CONFIDENTIAL).

These comments indicate RBOC market dominance and the distinctively higher earnings margins and cash flows realized by the incumbent local Bell company publishers, relative to the lower-margin competitors' financial performance. Such market dominance and financial performance among the RBOC publishers, relative to non-RBOC competitors, is indicative of the strategic advantages derived by linkages to the telephone operation and the benefits of official publisher status.

Q. Have Dex revenues, operating profits and cash flow trends continued to improve in the past few years?

A. Yes. According to the Dex Confidential Descriptive Memoranda prepared to describe the Dex business in soliciting bids from potential acquirers, the recent year's unaudited actual and projected Dex revenue and EBITDA values were:

(START CONFIDENTIAL TABLE)

Confidential — Consolidated Dex Financial Information ($millions)

	1999	2000	2001	2002Est	2003Est	2004Est	2005Est	2006Est
Dex Total Revenues	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
EBITDA	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: STF 1-26S1, Attachment A, pages 37 and 49.

(END CONFIDENTIAL TABLE)

Q. Do the linkages between the telephone company and the publishing affiliate justify the continued imputation of directory revenues into QC income for ratemaking purposes?

A. Yes. Imputation of revenues from the directory publishing affiliate has been necessary historically when setting rates because these revenues are created in large part from the unique benefits of affiliation with Qwest's telephone business, benefits that arise from and are integrally related to the provision of local telephone services. Upon sale of the Dex business, the ongoing earnings stream reflective of the linkages is to be transferred, but the Commission can now consider the fair market value of the directory operations business and determine the final financial adjustments and any other conditions needed to properly attribute this value to ratepayers.

Q. Earlier in your testimony, in describing the pending Dex sale transaction, you stated, "The commercial agreements are required to convey the full value of the business to the Buyers". Do the commercial agreements serve the purpose of preserving the linkages between Qwest Corporation's ILEC telephone business and the directory publishing business, after Dex is no longer an affiliate of Qwest Corporation?

A. Yes. The unique benefits of affiliation between QC and Dex, that were assured in the past through common corporate ownership and control, are now carefully formalized within the commercial agreements that are incorporated into the Dex sale contracts.

Q. *How does the new Publishing Agreement between Dex Holdings L.L.C. and Qwest Corporation preserve the benefits of linkages between the regulated telephone company and the directory publisher?*

A. The new Publishing Agreement designates the Buyer as Qwest Corporation's exclusive official publisher of all Directory Products in its region for a 50 year period, with certain Qwest Dex "branding rights" and a right to any referrals QC makes concerning directory advertising. (Exhibit D at 4.2).

Q. *Have the parties to the Dex sale agreement also made provision for the continued use of Qwest Dex intangible assets, so as to maintain the identity of the buyer as the publisher of the "official publisher" of Qwest's directories?*

A. Yes. The new Trademark License Agreement grants the Buyer the right for five years to use the "Qwest Dex" trademark on its products within the directory publishing service area, to provide continuity in the public identity of the business. (Exhibit J at 2.1).

Q. *Earlier in your testimony, you mentioned the new Noncompetition Agreement that was negotiated to protect the Buyer against Qwest Corporation's potential re-entry into the lucrative RBOC directory publishing business. How does this agreement work?*

A. The new Non-Competition and Non-Solicitation Agreement serves to prevent Qwest from marketing, selling or distributing Directory Products in the Dex region in competition with the Buyer within the 40-year term of the Agreement. Qwest also agrees to not solicit for hire any employees or management transferred to the Buyer for a period of two years. (Exhibit M at 3.1, 4).

Q. Is this Agreement intended to be binding upon Qwest Corporation ("QC"), the entity regulated by the Commission?

A. Yes. Qwest Corporation is listed as one of the "Qwest Parties" in the preamble of Exhibit M that are subject to the restrictions precluding in-region publishing of listings and advertising. However, even though QC surrenders its right to publish white and yellow pages directories in Arizona and other local exchange areas it served for 40 years, Qwest Corporation is not the owner or seller of Dex and will not receive any of the proceeds from the sale of Dex. The Noncompetition Agreement recognizes and eliminates the risk to the Buyer that QC might choose to re-enter the directory publishing business as a formidable competitor because of the many advantages enjoyed by RBOC official directory publishers.

Q. Has provision also been made within the commercial agreements between Buyer and Seller for a continuation of billing and collection services by QC, for the benefit of the new owner of Dex?

A. Yes. A new Billing and Collection Services Agreement allows the Buyer to receive billing and collection services from Qwest Corporation, services not received by any other directory publisher. The linkage between the telephone company and the Dex business is reinforced by providing many Dex advertising customers with a combined bill that also reflects the customer's Qwest Corporation telephone service charges. Creation of the combined end-user bill creates an accounts receivable balance for advertising as well as telecommunications services.[29]

Q. Will Dex continue to be the supplier of directories for QC payphones throughout Arizona and the other states served by QC?

A. Yes. A new Public Pay Stations Agreement provides for the continued placement of Dex directories within Qwest Corporation's payphones. (Exhibit I)

Q. You previously mentioned the extraordinary profitability and cash flow realized by RBOC-affiliate directory publishers like Dex. Will the Buyer of the Dex business receive and employ the human resources, automated systems, customer information and management personnel required to maintain business continuity and profitability?

A. Yes. Under the Rodney Purchase Agreement and the related Exhibit B Contribution Agreement, all of the existing tangible and intangible assets, allocated employees, designated management personnel and customer data of Dex that is related to the Rodney business will be transferred and sold to the Buyers. Thus, the Buyer receives the full going concern business at closing and is assured of no diminution of that value because of the protections built into the various other commercial agreements described above.

Q. After the Rodney Purchase Agreement and all of the incorporated commercial agreements are made effective, will the resulting complete and permanent

29 Qwest Corporation has also agreed to (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) to the confidential Agreement for the Provision of Billing and Collection Services, identified as Exhibit G to the Rodney Sale Agreement.

liquidation of the Dex directory publishing business preclude any future consideration by the Commission of changes in the value of fees and services associated with the directory publishing business?

A. Yes. QCI is left with only cash proceeds until applied to debt repayment, and with no further opportunity to publish directories on its own behalf. The operational and financial details of directory publishing within Arizona will no longer be accessible through an affiliated Qwest entity.

Risks to Customers Created by the Sale of Dex

Q. What are the risks to customers and regulatory issues that are created by the pending Dex sale?

A. The sale of Dex creates substantial new risks and issues to be addressed by the Commission:

- The liquidation of the directory business terminates the 1988 Settlement Agreement that historically governed the affiliate relationship between QC and Dex, creating uncertainty about how directory imputation is to be quantified or adjusted in the future.

- The sale of Dex to a non-affiliated Buyer will cause regulators to lose access to directory publishing financial and operational information that is needed to evaluate the value of fees and services for consideration within telephone company financial reporting and to determine revenue requirements.

- Sale of the Dex income stream also substantially reduces the long-term ability of the Qwest consolidated businesses to generate cash flow from operations needed to service debt and attract capital on reasonable terms.

- Sale of Dex provides a market valuation for the directory publishing regulatory asset and a corresponding gain on sale that must be attributed either to shareholders or ratepayers. Qwest's witnesses suggest that none of the gain should be attributed to telephone customers.

- Sale of Dex will cause the actual production and distribution of directories to be performed by a non-affiliated entity for the first time in Company history. The sale potentially reduces th: Commission's ability to regulate Qwest's directory publishing obligation to customers.

- Sale of Dex will likely increase corporate shared costs to be borne by QC.

Q. Please explain the risks created when the directory business is no longer available for imputation in any future proceedings in which the Commission may be concerned with Qwest's Arizona intrastate earnings and financial condition?

A. The future earnings and cash flows of Dex are being sold by Qwest to improve liquidity and satisfy the near-term demands of creditors. As a result, there will not be any affiliate publisher directory revenues to impute and no corporate accounting information from which to determine the value of fees and services from the Dex business that continues to operate in Arizona under new ownership. The sale of the income stream and the absence of Dex financial data creates risk that future imputation will be impossible to quantify or justify with factual data. For the first time in the Company's history, Dex is the subject of a true sales transaction that will permanently transfer all of the tangible property, employees, customers and specific intangible assets that are required to install the buyer as official publisher for the next 50 years.

Q. Is the financial condition of Qwest Corporation and its parent QCI of vital importance to the Commission, even if price cap regulation continues in Arizona?

A. Yes. The Company must continue to have access to capital on reasonable terms to provide high quality regulated services. A major segment of Qwest's business that has been extremely profitable for many years is being liquidated to satisfy creditors' demands over the next few years. However, by the Company's own consolidated projections of cash flows with the complete sale of Dex within this year, the ability to (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL).[30] In a very real sense, the sale of Dex appears to be a corporate survival tactic that compromises the long-term strength of the business in an attempt to increase liquidity and meet near-term debt repayment obligations. Qwest's significant financial problems were not caused by financial failures within the regulated business, yet a source of financial support to the regulated business is being liquidated in an effort to remedy Qwest's liquidity crisis.

Q. Do you agree with the testimony of Qwest witness Mr. Brian Johnson that the sale of Dex is important to the continued financial viability of QC and the parent company QCI?[31]

A. Yes. Mr. Johnson and Mr. Cummings describe in some detail the deterioration in Qwest's consolidated financial performance, credit rating downgrades to junk status, accounting investigations and Qwest's resulting liquidity crisis. While it may have been possible for Qwest to sell assets or business segments other than Dex, issue new securities at extremely high cost or reorganize the business through a merger, the sale of Dex was an attractive option for several reasons. Dex is an attractive business segment to sell because of its enviable market position, robust cash flows and financial strength and will therefore yield cash proceeds upon sale that are

30 See Highly Confidential financial projections in STF 2-115S1.
31 Brian G. Johnson Direct Testimony, page 13.

large enough to measurably improve Qwest's financial condition by reducing debt leverage. Notably, the Dex sale is larger, but similar to other directory sale transactions recently announced by Sprint, McLeod USA and Bell Canada to improve liquidity and access to capital markets.[32]

Q. Should the financial viability of Qwest and the desire of QCI to de-lever its balance sheet prevent the Commission from considering the interests of ratepayers in the Dex business and the proper distribution of the gain being realized from the sale?

A. No. In my opinion the interests of ratepayers in the Dex business are not subordinate to the interests of shareholders in preserving the gain and cash proceeds for corporate purposes. A reasonable attribution of the gain to Arizona customers is necessary to secure increased imputation levels (or an economic substitute for such imputation) and ensure that the sale of Dex is consistent with the public interest. It remains possible that Qwest will not survive its liquidity crisis even with the sale of Dex. If a Qwest bankruptcy eventually occurs, there may then be less of an opportunity to be sure that customers' interests in the Dex business are safeguarded.

Q. Does the Rodney Agreement explicitly recognize and provide for regulatory impacts that may be imposed by this Commission and by other state commissions?

A. Yes. At paragraph 5.4(b)(ii), the Rodney Agreement allows Qwest to not close the Rodney phase of the Dex sale in the event regulatory conditions imposed by states, including net revenue reductions or mandated incremental capital expenditures,

32 Sprint agreed to sell its directory business to R.H. Donnelley Corp for $2.23 billion in cash, as announced in September 2002. McLeodUSA Publishing was sold to U.K.-based Yell Group for $600 million in a deal announced in January 2002. The Bell Canada Directories business was sold for $3 billion in cash (Canadian) to KKR and the Teachers' Merchant Bank in a deal announced in September 2002.

become large enough to qualify as a "material regulatory impact" or "MRI". A separate "confidential letter of understanding" defines the MRI threshold to be (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL).[33] Thus, Qwest can terminate its obligations under the Rodney agreement if net economic losses from regulatory conditions reach this threshold value. Qwest's confidential Seller's Disclosure Schedule at Section 3.4 identifies (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL).

Q. Has Qwest assumed any MRI reduction will occur within its financial projections contained in the highly confidential response to STF 2-115S1?

A. (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) to the cash proceeds from the Rodney transaction are assumed in the year 2003, when Rodney is projected to close. In addition, the projections also appear to assume (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) to the Buyers pursuant to the Rodney Agreement.[34] Thus, the cash proceeds ultimately available to the Company for debt repayment are uncertain, depending upon the magnitude of regulatory demands on behalf of ratepayers as well as the extent to which Qwest contributes seller financing to the transaction.

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33 See MRI Side Letter captioned, "Confidential Letter of Understanding".

34 In its response to Data Request STF 2-114, the Company stated, "The Buyer has orally informed Qwest that it will need up to $117 million of equity in addition to amounts committed by others in the Rodney Equity Financing Commitment Letter. Qwest has the option of funding that equity to ensure closure of the transaction. However, Qwest expects that the buyer will cover that amount itself or will arrange for other third parties to cover it…At this point, it is too early to speculate on a final result. Decisions relating to whether Qwest will ultimately

Q. Please explain how the sale of Dex can be expected to increase corporate shared costs to be borne by QC.

A. Qwest incurs certain corporate overhead costs related to its corporate executive management, finance and accounting, treasury, human resources, marketing and other centralized administrative functions. These costs have historically been pooled and assigned or allocated across the various Qwest subsidiary operations, including QC and Dex, with Dex receiving a substantial portion of such charges.[35] Upon sale of Dex, for a limited transition period of 18 months after closing, some of these centralized corporation service functions will be provided to the Buyer pursuant to a Transitional Services Contract.[36] However, this contract may not fully offset the additional cost burden upon QC when Dex is no longer a corporate affiliate receiving a full allocated share of corporate administrative overhead costs. After the 18-month term of the Transition Services Agreement, corporate shared costs that cannot be reduced after Dex is sold will necessarily be absorbed by allocation across the remaining affiliates including QC's regulated business. In an effort to evaluate this concern, Staff submitted Data Request STF 2-83 asking for "a calculation of the expected annual impact upon Qwest Corporation's Arizona-intrastate charges from affiliates as a direct result of Qwest Dex being sold and no longer receiving its allocated share of such affiliate charges", to which the Company replied, "Qwest has not prepared the requested calculation. Preparation of the requested information would require a special study".

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contribute any equity will be made as the Rodney closing nears in 2003."

35 According to Qwest's confidential response to Data Request STF 2-82, Attachment A, Qwest Services Corporation headquarters cost allocations to Dex have ranged from (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) million in the years 1999, 2000 and 2001, information technologies affiliate charges were more than (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) million in 2001, and significant other legal, property administration and other affiliate charges were attributed to Dex.

Beyond the effect of more narrowly allocated shared corporate costs, another cost increase to be imposed by the sale of Dex relates to the commitment by the Qwest parties to purchase on a take or pay basis at least (START CONFIDENTIAL) $[redacted] (END CONFIDENTIAL) per year in directory advertising from Dex for each of the next 15 years after the sale.[37]

Recommended Conditions Upon Approval

Q. What is your recommendation regarding the Dex transaction in Arizona?

A. If not for the acute financial condition of Qwest and the possibility that selling Dex may allow the Company to survive its financial crisis, I would recommend that the Commission reject the sale of the directory publishing business. However, given the present economic circumstances of Qwest as well as the risks created by the transaction, I recommend approval of the Dex sale, subject to imposition of the following specific conditions by the Commission:

1) The 1988 Settlement Agreement should be found not applicable to ongoing transactions with the Buyer of Dex. In place of the fixed, $43 million imputation in that Settlement, the Arizona share of the gain should be used to provide for an updated annual revenue credit in lieu of imputation. If price cap regulation is continued in Arizona, a condition of sale approval should be an annual credit of $100 million of directory revenues to telephone company operations in all future financial reporting, earnings investigations and other filings prepared for submission to the Commission in all future periods. Alternatively, if price cap regulation is terminated and traditional regulation is resumed, an annual credit of $121.3 million should be ordered for each of the next 20 years.

2) In the event the $43 million imputation is not increased in accordance with recommendation 1, above, the remaining Arizona share of the gain after accounting for the ongoing $43 million imputation, should

36 Exhibit K to the Rodney/Dexter Agreements is a Transition Services Agreement.

37 This is referred to as the "Annual Ad Commitment" in Exhibit A to the Rodney Agreement.

be flowed to QC's Arizona customers on a one-time basis, through a customer bill credit. If the recommended updated imputation value in item (1) is approved, no customer bill credits will be necessary. However, if annual imputation is retained at the $43 million annual level and price cap regulation continues, the bill credit amount set forth in Exhibit MLB-1 at line 26 of $593 million would be required to fully credit customers for the Arizona share of the value of fees and services being realized by Qwest. The comparable value under future traditional regulation is $671.5 million.

3) In the event the Commission determines that specific network investment commitments or desirable service quality improvement programs that require financial commitments by QC would not otherwise occur, these initiatives could be funded with a portion of the remaining Arizona share identified in item 2, above. Any dedication of ratepayer funds in this manner should be subject to rigorous reporting and regulatory monitoring with administration through discrete regulatory liability accounts on QC books.

4) Informational disclosures within the Arizona directories of Dex should be expanded to include Spanish and English language tariff information, consistent with correspondence between the Commission and the QC President of Arizona operations dated December 19, 2002.

These measures will ensure that Arizona customers are not adversely impacted by ceasing imputation and raising future rates, while also ensuring that the Arizona portion of the economic value of the Dex business enterprise is attributed to customers, rather than shareholders. Since most of the Arizona share of the Dex gain on sale proceeds would be retained by Qwest to fund the increased imputation liability to customers under Staff's primary recommendation, the vast majority of cash is immediately available to reduce corporate debt. The amounts set forth in the Staff's recommendations are explained in the following section of testimony.

Gain on Sale Allocation to Arizona

Q. Was the Company asked to provide a calculation of the gain on sale anticipated to be realized from the Dex sale transaction?

A. Yes. Data Request STF 2-68 requested information about the book and tax basis of the business interest to be sold and detailed calculations of the estimated book and tax gain on sale to be realized by QCI as a result of each (Dexter/Rodney) transaction, with supporting workpaper calculations, assumptions and underlying source documents. The Company provided a narrative response stating:

> An accurate estimation of the book and tax basis for the Dex business interest to be sold and the final sales price remains impracticable at this time. However, Qwest has now prepared a preliminary estimate of the gain on the sale of Dex and a computation of the portion of that estimated gain related to Arizona. Qwest's preliminary estimate is provided in Confidential Attachment "A".
>
> The gain estimate assumes a sales price of $7.05 billion. The actual sales price will not be known until after computation of the Post-closing Working Capital Purchase Price Adjustment set out in Paragraph 2.9 of the Rodney Purchase Agreement and the Buyer's and Seller's agreement on that adjustment.
>
> This preliminary gain calculation relies on estimates of net book value and transaction costs. Neither the actual net book value at closing nor the actual transaction costs will be known until after closing.

I utilize the Company's estimated gain calculation on confidential "Attachment A" from this response as the starting point for information set forth in my Confidential Exhibit MLB-1 and have included each step of the Company's estimated Arizona gain calculation (column B) for comparison to the Staff's recommended calculations (column C). In this way, each disagreement or potential issue regarding the gain calculation and allocation to Arizona is highlighted for consideration by the Commission.

Q. Did Qwest provide each of the estimated values shown at lines 1 through 4 of Confidential Exhibit MLB-1 in its response to Data Request STF 2-68?

A. Yes. The sale price of $7.05 billion is the combined Dexter and Rodney price according to the Purchase Agreements, assuming no working capital adjustments are ultimately applied to this value. The (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) is approximately equal to the total assets of Dex Holdings as of December 31, 2001 and contains mostly current assets that will be subject to the purchase price true-up provisions referenced ab /e.[38] The "transaction costs" subtracted from sale proceeds at line 3 include estimates of the total fees payable to investment bankers, legal and other advisory personnel involved in the transaction.[39] As noted in Confidential Exhibit MLB-1, Staff has not challenged any of the Company's estimates regarding purchase price, contributed assets or transaction costs.

Q. Is the $7.05 billion purchase price negotiated between the Buyer and QCI representative of full, fair market value for the Dex business?

A. The increasingly urgent financial difficulties facing Qwest were widely known at the time the Company was soliciting interest in the purchase of the Dex business. In addition, the large size of the business and the Company's need for cash consideration tended to limit the number of potential buyers in a position to finance such a transaction. These factors detracted from Qwest's ability to get top dollar for Dex and (START CONFIDENTIAL) [redacted]

38 The Company's confidential response to Data Request STF 2-55, Attachment B, provided restated financial statements for Qwest Dex Holdings, Inc. indicating total assets of (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) at 12/31/2001.

39 In response to Data Request STF 2-60, the Company itemized actual transaction costs payable through September 30, 2002 that totaled $3.7 million. However, large amounts payable pursuant to engagement letters with Lehman Brothers and Merrill Lynch are not due until closing.

[redacted] (END CONFIDENTIAL).[40] In the "fairness opinions" prepared for Qwest by Merrill, Lynch and Lehman Brothers, the $7.05 billion negotiated price for Dex is near (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL)[41]. From this information, it is reasonable to conclude that the negotiated purchase price for the Dex business is just barely adequate to be considered fair to Qwest's shareholders and customers. Nevertheless, to be conservative in my recommended ratemaking conditions for approval of the transaction, I have not contested or adjusted the $7.05 billion purchase price.

Q. At line 5 of Confidential Exhibit MLB-1, you have reduced the Dex sale proceeds by almost (START CONFIDENTIAL) [redacted] billion (END CONFIDENTIAL) for income taxes at a 39.53 percent composite tax rate. Will QCI pay any income taxes on the Dex sale gain it experiences?

A. Probably not. As mentioned in my earlier testimony, QCI has accumulated large net operating loss ("NOL") carryforward balances for income tax purposes. In addition, the [redacted] was included by Qwest in the assets being acquired by the purchaser for the apparent purpose of reducing income taxes otherwise payable on the transaction.[42] However, because the sources of negative consolidated taxable income in past years giving rise to the NOLs and the tax circumstances of the LCI

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40 ~~28~~ Confidential response to Data Request STF 2-58, Attachment A, page 7, (START CONFIDENTIAL), [redacted] (END CONFIDENTIAL).

41 Confidential response to Data Request STF 2-58, Attachment C, Lehman Brothers at page 13 and Attachment E, Merrill Lynch at page 14.

42 Refer to footnote number 12 and the response to Data Request STF 2-118 indicating Qwest's consolidated Federal NOL position at $5.82 billion as of 12/31/2001.

entity are not related to the business operations of either the QC regulated telephone business or Dex, I have attributed Qwest's shelter from income taxes on the gain entirely to shareholders. There is no denying that the sale of Dex creates an opportunity for Qwest to realize these tax benefits as additional cash flow via tax savings, so shareholders are clearly advantaged by my regulatory calculations that attribute full statutory income tax rates to the Dex gain, even though such income taxes will not be payable by the seller. According to the Company's response to Data Request STF 2-118, "The Company has not finally determined what net operating losses, if any, will be used to offset any taxable gain resulting from the Dex sale. The Company has not computed its consolidated taxable income or loss for the tax year ending December 31, 2002."

Q. Please explain the purpose for Lines 7 through 13 of Confidential Exhibit MLB-1.

A. These lines disclose four allocations proposed by Qwest that would reduce the Dex sale transaction and resulting gain to be attributed to the portion of the directory publishing business that has historically been subject to regulatory jurisdiction or imputation. Specifically, the Company's confidential preliminary gain calculation that was provided in response to Data Request STF 2-68 carves out portions of the sale price and resulting gain for attribution to (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL). For each of these portions of the Dex sale, the Company would attribute the realized Dex sale gain to shareholders, rather than to the basic printed directory business that has been recognized in imputation calculations.

Q. Does the LCI business have anything to do with directory publishing or Dex?

A. Aside from common ownership by Qwest, LCI has nothing to do with Dex or directory publishing. According to the response to Data Request STF 2-117, "LCI International owns a limited partnership interest in Qwest N. Limited Partnership. Qwest N. Limited Partnership leases telecommunications equipment to Qwest Communications Corporation", which is the long distance and data networking subsidiary of QCI. Because it is unrelated to Dex and appears to have been bundled into the Dex sale transaction at Qwest's request to realize certain income tax advantages available to Qwest,[43] I agree with the Company that the sale proceeds and gain amounts attributed to LCI should be excluded from my calculations on Confidential Exhibit MLB-1. However, as noted in Confidential Exhibit MLB-1, (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) Therefore, LCI is not at issue in allocation of the Dex gain.

Q. The next allocation of Dex sale proceeds and gain shown on Confidential Exhibit MLB-1 at line 9 is for an "Allocation to New Ventures". What is "New Ventures" and why is it excluded in allocating the Dex sale gain to the Arizona jurisdiction?

A. As implied by the label, New Ventures is the portion of Dex that engages in non-traditional businesses such as internet directories, direct marketing services and other activities beyond directory publishing. Historically, these activities were not included within the core directory publishing division of Dex and were not included in calculation of imputation by regulators. Therefore, I concur with Qwest's calculation

43 In response to Data Request STF 3-132, the Company stated, "The LCI business was included in the Dex sale to maximize the net proceeds received by Qwest."

of the percentage of the estimated gain on sale of Dex that should be attributed to the New Ventures business. This percentage was based upon the relative revenues of the New Ventures activities to total Dex revenues and is likely to overstate the portion of Dex gain properly attributed to New Ventures because these non-traditional "ventures" are likely to be less profitable than the established publishing business. However, to be conservative in Staff's calculations in Confidential Exhibit MLB-1 and to reduce the number of issues in this proceeding, I accept the Company's revenue-based allocation to New Ventures at line 9.

Q. So far, in describing the line items in the Confidential Exhibit MLB-1 gain allocation schedule, nothing has appeared in the "Difference At Issue" in column D. However, when we get to the "Allocation to Secondary Directories" at line 10, you have completely rejected the Company's treatment. What are secondary directories?

A. Secondary directories are discretionary additional phone books produced by Dex within the QC territory to earn additional advertising revenues. Typically, they include regional and specialized directories, such as the "On The Go" directories for use with cellular telephones and in automobiles. In Arizona, the Dex secondary directories include the Scottsdale, Greater Northwest Valley, Greater Southwest Valley, East Valley, Mohave County, Phoenix On-the-Go and several Tucson regional directories, which are additional books marketed to advertising customers by addressing the value the advertiser receives, considering the circulation of the directories, the scope of the directories and the quality of the directories.[44]

44 See Qwest's responses to Data Request STF 2-122S2 and STF 3-140.

Q. What is your understanding of the Company's rationale to allocate some of the gain on the Dex sale to its shareholders, rather than to Arizona customers, because of the secondary directories that are published by Dex?

A. According to the response to Data Request STF 3-128, "Secondary directories are published at Dex's discretion in order to compete more effectively in the advertising market and maximize advertising sales by providing directories that allow advertisers to focus their advertising message to a specific geographic scope which best represents their customer base." Additional reasoning for the Company's position is stated in Qwest's evidence in the Dex sale Docket that was recently concluded in Utah:

> Secondary directories were not published in all the years that the directory operations were part of the regulated Mountain Bell operations. While one could speculate that they might have eventually developed had the transfer never occurred, the facts are that no Secondary directories were published when directory publishing was part of the Utah regulated operations. Secondary directories are not tied to QC's regulatory obligation to provide Primary directories.[45]

Q. Should secondary directories be excluded in allocating the Dex gain on sale to Arizona?

A. No. Secondary directories represent additional products through which the directory publisher can prudently maximize revenues and profits, by scoping and publishing additional directories in targeted markets that do not conform strictly to telephone exchange areas. This is not a new or particularly innovative practice and is not unique to Dex. Prudent management is reasonably expected to seek growth opportunities in new markets and leverage recognized brand names like Qwest and U S West. Indeed, if the telephone company had remained in the directory

45 Rebuttal Testimony of Ann Koehler-Christensen, filed on February 17, 2003 in PSCU Docket No. 02-049-

publishing business after 1983, nothing would have precluded adding secondary book publications to maximize revenues, so as to reduce the net cost of providing telephone service. There is no reasonable basis to arbitrarily constrain the directory operations subject to imputation to only those primary directories said to be required under affiliate publishing agreements, because the value of service transactions between the telephone company and the affiliate publisher are only fully captured when all profitable directory publishing opportunities are exploited.

Q. Has Dex incurred any significant costs or investment risks associated with publishing secondary books?

A. No. The Dex business has consistently positive and growing income and revenues over the past decade and there is no evidence that significant risks or costs associated with the addition of Secondary Directories has been a burden to shareholders.

Q. What is the nature of the dispute involving "non-Qwest listings", the issue appearing at line 11 of Confidential Exhibit MLB-1?

A. The Company seeks to retain a significant additional share of the gain to be realized upon the sale of Dex because its primary printed directories contain some listings that are not QC telephone company customers. Qwest proposes to carve out part of its directory revenues (and an equivalent share of the Dex sale gain) based upon the percentage of listings contained within its primary directories that are not Qwest telephone subscribers. For example, if the white pages listings in Phoenix are determined to contain 90 percent QC customers and 10 percent customers who are served by competitive or independent local exchange carriers, the Company would

76, page 7.

attribute 10 percent of yellow pages advertising revenues (and the resulting Dex gain) to its shareholders. This proposed carve out, like Qwest's treatment of secondary directories, appears related to the Company's theory that imputation has been ordered only because the listings of telephone company subscribers appear within Qwest directories.

Q. Has imputation been required by regulators solely because of the inclusion of the telephone company's listings within the published directories?

A. No. There are many linkages between the telephone company and the directory publishing operation, only one of which is the listing linkage. My earlier testimony explained the many bases for imputation.

Q. Were non-Qwest listings included within the directories that were published by Mountain Bell, prior to transfer of directory assets into the publishing affiliate in 1984?

A. Yes.[46]

Q. Does Dex seek to include the listings of CLECs and independent telephone companies in its directories, without regard to any obligations that may require such inclusion?

A. Yes. Directory customers receive more "value" for their paid advertising in a more comprehensive directory that includes all relevant listings within a market area and that is distributed to more customers. Thus, it is simply good business to publish the most complete possible directories and in doing so Dex management is simply doing its job. Dex delivers its directories to every address located within the

46 Id. Page 8.

geographic scope of each of its directories and the advertising is targeted to all customers in the area, without regard to which CLEC or ILEC provides telephone service to the customer. Qwest should not be allowed to inject arbitrary criteria into the allocation of the Dex sale gain, based upon the inclusion of non-Qwest listings or the discretionary publication of secondary directories, when the decisions to expand the scope of directories in these ways is simply reflective of prudent, profit-maximizing behavior.

Q. Has Dex absorbed any added costs or risks in order to publish secondary directories or to include non-Qwest listings in its directories?

A. No. It is my understanding that Dex revenues and profits have consistently grown throughout the years when the scope of published directories expanded to include additional secondary directories and non-Qwest listings. Therefore, Dex has not absorbed any additional costs or assumed any uncompensated risks by producing secondary directories or more complete primary directories that contain the customer listings of QC, CLECs and ILECs that provide telephone services within Dex directory market areas. In fact, in its response to Data Request STF 2-124S1, the Company stated, "Dex believes that putting its directories in the hands of as many users as possible enhances the value of its directories." As in the case of discretionary Secondary directories, the inclusion of non-Qwest listings is valuable to Dex in the production of more complete directories that are more attractive to advertising customers. This sort of strategic planning that is sensitive to customer needs is to be expected of management and, in my opinion, does not justify carving out a large share of the Dex sale gain for retention by shareholders.

Q. What is the overall impact upon the Dex sale gain of the Company's proposed carve-out allocations to secondary directories and non-Qwest listings within primary directories published by Dex?

A. At line 12 of Confidential Exhibit MLB-1, the cumulative difference in allocations indicates that Qwest's new proposals regarding secondary directories and non-Qwest listings would improperly remove approximately (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) of the Dex sale gain for retention by shareholders. Across the 14-state QC service territory, this treatment would reduce the gain potentially attributable to customers by more than (START CONFIDENTIAL) [redacted] (END CONFIDENTIAL) on a post-tax basis, as shown at line 13 in column D.

Q. Why is the Arizona percentage allocation proposed by Staff at line 15 of Confidential Exhibit MLB-1 different than the percentage proposed by Qwest in its response to Data Request STF 2-68?

A. The Company's proposed Arizona allocation percentage is based upon the ratio of Arizona directory revenues to total Dex directory revenues, <u>excluding secondary directories and non-Qwest listings</u>. However, since Staff opposes Qwest's exclusion of secondary directories and non-Qwest listings within primary directories, the Arizona allocation percentage must be recalculated to maintain consistency using revenues from all directories. A relatively higher share of Dex secondary directory revenues are earned in Arizona than in other states, so Staff's inclusion of secondary directory revenues in calculating the allocation factor tends to increase the Arizona share of overall Dex revenues. If the Commission agrees with the Company's proposed carve out of secondary directories and non-Qwest listings, the lower Arizona percentage calculated by Qwest and shown in column B should be employed to maintain consistency.

Q. What is shown at line 16 of Confidential Exhibit MLB-1?

A. Line 16 shows the Arizona share of the anticipated Qwest Dex after-tax gain on sale, under the Company's allocation approach in column B, and as proposed by Staff in column C. Because these amounts are net of accrued income taxes (from line 5) it is necessary to factor-up to a pretax equivalent value for comparison to imputation revenues. This factor-up appears at lines 17 and 18.

Q. Is the amount shown at line 18 the total Dex pretax gain on sale amount properly attributed to the Arizona jurisdiction?

A. Yes. This is the amount available, pursuant to the negotiated terms of the Dex sale transaction and after the allocations just described, to fund annual revenue credits in lieu of imputation or other forms of benefit to Arizona customers.

Q. At line 19, you show the amount of imputation ordered by the Commission in the last settled Arizona rate case. Does this amount represent an ongoing customer benefit that is embedded within current rates and revenues that was derived pursuant to the 1988 Settlement Agreement?

A. Yes.

Q. Has the Company proposed the ultimate removal or adjustment of the embedded imputation amount?

A. No. The Company appears to support continued application of the 1988 Settlement Agreement after Dex is sold, even though that Agreement cannot reasonably be applied to the new transaction or to a non-affiliate publishing arrangement. According to Company witness Arnold, "Finally, the 1988 Settlement Agreement ensures that this transaction will not impact QC rates, and provides for continued imputation to the benefit of ratepayers."[47] This testimony seems to imply that Qwest supports imputation in the annual amount of $43 million, but the Company makes no firm or permanent commitment to not challenge future imputation in future regulatory proceedings. As noted in my earlier testimony, Qwest proposed reducing imputation to zero in its most recent Arizona rate filing under its interpretation of the 1988 Settlement Agreement at that time.

Q. Does the pending sale of Dex provide an opportunity to resolve directory imputation issues with some finality?

A. Yes. The sale of Dex provides a liquidating gain on sale value for the directory publishing business as well as an extraordinarily large cash payment for consideration by regulators. In my opinion, the Arizona customers of QC are entitled to the pretax value shown at line 18 of Confidential Exhibit MLB-1 as of the date of closing the Rodney transaction. Fortunately, the extraordinarily large cash value for Dex that is being realized in the sale, in spite of the lower sale price caused by QCI's financial predicament, is sufficient to fund: 1) substantially increased annual imputation to replace the insufficient amounts under the 1988 Settlement Agreement, **or** 2) continuation of present imputation at $43 million per year with a substantial immediate credit to customers to mitigate the risks arising from the transaction. Staff recommends the first alternative, in order to correct and update the obsolete customer credits within the 1988 Settlement Agreement while also preserving more cash flow for QCI debt repayment.

47 Direct Testimony of Maureen Arnold, page 20.

Q. Referring to Confidential Exhibit MLB-1, how did you calculate the increased annual credits to Arizona customers equal to the $100 million per year in place of embedded imputation, as shown at line 20?

A. The proposed "Perpetual Revenue Credits for Price Regulation" represents the annual value of a perpetuity based upon the Arizona pretax gain amount on line 18. The discount rate used in this calculation is the 9.61 percent fair rate of return stipulated by Staff and USWC and approved by the Commission in USWC Docket No. T-1051B-99-105. I recommend that the Arizona share of the gain be attributed to customers through this perpetual benefit if price cap regulation is continued, as updated compensation for the value of services being transferred pursuant to the new Publishing Agreement and Noncompetition Agreement between Qwest and the Buyer of Dex.

Q. Why is it appropriate to use a perpetual revenue credit if price cap regulation is continued?

A. Under price cap regulation, rate cases are not required and therefore, there is no periodic opportunity to change or remove the amount of directory-related revenue credits. The revenue credit to be employed in the Commission's review of the initial price cap plan should be a perpetual amount to reflect the permanence of revenue changes that may be ordered in that review. Under this perpetuity calculation, ratepayers would forever receive this revenue benefit, while shareholders retain the underlying gain value principal amount.

Q. Is a different annual revenue credit amount more appropriate if Arizona price cap regulation is discontinued upon review by the Commission?

A. Yes. At line 21 of Exhibit MLB-1, I provide a larger annual revenue credit amount of $121.3 million based upon a traditional 20-year amortization of the Arizona share of the Dex gain. This amount is larger because of the scheduled 20-year period, rather than a perpetual credit, and because the principal amount of the gain is distributed to customers to fully reflect the value of fees and services between the Buyer and seller of Dex.

Q. Why is a 20-year period appropriate for amortization of the Dex gain under traditional regulation?

A. It is difficult to predict how telecommunications services may be provided or regulated in the distant future. It is probable that continuing public policy initiatives and technological changes will eventually succeed at substituting competition for regulation of such services within the next 20 years. However, in an abundance of caution, I elected to secure customer revenue credits for this entire period. In any traditional rate case test period calculations of revenue requirement that might occur after the year 2023, the annual revenue credits would cease and rate increases may be required for other service.

Q. What is shown on page 2 of Exhibit MLB-1?

A. Calculations are presented on page 2 to determine the net present value of annual revenue credits of $43 million and of $121.3 million over the 20 year period. These amounts are then carried forward to page 1, line 23, to indicate how the present value of these credits compares to the Arizona share of the Dex gain at line 18.

Q. In the event the Commission agrees with Qwest that annual imputation should not be increased above the $43 million in the 1988 Settlement Agreement, is there is a residual amount available for a one-time crediting to Arizona ratepayers?

A. Yes. The present value of the $43 million annual imputation value is much lower than the value of fees and services being derived upon sale of Dex. The residual gain amount should be credited to Arizona customers.

Q. What amount of one-time credit to Arizona ratepayers should be ordered as a condition of Dex sale approval in this Docket, if the embedded amount of imputation is not increased?

A. Lines 23 and 24 of Confidential Exhibit MLB-1, in Column B, reflect the present value of Continued Embedded Imputation using the same 9.61% discount rate, assuming a 20-year period and assuming a perpetuity, respectively. After subtracting these present value amounts associated with continued $43 million annual imputation on these lines from the Pretax Arizona Value at line 18, a large "Residual Value Not Used for Imputation Credits" remains at lines 25 and 26 in amounts ranging from $593 to $671 million.

Q. What should be ordered by the Commission with respect to these Residual Values?

A. At least $593 million of the Dex sale proceeds should to be credited to Arizona customers on a one-time basis, as a bill credit after the Rodney transaction is closed, if Staff's primary recommendation to increase annual imputation from $43 million to $100 million (under price cap regulation) is not approved. This recommendation presumes perpetual revenue credits of $43 million for ratemaking purposes, which is the assumption most compatible with existing price cap regulation.

Q. Why is a one-time credit to QC Arizona customers for the residual Dex sale Arizona gain amount appropriate?

A. Staff's primary recommendation is to adjust and update the ongoing imputation value to compensatory levels and not impose large cash credits to flow the Arizona share of the Dex gain to customers. However, as explained in my earlier testimony, the Dex directory publishing business represents an affiliate enterprise that derives considerable value from the official publisher linkages into the telephone company. The sale of Dex is an extraordinary event that yields a gain to be attributed to customers. The Arizona share of this gain should first be used to adjust and update embedded imputation, with any residual gain above this amount flowed to customers as a one-time credit so as to reflect the value of fees and services flowing to Qwest upon sale of Dex.

Q. Is the percentage of Dex proceeds that you propose for credits to customers a relatively minor portion of the overall anticipated Dex proceeds on sale?

A. Yes. Staff's primary recommendation is to modify and increase embedded imputation by either $57 or $78 million per year. These values represent less than 1.2 percent of total Dex sale proceeds in each future year. If imputation is not adjusted, the Residual Value on line 26 represents about 8.4 percent of the gross proceeds.

Q. Should the Commission be discouraged from either increasing imputation or imposing a one-time $593 or $671.5 million customer credit in Arizona because the amount represents a large percentage of annual revenues earned by QC in the State?

A. No. QCI will realize the large gain from the sale of Dex within its income statement, but will not be recording a reasonable share of this gain within the Arizona QC income statement. If the Arizona share of the Dex gain were credited into the Arizona books, the gain would more than offset an accounting accrual for the customer credits being proposed by Staff. The residual customer credit is proposed by Staff as a secondary recommendation and should be thought of as funded by the parent entity that is realizing the large gain on sale associated with liquidation of Dex.

Q. Will the imposition of either increased imputation or a one-time customer credit in Arizona, combined with reasonably expected regulatory impacts from the Utah and the Washington Commissions, where the Dex sale transaction is also under consideration, cause QCI to fail in its efforts to de-lever its balance sheet and improve its credit ratings?

A. The Utah Commission has ordered one-time customers credits of $22 million and continued annual imputation at amounts currently embedded in rates, pursuant to a Stipulated Agreement among parties to the Dex sale proceedings. It is difficult to predict the regulatory outcome in Washington that may involve customer credits from the Dex gain on sale, but if one assumes a regulatory response in that state that is proportionate to my recommendation in Arizona, the majority of the Dex gain on sale and cash proceeds will be retained for shareholders and will be available to the Company to reduce outstanding debt.[48]

48 In the Company's highly confidential financial projections provided in response to Data Request STF 2-115S1, the Rodney proceeds were (START HIGHLY CONFIDENTIAL) [redacted] (END HIGHLY CONFIDENTIAL). Paragraph 2.5 of the Rodney Agreement that provides for the payment of up to $300 million of the purchase price at closing by Buyer tendering "Buyer Securities" in lieu of cash. Even with these (START HIGHLY CONFIDENTIAL) [redacted]

Q. How should the increased revenue credit values to replace imputation under Staff's primary recommendation be considered by the Commission?

A. The Company's existing Price Cap Plan is nearing completion of its initial term. A filing is required to evaluate performance under the plan nine months prior to the third anniversary of the Plan. Increased revenue credit values can be considered in evaluating earnings experienced by the Company under price cap regulation and any appropriate adjustments to rates and revenues can be considered as part of any Commission renewal or modification of the Price Cap Plan.

Rebuttal to Qwest Witnesses

Q. At page 11 of her testimony, Ms. Arnold states, "First, this transaction will not result in increased capital costs to QC." Has the Company made any showing of how its future cost of capital attributable to the regulated operations of QC will be impacted by the sale of Dex?

A. No. Ms. Arnold refers to Mr. Cummings' testimony in support of this conclusion. However, Mr. Cummings' testimony indicates only that the sale of Dex has favorably impacted the QCI stock price and credit spreads in recent periods, with no apparent evaluation of the longer-term cost of capital consequences associated with the loss of Dex income and cash flows. The QCI stock price remains quite depressed and is presently (week of March 25, 2003) below the $4 to $5 per share range mentioned by Mr. Cummings at page 23 of his testimony.

Q. Another assertion by Ms. Arnold at page 11 is that, "Second, this transaction will not result in the allocation of any additional cost to the Arizona jurisdiction since no DEX

[redacted] (END HIGHLY CONFIDENTIAL).

costs have ever been allocated to Arizona regulated results of operations." How do you respond?

A. Arizona expenses are likely to increase as a direct result of the sale of Dex. It is my expectation that the shared corporate administrative costs of the corporation, that are presently subject to allocation among QC, Dex and other QCI subsidiaries, will be subject to larger allocations to QC after the Dex business has been sold is no longer receiving an allocation of such costs. As noted in my earlier testimony, the Company has performed no studies of these effects and the Transition Services Agreement (Exhibit K) will charge some of these costs that were previously allocable to Dex to the Buyer of Dex for only the first 18 months after closing. Beyond that date, it is quite likely that QC will absorb a larger share of shared administrative overheads.

There is also a new "Advertising Commitment" that obligates QCI and QC to take or pay for a specified amount of directory advertising from the Buyer of Dex that may increase costs charged or allocated to QC in the future.

Q. At page 12, Ms. Arnold asserts, "Third, the transaction will not result in a reduction of QC's net operating income." Is this correct?

A. No. The same concern regarding administrative overhead cost reallocations and the Dex advertising commitment would have the effect of reducing QC's net operating income.

Q. At pages 16 and 17 of her testimony, Ms. Arnold describes QC's directory publishing obligations under the Federal Telecommunications Act of 1996 and the Arizona Commission's rules and explains how these specific obligations are met under the current and proposed directory publishing agreements. Has the existing affiliate publishing agreement between QC and Qwest Dex ever been found by the Commission to be reasonable in the way it compensates QC for the official publishing rights transferred to Dex?

A. No. The existing form of affiliate publishing agreement made effective between the directory publisher and the affiliate regulated telephone company has not been accepted and was consistently restated by the Commission via ratemaking imputation adjustments, because these agreements failed to fairly compensate the telephone company as required under the Settlement Agreement. The new Publishing Agreement with the Buyer of Dex also provides no compensation to the telephone company for the valuable ILEC official publishing rights. The negotiated $7.05 billion price for Dex is largely reflective of this valuable official publishing right that is being purchased from QCI for cash and then being secured by long-term Publishing and Non-Competition Agreements that prevent the ILEC from re-entering the directory business and eroding this value.

Q. At pages 7 and 8 of his testimony, Qwest witness Mr. Burnett refers to efforts made to expand and improve the directory publishing business that have been made since the 1984 transfer outside the telephone company. Do these enhancements or the additional revenue they produce justify attributing a portion of the value of the gain on sale of Dex to shareholders, rather than QC customers?

A. No. Changes made to printed directories, such as the improvement of fonts, inclusion of color maps, community information pages, colored advertising and white pages enhancements should not be attributed to shareholders at all, because such improvements are simply the result of prudent business management and did not entail any significant startup costs or risks to shareholders. I explained in earlier testimony why Dex earnings associated with secondary directories and non-Qwest listings in primary directories should not be attributed to shareholders.

Q. Mr. Burnett describes the relationship between Dex and QC at page 4 of his direct testimony, stating, "All the tangible and intangible assets, intellectual property, human resources and operational know-how for directory operations were transferred to the new entity." Was any compensation provided to the telephone company or its customers when all of these assets were "transferred to the new entity"?

A. No. The telephone company received compensation for $56.3 million of cash and $8.334 million in fixed assets including a building, PBX, motor vehicles, furniture and computers that were transferred to the affiliate, less a $2.0 million accounts payable liability at the formation of U S West Direct, as referenced in the Company's response to Data Request STF 4-156. There was no compensation for the fair market value of the directory publishing business enterprise paid to the telephone company or its customers in 1984, as no true sale of the business occurred on that date. The Commission initially rejected the transfer that occurred in 1984 and later approved the 1988 Settlement Agreement that resolved litigation surrounding this matter, subject to imputation of $43 million per year as ongoing compensation for the use of these types of intangible assets.

Q. Is it possible for any of the $56.3 million of cash that was transferred to the new publishing affiliate in 1983 to now be part of what is being sold to the Buyer of Dex?

A. No. Schedule 2.2 of the Contribution Agreement (Exhibit B) related to the Dex Purchase agreements lists "Cash and cash equivalents" in the list of "Excluded Assets" not being conveyed to the Buyer of Dex.

Q. Is it likely that the $8.334 million in fixed assets, including a building, PBX, motor vehicles, furniture and computers, that were transferred to the publishing affiliate in 1984 are now included in the pending sale of Dex?

A. No. The same Rodney Contribution Agreement (Exhibit B) lists a number of Dex leasehold interests in facilities that are part of the "Contributed Assets" in Schedule 2.1, but this listing includes no Dex-owned buildings. In fact the first item on the list of "Excluded Assets" in Schedule 2.2 of the Dexter Agreement is "Seller's interests in all real estate located outside the Transfer Region (all such real estate collectively, the "Excluded Facilities") and the fee interest in the 198 Inverness Drive Building." Thus, it appears that no buildings are being conveyed to the Buyer of Dex. It is unlikely that any significant amount of PBX, motor vehicles, furniture or computers that were in service in 1984 are still serviceable and included in the Dex sale 19 years later.

Q. At page 5 of his Direct Testimony, Mr. Burnett discusses the existing Publishing Agreement between Dex and QC that designates Dex as the "official publisher" for QC. Then at page 6 he states, "QC does not pay Dex for the services that Dex performs, nor does Dex pay QC under the Publishing Agreement for the right to be QC's official publisher." Has the Commission ever accepted this arrangement for purposes of regulation in Arizona?

A. No. Imputation adjustments have been required in Arizona in rate cases since 1984 because of the inadequate compensation received by the telephone company under the affiliate Publishing Agreement. The new Publishing Agreement with the Buyer of Dex will perpetuate this arrangement, where no compensation is provided to the telephone company for the "official publisher" designation or for the many other beneficial linkages to the telephone company that are provided. These benefits under the Publishing Agreement and other commercial agreements are secured by the new Non-competition Agreement in favor of the Buyer and represent a large part of what is being purchased for $7.05 billion.

Conclusion

Q. In your opinion, based upon the evidence sponsored by Qwest witnesses in this Docket and the work you have done to evaluate the proposed Dex sale transaction, should the Commission approve the sale of Dex?

A. The proposed Dex sale is vital to the efforts of Qwest to improve liquidity and maintain access to capital on reasonable terms. Therefore, the Dex sale should be approved by the Commission, but only if QC customers in Arizona are afforded adequate and equitable participation in the financial benefits of the transaction and protection against the risks associated with the transaction. The Arizona share of the Dex sale gain should be used to increase the currently understated imputation of $43 million level that is embedded within present rates, to a new level of $100 million per year assuming continued price cap regulation or $121.3 million for each of the next 20 years assuming traditional regulation. In the event such an increased imputation is not ordered, the remaining Arizona share of the gain calculated on Confidential Exhibit MLB-1, after accounting for continuation of current imputation at $43 million, should be treated as an extraordinary credit to customers on a one-time basis, or at the discretion of the Commission, directed toward customer-funded service quality or network investment initiatives with rigorous regulatory oversight and accounting controls. With these financial conditions, and the infrastructure and publishing conditions stated at pages 43 and 44 of my testimony, approval of the proposed Rodney transaction can be found to be consistent with the public interest.

Q. Does this conclude your testimony at this time?

A. Yes.

Qwest Dex Sale Application
Arizona Docket No. T-01051B-02-0666
Gain on Sale Allocation to Arizona

Line #	Description (A)	Sale of Dex - Estimated Gain to Arizona: Per Company Staff DR 2-68 $ Millions (B)	Staff Position $ Millions (C)	Difference At Issue (D)
1	Sale Price of Qwest Dex	$ 7,050	$ 7,050	
2	Less: Estimated Contributed Assets	[redacted]	[redacted]	
3	Transaction Costs			
4	Estimated Pretax Gain on Sale			
5	Income Tax on Gain 39.53% FIT/SIT	[redacted]	[redacted]	
6	Estimated Post-tax Gain on Sale	[redacted]	[redacted]	
7	Gain Allocation to Shareholders:			
8	Allocation to LCI	[redacted]	[redacted]	
9	Allocation to New Ventures			
10	Allocation to Secondary Directories			[redacted]
11	Allocation to non-Qwest Listings			
12	Total Gain Allocation to Shareholders			
13	Shareholder Gain Amount	[redacted]	[redacted]	[redacted]
14	Residual = Gain to QC Customers	[redacted]	[redacted]	[redacted]
15	Approximate Arizona Share	[redacted]	[redacted]	[redacted]
16	Arizona Intrastate Share of Dex Gain - Post Tax	[redacted]	$ 629	[redacted]
17	Income Tax Factor-Up (1/[1-.3953] composite FIT/SIT rate)		1.6537	
18	Pretax Arizona Value For Customer Attribution		$ 1,040.5	
		Alternative Annual Revenue Credits ($ millions)		
19	1988 Settlement Agreement Level of Imputation Credit	$ 43.0		
20	Perpetual Revenue Credits For Price Cap Regulation		$ 100.0	
21	20 Year Fixed Revenue Credits For Traditional Regulation			$ 121.3
22	Present Value of Alternative Annual Revenue Credits			
23	Present Value of Revenue Credit for 20 Years	$ 369.0		$ 1,040.5
24	Present Value of Revenue Credit in Perpetuity	$ 447.5	$ 1,040.5	
25	Residual Value Not Used for Annual Credits - 20 Years	$ 671.5		$ (0.0)
26	Residual Value Not Used for Annual Credits - Perpetual	$ 593.0	$ -	

Confidential

Qwest Dex Sale Application
Arizona Docket No. T-01051B-02-0666
Gain on Sale Allocation to Arizona

Year	Description (A)	Principal Amount (B)	9.61% Discount Factor Half Year Used (C)	Present Value (D)
1	Present Value of Current $43 Million Imputation	$ 43.00	0.950736557	$ 40.88
2		43.00	0.859370773	36.95
3		43.00	0.776785242	33.40
4		43.00	0.70213618	30.19
5		43.00	0.634660893	27.29
6		43.00	0.573669982	24.67
7		43.00	0.518540296	22.30
8		43.00	0.468708574	20.15
9		43.00	0.42366568	18.22
10		43.00	0.382951408	16.47
11		43.00	0.346149778	14.88
12		43.00	0.312884784	13.45
13		43.00	0.282816556	12.16
14		43.00	0.255637885	10.99
15		43.00	0.231071085	9.94
16		43.00	0.208865153	8.98
17		43.00	0.188793212	8.12
18		43.00	0.170650184	7.34
19		43.00	0.154250702	6.63
20		43.00	0.139427209	6.00
				$ 369.02
1	Present Value of Proposed Revenue Credits	$ 121.25	0.950736557	$ 115.28
2		121.25	0.859370773	104.20
3		121.25	0.776785242	94.19
4		121.25	0.70213618	85.13
5		121.25	0.634660893	76.95
6		121.25	0.573669982	69.56
7		121.25	0.518540296	62.87
8		121.25	0.468708574	56.83
9		121.25	0.42366568	51.37
10		121.25	0.382951408	46.43
11		121.25	0.346149778	41.97
12		121.25	0.312884784	37.94
13		121.25	0.282816556	34.29
14		121.25	0.255637885	31.00
15		121.25	0.231071085	28.02
16		121.25	0.208865153	25.32
17		121.25	0.188793212	22.89
18		121.25	0.170650184	20.69
19		121.25	0.154250702	18.70
20		121.25	0.139427209	16.91
				$ 1,040.54

EXHIBIT
S-2
Admitted

SUPPLEMENTAL

TESTIMONY

OF

MICHAEL BROSCH

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

APRIL 28, 2003

BEFORE THE ARIZONA CORPORATION COMMISSION

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

SUPPLEMENTAL TESTIMONY

OF

MICHAEL BROSCH

ON BEHALF OF THE UTILITIES DIVISION STAFF

APRIL 28, 2003

Executive Summary of Testimony

Utilitech assisted Staff in negotiating a Stipulation of issues surrounding the pending sale of Dex. The Stipulation resolves the central dispute in this matter – whether or not an earlier 1988 Settlement Agreement remains in force, limiting the annual directory imputation credits to customers to $43 million. Qwest asserted that the 1988 Settlement Agreement represents the Commission's consent to transfer of all directory assets out of the telephone business as of 1984, resulting in no continuing Commission jurisdiction over the further transfer of Dex assets at this time and no current or future regulatory claim on the proceeds from the sale of Dex. Qwest argued that the 1988 Settlement Agreement remains effective to govern rate treatment of the directory publishing business in future Arizona rate cases.

As explained in my direct testimony, the sale of Dex should terminate the 1988 Settlement Agreement. The sale of Dex will eliminate the affiliate publishing arrangement with USWD (now Dex) that was the basis of the 1988 Settlement Agreement. My testimony explained that the 1988 Settlement Agreement pertained to and resolved a disputed specific transfer of certain assets among corporate affiliates that occurred in 1984 and did not contemplate or address the pending sale of the publishing business enterprise to a non-affiliated buyer.

The Stipulation adopts Staff's view that the 1988 Settlement Agreement must be replaced with a new agreement with increased annual revenue credits to Qwest Corporation's ratemaking income statement. The sale of Dex yields a very large gain on sale that should be used to benefit customers. The Stipulation is a compromise that uses most of the Arizona portion of this gain to maintain and increase the imputation adjustment amount embedded within customers' rates from $43 million annually to $72 million per year for 15 years. This prospective adjustment will cause future QC revenue requirements to be lower than under the 1988 Settlement Agreement. These ratemaking imputation adjustments recognize that historically Dex has been treated as a source of jurisdictional telephone company revenue in Arizona and that ratepayers have a vested interest in the fees and value associated with the directory business.

The 1988 Settlement Agreement that is being replaced by the new Stipulation has been controversial to administer in the past, due to ambiguities surrounding the definition and measurement of "value of fees and services". The new Stipulation provides for annual revenue imputation adjustments that are fixed in amount for future rate cases and not subject to adjustment based upon future showings of "value" or other subjective changes.

The Stipulation should be approved because it provides certainty and finality to a controversial element of Qwest regulation, while addressing the Company's need for financial liquidity and customers' need for increased revenue imputations from the directory publishing business in ratemaking proceedings.

Q. Please state your name and business address.

A. My name is Michael L. Brosch. My business address is 740 Northwest Blue Parkway, Suite 204, Lee's Summit, Missouri 64086.

Q. Are you the same Michael L. Brosch who previously submitted testimony in this Docket?

A. Yes. My qualifications are described in that previous testimony.

Q. What is the purpose of your testimony at this time?

A. My testimony is supportive of the Stipulation that was negotiated between Staff and the Qwest parties. I explain why the Stipulation is reasonable, consistent with the public interest, and should be approved by the Commission.

Q. What are the substantive provisions of the Stipulation?

A. The Stipulation allows Qwest to sell the Dex business and apply the cash proceeds to debt repayment and provides for increased customer benefits from the Dex sale in the following manner:

- Commission approval of the sale of Dex and the Arizona directory assets of Dex, pursuant to the Rodney transaction documentation, is conditioned upon firm, fixed amounts of imputed revenues to the telephone company in future rate proceedings.
- Replacement of the 1988 Settlement Agreement that had served to limit annual directory imputation to only $43 million per year, subject to adjustment based upon the "value of fees and services".
- Increasing the annual directory revenue imputation to $72 million per year for all ratemaking proceedings within a fixed 15-year term, and with no potential adjustment or reduction in such amounts.
- Explicit inclusion of the increased $72 million imputation of revenues within the Qwest Price Cap Review filing that is anticipated later this year, so the Commission can consider any rate changes that may be appropriate in connection with continuation or modification of the Price Cap Plan.

- Recognition of the $72 million of directory revenue imputation in all reporting of Qwest Corporation's Arizona earnings and intrastate rate of return for the next 15 years.

These provisions resulted from extensive negotiations between Staff and Qwest and represent a compromise of the positions taken by each party in pre-filed evidence in this Docket.

Q. Why is the existing 1988 Settlement Agreement important in the Commission's review of the Dex sale transaction at this time?

A. The Arizona directory publishing assets of Mountain Bell were transferred to an affiliated company at divestiture in 1984. This transfer was disputed and ultimately rejected by the ACC, resulting in litigation that was resolved by the 1988 Settlement Agreement. Qwest argued that, through the 1988 Settlement Agreement, the Commission has already approved the transfer of the directory business to an unregulated affiliate, causing the directory assets to not be public service corporation assets and the pending sale of Dex to not fall within the scope of Arizona's asset transfer statute.[1] Alternatively, if the Commission has any jurisdiction over the pending sale, Qwest asserted that the 1988 Settlement Agreement, "ensures that the benefit of directory imputation included in current rates will remain in place, and will insulate ratepayers from any adverse rate affects based on the sale of Dex".[2] My Direct Testimony rebutted these assertions and explained Staff's view that the 1988 Settlement Agreement is terminated by the proposed sale of Dex to a non-affiliate.

Q. Has the 1988 Settlement Agreement been the subject of controversy in spite of its specification of $43 million in annual revenue imputation to the telephone company?

A. Yes. The 1988 Settlement Agreement had the effect of freezing the directory revenue imputation adjustment in rate cases, based upon directory profit levels being earned in the

1 Testimony of Maureen Arnold, page 4.
2 Id. Page 5.

mid-1980's. However, actual directory publishing profits have continued to grow and all of this growth has been retained for the sole benefit shareholders in Arizona, to the detriment of ratepayers. In other Qwest jurisdictions that do not have such a one-sided settlement, directory profitability and imputation adjustments have grown substantially since the mid 1980's. For example, the U S West 1997 Washington rate case produced an imputation value of $85 million in a state similar in size to Arizona. Utah's 1997 U S West rate case yielded an imputation order of $30 million per year, even though Utah is less than half the size of Arizona. In the 1993 Arizona rate case of U S West, this Commission accepted my calculation of a $60 million imputation adjustment, only to have this finding reversed upon appeal because of the 1988 Settlement Agreement.[3]

In the most recent 1999 Arizona rate case, Qwest advocated a zero directory revenue imputation amount through its interpretation of the 1988 Settlement Agreement and its evaluation of the "value of fees and services", as required under that Settlement. I calculated the much larger imputation credit that would be equitable to customers in 1999, but included only $43 million in Staff's filing in deference to the 1988 Settlement Agreement and the Court's interpretation of that Settlement. This $43 million value was used to determine the start-up revenue requirement within the current Price Cap Plan.

Q. If the Commission agreed with Qwest's view that the 1988 Settlement Agreement continued to apply after Dex is sold, would the Company still be able to argue in future rate cases that the "value of fees and services" being received by the telephone company under the new Publishing Agreement with Dex Holdings L.L.C. justifies downward adjustment or elimination of the $43 million in imputation credits provided for in that Settlement Agreement?

A. Yes. It is reasonable to anticipate that Qwest would again assert its argument that satisfaction by Dex of the telephone company's publishing obligation to produce and

3 Brosch Direct Testimony, page 25.

distribute white pages directories, at no cost to the telephone company, represents substantial "value" to the telephone company in lieu of imputation. The facts supporting these arguments, as raised by the Company in the 1999 rate case, will remain in place under the new Publishing Agreement with Dex Holdings L.L.C. In addition, Qwest continues to argue that imputation of directory revenues is an improper subsidy and is otherwise objectionable as a matter of public policy. Staff rejects these arguments and would vigorously defend its view that imputation remains appropriate in spite of Qwest's continuing opposition, but these controversies are all resolved under the Stipulation.

Q. How does the new Stipulation address the problems that have surrounded the 1988 Settlement Agreement?

A. The Stipulation supercedes and replaces the 1988 Settlement Agreement. The Stipulation increases the $43 million in annual revenue imputation by 67 percent, to $72 million per year. Perhaps more importantly, the new and larger revenue imputation is fixed in amount and not subject to adjustment based upon a vaguely defined "value of fees and services" provision. Qwest has no opportunity to argue that directory imputation should be reduced prior to the expiration of the 15-year term specified for the new revenue imputation adjustment. Thus, considerable litigation risk associated with this Docket and many future rate proceedings is eliminated. Customers of Qwest's intrastate Arizona telephone services are assured long-term participation in the profits earned through directory publishing, even though the business enterprise creating such profits is being sold.

Q. How does the negotiated $72 million in annual credits compare to your recommendation in Direct Testimony?

A. Assuming continued price cap regulation in Arizona, my pre-filed Direct Testimony in this Docket recommended perpetual directory imputation adjustments of $100 million per year. This recommendation was based upon retention for ratepayers of 100 percent of my calculation of the Arizona share of the gain to be realized on sale of the Dex directory publishing business. As an alternative recommendation, if the Commission decided to terminate the Price Cap Plan and revert to traditional rate case regulation, my testimony supported crediting of the Arizona share of the entire gain to customers based upon a 20-year amortization that produced a $121.3 million annual customer credit. My calculations of these amounts are set forth in Confidential Exhibit ___ MLB-1 and include a series of gain allocation steps and present value discount rates that are disputed by Qwest. The Stipulation represents a compromise that provides $72 million in annual imputation credits for 15 years, irrespective of the form of regulation that is used.

Q. Are customers assured of near-term benefits from the increase in imputation provided for in the Stipulation?

A. Yes. The initial term of the Arizona Price Cap Plan is due to expire in 2004 and Qwest anticipates filing its proposals regarding continuation or modification of the Plan, as well as a required earnings calculation, on or about July 1, 2003. Paragraph 3 of the Stipulation requires the increased imputation amount be included in Qwest's calculation of intrastate earnings and rate of return for these purposes. Staff will review these calculations in formulating its recommendations regarding any rate changes or other relief that should be a part of future Qwest regulation. The stipulated increase in directory imputation will make the Company's intrastate revenue requirement $29 million lower than would otherwise be calculated later this year.

Q. What are the benefits to Qwest under the Stipulation?

A. Qwest is able to secure ACC approval for the sale of Dex, removing a contingency and possibly expediting sale closure, particularly if a settlement is also achieved in Washington, which is the last state where regulatory approval is required. The large cash infusion from the Dex sale proceeds will enable the Company to repay debt obligations and improve the financial condition of the business, removing some of the risks that jeopardize Qwest's access to capital markets on reasonable terms. Additionally, the Stipulation resolves with certainty the contentious issue of directory imputation, which should simplify and reduce Qwest's costs associated with future regulation in Arizona.

Q. Can the specific terms and amounts in the Stipulation be compared with settlements reached in other states having jurisdiction over the sale of Dex?

A. No. The circumstances in Arizona are unique because of the 1988 Settlement Agreement and the history of litigation surrounding that agreement, as well as the existing Arizona Price Cap Plan and scheduled review of that plan later this year. Other Qwest states have unique regulatory histories with regard to directory publication and differences in the regulatory framework that must be considered.

Q. In your opinion, for the reasons stated above, is the Stipulation reasonable and consistent with the public interest?

A. Yes.

Q. Does this conclude your testimony at this time?

A. Yes, it does.