BEFORE THE WASHINGTON UTILITIES AND

TRANSPORTATION COMMISSION

| | |
|---|---|
| In the Matter of the Application of<br><br>QWEST CORPORATION<br><br>Regarding the Sale and Transfer of Qwest Dex to Dex Holdings, LLC, a non-affiliate. | Docket No. UT-021120<br>Volume IX<br>Pages 881-1038 |

A hearing in the above matter was held on May 28, 2003, at 11:13 a.m., at 1300 Evergreen Park Drive Southwest, Olympia, Washington, before Administrative Law Judge DENNIS MOSS and Chairwoman MARILYN SHOWALTER and Commissioner RICHARD HEMSTAD and Commissioner PATRICK J. OSHIE.

The parties were present as follows:

QWEST CORPORATION, by Lisa Anderl and Adam Sherr, Attorneys at Law, 1600 Seventh Avenue, Suite 3206, Seattle, Washington 98191.

THE PUBLIC, by Robert W. Cromwell, Jr., Assistant Attorney General, 900 Fourth Avenue, Suite 2000, Seattle, Washington 98164-1012.

DEX HOLDINGS, LLC, by Brooks E. Harlow, Attorney at Law, Miller Nash, LLP, 601 Union Street, Suite 4400, Seattle, Washington 98101.

WEBTEC, by Arthur A. Butler, Attorney at Law, Ater Wynne, LLP, 601 Union Street, Suite 5450, Seattle, Washington 98101.

Barbara L. Nelson, CCR
Court Reporter

THE COMMISSION, by Shannon E. Smith and Gregory J. Trautman, Assistant Attorneys General, 1400 Evergreen Park Drive, S.W., P.O. Box 40128, Olympia, Washington 98504-0128.

## INDEX OF WITNESSES

INDEX OF EXHIBITS

JUDGE MOSS: Let's come to order. A couple of housekeeping matters. We received by filing at the Commission -- I've lost track of the days, I suppose it was yesterday -- the final prefiled testimony, I believe, which was -- which is MSR-3 SRTC, supplemental rebuttal testimony regarding Dr. Blackmon's response testimony, as revised on May 14th, 2003, and this is by Mr. Reynolds. That will be Exhibit 94 for identification. And there was attached to that an exhibit pre-identified as MSR-4C, Qwest's illustration of Staff's May 4, 2003 proposal, also by Mr. Reynolds, and that will be marked for identification as 95.

We have had handed up this morning the responses by Dex Holdings to Record Requisition Number Two, which will be marked for identification as Exhibit 3; the response to Record Requisition Number Three, which will be marked as Exhibit Number 4; and the response to Record Requisition Number Six, which will be marked as Exhibit 13, for purposes of identification in this proceeding. And I'll take care of those exhibits in due course.

In the meantime, let us take advantage of our available time remaining before the luncheon recess and resume with Dr. Selwyn's cross-examination. And Dr. Selwyn, of course I remind you that you are under oath.

DR. SELWYN: Yes, sir.

JUDGE MOSS: And --

MR. HARLOW: Excuse me, Your Honor.

JUDGE MOSS: Yes, Mr. Harlow.

MR. HARLOW: Ms. Anderl's pointed out that I probably was premature in handing the record requisitions to the Bench, that Mr. Trautman may want an opportunity to review before deciding whether to mark them as exhibits.

JUDGE MOSS: All right. Well, I've just marked them for identification, so we'll deal with their admission later. Let's deal with that or you can do that over the lunch hour and we can talk about it over the close of the hearing.

MR. HARLOW: Okay. I apologize to Mr. Trautman for jumping the gun on that.

JUDGE MOSS: That's all right. There's a lot of paper. Whole generations of forests are dying. So I think we're ready to resume with your cross-examination, Ms. Anderl.

MS. ANDERL: Thank you, Your Honor. Just as an additional note for later, we also provided responses to a number of bench requests yesterday.

JUDGE MOSS: That was through filing?

MS. ANDERL: Yes.

JUDGE MOSS: I apparently didn't receive them as of this morning, but I'll get them at noon.

Whereupon,

DR. LEE L. SELWYN,

having been first duly sworn, was called as a witness herein and was examined and testified as follows:

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

BY MS. ANDERL:

Q. Dr. Selwyn, good morning.

A. Good morning.

Q. Let's talk a little bit about your view of the value of the asset or assets that are being transferred in this matter. I'd like you to turn to your direct testimony, Exhibit 311, page 10, line eight and line 19.

A. Yes.

Q. In both of those lines --

JUDGE MOSS: Ten.

MS. ANDERL: Yes, page ten of the direct testimony.

Q. In both of those line references that I've given you, you use the phrase virtually all of the

value, and in both cases, you're using the phrase virtually all of the value to describe your view of the value that is being conveyed to the buyer in this transaction; is that correct?
A. Yes.
Q. And again, on page 69, line 12, you state --
JUDGE MOSS: I'm sorry to interrupt. Dr. Selwyn, you'll need to push the red button on your microphone so that it is up, and that will turn it on. Thank you.
Q. And again, on page 69, line 12, you use the phrase virtually all of the intangible value, and again referencing the value that's being transferred in this case; is that correct?
A. Yes.
Q. Do the phrases virtually all mean the same thing each time you use them in those three instances?
A. I believe so, yes.
Q. And on page 81, line 25, you describe an amount of a value or level of value that principally arises out of assets that are the property of QC and not of Dex. Do you have that reference in mind?
A. Yes.

Q. And again, is that meant to describe the same general quantification as virtually all?

A. Well, I'm not offering a specific quantification in terms of an actual percentage. Obviously, if I were, I would have substituted that. But certainly it is my belief that substantially all, virtually all, practically all.

Q. Principally?

A. Principally all.

Q. You mean all those --

A. A lot, yes.

Q. And you mean those phrases to generally mean the same thing there? You're not trying to distinguish --

A. No.

Q. All right. That's all I was really looking for. Now, in Exhibit Number 340, which is a response to a data request that Qwest propounded to you, you were asked to provide all studies performed or relied upon in making the determination that virtually all of the value arises from QC, as we have just been discussing.

Now, you indicate in that response, It is not necessary to conduct separate studies to observe that the value of the Dex business will be substantially diminished without certain agreements and intangible assets to be provided by QC. Is that correct?

A. Yes.

Q. Did you perform any studies or rely upon any studies in making your determination that virtually all of the value arises from QC?

A. Other than as described in this response, no.

Q. Okay.

A. And -- well, and as discussed in my testimony generally.

Q. Okay. Does virtually all mean a hundred percent?

A. No.

Q. How much less than a hundred percent does it mean?

A. Well, I think there are two ways to respond to that. To the extent that the Commission has previously determined in the accounting order case that the Qwest Dex, or then USWC, US West Dex Yellow Page business was a regulatory asset, I think that in one sense that is dispositive of the issue anyway, irrespective of how Qwest Dex came to acquire whatever value it has in the Washington Yellow Pages.

But with respect to that value, more specifically, if one were to perform an analysis, and just based upon representations being made by the company in testimony and in other information provided in this proceeding, it's clear that there is a very heavy reliance by the buyer on the preexisting relationship between QC and Qwest Dex, the existence of the customer base that has been acquired by virtue of that preexisting relationship.

And in that sense, even if one were to perform such an analysis, which I don't think is necessary, because I think the Commission's already made that determination, but even if one were, it would still be clear that certainly a very large portion of the value would have to be attributed to that relationship.

Q. But you didn't undertake to quantify what you mean by very large?

A. No, I did not.

Q. And Dr. Selwyn, turn to Exhibit 343, please. That data request generally asked you, in Subpart A and B, to describe research efforts undertaken to quantify the value of some of the agreements that are being referred to in your testimony and in this docket, and the dollar amounts.

And is that your response there in Exhibit 343?
     A.   Yes, it is.
     Q.   Now, Dr. Selwyn, it's your contention that all of the gain should go to QC ratepayers; is that right?
     A.   Yes.  Well, more specifically, all of the gain computed with respect to a non-distress sale, fair market value.
     Q.   More than a hundred percent of the gain, actually.  You're saying that all of the value, as you calculate it, should go to ratepayers?
     A.   The gain, based on the fair market value, which I believe is in excess of the distress price, yes.
     Q.   As we discussed on Friday last week, you were not retained by Staff, nor did you, in fact, undertake to prepare a point estimate of fair market value on this asset; isn't that correct?
     A.   That's correct.
     Q.   Dr. Selwyn, do you believe that Dex's management has any expertise, either in the management of a publishing business or advertising sales?
     A.   I'm sure they do.
     Q.   To your knowledge, if Qwest Corporation had

to reconstitute a publishing operation in Washington today, wouldn't QC need to hire employees?  Were they to want to reconstitute that operation in-house, wouldn't they need to hire or train employees?

A.   I don't think that's the correct question in terms of a valuation.  I'm not sure if you're still on the same subject or not.  If we're turning to another subject, if QC were to reenter the business, they would have to recruit employees, but if QC had never exited the business, they would have those employees.

Q.   Do you believe that if QC were to reenter the publishing business today, it's likely that QC would have to develop relationships with printers?

A.   Well, let me make sure I understand the import of your question.  To be precise, you asked me if QC were to reenter the publishing business today, when, in fact, it still has an affiliate in the publishing business.  If it were to simply reacquire the publishing business that the affiliate currently maintains and reacquire the resources of that affiliate to accomplish that reentry, those employees, systems, relationships, customers would all be in place.

Q.   That wasn't my question, Dr. Selwyn.  I

think you understood it correctly the first time.
      A.   Well, you did say today, and today, to me, means today, which at this point we still have an affiliate.  The sale has not been consummated.
      Q.   If QC were to -- the question was if QC had to reconstitute a publishing operation today, not if it reacquired its affiliate or didn't sell the asset. So assume that the asset is sold and there's -- let's say no noncompete and no publishing agreement, so QC is in a such situation where it needs to have its directory publishing obligations met, the White Pages published.  In order to do that, wouldn't QC need to develop relationships with printing companies?
      A.   The answer's no.  And let me refer you to my supplemental testimony where I discuss this issue.
           CHAIRWOMAN SHOWALTER:  What exhibit?
           THE WITNESS:  This would be Exhibit T-363, beginning at page 12 and continuing through the end of the testimony.
      Q.   Right.  And I'm going to ask you again, Dr. Selwyn, to please keep the import of my question in mind.  I'm not asking you if QC had to go out and establish a relationship with another directory publisher in order to have its obligation met, because I will ask you some questions about that a

little later. I'm asking you, if QC had to reconstitute a directory publishing operation today, wouldn't QC, and let's start at the beginning on this, either need to hire or train employees to do that function?

A. Well, in the hypothetical that you've described, which I have already indicated in my testimony I disagree with, I suppose that if subject to that constraint, the answer's yes.

Q. And would need to develop relationships with printing companies?

A. Well, I suppose it could look them up in the Dex Yellow Pages and find one.

Q. And potentially develop relationships with other suppliers, such as paper and ink suppliers?

A. It would need to obviously acquire the resources to accomplish the various requirements of being in the publishing business in some manner, not necessarily in the manner you describe, but in some manner.

Q. Okay. Is it your understanding that Qwest Dex has all of those arrangements in place already today because it is already in the publishing business?

A. I would assume so, yes.

Q. Do you think it would potentially cost time and money to reconstitute a publishing operation today, as we've been discussing?

A. It probably would, which is precisely why I don't believe that's a feasible strategy for QC, or a necessary strategy for QC.

Q. To the extent that those functions and relationships would cost money and take time to recreate, would you agree with me that they have value?

A. Well, they certainly have value in that they are precisely part of the value that the Commission determined to be a regulatory asset, because, in fact, the Commission determined in the accounting order docket that there was no transfer, other than a publishing agreement of a non-permanent nature. So in fact, from the Commission's perspective, those assets, those relationships, personnel and so on, are effectively within QC's property for purposes of regulation.

Q. Is it your testimony that the Commission has the authority to approve or deny the transfers of employees under its transfer of property statutes?

A. I don't know.

Q. Is it also your understanding, Dr. Selwyn, that part of the transfer that was approved in 1983 included cash and hard assets?

A. Yes.

Q. Do you know how that -- would you accept, subject to your check, that the amount of cash that was transferred was approximately $23 million?

A. Subject to check.

Q. Do you know how that cash was used by Dex's management after the transfer occurred?

A. No.

Q. Turning to your direct testimony at page 52, lines 12 through 17, you seem to be stating there that Qwest should not sell Dex now, but rather should retain the asset until it's a better time to sell. Is that fair?

A. Yes. Yes.

Q. Okay. Assume for a minute that Qwest did decide to do just that and assume that Qwest retained the asset for five years and, further, that there was no rate case during that time. Would the period of time during which the Dex asset was retained by Qwest be risk-free to ratepayers?

A. Well, I guess the problem I'm having in responding to that question is that you're asking me to assume something that I can only know for certain in 20/20 hindsight, i.e., five years -- after the conclusion of five years, and that's not how one assesses risk. We can't assume today that there won't be a rate case for five years, and therefore ratepayers are at risk and will be at greater risk of a rate case if the Dex asset is sold than if it is not.

Now, after the fact, if there was no rate case, then there was no rate case. But, you know, after the fact, if I didn't have an insurance claim last year, I guess I shouldn't have paid my insurance premium, but I did, and I don't see any way of getting it back.

Q. Okay. Dr. Selwyn, I understand that sometimes you disagree with my hypotheticals, but I'm going to ask you to please try to answer the question, unless your counsel objects, within the confines of the hypothetical that I've given you.

A. Well, then, I don't understand your previous question.

Q. Would you like me to restate it?

A. Please.

Q. Assume that Qwest retained the Dex asset for the next five years and, during that time, there was no rate case. Would the period of time during which the asset was retained be risk-free to ratepayers?

A. I cannot respond to that question unless I know which time frame we're talking about, before -- at the beginning of the five years or at the end of the five years?

Q. I'm asking you for your assessment of risk today, not knowing what's going to happen during those five years, other than that there is no rate case?

A. But I don't know that and I can't know that.

JUDGE MOSS: Can you not assume that?

THE WITNESS: No, I can't assume it unless there's a firm -- some firm commitment that there won't be a rate case. I don't see how it could be assumed that there's no rate case in advance of that period of time. The rate cases are -- will arise based on the circumstances that exist. After the fact, I can assume anything -- I can know what happened, but I don't see how I can make that assumption.

Q. Okay. Well, let's look at a historical period of time, then, from 1998. March of 1998 through March of 2003 is a five-year period, about which we know everything we can probably know, since it has already happened, and during that time, Qwest Dex remained in the Qwest family of companies and QC had no rate case. Would you accept those facts?

A. Yes.

Q. During that time period, was QCI's retention of the Qwest Dex publishing business risk-free to ratepayers?

A. Was it risk-free to ratepayers?

Q. That's the question, Dr. Selwyn.

A. I want to make sure I understand this question, because, I apologize, but I'm having a great deal of difficulty with it. Are you assuming here sort of two scenarios, one under which QC retained Dex as it did as an affiliate and the other scenario where it did not, and the question is does -- is there a difference in risk to ratepayers as between those two scenarios?

Q. No, the question doesn't envision two scenarios; it just envisions the scenario that I gave you.

A. I don't have an answer to that question, then. I just -- either I don't understand it or I don't -- the question just doesn't make any sense. I don't know how to answer it. You can't assess risk.

I mean, QC did retain Dex, there was no rate case. If the reason that -- if perhaps the reason there was no rate case was because QC retained Dex, we can only assess the relative risk of that scenario on -- as against a scenario in which something different occurred. There's no absolute, no zero risk based on that that I can describe.

Q. Let's go back to looking forward, and let's assume --

A. Back to the future?

Q. Yeah, let's go back to the scenario where we were trying to look forward. And you were having a hard time with that, so let me re --

A. Well, I was not having a hard time looking forward. I'm having a hard time telling you that there was no risk.

Q. Okay, Dr. Selwyn. That wasn't a question. Go ahead and envision a period of five years from now into the future, during which time we don't know whether there's going to be a rate case. Can you accept that?

A. Yes.

Q. Okay. If, during this period of time, and assuming again that Dex does not get sold, but remains where it is today, if during that time a significant portion of Dex's computer systems and databases were wiped out by some sort of a catastrophic fire or earthquake, is it your testimony that the Commission would or should adjust rates for telephone service in the state of Washington such that Qwest's telephone ratepayers paid rates that compensated Dex in an amount sufficient to replace those lost assets?

A. My answer would be no, because were that to occur and there was no backup plan or other insurance coverage, I would consider that to have been a case of mismanagement or imprudent behavior on the part of management, and the Commission certainly should not bail management out in that circumstance.

Q. On page 57 of -- well, are there scenarios under which you could imagine a catastrophic loss of assets where there wasn't imprudence and ratepayers ought to be required to compensate Dex's management for a loss of those assets?

A. Well, for example, if there were an earthquake and the earthquake destroyed some -- had a major destructive effect on QC's network, causing large scale reconstruction of the network that it was not contemplated by any reasonable insurance coverage, that certainly would be factored into --

particularly in a rate of return regulated company, it would certainly be factored into a revenue requirement.

Q. I wasn't asking you about QC's network. I was asking you about Dex's assets.

A. Well, I suppose, by extension, you know, if one were to envision a catastrophic event of comparable magnitude, that had a comparable effect, I suppose that the same rule would apply. I just am having difficulty envisioning how you destroy a database that is easily backed up and stored off-site or in a different location, for example.

Q. What about the hardware? What about the computers themselves, to the extent that those are valuable?

A. Well, I feel quite certain that those are all -- represent insurable risks and probably are, in fact, being insured.

Q. So I guess, Dr. Selwyn, I'm trying to get back to the question which I still don't believe that I do have an answer for. Is there any scenarios under which you believe the Washington Commission should or would adjust telecommunications rates in the state of Washington to compensate Dex's management for any loss of Dex's assets?

A. Under the existing imputation arrangement, which is driven by earnings, if, for whatever reason, whether it was a loss of business, a loss of assets, the onset of competition, however it arose, if Dex's earnings from its Washington operations were to be affected up or down, that would affect the potential amount of the imputation, which in turn would effectively result in a change in the residual revenue requirement.

Now, if that -- if there were a loss of assets that were compensable in that way, under an imputation arrangement, then that would be eligible for consideration as part of a rate of return regulatory proceeding, just like any other QC network asset.

Q. And earnings -- if Dex's earnings in any instance ever became negative, is it your recommendation or understanding that the Commission would or should set rates to enable Dex to recover from Qwest Corporation's telecommunications ratepayers an amount sufficient to offset the negative earnings?

A. That would be my understanding of the implications of the Commission's determination in the accounting order case, yes.

Q. Now, on page 57 of your direct testimony, line 12, you state, Ratepayers supported the entire package. Do you see that phrase?

A. Yes.

Q. What ratepayers are you referring to there?

A. Well, I intend to be referring to Washington ratepayers, although I think the statement is generally true.

Q. Ratepayers for which services?

A. For, in this case, services furnished by -- to be precise, intrastate services furnished by QC and its predecessor companies subject to regulation.

Q. So intrastate telecommunications services?

A. All intrastate services that the revenues and costs of which are captured above the line which would include Yellow Page publishing, for example.

Q. Can you identify any specific telecommunications services rates that supported the Dex operation?

A. Rates that supported the Dex operation?

Q. That's right.

A. I don't think I contend that there are any.

Q. Okay. Thank you, Dr. Selwyn.

A. But as an example, certainly something that would flow in that direction would be charges for

unlisted numbers that have historically applied and that arguably are no different than any other directory-related revenue source.  So here you have a case where there's an additional charge for providing less service.
     Q.   You don't know how those charges are booked in Qwest's regulated accounts, do you?
     A.   Oh, I assume they're booked in Qwest's -- in QC's accounts, and not in Dex's accounts, but --
     Q.   Dr. Selwyn, I asked you, did you know?
     A.   I believe that's where they're booked.
     Q.   Do you know?
     A.   Well, they're a tariffed item, and therefore they -- you know, they are, I would expect, booked that way, yes.
     Q.   Turn to page 72 of your testimony, please. On lines 16 through 18, you list a number of intangible assets there.  Are you meaning to list or identify there intangible assets that you claim are subject to the sale transaction in this case, or merely provide an illustrative list?
     A.   Well, I would refer you to the description beginning at line 13, Intangible assets are those other elements of a business enterprise that enable it to produce revenues and profits, assets that exist

in addition to the firm's financial and tangible assets.

Continuing, the reference here is not specific to Dex, and it is also, very specifically, I'll note the phrase inter alia. It is not intended to in any way to be exhaustive.

Q. Did you do any analysis or did you reach any conclusions as to whether any of these intangible assets that you list generally are, in fact, being transferred in the Dex transaction?

A. Well, certainly some of them are. Customer loyalty, brand name recognition, trademarks, probably trade secrets, customer lists, databases, know-how, licenses, experienced work force. All of those are being transferred.

Q. The only one you didn't list was the embedded customer base. Did you leave that out intentionally?

A. No, I just started reading further in the line. That should be included, as well.

Q. All right. With regard to each of these assets, starting, for example, with the embedded customer base, did you perform a separate valuation to quantify the value associated with that?

A. No.

Q. Did you make any determination as to who owns that asset?

A. That would be a legal question. I believe the Commission made that determination in the accounting order case, but, in any event, these are customer relationships that were acquired quite specifically by virtue of the affiliate relationship with QC and its predecessors.

Q. And if I were to ask you the same questions with regard to each of these other intangible assets, would your answer be the same?

A. Substantially. Obviously, the circumstances of each are a little different, but either embedded customers clearly are more directly being transferred, you know, were directly acquired as a result of the affiliation. Less direct are things like employees and know-how, which were acquired by employees of Dex, but by virtue of the fact that Dex assumed a responsibility. Dex and its predecessors, US West Direct, assumed responsibility for the publishing of directories as a result of the 1983 publishing agreement. Had that not occurred, then those employees, that know-how, et cetera, would all be -- continue to reside in what is now QC.

Q. So just to take another item off the list, with regard to trade secrets, did you perform a separate valuation analysis to quantify the value associated with trade secrets?

A. No, I didn't perform a separate valuation or analysis with respect to any of these individually.

Q. And with regard to trade secrets, for instance, are you aware of any of the trade secrets that are being transferred in this transaction?

A. Well, I suppose if I were aware of them, they wouldn't be secrets.

Q. Well, Dr. Selwyn, you had an opportunity to review a number of confidential and highly confidential documents; isn't that right?

A. Yes.

Q. And did any of those documents disclose to you whether there were trade secrets that were being transferred?

A. Well, there was software that's being transferred, and to the extent the software is not subject to a copyright or trademark, it would qualify as a trade secret, for example. Customer lists typically fall in the list of trade secrets.

Q. Let's take the software for an example. Did you do any analysis with regard to any potentially trade secret software as to when that software was developed?

A. No, because it doesn't matter.

Q. Did you do any analysis as to who developed the software?

A. That doesn't matter, either.

Q. Dr. Selwyn, in your testimony, not here specifically, but in other places, you have emphasized the value associated with the publishing agreement and the noncompete; isn't that correct?

A. Yes.

Q. Okay. Do you agree that that's an important element in the directory publishing business?

A. Apparently. I mean, that -- I both concluded that independently, but just from the testimony of the various witnesses in this proceeding, it's clear it's an important element.

Q. Did you separately value the publishing agreement?

A. I did not, although there might have been a basis for it with respect to the liquidated damages provision, but I didn't necessarily consider that to be totally dispositive of the value because it had to be interpreted in the context of the overall contract. This whole transaction has to be viewed wholistically, not in its piece parts, which is one of the reasons that I didn't -- not only didn't I do individual valuations, but I didn't think it was either necessary or appropriate to do that.

Q. Do you agree that access to subscriber listings is an important element in the publication of directories?

A. It was certainly an important element at the time when subscriber listings were not generally available to competing providers, because it assisted Dex and its predecessors in acquiring their current customer base and critical mass to retain -- to acquire and maintain their dominance and preeminence in the market.

The availability of customer lists on an ongoing basis, now that that condition has been altered, will permit prospectively some fringe competition to enter the market, but it cannot alter the acquisition that -- the preexisting acquisition of the critical mass of customers.

Q. I take it from your answer, Dr. Selwyn, that you understand that Qwest is obligated to provide subscriber list information on a nondiscriminatory basis to all publishers?

A. I'm fully aware of that, but that's a relatively recent requirement.

Q. Are you contending in this proceeding that Qwest is not meeting that obligation?

A. No, no, I'm not.

Q. Let's look at page 78 of your testimony. You identified there assets that you claim that QC is providing in this --

A. What line are you on?

Q. -- transaction.

A. What line are you on?

Q. Starting on line one.

A. Okay. Yes.

Q. And one of the assets that you claim QC is contributing --

A. I would call your attention to the fact that some of this information is considered confidential.

Q. Actually, it's shaded, but that's a holdover. This whole page is white now, and so none of the information here is confidential.

A. So the designation on line two should be removed, should be deleted?

Q. Staff has filed testimony revising that and taking the confidential designation off; yes, that's correct.

A. Okay.

Q. Thank you for pointing that out.

A. I'm sorry. You had a question?

Q. Yes. Turn, please, to Exhibit 350-C, which is the intellectual property contribution agreement,

A. Three-fifty --

Q. C, as in confidential.

A. I have it.

Q. And Dr. Selwyn, just so that we are kind of literally on the same page here, I'm going to double check. On page one of that document, number one in the center, it's the second page, it identifies the parties to that agreement; is that correct?

A. Yes.

Q. Now, QC is not listed as a party to that agreement, is it?

A. That is correct.

Q. There are five exhibits to that -- to that Exhibit C. If you could turn back to page 28 -- it's number 28 in the center, number 29 in the lower right-hand corner, and so that's Exhibit A. Is there anything there on the Exhibit A that indicates that the assets listed there belong in any way to QC?

A. Well, subject to the general determination by the Commission with respect to the status of Qwest Dex for regulatory purposes, these appear to be marks associated with the -- specifically with the Yellow Page business.

Q. Is there anything there that indicates that any of those Dex marks belong in any way to QC?

A. Well, that calls for a legal conclusion, based on the Commission's order in the accounting order docket.

Q. Look at Exhibit B, which is the next page, Dr. Selwyn. That exhibit is entitled Dex Domain Names; is that right?

A. Yes.

Q. Is there anything on that Exhibit B that indicates to you that those assets belong in any way to QC?

A. Well, again, they appear to be all related specifically to the directory business, but subject to the same response to my previous question.

Q. Is it likely, Dr. Selwyn, that those domain names were developed after 1983?

A. I think that's a pretty safe bet. It's also irrelevant.

Q. Look at Exhibit C, which is the very next page, entitled Dex Patents.

A. By the way, I'm sorry, I need to respond -- I need to modify my previous answer. As domain names per se, clearly there was no Internet in 1983, and there was no such thing as a domain name. I cannot say as a fact that each and every one of these marks in some similar form didn't exist in 1983. That may well be the case, but I don't know it. All I can say is, specifically as domain names, they didn't exist in 1983.

Q. Okay, thank you. That's a fair clarification. Exhibit C, which is entitled Dex Patents?

A. Yes.

Q. Would you agree that in the column under filing date, all of those patents were either -- were filed in 1996 or after that?

A. Appears to be, yes.

Q. And is there anything on that Exhibit C, Dex Patents, that indicates to you in any way that those patents are owned by QC?

A. I have no way of knowing when the work leading to the creation of these patents was commenced and whether or not any of that work, for example, preexisted the transfer. In a typical example, an employee agreement would typically provide the employer with rights to patents where the work leading to the patent was performed by the employee.  If any of this occurred, began, was derived from activities that predate 1983, then that would certainly suggest that they were transferred.

Q.   Do you --

A.   So I don't know.

Q.   You earlier agreed with me, subject to check, that approximately $23 million in cash working capital had been transferred in 1983?

A.   Subject to check.  I don't even remember if that was the same number you said before, but I'll assume it was.

Q.   Okay.  I think it was.

A.   Okay.

Q.   Do you know, Dr. Selwyn, whether that cash working capital was used to either develop these patents or domain names?

A.   I told you before I didn't know what the money was used for.

MS. ANDERL:  Okay.  Your Honor, I -- this is not an unreasonable time to stop.  I have a series of questions, not a big topic.  I can keep going, if you'd like.

JUDGE MOSS:  How much?

MS. ANDERL: Oh, I'm not done. I have probably have a half hour, 45 minutes.

JUDGE MOSS: Oh, okay. We probably want to go ahead and take our luncheon recess. And I appreciate you pointing out a convenient moment to stop.

MS. ANDERL: Thank you.

JUDGE MOSS: So we'll take our luncheon recess and we'll come back at 1:30.

(Lunch recess taken.)

JUDGE MOSS: Let's be back on the record. Ms. Anderl, I believe we will just continue with your cross-examination.

MS. ANDERL: Thank you, Your Honor.

Q. Dr. Selwyn, before we broke, we were talking about your testimony on page 78, and the assets that you've discussed there. On lines eight and nine of that page 78, you discuss the expanded use list license agreement; is that correct?

A. Yes.

Q. Did you review that document?

A. Yes.

Q. Dr. Selwyn, you claim that this is a significant identifiable intangible asset; is that correct?

A. Yes.
Q. Okay. Did you value it separately?
A. No.
Q. Is it your testimony that this intangible asset is being transferred to Dex in this transaction or merely being licensed to Dex?
A. It's being licensed.
Q. Okay.
A. As I understand it.
Q. Okay. Now, in your review of the agreement, do you recall whether the agreement has any statement in it to the effect that it is nonexclusive?
A. It is nonexclusive.
Q. Would you take a look at Exhibit 352, please?
A. Yes, I have it.
Q. Is it, from your review of the expanded use list license agreement, do you recognize this as the price schedule associated with that agreement?
A. Yes.
Q. Do you understand that this pricing represents the amount Dex Holdings will pay to Qwest Corporation separate from and in addition to -- strike that.

Do you understand that this pricing represents the amount that Dex Holdings will pay to Qwest Corporation for the subscriber list database, load, and updates associated with the expanded use list license agreement?
A. Yes.
Q. Okay. And that that pricing is separate from and in addition to the purchase price associated with the Dex transaction?
A. Yes.
Q. Do you have -- is it your contention, Dr. Selwyn, that that pricing set forth in Exhibit C is discriminatory?
A. No.
Q. Do you have any evidence that that pricing is either above or below market value for the information that's being transferred?
A. I haven't studied it.
Q. And there's also a -- strike that.
I'd like to talk with you generally, Dr. Selwyn, about your testimony that all of the value associated with this transaction should go to Washington ratepayers.
A. Well, all of Washington's share of the value.

Q. Washington's share of the value. I was trying to find a place in your testimony where you set forth succinctly your rationale for that, and I find it, you know, sprinkled throughout your testimony. But tell me, if you turn to page 81, and I'd like to point you to some testimony here and ask you if I have found a spot in your testimony that summarizes your rationale, and that's lines 16 through 20.

A. I would say that's certainly part of the rationale, but it certainly is not the entire rationale, and in fact, this is actually sort of stated in the negative.

Q. Part of the rationale, though, is, in your view, the fact that the Commission has repeatedly ordered that ratepayers should receive the full value of the rights granted to Dex and its predecessors via imputation; is that right?

A. The Commission has used imputation as a device to simulate the -- what the -- the financial result of what would have occurred had Qwest Corporation and its predecessors continued to be the publisher of Yellow Pages in Washington State.

Q. And so is it, in your view, then, that the historic treatment of Yellow Pages is somehow dispositive or controlling in terms of what the Commission should do here?

A. Certainly, it's an important factor. A lot of the -- a lot of these issues were addressed in the accounting order case and were, I believe, resolved in that case, but as a general matter, I think as a -- in terms of just looking at it from simply a straight policy issue in terms of the history of how the Yellow Page business came into existence and how the QC and its predecessors acquired the critical mass during a monopoly era and acquired the value that is reflected in the transaction that is before the Commission here, I think that, looked at collectively and wholistically, the Yellow Page activity is part and parcel of the local telephone business. And if it is to be sold, it should be treated just like any other regulatory asset.

Q. Do you have in mind any asset disposition that this Commission has addressed wherein a value was returned to ratepayers that was in excess of the rate -- Washington's share of the realized sale price, such as you're proposing here?

A. I don't know.

Q. Dr. Selwyn --

A. I also don't know if the Commission had previously confronted what amounts to a distress sale situation, such as we have here, where there is an impending bankruptcy and a sale is being consummated during a period in which the availability of capital is limited, capital markets are very depressed, and the economy is in recession. So it's one of those perfect storm situations that I'm not sure the Commission has confronted before.

Q. When was the last time, Dr. Selwyn, that you reviewed the accounting order?

A. I reviewed it when I was drafting this testimony and I may have looked at it since.

Q. Okay. You've stated several times during your answers that you believe that the Commission decided a number of these issues in the accounting order; is that right?

A. Yes.

Q. And when you say decided a number of these issues, do you mean who should -- who has basically a beneficial interest in the assets that are the subject of this transaction?

A. I'm not sure whether those precise terms were used in the accounting order, so I'm hesitant to agree with the question as framed, but --

Q. I wasn't --

A. -- the Commission determined that, for regulatory purposes, the Yellow Page business would be treated as a regulatory asset and that imputation would continue.

CHAIRWOMAN SHOWALTER: Ms. Anderl, just so those past two questions are clear and it's clear in my head, what do you mean by the accounting order?

MS. ANDERL: Oh, I'm sorry, Your Honor. It's the -- I believe it's the 14th Supplemental Order in Docket 980948.

CHAIRWOMAN SHOWALTER: Thank you.

MS. ANDERL: July 2000.

CHAIRWOMAN SHOWALTER: Thank you.

Q. Dr. Selwyn, in your review of the accounting order, do you recall reading a statement by the Commission to the effect that the Commission does not rule out any Yellow Page treatment, nor does it predict what the Commission will do, given the facts of any possible future record?

A. I do recall that language.

Q. Now, on page 86 of your direct testimony, Dr. Selwyn, you address -- you discuss eBay and the first mover advantage?

A. Yes.

Q. During the time that eBay was establishing itself in the market and creating the first mover advantage, did the individual buyers and sellers on that auction site bear the risk of loss or the burden of the eBay operations?

A. No, but eBay was never a regulated entity with a franchised monopoly.

Q. You've anticipated my next question, and that was why or why not? Is that the only reason that you would state --

A. eBay was the result of entrepreneurial activity on the part of that company that acquired critical mass as a result of the presence of network externalities that, in that particular instance, afforded it a -- what is I think colloquially referred to as a first mover advantage, and I use that term with reservation, because sometimes the -- a firm can come to dominate a market as a result of network externalities that didn't happen to get there first, but for whatever reason, was able to acquire sufficient critical mass subsequent to its entry that it essentially eradicates or diminishes the importance of its competitors.

Examples, for example, are Microsoft Excel vis-a-vis Lotus 1-2-3 or Microsoft Word relative to other word processing programs like WordPerfect or the IBM PC relative to Apple are all examples of something coming along later than the first mover and the true absolute first to arrive, but as a result of achieving critical mass, was essentially able to come to dominate the market. VHS and Betamax are yet another example. There are plenty of examples.

Q. Now, I believe that you had previously testified that it is your belief that a first mover advantage is not appropriately attributable to QC shareholders because it is your view that they do not incur any risk in establishing that advantage; is that right?

A. Well, not only didn't they incur any risk, but that their ability to accomplish, again, as I've modified my use of the term first mover to refer now to the first to acquire critical mass in the face of -- and to exploit network externalities, in the case of QC and its predecessors, it had a de facto monopoly with respect to local telephone service and it did not have any requirement to license its subscriber database or to make its subscriber database available or its Yellow Page database available to competing providers.

So as a result and as a direct consequence of that monopoly condition of its local service and its ability to leverage that monopoly to come to dominate the Yellow Page business, it acquired dominance in the Yellow Page business, not through any risk-taking on its part, but rather by virtue of its position as the dominant incumbent local carrier.

Q. And along those lines, is it then your testimony that part of the benefit that the early Yellow Pages publisher would have received from its association with the telephone company is that it had established business relationships with virtually all of the potential advertisers? Is that your view?

A. Not as important, actually, as the fact that it had achieved critical mass in the market. Because of its dominance in the market, it has the largest circulation, the largest customer acceptance, which then makes advertisers most willing, more willing to advertise in that -- in that directory than in fringe competing directories.

And consequently, since there are more ads in that -- more ads, more listings in the dominant provider's, the dominant directory customers are more willing and more likely to accept that directory as their primary directory. So these two conditions feed on each other so as to support and maintain that dominance.

And that's far more important. The relationships part is important, certainly, but not as important as the externality. And the externality is what was acquired as a direct consequence of QC and its predecessor status as regulated monopolies.

Q. Dr. Selwyn, did you review Phil Grate's testimony?

A. I did.

Q. Would you accept, subject to your check, that the advertisements that he included as exhibits to his testimony show, in a number of instances, advertisements wherein the advertiser does not even list a telephone number in the early Yellow Pages publications?

A. I don't recall.

Q. Would you be willing to accept that, subject to your check?

A. We're also talking about a time when the penetration of telephone service was minimal, and it almost didn't matter, because a lot of people didn't have phones, so it was the advertisement that might have been more important than the phone number.

But certainly, when we're dealing with telephone penetration rates of five, 10, 15 percent, the network externality component is not operative to anywhere near the extent that we've had in more recent years, which is why I've suggested all along that early period was essentially completely irrelevant for any discussion here, and I still believe that.

Q. Dr. Selwyn, would you agree that circulation is an important component of the value of the Yellow Pages book?

A. It's a component, but it is, in the case of a product such as the publication such as Yellow Pages, it is not all that important, because the circulation itself is free to the -- that is, the delivery of the book is free to the recipient. And when -- so if a competing directory came along, it could achieve almost the same circulation simply by giving away free copies.

When I opened my hotel room this morning at the Phoenix, I found a new copy of the TransWestern Olympia directory on the floor in front of my room. I didn't ask for it and I don't think I was expected to take it with me, and I certainly don't have room to take it with me, so I assume it will stay there. The mere fact of circulation by itself is not dispositive. What's much more important is which book the customer reaches for when the customer's looking to a Yellow Page directory, and the evidence continues to suggest that the customer, most of the time, will reach for the incumbent phone company's directory.

Q. I'd like to read you a statement and I'd like to ask you if you agree or disagree with it. The willingness of advertisers to advertise is directly related to the circulation of the book. The value of the Yellow Pages -- put another way, the value of the Yellow Pages to advertisers is directly related to the total number of telephone subscribers in the coverage area.

A. Yeah, that's my language, so I obviously agree with it.

Q. And moreover, that value is not diminished merely because some subscribers may elect to take their service from a competing local carrier.

A. I'm referring to their telephone service.

Q. Right.

A. Not directory service.

Q. I had asked you a few moments ago whether circulation is an important component of the value of the book.

A. And I said it was, but not dispositive.

Q. Not dispositive of what?

A. Well, not dispositive of the value. I mean, I guess -- I'm defining circulation here, just to be clear, when we think of a paid publication, that is a publication someone has to go out and purchase at a newsstand or subscribe to. Circulation there means -- it reflects the customer's willingness to actually part with money to acquire a copy of the publication.

When you look to a publication that is distributed free, the circulation there has to be -- the concept of circulation has to be tempered by the likelihood that the customer will use the book, rather than just throw it away. Experience over the last 15 or 20 years with companies that have attempted to break into the Yellow Page business in various cities suggests that merely because they give out copies to everybody doesn't make that book accepted.

If I receive a copy of the book and toss it in the trash, then, for all practical purposes, that -- there is no circulation to me. That would be an incorrect count of circulation. And I think that, in viewing a statistic in the case, again, of a publication that's distributed free, one has to look not just at how many copies are handed out, but how many copies are retained and used.

Q. Dr. Selwyn, I have some questions for you about your supplemental rebuttal testimony, Exhibit -- I believe it's 363, but I'm not sure.

JUDGE MOSS: That's right, 363.

THE WITNESS: 363.

Q. Turn to page four, please. Well, actually, three. You state there, on lines 17 and 18, that the existing imputation, by contrast, increases over time to reflect the growth in Washington directory publishing profits. It is not required by any Commission rule or order to increase over time, is it?

A. That has been the practice.

Q. I'm sorry, is that a yes or a no?

A. I said that has been the practice, and it's my understanding that the manner in which imputation has been determined has been consistent in recent years.

Q. But it's not required to increase, is it?

A. I don't know.

Q. Now, you've stated, I think both in your direct testimony and in your rebuttal testimony, that imputation is probably not sustainable when there's no Dex revenue; is that accurate?

A. Well, what I've said in my supplemental testimony is that the concept of a revenue credit is not the same as imputation, and that it is the revenue credit that may not be sustainable in the absence of corresponding revenues in another affiliate.

Q. Didn't you also say in your direct testimony, though, at page 46, that it would probably not be a viable option to continue the imputation process if the Commission approved the sale? And I'm on lines nine through 13.

A. That is how I'm responding to that question, yes, probably not.

Q. And can you please explain why that is?

A. Well, as I've discussed in my supplemental testimony, imputation is essentially a device that is used by regulatory agencies to, in some cases and in this case, to effectively pierce the corporate veil, as it were, and treat, for purposes of regulation, revenues and expenses that are booked by the -- by the company in an affiliate as if those revenues and expenses occurred in the regulated entity itself.

So basically, Qwest, or more specifically, QC, comes before this Commission without any Yellow Page directory revenues or corresponding costs, because those are being captured in an affiliate. And the Commission, through the imputation process, is saying, Well, that's all well and good, but for regulatory purposes, we will treat QC as if those revenues were being booked here. Now, that's different than in the case of the revenue credit, which is being proposed in the partial settlement, because in that situation, there is no revenue that is coming in that the Commission effectively is saying shouldn't be in the affiliate; it should be here, in QC. And consequently, the revenue credit is unfunded.

In other words, if QC were to find itself in a situation where it was short of cash, for example, because of an imputation, it would be free -- there's nothing to prevent it from actually having the directory affiliate write out a check to QC for the amount of the imputation. In fact, that would effectively capture on the books of the company what the Commission is determining for regulatory purposes.

However, if there's no revenue coming in, there's no ability to write such a check. QCII would not have the ability to fund the revenue credit. So all that happens with the revenue credit is that it

erodes QC's earnings and QC's cash position.
Q. Now, to the extent that Staff has recommended that QCII make actual cash payments to QC after the sale, what revenue stream would QCII use to fund those actual cash payments that Staff has recommended?
A. Well, QC is realizing seven billion dollars from the sale, and with respect to funding those revenue credits, it certainly could allocate a portion of that revenue into some mechanism that would fund the credit and allow it to make the accounting transfer on an ongoing basis.
Q. And --
A. Or in the alternative, it could simply write out a check to QC for the full net present value of the revenue credit that QC could then effectively use to fund the revenue credit over time.
Q. And with regard to the difference in your recommended value and the realized sale price, do you have those figures in mind?
A. Yes.
Q. Where does that money come from?
A. Well, you know, as with any imputation, for example, an imputation of a capital structure, I mean, they're -- in this situation, the parent would

be required to make QC whole in order that QC receive fair market value, which is the only thing that has been authorized by, for example, the Washington Supreme Court, to justify an imputation.

Q. Wouldn't that, in effect, put additional debt on QCII's books?

A. Well, it might, but that's not a problem of the making of the Washington ratepayer. QCII has to find a solution for it.

Q. Turn to page six, please, of Exhibit 363. At lines 16 and 17, you express concern that if the sale now helps QCII to avoid bankruptcy, it would nevertheless mean that QCII would not have the quality asset of Dex to sell as a means for raising short term cash in the future; is that right?

A. Yes.

Q. If QCII were to wait to sell Dex until a year from now, and market conditions were worse, such that the Dex sale only brought in $6.3 billion, but it was necessary in order for QCII to raise short-term cash, is that the type of a solution that you're recommending here? Would that be appropriate, in your view?

A. I'm not sure I understand the question.

Q. Well, Dr. Selwyn, Staff's recommended --

let me cut right to the chase here. Staff's recommendation is that QCII not be permitted to sell the asset today. Your testimony, at lines 16 and 17, suggests that we should be retaining the asset to sell it tomorrow. What is Staff's response to the question of how can QCII be sure that the recommendation tomorrow would be any different from what Staff's recommendation is today, which is you shouldn't sell it; you should wait?

A. Well, I think you've mischaracterized my testimony, so let me clarify what I'm actually testifying to here. It is, has been, still is my recommendation that QC retain the Washington directory publishing business as a regulatory asset, that it not be sold. And I believe that that is the outcome that is in the best interests of Washington ratepayers now and in the future. And I don't alter that. Nothing I've said in my direct or in my supplemental testimony in any sense modifies that position.

What I'm addressing here is simply the question that has been raised, which is -- and I believe Dr. Blackmon discusses this. There was some cross-examination on this point of QC witnesses last week that the potential exists that even if this sale were consummated and even if the proceeds were used to pay down the QCII debt, that does not get QCII out of the woods, and that bankruptcy in the future, and perhaps not even the very far distant future, is still a possibilty.

And I'm addressing here the point that were that to occur and QCII no longer had Dex in its portfolio, then it would not have the option that it purports to have now as a device for staving off bankruptcy.

Q. So Staff thinks the more immediate prospect of bankruptcy is preferable to postponing that prospect?

A. I think, number one, I would defer the specifics of Staff's position on that to Dr. Blackmon, but, that said, I think the Commission has to address this issue not in terms of the immediate impact, but to look at the impact on this company over time.

For example, just -- there was a lot of discussion last week about whether or not this revenue credit was sustainable, and there were contentions by QC witnesses to the effect that it was, but the very existence of the revenue credit will depress the value of QC going forward, by my calculations, perhaps something on the order of a billion dollars in market value.

And on that basis, going forward, if QC were to be put on the block to prevent QCII bankruptcy a couple of years from now, that the existence of the revenue credit would depress the price that could be obtained, the cash price that could be obtained for QC, and therefore we'd be right back where we were.

And I think that the Commission needs to look at this issue not in terms of the immediate crisis, but in terms of a solution that is in the best interests of ratepayers in this state.

Q. Turn to your rebuttal testimony at page eight, please.

A. It's not --

Q. Or supplemental?

A. Okay. This is --

Q. Supplemental testimony.

A. Yes.

Q. On line 14, you say, None of the gain will be shared with QC ratepayers under the settlement. Was that your testimony?

A. Yes.

Q. You've read the settlement; is that

correct?

A. Yes.

Q. Is it your understanding that the settlement provides for a $67 million one-time bill credit?

A. Yes.

Q. And that that bill credit will not exist if the sale does not take place; is that right?

A. Apparently, yes.

Q. Turn to page 11.

A. But that's not sharing the gain. In fact, the net result is, as I explain right in this very paragraph, that the ratepayers, even with the bill credit, end up with less than they would without the settlement. And in addition, we don't know -- I can't tell from this stipulation document actually who's paying that $67 million. If the 67 million is being paid by QC, then -- and yet the revenue from the sale is being captured by QCII, then all that 67 million payment is going to do is further weaken QC, and there's certainly no sharing of any gain going on.

MS. ANDERL: Your Honor, I'd move to strike that as non-responsive.

JUDGE MOSS: Let's have the question back.

MR. TRAUTMAN: Your Honor --

MS. ANDERL: I'm sorry, Your Honor, did you ask the reporter to read the question back?

(Record read back.)

JUDGE MOSS: Did you want to be heard, Mr. Trautman.

MR. TRAUTMAN: Well, I believe he's entitled to explain his answer. And the question directly related to his statement in the testimony that was referred to, that none of the gain would be shared with QC ratepayers, and he was answering it with reference to that.

JUDGE MOSS: I think the Bench finds it reasonably responsive, Ms. Anderl. If you want to move on to your next question.

MS. ANDERL: Thank you, Your Honor.

Q. Turn to page 11, please, Dr. Selwyn. Line three, you say that elimination of the contribution from Yellow Pages would not cause below-cost services to be priced above cost. Do you see that?

A. Yes.

Q. Why couldn't the Commission make such a pricing decision?

A. Oh, obviously, the Commission can do anything it wants, but it seems to me that the more immediate problem is to deal with the above-cost pricing of services that are provided as inputs to other carriers. And my point simply here is that we have a tension between the public policy objective of making services, basic services affordable, which in some cases might cause them to be priced either below cost or certainly to generate minimal or no contribution, with the contribution from other services being used to fund the common costs of the company's operations.

And if you eliminate the contribution from Yellow Pages, then you make it more difficult for the Commission to, for example, reduce access charges and at the same time maintain the affordability of basic services, and that -- my point simply is that, in terms of achieving a fair and effective competitive environment, it's far more important to reduce things like access charges than it would be to reduce Yellow Page rates because -- or I'm sorry, to reduce the Yellow Page contribution, because reducing the Yellow Page contribution will not result in a reduction in Yellow Page rates, whereas reducing access charge contribution will result in a reduction in access charge rates.

Q. So is it your testimony here, then, that there are a number of different support mechanisms for local rates and some ought to be eliminated before others are considered to be eliminated?

A. That's certainly one of the points I'm making here, yes.

Q. Now, let's talk a little bit about your proposal that starts on page 12, wherein you describe the potential for QC to enter into an arrangement with another publisher to have its directory publishing obligation met.

A. Yes.

Q. You also talked about that in your direct testimony, and I'm just going to refer you briefly to page 91 of that testimony. You state, at lines three through five, that QC, if it were not required to enter into the publishing agreement and noncompetition agreement with the buyer, would be able to accept bids and assign the publishing agreement and title of official publisher to an alternative directory publisher. Do you have that testimony in mind?

A. Yes.

Q. You also indicated in that testimony that QC could do so with significant royalties. Is that also correct?

A. Yes.

Q. Now, at Exhibit 349, Qwest asked you to quantify those royalties. Can you please turn to page -- Exhibit 349 and indicate to me if that's your response to that question?

A. Yes, that is my response.

Q. Now, I wanted to ask you a little bit about Verizon as a potential publisher, but since you indicated earlier that you're also familiar with TransAmerica's publication of a competing book, we could use that one.

A. I think I said TransWestern.

Q. TransWestern.

A. I'm familiar with it to the extent that I saw it on the floor this morning outside my hotel room, and I picked it up and I brought it in.

Q. Close enough, Dr. Selwyn.

A. I didn't even open it.

Q. Did you happen to notice whether it was a publication of both Yellow and White Pages?

A. I think it was, but I -- in all honesty, I'm not going to swear to that.

Q. Did it purport to be for the Olympia area?

A. It said Olympia on the front cover. Now I'm sorry I didn't bring it with me. But you're staying at the Phoenix, I think. You probably got the same book.

Q. I checked in today. I'll see if I have one tomorrow.

A. Okay.

Q. Let's look at the economics of a situation where there is no directory publisher or QC in Washington. Let's say the sale transaction has gone through, but the Washington share has not been transferred, and so QC has no publishing agreement and no in-house way of having its directory publishing obligation met. Do you have that in mind?

A. Yes.

Q. And you've suggested here in your testimony that Verizon might -- Verizon's directory affiliate might be willing to step in and perform that function for QC; is that right?

A. I don't think I put it quite in those terms, but I'm certainly suggesting that Verizon is one of the possible publishers.

Q. Now, let's look at the economic incentives or the economics of such an arrangement. If QC needs to have a directory published to meet its regulatory obligation, would you agree with me that QC's economic incentive there is to try to extract from a

publisher as large a publishing fee as possible?
A. Yes.
Q. Okay. And let's look at the publisher's economic incentives. Would you agree with me that the publisher's economic incentive is likely to be -- to gain the official publisher status and title in exchange for as small a publishing fee as possible?
A. Yes.
Q. Okay. Are you aware of what, if anything, Dex currently pays to other independent local exchange companies in the state of Washington for the right to be their official publisher?
A. I'm not aware of it, but it's not a comparable situation by any remote stretch of the imagination.
Q. Would you accept, subject to your check, that Dex does not pay those independent companies anything?
A. It wouldn't surprise me. In fact, I could envision a situation where Dex could try to extract money from the independents for the privilege of having their listings combined in a larger area directory. That's why I say it's not comparable to a situation where you're dealing with directories that cover the area that is served by the dominant

carrier.
Q. If Verizon already publishes a competing book, let's say in the Seattle market, which I think you indicate in your testimony that you're aware of that?
A. I said I was aware that they published directories in Seattle metropolitan area. I'm not precisely sure what parts of the Seattle metropolitan area they cover.
Q. So to the extent Verizon already publishes Yellow Pages directories serving portions of the Seattle metro area that are currently Qwest-served areas, do you think, under those circumstances, it is reasonable to assume that if Dex were not publishing directories in those areas, Verizon could capture 100 percent of the advertising revenues that Dex currently receives?
A. Well, that's actually a very interesting question. That goes to, among other things, the issue of what the effect of competitors are in the marketplace on the dominant carrier's revenues, because it's not all obvious that competing directories actually take away revenues from the dominant carrier; they simply may force advertisers, if they have even a modest share of the market, to

buy advertising in the additional directories, as well.

I would expect that Verizon would certainly increase its share and its revenues and its advertising rates and a number of other aspects of its directory business, including the coverage areas and other things, were it to become the official directory for Qwest -- for QC in Washington, and that it would realize a very substantial increase in its revenues from that activity.

Q. And if --

A. Whether it would get every last nickel, I can't say.

Q. And if Qwest were to put the publishing function out to bid and the right to be its official publisher and were to receive bids from Verizon and TransWestern for no more than $20 million for the state of Washington, would you accept that as the right and proper amount?

A. I think I'm not going to -- sitting here, with the minimal facts that you've given me about what that bid might constitute and what the parameters of the deal would be, I'm not in a position to tell you that that would be the right and proper amount.

Q. Is it your testimony that only an amount that matched or exceeded today's imputation would be the right and proper amount?

A. No, it might well be less than that, you know. As I've said any number of times, I'm going to repeat it again, I think the best solution is to simply retain the directory operation in its present form, and that probably none of the other alternatives are as good.

MS. ANDERL: Thank you, Your Honor. I have no further cross at this time.

JUDGE MOSS: Thank you. Mr. Harlow.

MS. ANDERL: Oh, I will move some exhibits, but I'll figure out which ones I want to move while Mr. Harlow's doing his cross.

JUDGE MOSS: All right.

MR. HARLOW: Does that mean you won't be paying attention to my cross?

MS. ANDERL: I didn't say that.

MR. HARLOW: Your Honor, there's not a lot left.

MR. BUTLER: We'll be mindful of everything you say.

MR. HARLOW: Oh, great. There's not a lot left of my initial cross after Ms. Anderl's cross, Your Honor, but I do have some follow-ups.

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

BY MR. HARLOW:

Q. First of all, if you would, please, turn, Dr. Selwyn, to Exhibit 312, your qualifications. And I note in the first paragraph, you may be able to do this from memory, actually, that you state you have a Ph.D. degree, but you do not state what your degree is in; is that correct?

A. I thought I did. My degree is in management. It's from the Sloan School of Management at MIT.

Q. That's all I wanted to clarify, was your Ph.D. is not in economics; is that correct?

A. Well --

Q. Is that correct or not?

A. It's not issued by the economics department. The program was heavily oriented toward economics and my dissertation was certainly an area relating to applied economics.

Q. Okay. Can you answer the question yes or no, Dr. Selwyn? Do you have a degree, a Ph.D., that says it's in economics?

A. No.

Q. I understand your master's degree is also not in economics; is that correct?
A. That's correct.
Q. You do have bachelor of arts degrees from Queens College in economics; is that correct?
A. Yes.
Q. Dr. Selwyn, at Exhibit 354, which is a data request response to Dex Holdings, you indicate that you define the relevant product market -- are you with me yet?
A. Yes.
Q. You would define the relevant product market for Yellow Pages directories, and if I can just sum up, basically you define it as printed Yellow Page directories. Would that be a fair summation?
A. Yes.
Q. And so you would exclude from the definition of relevant product market, for the product market in which Yellow Pages directories are defined, things such as radio advertising?
A. Yes.
Q. I assume you'd also exclude newspapers and the Internet and those kinds of outlets?
A. Well, that gets a little closer.

Q. But according to your definition in Exhibit 354, you would not include those, even though you now testify they're close; is that correct?

A. As stated here, I do not include it. The notion of a product market or a relevant product market is not absolute. There isn't necessarily a bright line where one ends and the other begins. And clearly Internet directories or the ability to obtain similar information to a printed directory over the Internet is certainly a very close market. Whether it's actually separate at this point or not is certainly subject to question.

Q. So and I assume your answer, that answer is based on the fact that there is some substitute -- at least some degree of substitutability among advertisers and they have a choice whether they're going to advertise in Yellow Pages versus on the Internet?

A. Well, that's part of it. It's not a matter of so much a choice of one versus the other, but these are, in a sense, both complements and substitutes. Some customers will obtain information -- we might have a common database that is used both by a Yellow Page publisher both to produce printed directories, as well as to provide access to that database over the Internet. And so some customers might obtain the sought-after information by opening up a printed directory or, alternatively, by using a directory, a searchable directory on the Internet that accesses the identical database, and it's not really clear that those are separable product markets.

Q. What would you say the penetration rate of Yellow Pages advertising is in the market?

A. Define penetration rate for -- I'm not sure I understand how that relates to this question.

Q. Well, would you say that nearly everyone, nearly a hundred percent of the population has access to Yellow Pages directories?

A. In terms of the user or the advertiser now? That's why I'm --

Q. In terms of the user?

A. I would agree that Yellow Pages directories are probably distributed to nearly a hundred percent of the market. Whether they actually have access to it is another question.

Q. Would you agree that the access that the user has to the Internet is something substantially less than a hundred percent?

A. It's less.

Q. Would you agree that, as the penetration rate for Internet access increases, that that will in turn become a more important avenue for advertisers?

A. It will shift the access to the common database away from the printed directory and toward the Internet-based directory.

Q. If we could turn to the scope of your engagement again. Did your engagement encompass studying whether or not the relevant product market for Yellow Pages directories is effectively competitive in Washington?

A. No.

Q. So you have offered no opinion in this matter on whether or not Yellow Pages directory market, product market, that is, is or is not effectively competitive?

A. Oh, I think I have offered such an opinion.

Q. So your opinion goes beyond the scope of your engagement. Is that what I'm hearing?

A. I thought you asked me -- I heard your question on the scope of engagement, whether or not I was engaged to conduct a study of whether or not the market was competitive, and that clearly was beyond the scope of my engagement.

Your second question, at least the way I heard it, and perhaps the reporter could read it back, was did I have an opinion, and I do have an opinion.

Q. My question was have you offered an opinion in this docket. Do you understand the question now?

A. I understand the question.

Q. And the answer is?

A. I don't remember whether I did or didn't.

Q. If you would turn --

A. I think, on balance, I probably did.

Q. If you'd turn again to Exhibit 354, would you please read out loud the last sentence of that response?

A. Dr. Selwyn has not specifically investigated the extent to which those separate geographic markets in Washington are effectively competitive.

Q. Okay. To your knowledge, has the Staff supplemented this response in any way?

A. I don't believe so.

Q. Dr. Selwyn, did you interview any of the bidders for the Qwest Dex business?

A. No, I did not.

Q. And specifically, I assume you've had no conversations with anyone at Carlyle Group or Welsh,

Carson, Anderson and Stowe?
A. No.
Q. So you have no direct contact from which to base any assumptions as to their motivations in establishing their bids for the Qwest Dex business?
A. Except as described in their testimony, that's correct.
Q. How long have you been testifying in telecom?
A. About 30 years. Well, more than that.
Q. Do you remember a time when at least most telephone companies would not allow people to connect their own telephones to the network in their homes?
A. Yes.
Q. And the concept was, at that time, that telephone set, the CPE, to use the vernacular, was considered an integral part of the network. Do you remember that time?
A. Yes.
Q. And do you recall that, typically, your basic service included only one telephone set?
A. Typically, yes.
Q. And do you recall typically you'd pay an extra monthly charge to connect another telephone to that same telephone line?

A. Well, you would pay an extra charge to rent additional CPE, a component of which was perhaps a fee for the equipment and another component was a fee for the right to connect it, but these were not separable.

Q. And do you recall kind of a range of what those extension phone charges were, say 30, 25, 30 years ago?

MR. TRAUTMAN: Objection. Your Honor, I don't see the relevancy of this line of questioning.

JUDGE MOSS: Sounds like foundation to me, Mr. Harlow.

MR. HARLOW: Your Honor, we are getting into an area here as an illustration of what happens as markets begin to open up to competition, which is exactly the situation we believe we're facing with directory publishing.

JUDGE MOSS: Yeah, I think we'll allow it. Sure.

Q. Do you recall the question?

A. Yes. My recollection is it's probably in the range of a dollar a month.

Q. And to the extent that there's this component that you mentioned, for the right to connect, would that have been a cost-based component?

A. Well, nothing in those days was cost-based, but in fact, the dollar a month actually covered three things. It covered the equipment rental, it covered the -- well, more than three things, for that matter. Covered equipment rental, it covered maintenance on that equipment, it covered inside wire and maintenance on the inside wire, as well as what might be considered a network access fee, and that fact is borne out that it was not at all uncommon for the extension monthly rental rate to be higher for flat rate service customers than for measured rate service customers on the theory that it would stimulate additional usage, and therefore some of that additional usage would be captured in the extension charge.

Q. Was there ever an element of support for the basic local exchange service in these rental charges?

A. My opinion is yes, but there were also in those days very few actual cost studies that would have permitted that fact to be established. And when one looked at the components of the -- of all of the elements of those charges, it's unclear precisely what that was. Certainly, as you got into premium sets, like trimline phones or, you know, other types of premium equipment, there would have been support from those -- for that type of equipment, more so than from the plain black telephone.

Q. Do you remember buying your first or maybe one of your first phones, roughly what it cost?

A. Yeah, I actually bought a fair amount of equipment shortly after it became available for my firm. And I think a standard 500 type hand set, which would have been a plain black dial telephone, of the type that was similar to Western Electric, was probably about, at retail, maybe 35 bucks or something like that.

Q. Do you know what a trimline style touch tone phone would have been in that time frame?

A. Not precisely, but it would have been somewhat more than that.

Q. Maybe 60 to 80 dollars?

A. I don't think that much, but perhaps something in that range.

Q. And would a comparable phone today, do you agree, we're talking, again, about the trimline touch tone, be available in many stores for around 10 or 12 dollars?

A. Well, I guess I would hesitate to respond to that by your use of the word comparable. I have telephone sets --

Q. Let me withdraw that question. Let me try and clarify it. Would a phone of comparable functionality be available today at many outlets for 10 or 12 dollars?

A. Yeah, same point. I have equipment, phones that I bought 20 years ago that are still working and I have phones that I bought five years ago that don't work. So I think that it's hard to make a direct assessment. They certainly are cheaper, but they're much poorer quality.

CHAIRWOMAN SHOWALTER: Mr. Harlow, are you going to finish with your foundation pretty soon?

MR. HARLOW: Yes.

Q. Would you agree that the price drops that occurred in the equipment market did not happen overnight, but it took place over a number of years?

A. Didn't happen overnight. It actually didn't take very long to occur, however. For example, in 19 --

Q. I think you've answered the question adequately.

MR. TRAUTMAN: Your Honor, I believe the witness is entitled to finish his answer.

JUDGE MOSS: Well, I think he probably did respond adequately to the question that was asked. We'll move on, Mr. Harlow.

MR. HARLOW: And I'm ready to move on.

Q. Dr. Selwyn, do you have some familiarity with the requirements of FAS 141?

A. Yes.

Q. And would you agree that Exhibit 243, which was the attachment to Mr. Kennard's testimony, is an example of a report prepared pursuant to FAS 141?

A. Yes.

Q. To your understanding, would your report in this docket comply with the requirements of FAS 141?

A. No, and it shouldn't.

Q. Do you recall the questions by Ms. Anderl about -- first it was about the expertise of the Dex management, and then it was about the employee relationships in relation to the hypothetical of Qwest reentering the Yellow Pages markets with in-house capability?

A. I recall them generally, yes.

Q. And I'd like to pose a slightly different hypothetical, which I've called the go it alone strategy or option. Assume somehow, hypothetically, that Dex Holdings were to purchase the directory business for 13 out of the 14 Qwest states, excluding

Washington. Do you have that hypothetical in mind?

A. Yes.

Q. Assume that, for whatever reason, regulatory action or some other reason, the Washington business were not sold. Do you have that further supplemental hypothetical in mind?

A. Yes.

Q. If Dex Holdings were to put ads in the newspaper help wanted sections, advertising major directory publisher, 13 of 14 Qwest states seeking employees to enter into the Yellow Pages business in competition with Qwest Corporation of Washington, would there be anything that this Commission could do, to your understanding, to prevent those employees from taking a job with Dex Holdings?

A. There would be nothing that the Commission could do to prevent employees from taking a job with Dex Holdings. Whether or not Dex Holdings, in that scenario, would be able to enter the Washington market using the Dex brand name, for example, or certainly using the Qwest brand name or in any way benefit from the preexisting Dex presence in the Washington market is a totally different question and it would have to be addressed by an examination of the various agreements.

Q. But the Commission couldn't prevent the employees from taking a new job; is that correct?

A. They're at-will employees, best of my knowledge, so no.

Q. And a little different scenario. Supposing, contrary to your suggestion, Verizon decided it had no interest in becoming the official publisher for Qwest Corporation in Washington, and likewise, Verizon were to run an ad indicating that it decided it was going to go into competition with Qwest Corporation for Yellow Pages in Qwest's local service territories in Washington. I assume the same answer would be true, that this Commission couldn't prevent the employees from responding to a Verizon help wanted ad?

A. I suppose not.

Q. If you would please turn to Exhibit 417.

JUDGE MOSS: Who was that identified with, Mr. Harlow?

MR. HARLOW: Dr. Blackmon.

Q. Do you have a copy of that?

A. I don't.

MR. HARLOW: May I approach the witness, Your Honor?

JUDGE MOSS: Yes.

MR. HARLOW: Thank you.

JUDGE MOSS: Give us a minute to find the exhibit.

MR. HARLOW: I could use a minute to get another copy of it.

JUDGE MOSS: Go ahead, Mr. Harlow.

MR. HARLOW: Thank you, Your Honor.

Q. Dr. Selwyn, I see you've had a chance to study this. This was prepared by Mr. Blackmon, Dr. Blackmon, for another purpose, but would you agree that this could well roughly illustrate the performance in the stock market of any number of particular tech stocks over this time period reflected by Exhibit 417?

A. Sadly, yes.

Q. And this relates to your testimony, again, in response to Ms. Anderl, regarding your prefiled Exhibit 311, page 52, and Ms. Anderl asked you if you were saying that Qwest should wait until a better time to sell Dex, and your answer was yes. And I've paraphrased that, but do you recall that testimony?

A. Well, actually, I don't recall that being my answer. I think my answer was that it's my position that Qwest should not be selling Dex.

Q. And is your answer because you believe that

Dex will be worth more in the future if Qwest were to wait?

A. My -- on the basis of the valuation studies that were done by the Qwest and Dex, Dex Holdings' financial advisers, on the basis of growth projections that were provided, it appears that the present value of the Washington share of the revenues that Qwest Dex will generate, if retained by Qwest, exceed the price that Dex Holdings will pay for the company or the Dex -- or that Qwest will be receiving for the company.

Therefore, I've expressed the opinion as a general matter that the company should not be sold. And certainly given the current market condition, the difference between the sale price and that stream of revenues is greater than it might have been had the company been sold let's say three years ago.

MR. HARLOW: Your Honor, I object and move to strike that answer as non-responsive. I asked Dr. Selwyn if his testimony was because he believed that Dex would be worth more in the future.

JUDGE MOSS: Could you try to answer that question, Dr. Selwyn? I don't believe you did quite get there.

THE WITNESS: Well, I don't think that was my -- my point was that it was not specifically my testimony, but that my testimony is this is not the best time to sell. I do believe that if one looks at the long-term trend in the stock market, that the stock market will rebound. We don't know precisely when and we don't know precisely how much, but I think it's fair to say that in the future we can expect to see the stock market to turn around and that the value of equities generally to increase, the availability of equity capital to increase, and that this is just not a good time to sell.

Now, that's not to say that, you know, it could get worse for the next six months. I'm not offering a prediction what's going to happen in the near term, but merely that this -- today is not a good time to sell.

Q. Are you offering a prediction as to what's going to happen in the long-term with regard to the value of the Dex business?

A. I am not offering a specific projection, other than to observe that I believe Mr. Kennard testified that it was his company's expectation that the value would increase over time and that the ability to sell Dex at a profit was certainly a significant consideration in the offer that was extended. Therefore, if the Carlyle Group expects the value of Dex to increase over time, then I certainly would defer to them in terms of that expectation.

Q. I'm not asking you to characterize Mr. Kennard's testimony; I'm asking you if you are offering an opinion as to whether or not the long-term value of Dex will increase?

A. I'm not offering an independent opinion, because I haven't made an assessment, an independent assessment of that, but I am indicating my understanding that the buyer in this case does expect the value to increase and, moreover, that the present value of the revenues that have been projected for Dex is considerably higher than the price that has been negotiated. So those two factors taken together certainly give me a basis to expect that the price will go up over time.

Q. Take a look at Exhibit 417, the time period roughly middle of the year -- well, excuse me. This is a two-year scale. Take a look at 2001, the point halfway between 2000 and 2002. Do you see that point on the curve?

A. Yes.

Q. Do you see that that curve is in a steep

decline with some spikes upward?
A. Yes.
Q. And would you agree that all of those transactions -- this, again, is in the hypothetical, this is a hypothetical stock. Would you agree that the transactions that occurred during that time frame have both buyers and sellers in equal numbers of shares?
A. Market clears, yes.
Q. And would you expect that the buyers and sellers of those stocks at those particular points in time had different views of what the future value of the stock would be?
A. Yes.
Q. And isn't it true that one side of the equation, in hindsight, was wrong, and the other side, in hindsight, was right?
A. One could certainly draw that conclusion.
Q. Isn't it true, Dr. Selwyn, that it's really impossible to predict, with any degree of certainty, what's going to happen to the value of any particular business over the long term?
A. Of course.
Q. Okay. I'd like to go back to your insurance discussion. Do you recall your analogy to

an insurance policy?

A. Yeah. Are we done with this?

Q. Yes, we are. Thank you. Do you recall that discussion with Ms. Anderl?

A. Yes.

Q. When you buy fire insurance for your house, Dr. Selwyn -- well, I assume you do have fire insurance on your house?

A. I do.

Q. And when you buy that insurance policy every year, do you expect that your house is going to burn down in that particular year?

A. No.

Q. Do you expect your house is never going to burn down, Dr. Selwyn?

A. I expect that it might. That's why I buy insurance.

Q. Okay. So in other words, you're managing that risk?

A. Yes.

Q. And you're willing to pay something, if you will, give up a little to avoid a much larger risk; is that correct?

A. Yes.

Q. And you would agree that it would be

imprudent to try to maximize the dollars in your pocket by foregoing the premium based on your expectation that your house is not going to burn down?

A. That's correct.

Q. There's one other thing I just want to clarify and make sure I understand this correctly. This is your testimony, as I understand it, based on the accounting order, about what would happen if the Yellow Pages business became unprofitable with regard to imputation in Washington. Do you recall that line of questioning?

A. Yes.

Q. Just so I understand it, are you saying that you would recommend that the Commission should impute negative excess revenues, if you will, if, hypothetically, the formula developed that Yellow Pages were losing money?

A. Not only would I recommend it, but I think that is the implication of the Commission's determination in that docket.

Q. Would you recommend the Commission do that indefinitely or just for a period of time till it became clear whether or not Yellow Pages were a viable business?

A. Well, the part of the directory publishing operation or activity is to fulfill the regulatory requirement to produce a White Pages directory.

Q. Excuse me. I need to stop you there, because my question was specifically directed to Yellow Pages. Does that change your answer with that understanding?

A. No, because Yellow Pages and White Pages directories are both published by the affiliate and that -- they're part and parcel of the same activity.

Q. Are you --

A. I'm saying -- I'm suggesting here the cost of the White Pages directory is a reduction in the amount of profit that is available to be used for imputation. So therefore, it is effectively being paid for by ratepayers, unlike, for example, other directories that might only publish Yellow Pages.

As long as the Commission maintains a requirement that a White Pages directory be produced, if that activity, when combined with the Yellow Pages, is incapable of generating a profit, then the Commission can continue to evaluate whether or not at that point it wants to continue that requirement. It may conclude at that point that it doesn't and shut it down. But I believe that certainly if the import of the accounting order -- order is to treat the Yellow Page operation as a regulatory asset, then it makes a profit, fine. If it incurs a loss, then the ratepayer has to sustain that loss.

Q. All right. In your answer, Dr. Selwyn, I hear you're still talking about the combined function of Yellow and White Pages and the profitability of that combined function. Am I understanding your answer correctly?

A. Yes.

Q. Okay. Then, again, I want you to separate out Yellow Pages, put aside White Pages for a moment. Assume that Yellow Pages itself hypothetically has become unprofitable. Is it your testimony, then, that the Commission should impute negative excess revenues to local exchange rates?

A. Yes, under -- under the present condition where it has accepted the notion that the -- that that activity is a regulatory activity and subject to contribution toward revenue requirement, then as long as that activity continues to exist, then both the risks of loss and the gains are -- go to ratepayers.

Q. And by that activity, you're strictly speaking now about Yellow Pages?

A. Yes. Well, I think you're asking me to assume -- to strip off something that at the moment is entirely integrated and, you know, I'm not sure exactly how one does that. Since I certainly have read both the Qwest and Dex Holdings' position in this case that, among other things, one of the benefits that would continue to accrue to QC is that the White Pages obligation would be fulfilled by the non-affiliated Dex Holdings entities, so I don't know how one separates those out, but if you insist that they be separated out, I would still answer the same way.

Q. Well, and your testimony that they're tied together, that would be -- that would have to assume that the current transaction were approved by this Commission; isn't that correct?

A. No, they're tied together because they're tied together. I mean --

Q. Are you aware of any legal obligation that currently -- I'll withdraw that. Are you aware of what the current term of the existing publishing agreement between Qwest Dex and QC is? When is that agreement up?

A. I don't recall.

MR. HARLOW: Thank you, Dr. Selwyn. That's all I have.

CHAIRWOMAN SHOWALTER: Let's have a break.

JUDGE MOSS: Okay. We'll have our afternoon recess before we turn to questions from the Bench. So let's return at 3:15.

(Recess taken.)

JUDGE MOSS: Let's come back to order and be on the record. Before we go to the Bench questions, why don't we have the cross exhibits moved. And we'll go first to Qwest, and then we'll get Dex Holdings.

MS. ANDERL: Thank you, Your Honor. We would move the following exhibits: 335, 336, 338, 339, 340, 343, 344, 345, 349, 350, and 352.

JUDGE MOSS: Okay. Any objection on any of those?

MR. TRAUTMAN: No, Your Honor.

JUDGE MOSS: All right. Then those exhibits will be entered as previously marked. Now, Dex Holdings.

MR. HARLOW: Thank you, Your Honor. We move for admission of Exhibits 354 and 356 through 362, inclusive.

JUDGE MOSS: Okay. Any objections to any of those?

MR. TRAUTMAN: No, Your Honor.

JUDGE MOSS: All right. Then those will be admitted as marked. Let's see. I believe, then, we are ready for our questions from the Bench.

E X A M I N A T I O N

BY CHAIRWOMAN SHOWALTER:

Q. Good afternoon, Dr. Selwyn, and thank you for returning.

A. Good afternoon.

Q. The line of questions I'm interested in has to do with the multi-state aspect of this proposed sale, and Mr. Harlow started down this line, but it strikes me that much of your testimony is about the wisdom of selling or not selling Dex as a whole business, and I'm not certain that's going to be our choice.

So for this line of questioning, assume that the Dex sale is approved or not needed in every state but ours, all 13 states, and that now this Commission, as you recommend, disapproves the sale. I want to play out that sequence and then compare it to our alternatives of approving the sale.

A. Okay.

Q. In the first instance, do you assume that if all other states approve the sale or it's not acquired and we disapprove, that we can hold up the entire sale, or do you -- would you expect there'd be some kind of renegotiations or end state wherein Dex, in general, was sold, but just not -- the agreements in Washington would be maintained?

A. Well, I think there are several possible scenarios. I seriously doubt that Dex Holdings would walk away from its proposed purchase of the -- or completion of the rest of the Rodney transaction merely because Washington was not included, and I say that simply because it's already completed the purchase of Dexter, so it's already in that business, and the remaining Rodney states, other than Washington, would certainly be assets that the purchasers would want to have.

So I think that the more realistic issue is not that they would walk from the transaction, but what sort of issues would be raised and would have to be renegotiated between QCII and the buyers for a Rodney transaction that did not include Washington. And there are several possibilities. For example, one thing the Commission could do is --

Q. I want you to assume that we disapprove the sale entirely.

A. Okay.

Q. That's your first recommendation.

A. First -- well, my first recommendation is that the sale, as proposed, makes ratepayers worse off than a -- than the status quo. Now --

Q. How are you defining status quo? That's the very word that is getting at me, because there's a status quo of today, but there's what you might call the status quo of all other 13 states going one way and us being the other. And as compared to that status quo, that's actually what I'm interested in figuring out.

A. I've suggested, both in my direct testimony and in my supplemental testimony, that I believe that it will be possible for Qwest in Washington to effectively transfer the official Yellow Pages function to another publisher that already has the expertise and the scale at a level that would be comparable to Dex and, therefore, that the result would be a continuation of a Washington -- a viable Washington Yellow Pages business.

Whether that arrangement would produce quite as much revenue to QC Washington as has been -- as the status quo, assuming the status quo were to simply persist, is obviously something that one can only speculate about. But on the other hand, whatever revenue it produces would be real cash, and not some vague and I believe unenforceable promise of a revenue credit.

Q. All right. Well, let's take up that scenario, then. Assume that Dex, in general, is sold and -- but that in Washington, there are no agreements with Dex to publish the official White Pages book?

A. Right.

Q. First, are you assuming that there would be a number of employees still associated with Washington who would still be employed somewhere in the Qwest family or not?

A. Yes, I'm making that assumption, and the basis for it is that I think anything other than that would, you know, represent a cannibalization of the company, and the Commission would be in a position to address that in its order.

Q. Well, if we simply disapprove the sale, if we say this entire transaction does not have our approval, what is our leverage over the employees currently associated with Dex, currently associated with Washington? How do we insist that they be maintained in the Qwest auspices?

A. Well, I mean, that is a good question, and you know, I'm not sure that there's necessarily a good answer, because none of the -- none of the scenarios before you is really good. You know, a company that has gotten itself into a financial condition and is looking for ways to sell off assets in order to remedy the problem, and I'm not sure if there's a way to avoid inflicting some pain on the state.

But at the same time, I think that the Commission ought to be in a position to establish requirements on the company with respect to what it is expected to continue to do as a -- as part of its regulatory obligations, and the Commission, having already made the determination that the Washington portion of the Qwest Dex business is to be treated as if it were part of QC, then actions by the affiliate to cannibalize the QC Washington asset, it seems to me, fall within the Commission's jurisdiction.

Q. Beginning with something that seems much more squarely within QC's and our purview are the publishing agreements. Do you agree with that?

A. Yes.

Q. And --

A. And a noncompete agreement.

Q. Right. So let's assume, for purposes of this question, that we disapprove any assignment or sale or extension of those publishing agreements with any new sold Dex operation, but that we have -- but that we don't have ability to control the employees or the aspect of the business that is -- that they work for.

And that may be a debatable legal question, but supposing all that is left is QC's ability to assign or contract the publishing rights for the White Pages. Is that a reasonable assumption, first of all, a plausible assumption, I guess? I'm not asking for ultimate legal judgments, but is that one of the possible outcomes here?

A. Well, I think -- I think it's actually more than that, that it will be left. I mean, there is the established base of customers that would be part -- for example, if you were to direct QC in Washington to, in effect, put on the market and go out for bid for the right to be official publisher, which would include, among other things, the transfer of the entire existing customer base and all of the other benefits of the affiliation, including a publishing agreement and, in effect, the noncompete agreement, the same sorts of things that are being proposed to be given by QC in this transaction, I believe that there is every reason to expect that there will be bidders who will bid prices that will be comparable to the kind of numbers that we're seeing from the buyer for the purchase of those rights under this transaction.

Q. All right. Let's suppose that we don't have the ability to keep our regulatory hands on the customer base and employees, et cetera. Supposing we're limited to keeping our regulatory hands on the publishing agreement and the ability of the regulated company to give its literal seal of approval, this is the official publication of the White Pages. If that is all -- I'm not saying it is all; I'm just saying if it's all -- what kind of value is there in that without those other things?

Maybe this is a good way to ask that question. If there were two books and they -- and one has on its cover Qwest, the Official Publication of the White Pages, and maybe there are ten pages of Yellow Pages also in it, and the other book says Dex, the Book You've -- the Businesses and Information You've Always Used, and it's a really big, fat set of Yellow Pages that looks a whole lot like the Yellow Pages that always used to exist, and in fact, has the same customers and ads and it also has some White

Pages there. So one is the official version, but one's the big, fat version. Which would be the one that people would likely pick up, do you think? You could ask just as a lay person.
A. In that scenario, I think clearly that the Dex book, as you've described it, would be the preferred book and the Qwest book wouldn't get very far, but I'm not sure that that scenario, it's not clear to me that that scenario could exist. I don't know that Dex could use -- if QC does not -- if the Dex Washington operation is not sold, it's not clear to me that the Dex trademark could be used in Washington State.
Q. Well, let's take that element out of it, then. There is no Dex on the front cover; it's just big and fat and these are the businesses and information and ads that you've always used, something a little more elegant than that.
A. I understand that, but it's also not clear they could then inherit the customer base in the same way, either, that they would have -- in other words, I think in the -- you know, in the scenario you describe, where they get everything except the right to call themselves the official directory, I suppose that that obviously would give that book a very

considerable advantage and could maintain the network externality advantage that I've discussed earlier.

I think, however, that that would constitute a cannibalization of the assets. In effect, what would be happening here is that Qwest would be -- sorry, Dex would be getting the Washington operations for free. That's certainly not what is intended. Now, if the effect here is that the buyers are effectively, you know, holding a gun to the Commission's head to the effect to either approve the sale or we're going to come in and steal it, you know, I don't know how to respond to that, but that's the scenario I think you're painting.

Q. But steal -- but then, from your answer, do you agree that one of the critical questions here is what legal reach does the Commission in fact have? You don't need to know the legal answer, unless you care to venture one as a regulatory expert, but one of the critical questions is what legal reach do we, in fact, have over the customer base, ad employees, aspects of the business other than the -- I've forgotten the term, the agreement, the publishing agreement?

A. The publishing agreement.

Q. Right. I mean, that is, if we don't have legal reach, then it's not stealing, and if we don't have legal reach, then the new Dex or somebody else, for that matter, a Verizon or anyone else, could come in and try to set up a business, but a business that already had had that business would be likely to do a very good job.

A. Well, I mean, obviously Verizon could, at any time, start publishing directories throughout the state, and there's certainly name recognition. Verizon, they advertise Verizon Wireless all over the state. People have heard of it, even if they're in Qwest territory. That always remains a possibility, yet it isn't happening because -- and simply because the value of the incumbency and the relationship with the local -- with the current incumbent local phone company is extremely important, and the -- you know, the scenario that you are describing basically suggests that even in the absence of a noncompete agreement, in the absence of a publishing agreement, or even with a publishing agreement that could be withheld, that a strong Dex, with operations in 13 states, could come in and sort of just slide along with what it already has.

You know, if that were really the case, then it's unclear to me why the buyer in this situation would be placing such enormous importance upon all of these QC-related aspects of the deal, the official status, the noncompete agreement, the publishing agreement.

Q. Well, might the answer be that at the outset of this whole proposal, there were 13 states, and if all 13 states had said no, this deal isn't good enough, and actually, Mr. Kennard, you can't do this unless we all -- or at least almost all of us agree to not just approve the sale, but enable you to use the White Pages and be called the official listing. But doesn't it change if almost all or all but one of the states has made that decision? I think it does.

A. I mean, sure --

Q. Unless we have the ability, legally, which we will look at, to hold kind of a pro rata share of the business for ourselves, which, even then, is only, you know, not 1/14th, it's probably bigger than 1/14th, but it's a piece of this bigger whole. It's an issue of the whole being worth more than the sum of the parts, I think.

A. Well, there's no question, Chairwoman Showalter, that you are not in as good a position as you would have been if all the 14 states had decided to deal with this on a -- with a single voice, as it were. You know, but -- you know, there are various alternate scenarios. You know, there's the widow who lives in a house that -- where the land is attempting to be taken by somebody who wants to put in a shopping center, and she holds off on the sale and, you know, either ultimately the price of her house is going to be bid up just to get rid of her or, alternatively, they're going to build a shopping center and she's going to be right smack in the middle of it.

And you know, clearly you can envision various outcomes where you in some cases win, in some cases lose, and I'm not in any sense proposing that the Commission engage in a game of chicken with Qwest or with Dex Holdings in this case, but, I mean, there's no question that the story is different given the fact that the other 13 states are going to happen.

That said, it still seems to me that Washington is a very major portion of the total sale, and it is an even larger portion of the Rodney transaction, and that the Commission has traditionally viewed this as a regulatory asset. It has treated it as a regulatory asset for purposes of rate of return regulation, and if the effect of the company's action is to undermine the value of that asset in some manner, such as by engaging in a transaction that undermines its value, then it seems to me the Commission still has the authority to impute that value back into the company's operations as sort of the ultimate club.

I'm not saying that's necessarily the scenario that you need to pursue, and the Staff has recommended and has proposed various alternative ways in which this transaction could be accomplished that might not be -- produce, you know, that sort of draconian result. For example, you could approve the --

Q. Well, I haven't gotten into the alternatives yet. And I'll tell you why -- one reason I haven't, is it seems to me that the alternative recommendations, your backup recommendations, need to be compared to us doing nothing. In other words, it's either we say no or we say yes totally or yes with conditions, but that the -- the status quo of today, and how the Yellow Pages is actually being produced today I don't think is the apt comparison, because we know that the other states have either approved or approval is not required with

-- I think maybe Arizona is not done yet. So that may be, you know, a variation, but don't we need to bear in mind what the -- don't we have to compare that status quo, not the status quo ante, if you want to call it that, even though it's in place today?

A. I think you have to be informed by that status quo. I'm not sure that the status quo ante should be entirely dismissed. It would be unrealistic to ignore the fact that the world has changed by virtue of the fact that this transaction is partially completed and it is heading toward completion or near completion in some form. I don't suggest -- I mean, it would make no sense to ignore that, but I'm not sure that's necessarily the only controlling factor here.

The point is that, you know, we are here because an affiliate of the regulated company has created a financial condition that was not the doing of the regulated company, and to the extent that the regulated entity is being made to bail out the affiliate, in this case the parent, that constitutes a requirement that ratepayers subsidize the competitive activities of the parent. And I mean, that fact is also inescapable and should not be ignored, even if the outcome is less than ideal.

Q. Well, you talk about the game of chicken, and that's a pejorative way to put it, but it is the case, isn't it, that if the demands that this Commission makes are deemed to be too demanding, doesn't the company and the other states and Dex Holdings, et cetera, don't they have the option to sort of leave us on the table and walk away and reconfigure their deal and -- in some manner. I don't know what it would be. But in other words, this isn't all up to us, I think is what --

A. I can't disagree. I mean, they can build that shopping center right around the house.

Q. Right.

A. Absolutely. You know, to suggest otherwise would be foolish, and I'm not ever suggesting otherwise. But, you know, I think you need to -- I guess what I'm saying and trying to say is you need to temper reality with, you know, sort of what it ought to be and come up with some solution that balances what you should be doing, you know, in an ideal situation, versus what a pragmatic result would require.

Q. Right. Now, it seems absolutely clear we're not in the ideal situation. The merger didn't work out the way that it had been promised. There are these economic constraints that are simply present, and aren't we really just dealing with various alternatives, none of which is very encouraging financially?

A. Yes, but I think what I'm saying here is that when we heard the testimony of Qwest witnesses in this case suggesting that they had explored all of the alternatives and this is the one they decided to pursue, that decision was made in the best interests of QCII and its shareholders, and not necessarily in the best interests of Washington ratepayers.

For example, a spinoff of the Washington operation altogether into a stand-alone LEC might be a very viable choice for the Commission to pursue, even though it might not necessarily be good for QCII shareholders. And it may not have been addressed by QCII simply for that reason. I think, for example, that would be a much better result than the outcome that pushes -- if one is to believe the admonitions of Mr. Mabey and other Qwest witnesses that bankruptcy is -- would be detrimental to the operation of the Washington company, then another approach that would be available to the Commission is to pursue a spinoff of the Washington company to sort of separate it from the rest of QCII.

And that's something that, short of simply allowing this asset to -- which, by the way, right now produces literally half the earnings, half the intrastate earnings of this company, as the imputation amount is roughly comparable to the earnings other than imputation. Rather than let that happen, there may be other alternatives.

Q. I'm not sure. Did you say a spinoff of QC or QC Washington?

A. QC Washington.

Q. Now, are you assuming in that spinoff that it has its Yellow Pages revenues and employees?

A. Yes.

CHAIRWOMAN SHOWALTER: Thank you.

E X A M I N A T I O N

BY COMMISSIONER HEMSTAD:

Q. Well, pursuing part of that line of questioning, do you have an opinion of if the sale is not approved and assuming, you know, the best kind of scenario that you would describe, with the Yellow Pages Washington staying with the company, the QC Washington, either published there or, on a contract basis, with some other publisher. Do you have an opinion as to what would be the likelihood that Dex would actually, in fact, mount a competitive assault in Washington?

A. That's difficult to say. And certainly, we have seen Dex go into non-Qwest territory in a limited -- at least in a limited way in this state. I don't know what their relative degree of success of that product is financially, but I suppose they might give it a try, but I don't think they would be permitted to -- as I would understand it, if the Washington operation is not sold, then they would not inherit customers or brand names or any of the things associated with the Washington Yellow Pages operation, and -- at least they shouldn't.

And I think, you know, that is obviously an issue here. But if they don't, just coming into the market in the same way as a Verizon might or a BellSouth or TransWestern might come into the market as a new entrant, then I think that their potential for achieving a substantial share would be very limited.

Q. Assuming, again, that we would not approve the sale and Yellow Pages Washington would stay with QC Washington in some form, do you have an opinion as to how such assets, as you were asked about on cross-examination, such as trademarks, domain names, and patents, would be allocated?

A. Well, I think they would basically have to be licensed back to the Washington operations and that -- some manner in which their use in Washington would be permitted. I think certainly, in the case of printed directories, this really is probably not a particularly big issue. The brand names can continue to stay on the printed directories.

It gets a little more complicated in the case of domain names, because, you know, if you access Qwestdex.com and then ask for a Washington phone number, it's really still somewhat unclear as to how that would necessarily get back to the Washington operation, but that actually is a problem that has been addressed by other companies that have split up and yet, with the sharing of brand name, for example, AT&T and AT&T Wireless can both be accessed by using the ATT.com domain, and under their separation agreement, both are available on the home page of ATT.com.

I can envision a situation in which, for example, Qwestdex.com, if whatever advertising is being -- and advertising revenue is being purchased for customers in Washington, with businesses in Washington, that revenue would go to the Washington company, even though they are accessed in common. So I don't think that's an insurmountable problem.

Q. And you believe that this Commission would have the authority, assuming, you know, a quote, fair, end quote, solution, would have the authority to require it?

A. Well, I'm not an attorney and I'm not offering a legal opinion. And with that caveat, you know, my sense is this. That the Commission has determined that Qwest needs the approval for this sale, which is why we're all here. And you know, if the Commission disapproves the sale and, you know, Qwest sort of proceeds to -- with a de facto transfer of the business anyway, then certainly that raises some serious issues.

I am operating on the assumption, and perhaps an incorrect assumption that if the Commission disapproves the sale, that Qwest will not engage in a de facto transfer of the business to the buyer, to Dex Holdings in this case. I don't see why they would want to if they're not being paid for it, and it seems to me that it would be in QCI's interest, as well as in QC's interest, to take whatever measures are necessary to maintain that equity value, which is certainly an amount that is well in excess of a billion dollars by -- even by their own -- by Qwest's own calculations.

Q. In your discussion about the upfront payment, you responded -- and it may have been in your testimony, also, that an alternative would be to reduce rate base. In some ways, isn't that a more attractive solution than just a one-time, one shot payout?

A. I think it is, actually, because that's not clear to me that a one-shot payout is all that fair, because it rewards present customers while not necessarily providing the support going forward that continued imputation would provide.

It also actually closely simulates, from a financial perspective, the effect of the revenue credit that the company is proposing in the sense that if one accepts the representations of Qwest that the revenue credit is real and enforceable and will, you know, continue for the stated period of time, then the effect of the revenue credit, on an ongoing basis, is to diminish the value of QC Washington as -- that is, the business enterprise value of QC Washington by the present value of the revenue credit.

In other words, if we take, sort of as a default condition, that QC Washington is earning precisely the authorized rate of return, and that the authorized rate of return is properly set to reflect market conditions, then the value or the business enterprise value of QC Washington ought to be equal to its book value.

If you force those revenues to be cut by roughly 50 percent, by virtue of the revenue credit, which is, again, approximately what would happen, then, all else being equal and adjusting for the fact that it's not going to continue in perpetuity, but only for 15 years under the settlement proposal, then the market value of QC Washington, if sold, would only be a little more than 50 percent of its book value, and that would correspond roughly to what would happen if you took a rate base adjustment.

Q. I wanted to pursue with you -- you made the comment you're not at all sure where the $67 million money amount to be paid up front in the proposed settlement, where that's coming from. Will you elaborate on that?

A. Well, I don't have the stipulation in front of me, but my recollection is that the stipulation, in its first reference to the various Qwest entities, collectively refers to them as Qwest, and then, in discussing the 67 million, says Qwest will pay -- will make -- pay the 67 million as a one-time bill credit.

So essentially, the stipulation is not specific as to exactly which of the various Qwest entities that are collectively being referred to as Qwest will be actually paying the 67 million. Now, if the 67 million is coming from QCII, that's one thing. That means it is a simply a portion of the proceeds of the sale. If, on the other hand, it is coming from QC, well, we already have QC intrastate revenues in the neighborhood of $100 million, representing something south of a five percent return on investment. And if you now take two-thirds of that away in the form of a bill credit, then their intrastate return drops down to something in the less than two percent range. That obviously creates a potential problem, and I don't see that as so much sharing the gain as simply creating the prospect of a rate case occurring that much sooner.

Now, perhaps Mr. Reynolds, in his testimony, will clarify exactly who's paying the 67 million.

Q. A couple of other questions here. You were asked by Mr. Harlow about the issue of whether the

Yellow Page market is effectively competitive and that you hadn't done a study on it. Do you have an opinion as to whether you believe the Yellow Page market in the QC Washington territory is effectively competitive?

A. Yes, I do.

Q. And what is it?

A. I think that by any reasonable standard, the market is not competitive, and there's several tests that can be applied in order to establish that fact. First off, despite the nominal presence of some competitors in the market, and in fact, despite a slowing economy over the last several years, which would, if anything, suggest that the demand for advertising might be somewhat reduced, we actually see the Yellow Page revenues increasing.

When a new directory enters the market, it would be very unusual for a business to substitute that directory for the incumbent directory. If anything, they would simply place an additional ad in the new directory.

So that the entry of a competitor in the market doesn't so much take business away from the incumbent, but rather increases the total revenues of the market to the extent that the new entrant is able to capture and attract customers willing to pay for advertising.

If we look at the overall profitability of the Dex Yellow Page operation, it's clear that this is -- Dex is able to sustain rate levels for advertising that are capable of producing enormous profits and enormous value -- enterprise value well in excess of the actual asset -- value of the tangible assets, which would imply a very significant entry barrier, that is, a buyer is willing to pay a huge premium over the costs of simply replicating the physical assets of the business in order to enter the market, which implies that the incumbent has achieved a very significant market presence that cannot simply be duplicated by mere entry.

All of these factors taken together would lead, I think, to a compelling -- would compel a conclusion that this is in no remote sense a competitive market.

Q. You were asked by Mr. Harlow about the circumstance where Yellow Pages would lose money, if I recall correctly, those questions and answers?

A. Yes.

Q. I think we'd all agree that White Pages and Yellow Pages are joined at the hip, they have been

seen as an integral publication. But if, in the unlikely scenario that Yellow Pages were, because of now unforeseen circumstances, were to start losing money, a relatively quick result would be to exit that market, wouldn't it? Wouldn't that be the result?
A. That would certainly be a choice, yes.
Q. Rather than continuing to lose money on advertising, the rational choice would be simply to stop advertising, to stop selling --
A. To shut down that operation.
Q. Yeah.
A. Yeah, I would agree with that, but that's true of a lot of things. I mean, the same could be said with respect to caller ID or --
Q. Sure.
A. -- you know, or centrex or, you know, other services that are currently being priced in excess of cost to produce a profit. If that market suddenly goes away and they're not essential services, then they could be exited.
Q. And if the company were to, for any period of time, persistently continue to lose money, at some point it would become an imprudent choice on its part?

A. Yes, I'd agree with that.

COMMISSIONER HEMSTAD: That's all I have. Thank you.

COMMISSIONER OSHIE: I don't have any questions.

JUDGE MOSS: Okay. Well, let's turn back and see if we have any follow up before we get to the redirect, and that way we can perhaps economize on our time.

MS. ANDERL: Thank you, Your Honor. Just a couple of questions.

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

BY MS. ANDERL:

Q. You were asked by the Chairwoman about a hypothetical -- well, I'm sorry, not a hypothetical, different scenarios where you were asked to assume that either the employee and customer base were to transfer to Dex Holdings, even if Washington weren't sold, and other scenarios where perhaps the employees and customer base were not to transfer to Dex Holdings if the other 13 states were sold and Washington weren't. Do you have that in mind?

A. Yes.

Q. In your review of the sale transaction documents in this case, have you found anything that would indicate that the advertising customer base is required in this transaction to continue to advertise with Dex Holdings once the sale transaction is consummated?

A. Is required to?

Q. Yes.

A. You mean -- well, in the sense that there is a noncompete agreement that would prevent QC, for example, from going -- from attempting to capture those customers, then in that sense there is a requirement in that an alternative that might be offered by QC would not be available.

Q. Those customers are free to advertise with Dex Holdings or not as they choose; isn't that right?

A. Well, obviously they can shoot themselves in the foot and decide not to place an ad in the Yellow Pages, but given that that is their preference as a business decision for their respective business, I think that, for all practical purposes, they don't have a choice.

Q. But they aren't required to advertise in the new book, are they?

A. There's no legal requirement that they have to advertise in the book, but as a business matter, they are required to advertise in the book.

Q. Essentially, what Dex Holdings gets with regard to the embedded customer base is the opportunity to retain those customers; isn't that right?

A. Well, it gets more than the opportunity to retain those customers. It gets the likelihood that those customers will renew their contract, which is something that is, in fact, specifically recognized in the FAS 141 study that was admitted as Exhibit 243.

Q. Legally, does Dex Holdings get anything more than the opportunity to retain those customers?

A. I said legally, no.

Q. Okay. Thank you.

A. But that's not what's relevant.

Q. Now, you were asked by Commissioner Hemstad to assume that the sale was not approved and that the publishing operation stays with Washington. Do you recall that?

A. Yes.

Q. Is it your understanding that there is a stand-alone publishing operation currently existent in Washington?

A. It's my understanding that there is not a stand-alone publishing operation per se that serves Washington. And that it would be necessary to, under those circumstances, for Qwest and QC to assure themselves that, in renegotiating the transaction, that they retain the value that they were not being compensated for.

Q. Now, Dr. Selwyn, you've never operated a publishing business, have you?

A. Actually, I have.

Q. How large of an operation?

A. Very small.

Q. Was it a Yellow Pages publishing operation?

A. No, it wasn't.

Q. Did you hear Mr. Burnett's testimony in this case?

A. Yes.

Q. And did you hear him testify that there are a number of currently common functions that are being provided by Dex/Dex Holdings employees, such as HR, legal, finance and marketing?

A. Well, actually, I heard him say that some of those were actually being provided by a Qwest entity other than Dex, and that they were being transferred from the Qwest entity to Dex.

Q. Did you hear him testify that a number of those common functions were not scalable to any significant degree?

A. I heard him say that.

Q. Do you know --

A. He didn't quantify precisely what he was referring to. I mean, clearly, there are economies of scale that would suggest that in many common functions, but that would suggest -- if he meant by scalability a precise, proportionate change, then that's one thing. If you mean by not scalable that the function is absolutely fixed for all sizes, I didn't hear him say that, and I don't think he said that.

Q. Now, you responded to a question about whether Yellow Pages is a competitive business, and you indicated that you did not think that it was. In that response, you also stated that one of the reasons you held that belief was because, even in a slowing economy, where you would expect demand for advertising to be reduced, we saw Dex's revenues increasing. Is that a fair summary of your testimony?

A. It's a fair summary of one aspect of my testimony. It certainly was not the only thing that I mentioned as a basis for my conclusion.

Q. In a generally slowing economy, would you agree, as a general principle, that businesses might be willing to exert more effort and expend more money than under other economic conditions to try to gain new business?

A. Yes, but businesses also go out of business in a slowing economy, and that would be a suggestion that we would expect to see less advertising.

Q. In a situation where businesses were attempting to attract new customers or retain existing customers, do you think it would be reasonable for them to either spend more on advertising or at least not decrease their advertising expenses under those circumstances?

A. Well, they're going to be looking at various advertising scenarios, but I was -- in making my assessment, I was also considering other advertising media in which competition has arrived. For example, we know that network television has been -- network television advertising revenues have been impacted by competition from other cable channels, whereas there's no evidence that Yellow Pages revenues, advertising revenues, have been materially impacted. That is, the dominant incumbent telephone company Yellow Page revenues have been impacted by fringe competitor Yellow Page directories.

MS. ANDERL: That's all. Thank you.

JUDGE MOSS: Mr. Harlow, anything at all?

MR. HARLOW: Briefly, Your Honor. Just give me a moment.

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

BY MR. HARLOW:

Q. There was a line of questioning that I started, which arose out of a hypothetical that I called the go it alone scenario, which turned into the would Dex Holdings steal the business scenario. Do you recall that?

A. Yes, generally.

Q. And I do want to clarify. I assume, when you say steal, you don't mean in the sense of violating any criminal laws; is that correct?

A. I don't have an opinion on whether they'd be violating any criminal laws. Apparently, some other aspects of Qwest management recently may have violated some criminal laws, so I'm not going to suggest that that can't be a possibility here.

Q. Well, okay. Commissioner Hemstad followed up and asked you what the likelihood that Dex would mount a competitive assault in Washington. That was how he phrased it.  Is that kind of what you had in mind?

CHAIRWOMAN SHOWALTER:  He didn't mean that criminally.

THE WITNESS:  I'm assuming he did not mean assault in the criminal sense.

Q.   Yes.  And you said, I believe it's difficult to say whether or not that would happen?

A.   That's what I said.

Q.   Would you agree that the hypothetical I proposed, which then two commissioners followed up on, is but one of many potential scenarios that could fall out of the Commission -- hypothetical Commission denial of this transaction?

A.   Look, anything is possible, but the fact is that if --

MR. HARLOW:  That answers the question, Your Honor.

JUDGE MOSS:  Mr. Harlow, I'm going to ask you not to interrupt the witness when he's trying to answer your question, and he's doing his best to do that.

MR. HARLOW:  Okay, Your Honor.

JUDGE MOSS:  Please let him finish.

THE WITNESS:  In a situation in which -- a scenario in which a significant portion of the transaction, and I'm trying to remember the precise number and I'm trying to remember whether it's proprietary, but my recollection is it would be well in excess of 30 percent of the Rodney transaction, would constitute -- would be represented by the Washington portion.

If the Commission did not approve that transaction and the deal had to be renegotiated to exclude Washington, I am assuming that QC and QCII, represented by competent counsel and competent management, would, in the course of the renegotiation, assure themselves that the value of the Washington Yellow Page operation was simply not handed over to Dex, but was retained, and that they would -- and that they have, in contemplation of that possibility, recognized the steps that would be necessary to protect the Washington Yellow Pages operation from encroachment by Dex.

And I'm assuming that they would not be throwing away a billion and a half dollars of value and handing it to the buyer in this case without compensation, and I think that's a reasonable assumption. That's the basis upon which my recommendation is framed.

Q. Is another possible scenario that Qwest would file bankruptcy and the bankruptcy court would be in control of the new sale, rather than Qwest?

A. Well, certainly that scenario has been posited.

Q. Is another possible scenario that maybe TransWestern or some other competitive directory publisher with a strong foothold in the Rodney region might attempt to do a six-state deal with Qwest International?

A. Certainly that's a possibility, although apparently there wasn't that much interest in that before, but conditions have changed.

Q. So doesn't this all suggest that there are a lot of uncertainties? In fact, I think on cross by Commissioner Showalter, you mentioned it was not clear that, in the Dex Holdings scenario, they could inherit the customer base. Do you recall that?

A. I'm sorry. I'm not sure that's --

Q. Let me rephrase it. Because there's so many scenarios of how this could play out if the Commission were to deny the approval of the sale, doesn't that create a lot of uncertainty for all parties concerned as to exactly what the competitive situation will be with regard to Yellow Pages books in Washington?

A. Well, I mean, nothing is certain, but as I said, I have sufficient confidence and expectation that QC would not hand off a billion and a half dollar business to Dex Holdings without compensation, and would take the steps necessary to protect that business in a renegotiation of the Rodney transaction to the extent that that would be required in the event that the Commission did not approve the sale.

And if the buyers in this case decided to walk away from the transaction because Washington wasn't included, then I think there's still the same expectation that the value of that -- of the Washington Yellow Page business would be preserved and protected.

Q. Okay. And indeed, in Exhibit 311, you posit the scenario that the way Qwest Corporation would protect its Washington portion of the Dex asset would be to enter into an agreement with some other publisher?

A. And I posit that in Exhibit 363, as well, as certainly one possible outcome.

Q. And wouldn't this other hypothetical publisher be aware of the scenarios and potentials for competitors to come in and either, to use your term, steal or perhaps do another deal and come in with a competitive book that has strong assets, be something that your hypothetical publisher would take into account in deciding how much to agree to pay Qwest Corporation for the right to be the official publisher for Washington?

A. Well, that would be no different than the considerations that the Dex Holdings buyers, in this case, would have had to consider.

MR. HARLOW: Your Honor, I think I'm entitled to a yes or no answer to that to accompany that explanation.

JUDGE MOSS: Can you answer his question yes or no, Dr. Selwyn?

THE WITNESS: Yes, but that would be no different than the considerations that the buyer in this case would have had to have considered.

MR. HARLOW: Thank you, Your Honor. No further questions.

JUDGE MOSS: Redirect.

MR. TRAUTMAN: I'll be very brief, Your Honor.

JUDGE MOSS: Thank you, Mr. Trautman.

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

BY MR. TRAUTMAN:

Q. Dr. Selwyn, do you recall a question earlier from Mr. Harlow, and he asked whether your report complied with FAS 141, and I believe your answer was no, but it doesn't have to. Do you recall that?

A. Yes, I do.

Q. And why doesn't your report have to comply with FAS 141?

A. Well, the purpose of FAS 141 is to comply with certain financial reporting and potentially taxation requirements that, while they might, to a limited extent, be informative, certainly do not address the matter of the value that is being contributed by QC to the transaction.

And I can give you a very good example of why this is the case. Specifically in valuing the noncompete agreement, which has the 30 percent liquidated damages provision, what the FAS 141 report does is it takes the 30 percent of the Dexter transaction and then multiplies that by the probability that Qwest would be in default. That is, it would violate the noncompete agreement in an attempt to reenter the market.

So it then comes up with a value of -- in other words, we start with a value of 275 -- 2.75 billion for the Dexter transaction, 30 percent of that -- which is the liquidated damages provision, is 825 million, and then, based on the probabilities that are assigned by the Murray Devine firm, that is then reduced to 200 some odd million dollars.

Well, supposing, just as a hypothetical, that Rodney -- I'm sorry, Murray Devine were to have concluded that there is no chance that Qwest would violate the noncompete agreement because the terms were so onerous.  In that situation, they would have assigned the probability of zero, and under this methodology, they would have assigned a zero value to the noncompete agreement.

That clearly doesn't make any sense, because, in fact, if the noncompete agreement were so onerous as to almost absolutely assure that it would not be violated, it would have a fairly substantial value.  So by contrast, if there was a hundred percent chance that Qwest would violate the agreement, well, this methodology would have assigned even more value to the noncompete agreement than it actually has.

So clearly, for whatever -- and I'm not questioning here whether or not this report, as it was prepared, does or does not comply with FAS 141. I will accept, for purposes of this discussion, that it does comply with the requirements of FAS 141, but clearly it produces results that would be anomalous in terms of the purpose for which I attempted to -- and have suggested that there is a value that QC brings to the table. That is, that this report simply is incapable of capturing. Therefore, there is simply -- there's no reason why my analysis should attempt to comply with this report or whether this report, for that purpose, would be dispositive of the Commission's determination that QC is contributing value and how much value that might be.

Q. You also were given a line of questions regarding the condition and the direction of the market and how they affect the price of Dex. Do you recall that line of questioning?

A. Yes.

Q. Are the market conditions and direction the only factors affecting the price of Dex?

A. No, there are obviously other things, including, in this particular instance, the distress nature of the sale. The fact that the sale is taking place at all is solely, if not certainly primarily, due to the financial distress of QCII. And Mr.

Kennard, as I've mentioned in my supplemental testimony, testified that if he were the CEO of an RBOC, he wouldn't be selling its Yellow Page business, because he considered it to be a high-quality asset.

The fact that Qwest is selling it is itself an indication of the distress nature of the transaction. And the timing of the transaction in terms of the market condition only further contributes to the loss of value that is being realized.

MR. TRAUTMAN: Thank you. I have no further redirect.

JUDGE MOSS: Okay. Assuming there's nothing further from the Bench -- all right. Dr. Selwyn, we appreciate it and we appreciate you coming back and rejoining us today, and I'm happy we were able to fulfill our commitment to get you off the stand today, so thank you for testifying in our proceeding.

THE WITNESS: Thank you, Your Honor.

JUDGE MOSS: We had previously the suggestion that we would go to Mr. Reynolds. I'm just raising the question whether we would get Dr. Taylor up and off before 5:00, and if that would be a more efficient use of our time or whether we should go ahead and put Mr. Reynolds on the stand.

MS. ANDERL: I think, Your Honor, it would be our preference that Mr. Reynolds be able to take the stand and that he precede Dr. Taylor.

JUDGE MOSS: All right. Very well. We will proceed in that fashion, then, when Dr. Selwyn has comfortably gathered his things and Mr. Reynolds can take the stand.

(Recess taken.)

JUDGE MOSS: Let's be back on the record.

Whereupon,

MARK S. REYNOLDS,

having been first duly sworn by Judge Moss, was called as a witness herein and was examined and testified as follows:

JUDGE MOSS: Thank you. Please be seated.

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

BY MS. ANDERL:

Q. Good afternoon, Mr. Reynolds.

A. Good afternoon.

JUDGE MOSS: We're off to a slow start.

MS. ANDERL: I was going to say --

THE WITNESS: Is this adverse cross?

MR. HARLOW: It was a trick question.

Q. It was not a trick question. Could you please state your name and your business address for the record?

A. My name is Mark Reynolds, and my business address is 1600 7th Avenue, Seattle, Washington, Room 3206.

Q. And Mr. Reynolds, you filed several pieces of testimony with accompanying exhibits in this case, as well as having adopted some of Ms. Teresa Jensen's testimony; is that right?

A. That's correct.

Q. And do you have those testimonies, marked 61 -- Exhibit 61, 62, 63, 64, 65, and 93, 94 and 95 before you?

A. Yes, I do.

Q. And you've also, at various times in this proceeding, filed erratas to those testimonies; is that also correct?

A. That is correct.

Q. With those erratas and corrections, is the testimony that I've previously identified true and correct, to the best of your knowledge?

A. Yes, it is.

Q. And if I were to ask you the questions contained in those testimonies today, would your answers be the same?

A. Yes.

MS. ANDERL: Your Honor, we would offer the exhibits that have been preidentified for Mr. Reynolds.

MR. TRAUTMAN: No objection.

JUDGE MOSS: Those will be admitted as marked.

MS. ANDERL: And Mr. Reynolds is available for cross.

JUDGE MOSS: Thank you. Will this be Mr. Trautman?

MR. TRAUTMAN: Yes, Your Honor.

JUDGE MOSS: Go ahead.

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

BY MR. TRAUTMAN:

Q. Good afternoon, Mr. Reynolds.

A. Good afternoon.

Q. I'm Greg Trautman, Assistant Attorney General, for the Commission Staff. If you could turn first to what's been marked as Exhibit 64, which is your rebuttal testimony, and turn to page one. On line five, I believe you indicate that you're employed by Qwest Services Corporation; is that correct?

A. That's correct.

Q. And is that the intermediate corporation between QC and QCII?

A. Yes, it is.

Q. You indicate, also, that you're the senior director of Washington regulatory affairs for Qwest Corporation and other Qwest companies; is that correct?

A. That is correct.

Q. Now, as the senior director of Washington regulatory affairs for Qwest Corporation, is it true that most of your work is done for Qwest Corporation?

A. Yes.

Q. And is it true that your salary, for the time that you spend working on behalf of Qwest Corporation, ultimately is paid by Qwest Corporation?

A. I'm not entirely sure of that.

Q. Do you hold stock in QCII?

A. Yes, I do.

Q. On whose behalf are you testifying in this proceeding? Would it be Qwest Corporation, QCII, or both entities?

A. I believe I'm testifying on behalf of the company that I -- the entity that I work for, which is Qwest Services Corporation, and I am also representing QC on that behalf as one of the subsidiaries of Qwest Services Corporation.

Q. So would you be testifying on behalf of QCII in any respect?

A. I guess I don't know the answer to that question.

Q. Were you directly involved in the negotiation of the Dex sale?

A. No, I was not.

Q. Were you involved in any degree in the negotiation of the Dex sale?

A. No.

Q. Did you participate in the negotiation or the drafting of the ancillary agreements that involve QC, such as the publishing agreement or the noncompetition agreement?

A. No, I did not.

Q. Do you have personal knowledge of any plans that QCII may have for bankruptcy?

A. I do not.

Q. Now, in Exhibit 64, on page 13, and I'm looking at the bottom of the page, on line 22, and there you state that, as of December 31st, 2001, Qwest employees owned approximately 70 million shares of Qwest stock in their 401(k) plans; is that correct?

A. Yes.

Q. Just for clarification, would you agree now that there is no longer any disagreement between Qwest and the Staff about the number of shares held by Qwest employees, and that Dr. Blackmon's revised testimony now uses the same figure of 70 million shares as you do?

A. Yes, I saw that correction in Dr. Blackmon's most recent addition.

Q. And as your testimony indicates in the footnote to the testimony, the $70 million figure is from December 30th, 2001; is that correct?

A. Yes.

JUDGE MOSS: Just for clarification, it's 70 million shares.

MR. TRAUTMAN: Oh, I'm sorry, 70 million shares. Thank you. I stand corrected.

Q. Are there any current restrictions on the sale of Qwest stock by Qwest employees?

A. It depends on how they purchase the shares. For example, if they purchase them as a part of the employee stock, actually as part of their 401(k) and the company matching program, I believe they need to hold those shares for a short period of time. It's not very long.

Q. Could I refer you to an excerpt I handed out from Exhibit 83? And this is the one from the Form 11-K annual report. And I attached two pages to that, and I'm referring now to the page that is marked 16 on the bottom. At the top, it says Qwest Savings and Investment Plan, Notes to Financial Statements Continued, do you see that?

A. I'm totally lost. Could you give me the -- it's the Form 8-K, did you say?

Q. It's the Form 11-K.

A. I'm sorry, I'm sorry.

Q. And it's for the year ended December 30th, 2001?

A. Page 16?

Q. Yes.

A. Yes.

Q. Okay. And under employer matching contributions, does that not indicate -- it states, quote, The plan was amended effective April 8th, 2002, to allow all participants the ability to transfer the value of Qwest common stock, which was received as the company match, to fund available --

to any fund available for investment within the plan?
A. That's correct. That's what it says, but I think, as a part of the process, you have to hold on to the stock I believe like a month or so. It's part of the -- you know, you receive the matching stock, and I don't think you can transfer it instantaneously. I think you have to wait a minimum period of time.
Q. Has that feature always been a part of the plan?
A. No, at one point you needed to hold the stock -- in fact, I don't think you could sell the stock.
Q. And do you know on what date that was changed?
A. Well, it may have been this April 8th, 2002. I'm not sure, but -- you know, that seems about the right time frame from when it may have changed. And I believe, prior to that, you had to hold the stock that the company provided you on a matched basis.
Q. Now, is it not correct that Qwest employees lost most of the value of their Qwest stock before the Dex sale agreement was reached?
A. I guess I don't know that for a fact. I

mean, I don't know which employees -- you know, that's a pretty wide open question, so --

Q. All right. Let me refer you again to page 16 of the excerpt from Exhibit 83, the Form 11-K annual report from December 30th, 2001. And under the paragraph headed Qwest Common Stock, I believe it indicates that, as of December 30th, 2000, the closing price of the stock was $40.88 per share.

CHAIRWOMAN SHOWALTER: 2000.

MR. TRAUTMAN: Well, it was $14.24 in 2001, but it was $40.88 in December 31st, 2000. And by June 26th, 2002, the closing price of the stock was $1.79 per share; is that correct?

A. That is correct.

Q. So is it not correct that, between December 30th of 2000, and June 26th of 2002, the difference between $40.88 down to $1.79 would represent a 96 percent loss in value; is that correct?

A. I would agree with that. I would also agree that employees that held stock during that time experienced that type of reduction. What I couldn't agree -- you were asking me a generalized question about all employees, and it just wasn't true of all employees. There are employees that have come on with the company since then, so -- I wasn't trying to be difficult.

Q. But as to an employee that held stock as of December 30th, 2000, then the figures I've stated would be correct?

A. I would agree.

Q. And would you agree that Qwest employees take a risk when concentrating too much of their contributions into the Qwest shares fund?

A. I guess I would agree with that as a general proposition, but, you know, employees take a risk if they concentrate their savings in any one area, I would think, rather than diversify.

Q. And staying with that same exhibit, the Form 11-K, Exhibit 83, turning to page seven, which is the preceding page of the excerpt, in -- the fourth bullet point down refers to the Qwest shares fund, and is it correct that the last sentence of that paragraph says, This is an undiversified limited stock investment and concentrating any undiversified investment shares is considered a high-risk investment?

A. That's what it says.

Q. The 70 million dollar -- 70 million shares, pardon me, of Qwest stock held by Qwest employees would not include the shares held by Qwest's current

CEO; is that correct?

A. I don't know that.

Q. Well, since the -- since it was dated as of December 31st, 2001, it would not include his shares?

A. That's right, but it may have included the shares of the prior CEO.

Q. Staying -- going back, I should say, to Exhibit 64, which is your rebuttal testimony, and turning to page 12, and looking at lines 18 to 19, from this statement, is it correct that you don't know what would happen if QCII went bankrupt?

A. I think there's a lot of uncertainty around what would happen if QC went bankrupt, and I think that's what I'm trying to predict there or to portray there. And you know, I do footnote the testimony of Ralph Mabey, and I received a lot of the information I know about bankruptcy from Mr. Mabey, and I think he says that it is a high-risk proposition as to what might come out of a bankruptcy.

Q. So again, you don't know what would happen; correct?

A. No.

Q. You can't say for certain whether Staff is wrong about how QC employees would fare in a bankruptcy; is that correct?

A. I guess I don't understand what you're referring to about what Staff's position is with regard to employees. I mean, Staff certainly didn't focus very much attention on the employees. My testimony, I think, takes a little bit broader approach and says that there are implications that could come out of a bankruptcy that would affect our employees. That's all I was trying to point out in my testimony. I don't think Staff took the time to take a look at the broad perspective.

Q. Do you believe there's room remaining to cut employment at QC without harming service to customers?

A. Hopefully that there isn't. Hopefully we are operating at the margin and we're operating such that every dollar counts. I don't know for a fact whether there is something out there that we could cut. I haven't done that type of analysis.

Q. Are you aware of any plans by Qwest management to cut more employees?

A. I don't know of anything right now, no.

Q. Do you think that the present management of Qwest could increase profits or free cash flow of QC by reducing employment levels?

A. I don't have any specific knowledge, nor have I done any analysis along those lines, nor do I believe that that's even in my testimony.

Q. Now, assuming for the moment that Qwest avoids a bankruptcy filing. Is it possible that Qwest either could be acquired by another company or that it would voluntarily sell its telephone company operation?

MS. ANDERL: May I have a clarification, Your Honor? The question, I believe, was directed to Qwest avoiding bankruptcy. Is there a specific Qwest entity that the question references?

JUDGE MOSS: That might be a useful clarification, Mr. Trautman. When we say Qwest, we really don't know which company we're talking about in this proceeding.

Q. Well, assuming that they all stay out of bankruptcy. Okay. Is it possible that QCII either could be acquired by another company or that it would voluntarily sell its telephone company operation?

A. I don't know about the former. I think that the latter was one of the possibilities that Mr. Mabey listed in his testimony. I don't know if -- yeah, I would assume that it depends on the type of bankruptcy the company goes into. To the extent it goes into one for reorganization, I don't think it would entertain being taken over.

Q. Now, this was assuming that Qwest avoids a bankruptcy filing.

A. Okay.

Q. In that scenario, would it be possible that QCII could either be acquired by another company or that it would voluntarily sell its telephone company operation?

A. Are you asking are those possibilities?

Q. Yes.

A. Are they likely possibilities or -- I mean, is there a degree?

Q. Are they possibilities?

A. I'm sure they're possible.

Q. And is it possible, also, that QCII would sell the business to another company that provides local exchange telephone service?

MS. ANDERL: Objection, Your Honor. A clarification. The question's vague. Sell which business?

JUDGE MOSS: I agree. I'm not sure which business you're referring to.

Q. Sell QC. Is it possible that QCII would sell QC to another company that provides local exchange telephone service?

MS. ANDERL: Well, and I guess I also have to object as to the -- the questions calls for the witness to speculate, and is really without foundation in his direct testimony. We're ranging somewhat far afield here, talking about non-bankruptcy scenarios, it's unclear we're talking about with or without the Dex sale transaction. You know, I don't see how this is illuminating any issues for us in this proceeding.

JUDGE MOSS: I'm not sure where the line is going, Mr. Trautman, but I do find right now that it would be helpful to me, at least, if you could restate the question with some greater degree of focus, because I'm not quite -- I don't quite understand it, so I'm afraid what we get from the witness may not be helpful. So maybe you could just restate the question and --

CHAIRWOMAN SHOWALTER: Also, I just want to add, you've had questions assuming bankruptcy, questions not assuming bankruptcy and of different companies, so I think each question should contain the assumptions that you want the witness to consider.

MR. TRAUTMAN: Well, these questions, which are --

CHAIRWOMAN SHOWALTER: Mr. Trautman, just ask each question with a given assumption. It's too hard for us to remember the assumption of the third question before.

MR. TRAUTMAN: I'm sorry, Your Honor. I was trying to respond to the concern of the Bench for clarification. The question that I asked about, QCII selling QC to another company that provides local exchange service posited a non-bankruptcy filing and -- or not filing for bankruptcy. The questions arise because --

CHAIRWOMAN SHOWALTER: Mr. Trautman, by whom -- can you just ask each question and with all the assumptions in it specific to who is going to go bankrupt or who hasn't, and that way we can understand the question, and so can the witness, and then we can understand the answer that the witness is giving, because it's too hard for us to hold in our heads the different assumptions of the line of questions.

Q. Assuming that Qwest does not make a bankruptcy filing --

CHAIRWOMAN SHOWALTER: Mr. Trautman, which Qwest?

Q. Assuming that QCII does not make a

bankruptcy filing, is it possible that QCII would sell QC to another company that provides local exchange telephone service?

A. And I think I answered before, and I think I would repeat my answer here that, yes, that is a possibility. I think it would probably be unlikely.

Q. In that scenario, assuming that such a sale did occur, would the opportunity to consolidate and eliminate duplicate jobs be a potential positive factor?

A. Yes, I would agree with that.

Q. When Qwest -- when QCII and US West agreed in 1999 to merge, did QCII propose to the WUTC any restrictions on the number of telephone company employees that would be laid off after the merger?

A. Not to my knowledge.

Q. And if you could turn to the 8-K excerpt from Exhibit 83, and I'm turning to the page marked Attachment E at the top. And I believe this indicates that, as of December 31st, 2002, there were 50,788 employees for QCII overall; is that correct? At the top of the column under 2002.

A. I'm sorry, Mr. Trautman, did you say that as of December 31st, 2001?

Q. December 31st, 2002.

A. Yes, that's what it says.
Q. And is that the most current employee count for QCII?
A. I don't know.
Q. And according to this same exhibit, how many people did QCII employ at the end of 2001?
A. It appears to be 61,306.
Q. Now, switching to another line of questioning, are you aware that telephone companies, such as QC, from time to time purchase or sell telephone exchanges with other telephone companies?
A. Yes.
Q. To your knowledge, has QC or its predecessor, US West Communications, ever sold any telephone exchanges in Washington?
A. That I don't know. I'm aware of the sale of some access lines, but I think that had to do with a sale in Idaho that impacted some access lines in Washington, but I'm not aware of any exchanges that were sold.
Q. Do you know whether US West Communications sold exchanges to PTI, which is now CenturyTel, in about 1995?
A. I'm generally aware of some exchange sales, but I don't have any specific knowledge. I know that

some took place in the past, but I don't have specific knowledge about the buyer or the terms.

Q. Is it possible at any point in the future that QC might sell other Washington exchanges?

A. Once again, I'd be speculating, but I think that, you know, in some of our own 8-Ks, we've suggested that QCII is looking really at all means to deliver its balance sheet, and that may include the sale of exchanges.

Q. Now, when Qwest sells a telephone exchange, are the assets sold on the books of QC or the books of QCII?

A. I think probably both. I think it impacts both sets of books. From my knowledge about how it would work, you would have to reflect it, I think, both on the FR books and the MR books.

CHAIRWOMAN SHOWALTER: What's FR and MR?

THE WITNESS: I'm sorry, the financial reports that we make to the Securities and Exchange Commission, as opposed to the monthly reports, the regulatory reports that are the basis for what we file in the states. And the MR reports are actually the FCC rules, and we modify those, per each particular state's jurisdictional changes, to the FCC rules.

Q. What assets of QCII would be sold?

A. Well, I think, by extension of QCII owning QC, it would be the assets owned by QC.

Q. Is it correct that QCII owns the stock of QC, but does not directly own the assets of QC?

A. I think that's correct.

Q. And is it correct that the proceeds of the sale are paid to QC, rather than to QCII?

A. That I don't know.

Q. Now, under the terms of the Dex purchase agreement that is the subject of this hearing, if Qwest Corporation were to sell any exchanges to another telephone company, would the purchasing company be allowed to publish its own directory or enter into a new publishing agreement with someone other than Dex?

MS. ANDERL: Your Honor, I would ask that the witness be directed to a particular document somewhere within the 1,300 pages that are the purchase agreement, if Mr. Trautman wants to ask a specific question about what would or wouldn't be required.

Q. The purchase agreement is Exhibit 77. And I'm looking at Bates number 000719 in the lower right-hand corner.

A. This is the purchase agreement, Mr. Trautman?

Q. This is a publishing agreement. And do you --

A. I'm sorry, which exhibit number did you say that was?

Q. Seventy-seven.

A. Oh, I apologize. And what was the page number?

Q. 719 in the lower right-hand corner.

A. Okay.

Q. And I'm looking at Section 3.10(c), and after the large sub A, six lines down, does it not state that QC will require the acquiring person to agree in writing, then a parenthetical, to assume this agreement and the noncompetition agreement to the extent of the relevant service areas?

MS. ANDERL: Well, Your Honor, I would, I guess, object. The agreement says what it says and it speaks for itself. To the extent that the witness is being asked for a legal interpretation of the contract, he's not offered in that capacity.

JUDGE MOSS: Well, at this point, all he's been asked to do is confirm that it says what it says, So let's make sure he's read it, and then perhaps we'll have the follow-up question.

THE WITNESS: It does say what it says.

Q. All right. All other things being equal, would this restriction tend to reduce the price that Qwest Corporation could expect to receive for the sale of an exchange?

MS. ANDERL: Well, and I'll object again on different grounds. It is asking this witness to speculate and it is also asking this witness to respond to things -- issues upon which there's been no foundation laid that are outside the scope of his direct testimony. Certainly, if Staff wishes to argue that as a matter of logic on brief, they can do that, but I don't believe this is the appropriate witness to explore that issue with.

MR. TRAUTMAN: Well, Your Honor, we felt that Mr. Reynolds was the closest witness we would have to an executive type of witness and that this type of decision would be the type of management decision that might occur in the future and that he might be the witness who would be best able to answer what -- answer what might happen if Qwest would decide to sell exchanges in the future and what the effect of that sale would be.

JUDGE MOSS: Well, let's find out if he is the appropriate witness by having you lay that foundation with him, Mr. Trautman.

It being a few minutes after 5:00 in the afternoon, I think it's best that we take our recess at this time. And so we can start at 9:00 -- we'll resume at 9:00 tomorrow morning. So we'll see you then. Thank you.

MS. ANDERL: Thank you, Your Honor.

MR. HARLOW: Good night.

(Proceedings adjourned at 5:09 p.m.)