



0000055880

Transcript Exhibit(s)

Docket #(s): T-01051B-02-0666

Exhibit #: DOD 1,3

* Admitted with May 19, 2006
transcript *

EXHIBIT
DOD-1
admitted

BEFORE THE ARIZONA CORPORATION COMMISSION

- MARC SPITZER
Chairman
- WILLIAM A. MUNDELL
Commissioner
- JIM IRWIN
Commissioner
- MIKE GLEASON
Commissioner
- JEFF HATCH-MILLER
Commissioner

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

REBUTTAL TESTIMONY
of
RICHARD B. LEE

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE
And
ALL OTHER FEDERAL EXECUTIVE AGENCIES

ROBERT N. KITTEL, CHIEF
Regulatory Law Office
Office of the Judge Advocate General
U.S. Army Litigation Center
901 N. Stuart Street, Suite 713
Arlington, Virginia 22203-1837

by

Peter Q. Nyce, Jr.
General Attorney

March 4, 2003

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I. INTRODUCTION

1

2

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

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

7 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

8 A. I earned a Bachelor of Science degree in Industrial Administration with High Honors
9 from Yale University in 1961. I earned a Master of Business Administration degree with
10 Distinction from the Harvard Business School in 1963.

11 **Q. PLEASE DESCRIBE SNAVELY KING.**

12 A. Snavelly King, formerly Snavelly, King & Associates, Inc., was founded in 1970 to
13 conduct research on a consulting basis into the rates, revenues, costs and economic
14 performance of regulated firms and industries. The firm has a professional staff of 13
15 economists, accountants, engineers and cost analysts. Most of its work involves the
16 development, preparation and presentation of expert witness testimony before Federal
17 and state regulatory agencies. Over the course of its 33-year history, members of the firm
18 have participated in over 600 proceedings before almost all of the state commissions and
19 all Federal commissions that regulate utilities or transportation industries.

20 **Q. PLEASE DESCRIBE THE TYPE OF WORK YOU HAVE PERFORMED WHILE**
21 **AT SNAVELY KING.**

22 A. Since joining Snavelly King in 1991, I have assisted clients in proceedings before the

1 Federal Communications Commission ("FCC") related to a variety of matters.
2 Attachment 1 is a list of the FCC filings I have prepared on behalf of the General
3 Services Administration ("GSA"). The GSA represents the customer interests of the
4 Federal Executive Agencies in matters before the FCC.

5 I have also assisted clients in proceedings before twenty-eight state commissions
6 related to the telephone, cellular telephone and electric industries.

7 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN ANY REGULATORY**
8 **PROCEEDINGS?**

9 A. Yes, I have. Attachment 2 is a list of my appearances before regulatory agencies on
10 behalf of various clients.

11 **Q. WHAT WAS YOUR EMPLOYMENT PRIOR TO JOINING SNAVELY KING?**

12 A. From 1980 to 1990, I was employed by American Telephone and Telegraph Company
13 ("AT&T") in its Federal Regulatory Affairs Division. As Regulatory Vice President -
14 Financial and Accounting Matters, I represented AT&T before the FCC in all financial
15 and accounting matters. In that capacity, I directed the preparation and presentation of all
16 AT&T Communications depreciation rescription filings before the FCC. I also
17 conceived and developed a methodology which reduced the administrative burden of
18 AT&T's depreciation filings by over 90 percent. Prior to divestiture, I directed the
19 preparation and presentation of all Bell Operating Company ("BOC") depreciation filings
20 before the FCC.

21 **Q. WHAT WAS YOUR EMPLOYMENT HISTORY PRIOR TO 1980?**

22 A. From 1963 to 1980, I was employed by the New York Telephone Company. I held a

1 variety of progressively responsible positions leading to a position representing the
2 Company in accounting matters before the New York Public Service Commission. In
3 this capacity, I participated in a number of general rate cases and related proceedings.

4 My complete resume is attached as Attachment 3.

5 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**

6 A. I am appearing on behalf of the customer interests of the United States Department of
7 Defense and all other Federal Executive Agencies ("DOD/FEA").

8 **Q. WHAT IS DOD/FEA'S INTEREST IN THIS PROCEEDING?**

9 A. DOD/FEA purchases large quantities of telecommunications service from Qwest
10 Corporation ("Qwest") in Arizona. Indeed, the 60,000 civilian and military employees of
11 DOD/FEA in Arizona probably make DOD/FEA the largest user of telecommunications
12 services in the state. As a Qwest customer in Arizona, DOD/FEA will be directly and
13 substantially affected by the sale of Qwest Dex, Inc. ("Dex") by Qwest's parent
14 company, Qwest Communications International, Inc. ("QCI").

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

17 A. Yes, it was.

18 **Q. PLEASE SUMMARIZE YOUR TESTIMONY?**

19 A. In this Rebuttal Testimony, I respond to the testimony of Qwest witnesses with respect to
20 the approval of QCI's sale of Dex and its regulatory implications. I recommend that the
21 Commission approve QCI's sale of Dex subject to certain conditions which will ensure
22 that the gain from the Dex sale appropriately accrues to the benefit of local ratepayers. I

1 also recommend a procedure to accomplish this end result.
2

3 **II. THE SALE OF DEX IS IN THE PUBLIC INTEREST**

4
5 **Q. DO YOU AGREE WITH QWEST'S POSITION THAT THE SALE OF DEX IS IN**
6 **THE PUBLIC INTEREST?**

7 A. Yes. Qwest witness Maureen Arnold states the "the sale of Dex serves the public
8 interest, as it allows QCI to avoid bankruptcy."¹ The testimonies of Qwest witnesses
9 Peter C. Cummings and Brian G. Johnson support Ms. Arnold's conclusion.

10 **Q. DO YOU RECOMMEND, THEREFORE, THAT THE COMMISSION APPROVE**
11 **THE SALE OF DEX?**

12 A. Yes, I do, subject to certain conditions which will ensure that the gain from the Dex sale
13 appropriately accrues to the benefit of local ratepayers. QCI's financial difficulties have
14 not been the result of Qwest's regulated operations, but rather its non-regulated
15 endeavors. For this reason, I believe that ratepayers should not be harmed by the sale of
16 Dex. To the contrary, ratepayers should be assured of some sort of guaranteed
17 compensation for having given up this valuable asset in order to rescue their telephone
18 utility's parent company.
19

¹ Testimony of Maureen Arnold ("Arnold Testimony") at 15.

1 **III. THE GAIN FROM THE SALE OF DEX SHOULD**
2 **BENEFIT LOCAL SERVICE RATEPAYERS**
3

4 **Q. WHY DO YOU BELIEVE THE GAIN FROM THE SALE OF DEX SHOULD**
5 **BENEFIT LOCAL RATEPAYERS?**

6 A. Upon AT&T's divestiture in 1984, the directory publishing business was assigned to
7 Qwest's predecessor, U S West, and other Bell operating companies in order to generate
8 "a substantial subsidy for local telephone rates."² In Arizona, this subsidy has been
9 effected by means of an imputation of directory revenues in various Qwest rate cases.³

10 Now that the directory function is being divested to an unaffiliated enterprise,
11 ratepayers are entitled to compensation for the full value of the divested asset. The sale
12 price of Dex provides a quantification of that value. Ratepayers are, therefore, entitled to
13 a benefit equal to the full price of the Dex sale, less any contributed assets that pass out of
14 the Company, and less costs that are incurred by the transaction.

15 **Q. SHOULDN'T QCI SHAREOWNERS SHARE IN THE GAIN FROM THE DEX**
16 **SALE?**

17 A. QCI's shareholders receive a very substantial immediate benefit from the gain, since the
18 sale of Dex generates the cash by which QCI hopes to avoid bankruptcy. This benefit,
19 however, is ultimately owed to ratepayers. The only reason that QCI has Dex to sell, is
20 because it was assigned to U S West to generate a subsidy for local rates. If any portion
21 of the gain from the Dex sale flows through to shareowners, it will serve to reward them

² United States vs. American Tel. And Tel Co. et al., 552 F. Supp. 131 at 224.

1 for allowing QCI management to drive the company into this near bankruptcy condition.
2 In effect, any portion of the gain from the sale of Dex that does not benefit local
3 ratepayers will represent a subsidy of QCI's non-regulated operations by its regulated
4 operations.

5 **Q. DO YOU AGREE WITH MS. ARNOLD THAT THE 1988 SETTLEMENT**
6 **AGREEMENT HAS APPLICABILITY TO THIS PROCEEDING?⁴**

7 A. No, I do not. The 1988 Settlement Agreement only resolved "issues relating to the
8 transfer of Yellow Pages assets from Mountain Bell to USWD."⁵ This transfer simply
9 involved an organization change within U S West, QCI's predecessor as parent of Qwest.
10 This proceeding addresses the proposed sale of Dex to an unrelated third party, an
11 entirely different matter.

12 The basis of the 1988 settlement agreement was an analysis of affiliate
13 transactions related to directory operations. The focus of this proceeding must be on the
14 procedure for ensuring that the gain from this sale appropriately benefits local service
15 ratepayers. The gain from this sale has been estimated by Qwest, and an analysis of past
16 or future transactions is irrelevant to the appropriate attribution of this gain.

³ See Arnold Testimony at 7-10.

⁴ Arnold Testimony at 5.

⁵ 1988 Settlement Agreement, provided as Appendix C to Qwest Notice of Sale, Request for Waiver or Application for Approval Pursuant to R14-2-803, at 1.

1 **IV. BILL CREDITS AND A REGULATORY LIABILITY**
2 **SHOULD BE ADOPTED**

3
4 **Q. WHAT PROCEDURE DO YOU RECOMMEND FOR ENSURING THAT THE**
5 **GAIN FROM THE DEX SALE ACCRUES TO THE BENEFIT OF LOCAL**
6 **RATEPAYERS?**

7 A. The procedure I recommend is detailed in Attachment 4 to this Rebuttal Testimony. On
8 Line 1 of Attachment 4, I show the total pre-tax gain as estimated by Qwest.⁶ On Line 2,
9 I show the Arizona share percentage as proposed by Qwest.⁷ Line 3 shows Arizona's
10 share in dollars (Line 1 x Line 2).

11 I recommend that 10 percent of this benefit be in the form of an immediate bill
12 credit which I will describe below. This amount is shown on Line 4 (Line 3 x 10%). I
13 further recommend that the remainder of the gain as shown on Line 5 (Line 3- Line 4) be
14 established as an initial regulatory liability. Finally, I recommend that this liability be
15 amortized over 15 years as shown on Line 6 (Line 5/15).

16 **Q. HOW WILL THE REGULATORY LIABILITY BENEFIT LOCAL**
17 **RATEPAYERS?**

18 A. For the next 15 years, the annual amortization amount (Line 6 on Attachment 4) would
19 serve as a revenue imputation in any general rate case. I have selected 15 years because
20 that is probably the longest time horizon over which we can predict that rate base/rate-of-

⁶ See Attachment A to Qwest Response to Staff Data Request 68.

⁷ Id.

1 return regulation will remain in effect. We have no idea what the land-line telephone
2 market will look like more that 15 years from now. The unamortized regulatory liability
3 would serve as a rate base offset. The combination of these adjustments would thus
4 provide a subsidy for local rates, exactly as intended by the court overseeing AT&T's
5 divestiture in 1984. At the end of this period, the full benefit of the Dex sale will have
6 been (theoretically) provided to local ratepayers, and the subsidy would end. *what is full benefit?*

7 **Q. WHY DO YOU PROPOSE AN IMMEDIATE BILL CREDIT FOR 10 PERCENT**
8 **OF THE TOTAL DEX SALE GAIN?**

9 A. It is quite possible that ratepayers may never see the above benefits because there may
10 never be a rate case in which they impact the revenue requirement. For this reason, ten
11 percent of the value of the Dex sale should be flowed through to end-user ratepayers in
12 the form of an immediate bill credit. I have picked ten percent because it is sufficiently
13 large to provide a tangible benefit to ratepayers, but not so large as to dilute seriously the
14 cash flow needed by the Company to pay down its debts. This credit would flow to all
15 Qwest local service ratepayers without specification as to type of customer as a
16 percentage deduction from their recurring local network service bill. The percentage
17 would be calculated by dividing the total bill credit to be provided (Line 4 on Attachment
18 4) by Qwest's total recurring local network service revenue times the number of months
19 to be credited. In order not to distort competitive relationships among carriers, this credit
20 should be applied to bills over a relatively short time, possibly three months.

21

1 Q. **WHY DO YOU EXCLUDE THE GAIN FROM LCI IN YOUR CALCULATIONS?**

2 A. LCI International's sole asset is a minority interest in Qwest N limited partnership, an
3 equipment leasing partnership that leases equipment to unregulated Qwest affiliates.⁸

4 The LCI business was included in the Dex sale so that QCI could report certain tax events
5 on its consolidated federal income tax return Form 1120 for the year 2002.⁹ Since LCI is
6 unrelated to the directory function, any gain from it need not benefit local service
7 ratepayers.

8 Q. **WHY DO YOU INCLUDE THE GAIN FROM NEW VENTURES IN YOUR
9 CALCULATION?**

10 A. New Ventures is the portion of Dex that engages in non-traditional activities such as the
11 production of internet directories. Since these activities are related to the directory
12 function, as indicated by their organization placement, any gain with respect to their sale
13 should accrue to the benefit of local service ratepayers.

14 Q. **WHY DO YOU INCLUDE THE GAIN FROM SECONDARY DIRECTORIES IN
15 YOUR CALCULATION?**

16 A. Secondary directories are published at Dex's discretion in order to compete more
17 effectively in the advertising market and maximize advertising sales by providing
18 directories that allow advertisers to focus their advertising message to a specific

⁸ Qwest Response to Staff Data Request 17.

⁹ Qwest Response to Staff Data Request 132S1.

1 geographic scope which best represents their customer base.¹⁰ The production of these
2 directories is a directory function, and thus any gain associated with them should accrue
3 to the benefit of local service ratepayers as discussed above.

4 **Q. WHY DO YOU INCLUDE THE GAIN FROM NON-QWEST LISTINGS IN**
5 **YOUR CALCULATION?**

6 A. Dex is in the business of selling directory advertising.¹¹ Its directories are scoped on the
7 basis off calling and shopping patterns, in order to maximize advertising sales, not on the
8 basis of service areas of particular local exchange carriers.¹² Since non-Qwest listings are
9 an integral part of the directory function, any gain associated with them should accrue to
10 the benefit of local service ratepayers as described above.

11 **Q. WHY DO YOU BASE YOUR CALCULATIONS ON THE PRE-TAX GAIN**
12 **ASSOCIATED WITH THE DEX SALE?**

13 A. The net operating losses attributable to QCI's nonregulated operations, when fully
14 determined, will exceed the one-time gain from its sale of Dex. QCI will not, therefore,
15 pay taxes on this gain, and to adjust the gain for "phantom" taxes would effectively
16 represent a subsidy of QCI's unregulated operations by local service ratepayers.

17

¹⁰ Qwest Response to Staff Data Request 128.

¹¹ Qwest Response to Staff Data Request 123S1.

¹² Id.

1
2
3 **V. CONCLUSION**

4 **Q. DO YOU HAVE ANY CONCLUDING COMMENTS?**

5 A. Yes I do. I am not a lawyer, but I have been in the telephone industry for over 40 years
6 and directly involved in telephone regulation for over 25 years. It may be wishful
7 thinking, but I hope that Qwest's April 1 Surrebuttal will forgo controversial and
8 convoluted legal arguments and simply accept the following:

- 9 1. Dex is available for sale by QCI because it was assigned to its predecessor
10 specifically to subsidize local telephone rates.
- 11 2. It is appropriate, therefore, that a procedure (such as the one I propose) be
12 implemented to ensure that the entire gain from the Dex sale benefits local
13 service ratepayers.

14 The recognition of these two propositions would clearly signal that Qwest is, indeed,
15 under new management.

16 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

A. Yes, it does.

RICHARD B. LEE

FCC FILINGS ON BEHALF OF GENERAL SERVICES ADMINISTRATION

<u>PROCEEDING</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>DATE</u>
CC Docket No. 87-568	AT&T Communications Revisions to Tariff FCC No. 12	Reply	3/25/91
CC Docket No. 91-141	Expanded Interconnection with Local Telephone Company Facilities	Comments Reply Reply Comments Reply Comments Reply	8/6/91 9/20/91 12/10/91 1/14/93 2/19/93 4/2/93 4/30/93
DA Docket No. 91-698	New York Telephone Co. Petition for Waiver of Part 61.49(g) of the Commission's Rules	Comments Reply	8/9/91 9/9/91
CC Docket No. 89-79	Amend. of Part 69 of the Commission's Rules Relating to the Creation of Access Charge Subelements for Open Network Architecture	Comments	8/26/91 9/25/91 10/2/91
CC Docket No. 87-313	Policy and Rules Concerning Rates for Dominant Carriers	Comments Reply Reply	8/26/91 9/25/91 10/2/91

PROCEEDING

SUBJECT

TYPE

DATE

CC Docket No. 91-213	Transport Rate Structure and Pricing	Comments	11/22/91
		Reply	1/22/91
		Comments	2/1/93
		Reply	3/19/93
Petition	ONA Access Charge Tariff Filings	Petition to Suspend	11/26/91
DA No. 91-1452	Federal-State Joint Conference on ONA Staff Report on Uniform Tariffing Guidelines for ONA Services	Comments	12/20/91
		Reply	1/21/92
CC Docket No. 91-346	Intelligent Networks	Reply	4/6/92
		Comments	11/1/93
		Reply	12/1/93
CC Docket No. 92-133	Amend. of Parts 65 and 69 of the Commission's Rules to Reform the Interstate Rate of Return Represcription and Enforcement Processes	Comments	9/11/92
		Reply	10/13/92
CC Docket No. 92-91	ONA Tariffs of Bell Operating Companies	Comments	10/16/92
CC Docket No. 92-222	Amendment of the Part 69 Allocation of General Support Facility Costs	Comments	12/4/92
		Reply	12/18/92
CC Docket No. 92-256	Application of ONA and Nondiscrimination Safeguards to GTE Corporation	Comments	2/1/93
		Reply	3/24/93

PROCEEDING

SUBJECT

TYPE

DATE

CC Docket No. 92-296	Simplification of the Depreciation Prescription Process	Reply Reply Reply	4/13/93 1/21/94 12/14/94
DA 93-481	Ameritech's Petition for Declaratory Ruling and Related Waivers to Establish a New Regulatory Model for the Ameritech Region	Reply	7/12/93
DA 93-687	Rochester Telephone Corp. Petition for Waivers of Part 61 Tariff Rules and Part 69 Access Charge Rules to Implement Its Open Market Plan	Comments Reply	7/19/93 8/9/93
CC Docket No. 91-273	Amendment of Part 63 of the Commission's Rules to Provide for Notifications by Common Carriers	Comments	1/21/94
DA Docket No. 93-1537	NYNEX Transition Plan to Preserve Universal Service in a Competitive Environment	Reply Reply	2/22/94 3/2/94
Petition	Petition for Declaratory Ruling Assigning an N11 Dialing Code for use by the Public in Gaining Access to the Services of the Federal Executive Agencies	Petition	3/11/94

<u>PROCEEDING</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>DATE</u>
CC Docket No. 94-1	Price Cap Performance Review for Local Exchange Carriers	Comments Reply Comments Comments Comments Reply Comments Reply	5/9/94 6/29/94 1/31/95 4/17/95 10/27/95 11/20/95 12/18/95 3/1/96
CC Docket No. 94-54	Equal Access and Interconnection Obligations Pertaining to Commercial Mobile Radio Services	Comments Reply	8/30/94 10/13/94
IAD File No. 94-101	Requests of Federal Agencies and Others for the Assignment of N11 Codes	Reply	9/23/94
CC Docket No. 80-286	Amendment of Part 36 of the Commission's Rules and Establishment of a Joint Board	Reply Comments Reply	12/2/94 9/12/95 11/9/95
CC Docket No. 92-237	Administration of the North American Numbering Plan	Nomination Application	8/7/95 9/12/95
CC Docket No. 95-115	Amendment of the Commission's Rules and Policies to Increase Subscribership and Usage of the Public	Comments Reply	9/27/95 11/13/95

<u>PROCEEDING</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>DATE</u>
CC Docket No. 95-155	Toll Free Service Access Codes	Comments Reply	1/1/95 11/20/95
CCB-IAD 95-110	Telecommunications Access Provider Survey	Comments Reply	12/1/95 1/16/96
CC Docket No. 87-124	Access to Telecommunications Equipment and Services by Persons With Disabilities	Comments Reply	1/12/96 2/29/96
AAD 96-28	Rate of Return Inquiry	Comments Reply	3/11/96 4/15/96
CS Docket No. 96-46	Implementation of Section 302 of the Telecommunications Act of 1996	Comments Reply	4/1/96 4/11/96
CC Docket No. 96-45	Federal-State Joint Board on Universal Service	Comments Reply	4/12/96 5/7/96
CC Docket No. 96-61	Policy and Rules Concerning the Interstate, Interexchange Marketplace	Comments Reply	4/17/97 5/3/96
CC Docket No. 96-98	Implementation of the Local Competition Provisions in the Telecommunications Act of 1996	Comments Reply	5/16/96 6/3/96

<u>PROCEEDING</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>DATE</u>
CC Docket No. 96-112	Allocation of Costs Associated with Local Exchange Carrier Provision of Video Programming Services	Comments Reply	5/28/96 6/12/96
CC Docket No. 96-150	Accounting Safeguards Under the Telecommunications Act of 1996	Comments Reply	8/26/96 9/10/96
CC Docket No. 91-141 CCB-IAD File No. 98-102	Local Competition Survey	Comments Reply	6/8/98 6/22/98
CC Docket No. 98-81	1998 Biennial Regulatory Review - Review of Accounting and Cost Allocation Requirements	Reply	9/4/98
CC Docket No. 98-117	1998 Biennial Regulatory Review Review of ARMIS Reporting Requirements	Reply	9/4/98
CC Docket No. 98-166	Prescribing the Authorized Unitary Rate of Return for Interstate Services of Local Exchange Carriers	Comments	1/19/99 3/16/99
CC Docket No. 96-45 CC Docket No. 97-160	Federal-State Joint Board on Universal Service Forward-Looking Mechanism for High Cost Support for Non-Rural LECs	Comments Reply	7/23/99 8/6/99
CC Docket No. 98-147	Deployment of Wireline Services Offering Advanced Telecommunications Capability	Comments	9/24/99

<u>PROCEEDING</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>DATE</u>
CC Docket No. 98-137	1998 Biennial Regulatory Review - Review of Depreciation Requirements for Incumbent Local Exchange Carriers	Comments Reply	4/17/00 4/28/00
-----	Biennial Regulatory Review 2000	Comments Reply	10/10/00 10/20/00
CC Docket No. 00-199	2000 Biennial Regulatory Review – Comprehensive Review of the Accounting Requirements and AFMIS Reporting Requirements for Incumbent Local Exchange Carriers: Phase 2 and Phase 3	Comments Reply Comments Reply Comments Reply Comments	12/21/00 1/30/01 2/13/01 3/14/01 7/16/01 7/26/01 4/8/02
File No. ASD-01-20	Application for Review of Responsible Accounting Officer Letter 31, Cost Allocation Manual Audit Requirements for Large Local Exchange Carriers	Comments Reply	3/28/01 4/9/01
CC Docket No. 99-301	Local Competition and Broadband Reporting	Reply	4/2/01
CC Docket No. 80-286	Jurisdictional Separations Reform and Referral to the Federal-State Joint Board	Comments Reply	7/20/01 8/6/01
CC Docket No. 01-337	Review of Regulatory Requirements for Incumbent LEC Broadband Telecommunications Services	Reply	4/22/02

WC Docket No. 92-80

Winstar Communications, LLC Emergency Petition
for Declaratory Ruling Regarding ILEC Obligations
to Continue Providing Service

Comments 4/29/02

Attachment 1
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02/27/03

RICHARD B. LEE

APPEARANCES BEFORE REGULATORY AGENCIES

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
CA	US Department Of Defense	All LECs	1.87-11-033 Phase III	IntraLATA Competition	Direct Reply	9/23/91 10/2/91	10/7/91 10/7/91
CA	US Department Of Defense	All LECs	1.87-11-033 Phase III	Rate Design	Direct Reply Suppl.	12/16/91 1/17/92 4/18/92	4/28/92 4/28/92 4/28/92
CO	US Department Of Defense	All LECs	92R-050T	Interconnection	Direct	8/20/92	8/31/92
WV	Consumer Advocate Division of WV PSC	C&P	90-424-T-PC	Cost Allocation	Direct Reply	10/6/92 12/18/92	1/14/93 1/14/93
CA	US Department Of Defense	Pacific Bell	A.92-05-004	Incentive Regulation	Direct Reply	4/8/93 5/5/93	6/9/93 6/9/93
DC	US Department Of Defense	C&P	926	Productivity	Direct	7/30/93	10/7/93

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASES</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
NJ	US Department Of Defense	All LECs	TX90050349 TE92111047 TE93060211	IntraLATA Competition	Direct Reply	4/5/94 4/25/94	--
CT	Connecticut Resellers	Cellular Carriers	94-03-27	Financial Performance	Direct	--	6/7/94
NY	US Executive Agencies	Niagara Mohawk	94-E-0098 94-E-0099 94-G-0100	Incentive Regulation	Direct	8/31/94	10/26/94
DC	DC Office Of People's Counsel	Pepco	939	Productivity	Direct	1/17/95	3/17/95
GA	GA Public Service Commission	Southern Bell	5503-U	Cost Allocation	Direct Reply	1/27/95 4/14/95	2/14/95 4/25/95
HI	US Department Of Defense	GTE Hawaiian	94-0298	Rate Case	Direct	5/7/96	--
CANADA	AT&T Canada	Stentor Companies	96-8	Depreciation	Direct	8/27/96	11/5/96

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
NJ	AT&T	Bell Atlantic	T096070519	Depreciation	Direct	9/18/96	10/3/96
MA	AT&T	New England Telephone	DPUG96-80/81	Depreciation	Direct	10/11/96	--
NY	AT&T	New York Telephone	95-C-0657 94-C-0095 91-C-1174	Depreciation	Rebuttal	10/15/96	11/8/96
VA	AT&T	GTE	PUC960117	Depreciation	Direct	10/30/96	--
NJ	AT&T	All LECs	TX95120631	Depreciation	Direct Rebuttal	11/1/96 12/20/96	1/24/97 1/24/97
PA	AT&T/MCI	Bell Atlantic	A-310203F0002	Depreciation	Rebuttal Direct Surrebuttal	1/13/97 2/7/97 2/21/97	1/28/97 2/25/97 2/25/97
DE	AT&T/MCI	Bell Atlantic	96-324	Depreciation	Rebuttal	2/4/97	2/18/97
WY	AT&T	U S West	7200-TF-96-95 7000-TF-96-319	Depreciation	Direct	2/5/97	2/12/97

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
WV	AT&T	Bell Atlantic	96-1516-T-PC 96-1561-T-PC 96-1009-T-PC 96-1533-T-T	Depreciation	Direct Rebuttal	2/13/97 2/20/97	2/27/97 2/27/97
MD	AT&T/MCI	Bell Atlantic	8731, Phase II	Depreciation	Direct	3/7/97	4/14/97
UT	AT&T/MCI	U S West	94-999-01	Depreciation	Direct Rebuttal Surrebuttal Sup. Surr.	3/19/97 3/31/97 4/23/97 5/2/97	5/13/97 5/13/97 5/13/97 5/13/97
DC	AT&T/MCI	Bell Atlantic	962	Depreciation	Direct Rebuttal	3/24/97 5/2/97	6/11/97 6/11/97
VA	AT&T/MCI	Bell Atlantic	970005	Depreciation	Affidavit Direct Rebuttal	4/7/97 4/23/97 6/10/97	6/27/97 6/27/97 6/27/97
HI	US Department Of Defense	GTE	7702	Depreciation	Direct Reply	7/03/97 8/28/97	10/22/97 10/22/97
LA	AT&T/MCI	Bell South	22022/22093	Depreciation	Direct	8/25/97	9/16/97

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
ME	AT&T	Bell Atlantic	96-781	Depreciation	Direct	9/15/97	1/20/98
					Surrebuttal	12/22/97	1/20/98
TENN	AT&T/MCI	Bell South	97-01262	Depreciation	Direct	10/10/97	2/25/98
						10/17/97	2/25/98
VT	AT&T	Bell Atlantic	5713	Depreciation	Direct	10/30/97	12/11/97
					Surrebuttal	12/4/97	12/11/97
KY	AT&T/MCI	BellSouth, GTE, CBT	360	Depreciation	Reply	11/4/97	--
PA	AT&T	GTE	A-310125F002 GTEN-11	Depreciation	Direct	11/13/97	--
NC	AT&T/MCI	BellSouth, GTE, Sprint	P-100, SUB133b	Depreciation	Direct	12/10/97	--
						1/30/98	
NC	AT&T/MCI	BellSouth, GTE, Sprint	P-100, SUB133d	Depreciation	Direct	12/15/97	--
						3/9/98	
OHIO	AT&T/MCI	CBT	96-899-TP-ALT	Depreciation	Direct	12/17/97	3/22/99
					Reply	12/23/98	3/22/99
LA	AT&T/MCI	BellSouth	U-20883 Subdocket A	Depreciation	Direct	1/9/98	--
					Reply	1/20/98	

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
OK	AT&T	SBC	970000213 970000442	Depreciation	Direct	1/12/98	--
MISS	AT&T	BellSouth	97-AD-544	Depreciation	Direct Reply	1/28/98 3/13/98	--
MISS	AT&T	BellSouth	98-AD-035	Depreciation	Direct Reply	2/23/98 3/6/98	--
TENN	AT&T	BellSouth, GTE, Sprint	9700888	Depreciation	Direct Reply	3/18/98 3/25/98	--
RI	AT&T	Bell Atlantic	2681	Depreciation	Direct Surrebuttal	6/30/98 12/11/98	1/7/99
AZ	U S Department Of Defense	U S West	T-01051B- 97-0689	Depreciation	Direct Suppl Surrebuttal Comments Suppl Direct Reply	7/13/98 7/15/98 8/17/98 10/30/98 4/2/99 2/7/00 2/22/00	11/13/98 11/13/98 11/13/98 11/13/98 4/27/99 2/28/00 2/28/00

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
MICH	Michigan Cable Television Association	All	U-11016	Affiliate Transactions	Direct Reply	5/27/98 7/1/99	7/29/99 7/29/99
HI	U S Department of Defense	GTE	7702	Collocation and Nonrecurring Charges	Direct	6/2/00	--
NY	AT&T/WorldCom	Bell Atlantic	98-C-1357	Depreciation	Reply Rebuttal	6/26/00 10/19/00	-- --
AZ	US Department Of Defense	Qwest	T-01051B-99-0105	Revenue Requirements	Direct Surrebuttal Direct	7/25/00 9/8/00 11/13/00	12/1/00 12/1/00 12/1/00
MA	AT&T/WorldCom	Verizon	D.T.E. 01-20	Depreciation	Direct Rebuttal Surrebuttal	5/8/01 7/18/01 12/17/01	1/8/02
MD	AT&T/WorldCom	Verizon	8879	Depreciation	Direct Rebuttal Surrebuttal	5/25/01 9/5/01 10/15/01	--
VA	AT&T/WorldCom	Verizon	FCC 00-218 FCC 00-249 FCC 00-251	Depreciation	Direct Rebuttal Surrebuttal	7/31/01 8/27/01 9/21/01	10/23/01

<u>STATE</u>	<u>CLIENT</u>	<u>UTILITY</u>	<u>CASE</u>	<u>SUBJECT</u>	<u>TYPE</u>	<u>FILE DATE</u>	<u>CROSS DATE</u>
CA	US Department of Defense	Pacific Bell	A01-20-024	Depreciation	Direct	9/19/01	
					Direct	10/18/02	
					Direct	2/7/03	
PA	AT&T/WorldCom	Verizon	R-00016683	Depreciation	Direct	12/7/01	--
					Rebuttal	1/11/02	
					Surrebuttal	2/8/02	

2/25/03

Experience

**Snavelly King Majoros O'Connor
& Lee, Inc.
Washington, DC**

***Vice President (1996 to Present)
Senior Consultant (1991 to 1995)***

Mr. Lee provides consulting services that reflect his depth of experience with regulated utilities. For over a quarter of a century, he has been extensively involved in regulatory financial and accounting matters.

Mr. Lee has provided expert witness testimony, technical assistance and strategic support to clients in state commission proceedings related to the telephone, cellular telephone and electric industries. His testimony has addressed such matters as competition, interconnection, incentive regulation, rate design, cost allocation, depreciation, productivity, and overall financial performance. Mr. Lee has also conducted a cost allocation and affiliate transaction audit of a major telephone company on behalf of its state commission.

Mr. Lee has assisted clients in proceedings before the Federal Communications Commission (FCC) related to competition, interconnection, universal service, incentive regulation, accounting, cost allocation, reporting, depreciation, and advanced services. Mr. Lee also performed a study on plant writedowns in the U.S. telecommunications industry on behalf of the Canadian Radio-Television and Telecommunications Commission.

AT&T, Basking Ridge, NJ

***Regulatory Vice President (1988-1990)
Division Manager (1980-1988)***

Mr. Lee represented AT&T before the FCC in all financial and accounting matters. In this capacity, he directed the preparation of all financially related AT&T filings and coordinated the analysis of commission and intervenor responses. In addition, he was responsible for the periodic review of AT&T financial operating results and the development of related capital and expense forecasts.

Mr. Lee directed the design and implementation of AT&T's automated system for the reporting of financial information to the FCC. He also was responsible for the implementation of AT&T's manual for the separation of regulated and unregulated costs and the conversion of the company to the revised Uniform System of Accounts.

His responsibilities included liaison with the FCC's audit staff and coordination of their activities with respect to AT&T. During his tenure, Mr. Lee brought scores of FCC investigations involving many billions of dollars to equitable conclusions.

Mr. Lee participated in the strategic development of price cap incentive regulation proposals and performed numerous related financial analyses. He also conceived and developed a methodology which reduced the administrative burden of AT&T's depreciation filings by over 90%.

Prior to divestiture, Mr. Lee coordinated all Bell System depreciation filings, rate of return pleadings and interstate rate cases. He was responsible for securing FCC approval of the accounting entries which implemented the Modified Final Judgment.

**New York Telephone Company
New York, NY**

***District Manager (1970-1980)
Accounting Manager (1963-1970)***

Mr. Lee held a variety of progressively responsible positions leading to his selection as the Company's accounting representative before the New York Public Service Commission. In this capacity, he participated in numerous general rate cases and related proceedings.

In an earlier assignment, Mr. Lee directed an inter-departmental study of the company's "Lost Telephone Set" problem. The study resulted in both operational improvements and major strategy changes by the company.

While in a rotational assignment to AT&T, Mr. Lee developed a cost accounting and productivity measurement system that was implemented in all Bell System Comptrollers Departments.

Mr. Lee also managed numerous line organizations of up to 200 persons responsible for billing and collection, property and cost and data processing functions.

Education

***Yale University, B.S. (High Honors)
Harvard Business School, MBA (Distinction)***

Professional Affiliations

Society of Depreciation Professionals

Recommended Regulatory Treatment of DEX Sale

(Dollars in Millions)

1.	Pre-tax Gain on Sale	---
2.	Arizona Share	---
3.	Arizona Regulatory Benefit (L1xL2)	---
4.	Bill Credit (L3x10%)	---
5.	Initial Regulatory Liability (L3-L4)	---
6.	Annual Amortization (L5/15)	---

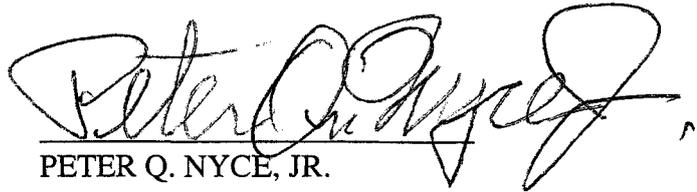
Source: Lines 1 and 2, Attachment A to Qwest Response to Staff Data Request No. 68.

PUBLIC VERSION

CERTIFICATE OF SERVICE

I hereby certify that a true and correct copy of the foregoing expurgated Rebuttal Testimony of Mr. Richard B. Lee on behalf of the United States Department of Defense and All Other Federal Executive Agencies was sent to the parties on the attached service list either by United Parcel Service - Next Day Air, or by first class mail, postage prepaid on February 28, 2003. Copies of the Confidential version of Mr. Lee's "Attachment 4" to his Rebuttal Testimony have been sent only to Parties who have executed the appropriate Protective Agreement.

Dated at Arlington County, Virginia, on this 28th Day of February 2003.


PETER Q. NYCE, JR.

DOCKET CONTROL
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

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

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

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

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

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

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

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

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

MARK BROWN
3033 N 3RD STREET
PHOENIX AZ 85012

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

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

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

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

BEFORE THE ARIZONA CORPORATION COMMISSION

MARC SPITZER
Chairman
JAMES M. IRVIN
Commissioner
WILLIAM A. MUNDELL
Commissioner
JEFF HATCH-MILLER
Commissioner
MIKE GLEASON
Commissioner

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

REJOINDER TESTIMONY
of
RICHARD B. LEE

on behalf of

THE UNITED STATES DEPARTMENT OF DEFENSE
And
ALL OTHER FEDERAL EXECUTIVE AGENCIES

ROBERT N. KITTEL, CHIEF
Regulatory Law Office
Office of the Judge Advocate General
U.S. Army Litigation Center
901 N. Stuart Street, Suite 713
Arlington, Virginia 22203-1837

by

Peter Q. Nyce, Jr.
General Attorney

May 9, 2003

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1 I. INTRODUCTION

2

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

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

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

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

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

12 A. Yes, I am.

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

15 A. Yes, it did.

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

18 A. Yes, it was.

19 Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

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

1 the Arizona Corporation Commission Staff ("Staff") and Qwest Corporation ("Qwest").¹
2 I will also respond to the surrebuttal testimonies of Qwest witnesses Ann Koehler-
3 Christensen and Phillip E. Grate.

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

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

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

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

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

¹ Stipulation dated April 10, 2003.

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

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

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

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

15 Q. WHAT HAS LED YOU TO THIS BELIEF?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 Dex (Line ⁶~~8~~) is much less than that of the other parties (Lines 1, 2 and 3), largely because
2 Qwest contends that the gain associated with Secondary Directories and non-Qwest
3 listings should be “carved out” of the ratepayer benefit calculation. This is a highly
4 controversial contention, as I will discuss below. At any rate, the Stipulation benefit
5 (Line ⁷~~8~~) does not represent a compromise on this issue – the Stipulation benefit is even
6 less than Qwest’s calculation of gain. I cannot, in good conscience, recommend that
7 DOD/FEA support a settlement that represents a capitulation instead of a compromise.

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

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

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

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

⁶ Lee Rebuttal, at 7-8.

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

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

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

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

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

18
19 The two states referenced are Arizona and Washington.

⁷ Id.

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

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

¹⁰ Id., at paragraph 25.

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

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

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

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

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

¹¹ Koehler-Christensen Rebuttal, at 3.

¹² Id., at 17.

¹³ Id.

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

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

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

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

¹⁵ Response to STF 1-26, Attachment A.

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

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

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

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

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

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

¹⁶ Grate Surrebuttal, at 38-40.

¹⁷ Id., at 38.

¹⁸ Lee Rebuttal, at 6.

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

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

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

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

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

¹⁹ Grate Surrebuttal, at 38.

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

1 operations, when fully determined, will exceed the one-time gain from its sale of Dex.²¹
2 Mr. Grate does not dispute this assertion.²²

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

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

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

13 A. On Attachment RBL5, I calculate the present value of my proposal as \$1,217.3 million.
14 On Attachment RBL4, I recalculate my proposal assuming that the Arizona Regulatory
15 Benefit is determined on a Post-Tax basis. Using the rounding convention I adopted in
16 my original proposal the immediate bill credit (Line 4) becomes \$98 million (instead of
17 \$97 million) and the Annual Amortization (Line 6) remains \$58 million. The Initial
18 Regulatory Liability (Line 5), however, drops from \$873 million to \$528 million.
19

²¹ Lee Rebuttal, at 10.

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

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

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

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

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

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

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

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

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

²³ Grate Surrebuttal, at 39.

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

1 marked by the circumstances in Arizona.”²⁵

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

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

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

²⁵ Id.

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

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

²⁸ Grate Surrebuttal, at 39.

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

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

12

13

V. CONCLUSION

14

15 Q. DOES THIS CONCLUDE YOUR TESTIMONY?

16 A. Yes, it does.

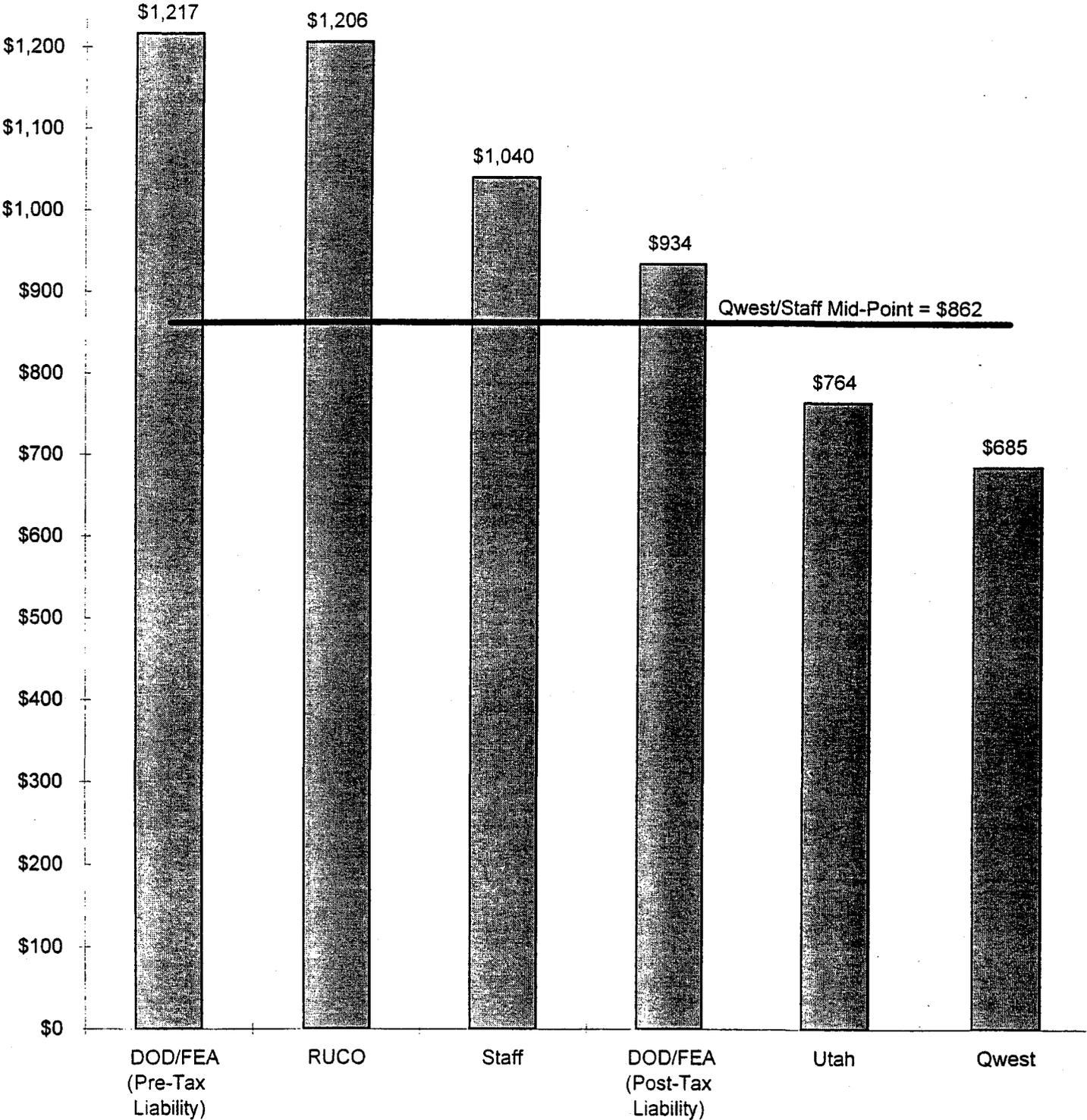
²⁹ Id., at 40.

Comparison of Ratepayer Benefits

(Dollars in Millions)

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

Comparison of Ratepayer Benefits (Dollars in Millions)



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

Confidential Information
Subject To Protective Agreement

Recommended Regulatory Treatment of DEX Sale

(Dollars in Millions)

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

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

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

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

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

Present Value of DOD/FEA Proposed Customer Credits

Post-Tax Regulatory Liability

(Dollars in Millions)

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

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

CERTIFICATE OF SERVICE

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

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


PETER Q. NYCE, JR.

DOCKET CONTROL
ARIZONA CORPORATION COMMISSION
1200 WEST WASHINGTON
PHOENIX AZ 85007

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

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

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

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

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

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

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

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

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

MARK BROWN
3033 N 3RD STREET
PHOENIX AZ 85012

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

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

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

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

ALJ JANE RODDA
400 WEST CONGRESS
TUCSON AZ 85701-1347