

**BEFORE THE  
WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the )  
 )  
Merger of the Parent Corporations of ) Docket No.  

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 )  
Qwest Communications Corporation, )  
LCI International Telecom Corp., )  
USLD Communications, Inc., )  
Phoenix Network, Inc. )  
and U S WEST Communications, Inc. )

**DIRECT TESTIMONY OF**

**CARL INOUYE**

**Lead Director – Financial Advocacy**

**U S WEST COMMUNICATIONS, INC.**

**August 31, 1999**

1 **Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.**

2 My name is Carl Inouye and my business address is 1600 7<sup>th</sup> Avenue, Seattle, Washington,  
3 98191.

4  
5 **Q. PLEASE STATE YOUR POSITION AND RESPONSIBILITIES WITH**  
6 **U S WEST COMMUNICATIONS, INC. (“U S WEST”).**

7 A. I am employed by U S WEST as Lead Director-Financial Advocacy. In that capacity I  
8 am responsible for the presentation of financial matters before the state regulatory  
9 commissions that regulate U S WEST.

10

11 **Q. PLEASE DESCRIBE YOUR EDUCATION AND PROFESSIONAL**  
12 **EXPERIENCE.**

13 A. Exhibit CTI-1 attached to this testimony, describes my education and professional  
14 experience.

15

16 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

17 A. The purpose of my testimony is to explain the financial and accounting aspects of the  
18 Agreement and Plan of Merger (“Merger Agreement”) between U S WEST, Inc. and  
19 Qwest Communications International Inc. (“Qwest Inc.”) dated July 18, 1999. A copy of  
20 the Merger Agreement can be found as Exhibit C to the Joint Application.

21

22 **DESCRIPTION OF MERGER**

23

24 **Q. PLEASE DESCRIBE, IN GENERAL TERMS, THE PROPOSED MERGER**  
25 **BETWEEN U S WEST, INC. AND QWEST INC.**

26 A. On July 18, 1999 U S WEST, Inc. and Qwest Inc. announced that they had agreed

1 to merge, thereby bringing together approximately 64,000 employees serving  
2 more than 29 million customers. The merged company will be named “Qwest  
3 Communications International Inc.” The transaction will be treated as a purchase  
4 for accounting purposes and is structured to be tax-free to U S WEST, Inc.  
5 shareholders to the extent of the Qwest Inc. stock delivered in the transaction.  
6

7 **WHAT IS THE OVERALL RESULT OF THE MERGER AGREEMENT?**

8 A. The Merger Agreement provides that as promptly as possible after various  
9 requirements are satisfied, U S WEST, Inc. will merge with and into Qwest Inc.  
10 Qwest Inc. will be the surviving corporation and the separate corporate existence  
11 of U S WEST, Inc. will then cease. However, the subsidiaries of U S WEST, Inc.,  
12 such as U S WEST, will become subsidiaries of the new holding company. No  
13 changes in the names of the subsidiaries and no assignment of assets of those  
14 subsidiaries are contemplated at this juncture.  
15

16 **HOW WILL THIS RESULT BE ACCOMPLISHED?**

17 A. The merger is a stock-for-stock swap that qualifies as a tax-free reorganization  
18 under federal income tax law.<sup>1</sup> Specifically, Qwest Inc. will issue shares of its  
19 common stock having a value of \$69.00 for each share of U S WEST, Inc.  
20 common stock, subject to a “collar” on Qwest’s average stock price between  
21 \$28.26 and \$39.90 per share.  
22

23 **Q. PLEASE DESCRIBE THE STOCK-FOR-STOCK SWAP.**

24 A. Upon completion of the merger, holders of U S WEST, Inc. common stock will  
25 receive, for each U S WEST, Inc. share they own, shares of Qwest Inc. common

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<sup>1</sup> Merger Agreement, Section 6.16

1 stock in an amount equal to their U S WEST, Inc. shares multiplied by a  
2 "Conversion Ratio." The Conversion Ratio is determined by a formula that  
3 depends on the stock price of Qwest Inc. during the 30 days immediately  
4 preceding consummation of the merger and is subject to a cash election  
5 procedure.<sup>2</sup> Qwest Inc. shareholders will continue to own their existing shares  
6 after the merger.  
7

8 **Q. PLEASE DESCRIBE THE CASH ELECTION PROCEDURE.**

9 A. If the price of Qwest Inc. stock is below a \$38.70 per share, Qwest Inc. may give  
10 written notice to U S WEST, Inc. to elect (the "Qwest Cash Election") to pay a  
11 portion of the Merger Consideration in cash (in lieu of shares of Qwest Common  
12 Stock) subject to agreement by U S WEST, Inc. and Qwest Inc. as to the amount  
13 of cash. The amount of cash that holders of U S WEST, Inc. shares may receive  
14 under the Cash True-Up is determined by a formula that also depends on the stock  
15 price of U S WEST, Inc. and Qwest Inc. during the 30 days immediately  
16 preceding consummation of the merger.<sup>3</sup> The shares of Qwest Common Stock  
17 and any cash received pursuant to the Qwest Cash Election are referred to herein  
18 as the "Merger Consideration."  
19

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1 <sup>2</sup> Merger Agreement, Section 2.02.

1 <sup>3</sup> Merger Agreement, Section 2.09.

1       **Q.     DID U S WEST, INC. AND QWEST INC. SEEK INDEPENDENT THIRD PARTY**  
2       **EXPERT OPINIONS THAT THE MERGER CONSIDERATION IS FAIR?**

3       **A.     Yes. U S WEST, Inc. received the opinions of Merrill Lynch, Pierce, Fenner &**  
4       **Smith Incorporated ("Merrill Lynch"), and Lehman Brothers Inc. ("Lehman**  
5       **Brothers") to the effect that the Merger Consideration is fair from a financial point**

1 of view to the holders of U S WEST Common Stock.<sup>4</sup> Qwest Inc. received the  
2 opinion of Donaldson, Lufkin & Jenrette Securities Corporation that the Merger  
3 Consideration is fair from a financial point of view to the holders of Qwest  
4 Common Stock.<sup>5</sup>

5  
6 **ACCOUNTING AND INCOME TAXES**

7  
8 **HOW WILL U S WEST, INC. ACCOUNT FOR THE MERGER?**

9 A. U S WEST, Inc. and Qwest Inc. will account for the merger under the purchase method of  
10 accounting, with U S WEST, Inc. being the acquirer for accounting purposes. Under this method  
11 of accounting, the assets and liabilities of U S WEST, Inc. will be brought forward at their net  
12 book values, a new basis will be established for Qwest Inc.'s assets and liabilities, and any excess  
13 of the consideration over the fair value of Qwest Inc.'s assets and liabilities will be accounted for  
14 as goodwill. The revenues and expenses of U S WEST, Inc. and Qwest Inc. will be consolidated  
15 from the date of consummation of the merger. The pre-merger historical results of operations and  
16 financial condition of the merged company will represent those of U S WEST, Inc.<sup>6</sup>

17  
18 **HOW WILL THIS ACCOUNTING AFFECT THE BOOKS AND RECORDS OF**  
19 **USWC?**

20 A. The merger will have no effect on the books and records of U S WEST. Only the  
21 assets of Qwest Inc. will receive a new basis after the merger. The basis of  
22 U S WEST's assets will not be adjusted.

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1 <sup>4</sup> Merger Agreement, Section 4.15.

1 <sup>5</sup> Merger Agreement, Section 3.15.

1 <sup>6</sup> SEC Form S-4/A filed August 13, 1999 by Qwest Communications International, Inc., pp. I-24  
2 and II-8.

1

2 **Q. PLEASE EXPLAIN THE FEDERAL INCOME TAX CONSEQUENCES**  
3 **OF THE MERGER.**

4 The merger will be treated for federal income tax purposes as a reorganization within the  
5 meaning of Section 368(a) of the Internal Revenue Code. Consequently, there  
6 are no federal or state income tax consequences to U S WEST or U S WEST, Inc.  
7 from the merger. For federal income tax purposes, U S WEST, Inc. shareholders  
8 will not recognize any gain or loss on the shares of Qwest Inc. that they receive in  
9 exchange for their shares of U S WEST, Inc. To the extent U S WEST, Inc.  
10 shareholders receive cash under the Qwest Cash Election or instead of fractional  
11 shares of Qwest Inc. stock, they will be subject to income tax on that cash. Qwest  
12 Inc. shareholders will not recognize taxable gain or loss as a result of the merger.<sup>7</sup>

13

14 **FINANCIAL EFFECTS**

15

16 **Q. WHAT WILL BE THE FINANCIAL EFFECT ON U S WEST OF THE**  
17 **CLOSING OF THE MERGER?**

18 A. The closing itself will have no direct financial effect on U S WEST because the  
19 merger is a stock-for-stock swap of shares of U S WEST, Inc. for shares of Qwest  
20 Inc. There will be no direct financial impact on U S WEST regardless of whether  
21 Qwest Inc. makes the Qwest Cash Election described above.

22

23 **Q. WHO WILL BEAR THE DIRECT EXPENSES OF THE MERGER AND**  
24 **HOW WILL THEY BE TREATED FOR REGULATORY ACCOUNTING**  
25 **PURPOSES?**

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1 <sup>7</sup> Id., pp. I-21 and I-22.

1 A. All direct expenses incurred by Qwest Inc. and U S WEST, Inc. in connection  
2 with the merger and the transactions contemplated by the Merger Agreement will  
3 be paid by the party incurring such expenses, except that expenses incurred by  
4 Qwest Inc. and U S WEST, Inc. in connection with the printing of their joint  
5 proxy statement/prospectus and the filing of the registration statement will be  
6 shared equally by Qwest Inc. and U S WEST, Inc.<sup>8</sup>

7

8 U S WEST's portion of the direct expenses of the merger will be charged to non-  
9 operating (or so called "below-the-line") accounts that are ordinarily excluded  
10 from cost-of-service rate making.

11 **DID U S WEST, INC. AND GLOBAL CROSSINGS LTD. ("GLOBAL")**

12 **TERMINATE THEIR EARLIER AGREEMENT TO MERGE?**

13 A. Yes. U S WEST, Inc. and Global terminated their merger agreement to enable  
14 U S WEST, Inc. to enter into the merger agreement with Qwest Inc. In  
15 connection with the termination, U S WEST, Inc. paid Global \$140 million in  
16 cash and 2,231,076 shares of Global common stock, and Qwest Inc. loaned \$140  
17 million in cash to U S WEST, Inc. Also, Qwest Inc. entered into an agreement to  
18 buy \$140 million in services from Global.<sup>9</sup>

19

20 **Q. WHAT COSTS WILL U S WEST BEAR AS A RESULT OF THE**  
21 **TERMINATION OF THE GLOBAL MERGER?**

22 A. None of the costs paid to Global for termination of the Global merger agreement  
23 were or will be borne by U S WEST.

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1 <sup>8</sup> Id., pp. I-39.

1 <sup>9</sup> Id. at pp. I-4 and I-38



1 **PROJECTED FINANCIAL BENEFITS**

2  
3 **DO YOU EXPECT TO SEE IMMEDIATE RECOGNIZABLE FINANCIAL BENEFITS AS A RESULT**  
4 **OF THE MERGER?**

5 A. No. Any potential financial benefits are expected to start slowly and grow over the  
6 years. However, U S WEST, Inc.'s Board of Directors believe the merger will enable  
7 both companies to achieve their mutual goals more quickly than either company could  
8 have achieved them separately. They also believe the merger will be accretive to the  
9 merged company's earnings per share and cash flow per share beginning in the first  
10 year of combined operations.<sup>10</sup>

11  
12 **EARLY PRESS RELEASES SPOKE OF POTENTIAL FINANCIAL BENEFITS RESULTING FROM**  
13 **THE MERGER ONCE IT CLOSES. CAN YOU EXPLAIN?**

14 The projected potential financial benefits were those identified at the overall corporate level.  
15 They are discussed more fully in both the Form S-4 Registration Statement filed with  
16 the SEC by Qwest on August 13, 1999, at pp. II-16, as well as in the Schedule 14A –  
17 Proxy Statement filed with the SEC by U S WEST on August 16, 1999, at pp. II-16.

18  
19 **WILL THERE BE AN IMPACT ON RATES FOR REGULATED SERVICES IN**  
20 **WASHINGTON?**

21 A. No. Nothing in the Merger Agreement affects regulated rates.

22  
23 **Q. WILL ANY OF THE COSTS OF THE MERGER TRANSACTION**  
24 **REFLECTED IN U S WEST, INC.'S OR QWEST INC.'S BOOKS BE**  
25 **FLOWED THROUGH TO CUSTOMERS IN THE RATES U S WEST**

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1 <sup>10</sup> Id. at pp. I-16.





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2 SEC Form S-4/A can be accessed on the Internet at [www.freeedgar.com](http://www.freeedgar.com) by typing  
3 “Qwest” in the “Company Name” search box or “QWST” in the “Ticker Symbols”  
4 search box and then clicking on “VIEW FILINGS.” Qwest Inc.’s filings with the SEC  
5 are then shown and the “S-4/A Registration Statement” filed “8/11/99” can be selected  
6 and viewed.

7

8 **Q. WILL U S WEST CONTINUE TO PREPARE SEPARATE FINANCIAL**  
9 **REPORTS AFTER THE MERGER?**

10 A. Yes. U S WEST will continue to prepare and report separate financial results for both  
11 external financial reporting and regulatory reporting.

12

13 **Q. WILL THE MERGER AFFECT THE REPORTING OF FINANCIAL**  
14 **RESULTS TO THE COMMISSION BY USWC?**

15 A. No.

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

17 A. Yes.

18

**Carl Inouye**  
Witness Qualifications

Present Employment:

Lead Director – Financial Advocacy  
Responsible for regulatory matters of a financial nature in the states USWC operates

Academic Experience:

BA – University of Washington, Economics  
BS – University of Washington, Mechanical Engineering  
MA – University of Washington, Economics

Prior Work Experience:

1974-1977: Pacific Northwest Bell Telephone Company, Business Research Section; responsible for economic and econometric studies

1978-1981: AT&T; managed preparation of witnesses and their economic studies for the U.S. v. AT&T antitrust suit that led to the breakup of the Bell System, worked in areas of financial effects of divestiture on the Bell System, network planning and operations, demand and cost modeling, organization theory and design, and research and development.

1992-1987: U S WEST Communications; worked in various positions in finance and treasury involving long term debt financing, jurisdictional separations, acquisitions, financial planning

Testifying Experience:

Oregon:

UT 80: Alternative Form of Regulation  
UT 85: general rate case  
UM 295: research and development policy  
UP 96: sale of telephone exchanges to PTI  
UT 119: collocation tariff  
CP 1, 14, 15: entry of local exchange competitors  
UM 351: pricing and costing policy  
UT 125: general rate case

Utah:

91-049-13: deregulation of voice messaging  
92-049-05: general rate case  
94-049-08: general rate case  
95-049-05: general rate case  
97-049-08: general rate case  
92-999-04: adoption of SFAS 106  
93-049-22: adoption of SFAS 112  
94-049-02/03: sale of exchanges  
89-049-11/21: contribution expenses on remand  
88-049-18: tax reform act on remand  
93-999-01: competitive entry and regulatory reform

Washington

UT-961596: sale of Bellcore  
UT-970766: general rate case  
UT-980948: directory imputation

Idaho

USW-S-96-5: general rate case