between the ILEC and others. Where regulation seeks to promote competition for the benefit of all ratepayers, conceptions of the public's interest that solely turn on rates paid by remaining customers of the regulated ILEC are too narrow and fail to account for numerous factors in which the public has legitimate interests.[2]

Recommendations for either blocking the sale of Qwest Dex or constraining the sale by perpetual imputation of sale proceeds into the ILEC's rates imply sustained un-leveling of the competitive playing field and attendant adverse impacts on the public's interest in a competitive and dynamic telecommunications marketplace. Any continued imputation that reduces the regulated price of services and distorts competition in those services should be limited in time and established at the level necessary to effect reasonable sharing of the gain on the sale of Qwest Dex without unduly impeding competition from Competitive Local Exchange Carriers ("CLEC").

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE PROPER REGULATORY TREATMENT OF THE QWEST DEX SALE?

A. The assets that generate the value of Qwest Dex's business are "assets" that have not been included in ratebase.[3] The assets at issue are not of the kind on which the traditional regulatory bargain of cost-of-service regulation allows shareholders the protected opportunity to earn a return in exchange for caps on the prices realizable in the business. Thus, ratepayers have not borne the burden of Qwest Dex's productive assets, and sharing of gains should be designed to minimize the impact on the competitive process in

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[2] ***See, e.g.,*** *Application of Avista Corporation, et al., for Authority to Sell Its Interest in the Coal-Fired Centralia Power Plant*, WUTC Consolidated Docket Nos. UE-991255, UE-991262, UE-991409, Second Supplemental Order, Order Approving Sale with Conditions, at ¶ 29.

[3] For example, Dex's FAS 141 analysis for the eastern portion of the transaction shows that ****** ****************** a significant share of the value in the directory business is attributable to the relationships maintained by Dex with potential advertisers.*********************** Murray Devine & Company "FAS 141 Analysis of Dex Media East, Inc. as of November 8, 2002," a copy of which is provided with the Rebuttal Testimony of William E. Kennard ("Kennard") at Exhibit ___ WEK-3HC.

Without such incentives, market performance could be expected to suffer, costs to rise, and Qwest Dex's market-leading EBITDA margins to fall.

Thus, even under Staff's "go it alone" strategy for Washington, the WUTC's options in this instance do not appear to include the protection of the full amounts of imputation indefinitely into the future.

Q. DR. BLACKMON SUGGEST THAT THE WUTC COULD (OR SHOULD) ORDER QC TO ENTER INTO A DIRECTORY PUBLISHING AGREEMENT THAT WOULD "COMPENSATE QWEST CORPORATION FULLY FOR THE ECONOMIC VALUE OF THE DIRECTORY FRANCHISE."[24] IS THIS SOUND POLICY ADVICE?

A. No, I don't believe it is. In addition to the policy considerations I have already discussed, Dr. Blackmon's conclusion is inconsistent with the evidence on the value of the Washington directory "franchise." Dr. Blackmon's argument is based on the assumption that the value of the directory business is contained in the publishing agreement and the non-compete agreements.[25] This conclusion, however is not consistent with the analysis Dex commissioned to support its FAS 141 accounting obligations attendant to the purchase of the Dex Media East or "Dexter" transaction. As Mr. Kennard indicates, Dex retained Murray Devine & Co. to value the intangible assets purchased by Dex. Murray Devine & Co.'s valuation shows that the value of the non-competition and publishing agreements together is approximately *********************** $251 million – or approximately 9 percent of the $2.75 billion transaction value.[26] ***********
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[24] Blackmon at 23.

[25] *See also* Blackmon at 25, "it is the QC publishing and non-competition agreements that create the value in this transaction." Dr. Selwyn makes similar assertions. See Selwyn at 90-91.

[26] Kennard at 12; Murray Devine & Company "FAS 141 Analysis of Dex Media East, Inc. as of November 8, 2002" at Exhibit ___ WEK-3HC.

Thus, Dex's FAS 141 analysis shows that the agreements that are purported to contain the value of Qwest Dex's directory business by preserving the connection of the directories to the legacy LEC are not the actual source of business value Dex purchased. This analysis indicates that rather than being in a position to enter into a publishing and non-competition agreement that would fully protect the value of imputation as it would be calculated today, QC would not be expected to be able to enter into a publishing agreement that yielded value of more than approximately ************ *********** 9 percent of the updated imputation level. This 9 percent amounts to on the order of $9 to $14 million per year.********************** Even if such payments went on indefinitely, they would effectively never provide the value of the $103 million per year for 10 years that Qwest is proposing as gain sharing.

As noted, Staff's witnesses have asserted that much or all of the value in the Qwest Dex purchase is contained in the publishing agreement and non-competition agreement. However, these agreements are standard business arrangements and could be expected to be part of any such sale – whether the seller was a former regulated monopolist or not. To the extent these agreements sustain the connection between the directories in the future and the ILEC, their being part of the agreement and the value independent analysts have placed on them do not support the conclusion that retained connection to the formerly regulated ILEC is the source of value attendant to the sale of Qwest Dex. Rather, for almost 20 years, the directory business has had to contend with the business challenges of increasing competition, changing technology, and dynamic industry structures. Going-forward productive activities and value associated with such factors as advertiser identities and even the concept of "yellow pages" must per force be related to Qwest Dex's relative success in meeting these challenges up through 2002 (rather than to a legacy of monopoly regulation that Staff's witnesses appear to see as unending in the face of change).

********************** substantial value on other assets, such as "Customer Relationships."[36] **********************

In sum, it is clear that Dex's value is not derived entirely from Qwest Dex's regulatory legacy or its relationship with QC. Thus, Dr. Selwyn's recommendation that ratepayers are entitled to the entire Qwest Dex enterprise value is not supportable on its own terms. The QC proposal to share the proceeds of the sale between shareholders and ratepayers is appropriate.

Q. HAVE QC RATEPAYERS IN WASHINGTON BORNE A REGULATORY BURDEN AS A RESULT OF THE IMPUTATION PROCESS?

A. No. Imputation has operated only as a means for allocating revenues from the directory business to Washington ratepayers and to shareholders. The WUTC has not used the imputation process to set prices for yellow pages advertising. The imputation procedure has never presented a risk to ratepayers that their rates would increase to compensate QC for revenue shortfalls in the directory business. In the (albeit unlikely) event that yellow pages costs exceeded yellow pages revenues, it is highly unlikely that the WUTC would have raised rates for local exchange service in order to make QC shareholders whole. QC ratepayers have not borne any risk associated with the potential "stranded cost" of directory services.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes. Thank you.

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[36] Murray Devine & Company, "FAS 141 Analysis of Dex Media East, Inc. as of November 8, 2002" at Exhibit ___ WEK-3HC.