BEFORE THE WASHINGTON TRANSPORTATION
AND UTILITIES COMMISSION

AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC., et al., Complainants, v. QWEST CORPORATION Respondent.	Docket No. UT-051682

DIRECT TESTIMONY OF

CLAY DEANHARDT

ON BEHALF OF
AT&T COMMUNICATIONS OF THE PACIFIC NORTHWEST, INC.
TCG SEATTLE, AND TCG OREGON

July 13, 2007

TABLE OF CONTENTS

Page

I. INTRODUCTION

Q. Please state your name, address and employer.

A. My name is Clay Deanhardt. My business address is 21-C Orinda Way, #374, Orinda, California, 94563. I am self-employed, and have been hired by AT&T Communications of the Pacific Northwest Inc., TCG Seattle and TCG Oregon (collectively "AT&T") to testify regarding my investigation into agreements that Qwest entered into with Eschelon Telecom, Inc. ("Eschelon") and McLeod USA ("McLeod") that provided for significant discounts on purchases of telecommunications products and services by those companies from Qwest.

Q. What is the purpose of your testimony?

A. In late 2000, Qwest entered into agreements with Eschelon and McLeod to provide them with discounts of up to 10% on every product and service purchased by those companies from Qwest between that point and the end of either 2003 (McLeod) or 2005 (Eschelon). In both cases Qwest deliberately concealed the agreements to prevent companies like AT&T from taking advantage of the same discounts. The primary purpose of my testimony is to: (a) describe these contracts and discounts, (b) explain how we came to discover that the agreements existed despite Qwest's ongoing efforts to conceal or deny them; and (c) describe the AT&T and TCG contracts with Qwest that entitled them to the same discounts as Eschelon and McLeod.

Q. What are your qualifications to provide this testimony?

A. In 2001 and 2002, I conducted the original investigation and analysis on behalf of the Minnesota Department of Commerce (the "Department") into the existence and terms of more than a dozen undisclosed, secret agreements between Qwest and several CLECs, including Eschelon and McLeod. Later the Arizona Residential Utility Consumer Office ("AZ RUCO") hired me to assist in their investigation of the same agreements.

In the course of those investigations, as detailed below, I reviewed thousands of pages of documents, drafted discovery questions for Qwest and read their responses, interviewed the people who negotiated the agreements, witnessed the depositions of Qwest and McLeod witnesses regarding the agreements and reviewed the transcripts of those depositions. I testified about my investigation and my findings before an ALJ in Minnesota Public Utilities Commission ("MPUC") Docket No. P-421/C-02-197 (the "197 Docket"), again in Docket No. P-421/CI-01-1371 (the "1371 Docket"), and before the Arizona Corporation Commission ("ACC") in Docket No. RT-00000F-02-0271. I also sat through every day of the hearings in the 197 Docket, read all of the testimony of witnesses for Qwest and the Department and attended the cross-examinations of those witnesses. Both the MPUC and the ACC agreed with my analyses and conclusions.

In addition, I have reviewed the AT&T and TCG interconnection agreements with Qwest in Washington.

Q. Are there other aspects of your background that are relevant to your testimony?

A. Yes. My resume is attached as Exhibit CD-2 to this testimony. I have been an attorney and a business person since graduating from law school in 1992. I have extensive experience negotiating telecommunications contracts, including interconnection agreements. I have been a business executive in a start up company and served both as members of and legal advisor to different boards of directors. Currently, I have my own solo law firm serving a variety of clients including technology companies for which I help draft and negotiate a variety of complex business agreements.

From January 1999 through September 2000 I was Senior Counsel for Covad Communications Company ("Covad") and responsible for Covad's legal relationship with Qwest (at the time, U S WEST). While at Covad, I led the operational and business team that determined, for the first time, how to implement DSL line sharing across telephone lines carrying Qwest voice services. As part of that work, I helped design the network architecture for line sharing over copper loops. I also helped design the processes that CLECs and ILECs use for ordering, provisioning and repairing line-shared lines.

After the completion of the line sharing trial ordered by the Minnesota, I also led a group of CLECs in negotiating the interim line-sharing agreement and the first ever line-sharing interconnection agreement in the telecommunications industry.

The negotiations for both the interim line-sharing agreement and the line-sharing interconnection agreement included the negotiation of pricing for unbundled network elements (UNEs), OSS enhancements and related services that were required for line sharing. As part of my preparation for those negotiations, I prepared (and helped others prepare) business case studies on the impact of line sharing on Covad's business and its ability to compete for residential broadband customers.

From September 2000 through July 2001, I served as COO, General Counsel and, eventually, President of Epidemic Networks, a start-up company designing communications and workflow software. In September, 2001, I created Deanhardt Consulting – a sole proprietorship – to offer consulting services for business plan reviews, telecommunications and regulatory issues. I subsequently assisted the Department in its investigation of Qwest related to Qwest's Section 271 application and Qwest's failure to file a number of interconnection agreements with the MPUC, giving testimony regarding the agreements, OSS checklist items, non-OSS checklist items and Section 271 public interest issues in the 197 Docket, the 1371 Docket and MPUC Docket Nos. P-421/CI-01-1370 and P-421/CI-01-1373. AZ RUCO subsequently asked me to assist in their investigation of interconnection agreements Qwest failed to file in Arizona, resulting in my testimony in Arizona Docket No. RT-00000F-02-0271

Through Deanhardt Consulting, I worked under contract to AT&T of California, prior to its merger with SBC, as a regulatory attorney responsible for cost dockets, UNE issues and interconnection arbitrations. I returned to Covad as an Assistant General Counsel in May, 2005 to integrate its litigation group with its business and regulatory units. Having accomplished that task, I left again to start my own practice in May, 2006. My current practice focuses primarily on general business and intellectual property law, including corporate formation, the drafting and negotiating of business agreements and IP licenses, alternative dispute resolution and other matters on an as-needed basis.

Q. What other involvement have you had with agreements between telecommunications companies?

A. As I already noted, I was responsible for Covad's interconnection relationship with Qwest. That work required me to be intimately familiar with our agreements with Qwest, interpret them, and enforce them. I also was charged with negotiating amendments with Qwest when necessary, and with knowing when such agreements were not necessary (generally because the matter was already addressed in our interconnection agreement).

In addition, I participated in interconnection negotiations with Southwestern Bell Corporation ("SBC") and interconnection arbitrations with Southwestern Bell Telephone ("SWBT") (in Texas and Kansas) and Ameritech (in Illinois). I also testified in Illinois' consideration of the SBC / Ameritech merger regarding SWBT's conduct in interconnection negotiations and Covad's interconnection arbitration with SWBT in Texas.

While working under contract for AT&T, I also advised the company on interconnection negotiations with SBC and prepared for interconnection arbitrations with SBC in Nevada and California.

Q. Can you please tell us about your investigation for the Minnesota Department of Commerce?

A. In the summer of 2001, the Department began an investigation into whether Qwest was providing adequate wholesale service in Minnesota. In November 2001, the Department asked me to assist in that investigation.

Among other things, the Department asked me to investigate whether Qwest had entered into agreements with Competitive Local Exchange Carriers ("CLECs") that should have been filed for approval by the Commission but were not. The Department also asked me to help it investigate Qwest's compliance with the checklist items set out in 47 U.S.C. §271(c)(2)(B).

At the beginning of my investigation, I reviewed more than 75 written agreements between Qwest and a variety of CLECs. These agreements had been produced by Qwest to the Department but had never been publicly disclosed or filed with the MPUC. Among those agreements was Qwest's written agreement to provide Eschelon with a 10% discount on all purchases made by Eschelon between October, 2000 and December 31, 2005.

I followed up my review of these agreements by helping the Department draft a series of discovery requests to Qwest regarding the various agreements. I then reviewed all of the documents and written responses provided by Qwest in response to those requests. I also conducted a series of interviews with CLEC witnesses, including those involved in the negotiation of the several undisclosed Eschelon agreements.

Based on my initial findings, the Department filed a complaint against Qwest for failing to file 11 written agreements with the MPUC. That complaint resulted in the 197 Docket.

After the hearing related to the initial 11 agreements concluded, the Department learned that Qwest might have entered into an oral agreement with McLeod to provide it with a discount similar to the one Qwest provided Eschelon. On behalf of the Department, I began a new investigation into those allegations.

This second investigation began with interviews of McLeod officers, employees and representatives who had knowledge of and confirmed the existence of the oral agreement. I continued the investigation by drafting new requests for the Department to provide to Qwest seeking the information necessary to determine whether the oral agreement identified by the McLeod witnesses did, in fact, exist. I then reviewed all of the written responses and documents provided by Qwest to the Department in response to those requests.

In addition, as noted above, I reviewed all of the written testimony and exhibits[1] submitted by Qwest in both phases of the hearings in the 197 Docket. I also sat through all of the hearings and cross-examinations of witnesses in that docket.

Q. What materials from your original investigation did you review again prior to filing this testimony?

A. I reviewed my Minnesota testimony in the 197 Docket and the 1371 Docket, including all of the exhibits attached to it. Those exhibits included Qwest discovery responses, documents provided by Qwest and McLeod, the transcript of the deposition of McLeod officer Blake Fisher, and the affidavits signed by Mr. Fisher and McLeod employee Lori Deutmeyer. I also reviewed the transcripts of the hearings in the 197 Docket and the transcript of the deposition of Audrey McKenney, a primary negotiator of

[1] Throughout my testimony, I refer to documents that I originally collected and reviewed for the Department in 2002. These documents were all included as exhibits to testimony I submitted in one or more MPUC dockets related to these agreements. In response to AT&T data request No. 29, Qwest agreed that AT&T could have access to these documents and treat them as if they had been produced by Qwest in this proceeding. It also is my understanding that these documents, many of which were originally designated as trade secret, have now been designated as public.

the agreements at issue. I also briefly scanned my Minnesota testimony in the other two dockets referenced above.

Q. Based on your investigations, what did you conclude that is relevant to this proceeding?

A. As discussed in more detail below, I concluded that Qwest entered into agreements to provide discounts of 10% to Eschelon and up to 10% to McLeod on all purchases made by those companies from Qwest over agreed-upon time frames, including purchases in Washington and even purchases outside of Qwest's ILEC territory. It may be more accurate to describe these agreements as rebate agreements, since the discount was provided via rebate payments to both carriers.

Qwest and Eschelon entered into a written agreement for the Eschelon discount and tried to conceal it with a sham consulting arrangement. The discount agreement between Qwest and McLeod was an oral agreement because Qwest refused requests by McLeod to put it in writing. In both cases, however, there are documents demonstrating that Qwest did, in fact, make the required rebate payments to each carrier and calculated the rebate amount by applying a 10% discount to all purchases made by those carriers from Qwest.

II. THE DISCOUNT AGREEMENTS

A. THE ESCHELON AGREEMENT

Q. Can you put the Eschelon agreement at issue here into its historical context?

A. Certainly. In the course of the Minnesota investigation, we found six agreements between Eschelon and Qwest that contained rates, terms or conditions that should have been made available to other CLECs. One of those agreements provided that Eschelon would receive a 10% discount on every purchase it made from Qwest so long as Eschelon met certain minimal purchase commitments from Qwest. In Minnesota, we referred to it as Eschelon Agreement IV because it was the fourth in the series of undisclosed agreements entered into between the two companies. That is the agreement at issue in this proceeding and is referred to in my testimony as the Eschelon Agreement. A copy of the Eschelon Agreement is attached as Exhibit CD-3 to my testimony.

Q. Have you read the Eschelon Agreement?

A. Yes. I read it many times during my initial investigation, again for the Arizona proceedings and again recently to refresh my recollection.

Q. Please describe the Eschelon Agreement.

A. The Eschelon Agreement is a written agreement entitled "Confidential Amendment to Confidential/Trade Secret Stipulation" and is dated November 15, 2000.

The agreement holds itself out as a settlement of disputes between Eschelon and Qwest regarding Eschelon's ability to provide services to its customers using UNE-P beginning in March, 2000. It is characterized as an amendment / addition to an agreement dated February 28, 2000 that was referred to in Minnesota as Eschelon Agreement I.

The Eschelon Agreement memorializes obligations of Eschelon and Qwest, including (a) that Eschelon purchase at least $15 million of telecommunications services and products from Qwest between October 1, 2000 and September 30, 2001; and (b) that Qwest make a $10 million payment to Eschelon by November 17, 2000.

Q. What does the Eschelon Agreement do that is pertinent here?

A. Under Paragraph 3 of the Eschelon Agreement, Qwest was required to pay Eschelon a 10% discount on all "aggregate billed charges for all purchases made by Eschelon from Qwest from November 15, 2000 through December 31, 2005" so long as Eschelon met its take or pay purchase commitments from an agreement attached to my testimony as Exhibit CD-4. In other words, Paragraph 3 created a concrete and specific legal obligation for Qwest to provide Eschelon with a 10% discount <u>on every purchase Eschelon made from Qwest between November 15, 2000 and December 31, 2005</u>. That discount applied to all purchases, including access charges, interconnection rates (including UNEs) and items Eschelon purchased from Qwest's tariffs.

Q. Paragraph 3 of the Eschelon Agreement purports to tie the 10% discount to a consulting arrangement with Eschelon. Did that change your opinion regarding the intent and effect of Paragraph 3?

A. Not in the slightest. My investigation determined that the consulting agreement was a sham agreement designed to help hide the 10% discount that Qwest had already agreed to provide Eschelon prior to Eschelon ever suggesting that it could provide consulting services to Qwest. I concluded, and the Minnesota ALJ, the MPUC and the ACC all agreed, that the entire "consulting" arrangement was a sham.

Q. Why do you suggest that the work Qwest claims Eschelon did under the agreement was not the legitimate *quid pro quo* for the 10% refund?

A. Several reasons. First, the fact that the consulting arrangement was intended to hide a straightforward discount is evidenced by Exhibit CD-5 to my testimony, a November 5, 2000 letter (sent by attached e-mail) from Richard Smith, President and COO of Eschelon, to Jim Gallegos, Judy Tinkham and Audrey McKenney at Qwest. According to numbered paragraph 1 in that letter, Qwest agreed on October 21, 2000 to provide Eschelon with a volume discount equal to 10% of its purchases from Qwest. Mr. Smith notes that the Qwest had not put the agreement in writing, and states in Paragraph 10 that he has an idea how to enter into the agreement with a "mechanism that makes it more difficult for any party to opt into our agreements." Qwest adopted Mr. Smith's idea when, ten days later, it entered into the Eschelon Agreement containing Qwest's agreement to give Eschelon a 10% refund on all of its purchases from Qwest in exchange for "consulting" services.

Second, the purported payment for these alleged consulting services had no rational relationship to the "consulting" services to be provided by Eschelon. Instead, the agreement tied Eschelon's "compensation" only to the dollar value of products and services that it purchased from Qwest.

In other words, if Eschelon performed 15 minutes of work from Qwest under the agreement, but purchased, say, $200,000,000 in services from Qwest, then Paragraph 3 required Qwest to pay Eschelon $20,000,000. On the other hand, if Eschelon did not meet the purchase commitment set out in Exhibit CD-4, then every penny of the discount would go back to Qwest even if Eschelon spent hundreds of hours providing "consulting services." That incongruity obviously demonstrates that the payments by Qwest to Eschelon had nothing to do with actual "consulting services."

Third, during the course of my investigation, the Department asked Qwest to produce all of its documents demonstrating the work done by Eschelon under the "consulting" agreement. I reviewed those documents in 2002 and again prior to submitting this testimony.[2] Based on that review, the "consulting" work allegedly performed by Eschelon was no different than the work other CLECs did all the time in order to get products and services provisioned better to them.[3] In fact, the work that Eschelon did with Qwest is almost identical to the work CLECs did to implement line sharing for the first time in Minnesota. I know this because I was the lead person from Covad performing that work. No company was paid for that work, nor would they have expected to be paid.

Finally, there was no evidence from the time period contemporaneous with the agreement or my investigation to suggest that Qwest ever really wanted or used the "consulting services" described in Paragraph 3. Qwest never produced any documents suggesting that it was in the market for such consulting services or that it had discussed the possibility of receiving such consulting services from any entity other than Eschelon. Moreover, Exhibits CD-6 and CD-7 to my testimony show that the list of purported

[2] Attached as Exhibit CD-74 to this testimony is the entire set of documents produced to the Department by Qwest as the sum total of the work performed by Eschelon for Qwest through 2001 purportedly for $2.5 million.

[3] My comments here are referring to the work that Qwest has claimed was the justification for the 10% discount – e.g. the work done on the DSL wholesale issues.

Eschelon "consulting" teams that Qwest provided to the Department in response to discovery requests was actually a list of teams intended to work on an entirely different issue – an implementation plan that was the subject of another Eschelon / Qwest agreement described in a letter dated November 15, 2000. (See Exhibit CD-8). In fact, the phrase "consulting teams" did not appear on the list for the first time until after the Department issued discovery requests to Qwest regarding the Eschelon Agreement on November 27, 2001.

Q. What else, if anything, led you to conclude that the "consulting agreement" was a sham?

A. In Minnesota, as discussed above, Qwest produced a list of the "consulting" teams purportedly established by Eschelon under the Eschelon Agreement.[4] I reviewed that list carefully, and based on my experience working with Qwest to design its line-sharing product, I can say that these teams were really focused on helping Qwest provide better service to Eschelon. Working with an ILEC to get your company better service was not a bad thing for Eschelon to do – quite the opposite – but it was not something a CLEC ever got paid to do.

After 1996, CLECs worked with Qwest every day, in face-to-face meetings, at change management meetings, and in regulatory forums to try to get Qwest systems and processes to work better. When I was at Covad, for example, we helped Qwest solve technical problems that were preventing Covad and other CLECs from being able to

[4] A true copy of Qwest's response to DOC 067 in MPUC Docket No. P421/DI-01-814 is included as part of Exhibit CD-9 to my testimony.

provision DSL under certain circumstances. Covad, not Qwest, funded the resources necessary to solve those problems.

CLECs did this work for free because the business of CLECs was, and is, serving end-users -- not consulting for ILECs. In fact, when I was at Covad, we were begging for the type of access and input that Qwest claims to have paid Eschelon for under this agreement, and usually we could not get Qwest to take it for free.

Ultimately, a telecom company lives or dies based on its ability to provide services to its customers at a price that is higher than the cost to provide that service. If you are a CLEC, helping Qwest provide you with better service so that you can provide your customers with better service is just good for your business. It is not a consulting business.

Q. Did Qwest actually make any payments to Eschelon under Paragraph 3 of the Eschelon Agreement?

A. Yes. In its supplemental response to data request 67 made by the Department in Docket No. P421/DI-01-814, Qwest admitted that it refunded $2,540,017 to Eschelon for the time period between November 15, 2000 and August 31, 2001. A copy of Qwest's response is attached as Exhibit CD-9 to my testimony.

Q. What did the Minnesota and Arizona commissions determine about the "consulting agreement" in Paragraph 3 of the Eschelon Agreement?

A. In its 197 Docket, the MPUC affirmed the findings of its ALJ that Paragraph 3 of the Eschelon Agreement contained a discount agreement and not a consulting services contract. Specifically, the MPUC found that the alleged "consulting" agreement with

Eschelon was "a sham designed to conceal the discount that Qwest agreed to provide Eschelon." *In the matter of the Complaint of the Minnesota Department of Commerce Against Qwest Corporation Regarding Unfiled Agreements*, ALJ Findings of Fact, Conclusions, Recommendation and Memorandum, ¶ 126 (MPUC Sept. 20, 2002) ("*Minn. ALJ 197 Order*") (adopted by MPUC, *id*., Order Adopting ALJ's Report and Establishing a Comment Period Regarding Remedies, 2002 Minn. PUC LEXIS 90 (MPUC Nov. 1, 2002.

The Arizona Corporation Commission similarly found that the Eschelon Agreement was a discount agreement, finding "[t]he evidence shows that the [Qwest] agreements with Eschelon for consulting services and with McLeod for purchases which Qwest claims were not subject to Section 252 requirements, were shams designed to hide the true nature of the agreements. *In the matter of Qwest's Compliance with Section 252(e) of the Telecommunications Act of 1996*, Opinion and Order (Decision No. 66949), at 38 (Apr. 30, 2004).

B. THE MCLEOD AGREEMENT

Q. Please describe again how you conducted your investigation into the oral discount agreement between Qwest and McLeod.

A. After the Department learned that their might be an oral discount agreement between McLeod and Qwest, I drafted discovery requests that the Department sent to both Qwest and McLeod. Those requests included interrogatories, document requests, and requests that Qwest admit or deny certain facts related to the Department's allegations. I then reviewed all of Qwest's responses, including every document produced by Qwest to the Department. When appropriate, I drafted follow-up requests to clarify the facts or to collect new information based on Qwest's responses. I also interviewed witnesses from McLeod regarding the alleged agreement. In addition, I was present at the depositions of Qwest's Audrey McKenney, McLeod's Lori Deutmeyer and Blake Fisher, a retired senior executive from McLeod.

Q. Who did you interview?

A. On May 23, 2002 I interviewed David Conn, a lawyer from McLeod. Mr. Conn gave me an overview of the relationship between McLeod and Qwest and he confirmed that Qwest had agreed orally to provide McLeod with a volume discount on all purchases made by McLeod from Qwest. Mr. Conn, however, was not directly involved in negotiating the agreements.

Therefore, on June 3 and 4, 2002 I interviewed Stacey Stewart, Lori Deutmeyer, and Todd McNally, all of whom worked for McLeod. Mr. Stewart was involved in negotiating the many agreements that Qwest and McLeod entered into on October 26, 2000, including the discount agreement. He confirmed that the discount agreement existed. He also informed me that Blake Fisher was the lead negotiator for McLeod during the negotiations that resulted in the agreement.

Ms. Deutmeyer was the person at McLeod responsible for verifying that Qwest paid McLeod the full amount of the discount owed to it. She explained how the discount was calculated. At my request, she also provided the Department and me with documents reflecting those calculations.

I interviewed Mr. McNally because of his knowledge of issues related to aspects of the investigation I was conducting for the Department that were unrelated to the discount agreement. Mr. McNally had no information related to the discount agreement.

On June 6, 2002 I interviewed Blake Fisher, who had retired from McLeod in May 2002. Mr. Fisher confirmed that he was McLeod's lead negotiator with Qwest for the various agreements that the parties entered on October 26, 2000. He also confirmed that Qwest had agreed to provide McLeod with a discount based on the volume of purchases made by McLeod from Qwest.

Q. How did you follow up on those interviews?

A. To memorialize the witnesses' statements, I prepared draft affidavits for Ms. Deutmeyer and Mr. Fisher based on my interview notes. I provided those affidavits to McLeod's in-house counsel, and Ms. Deutmeyer and Mr. Fisher reviewed their respective affidavits for accuracy. Both made changes / edits to their affidavits and then executed them. Mr. Fisher's affidavit and its exhibits are attached as Exhibits 3 and 4 to the transcript of his deposition taken on June 27, 2002. A true copy of that transcript is attached to my testimony as Exhibit CD-10. A true copy of Ms. Deutmeyer's affidavit is attached as Exhibit CD-11 to my testimony.

Q. What conclusions, if any, did you reach based on your investigation?

A. I concluded that on or about October 26, 2000 Qwest and McLeod entered into an oral agreement whereby Qwest agreed to provide discounts to McLeod for all purchases made by McLeod from Qwest. The discount ranged from 6.5% to 10% depending on the volume of purchases made by McLeod from Qwest over the course of a year. The discount applied to all purchases McLeod made from Qwest, not just purchases of the wholesale services Qwest is required to provide under the Telecommunications Act of 1996 (the “Act”). So, for example, the discount applied both to McLeod’s purchase of unbundled network elements (“UNEs”) under the Act as well as to its payments for switched access, wholesale long distance and tariffed retail services (including private line transport services). The discount applied to all purchases made by McLeod both within Qwest’s 14-state ILEC territory and outside of that region. The discount was available to McLeod if it met minimum purchase volume commitments to Qwest.

Q. Upon what was your conclusion based?

A. My conclusion is based on my review of documents provided by Qwest and McLeod; their written responses to information requests from the Department; the interviews I conducted on behalf of the Department; the depositions of Ms. McKenney, Ms. Deutmeyer and Mr. Fisher; affidavits signed by Ms. Deutmeyer and Mr. Fisher recounting the details of the discount agreement, and my participation in the hearings regarding this agreement in Minnesota. My conclusion is also based on my own business experience, detailed above.

Q. Has your conclusion changed based on your subsequent experience or your most recent review of the material you collected during your investigation?

A. No.

Q. Is there a single document that explains the discount?

A. Yes. Exhibit CD-36 to my testimony, discussed in more detail below, defines the level of discount Qwest agreed to provide McLeod and the purchase requirements

McLeod had to meet to get those discounts. Exhibit 3 to the Affidavit of Blake Fisher, which is included as part of Exhibit CD-10 to my testimony, is substantively identical to Exhibit CD-36 and was confirmed by Mr. Fisher as containing the terms of the oral discount agreement.

Q. Please explain the context in which Qwest and McLeod entered into the discount agreement.

A. Based on my interviews and the documents produced by Qwest and McLeod, it became clear that two things happened in 2000 to precipitate this agreement.

The first was that it became certain that ILECs were required to provide CLECs with access to some UNEs, including local switching, in a combined form. One combination of UNEs which included the local loop and local switching was referred to as "UNE-P" or "UNE¬Platform."[5] Before UNE-P came along, McLeod's relationship with U S WEST / Qwest was primarily that of a reseller. That is, McLeod purchased services from U S WEST / Qwest and resold them to McLeod's customers. Most of the services resold by McLeod were CENTREX services. McLeod recognized, however, that it could reduce its costs (and thereby increase net revenues) by immediately converting its resold lines to UNE-P lines and later moving as much traffic as possible off of U S WEST's network altogether.

The second thing to happen was that Qwest purchased and merged with U S WEST, and the newly merged Qwest made overtures to McLeod that it wanted to

[5] In 2004, the FCC eliminated the obligation for ILECs to provide access to unbundled switching – and thus to UNE-P. But in 2000 the obligation was real, and ILECs and CLECs were still trying to figure out how to implement it.

establish a better business relationship with McLeod and treat it more like a customer than a competitor.[6] So McLeod and Qwest entered into negotiations in the late summer / early fall of 2000 to create a new business relationship that would be beneficial to both. The new Qwest, according to its representatives, wanted to keep and even increase McLeod's traffic on its network. McLeod, on the other hand, wanted to reduce costs and increase service quality.

The leading persons involved in these negotiations from Qwest were Greg Casey, Executive Vice President for Wholesale Markets at the time; Audrey McKenney, then Sr. Vice President of Wholesale Markets; and Arturro Ibarra, then Director of Business Development. (See Exhibit CD-10, Fisher Affidavit, ¶ 4).

From McLeod, the lead negotiators were Blake Fisher, then the Group Vice President and Chief Planning and Development Officer; Jim Balvanz, McLeod's Vice President of Finance at the time; and Stacey Stewart, then Vice President of ILEC Relations. (See Exhibit CD-10, Fisher Affidavit, ¶ 5).

The negotiations resulted in six written agreements that the parties entered into on October 26, 2000. The key component of those agreements was the creation of a new product called UNE Star (or UNE-M when purchased by McLeod). The UNE Star product was a flat-rated UNE platform product that, in essence, converted McLeod resold CENTREX lines directly to UNE-P. One of the six agreements McLeod and Qwest entered into on October 26 was the Eighth Amendment to their interconnection

[6] See Exhibit CD-73 to my testimony, which is a true copy of an e-mail produced by McLeod to the Department.

agreement, which publicly disclosed some of the terms and conditions for the UNE Star product.

Two of the other written agreements were the purchase agreements between McLeod and Qwest that I discuss in more detail later in my testimony. Another of the six agreements was the document identified as McLeod Agreement II in the Department's complaint in the 197 Docket in Minnesota. The final two agreements were billing settlement agreements that moved substantial sums of money back and forth between McLeod and Qwest.

In addition to the six written agreements, Qwest and McLeod also entered into two oral agreements. The first was the discount agreement at issue in this proceeding and was tied to McLeod's purchase agreement with Qwest. The second was McLeod's agreement not to participate in proceedings considering Qwest's Section 271 applications.

Q. What did Mr. Fisher explain to you about the discount agreement?

A. According to Mr. Fisher, McLeod approached U S WEST before its merger with Qwest about converting McLeod's resold lines to UNE-P. At that point, the parties began negotiations to create a new product that would leave McLeod's customers on the same physical telephone lines they already had but give McLeod the benefit of better pricing across U S WEST's region. The parties, however, did not agree on acceptable pricing before the merger.

Mr. Fisher explained that, once the merger happened, Qwest indicated that it wanted to improve its relationship with McLeod as a customer. McLeod and the new Qwest subsequently restarted their conversations about converting McLeod's resold CENTREX lines into UNE-Platform lines and, as I described earlier reached an agreement on implementation and pricing for a UNE-P product called UNE Star.

According to Mr. Fisher, however, McLeod was not satisfied that the pricing was low enough for McLeod to keep its traffic on Qwest's network (as compared to installing its own switches and going off-network). Qwest and McLeod therefore negotiated an additional discount agreement whereby McLeod committed to purchasing specified volumes of Qwest products under a take-or-pay agreement, and Qwest agreed to provide McLeod with discounts if McLeod exceeded its take-or-pay commitments. A true copy of the McLeod take-or-pay agreement is attached as Exhibit CD-12.

I documented everything Mr. Fisher told me in his affidavit, attached as part of Exhibit CD-10.

Q. What is a take-or-pay agreement?

A. It is an agreement that Company A (in this case, McLeod) will purchase a specified quantity of goods and/or services from Company B (in this case, Qwest) over a specified period of time. If Company A does not meet its purchase commitment, then Company A pays Company B the difference between the commitment amount and the amount actually purchased by Company A. Thus, Company A will either "take" the goods or "pay" the difference. Take-or-pay agreements are used by sellers to secure a revenue stream / commitment. Buyers typically enter into them because they are getting something in return – generally a discount as compared to purchasing the same amount of goods and services without the commitment.

Q. What were the terms of the discount agreement?

A. Qwest agreed to provide McLeod with discounts of either 6.5%, 8.0% or 10.0% on all purchases made by McLeod from Qwest. The amount of the discount was determined by the aggregate dollar amount of purchases made by McLeod from Qwest within a given year. The table below shows, generally, how the discount worked. All dollar amounts are in millions.

October 2000 through December 2001		2002		2003	
Aggregate Purchases	Percentage Discount	Aggregate Purchases	Percentage Discount	Aggregate Purchases	Percentage Discount
$178 – $188m	6.5%	$199 - $230m	8.0%	$199 - $250m	8.0%
$189 - $199m	8.0%				
>$199m	10.0%	>$230m	10.0%	> $250m	10.0%

Mr. Fisher attested to the parameters of the discount reflected in the table above in paragraph 19 of his affidavit. These terms are also found in the document attached as Exhibit 3 to his affidavit, which is part of the document attached as Exhibit CD-10 to this testimony. As Mr. Fisher explained, the discount applied to all telecommunications products and services purchased by McLeod from Qwest inside and outside of Qwest's 14-state ILEC territory. See Exhibit CD-10, 34:24 – 35:12; see also Exhibit 1 to the

Deutmeyer Affidavit (Exhibit CD-11) and Exhibits CD-13 through CD-17 (discussed in more detail below).

Q. Why was the discount agreement not in writing?

A**.** When I interviewed him, Mr. Fisher said that he had asked Greg Casey and Audrey McKenney from Qwest to put the discount agreement in writing, but they would not do so. Mr. Fisher confirmed this under oath in his deposition (Exhibit CD-10) at page 58 line 6 through page 59 line 9.

Q. Why would Ms. McKenney and Mr. Casey not put the agreement in writing?

A. According to Mr. Fisher, they were concerned that other CLECs might feel entitled to the same discount if the agreement were written and made public. Mr. Fisher also confirmed this in his deposition at page 59 lines 10 - 24.

Q. Did Qwest propose an alternative to putting the agreement in writing?

A. Yes. Mr. Fisher expressed concern over the enforceability of the oral agreement for the discount. Qwest suggested that it would enter into its own take-or-pay agreement to purchases products from McLeod. According to Mr. Fisher's affidavit, the amount of the Qwest take-or-pay commitment was calculated by applying the 8% discount factor contained in the oral agreement to a projected amount of purchases by McLeod from Qwest. A true copy of the Qwest take-or-pay agreement provided to the Department by Qwest is attached as Exhibit CD-18.

Q. After October 2000, did Qwest honor the oral discount agreement?

A. Yes, it did. As Ms. Deutmeyer's affidavit explains, Qwest made payments to McLeod for what Qwest called the "Preferred Vendor Plan" for October 2000 through

September 2001. According to Ms. Deutmeyer's affidavit, Qwest calculated the amount of the payment by applying the 10% discount factors to all purchases made by McLeod from Qwest during the relevant time period. One of the spreadsheets Qwest used to calculate the discount amount is attached as Exhibit 1 to Ms. Deutmeyer's affidavit. As Ms. Deutmeyer's affidavit indicates, Qwest created this spreadsheet. Qwest confirmed this in its 2002 response to Department data request DOC 209, which is attached as Exhibit CD-19 to my testimony.

I should also point out that there was another set of regular payments made by Qwest to McLeod in addition to those related to the discount agreement. These additional payments refunded to McLeod the difference between the amount it actually paid Qwest for UNE-Star and the amount it was supposed to pay under the Eighth Amendment to its interconnection agreement. These separate payments were necessary because Qwest's billing system was not able to bill McLeod the correct amount for UNE-Star. I refer to them in this testimony only because I will later distinguish the evidence of those payments from the evidence of the discount payments.

Q. Does the spreadsheet attached to Ms. Deutmeyer's affidavit contain any other information to indicate Qwest's understanding that it was providing McLeod with a discount?

A. Yes. The spreadsheet is in Excel format, which I am familiar with and have used on many occasions. The file name and the worksheet name are printed in the bottom right-hand corner of each printed page of the Exhibit. Here, the file name is "vendor credit Q2 (2).xls" and the worksheet page is titled "M01 10% refund." In addition, the heading on the "Resale" chart reads "M01 10% True-Up Calculation", and the first column on nearly every chart is titled either “10%” or “Sum of 10%.” Many other documents I reviewed demonstrated that “M01” was Qwest’s way of referring to McLeod.

Q. Did you confirm that the numbers on this spreadsheet were calculated by applying the 10% discount to McLeod’s purchases?

A. Yes. Qwest confirmed this in its responses to a series of requests for admissions I drafted for the Department in 2002. Qwest was asked to confirm that the numbers associated with Minnesota were calculated by applying the 10% factor to the amount Qwest billed McLeod for the product or service indicated on the spreadsheet during the month indicated on the spreadsheet. In each case, Qwest admitted that the number was calculated in the way I just described. Qwest’s responses to those requests for admissions, numbered DOC 257 – 292, are attached as Exhibit CD-20 to my testimony.

Q. Are there any other documents that confirm your conclusions and the statements in Ms. Deutmeyer’s affidavit regarding this spreadsheet?

A. Yes. Attached as Exhibit CD-13 to my testimony is a true copy of a spreadsheet titled McLeodUSA Monthly Summary that Qwest produced to the Department in response to DOC 210. That request asked Qwest to produce all of Anthony Washington’s files regarding McLeod. At the time, Mr. Washington worked for Ms. McKenney and was one of two persons that Ms. Deutmeyer dealt with primarily when obtaining McLeod’s discount payment from Qwest. In 2002, I compared each of the figures found in the “Current Charges” column of the spreadsheet to the amounts in the “Resale” chart on Exhibit 1 to Ms. Deutmeyer’s affidavit and found that the numbers in the “Resale” chart are 10% of the numbers in the "Current Charges" column for October 2000 through March 2001, rounded off to the nearest dollar.

Q. Did you find any other spreadsheets similar to the one attached to Ms. Deutmeyer's affidavit?

A. Yes. Attached as Exhibit CD-14 to my testimony is a true copy of the spreadsheet I found that calculates the discount for October 2000 through March 2001. Attached as Exhibit CD-15 is a true copy of the spreadsheet calculating the discount for April 2001 through June 2001. Attached as Exhibit CD-16 is a true copy of the spreadsheet calculating the discount for July 2001 through September 2001. Attached as Exhibit CD-17 is a true copy of the spreadsheet calculating the discount for October 2001 through December 2001. Qwest produced all of these documents to the Department in response to requests either for the specific spreadsheet or for Anthony Washington's or Arturro Ibarra's files related to McLeod. Mr. Ibarra also worked for Ms. McKenney and was Mr. Washington's direct supervisor.

Q. Were these files originally sent by Qwest to McLeod?

A. Yes. As Ms. Deutmeyer's affidavit indicates, Qwest sent these files to McLeod as part of the process of finalizing the discount payment to McLeod. In addition, I was able to tie Exhibits CD-15 through CD-17 to transmittal e-mails produced by Qwest that show those files being delivered to McLeod.

Q. Did Qwest pay the amounts indicated on these spreadsheets to McLeod?

A. It did for all the discounts due through September 2001. As Ms. Deutmeyer's affidavit indicates, she would compare the amount on the spreadsheet she received from

Qwest to her own calculation of the discount amount owed and, if the numbers were close, she would create and send an invoice to Qwest for the amount indicated on the spreadsheets. The invoices for October 2000 through March 2001, April 2001 through June 2001 and July 2001 through September 2001 are attached to her affidavit as Exhibit 2. Qwest paid each of these invoices as evidenced by the wire transfer confirmations attached as Exhibits 3 – 5 to Ms. Deutmeyer's affidavit.

Q. Did you uncover records from Qwest indicating that they made these payments?

A. Yes. Qwest admitted to making the wire transfers referred to by Ms. Deutmeyer's affidavit in its responses to Department data requests DOC 171, 173 and 175, all of which are attached as Exhibit CD-21 to my testimony. In addition, Attached as Exhibit CD-22 to my testimony are three Vendor Payment Authorizations used by Qwest to authorize the payments to McLeod in response to invoices sent by McLeod to Qwest. Qwest produced these documents to the Department in its supplemental response to Department data request DOC No. 2220 in MPUC Docket No. P-421/CI-01-1371. Ms. McKenney confirmed her signature on the first two documents in Exhibit CD-22 during her deposition on June 11, 2002.

Q. Is there anything else about these records about which the Court should take note?

A. Yes. In the "Business Purpose" section of the authorization for the $10.77 million payment for October 2000 through March 2001 – which was signed by Audrey McKenney – someone at Qwest wrote "Refund per Vendor Agreement." This was authorization serial no. 501126547.

Q. What about the discount payments after September 2001?

A. E-mails produced by Qwest show that Qwest provided McLeod with Exhibit CD-17 calculating the amount due for the fourth quarter of 2001 (that is, October through December 2001) in March 2002. As Ms. Deutmeyer's affidavit explains, her calculation of the amount due for that quarter differed from Qwest's. As a result, McLeod and Qwest exchanged several e-mails trying to reconcile the differences to come up with a final amount that was due. They were still working on that task when the Department began making inquiries about the discount agreement. Subsequently, at an April 30, 2002 meeting, Qwest put the payment of the fourth quarter discount on hold for what Mr. Ibarra referred to as "undisclosed reasons" in an e-mail attached as Exhibit 6 to Ms. Deutmeyer's affidavit (Exhibit CD-11).

I was unable to ever confirm what those "undisclosed reasons" were, although there are indications in notes that Qwest provided that Stephen Davis had become involved in handling this matter for Qwest.[7] At the time, Mr. Davis was Qwest's Senior Vice President of Public Policy and Law, which suggests that Qwest recognized in the beginning of 2002 that continued payment of the discount had become a regulatory concern. To my knowledge, Qwest never made another discount payment to McLeod after the Department began its investigation.

Q. What other evidence demonstrates that Qwest agreed to provide this discount to McLeod?

[7] See pages 13 and 14 of Exhibit CD-69 to this testimony.

A. There are three categories of documents that further evidence the discount agreement. The first category is documents showing how the agreement was negotiated. The second is documents from Qwest's files where Qwest refers to the discount. The third category is post-agreement documents from McLeod that refer to the discount.

Q. Please describe the documents from the negotiation of the agreement that show the existence of the discount.

A. These are the negotiation documents that I found, discussed in chronological order (to the extent possible): Exhibit CD-23 to my testimony is a set of documents created by Qwest that were stapled together when produced to the Department in 2002. The dated documents in the Exhibit show that they were created in the early stages of Qwest's discussions with McLeod in July and August 2000. Most of these documents show Qwest's consideration of the financial impacts to it of McLeod staying on a resale platform as compared to McLeod converting to UNE-P.

The 15th page in the Exhibit, dated August 28, 2000, compares the two options from what Qwest positions as McLeod's perspective. According to the banner, the document was created by or for "Worldwide Wholesale Markets" for Qwest. It is titled "McLeod Resale/UNE-P Pricing Proposal."

In this document, Option 1 for McLeod, the option to "Remain on Resale Platform", shows Qwest was already considering "Pricing points reductions to TOTAL RESALE Billing" of between 10% and 20%. It also notes that the reductions would only be implemented if McLeod hit revenue targets for the time periods reflected for each discount, and that "Price reductions to be flowed back to McLeod as wire-transfer or quarterly or semi-annual basis based on actual billing for prior period."

The discounts finally agreed to by Qwest ended up being substantially lower, but they also ended up applying to *all* products and services, not just resale. But the significant point is that these two concepts from this very early document were incorporated into the final agreement.

Exhibit CD-24 to my testimony is a true copy of a letter from Mr. Fisher to Mr. Casey dated August 15, 2000. In the "Overview of Proposed Deal Structure" in this letter, Mr. Fisher included the following bullet point: "Revenue commitment for a period of 24 or 36 months with percentage discount breaks above minimums."

Exhibit 2 to Mr. Fisher's affidavit (part of Exhibit CD-10 to my testimony) is a true copy of a September 19, 2000 term sheet that, according to Mr. Fisher, the parties created together. Attached as Exhibit CD-25 to my testimony is another copy of the same document that came from Ms. McKenney's files. Item number 6 reads: "Based on the proposed commitment by M, within 5 business days, Q will propose volume and term discounts based on quarterly revenue targets, to be paid back to M by Q on a quarterly basis."

Exhibit CD-26 to my testimony contains three different documents that Qwest created during the negotiations (and produced to the Department in 2002 stapled together). The first is a presentation titled "McLeodUSA Discussion 9/29/00" and says that it was prepared by Freddie Pennington at Qwest. On the second page of the document, titled "Overview," there is a bullet point for the McLeod UNE Platform that contains a sub-point for "Additional Resale Revenue discount" of 12% in year 1, 14% in year and 16% in year 3. Another sub-point is "Out of Region Revenue discount TBD." The fourth page of the presentation touts "deeper discounts for long-term relationship," and the fifth page shows financial calculations that included the proposed discount.

The second document in Exhibit CD-26 is an e-mail from Ms. Pennington to Ms. McKenney and Mr. Ibarra attaching a second presentation. This presentation is titled "McLeodUSA Meeting Discuss New Resale Pricing Plan" and subtitled "Resale Revenue Commitment Incentive Plan." The overview on page two begins with "Incentive discount plan for Resale finished services (1FR, 1FB, Centrex)" and goes into further detail on how the discount would work. The fifth page of the presentation also touts "deeper discounts for long-term relationship," while the sixth page contains financials that show a five-year commitment proposal with discounts to increase over every year as revenue increases for Qwest.

The final document in Exhibit CD-26 is another PowerPoint presentation attached to an e-mail sent to Ms. McKenney and Mr. Ibarra on September 18, 2000. This presentation contains a "Revenue Volume Term Commitment Unbundled Network Element Regional Year Plan." A handwritten note on the second copy of the presentation reads "Global Volume Discount" in what Qwest has admitted is Ms. McKenney's handwriting.[8]

[8] See Qwest's response to Department data request DOC 343, attached as Exhibit CD-27.

Attached as Exhibit CD-28 is a true copy of an e-mail that James Balvanz at McLeod sent to Audrey McKenney on October 18, 2000 with McLeod's proposal for the discount. The McLeod proposal was based on quarterly revenues and contained finer gradations of discounts ranging from 5% to 20%.

Exhibit CD-29 is a true copy of an October 20, 2000 e-mail from Mr. Ibarra at Qwest to Mr. Balvanz at McLeod attaching a file called "SummaryOfOffer 10_20_00.xls." The third page of the attached spreadsheet file is a worksheet titled "DiscountSmmryForM01" in the bottom right hand corner. The tables on that worksheet are labeled "McLeod Growth & Discount Scenarios" and show Qwest's proposals for discount levels based on revenue generated by McLeod for Qwest.

Later that day, Mr. Ibarra sent Mr. Balvanz a second e-mail attaching a revised version of the "SummaryOfOffer 10_20_00.xls" file. The subject of the e-mail was "Revised Summary." The e-mail says among other things "2. I added a not[e] on the "McLeod Growth & Discount" page to note that the discount will not exceed 10%." A true copy of the e-mail is attached as Exhibit CD-30. The hardcopy produced to the Department in 2002 did not contain the attached file.

Exhibit CD-31 to my testimony is what appears to be McLeod's counterproposal to the October 20, 2000 offer just described. Item number four says, "The discount schedule will be as previously offered by McLeodUSA except that it will be capped at 15%. In addition, the discount will begin 4th Quarter, 2000. It is our expectation that the discount schedule as well as certain other items will be reviewed on an annual basis."

Exhibit CD-32 to my testimony is another group of documents that were stapled together when Qwest produced them to the Department. Based on the dates that appear on most of the documents, they were created between October 17 and 20, 2000.

The first 17 pages of Exhibit CD-32 show different pricing scenarios Qwest considered for the UNE Star product. Pages 18 – 20, 22, 31, 33, 37, 39 and 40 show Qwest's consideration of different potential discount rates in various documents titled "McLeod Growth and Discount Scenarios." Pages 26 and 29 are copies of the "McLeod Growth and Discount Scenario" worksheet that contains the "Discount will not exceed 10% in any year" language referred to in Exhibit CD-30. The following legend appears in the bottom right-hand corner of pages 26 and 29: "SmmryOfOffer 10_20_00 DiscountSmmryForM01." Page 30 is another version of the same document, printed later in the day.

Page 38 of Exhibit CD-32 is another version of the "McLeod Growth and Discount Scenarios" document. This one, however, contains charts identified as the "gCasey Proposal." In my review of the documents and investigation into this matter, the only person to whom that reference could apply is Greg Casey.

The final document in Exhibit CD-32 is titled "McLeod Growth and Discount Scenarios – Saturday, 10/21/00, 12:10 p.m. Counter Proposal." It contains a three-tiered proposal with discounts running between 8% and 10%, although the breakpoints are not the same as in the final agreement between Qwest and McLeod.

Exhibit CD-33 to my testimony is another e-mail from Mr. Ibarra to Mr. Balvanz. This one is dated October 21, 2000 and contains the subject line “Qwest Counterproposal.” The counterproposal attached to the e-mail sets out a three-tiered range of discounts for McLeod based on the revenue it generates for Qwest.

Exhibit CD-34 to my testimony is yet another e-mail from Mr. Ibarra dated October 21, 2000. The subject of this one is “Counter Proposal.” The e-mail header shows it was sent at 12:38 p.m. to Mr. Fisher, Mr. Balvanz and Randy Rings, a McLeod attorney. It contains a two-tiered discount proposal that differs slightly from the one attached as Exhibit CD-33.

Exhibit 3 to Mr. Fisher’s affidavit is a true copy of an October 21, 2000 e-mail sent to him by Ms. McKenney with an attachment that laid out what became Qwest’s final discount counterproposal to McLeod. It contains a three-tier discount structure tied to the amount of revenue generated by McLeod for Qwest.

At roughly the same time Qwest and McLeod were trading the proposals and counterproposals described above, Qwest was working internally to determine what its counterproposals should be. Attached as Exhibit CD-35 to my testimony is a group of documents showing Qwest’s internal deliberations over the amount of the discount to provide McLeod. Qwest produced these documents stapled together. The first document in the exhibit is an e-mail showing that the documents following it are “the business case associated with the McLeod negotiations.” The e-mail is dated October 21, 2000.

The business case compares the results of various revenue projections under the "New UNE-P" (UNE-Star) against projections for McLeod purchases of regulated UNE-P products. The spreadsheets for "New UNE-P" show "Vendor Plan" as a COGS or "Cost of Goods Sold" for providing the new UNE-P to McLeod. The second and third spreadsheets show the amount of the Vendor Plan COGS equals 10% of the revenue for the year in which it appears, rounded to the nearest million. The Regulated UNE-P plan has no Vendor Plan COGS.

Q. Are you familiar with the acronym COGS?

A. Yes. I have a businessperson's understanding of financial statements and business case analyses. In addition, when I was working to start up Epidemic Networks I created the financial plan that was part of the business plan. Based on that experience, I understand that COGS means the cost of goods sold – the costs directly associated with producing goods for sale.

Q. What else did you find in Exhibit CD-35?

A. The seventh page of Exhibit CD-35 is a handwritten note from Audrey McKenney to Greg Casey. It appears to be the coversheet for a fax Ms. McKenney sent to Mr. Casey who, at the time, was her direct supervisor. Ms. McKenney wrote that "Attached is the proposed <u>internal</u> McLeod Summary that Arturro, Dan, Freddie & I put together. – I could not go to 12% for YR 2001 or any 4 Q'00 discount. (We'd end up with negative revenues year to year)." (Emphasis in document).

Another note from Ms. McKenney appears on the tenth page of Exhibit CD-35. Here, she again writes to Mr. Casey, "Pls call me on McLeod. Their "take or pay" level

& Discount plan were unacceptable to us. Attached is their proposal and our counter!" (Emphasis in document.)[9] The next document behind this note is a "Qwest Counterproposal" that proposes discounts for 2001 through 2003 that range from 6.5% to 10% depending on the revenue generated by McLeod for Qwest.

The next three documents in Exhibit CD-35 are worksheets from a file named "mcleodunedealsummary" that was printed on September 21, 2000. Page 3 of the file again shows the proposed discount schedule and, under the heading "Key Settlement Points", says "Structure: - Mutual "Take or Pay" correlated to growth - Required growth levels must be met before discounts apply."

The next document in Exhibit CD-35 is another copy of the "Qwest Counterproposal" that is attached as Exhibit 3 to Mr. Fisher's affidavit (Exhibit CD-10). Handwriting in the top right hand corner of the document that appears to be Ms. McKenney's says "final Saturday 2:47 p.m." This is the same document that Ms. McKenney sent to Mr. Fisher at 2:46 p.m. on October 21, as demonstrated by Exhibit 3 to Mr. Fisher's affidavit.

The next three pages of documents in Exhibit CD-35 are labeled "Resale/UNE Settlement Impacts Summary McLeod." The footer indicates that the file was created at 4:07 p.m. on October 21. These three pages analyze the impact of the overall deal agreed to by McLeod and Qwest, including the flat rate UNE-M pricing and the overall discount

[9] Qwest admitted in its responses to Department data requests DOC 338 and 340, attached as Exhibit CD-75, that the handwriting on the seventh and tenth pages of Exhibit CD-35 is Ms. McKenney's.

given by Qwest to McLeod. The third page addresses the "Mutual Preferred Vendor Plan" and shows the application of the discount to revenues generated by McLeod. Under "Structure" there is a bullet point for "Required growth levels must be met before discounts apply." In addition, a box in the financial calculations shows the final take-or-pay commitments that appear in the McLeod take-or-pay agreement (Exhibit CD-12), attributing them to "per Casey & Fisher."

Q. What other negotiation documents did you find that led you to conclude that Qwest agreed to provide McLeod with this discount?

A. Exhibit CD-36 to this testimony is an October 22, 2000 document titled "Qwest Counterproposal" that contains the tiered discount structure to which Qwest and McLeod finally agreed. I determined this by comparing it to paragraphs 19, 26-27 and Exhibit 3 to Mr. Fisher's affidavit (Exhibit CD-10) and the discount contained on several post-agreement documents I discuss later in my testimony.

Exhibit CD-37 is a set of undated, handwritten notes that appear from their content to have been written during the negotiation of the October agreements. The second page of the notes start with the underlined heading "Discount Structure." Number 2 under that heading says "All products contribute (Globals). $1m => 10% overall commitment By product mix." At the bottom of the page are notes for "Key points w/ Joe (1) Bus to Bus (anchor client) (2) Bus. Important to Q." Qwest admitted in response to Department requests DOC 332 and 334 that the handwriting on these notes is that of Ms. McKenney and that the "Joe" to whom they refer is Joe Nacchio, Qwest's CEO when the notes were taken. True copies of those responses are attached as Exhibit CD-38.

Finally, Exhibit CD-39 is a true copy of an undated e-mail and a document Qwest produced to the Department on July 23, 2002. The document appears to be an early draft of the various agreements that the parties entered into on October 26, 2000, all combined into one agreement by Randy Rings at McLeod. This document is fashioned as "Interconnection Agreement Amendment Terms" and contains at paragraph 1.3 – 1.3.5 the same business escalation procedures that appear in what was identified in the 197 Docket as McLeod Agreement II.

The following note appears at paragraph 1.8.2: "Jim – this is intended to address the price squeeze concern we have raised. Attachment 1.8.2 will be the rates and discount." Then, at paragraph 3.2, the following appears in reference to Qwest's commitment to supply McLeod with products: "I need help from some biz folks to do these attachments, but the concept is the same as suggested in your note. Consider whether the discount on the total can be in a side letter." Ultimately, the various agreements in this draft – including the discount agreement – were broken apart and entered into as separate agreements on October 26, 2000.

Q. Where were these negotiation documents located?

A. The two documents attached to Mr. Fisher's affidavit were produced to the Department by McLeod. Exhibit CD-39 came from Stephen Davis' files, according to Qwest. Otherwise, the documents all came from Ms. McKenney's files and were produced by Qwest in 2002 response to Department information request DOC 212 for Ms. McKenney's files related to McLeod.

Q. What did you conclude from reading these documents?

A. I have negotiated many different business and legal agreements, both inside and outside the telecom industry. The documents I reviewed are consistent with the kind of documents I would expect to find for any heavily negotiated agreement. Based on the documents I reviewed, I concluded that, between July and October 2000, Qwest and McLeod entered into substantial negotiations over the scope of a discount that would apply to all purchases made by McLeod from Qwest once McLeod reached negotiated minimum revenue commitments. These negotiations were part of those that resulted in the series of written agreements and the oral discount agreement that Qwest and McLeod entered into on October 26, 2000.

Q. What documents did you find from your second category – documents from Qwest's files created after the agreement that refer to the discount?

A. The first document is an October 31, 2000 document Qwest apparently created to internally explain the complete deal it had struck with McLeod. A true copy is attached as Exhibit CD-40 to my testimony. The document consists of six pages of spreadsheets. The first is titled "Resale/UNE Settlement Impacts Summary McLeod." It shows revenue projections based on whether McLeod hits "High" or "Low" revenue targets and shows the "Vendor Plan – High" as a COGS. The numbers in the "Vendor Plan – High" row are calculated by multiplying high revenues by 10% and rounding to the nearest million. The "Low" revenue projections do not have a "Vendor Plan" correlation because the numbers are too low for Qwest to apply the discount. This is consistent with the deal that Qwest and McLeod struck.

The "Mutual Preferred Vendor Plan" also appears on page 3 of the presentation. Except for the title, page 3 is the same document that Qwest originally called the "Qwest Counterproposal" on October 22, 2000. You can see this by comparing this document to Exhibit CD-36. Other pages in this set of spreadsheets also refer to amounts associated with the "Vendor Plan," which can always be calculated by multiplying revenues by 10%.

I also found a set of handwritten notes that is undated but appears from its content to have been taken in a meeting held shortly after Qwest agreed to provide the purchase volume discount to McLeod. The notes, attached as Exhibit CD-41 to my testimony, address the "Implementation Plan with McLeod."[10] The second page contains the following notations: "(5) Reconciliation process 10% vendor payment," and "Discount 10% off top." Qwest admitted in its response to DOC 345, attached as Exhibit CD-42 that Ms. McKenney wrote these notes.

In addition, two sets of Qwest accounting documents that show Qwest understood both the McLeod and Eschelon agreements to be discounts. Exhibit CD-43 is a true copy of a printout of a file named "UNE DEAL REFUNDS.xls." The ninth page of Exhibit CD-43 is an April 3, 2001 memo from Mr. Ibarra to Suzy Francis that reads "This is to reduce UNE-Star revenues for 10% discount that will be issued to Eschelon and McLeod should they meet they're [sic] revenue/volume commitments per the UNE-Star contract."

[10] Qwest and McLeod agreed in another undisclosed agreement, dated October 26, 2000 and referred to in the 197 Docket as McLeod Agreement II, to create an implementation plan.

That same note appears on a March 5, 2001 memo to Ms. Francis from Mr. Ibarra that is the 12th page of Exhibit CD-43.[11]

The same April and March memoranda are also part of Exhibit CD-44, which is a true copy of the printout of "UNE DEAL REFUNDS 2.xls." They appear as the 22nd and 25th pages of Exhibit CD-44 and differ only in that the dollar amounts missing from the April 3 printout in Exhibit CD-43 appear in the printout attached as Exhibit CD-44.

Another accounting spreadsheet produced by Qwest is attached as Exhibit CD-45. This sheet is undated, but appears to have been created in March 2001. The file name is "M01 UNE M details.xls." The following legend appears at the top of the spreadsheet: "THIS SHEET WAS USED TO CALC M01 10% DISCOUNT THROUGH MARCH." (Capitalization in original). As I previously noted, "M01" is McLeod.

Exhibit CD-46 to my testimony is a true copy of an e-mail sent internally within Qwest containing the agenda for a meeting between Qwest and McLeod scheduled to take place on May 1, 2001. A handwritten note attached to the agenda says, "We have an agreement that they get add'l 10% off of billing by Q." This document comes from Ms. McKenney's files, and Qwest admitted that the handwriting is hers in its response to Department data request DOC 336, attached as Exhibit CD-47.

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[11] As I discussed earlier in my testimony, Qwest also made payments to McLeod equal to the difference between the resale price McLeod paid for UNE-Star and the UNE-Star contract price. The documents in Exhibit CD-43 to which I refer in the text clearly do not relate to those true-up payments, however, because accruals for the true-up payments are addressed in separate memos included in Exhibit CD-43 that follow the ones to which I refer.

Exhibit CD-48 to my testimony is a May 25, 2001 e-mail from Stacey Stewart at McLeod to Ms. McKenney and others at Qwest. The e-mail contains an attachment of "the issue list we discussed yesterday." The third item on the issue list is the "Mutual Preferred Vendor Plan." Under the heading "Description," Mr. Stewart writes "As part of our UNE-M agreement, McLeodUSA is eligible for a customer specific quarterly override of 10% based on total expenditures with Qwest for the applicable quarter."

Attached as Exhibit CD-49 are several e-mails exchanged between Ms. Deutmeyer at McLeod and Mr. Washington at Qwest addressing when Qwest will make its Preferred Vendor Plan payment for the third quarter of 2001. These e-mails are significant because both Qwest and McLeod refer to the plan payments as a discount. Thus, in a November 27, 2001 e-mail, Ms. Deutmeyer writes to Mr. Washington "I figured out the $5.6 credit and you are right that was 2nd quarters preferred vendor discount. I am still researching the Sept. #'s. Do you know when you will have the 3rd quarter preferred vendor discount calculated?" Following up on November 30, Ms. Deutmeyer writes "Can you also tell me when you will have info pulled together for the preferred vendor discount?" Mr. Washington replies on December 3: "as for the vendor discount we want to get this done before the end of the month – we'll see."

I also found an e-mail exchange in which Mr. Fisher writes to Ms. McKenney that "Our people have not received information concerning the third quarter payment of the preferred vendor discount. Could you please check on the status?" Ms. McKenney responds on December 14, 2001 as follows: "will do – I am not sure if it got caught up in a new wire transfer process that Robin, our CFO implemented." A true copy of this e-mail exchange is attached as Exhibit CD-50.

The remaining documents in this category come primarily from two sets of related negotiations between Qwest and McLeod that took place in the spring and summer of 2001.

The first set of negotiations grew out of an e-mail exchange between Mr. Fisher and Mr. Casey on April 25, 2001. A true copy of those e-mails is attached as Exhibit CD-51 to my testimony. In his initial e-mail to Mr. Casey, Mr. Fisher proposes that a meeting be scheduled to outline a new deal. One of the points Mr. Fisher suggests for discussion in the new deal is to "Revisit our override discount."

Two of the issues that Mr. Fisher's e-mail also addressed were rates for DSL and Voice Messaging Services (VMS). On April 25, 2001, Freddie Pennington at Qwest sent Ms. McKenney an e-mail with a file named "VMS DSL Chronology.doc." A true copy of that e-mail and its attachment are attached as Exhibit CD-52 to my testimony. Under the date 2/16/2001, the chronology states: "Lowest rates available are … 1FB UNE-STAR (10% discount applied all states)."

The negotiations that began thereafter centered on a term sheet and other documents that McLeod sent to Qwest on May 21, 2001. A true copy of the e-mail and the proposal created by McLeod is attached as Exhibit CD-53. The "Proposed Term Sheet" contains item 3, which reads: "In recognition of the preceding, McLeodUSA will provide to Qwest an increased commitment off revenue and term which includes an additional discount tier." The next attachment to the e-mail is the proposed "additional discount tier" which shows a higher level of discount and an additional year being added to the agreement Qwest and McLeod struck in October. On that document, the Tier 1-3 rows for the 2001 – 2003 columns accurately reflect the discount deal Qwest and McLeod actually entered into in October.

Exhibit CD-54 to my testimony is a true copy of another copy of Exhibit CD-53, but without the transmittal e-mail. This exhibit, however, contains handwritten notes made by Audrey McKenney.[12] Beside item 3 on the Term Sheet, Ms. McKenney wrote "give a counter proposal." The second page of the exhibit is the new discount proposal by McLeod. Beside the Tier 3 row, Ms. McKenney wrote, "Today's contract" with arrows pointing to proposed Tier 4 that say, "New level given M&As." Again, the Tier 3 row to which Ms. McKenney refers accurately reflects the discount deal Qwest and McLeod actually entered into in October 2000.

Qwest and McLeod met to discuss McLeod's new proposal on May 31, 2001. Exhibit CD-56 is a June 2, 2001 e-mail that Stacey Stewart of McLeod sent to Ms. McKenney and Mr. Casey, among others, summarizing the discussions. Item on the initial e-mail is "Qwest to provide a response to McLeod's tiered discount sheet by 6/11."

Arturo Ibarra at Qwest responded to Mr. Stewart's e-mail on June 13. A true copy of the response is attached as Exhibit CD-57. In paragraph 9 of the e-mail, Mr. Ibarra responds to the tiered discount sheet by saying, "On the tiered discount (Item #3), based

[12] See Qwest's response to Department request DOC 349, attached as Exhibit CD-55.

on the documentation on our 10/22/00 weekend proposals we understood that both parties had agreed to negotiate final rates based on market conditions and for the integration of Split Rock and other acquisitions. If you would like a copy of this document, let me know and I will fax it to you." Mr. Ibarra goes on to discuss how Qwest was already accounting for companies merged into McLeod when it calculated the "Preferred Vendor Plan."

The document to which Mr. Ibarra refers to in Exhibit CD-57 is the October 22, 2000 Qwest Counter Proposal attached as Exhibit CD-36. Qwest confirmed this in its response to Department request DOC 320, which is attached as Exhibit CD-58.

The language from Exhibit CD-36 to which Mr. Ibarra refers in Exhibit CD-57 is located within the 3-Tier discount proposal that was accepted by McLeod. It says "The above level is an interim default level. Both Parties agree to negotiate final rates based on market conditions on an annual basis and for the integration of Split Rock / other acquisitions."

The second set of new negotiations related to McLeod's desire to reduce the price of ISDN/PRI lines it purchased from Qwest. Gary Dupler, at the time a Vice President of Network Planning at McLeod, and Jim Shearburn, a Vice President of Sales for Qwest's Central Region, are the two individuals who appear to have done most of the negotiating on this issue.

In the course of these negotiations, Qwest prepared a letter to Mr. Dupler setting out its proposed new ISDN/PRI pricing, which would reduce McLeod's cost to $667 per circuit resulting in approximately $1.27 million per month in savings to McLeod.

On June 11, 2001 Mr. Shearburn sent Ms. McKenney and several other people at Qwest an e-mail regarding the drafting of that letter. The e-mail asks "Has the 10% across the board discount been negated by the reference that no additional discounts apply? Are we still required to discount this price component by an additional 10% in a monthly rebate per the B2B deal?" A true copy of the e-mail is attached as Exhibit CD-59.

Later that same day, Mr. Shearburn sent the Qwest proposal to Mr. Dupler. A true copy of the transmittal e-mail, with the proposal letter, is attached as Exhibit CD-60 to my testimony. Page three of the proposal letter says the following under "Approved Rates": "4) Please note 'NO' Additional Reseller Discounts Apply to the $667 price. The rate for McLeod's ISDN/PRI services stated in this contract does not apply to any other discounts and specifically, that the 10% Business to Business reduction does not apply to the services addressed in this Contract."

The June 11 proposal letter subsequently went through further revisions at Qwest (even though it had already been sent to McLeod). On June 13, 2001, Mr. Shearburn sent an e-mail to Ms. McKenney stating "As to the discount issue. What is not clear to OMR or product is that this 10% across the board applies to all products. I asked that the 'carve out' language be inserted in order to set the expectation that this is the best and final price, candidly I do not think we need to go any lower, he is pretty happy with this, I think." A true copy of this e-mail is attached as Exhibit CD-61.

Then, on June 18, Mr. Shearburn writes in another e-mail addressing the ISDN/PRI proposal to McLeod: "Audrey needs to come up with alternate language dealing with the 10% B2B deal. We should not use the language we have in the 1 proposal, too specific. We either use the alternate language, or reprice all components at a rate 10% higher, and remove the paragraph entirely." A true copy of this e-mail is attached as Exhibit CD-62.

Q. What did you conclude from these documents?

A. Based on my experience conducting business negotiations in a variety of settings and working with Qwest / U S WEST when I was employed by Covad, these documents are consistent with negotiation, deal evaluation and daily business communications. These documents indicate that Qwest understood that it had agreed to give McLeod a 10% discount on all purchases and that Qwest considered how to account for that fact when negotiating new deals with McLeod.

I also noted that Qwest never responded to any of the communications from McLeod about the discount by stating that the discount did not exist. I would certainly expect to see that kind of disclaimer if Qwest had not agreed to the discount.

Q. Did Qwest and McLeod enter into any new agreements based on the follow on negotiations you just discussed?

A. Not any of which I am aware.

Q. Where did you find these documents?

A. Qwest produced Exhibit CD-40 in response to the Department's request for all of Arturro Ibarra's files related to McLeod. It produced Exhibits CD-43 and CD-44 in response to the Department's request for all of Anthony Washington's files related to McLeod. Qwest produced Exhibit CD-49 in response to Department request DOC 188, which asked Qwest to produce all e-mails exchanged between Anthony Washington and Lori Deutmeyer. It produced Exhibit CD-58 in response to Department request DOC 320. The remainder of these documents came from Ms. McKenney's files, and Qwest produced them in its response to Department request DOC 212, which asked for Ms. McKenney's files related to McLeod.

Q. Please describe the documents from your third category – those created by McLeod after Qwest agreed to provide it with the discount.

A. The first is the document that is Exhibit 4 to Mr. Fisher's affidavit (Exhibit CD-10). This is a printout of a March 1, 2001 e-mail from Mr. Dupler to Mr. Balvanz in McLeod. Mr. Dupler asks Mr. Balvanz a series of questions about the discount agreement after opening his e-mail by saying "As I understand it there is a 6-10% additional discount on the prices we pay for all qwest services." Mr. Fisher's affidavit confirms the accuracy of Mr. Balvanz's handwritten responses to Mr. Dupler's questions. Those responses include Mr. Balvanz setting out the conditions under which the discount applies. Those conditions are consistent with the October 22, 2000 "Qwest Counterproposal" that is attached as Exhibit CD-36.

The second document is a March 28, 2001 e-mail that Mr. Fisher sent to Stephen Gray, McLeod's President. Mr. Fisher's e-mail sets out "the beginning of a concept of a term sheet with Qwest on the next possible business deal." Item number six is "M gets revised discount plan (probably in a form of amended take or pay)." A true copy of this e-mail is attached as Exhibit CD-63.

Finally, the third document is a May 18, 2001 draft version of the term sheet that ultimately went to Qwest on May 21, 2001 (Exhibit CD-53). Item 11 states "In recognition of the proceeding, McLeodUSA will provide to Qwest an increased commitment in revenue and term." Handwritten notes on the side say "Extend one yr, 180 take or pay for 2% more discount." A true copy of this document is attached as Exhibit CD-64 to my testimony.

McLeod produced all three of these documents to the Department in its response to Department Information Request No. 1224 in 2002.

Q. What did you conclude from these documents?

A. Again, these are the kinds of documents created in the course of conducting business and preparing for business negotiations with a significant vendor. The documents show that McLeod was operating under the belief that it had a discount from Qwest on all of its purchases

Q. Has Qwest made any effort to try to explain this discount?

A. My understanding is that, to date, Qwest continues to claim that it did not enter into a discount agreement with McLeod — that its only agreements with McLeod are the written agreements, including the Qwest take-or-pay agreement.

Q. How does Qwest explain the Preferred Vendor Plan payments?

A. In 2002 responses to Department discovery requests on that question Qwest claimed that the three payments were for "a calculated shortfall in purchases made by Qwest from McLeod and associated with" Qwest's written take-or-pay agreement to purchase products and services from McLeod (Exhibit CD-18). Qwest's responses in this regard are attached as Exhibit CD-65 to my testimony.

Q. Is this explanation consistent with the results of your investigation?

A. No. To begin with, Mr. Fisher, Mr. Conn and Mr. Stewart all confirmed that the oral discount agreement existed. In addition, Ms. Deutmeyer confirmed that Qwest made payments under the oral agreement, the amounts of which were calculated by applying 10% to the amount billed by Qwest to McLeod.

Moreover, as discussed throughout most of my testimony, I found a large number of documents showing that both Qwest and McLeod understood that Qwest had agreed to provide McLeod with a purchase volume discount.

Just as importantly, Qwest has acknowledged in discovery responses that it made additional payments to McLeod during 2001 for the telecommunications services it actually purchased from McLeod. These payments were separate from those made by Qwest to McLeod under the Preferred Vendor Plan / discount agreement. Exhibit CD-66 to my testimony is a true copy of a spreadsheet created by Qwest showing payments of $5,504,690 made by Qwest to McLeod for usage and private line services in 2001. The spreadsheets behind the summary page show the dates and check numbers for the various checks sent by Qwest to McLeod for these purchases.[13] In its response to DOC 358

[13] On July 22, 2002 Qwest produced a supplemental response to DOC that included a spreadsheet in the same format as Exhibit CD-66 showing payments made by Qwest to McLeod for October through December 2000. A true copy of the document produced by Qwest is attached as Exhibit CD-67.

attached as Exhibit CD-68, Qwest admitted that the summary sheet at the beginning of Exhibit CD-66 shows payments actually made by Qwest to McLeod.

The purchases reflected on Exhibit CD-66 are the types of purchases that would be covered by the Qwest take-or-pay agreement attached as Exhibit CD-18. If Qwest's explanation for the Preferred Vendor Plan payments were correct, then I would have expected to see the payments Qwest made calculated by subtracting the total actually spent by Qwest from the amounts owed under the take-or-pay agreement. I did not see any documents reflecting that kind of calculation in any of the documents produced by Qwest to the Department in 2002.

To the contrary, the spreadsheets Qwest used to calculate the Preferred Vendor Plan payments (See Exhibits CD-14 through CD-17) show that the payments were actually calculated by applying a 10% factor to revenues generated in various categories including "Resale", "Collocation" and "Unbundled Loops." In 2002, Qwest did not purchase those kinds of services from McLeod, but McLeod did purchase those services from Qwest.

In fact, as I discussed previously, Qwest has admitted that the amount of the Preferred Vendor Plan payments were calculated by multiplying the amounts Qwest billed to McLeod by 10%. That calculation is consistent with the discount agreement confirmed by Mr. Fisher and described in the many documents I have discussed. It is completely inconsistent with the claim in Exhibit CD-65 that Qwest was calculating a shortfall in purchases it was supposed to make from McLeod.

Q. Are there any other documents that led you to conclude that Qwest's explanation is not accurate?

A. Yes. As I already discussed, Qwest created several business case documents that it used internally to evaluate various aspects of the McLeod deal as it negotiated with McLeod in the fall of 2000 (Exhibit CD- 35). In those documents, Qwest referred to the Vendor Plan as a COGS, or cost of providing goods to McLeod. The Vendor Plan COGS for each year substantially exceed the take or pay amount set out in Exhibit CD-18, the Qwest take-or-pay agreement. In 2001, for example, the written agreement called for a $15.84 million take or pay commitment by Qwest. The Vendor Payment COGS for the second and third spreadsheet for the same time period was $20 million. In 2002, the numbers were $18.32 million for the take-or-pay and $25 million for the spreadsheet COGS, and in 2003 the numbers were $19.92 million and $29 million, respectively. If Qwest were only obligated to meet its take-or-pay commitment, then the maximum it should have projected as a cost of providing goods to McLeod would have been the full value of the commitment for the given year.

Q. Did you find any documents supporting Qwest's explanation?

A. I found only three Qwest documents (out of approximately eight boxes of documents produced by Qwest) that were consistent with Qwest's explanation. Two of them, however, were created only after the Department began investigating the discount agreement. The third was created by a person not involved in the negotiations and reflects a lack of understanding about the deal. All three documents are attached as Exhibit CD-69 to my testimony.

The first document is an e-mail and spreadsheet sent by Mr. Ibarra to Anne Richardson and Ms. McKenney on May 31, 2002. The spreadsheet, titled “McLeod Vendor Plan Summary” seems to compare the sum of the Preferred Vendor Plan payments and Qwest’s actual purchases from McLeod to the amount that would have been due under the Qwest take-or-pay contract (Exhibit CD-18), finding an overpayment of $12 million.

The second document is a set of handwritten notes from the April 30, 2002 meeting between McLeod and Qwest. The seventh page of the notes contains the following “Will Q be making 4Q payment? In legal today. Will resolve in face-to-face mtg. $5m pymt in June 01 included 4Q2000 & s/n/h/been. Offset amount issue & substantially overpaid in error. McLeod booked this in 4Q. Randy had conversation with Steve Davis on this.”

The third document – and the only one created *before* the Department began its investigation into the McLeod discount agreement – is a January 16, 2002 e-mail from Steve Hansen at Qwest to Robin Szeglia, Qwest’s CFO at the time, attempting to explain the request for the $5.9 million Preferred Vendor Plan payment to McLeod. Mr. Hansen refers to the payment as “a result of a take or pay commitment.” Mr. Hansen, however, goes on to say that “We enlisted there [sic] support on regulatory, legal, 271 and other matters of consulting for a $48M take or payment commitment over the same period. … We have a similar deal with Eschelon.”

Q. Did you consider these documents before you reached the conclusions about which you have testified?

A. Yes, I did. They did not change those conclusions, though. Both Mr. Ibarra's spreadsheet and the April 30, 2002 meeting notes were created only after the Department had filed its complaint in the 197 Docket and propounded substantial discovery requests to McLeod and Qwest designed to determine whether they had a discount agreement. Thus they may have been created in response to the Department's ongoing investigation of Qwest's unfilled agreements. All the day-to-day business documents created before then, on the other hand, consistently reflect the companies' joint understanding that the discount agreement existed.

I similarly gave less consideration to Mr. Hansen's e-mail because it is factually inconsistent with Qwest's own description of its agreements with McLeod. Mr. Hansen, who was not involved in the negotiation or execution of the October 2000 agreements, describes the Preferred Vendor Plan payment as if Qwest had entered into the same "consulting" agreement with McLeod that Qwest claims it did with Eschelon. That is not correct, and Qwest never produced to the Department any agreement with McLeod that suggested there was a consulting arrangement similar to the one Qwest claims in Eschelon Agreement.

Q. Did you find any other documents suggesting Qwest's explanation may be correct?

A. The evening before Ms. Deutmeyer's deposition, McLeod produced a document, attached as Exhibit CD-70, entitled "Summary of Qwest agreement package." That document states that "Under a highly confidential agreement, we also received a revenue / purchase commitment from Qwest based on the following." The document goes on to lay out commitments that correspond with Exhibit CD-36, the Qwest Counterproposal of October 22, 2000.

Q. Did you consider this document before you reached the conclusions about which you testified here?

A. Yes. Again, however, it doesn't change my conclusions. Ms. Deutmeyer explained at her deposition that this document was given to her by Joe Terfler. It does not appear that Mr. Terfler was involved in the negotiation of the October 2000 agreements. Also, the "purchase commitment" described in the document is not consistent with the Qwest take-or-pay commitment set out in Exhibit CD-18, but it is consistent with the discount agreement set out in Exhibit CD-36.

Moreover, Qwest has asserted on numerous occasions that it has no oral agreements with McLeod, suggesting that Exhibit CD-70 is not referring to a modified oral version of Exhibit CD-18. It would also be an odd "purchase commitment" since Qwest's commitment to McLeod is potentially unlimited and fluctuates based on McLeod's expenditures with Qwest. An agreement of that type would not be good business practice for Qwest because it commits Qwest to purchases for which it has no forecasted need. Therefore, this document reinforces the conclusion (also supported by Mr. Fisher's deposition), that the take-or-pay commitment by Qwest was intended to mask the discount agreement.[14]

[14] I should also note that Qwest produced, on July 24, 2002, a new document it said came from Audrey McKenney's files that appears to be a draft agreement from October 23, 2000 – the day after Qwest and McLeod reached the discount agreement. A true copy of the document is attached as Exhibit CD-71. Attachment 3.2 to the document is a draft purchase commitment that mirrors the description in Exhibit CD-70. The parties never

Q. If Qwest's explanation of its payments is correct, would that change your conclusion that the Preferred Vendor Plan payments were actually discount payments?

A. Possibly, but not necessarily. The mere fact that Qwest made take-or-pay payments would not resolve the question of whether those payments were a disguised discount. Here, for example, we know that Qwest only spent $5.5 million with McLeod in 2001. Qwest's take-or-pay commitment, however, was $15.84 million – or almost three times Qwest's actual expenditures. Those numbers are too far apart to be simply a miscalculation by Qwest of its need to purchase products and services from McLeod.

Moreover, Qwest never provided the Department with any documents showing its projections of what it might buy from McLeod in response to the Department's requests for such documents. I would expect to see those kinds of projections from a company as a matter of course before it commits to a take-or-pay contract. Based on the lack of documents and the enormous real-life difference between Qwest's actual expenditures and the commitment amount, I would conclude (absent additional evidence) that Qwest's commitment was a sham intended to disguise a discount to McLeod.

In fact, Mr. Fisher confirmed in both my interview of him and his deposition that Qwest and McLeod created the take-or-pay commitment only to insure that McLeod would at least receive a portion of the discount agreed to by Qwest. See Exhibit CD-10, 34:17 – 39:5 and Fisher Affidavit, ¶¶ 21-23.

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entered into this written agreement, however, further suggesting that Mr. Terfler's description of the discount as a "purchase commitment" is not accurate.

Q. If the Qwest take-or-pay agreement was a legitimate agreement for Qwest to buy needed goods and services from McLeod , would that change your conclusion regarding the existence of the oral discount agreement?

A. No. There are simply too many documents created by both McLeod and Qwest referring to the discount for it not to exist. There is simply no way to explain all of these discount references absent a discount. Moreover, Qwest did actually purchase needed services from Qwest, as reflected on Exhibit CD-66. It simply paid for those services separately from the discount payments it made to McLeod.

Q. Assuming that you are correct about this agreement, why did Qwest give McLeod this discount?

A. The documents suggest two reasons. First, as Mr. Fisher explains, the new Qwest wanted to keep McLeod's traffic on Qwest's network, thereby insuring a revenue stream for assets that might otherwise go unused. Without the discount, McLeod would have proceeded with its plans to move as much traffic off of Qwest's network as possible as quickly as possible. Many of the documents discussed earlier in my testimony contain references to this reason.

Second, Qwest's acquiescence to the October 2000 agreements, including the discount agreement, was expressly contingent on McLeod's oral agreement not to oppose Qwest's Section 271 application. One of the most important things Qwest could do to improve and grow its business was to obtain the authority to provide interLATA services again in the areas where Qwest had to stop providing such services after the merger. The importance of McLeod's agreement on this point was noted in the September 19, 2000 term sheet attached as Exhibit 2 to Mr. Fisher's affidavit. The Section 271 agreement is also discussed in several other exhibits to my testimony, including the documents reflecting Qwest's internal consideration of the deal with McLeod.

C. OTHER FACTORS

Q. Did Qwest and Eschelon take any action with respect to the Eschelon Agreement in response to the Department's investigation?

A. Yes. On March 1, 2002 – just two weeks after the Department filed its complaint in the 197 Docket – Qwest and Eschelon entered into a "Settlement Agreement" terminating nearly all of the undisclosed agreements between them, including the take-or-pay agreement and the Eschelon Agreement containing the discount agreement. A copy of the agreement is attached as Exhibit CD-72.

In exchange for agreeing to terminate these agreements, Eschelon received a payment, in the form of a credit against amounts it owed Qwest, for $7,912,000.00. Given that Eschelon had only earned a $2.54 million discount on ten months of purchases between November 2000 and August 2001, this $7.9 million *immediate* payment seems like quite a benefit to Eschelon in exchange for foregoing future potential discounts.

Q. Did Qwest and McLeod also terminate the McLeod agreement before it expired on its own terms?

A. No. Even in its responses to AT&T's data requests in this docket, Qwest still denies that the McLeod discount agreement ever existed. It would be impossible for Qwest to terminate an agreement that it says never existed.

Q. Are there any other factors that this Commission should be aware of that led you to conclude that Qwest agreed to provide the discounts you described to both Eschelon and McLeod?

A. Yes. There are simply too many similarities between the structure and timing of the McLeod discount agreement and the Eschelon discount agreement for Qwest to deny the existence of either agreement. In sum, those similarities are:

- The McLeod discount agreement and the Eschelon discount agreement were negotiated and entered into by Qwest concurrently, in October, 2000. The McLeod oral discount agreement was reached the weekend of October 22, 2000, and the written agreements were signed on October 26, 2000. The Eschelon discount agreement was reached on October 21, 2000 and the documents reflecting it were signed on November 15, 2000.
- In both cases, the parties entered into a series of interrelated agreements, including take or pay agreements with purchase volume commitments.
- In both cases, one of the interrelated agreements was filed as an interconnection agreement amendment that gave the CLEC access to UNE-Star. The two UNE-Star amendments are substantially similar to each other in form and content.
- In both cases, one of the agreements extracted from the CLEC was an agreement not to participate in the consideration of Qwest's various Section 271 applications.
- The same person at Qwest – Audrey McKenney – was intricately involved in the negotiation of both the Eschelon agreement and the McLeod agreement.

- In both cases, Qwest has attempted to hide the discount behind a sham agreement to prevent other CLECs from taking advantage of it.

In short, there are simply too many similarities for this to constitute a mere coincidence in the real business world.

Q. What did the Minnesota and Arizona commissions conclude about the McLeod oral discount agreement?

A. In its 197 Docket, the MPUC affirmed the findings of its ALJ that the McLeod oral discount agreement existed and constituted an interconnection agreement. Specifically, the MPUC found that the McLeod Agreement existed and discounts were paid and that Qwest's testimony to the contrary was not credible. *Minn. ALJ 197 Order*, ¶¶ 320-21, 338. As noted above, the ACC similarly found that "[t]he evidence shows that the [Qwest] agreements with Eschelon for consulting services and with McLeod for purchases which Qwest claims were not subject to Section 252 requirements, were shams designed to hide the true nature of the agreements. *In the matter of Qwest's Compliance with Section 252(e) of the Telecommunications Act of 1996*, Opinion and Order (Decision No. 66949), at 38 (Apr. 30, 2004).

III. THE FAILURE TO DISCLOSE THE DISCOUNT AGREEMENTS

Q. Did Qwest have any obligation to file or otherwise make the terms and conditions of the Eschelon and McLeod discount agreements available to AT&T and other carriers?

A. Yes. When Qwest entered into and tried to conceal its agreements with Eschelon and McLeod, Qwest had a statutory obligation under 47 U.S.C. § 252(e) to disclose and file with the WUTC and other state commissions the terms and conditions of any agreement for interconnection or access to unbundled network elements, including specifically rates. Discounts, of course, are a part of calculating any final rate.

Q. What are the practical effects of Qwest concealing the discount agreements?

A. By concealing the discount agreements, Qwest prevented AT&T and other companies from taking advantage of the "most favored nations" clauses in its interconnection agreements with Qwest to obtain the same discount. Thus, the legal and contractual obligation to disclose the discount agreements had a practical business purpose as well.

As discussed below, AT&T had "most favored nations" (or MFN) clauses in its agreements with Qwest. These MFN clauses required Qwest to make available to AT&T the same terms and conditions that Qwest made available to other carriers. The only way to check Qwest's compliance with that provision is either by Qwest notifying AT&T of the agreements or, more commonly, through review of publicly disclosed agreements. By concealing the Eschelon and McLeod discount agreements, Qwest intentionally deprived AT&T of the ability to take advantage of the same discount.

Q. Should Qwest have filed the Eschelon and McLeod Agreements in Washington?

A. Yes. In fact, the Washington Commission already found that the Eschelon Agreement should have been filed with the Commission in Orders No. 12 and 21 in Docket No. UT-033011 (See Order 12, paragraphs 12 and 46; Order 21, paragraphs 29 and 101.) By this failure and the lack of any other notice to AT&T, Qwest prevented AT&T from obtaining the same discounts as Eschelon and McLeod.

IV. AT&T AND TCG INTERCONNECTION AGREEMENTS

Q. What are AT&T Communications of the Pacific Northwest, Inc. and TCG Seattle/TCG Oregon?

A. Washington state CLEC affiliates of AT&T, Inc.

Q. Do you know whether they had interconnection agreements with Qwest at the time Qwest entered into the Eschelon and McLeod deals?

A. Yes, they did.

Q. Have you reviewed these AT&T/TCG interconnection agreements?

A. I have reviewed the AT&T Communications, TCG Seattle, and TCG Oregon interconnection agreements with Qwest in Washington.

Q. Do the agreements contain "most favored nation" type clauses?

A. Yes. In the AT&T Communications agreement, the MFN clause is found in Section 2.1 of the main body of the agreement, which contains the "Terms and Conditions." A true copy of the Terms and Conditions section of the AT&T agreement is attached as Exhibit CD-76. Section 2.1 provides that:

> **Most Favored Nation Terms and Treatment**
>
> Until such time as there is a final court determination interpreting Section 252(i) of the Act, U S WEST shall make available to AT&T the terms and conditions of any other agreement for interconnection, unbundled Network Elements and resale services approved by the Commission under Section 252 of the Act, in that agreement's entirety. After there is a final court determination interpreting Section 252(i) of the Act, the Parties agree to revise this Section 2.1 to reflect such interpretation.

The TCG Seattle and TCG Oregon agreements contain identical MFN language that reads as follows:

MOST FAVORABLE TERMS AND TREATMENT

> The Parties agree that the provisions of Section 252(i) of TA 1996 shall apply, including state and federal interpretive regulations in effect from time to time.

The MFN is found in Section XXVIII of the TCG Seattle agreement and Section XVI of the TCG Oregon agreement. Relevant excerpts from the TCG Seattle agreement are attached as Exhibit CD-77. The TCG Oregon agreement excerpts are attached as Exhibit CD-78.

Q. What is the purpose of these clauses?

A. In general, MFN clauses guarantee one party (Party A) to an agreement that no other entity doing business with the second party (Party B) will get a better deal that the first party (Party A). If a third party (Party C) does get better terms, then the first party is allowed to also incorporate the better terms into its own agreement.

In this case, the purpose of the MFN clauses at issue was to permit AT&T to opt into agreements Qwest had with other carriers that might be beneficial to AT&T. Here, the MFN clauses would have allowed AT&T to opt into the Eschelon and McLeod discount agreements such that the AT&T affiliates could have received the same discounts. AT&T's other witness here indicates that AT&T would have taken advantage of those discounts, which is not surprising given the substantial amount of money that AT&T could have saved.

Q: Does this conclude your direct testimony?

A: Yes, it does.