

1 BEFORE THE WASHINGTON UTILITIES AND
2 TRANSPORTATION COMMISSION

3 In the Matter of the)
4 Application of)
5 QWEST CORPORATION)
6) Docket No. UT-021120
7 Regarding the Sale and)
8 Transfer of Qwest Dex to) Volume IV
9 Dex Holdings, LLC, a) Pages 204 to 361
10 non-affiliate,)
11 _____)

12 A hearing in the above matter was held on May
13 19, 2003, from 1:30 p.m to 6:00 p.m., at 1300 South
14 Evergreen Park Drive Southwest, Room 206, Olympia,
15 Washington, before Administrative Law Judge DENNIS MOSS
16 and Chairwoman MARILYN SHOWALTER and Commissioner
17 RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

18 The parties were present as follows:

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1 P R O C E E D I N G S

2 JUDGE MOSS: Good afternoon, everyone. We
3 are convened this afternoon in the matter styled
4 Application of Qwest Corporation regarding the Sale and
5 Transfer of Qwest Dex to Dex Holdings, LLC, a
6 non-affiliate, Docket Number UT-021120. We are
7 scheduled this week to have our evidentiary proceedings.
8 Those now will include and involve a settlement
9 stipulation that was filed on Friday afternoon, and we
10 will talk more about that momentarily.

11 I believe we will be conducting ourselves on
12 the record from this point forward, so let us go ahead
13 and take appearances as a first order of business, and
14 we'll start with Qwest.

15 MS. ANDERL: Thank you, Your Honor, Lisa
16 Anderl and Adam Sherr, in-house attorneys appearing for
17 Qwest.

18 JUDGE MOSS: And let's just proceed around
19 the room.

20 MR. HARLOW: Thank you, Your Honor, good
21 afternoon, Brooks Harlow appearing on behalf of
22 intervenor Dex Holdings, LLC.

23 MR. CAMERON: And Richard Cameron, Latham &
24 Watkins, Washington, D.C., on behalf of Dex Holdings,
25 LLC.

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1 MR. MELNIKOFF: Steve Melnikoff on behalf of
2 the Consumer Interest Department of Defense and all
3 other Federal Executive Agencies.

4 MR. ROSEMAN: Ron Roseman appearing on the
5 intervenor AARP.

6 MR. BUTLER: Arthur A. Butler appearing on
7 behalf of WeBTEC.

8 MR. CROMWELL: Robert Cromwell, Assistant
9 Attorney General on behalf of Public Counsel.

10 MR. TRAUTMAN: Greg Trautman, Assistant
11 Attorney General for Commission Staff.

12 MS. SMITH: Shannon Smith for Commission
13 Staff.

14 JUDGE MOSS: All right, then I will just note
15 for the record that we previously had communication from
16 XO Washington's counsel, Mr. Kopta, that that party in
17 the proceeding would not be participating actively this
18 week, and I think everyone else is represented here in
19 the room, so thank you all very much.

20 Now we did meet informally this morning. I
21 met with you all for a brief period, and we talked about
22 the fact that the settlement or a settlement or a
23 partial settlement was filed on Friday accompanied by
24 certain testimony, and we marked all of that material
25 for identification.

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1 It seems that the first order of business we
2 need to take up this afternoon is the question of how to
3 proceed, and the first step in that is to turn, I will
4 turn to Staff and ask for a status conference. You did
5 have an opportunity this morning after our meeting all
6 together to have informal discussions among yourselves,
7 the parties. With respect to the settlement, Staff has
8 not taken a formal position on that, and so I would like
9 to have you do that now.

10 MS. SMITH: Thank you, Your Honor, this is
11 Shannon Smith again for Commission Staff. And although
12 we did meet with the parties this morning, Staff
13 continues to oppose or does oppose the settlement that
14 the other parties have reached.

15 JUDGE MOSS: All right. With that then, we
16 need to turn to the question of what process we need to
17 follow to consider the settlement in the context of our
18 overall proceeding. I understand it is the preference
19 of the settling parties to put into the record or to at
20 least seek the admission of the pre-filed testimonies
21 and exhibits of the several witnesses that are
22 identified in the exhibit list in the proceeding.

23 And so with that understanding, I would again
24 turn to Staff. As the only active opponent to the
25 proposed settlement agreement, we will want to consider

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1 your needs processwise in terms of the case, and so I
2 would like you to outline that if you could.

3 MS. SMITH: Thank you, Your Honor. I will do
4 my best, and if my co-counsel, Greg Trautman, has any
5 thoughts, I would expect him to tap me on the shoulder
6 and let me know.

7 Commission Staff anticipates that we would
8 just go ahead this afternoon with the evidentiary
9 hearing as scheduled but postponed several hours from
10 this morning to this afternoon. At this point in time,
11 the Commission Staff has not had an adequate opportunity
12 to study the settlement and the supporting documents,
13 and so we would be opposed to any panel presentation of
14 the settlement this afternoon. Perhaps during a break
15 we could discuss with the other parties what a good time
16 might be for doing that and how to perhaps go about
17 doing that, but we simply have not had time -- we have
18 not had time to prepare any opposition to such a panel,
19 and we would like the opportunity to do that prior to a
20 panel being seated.

21 JUDGE MOSS: And in terms of your suggestion
22 that we might simply go ahead with the evidentiary
23 proceedings as scheduled, our schedule had called for
24 having Mr. Kennard as our first witness. And, of
25 course, he has also submitted supplemental testimony

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1 with respect to the settlement stipulation. If we chose
2 to follow that procedural path, would Staff be prepared
3 to cross examine Mr. Kennard today?

4 MS. SMITH: Yes, we would be prepared to
5 cross examine Mr. Kennard today, including
6 cross-examination, if any, on the brief supplemental
7 testimony he has submitted with respect to the
8 settlement. It is the other witnesses who have
9 submitted testimony in favor of the settlement that we
10 would want to have more time to prepare for
11 cross-examination. So we would be prepared to handle
12 all cross of Mr. Kennard this afternoon.

13 JUDGE MOSS: And when you say the other
14 witnesses, that would be Mr. Reynolds for Qwest and
15 Mr. Brosch --

16 MS. SMITH: Yes, and I believe that the
17 Department of Defense is going to offer some testimony
18 from Mr. King in support of the settlement; is that
19 correct?

20 MR. MELNIKOFF: That is correct, he will be
21 here tonight. I hope to have that testimony filed
22 tomorrow.

23 JUDGE MOSS: And did I understand correctly
24 that Mr. Brosch will be available tomorrow morning,
25 Mr. Cromwell?

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1 MR. CROMWELL: Mr. Brosch may be available
2 tomorrow afternoon depending upon how -- I'm sorry, he
3 may be available tomorrow afternoon depending upon the
4 timing of his flight, but he is for certain available as
5 we had arranged on Wednesday.

6 JUDGE MOSS: On Wednesday.

7 MR. HARLOW: I wanted to note that we had
8 asked Staff for the accommodation to take care of
9 Mr. Kennard today, and we greatly appreciate Ms. Smith's
10 willingness to go forward with that.

11 JUDGE MOSS: And it sounds like we could have
12 Mr. King as early as tomorrow afternoon?

13 MR. CROMWELL: That may be possible -- I'm
14 sorry.

15 JUDGE MOSS: I was talking to Mr. Melnikoff.

16 MR. MELNIKOFF: I believe he would be
17 available. Whether or not I could have testimony filed
18 is a logistical hurdle that I have to get over.

19 JUDGE MOSS: Of course, that may impact on
20 Staff depending on how extensive and detailed his cross
21 is, you may want additional time.

22 MS. SMITH: Your Honor, assuming that we go
23 forward with evidentiary hearings notwithstanding the
24 settlement, we would propose to keep the same order of
25 witnesses to the extent possible.

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1 JUDGE MOSS: Mm-hm.

2 MS. SMITH: And my comment about not being
3 prepared to do the cross had to do with the
4 cross-examination of any panel that's put on to support
5 the settlement.

6 JUDGE MOSS: Or we might alternatively
7 proceed by simply having the witnesses individually.
8 But again, you would want some additional time to
9 prepare for Mr. Brosch, Mr. King, who am I leaving out?

10 MS. SMITH: Mr. Reynolds.

11 JUDGE MOSS: Mr. Reynolds, yes, thank you.

12 MS. SMITH: Thank you, Your Honor, that's
13 correct.

14 JUDGE MOSS: And we had previously under our
15 prior plans before Friday, last Friday, we had talked
16 about having Mr. Brosch I believe on Wednesday, and
17 Mr. King, was he -- he was for Friday, wasn't he?

18 MR. MELNIKOFF: He was for Friday, but I
19 think he might be available --

20 JUDGE MOSS: Sooner.

21 MR. MELNIKOFF: -- Thursday morning.

22 JUDGE MOSS: Thursday perhaps. And then I
23 think we have Mr. Reynolds as the third witness, so he
24 would be, presumably if we just proceeded from this
25 point forward, he would be tomorrow, because

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1 Mr. Burnett, the cross for Burnett was indicated at 15
2 minutes. Has that changed substantially?

3 MR. TRAUTMAN: No, Your Honor.

4 JUDGE MOSS: So presumably then we could get
5 to Mr. Reynolds as early as tomorrow if we chose to
6 follow the standing order. Would that be enough time?

7 MS. SMITH: Can I have one moment, Your
8 Honor, please?

9 JUDGE MOSS: Sure.

10 MS. SMITH: Your Honor, we might need a bit
11 more time to prepare to cross examine Mr. Reynolds with
12 respect to the settlement. We would be prepared to go
13 forward with cross-examination on the case on the merits
14 whenever Mr. Reynolds is called. Perhaps if we could
15 have another day and perhaps recall him for cross on
16 that.

17 JUDGE MOSS: If we needed to.

18 MS. SMITH: That would be helpful for us.

19 MR. CROMWELL: Your Honor, is the bridge on?

20 JUDGE MOSS: Yes, it is.

21 CHAIRWOMAN SHOWALTER: Do you want it unmuted
22 are you asking?

23 MR. CROMWELL: Yes.

24 JUDGE MOSS: Do you want to hear from
25 somebody on the bridge line?

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1 MR. CROMWELL: Mr. Brosch may be listening
2 in, and he could tell us precisely when he would expect
3 to be available.

4 JUDGE MOSS: Mr. Brosch, are you on the line?

5 Apparently not.

6 I thought I heard a comment over here.

7 MS. ANDERL: I was just going to say that it
8 does sound like if the Commission did want to do a panel
9 we would probably have at least three witnesses,
10 Mr. Brosch, Mr. King, and Mr. Reynolds, available on
11 Wednesday morning.

12 JUDGE MOSS: We could have that on Wednesday
13 perhaps, yes.

14 CHAIRWOMAN SHOWALTER: I have a question on
15 that. I mean if all parties are settling, then it would
16 make sense to have a panel. If one of the parties
17 isn't, I just pose the question, what is the real value
18 of a panel as distinct from the witnesses going in
19 order, and obviously the end conclusion of the witnesses
20 has altered in light of the settlement by those who are
21 proposing to settle, but why would we have a panel if
22 it's still contested?

23 MS. ANDERL: I think that the parties assumed
24 that that was the Commission's preference.

25 CHAIRWOMAN SHOWALTER: It has been our

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1 practice, but, of course, this is a different situation.

2 MS. ANDERL: And it does, even with some
3 parties not participating in the settlement, I think it
4 does ease the flow of give and take of information with
5 regard to the settlement to the extent that say a
6 certain point was more important to the buyer or more
7 important to Public Counsel. If that question were to
8 be posed to Mr. Reynolds, there would kind of be this
9 endless round of deferrals that you avoid if you've got
10 a panel.

11 CHAIRWOMAN SHOWALTER: But at least
12 Mr. Kennard is only going to be here today.

13 MS. ANDERL: Right, that's right.

14 COMMISSIONER HEMSTAD: Well, Judge Moss, this
15 is really a question of Staff, I guess. How do you see
16 this case proceeding, on a dual track. We have the case
17 in chief that's filed and Staff's position on that, and
18 now we have a settlement proposal of everybody else and
19 the Staff's position on that, but I take it in your
20 cross-examination of the settling party witnesses,
21 you're put in the position of examining them on both the
22 case in chief and the settlement.

23 MS. SMITH: That's correct, Commissioner
24 Hemstad, and I haven't had really, like Ms. Anderl, I
25 think that at least I personally assumed that there

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1 would be a panel at some time for the settlement. And
2 certainly there doesn't need to be. I guess I don't see
3 the need for that, it was just an assumption on my part.

4 I think our biggest concern with respect to
5 the settlement is having adequate time to ask the
6 witnesses the questions that we want to ask them about
7 the settlement. Really whether we do that in a panel or
8 whether we do it on a witness by witness basis, I think
9 our primary concern is the time. So we could adjust how
10 we see this case going forward depending on the Bench's
11 preference as to whether we do the panels or not. And
12 also because of this settlement, we now have
13 cross-examination for Mr. Brosch and Mr. King that we
14 didn't have before, so we would want to work that in
15 too.

16 COMMISSIONER HEMSTAD: And I wondered, does
17 this actually expand the time required for
18 cross-examination or compress it?

19 MS. SMITH: It expands Staff's estimates. It
20 may compress, I think it would compress the cross of the
21 other witnesses, but it extends Staff's, and at this
22 point we don't have an estimate, but we will have one as
23 soon as possible.

24 CHAIRWOMAN SHOWALTER: Well, one logistical
25 question I have is with respect to is it Dr. Brosch or

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1 Brosch?

2 MR. CROMWELL: Brosch.

3 CHAIRWOMAN SHOWALTER: Is it Mr. Brosch?

4 MR. CROMWELL: It's Mr. Brosch.

5 CHAIRWOMAN SHOWALTER: Mr. Brosch, if he is
6 to be here on Wednesday or earlier, is that too soon for
7 you to cross examine him on the settlement aspects, in
8 which case have you conferred with each other to see --
9 to avoid him having to come twice I guess?

10 MS. SMITH: We haven't. We certainly could
11 do that at a break. I think that Staff could be ready
12 to do that, I'm guessing, again I'm not sure I can
13 commit our experts to being ready, but I would imagine
14 that we could be ready to cross-examine the witness by
15 Wednesday. It's just a matter of starting off tomorrow
16 morning on something, and we may not be ready, but I
17 would think that we could be ready to do that on
18 Wednesday. At least that's -- I would like an
19 opportunity to confer before committing us to that, but
20 I think we could do it.

21 CHAIRWOMAN SHOWALTER: I think you're getting
22 that opportunity right now.

23 MS. SMITH: I didn't get confirmation on that
24 point, but I got another point to make for the
25 Commission, and it's just a matter of the Commission's

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1 preference to hear the presentation on the settlement
2 before or after the Commission receives Staff's written
3 testimony in opposition to it. We do intend to file
4 testimony in opposition to the -- in opposition to the
5 settlement, and whether you would want to hear the
6 presentation of that after having read Staff's testimony
7 or if you would like to hear that before reading Staff's
8 testimony and then have Staff's testimony after that. I
9 think it's a matter of your preference.

10 CHAIRWOMAN SHOWALTER: When were you planning
11 to get the testimony in?

12 MS. SMITH: We don't know at this point in
13 time.

14 JUDGE MOSS: Well, let's consider this. We
15 have scheduled through this week, and then we also have
16 two days next week reserved. The 29th and the 30th are
17 reserved. I have not previously heard the suggestion
18 that you would file written testimony in opposition to
19 the settlement, and we can take that into consideration
20 too, but is that, if that's something that the
21 Commission decides it would prefer to have, is that
22 something that could be done by the say early part of
23 next week? And then we could think about doing a panel.

24 MS. SMITH: Yes, Your Honor, we can do that
25 by the early part of next week. It would just be hard

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1 to do it during this week while we're also in here in
2 hearing.

3 JUDGE MOSS: That's what I was thinking, you
4 would have a several day period there.

5 MS. SMITH: Yes, we could do it by then, Your
6 Honor.

7 JUDGE MOSS: Let me ask another question here
8 in terms of witness availability. We previously had
9 some constraints with respect to the availability of
10 Mr. King and Dr. Taylor. Now Mr. King's constraint was
11 at the early part of the week, does he have any
12 constraints with respect to the 29th and the 30th?

13 MR. MELNIKOFF: I don't believe so, but since
14 he's going to be out here tonight, I would prefer to
15 have him on this week if we can get him on this week.

16 JUDGE MOSS: And let's see, Taylor would not
17 be a panelist anyway, but what about Dr. Taylor's
18 availability, is Friday -- he was out of the country or
19 something as I recall, so his constraint was also
20 earlier rather than later.

21 MS. ANDERL: That's right. And, in fact,
22 he's cutting his trip short to be in attendance here.
23 We can communicate with him between now and then if
24 things --

25 JUDGE MOSS: If we're going to put him off, we

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1 can --

2 MS. ANDERL: -- develop such that, yeah, he
3 is not going to go.

4 JUDGE MOSS: -- leave him in whatever exotic
5 locale he is.

6 MS. SMITH: If I may interject, if no other
7 party has questions for Dr. Taylor or Mr. Taylor, I'm
8 not sure which, Commission Staff may not have any
9 questions for him either, and we may not have any
10 questions for Mr. Kalt, and we can get back to you by
11 the end of the day with a firm answer on that, but we
12 may not have cross for those two witnesses, and we'll
13 let you know by the end of today.

14 MR. HARLOW: Don't struggle with Dr. Kalt,
15 because he is already in the room.

16 MS. SMITH: Oh.

17 MR. HARLOW: So he is available.

18 MS. SMITH: Thank you.

19 JUDGE MOSS: Mr. Cromwell.

20 MR. CROMWELL: I'm sorry, Your Honor, I don't
21 know Mr. Brosch's availability on the 29th or 30th, but
22 if he were available at that time and it was the
23 Commission's preference to have a panel then, I would
24 request that I in some fashion let him know that today,
25 because he is scheduled to get on a plane tomorrow

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1 morning.

2 JUDGE MOSS: Well, we'll make our process
3 decisions here momentarily and decide how we're going to
4 go forward. This is an information gathering
5 opportunity for us, so that's what we're trying to do.

6 And I assume Mr. Reynolds would be available
7 at any point during the hearing.

8 MS. ANDERL: That's right.

9 CHAIRWOMAN SHOWALTER: Commissioner Hemstad
10 has a comment.

11 COMMISSIONER HEMSTAD: This is a question to
12 the settlement parties, and maybe we have to wait to
13 hear this from each of the witnesses, but will it be
14 your position then that you all have a common position
15 and that's what you will be defending or -- Staff is in
16 a position of having a two track case, are your
17 witnesses then prepared also to defend the original
18 testimony?

19 MS. ANDERL: Well, with regard to Qwest's
20 witnesses, there's -- Qwest witnesses already pretty
21 much had a two track case built in to their testimony
22 because Staff's and Public Counsel's positions were so
23 far apart. We had to respond to Staff's, and we had to
24 respond to Public Counsel. The settlement is very much
25 along the lines of what Public Counsel and Qwest have

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1 both advocated as an appropriate outcome, and so that
2 still leaves the testimony in opposition to Staff's
3 case. So yes, our witnesses certainly are prepared to
4 go ahead and support the settlement and also stand by
5 their testimony in opposition to Staff's position.

6 MR. HARLOW: I'm not sure that kind of
7 addressed what your question was going to or not, but I
8 guess from my perspective as a settling party, I don't
9 think the Staff has a two track case, because the
10 settlement, well, the outcome of the case of any of the
11 parties' positions isn't a matter of finding certain
12 facts and then applying a mathematical formula. Instead
13 what you're dealing with is a range, and the settlement
14 comes down between the parties' ranges. And so it's
15 not, I don't perceive it as a two track case because of
16 the settlement.

17 CHAIRWOMAN SHOWALTER: Well, I think my
18 question maybe is just to myself, but given the
19 settlement proposal, I think that it will be natural to
20 want to ask any witness about it who comes along. It
21 would also be natural to want the Staff's position on
22 the settlement proposal before questioning that witness.
23 That is it would seem more normal to, we have the
24 settlement proposal, to get Staff's view of it, and if
25 there's going to be something in writing, pin that down.

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1 And then after we have that, proceed with the witnesses
2 on their underlying testimony as well as the settlement.
3 However, I think what that means is a delay, and that's,
4 I think maybe we're looking for some guidance, but I'm
5 trying to envision a hearing which starts today or
6 tomorrow, proceeds with witnesses, but we actually don't
7 have an articulated position from Staff. And after we
8 receive that, it may have -- it might prompt questions
9 of the very witnesses we have already had on the stand.

10 MS. SMITH: And I think if we did it that way
11 that that would be an inherent problem in proceeding
12 that way. I haven't conferred with my client about this
13 approach, but we could go ahead with the case on the
14 merits, and then at the conclusion of the case on the
15 merits with the exception of -- depending on the
16 availability of the witnesses and with the exception of
17 Mr. Kennard who we will question today, perhaps have a
18 panel on the settlement after the Commission Staff has
19 had an opportunity to put together its opposition to
20 that. So we would just go ahead with the case on the
21 merits and then at the conclusion of the case on the
22 merits have a settlement presentation.

23 MR. HARLOW: We would like to see that as
24 well, if for no other reason, for scheduling reasons.
25 And it could well be at the conclusion of Mr. Kennard's

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1 testimony today that both the Staff and Commission will
2 decide that he doesn't need to come back. He tends to
3 take a very high level policy approach to these issues.
4 He's not what I call a number cruncher.

5 MS. SMITH: And his testimony -- and we have
6 had an opportunity to review his testimony on the
7 settlement, and it is fairly high level. So anything
8 that we would need to question him about we could do
9 that today in addition to crossing him on the case on
10 the merits.

11 CHAIRWOMAN SHOWALTER: I see how we can get
12 through today with Mr. Kennard, but what about
13 Mr. Brosch, for example?

14 MR. CROMWELL: On that point, Your Honor,
15 it's our position, to address Commissioner Hemstad's
16 question, that the settlement agreement is the joint
17 position of the settling parties, and we're proffering
18 his pre-filed testimony in support thereof for the
19 Commission's information because it provides the
20 analytical framework that is referenced by his
21 supplemental testimony and his in essence background for
22 your benefit.

23 But I think Mr. Harlow adequately identified
24 that it really is Mr. Brosch and the Qwest witnesses had
25 essentially the same analytical approach in their

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1 pre-filed testimony as to this transaction, and
2 obviously there were different inputs on different
3 elements, but there was a range, and the parties through
4 negotiation reached a compromise that became their joint
5 position that's before you now.

6 CHAIRWOMAN SHOWALTER: So what is your view,
7 would Mr. Brosch have to return later for the panel
8 presentation on the settlement and questioning from the
9 Bench, for example, at that time?

10 MR. CROMWELL: My preference, Chairwoman
11 Showalter, would be that Mr. Brosch only make one trip
12 here, that it be at your election. And I don't know
13 whether he is available on the 29th or the 30th, I have
14 not checked with him on that. He may be on the line
15 now, I heard someone join us a little while ago. But he
16 is also available possibly by phone. I know that's not
17 preferred, but if we need him twice, that would be my
18 request, that he only come once and be available by
19 phone for any other time.

20 JUDGE MOSS: Mr. Brosch, are you on the line?

21 MR. BROSCH: Yes, I am.

22 JUDGE MOSS: Could you be here on the 30th or
23 the 29th of this month if we decide to proceed in that
24 fashion?

25 MR. BROSCH: I certainly can not on the 29th.

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1 I am scheduled to present some training materials in
2 Phoenix on that day. Those activities are scheduled to
3 conclude at the end of the day on the 29th. And
4 assuming they do, I could travel from there presumably
5 to Olympia or to Kansas City, my home, to participate by
6 telephone.

7 CHAIRWOMAN SHOWALTER: This is Chairwoman
8 Showalter. I think that we're, I anyway, am only
9 interested in your personal presence, not telephone.
10 And my co-commissioners are nodding their heads, so are
11 you able to be here physically on the 30th?

12 MR. BROSCH: Well, I think so, barring any
13 complications in rearranging travel plans. I will be
14 traveling Thursday evening from Phoenix.

15 MR. CROMWELL: Would another option, Your
16 Honor, be to have a panel at the end of this week?

17 MS. SMITH: No, that probably wouldn't work
18 for Staff, because we have to put together our
19 opposition to that.

20 But I was going to offer that Commission
21 Staff could cross examine Dr. Brosch on the 30th on both
22 the settlement and the case in chief. We can hold off
23 so he would just make the one trip, and we could perhaps
24 begin whatever that session is with our
25 cross-examination of the case on the merits and then

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1 proceed to a panel. And that way he would only need to
2 make one trip.

3 MS. ANDERL: We do have a minor time
4 constraint on Friday with Mr. Reynolds, who is
5 traveling --

6 CHAIRWOMAN SHOWALTER: Which Friday are we
7 talking about?

8 MS. ANDERL: The 30th, of course.
9 Mr. Reynolds has to be on an airplane at 5:00 on Friday
10 afternoon. So it's not a big time constraint, but it
11 would mean that if we were going to do a panel I guess
12 it would be our preference we start with the panel as
13 opposed to Mr. Brosch on the merits. It doesn't sound
14 like something that couldn't be worked out.

15 MS. SMITH: And I think we could accommodate
16 that.

17 MR. MELNIKOFF: Again in terms of Charles
18 King, I believe he's available, I'm not sure until
19 tonight or tomorrow morning, for next Thursday or
20 Friday. If we could accommodate him this week, that
21 would be my preference. If not, I will make him
22 available.

23 JUDGE MOSS: And just to be clear, Mr. King
24 is out of the country, so his --

25 MR. MELNIKOFF: I think he is in the country

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1 flying as we speak.

2 JUDGE MOSS: All right. Do we need any more
3 information before recessing to make some decisions?

4 Do the parties have any more information they
5 wish to inform us of before we recess to make some
6 process decisions?

7 MR. CROMWELL: I suppose I would pose one
8 question, Your Honor. Commission Staff did not identify
9 any cross for Mr. Brosch's pre-filed testimony when we
10 met last week. I can understand that they may have
11 subsequent to the filing of this settlement agreement
12 some questions for him in regards to his testimony in
13 support of the settlement agreement, but I do question
14 their -- I guess I'm wondering what the basis for
15 questioning his pre-filed testimony at this point is if
16 there was no basis for doing so prior.

17 MS. SMITH: To the extent that his testimony
18 in the case on the merits differs from the position in
19 the settlement, we would want to cross examine both.

20 COMMISSIONER HEMSTAD: I think the
21 Commissioners would want to ask him about both also.

22 MR. CROMWELL: I'm not saying he wouldn't be
23 available to answer questions about everything, I was
24 just questioning the --

25 JUDGE MOSS: It's a fine point.

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1 CHAIRWOMAN SHOWALTER: I guess I have one
2 more logistical question, and that is for judicial
3 economy, it seems to me to make most sense to question
4 witnesses who are settlement panel witnesses after we
5 have Staff's response, which means -- with the exception
6 of Mr. Kennard because we're making an exception for
7 him.

8 MR. HARLOW: Thank you.

9 CHAIRWOMAN SHOWALTER: But I think what that
10 means is Mr. Reynolds -- it's Mr. Reynolds, Mr. Brosch,
11 and Mr. Kennard, is that --

12 MS. ANDERL: And Mr. King.

13 CHAIRWOMAN SHOWALTER: And Mr. King. And so
14 the question would be, can we arrange to have those
15 panel members as witnesses next week after we receive
16 Staff's position so that they are not on the stand
17 before we have the benefit of Staff's position on the
18 settlement. Unless they're going to come back again,
19 which would I guess indicated in Mr. King's case maybe
20 he could or maybe Mr. Reynolds can, and maybe
21 Mr. Reynolds could be here Thursday. I mean my gut is
22 telling me that the idea of a panel on the last day will
23 be kind of an after effect at that point.

24 MS. ANDERL: I agree with that. I think that
25 it would be I think in the parties' and in the

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1 Commission's interest to have the settlement out there
2 and kind of fully explained even if not cross examined
3 on early in the process, because a lot of -- I think the
4 witnesses' responses to a lot of questions are going to
5 turn back to the settlement agreement.

6 MS. SMITH: I guess I didn't understand that
7 point. Do you -- what do you anticipate with respect to
8 the settlement during the process? I mean maybe you can
9 explain that a little further, because I didn't -- I
10 think I missed something there.

11 MS. ANDERL: Well, I guess all I was trying
12 to say is I recognize that it may be difficult to cross
13 examine the witnesses, not difficult but awkward to
14 cross examine the witnesses with an expectation that
15 everybody pretends the settlement doesn't exist because
16 we haven't yet formally presented it. That was all.

17 MS. SMITH: And what did you have in mind
18 with respect to formally presenting, having it marked
19 and admitted into the record or having some sort of oral
20 presentation from one of the witnesses?

21 MS. ANDERL: I thought it would be marked and
22 admitted. In a perfect world, I think that they would
23 also be available for questions from the Bench to just
24 kind of flesh things out if there were questions. I
25 wasn't anticipating that they give an oral summary or a

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1 direct presentation.

2 JUDGE MOSS: Basically you just want to see
3 it made part of the record so it can be readily referred
4 to, and I don't see any big logistical barrier to that.

5 But let me just remind counsel to direct
6 their comments to the Bench and not to each other during
7 the course of the formal proceedings, thank you.

8 MS. SMITH: Thank you, Your Honor, and
9 Commission Staff certainly has no objection to having
10 the settlement agreement and the supporting testimony
11 marked and made part of the record. What we would have
12 a problem with is some sort of presentation of witnesses
13 in support of that at this point in the game. Thank
14 you, Your Honor.

15 JUDGE MOSS: Okay.

16 CHAIRWOMAN SHOWALTER: All right, but just so
17 I am clear, Ms. Smith, do you have any problem with
18 those who would be part of the panel not being examined
19 until next week and then when they're on the stand to be
20 asked about the settlement even if it weren't part of a
21 panel presentation?

22 MS. SMITH: I don't think we would have a
23 problem with -- it's essentially delaying their
24 testimony until next week, I don't think we would have a
25 problem with that.

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1 JUDGE MOSS: And just to mention in that
2 regard that we do have a significant amount of
3 cross-examination indicated for Mr. Reynolds, so it
4 might be necessary to put him on separately and then
5 have him also participate as part of a panel, because we
6 have got already three and a half hours indicated, and
7 it could expand.

8 So, okay, do we have any other questions from
9 the Bench?

10 CHAIRWOMAN SHOWALTER: Yes, my last question
11 is are the witnesses who are part of a panel with the
12 exception of Mr. Kennard all available on either
13 Thursday or Friday, the 29th or the 30th?

14 MR. CROMWELL: NO.

15 JUDGE MOSS: And I think Mr. Brosch is only
16 available on the 30th.

17 CHAIRWOMAN SHOWALTER: Well, I said either
18 one of those.

19 MS. ANDERL: Mr. Reynolds and Mr. Brosch are
20 both available on the 30th. I think Mr. King is, we
21 don't know.

22 CHAIRWOMAN SHOWALTER: Is Mr. Reynolds
23 available on the 29th?

24 MS. ANDERL: He is, yes.

25 CHAIRWOMAN SHOWALTER: In other words, if we

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1 need to cover those witnesses --

2 MS. ANDERL: Oh, I see.

3 CHAIRWOMAN SHOWALTER: -- on the 29th and the
4 30th, is there a way to do it?

5 MS. SMITH: I would assume that the
6 Commission Staff would offer the testimony of
7 Dr. Blackmon with respect to the settlement, and I
8 believe that Dr. Blackmon would be available on the 29th
9 or the 30th. Mr. Selwyn, however, is not available. We
10 don't believe that he is available, but at this point
11 we're not sure that we would offer any testimony from
12 Dr. Selwyn in opposition to the settlement. We just
13 don't know at this point.

14 MR. HARLOW: Your Honor.

15 JUDGE MOSS: Go ahead, Mr. Harlow

16 MR. HARLOW: If the Commission would find it
17 helpful, Mr. Kennard could also return on the 29th or
18 the 30th.

19 JUDGE MOSS: Thank you, appreciate that.

20 CHAIRWOMAN SHOWALTER: Well, you just raised
21 another issue, Ms. Smith, which is if Staff witnesses
22 are opposed to the settlement but we don't actually know
23 that formally or we don't know what the specific
24 position is, are you saying that in order to start
25 questioning about the settlement, we would need to wait

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1 until next week? I guess what I -- it seems to me that
2 the proposed settlement is a fact that we're all quite
3 aware of and that the natural tendency, and it seems to
4 me the judicially economical tendency, would be to want
5 to ask all of the witnesses who are relevant to that
6 settlement proposal, whether presenting it or opposed to
7 it, about it.

8 MS. SMITH: That's correct, Your Honor.

9 CHAIRWOMAN SHOWALTER: And so does that then
10 have the effect of pushing into next week the Staff
11 witnesses as well?

12 MS. SMITH: I guess I mean I hadn't thought
13 about that. I know that Dr. Blackmon is available next
14 week. I don't know at this point in time where he is on
15 the witness order now. It's possible that parties could
16 cross examine him with respect to the settlement, but it
17 won't be until early next week that our opposition is
18 actually filed in the form of testimony. So I don't
19 really know logistically how that would work.

20 CHAIRWOMAN SHOWALTER: I have forgotten, are
21 we scheduled to meet Wednesday afternoon of next week?

22 JUDGE MOSS: No.

23 MS. SMITH: 29th and 30th.

24 JUDGE MOSS: Thursday and Friday.

25 All right, unless there's something further,

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1 I would suggest that the Bench retire to discuss process
2 and reach some decisions about how we're going to go
3 forward. All right, then we will take a recess, we'll
4 come back at 2:30 with some decisions made, and then we
5 will proceed with our cross-examination.

6 (Recess taken.)

7 JUDGE MOSS: We have had an opportunity to
8 meet some of the process challenges that have been --
9 that you all have posed to us, and our solution is thus.
10 We have scheduled some additional time next week first
11 of all. We are scheduling Wednesday afternoon in
12 addition to Thursday and Friday previously scheduled.
13 We will intend to begin next Wednesday immediately
14 following the conclusion of the Commission's open
15 meeting. That could be in the morning, probably late in
16 the morning, but --

17 CHAIRWOMAN SHOWALTER: It could be as early
18 as -- we'll check that, I think that we could get a
19 better read on that after some consultation.

20 JUDGE MOSS: So we'll give a better read on
21 that as time goes on and we check into that a little
22 more. But anyway Wednesday, put that on your schedules.

23 We will want to defer the examination of
24 witnesses Blackmon, Brosch, and Reynolds to next week.

25 MS. ANDERL: Blackmon?

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1 JUDGE MOSS: Blackmon, Dr. Blackmon, we will
2 not examine him before next week.

3 MS. ANDERL: Even on his direct presentation?

4 JUDGE MOSS: And frankly, that's not a change
5 probably from what we had before because of the way
6 things were stacked up. But right, we will have him on
7 the stand once. Our goal is to have each of the
8 witnesses on the stand once, and so we will put off
9 Blackmon, Brosch, and Reynolds until next week. And
10 that will provide an opportunity, among other things,
11 for Dr. Blackmon as I understand it will be filing some
12 response testimony speaking to the settlement
13 specifically, and so that could be, well, Monday is a
14 holiday, so let's say Tuesday I guess.

15 CHAIRWOMAN SHOWALTER: 9:00 a.m.

16 JUDGE MOSS: 9:00 a.m.

17 MR. HARLOW: I was just going to ask what
18 time, Your Honor.

19 JUDGE MOSS: And although the witness's
20 eyebrows have shot up, he did smile, so all right, we
21 will count on that.

22 So we'll just proceed with the other
23 witnesses as previously scheduled with perhaps some
24 shifting around toward the end game to take up the time
25 available. So that, for example, I had previously in my

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1 scheduling, which I have not shared with you all, but
2 based on our discussions together, Ms. Folsom would
3 probably have fallen late this week, or I'm sorry, would
4 have fallen next week, we'll probably end up moving her
5 up to late this week. Dr. Selwyn as I understand will
6 probably not be filing anything in connection with the
7 settlement specifically, and so we -- and we needed to
8 go ahead and get him in this week, right?

9 MS. SMITH: Can I just have one moment, he's
10 sitting right here?

11 JUDGE MOSS: Sure.

12 MR. CROMWELL: Your Honor, if I may just
13 follow up on that sidebar, confirm can I have Mr. Brosch
14 scheduled for a date certain on Friday the 30th given
15 his unavailability on the 29th? I don't know if he is
16 still on, but he may be able to come the 28th as well if
17 that's your preference.

18 MR. BROSCH: I am still on, Robert.

19 MR. CROMWELL: Are you available on the 28th?

20 MR. BROSCH: No, I'm not, I have to be in
21 Phoenix Tuesday through Thursday, the Dex hearing
22 commences Tuesday.

23 MR. CROMWELL: So may I have Mr. Brosch
24 confirmed for Friday the 30th, Your Honor?

25 JUDGE MOSS: That works for me, yeah. Yeah,

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1 we can do that, sure, we will confirm Mr. Brosch for
2 Friday the 30th.

3 MR. BROSCH: Thank you.

4 JUDGE MOSS: And what about Mr. Reynolds'
5 situation, Ms. Anderl?

6 MS. ANDERL: He's available Wednesday or
7 Thursday and then Friday until early afternoon.

8 JUDGE MOSS: So it might be a good idea to go
9 ahead and start with him and then go with -- go
10 Reynolds, Blackmon, Brosch, that order. Does that make
11 sense to everyone?

12 MS. ANDERL: That does.

13 JUDGE MOSS: Okay.

14 MS. SMITH: Your Honor, I have I guess a
15 request to make. We have not yet decided, I guess,
16 we're still in the process of trying to decide what
17 Staff's opposition to the settlement is going to be. It
18 is possible that Dr. Selwyn may be filing testimony in
19 opposition to the settlement as well. Dr. Selwyn has
20 informed me that he's available on the 29th of next
21 week; is that correct? That he's available on the 29th.
22 We would prefer that the Staff witnesses all testify
23 after Staff has filed its opposition to the settlement.
24 And if the Commission -- and I don't -- if the
25 Commission were willing to sort of free up two hearing

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1 days this week so Staff could prepare its opposition to
2 the settlement so the Staff could be working on that as
3 opposed to being in the hearing room, then we could get
4 that filed in a couple of days and then begin the
5 cross-examination of Staff witnesses and whatever other
6 witnesses are left to be crossed.

7 JUDGE MOSS: Well, you've got Thursday
8 afternoon. After 11:00 we will be in recess, so you
9 have most of the day Thursday. As far as giving up
10 another full hearing day, I'm a little hesitant to do
11 that. We're already on a pretty tight schedule here,
12 and we were trying to avoid having to ask you all to
13 come in here on Memorial Day or a Saturday, which is
14 something that's a possibility, but certainly that would
15 be I think a last choice.

16 CHAIRWOMAN SHOWALTER: Which Judge Moss
17 pointed out last Memorial Day we did have hearings.

18 JUDGE MOSS: Some of you were here.

19 CHAIRWOMAN SHOWALTER: So it's not unknown.

20 JUDGE MOSS: But that's not, yeah, I would
21 think that would be people's last choice given a choice,
22 especially those of you with young ones at home and so
23 forth and so on, those of you who have a life outside
24 the hearing room to put it bluntly.

25 CHAIRWOMAN SHOWALTER: I have one question.

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1 If, we're obviously going to get to Mr. Kennard this
2 afternoon, but if we did not have hearings tomorrow,
3 would you have your answer, could you have your answer
4 or additional testimony by Wednesday morning, or is that
5 too difficult?

6 MS. SMITH: That --

7 CHAIRWOMAN SHOWALTER: Because that might
8 actually make the whole proceeding go more smoothly if
9 we started on Wednesday and just kept going.

10 MS. SMITH: May I have a moment to ask?

11 JUDGE MOSS: Absolutely.

12 MR. CROMWELL: Maybe if I can jump in the
13 pause, just for your information, I do have
14 non-refundable travel plans and commitments over the
15 weekend out of the country.

16 JUDGE MOSS: And you see how well we're
17 taking care of you.

18 MR. CROMWELL: I appreciate it greatly.

19 JUDGE MOSS: We're doing our best,
20 Mr. Cromwell.

21 MR. CROMWELL: More to the point, my wife --

22 CHAIRWOMAN SHOWALTER: Just got married just
23 recently, Commissioner Hemstad back in the conference
24 said that holding hearings on Memorial Day would be
25 grounds for a divorce, so.

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1 MR. CROMWELL: I think my wife would agree
2 with you. I'm afraid she might.

3 MS. SMITH: Your Honor.

4 JUDGE MOSS: Yes.

5 MS. SMITH: If the Commission would be
6 willing to not hold hearings tomorrow, we believe we
7 could get our opposition filed on Wednesday. And that
8 being the case, then the Staff witnesses, Dr. Selwyn and
9 Ms. Folsom and perhaps Dr. Blackmon but maybe the next
10 week for Dr. Blackmon, could get on and off the stand
11 this week. So if we didn't have hearings tomorrow, we
12 could get our opposition filed on Wednesday.

13 CHAIRWOMAN SHOWALTER: Morning?

14 MS. SMITH: I think we could get it done in
15 the morning, yes.

16 JUDGE MOSS: That sounds like the way to go.

17 CHAIRWOMAN SHOWALTER: Does anybody else want
18 to respond to that?

19 JUDGE MOSS: Subject to somebody else
20 responding to that.

21 MS. ANDERL: We have no interest in delaying
22 this proceeding one bit.

23 JUDGE MOSS: Right.

24 MS. ANDERL: But it is --

25 JUDGE MOSS: We're trying to gain efficiency

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1 here.

2 MS. ANDERL: Yes, I'm certain that we would
3 be able to cross examine on this testimony, but we
4 haven't seen it yet. So, you know, if we get 100 pages,
5 then we reserve the right to howl in protest.

6 CHAIRWOMAN SHOWALTER: You would have until
7 the following -- I don't -- well, I don't know when --

8 MS. ANDERL: I thought the suggestion was
9 being made that if Dr. Selwyn filed testimony in
10 opposition, then we would cross him on Thursday.

11 MS. SMITH: Or Friday, sometime this week.

12 JUDGE MOSS: There are whole nights in
13 between these hearing days.

14 MS. SMITH: And just to satisfy the Bench and
15 all the parties, I would be very surprised to see 100
16 pages of testimony come in on this. So I think we could
17 probably do our best to accommodate any concerns that
18 the parties may have to have adequate time to cross the
19 witnesses. And, if possible, I believe that Dr. Selwyn
20 also would be available one day next week as well if
21 everything is so voluminous that this week is just not
22 doable for the parties, although I don't anticipate
23 that.

24 JUDGE MOSS: It sounds like everyone is
25 operating reasonably and in good faith best efforts

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1 here, so I'm not concerned about somebody getting
2 blindsided. And, of course, in all seriousness, while
3 we have tried to imbue this with a certain amount of
4 humor, in all seriousness, the goal from the Bench's
5 perspective is to get a full and complete record and to
6 ensure the ends of justice are met in terms of a fair
7 hearing, and so we will do what is necessary to ensure
8 that those goals are satisfied. And some of this we
9 will have to perhaps change a decision or a judgment
10 that we're making in the abstract when we have something
11 more concrete, say 20 pages of testimony or 100 if that
12 might be the case.

13 So with that said, go ahead, Mr. Melnikoff.

14 MR. MELNIKOFF: Your Honor, in order to
15 accommodate Staff, even though I probably won't be able
16 to physically file the hard copy of Charles King's
17 testimony until tomorrow, I can E-mail you tonight.

18 MS. SMITH: Thank you.

19 Mr. MELNIKOFF: The soft copy.

20 MS. SMITH: And Staff appreciates that.

21 JUDGE MOSS: Okay, good.

22 All right, so we're going to take a recess
23 tomorrow then, and that's the decision I believe that's
24 been taken here, yes, so that's what we will do, and
25 that will give Dr. Blackmon at least and perhaps

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1 Dr. Selwyn as well an opportunity to prepare and file
2 their supplemental testimony in response to the
3 settlement stipulation, and then we will proceed with
4 our cross-examination as we have previously discussed,
5 and some of that will no doubt be next week, and some of
6 it will be this week unless I'm very surprised.

7 MR. MELNIKOFF: Can I ask with trepidation
8 when Dr. or when Mr. King is scheduled?

9 JUDGE MOSS: I don't have a specific time for
10 him, but he was available when, Friday, right?

11 MR. MELNIKOFF: Friday, yeah, or Thursday
12 morning.

13 JUDGE MOSS: I think we could accommodate
14 that.

15 MR. MELNIKOFF: So he will go on this week
16 then?

17 JUDGE MOSS: Sure, we can take care of
18 Mr. King this week.

19 MR. MELNIKOFF: Thank you very much,
20 appreciate that.

21 JUDGE MOSS: And remind me at the end of the
22 day, and I will make some additional notes.

23 MR. HARLOW: Your Honor, do we want to get a
24 time on the record for the Staff's filing on Wednesday
25 morning, or does Wednesday morning mean --

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1 JUDGE MOSS: As soon as possible.

2 CHAIRWOMAN SHOWALTER: 9:00 a.m.

3 JUDGE MOSS: There you go, the Bench has
4 spoken, 9:00 a.m. And, of course, I know Staff has been
5 following the practice, as have all the parties, when
6 you have something prepared in the way of a file, go
7 ahead and submit it to everybody electronically so they
8 have it at the earliest possible moment, including
9 courtesy copies to me. Thank you.

10 MR. HARLOW: And I understand 9:00 a.m. will
11 still be our start time Wednesday morning as well; is
12 that correct?

13 JUDGE MOSS: Yes.

14 MR. HARLOW: Thank you, Your Honor.

15 JUDGE MOSS: I'm anxious to get on with
16 Mr. Kennard as the hour progresses, so can we do that?
17 Anything else?

18 All right, Mr. Kennard, if you will please
19 stand and raise your right hand.

20

21 (The following exhibit was identified in
22 conjunction with the testimony of WILLIAM E. KENNARD.)

23 Exhibit 251-T is WEK-4ST: Supplemental
24 Testimony of William E. Kennard in Support of
25 Stipulation and Settlement Agreement.

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1

2 Whereupon,

3

WILLIAM E. KENNARD,

4 having been first duly sworn, was called as a witness

5 herein and was examined and testified as follows:

6

7

D I R E C T E X A M I N A T I O N

8

BY MR. HARLOW:

9

Q. Mr. Kennard, if you will just pull the
10 microphone up, and the red button should be up, can you
11 please state your name for the record.

12

A. William Kennard.

13

Q. Mr. Kennard, do you have in front of you what
14 have been marked for purposes of this hearing as
15 Exhibits 441-T, excuse me, 241-T, 242-T, 243, and 251-T?

16

A. I do.

17

Q. Were these exhibits prepared under your
18 direction or supervision?

19

A. Yes, they were.

20

Q. Do you have any corrections to any of your
21 pre-filed testimony?

22

A. I do with reference to Exhibit 242-T.

23

Q. Could you please give, for the parties'
24 convenience, the page and line number before you give
25 the correction.

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1 A. Yes, it would be page 12, line 20 1/2 it
2 looks like, and the original exhibit had the figure \$1.4
3 Billion in that line, it should read \$1.1 Billion.

4 MR. HARLOW: Thank you.

5 And for the record, Your Honor, we have
6 predistributed a couple of days ago this corrected page.

7 JUDGE MOSS: Thank you.

8 BY MR. HARLOW:

9 Q. Mr. Kennard, if I were to ask you the
10 questions contained in Exhibits 241-T, 242-T, and 251-T,
11 would your answers be the same as set forth in those
12 exhibits?

13 A. Yes, they would.

14 MR. HARLOW: Your Honor, we offer Exhibits,
15 241-T, 242-T, 243, and 251-T.

16 JUDGE MOSS: Hearing no objection, those will
17 be admitted as marked.

18 Let me note for the record that while
19 previously designated as highly confidential, Exhibit
20 Number 243, there has been a waiver to that, so for
21 those who don't know that, they may strike the highly
22 confidential designation from Exhibit 243.

23 MR. HARLOW: Thank you, Your Honor,
24 Mr. Kennard is available for cross-examination.

25 JUDGE MOSS: Thank you. And we had not

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1 previously established an order of cross-examination,
2 but I think Staff is probably the only cross examining
3 party here under the circumstances, and so we will go
4 ahead with that, Mr. Trautman.

5 MR. TRAUTMAN: Thank you.

6

7 C R O S S - E X A M I N A T I O N

8 BY MR. TRAUTMAN:

9 Q. Good afternoon, Mr. Kennard.

10 A. Good afternoon.

11 Q. I'm Greg Trautman, Assistant Attorney General
12 for the Commission Staff. I'm looking, in terms of your
13 testimony, I will be looking at Exhibit 242-T, which was
14 your rebuttal testimony.

15 A. Yes, sir.

16 Q. And I'm on page 1, and on line 4 you state
17 that you're a managing director of the
18 telecommunications and media group of the Carlyle Group;
19 is that correct?

20 A. Yes.

21 Q. Are you a principal at the Carlyle Group?

22 A. I am a partner.

23 Q. And I believe, turning to Exhibit 248, which
24 was Dex's response to Staff Data Request Number 11, and
25 you were asked in that question whether you had a

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1 personal financial involvement in the outcome of this
2 case, and you responded that you did; is that correct?

3 A. That's correct.

4 Q. And what exactly is the nature and extent of
5 your personal financial interest in a successful
6 consummation of the Dex sale transaction?

7 A. Well, as indicated in my testimony, the
8 Carlyle Group is an investor in Dex Holdings, which is a
9 50% owner of Dex Media. And as a result, the Carlyle
10 Group -- that investment, to the extent it does well,
11 the Carlyle Group does well, and I personally would do
12 well financially.

13 Q. So you would do well as a partner, as a
14 principal?

15 A. Of course, yes.

16 Q. And in terms of any personal bonus or extra
17 compensation beyond what you have described?

18 A. Well, the way it typically works, because
19 this is a transaction that I was personally involved in
20 and fell within the ambit, if you will, of the group
21 where I'm principally assigned at the Carlyle Group,
22 which is the group that specializes in
23 telecommunications and media, the partners in that group
24 would have an augmented financial interest relative to,
25 not all, but some of the other partners, yes.

0252

1 Q. What are your specific responsibilities as
2 the managing director of the telecommunications and
3 media group?

4 A. Well, as a managing director in the
5 telecommunications and media group, my principal
6 responsibility is to oversee the investment activities
7 of Carlyle in the media and telecommunications area
8 worldwide. We really have two essential mandates. One
9 is to invest money out of our U.S. buyout fund, which is
10 our flagship fund, and also to coordinate the
11 investments of other funds worldwide, principally Asia
12 and Europe.

13 Q. So it would be correct then, would it not,
14 that you either identify or help to identify potential
15 acquisitions or other investments?

16 A. That's precisely right, yes.

17 Q. And do you personally participate in the
18 management of any companies or ventures in which Carlyle
19 becomes an investor or acquires a controlling interest?

20 A. Yes, I do.

21 Q. Could you refer now to Exhibit 249, and this
22 was material from the Carlyle Web site, a four page
23 document.

24 A. Yes, I have it.

25 Q. And turning to page 2 in the middle of the

0253

1 page where it talks about focused industries, I noticed
2 there that Carlyle is involved in a number of industries
3 other than telecom and media including health care,
4 energy, real estate, transportation, aerospace and
5 defense, among others; is that correct?

6 A. Yes.

7 Q. Now when Carlyle invests in a company or more
8 specifically when it acquires a controlling interest in
9 a company, is it Carlyle's practice to actively manage
10 the company's business on a permanent basis or
11 ultimately to sell the company hopefully for a profit?

12 A. Well, let me be clear. We don't precisely
13 manage companies. We typically rely on professional
14 managers who manage the company on the day-to-day basis
15 like in this case, George Burnett, the CEO of Dex Media.
16 However, we typically oversee our investments, most
17 usually through seats on the board of directors.

18 Q. And what are your intentions with respect to
19 Dex? That is to say, do you expect to own Dex for a
20 considerable length of time, or will you be seeking a
21 buyer when the market improves?

22 A. Well, that's unclear at this point. Our
23 immediate interest is to integrate Dex Media under its
24 new management, to hopefully close the Dex-Qwest
25 transaction and build it into a successful company under

0254

1 our stewardship. We don't have any for formulaic plan
2 as to when we would sell the company down the road. I
3 can't give you a precise answer other than that, you
4 know, our investment philosophy is not to hold companies
5 forever. We typically -- our investors typically like
6 to monetize their investment at some point.

7 Q. How long do you typically hold companies?

8 A. It varies. We have held companies, oh, for
9 over a decade. We have held companies for a shorter
10 window of time. I can't give you an average holding
11 period at this point.

12 Q. Now if Dex Holdings were sold, is it your
13 understanding that that transaction would require the
14 approval of the Commission or not?

15 A. Well, you know, sold is a broad term. There
16 are a number of ways that an investor can monetize its
17 interest in a transaction like this. An outright sale
18 is one of them. Another possibility is an initial
19 public offering where -- and that's quite typical in our
20 business where the financial sponsor, which is another
21 term for a private equity firm, will take a company
22 public but retain a stake. So you can monetize your
23 investment through the public markets but retain an
24 equity stake. Another possibility is to recapitalize
25 the company. After a period of time when you have paid

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1 down a sufficient amount of debt, it's possible to
2 refinance the company and monetize your investment that
3 way. So there are a number of ways to monetize your
4 interest short of an outright sale.

5 Q. And which of those options that you have
6 articulated, if any, would require Commission approval,
7 in your opinion?

8 A. Well, I would want to defer to my counsel,
9 who are much more familiar with the intricacies of
10 Washington law than I would be. I don't want to presume
11 an answer, but -- well, I will leave it at that. I
12 don't really want to venture a legal opinion as to what
13 would be required, particularly when I don't even know
14 what sort of sale you're referring to.

15 Q. I guess the question is whether in terms of a
16 possible sale, and you have articulated different ways
17 of doing that, has the company talked about any possible
18 exit strategies and what the cost would be, assuming or
19 not assuming a requirement of Commission approval?

20 A. No, we have not.

21 Q. Does the telecommunications and media group
22 have a specific annual dollar allocation or budget that
23 is earmarked for telecommunications and media
24 investments?

25 A. No.

0256

1 Q. If you were to determine that a particular
2 telecom or media investment opportunity is worth
3 pursuing, like the Dex acquisition, for example, do you
4 personally have the authority to proceed with that
5 investment, or do you have to bring it to an investment
6 committee of some sort that will compare it with other
7 opportunities that are being recommended by your
8 counterparts specializing in other industry sectors?

9 A. Well, let me describe how it works. As I
10 mentioned before, I and my partners in the telecom and
11 media group have responsibility for seeking out
12 investment opportunities, and then internally we decide
13 amongst the group whether we think that the investment
14 is worth pursuing if we're interested in it. And then
15 we do have an internal investment committee structure,
16 like most private equity firms, where we will present
17 the transaction to the investment committee for ultimate
18 approval.

19 Q. So would it be fair to say that within the
20 Carlyle Group that the telecommunications and media
21 group has to compete with the other industry specialty
22 sectors for capital investment dollars?

23 A. Well, only in a theoretical sense, because
24 typically if we find a transaction that we like and that
25 our investment committee likes, we don't have a lot of

0257

1 trouble raising financing for it. Dex Media is a good
2 example of that. And so there is in this marketplace a
3 lot of private equity capital available for good
4 transactions, and so I don't see myself as competing
5 against my colleagues in other groups. I really see
6 myself competing to bring -- competing with other peer
7 private equity firms to bring good deals to Carlyle.

8 Q. Do you come across very many telecom and
9 media investment opportunities in a given year?

10 A. Well, that depends on the year.

11 Q. Let me --

12 A. Some years are better than others. And, you
13 know, frankly I haven't been doing this all that long.
14 You know, I will say that the type of deals that we're
15 seeing now is quite different than what we saw say five
16 years ago in the private equity community, because the
17 market has changed pretty dramatically. But there are a
18 lot of interesting transactions available in this
19 marketplace, yes.

20 Q. About how many telecommunications and media
21 deals were presented to you in 2002 for consideration?

22 A. That's a tough question to answer. Almost
23 daily people are calling with investment opportunities
24 for us to look at. Some of them don't get very far.
25 Others that we're more interested in we will spend a lot

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1 of time evaluating and doing due diligence and doing
2 financial models around. So it's difficult to give you
3 a number. It really doesn't work that way. We don't
4 keep a score card in that respect.

5 Q. So there's no estimate at all that you could
6 give?

7 A. It would really be impossible, because I
8 would have to define the different categories of
9 opportunities that we look at from ones that we are --
10 that we quickly reject to those that we are more
11 interested in.

12 Q. How do you decide which ones you will pursue
13 and which ones you will reject?

14 A. Well, there are a number of factors that go
15 into determining whether an investment is a good
16 investment. The principal screen that we use is whether
17 the investment meets our funds' particular investment
18 parameters, and we look at such things as the particular
19 sector that the business is in, its cash flow
20 characteristics, financeability. There are a myriad of
21 factors, quality of management, quality of exit
22 opportunities.

23 Q. Would you look at also the potential for
24 appreciation and value?

25 A. Yes, of course, that's what investors do.

0259

1 Q. And also the ability ultimately to sell the
2 interest for a profit?

3 A. Yes, that's our business.

4 Q. In Exhibit 242-T, page 5, lines 9 through 11,
5 and there you state:

6 There are far fewer acquisition
7 opportunities today than there were even
8 a few years ago leading to great
9 competition for the limited number of
10 attractive acquisition targets that do
11 exist.

12 Now isn't it also true that there is much
13 less capital available for such acquisitions today than
14 there was a few years ago, for example in 2000?

15 A. No, that's not true actually, and I'm really
16 limiting my comments to the telecommunications and media
17 sector where I'm most expert and spend most of my time.
18 But during the what I will call the boom times in
19 telecom from say 1995 to 2000, there were -- there was a
20 lot of private equity being funded into the market for
21 lots of business models that this Commission is very
22 familiar with, CLEC, long haul fiber, metro fiber
23 opportunities. The ability to finance those
24 transactions has really waned at this point, and so --
25 but that doesn't mean that the private equity community

0260

1 hasn't been amassing capital.

2 And as we speak, there's about \$120 Billion
3 of private equity capital waiting to be invested in the
4 marketplace, so there's a huge amount of private equity
5 funding available for good deals. So there is a lot of
6 competition for quality telecommunications deals for the
7 simple reason that a lot of people have lost a huge
8 amount of money really in historically unprecedented
9 terms in telecom in the last seven or eight years since
10 the '96 Act.

11 Q. Would you agree that overall that the market
12 for telecom and media ventures is less attractive today
13 than it was three years ago?

14 A. Again, it depends on what -- how you define
15 that market. If you're looking at quality deals that
16 meet the parameters of large private equity funds like
17 ourselves, there's a scarcity of deals. And those deals
18 are defined as deals that are highly leverageable, that
19 have high EBITDA margins, produce free cash flow, and
20 are financeable like the Dex Media transaction. That's
21 why, as I have testified, there was a huge amount of
22 competition for this asset.

23 Q. Would you agree that the U.S. is currently in
24 the midst of a major economic downturn?

25 A. Well, I'm not Alan Greenspan, so, you know, I

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1 hesitate to give you an opinion on that, particularly
2 given the number of Ph.D. economists that are in the
3 room, but, you know, certainly anecdotally we have seen
4 -- and I don't know if I should stick to telecom and
5 media. Obviously we have seen a decrease in investment
6 opportunities and the telecom bubble having burst around
7 the middle of 2000.

8 Q. Would you agree that the duration of the
9 current bear market in stocks is one of the longest in
10 recent history?

11 A. Anecdotally yes, but, you know, you have to
12 -- economists define bear markets in different ways.
13 For people like myself who may be, you know, casual
14 readers of the business pages, I might agree with you.
15 An economist might have a different point of view. But
16 certainly, to answer your question overall, we are in a
17 difficult economy now, difficult macro economic
18 conditions, that's pretty apparent I would think.

19 Q. Staying on page 5 of your rebuttal testimony,
20 and if you could just read or review the paragraph from
21 line 17 to line 25 at the bottom of the page.

22 A. (Reading.)

23 Q. And have you read that?

24 A. Yes, I have.

25 Q. Is the point that you're making in this

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1 paragraph that because of the worsening market for debt
2 capital that existed last summer when the deal was done
3 that the price that you finally offered was in essence
4 the highest price that could have been supported at that
5 time given Dex's revenue level?

6 A. Yes.

7 And also I should add given our return
8 parameters.

9 Q. Now are you familiar with reports in the
10 financial press recently that we're technically now in a
11 bull market because stock prices have increased by more
12 than 20% since their lows of last fall?

13 A. I have heard those reports. I don't believe
14 them frankly. My personal opinion is that we're
15 certainly not in a bull market for stocks. I think we
16 have seen -- we have had, what, four or five weeks of
17 appreciation in the stock market, but if you look at
18 corporate earnings during that period of time, they're
19 still relatively anemic. So my own personal opinion,
20 I'm not an economist again, is that we still have a
21 fairly weak economy today.

22 Q. If over the next several years we see a
23 significant rebound in investor interest in equities,
24 one might expect that deals like the purchase of Dex
25 would command a higher price than they would today; is

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1 that correct?

2 A. Well, it's difficult to say, because the
3 premise of your question is if the stock market
4 increases, then the value of the Dex business increases,
5 and I don't think you can necessarily make that
6 connection, because the Yellow Pages business is a
7 subsector of the economy obviously, and you would have
8 to really look at the facts and circumstances involving
9 that particular business at that time. The competitive
10 dynamics could be quite different from the dynamics of
11 the economy as a whole.

12 Q. Do you expect the value of Dex to increase
13 over the next several years?

14 A. I'm hopeful that it will, yes.

15 Q. Returning to Exhibit 249, that was the
16 Carlyle web site material, page 2, and under the heading
17 global strategy, there it states that as of September
18 2002 the firm had over \$13.9 Billion in capital
19 committed to 23 private equity funds; do you see that?

20 A. Yes.

21 Q. Now the Dex purchase is \$7 Billion. Would
22 this one deal increase the total size of the Carlyle
23 Group by 50%?

24 A. No, that's really not the right way to read
25 that.

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1 Q. And that is because?

2 A. That's because \$13.9 Billion in committed
3 capital refers to the commitments that we have from our
4 investors to put money in the various funds that we
5 have, the 23 different funds. So the Dex investment is
6 just a portion of the equity capital invested out of one
7 of our funds. Plus even though the Dex business is a
8 \$7.05 Billion transaction, that's not all funded with
9 equity. A large portion of it is funded with debt, and
10 so it's comparing apples and oranges the way you stated
11 that.

12 Q. So how much equity is the Carlyle Group
13 investing in Dex assuming that the Rodney transaction is
14 ultimately completed?

15 A. Well, we committed to a total with our
16 partner Welsh Carson, the two private equity firms
17 committed to a total of \$1.5 Billion in equity. But a
18 lot of that will be sold down to co-investors, so the
19 final equity investment by Carlyle will be roughly \$500
20 Million.

21 Q. Who did you say it would be sold off to?

22 A. We have co-investors who -- those are
23 institutional investors who invest alongside Carlyle as
24 equity investors.

25 Q. Who will have operational control of Dex

0265

1 after the transaction?

2 A. Well, operational control, that is day-to-day
3 management, will be -- control will be vested in our
4 senior management team, and they will report to the
5 board of directors. The board of directors is
6 controlled by the Carlyle Group and Welsh Carson, we're
7 50/50 partners.

8 Q. And that will not change after you sell off
9 that portion to the other investors, you will still be
10 50/50?

11 A. That's right.

12 Q. 50/50 --

13 A. As I mentioned, those are passive
14 institutional investors. Board control is vested in
15 Welsh Carson and the Carlyle Group as equal partners,
16 50/50.

17 Q. And page 2 of your rebuttal testimony on
18 Exhibit 242, you had stated that to raise the necessary
19 capital, Carlyle partnered with Welsh Carson, WCAS, and
20 an additional firm, Madison Dearborn Partners; what is
21 the role of Madison Dearborn Partners at this point?

22 A. Well, Madison Dearborn Partners dropped out
23 during the bidding stage. They decided that they would
24 not proceed before we were awarded the deal.

25 Q. And staying on page 2, on line 13 you state

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1 that Dex represented a quality asset and why do you
2 consider Dex to be a quality asset?

3 A. Well, it has a lot of attractive
4 characteristics from an investor standpoint. It is
5 financeable, and in this market a lot of telecom and
6 media investments are not financeable because of the
7 downturn in the -- in that sector. It is -- it has
8 strong recurring cash flows. It has an excellent
9 management team. It has a terrific sales force. It has
10 a lot of attractive attributes from an investor
11 standpoint, which made it a very attractive asset for
12 financial buyers like the Carlyle Group.

13 Q. Now on page 3 of your rebuttal testimony,
14 Exhibit 242, you have a question starting at page or
15 line 11, and you say, the question is:

16 You say that Dex was a quality asset.

17 Do you mean that you disagree with

18 Mr. Brosch's and Dr. Selwyn's conclusion

19 that this was a distress sale of Dex?

20 Are you saying or implying that the seller of
21 a quality asset can not itself be in a financially
22 distressed condition?

23 A. No, I disagree with Dr. Selwyn and
24 Mr. Brosch, because I think they're confusing two
25 concepts. I think they're confusing the condition of

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1 the seller and the condition of the asset. I don't
2 think anyone would dispute the fact that at the time
3 that Qwest was -- decided to sell the Dex company that
4 it was having -- Qwest itself was having problems.
5 That's one of the things that motivated the sale, but
6 the asset itself is a very high quality asset. And if
7 you look in the marketplace today, a lot of private
8 equity investors like the Carlyle Group seek out quality
9 assets that are being sold by distressed companies. So
10 if you read the financial pages, look at people who are
11 chasing assets out of Vivendi, AOL, Time Warner, the
12 European telcos that are in trouble, Deutsch Telcom,
13 France Telcom, because they have quality assets for
14 sale. But that doesn't make it a distress sale, it
15 means that because the asset itself is not distressed,
16 but the buyer, or the seller rather is distressed.

17 Q. Why does it make sense for a company that is
18 in distress to sell off quality assets?

19 A. Well, typically to raise money to pay down
20 debt. A lot of telecom companies the past few years
21 have become overburdened with debt, they need to delever
22 their balance sheets, and so they have to sell off
23 quality assets in order to do that. And I think they do
24 so reluctantly, though you can ask those questions of
25 Qwest, they will be testifying here as well.

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1 But the point is that because it was a
2 quality asset, there was a lot of competition from among
3 those private equity companies, which collectively
4 control over \$100 Billion of uninvested capital, to win
5 that deal. It was very competitive for that reason.
6 You know, it's -- the analogy is just like when you're
7 buying a house, if your neighbor is bankrupt and has to
8 sell the house, but if it's a good house and a lot of
9 buyers are out there, they're going to get a good price
10 for it even though they're in distress.

11 Q. On page 2 carrying over to page 3 of your
12 testimony, rebuttal testimony, you list a number of
13 private equity firms that you believe submitted bids for
14 Dex, and you attribute this information to news reports;
15 is that correct?

16 A. Not entirely. I mean some of this was based
17 on news reports, but some of this was based on just
18 anecdotal information that we collected in the process.

19 Q. Okay.

20 A. You know, we're in this business, and we know
21 a lot of people in these firms, and many times we know
22 what they're up to, and we knew that these folks were
23 actively looking at this business.

24 Q. So did you have --

25 A. To buy.

0269

1 Q. Oh, I'm sorry.

2 A. To buy. I'm sorry, go ahead.

3 Q. So did you have first hand information with
4 respect to any of these purported bidders?

5 A. Not all of them, but some of them, yes. You
6 know, understand that --

7 Q. No, that's all right.

8 A. Okay.

9 Q. You have answered my question.

10 A. All right.

11 Q. You indicate also in that sentence that news
12 reports, the sentence on line 20, news reports indicated
13 that, at the time, indicated that numerous bidders had
14 made initial bids. Can you state as a fact that every
15 one of these firms remained active in the bidding
16 process up until the final buyer was selected?

17 A. You know, you would be better off asking
18 Qwest that question quite frankly, because they
19 conducted the sale. I know for a fact that toward the
20 end of the bidding there was at least one other
21 consortium bidding against us. That was the Tommy Lee
22 Blackstone consortium.

23 Q. And what's the source of that information?

24 A. Well, understand we're -- we were spending a
25 lot of time on this transaction. We were in -- we're

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1 out in the marketplace, we're talking to bankers and
2 lawyers and our colleagues in the private equity
3 business all the time. We were getting some limited
4 intelligence from Qwest at the time. So we had a good
5 view of the competition, at least with that particular
6 consortium.

7 Because Qwest did a very smart thing when
8 they sold this asset. They basically brought two
9 completely negotiated fully financed bids to their
10 board, because Dick Notebaert, the chairman and CEO of
11 Qwest, wanted to make sure that his board would have a
12 choice. And so throughout the summer of '02, we knew we
13 were in a competitive process, because they were
14 negotiating a completely separate but competitive bid.

15 So, for example, we would -- our team in New
16 York would be negotiating with Qwest all day, they would
17 disappear, their negotiating team would disappear for
18 several hours, call us back at 11:00 p.m. and say we're
19 ready to start again. So we knew that they were
20 negotiating with the other team. It was quite
21 frustrating, and there were a lot of tired people who
22 had to forgo their summer vacations.

23 Q. Well, how -- I guess this goes also on page 4
24 of your testimony, Exhibit 242, lines 9 to 12, and
25 you're talking about this same matter, and you said:

0271

1 Right up until the final minutes before
2 we signed the purchase agreements with
3 QCI we knew that we were competing
4 against one other bidder, at least one
5 other bidder, and that Qwest was
6 prepared to execute a purchase agreement
7 with that competitor if our offer were
8 not superior.

9 My question is, how did you know that, how
10 did you know that wasn't simply a negotiating strategy,
11 how did you know these things?

12 A. Because Dick Notebaert, the chairman and CEO
13 of Qwest, told me. And I have known him a long time,
14 and I know that he was telling me the truth. I was the
15 principal negotiator for our consortium with
16 Mr. Notebaert, and on a number of occasions he would
17 tell me that the other consortium was ahead of us, and
18 in some cases that we were behind in some respects, and
19 we knew what we had to do, which was to be competitive
20 if we wanted to win this asset.

21 Q. Turning to Exhibit 247, and this is Staff's
22 Data Request Number 10, and the question was whether you
23 were being offered as a fact witness or an expert
24 witness, and the response from your legal counsel was
25 both; is that correct?

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1 A. Yes.

2 Q. Now up until now we have been primarily
3 discussing various facts surrounding the transaction, so
4 I assume that you have been responding to those
5 questions in your capacity as a fact witness; is that
6 correct?

7 A. I don't frankly remember every single
8 question that you asked me, but as a general matter,
9 yes, I guess that's right.

10 Q. What's not particularly clear is the subjects
11 upon which you're offering expert testimony; can you
12 identify those areas?

13 A. Sure, let me be very clear about that. I
14 want to make it very clear that I am not here as a
15 disinterested expert witness. I have a financial
16 interest in the outcome of this proceeding. But I have
17 been working with our counsel on the regulatory issues
18 from the very beginning of this process when we first
19 decided to pursue this transaction. And I think given
20 my background and history in regulation and
21 telecommunications policy, I might have something that's
22 useful to the Commission that I might add on those
23 subjects. So I would say in the areas of
24 telecommunications regulation and policy I would be
25 offered as an expert witness.

0273

1 Q. Specifically what portions of your testimony
2 are expert witness testimony?

3 A. Do you want me to go through them page by
4 page? I mean I just described in general terms those
5 matters that I would be testifying as an expert.

6 Q. So anything involving telecom policy, is that
7 what you were saying?

8 A. Yeah, as a general matter. I'm familiar with
9 how regulatory commissions assess the public interest
10 having been in policy making positions in my career, and
11 I think I have some -- I certainly have a point of view
12 on this transaction from that perspective.

13 Q. And so I understand that as an expert then
14 that you are opining that the Qwest sale of Dex to the
15 buyer is in the public interest?

16 A. Yes.

17 Q. Is that correct?

18 A. Yes.

19 Q. On page 10 of your rebuttal testimony at line
20 7, you state that you were, "an active participant in
21 our ongoing evaluation of the value of Dex"; is that
22 correct?

23 A. Yes.

24 Q. And did that participation include
25 negotiation of the publishing and the non-competition

0274

1 agreements?

2 A. No, not really. Those agreements were
3 negotiated principally by our outside counsel, Latham &
4 Watkins, and also my partner Jim Atwood, who was the
5 leader of the skill team, and of course his counterpart
6 at Welsh Carson.

7 Q. Now don't those agreements affect the value
8 of the deal?

9 A. I'm afraid it's not a -- I don't quite
10 understand your question, but let me take a stab at it.
11 They do in that it was something that we wanted and we
12 negotiated and we paid for as part of the purchase
13 price, yes.

14 Q. So the deal would not be worth as much
15 without those agreements; is that correct?

16 A. I think that's probably right, although it
17 would be hard for me to quantify the extent of value.

18 Q. Are you generally familiar with the terms of
19 those agreements?

20 A. Only very generally.

21 Q. I believe I notified your counsel that I
22 might ask you a few questions about them, about the
23 agreements.

24 A. Yes.

25 Q. They have been pre-marked, the agreements, 77

0275

1 is the publishing agreement and 79 was the
2 non-competition agreement. They were identified I
3 believe with Mr. Reynolds, but they -- in fact, they're
4 actually portions of Exhibit Number 1, but they have
5 broad application.

6 A. Okay.

7 Q. Do you have them? All right.

8 A. I have 77, 78, and 79; is that what you're
9 referring to?

10 Q. Right now 77 and 79.

11 A. Okay, got it.

12 Q. Now the publishing and the non-competition
13 agreements, they're between the buyer, which is Dex
14 Holdings, and QC; is that correct?

15 A. Well, there are a number of parties to both
16 of these agreements beyond those that you just
17 mentioned. You know, if you look at the preamble to
18 both, there are multiple parties.

19 Q. And those are two of the parties, correct?

20 A. Yes.

21 Q. And do those agreements confer certain post
22 sale obligations upon QC, Qwest Corporation, with
23 respect to its dealings with Dex?

24 A. Yes, I believe so.

25 Q. For example, the non-competition agreement

0276

1 prohibits Qwest Corporation from reentering the
2 directory publishing business for 40 years following the
3 sale of Dex; is that correct?

4 A. As a general matter, yes. I really think
5 that the agreement should speak for itself. I'm not
6 going to characterize what the agreement says. I mean
7 the agreement is right here, you can read it. You can
8 admit it into evidence I presume.

9 Q. But is that your understanding --

10 A. Yeah, that's --

11 Q. -- your general understanding?

12 A. -- my general understanding, yeah.

13 Q. And is it also your general understanding
14 that the publishing agreement requires that Qwest
15 Corporation designate Dex Holdings as its "official
16 publisher" for a 50 year period?

17 A. Yes.

18 Q. Are you familiar with the consequences to QC
19 that are provided in those agreements in the event of a
20 material breach?

21 A. Yes.

22 Q. Of the agreement by QC?

23 A. Yes.

24 Q. Okay. For example, in the event that QC were
25 to materially breach the non-competition agreement or

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1 the publishing agreement by reentering the directory
2 publishing business throughout its 14 state operating
3 area following the sale of Dex, is it correct that these
4 agreements would obligate QC to pay liquidated damages
5 in the amount of about \$2.1 Billion or 30% of the sale
6 price?

7 A. Yes.

8 Q. And is it correct --

9 A. I don't know if that's \$2.1 Billion though.
10 30% of the sale price would be less than \$2.1 Billion.

11 Q. Well, the sale price for both --

12 A. Oh, for both, I thought you were just
13 referring to West.

14 Q. No, I was referring to --

15 A. Oh okay.

16 Q. I was referring to all 14 states.

17 A. Okay.

18 Q. Now Washington represents about what
19 percentage of the total \$7.5 Billion purchase price?

20 A. I don't know.

21 Q. Would you accept it's roughly 17% to 18%?

22 MR. HARLOW: Is that a subject to check,
23 Mr. Trautman?

24 Q. Subject to check 18%.

25 A. I'm not going to corroborate that actually,

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1 because I don't know.

2 Q. Okay.

3 MR. HARLOW: I'm sorry, so the subject to
4 check is Washington represents 17 to 18?

5 MR. TRAUTMAN: No, 18.

6 MR. HARLOW: 18% of the total?

7 MR. TRAUTMAN: Roughly.

8 BY MR. TRAUTMAN:

9 Q. If that number were correct, then a material
10 breach, in a material breach of QC, by QC I should say,
11 the QC's Washington share of the liquidated damages,
12 which is \$2.1 Billion, would be approximately \$378
13 Million. That's simply a mathematical calculation
14 subject to check.

15 A. Well, those aren't my numbers, so I can't
16 corroborate them.

17 Q. Okay.

18 A. I don't know what subject to check means
19 really.

20 CHAIRWOMAN SHOWALTER: It's one of our local
21 phrases.

22 JUDGE MOSS: Just to clarify for the witness
23 who has not testified, a witness can take a number here
24 subject to check, and then will have the opportunity
25 during the ten days following the testimony to inform

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1 the Commission that he disagrees with the testimony.

2 THE WITNESS: Oh, okay.

3 JUDGE MOSS: Otherwise it's admitted or taken
4 to be the fact. So this is a way to cut off having you
5 have to perform a lot of complicated calculations on the
6 stand.

7 THE WITNESS: Thank you, Your Honor, I
8 appreciate that.

9 MR. HARLOW: Part of the problem, and maybe
10 we can deal with it on the check, but there are
11 different methodologies to allocate the purchase price
12 too.

13 JUDGE MOSS: Sure, and that's one of the
14 disadvantages that counsel who ask witnesses to take
15 things subject to check encounter, they sometimes are
16 later informed that that could be looked at six
17 different ways.

18 BY MR. TRAUTMAN:

19 Q. We established, I believe, that the \$2.1
20 Billion was correct. You agreed it was 30% of the --

21 A. I agreed to the 30% number, yes.

22 Q. And Washington's percentage is whatever that
23 number --

24 A. Whatever it is.

25 Q. -- happens to be?

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1 A. Yeah.

2 Q. All right. Now if there were a breach by
3 QC --

4 MR. HARLOW: I'm sorry, before we move on,
5 Mr. Cameron has made a good point, which is Mr. Kennard
6 will only be able to check this with reference to
7 numbers supplied by other parties, so his testimony
8 would have to be limited to the hearsay. He wouldn't be
9 able to corroborate it based on his own knowledge.

10 CHAIRWOMAN SHOWALTER: Counsel, couldn't you
11 just ask the witness to assume that the sale price --

12 MR. HARLOW: That it's going to be a
13 hypothetical, fine.

14 CHAIRWOMAN SHOWALTER: -- and the Washington
15 share is \$378 Million, and on that assumption maybe he
16 could answer some questions.

17 MR. HARLOW: So it's converted to a
18 hypothetical as I understand, thank you.

19 MR. TRAUTMAN: Yeah, although my next
20 question does not really pertain directly to that. I
21 didn't anticipate this would be that difficult, I
22 apologize.

23 BY MR. TRAUTMAN:

24 Q. If there were a breach by QC, is the receipt
25 by Dex of the 30% liquidated damages payment the only

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1 remedy available to Dex Holdings, or does the agreement
2 permit Dex Holdings to pursue remedies over and above
3 that payment?

4 A. I would have to read the agreement to answer
5 that question. I will say that the general principle
6 behind the agreement was to include a hefty liquidated
7 damages provision, so that would be a deterrent for any
8 breach. And that's the whole point of having a 30%
9 liquidated damages clause, to be a deterrent but also to
10 be punitive in the event that it ever happens.

11 Q. But again you were -- are you saying that
12 you're not sure whether there are any other remedies
13 that could be -- that Dex Holdings could avail itself
14 of?

15 A. I would have to read the agreement.
16 Typically a liquidated damages provision is in lieu of
17 other damages, but I'm not familiar enough with this
18 particular agreement to tell you what -- if there are,
19 in fact, other remedies.

20 Q. And again, you -- would the liquidated
21 damages clause, for example, preclude a claim for
22 injunctive relief, or do you know?

23 A. I don't know. I would have to, again, I
24 would have to look at the agreement. Oftentimes
25 liquidated damages provisions do, but I don't know what

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1 this one provides.

2 Q. And so when determining whether this was a
3 good deal, for example, for Dex, you did not consider
4 that?

5 A. Well, as I said --

6 Q. That remedy?

7 A. -- I didn't have responsibility for
8 negotiating this particular agreement, so I can't -- I
9 can't answer that question.

10 Q. Do you know whether during the course of the
11 negotiation whether Dex Holdings at any time sought a
12 liquidated damages amount in excess of 30%?

13 A. I don't know.

14 Q. And do you know whether Qwest at any time
15 sought a liquidated damages amount that was less than
16 30%?

17 A. I don't know.

18 Q. Now on page 12 of your rebuttal testimony,
19 Exhibit 242, line 18, no, actually it starts at line,
20 hold on a second, it starts at line 12.

21 A. Yes.

22 Q. And you state:

23 For financial reporting, accounting, and
24 taxation purposes, Dex Media East, Inc.,
25 values the non-competition and

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1 publishing agreements taken together at
2 \$251 Million.

3 CHAIRWOMAN SHOWALTER: You're not reading a
4 confidential number, are you?

5 MR. TRAUTMAN: No, these are no longer
6 confidential. I believe counsel put --

7 MR. HARLOW: Your Honor, yes, we distributed
8 nonconfidential pages today. You should have those in
9 your book by now.

10 JUDGE MOSS: We do.

11 MR. HARLOW: You should have stars on the
12 page. We put stars in place.

13 CHAIRWOMAN SHOWALTER: I do, I just didn't
14 know how to interpret the stars.

15 MR. HARLOW: In order to maintain pagination
16 and line numbering, where it previously said begin
17 confidential we put stars in.

18 BY MR. TRAUTMAN:

19 Q. So it stated that those agreements -- well,
20 let me start over.

21 For financial reporting, accounting, and
22 taxation purposes, Dex Media East, Inc.,
23 values the non-competition and
24 publishing agreements taken together at
25 \$251 Million out of the total \$2.75

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1 Billion purchase price, or roughly 9% of
2 the transaction value. Applied to the
3 Dex Media West transaction, this ratio
4 would value the non-competition and
5 publishing agreements at roughly \$370
6 Million in the Rodney region.

7 Do you see that?

8 A. Yes.

9 Q. Could you refer now to what's been marked a
10 as Exhibit 243. It was formerly highly confidential and
11 now is not confidential, I believe.

12 MR. HARLOW: That's correct.

13 Q. And when you get that exhibit out, turn to
14 page 43 of 56.

15 A. Yes, I have it.

16 Q. And do you see that near the top there's a
17 line that says Dex East purchase price, and this is in
18 millions, 2,750,000?

19 A. Yes.

20 Q. And then below that a line that says
21 liquidated damages 30% of purchase price, 825 that would
22 be million, I'm sorry, 800 -- the first one was
23 \$2,750,000,000, and this one is -- and then the
24 liquidated damages, 30% of purchase price, is
25 \$825,000,000?

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1 A. Yeah, I see that.

2 Q. All right. Now going back to page 12 of your
3 testimony, you refer to the FAS 141 report in that
4 paragraph that we read from previously. And just to be
5 clear, that report was prepared solely for financial
6 reporting, accounting, and taxation purposes; is that
7 correct?

8 A. Yeah, it was prepared after the closing of
9 the Dex Media East transaction.

10 Q. And what intangible assets does that report
11 value?

12 A. Well, it values a number of intangible
13 financials, the trademarks, the non-compete and the
14 publishing agreement, and customer relationships at the
15 national and local level.

16 Q. Does that report value what is sometimes
17 called good will?

18 A. No, not specifically.

19 Q. Does it only value separable intangibles?

20 A. Correct, yeah. This was to comply with the
21 new Financial Accounting Standards rules, Rule 141.

22 Q. Can you explain in general what the purpose
23 of that financial reporting rule is?

24 A. Yeah, in general it was to meet the
25 requirements of the Financial Accounting Standards

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1 board, which wanted a more precise allocation of value
2 among intangibles and good will. And so companies like
3 Dex that have completed transactions after the
4 promulgation of Rule 141 have to precisely value their
5 intangibles for tax and accounting purposes.

6 Q. And this applies to the buyer, not to the
7 seller, correct?

8 A. Correct.

9 Q. Now looking to the source of the \$370 Million
10 figure that you have extrapolated.

11 A. Yes.

12 Q. As the value of the Rodney agreements, you
13 state that the FAS 141 report, which again is Exhibit
14 243, calculates a value for the publishing and
15 non-competition agreements. Now isn't it correct that
16 this value was calculated based on the probability of QC
17 breaking either agreement within three to five years?

18 A. Well, that's the -- they play out a number of
19 breached scenarios under the agreement and come up with
20 an appraisal process, which frankly is -- I'm not an
21 appraiser, and it's a fairly technical formulaic way of
22 valuing these intangibles. I will tell you from an
23 investor standpoint we look at these intangibles quite
24 differently.

25 Q. But could I just point you then to page 20 of

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1 56 of Exhibit 243.

2 A. 20 of 56, okay.

3 Q. And again, doesn't the table in the center of
4 the page along with the accompanying explanations
5 indicate that the value is based upon various
6 probabilities of breach?

7 A. That's right.

8 Q. Now is the \$370 Million value that you
9 calculated based on the Dexter, that is the Dex Media
10 East, FAS 141 report, is that value less than the
11 negotiated 30% of the purchase price arms length value
12 that was included in the publishing and the
13 non-competition agreement?

14 A. Obviously it's a lesser number, but as I
15 stated earlier, there's no necessary correlation between
16 the 30% liquidated damages clause which was negotiated
17 for one purpose, and the FAS 141 report which was
18 prepared for another purpose, so I'm not quite sure what
19 you're getting at.

20 Q. I just asked the question.

21 Well, let me ask, did you not offer this as
22 an exhibit in part to establish the value of the
23 non-compete agreement?

24 A. Yes.

25 Q. And in the event of a material breach of the

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1 Rodney agreement, QC would be obligated to pay the 30%
2 value, not the \$370 Million, that's correct?

3 A. That would be -- yes, to punish them for the
4 breach, that's right.

5 Q. And is it also correct on page, looking at
6 page 20 of 56 again of Exhibit 243, that Murray Devine,
7 who compiled the study, considered the probability of a
8 material breach in some or all of the Dex operating
9 areas to be a total of 50%?

10 A. I'm not sure if that's the correct way to
11 read that.

12 Q. In other words, there's the scenario of no
13 competition, no breach is 50%. All of the other
14 scenarios involve some breach going from the top three
15 markets down to scenario 5, which is a breach
16 everywhere.

17 A. Yes, I see, yeah, I see where you're going.

18 Q. Now again, the 30% penalty over Dexter and
19 Rodney let's say, and we again that was about \$2.1
20 Billion, correct?

21 A. Yes.

22 Q. That would be a pretty stiff penalty for QC,
23 correct?

24 A. Yes.

25 Q. Would it be reasonable to assume that if QC

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1 were to breach the agreement and expose itself to such a
2 large damages obligation that it would be because QC
3 concluded that the value to it of breaching that
4 agreement exceeded the amount that it would have to pay
5 to Dex Holdings?

6 A. Frankly, I think it's a pretty remote
7 possibility that they would breach an agreement and
8 expose themselves to that extent of liability, but I
9 guess theoretically yes. I mean these are -- these are
10 honorable people, so I don't think that they would make
11 a cold hearted calculation like that. I just don't -- I
12 can't conceive of that.

13 Q. But didn't --

14 A. But in theoretical terms, I suppose, yes.

15 Q. But didn't the consultant that did this
16 report consider that the chance of a breach with all the
17 possible breach scenarios was 50%?

18 A. Yeah, that's -- yeah, obviously that's what
19 the report says.

20 Q. Now has Dex Holdings done any analysis of the
21 cost that it would incur in order to comply with the
22 regulatory requirements of being designated as QC's
23 official publisher?

24 A. No, I don't think that was really necessary,
25 because we have always -- we always knew going into this

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1 transaction that we would want to fulfill the regulatory
2 obligations of the seller. And so -- and, in fact,
3 fulfilling those obligations is good business from a
4 Yellow Pages provider standpoint, and so we didn't do a
5 calculation of what compliance would be. It's really
6 part of the business.

7 Q. So that -- so therefore, for instance, as
8 part of the due diligence, Dex Holdings or Carlyle,
9 neither one of them analyzed the ongoing cost elements
10 of the Dex operations such as the cost of printing and
11 delivering white page directories, the cost of free
12 business small print listings in the Yellow Pages,
13 things of that nature?

14 A. I don't know definitively. You might want to
15 ask George Burnett that question, he might be more
16 familiar with whether there was a breakout calculation
17 on that. I suspect not, because I don't think we ever
18 seriously considered not continuing those business lines
19 and fulfilling those obligations. So that being the
20 case, I don't know why we would have done a separate
21 calculation.

22 Q. Now George Burnett, did he participate in
23 your due diligence?

24 A. No, but he would be aware of whether we did a
25 separate calculation of that I would think. You would

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1 have to ask him. I'm not sure.

2 JUDGE MOSS: Mr. Trautman, maybe this would
3 be a convenient moment then for me to ask how much more
4 you have.

5 MR. TRAUTMAN: We might have another, oh, it
6 might be 45 minutes or so.

7 JUDGE MOSS: Okay, go ahead.

8 Oh, Mr. Roseman, I'm sorry, go ahead.

9 MR. ROSEMAN: Your Honor, I know this is
10 right in the middle of his cross, we aren't going to
11 have anything, and depending on Dr. Blackmon, what his
12 comments are about our settlement, so I would like to
13 ask to be excused until next week until, depending on
14 what Dr. Blackmon's testimony is, but certainly any
15 cross-examination of our witness, Mr. Brosch, on the
16 settlement.

17 JUDGE MOSS: Well, surely I don't hesitate to
18 let you go if that's your decision, Mr. Roseman, but
19 counsel would always caution that when they're not here,
20 they may miss something, so you leave with that caution,
21 and with that you certainly may be excused.

22 MR. ROSEMAN: Thank you, Your Honor.

23 (Discussion on the Bench.)

24 JUDGE MOSS: All right, we seem to be at a
25 little bit of a pause in the action, so why don't we

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1 take a ten minute recess and give everybody a chance to
2 stretch their legs, get a drink of water and what have
3 you.

4 (Recess taken.)

5 JUDGE MOSS: Our witness is comfortably on
6 the stand, so you may resume, Mr. Trautman.

7 MR. TRAUTMAN: Thank you, Your Honor.

8 BY MR. TRAUTMAN:

9 Q. I wanted to move on and look at two other
10 agreements that I believe your counsel has provided you
11 copies of. One is the trademark license agreement,
12 which is Exhibit 78, and one is the branding exhibit,
13 which was Exhibit C to the publishing agreement. It was
14 marked as Exhibit 328. I believe it originally was
15 confidential, but I believe that confidentiality has now
16 been removed.

17 JUDGE MOSS: I still have it marked
18 confidential, so I need to know.

19 MS. ANDERL: Yes, Your Honor, it is
20 nonconfidential.

21 JUDGE MOSS: All right, very good, thank you.

22 BY MR. TRAUTMAN:

23 Q. What specific trademarks are covered by the
24 trademark license agreement?

25 A. Well, Mr. Trautman, I would have to refer you

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1 to the agreement.

2 Q. Okay.

3 A. Rather than enumerate these, and I probably
4 would leave some out.

5 Q. All right. Would you agree on page 21 of the
6 agreement, which is Appendix A, it shows two trademarks.
7 One is Qwest Dex, and one is Qwest Dex advantage.

8 A. I see that, yes.

9 Q. And on page 4 of the agreement, is it correct
10 that the trademark license agreement is for five years?

11 A. Yes. Well, Mr. Trautman, to be more precise,
12 it's five years or a termination of the agreement or the
13 publishing agreement, whichever occurs earlier.

14 Q. And is this the agreement that is valued in
15 Exhibit 243, the FAS 141 report?

16 A. Yes.

17 Q. All right. And do you know how the FAS 141
18 report values the trademark agreement in terms of
19 percentages?

20 A. I would have to look back at the FAS 141
21 analysis. If memory serves, it was about \$29 Million,
22 something like that.

23 Q. Well, turning to --

24 A. I'm sorry, 311 and 68, yes.

25 Q. In terms of the royalty rate, turning to page

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1 46 of 56 in Exhibit 243, now under the column royalty
2 rate, isn't it true that here it is valued on a
3 declining percentage basis, so there's a 5% figure for
4 year 1 declining to 4% in year 2 and so forth down to 1%
5 in year 5?

6 A. That's what it seems to suggest, yes.

7 Q. Does Dex Holdings intend to make use of the
8 Qwest Dex name during the transition away from Qwest Dex
9 to merely Dex alone?

10 A. I don't know definitively what the plan is
11 with respect to the trademark.

12 Q. Turning to pages if you look at page 22 and
13 carrying over to page 23 of 56 of this exhibit, and is
14 it correct here that the study notes, I'm quoting:

15 The trademark agreement is for a period
16 of five years, and over this period, the
17 company will phase out the Qwest marks
18 and shift the consumers' focus to the
19 Dex mark, which it acquired, and marks
20 associated with the Dex name and away
21 from those associated with Qwest.

22 A. Yes.

23 Q. And is it true that at the end of this
24 transition period that Dex Holdings will no longer have
25 the right to use the Qwest Dex name?

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1 A. Well, I would have to go back and read the
2 trademark agreement to know what our rights would be at
3 the termination of the five year period.

4 Q. Now we have been talking about the trademark
5 license agreement, and we have discussed that that
6 agreement covers only two particular marks, Qwest Dex
7 and Qwest Dex Advantage. Now are you familiar with the
8 branding exhibit to the publishing agreement, which was
9 marked as Exhibit 328?

10 A. No.

11 Q. Okay. Are you aware whether the branding
12 exhibit allows Dex Holdings as the official publisher of
13 the Qwest directories to continue to use the Qwest brand
14 name and mark on its directories for a period of 50
15 years, assuming no breach of the publishing agreement?

16 A. I don't know.

17 Q. If you look at page 1 of that agreement --

18 JUDGE MOSS: When you say that agreement, do
19 you mean --

20 Q. Oh, I'm sorry, Exhibit 328, I apologize. And
21 looking down on definitions, 1.10 Qwest directory
22 branding, and that's defined to include, the trademark
23 or service mark including without limitation Qwest, with
24 respect to directory products. Do you see that?

25 A. Yes.

1 Q. So if you look at the branding exhibit and
2 the trademark license agreement together, I'm trying to
3 understand what's permitted and what is not. It appears
4 that after the end of the five year transition period in
5 the trademark license agreement that Dex may not use the
6 Qwest Dex mark but that it still may use the Qwest mark
7 under the branding exhibit, and it may also use the Dex
8 mark, which it will, in fact, own; isn't that correct?

9 A. I don't know, I'm not going to opine and
10 interpret agreements that I haven't negotiated and
11 haven't read.

12 MR. HARLOW: Your Honor, I --

13 A. You will have to draw your own conclusions.

14 MR. HARLOW: -- we've gone through this about
15 three or four times now, and the answer is always I
16 don't know, the witness hasn't got the foundation to
17 answer these questions.

18 JUDGE MOSS: First of all, I'm going to
19 remind everyone again that we need to speak only one at
20 a time so that the court reporter can record everything
21 that is said.

22 Having said that, Mr. Trautman, we do have
23 the difficulty of the witness being referred to
24 documents with which he expresses no familiarity. The
25 documents do, of course, speak for themselves. So if

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1 you wish to ask him a question based on something that's
2 in one of the documents, I suppose we would have the
3 document or will have the document as part of our
4 evidence, and you can simply refer to it. If the
5 witness doesn't know, he doesn't know, and that's a
6 perfectly acceptable answer.

7 BY MR. TRAUTMAN:

8 Q. All right, let me turn back to Exhibit 243,
9 which is the FAS 141 report appended to your testimony,
10 and I'm looking at the subject of customer
11 relationships, which is about two thirds of the way down
12 that page.

13 A. What page was that?

14 Q. Oh, I'm sorry, page 26 of 56.

15 And that first paragraph reads:

16 If an entity establishes relationships
17 with its customers through contracts,
18 those customer relationships would arise
19 from contractual rights. Therefore,
20 customer contracts and the related
21 customer relationships are intangible
22 assets that meet the contractual legal
23 criterion of FAS 141. The FAS 141
24 requires that those intangible assets be
25 recognized as assets apart from good

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1 will even if confidentiality or other
2 contractual terms prohibit the sale or
3 transfer of the contract separately from
4 the acquired entity. If a customer
5 relationship does not arise from a
6 contract, FAS 141 requires that the
7 relationship be recognized as an
8 intangible asset apart from good will if
9 it meets the separability criterion.

10 Do you see that?

11 A. Yes.

12 Q. Now in your testimony on page 12, this is
13 Exhibit 242-T, your rebuttal testimony.

14 A. Mm-hm.

15 Q. Your accountant, Murray Devine, considered
16 that approximately \$1.1 Billion of the value of Dex
17 Media East to be based on contractual relationships with
18 customers; is that correct?

19 A. Yes. It's actually employee relationships
20 with national and local advertisers I think is the
21 precise category there.

22 Q. Well, that's the statement in your testimony
23 is that the FAS 141 report values the Dex Media East
24 employee relationships with national and local
25 advertisers at \$1.1 Billion; is that correct?

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1 A. Yes.

2 Q. In other words, the term employee
3 relationships is your characterization; is that correct?

4 A. Yes.

5 Q. Now isn't it true that FAS 141 treats
6 contractual relationships differently than value of the
7 work force?

8 A. I don't know. All I know is the excerpt that
9 you read from the Murray Devine valuation report, which
10 seems to characterize the FAS 141 rule, but that's not
11 the rule itself. So I don't know -- I'm reluctant to
12 adopt this characterization as accurate, because I
13 didn't write it.

14 Q. If you could turn to Exhibit 245, and these
15 are excerpts from the Financial Accounting Series
16 Statement of Financial Accounting Standards 141. And
17 turn to what's marked as page 16 in the lower right-hand
18 corner or numbered page 78 on the page number itself.

19 A. Did you say page 16?

20 Q. 16 on the lower right-hand corner.

21 A. Oh, I see.

22 Q. All right. And the actual page number is 78,
23 and there's a paragraph, two paragraphs below assembled
24 work force. Do you see that?

25 A. Mm-hm.

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1 Q. And at the very bottom of the page, the last
2 sentence, it says:

3 Consequently, it, the Financial
4 Accounting Standards board, decided to
5 make an exception to the recognition
6 criteria and require that the fair value
7 of an assembled work force acquired be
8 included in the amount initially
9 recorded as good will regardless of
10 whether it meets the recognition
11 criteria in Paragraph 39.

12 Do you see that?

13 A. Yeah, I see the last sentence. I just want
14 to glance at what comes before it.

15 Q. All right.

16 A. Okay.

17 Q. Now taking that in connection with your
18 testimony, again, when you talk about the value of
19 employee relationships, are you attributing the value of
20 the contractual customer relationships to Dex employees
21 rather than to the contracts themselves?

22 A. Well, again, I'm reading this excerpt from
23 FAS 141 for the first time, but it seems to draw a
24 distinction between the assembled work force and how you
25 value that on the one hand with the contractual

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1 relationships between a company and its customers on the
2 other hand. As a non-appraiser, non-accountant, that's
3 the best I can do.

4 Q. Do Dex employees handle national accounts, or
5 are those handled by certified marketing
6 representatives?

7 A. For the most part, they're handled by
8 certified marketing representatives, although we are in
9 the process of bringing on people who will be full time
10 employees of Dex and have responsibility for national
11 accounts.

12 Q. The employees that you inherited or that the
13 company inherited when it bought Dex did not handle
14 national accounts; is that correct?

15 A. For the most part they did not. There might
16 have been some of them with that responsibility, but I'm
17 not sure.

18 Q. So if the Dex employees do not handle
19 national accounts, then I would assume that you would
20 agree that the value of those national accounts can not
21 be ascribed to Dex employees; is that correct?

22 A. I'm not sure exactly what Murray Devine is --
23 what employees they're referring to in this, so I don't
24 know.

25 Q. I would like you to turn to page 19 of 56 in

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1 Exhibit 243.

2 A. 19 of 56.

3 Q. And I'm looking in particular at some
4 statements and Murray Devine's perspectives about QC's
5 potential reentry into the directory publishing
6 business. I'm starting with the sentence below
7 valuation of the agreements.

8 A. Yes.

9 Q. And it states:

10 The company, that being Dex Media East,
11 believes that the non-compete and
12 publishing agreements are assets due to
13 QC's extensive experience and knowledge
14 in the industry. QC has been the
15 dominant publisher of directories in the
16 region for many years.
17 And skipping down to the next paragraph, it
18 states:

19 If QC was to launch a competing product,
20 it would require the company to cut
21 prices or increase promotional expenses
22 to protect its market share. QC also
23 possesses an insider's knowledge of the
24 business's strengths, weaknesses, and
25 long-term strategy against which an

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1 effective competitive strategy could be
2 developed. The more successful a
3 competing business is, the greater the
4 negative financial implications to the
5 company, and the more the inherent value
6 of the non-compete.

7 And now with that in mind, if you would turn
8 to page 21, and you look down at the second paragraph
9 from the bottom, three sentences in, it says:

10 After 40 years, consumers would
11 recognize the company, that being Dex
12 Media East, as the provider of Yellow
13 Pages, and QC would essentially be
14 starting from scratch to develop a
15 competing product. In addition, QC
16 would have also lost any consumer
17 recognition it has as a Yellow Page
18 publisher. Given the level of
19 investment that would be required by QC
20 to compete at that point in time would
21 most likely make it economically
22 unviable.

23 Right, do you see those passages?

24 A. Yes, I read it.

25 Q. Now do you agree with Murray Devine's

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1 observation about QC having to start from scratch at the
2 end of a 40 year term?

3 A. Well, let me address your question as an
4 investor and not an appraiser or an accountant. When we
5 looked at this business, one of the principal values
6 that we thought that we were buying was the
7 relationships that the employees have with the
8 advertiser base. Because one of the uniquely valuable
9 things about the Dex business is that they have 1,000
10 quota carrying sales people on the street who have
11 established long-term relations with the base of
12 advertisers, and that differentiates this business from
13 some of the potential new entrants like Google or the
14 on-line folks, Yahoo, even Verizon Super Pages, because
15 it has a retail component which is valuable.

16 So to that extent, when I look at this Murray
17 Devine report and I see a high value attributed to the
18 customer relationships, that certainly is consistent
19 with my view of value as an investor. Although
20 obviously as an investor, we don't go through the
21 formulaic exercise of breach scenarios and whatnot in
22 valuing these intangibles. But the value of this
23 business, a principal component of the value, I would
24 say the principal component of the value in this
25 business inheres in the relationships that those

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1 employees have at the retail level with the customers.

2 Because this business is unique in that it
3 doesn't -- collectively there are some 400,000
4 individual customers who are advertisers of Dex, so it's
5 not the kind of business where you have a top 10 group
6 of customers that account for a majority of your
7 revenues like a lot of businesses. It is the average
8 revenue per user of Yellow Pages advertising is about
9 \$3,000, and so that means that those employees are
10 uniquely valuable to this business and not easily
11 replicatable, and I think that that's what Murray
12 Devine is getting at when they talk about the entry
13 barriers that Qwest would face if they had to start this
14 business anew in 40 years.

15 Q. All right. If that's the case, then why is
16 the non-competition agreement so important if the value
17 is conferred by the Dex employees?

18 A. Well, it's of a lesser value quite frankly,
19 because if you have acquired the employees in effect and
20 you have acquired their customer relationships, it gives
21 you a tremendous advantage against any new entrant into
22 the marketplace, and I think that's the relative values
23 that are reflected in this Murray Devine report.

24 Q. So if the, in line with that, the lesser
25 value of the non-competition agreement and the value

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1 ascribed to the Dex employees, would that analysis hold
2 if QC were to reenter the business after 15 years
3 instead of 40 years under the current non-competition
4 agreement?

5 A. I think that if the incumbent provider were
6 to leave this business for 15 years or 40 years, it
7 would face very, very difficult obstacles getting back
8 in. It would face the equivalent of an independent
9 directory coming into the marketplace, and as you're
10 probably familiar, independent directories typically
11 don't garner the majority of the market share, because
12 they just don't have the customer relationships to do
13 so.

14 Q. Now let's consider instead of 40 years the
15 other end of the spectrum. Suppose that QC decided to
16 reenter the directory publishing business not after 40
17 years, but after 40 hours. Let's assume the deal closes
18 at 5:00 p.m. on June 30th, and at 9:00 a.m. on July 2nd,
19 QC announces the new Qwest Spirit of Service directory.
20 In that case, would QC be starting from scratch?

21 A. You're asking me to speculate on something
22 that wouldn't happen. But again, absent those employees
23 and those customer relationships, it would be very
24 difficult to launch a competing business.

25 Q. Well, again, first of all, you said this is

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1 speculating on something that wouldn't happen, but isn't
2 it true that the, again, that the Murray Devine study
3 indicated a 50% probability of breach of some sort?

4 A. Well, that's one way of reading that report.
5 I mean I think basically -- I mean first of all it's
6 highly theoretical, it's based on appraisal methodology
7 that I don't fully understand. But basically as I read
8 that report, it's saying that if there were no agreement
9 in place, what is the probability that Qwest would come
10 in and market a competing directory. First of all, it's
11 a completely improbable scenario, because having
12 negotiated this agreement with Qwest, they're not going
13 to come in in the next 40 hours or the next 15 years.

14 Q. What's to prevent QC from breaching the
15 various agreements and rapidly reentering the directory
16 publishing business?

17 A. 30% liquidated damages provision, which is
18 the deterrent.

19 Q. Other than that, if they did not feel that
20 was a significant deterrent?

21 A. That's a pretty significant deterrent. \$2.1
22 Billion liquidated damages I would say is a pretty
23 strong deterrent, particularly for a company that's
24 trying to raise cash.

25 Q. Well, you have indicated in part of your

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1 response here that the lack of cash would be one of the
2 barriers, correct, to Qwest breaching the agreement?

3 A. Well, what I'm saying, just to be clear, is
4 that that liquidated damages provision is a hefty one in
5 my experience, and it was designed to deter a breach of
6 that agreement. But it's all hypothetical, because we
7 know that Qwest is exiting the Yellow Pages business and
8 has no interest in getting back in the business.

9 Q. Let me refer you again to page 20 of 56 of
10 Exhibit 243.

11 A. Yes.

12 Q. And first of all, there is a scenario 5,
13 RBOC, 25%, and the paragraph two paragraphs down reads:

14 Scenario 5 assumes that competition were
15 to occur in all markets led by QC
16 partnering with an RBOC. This scenario
17 was measured based upon the full damages
18 of \$825 Million. The scenario was
19 assigned the highest probability behind
20 the no competition, no breach scenario
21 since it was viewed as the most likely
22 to occur if the two agreements were not
23 in place.

24 Now that's a complete breach throughout the
25 service territory, and it would be accomplished by

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1 partnering with an RBOC. And the statement continues to
2 say:

3 Given the lack of capital available to
4 QC due to its poor financial condition,
5 it would be most likely they would
6 partner with an RBOC to compete against
7 the company.

8 So didn't Murray Devine see that as a 25%
9 chance?

10 A. They obviously do based on their report, but
11 it would be really interesting to cross examine the
12 author of this report as to how they came up with a 25%
13 probability, because I, you know, I submit to you as
14 someone who spends a lot of time looking at business
15 plans of telecom companies that it's pretty difficult to
16 put a probability on someone's willingness or ability to
17 compete like that. This is highly theoretical. You
18 know, clearly it satisfies FAS 141 and the IRS
19 requirements, but in terms of trying to translate that
20 into business models and strategies in the real world, I
21 think it's quite theoretical.

22 Q. Now this is an attachment to your testimony;
23 is that correct?

24 A. Yes.

25 Q. All right.

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1 A. And it was attached to demonstrate the
2 relative values of customer relationships versus the
3 non-competing publishing agreements.

4 Q. Now I assume that Dex Holdings reviewed
5 Staff's testimony when it was filed?

6 A. Could you repeat that question?

7 Q. In general, did you review Staff's testimony
8 after it was filed in this case?

9 A. Staff, what staff?

10 Q. Commission Staff.

11 A. The staff of the Commission, yes.

12 Q. And so are you aware of the Staff's
13 recommendation that the Washington Commission not
14 approve the sale?

15 A. Yes, I'm aware of that.

16 Q. And did you discuss the various options that
17 you would have should the Washington Commission not
18 approve the sale?

19 A. No.

20 Q. Is Dex Holdings willing to purchase the
21 Rodney portion without Washington if a sales price can
22 be negotiated?

23 A. Well, I find that it's difficult for me to
24 unilaterally answer that question without conferring
25 with our partner. Our 50/50 partner in this deal is

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1 Welsh Carson, and it wouldn't be appropriate for me to
2 speculate. I will say that that's not a scenario that
3 we have discussed. Let me amend that, we haven't
4 discussed that in any level of detail I should say.
5 There were some preliminary discussions.

6 Q. Now I believe you indicated earlier that part
7 of your expertise was in telecom policy; is that
8 correct?

9 A. Yes.

10 Q. All right. Now as a telecom policy expert,
11 what is the benefit to the public interest of having
12 Qwest excluded from the directory publishing business
13 for 40 years?

14 A. Well, I never stated in my testimony that
15 there was a value in Qwest being excluded from the
16 publishing business for 40 years. I think you're
17 reading something into what I have -- what my testimony
18 has said. What I have said is that given the totality
19 of the circumstances in this case, in particular the
20 reasons why Qwest was motivated to sell this asset, and
21 in particular given the recent development of the
22 partial settlement in this case, that, you know, clearly
23 it's in the public interest of consumers and rate payers
24 for this sale to go through. I find it frankly
25 remarkable that anyone would seriously countenance the

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1 bankruptcy of an RBOC as -- which is the alternative to
2 this sale not going through.

3 Q. Again, now the question was what is the
4 benefit to the public interest of having Qwest excluded
5 from the directory publishing business for 40 years, are
6 you saying there is none?

7 A. I'm saying that I have never testified that
8 there was a benefit to that per se. I'm saying that I
9 have testified and I am testifying now that there is a
10 benefit --

11 MR. TRAUTMAN: Objection, that is not my
12 question, Your Honor.

13 JUDGE MOSS: You don't object to your own
14 question, Mr. Trautman. The witness is trying his best
15 to answer your question.

16 MR. TRAUTMAN: The answer is nonresponsive.

17 JUDGE MOSS: Well, that may be, but wait,
18 please, until he has finished, and then you can ask a
19 follow-up question and get the response that you're
20 looking for perhaps, but that's the appropriate way to
21 proceed.

22 Were you finished, Mr. Kennard?

23 A. Just to clarify my answer, I was remarking
24 that there was an inaccurate premise in your question
25 that I want to make clear I have never testified that

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1 there was a benefit in excluding Qwest from the
2 directories business for 40 years.

3 BY MR. TRAUTMAN:

4 Q. I did not state that as a premise to my
5 question.

6 JUDGE MOSS: All right, well, why don't you
7 state what your question is, and we'll move on.

8 MR. TRAUTMAN: I stated it three times, Your
9 Honor.

10 JUDGE MOSS: Mr. Trautman, if you want to ask
11 a question, this is your opportunity.

12 BY MR. TRAUTMAN:

13 Q. All right, you have stated that the deal was
14 in the public interest.

15 A. Yes.

16 Q. So is it in the public interest despite the
17 40 year exclusion of Qwest from the directory publishing
18 business?

19 A. Yes, absolutely, based on the totality of the
20 circumstances, it is in the public interest.

21 Q. Is the 40 year exclusion of Qwest a negative
22 component of that public interest calculation?

23 A. What do you mean by a negative component?

24 Q. Does it reduce the public benefit?

25 MR. HARLOW: I still think the question is

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1 vague, Your Honor.

2 JUDGE MOSS: Well, let's let the witness
3 decide whether he understands. If he doesn't, he can
4 say so.

5 A. If your question, Mr. Trautman, is whether
6 that is one of the principal public interest benefits of
7 the transaction, I would say no. But I would say that
8 it is a necessary component of the overall transaction,
9 which in its totality is in the public interest.

10 BY MR. TRAUTMAN:

11 Q. Are there specific business concerns of the
12 buyers that justify the 40 year non-competition
13 agreement?

14 A. Yes, the -- and again, it's hard to quantify
15 what -- how you value that non-compete obligation, but
16 it was certainly a component of the transaction that was
17 negotiated and bargained for. And from our perspective
18 as a buyer, it's an attractive component.

19 Q. Would these business concerns be largely
20 satisfied by a shorter non-competition provision such as
21 five to ten years?

22 A. No, not at this point. Because the way this
23 transaction has been structured, as I'm sure the
24 Commission is aware, this is the second phase of a two
25 phase transaction, and we have gone to the high yield

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1 bond markets and gone to our co-investors and basically
2 lined up these two transactions in effect in cookie
3 cutter fashion. And, you know, I will tell you that we
4 had some nervous days when we went to the bond market
5 for the first deal, because the bond markets have been
6 rather volatile in the past year. At this point, if
7 those agreements were to be changed in really any
8 substantial way but certainly one that would reduce the
9 term, I think it would jeopardize the financeability of
10 the transaction.

11 Q. My question was with reference to at the time
12 that the deal was made, would the business concerns be
13 -- would they have been satisfied by a shorter
14 non-competition provision?

15 MR. HARLOW: Objection, there's no relevance
16 to that question. We can't in Washington unwind phase
17 one of the deal in other states.

18 JUDGE MOSS: Relevance, Mr. Trautman.

19 MR. TRAUTMAN: No, as to phase two, as to
20 Rodney.

21 MR. HARLOW: Asked and answered, Your Honor.

22 MR. TRAUTMAN: He said at this point in time.

23 MR. HARLOW: This point in time is after the
24 closing of phase one and before the closing of phase
25 two.

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1 MR. TRAUTMAN: We're trying to understand and
2 -- we're trying to understand the value of the
3 non-competition agreement, and it's relevant to Dex
4 Holdings.

5 JUDGE MOSS: Okay, well, go ahead, try your
6 question.

7 BY MR. TRAUTMAN:

8 Q. All right, at the time that you entered into
9 the transaction, setting aside the jittery bond market,
10 would your business concerns have been satisfied by a
11 shorter non-competition provision such as five to ten
12 years?

13 A. I don't think so, no.

14 Q. Does it reduce competition to have an
15 otherwise capable firm prohibited from entering a
16 particular market such as directory publishing?

17 A. Well, I suppose that from a consumer welfare
18 standpoint, there is some public interest benefit in
19 having robust competition in the marketplace. But
20 given, again, going back to my testimony here, you know,
21 I believe that you had a company that wanted to exit the
22 business and really had no intention of getting back in
23 the business, which is why they agreed to that
24 non-compete provision, which was of some benefit to us.

25 And so I think that as a practical matter in

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1 the context of this transaction, the question really
2 doesn't have a lot of meaning. Because clearly we got
3 some value from that non-compete as buyers. It's hard
4 for me to prescribe a precise value to it. Now its
5 value is, you know, enhanced by the fact that we got an
6 agreement for the first phase of the transaction, to
7 change it now could very well derail the transaction, so
8 its value is enhanced, if you will.

9 Q. You mentioned that, in your testimony, that
10 Dex was a quality asset. Would Dex still be a quality
11 asset without the non-compete clause?

12 A. Well, quality obviously is a subjective term.
13 I think I've got to stick with what I have told you
14 before a few times, which is that that non-compete has
15 value to the buyers here. I can't ascribe to you a
16 precise value, but it certainly has value and enhances
17 the quality, to use your adjective, of the asset.

18 Q. Well, I believe the adjective was one you
19 used in your testimony. You described it as a quality
20 asset.

21 MR. HARLOW: Objection, argumentative.

22 If you hadn't finished, I'm sorry.

23 Q. Using your term again, Dex being a quality
24 asset, would it still be a quality asset with a shorter
25 term of a non-compete clause?

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1 A. It would be a less quality asset I guess is
2 what I'm trying to make clear, from our perspective.

3 Q. Turning back to page 6 of your rebuttal
4 testimony, Exhibit 242, and at line 4 you state:

5 Indeed, we were only to sustain our bid
6 price of \$7.050 Billion after Qwest
7 agreed to grant us the option to obtain
8 \$300 Million in financing for the
9 transaction from Qwest. This seller
10 commitment was a critical piece of the
11 overall purchase agreement.

12 Do you see that?

13 A. Yes.

14 Q. Your testimony suggests that Qwest did not
15 initially offer to provide the buyers with the option to
16 use financing. Is this an accurate interpretation?

17 A. Yes. Again because of the volatility in the
18 high yield bond market, we were very concerned about our
19 ability to raise the high yield bonds at that purchase
20 price. So we went back to Qwest, and we told them that
21 in the event that we go to market with these bonds and
22 we're not able to finance them, then at our bank's
23 request, they are able to require Qwest to provide \$300
24 Million in backstop financing, if you will, in order for
25 us to sustain that purchase price.

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1 Q. Have the buyers made any decision yet on
2 whether to exercise the option for seller financing?

3 A. Well, we won't know until we go to market
4 with the bonds to assess whether we will be able to sell
5 these bonds in the market. If we can't, then we will
6 have to come back to Qwest or our banks will come back
7 to Qwest.

8 Q. Did you use seller financing with respect to
9 the Dexter bonds?

10 A. No.

11 MR. TRAUTMAN: I believe that's all the
12 questions I have. I would move to admit Exhibits 245
13 through 250 into the record.

14 JUDGE MOSS: All right, hearing no objection,
15 those will be admitted.

16 MR. HARLOW: Your Honor, give me a moment
17 please to confer with co-counsel on those.

18 JUDGE MOSS: Oh, I'm sorry, I didn't know
19 that you were conferring with co-counsel.

20 MR. HARLOW: Your Honor, we have no objection
21 with the caveat that we may wish to in the vein of
22 completeness as we often do introduce additional
23 portions of the FAS 141 statement or possibly even the
24 entire statement.

25 JUDGE MOSS: All right. If you do, of

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1 course, we will need the requisite number of copies.

2 MR. HARLOW: Of course.

3 JUDGE MOSS: So make provision for that.

4 All right, I think it's appropriate to ask if
5 there are questions from the Bench before we go to
6 redirect so that you can have the fullness of the
7 questions before you, so are there questions from the
8 Bench?

9 CHAIRWOMAN SHOWALTER: Yeah, I have a couple
10 of follow-up questions.

11

12 E X A M I N A T I O N

13 BY CHAIRWOMAN SHOWALTER:

14 Q. You gave the analogy of a distressed seller
15 with a nice house, and the seller is distressed, but the
16 house is nice, and so you posited that you could still
17 get a pretty good price for the house. But the further
18 element that occurred to me is, well, is it a hot
19 market, a hot housing market, or is it a slower one.
20 And I think of Seattle for example with a hot market two
21 years ago, it's sort of a slow one now.

22 A. Mm-hm.

23 Q. And in those circumstances, I'm not sure that
24 in a slow market the nice house brings as much as in a
25 hot market. So getting to our issue here, I heard your

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1 testimony about \$120 Billion of investment chasing
2 quality projects. At the same time, I heard your
3 testimony about some difficulty with financing, bond
4 jitters, needing to have seller financing.

5 A. Mm-hm.

6 Q. And the general poor economy. So I am
7 wondering, you know, is it a hot market, or is it a
8 depressed market for this kind of purchase?

9 A. It is a very hot market for these assets. As
10 my testimony reflects, there was a lot of competition in
11 the private equity community for this particular Yellow
12 Pages company, and there was also competition for Yellow
13 Pages assets that were sold at about the same time.
14 Sprint sold its directory business shortly after we
15 reached an agreement with Qwest for the Dex business.
16 Bell Canada sold their directories business. There is a
17 process underway in Europe now to Telecom Italia is
18 selling their directories business. And in all of these
19 cases, there is intense competition for these assets, so
20 the assets themselves are very attractive.

21 The financing market itself has been
22 volatile, as I have testified. But, you know, the
23 financing market in part is a result of timing. When we
24 went to market with the Dex bonds, we were at a lull
25 period in the bond market. It has recovered a little

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1 bit since then, but you never know what's around the
2 corner. With each announcement about SARS or the war in
3 Iraq or whatever, the bond market gets spooked, so you
4 just don't know what's going to happen.

5 I am very confident that for these types of
6 assets there is huge demand for them in the private
7 equity community. And they are financeable, although
8 financeability is subject to this volatility in the bond
9 market.

10 Q. But doesn't that volatility or spookiness
11 operate as some degree of constraint on the sales price
12 because the buyers can't get maybe as easy financing as
13 perhaps a couple of years ago?

14 A. Yeah, and to be clear, the financeability of
15 this depends in part on the capital structure of the
16 asset. And so, you know, all of these private equity
17 firms have a certain return criteria. Their investors
18 expect a certain return on their money. And so there is
19 a relationship between your returns and the amount of
20 leverage you put on the deal, the amount of bank and
21 bond debt that you put on the transaction. And so it's
22 those considerations that led us to seek seller
23 financing from Qwest, because we were not willing to put
24 more equity into the deal, because it would have
25 depressed our return. So we went to Qwest and said, we

0323

1 would like you to help us out to maintain the level of
2 leverage that we need in order to get the returns that
3 we expect.

4 Q. All right. Then also maybe for ease you
5 could turn to page 20 of 56 on Exhibit 243.

6 A. Okay.

7 Q. I have a few follow-up questions, and they
8 may not all relate to this page. First, just in terms
9 of the non-compete clause or breach of that clause, is
10 it fair to say just on a qualitative basis that the
11 earlier years are more important than the later years?
12 That is, the first five years is more significant in
13 terms of non-compete or breach than the last 5 years of
14 the 40 years agreement?

15 A. I think that's probably the case, although
16 from the buyer's perspective, we would not want to have
17 competition at any point in the continuum of time,
18 whether it's 5, 10, 15, 40.

19 Q. But wouldn't you be more worried about it in
20 the first 5 years than in year 37?

21 A. I think it depends on who the competitor was.
22 Certainly if it was Qwest competing against us in year
23 two or three, that would be a problem. If there was
24 competition from, you know, a small independent who
25 comes in in year two or three, it's not as much of an

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1 issue. But in this context, yes, I think the earlier
2 years are more important.

3 Q. And then you were asked the question, what if
4 Qwest turned around in 48 hours or 40 hours and tried to
5 get into the business. You pointed to the penalty
6 clause or liquidated damage clause. Isn't it also the
7 case that it would be next to impossible for Qwest to
8 get started up certainly that soon but any time soon
9 because it doesn't have the employees to do it, it would
10 have to go out and not just pay the money for the
11 employees, but train the employees, maybe buy them back
12 from --

13 A. Yes, it's a fantasy, it wouldn't happen.
14 Because the way this business is structured, the
15 incumbent directories have a tremendous advantage,
16 because they have that employee base. And so I just
17 can't conceive of Qwest, given its current
18 circumstances, wanting to make that kind of investment
19 to compete against a company that it's recently sold.

20 Q. Then on page 20 of 56, these probabilities
21 are "assigned". When I read this, I would not have
22 taken the word assignment to be the same or synonymous
23 with prediction.

24 A. Mm-hm.

25 Q. And I suppose it depends on the expertise of

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1 this Murray Devine.

2 A. Yeah.

3 Q. Sounds like a person to me, Murray Devine,
4 but it's probably a company. But I did not read an
5 actual prediction here that absent an agreement there is
6 50% probability that Qwest would get back into the
7 business. I read it as a scenario or in the way
8 forecasts are sometimes done with probabilities
9 assigned.

10 A. Mm-hm.

11 Q. With no real predictive value to them, and I
12 -- since this is a document you used, I'm just wondering
13 how you looked at it, if you got that fine of a toothed
14 comb on it.

15 A. Well, I tell you when I read it, the first
16 time I thought, gee, this is interesting, but it's very,
17 very theoretical. And, you know, perhaps it would have
18 been interesting to have the author of this report
19 testify about it rather than me, because I don't really
20 understand fully the process that they went through.
21 But it seems to me that assigning these probabilities is
22 so theoretical that it, you know, it makes it hard to
23 get a handle on it.

24 The main reason why I wanted to submit this
25 with my testimony is because it demonstrates in very

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1 broad terms, putting aside the nuances of assignment or
2 predictability, that the true value in the company or
3 majority of the value of the company on the intangible
4 side comes from the employees and what they do for the
5 business. And that itself is entirely consistent with
6 the way we look at this as investors.

7 CHAIRWOMAN SHOWALTER: Thank you.

8 THE WITNESS: Thank you.

9

10 E X A M I N A T I O N

11 BY COMMISSIONER HEMSTAD:

12 Q. Good afternoon, Mr. Kennard.

13 A. Good afternoon, Commissioner.

14 Q. First I'm looking at page 9 of your direct
15 testimony, Exhibit 241, and at line 15, the sentence
16 reads:

17 In the past three years, we have all
18 seen how the value of non-core assets
19 can be maximized and the services
20 provided more efficiently and in a more
21 competitively neutral way when those
22 assets are divested from large ILECs.

23 Is it your view that the Yellow Pages first
24 is not part of the core activities of an RBOC?

25 A. That is my view. I would define the core

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1 business of an RBOC as providing telecommunications
2 services. An advertising business or rather a Yellow
3 Pages business is really an advertising business, and it
4 doesn't depend on the core telecommunications network
5 that in my view is the core business of the RBOC.

6 Q. Well, pursuing that, would it be your view
7 that the RBOCs never should have been in the business in
8 the first place?

9 A. That's an interesting question. I think the
10 answer is yes, because, you know, clearly if you look at
11 the histories of Yellow Pages business, and we all know
12 how they got into it and what happened at divestiture
13 and whatnot, I won't repeat that history here. But when
14 I was at the FCC, we did struggle with some of the
15 anticompetitive features of these businesses when they
16 were embedded in the RBOC. And, in fact, Congress
17 passed Section 222 of the Telecommunications Act to deal
18 directly with that problem. And so yes, I think that
19 these businesses for a variety of reasons would have
20 done better if they had never been a part of the Bell
21 Company.

22 And one of the things that we as buyers are
23 excited about with this asset is that by taking it out
24 of the ILEC and operating it as a stand alone business
25 whose sole goal is to maximize our ability to make that

0328

1 a successful business, we can do a lot with it which I
2 don't think Qwest was able to do or could have done
3 given its financial constraints. So, for example, we're
4 investing in Spanish language directories. We have a
5 very aggressive program to augment the on-line
6 directories business. And, of course, as an independent
7 company, we're not burdened with any of the competitive
8 issues involving CLECs and others that the business was
9 burdened with or at least affected by when it was part
10 of Qwest.

11 So my testimony here which you have focused
12 on looks at a lot of different businesses that have been
13 spun out of RBOCs' non-core, and buyers have been able
14 to create a lot of value by running them as stand alone
15 businesses.

16 Q. Well, would rate payers have done better?

17 A. If we could rewrite history and we were able
18 to have earlier embraced a fully competitive
19 telecommunications marketplace, then the question is
20 sort of irrelevant. I mean because really what you have
21 right now is you have an artificial subsidy that's
22 artificially subsidizing the rate base because of this
23 asset. And I think it's a real subsidy. I mean this
24 imputation of \$100 Million plus does affect the ability
25 of competitors to offer competitive rates to Qwest. And

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1 so that's why as, putting on my policy maker hat, I
2 think there's a huge benefit of taking this asset out of
3 the RBOC and ending this imputation, giving fair value
4 to the rate payer, which I think the public counsel
5 settlement does, and ending that artificial subsidy in
6 the rate base.

7 Q. Does that mean that you fundamentally
8 disagree with the decision that Judge Green made at the
9 time of the breakup of AT&T; would you assign this to
10 the local network as a support for basic service?

11 A. No, its revision is history. I think Judge
12 Green was a great man. In fact, I don't believe that
13 Judge Green has gotten his due in history quite frankly.
14 He and Bill Baxter, who I think were the two guys most
15 responsible for breaking up the Bell system and
16 introducing competition in long distance, which in my
17 view created the foundation of the Internet as we know
18 it, because it spurred investment in long haul. And
19 given the monumental task he was dealing with in 1984, I
20 think he did a wonderful job. If we could go back in
21 history now and whisper in his ear and say, gee, there's
22 going to be a lot of problems for the next 20 years if
23 you put these Yellow Pages businesses in the ILECs and
24 the rate base with this imputation, you know, clearly he
25 could have come to a better decision. But I can't

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1 second guess Harold Green on this decision.

2 Q. Well, going on in that same paragraph at line
3 19, the sentence reads:

4 I also believe that Qwest's local
5 exchange customers are benefiting
6 financially from Qwest's decision to
7 retain the directory business until now.

8 The inference I take from that is going
9 forward you don't think so?

10 A. Yeah, I mean I think that's right. The local
11 exchange customers have benefited because they have had
12 that imputation. It's really -- you really have to look
13 at what policy goals you're trying to influence here.
14 These Yellow Pages businesses have probably done better
15 than anybody would have imagined in 1984 in terms of
16 their ability to generate cash for the RBOCs and the
17 rate payers. So from that perspective alone, the rate
18 payers have benefited.

19 But I think there's a broader policy question
20 here, and that is how do we move this market toward a
21 more fully competitive marketplace without these
22 artificial subsidies that are built into the market,
23 which are a legacy of divestiture and the way this
24 marketplace evolved. We have an opportunity here to
25 enhance this business, Yellow Pages business, provide

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1 fair value to consumers and rate payers, and remove this
2 artificial subsidy from the marketplace. So for those
3 principal reasons, I can opine confidently that I think
4 this agreement serves the public interest.

5 Q. Well, is that consistent or not then with
6 your phrase, continuing the artificial subsidy in the
7 settlement proposal for another 15 years?

8 A. Well, you know, it may be better if you can
9 take the present value of all of those imputation
10 payments and get them out of the rate base day one. But
11 frankly, from what I understand about the settlement
12 dynamics here, I don't think that's going to be
13 possible. And so, you know, the compromise, which is
14 the settlement, the partial settlement that you have
15 before you, is a reasonable phaseout of this subsidy
16 over time.

17 Q. In page 5 of your rebuttal testimony, 242, at
18 line 18 1/2, as part of that paragraph, the second
19 sentence:

20 We are financing a substantial portion
21 of the Dex acquisition with high yield
22 bonds.

23 You use the term high yield bond, I realize
24 or I assume these are being privately financed. Do I
25 take it that's an equivalent of what would be in a

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1 publicly floated bond, a junk bond?

2 A. Some people have referred to high yield bonds
3 as junk bonds, yes, and depending on the character of
4 the instrument. But, you know, the principal notion
5 here is that it's an instrument that's subordinated to
6 the secured senior debt, and so it has a higher risk
7 component, and as a result, it has higher interest.

8 Q. And what is the secured senior debt?

9 A. It's bank debt. I'm sorry, I don't
10 understand your question, what is it?

11 Q. Well, I'm trying to understand the difference
12 between bonds and the secured senior debt.

13 A. The secured senior debt has a higher position
14 in the capital structure so that if there is a default,
15 the senior debt is paid first. So the high yield bonds
16 have greater risk.

17 Q. All right, and that's owed to a group of
18 banks as against individual bond holders?

19 A. Typically they are sold to individual bond
20 holders, big institutional bond holders that buy these
21 bonds in the market.

22 Q. All right. I apologize for my lack of
23 understanding here. Who will be the holders of the
24 secured senior debt?

25 A. Well, we have a consortium of banks that

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1 participated in the Dex East transaction, and we expect
2 that they will participate in the Dex West transaction.
3 So we had five lead banks, and some of that, some of
4 their debt will be sold to other lenders, but it's --
5 it's a group of premier senior lenders, J.P. Morgan,
6 Wachovia, Deutsch Bank, GE.

7 Q. But those will be bonds too?

8 A. No, they will hold some senior debt as senior
9 lenders, and then you will have a class of bond holders
10 separate and apart from those senior lenders. They
11 won't be one and the same people if that's your
12 question.

13 Q. How will they be secured?

14 A. Who, the senior lenders?

15 Q. Yeah.

16 A. By the assets of the company, the cash flow
17 and the assets of the company.

18 Q. Again showing my lack of familiarity here,
19 isn't that the equivalent of a bond?

20 A. Well, you're right, it is a debt instrument
21 broadly speaking, but it really goes to the amount of
22 risk that the bond holder takes on relative to the
23 senior note holder. Because the senior lender is fully
24 collateralized. They assume much less risk than the
25 high yield bond holders.

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1 Q. Well, what I'm trying to get to is a Yellow
2 Page company has a very high level of cash flow.

3 A. Yes.

4 Q. By its history.

5 A. Mm-hm.

6 Q. And our records here are replete with that.

7 A. Yeah.

8 Q. And what I'm trying to understand is, with
9 that as its history and its projection apparently, why
10 you would be financing in a corporate interest like that
11 in the junk bond category. That's apparently because
12 the senior indebtedness takes most of the security?

13 A. Yeah, they want to be -- I guess the best way
14 to explain it is that they want to make sure that under
15 even the most disastrous scenarios their security is
16 money good, that they will be able to recoup their
17 investment. And this is a fairly highly levered capital
18 structure in that, you know, about 20% of the funding of
19 this is in equity, and the rest is in debt. And so
20 usually, you know, without getting into the
21 technicalities of the multiples that senior lenders
22 versus high yield investors will pay, I mean suffice it
23 to say that there is a limit below which senior lenders
24 will not accept collateral. I didn't say that very
25 artfully, but they want to be higher in the capital

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1 structure so that they will be assured of repayment.

2 Q. Well, that was going to be my next question.

3 From your response on your cross-examination, apparently

4 of the \$7.05 Billion of the purchase price, \$1 1/2

5 Billion will be equity, and of that, ultimately you and

6 your partner will have \$500 Million invested here?

7 A. And our co-investors as well. These are

8 other equity holders who invest alongside us,

9 institutional investors.

10 Q. And so then apparently what you're saying is,

11 haven't done any arithmetic, but from your statement

12 it's about 20% equity and 80% debt?

13 A. Correct.

14 Q. Is that comforting?

15 A. Given the quality of this asset, yes.

16 Q. Because of its high cash flow?

17 A. Yes.

18 Q. I'm looking at page 10 of your rebuttal. I

19 will skip that.

20 Moving to page 13 of your rebuttal, I'm

21 trying to get a better handle on the back and forth

22 between you on the one hand and Dr. Selwyn and

23 Dr. Blackmon on the other about risk. On the one hand,

24 it's your testimony to the effect that this business is

25 increasingly competitive, but you disagree with

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1 Blackmon's assertion then that if that's true, there
2 would be a decline in the value to the asset.

3 A. Mm-hm.

4 Q. Would you elaborate on your position a bit?

5 A. Well, when I read Dr. Selwyn and
6 Dr. Blackmon's testimony, they seem to suggest that
7 there is not a lot of risk in our ability as a buyer to
8 meet the competitive challenges of this business. And
9 this is, don't get me wrong, this is a quality asset,
10 and we were able to raise a lot of debt in the market
11 because it's a quality asset, but the Yellow Pages
12 business is being challenged like never before.

13 And so one of the things that we like about
14 this business is that we think that as an independent
15 company we will be able to meet those challenges better
16 than the company has as part of incumbent. Because
17 typically stand alone companies that are owned by
18 financial buyers can operate more nimbly. They don't
19 have competing uses of their cash flow, and they can
20 focus all that on the business.

21 So what I was trying to point out here is
22 that there are competitive threats to these incumbent
23 Yellow Pages businesses like never before. Actually in
24 the last year we have seen declining revenue from among
25 the incumbent Yellow Pages books nationwide. And these

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1 businesses have been able to continue to grow their
2 EBITDA because they have been able to increase the
3 amount of advertising, the advertising rates that they
4 charge their customers.

5 But we have got to keep a really close eye on
6 technology. I've got, in my briefcase there, I've got a
7 little wireless data device which is also a phone, and I
8 can click on the numbers in my address book once, find a
9 name, and then click again and it makes a call for me to
10 that person. Well, it won't be long before people use
11 those devices to access a wireless portal that has a
12 Yellow Page directory in it. And if you want to buy a
13 pizza, for example, you click on pizza and click three
14 or four times and you've got the call. And when the
15 wireless industry is required by the FCC in the next
16 couple of years to have location based technology, then
17 it's going to be that much more challenging, because you
18 will be able to find the pizza location within a mile.

19 And so these are things that we worry about
20 as owners of this business, and the days when this
21 business did not -- these businesses did not have to
22 adapt to new technologies and new platforms is over.
23 So, you know, my testimony is to -- I didn't think
24 Dr. Selwyn or Dr. Blackmon made any of those -- really
25 appreciated any of those risks in this business. We do,

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1 we have to, because we're the owners of the business.

2 Q. Well, as a hypothetical, and you as an expert
3 in the field, you know, assuming you were the CEO of an
4 RBOC, a stable RBOC, without the kind of financial
5 difficulties that Qwest International is facing, would
6 it be your view that with the cash flow coming from
7 Yellow Pages that it should be sold?

8 A. No, no. Because if you look at the
9 compliment of assets that the RBOCs own today, the
10 Yellow Pages business is among the more stable of the
11 assets that they own, because they're seeing decline in
12 their core business with access lines. So, you know, it
13 is a good business. That's why you don't see Verizon or
14 BellSouth or SPC selling their Yellow Pages businesses,
15 but you do see distressed telcos selling, Qwest, Sprint,
16 Telecom Italia, Bell Canada.

17 Q. So do I take it that the bottom line
18 justification that you would assert for this sale being
19 in the public interest is the risk of bankruptcy of
20 Qwest International?

21 A. That's correct.

22 Q. But for that, it would not be an asset that a
23 prudent RBOC should be selling?

24 A. Well, but for that, I wouldn't be here, and,
25 you know, but for that, I don't think Qwest would have

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1 sold the asset.

2 Q. Just two or three sort of technical issues or
3 questions without any trend to these questions. Staff
4 is recommending that the sale not be approved. Are
5 there any contractual remedies of the buyers if the
6 Commission were to disapprove the sale?

7 A. Contractual remedies in what respect, I'm not
8 sure?

9 Q. Well, of being able to proceed with the sale
10 without Washington, or would that have to be then
11 renegotiated?

12 A. That would have to be renegotiated if that
13 were to take place.

14 Q. Your testimony being pursued on cross and in
15 your written testimony was that Qwest has agreed to
16 provide \$300 Million in, your phrase, backstop
17 financing. What does that mean, that Qwest would end up
18 with then itself becoming a bond holder and taking \$300
19 Million less cash?

20 A. Yeah, they would provide \$300 Million in
21 seller financing, so we would give them a note, you
22 know, an interest bearing note, and it would actually
23 be, you know, higher interest than we would probably get
24 in the bond market in order for us to close the deal.

25 Q. And to that extent, that would reduce the

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1 cash that you would have available to reduce the debt?

2 A. Correct.

3 Q. The discussion about the trademark agreement,
4 which again paraphrasing, apparently requires over a
5 five year period to phase out the use of the term Qwest
6 in conjunction with the branding agreement. I'm trying
7 to understand, what is the purpose behind phasing out
8 the use of the term Qwest?

9 A. Well, I think that over time we would like to
10 have our own brand identity, and I really would prefer
11 to defer to George Burnett, who is our CEO and will be
12 testifying, who can give you more information about, you
13 know, how that will be implemented and what the time
14 frame is.

15 Q. But is the point of that to reduce the
16 residual value in the operating company of the Yellow
17 Page regulatory asset?

18 A. No, I think it has to do with marketing, to
19 have a separate identity for the company so that it has
20 an identity in the marketplace that's associated with
21 Dex alone.

22 Q. Independent of Qwest?

23 A. Yes.

24 Q. But isn't the net result of that then to
25 reduce at least the potentially returnable value to

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1 Qwest of the regulatory asset in view of your comments
2 about over time the difficulty of the operating company
3 to come back into the business?

4 A. Yeah, that's -- that may be the case. But,
5 you know, I'm -- my operative assumption here is that
6 Qwest has no interest in being in the Yellow Pages
7 business as a competitor against Dex. I mean that's the
8 spirit and letter of our agreement, so.

9 COMMISSIONER HEMSTAD: That's all I have.

10 THE WITNESS: Okay.

11

12 E X A M I N A T I O N

13 BY COMMISSIONER OSHIE:

14 Q. I just have I think one area that I would
15 like to follow up on, Mr. Kennard, from the questioning
16 by Commissioner Hemstad, and that is assuming that the
17 provisioning of the directory is an essential service to
18 the customers of Qwest, why is it in the public interest
19 under those circumstances to turn control over the
20 provisioning of the service to a third party?

21 A. Well, a couple of reasons, Commissioner.
22 First of all, the publishing agreement makes clear that
23 we have to fulfill Qwest's obligations to publish the
24 agreement consistent with your rules and regulations.
25 And as a practical matter, we have every interest in

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1 doing that, because that's the core of our Yellow Pages
2 business, so we would have no interest in not fulfilling
3 that.

4 Second, as I testified before, you know, I do
5 believe that this business will have great value to
6 consumers as a stand alone business focused exclusively
7 on Yellow Pages and being able to develop all sorts of
8 new products and plow revenues from those new products
9 back into new products and create a virtuous cycle for
10 this company that it hasn't been able to fully exploit
11 as part of the RBOC.

12 Q. Well, you think then that the control over
13 the provisioning of the directory to the customers has
14 no -- really isn't -- I guess has no value then to Qwest
15 as the telephone provider?

16 A. I think it has some value to Qwest, because
17 Qwest is the regulated entity and it has to make sure
18 that it fulfills its regulatory obligations to you, and
19 that agreement will ensure that those obligations are
20 fulfilled.

21 Q. Does Qwest have any control other than the
22 contract over your obligation, if you will, to provide
23 the directories to the customers?

24 A. No. Although as I understand it, based on
25 the laws of this jurisdiction we become an affiliate of

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1 Qwest for purposes of fulfilling that obligation. So we
2 are in effect responsible to this Commission to make
3 sure that those obligations are fulfilled. So Qwest,
4 you know, does not need to have an ongoing control or
5 oversight of that function. We will be directly
6 accountable to this Commission to make sure that those
7 obligations are fulfilled. I hope that's responsive to
8 your question.

9 Q. No, it is, and I guess the -- so you'll --
10 it's your then opinion that you would, the Carlyle Group
11 and your partner, then would be directly accountable to
12 the Commission for the provisioning of the directories
13 to customers in the state of Washington?

14 A. Well, Dex Holdings would be, not the owners,
15 not Carlyle or Welsh Carson, but Dex Holdings would be
16 responsible for fulfilling those obligations, yes.

17 COMMISSIONER OSHIE: Thank you very much.

18 THE WITNESS: Thank you.

19 CHAIRWOMAN SHOWALTER: I have a follow up on
20 that.

21

22 E X A M I N A T I O N

23 BY CHAIRWOMAN SHOWALTER:

24 Q. You said Dex Holdings would be directly
25 accountable to us. I take that to mean what you said,

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1 direct, and can you point in the -- I mean where is that
2 in the documents?

3 A. Yeah, I may have misspoken. I think that the
4 way the law works, and I'm not an expert on the law of
5 your jurisdiction obviously, but the way the law works
6 is that we become an affiliate of Qwest for purposes of
7 fulfilling these obligations. And you have, if for some
8 reason those obligations are not fulfilled, I think your
9 recourse is to Qwest directly, over whom which you have
10 jurisdiction. I'm not suggesting that you have
11 jurisdiction over Dex Holdings. I'm suggesting that
12 Qwest remains accountable for fulfilling those
13 obligations.

14 Q. Yes, and so then if it's the regulated
15 company's responsibility to accomplish a phone book and
16 Dex Holdings is the one that is doing it, if Dex isn't
17 doing a good job or falls through in some way, then it
18 would be the obligation of the regulated company, I
19 would think, to pursue Dex for breach of contract.

20 A. Yes.

21 Q. And that our only role would be to insist
22 that the regulated company do that.

23 A. Correct.

24 Q. Or hold the regulated company responsible for
25 having failed to do it.

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1 A. That's right.

2 CHAIRWOMAN SHOWALTER: Thank you.

3

4 E X A M I N A T I O N

5 BY COMMISSIONER HEMSTAD:

6 Q. After the 15 year period when these future
7 credits will be paid, you realize 15 years is a long
8 projection, but assuming everything else being equal,
9 which it probably won't, I would assume you would agree
10 that local rates would then have to rise; isn't that
11 true?

12 A. Well, not necessarily. I mean in 15 years
13 you could have a very different marketplace from what we
14 have today.

15 Q. I understand.

16 A. And hopefully you would have competition that
17 would be a check on monopoly rents or any single actors'
18 ability to raise rates. That's the hope.

19 Q. Do you have a view about the situation that
20 Qwest International will find itself in, it will lose
21 the revenue stream here even as it now has the
22 opportunity to reduce its debt, how will it be better
23 off or how will it on a longer term basis be able
24 thereby to avoid the bankruptcy scenario in any event?

25 A. Well, Commissioner, I really think it would

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1 be more appropriate for me to defer to the Qwest
2 witnesses to answer that question, because they are much
3 more familiar than I am with the impact of this
4 transaction on their own finances and balance sheet. I
5 really don't feel it would be appropriate for me to
6 opine on that.

7 COMMISSIONER HEMSTAD: All right, thank you.

8 JUDGE MOSS: Okay, well, I think that
9 completes our questions from the Bench, so we're ready
10 for redirect, if any, Mr. Harlow.

11 MR. HARLOW: Give me a moment, Your Honor.

12 Mr. Kennard, you will be happy to know that
13 the redirect won't take you past your flight this
14 evening.

15 THE WITNESS: Thank you.

16 JUDGE MOSS: What time is his flight?

17 MR. HARLOW: 10:00.

18 JUDGE MOSS: I'm not encouraged.

19 MR. HARLOW: The Bench will be happy to know
20 it won't take us anywhere close to that.

21 CHAIRWOMAN SHOWALTER: How about our dinner
22 time?

23

24

25

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1 R E D I R E C T E X A M I N A T I O N

2 BY MR. HARLOW:

3 Q. Fairly early on, a number of hours ago,
4 Mr. Trautman asked you about Exhibit 242 at page 4, and
5 I believe it was your discussion on line 9, right up to
6 the final minutes.

7 A. Mm-hm.

8 Q. Do you have that in mind, that question?

9 A. Yes.

10 Q. Do you have the question in mind? I wonder
11 if you could tell us whether or not there were any last
12 minute or up to the final minutes concessions that the
13 buyer was forced to make because of the perceived
14 competitiveness of this auction process?

15 A. I wrote that because I was -- it sort of took
16 me back to the hours really leading up to the time that
17 we knew we were going to be selected by Qwest's board of
18 directors to be able to buy this asset. And as I
19 mentioned before, Mr. Notebaert was very straight with
20 all of us but made it very clear that there was a
21 competing bidder.

22 And there was a -- I recall distinctly, it
23 was a Monday afternoon in August, and Qwest was having
24 its board meeting the next day, and I was on a business
25 trip, I was in a little town in Louisiana, and all I had

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1 was an analog cellular phone, terrible service. Dick
2 Notebaert called me, and he said, I've got to get these
3 two deals before my board by tomorrow, and if you want
4 to be competitive, you've got to put an additional --
5 and then the phone went dead. And so I called him
6 again, and I couldn't get service. And so we were -- so
7 we're in the middle of nowhere and we found an
8 Applebee's restaurant in a little strip mall, and I
9 rushed in, and I said, I've got to find a telephone.
10 And so I literally stood behind the bar in this
11 Applebee's restaurant in the middle of Louisiana, and I
12 called Dick Notebaert back and stayed there for about an
13 hour and a half to negotiate the final offer of our bid.
14 And we had to, back and forth, we had to put the final
15 \$50 Million on the table in order for Dick to finally
16 say, okay, your bid is in an acceptable range to take to
17 my board. And I will never forget looking up from this
18 bar in Louisiana and yelling into the phone, you've got
19 your \$50 Million, you've got your \$50 Million. I think
20 they thought I was moving drugs out of the Gulf or
21 something.

22 But I mean, you know, I tell that story to
23 impress on you that this was high stakes for us from the
24 -- to the very last minute, we believed that we were not
25 going to get this deal unless we put more money on the

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1 table. And, in fact, we had heard that weekend,
2 remember this was a Monday, we had heard from one of my
3 partners was on Cape Cod with one of the partners of the
4 competing bidder, and he came up to him and said, it's
5 too bad, you guys put up a big fight, but you lost. And
6 so Sunday night was pretty depressing, and then I got
7 the call from Notebaert, and I thought that, well, maybe
8 we're back in the game. So it was -- that's why I
9 wanted to impart that, because that -- it was a
10 competitive process, believe me.

11 Q. Thank you, Mr. Kennard. Mr. Trautman also
12 asked you whether or not Exhibit 78 is what was valued
13 in the Murray Devine appraisal, Exhibit 243; do you
14 recall that?

15 A. You're asking me whether Exhibit 78 was
16 valued in the, what was that, the trademark license
17 agreement?

18 Q. Yes. And my recollection was Mr. Trautman
19 asked you if that was what was valued; do you recall
20 that?

21 A. Yes.

22 Q. And I understood you to say yes.

23 A. Yes.

24 Q. I just wanted to clarify, was that the only
25 trademark that was valued in Exhibit 243?

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1 A. I want to be careful on this.

2 Q. Perhaps it would be helpful to turn to
3 summary page 3 of 56.

4 A. Yes. The summary of conclusions in the
5 Murray Devine report values the Dex trademark and the
6 Qwest and the Qwest Dex trademark.

7 Q. And so the Qwest Dex trademark agreement and
8 the Dex trademark, can you tell us which one is
9 associated -- which one valued Exhibit 78?

10 A. Well, Exhibit 78, I have to look at the
11 appendix here, which listed the trademarks. Exhibit 78,
12 the trademark license agreement, values Qwest Dex and
13 Qwest Dex Advantage. There's a separate valuation in
14 Murray Devine for the Dex trademark.

15 Q. And the Dex trademark is valued at \$311
16 Million?

17 A. Correct.

18 Q. Thank you for that clarification. You were
19 also asked about whether the buyer might be interested
20 in splitting off Washington and buying 13 states rather
21 than all 14 states. Do you recall that?

22 A. Yes.

23 Q. And some people would call it the go it alone
24 strategy, if you will. Do you have any opinion as to
25 what stand alone costs, what kind of impact that might

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1 have in a business such as Dex on Qwest Corporation if
2 they were put in a situation where they had to publish
3 Washington Yellow Pages but didn't have the other, the
4 business of the other 13 states?

5 A. Well, it would be a pretty unattractive
6 business, because they would -- they would be denied all
7 of the corporate support that they would need to run the
8 business, IT services, legal, accounting, finance, you
9 know, all of the functions that they would need to be a
10 functioning business would have to be replicated at, you
11 know, great cost, and I think it would make them
12 vulnerable as a stand alone business.

13 Q. Would --

14 A. I mean put it this way, would we buy a stand
15 alone Washington business with no infrastructure? I
16 don't think it would be very valuable.

17 Q. Again speaking hypothetically because I know
18 this isn't the deal before the Commission, but would Dex
19 Holdings potentially be able to come into Washington
20 without a purchase agreement, particularly with the
21 assets of all the other 13 states?

22 A. Yeah, Washington as a stand alone company
23 with no infrastructure would be a sitting duck for
24 competitors, because they would be a weakened company
25 without the infrastructure, and it would not be a very

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1 attractive business to own.

2 Q. And what impact could that potentially have
3 on the Washington rate payers as far as either revenues
4 that go directly to Qwest Corporation operations or
5 imputation?

6 A. Well, certainly if the revenues would
7 plummet, then the value of that company from an
8 imputation standpoint would plummet accordingly.

9 Q. And then finally in questioning by
10 Commissioner Hemstad, I think you agreed that he kind of
11 boiled down to the justification for this sale being
12 that the rate payers would be better off than they would
13 be in Qwest bankruptcy. Do you recall those few
14 questions?

15 A. Yes.

16 Q. I wonder if you could again just clarify for
17 the record, what would be the risk to the rate payers
18 that you as a policy maker would fear if Qwest
19 Corporation were allowed or forced to go into bankruptcy
20 because this sale was somehow blocked; what scenario
21 would you be worried about?

22 A. Well, the --

23 MR. TRAUTMAN: Objection, Your Honor, he
24 indicated earlier that he could not speak for Qwest on
25 these matters and on these risks.

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1 MR. HARLOW: I'm not asking, Your Honor, for
2 him to give the bankruptcy scenario, which is what he
3 has deferred to Qwest. I'm asking him in his expert
4 capacity what his concerns would be as a regulator.

5 JUDGE MOSS: I think the question is
6 appropriate, we'll allow it.

7 A. Well, when I was chairman of the FCC, I lived
8 through some bankruptcies of telecom companies, and it
9 is pretty devastating from a regulatory standpoint,
10 because you lose control, and the jurisdiction is
11 transferred to the bankruptcy court. We had a lot of
12 experience during that era with a company called Next
13 Wave, which was a large wireless carrier that went
14 bankrupt, and we had to convert about a third, as I
15 recall, of our Staff in the general counsel's office
16 became bankruptcy experts, and it was a huge diversion
17 of our staff resources to dealing with the bankruptcy
18 law.

19 In discussions I have had with my successor,
20 Michael Powell, he frequently bemoans the fact that
21 running the FCC in an environment where a lot of the
22 companies that you regulate are in Chapter 11 makes it
23 difficult to do your job, because you've got quality of
24 service issues, you've got government contracting issues
25 that are at stake when a company goes into bankruptcy.

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1 So it is not -- it's just not a healthy scenario.
2 That's why I was -- I thought it was remarkable that
3 Staff in this proceeding suggested that bankruptcy would
4 be a viable alternative and, in fact, a preferable
5 alternative to allowing Qwest to solve its financial
6 problems through this transaction.

7 MR. HARLOW: Thank you, Mr. Kennard, that's
8 all the questions I have.

9 CHAIRWOMAN SHOWALTER: I have a follow up on
10 that question.

11

12 E X A M I N A T I O N

13 BY CHAIRWOMAN SHOWALTER:

14 Q. If the sale is approved and Qwest
15 International avoids bankruptcy for some period of time
16 but then later for whatever reason it encounters a
17 bankruptcy, would you agree that this Commission should
18 do what it can at this stage to protect the regulated
19 company and the rate payers of the regulated company at
20 least without adversely affecting the overall prospect
21 of bankruptcy for the company? In other words, what I'm
22 saying, in the -- let's say we approve the sale, and
23 we're just -- and we distribute the assets in some way.
24 What happens if five years from now or two years from
25 now Qwest goes bankrupt anyway, and are there ways to

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1 protect the sale proceeds in some manner that insulates
2 the rate payers or at least gets them that benefit even
3 if the parent company goes bankrupt?

4 A. Yeah, I understand your question. I mean
5 first of all, I think it becomes very remote that Qwest
6 goes into bankruptcy if this deal is approved, because I
7 think that they're basically out of the woods. They
8 have been -- they had a unique situation, sort of a
9 perfect storm of accounting problems, government
10 investigations, and a terrible market, financing market.
11 I think it would be unusual that that appeared again,
12 and I think they have a very competent management team
13 now that's going to do everything they can to avert
14 that.

15 But just, you know, assuming that that
16 scenario could replicate itself, sure, I think the
17 responsible thing to do would be to find every available
18 method you can do to protect rate payers. I'm not
19 prepared to suggest what those might be, but certainly
20 if there's a way to, you know, protect rate payers
21 against a future bankruptcy, you should try to do it.

22 Q. Well, I meant with respect to this
23 transaction and either the proposed settlement or, well,
24 let's leave it there, how does the settlement, we are
25 asking this witness about the settlement I believe, how

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1 does the settlement protect the regulated company's rate
2 payers with respect to the proceeds of the settlement?

3 A. Mm-hm.

4 Q. If the parent company happens to go bankrupt
5 say five years from now, what would happen to those,
6 that proceeds; what would happen to the \$100 Billion or
7 so that's assumed to be still subsidizing the rates?

8 A. I don't know. You know, presumably -- I
9 don't know what mechanisms are in the settlement
10 agreement to protect against that bankruptcy
11 eventuality, and I don't know just searching my mind, I
12 don't know what you would do to modify the settlement
13 without undermining the deal and its ability to get
14 financed and closed.

15 Q. Okay. And I didn't mean a way to protect
16 against eventual bankruptcy. I meant a way to protect
17 the regulated company vis a vis the proceeds of this
18 very sale should a later bankruptcy occur.

19 A. Yeah, I think it's probably a better question
20 for Qwest, because it really has to do with, you know,
21 what the use of those proceeds is going to be. You
22 know, based on what I know about their capital structure
23 is that the funds that go into that company, the banks
24 are going to require that they be used to pay down debt,
25 which is, you know, has the collateral benefit to rate

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1 payers, because if those proceeds assist the company
2 either today or in the future from going into
3 bankruptcy, then you have averted the disaster scenario
4 that you suggest.

5 CHAIRWOMAN SHOWALTER: Thanks.

6 JUDGE MOSS: Anything else from the Bench?

7 Apparently not.

8 Mr. Trautman, did you have some brief follow
9 up? I hear mumbling from that part of the room.

10 MR. TRAUTMAN: We do, brief.

11 JUDGE MOSS: All right.

12

13 R E C R O S S - E X A M I N A T I O N

14 BY MR. TRAUTMAN:

15 Q. Following up to your response to a question
16 from the Bench about the level of return you would be
17 looking for, what is the level of return that your
18 equity investors expect or demand from this type of
19 deal?

20 A. That's really a proprietary number. It's
21 internal to that. I would want to consult with my
22 counsel before answering that on a public record.

23 MR. HARLOW: It sounds as though we might
24 need to designate this as confidential and clear the
25 room.

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1 CHAIRWOMAN SHOWALTER: Well, could it be
2 handled in writing, or do you need that?

3 MR. TRAUTMAN: No, we could take it in
4 writing.

5 MR. HARLOW: As a record requisition.

6 MR. TRAUTMAN: Yes.

7 MR. HARLOW: All right, do you want to
8 restate that.

9 MR. TRAUTMAN: What is the level of return
10 that your equity investors expect or demand from this
11 type of sale, investment, from this type of investment?

12 JUDGE MOSS: All right, and the response can
13 bear Number 251, and then obviously it sounds like you
14 may be designating it highly confidential.

15 MR. HARLOW: I think we have used 251, Your
16 Honor.

17 JUDGE MOSS: Oh, you're right, we did.

18 MR. HARLOW: It would be 252 I believe.

19 JUDGE MOSS: That was the supplemental
20 testimony was 251, you're quite right, so it will be
21 252.

22 MR. HARLOW: And I don't know at this point
23 whether it will be confidential or highly confidential.

24 JUDGE MOSS: Right, you will let us know.

25 Mr. HARLOW: We will let you know.

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1 JUDGE MOSS: All right, does that wrap us up,
2 Mr. Trautman?

3 MR. TRAUTMAN: No, we have a few additional
4 questions.

5 BY MR. TRAUTMAN:

6 Q. You had indicated in response to a question
7 that QC would never reenter the business because of its
8 need to acquire employees, and I believe you also said
9 that would be especially true if Washington were not
10 included in the deal, and I believe you said that would
11 leave QC Corporation Washington a stand alone entity,
12 correct?

13 A. Yes.

14 Q. Now could that, could the problems associated
15 with that not be avoided if QC were to partner with
16 Verizon, which has a staff of employees, systems, and
17 brand identity; if that were done, would that not
18 alleviate the problems of QC as a stand alone entity?

19 A. I can't imagine why the Washington operation
20 as a stand alone entity would partner with Verizon. I
21 guess it's conceivable. I suppose anything is possible.

22 Q. You also I believe in the response to some
23 questions from Commissioner Oshie were talking about the
24 extent of Dex's responsibilities. Is Dex also accepting
25 responsibility for QC's compliance with the Section 251

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1 and 271 obligations with respect to CLEC listings?

2 A. Well, we will certainly, as a company, we
3 will continue to provide those listings. And again, you
4 know, we have an obligation to fulfill whatever
5 regulatory obligations Qwest has under the -- to this
6 Commission. And if we don't, then the Commission will
7 seek enforcement against Qwest, and they will seek to
8 enforce the agreement.

9 Q. And with respect to the final negotiations
10 that you spoke of, to your knowledge, did the competing
11 bidder require Qwest seller financing?

12 A. I don't know.

13 MR. TRAUTMAN: That's all I have.

14 JUDGE MOSS: Okay, thank you.

15 I believe then, am I correct, that this
16 completes the examination?

17 MR. HARLOW: Yes, Your Honor.

18 JUDGE MOSS: Okay, thank you very much,
19 Mr. Kennard, we appreciate you being here to testify.
20 And it looks like we are going to get you out in time
21 for your plane, although we could, of course, encourage
22 you to enjoy some of our beautiful Pacific Northwest
23 weather while you're out here.

24 THE WITNESS: Thank you. I must say it was
25 more fun being on that side than over here.

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1 JUDGE MOSS: All right, well, thank you all
2 very much, and we will be in recess until Wednesday
3 morning at 9:00, and we will look forward to receiving
4 the supplemental testimony we discussed earlier in the
5 meantime. So with that, we will be in recess.

6 (Hearing adjourned at 6:00 p.m.)

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