EXHIBIT AKC-1RT

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Application of QWEST CORPORATION Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate	Docket No. UT-021120

REBUTTAL TESTIMONY

OF

ANN KOEHLER-CHRISTENSEN

QWEST CORPORATION

NON-CONFIDENTIAL VERSION

APRIL 17, 2003

TABLE OF CONTENTS

I. IDENTIFICATION OF WITNESS

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is Ann Koehler-Christensen and my business address is 1600 Bell Plaza, Room 3008, Seattle, Washington 98191. I am employed by Qwest Corporation ("QC") as a Regulatory Finance Analyst.

Q. PLEASE REVIEW YOUR PRESENT RESPONSIBILITIES, EDUCATION AND WORK EXPERIENCE.

A. As Regulatory Finance Analyst, I am responsible for preparing and presenting financial analyses on behalf of QC. I have been testifying on QC's affiliated interest relationship with Dex for the last fifteen years. My education, work experience and prior testimonies, including several before the Washington Utilities and Transportation Commission ("Commission"), are detailed in Exhibit AKC-2.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS PROCEEDING?

A. No.

II. PURPOSE AND SUMMARY OF TESTIMONY

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to properly identify the portion of the Dex sale that could accurately be considered a "regulatory asset" in Washington. Mr. Grate's rebuttal testimony discusses the unconventional way the parties are employing the term "regulatory asset" in this case. For purposes of my testimony, I will also adopt this unconventional usage of the term. I will clarify the difference between identifying the "regulatory asset" and allocating or sharing the gain from the sale between QC customers and shareowners. I correct several misrepresentations and incorrect assumptions of the Commission Staff ("Staff") Witness, Lee L. Selwyn, Attorney General ("ATG") witness, Michael Brosch, and Department of Defense ("DOD") witness, Charles King, with respect to the identification of the "regulatory asset." Based on these errors these witnesses improperly allocate more than 100 percent of the gain on the sale to Washington customers. I also adopt portions of Theresa A. Jensen's direct testimony.

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. In my testimony I adopt the portions of Theresa A. Jensen's Direct Testimony (Exhibit TAJ-1T), page 17, line 6 to page 19, line 7, page 25, line 18 to page 33, line 10, as well as Confidential Exhibits TAJ-2C and TAJ-3C. I examine the history of the directory operations as represented by the opposing witnesses, providing additional information relating to prior imputation calculations and identifying that portion of directory operations/revenues that should be available for the benefit of ratepayers in this state. Based on this history, I examine each of the parts of the sale and determine that the LCI, NewVentures, Secondary directories and non-Qwest listing portions of the sale are not and never have been part of the regulatory directory obligation. All parties have agreed to exclude the LCI portion of the Dex sale. Although the Staff and the DOD have included the NewVentures portion of the sale, it should not be considered in this proceeding and the ATG has correctly excluded NewVentures from the gain calculation. Staff, DOD and the ATG have incorrectly included Secondary directories and non-Qwest listings. The "regulatory asset" must be appropriately identified before any sharing of the gain on the sale of it can be calculated.

My testimony examines the NewVentures, Secondary directories and non-Qwest listing portions of Dex's directory operations that were developed well after 1984 and are not part of Dex's obligation to publish directories on behalf of Qwest Corporation ("QC"). I have removed these portions of the business, in conjunction with the LCI portion, to arrive at the appropriate gain on the sale. Not only were these lines of business never a part of the pre-1984 regulatory obligation, they do not facilitate the use of QC's telephone service. As such, they need to be excluded from a gain calculation. The portion of the remaining gain on sale must then be allocated to the state of Washington. Finally, the Commission must decide how the benefits of the sale should be shared between QC's Washington customers and Qwest's shareowners.

I also correct and rebut the testimony of Staff witness Lee Selwyn, DOD witness Charles King, and ATG witness Michael Brosch. Mr. King has erroneously relied on a decision made over 20 years ago that was superceded by the 1996 Federal Telecommunications Act.

Dr. Selwyn has developed a Washington allocation factor that relies on published rather than actual revenues and allocated expenses, while this Commission has always relied on actual revenues as an appropriate allocation factor. In addition, although Dr. Selwyn has appropriately identified the "first mover" advantage and "network" externalities as contributing a significant portion of the current value of Dex, he has inappropriately attributed both the "first mover" advantage and externalities to Washington ratepayers. Both of these predate "ratepayers"[1] and exist irrespective of QC and its customers. I examine the intangible assets identified by Dr. Selwyn and acknowledge that there are intangible assets in addition to goodwill that contribute to the gain from sale. However, Dr. Selwyn incorrectly claims that all the intangible assets and goodwill are attributable to QC. I examine the intangible assets identified by Dr. Selwyn and explain which of the assets are attributable to the "regulatory asset."

Mr. Brosch has identified eight "linkages" that he claims link the Dex directories business with QC's telephone service. I demonstrate that when such linkages exist, they do not apply to 100 percent of Dex's current operations, and particularly do not apply to Secondary directories or non-Qwest listings. I refute the potential "risks" of sale claimed by Mr. Brosch.

[1] "Ratepayers" is used here in the sense of customers who pay rates determined under a cost-of-service regulatory scheme.

III. HISTORY OF DIRECTORY CONTRIBUTION

Q. BOTH THE STAFF AND THE ATG HAVE CLAIMED THAT DEX'S DIRECTORY OPERATIONS WERE DEVELOPED AS PART OF THE REGULATED MONOPOLY. IS THIS TRUE?

A. No, the directory operations were begun and developed before the telephone operations were regulated. As Mr. Grate described in his direct testimony, QC's predecessor began operating in Seattle in 1883 but was not cost-of-service regulated until 1923. We know for certain that a directory with classified advertising was published in 1894 and that competing telephone companies published competing directories with classified advertising. Mr. Grate provided copies of advertising in some of these directories in his direct testimony. Although Dr. Selwyn has correctly claimed that much of the value of Dex's current directory business is due to its "first mover" advantage, he is incorrect when he attributes this value to the regulated monopoly operations. The shareholders and owners had invested in and developed the directory business including classified advertising for at least thirty years before the company was a cost-of-service regulated monopoly.

Dr. Selwyn notes that Ebay established a strong "first mover" advantage by beginning just a few years before competitors such as Amazon.com. A business establishes its "first mover" advantage, by definition, at the time its owners establish it. The Company's owners established the directory advertising business in the late 1800's and thereby created this valuable intangible asset well before any cost-of-service regulated monopoly existed. The value of the "first mover" advantage was created by the Company's owners and cannot be attributed to captive ratepayers. Dr. Selwyn attempts to rewrite history by claiming that captive ratepayers were responsible for the "first mover" advantage of a business that was well established at least thirty years before cost-of-service ratepayers existed. The owners established the directory operation—including its advertising line of business—at their own risk and expense to help promote and increase the value of their local telephone service business. Ratepayers have no claim whatsoever on the value of the "first mover" advantage of the telephone service business, the directory operation, or the directory advertising business.

Q. WHAT OCCURED DURING THE SIXTY YEARS PRIOR TO 1984 THAT DR. SELWYN AND MR. BROSCH RELY ON AS HAVING CONTRIBUTED ALL THE CURRENT VALUE OF DEX?

A. During this period of time, universal service was a prime objective of both the regulatory commissions and AT&T. Using the profits from directory classified advertising helped achieve this objective. This subsidization of telephone rates with profits from the advertising business was recognized and, in the cost-of-service regulated monopoly environment that existed at the time, considered acceptable public policy.

The value generated by the directory advertising business was used to subsidize local ratepayers. Although Mr. Brosch has relied in part on the directory revenues being "codified" in the FCC's uniform system of accounts, the FCC issued an order in 1977 that stated that the Yellow Pages and advertising in the White Pages of telephone directories do not represent common carrier communication service.[2]

Q. HOW DOES IMPUTATION RELATE TO THE PURPOSE OF THIS DOCKET?

A. Qwest believes that it is important to properly identify that part of the value of the of the directory operations that has historically been made available to ratepayers by the Commission through imputation. Only the gain on the portion of Qwest's directory operations that is attributable to the regulatory directory obligations should be considered by the Commission as subject to allocation between ratepayers and shareowners. The next part of my testimony provides that necessary historical background.

Q. DID IMPUTATION BEGIN IMMEDIATELY FOLLOWING THE CREATION OF A SEPARATE DIRECTORY AFFILIATE IN 1984?

A. No. Actual 1985 directory revenues and expenses on the Company's Washington intrastate books were used to set rates in Docket No. 85-52. The first imputation was included in a Settlement Agreement dated September 25, 1989. The Commission's Fourth Supplemental Order in Docket Nos. U-89-2698-F and U-89-3245-P, dated January 16, 1990 accepted the Settlement Agreement imputation

[2] Docket No. 19129, Phase II Final Decision and Order. Adopted: February 23, 1977; Released March 1, 1977. Paragraph 235.

calculation and established the basis for the imputation calculation that has been used ever since. Paragraph 18.H.a of this Settlement Agreement, which is attached to the order, states the starting point for the imputation calculation as follows: "U S WEST Direct's actual adjusted operating revenue associated with the publication of telephone directories <u>for U S WEST Communications</u> will be calculated [as follows]" (emphasis added). Because this was the standard used for applying a directory imputation it is also the appropriate standard for determining the Washington portion of the Dex gain that should be considered in this case. The settlement language indicates that it is only those revenues associated with fulfilling the publishing operations of U S WEST that the Commission considered to be available for the benefit of ratepayers. As will be seen from my detailed explanation below, only Qwest's calculation of the gain is consistent with this methodology.

Q. HAS THIS SAME STANDARD BEEN APPLIED IN SUBSEQUENT DOCKETS?

A. Generally, yes. I will explain each of the subsequent dockets, and will explain why and how certain directory revenues, which should not have been included in the imputation calculation, were included.

In Docket No. UT-950200 the Company took the position that directory imputation was no longer appropriate. The Commission chose to continue this imputation and ordered the imputation calculation proposed by Staff, which used the same calculation formula from the previous docket. Because the directory operations were not being performed within the regulated telephone company operations and the regulated company was not involved in the management or strategic planning of the directory operations, no analysis of the directory business as it was being conducted in 1995 was ever performed. At that time, U S WEST concerned itself with whether Dex was meeting its publishing obligations pursuant to its publishing agreement and was not focused on the fact that Dex had begun to expand its business beyond the publication of telephone directories for U S WEST Communications. The imputation calculation in Docket No. UT-950200 thus erroneously included not just operating revenues associated with publishing directories for U S WEST Communications, but also for additional directories and other local exchange carriers' listings. I say erroneously, because that calculation was inconsistent with the formula set forth in the 1989 Settlement Agreement, which limited the calculation to revenues associated with directories that Dex published for U S WEST, not for other carriers, and not on its own behalf as a separate line of business.

Q. WERE THE PROFITS FROM WHAT IS NOW NEWVENTURES INCLUDED IN THE IMPUTATION IN DOCKET NO. UT-950200?

A. No. In 1995, what is now NewVentures was not part of the directory publishing operations and these financial results were not included in the directory financial results used to calculate the imputation.

Q. HOW WAS THE DIRECTORY IMPUTATION CALCULATED FOR DOCKET NO. UT-970766 THAT WAS EFFECTIVE IN FEBRUARY 1998?

A. This Docket was considered a "make whole" rate case. In that case, the Staff and the Company agreed to simply update the revenue requirement using all the Docket No. UT-950200 Commission-ordered adjustments. This included the directory imputation. Again, Dex financials were used in total without any analysis of Dex's financial results or operational policy changes.

Q. WHY DIDN'T QWEST ADDRESS SECONDARY DIRECTORIES AND NON-QWEST LISTINGS IN DOCKET NO. UT-980948, THE ACCOUNTING ORDER CASE?

A. Secondary directories and non-Qwest listings were simply not relevant to the case. In Docket No. UT-980948, the Company was portraying the amount of directory contribution that had already flowed to the Washington ratepayers as a result of being embedded in regulated rates. The issue was not whether all of the amounts should have been included or not, it was simply an analysis of what had actually been included.

Q. DID YOU TESTIFY IN THE 1998 ACCOUNTING ORDER CASE THAT THE RATEPAYERS WERE ENTITLED TO THE FULL GROSS VALUE OF THE BUSINESS LESS ONLY THE ASSETS TRANSFERRED IN 1984, AS INTIMATED BY MR. BROSCH IN HIS DIRECT TESTIMONY[3]?

A. No, I did not. As I just explained, in the 1998 case, I was testifying about what had historically occurred, not about what I believed or what the Company believed "should have occurred." In Accounting Order Case, the Company presented an expert's business valuation of the directory business on January 1, 1984. I presented testimony that compared what Washington ratepayers had received between 1984 and the then current date with the estimated business value as of 1984. There was no need to analyze what the ratepayers were entitled to or what had been correctly or incorrectly included, because, from the Company's perspective, Washington ratepayers had already received more than the 1984 value of the business.

Q. DID THE COMMISSION ACCEPT QWEST'S POSITION IN THAT CASE?

A. No.

[3] Direct Testimony of Michael L. Brosch, dated March 18, 2003 ("Brosch"), page 104, line 27 to page 105, line 5.

Q. DID THE BUSINESS VALUATION PRESENTED IN ACCOUNTING ORDER DOCKET INCLUDE A VALUE FOR NEWVENTURES, SECONDARY DIRECTORIES OR NON-QWEST LISTINGS?

A. No. Before 1984, the directory operations had been operated within the regulated telephone company. There was no NewVentures/Internet line of business. Before 1984, the Company published only the directories necessary to meet its regulatory obligations and did not publish any Secondary directories. Before 1984, the Company did not publish directories on behalf of over one hundred independent and competitive local exchange companies as Dex does today, nor did the Company deliver its directories to all residences and businesses located within its geographic area.

In this case, we are examining a different directory business than the business that existed in 1983 and a different transaction than the transaction that occurred at the beginning of 1984. The sale of Dex is the sale of a business that has operated independent of the Company's regulated telephone operations for nearly twenty years. It has evolved far beyond the business that operated as a part of the regulated company. This sale is a sale of the directory operation to an independent third party in 2003, not the transfer that occurred in 1984. The Commission is now faced with how to distribute the Washington portion of the gain associated with the sale between the Washington ratepayers and Qwest's owners. It is not, as in the 1998 case, an analysis of the 1984 value and the amount of compensation Washington ratepayers had received between 1984 and 1998.

IV. IDENTIFICATION OF THE WASHINGTON PORTION OF THE GAIN

Q. PLEASE IDENTIFY THE ADJUSTMENTS NECESSARY TO DETERMINE THE ELEMENTS OF THE BUSINESS THAT MUST BE EXCLUDED BECAUSE THEY HAVE NO RELATIONSHIP TO QWEST'S REGULATORY DIRECTORY OBLIGATIONS.

A. There are four adjustments that need to be made in order to remove portions of the business that are not implicated in Qwest's regulatory directory obligations. These adjustments remove the portions of the sale related to LCI, NewVentures, Secondary directories, and non-Qwest listings.

LCI

Q. WHAT IS LCI AND WHY SHOULD IT BE EXCLUDED?

A. LCI is an entity that was a part of the Qwest business prior to its merger with U S WEST. This business was not related to the publishing business when it was a part of the Company's regulated operations, nor has it been a part of the Dex publishing operations since the Qwest merger. As Mr. Brosch correctly notes, at this time there is no gain identified with the LCI portion of this sale. However, there are assets associated with this entity. The value of the assets needs to be removed from the sale. LCI is not a part of the "regulatory asset" at issue, and both Staff and the ATG have accepted this adjustment.

<u>NewVentures</u>

Q. WILL YOU EXPLAIN THE NEWVENTURES LINE OF BUSINESS THAT NEEDS TO BE REMOVED?

A. The NewVentures/Internet lines of business began as a separate company, Marketing Resources Company ("MRC") that was created in 1985. MRC was created as a separate company and was not part of U S WEST Direct (Dex's predecessor). It was not until 1991 that NewVentures and U S WEST Direct became separate operating divisions of Marketing Resources Group, Inc. ("MRG"). MRG was formerly Landmark Publishing and in 1997 became U S WEST Dex. Inc. The two operations did not become integrated until after the July 2000 merger with Qwest.

The NewVentures lines of business encompass the highest risk areas of direct marketing and internet. They have <u>never</u> been included in the Dex financial results provided to this Commission. Accordingly, the imputation calculation has not included those results. With no real justification, Staff and the DOD want to include the gain from this portion of the sale. The ATG has correctly accepted that this portion of the business should be excluded.

Q. CAN THE FINANCIAL RESULTS FROM THE NEWVENTURES LINE OF BUSINESS BE REASONABLY SEPARATED FROM THE FINANCIAL RESULTS OF DEX DIRECTORIES?

A. Yes. Confidential segment information was provided by Qwest in response to Public Counsel's Data Request ATG01-02S1 and further information was provided in confidential attachments to Public Counsel's Data Request ATG01-016S2 in this docket. Yet Dr. Selwyn quotes a disclosure that appeared on a Confidential 2000 Affiliated Interests Report. The disclosure stated that the NewVentures and Internet lines of business were no longer conducted in a company or operating division separate from Dex Directories and that Qwest had not yet ascertained separate financials.[4] That was true at the time the report was filed, but it is not true at this time and evidenced by the Company's responses to the data requests cited above. Thus, there is no basis for Dr. Selwyn's allegation that NewVentures should not be segregated.

Secondary Directories

Q. WHAT ARE SECONDARY DIRECTORIES AND WHY ARE THEY PROPERLY EXCLUDED FROM ANY GAIN CALCULATION FOR REGULATORY PURPOSES?

A. Dex publishes both Primary directories and Secondary directories. Primary directories are the directories Dex publishes to cover the service areas for which QC

[4] Direct Testimony of Lee. L. Selwyn dated March 18, 2003 ("Selwyn"), page 104, lines 9 to 13.

is required to provide listings to its customers free of charge. In this context, Secondary directories include all other directories published by Dex. They include regional and specialized directories. They also include directories Dex publishes outside QC's local service area.

Q. DID ANY OF QC'S PREDECESSORS PUBLISH ANY SECONDARY DIRECTORIES PRIOR TO 1984 OR AT THE TIME OF THE 1989 SETTLEMENT AGREEMENT?

A. No. Dex started publishing Secondary directories after the directory operations were transferred to the separate unregulated subsidiary. There is no history of Secondary directories being published while the directory operations were part of the regulated operations of any of QC's predecessors in Washington. Dex's Secondary directory business did not exist in 1984 and, therefore, was not part of the directory business transferred in 1984. Nor were revenues from Secondary directories included in the formula established in the 1989 Settlement Agreement.

Q. HOW MANY SECONDARY DIRECTORIES DOES DEX PUBLISH IN WASHINGTON?

A. Dex publishes two Secondary directories in Washington. The Greater Snohomish County directory is a directory published outside QC's service area which competes head-to-head with Verizon, the local exchange carrier in Snohomish County. This directory, which was first published by Dex in December, 1994, has nothing to do with QC or QC ratepayers. The scope of this directory is outside QC's service area.

It is not published for QC and its customers. It is not targeted to QC customers, and it is not delivered to QC customers. The Greater Puget Sound On-the-Go directory is a specialized directory that includes only yellow pages and is targeted for use in automobiles and by wireless telephone users. The Greater Puget Sound directory was first published in 1998. Not only were secondary directories not a part of the pre-1984 directory business, they also do not, for the most part, facilitate the use of QC's telephone service.

Q. SHOULD SECONDARY DIRECTORIES BE CONSIDERED PART OF THE RELEVANT GAIN CALCULATION JUST BECAUSE THEY ARE THE RESULT OF GOOD MANAGEMENT AND COULD HAVE BEEN DEVELOPED HAD THE DIRECTORY OPERATIONS REMAINED IN THE REGULATED COMPANY?

A. No. Secondary directories were not published in all the years that the directory operations were part of the regulated Pacific Northwest Bell operations. While one could speculate that they might have eventually developed had the transfer never occurred, the facts are that no Secondary directories were published when directory publishing was part of the Washington regulated operations. Secondary directories are not targeted to QC customers. Secondary directories are not tied to QC's regulatory obligation to provide Primary directories. These directories do not qualify as part of the regulatory directory obligation under the standard by which the imputation is determined, i.e. "the publication of telephone directories for U S

WEST Communications" (now QC). Because they fail to satisfy the imputation test, Secondary directories should not be part of the relevant gain calculation. Also, Secondary directories do not facilitate the use of QC's telephone service. Therefore, that portion of the gain from the Dex sale attributable to these Secondary directories is not appropriately considered for sharing with QC customers.

<u>Non-Qwest Listings</u>

Q. WHY ARE NON-QWEST LISTINGS APPROPRIATELY EXCLUDED FROM THE RELEVANT GAIN CALCULATION?

A. Dex has expanded its directory business to meet the publishing needs of not only QC, but also many other local exchange carriers in the area. More than 25 percent of the listings Dex publishes in its Primary directories are not QC listings, but rather, listings of Washington residences and businesses that purchase their telephone service from other local exchange carriers. Revenues earned from Dex's advertising to customers of other local exchange companies are not connected to QC's regulatory directory obligations in which QC customers may have an interest.

Q. WERE NON-COMPANY LISTINGS EVER PUBLISHED IN DIRECTORIES PUBLISHED BY THE COMPANY?

A. Yes. The Company did publish a number of listings of other incumbent local exchange carriers. The Company included these listing when they were within the extended calling area of the Company's customers, as required by Commission rule. However, the Company did not deliver its directories to these non-Company customers. The Company included the listings to assist its own customers' completion of calls within their local calling areas and to meet its regulatory obligations. The listings were a product for the use of its own customers, not the customers of other carriers.

Dex, on the other hand, has expanded the scope of its business beyond the business that was part of the transferred regulatory obligation. Dex does not simply include the listings of other local exchange carriers in the directories it publishes and delivers to QC customers, as was the policy when the operations were conducted within the Company's regulated operations. Dex publishes these listings as part of its publishing obligation to many of these local exchange carriers and delivers directories to all homes and businesses located within the geographic scope of their directories. This was not part of the business that was operated before 1984 and this portion of the business is not part of Dex's publishing agreement and obligation to QC. Therefore, that portion of the gain from the Dex sale attributable to the value of the business associated with non-Qwest listings should be excluded from any gain sharing calculation. Non-Qwest listings are no part of the regulatory obligation in which the customers of QC have an interest.

Q. HOW DID THE COMPANY DELIVER ITS DIRECTORIES PRIOR TO THE 1984 TRANSFER?

A. Although the Company included the listings of adjacent incumbent local carriers in its directories, the Company delivered its directories only to the Company's customers. Delivery lists of the Company's customers were prepared and used in the delivery of its Washington directories. As a result, the advertising included in the directories published by the Company was targeted almost solely to the Company customers. That is not the case today. Dex now delivers its directories to every address located within the geographic scope of each of its directories. As a result, the advertising Dex sells is targeted to the customers of other local exchange companies as well as to QC's customers.

Q. DOES DEX HAVE AN OBLIGATION TO PUBLISH AND DELIVER ITS DIRECTORIES ONLY TO QC CUSTOMERS?

A. No. As explained in Mr. Burnett's direct testimony, Dex has equivalent publishing agreements with more than one hundred independent and competitive local exchange carriers, in addition to QC.

Q. WITH HOW MANY OTHER LOCAL EXCHANGE CARRIERS DOES DEX HAVE PUBLISHING AGREEMENTS IN WASHINGTON?

A. Dex currently has publishing agreements with nine competitive local exchange carriers[5] in Washington and one incumbent local exchange carrier, Inland Telephone Company. Additionally, Dex has listing agreements with eleven other incumbent local exchange companies in Washington, to include their listings in Dex directories, although Dex does not have the accompanying obligations as it does

[5] Allegiance Telecom, AT&T, MCIMetro, Now Communications, Sterling International Funding, dba 1800 RECONEX, Sprint, Teligent, Time Warner Telecom and Worldcom.

with Publishing Agreements. This means that Dex has expanded its business beyond the scope of the business operated in the regulated company. Dex has the same obligations to the ten local exchange carriers and their customers that Dex has to QC and its customers. This part of Dex's business was not a part of the Company's regulated business. The business that was operated within the regulated Company operations includes only the portion of Dex's current business that is related to QC listings in Primary directories and the standard set by the imputation calculation in Docket Nos. U-89-2698-F/U-89-3245-P.

Q. HAVE YOU CALCULATED THE PRELIMINARY GAIN ON THE SALE OF DEX ATTRIBUTABLE TO THE PORTION OF THE BUSINESS WHERE THERE ARGUABLY ARE REGULATORY OBLIGATIONS?

A. Confidential Exhibit TAJ-2C provides Qwest's preliminary gain on sale calculation including the adjustments to remove that portion of the gain attributable to the portions of the business that have no linkage to Qwest's regulatory directory obligations. The adjustments are necessary in order to provide a gain calculation that appropriately relates to the pre-1984 directory operations and that facilitates the use of QC's telephone service. I have excluded the NewVentures, Secondary directories and non-Qwest listing portion of the gain on sale based on their relative percentage of total Dex Holdings revenues.

Allocation to Washington

Q. HOW DID QWEST ALLOCATE THE GAIN TO WASHINGTON?

A. After arriving at the portion of the sale that is net of the exclusions I have just discussed, the balance was allocated to Washington by using Washington's portion of the equivalent Dex Primary Qwest revenues. I use a revenue allocator because revenues are directly assigned and identifiable by state and because revenues do not rely on additional allocations to develop a further allocation. This is also the standard that has historically been relied on for the imputation calculation.

Q. DID THE DOD, STAFF AND ATG USE THIS SAME FACTOR?

A. No. Mr. King of the DOD created an allocation factor based on an allocation of Dex's total net income to the income attributable to Washington, including NewVentures, Secondary directories and non-Qwest listings. His allocation strays from the imputation standard in two ways. First, he uses the wrong base by including portions of the Dex business that are not associated with directories that Dex publishes for QC. Second, he calculates Washington's percentage of this incorrect base by using allocated net income rather than using revenues.

Dr. Selwyn, on behalf of Staff, also uses the wrong base. He created his own base and his own allocation factor by using published revenues by directory, rather than actual earned revenues, and a combination of both variable (directly assigned) and fixed (allocated) expenses. There are two important reasons that published revenues should not be used. First, there is a mismatch in years between published revenues and booked revenues. Published revenues are reflected in the year the directory is published, rather than amortized over the life of the directory. This means that a significant amount of revenue is recognized a year earlier than it is recognized on the financial books of Dex. Second, published revenues reflect revenues before any adjustments are reflected. Dr. Selwyn's method overstates actual booked revenues and understates booked expenses. The result is a significantly overstated allocation to Washington.

Mr. Brosch, on the other hand, adjusted the Washington allocation factor to match the portion of the business that he claims should be allocated to Washington customers. While I disagree with Mr. Brosch's inclusion of Secondary directories and non-Qwest listings, I believe that he used the correct allocation methodology. In Washington, the method for determining the directory imputation has always relied on actual booked revenues because revenue is a measure that is clearly identifiable by state while other measures are not. Dr. Selwyn's and Mr. Lee's departure from this measurement standard is not in line with the imputation standard.

Q. IS THERE ANY PRECEDENT IN WASHINGTON TO SUPPORT THE ADJUSTMENTS THAT YOU HAVE MADE?

A. Yes. Staff's responses Dex Holdings Data Requests DEXH-S001 through S009 relate to Contel Corporation's 1985 sale of its directory publishing subsidiary, Leland Mast Directory Company. In these responses, particularly in Staff's response to Data Request DEXH-S004, it appears that Staff first allocated the gain on the sale to affiliated operations. By removing the gain associated with the LCI, NewVentures, Secondary directories and non-Qwest listings, I have identified the "affiliated operations" of Dex. Another allocation was made to identify the "CTNW share of the gain" and this share was then allocated to Washington. It appears both these allocations were made on the basis of revenues. This is just what I have done for this transaction. I have identified the portion of Dex's current business that relates to Dex's "affiliate operations" and allocated that portion to Washington on the basis of revenues.

V. SHARING THE GAIN

Q. DOES QWEST RECOMMEND THAT THE ENTIRE GAIN BE ATTRIBUTED TO QC'S WASHINGTON CUSTOMERS AND ONLY YOUR RECOMMENDED EXCLUSIONS BE ATTRIBUTED TO SHAREOWNERS?

A. No. The preliminary gain calculation Qwest provided in response Public Counsel's Data Request ATG01-15S2 (provided herewith as Confidential Exhibit AKC-3C), identifies the portion of the sale that is arguably related to regulatory obligation as I have just described. It is this portion and only this portion of the gain that is then subject to allocation between ratepayers and owners. In other words, the portion of the sale that is related to Qwest's regulatory directory obligation is the only part of the sale in which QC's Washington customers could have an interest. The

Commission must determine the extent of that interest and how the benefits of the gain associated that portion are to be allocated between ratepayers and shareholders. Mr. Grate and Mr. Reynolds discuss the principles for determining this allocation.

Q. HAVE THE ATG, DOD AND STAFF WITNESSES RECOMMENDED THAT THE COMMISSION CONSIDER MORE OF THIS SALE?

A. Yes. The ATG has included the portions of the business related to Secondary directories and non-Qwest listings. The DOD has included not only the portions of the business related to Secondary directories and non-Qwest listings, but also the portion related to NewVentures. The Staff has recommended including all that the DOD proposes to include and in addition has "imputed" an additional amount by fabricating a sales price that is more than a third higher than the actual sales price. Each of their recommendations allocates substantially more than 100 percent of the "regulatory asset" to QC's Washington customers.

Q. HOW DO THE DOD, ATG AND STAFF WITNESSES JUSTIFY INCLUDING SECONDARY DIRECTORIES AND NON-QWEST LISTINGS?

A. Each claims that a supposed advantage to Dex from its association with QC's regulated telephone operations justifies not only treating the gain related to these lines of business as a "regulatory asset," but also allocating all (or more than all) of it to Washington ratepayers. Mr. Brosch claims there are linkages between Dex directory operations and QC telephone services that justify considering all of Dex's directory operations a "regulatory asset." In his testimony, Mr. Brosch identifies eight such linkages to substantiate his claim. I will examine each of these linkages to determine if it applies to Dex. If it does, I will evaluate the portions of Dex's current directory business to which it applies and identify the related "regulatory asset" that this Commission needs to allocate between QC Washington customers and Qwest shareholders.

VI. ATG LINKAGES

ATG Linkage 1 - Listings

Q. WHAT IS THE LISTINGS LINKAGE ADDRESSED BY MR. BROSCH?

A. Listings are the primary content of White Pages directories and are at the heart of the directory business. It is important to examine how listings have played a role in the history and development of the directory business. However, the linkage between the telephone operations and listings has changed significantly over time.

During the period of time that the directory publishing business was part of the regulated telephone operations, subscriber listings were under total control of the regulated telephone company. Current laws and regulatory requirements that make subscriber list information ("SLI") available to all publishers on equal terms and conditions did not exist. In fact, the telephone company not only controlled the listings in the directories; copyright laws protected the listings once they were printed in white and yellow page directories. Thus, these listings were truly "linked" to the regulated telephone operations.

Although not required to, the Company had actually made its listings available to other directory publishers for a number of years before 1984. However the 1991 *Feist* decision[6] established that neither White nor Yellow Pages listings, nor Yellow Pages Headings, could be copyrighted. This affected the linkage between local exchange carriers and directory publishers in two ways. First, it meant that any publisher could obtain listings in order to publish directories, if not directly from the local exchange carrier, then by copying the listings from directories published by another publisher. This also had the effect of lowering the value of listings licensed from local exchange carriers. Next, the Federal Telecommunications Act of 1996 required that all local exchange carriers make their listings available to all publishers. Finally, in 1999 the FCC issued its SLI order that not only requires all local exchange companies to make their listings available, it established a maximum price that local exchange carriers can charge for their SLI without challenge. QC licenses its SLI to publishers. The license revenues are recorded on QC's books. As a result of the FCC order, QC has lowered its prices for SLI. QC actually began making its listings available to all publishers under equal terms and conditions in 1987. There is no longer any unique linkage between QC and Dex based on listings.

[6] *Feist Publications, Inc. v. Rural Tel. Serv. Co.*, 499 U.S. 340 (1991).

Q. DOES THIS MEAN THAT THE LISTING LINKAGE IS BROKEN?

A. Without a doubt. However, if this Commission were to determine that listings still creates a linkage between Dex and QC's customers, it could only exist with regard to QC's listings. Over 25 percent of the listings published in Dex's directories are not QC's listings. Obviously there can be no linkage between QC's customers and listings of other telephone companies' customers. The changes in the law have severed the historic linkages that existed between directory publishing and telephone companies' customer listings. To the extent the Commission were to find otherwise, it is still a fact that 25 percent of the listings published by Dex have no relationship to QC or its customers and thus no possible linkage.

Q. DOESN'T QC PROVIDE NON-QWEST LISTINGS TO DEX?

A. Yes. In many cases, QC does provide non-Qwest listings to Dex and to other publishers. Under the Telecom Act of 1996, as implemented through this Commission's interconnection rulings, QC is required to provide CLEC listings to Dex, if the CLEC so chooses. On the other hand, a CLEC may also elect to provide its own SLI directly to Dex and other publishers. QC also provides ILEC listings through agreements with many ILECs. In no case may Dex or any other publisher publish another carrier's listings without agreement from that carrier. Consequently, this obligation to provide non-Qwest listings to directory publishers does not create a claim by Washington customers to the gain from the business of advertising to non-QC subscribers.

Q. AS PART OF THIS LISTINGS LINKAGE, MR. BROSCH ALSO NOTES THAT IT IS A DEX REQUIREMENT TO HAVE BUSINESS TELEPHONE SERVICE IN ORDER TO ADVERTISE IN YELLOW PAGES. DOES THIS CREATE A LINKAGE TO QC TELEPHONE SERVICE AND ITS WASHINGTON CUSTOMERS?

A. No, it does not. While Dex has a policy that requires advertisers to have business telephone service, the policy does not require the advertiser to have QC's business telephone service. An advertiser may purchase its business telephone service from other local exchange carriers providing service within the scope of the Dex directory. In the Dex Tri-Cities Regional directory, for example, only 18 percent of the listings are QC listings and 82 percent are non-Qwest listings.

A business may actually be located anywhere in the country and still advertise in a Dex directory. Advertisers need no physical presence within the area to which the directory is delivered in order to buy advertising from Dex. Contrary to Mr. Brosch's assertion, there is absolutely no linkage between Dex's requirement that advertisers have business telephone service and QC or QC customers.

<u>**ATG Linkage 2 – Effective Use of Telephone Service**</u>

Q. IS THERE A LINKAGE DUE TO CUSTOMERS' DESIRE TO MAKE MORE EFFECTIVE USE OF THEIR TELEPHONE SERVICE?

A. No. Contrary to Mr. Brosch's assertion, if such a desire exists, it creates no linkage between Dex and QC. Customers' desire to make efficient use of their telephone service exists whether they are customers of QC or of another telephone company and whether they use a Dex directory or another directory. There is no linkage between the desire for efficiency and entitlement of QC's customers to gain from one of the directories that contributes to that efficiency. However, Mr. Brosch's argument does raise the issue of usage, and Dex's delivery policy does drive the usage of its directories

Q. WHAT IS DEX'S DELIVERY POLICY?

A. Dex delivers directories to every business and residence within the entire geographic area included in the scope of each of its directories. This means that Dex delivers directories to QC customers, CLEC customers, ILEC customers, wireless telephone customers, and to addresses with no telephone service whatsoever.

Q. HAS THIS ALWAYS BEEN THE DELIVERY POLICY?

A. No. Before divestiture the Company's policy was to deliver directories only to its own customers. Consequently, directory advertising was targeted only to the Company's customers when the directory operations were conducted as part of the regulated telephone company. Today, the advertising is targeted to all users, a significant portion of whom are not QC customers. In Dex's Greater Snohomish County Secondary directories, for example, virtually all the directories are delivered to customers of other local exchange providers.

ATG Linkage 3 – Enhanced Usefulness of Local Telephone Service

Q. WHAT IS THE THIRD LINKAGE CLAIMED BY MR. BROSCH?

A. The third linkage claimed by Mr. Brosch is that the usefulness of local telephone service is enhanced by the availability of both alphabetical and classified directories. There is no linkage here because, again, the availability of directories enhances the usefulness of the telephone service whether the customer purchases its service from QC or another provider. The value identified here is flowing from the publisher to the local exchange carriers and their customers, and will continue whether the directories are published by Dex as an affiliate of QC or as a stand-alone company. There is no rational argument that providing this value to QC and its customers entitles those customers to the gain on the sale of the directory business.

ATG Linkage 4 – Billing on Local Phone Bills

Q. WHAT ABOUT A LINKAGE CREATED AS A RESULT OF BILLING YELLOW PAGES ADVERTISING ON THE LOCAL PHONE BILLS OF QC?

A. Dex pays QC to provide billing and collection services ("B&C services"). B&C services are a competitive service offered by a number of different providers, including QC. Mr. Brosch implies that QC would not provide B&C services for other publishers. However, the fact is that other publishers are not interested in purchasing B&C services from QC. Not to belabor the point, but I have explained this in testimony and data request responses in several dockets in which Mr. Brosch was the opposing witness, including this case. As Mr. Brosch is undoubtedly aware, QC surveyed other publishers of directories to determine their interest in receiving B&C services from QC, and they indicated no interest at all. QC does provide B&C services for a number of unaffiliated companies. Selling B&C services to Dex does not create a linkage between Dex and QC any more than it creates a linkage between QC and a long distance carrier for which QC provides B&C services.

Q. WHAT PERCENTAGE OF DEX'S REVENUES FROM YELLOW PAGE ADVERTISING DOES QC BILL ON LOCAL PHONE BILLS?

A. In 1984, the Company billed approximately 90 percent of Dex's Yellow Pages advertising revenues. In 2001, QC billed less than 51 percent of Dex's Washington booked revenues. Even if this were considered a gain-entitling linkage—which it clearly is not—it relates to less than 51 percent of Dex's business.

<u>ATG Linkage 5 – Dex directories in Qwest Payphones</u>

Q. MR. BROSCH ALSO CLAIMS THAT A LINKAGE EXISTS BECAUSE DEX HAS BEEN CONTRACTED TO PROVIDE QWEST PAYPHONES WITH DEX DIRECTORIES. WILL YOU ADDRESS THIS CLAIM?

A. First, as Mr. Brosch has acknowledged, public pay stations are unregulated. Any linkage due to the appearance of Dex directories in Qwest public pay stations is with QC's unregulated operations and could not, therefore, support a linkage to the regulated operations. Mr. Brosch tries to perpetuate the myth of a linkage by claiming user "perception," (that he does not substantiate with any evidence) justifies a ratepayer claim to 100 percent of the gain from Dex's sale. I address this further in Linkage 7 below.

Second, Dex has contracts to stock its directories in public pay stations owned by 165 different pay station providers. Twenty-eight of these contracts are with pay station providers in the state of Washington. The stocking of directories is a contractual matter between Dex and many payphone providers, only one of which is QC. It creates no linkage to QC that entitles ratepayers to the gain on the sale of Dex.

ATG Linkage 6 – Tradenames and Trademarks

Q. IS THERE A LINKAGE DUE TO DEX'S USE OF TRADENAMES AND TRADEMARKS?

A. None at all. The tradenames and trademarks used by Dex were not created by and are not owned by the regulated company, QC. They cannot possibly establish a linkage of any sort to QC or entitle QC customers to the gain from selling Dex.

ATG Linkage 7 – Public Perception

Q. HOW DO YOU RESPOND TO A CLAIM OF LINKAGE CREATED BY PUBLIC PERCEPTION?

A. Although Mr. Brosch has claimed this public perception exists in this and other proceedings in other states, he has never offered any evidence whatsoever that it actually exists or that it is helpful to Dex. Certainly, there is no reason to believe that any perceived link between Dex and QC has any impact on non-Qwest customers. Furthermore, if such a link were to exist, it would not exist with the Dex directory users that are not QC's customers.

ATG Linkage 8 – Customer Referrals

Q. PLEASE DISCUSS THE LINKAGE MR. BROSCH CLAIMS IS RELATED TO CUSTOMER REFERRALS.

A. QC's practice of referring customers to Dex did not start until May of 1998. Referrals are not tracked on a state basis, but rather on a QC consultant basis for reimbursement by Dex. However, it is estimated that less than one quarter of one percent of QC's business customers are referred to Dex on an annual basis. The number of referrals is so small as to be considered inconsequential. This small number of referrals does not constitute a linkage that justifies attributing the gain from Dex's business to QC's customers. Even if it did, it must be remembered that since over 25 percent of the listings in Dex's directories are not QC customers, there can be no linkage to QC or its customers for this portion of Dex's unaffiliated business.

Q. DO THESE EIGHT ATG LINKAGES PROVIDE ANY JUSTIFICATION FOR CLAIMING THAT SECONDARY DIRECTORIES AND NON-QWEST LISTINGS SHOULD BE ASSOCIATED WITH QWEST REGULATORY DIRECTORY OBLIGATIONS, EVEN THOUGH THEY WERE NOT PART OF THE PRE-1984 DIRECTORY BUSINESS?

A. No. The linkages, to the extent they exist at all and have any nexus with Qwest's regulatory directory obligation, do not apply to Secondary directories or to non-Qwest listings. These linkages actually demonstrate that there are portions of Dex's current business that not only did not exist when directory operations were part of the regulated telephone operations in 1984, but also they do not facilitate the use of QC's telephone service.

Q. IS THE REVENUE GROWTH DEX HAS REALIZED IN ITS WASHINGTON DIRECTORY OPERATIONS ATTRIBUTABLE TO THE LINKAGE MR. BROSCH CLAIMS BETWEEN DEX AND QC'S TELEPHONE OPERATIONS?

A. No. Dex's recent revenue growth cannot be attributed to QC's telephone operations. Between 1999 and 2001, QC's access lines declined by 5.1 percent while during this same period of time Dex's Washington directory revenues grew by [BEGIN QWEST CONFIDENTIAL] ******* [END QWEST CONFIDENTIAL] percent. While Dex's revenues in Washington grew by [BEGIN QWEST CONFIDENTIAL] *** [END QWEST CONFIDENTIAL] percent from 2000 to 2001, revenues from QC listing in Dex's Primary directories in Washington have actually [BEGIN QWEST CONFIDENTIAL] ************************ [END QWEST CONFIDENTIAL] percent. If Dex's business were linked to the telephone operations, one would expect to find a correlation, but that correlation does not exist. That is because a significant portion of Dex's business comes not from the telephone subscribers of QC, but from subscribers of other telephone services providers both inside and outside Washington. QC's customers have no linkage to and no claim on this part of Dex's business.

Q. WERE SECONDARY DIRECTORIES AND NON-QWEST LISTINGS EXCLUDED FROM THE IMPUTATION CALCULATION IN THE LAST RATE CASE?

A. No. Qwest did not exclude the revenues from this calculation and as a result the imputation has been higher than it would have otherwise been. I discussed the reasons these revenues were not excluded earlier in my testimony. Inadvertently including such revenues in the last imputation calculation does not create a customer claim on the gain from these operations.

VII. RISKS OF TRANSFER

Q. MR. BROSCH LISTED SEVERAL RISKS TO QC CUSTOMERS THAT HE CLAIMS ARE CREATED BY THE SALE OF DEX. IS THE RISK ASSOCIATED WITH THE LOSS OF DEX'S INCOME STREAM AND ITS CASH FLOW A SEPARATE RISK THAT MUST BE ADDRESSED?

A. No. This risk goes to the question of whether or not Dex should be sold. Mr. Brosch has agreed that selling Dex at this time to address Qwest's financial situation is necessary. Revenues from Dex's income stream have been imputed to QC's revenue requirement, but QC does not actually receive the revenues, so there are no QC risks associated with the loss of these revenues.

Q. IS THERE A RISK TO QC CUSTOMERS BECAUSE REGULATORS MAY LOSE ACCESS TO DIRECTORY PUBLISHING FINANCIAL AND OPERATIONAL INFORMATION THAT IS NEEDED TO EVALUATE TELEPHONE COMPANY FINANCIAL PERFORMANCE AND REVENUE REQUIREMENT?

A. No. Once this Commission determines how the gain from the sale of Dex is to be distributed, there will be no need to have access to the Buyer’s financial records.

Q. DOES THE SALE REDUCE THE COMMISSION'S ABILITY TO REGULATE QWEST'S DIRECTORY PUBLISHING OBLIGATION TO CUSTOMERS?

A. No, it does not. This claim strikes me as a scare tactic. This Commission regulates QC and this sale will not limit its ability to regulate QC's publishing obligations. There are many incumbent and competitive local exchange carriers throughout this country and in Washington that meet their publishing obligations through contracts with unaffiliated publishers. A number of Bell and non-Bell companies operated this way even prior to 1984.[7] As I have previously testified, Dex currently meets the regulatory obligations of ten unaffiliated LECs in Washington. The 50-year Publishing Agreement includes quality control issues and assures that all publishing obligations will be well met.

Q. WILL THE SALE OF DEX LIKELY INCREASE CORPORATE SHARED COSTS TO BE BORNE BY QC?

A. Not likely. Qwest is in the midst of an ongoing process of evaluating the need for corporate services or overheads. Although it would take a special study to attempt to quantify the actual impact on QC's regulated operations, needs will almost certainly decrease with the sale of Dex and therefore, it is unlikely that QC's

[7] Illinois Bell, Cincinnati Bell, New York Telephone, and Chesapeake & Potomac with R.H. Donnelley, South Central Bell, Wisconsin Bell, Ohio Bell and United Telephone with L. M. Berry. New Jersey Bell with National Telephone Directory Company, Continental Telephone with Mast Advertising & Publishing, and Northwest Telephone with NorTel.

portion of corporate shared costs will increase as a result of this sale.

Q. FINALLY WHAT ABOUT THE RISK ASSOCIATED WITH ALLOCATING THE GAIN TO SHAREHOLDERS?

A. Mr. Brosch discusses a "risk" associated with attributing all of the gain to shareholders. I have identified the portion of this sale that is associated with Qwest's regulatory directory obligation in which QC's Washington customers and shareholders have an interest. The next step is to determine a gain allocation that balances the interests of customers and shareholders. Mr. Grate's and Mr. Reynolds' testimonies address this issue.

VIII. TANGIBLE AND INTANGIBLE ASSETS

Q. DR. SELWYN HAS IDENTIFIED THE ASSETS CONTRIBUTED BY QC TO THIS SALE. DO YOU AGREE WITH HIS LIST?

A. No. Dr. Selwyn has taken the position that everything of value in the sale has been contributed by QC and must be considered a regulatory asset. He has excluded only those agreements that will be replaced following the sale and liabilities to Dex. Dr. Selwyn has included all the gain from the sale of the NewVentures/Internet lines of business, even though this business was established and developed, not only outside of the regulated QC operations, but also separately from Dex and was only integrated with Dex Directories following the merger with Qwest. The assets associated with this line of business were acquired through shareholder investment and were not in any way tied to QC's regulated telephone operations or Washington ratepayers. Dr. Selwyn has claimed patents, licenses, trade secrets, know-how and other intangible values that stem directly from this line of business for Washington ratepayers. However, he has ignored the last twenty years of organization in his analysis. The facts are that Dex has operated in a separate affiliate for the last twenty years.

Q. ARE YOU IGNORING PREVIOUS COMMISSION ORDERS AND ATTEMPTING TO RE-ARGUE THE PAST DIRECTORY CASES?

A. No. Qwest acknowledges that this Commission ordered that the transfer was not a permanent transfer of the business to Dex and that only the tangible assets identified are to be considered transferred. None the less, we cannot ignore the organizational structure that has existed since January 1, 1984. This is important in evaluating the intangible assets and goodwill that Dr. Selwyn has identified in his testimony. Dr. Selwyn spends many pages identifying, defining and discussing the intangible assets. He concludes that the majority of the value of the intangible assets is due to three agreements between the Buyer and QC. He has identified these agreements as: 1) the Publishing Agreement; 2) the Non-Compete Agreement; and, 3) the Expanded Use License Agreement. I will discuss each of these individually.

Q. WHAT VALUE IS ASSOCIATED WITH THE EXPANDED USE LICENSE AGREEMENT?

A. The value associated with this agreement is the significant compensation that flows on an ongoing basis from the Buyer directly to QC. This five-year agreement is not an exclusive agreement. Without any evidence or justification, Dr. Selwyn implies that QC may not offer this expanded use license agreement to other publishers at the same price. He has no basis for this assertion. He further asserts that perhaps QC has priced this product so high that it has priced other publishers out of the market. Again, Dr. Selwyn has no basis for this implication. Prior to the 1999 FCC "SLI" order, QC offered Publisher Lists at between $0.19 to $0.38 per listing and Expanded Use Database listings at $0.13 to $0.21 per listing for an initial database load and $0.30 to $0.57 per listing for a database update. The ranges depend on the format and volume purchased. Following the SLI order by the FCC, QC revised its SLI offerings. It makes subscriber lists available for $0.04 per listing and updates available for $0.06 per listing. To obtain the expanded use listings, Dex pays an additional $0.04 and $0.06 per listing or a total of $.08 and $0.12 per listing. Any other publisher can purchase the expanded use listings for the same price Dex pays. Since QC revised its offerings, other publishers began purchasing the lower priced publisher listings. To date, no publisher, including those publishers that had previously purchased the expanded use product, has requested the expanded use product. Any allegation Dr. Selwyn makes that expanded use listings provide Dex a unique value unavailable to other publishers is pure, unsubstantiated supposition that implies Dex receives additional intangible value from QC where none actually exists. QC is fairly compensated on an on-going basis for the expanded use product and no additional intangible value can be attributed to this agreement.

Q. PLEASE DESCRIBE THE PUBLISHING AGREEMENT.

A. The Publishing Agreement Dex will have with the Buyer following the sale is virtually identical to the agreements that Dex has with over one hundred independent and competitive local exchange carriers. In all of these agreements, Dex, the publisher, agrees to publish the listings of the local exchange carrier and deliver white and yellow pages directories free of charge to all the customers of the local exchange carrier. Dex agrees to incur these costs and assume these obligations in exchange for being named the official publisher of the carrier. The parties stand at arms length from each other and agree to exchange what they perceive to be equal values. The values exchanged in these arms-length, non-affiliate agreements are the commitments the parties make to each other—no payments are made by either party. The only difference between Dex's agreements with these other local exchange carriers and Dex's agreement with QC is the length of its term (fifty years).

Q. IS THERE VALUE IN THIS VERY LONG TERM AGREEMENT?

A. Yes, there certainly is. Again, equal value flows in each direction. The Buyer is assured the official publisher status for fifty years, and QC and QC's customers are assured quality directories at no cost for this same period of time.

The Publishing Agreement provides a mutual benefit to both parties. However, despite this mutual exchange of value, the Commission has found in the Company's prior ratemaking proceedings that additional value, beyond what is provided in the publishing agreements, should flow from Dex to QC's customers in the form of the imputation. If the publishing agreement reflects an equal exchange of value, then the additional value transfer the Commission has required must relate to something else. This additional value is perhaps most appropriately ascribed to the new Non-Compete Agreement between the Buyer and QC.

Q. PLEASE DESCRIBE THE NON-COMPETE AGREEMENT.

A. The non-compete agreement between the Buyer and QC basically assures the Buyer that QC will not re-enter the publishing business and compete against the Buyer by publishing directories in the publisher's region unless the Publishing Agreement is terminated. I agree with Dr. Selwyn, that there is significant value in this agreement that flows from QC to the Buyer without on-going compensation to QC. This value is included as an intangible asset in the purchase price.

Q. HAS DEX MANAGEMENT CONTRIBUTED TO THE GOODWILL VALUE OF THE BUSINESS THAT HAS BEEN SOLD?

A. Yes, of course. Dex has been operated in a separate affiliate for almost twenty years without oversight or management input from QC. It is unrealistic to maintain that it has succeeded and grown over this considerable period of time through nothing other than its affiliation with QC. Dr. Selwyn implies that a chain pharmacy may not be able to maintain the loyal customer base established by an independent pharmacy owner, thereby losing the incumbent goodwill.[8] Although Dex has operated separately all this time, Dr. Selwyn attributes virtually all of the ongoing goodwill and franchise value to Dex's relationship with QC. Dr. Selwyn's attempt to portray Dex as succeeding despite itself relies on intentionally biased data should be disregarded.

Apparently the business judgement and strategy of Dex's management is to be expected, although not valued, when considering Dex's expansion of its business related to non-affiliate lines of business such as Secondary directories and non-Qwest listings. Dr. Selwyn admits that

> "Dex clearly has wide discretion in determining how it should design and produce the directories that it publishes, including those published in order to meet Qwest's regulatory obligations concerning directories. That discretion allows Dex to follow its best business judgements as to how best maximize the utility and value of its directories, from relatively narrow design decisions such as the appearance of the directory cover, inclusion of informational pages and type faces, to more strategic decisions such as to include other ILECs' subscriber listings or to introduce "secondary" directories."[9]

Dr. Selwyn accepts and even discounts these Dex management contributions in order to attribute gains from these non-affiliate lines of business to QC and its customers. Dr. Selwyn chooses to ignore the fact that Dex is no longer a business that only publishes for an affiliate, but has grown far beyond the business that it was

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[8] Selwyn, at page 84.
[9] Selwyn, page 102, lines 9 to 15 (emphasis added).

when it was operated within the regulated telephone business. This growth and expansion is due to the management and strategic planning of Dex and is not in any way attributable to QC or to QC's customers. Dex has expanded the scale of its business to include other incumbent and competitive local exchange carriers and the scope of its business with additional products.

The direct marketing line of business, for example, was begun in an unregulated affiliate separate from both QC and Dex. This line of business has required significant investment and, according to the market analysis Dr. Selwyn provided as Confidential Exhibit LLS-13C, this business will most certainly require additional investment and strategic planning. This investment and strategic planning were not and will not be tied to QC or QC's customers.

Dr. Selwyn is correct to conclude that there is an intangible value associated with the Publishing/Non-Compete agreements. However, he is incorrect when he concludes that all of the intangible and goodwill value is a result of the regulatory obligation associated with the publishing of directories for QC. QC's regulatory directory obligation is limited to the tangible and intangible assets of Dex used specifically for the publication of directories for QC. This is the only portion of the sale that this Commission can and should consider.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes, it does.