Exhibit ST-___ (GB-ST-__)
Docket No. UT-021120
Witness: Glenn Blackmon, Ph.D.

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	DOCKET NO. UT-021120

REDACTED SUPPLEMENTAL TESTIMONY OF

Glenn Blackmon, Ph.D.

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

May 21, 2003

Q. Please identify yourself.

A. I am Glenn Blackmon, Ph.D., assistant director for telecommunications, Washington Utilities and Transportation Commission. I previously testified in this proceeding in direct testimony pre-filed on March 18, 2003.

Q. What is the purpose of your supplemental direct testimony?

A. I am filing supplemental direct testimony in response to the Commission's request on May 19, 2003, to provide an explanation of Staff's position on the settlement that has been proposed by the other parties in this case. Staff is providing my testimony and that of Dr. Selwyn so that the Commission can understand our concerns with the proposed settlement and our opposition to that settlement.

Q. Please summarize the position of Staff on this settlement.

A. Staff believes the proposed settlement does not provide enough compensation to customers to offset the economic harm to customers that would result from the sale of the Qwest directory publishing business. The Commission should reject the sale rather than approve it on the terms agreed to by the other parties. If it decides to approve the sale, it should consider the conditions proposed by Staff rather than those proposed by the settlement parties.

Q. As a general matter, can you explain why Staff has not joined the other parties in supporting this settlement?

A. As the settlement parties have noted, Staff has participated in negotiations and made a significant effort to reach a settlement with the other parties. However, from the beginning of this proceeding, Staff's view of the issues has differed significantly from the other parties, including the parties that advocate for the interests of customers.

Q. Please explain how Staff's view has differed from The approach of the other parties.

A. The approach of the other parties has been to accept the sale itself as a *fait accompli* and to focus their attention on the distribution of the gain. This approach may come from an acceptance of the bankruptcy argument, which is the argument that in the absence of a sale all ratepayer interest in the directory publishing revenues would be destroyed through the bankruptcy process. It may also or instead have come from a perception that the prior cases specify that the Commission's role in a directory sale transaction is to distribute the gain but not to approve or disapprove the sale itself.

Staff, by contrast, has consistently evaluated all proposals in relation to the ongoing imputation benefits that customers could expect to realize in the absence of a sale. In doing that, we have closely examined Qwest's claim that without the Dex sale, bankruptcy is likely. As we have explained in our earlier testimony, we conclude that the risk of QC customers losing the directory publishing benefits through a bankruptcy have been greatly overstated by Qwest. This is due to the fundamental financial strength of QC and its crucial continuing role in directory publishing as demonstrated by the necessary long-term agreements. Qwest has overstated both the likelihood of a bankruptcy and the probable consequences to QC customers in a bankruptcy scenario.

Q. How does this affect Staff's analysis of the proposed settlement?

A. Because Staff has not accepted the inevitability of the bankruptcy scenario, Staff believes that the proposed settlement – as well as any other outcome in which the sale is approved – should be evaluated not just against the Washington gain amount but also against the future imputation amounts that customers would receive if the transaction were not completed. The proposed settlement comes much closer to matching the Washington gain amount than it does to matching the value of future imputation benefits, though it ultimately fails either test. The proposed settlement therefore fails the test of no harm to customers.

Q. You already have offered the Commission suggested conditions to apply if it decides to approve the Dex transaction. How does the settlement compare to those conditions?

A. If falls well short of the conditions that Staff has recommended as conditions of approval. The annual revenue credits start at a similar level to what Staff recommended, but the settlement level – perplexingly – decreases over time, while Staff's proposal would have the credit levels increase. Staff's proposal is based on the level of directory profits that Qwest and Dex management themselves project, so the proposed settlement would have customers receiving a decreasing share of the expanding directory benefits over time. After 15 years, the credits cease entirely even though QC would continue to be contractually bound not to publish a directory for 25 additional years. Staff's proposal matches the term of the customer benefits to the term of the contractual provisions in the transaction itself, while the settlement does not.

Q. Is the shorter term of the settlement offset by the one-time credit being provided under the settlement?

A. No. While the shorter term of the settlement might be reasonable if the absence of out-year benefits were offset by a larger up-front payment, the opposite occurs in the settlement. Where the Staff is recommending a one-time credit equal to 10% of the Washington share of the gain, or <<CONFIDENTIAL ___________, END CONFIDENTIAL>> the proposed settlement provides only $67 million.

Q. Is the settlement comparable to Staff's recommended conditions as to the form of the customer credits?

A. No. The settlement provides for annual revenue credits by Qwest Corporation but nothing from Qwest Communications International, Inc. Qwest Corporation is somehow expected to generate these credits even though it no longer would have any claim to the directory publishing profits. In other words, Qwest Corporation would be expected to ask for $103.4 million less than it really needs any time it files for a rate increase in this state. Dr. Selwyn's supplemental testimony discusses the long-term harm that this arrangement could produce. By contrast, the Staff recommendation provides for actual payments to QC by the corporate entity that is receiving the sale proceeds, QCII. These payments would be required by a binding contract between the corporate entities, and it could not be modified without Commission approval. The payments would be recorded as operating revenues on the books of QC, so the resulting profits would be real profits that would support continued investment in the telephone network of the state.

Q. Is the proposed settlement comparable to Staff's recommended conditions in terms of the structural protections for Qwest Corporation?

A. No. There is nothing in the proposed settlement to prevent this situation from occurring again in a few years. The Commission may well conclude that it is today faced with a real and credible bankruptcy threat brought on by the accounting irregularities and business decisions of the parent company's management. That conclusion could lead to the pragmatic decision by the Commission to let Qwest use the directory business to forestall bankruptcy. If Qwest is to be allowed to use the directory business in this way, then surely the company should be expected to revise its corporate structure to prevent a repeat occurrence. As I have already testified, Staff believes that the sale of Dex could increase the future risk of a Qwest bankruptcy, a point that Qwest disputes. If

Qwest really believes its contention that the Dex sale reduces the long-term risk of bankruptcy, then these structural safeguards should be of little concern to it.

Q. Is the proposed settlement comparable to Staff's recommended conditions in terms of the Commission's continuing oversight of the directory publishing obligations of Qwest Corporation?

A. No. There is no provision comparable to Staff's recommendation that the Commission require that any changes to the publishing agreement and any other agreement involving QC be made only with the Commission's approval.

Q. Please assume, solely for the purposes of analysis, that without the Dex transaction Qwest will seek bankruptcy protection and QC customers will lose all directory imputation benefits. In that scenario, would the settlement amount be sufficient?

A. No. In that scenario the settlement should be evaluated against the Washington gain amount, since there are no future imputation benefits to consider. That is an easier standard to meet, since the imputation benefits substantially exceed the gain amount. Nonetheless, the revenue credits plus the one-time credit in the proposed settlement are insufficient to return to customers even the gain amount. Moreover, if the Commission accepts the various arguments behind the bankruptcy theory, then the structure of the revenue credit approach is itself a significant problem. Dr. Selwyn discusses this point further. If the Commission believes this scenario is credible, it should increase the overall amount of the credits to equal the Washington gain amount and should require that Qwest distribute that amount to customers more directly and more promptly.

Q. Why, in this scenario, is it appropriate to give all of the gain to the customers, rather than sharing the gain between the company and the customers?

A. It is generally appropriate to use the gain on a sale to the benefit of the customers, and there is nothing about the circumstances of this transaction to support doing otherwise by allocating any part of the gain to the benefit of the company and its stockholders. Qwest certainly should not receive a portion of the gain as a reward for the management and strategy decisions that led it to the brink of bankruptcy.

Q. If customers are allocated the entire gain amount, does it follow that Qwest stockholders get no benefit from the Dex sale transaction?

A. No, that is not at all the case. Under the bankruptcy scenario, Qwest's stockholders actually are the biggest winners (with the possible exception of the buyers), even with the entire gain amount allocated to customers. In this scenario, the sale of the Dex business avoids the bankruptcy of Qwest and therefore avoids the total loss in value of Qwest stock. The aggregate value of Qwest stock is roughly $7 billion,[1] so avoiding bankruptcy provides a $7 billion economic benefit to Qwest stockholders. QC customers lose the even larger value of future imputation benefits. Balance and fairness dictate that the actual gain amount be allocated to QC customers in partial compensation for the loss of imputation benefits.

Q. In the bankruptcy scenario, what is the one-time credit amount that would be required to bring the settlement amount up to the amount of the Washington gain amount?

A. The $67 million one-time credit would have to be increased by <<BEGIN CONFIDENTIAL ________________________ END CONFIDENTIAL>>.

[1] This amount is the approximate aggregate value or "market capitalization" of all outstanding QCII stock at the current trading range of $4 to $4.50 per share. That it also is equal to the amount of the Dex transaction is apparently coincidental.

Q. Please explain why this amount is greater than the 10% credit that you proposed earlier.

A. The 10% credit was part of a schedule of customer benefits in which customers received directory publishing benefits for the entire life of the publishing and noncompetition agreements, rather than for 15 years as provided in the proposed settlement. With the shorter and smaller credits in the proposed settlement, a larger one-time credit is required even to meet the lower target of the Washington gain amount.

Q. Are there any other schedules of customer benefits that could provide customers with the full Washington gain amount?

A. Yes. There are many different combinations that can be constructed to produce the net present value equal to the Washington gain amount. For example, if the annual payments from QCII to QC were allowed to escalate over 15 years, rather than drop as the proposed settlement calls for, the 10% one-time credit that Staff initially proposed would be sufficient to return the Washington gain amount.

Q. The proposed settlement also includes provisions addressing government listings, contract rates for large business customers, operation of the low-

income telephone assistance program, and the customer service credit provisions in Qwest's tariff. Do these affect Staff's conclusions regarding the proposed settlement?

A. No. Staff does not necessarily oppose any of these provisions, but they are also unrelated to the subject at hand. They provide no material additional benefit in our analysis of the proposed settlement.