EXHIBIT MSR-3SRT

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

SUPPLEMENTAL REBUTTAL TESTIMONY

BY

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QWEST CORPORATION

NON-CONFIDENTIAL VERSION

MAY 27, 2003

Q. HAVE YOU PREVIOUSLY PROVIDED BIOGRAPHIC INFORMATION IN THIS DOCKET?

A. Yes. My rebuttal testimony provides my business address, current job responsibilities, employment background, and witness history in this state.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. The purpose of this testimony is to respond the revisions to the Direct Testimony of Glenn Blackmon as filed on May 14, 2003. Specifically, I will address Staff's apparent change in position as to what the Commission should do if it decides to approve the sale.

Q. WHY DO YOU THINK STAFF CHANGED ITS PROPOSAL REGARDING WHAT THE COMMISSION SHOULD DO IF IT DECIDES TO APPROVE THE SALE?

A. It appears that Staff realized that its prior proposal, which required the entire Washington portion of its phantom gain calculation to be paid via a one-time payment into a regulatory account, was the Hobson's choice that I depicted it as in my rebuttal testimony. That is, on the one hand, Staff had recommended that the Commission disapprove the sale, and on the other hand, Staff recommended that the Company be required to pay all the proceeds from Staff's phantom gain into a restricted regulatory account, effectively defeating the purpose of the sale in the first place. I surmise this because Staff now claims that its new recommendation ". . . permits QCII to use the proceeds of the sale transaction to reduce its debt, which is its stated reason for wishing to sell the directory business."[1] Obviously, Staff is trying to make its proposal appear to be more

[1] Direct Testimony of Glenn Blackmon, Revised May 14, 2003, p. 25, lines 9 to 11.

balanced and in line with the "no harm" standard the Commission has applied in utility asset sale cases.[2]

Q. HAS STAFF SUCCEEDED IN OFFERING A MORE BALANCED PROPOSAL IN ITS REVISED TESTIMONY?

A. Absolutely not. In fact, in many ways Staff's revised proposal is more of a Hobson's choice than its original proposal.

Q. WHY DO YOU SAY THAT?

A. Staff's revised proposal, instead of requiring a single up-front payment to a regulatory account, now amortizes the payments over the life of either the Publishing Agreement or the Non-Competition Agreement.[3] The revised proposal, however, appears to be based on the phantom gain calculation from Staff's Direct Testimony.[4] By this I mean that Staff once again rejects the <u>actual</u> sales price that Qwest will receive from consummation of the Dexter and Rodney agreements of approximately $7.05B in favor of a manufactured gain, calculated based on an estimated total company growth rate for Dex and the current value of the existing imputation.

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[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] Because these two Agreements differ in duration, it is unclear which Staff intends to be the term of its recommended stream of payments. Qwest has included information for both 40 years and 50 years in Confidential Exhibit MSR-4C, but has based its testimony on an assumption that the term will be 50 years (i.e., the longer of the two).

[4] *See* Confidential Exhibit LLS-24C. BEGIN QWEST CONFIDENTIAL *************************
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** END QWEST CONFIDENTIAL

Regardless of whether Staff proposes that the Company be required to pay proceeds in one up-front lump sum or over a period of time, the fact that this proposal adds additional liability,[5] over and above the actual sales price, makes the proposal totally and unequivocally unacceptable to the Company. This is for the simple reason that Qwest seeks to sell the Dex business in order to raise money to improve its financial condition and not create additional liability that would worsen its financial condition. Obviously, Staff's proposal is based on the premise that the current imputation has created a de facto perpetual imputation entitlement for ratepayers. Qwest disagrees with this premise and believes that it is inconsistent with the Supreme Court ruling and prior Commission decisions that address the final disposition of a sale of the directory advertising business. Specifically, the Supreme Court found:

> The Company has not been ordered to stay in the directory publishing business. The record shows the Company has always been free to sell the business for a fair value.[6]
>
> The Commission states in its Order that "neither never-ending imputation nor seizure of income is contemplated or attempted here. The profits of non-utility affiliates are not touched in any way. They are merely imputed to [U S WEST] as is permitted by law." AR at 1816. Similarly, as noted above, the Commission in its ruling regarding the transfer of the publishing rights explained that if the transfer were treated as a sale of the asset and a fair price paid, then imputation of revenue would cease.[7]
>
> U S WEST may petition the Commission for an end to imputation if and when it can show it has received fair value for the transfer of the asset.[8]

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[5] *See* Confidential Exhibit MSR-4C

[6] *U S WEST Communications, Inc. v. Washington Utilities and Transportation Commission*, 134 Wn. 2d 74, 98, 949 P.2d 1337 (1997).

[7] *Id*. at 101-102.

[8] *Id*. at 102.

Q. HOW DOES STAFF'S REVISED PROPOSAL COMPARE TO THE ACTUAL SALES PRICE?

A. Confidential Exhibit MSR-4C provides a simplistic financial analysis of Staff's revised proposal based on Dr. Blackmon's Confidential Exhibit (Exhibit GB-2C). The actual sales price, which does not appear to be in dispute, is $7.05B ("the realized price"). Staff contends that Washington pre-tax share of the gain from the sales price is BEGIN QWEST CONFIDENTIAL ******, END QWEST CONFIDENTIAL or BEGIN QWEST CONFIDENTIAL *******.[9] END QWEST CONFIDENTIAL Even though Qwest disagrees with these calculations,[10] they are based on the actual sales price and can be used for comparison purposes. What Confidential Exhibit MSR-4C reveals is that the net present value (NPV) of Staff's proposal far exceeds the Staff's calculation of the Washington share of the realized price using either Staff's 10% discount factor BEGIN QWEST CONFIDENTIAL (*******) END QWEST CONFIDENTIAL or Qwest's 8.145% discount factor BEGIN QWEST CONFIDENTIAL (********) END QWEST CONFIDENTIAL. What is even more alarming is that the sum of the nominal payments for the 50-year period recommended by Staff totals a whopping $10.73 Billion. This is $3.7 Billion more than the entire sales proceeds for all of Dex. This is why I say that Staff's revised proposal creates even more of a Hobson's choice than its previous proposal. No rational business would ever accept such a proposition.

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[9] *See* Confidential Exhibit GB-2C, page 2.

[10] *See* Rebuttal Testimony of Ann Koehler-Christensen, April 17, 2003.

Q. IS THERE ANY WAY TO COMPARE STAFF'S REVISED PROPOSAL TO THE STIPULATED SETTLEMENT BETWEEN QWEST AND THE OTHER PARTIES TO THIS PROCEEDING?

A. Yes. In his testimony in support of the Stipulation, Mr. Brosch filed Exhibit MLB-4C that provides comparable numbers for the Stipulated Settlement. Although Mr. Brosch did not run the numbers using a 10% discount factor, the comparable numbers using the 8.145% discount rates are as follows:

	Stipulation	Staff Revised
8.145% NPV	$928.5M	$2,021M
% of Sale Price[11]	81%	176%
Sum of Nominal Payments	$1.644B	$10.728B

As these numbers reveal, the Stipulation represents a fair and balanced settlement in relation to the realized price, whereas the Staff's revised proposal has no basis in reality.

Q. ARE THERE OTHER ASPECTS OF STAFF'S REVISED PROPOSAL WITH WHICH YOU DISAGREE?

A. Yes. The Stipulation offers a series of annual revenue credits that would operate similar to the existing imputation. The practical effect of the revenue credits, like imputation, is to effectively reduce the Company's revenue requirement, calculated in conjunction with an earnings review, which, in turn, results in lower rates than would otherwise occur if not for the credits. Staff's revised proposal,

[11] Washington share as depicted in Confidential Exhibit GB-2C. NOTE: Qwest does not agree with this calculation, but is using it merely for simplicity and illustration.

instead of annual revenue credits, would require a contract between QCII and QC in which QCII compensates QC each year based on the payments as shown in Confidential Exhibit MSR-4C. Qwest disagrees with the concept of actual payments between QCII and QC on the basis that it creates a constraint on cash, consequently defeating the purpose of the sale. Further, Staff's payment stream escalates for 50 years such that annual payments increase from $113.73M in year 1 to $338.17M in year 50. Once again, this is hardly beneficial to a company that is selling a business in order to improve its financial and liquidity condition. Finally, the revenue credits as proposed in the Stipulation most closely emulate the imputation that is in place today.

Q. COMPARED TO THE STIPULATION, DOESN'T THE TERM OF STAFF'S PAYMENT STREAM MORE CLOSELY ALIGN WITH THE TERMS OF PUBLISHING AND NONCOMPETE AGREEMENTS?

A. Not really. The Stipulation is based on the realized price for Dex, which includes the value of the 50-year publishing agreement and the 40-year non-compete agreement. The gain disposition provisions associated with the settlement (i.e., the up-front bill credit and the 15 years of revenue credits) actually return the 40 and 50 year term value of these agreements in a shorter time period to rate payers (i.e., 15 years).

Q. IS THERE ANY OTHER REASON WHY ANNUAL REVENUE CREDITS ARE PREFERRABLE TO CONRACT PAYMENTS?

A. Yes. Both Mr. Mabey and Dr. King testified that if bankruptcy were to occur after the completion of the Dex sale, annual revenue credits would better protect the ratepayers interest than actual contract payments. This testimony was based on the premise that a bankruptcy court would be less likely to disturb a Commission ratemaking-related provision, such as the application of revenue credits in the determination of revenue requirement, than a contract for actual payments between a parent in bankruptcy and one of its subsidiaries.

Q. DOES QWEST ALSO DISAGREE WITH STAFF'S PROPOSED ONE-TIME BILL CREDIT?

A. Qwest has agreed to a bill credit in the Stipulated Settlement. Qwest believes that level of the Stipulation bill credit is sufficient when coupled with the other provisions of the Stipulation. Also, as has been stated by numerous Qwest witnesses to this proceeding, the purpose of the sale is to improve Qwest's financial and liquidity condition and, consequently, Staff's level of bill credit is unacceptable to Qwest.

Q. WHAT ABOUT THE OTHER SAFEGUARDS STAFF RECOMMENDS THE COMMISSION IMPOSE REGADING A SPECIFIED DEBT-EQUITY LEVEL, DIVIDEND RESTRICTIONS, AND CASH LENDING/CREDIT RESTRICTIONS?

A. Most of these were included in Staff's previous proposal and so have already been responded to by Qwest in previous rounds of testimony. It does bear repeating that QC is a multi-state company that finances its operations on a total company basis. There are no Washington-specific bonds and no Washington-specific shares of stock. It is therefore not appropriate for Staff to attempt to extend Washington regulatory authority to company management of long-term financing and cash management on a 14-state basis.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.