

Brooks E. Harlow
brooks.harlow@millernash.com

April 30, 2003

VIA E-MAIL, FACSIMILE AND U.S. MAIL

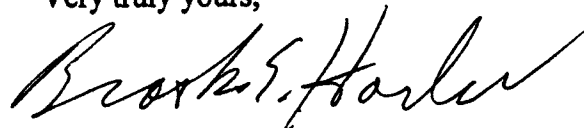
Ms. Carole J. Washburn
Executive Secretary
Washington Utilities and Transportation Commission
Post Office Box 47250
1300 S. Evergreen Park Dr. SW
Olympia, Washington 98504-7250

Subject: Docket No. UT-021120

Dear Ms. Washburn:

Enclosed, for filing, are an original and 12 copies of Dex Holdings' Answer in Opposition To Staff's Motion To Strike Portions Of The Rebuttal Testimony Of Joseph P. Kalt, in the above-referenced docket.

Very truly yours,



Brooks E. Harlow


cc w/enc: ALJ Dennis Moss
All Parties of Record

CERTIFICATE OF SERVICE - Docket UT-021120

I hereby certify that a true and correct copy of the foregoing was sent by e-mail, facsimile, and first-class mail addressed to the following:

<u>Non-Confidential</u>	<u>Confidential</u>	<u>Highly Confidential</u>
Gregory J. Kopta Davis Wright Tremaine 2600 Century Square 1501 Fourth Avenue Seattle, WA 98101-1688	Lisa Anderl Adam Sherr Qwest Corporation 1600 7 th Avenue, Room 3206 Seattle, WA 98191	Stephen S. Melnikoff Regulatory Law Office U.S. Army Litigation Center 901 N. Stuart Street, Suite 700 Arlington, VA 22203-1837
	Phil Roselli Qwest Corporation 1801 California Street, Suite 4900 Denver, CO 80202	Greg Trautman Assistant Attorney General 1400 S. Evergreen Park Dr. SW P.O. Box 40128 Olympia, WA 98504-0128
	Arthur A. Butler Ater Wynne LLP 601 Union Street, Suite 5450 Seattle, WA 98101	Michael Brosch Utilitech, Inc. 740 NW Blue Parkway, Suite 204 Lee's Summit, MO 64086
	Richard R. Cameron Latham & Watkins 555 Eleventh Street, NW, Suite 1000 Washington, DC 20004	Ronald Roseman 2011 14 th Avenue East Seattle, WA 98112
		Robert Cromwell Public Counsel Section Office of Attorney General 900 Fourth Avenue, Suite 2000 Seattle, WA 98164-1012
		Charles W. King Snavey King Majoros O'Connor & Lee, Inc. 1210 L Street Washington, DC 20005

Dated at Seattle, Washington this 30th day of April, 2003.



 Carol Munnerlyn

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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

DEX HOLDINGS' ANSWER IN OPPOSITION TO STAFF'S MOTION TO STRIKE PORTIONS OF THE REBUTTAL TESTIMONY OF JOSEPH P. KALT

I. INTRODUCTION

In this Answer, Dex Holdings, LLC ("Dex Holdings") urges the Commission to reject the April 24, 2003, Staff motion¹ to strike portions of the testimony of Dex Holdings' expert Joseph P. Kalt.² In its Motion, Staff mischaracterizes and misrepresents Dr. Kalt's testimony as improperly challenging traditional directory publishing imputation and inappropriately relitigating this "policy that has been explicitly upheld by the State Supreme Court in *US West Communications, Inc., v. Utilities and Transp. Comm'n*, 134 Wn.2d 74, 949 P.2d 1337 (1997)."³ Staff erroneously argues that any discussion regarding imputation is not the proper subject of rebuttal and should have been addressed during Dex Holdings' direct

¹ Motion of Commission Staff to Strike Portions of the Rebuttal Testimony of William E. Taylor and Joseph P. Kalt, or in the Alternative, to Permit the Filing of Surrebuttal Testimony and Reschedule Evidentiary Hearings, ("Motion").

² In this answer, Dex Holdings will address the issues in Staff's Motion related only to the testimony Dr. Joseph P. Kalt. Qwest will respond to Staff's concerns related to the testimony of Dr. William E. Taylor.

³ Motion at ¶¶ 1, 5, 9.

1 testimony.⁴ Staff also mistakenly asserts that Dr. Kalt "couched" his testimony as rebuttal to
2 Dr. Selwyn's testimony in order to introduce new evidence and deprive Staff of the right to
3 respond.⁵

4 The Commission should reject Staff's Motion in its entirety, including Staff's
5 (a) primary request to strike Dr. Kalt's testimony at page 2, line 17 through page 3, line 12; and
6 page 11, line 14 through page 14, line 20; and (b) alternative request to file surrebuttal testimony
7 and delay evidentiary hearings by at least one month, because Dr. Kalt's testimony constituted
8 proper rebuttal for at least three reasons. *First*, contrary to Staff's assertion, the challenged
9 portion of Dr. Kalt's testimony does not address the Commission's past determination that
10 imputation served the public interest as an interim measure pending Washington ratepayers'
11 receipt of fair value for the Dex assets. *Second*, Dr. Kalt's testimony properly exposes the false
12 choice that Drs. Selwyn and Blackmon attempt to offer the Commission between perpetual and
13 growing imputation on the one hand and the equivalent achieved through confiscation of a
14 portion of the gain far in excess of any reasonable measure of that allocable to Dex's Washington
15 operations on the other. *Third*, Dr. Kalt's testimony properly rebuts Staff's attempt to relitigate
16 the *US West* case by countering the Staff witnesses' apparent (and erroneous) belief that it would
17 be sound public policy for the Commission to deny Qwest the authority to consummate an arms-
18 length sale of Dex, refuse to follow well-established precedent for sharing the gain equitably
19 between ratepayers and shareholders, and preserve instead the interim remedy of revenue
20 imputation, contrary to the explicit order of the Supreme Court in the *US West* case.

21 II. ARGUMENT

22 Dex Holdings does not request that the Commission again address the validity of
23 current imputation absent the sale of Qwest Dex. To the contrary, Dex Holdings believes that
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25 ⁴ Motion at ¶ 1.

26 ⁵ Motion at ¶ 9.

1 such an analysis is beyond the scope of the issues presented in this proceeding. Dex Holdings
2 believes that, at the time the sale closes, Washington law provides for the elimination of
3 imputation in favor of an allocation of the gain between ratepayers and shareholders in
4 accordance with the Commission's and Supreme Court's prior orders.⁶ This is not relitigating the
5 imputation issue or introducing new evidence. It is providing testimony on a major underlying
6 issue confronting the Commission that Qwest identified even in its application nearly eight
7 months ago.⁷ Moreover, because Staff argues in its direct testimony for perpetual imputation
8 even after the arm's-length sale closes⁸ in derogation of Commission and Supreme Court orders,
9 further clarification on elimination of imputation after the sale is not only proper during Dex
10 Holdings' rebuttal, but it is required.

11 **A. Dex Does Not Attempt to Relitigate the Imputation Issue**

12 Although Staff throws about general assertions that Dr. Kalt's testimony
13 "constitute[s] a direct challenge to the Commission's well-established policy of imputation that
14 has been upheld by the State Supreme Court,"⁹ Staff fails to provide even one specific example
15 or cite from Dr. Kalt's testimony that supports this claim. To the contrary, a careful review of
16 Dr. Kalt's testimony reveals that Dr. Kalt does not challenge the Commission's use of imputation
17 prior to the advent of competition and the sale of Qwest Dex. For example, in a portion of the
18 challenged testimony, Dr. Kalt states explicitly that:

19 Following the breakup of the Bell system, the WUTC's use of imputation (or the
20 equivalent) was an understandable response to the restructuring of the industry

21 ⁶ *US West*, 134 Wn.2d at 102, 949 P.2d at 1352; *In the Matter of the Application of AVISTA CORPORATION for*
22 *Authority to Sell Its Interest in the Coal-Fired Centralia Power Plant, et al*, Consolidated Docket Nos. UE-991255,
UE-991262, UE-991409, Second Supplemental Order, Order Approving Sale with Conditions at 27-32, 42-43.

23 ⁷ Qwest Corporation's Application Regarding Transfer and Sale of Directory Business and Notice of Possible
24 Affiliated Interest Transaction at 6, lines 17-20, ("Washington Supreme Court * * * held that imputation of directory
earnings could end when there was a sale of the business and fair compensation had been received by U S WEST.")

25 ⁸ Blackmon Direct Testimony at 29.

26 ⁹ Motion at ¶ 9.

1 and the transition to a more dynamic and competitive setting. Kalt Rebuttal
2 Testimony at 13, lines 18-20.

3 Such testimony belies Staff's bald assertion that Dr. Kalt "challenges the
4 'traditional imputation' practices that have been applied by the Commission for almost two
5 decades."¹⁰ In fact, Dr. Kalt's testimony is perfectly consistent with the determinations of the
6 Commission and the Supreme Court that imputation is appropriate as an interim measure only,
7 until ratepayers receive fair value for any interest in the directory publishing assets.

8 **B. Dr. Kalt's Testimony Properly Rebuts Staff Arguments Against the
9 Dex Sale**

10 The challenged portion of Dr. Kalt's testimony also exposes the false choice
11 Drs. Selwyn and Blackmon offer to the Commission between perpetuating imputation by
12 denying Qwest authority to consummate the Dex sale on the one hand, and imposing exorbitant
13 regulatory conditions that achieve the same functional result on the other. Indeed, Staff fails
14 even to argue whether Dr. Kalt's testimony constitutes proper rebuttal to Dr. Blackmon. In fact,
15 Dr. Kalt's challenged testimony that imputation is unsustainable as both directory publishing and
16 local exchange businesses evolve and become more competitive strikes at the heart of Dr.
17 Blackmon's conclusion that "the transaction is not in the public interest because it harms
18 customers."¹¹

19 Dr. Kalt strongly rebuts the claims of these two Staff witnesses that the
20 Commission should block the Dex sale in order to preserve continued, increasing and perpetual
21 imputation of directory publishing revenues to Qwest Corp., or impose regulatory conditions that
22 would achieve an equivalent result if they did not make closing prohibitive for the parties
23 altogether. In this vein, Dr. Kalt explains that, especially in light of the mandated moves toward

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25 ¹⁰ Motion at ¶ 1.

26 ¹¹ Blackmon Direct Testimony at 4, lines 3-4.

1 a competitive local exchange environment, continued indefinite increases in the imputation
2 amount are not sustainable:

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4 Where imputation cannot, under current policy, continue effectively forever, and
5 where events (e.g., increased yellow pages competition) necessarily inhibit the
6 WUTC's ability to retain the value of Qwest Dex for ratepayers in the future,
7 approval of the sale of Qwest Dex, with proper account of ratepayer interests, is
8 indicated. Moreover, as described above, the sale price of Qwest Dex provides a
9 sound basis on which to evaluate ratepayer interests in the proposed transaction.
10 Kalt Rebuttal Testimony at 14, lines 6-11.

11 As Dr. Kalt properly explains, Staff's vision of indefinitely increasing imputation
12 is a mere chimera. It is the essence of proper rebuttal for a witness to expose the flaws and
13 weaknesses in the opponent's analysis. Once a rebuttal witness has done so, the mere fact that
14 Staff would like another opportunity to shore up the shaky foundation for their theory of the case
15 provides no legal basis on which to grant relief.

16 **C. Dr. Kalt's Testimony Is Required Rebuttal of Staff Arguments in**
17 **Favor of Imputation.**

18 Even more than merely exposing the false choice painted by Staff, Dr. Kalt's
19 testimony is proper rebuttal of Staff's claims that the public interest demands continued
20 imputation for the indefinite future. Staff's testimony that imputation should continue
21 indefinitely opened the door for rebuttal on the issue of whether perpetual imputation or its
22 equivalent—in lieu of gain sharing under the principles of *Centralia* and *Democratic Central*
23 *Committee*—is in the public interest. Dex expected Staff to follow this established precedent and
24 agree to end imputation in exchange for a fair allocation of the gain on the Qwest Dex sale. Staff
25 instead took the far more extreme and less defensible position that ratepayers are entitled to
26 continued and expanding imputation in perpetuity, and that the Commission should not approve
the arm's-length sale conducted through a competitive auction process.¹² Whatever the merits of

¹² Selwyn Direct Testimony at 11, 45-46, 52-54, 109; Blackmon Direct Testimony at 3, 29.

1 imputation as an interim means of preserving the status quo for ratepayers pending their receipt
2 of compensation for any interest they may hold in the directory publishing business, Dr. Kalt's
3 challenged testimony explains that imputation would make a poor long-term solution:

4
5 However, in the presence of sound and clearly established goals of enhanced
6 competition and reliance on marketplace forces for determining the quality,
7 packaging, and pricing of local exchange services, the public's interest is not
8 served by *perpetual* use of cash flows from an unregulated business to reduce
9 prices charged by the ILEC as it competes with competitive carriers. In fact, if
10 the policy of promoting competition were successful, the very success of the
11 policy would eliminate the basis for imputation entirely. For this reason, and
12 others, it is not proper to enact policies today based on the false presumption that
13 imputation can or should continue indefinitely into the future. Kalt Rebuttal
14 Testimony at 13, line 20 through 14, line 2 (emphasis added).

15 This is in direct rebuttal to Staff which seeks to block the sale in order to preserve
16 imputation indefinitely or, in the alternative, to "share" substantially more than the Washington
17 portion of the actual gain to achieve the effect of perpetual and growing imputation
18 notwithstanding the sale. Such a goal is not sound public policy, as Dr. Kalt explains in the
19 testimony Staff seeks to strike. Dr. Kalt submits that the Commission should eventually end
20 imputation, and the sale of Qwest Dex provides an opportune time to do so for the benefit of
21 ratepayers.

22 Indeed, Dex Holdings is astonished by Staff's claim that Dr. Kalt ambushed Staff
23 by taking a position that supports an end to imputation after the sale of Qwest Dex with a proper
24 allocation of the gain between ratepayers and shareholders. The Washington Supreme Court, in
25 the case cited by Staff in its Motion, very clearly articulated this same position, as follows:

26 We hold the Commission was within its statutory authority to impute excess
revenues from the publishing of the yellow pages to the revenue of US West.
US West may petition the Commission for an end to imputation if and when it can
show it has received fair value for the transfer of the asset. *US West*, 134 Wn.2d
at 102; 949 P.2d at 1352.

1 This position is supported by federal law in *Democratic Central Committee*,¹³
2 state law in *US West*,¹⁴ and the Commission in *Centralia*.¹⁵ If anyone is seeking to relitigate the
3 Supreme Court case, it is Staff, not Dex Holdings and Qwest. Staff should not have been
4 surprised when Dex Holdings, through Dr. Kalt, provided such rebuttal.

5 Further, the issue of ending imputation in favor of gain sharing credit was
6 discussed extensively in the opening testimony of both Qwest and Dex Holdings. In addition to
7 the portions of Ms. Jensen's testimony, now adopted by Mr. Reynolds, that Qwest identifies in
8 its Answer in Opposition to Staff's Motion, Mr. Kennard's initial testimony on behalf of Dex
9 Holdings cited the wisdom of exchanging the uncertainty of continued imputation for the
10 certainty of a gain sharing solution under existing Washington precedent.¹⁶

11 III. RELIEF

12 The Commission should deny Staff's motion to strike or for a continuance to file
13 surrebuttal. Dex Holdings would not object to the admission of the testimony for the limited
14 purpose of arguing for an end to imputation *only in the context of consummating the sale of*
15 *Qwest Dex*, since that was what was intended all along. Dex Holdings strongly opposes any
16 change to the procedural schedule that would delay the Commission's hearing in this matter.
17 A continuance of the hearing would be prejudicial to Dex Holdings as it would hamper Dex
18 Holdings' efforts to obtain financing for the Dex purchase by (1) increasing uncertainty that
19 regulatory approval can be obtained in time to close the sale; and (2) limiting the ability of Dex
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21 _____
22 ¹³ *Democratic Central Committee of the District of Columbia -v- Washington Metropolitan Area Transit*
Commission, 485 F.2d 796 (DC Cir. 1973), cert. Den. 415 U.S. 935 (1974).

23 ¹⁴ *US West Communications, Inc., v Utilities and Transp. Comm'n*, 134 Wn.2d 74, 949 P.2d 1337 (1997).

24 ¹⁵ *In the Matter of the Application of AVISTA CORPORATION for Authority to Sell Its Interest in the Coal-Fired*
25 *Centralia Power Plant, et al*, Consolidated Docket Nos. UE-991255, UE-991262, UE-991409, Second
Supplemental Order, Order Approving Sale with Conditions.

26 ¹⁶ See, e.g., Kennard Direct Testimony at 9, lines 21-23.

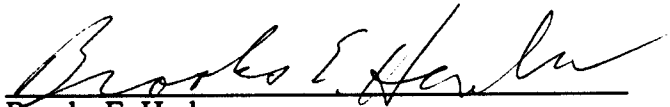
1 Holdings to take advantage of favorable conditions in the financial markets by narrowing the
2 window during which it can seek financing for the purchase.

3 **IV. CONCLUSION**

4 Staff mischaracterizes and misunderstands the challenged testimony of Dr. Kalt.
5 Neither Dr. Kalt nor Dex Holdings seek to challenge the current practice of imputation except in
6 conjunction with approval of the sale. That has been a central issue of this case since Qwest
7 filed the application for approval, and Dr. Kalt's testimony properly responds to Staff's position
8 opposing the sale as a means of preserving indefinite and increasing imputation. For the
9 foregoing reasons, Staff's motion should be denied.

10 DATED this 30th day of April, 2003.

11 MILLER NASH LLP

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13 Brooks E. Harlow
14 WSB No. 11843
15 William R. Connors
16 WSB No. 23232

17 Attorneys for Intervenor
18 Dex Holdings, LLC