1 **RESPONSE TESTIMONY OF**
2 **CHARLES W. KING**
3

4 **INTRODUCTION**

5

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

7

8 A. My name is Charles W. King. I am President of the economic consulting firm of
9 Snavely King Majoros O'Connor & Lee, Inc. ("Snavely King"). My business
10 address is 1220 L Street, N.W., Suite 410, Washington, D.C. 20005.

11

12 **Q. PLEASE DESCRIBE SNAVELY KING.**

13

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

23

1 **Q. HAVE YOU PREPARED A SUMMARY OF YOUR QUALIFICATIONS**
2 **AND EXPERIENCE?**
3
4 A. Yes. Exhibit_____(CWK-2) is a summary of my qualifications and experience.
5
6 **Q. HAVE YOU PREVIOUSLY SUBMITTED TESTIMONY IN**
7 **REGULATORY PROCEEDINGS?**
8
9 A. Yes. Exhibit_____(CWK-3) is a summary of my appearances before regulatory
10 agencies.
11
12 **Q. FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?**
13
14 A. I am appearing on behalf of the customer interests of the Department of Defense
15 and all other Federal Executive Agencies ("DOD/FEA").
16
17 **Q. WHAT IS DOD/FEA'S INTEREST IN THIS PROCEEDING?**
18
19 A. DOD/FEA purchases large quantities of telecommunications service from Qwest
20 Corporation ("Qwest"), the regulated entity that provides telephone service in the
21 state of Washington. Indeed, the approximately 60,000 civilian and 30,000
22 military employees of DOD/FEA in Washington probably make DOD/FEA the

1 largest user of telecommunications services in the state. As a Qwest customer in
2 Washington, DOD/FEA will be directly and substantially affected by the sale of
3 Qwest Dex, Inc. ("Dex") by Qwest's parent company, Qwest Communications
4 International, Inc. ("QCI").
5
6 **Q. WAS THIS TESTIMONY PREPARED BY YOU OR UNDER YOUR**
7 **DIRECT SUPERVISION?**
8
9 A. Yes, it was.
10
11 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**
12
13 A. I agree with the Qwest witnesses that the sale of Qwest Dex is in the public
14 interest, as it appears to be the only way that Qwest's parent company can stave
15 off bankruptcy. This potential bankruptcy, however, is not the fault of ratepayers.
16 Rather, it appears to be the fault of the over-ambitious management of QCI,
17 Qwest's parent, which was bent on expanding the company beyond its ability to
18 support that expansion. For this reason, I believe that ratepayers should not be
19 harmed by the sale of Dex. To the contrary, ratepayers should be assured of some
20 sort of guaranteed compensation for giving up the benefits of this valuable asset
21 in order to rescue their telephone utility's parent company.
22

1 The Company's survey of the history of directory publishing in Washington
2 notably fails to mention a crucial fact: in 1982, as part of the proceedings that
3 broke up the Bell System, Judge Harold Greene cited, as one of the reasons for
4 placing the publication of the Yellow Pages with the Regional Bell Operating
5 Companies ("RBOCs"), the subsidy which this publication provides to local
6 telephone services.[1]
7
8 Qwest witness Grate cites two Court cases[2] as establishing that the reward from
9 the disposition of an asset should go to the party that bore the risk of loss on the
10 asset. It has been this Commission's policy, as affirmed by the Washington
11 Supreme Court,[3] to impute net revenues from directory operations as though those
12 operations had never been spun off to affiliated entities. To the extent that those
13 net revenues have increased or declined, the revenue requirement imposed on
14 ratepayers has declined or increased correspondingly. Accordingly, ratepayers
15 have sustained the entire risk of loss from directory operations since the initiation
16 of regulation in Washington.

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[1] Modification of Final Judgement, 552 F. Supp.131, 194, (D.D.C. 1982), *aff'd* 460 U.S. 1001(1983) (*"MFJ Decision"*).
[2] Democratic Central Committee of the District of Columbia v. Washington Metropolitan Area Transportation Commission, 485 F.2d 786 (1973), (*"Democratic Central Committee"*) and Illinois Public Telecommunications Assn. v. F.C.C. 117 F3d 555 (D.C. Cir. 1997) (*"Illinois P.T.A."*).
[3] US WEST Communications, Inc. v. Washington Utilities and Transportation Commission 134 Wn.2d 74, 949 P.2d 1337 (1997) (*"US WEST v. WUTC"*).

1 Accordingly, now that the directory function is being sold to an unaffiliated
2 enterprise, ratepayers are entitled to compensation for the full value of the gain
3 from the sold asset. The sale price of Dex arguably provides a quantification of
4 that value. Ratepayers are therefore entitled to a benefit equal to the full price of
5 the Dex sale, less the value of any contributed assets that pass out of QCI, and less
6 the costs that are incurred by the transaction.
7
8 That ratepayer benefit should take two forms. First, 10 percent of the value of
9 Washington's share of the Dex gain should be flowed through to Qwest's end-
10 user ratepayers in Washington in the form of an immediate bill credit. Consistent
11 with prior Commission policy, this credit would flow to all end-use ratepayers,
12 without specification as to type of customer or service, as a percentage deduction
13 from their total local telephone service bills. In order not to distort competitive
14 relationships among carriers, this credit should be applied to bills over a relatively
15 short time, possibly three months.
16
17 Second, the remaining 90 percent of the benefit should be established as a
18 regulatory liability to be amortized over a period of 15 years. In any future rate
19 case, ratepayers would receive the benefit of two adjustments to the revenue
20 requirement: the annual amortization as a revenue imputation and the rate base
21 offset of the remaining unamortized liability. At the end of, say, 15 years, or in

1 2019, Qwest's obligation to ratepayers for the Dex sale would be considered to
2 have been fully discharged.
3
4 Qwest proposes to exclude portions of the gain on the Dex sale relating to its New
5 Ventures activity, to its "secondary directories," and to its non-Qwest listings.
6 None of these exclusions should be permitted because they all depend on the
7 primary Qwest directory activity as the basis for their existence. The New
8 Ventures activity is part of Dex and appears to be related to directory publishing.
9 Historically, it has incurred losses, which suggests that it contributes little or
10 nothing to the Dex gain. Secondary publications would not be possible without
11 the name recognition, advertiser contacts, subscriber lists, and operational
12 synergies that are provided by the primary directory activity. Non-Qwest listings
13 are clearly relevant to the gain because they expand the reach of the advertising
14 that generates the extraordinarily high profits enjoyed by Dex.
15
16 **THE PUBLIC INTEREST**
17
18 **Q. WHY HAVE YOU CONCLUDED THAT THE SALE OF DEX IS IN THE**
19 **PUBLIC INTEREST?**
20
21 A. Qwest witnesses Johnson and Cummings make a persuasive case that the sale of
22 Dex is critical to the short-term survival of QCI, the parent of Qwest. It is in the

public interest of the telephone users of Washington that QCI avoid bankruptcy. While Qwest would no doubt survive, its ability to raise capital would be severely hampered pending reorganization of the parent company. It would likely become totally dependent on the availability of its internally generated funds, limiting its ability to upgrade its facilities and respond to new demand. Worse yet, it is possible that a bankruptcy judge would reach into Qwest and require the sale of valuable assets that now provide service to Washington ratepayers.

Q. ARE THERE ANY ADDITIONS TO THE TERMS OF THE SALE THAT WOULD ENHANCE ITS BENEFIT TO THE PUBLIC?

A. Yes. The publishing agreement between Qwest and the new owners, Dex Holdings, conveys the Commission-mandated requirement to continue to publish white pages directories in each of the exchanges served by Qwest. There is, however, no mention of the "blue pages" government listings. These listings are an important benefit to the public because they identify the telephone numbers and addresses of the federal, state and local agencies that provide public services to the general population. Without them, many telephone subscribers would not know how to contact quickly the government agencies that affect their daily lives. This consideration has gained importance in light of the events of 9/11 and heightened levels of alert since then.

1 DOD/FEA is concerned that a non-utility entity, possibly beyond the jurisdiction
2 of the Commission, might find it unprofitable to continue to publish blue pages
3 listings. Unlike white pages subscribers, the blue pages "subscribers," that is, the
4 government agencies, are unlikely to make much use of Yellow Pages directories,
5 which are the source of profit for the publisher. This realization might tempt the
6 publisher to drop government listings and so avoid the expense of gathering,
7 organizing and printing blue pages.
8
9 Accordingly, in recognition of the considerable public interest involved, I
10 recommend that the Commission require that the publishing agreement between
11 Qwest and the new owners of Dex include an obligation to include blue pages
12 government listing in every primary directory.
13
14 **<u>ATTRIBUTION OF THE GAIN</u>**
15
16 **Q. WHO BEARS THE RESPONSIBILITY FOR THE FINANCIAL**
17 **DIFFICULTIES THAT REQUIRE QCI TO SELL DEX?**
18
19 A. The management of QCI and, by extension the shareholders of QCI, bear the
20 entire responsibility for the precarious financial condition that requires QCI to sell
21 Dex. It was they who allowed QCI to become so indebted that it faces the
22 possibility of bankruptcy.

1

2 **Q. WHERE DO RATEPAYERS STAND IN THIS SITUATION?**

3

4 A. Ratepayers are the innocent bystanders to the financial debacle that has engulfed
5 QCI. Yet it is they, through their continued revenue generation, who have
6 allowed QCI to survive as well as it has. If QCI avoids bankruptcy, it will be
7 thanks to Qwest's ratepayers and their surrender of their substantial vested
8 benefits from Dex. As discussed later in this testimony, I believe that ratepayers
9 deserve credit for these very substantial benefits to QCI's shareholders.

10

11 **Q. HAVE YOU REVIEWED THE TESTIMONY OF QWEST WITNESSES**
12 **GRATE AND JENSEN REGARDING THE HISTORY OF TELEPHONE**
13 **DIRECTORY PUBLISHING AND ITS REGULATORY TREATMENT?**

14

15 A. Yes, I have.

16

17 **Q. DO YOU HAVE ANY ADDITIONS OR COMMENTS TO MAKE WITH**
18 **RESPECT TO THESE WITNESSES' TESTIMONY?**

19

20 A. Yes, I do. First of all, both witnesses overlook a crucial point, which is the reason
21 why the directory publishing function remained with the RBOCs, including
22 Qwest's predecessor US WEST, at the time of the breakup of the Bell System. In

1 1982, when Judge Greene was evaluating the Modification of Final Judgment
2 negotiated between AT&T and the Department of Justice, the parties had
3 proposed that AT&T, the surviving parent company, retain the directory
4 publishing business. Judge Greene rejected this proposal as being anti-
5 competitive. He then stated a further reason for rejecting the proposal:

6 All those who have commented on or have studied the issue agree that the
7 Yellow Pages provide a significant subsidy to local telephone rates. This
8 subsidy would most likely continue if the Operating Companies were
9 permitted to continue to publish the Yellow Pages.
10
11 The loss of this large subsidy would have important consequences for the
12 rates for local telephone service. * * * This result is clearly contrary to the
13 goal of providing affordable telephone service for all Americans.[4]
14
15 Clearly, one of the reasons that US WEST, and now Qwest, received the directory
16 function, rather than AT&T, was to "subsidize" local telephone rates. Any
17 attempt by Qwest to avoid that objective is contrary to the Court's original intent.
18 US WEST agreed to – and operated according to – the terms of the *MFJ Decision*
19 that was upheld by the Supreme Court. Qwest should not now be allowed to
20 avoid the obligations that it undertook in connection with its divestiture from
21 AT&T.
22
23 Additionally, I am not sure that either Qwest witness fully explained the Wash-

[4] *MFJ Decision,* 552 F. Supp. at 194.

1 ington Supreme Court decision in *US WEST v. WUTC.*[5] In that decision, the
2 Court found that the Commission was correct in its finding that US WEST, the
3 regulated entity, had never received adequate compensation for the transfer of its
4 profitable Yellow Pages business to US WEST Direct. The Court upheld the
5 Commission's imputation of revenue from the Yellow Pages business, citing
6 several cases for the proposition that:

7 Imputation is proper to compensate ratepayers for the company's
8 imprudence in allowing free transfer of its valuable assets to affiliates;
9 ...nothing in the Constitution requires the shareholders [to] have a free ride
10 on the back of the ratepayers. A utility should receive reasonable
11 remuneration when its affiliates benefit from it.[6]
12

13 The Court found that imputation is not necessarily permanent, and that when the
14 Company has demonstrated that it has received fair compensation from its
15 affiliate for the value of the asset it transferred, imputation may cease.[7]
16

17 **Q. IS QWEST ABOUT TO RECEIVE FAIR COMPENSATION FOR THE**
18 **VALUE OF THE ASSET IT TRANSFERRED?**
19

20 A. I have not attempted to analyze the sale price of Dex to determine whether it is
21 fair and reasonable. On the one hand, it was the result of what appears to be a

[5] See note 3, supra.
[6] 134 Wn. 2d at 101, 949 P. 2d at 1351.
[7] Id.

1 fairly open auction of the business. On the other hand, it was common knowledge
2 that this was a "distress" sale in which the seller was desperate to raise cash as
3 soon as possible. For purposes of my testimony at this time, I am accepting that
4 the sale price of Dex is a reasonable quantification of the value of Dex.
5
6 **Q. DOES THIS MEAN THAT IMPUTATION MAY CEASE?**
7
8 A. Yes, but only if ratepayers are credited with the full "fair" price for the asset. As
9 the Washington Supreme Court found, the Commission was correct in treating the
10 profitability of the Yellow Pages publishing business as a benefit to ratepayers,
11 not shareholders.[8] When that benefit is translated into a sale price, it should be
12 treated as a ratepayer asset, not a shareholder asset.
13
14 **Q. DOES QWEST ACCEPT THAT THE DIRECTORY BUSINESS IS A**
15 **RATEPAYER ASSET?**
16
17 A. No, It does not. Mr. Grate argues that under the standards established in
18 *Democratic Central Committee* and *Illinois P.T.A.,* the allocation of value of the
19 gain on the sale of Dex between ratepayers and shareholders should go to the
20 party that bore the risk of loss on the asset and, if that risk of loss cannot be

[8] Id.

1 determined, to the party that bore the burden of the utility activity.[9] Mr. Grate
2 asserts that ratepayers bear the "risk of loss" only when they are obliged through
3 regulation to provide compensation to investors for loss in the value of an asset
4 that, absent such regulation, they would not be obliged to provide. The "burden
5 of the utility" means the burden of cost recovery, according to Mr. Grate.[10]
6
7 Mr. Grate then surveys the history of telephone regulation in Washington. He
8 concludes that prior to 1923, ratepayers bore no risk of loss. At some point after
9 1923, ratepayers began to bear the risk of loss on tangible assets, and that
10 condition prevailed through 1983. However, when the directory assets were
11 transferred to a separate subsidiary at the beginning of 1984, ratepayers no longer
12 bore any risk of loss from them, according to Mr. Grate.[11]
13
14 Mr. Grate further argues that the majority of the gain on the sale of Dex is
15 attributable to its goodwill. He states that for ratemaking purposes, the
16 Commission has never allowed the Company to earn a return on the goodwill
17 developed by the directory publishing and directory advertising business.
18 According to Mr. Grate, no mechanism has ever existed whereby the Company's

[9] Exhibit PEG-IT, pages 3, 4.
[10] Id., pages 4, 5.
[11] Id., pages 23, 24.

investors could recover a loss of goodwill in this business. "It follows that ratepayers have never borne the risk of loss on the goodwill of the directory publishing and directory advertising activities."[12] On this basis, Mr. Grate asserts that ratepayers are entitled to none of the gain related to the intangible "goodwill" of the Dex directory publishing operation.

Q. DO YOU AGREE WITH MR. GRATE THAT RATEPAYERS HAVE BORNE NO RISK OF LOSS FROM DIRECTORY OPERATIONS?

A. No, I do not. Ratepayers have borne all the risk of loss in the directory business since the inception of rate regulation in Washington. As Mr. Grate acknowledges, ratepayers bore the full risk of loss prior to 1984 when directory operations were fully integrated into the Company's regulated activities. Following the spin-off of the directory function to a separate affiliate, the Commission continued to impute directory net revenues into the revenue requirement as though the spin-off had not occurred.[13] In other words, regulation effectively ignored the affiliate spin-off, and the revenues and costs of that activity continued to be included in the revenue requirement calculation. This means that if directory profits improved, the benefit went to the ratepayers – as Judge Greene intended – but if directory profits declined, ratepayers, not the Company's shareholders, bore the burden of that de-

[12] Id., page 24.
[13] See Docket No. UT-970766, Tenth Supplemental Order, Commission Decision and Order Rejecting Tariff Filings; Requiring Refiling (January 16, 1998), §III.D. Table—Results of Operations. Also, Docket

1 cline in the form of a lower imputation.

2

3 It seems inconceivable that Qwest's directory operations could ever incur losses.
4 If such loses were even the remotest possibility, US WEST would never have
5 spun its directory activities off into a separate affiliate. That is because, if losses
6 were to occur, under current Commission rules, they would be recovered from
7 ratepayers. Ms. Jensen testifies that WAC 480-120-042 requires that the
8 incumbent local carrier publish a telephone directory for each exchange at least
9 once every 15 months and that those directories be distributed to all subscribers in
10 the exchange.[14] Whenever a regulatory body issues a requirement for a utility to
11 perform a function, there is an implicit obligation on the part of the regulator to
12 permit the utility to recover all costs associated with that mandated function.
13 Since the Commission requires directories, it also would be obliged to permit
14 Qwest to recover all costs incurred in publishing those directories, even if they
15 were not fully offset by directory revenues.

16

17 For this reason, I conclude that Mr. Grate is flatly wrong in saying that Quest's
18 customers have not borne the risk of loss from directory operations. Additionally,
19 he has totally ignored the Court's intent in the *MFJ Decision.*

20

No. UT-950200, Fifteenth Supplemental Order, Commission Decision and Order Rejecting Tariff Revisions; Requiring Refiling (April 11, 1996) ("*1996 Order*"), at pages 32-41.
[14] Exhibit TAJ-IT, page 10.

1 **Q. CAN YOU CITE ANY COURT FINDING THAT SUPPORTS YOUR**
2 **CONCLUSION?**
3
4 A. Yes. In *US WEST v. WUTC*, the Washington Supreme Court quoted approvingly
5 the Colorado Supreme Court, as follows:

6 > Mountain Bell argues that the publishing assets belong to its shareholders
7 > who took the risks to develop the publishing business. … We reject
8 > Mountain Bell's characterization of its publishing operations as purely
9 > private. The directory publishing business was developed over the past
10 > fifty years within the protective shelter of Mountain Bell's monopoly of
11 > telephone service. The assets were included in the base upon which
12 > Mountain Bell was permitted to earn a return. Mountain Bell concedes
13 > that the Yellow Pages always have generated "supra competitive" profits.
14 > It is an exaggeration to say that Mountain Bell's shareholders took any
15 > significant risk in developing the directory publishing business, and we
16 > find the public interest in those assets to be beyond dispute.[15]

17
18
19 **DISTRIBUTION OF THE GAIN**
20
21 **Q. IN LIGHT OF THIS DISCUSSION, HOW SHOULD THE BENEFIT OF**
22 **THE GAIN ON THE SALE OF DEX BE DISTRIBUTED BETWEEN**
23 **RATEPAYERS AND SHAREHOLDERS?**
24

[15] *US WEST v. WUTC* at 1351, citing Mountain States Tel. & Tel. Co. v. Public Utilities Commission, 763 P.2d 1020, 1027-28 (Colo. 1988).

1 A. Ultimately, ratepayers should receive all of the benefit of the gain, but if that
2 benefit were conveyed immediately, the effect would be to thwart the objective of
3 the sale, which is to save the parent company from bankruptcy. For this reason, I
4 recommend that most of the immediate benefit of the gain flow to shareholders in
5 the form of cash to pay down QCI's debt, with only a small amount flowing to
6 ratepayers. Ratepayers should receive a deferred benefit in the form of a
7 regulatory liability by Qwest to ratepayers that would be applied to reduce their
8 revenue requirement in future rate cases. In this manner, both parties benefit:
9 shareholders are substantially aided against the threat of bankruptcy, and
10 ratepayers receive rate relief over an extended period of time.
11
12 **Q. WHAT PORTIONS OF THE IMMEDIATE CASH BENEFIT SHOULD**
13 **FLOW TO RATEPAYERS AND TO SHAREHOLDERS?**
14
15 A. As noted, it would thwart the objective of the sale if shareholders did not receive
16 the immediate benefit of the majority of the sales proceeds. Given the distressed
17 state of QCI, the shareholders' portion must be a very large majority of the gain. I
18 therefore recommend that 90 percent of the immediate net gain on the sale
19 attributable to Washington flow to shareholders, with the remaining 10 percent
20 flowing to ratepayers. The ratepayer portion is a very modest compensation for
21 the ratepayers' loss of a significant future offset (directory imputation) to their
22 revenue requirement. In later rate cases, that loss could result in rate increases.

1

2 **Q. HOW SHOULD THE RATEPAYERS' 10 PERCENT OF THE CASH GAIN**
3 **BE DISTRIBUTED AMONG RATEPAYERS?**

4

5 A. In its past decisions, the Commission has been quite emphatic that it would not
6 "earmark" the directory imputation directly to any class of customers.[16] Instead,
7 the imputed revenue was treated as a reduction in the overall revenue requirement
8 applicable to all ratepayers. The distribution most consistent with the effect of
9 this treatment would be to reduce the local service bills of all Qwest customers in
10 Washington by an equal percentage sufficient to flow back 10 percent of the
11 Washington allocation of the gain on the sale.

12

13 **Q. HOW DO YOU DEFINE "QWEST CUSTOMERS" FOR PURPOSES OF**
14 **DISTRIBUTING 10 PERCENT OF THE GAIN?**

15

16 A. Qwest customers should include all end-use customers of Qwest's local services.
17 This would include both rate-regulated customers and customers of competitive
18 and contract services. All of these customers contribute to the base of subscribers
19 that make the Company's Yellow Pages business so profitable.

20

[16] *1996 Order* at pages 36, 40.

1 **Q. SHOULD THE CREDIT BE APPLIED TO THE ENTIRE BILL OF EACH**
2 **QWEST CUSTOMER?**
3
4 A. No. Consistent with the intent of the *MFJ Decision*, the credit should be applied
5 only to the portion of the customer's bill for local services. It should not be
6 applied to the interexchange portion of the bill. Arguably, optional services, such
7 as Voicemail and call forwarding, and wideband services, such as Internet access,
8 might also be exempted on the grounds that they are not "local services" as the
9 *MJF Decision* might have defined them. The difficulty is that the definition of
10 "local services" becomes somewhat arbitrary and certainly complex. In the
11 interest of simplicity, the credits should be applied to the customer's entire bill
12 exclusive of long distance charges and other charges and credits, e.g. Universal
13 Service, FCC Subscriber Line Charge, and non-recurring charges.
14
15 **Q. SHOULD ANY OF THE 10 PERCENT CASH DISTRIBUTION FLOW TO**
16 **WHOLESALE CUSTOMERS, THAT IS, THE COMPETITIVE LOCAL**
17 **EXCHANGE CARRIERS?**
18
19 A. No. The competitive local exchange carriers ("CLECs") are not end-use
20 customers. Additionally, the charges they pay for resale and unbundled network
21 elements are based on forward-looking avoided or incremental costs.
22

1 **Q. SHOULD ANY OF THE 10 PERCENT CASH DISTRIBUTION FLOW TO**
2 **INTEREXCHANGE CARRIERS AS CREDITS TO THEIR ACCESS**
3 **CHARGES?**
4
5 A. No. It is not appropriate that the gain credit be applied to the long distance
6 services provided by these carriers. When the *MFJ Decision* assigned the Yellow
7 Pages business to the RBOCs rather than to AT&T, the Court intended that the
8 benefit of the Yellow Pages' profit should be used to reduce local service rates. It
9 would therefore be inconsistent with the Court's original intent to flow the gain to
10 the interLATA services provided by the interexchange carriers.
11
12 **Q. OVER WHAT PERIOD OF TIME SHOULD THE BILL CREDITS BE**
13 **APPLIED?**
14
15 A. The period of the distribution should be short, say, three months. Otherwise,
16 Qwest gains a competitive advantage over the CLECs by reason of the bill credits.
17 Three months is well short of the 12-month period that many CLECs require as a
18 minimum contract period from their customers. The shorter distribution period
19 would therefore provide less disruption to the competitive market for local
20 services.
21

1 **Q. HOW SHOULD THE REMAINING 90 PERCENT OF THE GAIN BE**
2 **TREATED?**
3
4 A. The remaining 90 percent of the gain should be established as a regulatory
5 liability of Qwest to its ratepayers. This liability should then be amortized over a
6 period of years until it is extinguished. In any rate case during the amortization
7 period, the ratepayers would receive a reduction in their revenue requirement
8 equal to the annual amortization plus a reduction in the rate base corresponding to
9 the unamortized portion of the liability.
10
11 The effect of this treatment is to front-load the ratepayer benefit. In the initial
12 years, while the unamortized portion of the gain is quite large, there is a
13 significant offset to the revenue requirement. As the liability declines, the
14 revenue requirement offset declines as well.
15
16 **Q. WHAT IS AN APPROPRIATE PERIOD FOR THE AMORTIZATION OF**
17 **THE GAIN LIABILITY?**
18
19 A. The amortization period should be long enough to ensure that ratepayers realize
20 some extended benefit from this transaction. It should also be long enough that
21 the annual amortization amount does not represent an excessive revenue
22 requirement reduction to Qwest. On the other hand, it should not be so long that

1 it exceeds the horizon over which we can expect cost-based rate regulation to
2 survive. Nor should it exceed the period during which there is a strong likelihood
3 that directory services will remain highly profitable. Fifteen years would appear
4 to meet these criteria.
5
6 **QUANTIFICATION OF THE GAIN**
7
8 **Q. HOW HAS QWEST QUANTIFIED THE WASHINGTON PORTION OF**
9 **THE GAIN FROM THE SALE OF DEX?**
10
11 A. Qwest's quantification of the gain is found on Confidential Exhibit TAJ-2C to
12 Qwest witness Jensen's testimony. The total sale price of Dex is $7.05 billion.
13 From this amount, Ms. Jensen subtracts estimates of the contributed assets and the
14 cost of the sale to arrive at the pretax gain. She applies a 35 percent federal
15 income tax rate to derive a post-tax gain.
16
17 From these amounts, Ms. Jensen makes four deductions. The first is for LCI, an
18 equipment leasing operation, which was apparently included in the sale for certain
19 tax benefits that it provides.[17] The second deduction is for New Ventures, an
20 Internet-related business. The third deduction is for Dex "secondary" directories,
21 of which there are two. One is for Snohomish County, which is outside of

[17] See Qwest Response to ATG 7-109.

1 Qwest's service area; the other is the "on-the-go" directory of business listings in
2 the greater Puget Sound area that targets wireless phone users. Ms. Jensen's final
3 deduction is for non-Qwest listings in its white pages directories.
4
5 Having made these deductions, Ms. Jensen then applies the proportion of
6 Washington primary directory revenues to total Dex primary directory revenues to
7 generate a Washington allocation of the gain.
8
9 **Q. DO YOU AGREE WITH MS. JENSEN'S QUANTIFICATION OF THE**
10 **GAIN?**
11
12 A. No, I do not. I specifically disagree with:
13 - the deduction of New Ventures,
14 - the deduction of the secondary directories,
15 - the deduction of non-Qwest listings,
16 - the allocation factor to Washington, and
17 - the use of after-tax gain.
18
19 **Q. ARE THERE PORTIONS OF MS. JENSEN'S QUANTIFICATION THAT**
20 **YOU ACCEPT?**
21

1 A. Yes. For purposes of this testimony, I accept her estimates of the contributed
2 assets and the cost of the sale. I also accept her deduction of the LCI operation,
3 again for purposes of this testimony.
4
5 **Q. WHY DO YOU ACCEPT MS. JENSEN'S ESTIMATES OF**
6 **CONTRIBUTED ASSETS AND THE COST OF THE SALE?**
7
8 A. As Ms Jensen testifies, these numbers are merely estimates. The true values will
9 not be known until after the consummation of the sale. Whatever the
10 Commission's ruling in this case, it should be contingent on verification of these
11 deductions from the sales price once the transaction is complete. The final
12 quantification of the gain and the ratepayer allowances should be adjusted
13 accordingly.
14
15 **Q. WHY HAVE YOU ACCEPTED MS. JENSEN'S DEDUCTION OF THE**
16 **LCI ACTIVITY FROM THE GAIN?**
17
18 A. In evaluating whether an activity should or should not be deducted from the gain
19 for purposes of developing ratepayer credits and regulatory liabilities, I apply two
20 criteria. The first criterion is whether the activity is related to directory
21 publishing, that is, whether it would be conducted without the going-concern
22 capabilities of the traditional directory publishing operation. By "going concern

1 capabilities," I mean the name recognition, address lists, advertiser contacts,
2 distribution infrastructure and management expertise that are used to produce the
3 white pages that Qwest is obliged to publish and the Yellow Pages that provide
4 profit to the enterprise.
5 My second criterion is whether the activity contributes to the gain. That is, if the
6 activity has traditionally lost money and is likely to continue to do so in the
7 future, it clearly made no contribution to the very large gain that Qwest will
8 realize from this sale. To ascribe any gain to that activity is not appropriate.
9
10 With regard to the first criterion, LCI should be excluded because its activity,
11 which is the leasing of telecommunications equipment, bears no relation to the
12 directory publishing business. As for the second criterion, LCI should be
13 assigned no portion of the gain because, according to Ms. Jensen, "it is highly
14 probable there is no gain on the Dex sale attributable to LCI."[18] Qwest does not
15 assign any gain to LCI, because Ms. Jensen shows the LCI portion of the gain
16 matched exactly by the "contributed assets." I interpret this to mean that LCI is
17 being assigned a gain value that matches the book value of the assets it represents.
18 Its exclusion or inclusion has no effect on the net gain assignable to ratepayers.
19

[18] Exhibit TAJ-IT, page 27.

1 **Q. WHY DO YOU OBJECT TO MS. JENSEN'S DEDUCTION OF THE NEW**
2 **VENTURES ENTERPRISE FROM THE RATEPAYER PORTION OF**
3 **THE GAIN?**
4
5 A. The record to date contains very little information on the New Ventures
6 enterprise, other than that it is an Internet-related activity that is part of Dex and is
7 being purchased by Dex Holdings. It is unlikely that Dex Holdings would include
8 New Ventures in its purchase if it did not see it as related to and synergistic with
9 the directory activities. Also, it appears that the provision of Internet directory
10 listings is one of the services that New Ventures provides. If so, then there is a
11 direct tie between New Ventures and Qwest's directory publishing business.
12
13 But even if no such tie exists, New Ventures should not be assigned any portion
14 of the gain because, according to Ms. Jensen, it has been unprofitable for most of
15 its history.[19] If so, then it is unlikely that New Ventures added to the very
16 substantial gain that Qwest will realize from the sale of Dex. Undoubtedly, Ms.
17 Jensen's revenue-based allocation of the gain overstates the value of the gain
18 attributable to New Ventures. For this reason, it is inappropriate to deduct that
19 allocation from the ratepayer portion of the Dex gain.
20

[19] Id., page 28.

1 **Q. WHY DO YOU OBJECT TO THE DEDUCTION OF THE SECONDARY**
2 **DIRECTORIES FROM THE RATEPAYER PORTION OF THE GAIN?**
3
4 A. Qwest could never have published these directories if it did not already have its
5 "primary" directory activity in full operation. If nothing else, the advertiser
6 contacts provided by the primary Yellow Pages give Qwest a substantial "leg up"
7 over competitors in publishing both of its secondary directories. No doubt, Qwest
8 uses the same management, accounting, billing, printing and distribution
9 infrastructure for these secondary directories as it does for its primary directories.
10 In short, the secondary directories would not exist but for the primary directories.
11 For this reason, whatever portion of the gain they generate is derivative from
12 Dex's core publishing business which, as I have explained, is entirely attributable
13 to ratepayers.
14
15 **Q. WHY DO YOU OBJECT TO MS. JENSEN'S EXCLUSION OF GAIN**
16 **RELATED TO NON-QUEST LISTINGS?**
17
18 A. Qwest derives as much value from non-Qwest listings as it does from Qwest
19 listings. The source of Dex's profitability is not the number of Qwest subscribers
20 that it lists in its white pages. It is the ubiquity of the white pages listing, which
21 ensures that the Yellow Pages – the real money maker – are distributed
22 throughout the regions where Qwest provides local service. Since each white

1 pages subscriber also receives a Yellow Pages directory, it does not matter
2 whether that subscriber is a Qwest customer, a CLEC customer or another
3 incumbent local exchange carrier customer. All receive the Yellow Pages and the
4 advertising contained within them. That advertising generates the extraordinary
5 profits of Dex. There is no justification whatever for excluding any portion of the
6 Dex gain attributable to Qwest ratepayers based on non-Qwest listings.
7
8 **Q. WHY DO YOU OBJECT TO MS. JENSEN'S WASHINGTON**
9 **ALLOCATOR OF THE TOTAL DEX GAIN?**
10
11 A. Ms. Jensen has used as her allocator the Washington portion of total Dex revenues
12 from primary directories. This allocator leaves out secondary directories which,
13 as noted, are derivative from the primary directories and which no doubt
14 contribute to the size of the gain. If revenues must be used as an allocator, they
15 should include both primary and secondary revenues.
16
17 Moreover, the true driver of the gain is not revenues, but earnings. It is Dex's
18 profitability that permits it to be sold for $7.05 billion. Qwest has provided a
19 breakdown of earnings by state, and this factor should be used as the allocator to
20 Washington.
21

1 **Q. WHY DO YOU OBJECT TO MS. JENSEN'S USE OF A POST-TAX GAIN**
2 **AS THE MEASURE OF RATEPAYER BENEFIT?**
3
4 A. There are two reasons. First, given its extensive losses in the past few years, QCI
5 is not likely to pay any tax whatever on its gain from the Dex sale. That being the
6 case, a tax deduction from the ratepayer benefit is not a reflection of money
7 passing from Qwest to the government, but of money passing from ratepayers to
8 QCI. Since QCI is responsible for the financial difficulties that have prompted
9 the sale of Dex, it hardly seems fair to charge ratepayers, who are already
10 surrendering their substantial vested benefits from Dex, for "phantom" taxes that
11 actually go to QCI.
12
13 But even if the Dex gain were taxed, the mechanics of flowing this benefit back to
14 ratepayers incorporates the tax effects that Ms. Jensen would include in the initial
15 gain quantification. First, when Qwest applies the 10 percent ratepayer credit to
16 its customers' bills, its revenue, hence its net operating income, is reduced dollar-
17 for-dollar. For each dollar of reduced operating income, there is a 35 cent
18 contraction in the amount of income taxes that Qwest must pay the government.
19 Thus, if the base for the 10 percent bill credit were already reduced for income
20 taxes, there would be a double count of the tax effect when the credit is flowed
21 through to ratepayers.
22

1 The same is true of the rate base deduction. When rate base is reduced, the
2 Company's return is also reduced, and so are its taxes. Again, if the rate base
3 deduction has already been reduced to account for taxes, there would be a double
4 reduction for taxes when the rate base is adjusted in a rate case. For these
5 reasons, the gain attributed, and distributed, to ratepayers should be expressed in
6 pre-tax dollars. It should not be deflated for "phantom" taxes that, even if paid,
7 would be deducted again when flowed through to ratepayers.
8
9 **Q. HAVE YOU PROVIDED A QUANTIFICATION OF THE GAIN YOU**
10 **BELIEVE SHOULD BE ALLOCATED TO WASHINGTON**
11 **RATEPAYERS?**
12
13 A. Yes. Confidential Exhibit_____(CWK-4C) shows my quantification of the gain
14 on the Dex sale that is attributable to Washington ratepayers. It starts with
15 Qwest's quantification of the pre-tax gain, shows the add-back of Ms. Jensen's
16 three inappropriate deductions, and applies the income-based Washington
17 allocator to derive the appropriate allocation of the gain to Washington ratepayers.
18 The exhibit also shows the amount of bill credits that should be flowed to
19 ratepayers immediately on the consummation of the sale and the amount that
20 should be set aside as a regulatory liability of the Company to ratepayers. The
21 final line shows the annual amortization of this liability assuming a 15-year
22 amortization period.

1

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

3

4 A. Yes, it does.