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Transcript Exhibit(s)

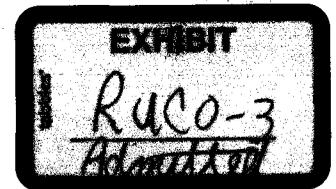
Docket #(s): T-01051B-02-06ddp

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Exhibit #: RU03,5,6

Q9,11

\* Admitted with June 3, 2003  
transcript (volume III) \*



**Qwest**  
1600 7th Avenue, Room 3206  
Seattle, Washington 98191  
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**Lisa A. Anderl**  
Associate General Counsel  
Regulatory Law Department

May 16, 2003

*Via E-Mail, Fax Filing  
And Hand Delivery (5/19/03)*

Ms. Carole J. Washburn, Executive Secretary  
Washington Utilities & Transportation Commission  
1300 S. Evergreen Park Drive SW  
P.O. Box 47250  
Olympia, WA 98504-7250

Re: Docket No. UT-021120  
Dex Transfer Application

Dear Ms. Washburn:

Enclosed for filing is the Stipulation and Settlement Agreement ("Agreement") entered into between Qwest, Dex Holdings, Public Counsel, AARP, WeBTEC, and DoD/FEA. Also enclosed is the supplemental testimony of Mark S. Reynolds and Michael L. Brosch in support of the Agreement. An original and 12 copies of these documents will be provided on Monday. Permission to file by facsimile was granted by ALJ Moss.

The parties respectfully request that the Commission accept this filing and consider the Agreement during the hearings already scheduled for the week of May 19, 2003. Dex Holdings will file its supplemental testimony under separate cover. DoD/FEA has authorized the undersigned to represent to the Commission that its testimony on the Agreement will be filed at the earliest possible date next week, due to Mr. King being out of the country.

Also enclosed is a diskette with an electronic copy of the documents.

Sincerely,

Lisa A. Anderl

LAA/llw  
Enclosures

cc: Service List (via e-mail and U.S. Mail)

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**BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the Application of  
QWEST CORPORATION  
Regarding the Sale and Transfer of Qwest Dex  
to Dex Holdings, LLC, a non-affiliate

Docket No. UT-021120

**STIPULATION AND SETTLEMENT  
AGREEMENT**

**I. INTRODUCTION**

The following parties ("Parties") enter into the this Settlement Agreement (the "Agreement") as of May 16, 2003: Qwest Corporation ("QC"), on behalf of its affiliates, Qwest Dex, Inc. ("Dex") and Qwest Services Corporation ("QSC"), and its ultimate parent, Qwest Communications International Inc. ("QCI") (collectively, "Qwest"); Dex Holdings LLC ("Dex Holdings"); the Public Counsel Section of the Attorney General of Washington ("Public Counsel"); WeBTEC; AARP; and, the Department of Defense on behalf of the consumer interest of the Department of Defense and all other Federal Executive Agencies ("DOD") (WeBTEC, AARP and DOD are also collectively referred to as "Intervenors"). The Parties agree this Agreement is in the public interest. The Parties understand this Agreement is subject to Commission approval.

**II. BACKGROUND**

On August 19, 2002, QCI, together with QSC and Dex, entered into two agreements to sell

1 Dex's directory publishing business to Dex Holdings, an unaffiliated third party. The Rodney  
2 Purchase Agreement, the purchase agreement covering the proposed sale of Dex's Washington  
3 assets and operations, is more fully described in Qwest's Application in this matter. On  
4 August 30, 2002 Qwest filed an Application with the Washington Utilities and Transportation  
5 Commission ("Commission") requesting an Order disclaiming jurisdiction or, in the alternative,  
6 approving the transfer and sale of the yellow pages publishing business.

7 At a prehearing conference held October 8, 2002, the Intervenorers were granted intervention  
8 in the proceeding. Pursuant to a notice issued October 11, 2002, the procedural schedule was  
9 structured to allow parties to the proceeding to discuss possible settlement. In accordance with  
10 that procedural schedule, Qwest and Dex Holdings filed direct testimony on January 17, 2003,  
11 Commission Staff ("Staff"), Public Counsel, and Intervenorers submitted their prefiled testimonies  
12 on March 18, 2003 and Qwest and Dex Holdings filed rebuttal on April 17, 2003.

13 Both before and after the filing of testimony by the participants in this proceeding and both  
14 before and after discovery thereon, the parties to this proceeding, including Staff, engaged in  
15 settlement discussions regarding the contested issues in this proceeding.<sup>1</sup> The Parties identified in  
16 Section I. above have now reached agreement on all of the issues presented in this proceeding,  
17 including the Commission's jurisdiction to approve this Agreement, and wish to present their  
18 agreement on these issues for the Commission's consideration. The Parties to the settlement  
19 therefore adopt the following Agreement. The Parties enter into this Agreement voluntarily to  
20 resolve the matters in dispute among them and to expedite the orderly disposition of this  
21 proceeding.

### 22 III. AGREEMENT

23 Now, therefore, the Parties hereby agree as follows:

#### 24 A. SCOPE OF AGREEMENT.

25 <sup>1</sup> XO Washington, Inc. ("XO") was also granted leave to participate in this proceeding as an Intervenor. XO was  
26 invited to participate in the settlement discussions, but chose not to.

1 The Parties agree that the terms of this Agreement resolve, as among them, the contested  
2 issues in this proceeding including, without limitation, issues regarding any and all necessary  
3 conditions to the approval of the sale of the directory publishing business as set forth in Qwest's  
4 August 30, 2002 Application. If approved, this Agreement would constitute a full settlement of all  
5 issues raised in Docket No. UT-021120. The Parties stipulate to the Commission's jurisdiction to  
6 approve this Agreement. This Agreement is presented for the Commission's approval under WAC  
7 480-09-465 (Alternative Dispute Resolution) and WAC 480-120-466 (Settlement conference;  
8 settlements). The Parties request that the Commission approve this Agreement in a time frame  
9 that would allow Qwest to finalize the Rodney transaction as soon as practicable.

10 **B. SALE IS IN THE PUBLIC INTEREST**

11 By this Agreement the Parties agree that the sale to Dex Holdings of the Washington assets  
12 and operations of Dex, in accordance with the terms of the Rodney Purchase Agreement pertaining  
13 to Washington (the "Sale") and as conditioned by the terms and conditions of this Agreement, is in  
14 the public interest and should be approved by the Commission.

15 **C. SPECIFIC TERMS AND CONDITIONS REGARDING THE SALE**

16 1. **Bill Credit.** During a complete billing cycle commencing not later than forty-five  
17 (45) days following the closing of the Sale (the "Billing Cycle"), Qwest shall provide bill credits  
18 totaling SIXTY-SEVEN MILLION and NO/100 DOLLARS (\$67,000,000.00) to active customers  
19 of record during the Billing Cycle who currently subscribe to the **services identified in Appendix**  
20 **1**, attached hereto and incorporated herein (collectively "Bill Credit"). The Bill Credit will not be  
21 issued to inactive, closed, or final billed accounts. The Bill Credit shall be in the **approximate**  
22 **amount identified in Appendix 1.**

23 Not later than fifteen (15) days prior to the start of the Billing Cycle, Qwest shall submit to  
24 the Commission and the Parties its best estimate of the amount of the actual bill credit that will be  
25 provided, consistent with the principles of Appendix 1, during the Billing Cycle. The intention of  
26 the Parties in entering into this Agreement is that Qwest will provide Bill Credits in an aggregate

1 amount of SIXTY-SEVEN MILLION AND NO/100 DOLLARS (\$67,000,000.00) within seventy  
2 five (75) days after closing of the Sale.

3         The Bill Credit shall be provided to the **customers identified in Appendix 1** in its entirety  
4 in the single Billing Cycle. The Parties recognize that there may be some discrepancy between the  
5 amount distributed to customers as a Bill Credit and the \$67 million commitment. Within a  
6 reasonable time subsequent to completion of the application of Bill Credits to customers' bills, but  
7 not longer than sixty (60) days, Qwest will render an accounting and reconciliation report to the  
8 Commission and all parties of the number and amount of credits applied during the billing cycle  
9 with a reconciliation of total Bill Credits to the \$67,000,000 target. This report will outline the  
10 amount of credits applied to customer accounts, the amount of credits that have been "worked off"  
11 customer accounts, as well as any amount provided to customers as a remittance consistent with  
12 Commission rules. Within sixty (60) days thereafter the Parties shall present to the Commission  
13 their joint or separate recommendations for the distribution of any Bill Credit residuary from the  
14 \$67,000,000.00.

15         The Bill Credit shall be applied equally to all qualifying customers **on a per access**  
16 **line/activated channel basis as set forth in Appendix 1**. Customers whose monthly bill during  
17 the billing cycle is less than the amount of the Bill Credit shall have the remaining amount, if any,  
18 carry forward and be applied to their next month's bill. Customers with delinquencies will have  
19 their Bill Credit applied to the account charges consistent with Commission rules, whereby any  
20 amounts credited are first applied toward basic local exchange service charges for the Bill Credit  
21 Billing Cycle .

22         The foregoing notwithstanding, Qwest shall provide the Credits only in the event that this  
23 Agreement becomes effective as set forth in section D.2. below. In the event any miscalculation,  
24 omission or other error occurs in granting to customers the Credits, Qwest shall correct such  
25 miscalculation, omission or error, in consultation with the Commission and the Parties, but  
26 otherwise shall have no liability of any kind whatsoever in excess of the \$67 million and the other

1 provisions of this Agreement. The Parties agree that the Bill Credit shall not be recoverable from  
2 ratepayers in this or any other proceeding. The Commission shall retain jurisdiction over  
3 implementation of the Bill Credit, including the authority to decide later if an audit is necessary.

4       **2. Annual Revenue Credit.** In the event of one or more future rate cases, earnings  
5 investigations, or other proceeding that includes a review of Qwest's earnings, and for purposes of  
6 reporting intrastate financial results to the Commission for these or any other purposes, there will  
7 be an annual revenue credit for a period of 15 years, after which the credit shall end. This credit  
8 shall be recognized by the Commission in any proceeding before it where Qwest's earnings or  
9 revenues are under examination during the 15 year period. A revenue credit of \$110 million shall  
10 be added to Qwest's Washington intrastate regulated revenues beginning on January 1, 2004 and  
11 ending on December 31, 2007, and an annual revenue credit of \$103.4 million (in replacement of  
12 the \$110 million) shall be added to Qwest's Washington intrastate regulated revenues beginning  
13 on January 1, 2008 and ending on December 31, 2018. The Parties agree that they will not initiate  
14 any request to change the annual revenue credit and will oppose any change. Nor will the Parties  
15 argue that the annual revenue credit is inapplicable in any current or future review of Qwest's  
16 earnings or revenues, including but not limited to general rate cases, alternative forms of  
17 regulation proceedings, and competitive classification proceedings.

18       The Parties intend and agree that the practice of imputing directory revenues to Qwest in  
19 rate cases or other rate proceedings shall cease on December 31, 2003 and that the annual revenue  
20 credit amounts described herein shall be instituted in place of any future directory revenue  
21 imputation calculations, except that no party waives the right to take any position with regard to  
22 imputation in the event that Qwest acquires a new directory publishing operation. In the event a  
23 rate proceeding is filed in 2004 the Parties agree that they will jointly consider and recommend in  
24 all advocacy before the Commission the Annual Revenue Credit to constitute a known and  
25 measurable change that shall be applied by the Commission in determining Qwest's earnings,  
26 revenue requirement, and customer rates. Also, in the event a rate proceeding is filed in 2019, the

1 Parties agree that the annual revenue credit will no longer be applied. The Parties agree that the  
2 Annual Revenue Credit shall not be recoverable from ratepayers in this or any other proceeding.

3       **3. Customer Service Guarantee Program.** As of June 30, 2003, Qwest has the right  
4 under the Merger Settlement Agreement in Docket No. UT-991358 to file tariff revisions to  
5 remove any customer-specific service quality remedy required in Sections II.A.3-7 of that  
6 Settlement Agreement, if that remedy is not required of all local exchange companies operating in  
7 exchanges in which QC operates. Those remedies are currently contained in QC's Washington  
8 intrastate tariff. WN U-40, Section 2.2.2.B, sheets 27 through 32. Qwest commits not to petition  
9 to remove those remedies for a period of two (2) additional years. The Parties agree, however, that  
10 QC may seek to change certain aspects of the Customer Service Guarantee Program during this  
11 period, and Qwest commits to discuss with the Parties no less than thirty (30) days in advance any  
12 changes it may seek to make and will consult with interested Parties prior to filing. This  
13 Agreement does not address the Qwest Service Quality Performance Program.

14       **4. WTAP Program.** In order to improve customer access to the Washington  
15 Telecommunications Assistance Program (WTAP) and associated benefits from the federal  
16 Lifeline and Link-Up programs, and the Tribal Lifeline/Link-Up (hereafter collectively referred to  
17 as 'Telephone Assistance Programs' or TAP), Qwest commits that within two months after the  
18 effective date of the Agreement, all Qwest service representatives answering calls from  
19 Washington customers will be knowledgeable about TAP benefits, enrollment procedures and  
20 payment plans provided by the company consistent with Commission rules. Qwest commits to  
21 taking specific steps to ensure that its service representatives can accurately provide interested  
22 customers with the necessary information regarding these programs and related payment options  
23 (including specific training on WAC 480-120-174 (which takes effect July 1, 2003)), subscribe  
24 customers to their service option, and properly apply all relevant credits, payment plans, and  
25 benefits. Within four months of the effective date of the Agreement, Qwest, in consultation with  
26 the Parties and interested stakeholders, will develop an action plan and specific steps associated

1 with it to improve customer awareness of these programs and to deal promptly with any issues that  
2 may arise regarding the effective operation of TAP and the provision of payment plans. This  
3 action plan may include but is not limited to training sessions for Qwest service representatives or  
4 the establishment of a dedicated service group to handle TAP enrollment and related calls. As  
5 part of the action plan, Qwest commits to work collaboratively with DSHS, Public Counsel, and  
6 other stakeholders to develop TAP customer information packages, including the copying and  
7 furnishing of such materials to DSHS and other interested stakeholders for distribution to  
8 customers.

9       **5. Rate Stability Contract Amendments.** Qwest and WeBTEC will attempt to enter  
10 into a Memorandum of Understanding (MOU) on specific rate stability provisions. Qwest and  
11 DOD will attempt to enter into an agreement on specific rate stability provisions. These will be  
12 filed with the Commission as soon as executed.

13       **6. Government Listings.** Dex Holdings, has represented to DOD that its present  
14 intent is to continue to publish the Government Listings directory section as it currently does.  
15 Based upon that representation, DOD does not advocate in this proceeding that the Commission  
16 make any regulatory requirement changes addressing Government Listings.

17 **D. GENERAL PROVISIONS**

18       **1. Settlement Discussions.** The Parties agree that this Agreement represents a  
19 compromise in the positions of the Parties and represents a fair and reasonable resolution between  
20 them of the matters in this proceeding. As such, all discussions, documents, other evidence or  
21 conduct disclosed in the negotiation of the Agreement and relating to this Agreement are  
22 privileged, confidential, and inadmissible in this or any other proceeding. This provision does not  
23 apply to pre-filed testimony or testimony/memoranda developed for submission to the  
24 Commission in support of the Agreement.

25       **2. Effective Date of Agreement.** This Agreement shall become effective only upon  
26 (1) the Commission entering an Order approving this Agreement and the Sale transaction in

1 accordance with Section III.B. above, and (2) the closing of the Sale. If this Agreement does not  
2 become effective according to its terms, it shall be null and void and no party shall be bound or  
3 prejudiced by the terms of the Agreement. The effective date of the Agreement shall be the date of  
4 closing of the Sale which shall not be unduly delayed by any Party. This does not preclude any  
5 Party's good faith participation in other state proceedings regarding Qwest's sale of the Dex  
6 directory publishing business to Dex Holdings, LLC. All Parties recognize that closing of the sale  
7 is contingent upon the fulfillment or waiver of the conditions set forth in the Rodney Purchase  
8 Agreement.

9       **3. No Precedent.** The Parties enter into this Agreement to avoid further expense,  
10 uncertainty, and delay. Except to the extent expressly stated in this Agreement, nothing in this  
11 Agreement, Appendix 1, or the MOU under section C.5 shall be (1) cited or construed as  
12 precedent or as indicative of the Parties' positions on a resolved issue, or (2) asserted or deemed in  
13 any other proceeding, including those before the Commission, the commission of any other state,  
14 the state courts of Washington or of any other state, the federal courts of the United States of  
15 America, or the Federal Communications Commission to mean that a Party agreed with or adopted  
16 another Party's legal or factual assertions. The limitation in this Section D.3. shall not apply to  
17 any proceeding to enforce the terms of this Agreement, Appendix 1, the MOU under section C.5,  
18 any implementing agreements, or any Commission order adopting this Agreement.

19       **4. Entire Agreement.** The Parties acknowledge that this Agreement is the product of  
20 negotiations and compromise and shall not be construed against any Party on the basis that it was  
21 or was not the drafter of any or all portions of this Agreement. This Agreement, Appendix 1, and  
22 the MOU under section C.5 constitute the Parties' entire agreement on all matters set forth herein,  
23 and they supersede any and all prior oral and written understandings or agreements on such matters  
24 that previously existed or occurred in this proceeding, and no such prior understanding or  
25 agreement or related representations shall be relied upon by the Parties. Accordingly, the Parties  
26 recommend that the Commission adopt this Agreement and related documents in their entirety.

1           **5. Full Satisfaction of All Claims.** Except as specifically provided in this  
2 Agreement, no Party shall advocate or otherwise argue in this docket, or in any future matter or  
3 docket, that customers of Qwest are entitled to any other compensation or any other benefit arising  
4 out of or connected in anyway with the directory publishing operations of Dex or the Sale. The  
5 Parties agree that the Bill Credit, annual revenue credits, and other benefits as provided in this  
6 Agreement constitute complete satisfaction of any and all interest of Qwest's customers in the  
7 directory publishing assets and operations of Qwest or Dex as recognized in *US WEST*  
8 *Communications, Inc. v. Washington Utilities and Transportation Commission*, 134 Wn.2d 74  
9 (1997). Nothing contained in this Agreement is intended to, or shall, require any change to  
10 Commission rules and regulations regarding the provision of a listing and a directory of listings to  
11 customers of Qwest.

12           **6. Execution in Counterparts.** This Agreement may be executed by the Parties in  
13 several counterparts and as executed shall constitute one agreement. Copies sent by facsimile are  
14 as effective as original documents.

15           **7. Necessary Actions.** Each Party shall take all actions necessary and appropriate to  
16 enable it to carry out this Agreement.

17           **8. Successors.** This Agreement applies to, inures to the benefit of, and is binding  
18 upon the Parties and their successors.

19           **9. Procedure.** The Agreement shall be filed with the Commission at 4:00 P.M., May  
20 16, 2003. All Parties shall cooperate in submitting this Agreement promptly to the Commission  
21 for acceptance, so that it may be implemented as soon as practicable. The Parties shall request one  
22 or more hearing dates during the week of May 19, 2003 to present the Agreement and shall  
23 cooperate, in good faith, in the development of such other information as may be necessary to  
24 support and explain the basis of the Agreement and to supplement the record accordingly. Any  
25 Party may elect to file with the Commission a memorandum explaining the Agreement or  
26 additional testimony. The Parties agree among themselves to suspend all existing due dates in this

1 docket including evidentiary hearings, and the briefing date, and to jointly request that the  
2 Commission so order. This agreement among the Parties with regard to the due dates and hearings  
3 does not affect the evidentiary hearings scheduled for the week of May 19, 2003 for purposes of  
4 presentation of other parties' evidence and cross-examination, and Qwest's and Dex Holdings'  
5 evidence and cross-examination with regard to the non-settling parties.

6 **10. Support of Agreement.** The Parties shall cooperate in submitting this Agreement  
7 promptly to the Commission for acceptance, and shall support adoption of this Agreement in  
8 proceedings before the Commission, through testimony and/or briefing as resolution of the issues  
9 in this proceeding. No Party to this Agreement or its principals, consultants or attorneys will  
10 engage in any advocacy or public relations contrary to the Commission's adoption of this  
11 Agreement as resolution of the issues in this proceeding. Each Party shall make available one or  
12 more witnesses in support of this Agreement if a hearing is determined necessary by the  
13 Commission. Each party may seek the admission of its pre-filed testimony in addition to  
14 testimony in support of the Agreement. Each Party shall not oppose any Commission order which  
15 adopts this Agreement in its entirety through the appellate process, if any, until final. In the event  
16 the Commission rejects all or any material portion of this Agreement, or adds additional, material  
17 conditions, each Party reserves the right, upon written notice to the Commission and all Parties to  
18 this proceeding within seven (7) days of the date of the Commission's order, to withdraw from this  
19 Agreement. If any Party exercises its right of withdrawal, this Agreement shall be void and of no  
20 effect, and all Parties shall support a joint request for a prompt Prehearing Conference and the  
21 reestablishment of those dates specifically suspended by the Commission pursuant to the above  
22 request.

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WeBTEC

Department of Defense and all other Federal  
Executive Agencies

By: \_\_\_\_\_  
Arthur Butler, Ater Wynne LLP  
WSBA # 04678

By: \_\_\_\_\_  
Stephen S. Melnikoff  
General Attorney  
U.S. Army Legal Services Agency

APPENDIX 1

CALCULATION OF ONE-TIME DISTRIBUTION OF CREDIT

May 16, 2003

1. The Credit amount of sixty-seven million and no/100 dollars (\$67,000,000.00) is to be distributed on a Residential and Business Access Line, activated channel basis. To illustrate this methodology, the number of residential access lines as of March 1, 2003 is 1,589,036. The number of business and miscellaneous access lines and activated channels is 654,376. These access line/channel counts include customers subscribing to the following services:

**Table 1 Access Line/Channel Services**

|                        |                   |                  |
|------------------------|-------------------|------------------|
| RES FLAT LINE          | BUS FLAT - 1FB    | STANDBY LINE     |
| RES FLAT-PRIM          | BUS MEAS LINE     | SVDS             |
| RES MEAS LINE          | CENTREX           | SWITCHNET 56     |
|                        |                   | MISC - UNKNOWN - |
| RES MULTIPARTY LINE    | CENTREX 21        | PROVISIONING     |
| DSS ADVANCED           | CENTREX PLUS-BLKD | FEATURE GROUP A  |
| DSS FLAT               | CENTREX PRIME     | HOME BUS LINE    |
| MULTIPARTY-BUS         | CENTRON           | UAS CIRCUIT      |
| ISDN BASIC RATE        | CNTRX PLS-NONBLKD | FLAT-CONTRACTED  |
| ISDN CENTRON           | PBX DID FLAT TRK  |                  |
| ISDN-PR-TRK-CONNECTION | PBX FLAT TRUNK    |                  |

2. The total amount of Credits is to be divided equally among the access lines/channels of all Residential and all Business and other access line customers who subscribe to the services outlined in Table 1. This distribution will result in an approximate credit amount of twenty-nine and 87/100 dollars (\$29.87) per each Residential and Business/Other Access Line/Channel, subject to adjustment to latest actual data at the time of the credits:

**Table 2 Credit Per Access line/Channel Calculation**

|                 | <u>Number of Access</u> |                           | <u>Credit Per Access</u> |
|-----------------|-------------------------|---------------------------|--------------------------|
|                 | <u>lines/Channels</u>   | <u>Total Bill Credits</u> | <u>line/Channel</u>      |
| Residential     | 1,589,036               |                           |                          |
| <u>Business</u> | <u>654,376</u>          |                           |                          |
| Total Access    |                         |                           |                          |
| lines/Channels  | <u>2,243,412</u>        | \$67,000,000              | \$29.87                  |

PLEASE NOTE – The above calculation of the individual end-user bill credit is only an estimation and the best available to the Parties at this time. The methodology and service categories are as agreed to between the parties.

EXHIBIT  
RUCO-5  
Admitted

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2003 MAR 19 P 4: 04

AZ CORP COMMISSION  
DOCUMENT CONTROL

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BEFORE THE ARIZONA CORPORATION COMMISSION

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

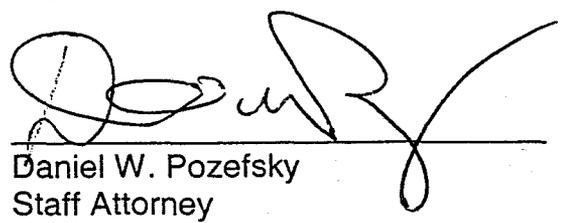
IN THE MATTER OF QWEST  
COMMUNICATIONS INTERNATIONAL,  
INC.'S, QWEST SERVICES  
CORPORATION'S, AND QWEST  
CORPORATION'S NOTICE OF SALE,  
REQUEST FOR WAIVER, OR  
APPLICATION FOR APPROVAL OF THE  
SALE OF THE ARIZONA OPERATIONS  
OF QWEST DEX, INC.

Docket No. T-01051B-02-0666

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Non-Proprietary Direct Testimony of Ben Johnson, Ph.D. in the above-referenced matter. The Proprietary version of the Testimony will be made available to those parties that have executed the appropriate Protective Agreements.

RESPECTFULLY SUBMITTED this 19<sup>th</sup> day of March, 2003.

  
Daniel W. Pozefsky  
Staff Attorney

1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 19<sup>th</sup> day  
3 of March, 2003 with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 West Washington  
6 Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
6 mailed this 19<sup>th</sup> day of March, 2003 to:

7 Lyn Farmer  
8 Chief Administrative Law Judge  
9 Arizona Corporation Commission  
10 1200 West Washington  
11 Phoenix, Arizona 85007

10 Christopher Kempley, Chief Counsel  
11 Legal Division  
12 Arizona Corporation Commission  
13 1200 West Washington  
14 Phoenix, Arizona 85007

13 Ernest Johnson, Director  
14 Utilities Division  
15 Arizona Corporation Commission  
16 1200 West Washington  
17 Phoenix, Arizona 85007

16 Timothy Berg  
17 Theresa Dwyer  
18 Fennemore Craig, P.C.  
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19 Russell P. Rowe  
20 William C. Brittan  
21 Campbell, Bohn, Killin, Brittan & Ray,  
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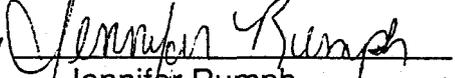
1 Marc Spitzer  
Chairman  
2 ACC  
1200 West Washington  
3 Phoenix, Arizona 85007

4 Jim Irvin  
Commissioner  
5 ACC  
1200 West Washington  
6 Phoenix, Arizona 85007

7 William A. Mundell  
Commissioner  
8 ACC  
1200 West Washington  
9 Phoenix, Arizona 85007

10 Jeff Hatch-Miller  
Commissioner  
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TESTIMONY  
OF BEN JOHNSON, PH.D.  
On Behalf of  
THE STATE OF ARIZONA  
RESIDENTIAL UTILITY CONSUMER OFFICE  
Before the  
ARIZONA CORPORATION COMMISSION

Docket No. T-01051B-02-0666

**Introduction**

**Q. Would you please state your name and address?**

A. Ben Johnson, 2252 Killearn Center Boulevard, Tallahassee, Florida 32309.

**Q. What is your present occupation?**

A. I am a consulting economist and president of Ben Johnson Associates, Inc., an economic research firm specializing in public utility regulation.

**Q. Have you prepared an appendix that describes your qualifications in regulatory and utility economics?**

A. Yes. Appendix A, attached to my testimony, will serve this purpose.

1    **Q.    Can you briefly explain the corporate names and acronyms that you will be using in**  
2    **your testimony?**

3    A.    Throughout my testimony, I will use the acronym "QCI" when specifically referring to Qwest  
4    Communications International, Inc. QCI is a publicly traded holding company that owns 100%  
5    of the stock of Qwest Corporation. I will use the acronym "QC" when referring specifically to  
6    Qwest Corporation, which is the entity that provides local exchange service in Arizona. I will  
7    use the acronym "QSC" if I am referring specifically to Qwest Services Corporation, another  
8    QCI subsidiary. I will use the term "Dex" when referring to Qwest Dex, Inc., which is another  
9    subsidiary of QCI—one whose primary function is the publication of telephone directories in  
10    QC's local exchange areas. When referring more generally or collectively to QCI and/or QC  
11    and its affiliates, I will use the term "Qwest" or "the Company."

12

13   **Q.    What is your purpose in making your appearance at this hearing?**

14   A.    Our firm has been retained by the Residential Utility Consumer Office ("RUCO") to assist with  
15   RUCO's participation in this proceeding. We have been asked to analyze the proposed sale of  
16   Dex to Dex Holdings LLC, along with various long term contracts which are part of this  
17   proposed sale. I will refer to the proposed sale of Dex and the associated contracts as the  
18   "proposed transaction."

19

20   **Q.    Would you please explain how your testimony is organized, and briefly summarize its**  
21   **major elements?**

22   A.    Yes. Following this introduction, my testimony has five sections. The first section contains a

1           brief discussion of the background of this proceeding. In the second section I describe the  
2           proposed sale and summarize Qwest's claims regarding the merits of the proposed transaction.  
3           The third section examines the linkage between directory publishing and local exchange service.  
4           Historically, telephone directories that are published by, or otherwise closely associated with,  
5           an incumbent local exchange carrier generate revenues far in excess of the direct costs of  
6           publishing those directories. In this section, I explain some of the reasons why the Dex  
7           directories generate high revenues and income, all of which directly relate to QC's local  
8           exchange operations. In the fourth section I discuss the concept of imputation of directory  
9           income for regulatory purposes and the potential impact on imputation of the proposed  
10          transaction. In addition, I analyze the proposed transaction from a public interest perspective.  
11          In the fifth and final section, I present my conclusions and recommend that the Arizona  
12          Corporation Commission (the "Commission") approve the proposed transaction with certain  
13          conditions.

14  
15   **Q.    Would you please briefly summarize your testimony?**

16   **A.    Yes. The Company argues the proposed sale will enable it to avoid bankruptcy, but this**  
17          **temporary infusion of cash would do little more than postpone QCI's liquidity problems.**  
18          **Moreover, the directory publishing operations are the source of a very substantial and growing**  
19          **flow of cash, revenues, and profits—all of which will be lost once the sale is completed. Hence,**  
20          **the proposed transaction will have a substantial adverse impact on all of the major long term**  
21          **indicators of financial health, including earnings per share, gross profit margins, and interest**  
22          **coverage.**

1           In Arizona, as in most jurisdictions, directory publishing has long been viewed as a  
2 profitable byproduct of local telephone service, serving to offset the cost of providing local  
3 telephone service. The Company has not provided adequate assurance that rates will not  
4 increase as a result of the proposed transaction. Once the directory publishing operations are  
5 no longer be located within the Qwest corporate family it will be more difficult to maintain an  
6 appropriate policy with respect to imputation of directory income. Furthermore, because of the  
7 unique structure of the proposed transaction, the relevant "value of fees and services" will be  
8 more difficult to determine.

9           For these and other reasons, I conclude that in the absence of adequate safeguards and  
10 assurances, the proposed transaction is not in the public interest. I recommend that the  
11 Commission reject the proposed transaction unless additional assurances and safeguards are  
12 provided. Furthermore, to ensure that all parties are treated fairly, it would be preferable for the  
13 Commission to establish an appropriate imputation amount (or formula) that will apply in future  
14 regulatory proceedings, notwithstanding any changes in circumstances that will result from  
15 completion of the proposed sale.

16           One way of accomplishing this is would be to establish an appropriate imputation  
17 amount (or formula) using the \$43 million imputation figure referenced in the 1988 Settlement  
18 Agreement as a starting point. When this amount was initially established in Mountain Bell's  
19 1984 rate case, it was equivalent to \$2.59 per line per month. Applying this figure to the current  
20 number of switched access lines in the Company's Arizona service territory, without taking  
21 inflation into account, this is equivalent to approximately \$90 million per year. Adjusting for  
22 inflation (based upon changes in the GDP Deflator from 1984 to 2001) this is equivalent to

1 approximately \$138 million as in 2001 dollars.

2 Without adequate safeguards and assurances, the proposed transaction is not in the  
3 public interest. Hence, if the Company is unwilling to voluntarily provide the type of assurances  
4 and safeguards I have recommended, or if it wants to reserve the right to appeal the  
5 Commission's imposition of such safeguards, the Commission should refuse to approve the  
6 proposed transaction.

7

8 **Background**

9

10 **Q. Let's turn to the first section of your testimony. Would you please start by outlining**  
11 **the history of this proceeding?**

12 **A.** Yes. On August 30, 2002, QCI, QSC, and QC filed a Notice of Sale, Request for Waiver or  
13 Application for Approval Pursuant to R14-2-803 wherein it sought to sell its "directory  
14 publishing assets in Arizona owned by Dex to Dex Holdings LLC (the "Buyer"), which is an  
15 entity not affiliated with Qwest. [Notice, p. 1 and p. 11.] Dex Holdings LLC is an unregulated,  
16 unaffiliated, third-party Buyer. It is owned by The Carlyle Group and Welsh, Carson,  
17 Anderson & Stowe—both private equity investment companies. [Kennard, p. 3]

18

19 "Established in 1987, The Carlyle Group is a private global investment  
20 firm that originates, structures and acts as lead equity investor in  
21 management-led buyouts, strategic minority equity investments, equity  
22 private placements, consolidations and buildups, and growth capital  
23 financings. Since its inception, the firm has invested more than \$7.2  
24 billion of equity in 263 corporate and real estate transactions with an

1 aggregate acquisition value of over \$19 billion. As of September 30,  
2 2002, the firm had more than \$13.9 billion of committed capital under  
3 management.” [<http://www.thecarlylegroup.com/profile.htm>]  
4

5 “Unlike other large private equity firms, our investment activities  
6 are exclusively focused in three industries: information services,  
7 communications and healthcare. Moreover, we can supply  
8 subordinated debt as well as equity to complete transactions. WCAS  
9 specializes in acquiring and building established businesses in our three  
10 targeted industries. The firm’s principals have significant operating  
11 experience as well as investment experience in our industries.”  
12 [<http://www.welshcarson.com/site/background.cfm>]  
13

14 William Kennard, testifying on behalf of the Buyer, states that the two firms have  
15 experience in “owning and managing communications-related businesses” through board  
16 members who used to work in the telecommunications industry and through communications  
17 and publishing investments. [Kennard, p. 5]

18 In its Notice of Sale, Qwest argued that the Commission should not block the  
19 proposed transaction for any of three reasons: (1) QCI need not comply with Commission rule  
20 R14-2-803 due to a waiver it received in Commission Decision No. 58087 and reaffirmed in  
21 Decision No. 64654, (2) the Commission vacated jurisdiction over directory asset sales in a  
22 “1988 Mountain Bell Settlement Agreement,” and (3) the sale is in the public interest. [Id., p.  
23 15]

24 To understand these contentions it is helpful to briefly retrace the history of these assets.  
25 In October 1987, the Commission voided a 1984 transfer of directory assets by Mountain Bell  
26 to one of its subsidiaries and fined Mountain Bell for completing the transfer without prior  
27 Commission approval. [Decision No. 55755, p. 8] The parties subsequently reached a

1 settlement resolving the issues that were in dispute. The parties agreed that Mountain Bell's  
2 transfer of directory assets would be allowed and that "the Commission will take no further  
3 action to challenge that transfer." [1988 Settlement Agreement, pp. 1-2]

4 The 1988 Settlement Agreement was the subject of subsequent disputes, particularly  
5 with regard to directory imputation. In setting Mountain Bell's rates after divestiture, the  
6 Commission took into account "imputed" directory publishing income of approximately \$43  
7 million. In the 1988 Settlement Agreement the parties agreed

8  
9 that in subsequent rate cases downward adjustments from the \$43  
10 million in fees received by Mountain Bell from USWD [U S West  
11 Direct—the Mountain Bell subsidiary to whom the directory assets were  
12 ultimately transferred] and included in Mountain Bell's 1984 rate case  
13 will require more than a showing by Mountain Bell that it negotiated a  
14 lesser amount with USWD. [Id., p. 2]  
15

16 In a subsequent rate proceeding US West argued that

17  
18 any imputation in excess of \$43 million was in conflict with the spirit and  
19 terms of the 1988 Settlement Agreement as approved in Decision  
20 56020. According to the Company, the clear language of the  
21 Settlement Agreement only referred to a possible decrease in the \$43  
22 million imputation and made no reference to any possible increase.  
23 [Decision 58927, p. 12]  
24

25 The 1988 Settlement Agreement indicated that the \$43 million figure was the amount reflected  
26 in rates since the 1984 rate case, based upon the fees paid by US West Direct (USWD) to  
27 Mountain Bell. However, larger imputation amounts weren't necessarily precluded, as

1 suggested by this language:

2

3 in future rate cases filed by Mountain Bell, the Commission, in arriving  
4 at the test year operating income of Mountain Bell, will consider the  
5 fees and the value of services received by Mountain Bell from USWD  
6 under publishing agreements with USWD; that Mountain Bell and the  
7 Commission Staff may present evidence in support of or in  
8 contradiction to those fees and the value of those services. [1988  
9 Settlement Agreement, p. 2]

10

11 The Commission subsequently rejected US West's argument that larger imputation amounts  
12 were precluded:

13

14 We agree with RUCO and Staff that the Settlement Agreement does  
15 not place a cap of \$43 million on the amount of imputation. It does  
16 indicate that the Commission in future cases "will consider the fees and  
17 the value of services received by Mountain Bell from USWD under  
18 publishing agreements with USWD. . . ." Subsequent to the Settlement  
19 Agreement, Direct no longer pays any publishing fees to the Company  
20 (formerly Mountain Bell). Hence, the Commission must determine  
21 what would be reasonable fees and value of services under the  
22 circumstances. [Decision 58927, p. 13]

23

24 **Q. Can you briefly elaborate on the concept of "imputation"?**

25 **A.** Yes. Imputation is a technique used by regulators to restate a utility's income for ratemaking  
26 purposes at a level equivalent to that which would be earned if the utility did not enter into  
27 transactions that serve to benefit an affiliated company. Without the option of using this  
28 ratemaking technique, regulators would be faced with a Hobson's choice: either attempting to  
29 block affiliated transactions that may not be fully beneficial to ratepayers, or allowing such

1 transactions to adversely impact ratepayers.

2 Imputation adjustments have been widely used with respect to directory publishing,  
3 where local exchange companies have entered into agreements with affiliated publishing entities  
4 that do not provide the local exchange operations with as much income as they could earn by  
5 publishing their own directories, and/or what they could earn if they entered into an arms length  
6 contract with a completely independent publishing company. The higher level of income which  
7 could potentially be achieved by the local exchange operations is "imputed" for ratemaking  
8 purposes, thereby ensuring that ratepayers are not harmed when an affiliated company is  
9 allowed to publish the directories.

10 In a concurring opinion, Utah Supreme Court Justice Stewart explained that directory  
11 imputation prevent a carrier "from cherry picking the most profitable assets and diverting the  
12 profits therefrom to its shareholders." Also, "the cessation of imputation of revenues would  
13 unfairly transfer the benefit of present and future profits from the ratepayers to the  
14 shareholders." He explained that Utah is not unique in this regard:

15  
16 ...directory imputation has also been upheld when other  
17 telecommunications utilities have transferred directory publishing  
18 operations to unregulated affiliates. See, e.g., Rochester Tel. Corp. v.  
19 Public Serv. Comm'n, 660 N.E.2d 1112, 1116-18 (N.Y. 1995); State  
20 ex rel. Util. Comm'n v. Southern Bell Tel. & Tel. Co., 299 S.E.2d 763,  
21 765-67 (N.C. 1983); Turpen v. Oklahoma Corp. Comm'n, 769 P.2d  
22 1309, 1327-28 (Okla. 1988)." [US West v. Public Service  
23 Commission of Utah, No. 980082, January 7, 2000]  
24

25

1     **Q.     What was the next major initiative pursued by Qwest following the 1988 Settlement**  
2     **Agreement?**

3     A.     In November 1992, U S West Communications, Inc., the parent company of Mountain Bell,  
4     filed an application for a waiver of Commission rules R14-2-803 and R14-2-805 (two of the  
5     Affiliated Interest Rules). [Decision No. 58087, p. 1] A waiver of R14-2-803 would allow US  
6     West to be exempt from filing "notice[s] of intent to organize or reorganize a public utility  
7     holding company" with the Commission under certain circumstances. [Id., p. 5] While it did not  
8     ultimately grant a waiver of rule R14-2-805, the Commission ruled that it would waive US  
9     West's reporting requirements under R14-2-803 so long as the "organizations or  
10    reorganizations" did not

11  
12           1) result in increased capital costs to USWCI [US West]; 2) result in  
13           additional costs allocated to the Arizona jurisdiction; or 3) result in a  
14           reduction of USWCI's net operating income. [Id.]  
15

16           Then, in a 1995 rate proceeding, controversy arose concerning the appropriate  
17    imputation of directory income. [Decision No. 58927, p. 1] In developing its revenue  
18    requirement and proposed rates, US West proposed a directory imputation adjustment of  
19    \$42,657,000, consistent with the 1998 Settlement Agreement. [Id.] The Commission Staff  
20    disagreed with this calculation, and recommended a directory imputation amount of  
21    \$60,684,000. [Id.] In resolving this dispute, the Commission ruled that "the Settlement  
22    Agreement does not place a cap of \$43 million on the amount of imputation." The Commission  
23    approved the Staff recommendation. [Id.]

1 US West appealed this decision to the Arizona Court of Appeals. The Company  
2 charged that

3  
4 the Commission unreasonably and unlawfully (1) imputed to US West  
5 an excessive amount of operating income for directory revenues that a  
6 related company earned, (2) disallowed a portion of US West's lease  
7 expenses, and (3) disallowed a transition cost adjustment to cover US  
8 West's change from cash to accrual accounting for non-pension  
9 retirement benefits. [US West Communication, Inc. v. ACC, 185 Ariz.  
10 277, 279 (App.1996)]  
11

12 The Court agreed with US West regarding the first complaint but not the second or third. [Id.]

13 The Court ruled that the Settlement Agreement did not preclude an upward adjustment to the  
14 imputation amount, but the adjustment must be based on the value of fees and services. [US  
15 West Communication, Inc. v. ACC, 185 Ariz. 277, 281 (App. 1996)] It ruled that the  
16 Commission's decision in that case was invalid, because it was not based on the value of fees  
17 and services:  
18

19 Accordingly, because the Commission relied on a methodology that its  
20 1988 agreement renders invalid, and because the staff introduced no  
21 evidence that would support a greater imputation under the proper  
22 methodology, we set aside the Commission's greater imputation and  
23 direct it on remand to impute only \$43 million of directory revenue. [US  
24 West Communication, Inc. v. ACC, 185 Ariz. 277, 281-282  
25 (App.1996)]  
26

27 In June 2000, the Commission authorized the merger of US West and QCI. As one  
28 result of the merger, QCI sought a reaffirmation of "the limited waiver of the Commission's



1 exempt from having to notify the Commission in writing of the organizational changes resulting  
2 from the sale, as it otherwise would be required to do under R14-2-803.

3  
4 QCI has significant first and second-tier subsidiaries, some of which  
5 have other affiliated interests. The creation, deletion and modification  
6 of the structure and interest in those affiliates is a common occurrence,  
7 which often has no effect on Arizona regulated telecommunications  
8 operations. [Id.]  
9

10 In response to Qwest's Notice of Sale, Staff filed a Request For a Procedural Order  
11 which was granted by the Commission on December 20, 2002. [Procedural Order, pp. 1, 3]  
12 The procedural schedule set by the Commission was meant to strike a balance between the  
13 "aggressive" timetable proposed by Qwest and the "extended" one proposed by Staff. In  
14 accordance with this schedule, four witnesses submitted direct testimony on behalf of QC: Brian  
15 Johnson, George Burnett, Maureen Arnold, and Peter Cummings. The Buyer submitted direct  
16 testimony of one witness (William Kennard).  
17

18 **Summary of the Proposed Transaction**  
19

20 **Q. Would you please describe the major components of the Dex sale?**

21 **A.** Yes. This \$7.05 billion transaction will be executed in two parts, referred to as the "Dexter"  
22 stage and the "Rodney" stage. [Notice of Sale, pp. 2-3]  
23

24 The first stage includes all Dex operations in Colorado, Iowa,

1 Minnesota, Nebraska, New Mexico and El Paso, Texas, North  
2 Dakota and South Dakota (the "Dexter"). The second stage includes  
3 the Dex operations in Arizona, Idaho, Montana, Oregon, Utah,  
4 Washington and Wyoming (the "Rodney"). [Id.]  
5

6 The Buyer has agreed to pay \$2.75 billion for the Dexter portion of the transaction. It will pay  
7 \$4.3 billion for the Rodney portion. [Qwest Form 8-K, August 8, 2002] The Dexter stage  
8 closed on November 8, 2002. [Kennard, p. 3]  
9

10 Just prior to that closing, Qwest Dex, Inc. transferred its assets and  
11 liabilities in each of those states to its newly created subsidiary, SGN  
12 LLC. At the closing, the ownership of SGN LLC transferred from  
13 Qwest Dex to Dex Media East. [Id.]  
14

15 Dex Media East is a subsidiary of Dex Media, Inc. which is in turn an indirect subsidiary of the  
16 Buyer. [Id.]

17 Immediately prior to the closing of the Rodney stage, Dex will transfer its directory  
18 publishing assets in the Rodney states in a manner similar to its transfer in the Dexter states.  
19 The Rodney transfer differs from the Dexter transfer in that SGN LLC is replaced by GPP  
20 LLC and Dex Media East is replaced by Dex Media West. [Id.]  
21

22 Consummation of each staged closing is conditioned, among other  
23 things, on (a) the receipt of debt financing on the terms set forth in  
24 Buyer's commitment letters, (b) the separation of the Dexter and  
25 Rodney businesses, and (c) the termination or expiration of the  
26 applicable waiting period under the Hart-Scott-Rodino Act. In  
27 addition, the Rodney closing may not occur in the event that state  
28 commission, individually or collectively, order gain sharing, rate

1           reduction, additional capital investments or other forms of economic  
2           loss to QCI and/or its subsidiaries (including QC) in excess of a  
3           specified level. [Notice of Sale, p. 3]  
4

5       **Q.     Will the organizational structure of the directory publishing operations remain the**  
6       **same following the closing of the sale?**

7       **A.     Yes and no. Mr. Kennard states little change will be seen from a labor standpoint. The**  
8       management team and rank and file workers at Dex will see little to no turnover in the course of  
9       the sale. [Kennard, p. 6] The corporate structure will, however, change:

10  
11           The former Dex operations will be divided into two regions, based on  
12           the Dexter and Rodney stages of the transaction: Dex Media East will  
13           include operations specific to the Dexter states, and Dex Media West  
14           will include operations specific to the Rodney states. Many functions  
15           common to directory publishing operations in both regions will remain  
16           consolidated and will operate from within Dex Media, Inc. Even  
17           though there will be two separate companies after Rodney closes, the  
18           Buyer plans to operate as an integrated entity ... [Burnett, p. 10]  
19

20       Mr. Burnett also describes three additional agreements reached by the parties to the transaction  
21       meant to overcome the difficulties associated with the organizational changes. These  
22       agreements are a Professional Services Agreement reached by SGN LLC and Dex, a Joint  
23       Management Agreement reached by SGN LLC and the Buyer, and a Transition Services  
24       Agreement reached by SGN LLC and QCI. [Id., pp. 11-13]  
25

26           For an interim period leading up to the Rodney close, this [Professional  
27       Services Agreement] requires Dex Media, Inc. to provide Dex with

1 intellectual property licenses as well as certain professional services.  
2 [Id., pp. 11-12]

3  
4 A Joint Management Agreement provides that Dex, as well as Dex  
5 Media, Inc. and its subsidiaries, will each employ the six key  
6 management team executives, including myself, during the transition  
7 period. [Id., p. 12]

8  
9 [Under the Transition Services Agreement,] QCI will make available to  
10 Buyer real estate, finance and accounting, procurement, treasury and  
11 cash management, human resources, marketing and public relations,  
12 legal, corporate/executive, IT, billing and other services. [Id., pp. 12-  
13 13]

14  
15 **Q. Are these long term agreements?**

16 **A.** No. The three agreements described above are only applicable during the transition period  
17 wherein Qwest and the Buyer wait for approval of the Dex sale in select Rodney states. Going  
18 forward, the parties entered into a different series of agreements that will help maintain or  
19 enhance the income generated by the transferred directories and related publishing activities:

20  
21 QC, the Buyer, Dex Media East and Dex Media West entered into a  
22 long term Publishing Agreement designating Dex Media East and Dex  
23 Media West as QC's official publisher in its 14-state local service  
24 region. ... Dex Media East and Dex Media West will use QC's  
25 designated branding scheme and follow QC's trademark instructions.  
26 [Id., p. 15]

27  
28 Under a Directory License Agreement,

29  
30 QC will grant to the Buyer for the term of the Publishing Agreement a

1                   restricted license to use the directory publisher lists and directory  
2                   delivery lists for the sole purpose of publishing and delivering the  
3                   directories to QC's 14-state region. [Notice of Sale, pp. 4-5]  
4

5                   Under a Non-Directory License Agreement,

6  
7                   QC will grant to the Buyer a restricted license to use the subscriber list  
8                   information in its direct marketing activities for a term of five years. [Id.,  
9                   p. 5]  
10

11                  And under a Public Pay Stations Agreement,

12  
13                  The Buyer will place directories in all of QC's public pay stations in the  
14                  Region available for directory placement (with certain limited  
15                  exceptions) for the term of the Publishing Agreement. [Id.]  
16

17                  Under these long term agreements, the Buyer will publish directories on behalf of QCI in the  
18                  14-state region for as much as 50 years. QCI, in turn, has agreed to not attempt to develop its  
19                  own directory publishing operations and will not compete with the Buyer in the directory  
20                  market for as much as 40 years. [Qwest Form 8-K, August 8, 2002]  
21

22                  **Q.    Why has QCI initiated the Dex sale and entered into these agreements with the**  
23                  **Buyer?**

24                  **A.    The Company's witnesses provide one primary reason for the initiation of the sale—the need to**  
25                  **improve QCI's financial condition. The Company's substantial cash flow generated by the**  
26                  **proposed transactions (\$7.05 billion) will allow it to pay down debt—particularly QCI's \$3.4**

1 billion Amended Credit Facility that is coming due in May 2003 and \$1.155 billion in debt that  
2 will have matured by June 2003. [Johnson, pp. 9-10] Without this infusion of cash, the  
3 Company is concerned that it may be forced to default on various credit arrangements, loans,  
4 and maturing debt. [Id., p. 11]

5 The Dex sale was split into two stages to facilitate this rapid infusion of cash. The  
6 Company felt that it could gain relatively expeditious approval of the sale in the Dexter states,  
7 allowing it to receive the proceeds from these assets quite quickly. This provided an immediate  
8 infusion of funds and allowed QCI to negotiate credit arrangements that, in the Company's  
9 view, allowed it to avoid filing for bankruptcy. [Id., pp. 8-9] QCI has received the Dexter  
10 portion of the proceeds and used these funds to reduce the balance due on the Amended  
11 Credit Facility from \$3.4 billion to \$2.0 billion. [Id.] Approval from the Rodney states was  
12 anticipated to be more time consuming because these states were expected to conduct a more  
13 extensive review of the sale. [Id., p. 10]

14 Mr. Johnson also argues that the funds which will be provided upon closing the Rodney  
15 stage remain crucial to QCI's financial viability. Without this capital, he feels that QCI "will be  
16 in great jeopardy of not being able to pay off its maturing debt." [Id., p. 10] The Company  
17 would also "likely have insufficient cash from internal operations to meet upcoming ARCA  
18 [Second Amended and Restated Credit Agreement] payments and long-term debt maturities."  
19 [Id., p. 11]

20  
21 QCI and its subsidiaries still must make the debt maturity payments of  
22 over \$6.5 billion over the next three years and over \$8.5 billion over  
23 the next five years. The Rodney proceeds are still vitally needed for

1 QCI and its subsidiaries to avoid defaulting under their obligations. [Id.,  
2 p. 12]  
3

4 **Q. In the previous section, you reference the Company's claim that the Dex sale is in the**  
5 **public interest. How does it reach this conclusion?**

6 A. The primary argument behind the Company's public interest analysis is similar to an argument  
7 made famous (or infamous—depending upon your perspective) by Charles Wilson, secretary of  
8 defense under President Eisenhower: "What's good for General Motors is good for the  
9 country." In their testimony, QC witnesses are basically saying, "what's good for QCI is good  
10 for Arizona." In other words, by saving QC's parent company from financial ruin, the  
11 Commission would be helping all of those Arizona citizens that rely on QC for their phone or  
12 data services, or who might be adversely affected by any disruption in Qwest's existing  
13 corporate structure. Ms. Arnold clearly makes this point.  
14

15 It has always been recognized that the financial health and viability of a  
16 public utility is a primary consideration in the public interest. ... The  
17 Commission also recognized the importance of QC's continuing  
18 financial viability by imposing several conditions on approval of the  
19 merger between QCI and [US West] designed to maintain QC's  
20 financial integrity. [Arnold, p. 14]  
21

22 Mr. Johnson emphasizes the point.  
23

24 [A bankruptcy] filing could be disruptive for all the companies in the  
25 Qwest family of companies, for the employees of all those companies,  
26 for the people who rely on those companies, and, potentially, for the

1 service provided by some or all of those companies. [Johnson, p. 13]  
2

3 QC also argues that the transaction is in the public interest in that it maintains the status  
4 quo where directory quality is concerned. Ms. Arnold contends that the Publishing Agreement  
5 outlined above will ensure that the Buyer meets all of the legal obligations that QC currently is  
6 required to meet regarding directory quality. [Arnold, p. 18] These obligations include  
7 providing a list of QC subscribers to competitive directory publishers and including in its own  
8 directories the listings for customers of competitive providers. [Id., p. 16] Further, in Arizona,  
9 “customers who purchase certain classes of service are entitled to a directory listing as part of  
10 the service.” [Id.] Close consultation between the parties to resolve changes to the directory is  
11 one such proposed method of ensuring all obligations are met. [Id., p. 18]

12 Mr. Kennard also notes that it is in the Buyer’s best interest to maintain directory  
13 quality:  
14

15 More importantly, Dex’s reputation and substantial goodwill are based  
16 on the public’s perception that its directories are accurate and complete  
17 and on advertisers’ confidence that the directories are widely  
18 distributed. This is an asset that the Buyer will protect above all by  
19 taking great pains to ensure full and complete listings and full and  
20 widespread distribution of the directories themselves, including  
21 placement at payphone stations. [Kennard, p. 7]  
22

23 Needless to say, this line of reasoning does more to rebut a potential claim that the sale could  
24 be contrary to the public interest (because quality might deteriorate) than it does to affirmatively  
25 demonstrate that the sale is in the public interest. To the extent it is “in the public interest” to

1 maintain the existing arrangements with other carriers and the status quo level of quality, this  
2 could also be accomplished by maintaining all of the existing arrangements by rejecting the  
3 proposed sale. The Buyer does not claim it will be making any specific additions or  
4 improvements to the directories—it just provides assurances that quality will not diminish. Hence,  
5 the public interest argument largely boils down to a contention that Arizonans may suffer if QCI  
6 is forced into bankruptcy, and they will benefit if QCI's financial health is enhanced or restored.

7  
8 **Economics of Directory Publishing**

9  
10 **Q. Please turn to section three of your testimony. Can you begin by discussing the origins**  
11 **of the RBOCs' directory publishing operations?**

12 **A.** Incumbent local exchange carriers have published directories throughout this century. Although  
13 initially conceived as a method of helping customers use the telephone, directories had become  
14 an important source of revenues and profits for all local exchange carriers.

15  
16 Prior to divestiture, both the "Yellow Pages" and "White Pages"  
17 directories were prepared and distributed by the local phone company.  
18 The directory publishing assets were included in the rate base of the  
19 local phone company from which significant profits were used to reduce  
20 local telephone rates. [Decision 58927, p.10]  
21

22 In the 1984 antitrust consent decree, the parties initially agreed, among other things, that the  
23 Regional Bell Operating Companies (RBOCs) would not pursue any "non monopoly" business,  
24 including the provision of directory advertising. This arrangement seemed logical, since

1 customer premise equipment, long distance, and other relatively competitive services were  
2 transferred to, or remained with, AT&T and the most monopolistic services were transferred  
3 to, or remained with, the RBOCs. However, state regulatory agencies and consumer advocates  
4 objected to the idea of transferring this enormous stream of revenues and profits to AT&T.

5  
6 **Q. Was the consent decree accepted by the court?**

7 **A.** Not as initially proposed. Judge Greene made several important changes in response to  
8 criticisms and comments submitted by state regulators and others. Most importantly in the  
9 context of this proceeding, he decided that the RBOCs should be allowed to retain the  
10 extremely profitable directory publishing business. Several factors contributed to this decision.  
11 For one thing, Judge Greene was not convinced that it was necessary to transfer the publishing  
12 business to AT&T in order to prevent the RBOCs from using their monopoly power in an  
13 anticompetitive manner. He noted that various aspects of the consent decree designed to  
14 restrict the RBOCs participation in non-monopolistic businesses "are based upon the  
15 assumption that the Operating Companies, were they allowed to enter the forbidden markets,  
16 would use their monopoly power in an anticompetitive manner." [*Opinion*, United States  
17 District Court for the District of Columbia, Civil Action No. 74-1698, Civil Action No.  
18 82-0192, Misc. No. 82-0025 (PI), August 11, 1982, p. 102.] However, Judge Greene said it  
19 was not clear that publishing directories allowed the Operating Companies much opportunity to  
20 exercise anticompetitive behavior:

21  
22 This restriction lacks an appropriate basis and is not in the public

1 interest. Neither of the reasons underlying the other restrictions on the  
2 Operating Companies--the need to prevent cross-subsidization and the  
3 importance of preventing competitor discrimination--has any relevance  
4 to the printed directory market.  
5

6 All parties concede that the Yellow Pages currently earn  
7 supra-competitive profits.... There is no warrant therefore for  
8 proceeding on the premise that the advertising prices charged by the  
9 Operating Companies are artificially low as the result of a subsidy from  
10 local exchange service." [*Id.*, pp. 113-114.]  
11

12 Further, he noted, other public policy issues must be considered:  
13

14 In addition to these factors directly related to competition, there are  
15 other reasons why the prohibition on publication of the Yellow Pages  
16 by the Operating Companies is not in the public interest. All those who  
17 have commented on or studied the issue agree that the Yellow Pages  
18 provide a significant subsidy to local telephone rates. This subsidy  
19 would most likely continue if the Operating Companies were permitted  
20 to continue to publish the Yellow Pages. [*Id.*, pp. 114-115.]  
21

22 Judge Greene noted that various intervenors had addressed the potential public policy  
23 effects of excluding Yellow Pages revenues from the Operating Companies' regulated  
24 operations.  
25

26 The loss of this large subsidy would have important consequences for  
27 the rates for local telephone service. For example, the State of  
28 California claims that a two dollar increase in the rates for monthly  
29 telephone service would be necessary to offset the loss of revenues  
30 from directory advertising. Evidence submitted during the AT&T trial  
31 indicates that large rate increases of this type will reduce the number of  
32 households with telephones and increase the disparity, in terms of the

1 availability of telephone service, between low income and well-off  
2 citizens. This result is clearly contrary to the goal of providing affordable  
3 telephone service for all Americans. [*Id.*, p. 115.]  
4

5 Therefore, Judge Greene concluded, the Operating Companies should be permitted to  
6 continue in the directory publishing business, thereby continuing to advance the policy goal of  
7 universal service through the maintenance of relatively low local exchange rates:  
8

9 "For these various interrelated reasons, the Court accordingly  
10 concludes that the prohibition, express or implied, on publication by the  
11 Operating Companies of the Yellow Pages directories is not in the  
12 public interest." [*Id.*, pp. 115-116.]  
13

14 In essence, Judge Greene concluded that whatever pro-competitive advantages might  
15 be gained by separating directory publishing from the local exchange business, these advantages  
16 were outweighed by the benefits of allowing the extraordinarily high revenues and profits  
17 generated by directory publishing to continue to offset local exchange costs, thereby keeping  
18 local rates more affordable. As a result of this decision, Mountain Bell and other Bell Operating  
19 Companies were allowed to continue participating in the directory publishing business.

20 These historic circumstances are well worth remembering, since the Dex assets that  
21 QCI wants to sell would not belong to QCI were it not for the intervention of state regulators,  
22 consumer advocates, and others who wanted to continue the longstanding arrangements that  
23 have linked the directory publishing and local exchange businesses, ensuring that income from  
24 directory publishing helps keep local exchange prices low, thereby advancing the universal  
25 service goal.

1 **Q. Judge Greene noted that local exchange carriers earn “supra-competitive” profits**  
2 **from the directory publishing business. Can you explain why these high profits exist,**  
3 **and why competitive pressures don’t reduce them to a more normal level?**

4 A. Yes. Telephone directories belong to a peculiar class of products that are inherently not well  
5 suited to effective competition. Other examples of successful products with similar  
6 characteristics include the VHS videotape format and the Windows computer operating  
7 system. In each of these examples, consumers find it preferable to standardize on the products  
8 or technology of one particular firm, to the exclusion of any alternatives. As a result, normal  
9 competitive conditions do not prevail.

10 In these situations, one choice emerges as the clear winner. Once this occurs, the  
11 winning firm gains a degree of monopoly power and protection from competitive pressures,  
12 because consumers are unlikely to subsequently switch their allegiance to different product or  
13 technology even if the price is significantly lower. Moreover, once it becomes clear which  
14 product or technology is the “winner” (preferred by or used by most consumers), other  
15 businesses tend to conform to this standard. In turn, the response of these other firms tends to  
16 allow the dominant firm to become stronger and more firmly entrenched.

17 To understand how this process works, consider the battle between VHS and Beta.  
18 Once a majority of consumers began to prefer the VHS format, dealers stopped carrying Beta  
19 tapes (it was cheaper to maintain an inventory of only one type of prerecorded tapes), causing  
20 even more consumers to switch to the VHS format. Eventually, it became difficult—if not  
21 impossible—to buy or rent Beta tapes in many locations, and VHS recorders became essentially  
22 the only option for most consumers. Eventually, Sony—the inventor of the Beta format and one

1 of the most powerful consumer electronics firms in the world—was forced to abandon the fight.  
2 Sony now pays license fees to its competitors in order to sell VHS cassettes and tape  
3 recorders.

4 The important thing to recognize about this peculiar class of products is that individual  
5 consumers do not simply compare prices and features and select whichever combination is  
6 most to their liking. Rather, they tend to prefer whichever product is dominant, even if the price  
7 is higher and the features are less attractive. In effect, consumers treat the “winning” product as  
8 falling within a class of its own. Furthermore, there is also a tendency for other businesses to  
9 focus on whichever product is the “winner.” These tendencies for both businesses and  
10 consumers to prefer the dominant product tend to be self-reinforcing, creating a “cascade”  
11 effect. Once a clear “winner” emerges and, it is very difficult, if not impossible, for new entrants  
12 to displace the winner. This creates a barrier to entry which allows the dominant firm to enjoy a  
13 high degree of monopoly power—allowing it to charge higher prices and to earn supra-  
14 competitive profits.

15 Upon cursory inspection, the market for these types of products may appear to be  
16 subject to normal competitive forces. There may be a variety of different substitutes (actual and  
17 potential) that could serve the same functions, and thus the dominant firm may seem to be  
18 subject to effective competition. However, upon closer inspection it becomes clear that  
19 substantial barriers to effective competition exist. Would-be competitors face the daunting task  
20 of convincing millions of consumers and hundreds or thousands of businesses to abandon the  
21 existing standard, and to start using their product instead. It can be exceedingly difficult, or  
22 impossible, to simultaneously convince enough consumers and businesses to accept the new

1 product. In order to be truly successful, the competitor must achieve a huge critical mass, which  
2 involves capturing the loyalty or acceptance of a very high percentage of both consumers and  
3 businesses.

4 This unusual barrier to effective competition arises in part because successful entry  
5 involves the nexus of two distinct processes of decision-making, in part because each of these  
6 groups of decision makers prefer to settle upon a single product rather than switching back and  
7 forth amongst multiple products, and in part because each decision maker finds it preferable to  
8 select whichever product has been selected by everyone else. When a successful and well  
9 established product exists in such a market, would-be competitors find it extremely difficult to  
10 gain the necessary level of joint acceptability on a widespread basis, in order to effectively  
11 compete.

12 Most people want only one type of videocassette recorder (for playing all their  
13 videotapes), and they will prefer the type which is selected by everyone else, since it guarantees  
14 compatibility with their friends' equipment, and since it guarantees compatibility with the tapes  
15 which are available at rental shops. Analogously, most people want to use only one type of  
16 computer operating system (for running all their programs), since it simplifies things and  
17 minimizes learning time, and they will prefer the type which is selected by everyone else, since it  
18 minimizes problems with training new employees, ensures compatibility with popular software,  
19 and so forth. This tendency towards standardization is often reinforced by the actions of  
20 computer manufacturers (who sell computers with Windows pre-installed), software  
21 manufacturers, (who sell programs that only work with Windows), and the manufacturers of  
22 printers, monitors and other peripheral devices (who sell equipment that only works with

1 Windows).

2 This self-reinforcing phenomena largely explains the popularity of Windows (and its  
3 predecessor, MS-DOS), along with the enormous profits this “winner” is generating, and the  
4 near-impossibility of displacing it from the market place. Sellers of Unix and Linux, the most  
5 popular alternative operating systems, have had difficulty gaining more than a tiny share of the  
6 personal computer market, despite slashing their prices to near-zero levels. Just as “economies  
7 of scale” can create barriers to entry and “natural monopoly” conditions, this self-reinforcing  
8 bias in favor of the “standard” product can allow a dominant firm to earn enormous profits. The  
9 term “economies of standardization” can be used to describe this phenomena, which partially  
10 explains why Microsoft has been able to sustain and expand its monopoly position. As a result,  
11 Microsoft has been able to increase the price of Windows to record-high levels during an era  
12 when the prices of most computers and computer-related products have been declining to  
13 record-low levels.

14 Telephone directories are also subject to “economies of standardization.” Most people  
15 only want to keep one phone directory at their bedside or on their desk, since this minimizes  
16 clutter and simplifies their life. Moreover, most people prefer using the “standard” directory,  
17 particularly if this one seems to have the best, most comprehensive listings and advertisements.

18 The distinctive characteristics described earlier with reference to video tapes and  
19 computer operating systems clearly apply to telephone directories. Most consumers prefer  
20 using the “standard” directory. When a competing directory is delivered to their home or  
21 business, they will often throw it away, or place it in a less frequented location in their home or  
22 office, where it receives relatively little use. It is difficult—perhaps impossible—for new entrants

1 to dislodge the dominant directory, because the habits and preferences of hundreds of  
2 thousands of consumers and thousands of businesses must simultaneously be changed. Most  
3 businesses don't want to buy ads in multiple directories, just as most firms don't want to market  
4 video tapes or software applications using multiple formats. Most businesses don't bother  
5 advertising in a secondary directory, just as most firms don't bother selling a version of their  
6 software that works with Unix or Linux.

7 The "official" yellow pages sponsored by the dominant local exchange carrier offers an  
8 archetypical example of a product which is subject to severe economies of standardization. The  
9 interests of the user and the advertiser uniquely converge on whichever directory happens to be  
10 the "standard" directory (typically the one that seems to offer the most accurate and  
11 comprehensive listings and advertisements).

12 Even if a competing firm enters the market, most advertisers won't be inclined to  
13 abandon the "official" or "standard" directory, because they know it is popular, and that most  
14 readers only need and use one directory. Even if the price of advertising is much lower (as it  
15 typically is), most businesses won't spend much on advertising that is seen by relatively few  
16 people.

17  
18 **Q. You have indicated that Mountain Bell was allowed to stay in the directory publishing**  
19 **business partly because it generates high profits that have helped keep local exchange**  
20 **rates low. Are these profits related to QC's local exchange business?**

21 **A.** Yes. In the case of video tapes or computer operating systems, there was initially great  
22 uncertainty concerning which firm would emerge with the successful standard. However, in the

1 case of telephone directories, the victor was largely pre-ordained. Since the telephone  
2 company historically created and controlled all of the telephone numbers, it was in a unique  
3 position to determine which directory would be accepted as the "official" or standard set of  
4 listings.

5 Experience around the country demonstrates that the decisions of the local phone  
6 company, not the competitive process, determines which company publishes the most widely  
7 accepted (and most profitable) directory in each local exchange area. Business prowess,  
8 creative genius, and other factors may explain why Microsoft came to dominate the market for  
9 desktop computer operating systems. And, these types of factors may explain the difference  
10 between modest success and complete failure for firms that attempt to publish a "second"  
11 telephone directory. However, the latter firms have little hope of ever achieving the critical mass  
12 that would be necessary to displace the "standard" directory, which is almost always endorsed  
13 by, or affiliated with, the incumbent local exchange carrier.

14 Once the telephone company decides whether to publish a directory itself (directly or  
15 through an affiliate), or it designates another firm to publish the "official" yellow pages (in  
16 conjunction with the white page directory), that firm inevitably publishes the most universally  
17 accepted and profitable directory. Even if publishing company X has enjoyed this favorable  
18 position for more than a decade (pursuant to contract), the moment the local exchange  
19 company contracts with company Y as its "official" publisher, company X will be ignominiously  
20 shut out of its longstanding position, and company Y will immediately dominate the market. The  
21 shift in fortunes will be so massive that in some case company X will simply pick up stakes and  
22 abandon the market entirely. Even if it remains in the market, company X will generally be

1           relegated to "also ran" status, charging lower rates and generating far lower profits, because it's  
2           directory is no longer officially endorsed by (or distributed by) the local exchange company.

3  
4   **Q.   You have indicated that the supra-competitive profits generated by telephone**  
5   **directories are closely linked to the local exchange business. Are there any other**  
6   **linkages between the Dex directory publishing business and QC's local exchange**  
7   **business?**

8   **A.**   Yes. Accurate, up-to-date information concerning the incumbent local exchange company's  
9   customers (particularly their names and telephone numbers) lies at the core of the directory  
10   business. Yet, the development and maintenance of this information is an integral part of QC's  
11   local exchange business. Furthermore, many other aspects of the yellow page business are  
12   closely related to, or a direct function of, the local exchange business. Information obtained  
13   from customers through their application for local service and changes in the use of this service,  
14   and even the local service billing mechanisms can be used to support the yellow page business.

15           The incumbent carrier's management of its switching systems, including its assignment  
16   of new telephone numbers, is closely linked to the telephone directory business. The goodwill  
17   and name recognition which are created or enhanced by the incumbent carrier's dominant  
18   position in the local exchange business also enhances the value and profitability of the directory  
19   business. Relatively few people in Arizona were aware of the Qwest brand name before it  
20   merged with US West. Now that they closely associate the Qwest name with their local  
21   exchange carrier, a directory with the Qwest name on the cover is far more likely to be used, or  
22   considered to be the "official" directory than one with any other name on the cover. Even a well

1 known brand names like AT&T, Time Warner or Conde Naste is unlikely to have as much  
2 impact on advertiser and user preferences as the Qwest brand name (or the US West brand  
3 name, or whatever name happens to be used by the dominant local exchange carrier in that  
4 particular area.)

5 Even if an affiliated company actually publishes the directory (e.g. Dex) customers are  
6 indirectly reassured that this directory is closely associated with the regulated public utility they  
7 depend upon for their basic local exchange service. Directories published by or on behalf of the  
8 local exchange company almost always prominently display a brand name, color scheme, logo,  
9 and other visual cues to strongly suggest this particular directory is the one that is officially  
10 sanctioned by the carrier that provides the readers with their local telephone service—the same  
11 carrier that creates and controls most of the phone numbers listed in the directory. In contrast,  
12 any alternative directories must necessarily suffer an identity problem, since they are not official  
13 publications of the local phone company, and thus inherently appear to be superfluous and  
14 unnecessary—and perhaps not as accurate or reliable.

15 A powerful combination of consumer habit, brand identification, and close linkages to  
16 the entity that controls most of the phone numbers gives the local exchange company's  
17 directories an "official" or "genuine" status in the minds of most consumers. This powerful  
18 competitive advantage is further reinforced by the historic circumstances of the directory  
19 publishing business—customers are accustomed to using the "official" directory published or  
20 licensed by the incumbent local telephone company.

1    **Q.    You have indicated that income from the directory publishing business has historically**  
2       **been used to help keep local exchange rates low. Can you briefly explain the rationale**  
3       **for this arrangement?**

4    A.    Yes. In most jurisdictions, directory publishing has long been viewed as an extremely profitable  
5       byproduct or extension of local telephone service. Hence, most (if not all) of the income  
6       generated from publishing directories has long been used as an offset to the cost of providing  
7       local telephone service. In Arizona, as in virtually every other state, publishing-related income is  
8       used to keep local exchange rates low and to help maintain universal service.

9           As I mentioned earlier, this long standing arrangement is the main reason state  
10       regulators, consumer advocates and other parties objected to placing the directory publishing  
11       business with AT&T at the time of divestiture, and it is one of the main reasons why Judge  
12       Greene decided that this business should instead be placed with US West (now Qwest) and the  
13       other RBOCs.

14          Of course, given the magnitude of the income streams involved, it is hardly surprising  
15       that almost immediately after divestiture many of the RBOCs attempted to change this  
16       arrangement, in hopes of increasing local rates and keeping more of the profits for their  
17       stockholders. For instance, US West placed its directory operations in a separate subsidiary,  
18       and it attempted to keep most of the directory income out of the regulatory process. In a 1986  
19       order the Commission commented on these efforts:

20  
21           Mountain States would never have had any "Yellow Pages" assets to  
22       transfer if it and AT&T had their way. It was through the efforts of the

1 Commission, among other commissions, that the BOC's rather than  
2 AT&T retained these assets. Our efforts were certainly not expended  
3 to "feather the nest" of USW. It was clearly our intent and that of the  
4 MFJ that this line of business was to remain with the BOC so as to  
5 produce a profit contribution to [benefit] local ratepayers. [Arizona  
6 Corporation Commission, Opinion and Order, Order 54843, Docket  
7 No. E-1051-84-100, January 10, 1986.]  
8

9 The Buyer is willing to pay Qwest an enormous amount for its directory business,  
10 because it generates such a large income stream—a continuing flow of profits that exceed normal  
11 competitive levels by a wide margin. The very existence of this income stream, as well as its  
12 magnitude, is largely attributable to the fact that Dex's publications are the "standard" directory  
13 in each of its local exchanges. It is important to remember that most of the income Qwest is  
14 proposing to sell has (quite appropriately) been used for decades to help keep local rates at  
15 reasonable, affordable levels. Furthermore, this directory business would not even be owned  
16 by Qwest, but for the efforts of state regulators in support of this longstanding policy. Thus, it is  
17 quite appropriate that the benefits of this long standing policy should continue—as a matter of  
18 logic and equity.  
19

20 **Dex Sale Concerns**

21  
22 **Q. Do you have any concerns with respect to the proposed transaction?**

23 **A.** Yes. There are several problems with the Company's proposal. First, it has not presented a  
24 comprehensive and convincing case that the sale is in the public interest. Second, there is a  
25 significant risk that local exchange rates will eventually increase as a result of the sale. Hence,

1 while the transaction may advance the interests and benefit QCI's stockholders, it would be  
2 contrary to the interests of QC's customers in the absence of adequate safeguards.

3  
4 **Q. Qwest claims the sale is in the public interest. Can you briefly summarize its**  
5 **reasoning?**

6 **A.** As I explained earlier, the Company claims the proposed sale would be in the public interest  
7 because it will enable it to avoid bankruptcy. The Company provided evidence during the  
8 discovery phase of this proceeding which arguably supports this claim. In response to Staff DR  
9 No. 115, QC provided an estimate of future consolidated cash flows under three different  
10 scenarios: both phases of the Dex sale are completed; only the first phase is completed, and,  
11 neither phase is completed. Without the sale, QCI projects that by the end of the second  
12 quarter 2004, its consolidated cash balances will be **\*\*\*Begin Highly Confidential**  
13 **million, End Highly Confidential\*\*\*** and by the end of the 3<sup>rd</sup> quarter 2004, these cash  
14 balances will have declined to **\*\*\*Begin Highly Confidential** **End**  
15 **Highly Confidential\*\*\*** If only the first phase of the sale is completed, QCI projects that by  
16 the end of the 3<sup>rd</sup> quarter 2004, its consolidated cash balances will be **\*\*\*Begin Highly**  
17 **Confidential** **End Highly Confidential\*\*\*** If both phases are  
18 completed, the Company projects its cash balances won't decline into the negative range until  
19 sometime in **\*\*\*Begin Highly Confidential** **End Highly Confidential\*\*\***

20  
21 **Q. Is QCI suffering from serious financial problems?**

22 **A.** Yes. However, the problems run much deeper than short term cash flow and liquidity concerns

1           which are the focus of Qwest's projections.

2           The root problem is that QCI is just one of several carriers that built enormous fiber  
3           optic networks during the tech stock "bubble." Too many networks were built, and these  
4           facilities are currently carrying traffic volumes that are a small fraction of their current capacity,  
5           and an even smaller fraction of their potential capacity (e.g. if dark portions of the network  
6           were lit and if the lit portions were upgraded to carry larger amounts of bandwidth). As a result  
7           of overbuilding, these networks aren't currently generating sufficient revenue to cover their  
8           operating costs and recover the initial investment, much less generate adequate profits.

9           Two of the largest carriers trapped in much the same situation—Global Crossing and  
10          Worldcom—have already entered bankruptcy. The fact that these large carriers have entered  
11          bankruptcy not only provides a vivid demonstration of the severity of QCI's problems, but  
12          these bankruptcies create an economic climate that makes QCI's own situation more difficult.  
13          The bankruptcy process will allow Global Crossing and Worldcom to reduce their debt and  
14          negotiate more favorable contracts. In turn, these competitors may emerge from bankruptcy  
15          with an enhanced ability to cut prices, survive the worldwide glut of fiber capacity, and gain  
16          market share at the expense of other carriers (like QCI).

17          QCI's underutilized fiber network is not the only problem it faces. For one thing, it is  
18          also heavily leveraged. According to its March 31, 2002 filing with the SEC, QCI had \$21.4  
19          billion of long term debt, \$9.9 billion of current liabilities, and \$2.9 billion of post-retirement and  
20          post-employment benefit obligations on a consolidated basis. In contrast, it reported  
21          consolidated current assets of just \$6.6 billion—substantially less than its current liabilities. The  
22          book value of QC's property, plant and equipment was just \$19.3 billion, which is substantially

1           less than the total of its outstanding liabilities. The analogous book value for QCI's property,  
2           plant and equipment was reported to be \$30.2 billion. This suggests the fiber network and other  
3           network facilities have a net book value of perhaps \$11.1 billion or so. However, in the current  
4           economic climate, the fiber assets can only be sold under "fire sale" conditions. If the amounts  
5           offered for the assets of Global Crossing and other large fiber carriers are any indication, QCI  
6           might be fortunate to obtain as much as \$1 billion from a distress sale of its network. Thus, it is  
7           fair to say that QCI is not in strong financial condition, and its concerns about a potential  
8           bankruptcy filing are valid.

9           Further aggravating these problems, existing and potential creditors and investors are  
10          reluctant to provide an infusion of additional capital, because there are serious questions about  
11          the reliability of QCI's reported financial data, and as a result it is difficult to evaluate the depth  
12          and severity of the problems it faces. The 2001 financial statements were audited by Arthur  
13          Anderson, a firm that subsequently collapsed in the wake of the Enron accounting scandal. The  
14          new auditors, KPMG haven't completed their initial audit, and there are indications they have  
15          encountered significant problems which are delaying the ability to provide accurate financial  
16          information. The potential severity of these problems is unknown, but four former Qwest  
17          executives were recently charged with accounting fraud by federal prosecutors. Moreover,  
18          QCI has not released any quarterly financial data since its March 31, 2001 filing with the SEC,  
19          and its chief executive officer (CEO) and chief operating officer have been unable or unwilling  
20          to certify the accuracy of these (or any other) financial statements pursuant to Section 302 of  
21          the Sarbanes-Oxley Act.

22                 A recent article about Richard Notebaert (QCI's new CEO) published by USA Today

1 provides a sense of the uncertainty which currently exists:

2

3 "He's doing the best job he can, but he inherited a mess," says analyst  
4 Patrick Comack of Guzman & Co. "If he can turn it around, he'll look  
5 like a hero."...

6 To reverse course, Qwest must retain more local phone customers and  
7 capture long-distance business users, says analyst Drake Johnstone of  
8 Davenport & Co.

9 But he says the specter of more indictments could undermine Qwest's  
10 sales staff and damage its brand image.

11 "It remains to be seen how deep the rot is," Johnstone says. "What's  
12 scary is that no one at Qwest, including Notebaert, knows."

13

14 Given these circumstances, it is fair to say that no one can accurately evaluate the  
15 likelihood of a bankruptcy filing, nor is it possible to determine whether the infusion of cash that  
16 would be provided by the Dex transaction will be sufficient to prevent a bankruptcy filing. In the  
17 short run, the infusion of cash provided by the Dex transaction would be helpful. However, the  
18 Commission's approval of the sale wouldn't necessarily ensure that the transaction will be  
19 completed. For instance, various contract provisions could enable either the Buyer or the seller  
20 to walk away from the deal under some circumstances. The Commission's decision in this  
21 proceeding will not determine whether the transaction goes forward. For instance, the  
22 Company is awaiting approval in several other states in addition to Arizona, and there is no  
23 assurance that approval will be granted in every state. Furthermore, even if every state grants  
24 approval and the deal is consummated, it may simply have the effect of delaying a future  
25 liquidity crisis. While an infusion of several billion more dollars will certainly be helpful in the

1 short term, it won't necessarily be sufficient to overcome QCI's problems.

2

3 **Q. Are QCI's financial problems a complete surprise, or could they be anticipated when**  
4 **QCI acquired US West?**

5 **A.** Some aspects of QCI's financial problems were not widely anticipated—particularly the  
6 magnitude of the stock market bubble and the subsequent collapse of technology stock prices,  
7 as well as the possibility of accounting fraud. However, the core problems that QSI  
8 encountered could be anticipated even at that time. For example, in my testimony in Docket  
9 T-01051B-99-0497, I pointed out some of the risks:

10

11 If [Qwest] is not successful in executing its business plan, or if  
12 competition in the long haul market continues to intensify, there is no  
13 assurance that Qwest will ever be able to generate substantial profits.  
14 It has built a modern, nationwide fiber network, but it is not unique in  
15 this regard. Unless Qwest is successful in filling this network with  
16 profitable traffic, it will never generate profits which are commensurate  
17 with the scale of its investment. In the meantime, the combined entity  
18 will have to rely upon USWCI to generate nearly all of its profits, and  
19 the majority of its discretionary cash flow. US West has used USWCI  
20 as a "cash cow." The profits generated by its dominant market position  
21 have been distributed to the parent, and subsequently reinvested in  
22 whatever ventures top management has felt hold the greatest long term  
23 potential. There is every reason to believe that this policy will continue  
24 after the merger. The difference is that the emphasis may shift even  
25 farther away from the 14 state region, because of Qwest's focus on  
26 nationwide markets. It is reasonable to assume that the cash and  
27 profits generated by USWCI will tend to flow where management  
28 believes they will be most beneficial to the merged entity's stockholders.  
29 Stated differently, USWCI's role as a subservient cash cow will  
30 probably be intensified, as the merged companies shift their

1 concentration even more heavily towards growth opportunities outside  
2 the 14 state region. [Ben Johnson, Direct Testimony, p. 18]  
3

4 In approving the merger, the Commission was fully aware that this transaction was primarily for  
5 the benefit of stockholders—not Arizona customers. As I explained in my testimony in that  
6 proceeding:  
7

8 The primary beneficiaries of the proposed merger will be the companies  
9 and their stockholders. Consumers outside of US West's region may  
10 also benefit, if the combined companies become more aggressive in  
11 trying to gain market share in other parts of the country.  
12

13 I also pointed out that there was a risk that Qwest would divert revenues and resources away  
14 from Arizona and towards ventures in other markets, such as its fiber optic network. [Id., p.  
15 36]  
16

17 **Q. Assuming the Commission rejected the Company's request in this proceeding, could**  
18 **the sale occur without the Arizona portion of the Dex operations?**

19 **A.** I have seen nothing which would prevent this. The Purchase Agreement provides that the Buyer  
20 and seller's obligations to close the transaction are contingent upon Qwest receiving all  
21 necessary approvals. [See, e.g., ¶7.1] However, it also explicitly provides that the parties can  
22 waive this contingency. [Id.] The first half of the transaction, including the directory publishing  
23 operations in seven states, has already been closed, and approval has already been (or is likely  
24 to be) granted in some of the remaining states. Thus, there is no reason to assume that approval

1 in Arizona is a "make or break" factor that will determine whether or not any remaining funds  
2 will be received.

3 Qwest and the Buyer have already invested a substantial amount of time, money and  
4 effort towards completing this sale. One can reasonably assume that the Buyer would like to  
5 obtain control over as much of Qwest's directory publishing operations as possible, and QCI  
6 certainly needs more cash. Accordingly, it is reasonable to assume that the remainder of the  
7 sale would be consummated even if it were necessary to exclude the Arizona directories. If the  
8 sales price were reduced on a pro rata basis to account for the exclusion of Dex's Arizona  
9 directories, the odds of QCI entering bankruptcy would not be significantly changed.

10

11 **Q. Doesn't QC claim that the Dex sale will ensure a financially stronger and more stable**  
12 **operating entity?**

13 **A.** Yes. The current liquidity problems would be alleviated by the Dex sale. However, this  
14 temporary infusion of cash may not be sufficient to overcome QCI's problems. Moreover, the  
15 proposed transaction could tend to weaken QCI's financial position over the longer term. The  
16 directory publishing operations are the source of a very substantial and growing cash flows,  
17 revenues, and profits—all of which will be lost once the sale is completed.

18 Like all incumbent LECs, the Company generates enormous financial benefits from  
19 directory publishing. Qwest Dex directories generate hundreds of millions of dollars of revenue  
20 and income each year. Yet, very little capital is required (other than the investment in the local  
21 exchange networks which make it possible to generate this income). Once this steady, growing  
22 stream of revenues, cash, and profits is lost, the Company's financial position will be

1 substantially weakened. The proposed transaction will have a substantial adverse impact on all  
2 of the major long term indicators of financial health, including earnings per share, gross profit  
3 margins, and interest coverage. The short term effect may be to avert a liquidity crisis, but the  
4 transaction could reduce the Company's fundamental financial health over the long term.

5  
6 **Q. Can you now discuss your second concern, that local exchange rates may increase as a**  
7 **result of this transaction?**

8 **A.** Yes. There will not be any immediate adverse impact, since QC is currently operating under a  
9 price cap plan. The historic relationship between directory revenues and local rates is reflected  
10 under the current price cap plan. As the Company explained, "[t]he current Price Cap Plan  
11 incorporates the level of imputation set by the Settlement Agreement." [Qwest response to Staff  
12 Dr 125, referring to the 1988 Mountain Bell Settlement Agreement] However, the Company  
13 has not provided any firm assurance that upon expiration of the current price cap plan, rates will  
14 remain unaffected by the proposed transaction. In fact, regardless of whether rates continue to  
15 be regulated through price caps, or through a more traditional form of regulation, rates could  
16 increase as a result of the proposed transaction.

17 First, the Commission will find it more difficult to develop and implement the  
18 appropriate imputation amount once the directory publishing operations are no longer located  
19 within the Qwest corporate family. It will be more difficult to obtain evidence concerning  
20 directory revenues and the value of the services provided by QC to the directory publishing  
21 operations, once these operations have been legally transferred outside of the same corporate  
22 family.

1           Second, the value of the services provided by QC (and thus arguably the appropriate  
2 imputation adjustment) could be reduced by this transaction. The contractual arrangement  
3 between the Buyer and QC is relatively unique, making it more difficult to estimate the value of  
4 the services being provided by the local exchange operations; furthermore, there are aspects of  
5 this unique arrangement that will have a tendency to reduce that value.

6           I am not suggesting it is unusual for a LEC to make contractual arrangements with an  
7 independent firm to publish its directories. To the contrary, it is quite common for smaller local  
8 exchange carriers to enter into joint ventures or other contractual arrangements with directory  
9 publishing firms. What is unique about the proposed Dex transaction is the duration and  
10 structure of the contractual arrangement. In a more typical arrangement (for convenience I will  
11 call it a "joint venture," although the actual legal structure can vary) the publisher sells the  
12 advertisements, and it designs, prints and distributes the actual directories. The local exchange  
13 carrier provides the telephone listings, licenses the use of its brand name and logo, and takes  
14 various steps to ensure that its local exchange customers accept these publications as the  
15 "official" directories with the best, most authoritative information. As compensation for these  
16 services, the carrier typically receives a share of the gross revenues. While the amount can vary  
17 widely, 50% or more of the gross revenues may be "retained" by or paid to the local exchange  
18 carrier.

19           The proposed Dex transaction is also unique in that, to the extent the Company is being  
20 compensated for these services, it is receiving this compensation as part of the cash received at  
21 the closing, rather than receiving a percentage to the directory revenues that are actually  
22 collected in future years. Again the contract is also unique because of its extremely long

1 duration. The Buyer will receive (and will need) the active co-operation and assistance of the  
2 Company's local exchange operations in order to maintain their dominant status. In an effort to  
3 protect this status, the proposed contractual arrangements require the Company to enter into a  
4 non-compete clause for 40 years, to designate the Buyer's directories as QC's "official"  
5 directories, and to allow the Buyer to prominently display on the directories whatever brand  
6 name and logo is used by QC's local exchange operations, and to provide listing information  
7 and other forms of co-operation and assistance for 50 years. Under the proposed structure,  
8 relatively little compensation is provided on an annual basis—virtually all of the compensation is  
9 provided in advance, as part of the one-time cash payment received at the closing. While this  
10 structure helps with QCI's immediate liquidity needs, it makes it harder to value the services  
11 that are being provided by QC's local exchange operations, thereby making it harder to  
12 quantify the appropriate imputation level to use in future regulatory proceedings.

13 Furthermore, this unique structure may reduce the value of the services contributed by  
14 QC to this joint venture. Under normal circumstances, most of the compensation would be paid  
15 annually (rather than in advance), and the level of compensation would be directly tied to the  
16 revenues generated by the directories. Also, the contract would normally expire or be subject  
17 to cancellation after relatively few years. That more typical arrangement provides stronger  
18 incentives for the parties to closely co-operate in maximizing the income generated by the joint  
19 venture. Because of its long duration and poor incentive structure, there is reason to be  
20 concerned that the value of the services provided by QC to the Buyer (and thus, arguably the  
21 magnitude of an appropriate imputation adjustment) will be impaired over time.  
22

1 **Q. Doesn't the 1988 Settlement Agreement determine the level of directory revenue**  
2 **imputation?**

3 A. The 1988 Settlement Agreement provides some parameters that may control future imputation  
4 adjustments, but it does not specify the precise dollar amount which will apply under any given  
5 set of circumstances (e.g. if the proposed transactions are consummated). The Company  
6 provides these explanations:

7  
8 "The sale of the directory publishing operations to an unaffiliated third  
9 party does not affect the continued applicability of that Settlement...  
10 The incorporation of imputation in future price cap plans or rate cases is  
11 governed by the terms of the Settlement Agreement." [Response to  
12 Staff DR 71]

13  
14 "Nothing about the sale of the directory publishing operation to a third  
15 party in and of itself should effect the 1988 Settlement Agreement."  
16 [Response to Staff DR 125]

17  
18 The Settlement Agreement applies, consistent with its terms, on a going  
19 forward basis whereby the value of fees and services received by  
20 Qwest from the new directory publisher would be the imputation  
21 amount. [Id.]  
22

23 **Q. What fees and services will Qwest receive from the Buyer?**

24 A. As I have indicated, the fees Qwest will receive from the Buyer are largely contained within the  
25 up front \$7.05 billion cash payment. It is not self evident what portion of this amount represents  
26 compensation for the services provided by QC to the Buyer and what portion represents  
27 compensation for tangible assets being sold to the Buyer. Thus, if QC believes the imputation

1 amount to be used in future regulatory proceedings should be determined by the actual amount  
2 of the “fees and services received by Qwest from the new directory publisher” it is by no means  
3 obvious what imputation adjustment, if any, QC would propose (or accept as reasonable).  
4 Conceivably, QC would contend that no separately identifiable “fees and services” have been  
5 or will be “received by Qwest from the new directory publisher” and thus it might argue that no  
6 imputation adjustment is calculable or appropriate (or that the value of the appropriate  
7 adjustment is zero).

8  
9 **Conclusions and Recommendations**

10  
11 **Q. Let’s turn to the last section of your testimony. Can you begin by summarizing your**  
12 **concerns?**

13 **A.** My biggest concern is that the proposed sale won’t solve QCI’s underlying problems, yet it will  
14 tend to weaken QC’s financial position over the long term, leading to upward pressure on rates.  
15 Unquestionably, QCI is in serious financial trouble. By selling its directory publishing  
16 operations, and requiring its local exchange subsidiary to provide services to the Buyer for 50  
17 years, QCI will quickly raise a substantial amount of cash. However, this transaction doesn’t  
18 solve the underlying problems that QCI is confronting. The Company’s own projections show  
19 that QCI’s annual cash outflows exceed its inflows. It is projected to eventually run short of  
20 funds regardless of whether or not the Rodney sale is completed. [See, e.g., Response to Staff  
21 DR 115] In an effort to alleviate the current liquidity crisis, the Company is relinquishing a  
22 substantial and stable flow of cash, revenues, and profits. The long term effect will be to place

1 downward pressure on QC's financial position, to the detriment of its customers.

2  
3 **Q. What options does the Commission have in this proceeding?**

4 A. The Commission has three basic options. First, it can unconditionally approve the transaction,  
5 as requested. Second, it can refuse to approve the transaction. Third, it can pursue a middle  
6 course, by approving the transaction provided appropriate safeguards and conditions are put  
7 into place.

8  
9 **Q. What do you recommend?**

10 A. I recommend the third option. The Commission should approve the transaction provided QC  
11 agrees to imposition of adequate safeguards and conditions.

12 To protect the public interest, the Commission should require adequate assurance that  
13 local exchange rates will not be adversely affected by the proposed sale, or by the legal or  
14 financial consequences of the sale. At a bare minimum, QC should be precluded from  
15 contending in future regulatory proceedings that imputation should be discontinued, or that the  
16 imputation amount should be reduced, as a result of the Rodney transaction. To provide  
17 customers with additional protection, and to ensure that all parties are treated fairly, it would be  
18 preferable for the Commission to establish an appropriate imputation amount (or formula) that  
19 will apply in future regulatory proceedings, notwithstanding any changes in circumstances that  
20 will result from completion of the proposed sale.

1    **Q.    Hasn't Qwest admitted that the 1988 Settlement requires imputation, and this will**  
2        **continue after the sale?**

3    **A.**    Perhaps, but the 1988 Settlement doesn't specifically contemplate the circumstances that will  
4        exist if the proposed transaction is completed. Once the Dex sale is completed, nothing will  
5        prohibit Qwest from arguing that imputation is no longer appropriate, or that the "value of fees  
6        and services" has declined due to changing circumstances. For instance, QC might argue that  
7        imputation is no longer appropriate because the publishing assets have been transferred outside  
8        its corporate family. Or, it might argue that the "value of fees and services" for imputation  
9        purposes should be limited to the (minimal) amount being paid by the Buyer to QC each year.

10           The Settlement Agreement referenced an imputation amount of \$43 million per year, as  
11        developed in the 1984 rate case. However, the Commission has ruled that this does not  
12        represent a fixed imputation amount, regardless of changing circumstances. This ruling was  
13        affirmed in 1996 by the Court of Appeals of Arizona.

14

15           US West argues that the quoted language sets a \$43 million cap on  
16        imputed income because only downward adjustments are mentioned.  
17        We reject this interpretation. ... The apparent purpose of the disputed  
18        provision is to preclude US West and USWD from assigning an  
19        artificial value to fees and services and thereby preempting the  
20        Commission's independent assessment. The agreement authorizes the  
21        Commission staff to "present evidence in support of or in contradiction  
22        to" whatever value US West and USWD might assign to fees and  
23        services, and it entitles the Commission to adjust the presumptive \$43  
24        million imputation either upward or downward as the evidence of fees  
25        and services supports. [US West Communication, Inc. v. ACC, 185  
26        Ariz. 277, 281 (App. 1996)]

27

1 While the Settlement Agreement leaves the door open for the Commission to determine the  
2 appropriate imputation amount as circumstances change, it also leaves the door open for the  
3 Company to argue that the imputation adjustment should be reduced, and rates increased, once  
4 the proposed transaction has been consummated.

5 A substantial portion of the cash received from the proposed transaction directly relates  
6 to services that have been and will be provided by QC's local exchange operations. However,  
7 given the structure of the proposed transaction, it isn't self evident what portion of the multi-  
8 billion dollar up front cash payment represents "fees and services" specifically attributable to  
9 QC's local exchange operations in Arizona. If the transaction is approved without adequate  
10 safeguards, QC could conceivably argue that imputation is no longer appropriate, or that the  
11 "value of fees and services" has dwindled to a minimal level, as evidenced by the minimal annual  
12 payments being made by the Buyer (subsequent to the initial payment).

13  
14 **Q. You have indicated that it would be preferable for the Commission to establish an**  
15 **appropriate imputation amount (or formula) that will apply in future regulatory**  
16 **proceedings. Why would this be appropriate?**

17 **A.** Qwest owns the assets involved in the proposed transaction because of the direct intervention  
18 of this Commission and other state regulators. Furthermore, the high level of income generated  
19 by Qwest's directories is logically traceable to its local exchange operations. Accordingly, this  
20 income has long been treated as an offset to the cost of providing local exchange service,  
21 thereby helping to maintain low local exchange rates and helping advance the policy goal of  
22 universal service. This arrangement would be placed in jeopardy if Qwest is allowed to sell its

1 existing directory publishing business and sign a 40 year non-compete clause, as proposed. The  
2 lucrative income stream that has long been used to keep local exchange rates low would no  
3 longer be available to provide that support, but would instead be bolstering the profit margin of  
4 an unregulated, non-affiliated third party.

5 If the Commission is inclined to approve the proposed transaction, it should insist upon  
6 appropriate safeguards to minimize the risk that customers will be adversely affected. In  
7 particular, it should explicitly establish an appropriate dollar amount (or formula) for imputation  
8 in the future. The amount of imputation should be based upon the value of fees and services  
9 without considering any diminishment in that value which results from the unique structure and  
10 characteristics of the proposed transaction. Stated another way, since the proposed transaction  
11 has been structured to maximize immediate cash flows for the benefit of QCI's stockholders;  
12 for rate purposes it is appropriate to continue to consider the level of directory imputation that  
13 Qwest would receive from its "official" directories, assuming it maximized its annual income  
14 from directories for the benefit of its local exchange operations. This imputation amount would  
15 be taken into consideration in any future price cap or rate based regulatory proceedings, as an  
16 offset to the cost of providing local exchange service.

17  
18 **Q. Can you illustrate this recommendation, to show how the Commission could establish**  
19 **an appropriate formula or imputation amount?**

20 **A.** Yes. A logical starting point would be the \$43 million imputation amount which was developed  
21 in the 1984 rate case. Assuming this represented a reasonable imputation value in 1984, one  
22 can reasonably conclude that the reasonable imputation amount currently would be substantially

1 higher, due to the effects of growth and inflation. In other words, the \$43 million figure should  
2 be adjusted upward to reflect growth in the number of listings included in the directories,  
3 growth in the number of copies distributed, and growth in the quantity of advertising included in  
4 the directories. The value of fees and services has logically increased, due to the effects of  
5 inflation—both in the economy generally and in the price of directory advertising specifically.  
6 One can reasonably expect that if QC were negotiating at arm's length with a third party, all of  
7 these factors would be considered, and the value of the fees and services it would receive  
8 would exceed \$43 million due to the effects of growth and inflation.

9 The following table shows one simple way to calculate the effects of growth and  
10 inflation. I start with the \$43 million imputation amount and divide by the number of switched  
11 access lines in 1984, resulting in an imputation amount per line of \$31.11 per year or \$2.59 per  
12 line per month. I then multiplied this amount by the number of switched access lines served by  
13 QC in Arizona as December 2001. This indicates that the \$43 million imputation figure is  
14 currently equivalent to \$ 89,971,955, after taking into account growth in QC's Arizona service  
15 territory, but without taking inflation into account.

16  
17 **Table 1**

|                             |               |
|-----------------------------|---------------|
| 18 1984 Imputation          | \$ 43,000,000 |
| 19 1984 Lines               | 1,382,230     |
| 20 1984 Imputation per Line | \$ 31.11      |
| 21 2001 Lines               | 2,892,059     |
| 22 2001 Imputation          | \$ 89,971,955 |

1 **Q. Should inflation also be taken into account?**

2 A. Yes. It is reasonable to assume that the "value of fees and services" has not only increased due  
3 to growth in QC's service territory (as indicated by growth in the number of switched access  
4 lines), but also due to the effects of inflation. One way of adjusting for inflation would be to  
5 analyze changes in directory advertising rates since 1984 (e.g. per listing and per column inch).  
6 However, this data isn't readily available. Accordingly, I have used a simpler  
7 approach—adjusting for inflation based upon changes in the GDP Deflator. This is the same  
8 measure of inflation which is used in the Company's price cap plan in Arizona.

10 **Table 2**

|                                     |                |
|-------------------------------------|----------------|
| 11 1984 Imputation per Line         | \$ 31.11       |
| 12 Change in GDPD from 1984 to 2001 | 53.16%         |
| 13 2001 Imputation per Line         | \$ 47.65       |
| 14 2001 Lines                       | 2,892,059      |
| 15 2001 Imputation                  | \$ 137,806,611 |

16  
17 **Q. Will the safeguards you have just recommended be sufficient to ensure that local  
18 exchange rates will not be adversely affected by the proposed sale?**

19 A. Not necessarily. While these safeguards would be helpful and are worthwhile, they may not be  
20 sufficient to fully eliminate the risks to customers. Imputation is intended to protect the interests  
21 of customers; this intended result has easily been achieved where the actual income involved in  
22 the imputation process continues to flow to another affiliate (e.g. Qwest Dex) within the same

1 corporate family. Under these circumstances, the per-books income of the local exchange  
2 carrier is understated and the per-books income of a sister company is overstated, but the  
3 parent corporations's consolidated financial statements are largely unaffected. Thus, customers  
4 could be protected while allowing publishing income to be shifted to an affiliate, provided an  
5 appropriate share of that income continued to be imputed to the local exchange operations.  
6 However, if the proposed sale is approved and consummated, the Commission will be  
7 embarking into uncharted waters. While imputation will still be appropriate, the imputed income  
8 will no longer represent a share of revenues that are being received each year by QCI or any of  
9 its subsidiaries. Instead, imputation will reflect the hypothetical level of income that would have  
10 been available to the local exchange operations if it published its own "official" directories, and  
11 had not entered into the proposed transaction.

12 To the extent QCI is being compensated for the services to be provided by its local  
13 exchange operations over the next 50 years, this compensation will have largely (or entirely)  
14 been received as part of the one-time up front payment received at the time the transaction is  
15 closed. Once the Dex assets are sold, the Commission will no longer be imputing to QC  
16 revenues that are currently being booked by another member of the Qwest corporate family.  
17 Instead, the Commission will be imputing compensation for services that have been and will  
18 continue to be provided by QC.

19 Imputation will still be appropriate, of course, since QC could be obtaining this flow of  
20 income but for QCI's decision to enter into the proposed transaction in return for a \$7.05  
21 billion cash infusion. It is appropriate to impute a higher level of income from the Buyer, since  
22 the consideration being paid directly to QC is not commensurate with the extremely valuable

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Direct Testimony of Ben Johnson, Ph.D.

On Behalf of the Residential Utility Consumer Office, Docket No. T-01051B-02-0666

1 services and other benefits that the local exchange operations are contributing to the  
2 transaction. Among other things, the QC is providing a promise not to compete with the Buyer,  
3 the use of the brand name and logo used with its tariffed local exchange services, and  
4 designation of the Buyer's directories as QC's "official" local telephone directories in Arizona.

5

6 Q. ~~Does this complete your direct testimony, which was prefiled on March 19, 2003?~~

7 A. Yes, it does.

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Appendix A  
**Qualifications**

***Present Occupation***

**Q. What is your present occupation?**

A. I am a consulting economist and President of Ben Johnson Associates, Inc.®, a firm of economic and analytic consultants specializing in the area of public utility regulation.

***Educational Background***

**Q. What is your educational background?**

A. I graduated with honors from the University of South Florida with a Bachelor of Arts degree in Economics in March 1974. I earned a Master of Science degree in Economics at Florida State University in September 1977. The title of my Master's Thesis is a "A Critique of Economic Theory as Applied to the Regulated Firm." Finally, I graduated from Florida State University in April 1982 with the Ph.D. degree in Economics. The title of my doctoral dissertation is "Executive Compensation, Size, Profit, and Cost in the Electric Utility Industry."

***Clients***

**Q. What types of clients employ your firm?**

A. Much of our work is performed on behalf of public agencies at every level of government involved in utility regulation. These agencies include state regulatory commissions, public counsels, attorneys general, and local governments, among others.

1           We are also employed by various private organizations and firms, both regulated and  
2           unregulated. The diversity of our clientele is illustrated below.

3

4           Regulatory Commissions

5

6           Alabama Public Service Commission—Public Staff for Utility Consumer Protection

7           Alaska Public Utilities Commission

8           Arizona Corporation Commission

9           Arkansas Public Service Commission

10          Connecticut Department of Public Utility Control

11          District of Columbia Public Service Commission

12          Idaho Public Utilities Commission

13          Idaho State Tax Commission

14          Iowa Department of Revenue and Finance

15          Kansas State Corporation Commission

16          Maine Public Utilities Commission

17          Minnesota Department of Public Service

18          Missouri Public Service Commission

19          National Association of State Utility Consumer Advocates

20          Nevada Public Service Commission

21          New Hampshire Public Utilities Commission

22          North Carolina Utilities Commission—Public Staff

23          Oklahoma Corporation Commission

24          Ontario Ministry of Culture and Communications

25          Staff of the Delaware Public Service Commission

26          Staff of the Georgia Public Service Commission

27          Texas Public Utilities Commission

28          Virginia State Corporation Commission

29          Washington Utilities and Transportation Commission

30          West Virginia Public Service Commission—Division of Consumer Advocate

31          Wisconsin Public Service Commission

1 Wyoming Public Service Commission

2

3 Public Counsels

4

5 Arizona Residential Utility Consumers Office

6 Colorado Office of Consumer Counsel

7 Colorado Office of Consumer Services

8 Connecticut Consumer Counsel

9 District of Columbia Office of People's Counsel

10 Florida Public Counsel

11 Georgia Consumers' Utility Counsel

12 Hawaii Division of Consumer Advocacy

13 Illinois Small Business Utility Advocate Office

14 Indiana Office of the Utility Consumer Counselor

15 Iowa Consumer Advocate

16 Maryland Office of People's Counsel

17 Minnesota Office of Consumer Services

18 Missouri Public Counsel

19 New Hampshire Consumer Counsel

20 Ohio Consumer Counsel

21 Pennsylvania Office of Consumer Advocate

22 Utah Department of Business Regulation—Committee of Consumer Services

23

24 Attorneys General

25

26 Arkansas Attorney General

27 Florida Attorney General—Antitrust Division

28 Idaho Attorney General

29 Kentucky Attorney General

30 Michigan Attorney General

31 Minnesota Attorney General

- 1 Nevada Attorney General's Office of Advocate for Customers of Public Utilities
- 2 South Carolina Attorney General
- 3 Utah Attorney General
- 4 Virginia Attorney General
- 5 Washington Attorney General

6

7 Local Governments

8

- 9 City of Austin, TX
- 10 City of Corpus Christi, TX
- 11 City of Dallas, TX
- 12 City of El Paso, TX
- 13 City of Galveston, TX
- 14 City of Norfolk, VA
- 15 City of Phoenix, AZ
- 16 City of Richmond, VA
- 17 City of San Antonio, TX
- 18 City of Tucson, AZ
- 19 County of Augusta, VA
- 20 County of Henrico, VA
- 21 County of York, VA
- 22 Town of Ashland, VA
- 23
- 24 Town of Blacksburg, VA
- 25 Town of Pecos City, TX

26

27 Other Government Agencies

28

- 29 Canada—Department of Communications
- 30 Hillsborough County Property Appraiser
- 31 Provincial Governments of Canada

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Appendix A, Direct Testimony of Ben Johnson, Ph.D.  
On Behalf of the Residential Utility Consumer Office, Docket No. T-01051B-02-0666

- 1 Sarasota County Property Appraiser
- 2 State of Florida—Department of General Services
- 3 United States Department of Justice—Antitrust Division
- 4 Utah State Tax Commission

5

6 Regulated Firms

7

- 8 Alabama Power Company
- 9 Americall LDC, Inc.
- 10 BC Rail
- 11 CommuniGroup
- 12 Florida Association of Concerned Telephone Companies, Inc.
- 13 LDDS Communications, Inc.
- 14 Louisiana/Mississippi Resellers Association
- 15 Madison County Telephone Company
- 16 Montana Power Company
- 17 Mountain View Telephone Company
- 18 Nevada Power Company
- 19 Network I, Inc.
- 20 North Carolina Long Distance Association
- 21 Northern Lights Public Utility
- 22 Otter Tail Power Company
- 23 Pan-Alberta Gas, Ltd.
- 24 Resort Village Utility, Inc.
- 25 South Carolina Long Distance Association
- 26 Stanton Telephone
- 27 Teleconnect Company
- 28 Tennessee Resellers' Association
- 29 Westel Telecommunications
- 30 Yelcot Telephone Company, Inc.

31

1 Other Private Organizations

2

3 Arizona Center for Law in the Public Interest

4 Black United Fund of New Jersey

5 Casco Bank and Trust

6 Coalition of Boise Water Customers

7 Colorado Energy Advocacy Office

8 East Maine Medical Center

9 Georgia Legal Services Program

10 Harris Corporation

11 Helca Mining Company

12 Idaho Small Timber Companies

13 Independent Energy Producers of Idaho

14 Interstate Securities Corporation

15 J.R. Simplot Company

16 Merrill Trust Company

17 MICRON Semiconductor, Inc.

18 Native American Rights Fund

19 PenBay Memorial Hospital

20 Rosebud Enterprises, Inc.

21 Skokomish Indian Tribe

22 State Farm Insurance Company

23 Twin Falls Canal Company

24 World Center for Birds of Prey

25

26 *Prior Experience*

27

28 **Q. Before becoming a consultant, what was your employment experience?**

29 **A.** From August 1975 to September 1977, I held the position of Senior Utility Analyst  
30 with Office of Public Counsel in Florida. From September 1974 until August 1975, I

1           held the position of Economic Analyst with the same office. Prior to that time, I was  
2           employed by the law firm of Holland and Knight as a corporate legal assistant.

3

4   **Q.    In how many formal utility regulatory proceedings have you been involved?**

5    A.    As a result of my experience with the Florida Public Counsel and my work as a  
6           consulting economist, I have been actively involved in approximately 400 different  
7           formal regulatory proceedings concerning electric, telephone, natural gas, railroad, and  
8           water and sewer utilities.

9

10 **Q.    Have you done any independent research and analysis in the field of regulatory**  
11 **economics?**

12   A.    Yes, I have undertaken extensive research and analysis of various aspects of utility  
13           regulation. Many of the resulting reports were prepared for the internal use of the  
14           Florida Public Counsel. Others were prepared for use by the staff of the Florida  
15           Legislature and for submission to the Arizona Corporation Commission, the Florida  
16           Public Service Commission, the Canadian Department of Communications, and the  
17           Provincial Governments of Canada, among others. In addition, as I already mentioned,  
18           my Master's thesis concerned the theory of the regulated firm.

19

20 **Q.    Have you testified previously as an expert witness in the area of public utility**  
21 **regulation?**

22   A.    Yes. I have provided expert testimony on more than 250 occasions in proceedings  
23           before state courts, federal courts, and regulatory commissions throughout the United  
24           States and in Canada. I have presented or have pending expert testimony before 35  
25           state commissions, the Interstate Commerce Commission, the Federal Communications

1 Commission, the District of Columbia Public Service Commission, the Alberta, Canada  
2 Public Utilities Board, and the Ontario Ministry of Culture and Communication.

3

4 **Q. What types of companies have you analyzed?**

5 A. My work has involved more than 425 different telephone companies, covering the  
6 entire spectrum from AT&T Communications to Stanton Telephone, and more than 55  
7 different electric utilities ranging in size from Texas Utilities Company to Savannah  
8 Electric and Power Company. I have also analyzed more than 30 other regulated firms,  
9 including water, sewer, natural gas, and railroad companies.

10

11 *Teaching and Publications*

12

13 **Q. Have you ever lectured on the subject of regulatory economics?**

14 A. Yes, I have lectured to undergraduate classes in economics at Florida State University  
15 on various subjects related to public utility regulation and economic theory. I have also  
16 addressed conferences and seminars sponsored by such institutions as the National  
17 Association of Regulatory Utility Commissioners (NARUC), the Marquette University  
18 College of Business Administration, the Utah Division of Public Utilities and the  
19 University of Utah, the Competitive Telecommunications Association (COMPTEL), the  
20 International Association of Assessing Officers (IAAO), the Michigan State University  
21 Institute of Public Utilities, the National Association of State Utility Consumer  
22 Advocates (NASUCA), the Rural Electrification Administration (REA), North Carolina  
23 State University, and the National Society of Rate of Return Analysts.

24

1     **Q.     Have you published any articles concerning public utility regulation?**

2     A.     Yes, I have authored or co-authored the following articles and comments:

3

4             “Attrition: A Problem for Public Utilities—Comment.” *Public Utilities Fortnightly*,  
5             March 2, 1978, pp. 32-33.

6

7             “The Attrition Problem: Underlying Causes and Regulatory Solutions.” *Public Utilities*  
8             *Fortnightly*, March 2, 1978, pp. 17-20.

9

10            “The Dilemma in Mixing Competition with Regulation.” *Public Utilities Fortnightly*,  
11            February 15, 1979, pp. 15-19.

12

13            “Cost Allocations: Limits, Problems, and Alternatives.” *Public Utilities Fortnightly*,  
14            December 4, 1980, pp. 33-36.

15

16            “AT&T is Wrong.” *The New York Times*, February 13, 1982, p. 19.

17

18            “Deregulation and Divestiture in a Changing Telecommunications Industry,” with  
19            Sharon D. Thomas. *Public Utilities Fortnightly*, October 14, 1982, pp. 17-22.

20

21            “Is the Debt-Equity Spread Always Positive?” *Public Utilities Fortnightly*,  
22            November 25, 1982, pp. 7-8.

23

24            “Working Capital: An Evaluation of Alternative Approaches.” *Electric Rate-Making*,  
25            December 1982/January 1983, pp. 36-39.

26

1           “The Stagers Rail Act of 1980: Deregulation Gone Awry,” with Sharon D. Thomas.  
2           *West Virginia Law Review*, Coal Issue 1983, pp. 725-738.

3  
4           “Bypassing the FCC: An Alternative Approach to Access Charges.” *Public Utilities*  
5           *Fortnightly*, March 7, 1985, pp. 18-23.

6  
7           “On the Results of the Telephone Network's Demise—Comment,” with Sharon D.  
8           Thomas. *Public Utilities Fortnightly*, May 1, 1986, pp. 6-7.

9  
10          “Universal Local Access Service Tariffs: An Alternative Approach to Access  
11          Charges.” In *Public Utility Regulation in an Environment of Change*, edited by  
12          Patrick C. Mann and Harry M. Trebing, pp. 63-75. Proceedings of the Institute of  
13          Public Utilities Seventeenth Annual Conference. East Lansing, Michigan: Michigan  
14          State University Public Utilities Institute, 1987.

15  
16          With E. Ray Canterbury. Review of *The Economics of Telecommunications: Theory*  
17          *and Policy* by John T. Wenders. *Southern Economic Journal* 54.2 (October 1987).

18  
19          “The Marginal Costs of Subscriber Loops,” A Paper Published in the Proceedings of  
20          the Symposia on Marginal Cost Techniques for Telephone Services. The National  
21          Regulatory Research Institute, July 15-19, 1990 and August 12-16, 1990.

22  
23          With E. Ray Canterbury and Don Reading. “Cost Savings from Nuclear Regulatory  
24          Reform: An Econometric Model.” *Southern Economic Journal*, January 1996.

25

1 ***Professional Memberships***

2

3 **Q. Do you belong to any professional societies?**

4 **A. Yes. I am a member of the American Economic Association.**

5

ERRATA SHEET

for the

Direct Testimony

of

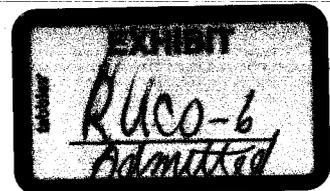
Ben Johnson, Ph.D.

on behalf of the

Residential Utility Consumer Office

Docket No. T-01051B-02-0666

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BEFORE THE ARIZONA CORPORATION COMMISSION

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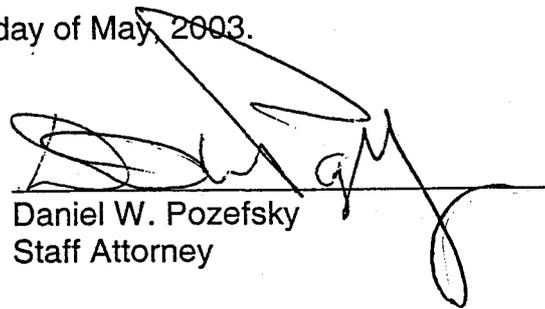
IN THE MATTER OF QWEST  
COMMUNICATIONS INTERNATIONAL,  
INC.'S, QWEST SERVICES  
CORPORATION'S, AND QWEST  
CORPORATION'S NOTICE OF SALE,  
REQUEST FOR WAIVER, OR  
APPLICATION FOR APPROVAL OF THE  
SALE OF THE ARIZONA OPERATIONS  
OF QWEST DEX, INC.

Docket No. T-01051B-02-0666

NOTICE OF FILING

The Residential Utility Consumer Office ("RUCO") hereby provides notice of filing the Rejoinder Testimony of Ben Johnson, Ph.D. in the above-referenced matter.

RESPECTFULLY SUBMITTED this 9<sup>th</sup> day of May, 2003.



Daniel W. Pozefsky  
Staff Attorney

1 AN ORIGINAL AND THIRTEEN COPIES  
2 of the foregoing filed this 9<sup>th</sup> day  
3 of May, 2003 with:

3 Docket Control  
4 Arizona Corporation Commission  
5 1200 West Washington  
6 Phoenix, Arizona 85007

5 COPIES of the foregoing hand delivered/  
6 mailed/emailed this 9<sup>th</sup> day of May, 2003  
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10 By  Jennifer Rumph

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TESTIMONY  
OF BEN JOHNSON, PH.D.  
On Behalf of  
THE STATE OF ARIZONA  
RESIDENTIAL UTILITY CONSUMER OFFICE  
Before the  
ARIZONA CORPORATION COMMISSION  
Docket No. T-01051B-02-0666

**Q. Would you please state your name and address?**

A. Ben Johnson, 2252 Killearn Center Boulevard, Tallahassee, Florida 32308.

**Q. What is your purpose in submitting this testimony?**

A. The primary purpose of this testimony is to address the proposed settlement agreement filed by Staff and Qwest in this proceeding. I am also briefly responding to a few portions of the Surrebuttal testimony filed by Qwest, particularly the testimony of Maureen Arnold, who focuses on the Stipulation, claiming that it is in the public interest. The fact that I do not directly respond to certain other positions taken by Qwest witnesses in their surrebuttal testimony should not be construed as agreement with such undiscussed positions.

1 **Q. Can you explain why you have focused on the settlement agreement, rather than**  
2 **providing an extensive response to Qwest's surrebuttal?**

3 A. Staff and Qwest have proposed a stipulation agreement ("Stipulation") which, if approved by  
4 the Commission, would replace the 1988 Settlement Agreement between Mountain States  
5 Telephone and Telegraph Company and Staff. Qwest contends that the focus at this point in  
6 the proceeding should be the Stipulation and whether or not it is in the public interest. I agree  
7 with this contention. Furthermore, time and resource constraints precluded me from providing  
8 both a detailed response to the Stipulation and a detailed response to Qwest's surrebuttal  
9 testimony. Therefore, I have concentrated on the proposed Stipulation, and Qwest's claim that  
10 the settlement is in the public interest.

11  
12 **Q. Can you begin by briefly summarizing the settlement agreement?**

13 A. The Stipulation provides that in any price cap or rate proceeding, the annual amount of  
14 directory revenues imputed to Qwest shall be \$72 million. Imputation under the Stipulation will  
15 continue for 15 years, beginning on the date Qwest submits its first Price Cap Review filing.  
16 These imputation provisions are contingent upon: 1) the Commission approving and adopting  
17 the Stipulation; 2) the Commission approving the Dex sale; and, 3) the sale being completed by  
18 December 31, 2003. [Stipulation, pp. 2-3.] Imputation will cease for any proceedings which  
19 commence after this 15 year period.

20  
21 **Q. Do you have any concerns with the proposed Stipulation?**

22 A. Yes. The Stipulation results in a severe mismatch between the duration of imputation (15 years)

1 and the duration of the services that will be provided by Qwest (up to 50 years). While I don't  
2 agree that \$72 million per year is necessarily an adequate imputation amount, I recognize that  
3 the Settlement represents a compromise between the Staff (which advocated a much higher  
4 annual dollar amount) and Qwest (which sought to eliminate imputation). No justification has  
5 been offered for ending imputation after just 15 years when the underlying contract obligates  
6 Qwest for up to 50 years.

7 On Schedule 1, I compare the annual imputation amounts under the Stipulation with  
8 those that were discussed in my rebuttal testimony and the Staff's rebuttal testimony (filed prior  
9 to signing the Stipulation). Recall that I presented two illustrative imputation amounts, based  
10 upon the \$43 million included in Mountain Bell's 1984 rate case and the 1988 Settlement  
11 Agreement. In the first example, I used growth in Qwest Arizona access lines to increase  
12 imputed directory revenues to the analogous amount applicable to 2001 (approximately \$90  
13 million). In the second example, I also considered the effects of inflation in arriving at the 2001  
14 equivalent level of imputation. Applying a line-based growth factor and a GDP-based inflation  
15 factor to the \$43 million figure, I developed a 2001 imputation amount of approximately \$138  
16 million. In Schedule 1 I use the same techniques, extending the calculations out to the years  
17 2004 through 2048. For comparison purposes, I also develop analogous figures for the  
18 recommendations set forth in the Staff's rebuttal testimony.

19  
20 **Q. Can you explain the line growth and inflation factors used to develop the RUCO**  
21 **imputation amounts shown on this schedule?**

22 **A. It is not clear to what extent Qwest access lines will grow in the future. In fact, Qwest's access**

1 lines may decline somewhat in the near future, as they have during the past couple of years. In  
2 developing these calculations, I have used the 2002 line count and assumed the number of  
3 Qwest access lines remains constant in the future. I developed my annual inflation rate by taking  
4 the average change in the GDP Implicit Price Deflator (GDPD) from 1929 to 2002. Over this  
5 period the GDPD increased 3.1% per year, on average.

6 As shown on Schedule 1, under the Stipulation, imputation in the amount of \$72  
7 million will occur through 2018. This is less than the status quo level of imputation based upon  
8 either RUCO methodology (i.e., an imputation amount equivalent to \$43 million adjusted for  
9 line growth, or an amount that is also adjusted for inflation). Although the \$72 million figure is  
10 substantially less than the status quo level of imputation, the gap is much wider when one  
11 considers what happens after the 15th year. For example, in the 20th year (2023), under the  
12 Stipulation no directory income is imputed to Qwest's local exchange operations. However, the  
13 status quo level of imputation amounts to either \$84 million or \$247 million, depending upon  
14 whether or not inflation is considered.

15  
16 **Q. Can you explain the portion of Schedule 1 relating to the Staff calculations that were**  
17 **developed prior to reaching a settlement with Qwest?**

18 **A.** Staff witness Michael Brosch recommended two alternatives, depending upon whether Qwest  
19 remains under price cap regulation, or reverts back to traditional regulation. If Qwest remains  
20 under price cap regulation, Mr. Brosch recommends imputation of \$100 million, in perpetuity. If  
21 Qwest is subject to traditional rate of return regulation, Mr. Brosch recommends imputation of  
22 \$121.3 million for a period of 20 years.

1 **Q. Why is it inappropriate to end imputation after 15 years?**

2 A. As I explained in my rebuttal testimony, telephone directories are subject to “economies of  
3 standardization.”; a self-reinforcing bias in favor of the “standard” product which allows a  
4 dominant firm to earn enormous profits. The “official” yellow pages (whether published directly  
5 by the incumbent, through an affiliate, or by a designated third party) are inevitably the most  
6 universally accepted and profitable. The profits that can be generated by the “official” yellow  
7 pages are almost exclusively attributable to their association with the dominant carrier’s local  
8 exchange operations. Simply put, incumbent carriers have a unique ability to generate supra-  
9 competitive directory profits, because of their monopoly position in the local exchange market.  
10 Hence, in Arizona and elsewhere directory publishing has long been viewed as a profitable  
11 byproduct of local telephone service, serving to offset the cost of providing local telephone  
12 service.

13 QCI has, in essence, directed Qwest Corporation (QC) to transfer all of the benefits of  
14 this “official” designation to the Dex purchasers for a period of 40 years. Rather than QC  
15 receiving a substantial annual payment, its parent corporation is receiving a large lump-sum  
16 payment. The end result is the same, however: QC is required to forgo the opportunity to earn  
17 substantial income during each of the next 40 to 50 years—income that has historically been  
18 used to minimize local rates (either directly or through imputation).

19 In reviewing the Stipulation, the Commission needs to evaluate whether the imputation  
20 provisions provide the Arizona local exchange operations (and ratepayers) with adequate  
21 compensation when compared with the value of the “official” directory designation and the  
22 Noncompetition Agreement. It is impossible to conclude that the imputation provisions are

1           adequate when the imputation only lasts 15 years, while the“official” directory designation and  
2           the Noncompetition Agreement extend for at least 40 years. This problem could be solved by  
3           extending the imputation provisions to last for at least 40 years, or by reducing the duration of  
4           the“official” directory designation and the Noncompetition Agreement to match the duration of  
5           the imputation provisions (e.g. 15 years).

6  
7           **Q. Let’s discuss Qwest’s claims that the Stipulation is in the public interest. What is the**  
8           **basis for this claim?**

9           A. Qwest witness Maureen Arnold claims that the Stipulation is in the public interest, for three  
10           reasons: 1) imputation will increase from a “presumptive” level of \$43 million, to a “definite”  
11           amount of \$72 million; 2) approval of the Application is necessary to close the sale, and will  
12           help Qwest “meet its immediate financial needs”; and, 3) imputation of a specific negotiated  
13           amount will remove uncertainty and complexity from future rate proceedings.

14  
15           **Q. Can you address the first of her claims, that the stipulation will increase the level of**  
16           **imputation?**

17           A. Mrs. Arnold starts with a false premise: in effect she assumes that, absent the Stipulation, the  
18           Commission would be limited to the \$43 million in imputation that was included in the 1984 rate  
19           case. This assumption is unfounded. The 1988 Settlement Agreement indicated that the \$43  
20           million figure was the amount reflected in rates pursuant to the 1984 rate case. However, as I  
21           explained in my rebuttal testimony, the 1998 Settlement Agreement also contained language  
22           which provided the Commission with ample flexibility to establish a different, larger, imputation

1 amount as circumstances evolved. This flexibility was confirmed by the Commission in Decision  
2 58927, when it held that “the Settlement Agreement does not place a cap of \$43 million on the  
3 amount of imputation.” [Decision 58927, p. 13]. This flexibility was also confirmed by the  
4 Arizona Court of Appeals. [See, US West Communication, Inc. v. ACC, 185 Ariz. 277, 281  
5 (App. 1996)].

6 As I explained in my rebuttal testimony, the \$43 million in imputation included in the  
7 1984 rate is a logical starting point, but it does not represent the appropriate amount of  
8 imputation today, nor at any point in the future. To the contrary, as I explained in my rebuttal  
9 testimony, an appropriate imputation amount must take into consideration growth in the  
10 directory publishing business since the 1984 rate case. The value of the services contributed by  
11 the local exchange operations to the directory publisher has greatly increased as the state has  
12 grown. It is also appropriate to consider inflation during the intervening years since 1984. When  
13 these factors are considered, it is self evident that the appropriate imputation value today is far  
14 in excess of the \$43 million figure.

15 Furthermore, Mrs. Arnold fails to recognize that, under the Stipulation, imputation will  
16 cease after 15 years, whereas under the status quo imputation would continue indefinitely. Even  
17 if the Commission were required to limit the annual imputation amount to \$43 million (which it is  
18 not), there is no basis for assuming that \$72 million for 15 years is better than \$43 million for 50  
19 years. In total dollars, the Stipulation provides just \$1,080,000,000; this represents a decrease  
20 in imputation relative to \$43 million per year over 40 years (\$1,720,000,000) or 50 years  
21 (\$2,150,000,000). From a public interest perspective, and from the perspective of local  
22 exchange customers, this represents a decrease in imputation compared to the \$43 million level,

1 not an increase as Mrs. Arnold claims. As I explained earlier, in evaluating the Stipulation, the  
2 appropriate time period is 40 to 50 years, coinciding with duration of the Noncompetition  
3 Agreement and the "official" designation, respectively.  
4

5 **Q. Can you now address Qwest's second point, that approval of the Application is**  
6 **necessary to close the sale and help Qwest meet its immediate financial needs?**

7 **A.** It is not clear how this point relates to the proposed Stipulation, or how it supports the  
8 contention that the Stipulation is in the public interest. Mrs. Arnold seems to be confusing  
9 Qwest's request for approval of the sale, with its request for approval of the Stipulation. While  
10 they are certainly related, one is not necessarily contingent upon the other. The sale could be  
11 approved by the Commission and consummated by the parties even if the Stipulation were  
12 rejected. Similarly, the sale might be approved and consummated pursuant to some other  
13 Stipulation, or pursuant to an order of the Commission that sets forth some different set of  
14 regulatory conditions.

15 Even if we were to assume, for the sake of argument, that Mrs. Arnold's underlying  
16 thesis were valid (i.e., that consummation of the sale is vitally necessary to Qwest's short term  
17 financial viability) that does not shed any light on a public interest analysis of the terms of the  
18 Stipulation, since the sale could still be completed even if the Stipulation is rejected.  
19 Furthermore, as I explained in my rebuttal testimony, Qwest's problems run much deeper than  
20 the short term cash flow and liquidity concerns which seem to be the focus of Mrs. Arnold's  
21 reasoning. The root problem is QCI's underutilized long haul fiber optic network. This problem  
22 is compounded by the fact that QCI is heavily leveraged, and by the Company's financial

1 reporting problems. In the short run, the infusion of cash provided by the Dex transaction  
2 would undoubtedly be helpful. However, it is by no means clear that this cash infusion will  
3 suffice, or whether it will simply delaying a future liquidity crisis. Further, as I explained in my  
4 rebuttal testimony, selling Dex will tend to exacerbate QCI's financial weaknesses and cash  
5 flow problems over the long haul.

6  
7 **Q. Do you see the Dex sale as a long term solution to QCI's problems?**

8 **A.** No. The sale offers short term relief from Qwest's cash crunch, but it does nothing to solve the  
9 accounting uncertainties, and it does nothing to solve Qwest's core problems, including a long  
10 haul fiber network with enormous amounts of excess capacity and a weak competitive position,  
11 as well as wireless operations that are losing market share in the face of increased competition  
12 from national carriers like Verizon and Sprint.

13  
14 **Q. Doesn't Qwest offer some evidence that the sale will improve the Company's long  
15 term financial position?**

16 **A.** Qwest witness Peter C. Cummings states: "The Dex sale transaction's positive impact on  
17 QCI's stock price and the lower credit spreads and borrowing costs for QC indicates positive  
18 long term expectations from Qwest's long term investors". [Cummings Surrebutal, p. 3]  
19 According to Mr. Cummings, these positive expectations are evidence of "the long term  
20 prospects for QCI after the sale". [Id.] Mr. Cummings appears to be referring to the stock and  
21 debt market data discussed in his direct testimony. With regard to stock prices, he points to  
22 QCI's market performance around the time of the announcement of the Dex sale, and around

1 the time of the closing of the first phase of the sale.

2

3 During the month before the 8/20/2002 announcement of the Dex sale,  
4 QCI stock traded at prices under \$2.00 a share. Since that date, QCI  
5 stock price has steadily increased, generally trading above \$4.00 per  
6 share since the 11/8/2002 Dexter sale close and ending the year 2002  
7 at \$5.00 per share. [Cummings Direct, p. 23]  
8

9 According to Qwest, the recent stock price of \$4 to \$5 reflects the anticipated completion of  
10 both parts of the Dex sale. [Cummings Direct, p. 22] If the Rodney sale is approved in Arizona  
11 and Washington (the only states where approval is still pending), this will only have a "neutral to  
12 slightly positive impact" on the Company stock price, confirming that investors have put little  
13 weight into the ability of this sale to save Qwest from bankruptcy.

14

15 **Q. What is your response to the stock market data cited by Mr. Cummings?**

16 **A.** It is always difficult to interpret market data, because so many factors influence stock price  
17 fluctuations. Mr. Cummings emphasizes the increase in the price that was experienced around  
18 the time the Dex sale was announced, which he contends continued through the end of 2002.  
19 Looking at the stock price in the immediate time period surrounding the Dex announcement one  
20 sees that the price did increase in August 2002. However, as shown on page 1 of Schedule 2,  
21 it is impossible to know how much of this increase resulted specifically from the Dex  
22 transaction, particularly since the price increase began about a week before the transaction was  
23 publicly announced. In fact, the price reaction in the month after the announcement was largely  
24 neutral. On the day before the announcement (August 19, 2002) QCI's stock closed at \$2.24

1 per share. More than a month later, on September 30, 2002, the stock closed at \$2.28 per  
2 share.

3 While it is certainly possible that investors have reacted favorably to the Dex  
4 transaction, it is also possible that the stock simply "bounced" in mid August, once a "tipping  
5 point" was reached, as speculators concluded the stock price was finally "oversold." While  
6 rumors of the Dex transaction may have contributed to the mood shift, the primary factor  
7 explaining the price upturn in mid August, 2002 may have simply been a change in investor  
8 perceptions and expectations. As shown on page 2 of Schedule 2, the stock had been in a 2  
9 year downtrend, dropping from a high of about \$50 in June 2000 to less than \$5 in mid-June  
10 2002. Then, as shown on page 1 of Schedule 2, on June 26, 2002 the stock opened sharply  
11 lower, plunging by more than 60% during the course of the day, reaching a low of less than  
12 \$1.25 before closing at \$1.79. During the ensuing weeks, the stock price finally began to flatten  
13 out, showing signs of price support in the vicinity of \$1.25 per share. Under these  
14 circumstances, it is hard to know whether the upward movement that began in August 2002  
15 was due to increasing speculation that this long decline was finally coming to an end, or the  
16 extent to which this movement was fueled by rumors of the Dex transaction. Either way, at least  
17 some of the stock runup was probably due to "short covering" as the stock showed signs that  
18 the downtrend was finally ending.

19 It is certainly true that the stock has performed better since that time, reaching as high  
20 as \$6.00 in January 2003, before settling back to its recent level of approximately \$3.00 to  
21 \$4.50. However, none of this data provides strong evidence that the Dex transaction is seen by  
22 investors as a complete long term solution to the Company's financial problems.

1     **Q.     Are there indications that the Dex transaction does not completely solve Qwest's long**  
2     **term problems?**

3     A.     Yes. I looked at the Company's stock market capitalization relative to the number of local  
4     access lines it serves, in order to compare the recent price with the price of the other RBOCs. I  
5     found that the Company's stock market capitalization is equivalent to just \$400.50 per access  
6     line. This market valuation is just a fraction of what the underlying assets are worth—as  
7     suggested by the much higher price per line that Qwest has received when selling some of its  
8     most rural exchanges. Some of this discrepancy is due to leveraging (since the assets are  
9     encumbered by debt), but given the size of the gap, it is clear the market continues to have  
10    serious doubts about Qwest's long term financial future. This depressed stock price suggests  
11    that investors continue to be worried about the Company's financial accounting, its debt load,  
12    and the problems with the Company's excess fiber capacity.

13           This conclusion is confirmed by a comparison of QCI's market capitalization per  
14    access line with the analogous data for the other RBOCs—BellSouth, SBC, and Verizon.  
15    BellSouth is currently valued at approximately \$1,800 per access line, SBC is valued at  
16    approximately \$1,400 per line and Verizon is valued at approximately \$2,400 per line.  
17    Considering the huge gap between these valuations and QCI's stock market value (\$400 per  
18    line), it is clear that many investors continue to be concerned about the firm's long term financial  
19    viability despite (or because of) the Dex transaction.

20           If the Dex sale was, in the eyes of stockholders, a complete long-term solution to the  
21    Company's financial problems which would eliminate any risk of bankruptcy, one would expect  
22    to see the stock price move much closer to levels of the other RBOCs. QCI's stock

1 performance over the past 3 years certainly does not confirm Mr. Cummings' hypothesis,  
2 particularly when this performance is compared with that of the other RBOCs, as shown on  
3 page 3 of Schedule 2.

4  
5 **Q. Do analysts in the financial community see the Dex sale as a long term solution to**  
6 **QCI's problems?**

7 A. Some do, or at least they did. For example, when the transaction was announced, Lehman  
8 Brothers, Qwest's financial adviser on the Dex transfer, told the investment community that it  
9 believed the sale would largely eliminate the risk of bankruptcy: it "achieves the key missing  
10 ingredient and greatly enhances the probability of successfully eliminating any need to  
11 restructure the company". [Lehman Brothers, Q Liquidity Crunch Over - \$7B DEX Sale,  
12 August 20, 2002.] Even so, Lehman Brothers recently stated that "all of the company's value is  
13 supported by our per access line local valuation" [Lehman Brothers, Trend/Guidance Week.  
14 Target Reduced, February 20, 2003]. In effect, this suggests that, despite the partial rebound of  
15 Qwest's stock price, the market is placing little or no value on Qwest's assets other than the  
16 local exchange operations.

17 Other analysts are more concerned about Qwest's long term financial prospects, and  
18 they seem concerned about the possibility of default or bankruptcy notwithstanding the Dex  
19 transaction. For instance, Standard and Poor's states:

20  
21 We no longer have confidence in management ... in light of Q's need to  
22 restate prior year results for a third time, due to improper accounting  
23 practices ... It is not clear that this is the last of the restatements, in light

1 of ongoing SEC and Department of Justice probes, and review of the  
2 company's financial statements by a new auditor, KPMG. Although  
3 debt has been reduced somewhat, credit risks remain high on Q's  
4 \$22.6 billion load. [Standard and Poor's Stock Reports, Qwest  
5 Communications, May 3, 2003]  
6

7 Similarly, Morgan Stanley Co. recently cut its Qwest stock estimates "as we believe the sale of  
8 the DEX business will have a negative effect on the operating fundamentals, once completed".  
9 [See, biz.yahoo.com/tsp/020603/10025210\_2.html] Other analysts also seem concerned that  
10 the Dex transaction involves an unhappy tradeoff between short and long term financial health.  
11 For instance, Scott Moritz, Senior Writer for TheStreet.com, made these comments shortly  
12 after the transaction was announced:  
13

14 [A]s new management wins plaudits for cleaning house, the numbers tell  
15 a different story. Qwest's core keeps shrinking: Third-quarter business  
16 services revenue fell 5% from a year ago, while consumer services  
17 revenue fell 9%. Meanwhile, Qwest remains under the cloud of  
18 numerous investigations and its accountants still haven't finalized their  
19 audit of 2000 and 2001 numbers.  
20

21 But most jarringly, Wednesday's report underlined the stark reality of the  
22 company's future: Without the cash-generating buoyancy of its soon-to-be-  
23 sold directory unit, Qwest's core phone service business will struggle to stay  
24 afloat. ...  
25

26 While pawning the business may have kept Qwest in business for this year, the  
27 sale has also robbed Qwest of a rare cash cow whose steady health could  
28 offset the company's numerous ills. [TheStreet.com, Qwest Rise, But Core  
29 Business Keeps Shrinking, October 30, 2002]  
30

31 In evaluating the Stipulation and the proposed transaction, the Commission should recognize

1           that the transaction is not an unmixed blessing that should be approved regardless of how it  
2           impacts customers. To the contrary, it provides a short term infusion of cash, but it may  
3           significantly weaken Qwest's long term financial position.

4

5   **Q.    Can you address Qwest's third reason why it believes the sale is in the public interest?**

6    A.    As I explained earlier, Qwest claims that imputation of a specific negotiated amount will  
7           remove uncertainty and complexity from future rate proceedings. There is merit to this claim.  
8           The amount of imputation allowed or required by the 1988 Settlement Agreement, and the  
9           methodology used to calculate the imputation, have been litigated for years, and remain in  
10          dispute to this day. This proceeding presents an opportunity to end that dispute and establish a  
11          definite, unambiguous imputation amount and/or formula. However, this can be accomplished  
12          without having to end the imputation after 15 years. An unambiguous, indisputable imputation  
13          amount or formula can (and should) be adopted by the Commission for duration of at least 40  
14          years.

15

16   **Q.    What do you recommend the Commission do with regard to the Stipulation?**

17    A.    I recommend the Commission reject the transaction and Stipulation as currently structured,  
18           because the proposed 15 year imputation period is drastically shorter than the period of time  
19           QC will be prohibited from reentering the directory publishing market, and the period of time  
20           that the Dex purchasers will be designated as the official directory publishers for Qwest's  
21           Arizona local exchange operations.

22                   I recommend the Commission issue an order that provides Qwest with an opportunity

1 to establish the same number of years for imputation, the non-compete clause, and the official  
2 directory designation. This can be accomplished by shortening the duration of the  
3 Noncompetition Agreement and the Publishing Agreement (Exhibits M and D to the Rodney  
4 Purchase Agreement, respectively) to 15 years. If the Dex purchasers are anxious to complete  
5 the transaction, they might agree to this modification if it is necessary to facilitate approval even  
6 without any further concessions from Qwest. Alternatively, if the Dex purchasers refuse to  
7 renegotiate the duration of these contracts with respect to Arizona, Qwest could amend the  
8 Stipulation to increase the imputation period to 45 years, consistent with the average duration of  
9 the Noncompetition Agreement and the Publishing Agreement. Another reasonable alternative  
10 would be to extend the imputation period and to negotiate shorter non-compete and official  
11 designation periods, equalizing all of the time periods at a consistent duration like 20 or 25  
12 years.

13  
14 **Q. Is there any indication that Qwest has the flexibility to make further concessions in**  
15 **order to gain approval of the transaction?**

16 **A.** Yes. I don't know if Qwest would need to provide further concessions to the Dex purchasers  
17 in order to convince them to shorten the non-compete and official designation periods in  
18 Arizona. However, it is clear that Qwest anticipated the need to provide significant concessions  
19 in order to win regulatory approval for the transaction. According to Qwest Chief Financial  
20 Officer Oren Shaffer, Qwest originally ear-marked \$500 million of the proceeds from the sale  
21 to gain regulatory approval. [Qwest to Keep High Percentage of \$4.3B Dex Proceeds, The  
22 Wall Street Journal, March 13, 2003] Mr. Shaffer now feels that he "overestimated" the

1 magnitude of the concessions that would be necessary to obtain regulatory approval, since  
2 Qwest settled with Utah for \$22 million, and approval of only 2 more states is required  
3 (Arizona and Washington).

4 Considering that most of these earmarked funds remain unspent, Qwest clearly has the  
5 flexibility to bargain in good faith with the Dex purchasers concerning the duration of the  
6 Arizona contracts. Of course, if it chooses to extend the imputation period from 15 years to 45  
7 years it would not need to use any of the earmarked funds, since the only impact will be on the  
8 level of rates charged after the initial 15 year period (precluding a potential rate increase upon  
9 expiration of the 15 year period).

10  
11 **Q. Does this complete your rejoinder testimony, which was prefled on May 9<sup>th</sup>, 2003?**  
12 **A. Yes, it does.**

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Appendix A  
**Qualifications**

***Present Occupation***

**Q. What is your present occupation?**

A. I am a consulting economist and President of Ben Johnson Associates, Inc.®, a firm of economic and analytic consultants specializing in the area of public utility regulation.

***Educational Background***

**Q. What is your educational background?**

A. I graduated with honors from the University of South Florida with a Bachelor of Arts degree in Economics in March 1974. I earned a Master of Science degree in Economics at Florida State University in September 1977. The title of my Master's Thesis is a "A Critique of Economic Theory as Applied to the Regulated Firm." Finally, I graduated from Florida State University in April 1982 with the Ph.D. degree in Economics. The title of my doctoral dissertation is "Executive Compensation, Size, Profit, and Cost in the Electric Utility Industry."

***Clients***

**Q. What types of clients employ your firm?**

A. Much of our work is performed on behalf of public agencies at every level of government involved in utility regulation. These agencies include state regulatory commissions, public counsels, attorneys general, and local governments, among others.

1           We are also employed by various private organizations and firms, both regulated and  
2           unregulated. The diversity of our clientele is illustrated below.

3

4           Regulatory Commissions

5

6           Alabama Public Service Commission—Public Staff for Utility Consumer Protection

7           Alaska Public Utilities Commission

8           Arizona Corporation Commission

9           Arkansas Public Service Commission

10          Connecticut Department of Public Utility Control

11          District of Columbia Public Service Commission

12          Idaho Public Utilities Commission

13          Idaho State Tax Commission

14          Iowa Department of Revenue and Finance

15          Kansas State Corporation Commission

16          Maine Public Utilities Commission

17          Minnesota Department of Public Service

18          Missouri Public Service Commission

19          National Association of State Utility Consumer Advocates

20          Nevada Public Service Commission

21          New Hampshire Public Utilities Commission

22          North Carolina Utilities Commission—Public Staff

23          Oklahoma Corporation Commission

24          Ontario Ministry of Culture and Communications

25          Staff of the Delaware Public Service Commission

26          Staff of the Georgia Public Service Commission

27          Texas Public Utilities Commission

28          Virginia State Corporation Commission

29          Washington Utilities and Transportation Commission

30          West Virginia Public Service Commission—Division of Consumer Advocate

31          Wisconsin Public Service Commission

1 Wyoming Public Service Commission

2

3 Public Counsels

4

5 Arizona Residential Utility Consumers Office

6 Colorado Office of Consumer Counsel

7 Colorado Office of Consumer Services

8 Connecticut Consumer Counsel

9 District of Columbia Office of People's Counsel

10 Florida Public Counsel

11 Georgia Consumers' Utility Counsel

12 Hawaii Division of Consumer Advocacy

13 Illinois Small Business Utility Advocate Office

14 Indiana Office of the Utility Consumer Counselor

15 Iowa Consumer Advocate

16 Maryland Office of People's Counsel

17 Minnesota Office of Consumer Services

18 Missouri Public Counsel

19 New Hampshire Consumer Counsel

20 Ohio Consumer Counsel

21 Pennsylvania Office of Consumer Advocate

22 Utah Department of Business Regulation—Committee of Consumer Services

23

24 Attorneys General

25

26 Arkansas Attorney General

27 Florida Attorney General—Antitrust Division

28 Idaho Attorney General

29 Kentucky Attorney General

30 Michigan Attorney General

31 Minnesota Attorney General

- 1 Nevada Attorney General's Office of Advocate for Customers of Public Utilities
- 2 South Carolina Attorney General
- 3 Utah Attorney General
- 4 Virginia Attorney General
- 5 Washington Attorney General

6

7 Local Governments

8

- 9 City of Austin, TX
- 10 City of Corpus Christi, TX
- 11 City of Dallas, TX
- 12 City of El Paso, TX
- 13 City of Galveston, TX
- 14 City of Norfolk, VA
- 15 City of Phoenix, AZ
- 16 City of Richmond, VA
- 17 City of San Antonio, TX
- 18 City of Tucson, AZ
- 19 County of Augusta, VA
- 20 County of Henrico, VA
- 21 County of York, VA
- 22 Town of Ashland, VA
- 23
- 24 Town of Blacksburg, VA
- 25 Town of Pecos City, TX

26

27 Other Government Agencies

28

- 29 Canada—Department of Communications
- 30 Hillsborough County Property Appraiser
- 31 Provincial Governments of Canada

- 1 Sarasota County Property Appraiser
- 2 State of Florida—Department of General Services
- 3 United States Department of Justice—Antitrust Division
- 4 Utah State Tax Commission

5

6 Regulated Firms

7

- 8 Alabama Power Company
- 9 Americall LDC, Inc.
- 10 BC Rail
- 11 CommuniGroup
- 12 Florida Association of Concerned Telephone Companies, Inc.
- 13 LDDS Communications, Inc.
- 14 Louisiana/Mississippi Resellers Association
- 15 Madison County Telephone Company
- 16 Montana Power Company
- 17 Mountain View Telephone Company
- 18 Nevada Power Company
- 19 Network I, Inc.
- 20 North Carolina Long Distance Association
- 21 Northern Lights Public Utility
- 22 Otter Tail Power Company
- 23 Pan-Alberta Gas, Ltd.
- 24 Resort Village Utility, Inc.
- 25 South Carolina Long Distance Association
- 26 Stanton Telephone
- 27 Teleconnect Company
- 28 Tennessee Resellers' Association
- 29 Westel Telecommunications
- 30 Yelcot Telephone Company, Inc.

31

1 Other Private Organizations

2

3 Arizona Center for Law in the Public Interest

4 Black United Fund of New Jersey

5 Casco Bank and Trust

6 Coalition of Boise Water Customers

7 Colorado Energy Advocacy Office

8 East Maine Medical Center

9 Georgia Legal Services Program

10 Harris Corporation

11 Helca Mining Company

12 Idaho Small Timber Companies

13 Independent Energy Producers of Idaho

14 Interstate Securities Corporation

15 J.R. Simplot Company

16 Merrill Trust Company

17 MICRON Semiconductor, Inc.

18 Native American Rights Fund

19 PenBay Memorial Hospital

20 Rosebud Enterprises, Inc.

21 Skokomish Indian Tribe

22 State Farm Insurance Company

23 Twin Falls Canal Company

24 World Center for Birds of Prey

25

26 ***Prior Experience***

27

28 **Q. Before becoming a consultant, what was your employment experience?**

29 **A.** From August 1975 to September 1977, I held the position of Senior Utility Analyst  
30 with Office of Public Counsel in Florida. From September 1974 until August 1975, I

1 held the position of Economic Analyst with the same office. Prior to that time, I was  
2 employed by the law firm of Holland and Knight as a corporate legal assistant.

3

4 **Q. In how many formal utility regulatory proceedings have you been involved?**

5 A. As a result of my experience with the Florida Public Counsel and my work as a  
6 consulting economist, I have been actively involved in approximately 400 different  
7 formal regulatory proceedings concerning electric, telephone, natural gas, railroad, and  
8 water and sewer utilities.

9

10 **Q. Have you done any independent research and analysis in the field of regulatory**  
11 **economics?**

12 A. Yes, I have undertaken extensive research and analysis of various aspects of utility  
13 regulation. Many of the resulting reports were prepared for the internal use of the  
14 Florida Public Counsel. Others were prepared for use by the staff of the Florida  
15 Legislature and for submission to the Arizona Corporation Commission, the Florida  
16 Public Service Commission, the Canadian Department of Communications, and the  
17 Provincial Governments of Canada, among others. In addition, as I already mentioned,  
18 my Master's thesis concerned the theory of the regulated firm.

19

20 **Q. Have you testified previously as an expert witness in the area of public utility**  
21 **regulation?**

22 A. Yes. I have provided expert testimony on more than 250 occasions in proceedings  
23 before state courts, federal courts, and regulatory commissions throughout the United  
24 States and in Canada. I have presented or have pending expert testimony before 35  
25 state commissions, the Interstate Commerce Commission, the Federal Communications

1 Commission, the District of Columbia Public Service Commission, the Alberta, Canada  
2 Public Utilities Board, and the Ontario Ministry of Culture and Communication.

3

4 **Q. What types of companies have you analyzed?**

5 A. My work has involved more than 425 different telephone companies, covering the  
6 entire spectrum from AT&T Communications to Stanton Telephone, and more than 55  
7 different electric utilities ranging in size from Texas Utilities Company to Savannah  
8 Electric and Power Company. I have also analyzed more than 30 other regulated firms,  
9 including water, sewer, natural gas, and railroad companies.

10

11 *Teaching and Publications*

12

13 **Q. Have you ever lectured on the subject of regulatory economics?**

14 A. Yes, I have lectured to undergraduate classes in economics at Florida State University  
15 on various subjects related to public utility regulation and economic theory. I have also  
16 addressed conferences and seminars sponsored by such institutions as the National  
17 Association of Regulatory Utility Commissioners (NARUC), the Marquette University  
18 College of Business Administration, the Utah Division of Public Utilities and the  
19 University of Utah, the Competitive Telecommunications Association (COMPTEL), the  
20 International Association of Assessing Officers (IAAO), the Michigan State University  
21 Institute of Public Utilities, the National Association of State Utility Consumer  
22 Advocates (NASUCA), the Rural Electrification Administration (REA), North Carolina  
23 State University, and the National Society of Rate of Return Analysts.

24

1    **Q.    Have you published any articles concerning public utility regulation?**

2    A.    Yes, I have authored or co-authored the following articles and comments:

3

4            “Attrition: A Problem for Public Utilities—Comment.” *Public Utilities Fortnightly*,  
5            March 2, 1978, pp. 32-33.

6

7            “The Attrition Problem: Underlying Causes and Regulatory Solutions.” *Public Utilities*  
8            *Fortnightly*, March 2, 1978, pp. 17-20.

9

10            “The Dilemma in Mixing Competition with Regulation.” *Public Utilities Fortnightly*,  
11            February 15, 1979, pp. 15-19.

12

13            “Cost Allocations: Limits, Problems, and Alternatives.” *Public Utilities Fortnightly*,  
14            December 4, 1980, pp. 33-36.

15

16            “AT&T is Wrong.” *The New York Times*, February 13, 1982, p. 19.

17

18            “Deregulation and Divestiture in a Changing Telecommunications Industry,” with  
19            Sharon D. Thomas. *Public Utilities Fortnightly*, October 14, 1982, pp. 17-22.

20

21            “Is the Debt-Equity Spread Always Positive?” *Public Utilities Fortnightly*,  
22            November 25, 1982, pp. 7-8.

23

24            “Working Capital: An Evaluation of Alternative Approaches.” *Electric Rate-Making*,  
25            December 1982/January 1983, pp. 36-39.

26

1           “The Staggers Rail Act of 1980: Deregulation Gone Awry,” with Sharon D. Thomas.  
2           *West Virginia Law Review*, Coal Issue 1983, pp. 725-738.

3  
4           “Bypassing the FCC: An Alternative Approach to Access Charges.” *Public Utilities*  
5           *Fortnightly*, March 7, 1985, pp. 18-23.

6  
7           “On the Results of the Telephone Network’s Demise—Comment,” with Sharon D.  
8           Thomas. *Public Utilities Fortnightly*, May 1, 1986, pp. 6-7.

9  
10           “Universal Local Access Service Tariffs: An Alternative Approach to Access  
11           Charges.” In *Public Utility Regulation in an Environment of Change*, edited by  
12           Patrick C. Mann and Harry M. Trebing, pp. 63-75. Proceedings of the Institute of  
13           Public Utilities Seventeenth Annual Conference. East Lansing, Michigan: Michigan  
14           State University Public Utilities Institute, 1987.

15  
16           With E. Ray Canterbury. Review of *The Economics of Telecommunications: Theory*  
17           *and Policy* by John T. Wenders. *Southern Economic Journal* 54.2 (October 1987).

18  
19           “The Marginal Costs of Subscriber Loops,” A Paper Published in the Proceedings of  
20           the Symposia on Marginal Cost Techniques for Telephone Services. The National  
21           Regulatory Research Institute, July 15-19, 1990 and August 12-16, 1990.

22  
23           With E. Ray Canterbury and Don Reading. “Cost Savings from Nuclear Regulatory  
24           Reform: An Econometric Model.” *Southern Economic Journal*, January 1996.

25

1    ***Professional Memberships***

2

3    **Q.    Do you belong to any professional societies?**

4    **A.    Yes. I am a member of the American Economic Association.**

5

**Imputation Comparison***Proposed Stipulation vs. RUCO and Staff Recommendations*

| Year | Proposed<br>Stipulation | RUCO<br>(Line Growth) | RUCO<br>(Line Growth<br>and Inflation) | Staff<br>(Traditional<br>Regulation) | Staff<br>(Price Cap)<br>Regulation) |
|------|-------------------------|-----------------------|--|--------------------------------------|-------------------------------------|
| 2004 | 72,000,000              | 83,961,293            | 138,221,553                            | 121,300,000                          | 100,000,000                         |
| 2005 | 72,000,000              | 83,961,293            | 142,494,954                            | 121,300,000                          | 100,000,000                         |
| 2006 | 72,000,000              | 83,961,293            | 146,900,475                            | 121,300,000                          | 100,000,000                         |
| 2007 | 72,000,000              | 83,961,293            | 151,442,202                            | 121,300,000                          | 100,000,000                         |
| 2008 | 72,000,000              | 83,961,293            | 156,124,346                            | 121,300,000                          | 100,000,000                         |
| 2009 | 72,000,000              | 83,961,293            | 160,951,247                            | 121,300,000                          | 100,000,000                         |
| 2010 | 72,000,000              | 83,961,293            | 165,927,382                            | 121,300,000                          | 100,000,000                         |
| 2011 | 72,000,000              | 83,961,293            | 171,057,365                            | 121,300,000                          | 100,000,000                         |
| 2012 | 72,000,000              | 83,961,293            | 176,345,951                            | 121,300,000                          | 100,000,000                         |
| 2013 | 72,000,000              | 83,961,293            | 181,798,045                            | 121,300,000                          | 100,000,000                         |
| 2014 | 72,000,000              | 83,961,293            | 187,418,701                            | 121,300,000                          | 100,000,000                         |
| 2015 | 72,000,000              | 83,961,293            | 193,213,132                            | 121,300,000                          | 100,000,000                         |
| 2016 | 72,000,000              | 83,961,293            | 199,186,708                            | 121,300,000                          | 100,000,000                         |
| 2017 | 72,000,000              | 83,961,293            | 205,344,971                            | 121,300,000                          | 100,000,000                         |
| 2018 | 72,000,000              | 83,961,293            | 211,693,628                            | 121,300,000                          | 100,000,000                         |
| 2019 |                         | 83,961,293            | 218,238,567                            | 121,300,000                          | 100,000,000                         |
| 2020 |                         | 83,961,293            | 224,985,856                            | 121,300,000                          | 100,000,000                         |
| 2021 |                         | 83,961,293            | 231,941,752                            | 121,300,000                          | 100,000,000                         |
| 2022 |                         | 83,961,293            | 239,112,703                            | 121,300,000                          | 100,000,000                         |
| 2023 |                         | 83,961,293            | 246,505,358                            | 121,300,000                          | 100,000,000                         |
| 2024 |                         | 83,961,293            | 254,126,573                            |                                      | 100,000,000                         |
| 2025 |                         | 83,961,293            | 261,983,412                            |                                      | 100,000,000                         |
| 2026 |                         | 83,961,293            | 270,083,162                            |                                      | 100,000,000                         |
| 2027 |                         | 83,961,293            | 278,433,333                            |                                      | 100,000,000                         |
| 2028 |                         | 83,961,293            | 287,041,665                            |                                      | 100,000,000                         |
| 2029 |                         | 83,961,293            | 295,916,142                            |                                      | 100,000,000                         |
| 2030 |                         | 83,961,293            | 305,064,992                            |                                      | 100,000,000                         |
| 2031 |                         | 83,961,293            | 314,496,696                            |                                      | 100,000,000                         |
| 2032 |                         | 83,961,293            | 324,220,001                            |                                      | 100,000,000                         |
| 2033 |                         | 83,961,293            | 334,243,922                            |                                      | 100,000,000                         |
| 2034 |                         | 83,961,293            | 344,577,753                            |                                      | 100,000,000                         |
| 2035 |                         | 83,961,293            | 355,231,075                            |                                      | 100,000,000                         |
| 2036 |                         | 83,961,293            | 366,213,766                            |                                      | 100,000,000                         |
| 2037 |                         | 83,961,293            | 377,536,009                            |                                      | 100,000,000                         |
| 2038 |                         | 83,961,293            | 389,208,303                            |                                      | 100,000,000                         |
| 2039 |                         | 83,961,293            | 401,241,469                            |                                      | 100,000,000                         |
| 2040 |                         | 83,961,293            | 413,646,665                            |                                      | 100,000,000                         |
| 2041 |                         | 83,961,293            | 426,435,393                            |                                      | 100,000,000                         |
| 2042 |                         | 83,961,293            | 439,619,510                            |                                      | 100,000,000                         |
| 2043 |                         | 83,961,293            | 453,211,242                            |                                      | 100,000,000                         |
| 2044 |                         | 83,961,293            | 467,223,189                            |                                      | 100,000,000                         |

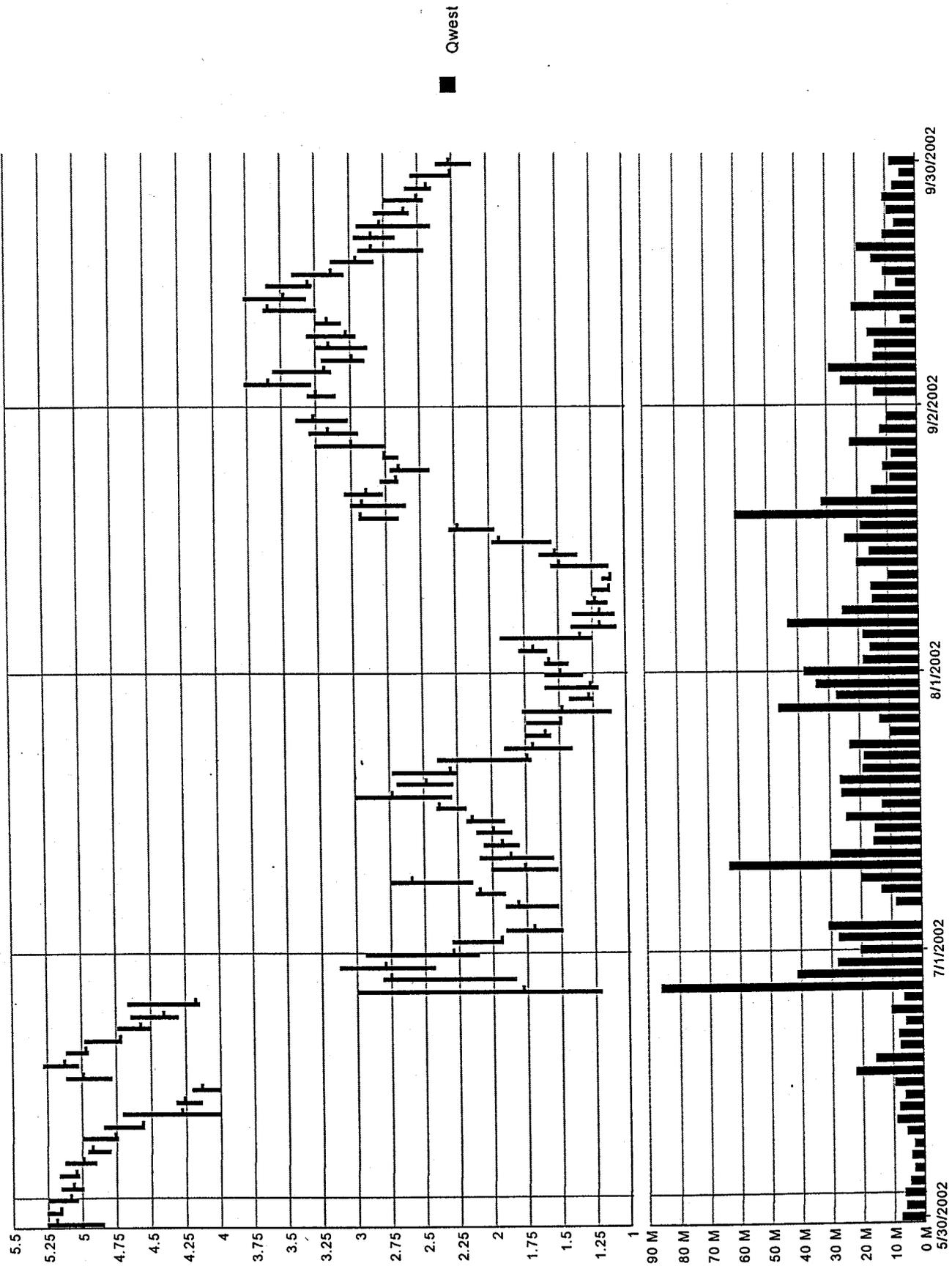
**Imputation Comparison***Proposed Stipulation vs. RUCO and Staff Recommendations*

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| Year | Proposed<br>Stipulation | RUCO<br>(Line Growth) | RUCO<br>(Line Growth<br>and Inflation) | Staff<br>(Traditional<br>Regulation) | Staff<br>(Price Cap<br>Regulation) |
|------|-------------------------|-----------------------|--|--------------------------------------|------------------------------------|
| 2045 |                         | 83,961,293            | 481,668,344                            |                                      | 100,000,000                        |
| 2046 |                         | 83,961,293            | 496,560,100                            |                                      | 100,000,000                        |
| 2047 |                         | 83,961,293            | 511,912,266                            |                                      | 100,000,000                        |
| 2048 |                         | 83,961,293            | 527,739,075                            |                                      | 100,000,000                        |

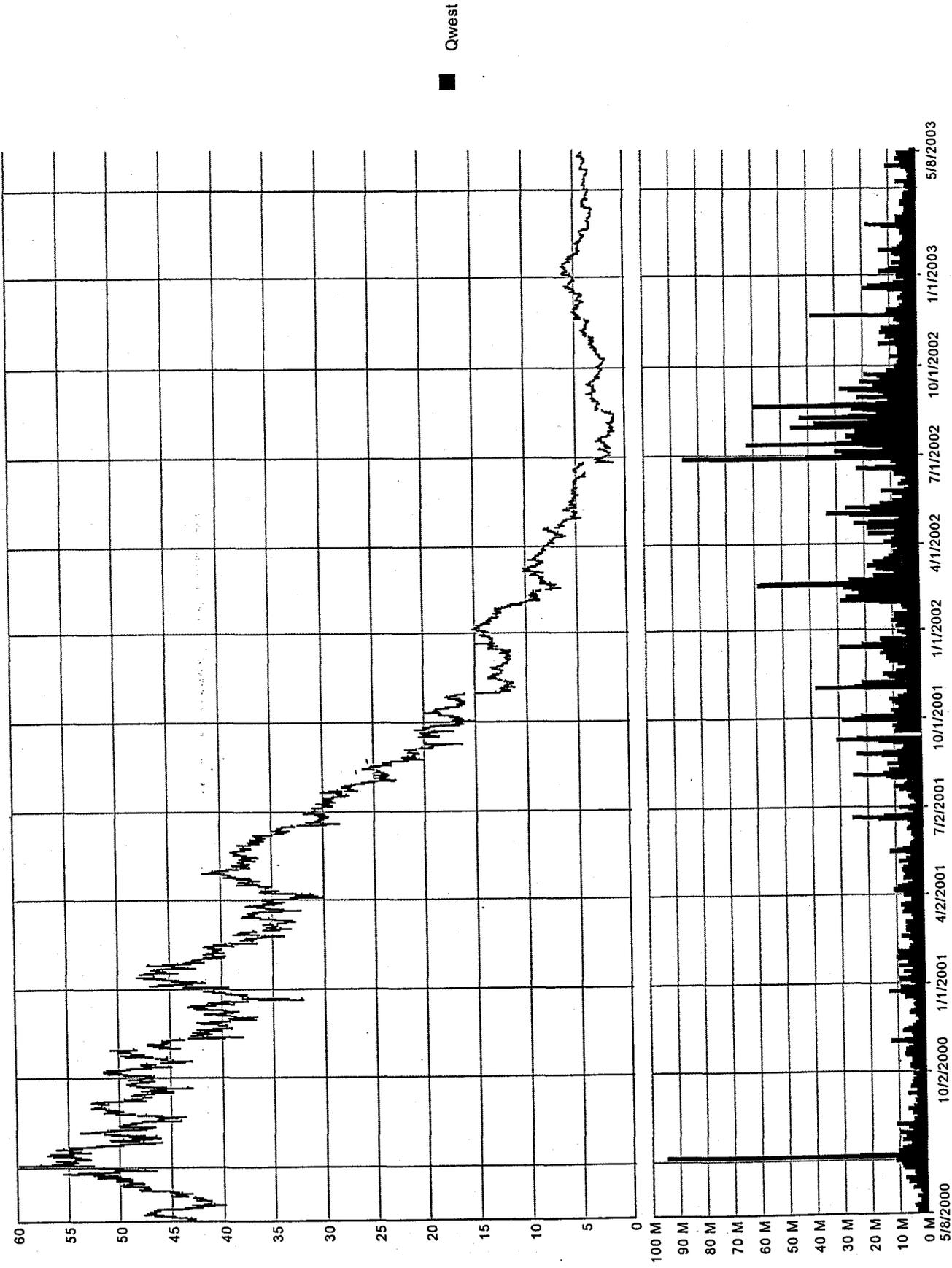
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Schedule 2 - Price History - Qwest Communications International Inc. (5/30/2002 - 9/30/2002)

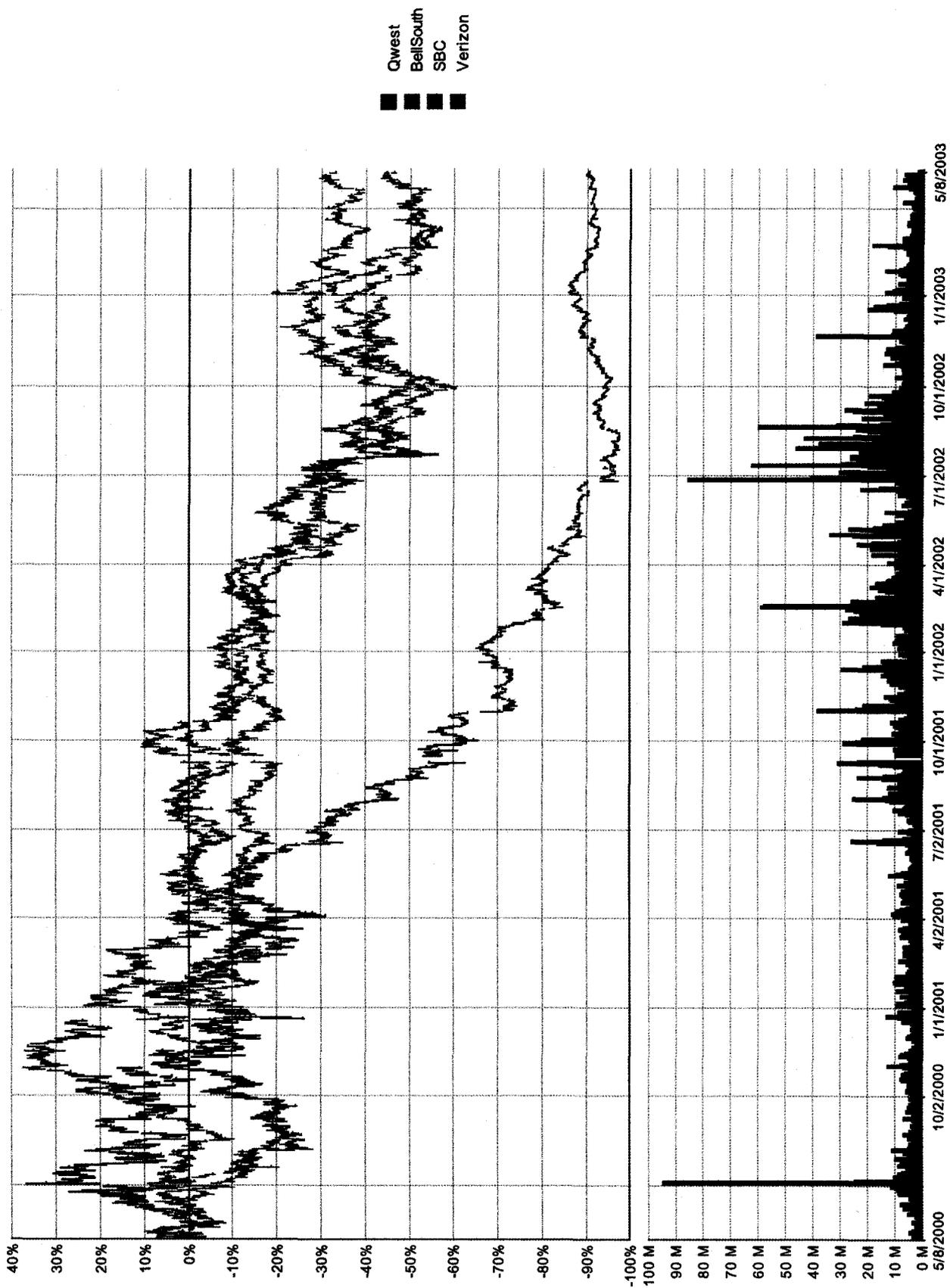


■ Qwest

Schedule 2 - Price History - Qwest Communications International Inc. (5/8/2000 - 5/8/2003)



Schedule 2 - Price History - Qwest Communications International Inc. (5/8/2000 - 5/8/2003)



Source: MSN Money

ERRATA SHEET

for the

Rejoinder Testimony

of

Ben Johnson, Ph.D.

on behalf of the

Residential Utility Consumer Office

Docket No. T-01051B-02-0666

| <u>Page</u> | <u>Line(s)</u> | <u>Change From</u> | <u>Change To</u> |
|-------------|----------------|--------------------|------------------|
| 9           | 3              | delaying           | delay            |
| 15          | 13             | for                | for a            |

EXHIBIT

SETTLEMENT AGREEMENT

This agreement is entered into this 27<sup>th</sup> day of ~~April~~<sup>May</sup>, 1988 between the Arizona Corporation Commission ("Commission") and The Mountain States Telephone and Telegraph Company ("Mountain Bell"). The parties agree as follows:

1. On October 8, 1987, the Commission entered Decision No. 55755 which declared that the transfer of Yellow Pages assets from Mountain Bell to U S West Direct ("USWD") was void because the provisions of A.R.S. § 40-285 had not been complied with by Mountain Bell.
2. On December 15, 1987, Mountain Bell filed an action in the Superior Court of Arizona (No. CV 87-33850) challenging Commission Decision No. 55755.
3. The parties desire to settle the issues relating to the transfer of Yellow Pages assets from Mountain Bell to USWD on the following basis:
  - (a) Mountain Bell agrees to dismiss Action No. CV 87-33850 and to take no further action to challenge the \$5,000 fine assessed in Decision No. 55755.
  - (b) 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.

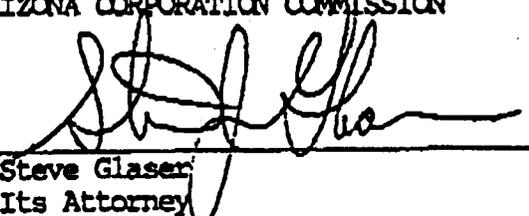
- (c) That included in Mountain Bell's 1984 rate case (which is the basis for rates currently charged the ratepayers) were the fees received from USWD under publishing agreements with USWD; that in future rate cases filed by Mountain Bell, the Commission, in arriving at the test year operating income of Mountain Bell, will consider the fees and the value of services received by Mountain Bell from USWD under publishing agreements with USWD; 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. Mountain Bell and the Commission agree 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.
- (d) Mountain Bell agrees that in subsequent Mountain Bell rate cases the Commission will be provided with reasonable access to the financial records of USWD (hereinafter "USWD" includes any U S West subsidiary or affiliate made a party to the publishing agreement or a successor to the directory publishing activities on behalf of Mountain Bell) 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. "Financial records" as used in this paragraph, shall include, but not be limited to, financial statements, books, records and related supporting documents. Further, 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.

(e) Mountain Bell agrees that USWD will submit written confirmation to the Commission that it will cooperate with Mountain Bell in its fulfillment of subparagraph 3(d).

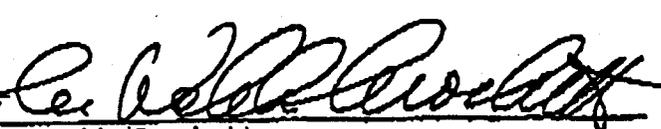
4. The parties agree that Decision No. 55755 will be amended to reflect this settlement.

ARIZONA CORPORATION COMMISSION

By 

Steve Glaser  
Its Attorney

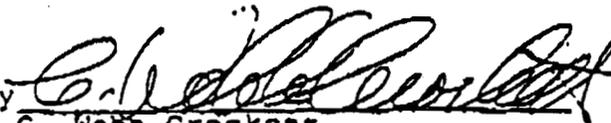
THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH  
COMPANY

By 

C. Webb Crockett  
Its Attorney

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FENNEMORE CRAIG  
A Professional Corporation

By 

C. Webb Crockett  
Timothy Berg  
Two North Central, Suite 2200  
Phoenix, AZ 85004-2390  
Attorneys for Plaintiff  
The Mountain States Telephone  
and Telegraph Company

**Settlement Agreement Analysis  
NPV of Incremental Effects**

**EXHIBIT**  
*Q-11*  
*Admitted*

| ARIZONA SETTLEMENT  |                          |                          |                    |   |                                     |
|---------------------|--------------------------|--------------------------|--------------------|---|-------------------------------------|
| Periods after close | Customer /Revenue Credit | Current Imputation Value | Incremental Change | Discount Factor Using Half Year Convention at Post-tax cost of capital of | Present Value of Incremental Change |
| Years               | \$millions               | \$millions               | \$millions         | 8.29%   | \$millions                          |
| (a)                 | (b)                      | (c)                      | (d=b-c)            | (e)   | (f=d*e)                             |
| 0                   |                          |                          |                    | 1.000000  |                                     |
| 1                   | 72.0                     | 43.0                     | 29.0               | 0.960979  | 27.9                                |
| 2                   | 72.0                     | 43.0                     | 29.0               | 0.887445  | 25.7                                |
| 3                   | 72.0                     | 43.0                     | 29.0               | 0.819538  | 23.8                                |
| 4                   | 72.0                     | 43.0                     | 29.0               | 0.756828  | 21.9                                |
| 5                   | 72.0                     | 43.0                     | 29.0               | 0.698915  | 20.3                                |
| 6                   | 72.0                     | 43.0                     | 29.0               | 0.645435  | 18.7                                |
| 7                   | 72.0                     | 43.0                     | 29.0               | 0.596046  | 17.3                                |
| 8                   | 72.0                     | 43.0                     | 29.0               | 0.550437  | 16.0                                |
| 9                   | 72.0                     | 43.0                     | 29.0               | 0.508318  | 14.7                                |
| 10                  | 72.0                     | 43.0                     | 29.0               | 0.469422  | 13.6                                |
| 11                  | 72.0                     | 43.0                     | 29.0               | 0.433502  | 12.6                                |
| 12                  | 72.0                     | 43.0                     | 29.0               | 0.400330  | 11.6                                |
| 13                  | 72.0                     | 43.0                     | 29.0               | 0.369697  | 10.7                                |
| 14                  | 72.0                     | 43.0                     | 29.0               | 0.341408  | 9.9                                 |
| 15                  | 72.0                     | 43.0                     | 29.0               | 0.315284  | 9.1                                 |
|                     |                          |                          | <u>435.0</u>       |   | <u>253.9</u>                        |

| UTAH SETTLEMENT     |                          |                          |                    |   |                                     |
|---------------------|--------------------------|--------------------------|--------------------|---|-------------------------------------|
| Periods after close | Customer /Revenue Credit | Current Imputation Value | Incremental Change | Discount Factor Using Half Year Convention at Post-tax cost of capital of | Present Value of Incremental Change |
| Years               | \$millions               | \$millions               | \$millions         | 8.29%   | \$millions                          |
| (a)                 | (b)                      | (c)                      | (d=b-c)            | (e)   | (f=d*e)                             |
| 0                   |                          |                          |                    | 1.000000  | 22.0                                |
| 1                   | 22.0                     |                          |                    | 0.960979  | -                                   |
| 2                   | 30.1                     | 30.1                     | -                  | 0.887445  | -                                   |
| 3                   | 30.1                     | 30.1                     | -                  | 0.819538  | -                                   |
| 4                   | 30.1                     | 30.1                     | -                  | 0.756828  | -                                   |
| 5                   | 30.1                     | 30.1                     | -                  | 0.698915  | -                                   |
| 6                   | 30.1                     | 30.1                     | -                  | 0.645435  | -                                   |
| 7                   | 30.1                     | 30.1                     | -                  | 0.596046  | -                                   |
| 8                   | 30.1                     | 30.1                     | -                  | 0.550437  | -                                   |
| 9                   | 30.1                     | 30.1                     | -                  | 0.508318  | -                                   |
| 10                  | 30.1                     | 30.1                     | -                  | 0.469422  | -                                   |
| 11                  | 30.1                     | 30.1                     | -                  | 0.433502  | -                                   |
| 12                  | 30.1                     | 30.1                     | -                  | 0.400330  | -                                   |
| 13                  | 30.1                     | 30.1                     | -                  | 0.369697  | -                                   |
| 14                  | 30.1                     | 30.1                     | -                  | 0.341408  | -                                   |
| 15                  | 30.1                     | 30.1                     | -                  | 0.315284  | -                                   |
|                     |                          |                          | <u>22.0</u>        |   | <u>22.0</u>                         |

| WASHINGTON SETTLEMENT VS LAST REPORTED |                          |                          |                    |   |                                     |
|--|--------------------------|--------------------------|--------------------|---|-------------------------------------|
| Periods after close                    | Customer /Revenue Credit | Current Imputation Value | Incremental Change | Discount Factor Using Half Year Convention at Post-tax cost of capital of | Present Value of Incremental Change |
| Years                                  | \$millions               | \$millions               | \$millions         | 8.29%   | \$millions                          |
| (a)                                    | (b)                      | (c)                      | (d=b-c)            | (e)   | (f=d*e)                             |
| 0                                      | 67.0                     |                          | 67.0               | 1.000000  | 67.0                                |
| 1                                      | 110.0                    | 103.4                    | 6.6                | 0.960979  | 6.3                                 |
| 2                                      | 110.0                    | 103.4                    | 6.6                | 0.887445  | 5.9                                 |
| 3                                      | 110.0                    | 103.4                    | 6.6                | 0.819538  | 5.4                                 |
| 4                                      | 110.0                    | 103.4                    | 6.6                | 0.756828  | 5.0                                 |
| 5                                      | 103.4                    | 103.4                    | -                  | 0.698915  | -                                   |
| 6                                      | 103.4                    | 103.4                    | -                  | 0.645435  | -                                   |
| 7                                      | 103.4                    | 103.4                    | -                  | 0.596046  | -                                   |
| 8                                      | 103.4                    | 103.4                    | -                  | 0.550437  | -                                   |
| 9                                      | 103.4                    | 103.4                    | -                  | 0.508318  | -                                   |
| 10                                     | 103.4                    | 103.4                    | -                  | 0.469422  | -                                   |
| 11                                     | 103.4                    | 103.4                    | -                  | 0.433502  | -                                   |
| 12                                     | 103.4                    | 103.4                    | -                  | 0.400330  | -                                   |
| 13                                     | 103.4                    | 103.4                    | -                  | 0.369697  | -                                   |
| 14                                     | 103.4                    | 103.4                    | -                  | 0.341408  | -                                   |
| 15                                     | 103.4                    | 103.4                    | -                  | 0.315284  | -                                   |
|  |                          |                          | <u>93.4</u>        |   | <u>89.6</u>                         |

| WASHINGTON SETTLEMENT VS LAST ORDERED |                          |                          |                    |   |                                     |
|---------------------------------------|--------------------------|--------------------------|--------------------|---|-------------------------------------|
| Periods after close                   | Customer /Revenue Credit | Current Imputation Value | Incremental Change | Discount Factor Using Half Year Convention at Post-tax cost of capital of | Present Value of Incremental Change |
| Years                                 | \$millions               | \$millions               | \$millions         | 8.29%   | \$millions                          |
| (a)                                   | (b)                      | (c)                      | (d=b-c)            | (e)   | (f=d*e)                             |
| 0                                     | 67.0                     |                          | 67.0               | 1.000000  | 67.0                                |
| 1                                     | 110.0                    | 85.2                     | 24.8               | 0.960979  | 23.8                                |
| 2                                     | 110.0                    | 85.2                     | 24.8               | 0.887445  | 22.0                                |
| 3                                     | 110.0                    | 85.2                     | 24.8               | 0.819538  | 20.3                                |
| 4                                     | 110.0                    | 85.2                     | 24.8               | 0.756828  | 18.8                                |
| 5                                     | 103.4                    | 85.2                     | 18.2               | 0.698915  | 12.7                                |
| 6                                     | 103.4                    | 85.2                     | 18.2               | 0.645435  | 11.7                                |
| 7                                     | 103.4                    | 85.2                     | 18.2               | 0.596046  | 10.8                                |
| 8                                     | 103.4                    | 85.2                     | 18.2               | 0.550437  | 10.0                                |
| 9                                     | 103.4                    | 85.2                     | 18.2               | 0.508318  | 9.3                                 |
| 10                                    | 103.4                    | 85.2                     | 18.2               | 0.469422  | 8.5                                 |
| 11                                    | 103.4                    | 85.2                     | 18.2               | 0.433502  | 7.9                                 |
| 12                                    | 103.4                    | 85.2                     | 18.2               | 0.400330  | 7.3                                 |
| 13                                    | 103.4                    | 85.2                     | 18.2               | 0.369697  | 6.7                                 |
| 14                                    | 103.4                    | 85.2                     | 18.2               | 0.341408  | 6.2                                 |
| 15                                    | 103.4                    | 85.2                     | 18.2               | 0.315284  | 5.7                                 |
|                                       |                          |                          | <u>366.4</u>       |   | <u>248.9</u>                        |