

**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

REBUTTAL TESTIMONY

OF

MARK S. REYNOLDS

QWEST CORPORATION

NON-CONFIDENTIAL VERSION

APRIL 17, 2003

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1

I. IDENTIFICATION OF WITNESS

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

4 A. My name is Mark S. Reynolds and my business address is 1600 7th Avenue,
5 Room 3206, Seattle, Washington, 98191. I am employed by Qwest Services
6 Corporation (“QSC”) as the Senior Director of Washington Regulatory Affairs for
7 Qwest Corporation (“QC”) and other Qwest companies.

8 **Q. PLEASE REVIEW YOUR PRESENT RESPONSIBILITIES.**

9 A. I am primarily responsible for all aspects of regulatory compliance for Qwest
10 Communications International Inc. (“QCII”), particularly QC’s regulated
11 Washington operations. My responsibilities include oversight of regulatory
12 filings and advocacy, including presentation of testimony, as in this docket. I am
13 also responsible for QCII's and its affiliates' communications and activities with
14 the Washington Utilities and Transportation Commission (“Commission”).

15 **Q. BRIEFLY OUTLINE YOUR EMPLOYMENT BACKGROUND.**

16 A. I received a B.A. from Oregon State University in 1977, and an M.B.A. in 1979
17 from the University of Montana. My professional experience in the
18 telecommunications industry spans 22 years working for Qwest and its
19 predecessors, U S WEST Communications, Inc. (“U S WEST”) and Pacific
20 Northwest Bell. I have held various director positions in costs, economic
21 analyses, pricing, planning and interconnection for U S WEST in the marketing
22 and regulatory areas. I was responsible for ensuring economic pricing
23 relationships between and among U S WEST’s product lines, including telephone

1 exchange service, long distance, and switched/special access services. I
2 represented U S WEST, both as a pricing policy witness, and as the lead company
3 representative, in a number of state regulatory and industry pricing and service
4 unbundling workshops. Subsequently, I managed an organization responsible for
5 the economic analyses and cost studies that supported U S WEST's tariffed
6 product and service prices, and costs before state and federal regulators.

7 I have also managed U S WEST's interconnection pricing and product strategy
8 and the interconnection negotiation teams that were responsible for negotiating
9 interconnection and resale contracts with new local service providers. In addition,
10 I managed U S WEST's cost advocacy and witness group, which was responsible
11 for providing economic cost representation in telecommunications forums,
12 workshops and regulatory proceedings. Finally, prior to my current position, I
13 was responsible for state regulatory finance issues and, specifically, the
14 development and implementation of Qwest's performance assurance plans in
15 conjunction with its recent 271 applications.

16 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION?**

17 **A.** Yes. I have testified in a number of proceedings before the Commission dating
18 back to 1989, including rate and cost dockets, wholesale arbitration dockets,
19 wholesale complaint dockets, the Qwest/U S WEST merger docket, and the 271
20 docket.

1 **Q. WHAT IS THE STATUS OF THE DIRECT TESTIMONY OF THERESA**
2 **A. JENSEN FILED ON JANUARY 17, 2003, AND UPDATED WITH AN**
3 **ERRATA FILING ON FEBRUARY 14, 2003?**

4 A. Theresa Jensen has retired from Qwest, and will not serve as the witness for her
5 direct testimony. I will adopt all of Ms. Jensen's direct testimony (Exhibit TAJ-
6 1T), except for page 1, and not including the portions listed below which will be
7 adopted by Ann Koehler-Christensen. I will also adopt Confidential Exhibit TAJ-
8 4C.

9 Ms. Koehler-Christensen will adopt Exhibit TAJ-1T page 17, line 6 through page
10 19, line 7, and page 25, line 18 through page 33, line 10, as well as Confidential
11 Exhibits TAJ-2C and TAJ-3C.

12 **II. PURPOSE OF TESTIMONY**

13 **Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?**

14 A. One purpose of my testimony is to introduce Qwest's rebuttal witnesses and
15 summarize their responses to the testimony filed in this proceeding on March 18,
16 2003 by Staff witnesses Glenn Blackmon, Lee Selwyn, and Kathy Folsom, Public
17 Counsel, AARP, WeBTEC witness Michael Brosch, and Department of Defense
18 witness Charles King (collectively "opposing parties").

19 My testimony will also address the standard of review for transactions such as the
20 sale of Dex. I will rebut Staff's contention that Qwest's proposal "... fails the

1 test of no harm to customers, because it will lead to higher rates for customers,”¹
2 on the basis that the Commission has applied a much broader standard in
3 reviewing similar transactions.² Qwest believes that its proposal falls well within
4 the range of “no harm” when evaluated in terms of the correct standard and that
5 Staff’s recommendation does not meet such a test.

6 Finally, most of the opposing party witnesses provide testimony that Qwest’s gain
7 disposition proposal contained in Ms. Jensen’s direct testimony is insufficient to
8 satisfy ratepayers’ interest in the directory publishing asset.³ In response to this
9 testimony, in part, and also in order to provide Washington with a gain disposition
10 proposal that is consistent with the stipulated settlements in the Utah and Arizona
11 Dex sale proceedings, my testimony revises the gain disposition proposal
12 contained in Ms. Jensen’s direct testimony. In order to provide a frame of
13 reference for the revised proposal, my testimony will include an overview of the
14 stipulated settlements reached by the parties to the Utah and Arizona Dex sale
15 approval proceedings. These settlements have occurred since Qwest filed its
16 direct testimony in this proceeding.

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18
19

¹ Direct Testimony of Glenn Blackmon, Ph.D. dated March 18, 2003 (“Blackmon”) at page 3.

² *In the Matter of the Application of Avista Corporation for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant, etc.* Docket Nos. UE-991255, UE-991262 and UE-991409, Second Supplemental Order; Order Approving Sale with Conditions, March 6, 2000, paragraph 29.

³ Blackmon at page 4; Direct Testimony of Lee L Selwyn dated March 18, 2003 (“Selwyn”) at page 45; Direct Testimony of Michael L. Brosch dated March 18, 2003 (“Brosch”) at pages 70 to 71; Response Testimony of Charles W. King dated March 18, 2003 (“King”) at page 23.

1 **III. QWEST REBUTTAL WITNESSES AND ISSUES SUMMARY**

2 **Q. WHAT ARE THE MAJOR ISSUES RAISED BY THE OPPOSING**
3 **PARTIES IN THEIR DIRECT AND RESPONSE TESTIMONY?**

4 A. The opposing parties' direct and response testimony raises the following major
5 issues that will be addressed by Qwest witnesses in their rebuttal testimony:

- 6 • Staff contends that the sale is not in the public interest and should not be
7 approved by the Commission;
- 8 • Staff contends that a potential QCII bankruptcy is not a valid reason for the
9 Commission to approve the sale because QC would be better off as a result of
10 bankruptcy;
- 11 • Should the Commission approve the sale, Staff's proposal includes: a gain
12 disposition proposal that is based on a hypothetical sales price that exceeds the
13 actual sales price; a debt/equity ratio limit; and, a requirement for Commission
14 approval for QC dividends to owner and for any changes to the publishing
15 agreement;
- 16 • Opposing parties' claim that ratepayers are entitled to 100% of the gain on the
17 sale because Dex's value is attributable to its linkage with regulated telephone
18 company operations;
- 19 • Opposing parties' responsive arguments to Mr. Grate's risk and burden
20 analysis, regarding gain entitlement, from his direct testimony; and
- 21 • Public Counsel, AARP, WeBTEC, and the Department of Defense all offer
22 gain disposition proposals that allocate 100% or more of the gain from the
23 sale to the ratepayers should the Commission approve the sale.

1 **Q. WHO ARE THE QWEST REBUTTAL WITNESSES AND WHAT ISSUES**
2 **DO THEY ADDRESS IN THEIR REBUTTAL TESTIMONY?**

3 A. Peter C. Cummings is a Director of Finance for Qwest Corporation. Mr.
4 Cummings filed direct testimony on January 17, 2003 explaining why the sale of
5 Dex is critical to the continued financial viability of Qwest. In addition to his
6 rebuttal testimony, Mr. Cummings will also adopt the direct testimony of Qwest
7 witness Brian G. Johnson. Mr. Cummings' rebuttal testimony responds to Staff
8 witness Blackmon's testimony regarding the "Material Regulatory Impact" (MRI)
9 side letter agreement from the Rodney sales agreement. He clarifies that the MRI
10 is a measurement of any regulatory-driven changes that result in a change to net
11 revenues, capital obligations or other regulatory charges or costs, and not part of a
12 reserve fund as intimated by Dr. Blackmon. Mr. Cummings also responds to a
13 number of bankruptcy-related issues raised by Staff witnesses Blackmon and
14 Folsom including:

- 15 ○ QC would better off without QCII;
- 16 ○ Enron/Portland General Electric as a valid bankruptcy comparison for
- 17 QCII and QC; and
- 18 ○ Long-term effect of Dex sale is to increase risk.

19 Finally, Mr. Cummings responds to claims by Staff witness Selwyn that the Dex
20 sales price did not reflect fair market value based on financial analysts' valuations
21 and Selwyn's DCF of projected growth of future imputations.

22 Philip E. Grate is a Director of Finance for Qwest Corporation. Mr. Grate also
23 filed direct testimony on January 17, 2003 examining the disposition of the gain
24 on the sale of Dex using the two-step risk and burden test the Commission has
25 previously applied to make such determinations. Mr. Grate's direct testimony

1 reviewed the financial and regulatory history of the directory business in
2 Washington. Mr. Grate will rebut the opposing parties' testimony with regard to
3 Mr. Grate's gain attribution analysis for the historical directory business review in
4 his direct testimony. Mr. Grate will also rebut the opposing parties' testimony
5 that 100% of the proceeds from the Dex sale must go to the ratepayers. Mr. Grate's
6 analysis shows that the ratepayers have never been at risk for incurring a loss
7 from the assets, and, in fact, have never been required to contribute anything to
8 the directory business. Finally, Mr. Grate will correct many factual inaccuracies
9 in the opposing parties' testimony about the regulatory history of the directory
10 business, the regulatory accounting of the directory business, and the relationship
11 between the directory business and the regulated telephone business.

12 Ann Koehler-Christensen is a Financial Analyst for Qwest Corporation who has
13 provided financial expertise on the Dex /QC business relationship for a number of
14 years. In addition to her rebuttal testimony, Ms. Koehler-Christensen will also
15 adopt the portions of Ms. Jensen's direct testimony regarding the history of
16 directory imputation in Washington, and the derivation of and logic for the
17 exclusions from Qwest's gain calculation associated with LCI, NewVentures,
18 secondary directories, and non-Qwest listings. Ms. Koehler-Christensen's
19 rebuttal testimony will correct inaccuracies in the opposing parties' testimony
20 regarding the current and historic business relationship between the directory
21 business and the telephone company. Finally, Ms. Koehler-Christensen will
22 provide a thorough analysis of the commercial agreements associated with the
23 Dex sale. In so doing, she will dispel many incorrect assumptions relied on by the

1 opposing parties in their testimony regarding to whom the value of the
2 commercial agreements should inure.

3 Ralph R. Mabey is a bankruptcy expert who will provide testimony regarding the
4 potential risks associated with utilities in bankruptcy. Mr. Mabey is President of
5 the American College of Bankruptcy and served as a United States Bankruptcy
6 Judge from 1979 to 1983. Mr. Mabey's testimony will address some of the issues
7 related to bankruptcy raised in Staff's testimony.

8 William Taylor is a Ph.D economist with National Economic Research Associates
9 (NERA) who will provide expert economic testimony regarding business
10 enterprise valuation (BEV) techniques. Dr. Taylor concludes that the best
11 estimate of BEV is a price determined by the market, in an arms length
12 transaction, with multiple qualified bidders. Dr. Taylor will provide an analysis
13 of the economic relationship between the directory business and the regulated
14 telephone operation in order to conclude that the directory advertising revenue
15 stream has always been a source of contribution, but not a ratepayer asset. Dr.
16 Taylor will also explain that ongoing contributions from directory revenues to
17 regulated telephone operations distort both local advertising and
18 telecommunications markets. Finally, Dr. Taylor will demonstrate how DOD's
19 gain amortization methodology fails from accounting, economic, and public
20 policy perspectives.

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IV. STANDARD OF REVIEW

2 **Q. AT PAGE 3 OF HIS MARCH 18, 2003 DIRECT TESTIMONY, STAFF**
3 **WITNESS BLACKMON CLAIMS THAT THE DEX SALE**
4 **TRANSACTION, INCLUDING QWEST'S GAIN DISPOSITION**
5 **PROPOSAL, "... FAILS THE TEST OF NO HARM TO CUSTOMERS,**
6 **BECAUSE IT WILL LEAD TO HIGHER RATES FOR CUSTOMERS."**
7 **DO YOU BELIEVE THAT THIS IS A PROPER APPLICATION OF THE**
8 **STANDARD THE COMMISSION HAS USED IN CASES EVALUATING**
9 **SIMILAR SALE TRANSACTIONS?**

10 **A. No. In *Centralia Coal*,⁴ at paragraph 29, the Commission stated:**

11 In undertaking its review and arriving at a decision to approve or
12 disapprove a requested property transfer the Commission looks to its
13 general responsibility to regulate in the public interest, RCW 80.01.040.
14 In past decisions and under our rule, WAC 480-143-170, we have
15 interpreted this as a "no harm" standard. That is, we will deny the
16 application if the transaction is not consistent with the public interest, but
17 will approve it, if the applicant demonstrates that the transaction, on
18 balance, at least does not harm. To reach this determination, we have, in
19 the past and in this case, considered and balanced four principles. The four
20 principles address: (1) the rates and risks faced by ratepayers, (2) the
21 balance of interests among customers, shareholders, and the broader

⁴ *In the Matter of the Application of Avista Corporation for Authority to Sell its Interest in the Coal-Fired Centralia Power Plant, etc.* Docket Nos. UE-991255, UE-991262 and UE-991409, Second Supplemental Order; Order Approving Sale with Conditions, March 6, 2000, paragraph 29.

1 public, (3) the effect of the transaction on competitive markets, and (4)
2 protection of the interests of Washington ratepayers.⁵ These four
3 principles do not constitute a checklist or a definitive set of minimum
4 requirements. In *Colstrip*, we stated that, “These principles are not
5 minimum standards; rather they are guidelines that, when taken together,
6 can be used to determine whether there is, at least, no harm to the public
7 interest.” (*Colstrip*, Third Supplemental Order at 8). We also advised
8 that, “Over time, and across different industries and transactions, different
9 considerations may prove relevant to determining the public interest.” *Id.*
10 Each principle may not be relevant in every case, and where they are
11 relevant, the unique mix of factors each transaction presents for evaluating
12 risks and benefits will dictate that they apply in different measure.

13 Although the Commission has indicated that these consideration are guidelines
14 and not minimum standards, I believe the circumstances of the Dex transaction
15 are properly considered under the standards set forth in *Centralia Coal*.
16 Obviously, these review guidelines are much broader than the singular
17 consideration as to whether the transaction results in a rate increase to customers.
18 Consequently, Qwest believes that both its initial and revised proposals for gain
19 disposition clearly fall within the “no harm” range. The extraordinary
20 circumstances⁶ that led Qwest to sell Dex require that the transaction be examined
21 in light of those unique circumstances rather than assuming they have no effect on

⁵ Footnote imbedded in cite: These principles, as expressed in *Colstrip*, Docket No. UE-990267, Third Supplemental Order, at pp. 9-10, are:

1. The transaction should not harm ratepayers by causing rates or risks to increase, or by causing service quality and reliability to decline, compared with what could reasonably be expected to have occurred in the absence of the transaction.
2. The transaction, with conditions required for its approval, should strike a balance among the interests of ratepayers, shareholders, and the broader public that is fair and that preserves affordable, efficient, reliable, and available service.
3. The transaction, with conditions required for its approval, should not distort or impair the development of competitive markets where such markets can effectively deliver affordable, efficient, reliable, and available service.
4. The jurisdictional effect of the transaction should be consistent with the Commission’s role and responsibility to protect the interests of Washington gas and electricity ratepayers.

⁶ See Direct Testimony of Peter C. Cummings and Brian G. Johnson dated January 17, 2003.

1 the event.⁷ Indeed, the Commission envisioned that the guidelines be applied in
2 such a holistic manner in *Centralia Coal*, at paragraph 85, which states “. . . the
3 Commission, when determining the public interest, must look both at the
4 particular asset and also at the broader context in which the asset is being sold.”

5 **Q. DO YOU BELIEVE THAT STAFF HAS UNDERESTIMATED THE RISK**
6 **THAT IN A BANKRUPTCY PROCEEDING PROCEEDS FROM A DEX**
7 **SALE WOULD NOT BE AVAILABLE TO “COMPENSATE” THE**
8 **RATEPAYER?**

9 A. Yes, I do. Based on the rebuttal testimony of Ralph Mabey, a preeminent expert
10 on utilities in bankruptcy, that risk is quite high.⁸ From his testimony, it appears
11 reasonable to conclude that a bankruptcy court would likely try to maximize the
12 value of Dex through commercial agreements with QC and would sell Dex to pay
13 creditors, leaving no return whatsoever for ratepayers.

14 **Q. HOW IS THIS RELEVANT TO THE COMMISSION’S REVIEW OF**
15 **QWEST’S PETITION/APPLICATION IN THIS CASE?**

16 A. It is relevant because if Mr. Mabey is right, and Staff is wrong on the risks
17 attendant to a bankruptcy filing, the benefit to ratepayers is maximized by
18 allowing Qwest to reduce its debt load with some of the proceeds from Dex.
19 Qwest’s balanced proposal also satisfies the other guidelines of review in that it
20 balances the interests of customers, shareholders and the broader public.

⁷ See Blackmon page 16, where he theorizes that in order to secure the value of Dex, a bankruptcy court would surely not separate the publishing company and the telephone company.

⁸ See Rebuttal Testimony of Ralph Mabey.

1 **Q. ARE YOU SAYING THAT STAFF'S ADVOCACY IN THIS**
2 **PROCEEDING MAY NOT MEET THE PUBLIC INTEREST/"NO HARM"**
3 **STANDARDS PREVIOUSLY USED BY THIS COMMISSION TO**
4 **EVALUATE THIS TYPE OF TRANSACTION?**

5 A. Yes. In addition to ignoring the potential risk associated with the disposition of
6 Dex sale proceeds to creditors in a bankruptcy proceeding, Staff provides only a
7 cursory review of the other potential risks associated with bankruptcy.
8 Additionally, Staff's proposal for the amount and disposition of the proceeds from
9 a sale, should the Commission approve Qwest's petition, significantly increases
10 the risk of QCII's bankruptcy by creating an ill-defined, phantom gain liability
11 and requiring that all proceeds attributable to this liability be paid into a
12 regulatory fund.

13 **Q. DR. BLACKMON INTIMATES THAT THERE IS NOT MUCH RISK**
14 **THAT A QWEST BANKRUPTCY WOULD CAUSE ANY ADDITIONAL**
15 **HARDSHIP FOR EMPLOYEES, BEYOND WHAT THEY HAVE**
16 **ALREADY EXPERIENCED AS A RESULT OF QWEST'S FINANCIAL**
17 **DIFFICULTIES. DO YOU AGREE?**

18 A. No. There is no certainty about what would happen to QC in a bankruptcy
19 proceeding.⁹ If QC were to be sold in bankruptcy, it is logical to assume that the
20 bidders would include other local telephone companies. An acquisition of QC by
21 another local telephone company may well result in consolidations and the
22 elimination of duplicate jobs. Even though the acquisition of QC in a bankruptcy
23 proceeding by another local telephone company is but one of many possibilities,

⁹ See Testimony of Ralph R. Mabey.

1 the Commission should be cognizant of and consider the entire range of
2 possibilities, rather than consider only the limited perspective offered by Staff.
3 Qwest believes that the testimony of Ralph Mabey will aid the Commission in
4 appropriately assessing and appreciating the risks associated with a potential
5 Qwest bankruptcy.

6 **Q. ARE THERE ANY OTHER, EMPLOYEE-RELATED, BANKRUPTCY**
7 **ISSUES RAISED BY STAFF THAT YOU WISH TO ADDRESS?**

8 A. Yes. Although it is probably a minor point, I don't agree with Dr. Blackmon's
9 assessment of the employees' risk associated with loss of the value of their stock
10 in a bankruptcy. Dr. Blackmon tries to make the point that avoiding bankruptcy
11 primarily protects Qwest's principal shareholder, Philip Anschutz, as the holder of
12 one-sixth of the company's common stock. He does this through a comparison of
13 Mr. Anschutz's loss potential, based on his current Qwest stock holdings and a
14 current Qwest stock price of \$4.00, to the loss potential of employees, based on
15 the \$4.00 stock price, and the stock purchased by the employees from 1999 to
16 2001 through the employee stock purchase plan. Because the stock purchased in
17 the employee stock purchase plan during the specified three year period only
18 represents about 1% of Mr. Anschutz's holdings, Dr. Blackmon concludes that the
19 employees' loss potential is only about 1% of the \$1.1 billion loss potential of Mr.
20 Anchutz's loss potential, or \$12 million. In actuality, Qwest employees have
21 much more Qwest stock than the 3 million shares purchased via the stock
22 purchase plan. As of December, 31, 2001, Qwest employees owned
23 approximately 70 million shares of Qwest stock in their 401K plans,¹⁰ which at

¹⁰ Qwest Form 11-K, Annual Report to Security and Exchange Commission, Qwest Savings and Investment Plan, for the Year Ended December 30, 2001, original page 9.

1 \$4.00 per share, totals \$280 million in loss potential to employees should QCII go
2 bankrupt, not \$12 million.

3 **Q. YOU STATED THAT STAFF’S PROPOSAL FOR THE AMOUNT AND**
4 **DISPOSITION OF THE PROCEEDS FROM A SALE, SHOULD THE**
5 **COMMISSION APPROVE QWEST’S PETITION, SIGNIFICANTLY**
6 **INCREASES QWEST’S FINANCIAL EXPOSURE BY CREATING**
7 **PHANTOM GAIN LIABILITY AND REQUIRING THAT ALL**
8 **PROCEEDS BE PAID INTO A REGULATORY FUND. PLEASE**
9 **EXPLAIN WHAT YOU MEAN.**

10 A. Simply put, Staff’s proposal fabricates gain for which there is no corresponding
11 sale proceeds. On a total company basis, Staff proposes that a BEGIN QWEST
12 CONFIDENTIAL *****¹¹ END QWEST CONFIDENTIAL sales price be
13 used when the total proceeds of the sale are actually approximately \$7.05
14 billion.BEGIN QWEST CONFIDENTIAL¹² END QWEST CONFIDENTIAL
15 Although Qwest witness Taylor provides testimony that rebuts the rationale for
16 this phantom sales price increase, Staff’s proposal to increase a financially
17 strapped company’s net payment liability by BEGIN QWEST CONFIDENTIAL
18 ***** END QWEST CONFIDENTIAL needs to be questioned in light of
19 the public interest standard. There is no question that obligating QC to set aside
20 purely fabricated, phantom gains for ratepayers dramatically increases Qwest’s
21 financial exposure, even if the sale is consummated. And, as if the phantom gain
22 were not enough, Staff proposes that Washington’s share of their recommended
23 sales proceeds be paid into some type

¹¹ See Selwyn Exhibit LLS-24C.

¹² BEGIN QWEST CONFIDENTIAL ***** END QWEST CONFIDENTIAL

1 of undefined regulatory fund.¹³ Although Staff is unclear about how such a fund
2 would operate,¹⁴ it is clear that the money would not be available to QCII to pay
3 down debt, which is the motivation for selling Dex in the first place.¹⁵ The other
4 parties to this proceeding, including Qwest, all employ gain disposition
5 techniques that would allow Qwest to amortize the return to the ratepayers over a
6 period of time. This would allow Qwest to use the immediate proceeds from the
7 sale to address its immediate financial concerns. Although Staff makes it clear in
8 its testimony why it believes it needs to apply such draconian measures, Staff's
9 recommendation ultimately creates a Hobson's choice for the Commission. On
10 the one hand Staff recommends that the Commission not approve the sale; on the
11 other hand, Staff suggests a gain disposition proposal that only serves to defeat
12 the purpose of the sale.

13 **Q. COULD YOU PLEASE RESPOND TO THE PROPOSAL BY PUBLIC**
14 **COUNSEL AND DOD THAT QWEST BE REQUIRED TO PROVIDE AN**
15 **IMMEDIATE, UP-FRONT RATEPAYER CREDIT?**

16 A. Qwest is opposed to the proposals of Public Counsel and DOD that would require
17 a substantial up-front credit to ratepayers. The Commission should not adopt
18 such a requirement in this proceeding because the credit would amount to a
19 windfall and is unnecessary in order to meet the "no harm" standard. The credit
20 should also be rejected because such a requirement diminishes the cash that

¹³ Blackmon at p. 26 – "QC should be required to account for these funds on its regulated books to recognize that they are not supplied by investors and that Qwest's stockholders are not entitled to a return on the funds."

¹⁴ Staff response to Qwest Data Request No. 12 state that "[t]he specific method of holding or using the sale proceeds should be determined by the Commission if its decides to approve the sale."

¹⁵ Staff's recommendation is not clear on whether or not the regulatory fund could be used to pay down QC debt.

1 Qwest will realize from the sale in order to pay down debt, thereby working
2 against the very purpose of the sale.

3 **Q. PLEASE RESPOND TO PUBLIC COUNSEL'S PROPOSAL TO EXTEND**
4 **THE SERVICE QUALITY REQUIREMENTS FROM THE U S**
5 **WEST/QWEST MERGER PROCEEDING, DOCKET NO. UT-991358**

6 A. Public Counsel's proposal to extend the merger conditions is totally unfounded in
7 this docket. There are no issues in this docket that give rise to service or
8 performance concerns. Service has not been otherwise made an issue in this
9 proceeding and Public Counsel's request for such an extension is without factual
10 or legal basis. Additionally, the Commission has recently adopted service quality
11 rules of general applicability, making such an extension unnecessary.

12 **V. QWEST'S REVISED GAIN DISPOSITION PROPOSAL**

13 **Q. HOW DID THE OTHER PARTIES RESPOND TO QWEST'S PROPOSED**
14 **GAIN DISPOSITION PROPOSAL CONTAINED IN MS. JENSEN'S**
15 **DIRECT TESTIMONY?**

16 A. The opposing parties generally disagree with Qwest's proposal on the basis of
17 their contention that 100% of any gain on the sale of Dex should be returned to
18 ratepayers. Dr. Blackmon also claims that the proposal fails the test of no harm to
19 customers, because it only protects customers from rate increases for a few
20 additional years.¹⁶

¹⁶ Blackmon at pages 4 and 5.

1 **Q. HOW DOES QWEST RESPOND TO THESE CONTENTIONS?**

2 A. As previously summarized in this testimony, and addressed in detail in the
3 rebuttal testimony of the other Qwest witnesses in this proceeding, Qwest believes
4 that it has presented a compelling case that the gain from Dex should, at most, be
5 equally split between ratepayers and shareholders. More importantly, however,
6 Qwest believes that a balanced approach that both provides funds to ensure the
7 company's solvency and continues, for a limited, specified period, some of the
8 historic benefits associated with directory affiliation, avoids any harm to
9 ratepayers.

10 **Q. WHAT IS THE STATUS OF THE DEX SALE IN OTHER STATES**
11 **WHERE STATE COMMISSION APPROVAL IS REQUIRED?**

12 A. The two other regulatory commissions with in which Qwest commenced
13 proceedings relating to this portion of the sale are Utah and Arizona. On March
14 11, 2003, the Public Service Commission of Utah issued an order adopting a
15 stipulated settlement and approving the terms and condition of the Dex Sale
16 Rodney Agreement pertaining to Utah. The Utah stipulated settlement required
17 Qwest to make one time bill credits totaling \$22 million to customers for
18 specified services within 45 days of the close of the Rodney portion of the sale.
19 The stipulation also left undisturbed a \$30.1 million directory imputation ordered
20 in the Company's 1997 Utah rate case in that was the starting point for those rates
21 that are still price regulated in Utah under a statutory price cap.¹⁷

¹⁷ Utah Docket No. 02-049-76, at paragraph 4: "To the extent required by law, including a Commission order, Qwest shall continue to include directory revenue imputation as provided in the December 4, 1997 Report and Order of the Commission in Docket No. 97-049-08 in regulatory reports or other filings with the Commission."

1 In Arizona, Qwest and the Arizona Corporation Staff have reached a stipulated
2 settlement for approval of the sale. Qwest continues to discuss settlement with
3 the other parties in that proceeding.

4 **Q. BASED ON THE SETTLEMENT ACTIVITIES IN UTAH AND ARIZONA,**
5 **IS QWEST WILLING TO REVISE ITS GAIN DISPOSITION PROPOSAL**
6 **IN WASHINGTON?**

7 A. Yes. However, Qwest's willingness to revise its proposal in no way
8 countermands its advocacy regarding entitlement to the gain. Rather, it reflects
9 Qwest's good faith effort to reduce the differences between the proposals
10 currently before the Commission, and to be consistent with Qwest's position in
11 other states where agreement has been reached.

14 **Q. WHAT IS QWEST'S REVISED PROPOSAL?**

15 A. Qwest's revised proposal provides to ratepayers the current value of the exiting
16 imputation of \$103,370,843 as an adjustment to revenues for the regulated results
17 of operations for a period of 10 years after the sale is approved. Qwest's previous
18 proposal, contained in Ms. Jensen's January 17, 2003 Direct Testimony at pages
19 20 and 21, and revised Exhibit TAJ-4C, offered an imputation benefit of
20 \$103,370,843 for approximately 4.5 years. Based on Qwest's pre-tax gain
21 calculation contained in Exhibit TAJ-2C, Qwest's previous proposal returned
22 BEGIN QWEST CONFIDENTIAL **** END QWEST CONFIDENTIAL of the
23 gain to ratepayers through 4.5 years of imputation. Qwest's revised proposal

1 returns BEGIN QWEST CONFIDENTIAL ***** END QWEST
2 CONFIDENTIAL of Qwest's calculation of the gain to ratepayers through 10
3 years of imputation. Further, even when compared to the Public Counsel and
4 Department of Defense gain calculations, Qwest's revised proposal would return
5 BEGIN QWEST CONFIDENTIAL ***** END QWEST
6 CONFIDENTIAL of the gain to ratepayers, as the gain has been calculated by
7 those parties, respectively. The calculations supporting the revised proposal,
8 using the same format as Exhibit TAJ-4C, are contained Exhibit MSR-2RC.

9 **Q. IN FOOTNOTE 5 ABOVE, YOU INCLUDE THE FOOTNOTE FROM**
10 **THE *CENTRALIA COAL* MATTER AND LIST THE PRINCIPLES THE**
11 **COMMISSION HAS TRADITIONALLY APPLIED TO TRANSACTIONS**
12 **SUCH AS THE DEX SALE TO DETERMINE IF ITS "NO HARM"**
13 **STANDARD HAS BEEN MET. WOULD YOU SUMMARIZE HOW**
14 **QWEST'S PROPOSAL MEETS THE COMMISSION'S STANDARD?**

15 A. Yes.

16 1. The transaction should not harm ratepayers by causing rates or risks to
17 increase, or by causing service quality and reliability to decline, compared
18 with what could reasonably be expected to have occurred in the absence of
19 the transaction.

20 Qwest has put forth compelling evidence that it requires a portion of the proceeds
21 from the sale to reduce its debt load and avoid bankruptcy.¹⁸ If Qwest goes into
22 bankruptcy, there is a high risk that all proceeds from a Dex sale would be used to
23 pay creditors and that nothing would be available for ratepayers.¹⁹ Given the

¹⁸ See Direct Testimony of Peter C. Cummings and Brian G. Johnson.

¹⁹ See Rebuttal Testimony of Ralph R. Mabey.

1 relatively high risk of bankruptcy in the absence of a sale, and the need of
2 proceeds from a sale to avoid bankruptcy, Qwest believes that its proposal clearly
3 meets the goals expressed in Principle No. 1.

- 4 2. The transaction, with conditions required for its approval, should strike a
5 balance among the interests of ratepayers, shareholders, and the broader
6 public that is fair and that preserves affordable, efficient, reliable, and
7 available service.

8 Qwest's revised proposal for gain disposition in this proceeding is to share a
9 sizeable portion of gain with ratepayers, such that they would receive the benefit
10 associated with the current imputation for 10 years after the sale is approved.
11 This proposal represents providing ratepayers with over 90% of the gain by
12 Qwest's calculations, over 65% of the gain by Public Counsel's calculations, and
13 over 58% by the Department of Defense's calculations. Such a proposal meets
14 the objectives of Principle No. 2 in that it allows Qwest to provide the ratepayer
15 benefit on an amortized basis, freeing up the immediate sale proceeds to reduce
16 debt. This balanced approach provides ratepayers protection from increased rates,
17 while Qwest is allowed to improve its financial condition. The broader public
18 also benefits because a financially healthy Qwest is able to continue to invest in
19 the State, provide high quality service to its customers, and meet its obligations,
20 including payroll and employee benefit expenses.

- 21 3. The transaction, with conditions required for its approval, should not
22 distort or impair the development of competitive markets where such
23 markets can effectively deliver affordable, efficient, reliable, and available
24 service.

25 Although Qwest's proposal extends the current benefit of imputation to ratepayers
26 for some time into the future (10 years), it is not an endless subsidy that has the
27 potential to distort or impair the development of competitive markets indefinitely.

1 Dr. William Taylor provides expert economic testimony that an on-going
2 contribution from Dex distorts both local advertising and telecommunications
3 markets. Consequently, Qwest "phased" proposal meets the objectives expressed
4 in Principle No. 3.

- 5 4. The jurisdictional effect of the transaction should be consistent with the
6 Commission's role and responsibility to protect the interests of
7 Washington gas and electricity ratepayers.

8 This principle has in the past only been articulated with respect to gas and electric
9 utilities. However, it is clear that a proposal that satisfies the first three principles,
10 as Qwest's does, also protects the interests of Washington ratepayers.

11 **VI. CONCLUSION**

12 **Q. PLEASE SUMMARIZE YOUR TESTIMONY.**

13 A. In this testimony I have adopted a significant portion of the direct testimony of
14 Theresa A. Jensen.²⁰ I have also outlined the issues raised by the opposing parties
15 in this matter that form the basis for Qwest's rebuttal testimony and provided a
16 summary of Qwest rebuttal witnesses that respond to these issues.

17 My testimony also addresses the standard that the Commission has previously
18 applied in evaluating transactions such as the Dex sale to determine if the sale is
19 in the public interest. I conclude that the standard applied by the Commission is
20 much broader than the principles applied by Staff in its cursory bankruptcy

²⁰ As stated above, Mr. Reynolds adopts the January 17, 2003 Direct Testimony of Ms. Jensen (Exhibit TAJ-1T), except page 1, page 17, line to page 19, line 7, and page 25, line 18 to page 33, line 10 as well as Confidential Exhibits TAJ-2C and TAJ-3C, all of which will be adopted by Ms. Koehler-Christensen.

1 analysis used to support its recommendation that the Commission not approve the
2 sale. Based on the Commission's broader standard, I believe the Commission
3 must conclude that Qwest's approach to gain disposition is more in line with
4 Commission precedent than Staff's recommendation. Based on Qwest's need to
5 use a portion of the proceeds from the sale to avoid bankruptcy, and based on the
6 sizable risk that the Dex business would be liquidated without oversight by the
7 Commission to pay creditors in a bankruptcy, the public interest is best served by
8 sharing the proceeds from the sale with the shareholder and ratepayers. As
9 recognized by the Commission in *Centralia Coal*, at paragraph 85, "... the
10 Commission, when determining the public interest, must look both at the
11 particular asset and also at the broader context in which the asset is being sold."

12 Finally, I have revised the gain disposition proposal contained in Ms. Jensen's
13 January 17, 2003 Direct Testimony that provides ratepayers the current value of
14 the existing imputation of \$103,370,843 until 2008. Under the revised proposal,
15 ratepayers would receive the current value of the exiting imputation of
16 \$103,370,843 as an adjustment to revenues for the regulated results of operations
17 for a period of 10 years after the sale is approved. Qwest is making this revision
18 in light of its settlements in Utah and Arizona, and to narrow the differences
19 between Qwest's and opposing parties' proposals.

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

21 A. Yes, it does.