

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

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In the Matter of the Petition of )  
QWEST CORPORATION for Declaratory )  
Ruling or, in the Alternative, for Approval of )  
the Sale of the Utah Assets of Qwest Dex, )  
Inc. )

DOCKET NO. 02-049-76  
REPORT AND ORDER

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ISSUED: March 11, 2003

SYNOPSIS

By this Order, the Public Service Commission of Utah approves the sale by Qwest Dex, Inc. (Dex), together with Qwest Communications International Inc. and Qwest Services Corporation, of the Utah assets and business of Dex to Dex Holdings, LLC, on the terms and conditions set forth in the Purchase Agreement dated August 19, 2002, and the terms and conditions of the Stipulation between Qwest Corporation (Qwest), the Division of Public Utilities and the Committee of Consumer Services dated February 26, 2003. Pursuant to the Stipulation, Qwest will provide a one-time credit to certain of its retail customers following closing of the sale in the total amount of \$22 million. In addition, the parties have agreed that Qwest's prices to its customers will not change as a result of the sale.

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APPEARANCES

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By The Commission:

### PROCEDURAL HISTORY

On August 30, 2002, Qwest Corporation (Qwest) commenced this docket by filing a petition with the Commission. The petition stated that Qwest's parent Qwest Services Corporation and its parent Qwest Communications International Inc. (QCI) and their subsidiary Qwest Dex, Inc. (Dex) had entered into two agreements on August 19, 2002, to sell Dex's directory publishing assets and operations to Dex Holdings, LLC (Buyer), a company formed and owned by The Carlyle Group and Welsh, Carson, Anderson & Stowe, private equity investment firms unrelated to Qwest. The two agreements, referred to as Dexter and Rodney, were described in the petition and attached as exhibits. The petition requested a declaratory ruling, pursuant to Utah Code Ann. § 63-46b-21 and Rule R746-101 of the Utah Administrative Code, that approval of the sale was not required. Alternatively, if the Commission determined that approval of the sale was needed, the petition requested that the Commission approve the sale of the Utah assets and business of Dex (Sale).

Qwest also filed a motion for entry of a protective order. The Commission issued a Protective Order on September 4, 2002 and an Erratum Protective Order on September 18, 2002.

An initial hearing was held on the petition pursuant to notice on September 26, 2002. In addition to Qwest, the Division of Public Utilities (Division), the Committee of Consumer Services (Committee), the Buyer, XO Utah, Inc. (XO), and representatives of Salt Lake Community Action Program (CAP) and Crossroads Urban Center (Crossroads) appeared. After hearing from the parties on the request for declaratory ruling, the Commission directed the parties to proceed with the matter as if approval were required, reserving the question of the declaratory ruling requested for later determination. Qwest agreed to extend the 60-day period for the declaratory ruling to facilitate this process. The Commission also set a procedural schedule in the case at that time which was memorialized in a Procedural Order issued October 8, 2002. Hearings were scheduled for February 27 and 28, 2003, with a public witness hearing at 4:30 p.m. on February 27, 2003.

Qwest filed the direct testimony of Laura L. Scholl, Brian G. Johnson and George A. Burnett on November 15, 2002. The Division filed the testimony of Ingo Henningsen, Krystal Fishlock and Joni Zenger, Ph.D., the Committee filed the testimony of Michael Brosch, and the Buyer filed the testimony of William E. Kennard on January 28, 2003. Qwest provided rebuttal testimony of Laura L. Scholl, Ann Koehler-Christensen, Philip E. Grate and Harry M. Shooshan III on February 17, 2003.

A technical conference was held on January 8, 2003, pursuant to the Procedural Order, for the purpose of determining whether any issues might be resolved by stipulation and to allow interested persons who had not yet moved to intervene an opportunity prior to the intervention deadline to review the status of the matter. The deadline for intervention set in the Procedural Order was January 9, 2003. XO petitioned to intervene on September 5, 2002. The Buyer petitioned to intervene on January 7, 2003, and CAP, Crossroads, and Utah Legislative Watch (ULW) petitioned to intervene following the technical conference on January 8, 2003.

On January 29, 2003, the Commission issued its order granting the petitions to intervene of CAP, Crossroads, ULW, the Buyer and XO. On February 21, 2003, the Commission issued an Amended Procedural Order, rescheduling the public witness hearing to 4:00 p.m. on February 27, 2003. Notice of this change was published in the Salt Lake Tribune and the Deseret News on February 25, 2003.

On February 26, 2003, Qwest, the Division and the Committee filed a Stipulation resolving their disputes on all issues in the case. A copy of the Stipulation is attached to and incorporated in this Order.

A hearing was held on February 27, 2003. All of the testimony previously filed by the parties was offered and admitted without objection. Counsel for Qwest proffered the Stipulation. In addition, Laura L. Scholl, Ingo Henningsen and Dan Gimble, representing the parties to the Stipulation, were sworn and presented testimony in support of the Stipulation. The Commission asked questions of the witnesses and counsel for the parties regarding the Stipulation. Counsel represented that XO did not oppose approval of the Stipulation. Counsel for the Buyer also stated that the Buyer supported approval of the Sale and the Stipulation. Representatives of CAP and Crossroads were present during the hearing, but did not offer testimony or argument. No representative of ULW was present during the hearing. In addition, the public witness hearing was convened at 4:00 p.m. on February 27, 2003. No person appeared at the hearing wishing to present testimony, sworn or unsworn.

### FACTS

The following facts are established by the record in this matter.

QCI, QSC and Dex agreed to sell the assets and business of Dex to Buyer for \$7.05 billion. The agreement was contained in two agreements and their various attachments, Dexter and Rodney. Under the Dexter Agreement, which closed on November 8, 2002, Dex's directory assets and operations in Colorado, Iowa, Minnesota, Nebraska, New Mexico, North Dakota, South Dakota and El Paso, Texas were sold to Buyer for \$2.75 billion. The closing of the Dexter Agreement has been transparent to Dex's customers and to the customers of Qwest and its competitors in those states. Under the Rodney Agreement, Dex's directory assets and operations in Arizona, Idaho, Montana, Oregon, Utah, Washington and Wyoming will be sold to Buyer for \$4.3 billion, as adjusted at closing. The Qwest parties and Buyer have also entered into a Publishing Agreement pursuant to which Buyer agrees to publish directories and distribute them free of charge to Qwest's customers and to otherwise fulfill Qwest's directory publishing and listing obligations for 40 years.

Following the filing of the petition, the parties engaged in extensive discovery of Qwest. The discovery responses to the Division and Committee were substantial and included detailed and highly sensitive information regarding Qwest's financial situation, Dex's business and the Sale. In addition to this formal discovery, a great deal of informal discovery took place between Division and Committee witnesses and Qwest witnesses both as part of settlement negotiations and outside of the negotiations.

Qwest's direct testimony explained QCI's financial situation, how that financial situation affected Qwest and why the Sale was necessary. It provided information about the sale transaction and explained how it had been structured in a manner that would allow Qwest to continue to fulfill all of its obligations related to publishing directories containing listings of its customers and those of its competitors and how the Buyer would continue to provide quality directories and directory advertising to the customers of Qwest and its competitors. The testimony acknowledged that Qwest's retail local telephone customers had an interest in the directory publishing business transferred by Qwest's predecessor, The Mountain States Telephone and Telegraph Company (Mountain Bell), to Dex's predecessor in 1984 at the time of divestiture and breakup of the Bell System in light of the decision of the Utah Supreme Court in *US West Communications v. Public Service Commission*, 2000 UT 1, 998 P2d 247 (2000). The testimony was that the interest of Qwest's customers in the directory publishing business was satisfied by the directory imputation embedded in Qwest's prices set by the Commission in its last general rate case, Docket No. 97-049-08, without the imposition of additional conditions relating to the gain realized on the Sale. In addition, the testimony provided a brief history of the directory publishing business in Utah, directory imputation and developments in directory publishing following the transfer of the business to Dex's predecessor on January 1, 1984.

Division and Committee testimony did not contest the need for the Sale or that Qwest's listing and publishing obligations would be satisfied by the agreements associated with the Sale. However, given their calculations of the gain on the Sale, their testimony contested Qwest's testimony that the interest of Qwest's customers in the directory publishing business would be satisfied by continued imputation. Division testimony was that in addition to continued directory imputation, the Sale should only be approved on condition that Qwest make a credit to customers in the

amount of \$46 million. Based on its calculation of the gain on the Sale, the Committee testimony was that the Sale should only be approved on condition that Qwest make a credit to customers of \$90.8 million. The Division and Committee testimony was that they would not object if a portion of the customer interest was satisfied through directed infrastructure investments by Qwest.

The Buyer's testimony provided information regarding the qualifications of the Buyer. It also supported the petition and provided assurance that the Buyer would continue to provide quality directories to the customers of Qwest and its competitors and that the Sale would be transparent to the customers of Dex, Qwest and Qwest's competitors. The Buyer's testimony was that the Buyer intended to retain the management and employees of Dex and would allow the operations to continue basically as they had in the past.

Qwest's rebuttal testimony presented Qwest's calculation of the gain on the Sale attributable to the directory publishing business transferred from Mountain Bell to Dex's predecessor in 1984. It also provided an analysis of an appropriate sharing of the benefit of the gain between customers and shareholders based on the history of directory publishing in Utah. Qwest's testimony was that the interest of customers was fully satisfied either by the present value of continued imputation or by the fact that the directory imputation was embedded in the final prices set by the Commission under cost of service regulation because the change in the manner of regulation of Qwest and the introduction of competition ended the relationship between Qwest's prices and its costs and revenues. In addition, Qwest's rebuttal testimony provided information regarding the prior practice of the Commission in treating the gain realized on various sales of utility assets.

Based on the parties' positions in the testimony, it is apparent that all parties that addressed these issues agreed on at least two fundamental points. First, the Sale was necessary to address issues related to Qwest's financial situation and should be approved. Second, based on the decision of the Utah Supreme Court in *US West Communications*, Qwest's customers had an interest in the directory publishing assets and operations that had been transferred from Mountain Bell to Dex's predecessor that needed to be addressed in this case.

The principal areas of dispute between the parties were (1) the portion of the gain on the Sale that was subject to the customer interest, (2) how the benefit of that portion of the gain should be shared between customers and shareholders, (3) whether that interest was satisfied by the directory imputation embedded in Qwest's prices set in its last general rate case and, (4) if not, whether any excess should be satisfied through credits to customers' telephone bills or through other mechanisms such as investments in infrastructure or regulatory accounting adjustments as had been done in prior gain on sale of utility asset cases before the Commission. These issues included questions regarding the impact of the end of rate of return regulation and introduction of competition on the appropriate treatment of the customer interest.

At about the time Qwest filed its direct testimony, the parties started settlement negotiations. These negotiations occurred over the course of the next three months with meetings held on a fairly regular basis. All interested parties, including parties that had not yet intervened, were allowed to participate in these discussions on condition that they sign Appendix A to the Protective Order and agree that the negotiations were confidential. In addition to representatives of Qwest, the Division and the Committee, representatives of the Buyer, CAP, Crossroads and ULW participated in these negotiations. The negotiations were at arms length; each of the parties vigorously advocated its positions. The Committee's retained expert, Mr. Brosch, participated with other representatives of the Committee in the negotiations.

Following the filing of Qwest's rebuttal testimony, settlement discussions continued with the Division and Committee. As a result of those discussions, these parties were able to come to a settlement, which was memorialized in the Stipulation.

#### STIPULATION

The Stipulation involves compromises by each of the parties. For Qwest, the principal areas of compromise were in its positions that the customers' share of the interest in Dex was fully satisfied by the directory imputation embedded in Qwest's prices set in its last rate case and that if the Commission determined that any amount in excess of that benefit should be provided, it should not be provided in the form of customer credits. For the Division and Committee, the principal areas of compromise were with respect to the amount of credit that should be provided to customers based on the Sale.

A brief summary of the Stipulation is provided in this Order. This summary is not intended to modify the terms of the Stipulation.

Paragraph 1 of the Stipulation evidences the parties' agreement that the Sale, based on the terms of the Rodney Agreement pertaining to Utah and the terms of the Stipulation, is in the public interest.

Paragraph 2 is the agreement for Qwest to provide a one-time billing credit to its retail customers in the amount of \$22 million (Credit). The Credit is contingent on the closing of the Sale. The division of the Credit is set forth in Appendix 1 to the Stipulation. Generally, Appendix 1 provides that the Credit is to be made during a complete billing cycle commencing within 45 days following closing of the Sale to retail customers of record of the services to which the directory imputation has historically been applied based on the number of customer accounts for each of those services. The estimated credit per account is \$32.91. Because the number of accounts changes over time, the Stipulation provides that Qwest will update the number of accounts and the amount of credit per account with its best current estimate after the sale closes and just before the Credit is made. The parties have agreed that their intent is that Qwest will credit as close to \$22 million as is reasonably possible without exceeding that amount. Qwest will promptly pay any balance of the \$22 million remaining after the Credit is made to the Universal Public Telecommunications Service Support Fund.

Paragraph 3 of the Stipulation is the parties' agreement that they will not seek adjustments to either the price cap index or Qwest's prices based on the Sale.

Paragraph 4 is Qwest's agreement that it will continue to include directory imputation at the level set by the Commission in Docket No. 97-049-08 in those reports and filings that require it so long as the Commission continues to require such reporting.

Paragraph 5 is the parties' agreement that the historic issue of the interest of customers of Qwest in the directory publishing business is fully satisfied by the terms and conditions of the Stipulation. There has been an ongoing dispute for almost 20 years over this issue. The Stipulation is intended to resolve that dispute.

Paragraphs 6 through 11 are customary legal provisions found in stipulations of this sort. Among other things, they acknowledge that the Stipulation is a compromise, that it is not binding on the parties in other proceedings, that it may not establish precedent, that it is an integrated whole and that the parties will support it before the Commission and on any petition for rehearing or appeal of any order approving it.

Five parties that intervened in this case are not parties to the Stipulation. None of them objected to Commission acceptance and approval of the Stipulation. In addition, Buyer supported approval of the Sale and Stipulation as in the public interest, and counsel for XO contacted the parties and authorized them to represent to the Commission that XO does not oppose adoption of the Stipulation by the Commission.

### DISCUSSION

Settlement of matters before the Commission is encouraged at any stage of proceedings. Utah Code Ann. § 54-7-1. *See also Utah Dept. of Admin. Services v. Public Service Commission*, 658 P.2d 601, 613-14 (Utah 1983). The Commission may approve a stipulation or settlement after considering the interests of the public and other affected persons if it finds the stipulation or settlement is in the public interest. *Id.* Parties to a proceeding not joining in a stipulation or settlement shall be entitled to oppose the agreement in a manner directed by the Commission. Utah Admin. Code R746-100-10(F) (4) & (5).

Accordingly, we must determine whether the Stipulation in this case is in the public interest. The fact that the Stipulation was reached after extensive proceedings, including discovery, filing of testimony and arms length negotiations between parties with deeply divided views on the issue of appropriate regulatory treatment of directory publishing, extending over several prior proceedings before the Commission, weighs heavily in our determination. The parties to the Stipulation represent the interests of Qwest, residential and small commercial customers of Qwest and the public interest generally. In addition, no intervenor or person interested in the proceeding objected to the Stipulation.

All parties to the Stipulation agree that the Sale is an important part of QCI's strategy to reduce debt and to address its liquidity issues. They also agree that maintaining the financial integrity of public utilities is one of the cornerstones of the public interest. Utah Code Ann. § 54-4a-6(4)(a). A healthy incumbent telephone corporation is able to invest in facilities necessary to provide high quality public telecommunications services to its customers and to introduce advanced services and technologies as well. *Id.* 54-8b-1.1.

The Stipulation ensures that the price index or indices applicable to Qwest's tariff services, the directory imputation and the prices Qwest charges its customers will not change based on the Sale. In addition, it provides a substantial additional benefit to Qwest's customers upon the closing of the Sale in the form of a significant one-time credit on their telephone bills. Because the Credit is one-time, concerns about the Credit adversely impacting the continued development of competition are minimized. XO intervened in this proceeding in part to protect this interest. The fact that XO is not opposed to adoption of the Stipulation is significant in this regard.

The provisions of the Publishing Agreement provide assurance that Qwest will continue to meet its directory publishing and listing obligations. The fact that Qwest retains the directory publishing and listing obligations is established by the Stipulation and by the testimony offered in the hearing. It has contracted with the Buyer to perform those obligations. If those obligations are not performed satisfactorily, the Publishing Agreement provides escalating options, including termination of the agreement with respect to directories for which the obligations are not met. Another of the reasons XO intervened in this proceeding was to assure that the Sale would not adversely impact Qwest's performance of its obligations to competitors with respect to directories and listings. Again, the fact that XO is not opposed to the Stipulation is a significant indication that this interest has been adequately protected. We also find it encouraging that the closing of the Dexter Agreement has been transparent to customers of Dex and to customers of Qwest and its competitors.

Finally, the Stipulation resolves a dispute regarding directory publishing that has manifested itself in many forms before the Commission over the past 19 years. It is in the public interest for the parties to resolve such disputes and devote their resources to other issues.

Based upon the foregoing, we find and conclude that the Sale in accordance with the terms of the Rodney Agreement as they pertain to Utah and the Stipulation is in the public interest and should be approved. Therefore, based upon the foregoing, and good cause appearing, the Commission makes the following order:

### ORDER

NOW, THEREFORE, IT IS HEREBY ORDERED, that:

1. The Stipulation is accepted and approved and is adopted as part of this Order.
2. The Sale in accordance with the terms and conditions of the Rodney Agreement pertaining to Utah and the Stipulation is approved.
3. During a complete billing cycle commencing not later than 45 days following the closing of the Sale (Billing Cycle), Qwest shall provide bill credits totaling \$22 million to customers of record during the Billing Cycle who subscribe to the services identified in Appendix 1, attached to the Stipulation and incorporated herein (Credits). The Credits shall be in the approximate amount identified in Appendix 1. Not later than 15 days prior to the start of the Billing Cycle, Qwest shall submit to the Commission, the Division and the Committee its best estimate of the amount of the actual Credits that will be provided, consistent with the principles of Appendix 1, during the Billing Cycle. The intention of this Order is that Qwest will provide Credits in an aggregate amount as close to, but not exceeding, \$22 million as is reasonably possible. Any residual amount resulting from implementation of the Credits will be promptly paid to the Utah Universal Public Telecommunications Service Support Fund (USF). The foregoing notwithstanding, Qwest shall provide the Credits and payment to the USF only in the event that it does, in fact, close the Sale. In the event any miscalculation, omission or other error occurs in granting the Credits to customers, Qwest shall correct such miscalculation, omission or error, in consultation with the Commission, Division and Committee, but otherwise shall have no liability of any kind whatsoever as a result.

4. No person shall initiate any request, based on the Sale, to make: (a) any adjustment, exogenous or otherwise, under the price cap index of Utah Code Ann. § 54-8b-2.4 or Utah Admin. Code R746-352, or any successor statute or rule, to change the directory revenue imputation embedded in rates, or (b) any adjustment of any of the prices Qwest charges customers for public telecommunications services.

5. To the extent required by law, including a Commission order, Qwest shall continue to include directory revenue imputation at the level 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.

6. Except as specifically provided in this Order, the Credits and continuation of imputation as provided in this Order constitute complete satisfaction of any and all interest of Qwest's customers in the directory publishing assets and operations of Qwest or Dex as recognized in *US West Communications v. Public Service Commission*, 2000 UT 1, 998 P.2d 247 (Utah 2000).

7. Nothing contained in this Order is intended to, or shall, require any change to Commission rules and regulations regarding the provision of a listing and a directory of listings to customers of Qwest.

8. Pursuant to Utah Code Ann. § 63-46b-13, an aggrieved party may file, within 20 days after the date of this Order, a written request for rehearing or reconsideration by the Commission. Pursuant to Utah Code Ann. § 54-7-15, failure to file such a request precludes judicial review of the Order. If the Commission fails to issue an order within 20 days after the filing of such a request, the request shall be deemed denied. Judicial review of this Order may be sought pursuant to the Utah Administrative Procedures Act (Utah Code Ann. §§ 63-46b-1 *et seq.*)

DATED at Salt Lake City, Utah this 11<sup>th</sup> day of March, 2003.

/s/ Stephen F. Mecham, Chairman

/s/ Constance B. White, Commissioner

/s/ Richard M. Campbell, Commissioner

Attest:

/s/ Julie Orchard,  
Commission Secretary

G#33029