

1 BEFORE THE WASHINGTON UTILITIES AND
2 TRANSPORTATION COMMISSION

3 _____
4 In the Matter of the)
Application of:)
)
5 QWEST CORPORATION)
)Docket No.UT-021120
6 Regarding the Sale and Transfer)
of Qwest Dex to Dex Holdings,)Volume X
7 LLC, a non-affiliate,)Pages 1039 to 1257

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9

10 A hearing in the above matter was held on May
11 29, 2003, at 9:00 a.m., at 1300 South Evergreen Park
12 Drive Southwest, Room 206, Olympia, Washington, before
13 Administrative Law Judge DENNIS MOSS and CHAIRWOMAN
14 MARILYN SHOWALTER and COMMISSIONER RICHARD HEMSTAD, and
15 COMMISSIONER PATRICK OSHIE.

16 The parties were present as follows:

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1 -----

2 INDEX OF EXAMINATION

3 -----

4 WITNESS: PAGE

5

6 MARK REYNOLDS

7 Cross Examination by Mr. Trautman 1044

8 Examination by Chairwoman Showalter 1120, 1182

9 Examination by Commissioner Hemstad 1154, 1186

10 Examination by Commissioner Oshie 1170, 1189

11 Examination by Judge Moss 1191

12 Recross Examination by Mr. Trautman 1196

13 Redirect Examination by Ms. Anderl 1199

14

15 WILLIAM E. TAYLOR, Ph.D

16 Direct Examination by Ms. Anderl 1210

17 Examination by Chairwoman Showalter 1212

18

19 KATHLEEN M. FOLSOM

20 Direct Examination by Ms. Smith 1224

21 Cross Examination by Mr. Sherr 1225

22 Examination by Chairwoman Showalter 1245

23 Examination by Commissioner Oshie 1252

24 Redirect Examination by Ms. Smith 1253

25 Recross Examination by Mr. Sherr 1254

1 -----
2 INDEX OF EXHIBITS
3 -----

5	EXHIBIT	OFFERED	ADMITTED
6	MARK REYNOLDS		
7	74-86, 96, 97	1119	1120
8			
9	WILLIAM E. TAYLOR, Ph.D		
10	221-C, 222, 223-C	1212	1212
11			
12	KATHLEEN FOLSOM		
13	431	1224	1225
14	433-435, 438-444, 447-449	1244	1244
15			
16			
17	BENCH REQUESTS		
18			
19	NUMBER 7		1162
20	NUMBER 8		1199

21
22
23
24
25

1 PROCEEDINGS

2 JUDGE MOSS: Let's come to order. Good
3 morning, everyone. Ms. Cook is with us as our
4 court reporter for the first time today, so I am
5 going to ask everyone to identify themselves.

6 Also, for her benefit, I've introduced her to our
7 witness, Mr. Reynolds.

8 So, Counsel, just your name and the party
9 you represent.

10 MS. ANDERL: Thank you. Lisa Anderl for
11 Qwest.

12 MR. HARLOW: Brooks Harlow for Dex
13 Holdings.

14 MR. CAMERON: Richard Cameron for Dex
15 Holdings.

16 MR. BUTLER: Arthur Butler for Webtec.

17 MR. CROMWELL: Robert Cromwell on behalf of
18 Public counsel.

19 MS. SMITH: Shannon Smith, assistant
20 attorney general for Commission Staff.

21 MR. TRAUTMAN: Gregory J. Trautman,
22 assistant attorney general for Commission Staff.

23 JUDGE MOSS: And you will be meeting Dr.
24 Blackmon, who is next to Mr. Trautman, later. He
25 will be a later witness.

1044

1 All right. We were in the early stages of
2 Mr. Reynolds' cross examination by Mr. Trautman.
3 And so we will pick up where we left off, unless
4 there's something preliminarily.

5 There is -- Mr. Trautman handed up a new
6 proposed cross examination exhibit. I assume
7 this is for Mr. Reynolds, so I have identified it
8 with him as No. 96 for identification. And the
9 description is Qwest Communications Report, First
10 Quarter Earnings.

11 (EXHIBIT 96 IDENTIFIED.)

12 JUDGE MOSS: And with that, Mr.
13 Trautman, you may resume.

14

15 CROSS EXAMINATION (Continuing)

16

17 BY MR. TRAUTMAN:

18 Q Thank you. Mr. Reynolds, I believe on page 1
19 of your Exhibit 64, which is your rebuttal
20 testimony, you indicate that you are responsible for
21 all aspects of regulatory compliance for QC, and
22 particularly QC's regulated Washington operations;
23 is that correct?

24 A Yes.

25 Q And you say that you are -- your

1045

1 responsibilities include oversight of
2 regulatory filings; is that correct?

3 A That's correct.

4 Q Now, if QC were to desire to sell
5 exchanges, any of its exchanges, would that not
6 have to come before the Commission?

7 A My understanding is that it would have to
8 come before the Commission.

9 Q And would you not have any role in either
10 supervising, advocating or playing a part in that
11 filing for the sale of the exchange?

12 A Yes, I would have a role.

13 Q And would you not need to know the effect
14 of the sale of exchange that the sale of exchange
15 would have, or any other impacts from that sale of
16 exchange?

17 A It would. Depends on what role that I
18 took. If it were purely an administrative role,
19 and it was managing other company witnesses coming
20 in, I would think that the degree of my involvement
21 and understanding of the finer points of the
22 transaction wouldn't be as great.

23 However, if I took an active role in
24 advocating for the company, I would certainly have
25 to have more in-depth understanding of that type of

1046

1 information.

2 CHAIRWOMAN SHOWALTER: Mr. Reynolds, would
3 you get that microphone just a little closer.

4 Thank you.

5 BY MR. TRAUTMAN:

6 Q Are you also familiar in any way with the
7 publishing agreement that is at issue in this case?

8 A I have reviewed the agreement. I can't
9 say that I am an expert on the agreement.

10 Q Would you not need to know the effect that
11 that agreement might have on a future sale of any
12 exchanges?

13 A I don't think that that would be a
14 prerequisite for the role that I am playing in this
15 proceeding.

16 Q Do you have any such knowledge?

17 A Knowledge --

18 Q Of those matters, of how the publishing
19 agreement could affect sales and change sales of
20 exchanges?

21 A I hadn't thought about it in those terms
22 prior to your asking the question yesterday about
23 how it might affect the sale -- how the publishing
24 agreement successor assigned provision that you
25 pointed out to me might affect a sale. So I had

1047

1 not thought about it.

2 Q Do you know if anyone at QC has thought
3 about that matter?

4 A I don't know that.

5 Q If you could turn to Exhibit 61, this was
6 the direct testimony of Theresa Jensen that you --
7 a portion of which you had adopted. And turn to
8 page 7.

9 A (Complies.)

10 Q And in the paragraph where you describe
11 the relationship between QCI, QC, and Dex, in the
12 last sentence you say, "Although QCI indirectly
13 owns both QC and Dex, the two companies are
14 otherwise financially separate and operationally
15 independent."

16 Could you please explain what you mean by
17 that phrasing?

18 A (Reading document.) Well, I think I
19 explained up above in that same paragraph that QSC
20 owns Dex Holdings, and it also owns QC. And the
21 parent company of both is QCI. The financial
22 operations of Dex are entirely separate from QC.

23 And I don't know what further explanation you
24 want. That's what I meant by that statement

25 Q Is it your testimony that Dex receives no

1048

1 services from QC?

2 A No. That was not the intent of that
3 statement.

4 Q What services does QC provide to Dex?

5 A I believe that the commercial agreements
6 that are in place in the purchase agreement that is
7 at issue in this proceeding are in existence today.
8 And some of those agreements are between Dex and
9 QC. And QC provides some services for Dex in
10 accordance with those agreements.

11 Q Could you identify more specifically what
12 those services are?

13 A For example, the billing and collection
14 agreement where, I believe, QC provides billing and
15 collection services to Dex, is one example.

16 Q Do you know of any others?

17 A I am sure there are. None come to mind
18 right now.

19 Q Does QC act as a sales agent for Dex?

20 A They may well. I don't have firsthand
21 knowledge of that. I believe that there is a sales
22 agent agreement that I recall, but I haven't
23 reviewed it recently.

24 Q Turning to page 9 of that same testimony,
25 at the top of the page you state, "As explained by

1049

1 Mr. Johnson and Mr. Cummings, QCI was required to
2 sell Dex as a critical component of its strategy to
3 preserve and strengthen the financial integrity of
4 QCI. Without the entire sale, bankruptcy is
5 likely."

6 Do you see that?

7 A Yes, I do.

8 Q When you say that bankruptcy is likely,
9 do you have any specific figure in mind for the
10 likelihood of bankruptcy without the sale?

11 A Well, I would refer you back to
12 Mr. Cummings' testimony. Mr. Cummings speaks of
13 the agreement, the credit agreement. And he speaks
14 to the requirement for the proceeds from the Dex
15 sale, specifically the first part of the sale, the
16 Dexter sale, to help pay down \$1.354 billion of
17 that credit facility.

18 The second part is I think Mr. Cummings
19 testifies to obligations coming due in the next
20 three to five years. And I believe he states that
21 there are \$6.5 billion coming due in the next three
22 years. And there's over \$8 billion coming due in
23 the next five years.

24 So it's based on Mr. Cummings' testimony, and
25 my understanding of the types of obligations that

1050

1 are coming due that that statement is made.

2 Q Well, with reference to my question, and
3 maybe it wasn't as clear as it should have been,
4 do you have any percentage of likelihood of
5 bankruptcy that you are referring to?

6 A No. I don't have a percentage in mind. I
7 think "likely" speaks for itself. It's obviously
8 more than 50 percent.

9 Q All right. Is it 60 percent?

10 A I don't know. Likely is likely.

11 Q And is your testimony on this matter based
12 entirely on that of Mr. Mabey and Mr. Cummings?

13 A Yes.

14 Q You refer to the entire sale. In your
15 view, is bankruptcy less likely with the Dexter
16 sale completed than it would be if neither Dexter
17 nor Rodney had closed?

18 A I think obviously by my prior statement it
19 was critical to do the Dexter piece of this,
20 because of its connection with the ARCA agreement.

21 But I stand by my statement that without the
22 additional \$4.3 billion, I think bankruptcy would
23 still be likely.

24 Q In your view, is there any likelihood that
25 QCI would declare bankruptcy even if the Rodney

1051

1 transaction closes?

2 A I suppose anything is possible, but that's
3 certainly not the business plan of our corporation.
4 I think we have laid out a sound business plan, and
5 bankruptcy is not in our future. And that's why we
6 chose to sell this asset, and trust to deliver a
7 balance sheet in a number of other ways. So we
8 don't anticipate bankruptcy down the road, and I
9 think we're on our business plan. And that's
10 promising, so --

11 Q So are you saying that there's no
12 likelihood that QCI would declare bankruptcy in
13 this case?

14 A I didn't say that.

15 Q So you are saying there is some likelihood
16 it could occur?

17 A I think for any company there's always a
18 possibility of bankruptcy.

19 Q Is your testimony that bankruptcy is
20 likely, referring to the conditions in August of
21 2002, or to the conditions that exist today?

22 A I think the date of the testimony is
23 January 17. And I think that it was appropriate as
24 of January 17. And I think, as I suggested, I
25 still believe I've adopted the testimony, and I

1052

1 still believe it's appropriate today.

2 And to answer -- I apologize. To answer your
3 question directly, yes, I think it was appropriate
4 back then as well.

5 Q Do you believe there's any difference in
6 the likelihood of bankruptcy now, compared to the
7 likelihood of bankruptcy as of August 2002?

8 A I think that the economic conditions are
9 more favorable today than they were then, so things
10 look brighter for the company.

11 I stand by my statement that I still believe
12 that we need to conclude the Rodney portion of this
13 sale to be able to move ahead without the likelihood
14 of bankruptcy.

15 Q So was your answer "yes" or "no" -- what
16 was your answer in terms of whether there was a
17 difference of a likelihood of bankruptcy today?

18 A I don't think that was the question. You
19 asked me if there was a difference, I think, in the
20 environment back then as opposed to today.

21 Q No. I asked, is there any difference in
22 the likelihood of bankruptcy compared to the
23 likelihood of bankruptcy as of August 2002?

24 A I would say, just stated that way for
25 bankruptcy, no.

1053

1 Q Doesn't it seem reasonable that the risk
2 of bankruptcy was greater when Qwest stock was
3 trading at about \$1.07 per share last summer,
4 compared to today when the share price is about
5 \$4.70 per share?

6 A I think that's important, but I don't know
7 that it is determinative.

8 Q At what point in time did the bankruptcy
9 of QCII become likely?

10 A I would refer you, again, to Mr. Cummings'
11 testimony. But I believe he tells the story that
12 we got to a point where we had to exercise a \$4
13 billion credit facility that had terms that
14 ultimately we could not meet.

15 And to the extent we could not meet those
16 terms and the banks were foreclosing, without doing
17 an amended restated credit agreement, bankruptcy was
18 extremely likely at that point.

19 The amended restated credit agreement tied in
20 the sale of Dex to our ability to move forward with
21 additional financing. And so I think all of those
22 events are sort of integrated to a large degree.

23 Q Is your testimony that bankruptcy is
24 likely, based in any way on quantitative measures
25 of risk that are used by financial analysts?

1054

1 A I believe -- and once again, I relied
2 heavily on Mr. Cummings' testimony. And I think
3 Mr. Cummings has analyzed the financials, has taken
4 a look at the upcoming cash needs of the company.
5 And, you know, he has concluded that without this
6 additional funding, this company -- bankruptcy
7 would be likely. I think that's his testimony, and
8 it's mine.

9 Q Did Mr. Cummings ever share with you any
10 of those quantitative measures of risk?

11 A Yes, he did. And we actually discussed
12 some of the responses to discovery requests. And
13 so, I mean, I have seen some of the financial data
14 that was provided in response to the discovery
15 requests. In fact, some of the information that
16 Mr. Cummings was crossed on I have reviewed.

17 Q Have the directors of QCII taken any
18 formal action to recognize that bankruptcy is
19 imminent, and that they no longer have a fiduciary
20 duty to the stockholders?

21 MS. ANDERL: Objection to the form of the
22 question, Your Honor. I don't believe that
23 bankruptcy is imminent is a fact established in
24 this record, nor does it properly characterize the
25 witness' prior testimony.

1055

1 JUDGE MOSS: Well, I don't think I can
2 sustain that objection. But it is a compound
3 question, and I have a problem with it on that
4 level.

5 So maybe you can break it into two pieces.

6 BY MR. TRAUTMAN:

7 Q Have the directors of QCII taken any
8 formal action to recognize that bankruptcy is
9 imminent?

10 A Not to my knowledge.

11 Q Turning to the exhibits that have been
12 marked as Exhibits 85 and 86.

13 A (Complies.)

14 Q These simply ask about your credentials to
15 offer expert opinion testimony regarding bankruptcy
16 law and procedure, and also any bankruptcy cases in
17 which you have participated. Are these answers
18 correct?

19 A That's Exhibit 85 and 86?

20 Q Correct.

21 A Yes, they are.

22 Q In Exhibit 61, again, the direct testimony
23 of Theresa Jensen, adopted by you, in part, turning
24 to page 11.

25 A (Complies.)

1056

1 Q And I am looking at the paragraph that
2 states, "How does QC currently fulfill its
3 directory obligations in Washington arising under
4 federal and State law?" You indicate, "QC
5 currently fulfills its directory publishing
6 obligations in three ways: through a publishing
7 agreement with Dex whereby Dex publishes and
8 distributes white page directories for QC; through
9 its interconnection agreements with competitive
10 carriers that either extend to directories or
11 facilitate competitors' contact with Dex; and by
12 integrating listings from competitive carriers, and
13 including them in the information that QC transmits
14 to Dex for publishing. QC will continue to fulfill
15 these obligations in the same way with the buyer
16 after the sale of the business and assets of Dex."

17 Do you see that?

18 A Yes.

19 Q Would you agree that today, with QC and
20 Dex under common ownership, Qwest has the option at
21 any time to stop publishing its own directory and
22 instead contract that function to another?

23 A I believe that there is a publishing
24 agreement in place between the affiliate today. So
25 subject to the terms of any current contracts, I

1057

1 think maybe I could agree with your question.

2 Q But if QCII wanted to have a contract
3 cancelled, couldn't it have QC and Dex both agree
4 to cancel the contract?

5 A I suppose that's a possibility. I need to
6 look at the contract to see what the clause with
7 regard to cancellation/termination said.

8 Q Could QCII make a business decision to
9 accept a proposal from an independent publisher?

10 A For the purpose of publishing QC's
11 directories, is that the --

12 Q Yes.

13 A Yes. I suppose they could. It wouldn't
14 make much business sense if they already had a
15 publishing company in-house, but they could do
16 that.

17 Q Assuming that the Commission required that
18 the directory be published in a different format or
19 medium, under the current arrangements is it
20 correct that QC could ask for proposals from firms
21 that would handle the new requirements?

22 A Once again, I suppose that could happen.
23 It wouldn't make much sense with an in-house
24 publishing company already in place. It would make
25 more sense if they asked the Dex company to do

1058

1 that, and to arrange for those changes.

2 Q But could they do that? Could QC ask for
3 proposals from firms to handle the new
4 requirements?

5 A Once again, I think it's probably
6 possible.

7 Q Would you agree that if the publishing
8 agreement in this case goes into effect, Qwest will
9 lose the flexibility to change the method by which
10 the directory gets published?

11 A I guess I don't know that I can agree with
12 that the way it was stated. Qwest does have some
13 discretion in the contract about how the
14 directories are published, and to the extent there
15 are any regulatory changes, there are provisions in
16 the contract to cover that. So I think what --
17 Qwest does have quite a bit of say over how the
18 directories are going to be published.

19 Q Does it have as much flexibility as it
20 would have had without the publishing agreement?

21 A I guess, you know, I am having a hard time
22 answering that, because I don't know what you mean
23 by the flexibility.

24 But my understanding, and I am basing my
25 understanding on testimony of

1059

1 Ms. Koehler-Christensen, that is the publishing
2 agreement that is in place, and the one contained in
3 the purchase agreement are very similar.

4 I will agree with you that the term is
5 different, that there is a 40-year term -- or
6 40-year noncompete, and a 50-year term of the
7 publishing agreement in the purchase, the one that
8 is attached to the purchase agreement in this
9 proceeding.

10 But as far as a lot of the other flexibility
11 regarding Qwest's ability to respond to regulatory
12 changes and needed discretion over how the books are
13 published are very similar, I believe, between the
14 two agreements.

15 Q If someone were to develop the technology
16 to deliver directory listings and advertising to
17 QC's customer telephone sets, would QC be allowed
18 to implement this technology without violating the
19 publishing agreement, or the noncompetition
20 agreement?

21 A I don't know the answer to that.

22 Q Are you familiar with the term "voice
23 portal directory" as it is used in the
24 noncompetition agreement?

25 A No, I am not.

1060

1 Q And, again, you have indicated that in
2 your testimony, page 11 -- actually, Ms. Jensen's
3 that you adopted -- "QC will continue to fulfill
4 these obligations in the same way with the buyer
5 after the sale of the business and assets of Dex."

6 Is it correct that if this transaction is
7 approved, that Qwest Corporation and the new owners
8 of Dex will be negotiating a master sales agent
9 agreement?

10 A I don't know that.

11 Q Would you turn to what has been marked as
12 Exhibit 74, which is the purchase agreement.

13 A (Complies.)

14 Q And I am looking at page 604, at the
15 bottom right-hand corner, the Bates number.
16 Paragraph 5.13, Additional Agreements.

17 A (Reading document.)

18 Q Do you see that language?

19 A Yes. I am just reviewing it. I have read
20 it.

21 Q Is it correct that if the transaction is
22 approved, that QC and the new owners of Dex will be
23 negotiating a master sales agent agreement?

24 A It says they will try to come to terms on
25 it, but it's not a condition of the consummation of

1061

1 the transactions contemplated by the agreement.

2 Q What will that sales agreement cover?

3 A I don't know.

4 Q Do you know whether it would cover QC
5 employees performing sales functions related to
6 directory advertising?

7 A No, I don't know that.

8 Q And do you know what levels of revenues QC
9 projects it would receive under such an agreement?

10 A No, I don't.

11 Q Do you know whether the agreement has been
12 negotiated yet?

13 A I don't.

14 Q Do you know when it would be negotiated?

15 A No, I don't.

16 Q And do you know whether QC has a master
17 sales agent agreement with any directory publisher,
18 other than Dex?

19 A I don't know that either.

20 Q I am turning, now, to your Supplemental
21 Rebuttal Testimony of May 27, 2003. I don't have
22 an exhibit number.

23 A I believe it's 94.

24 JUDGE MOSS: 94.

25 BY MR. TRAUTMAN:

1062

1 Q (Reading document.) And turning to page
2 2, and I am looking under the paragraph, the
3 sentence heading is, "Why do you say that?" And at
4 the end of the paragraph, the last sentence, you
5 say, "By this, I mean that Staff once again rejects
6 the actual sales price that Qwest will receive from
7 consummation of the Dexter and Rodney agreements of
8 approximately \$7.05 billion in favor of a
9 manufacturing gain calculated based on an estimated
10 total company gross rate for Dex, and the current
11 value of the existing imputation."

12 Do you see that?

13 A Yes, I do.

14 Q What is your understanding of the source
15 of the annual payment amounts that Staff has
16 developed?

17 A My understanding of the payment amounts
18 that Staff has developed is that they have taken
19 the imputation that's been discussed in this
20 proceeding at the 103.4 imputation, the current
21 value of the imputation, and they have applied
22 growth factors to that consistent with Dr. Selwyn's
23 testimony. And I believe it's in LLS-24C.

24 And that if you apply the same factors Dr.
25 Selwyn applied consistently over the period that

1063

1 Staff suggests in their testimony -- and it's not
2 entirely clear what Staff is suggesting, whether
3 it's the term of the noncompete agreement or whether
4 it's the term of the publishing agreement.

5 So in my testimony, I actually do it both
6 ways. But if you carry that out, you come out with
7 a stream of payments that is consistent with the
8 exhibit in Dr. Blackmon's testimony. That's my
9 understanding of Staff's approach.

10 Q You referred to the growth rate that was
11 used by Dr. Selwyn. Is it correct that the growth
12 rate is the growth rate that Qwest provided to
13 Lehman Brothers?

14 A Qwest, Dex, or --

15 Q QCII.

16 A My understanding is that Dr. Selwyn got
17 those growth rates from documents provided by
18 Qwest, yes.

19 Q Do you believe that the initial value of
20 \$103.4 million that Staff used is an unreasonable
21 measure of the directory profits attributable to
22 Washington in 2002?

23 A No. I think it's a reasonable
24 approximation based on the data that we had
25 available.

1 Q Do you believe that the Lehman Brothers
2 study overstates the growth rate that can be
3 expected for the directory business?

4 A My understanding of the growth rate that
5 is applied is that it's a total company growth rate
6 for Dex. Our testimony in this proceeding is that
7 the amount of the gain that is applicable for the
8 Washington share is much smaller due to some parts
9 of the business that aren't directly related to our
10 directory publishing obligation in this state.

11 And I believe Ms. Koehler-Christensen goes
12 into a great deal of detail on that. So to apply an
13 overall company growth factor to this implication
14 over the years, I don't think is consistent with our
15 advocacy. So we would reject it. And we have
16 rejected it in our testimony.

17 Q On page 3 of your Supplemental Rebuttal
18 Testimony, line 7 through 9, you state, "Obviously
19 Staff's proposal is based on the premise that the
20 current imputation has created a defacto perpetual
21 imputation entitlement for rate payers."

22 Do you see that?

23 A Yes, I do.

24 Q Is Staff's proposal actually for perpetual
25 imputation, or is it for the duration of the

1065

1 publishing agreement and the noncompetition
2 agreement?

3 A specifically, it is for the latter of what
4 you suggested. However, if you look at the
5 application of that on a quantitative basis, and
6 Dr. Selwyn does this in his testimony, he applies a
7 terminal value to a net present value of those
8 stream of payments.

9 And if you look at the terminal value, that
10 is, that would represent perpetual imputation, and
11 you compare it with a 50-year amortization such as I
12 provided in my testimony, you find that they are
13 very close. So it is akin to perpetual imputation.

14 Q The imputation in the Staff proposal,
15 again, is only for the duration of the publishing
16 agreement and the noncompetition agreement?

17 A I agree with that.

18 Q You then at the bottom of that same page,
19 you cite a passage from the State Supreme Court
20 opinion in 1997. By citing this particular
21 passage, are you asserting that Qwest has received
22 fair value for the transfer of the asset?

23 A Yes.

24 Q Are you asserting that Qwest Corporation
25 has received fair value for the transfer of the

1066

1 asset?

2 A I am not distinguishing between Qwest and
3 Qwest Corporation. Qwest Company has received fair
4 market value in the transaction that took place,
5 and that's what I am speaking to. And that's what
6 I believe the Supreme Court had in mind, and even
7 in this Commission in its prior rulings had in mind
8 when it said, "When the transaction is done and
9 fair market value is received for the asset, come
10 back to us and we will take a look at it." And
11 that's what we're trying to do.

12 Q Now, the Supreme Court opinion refers to
13 US West, although the caption of the case is US
14 West Communications, Inc., is it not?

15 A I believe that's correct.

16 Q And the company that was in front of the
17 State Supreme Court was US West Communications,
18 Inc.; is that not correct?

19 A I would accept that, subject to check,
20 Mr. Trautman. I don't have it in front of me.

21 Q And Qwest Corporation is a successor of US
22 West Communications; is that correct?

23 A Yes. But I would still maintain that my
24 answer remains the same in that that is what this
25 proceeding is about here, is to determine the

1067

1 disposition of that gain from a regulatory
2 perspective.

3 So I was speaking to the actual transaction
4 itself, and whether fair market value was received.
5 And the company believes that it was, and the
6 testimony that the company has provided here through
7 various iterations is what we believe is a fair
8 settlement of the regulatory obligation.

9 Q So is it Qwest's position that as long as
10 it can demonstrate that it is receiving fair value,
11 that the Commission does not have the option to
12 deny approval on the sale?

13 A Well, I guess I disagree with that. I
14 think it's too simplistic an approach, because
15 obviously the Commission is going to take into
16 account two things. They are going to take into
17 account, did the company receive fair market value
18 for this asset? And then, what is the disposition
19 of the gain in this state, because that's been very
20 important to them if you studied the history of the
21 directory publishing business, at least over the
22 last 20 years in this state.

23 Q So are you saying you can't answer the
24 question "yes" or "no"? Is that what you are
25 saying?

1068

1 A I think I disagree with your premise.

2 Q So even if QCII got fair value, you
3 believe the Commission would have the option to
4 disapprove the sale?

5 A Does your question assume that the Commission
6 believes that we got fair market value?

7 Q Yes.

8 A No. I think the Commission could still
9 disapprove the sale. I think if you studied the
10 history of directory publishing and the proceedings
11 that took place in this state, it's more complex
12 than the company just receiving fair market value.

13 As I stated earlier, I think it's a
14 combination of the company receiving fair market
15 value, and the Commission agreeing that whatever
16 regulatory obligation it believes it has to the rate
17 payers is also satisfied.

18 Q So if the Commission were to conclude that
19 QCII were not receiving fair value, then I take it
20 you believe the Commission would also have the
21 option to deny approval of the sale?

22 A I believe that's correct.

23 Q Turning to page 4, and you -- starting on
24 line 16, you state, "What is even more alarming is
25 that the sum of the nominal payments for the

1069

1 50-year period recommended by Staff totals a
2 whopping \$10.73 billion. This is \$3.7 billion more
3 than the entire sales proceeds for all of Dex."

4 Do you see that?

5 A Yes.

6 Q Now, with reference to this \$3.7 billion
7 figure, is it correct that you are comparing the
8 amounts that Qwest would receive in 2002 and 2003
9 from the sale of the Dex business to the simple sum
10 of the payments that it would be required to make
11 over the next 50 years?

12 A That's correct. And, in fact, I might
13 add, Mr. Trautman, that my purpose in doing that
14 was to provide a comparison for the Commission with
15 the exhibit that Mr. Brosh filed in support of the
16 settlement. He also does the sum of the nominal
17 payments, he also does a net present value
18 analysis.

19 And I thought it would be helpful if the
20 Commission could see Staff's entire presentation in
21 roughly the same light. And to me, it was
22 informative.

23 Q Why do you consider that to be more
24 alarming than the discounted net present value?

25 A I guess just the magnitude of the number

1070

1 jumps out at you, that it far exceeds the actual
2 sales price received from the entire Dex property
3 for all of the states. And if you compare it to
4 Mr. Brosh's figure associated with the settlement,
5 you see that that figure is much, much smaller.

6 Q So it sounds like you are actually being
7 charitable to Staff by using the entire sales
8 proceeds, rather than the Washington State share.

9 Using the Staff allocation factor --

10 MR. TRAUTMAN: And I believe one of them is
11 not confidential; is that correct?

12 MS. ANDERL: The 18 percent is not
13 confidential.

14 BY MR. TRAUTMAN:

15 Q Of about 18 percent, the Washington share
16 of the sale proceeds is only \$1.3 billion; is that
17 correct?

18 A I believe that's correct. And the devil's
19 in the detail. It depends on what you are talking
20 about as far as sales proceeds and gain. I would
21 refer you to footnote 4 on page 2 where I try to
22 develop an equivalent number to that developed by
23 Dr. Selwyn in his testimony using the same
24 methodology that Staff used to develop their
25 number.

1071

1 And unfortunately, it's confidential. But I
2 would agree that the number that I show there for
3 applying Staff's methodology to the actual realized
4 price, the 7050, and applying the 18 percent
5 Washington share that Staff uses, results in a
6 number that is very similar to the one you just
7 mentioned, Mr. Trautman.

8 Q Are you not comparing the gain amount, but
9 rather that's gross proceeds of the sale?

10 A I believe in footnote 4 that is the gross
11 proceeds to the sale -- well, hold on one second,
12 and let me check my notes. (Reading document.)

13 I believe that that is a gross proceeds
14 figure.

15 CHAIRWOMAN SHOWALTER: Mr. Reynolds, LCI
16 means -- while you are at it, tell us what LCI
17 means.

18 THE WITNESS: LCI was a company that was
19 acquired by Qwest. It is LCI, the long distance
20 company.

21 CHAIRWOMAN SHOWALTER: Okay. Thank you.

22 BY MR. TRAUTMAN:

23 Q So do you agree that the Washington share
24 of the gross proceeds is about \$1.3 billion?

25 A Mr. Trautman, I would have to ask for a

1072

1 clarification. When you say the Washington share
2 of the gross proceeds, do you mean when applied to
3 the realized sales price, the 7050?

4 Q Yes.

5 A Yes.

6 COURT REPORTER: Can you clarify "7050" and
7 be specific?

8 THE WITNESS: Sure. The realized sales
9 price was 7 billion, 50 million dollars. And I
10 should correct that, the estimated sales price.

11 BY MR. TRAUTMAN:

12 Q Now, what did -- would it not be more
13 accurate to compare the \$10.73 billion figure that
14 you say Staff is proposing to the Washington
15 portion of the sales price of about \$1.3 billion?

16 A When you say "would it be more fair," I
17 guess I don't understand to whom. And I know that
18 early on --

19 Q Would it be more accurate.

20 A It would be more accurate, because both of
21 those figures deal with the Washington share. I
22 was pointing out that the number actually more
23 closely compares to the full sales price, and I was
24 doing it for purpose --

25 Q Now, is it common practice at Qwest to

1073

1 perform financial analysis of business ventures
2 without discounting payments or receipts that occur
3 in future years?

4 A Typically when you want to compare streams
5 of payments, it's appropriate to apply an
6 appropriate discounting factor so you can compare
7 the net present value of those.

8 I think I explained earlier that one of my
9 purposes of doing the nominal sum was so that the
10 Commission had another touch point to compare to the
11 document that Mr. Brosh prescribed in his testimony.

12 He did the sum of the nominal payments for
13 our stipulation, and I thought that was appropriate
14 that we do the sum of the nominal payments for
15 Staff's proposal as well.

16 Q And, again, my question was, how does
17 Qwest perform its own financial analysis? Would it
18 do so without discounting future payments or
19 receipts?

20 A To be honest with you, Mr. Trautman, I
21 have seen it done both ways. Depending on whether
22 you are looking at future cash needs, cash flows.
23 You may look at a sum of the nominal payments, but
24 I think for comparing -- I think it goes without
25 saying that when you compare two different types of

1 transactions, or two different proposals for the
2 same transaction, the fair way to do it would be to
3 present worth the future stream of payments or
4 expenses back to a consistent number for comparison
5 purposes.

6 Q When Qwest made its various investments in
7 unregulated projects in recent years, did it assume
8 that revenues being paid 10, 20, or 40 years in the
9 future were just as valuable as money being paid
10 out now?

11 A I honestly don't know. I wasn't involved
12 in those types of analyses. But I would hope that
13 they would have applied the appropriate discounting
14 to the future payments. It is appropriate.

15 Q When QCII incurred \$26 billion of debt,
16 did it factor into its analysis the cost that it
17 would incur in servicing the debt over the years
18 before the principle was repaid?

19 A I wasn't involved in that, Mr. Trautman.
20 So I don't know.

21 Q Would it be common practice to do that,
22 do you believe?

23 A I think I have already suggested that, on
24 a lot of different fronts, that it is common
25 practice to take a look at the financials, both

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1 from a net present worth perspective, and also to
2 take a look at what the stream of payments look
3 like.

4 Q But you don't know whether QCII did that?

5 A That's true. That's my testimony.

6 Q Staying on page 4 of Exhibit 94, at lines
7 19 to 21, you say, "This is why I say that Staff's
8 revised proposal creates even more of a hopson's
9 choice (ph.) than its previous proposal. No
10 rational business would ever accept such a
11 proposition."

12 Do you see that?

13 A Yes.

14 Q You say no rational business would accept
15 the conditions proposed by Staff. Are you saying
16 Qwest would deny approval of the Dex sale rather
17 than to approve it with the suggestions suggested
18 by Staff?

19 A I don't think that's what that says. And
20 I guess that's my answer. That's not what it says.

21 But I do stand by my statement that Staff's
22 proposal is unacceptable to the company. Part of
23 the reason for selling the property is to be able to
24 improve our financial condition. And Staff's
25 proposal would make it worse. It adds liability

1076

1 that doesn't currently exist. It adds liability
2 above the actual realized sales price. And all I am
3 saying is that a rational business in the situation
4 that we're in wouldn't accept that as a proposition.

5 Q If the Commission were to condition its
6 approval on the provisions suggested by Staff,
7 would Qwest seek to cancel the transaction?

8 A I don't know that for a fact,
9 Mr. Trautman. I think that Qwest would have to
10 seriously reconsider the transaction.

11 Q Now, assuming that the economic impact of
12 the conditions were within the range provided by
13 the material regulatory impact provision of the
14 publishing and noncompetition agreements, would
15 Qwest have the discretion under those agreements to
16 back out?

17 A My reading of what you refer to as the
18 material regulatory impact is that there is a
19 certain amount of regulatory impact that can take
20 place that can be a part of the regulatory approval
21 process that is contained -- or that Qwest cannot
22 back away from the sale as a result of those types
23 of regulatory impacts.

24 I will tell you that the devil is in the
25 detail as to what constitutes material regulatory

1077

1 impact.

2 Q Have you performed a calculation using the
3 methodology and the material regulatory impact
4 provision of the effect of the conditions that have
5 been suggested by Staff?

6 A I have not, no.

7 Q Turning to page 55 of Exhibit 94 --

8 A (Complies.)

9 Q You have a table that has Stipulation and
10 Staff Revised headings. And then there are figures
11 below that.

12 Do you see that?

13 A Yes.

14 Q And you have, under the column heading
15 Stipulation, you have a figure of 81 percent. And
16 then on the left-hand side it says, "percentage of
17 sales price."

18 Do you see that?

19 A Yes.

20 Q Now, isn't the 81 percent actually the
21 percentage of the gain on sale, rather than the
22 total sales price?

23 A Yes, it is. It's net -- just to make the
24 record clear, it's developed based on the sales
25 price, less the contributed assets, times Staff's

1078

1 calculations of the Washington share. And I
2 believe the figure is in Dr. Blackmon's testimony
3 at GB-2C.

4 Q So if you were to take the \$928.5 million
5 and divide it by 81 percent, you would then get the
6 Staff's calculation of the Washington gain amount;
7 is that correct?

8 A Yes. And, Mr. Trautman, just to be
9 specific, it's Staff's calculation of the gain
10 amount, as Dr. Blackmon presents it in his exhibit,
11 based on the actual realized price.

12 There's a lot of gain amounts being talked
13 about, and I wanted to be specific for the record.

14 Q Now, using these numbers, then, would you
15 agree that the stipulation would result in Qwest
16 retaining 19 percent of the Washington gain amount?

17 A Only when compared with Staff's
18 calculation of what that gain is, based on the
19 realized sales price. Obviously Qwest has
20 testimony in this proceeding that the actual
21 appropriate gain is less than that, so the 928
22 actually exceeds the amount of gain that Qwest
23 believes should be made available for regulatory
24 purposes.

25 Q But using the assumption that you have

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1 laid out, now if you took 19 percent, you would
2 then -- 19 percent of the total Washington gain
3 amount calculated under this formula, that would be
4 \$218 million; is that correct? Would you accept
5 that subject to check?

6 A Just to be clear, Mr. Trautman, if you are
7 saying that the residual between 81 percent and 100
8 percent is the number you just stated, I would
9 agree, yeah.

10 I don't want to be mistaken here, that I
11 don't necessarily agree with the calculations Staff
12 does. I did this for simplicity purposes and
13 comparison purposes.

14 Q So that percentage, in whatever dollar
15 amount it is, would go to Qwest, correct? My
16 question is simply, assuming that 19 percent goes
17 to Qwest, could you briefly summarize the
18 management decisions or initiatives that Qwest has
19 made that should entitle it to that 19 percent
20 portion of the Washington state portion of the gain
21 on sale?

22 A I believe that that is -- that's dealt
23 with in Ms. Koehler-Christensen's testimony about
24 why the gain should be carved up the way it is.
25 And she speaks to the development of the secondary

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1 directories of the non-Qwest listings, and also the
2 internet business.

3 And she believes that those have been
4 developed by the Dex company and are separate from
5 our Washington regulatory obligations, and that
6 should not be included in any gain determination.

7 Q And on page 5, below the table that I had
8 referred you to, page 5 of Exhibit 94, you state,
9 As these numbers revealed, the stipulation
10 represents a fair and balanced settlement in
11 relation to the realized price, whereas the Staff's
12 revised proposal has no basis in reality.

13 Now, by making that latter statement that
14 Staff's proposal has no basis in reality, is it your
15 testimony that the projected level of directory
16 publishing revenues is unrealistic?

17 A No. I think that statement is based on the
18 fact that Qwest is only going to receive \$7 billion
19 for this asset. And it's not going to receive any
20 more than that, no matter how much you try to base a
21 theory on forecasted earnings or forecasted
22 imputations.

23 The sum total that we're going to receive
24 is 7050. So that's the reality. And all I am
25 saying is that Staff's proposal is not based in that

1081

1 reality.

2 Q On page six of Exhibit 94, lines 3 through
3 5, you state that "Qwest disagrees with the concept
4 of actual payments between QCII and QC on the basis
5 that it creates a constraint on cash consequently
6 defeating the purpose of the sale."

7 Do you see that?

8 A Yes, I do.

9 Q Could you explain why it creates a
10 constraint on cash to require that one Qwest entity
11 make a payment to another Qwest entity?

12 A My understanding of Staff's proposal is
13 that QCII would be required to make monetary
14 payments to QC, and that QC's ability to dividend
15 any payments back to the parent, or any revenues
16 back to the parent in excess of, I guess, a certain
17 amount -- it's not entirely clear -- would be
18 restricted without Commission approval.

19 That type of restriction on our company's
20 cash flows does not exist today. The company has
21 the ability to move cash around at will. All I am
22 saying is that this provision constrains cash, and
23 constraints on cash for a company that is strapped
24 for cash is a serious implication, and, to us, a
25 serious concern with Staff's proposal.

1082

1 Q Are the payment amounts proposed by Staff
2 greater than the amounts that typically move
3 between QCII and QC in a given year?

4 A Mr. Trautman, I don't know that.

5 Q Staying on page 6, and lines 5 through 7
6 you say, "Further, Staff's payment stream escalates
7 for 50 years such that the annual payments increase
8 from \$113.73 million in year one, to \$338.17
9 million in year 50."

10 Do you see that?

11 A Yes, I do.

12 Q Would you accept, subject to check, that
13 the values that you report here on lines 6 and 7
14 produce a compound annual growth rate of 2.25
15 percent?

16 A Yes, I would.

17 JUDGE MOSS: Mr. Trautman, unless you are
18 nearly finished, I wonder if this would be a
19 convenient time for us to take our morning recess?

20 MR. TRAUTMAN: Yes, it would, because I
21 have additional questions. And then, also, on the
22 settlement testimony.

23 JUDGE MOSS: Well, let's take our morning
24 recess until 10:30.

25 (Brief recess.)

1083

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

2 Mr. Trautman, you may resume your cross
3 examination.

4 MR. TRAUTMAN: Thank you.

5 BY MR. TRAUTMAN:

6 Q Mr. Reynolds, I believe we're still on
7 Exhibit 94. And I am on page 7, on lines 11 to
8 12 -- actually, lines 9 to 12.

9 A (Complies.)

10 Q And you say, "Also, as has been stated by
11 numerous Qwest witnesses to this proceeding, the
12 purpose of the sale is to improve Qwest's financial
13 and liquidity condition, and consequently Staff's
14 level of bill credit is unacceptable to Qwest."

15 Do you see that?

16 A Yes, I do.

17 Q Is acceptable to Qwest the standard that
18 the Commission is using in this proceeding?

19 A Probably not. But I think the way that
20 that is phrased is that I think one of the
21 standards that the Commission will evaluate is
22 Qwest's need for the money from the sale.

23 And I think that's the point I was trying to
24 make there, is really every dollar counts. And the
25 dollars that we need to pay out in terms of excess

1084

1 bill credits can't go to help our financial
2 condition.

3 Q Now, using the numbers that you have
4 supplied in this testimony, if the Commission were
5 to decide that it was unreasonable to customers to
6 give them 81 percent of the gain and let Qwest keep
7 19 percent of the gain, should the Commission
8 consider increasing the one-time customer credit
9 amount to reach whatever level of sharing that it
10 determined to be appropriate?

11 A No. And I guess I disagree with your
12 characterization, Mr. Trautman, of 81 percent of
13 the gain. I hopefully clarified earlier that I
14 only used that number to compare like numbers.

15 We don't agree that our offer in the
16 settlement is 81 percent of our determination of
17 the gain.

18 Q Well, should the Commission consider
19 increasing the one-time customer credit amount to
20 reach whatever level of sharing that it would
21 determine to be appropriate?

22 A I don't think that that is appropriate. I
23 think my testimony stands, both here and in my
24 stipulation testimony, that the stipulation is a
25 real fair and balanced approach to the combination

1085

1 of bill credit with the extension of the imputation
2 type benefit.

3 Q Whether it's characterized as sharing or
4 not, if the Commission were to decide that a
5 greater level of customer benefit were necessary,
6 would it be appropriate to increase the one-time
7 customer bill credit to give customers that greater
8 benefit?

9 A Is it -- I guess I don't understand your
10 question. As opposed to other ways the Commission
11 could provide benefit to the customer?

12 Q Yes.

13 A Well, you know, I will support the
14 stipulation as being balanced and fair. I guess if
15 your question is, if the Commission does not accept
16 the stipulation and decides that more customer
17 benefit is due, and I had to choose where the
18 Commission should apply that, you know, I go back
19 to supporting the stipulation first and foremost as
20 being balanced and fair.

21 And then I would say that how the Commission
22 proceeds from there, I think, is really up to the
23 Commission. We put together a package that was
24 acceptable to all of the parties to the settlement,
25 and we think it's a fair and balanced package. So

1086

1 I'm not going to speculate as to how the Commission
2 should apply additional --

3 Q Well, again, without speculating -- going
4 into speculation, but if the Commission were to
5 decide that a greater customer benefit was
6 necessary, have you or the company decided whether
7 providing a greater up-front customer benefit would
8 be either an appropriate way to do it, or the best
9 way to do it?

10 MS. ANDERL: Objection, Your Honor. Asked
11 and answered.

12 JUDGE MOSS: I think we have covered this
13 ground, Mr. Trautman. I don't know how we can get
14 anymore. I think what Mr. Reynolds has said is the
15 company has thought only so far as to support the
16 stipulation, and he would be speculating. That's
17 how I understood his answer.

18 To go beyond that, unless the company has
19 some concrete proposal --

20 THE WITNESS: No. And Judge Moss, I think
21 I stated earlier that an up-front payment is very
22 serious for the company given its current financial
23 condition. And I talked in terms of Staff's
24 increment to what we have offered in the
25 stipulation in those terms.

1087

1 So hopefully Staff can take away from that
2 that an up-front payment, actual out-of-cash,
3 up-front when we need it the most, would be very
4 damaging to Qwest. And I think damaging to the
5 public interest, if the public interest is served by
6 Qwest staying a financially healthy corporation.

7 BY MR. TRAUTMAN:

8 Q At the bottom of page 7, lines 18 through
9 21, you state, "It does bear repeating that QC is a
10 multi-state company that finances its operations on
11 a total company basis. There are no
12 Washington-specific bonds, and no
13 Washington-specific shares of stock."

14 Do you see that?

15 A Yes, I do.

16 Q Now, would you agree that the fact that
17 there's no Washington-specific subsidiary of Qwest
18 is due to the company's having made the business
19 decision not to operate with state-specific
20 operating companies?

21 A I would agree with that, Mr. Trautman. It
22 happened some time ago for reasons -- I am sure for
23 good reasons at the time.

24 Q You continue, "It is therefore not
25 appropriate for Staff to attempt to extend

1088

1 Washington regulatory authority to company
2 management of long-term financing and cash
3 management on a 14-state basis."

4 Do you see that?

5 A Yes, I do.

6 Q Now, isn't another way of looking at the
7 situation would be that Qwest, by organizing its
8 corporate structure in the way that it has, has
9 perhaps attempted to prevent individual state
10 regulatory Commissions from exercising the
11 oversight that they could do for single-state
12 operating subsidiaries?

13 A You know, I don't know what the
14 motivations were when the company organized on a
15 regional basis. I suspect it had to do with
16 economies that could be gained in the management of
17 the company that way.

18 It would be speculative of me to assert that
19 somehow that was done in order to circumvent
20 Commission authority at the time.

21 Q If the Commission were to adopt the
22 structural safeguard that Staff has recommended, do
23 you think that Qwest might attempt to limit the
24 effect of those provisions by establishing an
25 operating company specific to Washington state?

1089

1 A That wasn't my thought. My thought in
2 drafting this testimony is that as a practical
3 matter, given the company's current structure, it
4 would be very difficult to extend the Commission's
5 authority over all of QC, and its cash management,
6 and its dividend into the parent, and the debt
7 equity ratio that QC may have.

8 Other than the way that the Commission
9 manages us on a regulated basis, and it might manage
10 an earnings investigation and the types of
11 adjustments they might do in a rate-making process,
12 you are looking at extending the Commission's
13 authority beyond that, to actual financial
14 management of the company between the subsidiary and
15 its parent.

16 Q So again, if the Commission were to adopt
17 Staff's recommended structural safeguard, do you
18 think that Qwest might attempt to limit the effect
19 of these provisions by establishing an operating
20 company specific to Washington State?

21 A I don't think that would be the first move
22 Qwest would do. I think Qwest would challenge the
23 Commission's authority to do that on a legal basis.

24 Q I have a few questions, now, pertaining to
25 the Stipulation and Settlement Agreement, which I

1090

1 believe is Exhibit 2.

2 JUDGE MOSS: That's correct.

3 THE WITNESS: (Reading document.)

4 Mr. Trautman, you are referring to the actual
5 stipulation, and not my testimony?

6 JUDGE MOSS: Correct. We're looking for
7 the actual Stipulation and Settlement Agreement,
8 which is Exhibit No. 2.

9 I think the bench has now located it, and
10 the witness seems to have it. So I think we're
11 ready.

12 BY MR. TRAUTMAN:

13 Q First of all, does the Settlement require
14 that if Qwest sells all or part of its Washington
15 telephone operation that the purchaser must be
16 bound by the terms of the settlement?

17 A Could you repeat that? I am sorry,
18 Mr. Trautman. I lost it.

19 Q Does the Settlement contain any provisions
20 requiring that if Qwest sells all or part of its
21 Washington telephone operation, that the purchaser
22 must be bound by the terms of the Settlement?

23 A It well could, Mr. Trautman. I am not
24 aware of a specific provision.

25 Q But --

1091

1 A I apologize. I was just looking on page 9
2 where it says successors, and it says, "This
3 agreement applies to and inures to the benefit of,
4 and is binding upon the parties and their
5 successors." So possibly that speaks to your
6 question.

7 Q But if -- let's say that Qwest were to
8 sell off the Rochester exchange. Would the buyer
9 of those exchanges be a successor, or do you know?

10 A I don't know. But I would assume not, for
11 purposes of this settlement.

12 Q Was it Qwest's intent to require a
13 purchaser of, say, those exchanges -- say the
14 Rochester exchange, to provide the revenue credits
15 provided for in the settlement?

16 A Was it our intent?

17 Q Yes.

18 A I think the intent of -- the way I read
19 No. 8 -- and I'm not an attorney -- was that the
20 intent was to the extent that the company is sold,
21 or any of the other parties transition into other
22 agencies, that they would still carry with it the
23 terms of this agreement.

24 Now, you are creating a hypothetical that I
25 don't think is anticipated by this agreement, that

1092

1 is, what if you sold off a small piece of it? What
2 would be their obligation under this agreement?

3 And I guess what I am saying is I have an
4 opinion that I don't think that would apply. I
5 think that the company that owns the majority of the
6 exchanges would still have the obligations
7 associated with the settlement, but it doesn't say
8 that. I mean, it's not explicitly addressed.

9 Q All right. Let's assume that Qwest sold
10 off every exchange but one. Does it believe that
11 that one exchange, it would have to pay the \$103
12 million revenue credit -- or \$110 million revenue
13 credit each year?

14 A No. I believe that the obligation should
15 stay with the company that owns the majority of the
16 company. I mean, I think that is what is
17 envisioned under No. 8.

18 As I said before, though, I'm not an
19 attorney. And maybe it would require the parties to
20 reconvene to discuss the situation that you have
21 posed to me here today.

22 Q On page 3 of the Settlement, paragraph C1
23 under Bill Credit, and the Settlement says that
24 Qwest will provide \$67 million in bill credits,
25 which Qwest is being referred to in that provision.

1093

1 A I don't think it's necessarily specified,
2 but I guess I would refer you, also, to page 5, the
3 top of the page, where it indicates that the
4 parties agree that the bill credit shall not be
5 recoverable from rate payers in this or any other
6 proceeding.

7 So to the extent that cash is fungible and in
8 the corporation, whether it comes from QC or QCII, I
9 don't think it matters. What matters to this
10 Commission is we're not going to seek to recover
11 that credit from rate payers.

12 Q Well, one point of clarification. One
13 reason I asked the question is because in the
14 introduction, QC, QSC and QCI are referred to
15 collectively as Qwest, and that's why. And then
16 the term Qwest is used in paragraph C, hence the
17 confusion.

18 A It's a valid question, Mr. Trautman. I
19 don't have an answer as to specifically what
20 organization the money would come out of. But I
21 think the important point is that we're certainly
22 not going to hold the rate payers liable for that.

23 Q So since the agreement defines Qwest to
24 include Qwest Services Corporation, and QCII, would
25 it be reasonable to read this provision in

1094

1 paragraph C1 as committing one of those two
2 entities to provide the funds necessary for the
3 credit?

4 A Could you restate the question? I think
5 you asked if it was only two entities, and if I
6 turn back to page 1, I think it defines four
7 entities as the collective Qwest. Am I
8 misreading --

9 Q It defines three, but since it doesn't
10 specify in C-1 which of those three, I asked whether
11 it would be reasonable to read the provisions
12 committing one of the two entities that I read,
13 being QSC and QCII. Would it be reasonable to read
14 paragraph C1 as committing one of those two entities
15 to provide the funds necessary?

16 A And your rationale? I am sorry.

17 CHAIRWOMAN SHOWALTER: Mr. Trautman, I really
18 don't understand the question. The first page says
19 there are three entities that are collectively
20 Qwest, that is, QC, QSC, QCII so give us how you get
21 from three to two.

22 BY MR. TRAUTMAN:

23 Q Let me go at it a different way. Let's
24 assume that it is QC that pays the bill credit. If
25 it were that situation, does QCII intend to

1095

1 reimburse QC for the cost of either the one-time
2 credit, or the annual revenue credits?

3 A I thought I addressed that earlier in that
4 I don't think it matters, because cash is fungible
5 to the extent that QCII would infuse \$40 million to
6 QC, or if QC would dividend money up to QCII, where
7 the actual dollars come from, I don't think really
8 matters.

9 I think what matters is whether Qwest would
10 try to seek any recovery of that money through the
11 regulatory process. And I think we put a provision
12 in there that keeps that from happening.

13 Q Would it be consistent with the agreement
14 to have QC fund the credit?

15 A To the extent that QC is listed as one of
16 the collective pieces of the Qwest designator in
17 this agreement, I think you could read that, that
18 it could be QC.

19 Q Could it be QSC?

20 A Yes.

21 Q And could it be QCII?

22 A Yes.

23 Q Paragraph C2, which is on page 5, states
24 in part that "The annual revenue credits will be
25 included for purposes of reporting intrastate

1096

1 financial results to the Commission for these or
2 any other purposes."

3 Do you see that?

4 A Yes, I do.

5 Q Will QC include the revenue credit amounts
6 as revenue for purposes of calculating the
7 regulatory fee that it pays to the WUTC?

8 A Mr. Trautman, I don't know the answer to
9 that. And I suppose it may hinge on the current
10 practice with regard to the existing imputation,
11 but I don't know the answer.

12 Because my point is, today there's an
13 imputation that's in place. And I don't know if
14 that imputation -- those imputed revenues are
15 included for purposes of determining a regulatory
16 fee or not. I suppose it would make sense to be
17 consistent with what that practice is.

18 Q It's a part of your testimony, is it not,
19 that the revenue credits are different from
20 imputation; is that not right?

21 A I think they are different in the sense
22 that they are a specified amount for a specified
23 period. But the effect of the revenue credits as
24 far as determining rate of return, and any type of
25 investigation that would seek to do that, I don't

1097

1 think they are different in that respect.

2 I mean, I think you would essentially report
3 them the same way, and you would use them in the
4 calculations of earnings the same way.

5 Q So it's your testimony that however it's
6 being done now relative to imputation, it would be
7 done the same way relative to revenue credits?

8 A And I don't know what you are referring
9 to, if you are referring to the regulatory fee --

10 Q Yes.

11 A To the regulatory fee?

12 Q Yes.

13 A My testimony is it would seem to make
14 sense that we be consistent. Now, I don't have
15 authority to tell you how -- what the company will
16 do in that respect. But I am telling you from my
17 opinion that it would seem to make sense to be
18 consistent with what we have done in the past.

19 Q Turning to Appendix 1 of the Settlement.

20 A (Complies.)

21 Q And there's a list of services that will
22 be included in the one-time credit.

23 Do you see that?

24 A Yes.

25 Q On the very lower left-hand corner there's

1098

1 a reference to ISDN- PR- TRK-Connection.

2 Do you see that?

3 A Yes, I do.

4 Q Does this service provide more than one
5 connection to the network?

6 A I believe it does. I believe primary
7 rate -- that's what the PR stands for -- primary
8 rate ISDN is provision on a DS1 type facility. So
9 I believe there are multiple channels that are
10 derived on that circuit.

11 Q And will this service receive a per-line
12 credit for each network connection, or just a
13 single per-line credit?

14 A I believe that the way the calculations
15 were done is that channels served as line
16 equivalents so that each channel would receive
17 a portion of the payments -- I am sorry. I said
18 a portion of the payments.

19 Each channel would receive its respective
20 payment, to be more clear. For example, if the
21 number that we have estimated is 29 plus dollars per
22 line, and it was estimated, based on taking into
23 account both actual physical lines and channel
24 equivalents. So when you have a service that has
25 more than one channel equivalent being provided on

1099

1 the line, it would receive a full share.

2 CHAIRWOMAN SHOWALTER: I still don't
3 understand the answer. You said receive -- just,
4 can you just be a little more concrete in the
5 example. Use some numbers.

6 THE WITNESS: Absolutely. To the extent you
7 have a service where you could derive 24 channels --
8 in fact, 24 channels are being derived, I think that
9 would be a requirement. You have to have the
10 channels up and running and active, and if they are
11 tabulated that way, each of the 24 channels would
12 receive the \$29 bill credit.

13 BY MR. TRAUTMAN:

14 Q I had a few other questions regarding the
15 Settlement, but they also relate to a passage of
16 testimony from Exhibit 61 that I think I can just
17 read. It's not particularly complicated. It was
18 from the top of page 8, and this was Ms. Jensen's
19 testimony. And she states that "It has long been
20 recognized that the financial health and viability
21 of a public utility is a primary consideration of
22 the public interest. Under rate of return
23 regulation this consideration is addressed by
24 assuring that QC is allowed the opportunity to earn
25 a sufficient and fair rate of return."

1100

1 Do you see that?

2 A Yes, I do.

3 Q If the Commission were to accept a
4 proposed settlement with a revenue credit of \$103.4
5 million in years five through 15, would the result
6 be that QC is allowed the opportunity to earn a
7 sufficient and fair rate of return in those years?

8 A I think that as a result of this
9 Settlement, I think the company is committing
10 itself to the type of return that it will earn.

11 Q And for years one through -- so is that
12 "yes" or "no"? Would that be a sufficient and fair
13 rate of return?

14 A I believe that the way that revenue credit
15 works, and the way that the Imputation has worked
16 in the past is it's a recognition of the revenue
17 stream from the directory business that used to be
18 integrated in the company prior to '83.

19 And the Commission has issued numerous orders
20 with regard to the imputation. That imputation has
21 become part and parcel of our revenues. And that --
22 our rate of return is not adjusted for that
23 imputation, and if we're going to be consistent with
24 the way the imputation has been treated in the past,
25 I would say it would be an unadjusted rate of return

1101

1 in the future as well.

2 Q So that's a "yes"?

3 A I believe it is.

4 Q Now, for years one through four where the
5 revenue credit would be \$110 million --

6 A The only thing I would correct is that I'm
7 not sure the company believes that 9367 is a fair
8 and sufficient rate of return. We would argue
9 that, I am sure, in a rate case. And I believe we
10 were ordered to that, and I believe we argued for a
11 different one during the last rate case.

12 So just so we understand, I'm not telling you
13 we believe it's a fair and sufficient rate of
14 return. It's what was ordered to us, and we have
15 lived with it because of the order.

16 Q Now, for years one through four where the
17 revenue credit would be \$110 million, would the
18 result be that QC is allowed the opportunity to
19 earn a sufficient and fair rate of return?

20 A I would say that my answer would be the
21 same as the other years.

22 Q If the Commission were to increase the
23 revenue credit amounts by a small amount, such as,
24 for example, 10 percent, would that deprive QC of
25 the opportunity to earn a sufficient and fair rate

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1 of return?

2 A Once again, I will go back to my
3 correction before that with regard to sufficient
4 and fair rate of return. Those are the types of
5 issues that are argued during an earnings
6 investigation, and we will argue what we argue at
7 that point in time.

8 And what is ordered in terms of a revenue
9 credit, if that goes into place and the company
10 accepts that, that will become part and parcel of
11 the determination that is made at that point in
12 time.

13 It's hard for me to answer your question here
14 without an actual investigation having taken place.

15 Q All right. To the extent you would agree
16 that \$110 million would provide enough for a
17 sufficient and fair rate of return, would 10
18 percent more than that provide a sufficient and
19 fair rate of return?

20 A I don't think I agreed with that. I mean,
21 I think I told you that the revenue credit has the
22 imputation, in the past. The way that they are
23 applied will be taken into account in any earnings
24 investigation.

25 The company will argue what it believes is

1103

1 a fair, reasonable, and sufficient rate of return.
2 Other parties will present their cases, and the
3 Commission will make a determination. And from
4 there on out, to the extent that the Commission's
5 order is not stayed, the company will comply.

6 Q Would the company argue for a different rate
7 of return based on the amount of revenue credit that
8 is provided?

9 A I don't think I could speculate as to what
10 the company may or may not do in a future earnings
11 investigation. I do think that in the past a bone
12 of contention has been the imputation amount, and
13 the company has repeatedly brought cases before the
14 Commission with regard to the imputation.

15 I believe that to the extent that the company
16 voluntarily submits to this revenue credit as a part
17 of this settlement, and the Commission adopts that,
18 that that is fairly determinative in any future
19 investigation that the company committed to do that.
20 And it was not necessarily as a result of a
21 Commission order.

22 Q So were you saying it would depend on
23 what -- are you saying it would depend on the fact
24 that the company agreed to it?

25 A I am saying that I think that that would

1104

1 carry some weight with the Commission in any future
2 earnings investigation that the company committed
3 to apply this revenue credit in the future, and
4 that that should be taken into account.

5 Q If you could turn, now, to Exhibit 93,
6 which was your testimony in support of the
7 Settlement Agreement filed on May 16.

8 A (Complies.)

9 CHAIRWOMAN SHOWALTER: Would you say that
10 again?

11 MR. TRAUTMAN: Exhibit 93. It's
12 Mr. Reynolds' testimony in support of the
13 Settlement Agreement, and it has a date of May 16,
14 2003.

15 CHAIRWOMAN SHOWALTER: Hold on.

16 BY MR. TRAUTMAN:

17 Q And if you could turn to page 3 --

18 COMMISSIONER HEMSTAD: Would you wait a
19 minute, please.

20 MR. TRAUTMAN: I'm sorry.

21 CHAIRWOMAN SHOWALTER: (Looking for
22 document.) Oh, here it is. I have it now.

23 BY MR. TRAUTMAN:

24 Q On page 3 at the top of the page you
25 state, lines 2 and 3, "The annual revenue credit is

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1 intended to extend the benefits of the current
2 directory imputation to customers for the
3 foreseeable future."

4 Do you see that?

5 A Yes, I do.

6 Q You used the term "foreseeable future."
7 By this term do you mean 15 years?

8 A Yes.

9 Q Are you saying that the Commission should
10 give no consideration to whatever circumstances
11 exist after the 15 years have expired?

12 A Yes. I mean, to the extent that this
13 satisfies our obligation because we have sold the
14 business, that's what this proceeding is about.
15 And when you are done, you are done.

16 Q Let's assume that Qwest could have
17 obtained the same price for the Dex sale with a
18 15-year publishing agreement, and a 15-year
19 noncompetition agreement, rather than the 40- and
20 50-year agreements that are actually proposed.

21 Do you believe Qwest would have preferred the
22 15-year term?

23 MS. ANDERL: I object, Your Honor. That
24 assumes facts not in evidence.

25 MR. TRAUTMAN: It's a hypothetical.

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1 JUDGE MOSS: I will overrule the
2 objection. He's just asking if a 15 year would
3 have been acceptable.

4 BY MR. TRAUTMAN:

5 Q Preferable.

6 A Mr. Trautman, I was not involved in those
7 negotiations, so I can't tell you what was in the
8 minds of those that were on either the buyer's
9 part, or the seller's part. There are benefits the
10 company gets from the publishing agreement, and
11 those are very valuable to QC. And that's all I
12 can tell you.

13 I mean, I don't know whether there's a lot of
14 value associated with a shorter publishing
15 agreement.

16 Q Is it your understanding that the buyers
17 would not like to see the 40- and 50-year
18 agreements reduced to 15-year agreements?

19 A Yes.

20 Q Does it seem to you that both the buyer
21 and the seller are attributing some value to the
22 years beyond year 15 of this transaction?

23 A I think to the extent there's been
24 testimony based on the FAS 141, and also based on
25 the actual publishing agreement itself and the

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1 noncompete agreement containing liquidated damage
2 clauses, I think you could ascribe some value to
3 those provisions.

4 Q So is that a "yes"?

5 A It's a "yes," but it's a qualified yes. I
6 don't know how much stock to put in that.
7 Obviously Mr. Kennard sat up here and told you that
8 it was important for them to get a long-term
9 agreement.

10 Q Staying on page 3, at the bottom of the
11 page you state, "Qwest's current customer service
12 guarantee program was last addressed in the US
13 West/Qwest Merger Settlement Agreement in Docket
14 UT991358. That agreement allowed Qwest to file
15 tariff revisions to remove any customer-specific
16 service quality credits required in Section II
17 A.3-7 of the Merger Settlement Agreement that are
18 not required of all telecommunications carriers
19 operating in exchanges in which the company
20 operates three years after the merger closing date,
21 June 30 of 2003."

22 Do you see that?

23 A Yes.

24 Q Now, regarding your characterization of
25 the terms of the merger order, you state that Qwest

1108

1 is, quote, allowed to file a tariff.

2 Would you agree that this simply allows Qwest
3 to propose an end to the customer service guarantee
4 program?

5 A Absolutely.

6 Q Would other parties, including Staff and
7 public counsel, be free to oppose that proposal?

8 A Yes.

9 Q And would the Commission be free to
10 suspend that filing?

11 A Yes.

12 Q Was Qwest planning to make a filing after
13 June 30, 2003, to remove those provisions?

14 A Qwest has certainly looked at the
15 provisions, and has questioned the level of the
16 actual credits. And whether Qwest was actually
17 going to make a filing to remove the provisions
18 altogether or to adjust the credits, I don't think
19 it had been determined.

20 But we certainly have looked -- we have
21 looked at the credits. We have looked at our
22 performance. And we believe that the penalty
23 doesn't necessarily fit the crime.

24 And I don't think we have kept that a secret.
25 We have shared that with a lot of parties, and I

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1 believe we shared that with the Commission.

2 So to the effect that we had plans after that
3 point in time, yes, I would say we did. But I don't
4 know that those plans extended to removing the
5 provision altogether.

6 Q Which of the service quality credits that
7 are required by the merger order are not required
8 of all other telecommunications carriers?

9 A I don't know that, Mr. Trautman.

10 Q On page 4, continuing on Exhibit 93, lines
11 7 through 10, you state, "This would not limit
12 Qwest's ability to seek modification to the
13 program, including the service quality credits,
14 although Qwest commits to consult with the parties
15 prior to any such filing."

16 Do you see that?

17 A Yes, I do.

18 Q What is the practical effect of saying
19 that Qwest cannot propose to eliminate any of the
20 service quality credits, but it is allowed to
21 propose to modify the program?

22 A Well, Qwest retained its right to do what
23 I suggested a few minutes ago. And that is, Qwest
24 could still go in and request modification to
25 certain aspects of the program. It could not do

1110

1 so, though, before it consulted with the other
2 parties to the stipulation to discuss what types of
3 changes it would want to make, and have a
4 discussion along those lines.

5 Q Would it violate the terms of the proposed
6 settlement if Qwest were to reduce the amount of
7 the \$50 credit for missed appointments?

8 A It would violate the terms if Qwest
9 unilaterally filed without consultation of the
10 other parties. Qwest has the ability to propose
11 changes, however.

12 Q That's consultation, correct?

13 A Yes.

14 Q You don't have a veto -- they don't have a
15 veto?

16 A No.

17 Q Does the settlement prevent Qwest from
18 proposing to eliminate all of the reporting
19 requirements that are used to track Qwest's service
20 quality performance?

21 A I don't believe it does.

22 Q Turning to page 6 of Exhibit 93, and
23 starting at line 1, there's a paragraph that
24 states, "The transaction should not harm rate
25 payers by causing rates or risks to increase, or by

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1 causing service quality and reliability to decline,
2 compared with what could reasonably be expected to
3 have occurred in the absence of the transaction."

4 Then you state, "The agreement offers rate
5 payers protection from rate increases for the
6 foreseeable future, and it extends the current
7 benefits of imputation for 15 years. Furthermore,
8 the agreement provides for a one-time bill credit to
9 customers of \$67 million, effectively making a
10 direct payment to rate payers for partial
11 disposition of the sale."

12 Do you see that?

13 A Yes, I do.

14 Q Now, you have testified about how the
15 proposed settlement extends the current level of
16 imputation for 15 years, and provides a one-time
17 credit. But this does not directly address the
18 question of, quote, from the paragraph preceding,
19 what could reasonably be expected to occur in
20 absence of the transaction.

21 And is it your testimony that it is
22 reasonable to expect if Qwest keeps the directory
23 business that revenues will decline over the next
24 five years, directory revenues?

25 A I think that's not what I was referring to

1112

1 there. I was referring to the extent that the sale
2 is not done, and there's a likelihood of
3 bankruptcy, that rate payers would be worse off.
4 They wouldn't have any disposition from the gain.
5 So the settlement proposal is far superior to that
6 outcome, and we believe that that outcome was
7 likely. And so that's my rationale for how I --
8 for how I interpreted that particular provision.

9 MR. TRAUTMAN: That's all the questions I
10 have on the Settlement Agreement. The only other
11 questions I would have are for exhibits that were
12 passed around earlier, Exhibits 96 and 97.

13 JUDGE MOSS: I haven't identified 97 on
14 the record. Let me do that now. Earlier,
15 Mr. Trautman did distribute a document that I will
16 mark for identification as Exhibit 97, with the
17 description "ASCI, First Quarter Scores."

18 (EXHIBIT 97 IDENTIFIED.)

19 BY MR. TRAUTMAN:

20 Q And I am looking, first, at Exhibit 96,
21 which I believe came out today.

22 A (Looking at document.)

23 Q And is it correct that this report
24 contains -- or is entitled "Qwest Communications
25 Report's First Quarter Earnings, Operational

1113

1 Highlights and Additional Results of Financial
2 Restatement and Audit Review"?

3 A Yes, that's what it says on the header.

4 Q And looking down below the date line of
5 Denver, May 29, 2003, in that paragraph, do you see
6 there that in the second sentence it states that
7 "The company announced first quarter net income" --
8 and this is QCII, I should state -- announced first
9 quarter net income of \$150 million, or 9 cents per
10 diluted share?

11 A Yes.

12 Q Do you know what the comparable figure for
13 the same period in 2002 is?

14 A (Reading document.) I don't.

15 Q If you turn to page 2 --

16 A (Complies.)

17 Q -- of this exhibit, it would be the fourth
18 paragraph down under the heading, "Operating
19 Results," the second sentence of that paragraph,
20 do you see there, "This compares to a net loss in
21 the first quarter of 2002 of \$23.9 billion, or
22 \$14.32 per share"?

23 A Yes, I see that.

24 Q If you could turn now to the next page of
25 the attachment, page 3, and look at the third

1114

1 bullet point. And in the second sentence it refers
2 to the American Customer Satisfaction Index and
3 states, "In the American Customer Satisfaction
4 Index, ASCI, published by the University of
5 Michigan Business School, Qwest's score moved up
6 10.7 percent over last year's survey, the largest
7 improvement of any telecom company, and the second
8 highest improvement of all the companies surveyed."

9 Do you see that?

10 A Yes.

11 Q Now, referring you to Exhibit 97, at the
12 top it says, "First Quarter Scores." Do you know
13 whether this is the survey that is referenced in
14 Exhibit 96?

15 A I do not.

16 Q Would you look -- could you turn to page 2
17 of Exhibit 97?

18 A (Complies.)

19 Q And look for the -- if you see the
20 columns, the last two columns, if you look at the
21 headings that carry over from page 1 you will
22 see -- not including the cut-off column, the second
23 column from the end says, Q-1 2002, and the next
24 one would be Q-1, 2003. Do you see that? Do you
25 see, first of all, the column heading?

1115

1 A Yes.

2 Q And then turning to page 2, going down
3 under Telecommunication, Local, it says Qwest
4 Communication International, Inc. And do you see
5 there that the score for first quarter 2002 is a
6 56?

7 A (Reading document.) Yes, I am sorry.
8 Yes.

9 Q And then in 2003 it's 62?

10 A Yes.

11 Q And so would you agree, subject simply to
12 mathematical check, that the increase of 62 over 56
13 is an increase of 10.7 percent?

14 A Yes. I have checked it.

15 Q So that appears to be the 10.7 percent
16 that was referred to in Exhibit 96; is that
17 correct?

18 A Either that, or it's very coincidental.

19 Q Now, looking at Qwest's score for first
20 quarter 2003 of 62, if you move up the page, do you
21 see that the score for MCI Group under
22 Telecommunication Long Distance is 67?

23 MS. ANDERL: I would object to any further
24 cross on this document. It's not been offered,
25 hasn't been authenticated, doesn't appear to be

1116

1 complete; has a column cut off; it's unclear that
2 this document is admissible at all for any purpose,
3 and having the witness answer questions with regard
4 to that puts the information into the record without
5 any ruling on its admissibility.

6 JUDGE MOSS: Well, we don't typically rule
7 on the admission of the exhibits until the cross
8 examination has been completed. That's been our
9 practice in this hearing, as in most Commission
10 hearings, so I'm not going to cut off the line of
11 questions on that basis.

12 If your question is to foundation, you have
13 laid some foundation for this, Mr. Trautman, but I
14 think the witness has indicated that he can't
15 directly corroborate that the one document relates
16 to the other. And so you might want to lay some
17 additional foundation to establish whether the
18 witness can reliably respond to questions concerning
19 this exhibit that has been marked as Exhibit No. 97.

20 Otherwise, Ms. Anderl's point may be well
21 taken, that the testimony will not be particularly
22 useful.

23 BY MR. TRAUTMAN:

24 Q Do you have any reason to believe, looking
25 at Exhibit 96, and again the third bullet point

1117

1 that specifically refers to a 10.7 percent
2 improvement in QCII's score under an index that is
3 expressly called the American Customer Satisfaction
4 Index, ASCI -- having that in mind, and then
5 looking at Exhibit 97, which expressly has the
6 heading ASCI, American Customer Satisfaction Index,
7 and as we have agreed, derives the percentage of
8 10.7 percent, do you have any reason to believe
9 that this American Customer Satisfaction Index
10 report is not the report that is referred to in
11 Exhibit 96?

12 A I don't have any reason to believe it's
13 not, Mr. Trautman. But I can't, with all comfort,
14 substantiate that it is. I mean, it appears to be
15 the document that refers to the percentage increase
16 words. But as I said earlier, I'm not familiar
17 with this document.

18 Q And this is -- Exhibit 97 is a document
19 that is referred to by Qwest in its own Reports of
20 First Quarter Earnings, Operational Highlights and
21 Additional Results; is that correct?

22 A Yes, I can't deny that. At least it lists
23 the American Customer Satisfaction Index, and this
24 document has the same label on it. But that's all
25 I can put together. I don't have any other

1118

1 original knowledge of this document.

2 Q And Qwest also indicates that in citing
3 Exhibit 97, not only that its score moved up 10.7
4 percent, but this was the largest of the
5 improvements of any telecom company, and the second
6 highest of all the companies surveyed; is that
7 correct?

8 A That's what the document says, yes.

9 Q Now, on Exhibit 97, as we saw, the Qwest
10 score was 62?

11 MS. ANDERL: Your Honor, I would renew my
12 objection.

13 JUDGE MOSS: I'm going to overrule the
14 objection, because it goes to the weight, not to
15 the admissibility. And so if you want to ask the
16 questions, the witness can answer to the best of
17 his ability. The Commission can be asked to infer
18 what it will about the reliability of the
19 underlying exhibits.

20 MR. TRAUTMAN: Thank you.

21 BY MR. TRAUTMAN:

22 Q Looking at the line for the MCI Group, and
23 this is on Exhibit 97, page 2, and you see in the
24 far right corner that the score for MCI Group is
25 67; is that correct?

1119

1 A That's what it says, yes.

2 Q And then turning forward two pages to page
3 4 of 4, at the very top you see, PG&E Corporation.
4 And is it correct that PG&E Corporation is 66?

5 A Yeah, that's what it says.

6 MR. TRAUTMAN: All right. That's all the
7 questions I have on these documents.

8 We would like to move them into the record,
9 and I would move for admission of Exhibits 74
10 through 86, as well as Exhibits 96 to 97.

11 (EXHIBITS 74-86, 96, 97 OFFERED.)

12 JUDGE MOSS: Any objections?

13 MS. ANDERL: Your Honor, 97, in addition
14 to the other objections that I have already noted,
15 does appear to be an incomplete document.

16 The far right-hand column and any other
17 information further to the right that may or may not
18 have been there, does not appear on the printed page
19 that I have.

20 MR. TRAUTMAN: We can correct that, if the
21 Commission would like.

22 JUDGE MOSS: Sure. That's not an issue.

23 JUDGE MOSS: Is that the extent of your
24 objections?

25 MS. ANDERL: Yes.

1120

1 JUDGE MOSS: The objection will be
2 overruled, and the exhibits will be admitted as
3 marked.

4 (EXHIBITS 74 to 86, 96, 97 ADMITTED)

5 JUDGE MOSS: I will just note for the
6 record that we had previously admitted Exhibits 87
7 through 90 with another witness, and that we are
8 ready for questions from the bench. We might as
9 well get started before lunch.

10

11 EXAMINATION

12

13 BY CHAIRWOMAN SHOWALTER:

14 Q Mr. Reynolds, if you could turn to Exhibit
15 94, it's page 3.

16 A (Complies.)

17 Q I am looking at line 4. You were asked
18 some questions about what it means to say that the
19 Staff proposal is totally and unequivocally
20 unacceptable to the company. And without getting
21 to the Staff's recommendations specifically, I
22 assume there is some set of conditions that the
23 Commission might impose that would cause the
24 company to refuse to accept them; is that correct?

25 A I believe that that is true. And

1121

1 Chairwoman Showalter, it would not be in violation
2 of a Commission order. It would be that the
3 company would probably back away from the deal, or
4 restructure the deal.

5 Q And, actually, we have, in the prior case,
6 Coast laid out conditions that the company rejected
7 and the sale did not go through. So it happens. I
8 think in retrospect, I think that was a very good
9 decision for the company, but that's not the issue
10 I am getting at here.

11 I think it's -- would you agree that for a
12 sale to occur, it has to occur with the concurrence
13 of both the company and the Commission? Otherwise,
14 either the sale does not occur, or this Commission
15 gets left out of the transaction in some way; is
16 that correct?

17 A Yes. But let me hedge it a little. I
18 think if you are asking from a jurisdictional
19 perspective, I have some testimony that I adopted
20 from Theresa Jensen regarding the Commission's
21 authority to approve this, and it's based on, I
22 believe -- well, let me --

23 Q I see where you are going. You are saying
24 that it may be that you don't need our permission,
25 in any event, and you are preserving that legal

1122

1 option?

2 A Exactly. And not withstanding that, if
3 your question was beyond that, I would certainly be
4 willing to attempt to offer it a response.

5 Q Well, then, turning to the Staff -- well,
6 the immediate Staff -- the first Staff
7 recommendation is that we simply do not approve the
8 sale, period. So I would like to take that
9 scenario for a minute. Suppose we say, "No, the
10 sale is not in public interest. Denied."

11 What would be the company's reaction? Would
12 you seek to renegotiate the transaction in some
13 manner without the State of Washington?

14 A To the extent that the company saw a
15 benefit, and that it could realize value for the
16 property doing so, I think that that is a likely
17 outcome.

18 And I think that later, during whatever type
19 of earnings investigation might occur, then it would
20 leave the company and the Commission to deal with
21 the preexisting imputation, and other issues
22 associated with that.

23 It seems to me that might be where that comes
24 to a head as to what the Commission's authority is
25 to continue to impose some type of benefit to the

1123

1 rate payer.

2 Q All right. Now, turning to the Staff
3 response to the proposed settlement, if the
4 Commission were to adopt all of those conditions as
5 a condition for approval, which I believe you have
6 said is totally and unequivocally unacceptable to
7 the company, what does that mean? Does that also
8 mean you would seek to renegotiate the deal without
9 the State of Washington?

10 A If that were the only recourse that was
11 left -- I think what I'm saying is I don't think
12 it's acceptable to the company to accept an amount
13 that is greater than the actual realized price,
14 because that defeats the whole purpose of the sale
15 for us.

16 So I think we would try to find a way,
17 whether it's renegotiating the sale around
18 Washington -- or I can't think of what another
19 possibility would be. So obviously I think that's
20 what we're faced with. Either the entire Rodney
21 deal falls away, which I don't think would happen.
22 I think the buyer and the seller would try to put a
23 deal together that envisioned no Washington.

24 And there's been a lot of testimony up here
25 about people envisioning what that might look like.

1 And I think I just tried to play that out a little
2 bit for you both on a regulatory front, and also on
3 a buyer-seller front. But, you know -- is that
4 responsive to your question?

5 Q Yes. Well, as you mentioned, one
6 possibility might be that the Rodney sale as a
7 whole simply does not go through, period. The
8 other would be some kind of renegotiation of the
9 Rodney sale.

10 Now, as I understood you, you said you
11 thought it would be more likely that there would be
12 at least an attempt at a renegotiation of the Rodney
13 sale, than just a decision to forget the sale; is
14 that correct?

15 A Yes. And Chairwoman Showalter, that's my
16 opinion based on everything that I have heard here,
17 and the company's need for money and cash. I think
18 they would definitely try to put some sort of deal
19 together.

20 Q So all of these are probabilities, so none
21 is a certainty. But assuming that's what the
22 company does, or would do, do you agree that the
23 most realistic situation for the Commission to
24 consider is some order of some kind, whether it's
25 accepting your settlement or Dr. Blackmon's

1125

1 settlement, or some other set of conditions, that
2 we would be comparing that to Qwest's attempting to
3 renegotiate the sale without us? Is that the
4 realistic comparison we should be looking at?

5 A I think if your question stems from a
6 comparison of certain bankruptcy to the proposals
7 that have been presented, I think the company is
8 set on surviving without bankruptcy.

9 And once again, it's my opinion, but I think
10 there would be a very real possibility that the
11 company would try to put together a deal with the
12 buyer to complete the sale. And if that meant
13 completing it around Washington, because
14 Washington's terms and conditions were unacceptable,
15 then I think that's a likelihood.

16 Q Well --

17 A And to your point for the Commission's
18 comparison purposes, I think you are being a
19 realist.

20 Q I hadn't mentioned the bankruptcy issue,
21 but I will ask it now. Sitting here today, do you
22 think that if the entire Dex West sale does not go
23 through, that bankruptcy of Qwest International is
24 likely; that is, more likely than not?

25 A I think it's less likely than the Rodney

1126

1 deal closing or not closing. It's in its entirety.

2 I think to the extent that Qwest could get
3 some funds from this deal, it obviously improves
4 our chances. Washington is a big share of the
5 Rodney deal, and that's a lot of money.

6 Q I'm not sure you understood my question.

7 A I'm not sure I did.

8 Q My question -- this question is, if you
9 compare the whole sale going through with the whole
10 Rodney sale not going through -- and actually that
11 is not my comparison.

12 If the Rodney sale does not go through, the
13 whole thing, in your opinion, is it more likely than
14 not that Qwest would have to file for bankruptcy?

15 A That has been my testimony.

16 Q Today?

17 A Yes.

18 Q As of today?

19 A Yes. I think -- yes.

20 Q Now I will ask the question that maybe you
21 thought I had asked, which is, if the State of
22 Washington is left out of the deal, but the rest of
23 the Rodney sale does go through -- and let's say on
24 reasonably comparable pro rata terms, do you think
25 it is likely, that is, more likely than not, that

1127

1 QCII would have to file for bankruptcy?

2 A The way I would answer that -- and you
3 said pro rata, it really depends on what the seller
4 can work out with the buyer, and what the buyer --
5 how that scenario would play out, and how much the
6 buyer thought they could play in this market.

7 And so what the residual -- if there's a
8 Rodney, Rodney, the rest of Rodney deal -- what
9 that is worth to the buyer might be more than the
10 pro rata share that we have been talking about, if
11 you understand what I'm saying.

12 Q Yes, I do. In other words, I think what
13 you are saying, there are economies to having the
14 whole sale go together to the buyer. And there are
15 probably -- those same economies would be reflected
16 in the value of Qwest, of Yellow Pages Washington
17 that might be left in us. That is, the whole is
18 worth more than the sum of the parts, I think?

19 A That's true. But it's also a question of
20 how quickly the buyer felt they could reconstitute
21 a company in this state. And I think there's been
22 testimony to that effect. And so they would have
23 to weigh that against not having the certainty of
24 having the State of Washington included in the
25 deal.

1128

1 Obviously that's fraught with some
2 regulatory problems, and I am sure there's concerns
3 on both of the buyer's and seller's part that they
4 would rather do this deal here in front of you, and
5 have you approve the sale, and have it be in
6 accordance with terms and conditions that everyone
7 can live with, and that everyone benefits from. I
8 mean, that is definitely the idea, and that's why
9 we're here.

10 Q And in making the judgment to renegotiate,
11 wouldn't the value of the renegotiated package
12 depend somewhat on what actually does get left in
13 Washington, that is, simply the publishing
14 agreements, or also employees, the Washington
15 Yellow Page business itself?

16 A I think those are factors that would play
17 out. You have heard people talk about whether Dex
18 could use the Dex name here. I mean, there are all
19 kinds of considerations that I am sure the buyer
20 and seller would assess if they engaged in that
21 type of discussion.

22 CHAIRWOMAN SHOWALTER: I am just about to
23 go to a different line of questioning, so probably
24 it would be best to stop.

25 JUDGE MOSS: All right. We will take our

1129

1 luncheon recess, and we will be back at 1:30.

2 (Lunch recess taken.)

3 JUDGE MOSS: All right. Let's come back
4 to order, and momentarily we will get back into
5 cross examination.

6 I have marked some exhibits, and let me
7 take care of that housekeeping matter. I have
8 given numbers to the Record Requisitions Responses,
9 as well as the Bench Request Responses.

10 We will see at some point about admitting
11 these, but to bring everyone up to date in terms of
12 their exhibit lists, unfortunately I am off by one
13 number here.

14 So Record Requisition 2, is Exhibit 3.
15 Record Requisition 3 is Exhibit 4. Bench Request 1
16 is Exhibit No. 5, and Bench Request 2 is Exhibit
17 No. 6. Record Requisition 4 corresponds to Exhibit
18 No. 7. Record Requisition 5 corresponds to Exhibit
19 No. 8. Bench Request 3 is Exhibit 9. Bench
20 Request 4, 10. Bench Request 5 is 11. Bench
21 Request 6 is Exhibit 12. And Records Requisition 6
22 is Exhibit 13.

23 So those numbers are at least reserved.
24 The Bench will move all of its Bench Request
25 Responses at the end of the proceeding, and we will

1130

1 take their admission or not at that time.

2 Records Requisitions, in light of parties'
3 preferences, as I have heard them expressed, can be
4 moved or not, as the requesting party wishes. And
5 then, of course, all of these are subject to
6 objections that might be interposed.

7 MR. CROMWELL: Your Honor, will you state
8 what corresponds to Exhibits 8 through 12 again?

9 JUDGE MOSS: Record Requisition 5 is
10 Exhibit 8, Bench Request 3, 4, 5, 6 correspond to
11 Exhibit Nos. 9, 10, 11 and 12.

12 MR. CROMWELL: Great. Thank you.

13 JUDGE MOSS: Uh-huh. And the court
14 reporter's favorite expression, "uh-huh." I
15 apologize.

16 Why don't we resume. Mr. Reynolds remains
17 under oath after our lunch recess, and we're ready
18 to resume his cross examination from the bench.

19

20 BY CHAIRWOMAN SHOWALTER:

21 Q Mr. Reynolds, let's start off with a
22 trivia question, and see if you know the answer.

23 Where does the name Dex come from?

24 A That, I don't know.

25 Q You failed the test.

1131

1 A Yeah.

2 Q I don't know either. Can we ask about
3 Qwest?

4 JUDGE MOSS: Can we ask about Qwest?

5 MS. ANDERL: I can volunteer an answer
6 from Dex, because I do know that from the documents
7 in the case.

8 CHAIRWOMAN SHOWALTER: Since we don't need
9 it in evidence, what is the answer?

10 MS. ANDERL: It's short for Directory
11 Expert.

12 JUDGE MOSS: How about Qwest?

13 MS. ANDERL: That's short for Qwest.

14 THE WITNESS: In fact, you jogged my
15 memory. You will recall that one of the logos
16 early on was a man with glasses. He was the
17 Directory Expert.

18 JUDGE MOSS: Like that annoying little
19 thing that pops up on the windows --

20 THE WITNESS: Looked a lot like that.

21 JUDGE MOSS: No implication intended.

22 BY CHAIRWOMAN SHOWALTER:

23 Q All right. Can you turn to page 5 of
24 Exhibit 94.

25 A (Complies.)

1132

1 Q And as I read your testimony on this page
2 and the next, you are saying that a contract for
3 credits, as Staff recommends, interferes with
4 Qwest's cash liquidity, which is one of the
5 problems it wants to address; is that correct?

6 A Yes.

7 Q But what I want to ask about is the
8 settlement proposal also has credits and
9 imputations not backed by contracts. So that's not
10 an "also," it has credits not backed by contracts.

11 But if the money -- if the money is going
12 to be there to back that credit or that imputation,
13 doesn't it amount to the same thing?

14 A No. The payments that Staff recommends
15 would be actual cash payments each and every year
16 that would have to be made from the parent to its
17 subsidiary QC. And as I point out, that constrains
18 cash, because Staff put some other conditions
19 around that, such that QC would now be limited in
20 its ability to dividend back up to its parent
21 unless it gained Commission approval to do so.

22 So if you couple those two together, it
23 constrains the cash at the QC level. Revenue
24 credits apply very similar to the preexisting
25 imputation, and they are reported but they come

1133

1 into play only during an earnings investigation.

2 And that's not entirely true, because they
3 actually have an effect each and every year they
4 are in effect. The company looks at its authorized
5 rate of return and makes a determination as to
6 whether it wants to come in and seek higher rates
7 from the Commission, and the Commission would also
8 watch that. And obviously the revenue credit has a
9 very real impact each and every year. But it
10 doesn't manifest itself in revenues to the company
11 unless you have a rate case that results in rate
12 change also, that takes into account those revenue
13 credits.

14 Q But the revenue that comes from rates is
15 lower than if you do not have the credit or
16 imputation, correct?

17 A That's correct. That's correct.

18 Q And today there actually is a source of
19 revenue to make up that difference called the
20 Yellow Pages. But in the future if the sale goes
21 through, there is not that revenue stream?

22 A I would suggest that there's actually an
23 offset at the parent level. To the extent that you
24 sell the business, you forgot future revenue
25 streams. But you also have \$7 billion to pay down

1134

1 debt and the capital costs on that debt. So you no
2 longer have those debt payments.

3 So at the parent level, I'm not saying
4 it's a one for one satisfaction of revenues versus
5 debt, but you can think of it in those terms. And
6 at the QC level, the imputation continues, albeit
7 on an incremented basis. If you would agree that
8 the last time we actually had an imputation
9 determined as a result of a Commission order, it
10 was determined at \$85 million. That's what is
11 embedded in our rates today. We have not had a
12 rate case since that period of time.

13 So to the extent the Commissions adopts
14 this stipulation, and we have \$110 or \$103 in a
15 year, that's what we will be taking into account.
16 So the real difference between today versus
17 tomorrow would be the increment between the 85 and
18 110, or 103.

19 And that's the additional revenue effect
20 that the company would have to live with, and
21 that's what it is willing to sign up for in terms
22 of the stipulation. And to the extent that it was
23 able to pay down some debt with the proceeds from
24 Dex, it's really under the same type of financial
25 status as it is today, is what I would submit to

1135

1 you.

2 Q And I understand that it's beneficial to
3 QCII and the Qwest family to pay off some debt, but
4 I want to be sure you are not counting this money
5 twice. That is, you use the proceeds to pay off
6 the debt, and now that there is, in essence, some
7 equivalent to a revenue stream which really isn't
8 there, if the company does all right in the future,
9 then you can take it out of other profits, I guess.

10 A That's true. But I think you truly have
11 to think about the transaction in terms of
12 monetizing, to use a word, a future stream of
13 revenues -- that's what Dex represented to the
14 company -- and taking that gross value and turning
15 around and taking care of obligations that had debt
16 payment obligations associated with them.

17 And so there is actually an offset. I
18 mean, today we take in the Dex revenues, and we
19 turn around and pay the bank the interest on the
20 loans. And tomorrow, at least for a portion of
21 that, we won't have the Dex revenues, but we also
22 won't have the interest on the loans. So there
23 tends to be an offset at the corporate level;
24 meanwhile at the QC level, there is a change from
25 the preexisting imputation and revenue credit, but

1136

1 it's an incremental change. It isn't a huge
2 change.

3 Q And tomorrow is what I'm concerned about,
4 because the company is not willing to say that
5 we're so confident that we can meet this obligation
6 tomorrow, that we will commit to a definite revenue
7 stream. We will just commit to the credit and
8 imputation, but not a clear obligation to pay
9 certain amounts equivalent to those credits or
10 imputation amounts.

11 A Yes, but it's sort of a double-edged
12 sword. I think as I explained, to the extent the
13 payments actually weakened the company, we would
14 maintain that that is not in the interest of
15 anyone, including QC, QCII, or the rate payers to
16 the extent that it works adverse to the company's
17 financial condition, when you can pass along the
18 same type of benefit that you have been passing
19 along in the past through the revenue credit, which
20 is more or less an extension of the imputation
21 benefit.

22 Q If you were actually able to pass along
23 the same type of benefit --

24 A Well, I don't think -- I mean, to the
25 extent that that revenue credit is there, and we go

1137

1 into an earnings investigation, the company is not
2 going to be able to sidestep it. It's there, plain
3 and simple. And we will be required to take it
4 into account in setting rates.

5 And so QC has already sort of absorbed
6 that amount of -- I mean, in the past they have
7 decided -- or, I mean, QCII has accepted the fact
8 that they are going to earn less as a result of
9 this imputation from one of its subsidiaries dating
10 back to the first imputation, and it's a
11 continuation of that.

12 Q I know I have been seeing that Kirk Nelson
13 has been in the audience the whole time recognizing
14 what his profits may show.

15 I suppose one of the things you are
16 saying, on the other hand, if we don't approve the
17 sale you don't think those credits and
18 imputations -- or the imputations will be
19 guaranteed anyway, because you think there would
20 be, more likely than not, a bankruptcy?

21 A Yes, that is an alternative.

22 Q I have in mind a matrix, and you will need
23 a piece of paper to follow it. And it has -- well,
24 it has four columns, three that are actually filled
25 in, and four rows.

1138

1 But aside from the titles it's got 12
2 cells, so you have to draw three lines down the
3 middle -- down the page, and 5 lines across the
4 page.

5 A (Complies.)

6 Q And the --

7 CHAIRWOMAN SHOWALTER: You want a
8 photocopy of this?

9 JUDGE MOSS: If I could. Let's take a
10 brief informal --

11 (Brief recess.)

12 JUDGE MOSS: All right. Let's be back on
13 the record.

14 Ms. Smith has kindly made copies for the
15 bench and the bar, and the witness has a copy. So
16 I think we're ready to proceed with our matrix.

17 BY CHAIRWOMAN SHOWALTER:

18 Q Well, you will see that is titled June
19 2006, so I am looking ahead several years, and
20 trying to think of different scenarios that may
21 prove to be the case, recognizing we don't know
22 what the case will be.

23 And just in case you can't read my
24 writing, column 1 says that QCII is viable,
25 financially viable. Column 2 is QCII is in

1139

1 financial trouble, and column 3 is it is bankrupt.

2 And then the rows, row A is the settlement
3 is approved and Dex is wholly sold. I hope I
4 spelled that right. Row B is QC Washington retains
5 its publishing agreements, but nothing else. Row C
6 is QC Washington retains its publishing agreements,
7 employees, and the Dex business, although it would
8 lose certain economies of scale, because the rest
9 of Dex would have been sold. And row D is the most
10 recent Staff response to the settlement proposal;
11 in other words, what Staff is currently proposing
12 if we approve with conditions.

13 And I don't plan to ask you about every
14 single box. But let me begin with column 1, that
15 QC is viable in the future. And why don't I jump
16 down to zero D.

17 Is it your testimony that you don't think
18 column 1, row D will really -- will exist? That
19 is, is it your testimony that if we approve the
20 Staff conditions, we don't ever -- won't get to QC
21 being viable?

22 A I believe that's correct, that it's a
23 price that is too high to pay.

24 Q Now, let's go to A-1, the settlement is
25 approved, and it turns out the company is viable in

1140

1 three years. In that case, would you agree that
2 there probably will be enough money to honor the
3 settlement, enough revenue to all of QCII to honor
4 the settlement?

5 A Yes.

6 Q All right. Now, I want to move across
7 that row. Let's say we're in column 2, row A. We
8 have approved the settlement, but it proves to be
9 the case that QCII is in some kind of financial
10 trouble. Then what -- how will the Commission
11 order rates that include imputation without either
12 QC or QCII coming to the brink of bankruptcy, let's
13 say, or being in a sustained poor financial state?

14 A I would submit that if QCII were in a poor
15 financial state that it isn't the credit imputation
16 that determines whether it survives or not; that to
17 the extent that QCII is on the verge of bankruptcy,
18 and thus, I guess, I am suggesting -- I don't know
19 that there's too much difference between 2 and 3,
20 that you Commissioners can effect here in the State
21 of Washington.

22 And to the extent that QCII goes into
23 bankruptcy, I think we have heard some testimony to
24 the extent --

25 Q Well, now you are getting into my next

1141

1 cell. I will ask you about that cell. But,
2 actually, if I did say "verge of bankruptcy" I
3 meant to say in financial trouble. Everything is a
4 matter of degree.

5 A Okay. I think what you would see, to the
6 extent that we believed we needed higher earnings,
7 we may argue for that. We may bring a case before
8 you, and obviously would honor the stipulation.
9 The revenue credit would be built in. But that's
10 if we have a case, we have a case. If we don't
11 have a case, we don't.

12 So I don't know that at least at the QC
13 level there's a change. Does it mean -- I mean, if
14 that the action that puts QC over the edge, then so
15 be it. But what I'm trying to suggest is I don't
16 think that Washington revenue credit or even an
17 extension of an imputation is going to push the
18 company over an edge. It's going to be the QCII
19 financial condition throughout the region.

20 Q Well, then, let's go to the next step.
21 And I did have some discussion with Mr. Mabey on
22 this kind of thing, and Mr. Cummings.

23 Let's say that we're now in column 3, row
24 A, and QCII does go bankrupt. You are not a
25 bankruptcy expert, I recognize, but do you agree

1142

1 that the Bankruptcy Court, at least according to
2 Mr. Mabey, would not actually recognize the
3 imputation amounts, either as a debt or as an
4 obligation?

5 A That's my understanding. That is, that
6 the highest level that the Commission -- highest
7 standing the Commission has in a bankruptcy
8 proceeding is its rate making orders.

9 And I think what Mr. Mabey said was that's
10 how this would be viewed. If this were taken into
11 account in the context of the sale, and the
12 Commission issued an order adopting this practice,
13 the revenue credit practice, that when Qwest sets
14 rates or comes in for any type of earnings
15 investigation, that this is the practice that will
16 be performed.

17 That that carries the most weight that the
18 Commission could possibly have as opposed to a
19 contract between a parent and its subsidiary.
20 That, obviously, is very much in jeopardy, I would
21 think, in a Bankruptcy Court where the parent goes
22 bankrupt.

23 Q Well, you are jumping down to D-3.

24 A Okay.

25 Q But at some point, if we are in column 3,

1143

1 at some point you cannot squeeze blood from a
2 turnip. That's part of the problem here. There's
3 only so much money to go around, so aren't we
4 really trying to decide which little cell in column
5 1 is the most likely, because otherwise we're over
6 in column 3 and you get into some interesting
7 questions about what would happen to QC in column
8 3.

9 A Well, I don't disagree with you. I want
10 to stay in column 1, too. But there are certain
11 actions in column 1 that might have repercussions
12 in 3. I think we already talked about D, if that's
13 unacceptable to the company. And we had an earlier
14 discussion about the possibility of writing
15 Washington out of the deal, and I gave you my
16 opinion.

17 That doesn't mean that the buyer accepts
18 my opinion, or that we would be able to compel the
19 deal to be done. If we can't compel the deal to be
20 done, and if it actually scraps Rodney, you end up
21 probably over in 3 anyway.

22 So I think that there are implications of
23 what you accept in column 1, or what the company is
24 willing to accept.

25 Q All right. Well, let's go down to row D.

1144

1 I think we just discussed -- we discussed cell D-1.

2 Now, let's discuss D-2.

3 The obligations under D are greater than
4 the obligations under A from the company to the
5 rate payers, correct?

6 A That's correct.

7 Q So if we're in column 2, at that point D
8 puts more stress on the company than A, correct?

9 A Yes.

10 Q Now, we're going to go over to D-3.

11 A Okay.

12 Q The company is in bankruptcy. Now, here,
13 what is the effect of these contract amounts, if
14 you know? Would they be viewed by the Bankruptcy
15 Court as a contractual obligation so that maybe the
16 rate payers would get a certain amount on the
17 dollar anyway? Maybe not full value, but some
18 value, or would they be wiped out in some way by
19 the Bankruptcy Court? You may not know the answer,
20 but maybe you do.

21 A Well, I heard Mr. Mabey say that the rate
22 payers' claim, they would be the lowest on the
23 rungs of the ladder. And I echo something you said
24 earlier, you can't squeeze blood from a turnip. If
25 QCII is broke, it can't make those payments.

1145

1 Q So one possibility is even though there
2 are contractual amounts owed, when it comes to
3 bankruptcy, the rate payers, being low on the totem
4 pole, would get perhaps nothing on the dollar of
5 their contract, whereas other contractual obligees
6 would get some cents on the dollar, most likely?

7 A Yes. The higher the secured creditor, the
8 more they stand of making a claim.

9 Q Now, I think that I haven't addressed B
10 and C. I have this gnawing feeling that I haven't
11 laid out all of the necessary elements, because I
12 think I haven't said, in B and C, what would happen
13 to imputation amounts. But I think they would be
14 gone. Let's assume they are gone. In B all that
15 is left is a publishing agreement that QC
16 Washington owns.

17 Now, in that case, if we're going to --
18 that assumes, by the way, that the rest of Dex was
19 sold, and there's a 13-state, at least Dex
20 operation, out there.

21 A Right.

22 Q So in B-1, do you agree that the QC
23 Washington would be able to determine for itself
24 how it wants to handle its publication of the White
25 Pages, assuming that the current contract is up? I

1146

1 don't know when that date is, but let's assume it
2 happens before June 2006, or that in the
3 renegotiation of a contract somehow Washington is
4 free to publish its own. So my question -- what is
5 my question? I think you think I am correct.

6 I think this cell, B-1 really has the two
7 companies not having -- QCII and QC Washington not
8 having very much to do with one another on the
9 subject of publishing?

10 A I think that's true. I think it would be
11 the Commission's goal, it seems to me, to try to at
12 least return the preexisting value that they
13 experienced from the preexisting imputation to the
14 rate payers.

15 And I think -- you know, I think you are
16 looking for things to compare, and all other things
17 being equal, the sale didn't occur, you would still
18 have an imputation in place. And now -- but now
19 that the sale occurred, and Washington was isolated
20 on its own, and it's in the future, what can
21 Washington try to do to return that same value to a
22 rate payer, because it's now in the Commission's
23 control, the publishing agreement.

24 And it seems to me that you are sort of
25 left with the scenario that's been discussed in the

1147

1 hearing room about trying to either take on the
2 publishing function yourself -- by yourself, I mean
3 QC -- or contracting it out with another publisher.

4 And I think we have talked about some of
5 the problems associated with that in trying to
6 return that full value back, that it would be very
7 difficult. You have other publishers that publish
8 directories in the same territory. They probably
9 have many of the same advertisers in their books,
10 and they are going to be a lot less willing to pay
11 you the same value that you had with your own book.

12 And so I think that's a difficult
13 proposition. I think you would have to put in that
14 box some sort of discounted value associated with,
15 you know, either a publishing fee from a publisher
16 in return for them being QC's official publisher,
17 because I don't think you would get the same value
18 back. That's my own opinion.

19 Q Depending on which cell you are comparing
20 to, for example, if you were comparing B-1 to A-1,
21 I think your answer might be correct. Because B-1
22 has Qwest Washington on its own having to figure
23 out a good publishing arrangement, whereas under
24 A-1, it's got this revenue stream coming in that
25 the company is committed to. That looks favorable

1148

1 for A-1.

2 But now let's move over to column 2. Now,
3 in column 2, B-1 and B-2 would be more or less the
4 same issue. Qwest is on its own. It has to figure
5 out what to do, and how to team up with somebody to
6 publish its White Pages for whatever amount of
7 money it can get.

8 So there's not too much difference from
9 QC's point of view, Washington's point of view on
10 B-1 and B-2. But, now, if you compare B-2 to A-2,
11 that's just right where this revenue stream that
12 this settlement commits to, looks a lot less
13 certain. And so it might be in that situation that
14 B-2 looks like a better scenario to be in than A-2.
15 Would you agree to that?

16 A No.

17 Q All right. Why?

18 A Because I don't think that B-2 -- I
19 think -- and I said I think you have to discount
20 what you think you are capable of getting in the
21 way of a publishing fee. And I continue to think
22 about that from the Commission's perspective,
23 because I would think you are thinking about what
24 do I have today, and what will I have tomorrow?

25 And if you have in your pocket today an

1149

1 \$85 million imputation embedded in your rates, it
2 seems to me in the future that imputation would
3 cease in B. I think I have already said the
4 imputation goes away, because you now have the
5 publishing business quasi in-house, and you are out
6 hunting for a publisher.

7 And my point is, you are probably not
8 going to find a publisher that is going to pay you
9 anywhere close to your \$85 million imputation
10 value. Now, this is my own speculation, but based
11 on my knowledge of what I have learned in this
12 case, and the fact that some of the most likely
13 other publishers like Verizon already have
14 competing books, and they already have those
15 advertisers in their books.

16 So they are not -- that isn't another
17 revenue source for them. And I can't see the
18 scenario where you can get that value back for the
19 rate payers. Essentially, you know, you are going
20 to be at the whim of two or three publishers, and
21 you're going to have Dex entering in from its 13
22 state operations, trying to retain the marketshare
23 that it had before.

24 So I think it's a very tenuous situation
25 whether you are in column 1 or 2. And I don't

1150

1 think it's superior to having the revenue credit in
2 place that you can continue to argue that the
3 company signed up for this thing, and that's that.
4 When I set the rates in this state, that's the way
5 they are going to be set.

6 Q All right. Well, let's move over to
7 column B-3. In that situation I am not sure what
8 happens. QC would -- QC Washington and its
9 business, whatever that was on the Yellow Page
10 side, would be, I suppose, eligible to be declared
11 bankrupt, along with QCII, or it might be sold
12 separately as a way to manage the bankruptcy; is
13 that correct?

14 A To the extent that maybe there was some
15 value that they thought they could extract -- and I
16 am projecting this from Mr. Mabey's testimony, he
17 theorized when it was part of the entire company
18 that you might bring QC into the bankruptcy and
19 sell it. Establish the same types of agreements
20 between the companies and the potential buyer as
21 were there before in order to extract the maximum
22 value, but then sell Dex and return those proceeds
23 to the creditors.

24 And Bankruptcy Court, from my
25 understanding, is going to proceed in a very

1151

1 logical manner in order to maximize the amount of
2 return to the creditors. So it only makes sense
3 that they would sell Dex in such a manner that
4 maximized that value.

5 I think if you take that down to the
6 Washington level, I'm not sure that it changes. To
7 the extent that it benefits QCII to bring QC into
8 bankruptcy, and for 13 states it has this -- well,
9 it doesn't have the Dex property anymore. It's
10 only in Washington. But if that had value, then
11 quite possibly they would sell at least the
12 publishing agreement part of that. Because I think
13 you have to remember in column B we don't have a
14 business. All we have is an agreement.

15 Q Right. That's right. So let's go to
16 column C where there actually is a business, at
17 least to start with.

18 A Right.

19 Q That is, assume after the transaction is
20 completed the 13 states go their way, and we issue
21 an order that accomplishes retaining the publishing
22 agreements, as well as a certain number of
23 employees assigned to Washington, and an ongoing
24 business, recognizing that there are some economies
25 of scale that would be gone as a result of the 13

1152

1 other states being gone.

2 A Right.

3 Q And actually, why don't we begin with 3-C,
4 because I think it's a similar answer to the one
5 you just gave.

6 A It is. In fact, it is probably what I was
7 envisioning, that there would be a business there.
8 So that would be what would happen in 3-C, that it
9 would be logical if that had value for QCII to
10 bring that into bankruptcy, establish the new
11 agreements with a new buyer, and sell the property
12 in order to pay creditors. So that's based on what
13 Mr. Mabey testified to earlier. That's what --

14 Q And then C-2, I guess I'm not sure what
15 dynamics that would produce, because no credits are
16 owing. So in that cell C-2, would we have
17 Washington carrying on its business, however
18 profitable a business that might or might not be?

19 A That's right. And I think from the
20 Commission's perspective, if you look at 1 and 2 --

21 Q Are you looking at C-1 and C-2?

22 A Yeah. C-1 and C-2, the question you will
23 have to ask, once again, is a comparison to what do
24 I have today? I have an embedded imputation. And
25 what would I have tomorrow? Well, I would have

1153

1 this business that is going to sell directory
2 advertising.

3 And I think you would have to discount
4 this one, too. And the reason why is that once
5 again, you have closed around the prior Dex
6 company, who is in here competing, I am sure, as
7 well as Verizon and a number of other publishing
8 companies. And I think the dynamics change. Maybe
9 they don't. Maybe you can put out a book on a
10 stand-alone basis, and your common costs aren't so
11 great that they don't eat you alive. Those are the
12 dynamics that you would be facing.

13 But you also have to ask, how much of the
14 prior market share that the prior Dex book had
15 would I be able to retain in this state? And quite
16 frankly, Chairwoman, I don't know the answer to
17 that. I'm not a specialist there, but I think
18 those are the dynamics of the proceeds.

19 Q So one possibility is that in June 2006,
20 or by June 2006, row C is not actually realistic
21 because the business has not thrived, or the
22 employees have been lured away and there really
23 isn't a stand-alone Yellow Pages business?

24 A That's certainly a possibility. I mean, I
25 think you are basing that on some of the prior

1154

1 testimony, and that's all I would have to go on,
2 too, is the possibility of employees migrating to
3 other, stronger books and higher pay.

4 So I would think, though, as far as the
5 actual revenues coming in, it's going to be a
6 dynamic of -- I mean, there's all of a sudden one
7 more major competing book in the market, that is
8 your book, in addition to the old Dex books, in
9 addition to the Verizon book.

10 CHAIRWOMAN SHOWALTER: All right. Well, I
11 think I have exhausted this table, and also myself.
12 And I will be interested to see how other witnesses
13 comment on these boxes. I don't pretend to be
14 completely exhaustive in all the possibilities, but
15 I'm trying to get a sense of the ranges and the
16 scenarios. Thank you.

17 THE WITNESS: Uh-huh.

18

19 EXAMINATION

20

21 BY COMMISSIONER HEMSTAD:

22 Q Pursuing the matrix --

23 COMMISSIONER HEMSTAD: By the way, I
24 assume it will be helpful to put this in as an
25 exhibit for illustrative purposes.

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1 JUDGE MOSS: We will mark it as Bench
2 Illustrative Exhibit, and give it No. 14.

3 (Exhibit No. 14 was
4 marked for identification.)

5 BY COMMISSIONER HEMSTAD:

6 Q I was listening to your answers to the
7 Chair's questions. In column 2, row 1, where QCII
8 is in financial in June 2006, I thought I heard you
9 say that it would be possible that the company
10 would bring a rate case. Was that your answer?

11 A No. I was assuming that in order to
12 effectuate the revenue credit into rates, the rate
13 case would happen. If a rate case doesn't happen,
14 the revenue credits are still an effective potent
15 force to the extent that the company is at or under
16 its authorized rate of return. Even with the
17 revenue credit in place, it doesn't come in. It
18 doesn't have a case.

19 But I was just suggesting that, because
20 that's the way it gets operational.

21 Q And I take it, then, you weren't intending
22 to suggest that this scenario where QC doesn't need
23 additional revenue, a rate case wouldn't be brought
24 because QCII is having financial problems?

25 A No. I think that would be a tough case to

1156

1 prove.

2 Q I think so, too. And then the other one,
3 the other area is in column 3, rows B and C, which
4 I think you largely lumped together in your
5 responses. And the points you were making was that
6 it would be logical in the bankruptcy proceeding
7 that the Yellow Pages would be sold. But wouldn't
8 you agree there would be greater value with QC and
9 Yellow Pages sold as a unit?

10 A I don't know that for a fact. You know,
11 it would be the newly constructed Dex business that
12 you are talking about here. And I think in my
13 conversation with the Chairwoman, I had some
14 concerns about how successful an operation that
15 would be. And whether the combined company would
16 bring a higher value than selling it off, that I
17 don't know, Commissioner. It's possible. I don't
18 know that there would be a huge difference.

19 It's kind of like asking the question
20 today, would QC with Dex in tow bring more than the
21 two companies independently? And I don't know the
22 answer to that.

23 Q Well, at least historically the nexus
24 between the company and Yellow Pages -- the
25 company, QC and Yellow Pages has been well

1157

1 understood, hasn't it?

2 A Well, for argument's sake, assume that
3 that value is bestowed through the official
4 publisher status. You can pass that along to any
5 other publisher, and they can extract whatever
6 value that has.

7 And so I don't know that the companies
8 need to be integrated to extract any additional
9 value. In fact, today those companies are not
10 integrated within the QCII --

11 Q I understand that. I also understand you
12 don't hold yourself out as a bankruptcy expert, but
13 do you think it is plausible that a Bankruptcy
14 Court would sell Yellow Pages independent of the
15 operating utility with the right to hold itself out
16 as the official publisher of the utility?

17 A And I am speaking, once again, based on
18 Mr. Mabey's testimony. I think to the extent that
19 they have authority to do that, yes, I think they
20 would. I think they would try to extract the
21 maximum value that they could out of the Dex, or
22 whatever mini-Dex property was there. And if that
23 included bestowing on the buyer the official
24 publisher, I don't know why they wouldn't do that.

25 I'm not a lawyer, and I don't -- I'm not a

1158

1 bankruptcy expert, but it seems to me the
2 principles laid out by Mr. Mabey is that the
3 creditors would be very interested in trying to
4 create a contract that would extract the maximum
5 value.

6 Q Okay. Well, then, assume for purposes of
7 this question that there is greater value in
8 retaining the connection between the operating
9 company and Yellow Pages in bankruptcy and a sale.

10 Would the customers or rate payers of the
11 whole company care whether it was sold or not?

12 A If I understand your question correctly --

13 Q Well, let me pursue it further. Let's
14 assume, further, the fact that it's sold to another
15 RBOC called SBC. Wouldn't the customers rate
16 payers be indifferent to that sale?

17 A I think that they could be indifferent.
18 And I also think that they could be indifferent to
19 the sale of the companies on an independent basis
20 if they don't know. I mean, to the extent that
21 they don't see anything different in either the
22 service that is rendered from a basic exchange
23 service perspective, or their book looks the same,
24 I don't know that they know, unless they read the
25 business section of the paper.

1159

1 Q That's all I have on the matrix. I wanted
2 to ask you about the whole issue of cash
3 management, and I really, at this point, don't
4 understand very well.

5 Does QCII on a routine basis, daily,
6 weekly, sweep all the cash from QC into the parent?

7 A Commissioner Hemstad, I'm not sure the
8 cycle, that is, the timing. My understanding is
9 that right now QC does dividend its revenues up to
10 the parent.

11 I think that in the past that has been
12 less. It's been on a less periodic basis; that is,
13 there may have been months that have gone by and
14 then monies are dividended up. My understanding is
15 that that is on a more consistent schedule now.

16 Q So in that sense, there's no structural
17 differentiation between QCII and the primary
18 revenue generator of the entire corporate
19 structure, which is QC? There's no significant
20 differentiation between the two in the cash flow?

21 A From a cash perspective, I think I would
22 have to agree with that. In fact, you heard me
23 answer earlier the question about where the cash
24 would come from the Bell credit, and I said as long
25 as the rate payer is protected from QC's

1160

1 perspective, it really doesn't matter which entity
2 that cash comes from.

3 Q Well, how does the term dividend up
4 overlay this issue? If cash is moving without any
5 significant differentiation, is there such a thing
6 as a dividend?

7 A Yeah, maybe it's just a term. It's how we
8 refer to it, because I think the relationship
9 between the parents and the subsidiary is through a
10 stock ownership type relationship. And so the
11 monies truly are dividends. And I think that's why
12 they are referred to that.

13 But for all intents and purposes, if your
14 question is if that were not the relationship,
15 wouldn't the money just flow or could it flow, I
16 would say yes, probably.

17 Q So as an example, the cash is consolidated
18 daily, then there would be a daily dividend. Is
19 that a fair statement?

20 A That's the idea. I'm not sure that it's
21 daily. I don't think it is, but the concept is
22 right.

23 Q You were asked by counsel for the Staff
24 about the master sales agreement that is in
25 reference in Exhibit 74 at page 604, paragraph

1161

1 5.13.

2 Do you remember that conversation?

3 A Yes, I do.

4 Q And I believe your response is that you

5 didn't know the purpose for that expected

6 agreement. Is that a fair summary?

7 A I think that I expressed that I wasn't

8 aware of what was in that agreement. And I think

9 probably the reason why, Commissioner, is that it

10 wasn't available for me to review, because it

11 wasn't consummated.

12 And I don't think it's been consummated

13 yet. I believe that there probably is an agreement

14 like that in place today, but I have to still

15 answer that I'm not familiar with it. So I don't

16 really know what types of activity it covers.

17 Q All right. Then I would like to make a

18 Bench Request. If such an agreement has been

19 executed, I would request that the Bench be

20 provided with a copy of it. If it has not been

21 executed, then as a Bench Request I would like

22 Qwest to describe to us the purpose and the

23 anticipated contents of such an agreement.

24 JUDGE MOSS: Do you have that, Ms.

25 Anderl?

1162

1 MS. ANDERL: I do.

2 JUDGE MOSS: And that will be Bench
3 Request No. 7.

4 (BENCH REQUEST NO. 7)

5 THE WITNESS: Mr. Hemstad, I might point
6 you, and perhaps my counsel can help me out, but I
7 believe there's a discovery response notice record
8 that includes all of the existing agreements today.
9 Not the agreements associated with Rodney, but they
10 include all the existing agreements. So if that
11 agreement exists today, I think it would be a part
12 of that discovery response.

13 MS. ANDERL: Well, Mr. Reynolds points out
14 a good clarification. Mr. Hemstad, are you looking
15 for one that might exist today between Qwest
16 Corporation and Qwest Dex, or are you only
17 interested in what might exist if the sale were to
18 close?

19 COMMISSIONER HEMSTAD: Well, it has closed
20 in part.

21 MS. ANDERL: In the Eastern region, yes.

22 COMMISSIONER HEMSTAD: Well, I'm not sure
23 what I am looking for.

24 MS. ANDERL: We will investigate what is
25 available, and then if we have an array of options

1163

1 to present to you, we will bring those back prior
2 to responding.

3 COMMISSIONER HEMSTAD: Okay.

4 BY COMMISSIONER HEMSTAD:

5 Q This is probably covered by one of the
6 other witnesses, but I lost the point. Wouldn't
7 the rationale for the revenue credit decline rather
8 than increase it?

9 A I think that the idea there was that given
10 that we're under a rate case moratorium, I believe,
11 until the end of this year, probably the prime time
12 for a rate case will be in the four years that
13 follow.

14 And so it's sort of front-end loaded, the
15 revenue credit during those years, and 110 for each
16 of the four years. And then it dropped back to the
17 preexisting revenue credit of 1034. That is my
18 understanding of the rationale why there was a
19 higher revenue credit up front. And of course,
20 that's part of the stipulation, and we support
21 that.

22 Q But is that assumption that there be a
23 likelihood of a relatively faster, or a near term
24 rate case, but then not one thereafter?

25 A Well, I think it reflects the possibility

1164

1 that there's probably more value to a rate case in
2 the early years. To the extent that the -- to the
3 extent that the competition marches on, and more
4 and more of our services are competitively
5 classified, as you get out into years 9, 10, 11,
6 12, and 13, the value of imputation to a revenue
7 requirement might become meaningless, if we no
8 longer have any services that are rate return
9 negative. So the up-front increase in the revenue
10 credit was a reflection of that.

11 Q I asked Dr. Selwyn the alternative of
12 pursuing a reduction in rate base versus the bill
13 credit. Do you have any view on that?

14 A First and foremost, I do support the
15 stipulation. And I don't do it because we're bound
16 to it. I do it because I think it probably returns
17 the closest to the rate payers of the preexisting
18 method of sort of reflecting the directory
19 obligation.

20 And that is, the preexisting requirement
21 was via the imputation. And that resulted in an
22 addition to our revenues of the \$85 million. On a
23 going-forward basis, the revenue credit works the
24 same way. Depending on how you do the bill credit,
25 if it's a one-time reduction to rate base, that

1165

1 happens up front. And it doesn't look like that
2 consistent revenue credit over a 15-year period.

3 And so it may have a very large up-front
4 effect, but it will diminish over time, and it
5 won't look the same as the preexisting imputation.

6 And so --

7 Q I see. The reduced rate base value will
8 diminish over time?

9 A The value of the reduction -- as the
10 company continues to add plant and build back up
11 its rate base, the value of the reduction to the
12 rate payer, that is, when you actually calculate
13 your rate of return and calculate rates, diminishes
14 over time as you build your assets back up that are
15 in rate base.

16 And so, you know, it would depend on how
17 you apply it. But like I say, I think the method
18 that most consistently reflects the past benefit
19 that the Commission has passed on to the rate payer
20 is the revenue credit.

21 Q I think we're talking about the bill
22 credit, the \$67 million or whatever figure, for an
23 immediate payment to rate payers. It seems to me
24 the issue is we have had the availability of
25 earnings from Yellow Pages that have benefited rate

1166

1 payers through time.

2 And now with the sale, we have the
3 circumstance of, call it the act of whoever, or in
4 a moment in time the rate payers getting the
5 benefit, but those who are rate payers next year
6 don't get it. It's a constantly changing group
7 of -- call it beneficiaries here.

8 Why should only rate payers at a given
9 moment in time get the benefit?

10 A Commissioner, I do understand your point.
11 I am bound to support our stipulation, and I think
12 it's a good, balanced approach. I think that has
13 to be my answer.

14 Q This is a more general question. In the
15 scenario of QCII, on a going-forward basis,
16 continuing to be in financial trouble -- that was
17 the second column of the Chair's matrix -- do you
18 have any comment to make on how rate payers would
19 be protected from QCII simply, on a continuing
20 basis, bleeding QC?

21 A Well, Commissioner Hemstad, I think -- I
22 guess it doesn't make much sense to me that you
23 would kill the goose that lays the golden eggs.

24 The QC business to QCII is a huge portion
25 of its value. In fact, it's probably most all of

1167

1 its value today. And I would think that QCII would
2 be doing everything it can to sustain that value,
3 and to foster that value.

4 So I don't understand why they would want
5 to bleed it, and to not increase the value of that
6 property through investment, and to the extent that
7 it can. I just don't understand why it would want
8 to bleed it. Especially given the decision -- it
9 seems to me that the management of this company and
10 the board of directors had the opportunity to take
11 this company into bankruptcy if they wanted to, and
12 sort of dispense with QC and pay off the creditors.

13 But when they made the decision that
14 they were going to -- that that wasn't an option,
15 that we could make it through the financial times,
16 the difficult financial times, it seems to me that
17 that lays a course for a business plan that you
18 would want to have QC be all that it can be.

19 Q Well, I certainly have the distinct
20 impression in the now fairly numerous circumstances
21 throughout the country of utilities with regulated
22 and unregulated activities, that on a short-term
23 basis the pattern has been for the parent needing
24 cash for unregulated activities, has been to bleed
25 a regulated cash cow.

1168

1 But you think QCII wouldn't have that same
2 incentive? For example, such as to cut back
3 drastically and otherwise on the short-term basis,
4 needed capital expenditures?

5 A My understanding is if QCII has its chance
6 of surviving at all, it's through QC. And the only
7 way it can survive through QC is bringing new
8 products to market, overcoming some regulatory
9 barriers, such as the 271 in order to bring new
10 products that can inject new cash into the
11 business.

12 I honestly don't see any activities at the
13 QCII level that are capable of doing that. It's
14 only at the QC level that you can actually bring
15 those new products to bear. It's where you have
16 the network. It's where you have the marketing
17 forces.

18 And so I truly think QC is the key to
19 QCII's success. And I don't think there's a bleed
20 mentality. Since our new CEO has come on board,
21 it's been just the opposite of that. It's been a
22 very positive outlook, that we're going to make
23 this company go, and we're going to make it go
24 through new products and services, and better
25 quality services to our customers.

1169

1 And maybe it's a lot of propaganda, but
2 there's a heck of a lot of people at this company
3 buying it right now.

4 Q Just one final question, and it's more
5 informational than anything. If you know, who on
6 the QCII side of the negotiations, were the
7 negotiators for the sale of Dex?

8 A I know one individual's name on the QCII
9 side. I believe that there were a number of law
10 firms involved representing the company's
11 interest --

12 Q But I assume they were -- what lawyers do,
13 advising as to what you need to do, and what you
14 need to watch out for. But I assume some
15 executive, or more, of QC was doing the
16 negotiating.

17 A The one name I am familiar is a man named
18 Peter Hutchinson.

19 Q What is his title?

20 A I'm not sure of that. I know he's at a
21 vice presidential level, and I believe it's in our
22 Merger and Acquisition Group, so --

23 COMMISSIONER HEMSTAD: All right. Thank
24 you. That's all I have.

25 THE WITNESS: Yes.

1170

1

EXAMINATION

2

3

BY COMMISSIONER OSHIE:

4

Q That's an easy one to follow-up on.

5

6

Mr. Reynolds, was anyone from QC involved in the negotiation of the sale of Dex, either

7

Rodney or Dexter?

8

A I don't know that.

9

10

Q Would it surprise you if the negotiations were handled entirely within the parent company

11

QCII?

12

13

14

15

16

17

18

19

A It would not surprise me, only because the company operates on such an integrated basis. I think you maybe heard me being asked the question of which entity I worked for the other day, and it's hard to tell. I mean, we have a corporate structure, but we are a highly integrated company, such that we don't really think that there's a specific QC entity, or a QCII entity.

20

21

So hopefully that is responsive to your question?

22

23

24

25

Q Well, I guess my question is, really at the heart is, who within QC would have agreed to buying the company through the publishing agreement, and the trademark agreement, and also

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1 the noncompete agreement?

2 A My understanding -- let's assume that
3 there was no one associated with QC involved. QCII
4 is the parent company of QC, owns 100 percent of
5 the stock. And so actually represents the company
6 in its entirety. And that's what I mean by about a
7 highly integrated management.

8 Q And I guess from that standpoint, or
9 looking at it as far as how the family of companies
10 are managed, if the decision was made at QCII to
11 breach the Rodney Dexter agreements, QC would then
12 be left essentially with that decision and whatever
13 financial bag would be left on its doorstep?

14 A I don't know that I would agree with that.
15 I mean, I believe that the agreement would -- at
16 least to the extent that QC tried to foist that --
17 or to the extent that QCII tried to foist that on
18 QC, I think the regulators would have a large say
19 in that, if there were some sort of liability.

20 I mean, to the extent that this deal goes
21 through, and you accept the stipulation, and we
22 move ahead with those provisions, really those are
23 what this Commission will manage and have authority
24 over.

25 To the extent that there's a breach of the

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1 Rodney deal, or the Dexter deal between the
2 companies, I am sure they will fight it out at the
3 QCII and Carlyle level. But how the actual
4 regulated entity is impacted, if at all, I don't
5 know. I think it would be speculative.

6 Q Well, if the QCII breached the Rodney or
7 Dexter deal, how would that affect the settlement
8 that you have proposed to this Commission?

9 A Well, to the extent that the parties might
10 walk away from the deal -- I mean, there's 100
11 different possibilities, and there's a lot of --
12 the actual purchase and publishing agreements are
13 very thick. And there's all kinds of caveats for
14 material breaches, minor breaches.

15 I do know that in -- and Commissioner
16 Oshie, I think your questions have to do with QCII
17 breaching and not the buyer; is that correct?

18 I mean, if the buyer were to breach we
19 have full ability to walk away from it, and to
20 become our own publishing business again, if
21 there's a material breach.

22 Q And what would happen to the Settlement
23 Agreement at that point? Is it still binding? Is
24 it still to be performed by the parties?

25 A You know, I don't know the answer to that.

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1 I don't know that the settlement has a provision in
2 the event of breach.

3 Q And your answer would be the same if QCII
4 happened to be the breaching party?

5 A Yes.

6 Q Let's -- just to clarify, you know,
7 another clause, if you will, or sentence within the
8 Settlement Agreement, would you please refer to
9 Exhibit 2 on page 5.

10 A (Complies.)

11 Q And there's a sentence that begins at the
12 end of line 14 and ends on line 17.

13 A (Reading document.) And the line numbers
14 again?

15 Q It begins at the end of line 14, and ends
16 on line 17.

17 A (Reading document.) Yes.

18 Q And my question is, what -- and maybe we
19 can start generally. What has Qwest agreed to by
20 that sentence?

21 A Qwest has agreed, by that sentence, that
22 in the event of any type of earnings investigation,
23 it will not argue that the revenue credit is
24 inappropriate, or that it ought to be a greater
25 amount or lesser amount.

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1 And I think the other parties bind
2 themselves to that as well. When we come before
3 the Commission, we will argue that the revenue
4 credit is what should be applied on an imputed
5 basis.

6 Q As far as the last clause in that
7 sentence, and competitive classification
8 proceedings --

9 A Yes.

10 Q What does -- what did Qwest agree to by
11 agreeing to not argue that the annual revenue
12 credit is inapplicable in a competitive
13 classification proceeding?

14 A Commissioner Oshie, I honestly don't know
15 the answer to that. And I questioned it at the
16 time. It was important to one of the other
17 parties, and we did not see a problem with it.

18 But I honestly don't see what the
19 relationship is. I don't think that they are
20 connected. But to the extent that possibly the
21 rates or costs that might be examined in a
22 competitive classification proceeding could be
23 impacted by what is argued in a rate case, and then
24 possibly there's a connection. So I think it was
25 belt and suspenders.

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1 Q I guess I asked that -- I had planned to
2 ask you the question anyway, but then I believe
3 that you had made a statement in your earlier
4 testimony on cross examination that the revenue
5 credit essentially would have no value in the event
6 that Qwest's services are competitively classified.

7 And maybe I misunderstood you, but it
8 seemed to me that your statement was inconsistent
9 with this particular clause in the Settlement
10 Agreement.

11 A Well, the way I see this clause applying
12 is if the revenue credit is relevant at all to the
13 proceedings that are listed here, that the parties
14 will be bound to arguing the revenue credit as it
15 is listed in the stipulation.

16 And what I just told you is, I don't see
17 how that revenue credit would ever be an issue in a
18 competitive classification proceeding.

19 What I said earlier about competitive
20 classification with regard to the revenue credit
21 and its actual application is that if our services
22 are competitively classified, the prices are not
23 set in accordance with rate of return regulation.
24 And so regardless of what the revenue credit is, it
25 really doesn't have an impact on the prices of

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1 services that are competitively classified. And
2 that's the distinction.

3 So I think they are very different issues,
4 and this may be a little confusing in here because
5 I can't tell you -- I can't think of an issue where
6 the actual revenue credit amount would become a
7 major issue in a competitive classification
8 proceeding.

9 Q By not -- I guess I am interpreting that
10 to mean it's not an issue at all?

11 A I don't think it is. I mean, we just
12 filed a competitive classification petition with
13 the Commission, and you can think through the types
14 of factors that the Commission must consider. And
15 really the only issues that are tangential to this
16 revenue credit would be the price and cost issues,
17 but it's a distant relationship.

18 Q Let me move to Exhibit 77, and refer you
19 to what has been paginated as 000714.

20 CHAIRWOMAN SHOWALTER: 714?

21 COMMISSIONER OSHIE: Yes.

22 BY COMMISSIONER OSHIE:

23 Q And we're referring to Exhibit 77 as the
24 Publishing Agreement. And it's clause 3.1 D, so
25 the middle of page 000714.

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1 A (Reading document.) Yes, I have it.

2 Q And I will -- I am referring to the second
3 sentence, and I will paraphrase. And basically, as
4 I understand it, that if there's an additional
5 legal requirement that would be proposed, Qwest
6 Corporation will object to and attempt to prevent
7 the implementation of any such proposal.

8 And I did omit the clause in there "in
9 good faith" in using commercially reasonable
10 efforts. But what is meant, or what did Qwest
11 agree to in the Publishing Agreement by that
12 clause?

13 A I think Qwest agreed to trying to -- any
14 types of additional legal requirements that might
15 come up in the state jurisdictions, because QC is
16 actually the regulated part of the company and
17 would interface with those regulators, it would be
18 able to argue against additional regulation
19 associated with directory publishing obligations.

20 To the extent that that represents
21 increased cost to the buyer, this is a clause that
22 requires QC to do due diligence in trying to keep
23 those costs down by arguing against additional
24 regulatory requirements.

25 Q What if QC believed that the additional

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1 regulatory requirement was in the public interest?

2 A Well, you know, the clause says what it
3 says. I think we would be bound to this clause.

4 And, Commissioner Oshie, possibly it
5 wouldn't be as absolute as I just made it. To the
6 extent that QC felt that the government entity, or
7 the entity proposing the change had a good point,
8 and it was in the public interest, then it looks
9 like that requirement requires you to update the
10 buyer of what it goes on.

11 And if your chances were nil of carrying
12 forward, and you created more ill will for the
13 company and for the buyer by arguing in the
14 alternative, it seems to me it would be foolhardy
15 for us not to apprise the buyer of that, and to
16 proceed accordingly.

17 Q Let me refer you to the same exhibit,
18 000720. And also section 3.13. Start with
19 paragraph A?

20 A (Reading document.) Yeah.

21 Q And I'm just going to ask you for your
22 opinion as to what QC has agreed to in the
23 Publishing Agreement in defining, if you will, the
24 regulatory change?

25 A I would define that as -- and I will use

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1 an example, which is very fresh in my memory. The
2 Commission recently modified some of the rules
3 associated with our directory publishing
4 obligations in this state. And to the extent that
5 that was being proposed in any given state, a
6 change in the rules, we have a requirement to
7 notify the publisher immediately. Which only makes
8 sense, because that publisher is going to have to
9 start to prepare if those changes become required.

10 Q Now, is Qwest obligated to cover the cost
11 of any regulatory change under all circumstances?

12 A That, I don't know. I think that it does
13 address cost responsibility in the next couple of
14 provisions, but I'm not an expert on this
15 agreement.

16 I have read through it once, but my
17 understanding is that it is addressed. And to the
18 extent that I believe it's material, and I even
19 think that they go into some detail on what
20 constitutes material, that Qwest might be required.
21 But I'm not an expert on this agreement.

22 Q Let's shift gears a little bit, and I
23 would like you to refer to Exhibit 363, which is
24 Dr. Selwyn's Supplemental Direct Testimony, page 5.

25 JUDGE MOSS: Do you have a copy of that,

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1 Mr. Reynolds?

2 THE WITNESS: No.

3 JUDGE MOSS: Can he be furnished with a
4 copy, Ms. Anderl?

5 MS. ANDERL: Sure.

6 THE WITNESS: I have a copy of it.

7 Commissioner Oshie, did you specify line
8 numbers?

9 BY COMMISSIONER OSHIE:

10 Q Page 5. It begins as a question on line
11 14. And Dr. Selwyn's answer, at least the first
12 two sentences -- I am really concerned about the
13 sentence 2, which begins on line 16 and ends on 17.

14 A (Reading document.)

15 MS. ANDERL: I am sorry, Your Honor. What
16 page?

17 COMMISSIONER OSHIE: Page 5.

18 THE WITNESS: I have it in mind.

19 BY COMMISSIONER OSHIE:

20 Q Do you agree, first, would be my first
21 question? I should say, would you agree with
22 Dr. Selwyn's concern here that the revenue credit
23 may impair QC's ability to attract capital, and
24 could result in a higher cost of capital for the
25 company in the future?

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1 A I disagree on the basis that the existing
2 imputation has the same effect, and it's been in
3 place for 10 years. So I guess if you compare it
4 with the status quo, there's not much of a change.

5 I think I explained to the Chairwoman that
6 there would be an incremental change, but I don't
7 think the increase of \$15 million on an annual
8 basis would affect our ability to borrow or
9 actually change our ratings because of that.
10 That's an insignificant amount compared to our
11 actual rate base.

12 So I guess I disagree, and I am
13 disagreeing on the basis that we have an imputation
14 in place today that affects our earnings level.

15 Q Would Qwest Corporation, QC, be willing to
16 hold the rate payer harmless, at least during the
17 term of the proposed settlement for any increase in
18 the cost of capital that could be directly
19 attributed to a revenue credit?

20 A I can't answer that myself on behalf of
21 the company. I would recommend against it, because
22 I think it would be very difficult to try to
23 pinpoint a change in cost of capital pursuant to
24 the revenue credit. I don't think -- I think it
25 would be difficult to try to pinpoint it.

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1 If our cost of capital changes, it could
2 change for many reasons. It could change because
3 of actions at the corporate level, as is exhibited
4 in the recent financial downturn.

5 And so I think it would be very difficult
6 to try to track and pinpoint. Well, that would be
7 my recommendation, and I can't answer you today
8 whether the company would be willing to go along
9 with the proposition.

10 COMMISSIONER OSHIE: I don't have any
11 other questions. Thank you.

12 CHAIRWOMAN SHOWALTER: I have just two
13 follow-up questions.

14

15 EXAMINATION

16

17 BY CHAIRWOMAN SHOWALTER:

18 Q First of all, regarding Peter Hutchinson,
19 is he the person from Qwest who would have
20 first-hand knowledge of the competitive bidding
21 process for the sale between Carlyle and, say, the
22 last survival bidder that did not win the bids?

23 A He would certainly be very familiar with
24 it, yes.

25 Q For example, would he know the last bid

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1 from a bidder other than Carlyle?

2 A Yes.

3 Q Do we have any first-hand information
4 about the bidding process from Qwest's side in the
5 record?

6 A That, I don't know.

7 Q I know that Mr. Kennard had first-hand
8 knowledge of the bidding process and felt strongly
9 that there was another active bidder, but he didn't
10 actually have first-hand knowledge of that fact,
11 although he came fairly close to it.

12 A Right. I don't know whether it's in the
13 record or not.

14 Q All right. My other question is,
15 regarding reduction in rate base, if, as a
16 consequence of the sale, the rate base in
17 Washington were reduced by \$1.2 billion, the whole
18 thing were taken in as a reduction in rate base,
19 what would the effect be on the operation of the
20 company? I recognize, by the way, that's not a
21 proposal. It's just for -- I'm interested in
22 following that effect through.

23 A I don't know. I was going to try to give
24 you some comparative data, and I guess I would ask
25 counsel whether our A-61 report is public

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1 information.

2 MS. ANDERL: That is filed on a
3 confidential basis. The Commission -- there may be
4 certain numbers that may be used on a public basis,
5 although without knowing what they are, I can't
6 say.

7 THE WITNESS: Let me see if I can get
8 around mentioning anything confidential. I can
9 tell you that a \$1.2 million rate write-down of
10 rate base would be a significant portion of the
11 rate base, and the net result of doing that would
12 create a relatively small denominator to determine
13 the rate of return.

14 And so in -- at least initially, right
15 after the write-down you would have a virtually --
16 you would have a very negative revenue requirement
17 for the company. That is, if Staff or another
18 party wanted to engage in an earnings
19 investigation, they essentially could reduce our
20 rates way down because of it. It would have a
21 strange effect on our rate of return, and our
22 authorized revenues that we're allowed.

23 Over time it would dissipate. As we
24 brought new capital in and started to build the
25 rate base up, it would dissipate. But a one-time

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1 hit that way, it would have a significant effect.

2 Q And I am actually just trying to get at
3 this issue conceptually, and I'm sure the rate
4 making experts think this is a stupid question.

5 But I guess now there's a bigger rate
6 base, but the Yellow Pages business provides
7 revenue to offset the revenue needed to support a
8 rate of return on that rate base. Whereas if you
9 just took a write-down of the rate base you don't
10 have the revenue, but you also don't have the,
11 quote, real rate base; is that right?

12 A Well, if your question is, are they two
13 different methods to get to the same place, or to
14 potentially, I guess I will have to say yes. Maybe
15 depending on how you did your write-down. A
16 one-time write-down of a large amount won't be the
17 equivalent of the treatment that you would get in a
18 consistent, stable revenue credit.

19 That's more like what you just explained,
20 kind of an extension of the imputation benefit.
21 We're adding revenues, and we're not really
22 realizing any actual revenues from it. So it has
23 the effect of holding rates lower than they
24 ordinarily would be.

25 Writing down rate base in determining rate

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1 of return also has the effect of lowering revenue
2 requirements lower than it ordinarily would be. If
3 you do it in a one-time shot, what I am saying is
4 that it will take a while for that to dissipate,
5 and it will be quite different than taking like a
6 15-year revenue credit.

7 Q In other words, if you immediately wrote
8 down the rate base and ended imputation, would the
9 rates be lower than they are today with imputation?

10 A Well -- and I would need to do the
11 calculations, but if you were to do a significant
12 one-time write-down, it would be different than
13 imputation, yes.

14 Q Greater than \$3 or \$4 a month?

15 A Greater than the imputed amount, yeah.

16 CHAIRWOMAN SHOWALTER: All right. Thank
17 you.

18

19 EXAMINATION

20

21 BY COMMISSIONER HEMSTAD:

22 Q I neglected to ask you about one provision
23 in the stipulation, Exhibit 2. And it's section --
24 well, on page 67 there's -- at section 5, which is
25 the Rate Stability Contract Amendments, and I will

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1 just read it. It's brief.

2 "Qwest and Webtec will attempt to enter
3 into a memorandum of understanding, MOU, and
4 specific rate stability provisions. Qwest and PUD
5 will attempt to enter into an agreement on specific
6 rate stability provisions. These will be filed
7 with the Commission as soon as executed."

8 I am trying to understand what is the
9 purpose here. Is this focused on competitively
10 classified services, or is it focused on regulated
11 rates or both? And in any event, either event,
12 what does rate stability in the context here mean?

13 A I think it's both, Commissioner. And I
14 think that the concern was that the sale of Dex and
15 the consequent settlement might place upward
16 pressure on rates.

17 And the party -- it was one of the parties
18 to the settlement that that was important to. And
19 it ended up as a provision in our agreement.

20 But the basis for their concern was that
21 because of the sale of Dex, they felt that -- and
22 the subsequent settlement and fallout from that,
23 that there might be upward pressure on their rates.

24 Q But that would be -- if true, that would
25 be true in putting at risk all classes of rate

1188

1 payers, wouldn't it?

2 A Potentially. But I mean, I'm not
3 saying -- I mean, I support the provision. It was
4 important to this party. I don't need to agree
5 with the principles behind it. But to the extent
6 it was important to them, I support it in this
7 agreement.

8 Q And what would such a rate stability
9 filing potentially entail? A commitment that --

10 COURT REPORTER: Commissioner, I can't
11 hear you. Would you repeat that, please.

12 BY COMMISSIONER HEMSTAD:

13 Q What would a rate stability filing of some
14 kind potentially entail? For example, rates would
15 not change for a certain period of time?

16 A It could entail that. And if you think
17 about it, we do term contracts like that all the
18 time, so it does envision that.

19 We haven't reached a memorandum of
20 understanding yet, so I can't tell you the full
21 extent of that. But I can guarantee you that
22 anything we agree to under that provision will come
23 back before this Commission for their approval. So
24 it's very much subject to your approval.

25 COMMISSIONER HEMSTAD: Thank you. That's

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1 all I have.

2

3

EXAMINATION

4

5 BY COMMISSIONER OSHIE:

6 Q Mr. Reynolds, I have one follow-up
7 question: Your testimony on the effect of
8 competitive classification on the Settlement
9 Agreement at least raises one more issue with me.

10 And that is, if we currently have before
11 us a petition to competitively classify all
12 business services within the state of Washington,
13 if the Commission agreed with Qwest that those
14 services should be competitively classified, under
15 your interpretation of the agreement would the
16 Settlement Agreement inure to the benefit of the
17 business customers following the competitive
18 classification, and -- strike that "and," and we
19 will go with the first to avoid the compound
20 question.

21 A I think I would have to answer yes to the
22 extent that the one-time bill credit would
23 definitely inure to them. It would be very
24 positive thing to them. And I don't think that --
25 I mean, the revenue credit can only help keep rates

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1 lower than they ordinarily would be.

2 And as far as the competitive
3 classification, the underlying rates for the
4 services that we identify as wholesale services
5 that are purchased by our competitors, they are not
6 based on a rate of return approach. They are a
7 cost based approach based on TELRIC costing. And
8 so they would not be impacted by the revenue credit
9 one way or the other.

10 So I don't think it would affect the
11 competitors, and it shouldn't affect our filing.

12 Q Other than the -- I guess if I understand
13 you correctly, other than the \$67 million up front
14 payment, should the business customers be
15 competitively classified, or business services be
16 competitively classified, there would be no benefit
17 from the future revenue credits inuring to those
18 business service customers?

19 A And I apologize. I understand your
20 question now. And I think that's probably correct.

21 Q And I guess the impact of that would be
22 the benefits would be spread -- the entire revenue
23 credit benefit would be spread among those
24 customers still taking service under a cost of
25 service base?

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1 A Yes. And, also, I don't think we
2 distinguish between cost of service or
3 competitively classified. So services that are
4 currently competitively classified are listed on, I
5 believe, Appendix 1 or A of the settlement.

6 COMMISSIONER OSHIE: Okay. Thank you.

7 THE WITNESS: You are welcome.

8 JUDGE MOSS: I have a couple of quick
9 questions for you, Mr. Reynolds.

10

11 EXAMINATION

12

13 BY JUDGE MOSS:

14 Q With respect to some of the questions that
15 were put to you concerning the proposal to, if you
16 will, back up the revenue credit with sort of a
17 contract providing for actual payments that flow
18 from QCII to QC, you were, I think, careful to
19 qualify some of your answers in terms of the
20 problem -- one of the problems, or one of the
21 difficulties you perceived in that proposal is that
22 it is coupled with another proposal that would
23 restrict the ability of QC to dividend all or a
24 portion of that money back to QCII.

25 Is that, indeed, part of the problem, from

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1 your perspective? If QC were free to dividend that
2 money back, would that problem disappear?

3 A It probably would, because you could make
4 the payment one day, and make the -- dividend it
5 back the next day, or maybe even the same day, so
6 yes. The answer is yes.

7 Q Does the company maintain different sets
8 of books for financial accounting and reporting
9 purposes, and for regulatory accounting and
10 reporting purposes?

11 A Yes, it does.

12 Q Does the revenue credit, would that look
13 different on those two types of books?

14 A The revenue credit would not show up on
15 the financial books.

16 Q So, therefore, to the extent these
17 proposals were implemented through a revenue
18 credit, then it really wouldn't matter what its
19 size was in terms of access to capital markets; is
20 that correct? Isn't that what they are going to
21 focus on in the financial accounting?

22 A They may, but I would think that a savvy
23 analyst would understand the value of a revenue
24 credit. And if the revenue credit was deemed to be
25 excessive, and it kept the rates too low, I think

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1 that they would have concerns.

2 Q Okay. One more question. You refer in
3 your testimony, in part -- this is the adopted
4 testimony Theresa Jensen had filed originally -- to
5 the current value of the imputation being \$103.4
6 million.

7 Now, I want to be clear, and I want the
8 record to be clear. What is currently embedded in
9 rates in terms of imputation amount is \$85.2
10 million?

11 A That's correct.

12 Q And unless and until there is a rate case
13 and that is changed, then that is the actual value,
14 if you will, of the imputation in terms of rates,
15 the \$85.2 million?

16 A I am having a difficult time answering
17 that, because I don't know what, if any,
18 requirement we had to update that. I know in the
19 context of our A-61, starting in 2001, we actually
20 filed the updated number. And we explained the
21 rationale behind the updated number.

22 I believe an earlier witness explained --
23 in fact, it was Ms. Koehler-Christensen explained
24 why we did that.

25 I would certainly agree that the number

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1 embedded in the rates is 85.2, and our most recent
2 projection of what that would look like, using what
3 we believe to be the proper imputation
4 calculations, would be 103.

5 Q So in other words, if you bring the 85.2
6 up to date in terms of the revenue today, then it's
7 just a proportional increase?

8 A Yes. Yes.

9 Q Nothing changes in the rates?

10 A That's correct.

11 Q So the reported amount might be different,
12 but it doesn't have any practical impact as far as
13 the rate payers are concerned?

14 A Well --

15 Q Unless and until a rate case is filed?

16 A Yes. Yes.

17 Q And so that would also be true with
18 respect to the proposed settlement? In other
19 words, the proposed settlement provides for \$110
20 million revenue credit if a rate case is filed
21 within four years; otherwise it has no practical
22 impact?

23 A I would disagree with the latter
24 statement. The practical impact it has is for both
25 other parties that may seek to insure that we're

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1 being held to our authorized rate of return, or
2 from our perspective to make sure that we are
3 earning our authorized, we watch that very
4 carefully.

5 And were that not there, our revenues
6 would be \$110 million different, and other actions
7 would be much different. So it has that effect.

8 Q It would influence your decision whether
9 or not to file a rate case?

10 A Exactly. Or it might influence the
11 Staff's decision to file a rate case -- or a
12 complaint, I should say; that's correct.

13 JUDGE MOSS: That's all I have. The
14 Commission has some other brief business that it
15 needs to conduct at this time. We also -- it's
16 time for our afternoon break.

17 I would just note the hour of the day and
18 the amount of work that we have left to do in this
19 case, which is considerable. And so I am just
20 going to offer the encouraging comment that I hope
21 all of that furious notetaking I have been
22 observing is going to lead during the break to
23 counsel considering very carefully the necessity
24 for any follow-up questions, or redirect for this
25 witness who has been on the stand for some hours.

1196

1 And try to minimize that to the truly important.

2 So I want you to use your time wisely
3 during the break to consider that, and also
4 consider again how much work we have left to do in
5 the remaining time available.

6 So with that, we will take our recess.

7 And I'm going to announce our recess for 15
8 minutes, although the Commissioners may need a few
9 minutes beyond that. I will ask the reporter and
10 the attorneys to be back at 20 to the hour. Thank
11 you.

12 (Brief recess.)

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

14 Let's see. Okay.

15 Any follow-up, Mr. Trautman?

16 MR. TRAUTMAN: We just have one question.

17

18 RE CROSS EXAMINATION

19

20 BY MR. TRAUTMAN:

21 Q There were some questions from the Bench
22 pertaining to the role of QCII and QC in the
23 negotiations, and who negotiated from those
24 entities. Do you recall that?

25 A Yes, I do.

1197

1 Q Who were the members of the board of QC?

2 A That I don't know.

3 JUDGE MOSS: That would be in the 10-K,
4 wouldn't it?

5 MS. ANDERL: It may be. I think -- I
6 don't know if it's reported in every 10-K. I think
7 it probably is.

8 JUDGE MOSS: I think the board members are
9 listed in the 10-K, which is an exhibit.

10 MS. ANDERL: Although that may only be of
11 QCII, and I think the question was QC.

12 JUDGE MOSS: You are probably right.

13 MR. TRAUTMAN: Could we make a Record
14 Requisition for the QC board of directors?

15 JUDGE MOSS: Let's do that to save time.
16 And if it's not already in the record somewhere, it
17 can be furnished. That's easy enough.

18 MS. ANDERL: Clarification: at what point
19 in time?

20 JUDGE MOSS: What point in time, Counsel?

21 MR. TRAUTMAN: Today.

22 JUDGE MOSS: As of today. Okay. That's
23 it. Thank you.

24 (RECORD REQUISITION No. 7.)

25 JUDGE MOSS: And a Bench request. I will

1198

1 somewhat relate it.

2 We would like to have the date and time of
3 the successful Carlyle bid, and the date and time
4 of the last non-Carlyle bid that preceded it.

5 CHAIRWOMAN SHOWALTER: And the source of
6 that information.

7 MS. ANDERL: Date and time of the
8 successful Carlyle bid at \$7.05 billion, and the
9 date and time of the --

10 JUDGE MOSS: The last preceding bid before
11 that bid was accepted from a non-Carlyle.

12 MS. ANDERL: And the preceding bid from
13 another party, and in both cases the source.

14 CHAIRWOMAN SHOWALTER: The source of your
15 Qwest information, who is providing it? Somebody
16 like Mr. Hutchinson.

17 JUDGE MOSS: And whether it was called in
18 from a Denny's.

19 MS. ANDERL: I think it was an Appleby's,
20 Your Honor.

21 JUDGE MOSS: That'll be Bench Request 8, I
22 believe.

23 MS. ANDERL: Yes. Your Honor, and was it
24 Record Requisition No. 7?

25 JUDGE MOSS: Yes. I believe Record

1199

1 Requisition was No. 7, and Bench Request No. 8.

2 (BENCH REQUEST NO. 8.)

3 JUDGE MOSS: We had Staff's follow up.

4 Appreciate your brevity. And we're ready for

5 redirect.

6 Ms. Anderl.

7 MS. ANDERL: Thank you, Your Honor.

8

9 REDIRECT EXAMINATION

10

11 BY MS. ANDERL:

12 Q Mr. Reynolds, you were asked some
13 questions by Mr. Trautman earlier today about the
14 extent to which QC might want to limit the effect
15 of the establishing -- or strike that question --
16 about whether, if the Commission adopted structural
17 safeguards, could QC limit the effect of those
18 structural safeguards by establishing a Washington
19 State specific operating company. Do you recall
20 that?

21 A Yes.

22 Q And I wanted to ask you, even if QC were
23 willing or desired of doing that, do you believe
24 that QC would be able to take that action
25 unilaterally?

1200

1 A No.

2 Q Can you explain why?

3 A I am sorry. I have lost it. I've lost
4 the question in my mind. Could you repeat it
5 again?

6 Q Yes. Mr. Reynolds, in your testimony --
7 and let me just back up and give you some better
8 context.

9 In your testimony, your written testimony,
10 you had explained that QC does not have any
11 Washington state specific operating company
12 currently in existence. You also pointed out that
13 the company has region-wide bond holders.

14 And within that context, my question to
15 you is, if QC wanted to establish a Washington
16 state specific operating company unilaterally,
17 do you believe it could do so?

18 A No.

19 Q Could you please explain why.

20 A It's because of the other entities that
21 have an interest in the company, the bond holders,
22 and the shareholders. And I would think that
23 we would have to get approval for that to happen.
24 And so I think it would be quite difficult.

25 I mean, essentially the value of the

1201

1 interest that they hold in the company is based on
2 the company as a whole, and that would be a
3 significant structural change to the company and
4 might affect their value.

5 Q You were also asked by Mr. Trautman
6 whether the buyer and seller in this transaction
7 were attributing value to years 15 through 40, or
8 years 15 through 50. Do you recall that?

9 A Yes.

10 Q And I believe you responded that
11 they were.

12 Mr. Reynolds, is that value captured, in
13 your view, in the sale, please?

14 A Yes, it is, because the sales price
15 captures the concept of a 50-year publishing
16 agreement, and a 40-year noncompete.

17 Q And to the extent that the Settlement
18 Agreement flows that value back over a shorter
19 period of time, is that an inappropriate mismatch?

20 A It depends on whether you are the
21 beneficiary of that. I mean, to the extent that
22 you are the beneficiary, I suppose that you would
23 encourage that mismatch.

24 But from Qwest's perspective, it is
25 actually extending a greater value to the rate

1202

1 payers in a shorter period of time.

2 Q Now, you were asked some questions by
3 Chairwoman Showalter about a hypothetical wherein
4 the Dex sale transaction essentially closed around
5 Washington. And so there were 13 states in Dex
6 Holdings, and no Dex Holdings publisher for the
7 State of Washington. Do you recall that?

8 A Yes, I do.

9 Q Do you have any knowledge of whether that
10 is currently the way the transaction before the
11 Commission in this case is structured?

12 A Yes. It's not structured that way.

13 Q Do you have any knowledge as to whether
14 the buyer, Dex Holdings in this case, would be
15 willing to renegotiate the sale transaction to
16 accomplish a six-state Rodney closing?

17 A No, I don't. In fact, I hope that I was
18 clear in saying that it was my opinion it was
19 speculative.

20 Q Do you know what would happen if the buyer
21 and seller were either not willing or not able to
22 renegotiate such a transaction?

23 A Yes. I think we're back to the point that
24 I discussed, and it would be that the Rodney sale
25 would not go through, and it has the impact of us

1203

1 not receiving \$4.3 billion that I believe we
2 require to stay out of bankruptcy.

3 Q You were also asked some questions about
4 where rate payers might be on the priority ladder
5 in a bankruptcy. Do you recall that?

6 A Yes.

7 Q And I believe you responded that rate
8 payers' claims would be the lowest on the priority
9 ladder. Is it your understanding that rate payers
10 would even attain status as creditors under most
11 circumstances?

12 A It's my understanding they would not. And
13 I probably misspoke that I even gave them the
14 lowest rung on the ladder. I believe Mr. Mabey
15 says they would not be taken into account.

16 CHAIRWOMAN SHOWALTER: I am sorry. Was
17 that in the scenario of imputation, or a contract,
18 or both?

19 THE WITNESS: I think that's the scenario
20 of -- and, oh, well, let me straighten that out,
21 too. A contract would not be with the rate payers.
22 It would be between QCI and QC, so that really
23 wouldn't affect the rate payers.

24 I think that -- well, I'm not sure that
25 the specific question was asked with regard to the

1204

1 rate payers. In their -- where they would stand.
2 I think I may have answered it, but I don't know
3 that I can place what type of claim they would
4 have.

5 In fact, the only thing I can think of is
6 in terms of a bill credit, that they may have felt
7 they had a claim there.

8 BY MS. ANDERL:

9 Q You were asked some questions about
10 whether you knew who the QCII negotiators were with
11 regard to the sale transaction. And you responded
12 that you recall that Peter Hutchinson was involved
13 in that?

14 A Yes.

15 Q Do you remember that?

16 A Yes.

17 Q Do you also recall Mr. Kennard testifying
18 that for at least some part of the transaction, he
19 negotiated with Dick Notebaert?

20 A Yes.

21 Q Mr. Reynolds, could you please take a look
22 at what is marked as Exhibit 14, which is the
23 Chairwoman Illustrative Bench Exhibit.

24 A (Complies.)

25 Q Now, row A assumes that the Rodney

1205

1 transaction, as currently structured, is approved
2 and closes; is that correct?

3 A Yes.

4 Q Now, rows B and C approve the -- assume,
5 rather, the sum variation on the 13 state
6 transaction that we had talked about a little while
7 ago. Is that your understanding?

8 A Yes.

9 Q Now, isn't one of the differences between
10 zero A and rows B and C --

11 MR. TRAUTMAN: Objection; leading.

12 JUDGE MOSS: Well, she hasn't finished her
13 question yet.

14 Go ahead with your question, Ms. Anderl.

15 MS. ANDERL: Then I will leave off the
16 "isn't it true."

17 BY MS. ANDERL:

18 Q Is one of the differences between row A
19 and row B the fact that in row B, QCII will not
20 have received the Washington portion of the Rodney
21 proceeds?

22 MR. TRAUTMAN: Objection; leading.

23 JUDGE MOSS: I don't find that the
24 question in its current form suggested the answer,
25 and that is the definition of a leading question.

1206

1 Therefore, your objection is overruled.

2 THE WITNESS: The answer to that is yes.

3 And I think the Chairwoman and I had a conversation
4 about what that amount may or may not be. But at
5 its maximum, it would be the Washington portion of
6 the current Rodney deal.

7 BY MS. ANDERL:

8 Q Might it not even be more than that?

9 Mr. Reynolds, you don't know how the negotiations
10 would come out if there were only six states,
11 do you?

12 A No, I do not.

13 Q And is it possible that the buyer would
14 find the six states incrementally less valuable?

15 A It's possible.

16 Q And is the same difference between -- that
17 we just discussed between rows A and B pertain to
18 any difference between row A and row C?

19 A Yes.

20 Q And in your view does that difference,
21 i.e., the lack of any proceeds associated with the
22 Washington portion of the sale, affect the
23 likelihood of QCII being in either column 1 or
24 column 2 or column 3?

25 A Yes, it could. To the extent that we fell

1207

1 short of what we needed to retain our financial --
2 or previous financial condition, it could push you
3 from column 1 to column 2, and maybe even all the
4 way over to column 3.

5 Q Now, Mr. Reynolds, you were asked some
6 questions about writing down the rate base by \$1.2
7 billion?

8 A Yes.

9 Q Do you have that in mind?

10 A Yes, I do.

11 Q And I believe you stated two things with
12 regard to that. You characterized the difference
13 that that would make with regard to current
14 imputation, and you also, I believe, stated that
15 the effect of that write-down would dissipate over
16 time.

17 Are there any clarifications or additions
18 that you would like to make to that testimony?

19 A Yes. I guess the first thing I would like
20 to clarify is that if you are taking a write-down
21 of rate base, you have to take it on an after tax
22 basis. So unless the \$1.2 billion were after tax,
23 you would need to tax adjust that. And that would
24 tax adjust down in the neighborhood of about \$750
25 million.

1208

1 And so if you were to subtract that amount
2 from rate base, it would have an effect that is
3 roughly equivalent to something between the
4 existing value of the imputation, 85 and the 103.
5 It would be somewhere in that neighborhood. And
6 that amount would not dissipate over time. It
7 would continue in perpetuity, that amount.

8 So I wanted to correct that. Luckily I
9 had our financial advisor on hand, and he advised
10 me on the break.

11 Q So just to clarify, Mr. Reynolds, are you
12 saying if you write down the rate by \$750 million,
13 you essentially never get that rate base back?

14 A That's correct.

15 Q And the rate impact, I believe you said,
16 is perpetual?

17 A That's correct.

18 MS. ANDERL: That's all the redirect.

19 JUDGE MOSS: Thank you, Ms. Anderl.

20 Assuming there's nothing further for this
21 witness?

22 (No response.)

23 JUDGE MOSS: Mr. Reynolds, thank you for
24 your testimony. And you may step down.

25 MS. ANDERL: Dr. Taylor.

1209

1 JUDGE MOSS: Thank you.

2 MS. ANDERL: And while Dr. Taylor is
3 getting comfortable, do you have a response date in
4 mind for the latest Record Requisition and Bench
5 Request?

6 JUDGE MOSS: When do you think is
7 reasonable?

8 MS. ANDERL: After tomorrow. Wednesday,
9 June 4.

10 JUDGE MOSS: Let's see, I think that'll
11 work, Ms. Anderl.

12 MS. ANDERL: Thank you.

13 JUDGE MOSS: Dr. Taylor, if you would rise
14 and raise your right hand.

15

16 WILLIAM E. TAYLOR, Ph.D,
17 produced as a witness in behalf of Qwest, having been
18 first duly sworn, was examined and testified as
19 follows:

20

21 JUDGE MOSS: Thank you. Please be seated.

22 Your witness, Ms. Anderl.

23

24

25 DIRECT EXAMINATION

1210

1

2 BY MS. ANDERL:

3 Q Thank you, Dr. Taylor.

4 A Good afternoon.

5 Q Would you state your name and business
6 address for the record.

7 A William E. Taylor. My business address is
8 One Main Street, Cambridge, Massachusetts 02142.

9 Q By whom are you employed, and in what
10 capacity?

11 A National Economics Research Associates,
12 Inc. I am a senior vice president, and I head the
13 communications practice.

14 Q Dr. Taylor, do you have before you the
15 documents that have been marked as Exhibits 221-C,
16 222, and 223-C, consisting of your rebuttal
17 testimony, your qualifications, and your valuation
18 of Dex?

19 A Yes, I do.

20 Q Do you have any changes or corrections to
21 make to that testimony?

22 A I have one change or correction on page 36
23 of the rebuttal testimony. On the passages, line
24 17 through the bottom of the page, I would like to
25 omit the sentence beginning on line 17, which

1211

1 begins "Currently less than," something, something,
2 something. Drop that sentence.

3 Then the next sentence is all right.
4 "Because of competition and the reclassification of
5 some of Qwest's services as competitive," blah,
6 blah, blah, "from Yellow Pages has," then scratch
7 the words "over confidential times the" and replace
8 it with the phrase "a larger."

9 So the phrase would read, "Every
10 additional dollar of imputed contribution from
11 Yellow Pages has a larger effect on regulated
12 service prices," blah, blah, blah.

13 CHAIRWOMAN SHOWALTER: Leaving off the
14 blah, blah, blah.

15 MS. ANDERL: And, Your Honor, as an aside,
16 with that change that page would no longer be
17 confidential in his testimony.

18 BY MS. ANDERL:

19 Q Dr. Taylor, with that change, is your
20 testimony true and correct to the best of your
21 knowledge?

22 A Yes, it is.

23 MS. ANDERL: Your Honor, we offer those
24 exhibits.

25 (EXHIBITS 221-C, 222, 223-C OFFERED.)

1212

1 JUDGE MOSS: Hearing no objection, those
2 will be admitted.

3 (EXHIBITS 221-C, 222, 223-C ADMITTED)

4 MS. ANDERL: And Dr. Taylor is available
5 for cross examination, and/or questions from the
6 bench.

7 MR. TRAUTMAN: We have no questions.

8 JUDGE MOSS: Dr. Taylor is available for
9 questions from the bench.

10

11 EXAMINATION

12

13 BY CHAIRWOMAN SHOWALTER:

14 Q Since Commissioner Hemstad and I were
15 talking when Mr. Reynolds got off the bench, I'm
16 going to ask you what I would have asked him, but I
17 think you were listening --

18 JUDGE MOSS: We can always recall Mr.
19 Reynolds.

20 CHAIRWOMAN SHOWALTER: That's okay. I
21 think a fresh witness probably has a fresh mind.

22 BY CHAIRWOMAN SHOWALTER:

23 Q Regarding this reduction in rate base, if
24 rate base were reduced \$1.2 billion after taxes, so
25 it's approximately \$750 thousand --

1213

1 A Million dollars.

2 Q Million. -- million, isn't it the case
3 that over some period of time, the effect of
4 depreciation and assets that would have been in
5 going off, and new assets coming back on, that over
6 some period of time the reduction would phase
7 itself out compared to had it not happened at all?

8 A No. And the critical thing is the last
9 phrase, compared to if it hadn't happened at all.

10 Over time the rate base will change.
11 Hopefully it will grow, perhaps not. But it will
12 change. Assets will come in. Assets will go out.
13 But there will always be, compared to what there
14 otherwise would have been, a missing \$700 million.

15 Q So in my question, I probably was double
16 counting that \$750 million in terms of the assets
17 that otherwise would have been there, going off --
18 being phased out.

19 A Yes.

20 Q Now, supposing that there was a reduction
21 of rate base of some amount, perhaps not \$750
22 million, but a reduction in rate base for a
23 definite period of time, maybe 15 years, what does
24 that do, analytically, to rate of return and
25 opportunity to earn -- and I suppose the question

1214

1 is compared to credits and imputation, and those
2 sorts of alternatives.

3 A Okay. Well, let's do it first compared
4 with a one-time removal of \$700 million forever.
5 The difference is, after 15 years, or whatever the
6 period is, the rate base would suddenly increase
7 again. And were there -- the rate base would
8 increase again. And were there a rate case that
9 followed that, prices would then be that much
10 higher than they otherwise would be.

11 That would not happen under the perpetuity
12 assumption if you removed \$700 million forever.

13 The difference between the revenue credit
14 and either of these adjustments to the rate base, I
15 think, are fundamental. You can make an adjustment
16 to the rate base given an assumption about what the
17 cost of capital is that would essentially reproduce
18 a revenue credit, or the effect of a revenue
19 credit. As Mr. Reynolds' testified, the Staff's
20 proposal after tax comes moderately close to that.

21 But it's bad accounting in some sense.
22 That is, you are taking something out of the rate
23 base that was never in it, as I am sure we're all
24 aware. This asset was never part of the rate base
25 on which the company earned.

1215

1 And you can get into all kinds of
2 unintended problems, I think, by trying to solve
3 the problem that way. One for example is, suppose
4 the cost of capital changed radically, not because
5 of anything Qwest does, but because of something
6 Mr. Bush does, or something like that. Then all of
7 a sudden the equivalentents that you might have had
8 between a given revenue credit change, and the
9 reduction you chose in the rate base would go away.
10 If the cost of capital were very different, you
11 would need a different adjustment in the rate base
12 to make it equivalent to a given revenue credit.

13 That's just an example of the sort of
14 things that can go wrong when, in essence, you are
15 fooling yourself when you are taking it out of the
16 rate base.

17 The rate base is still whatever it was.
18 The capital is still there. The investors have
19 still given up the investment that has gone into
20 the rate base. And to try to adjust the rate base
21 to account for the desire to reduce rates is a
22 dangerous way to do it.

23 Q Now, looking at the revenue credit idea in
24 the settlement proposal, do you agree that after 15
25 years, all things being equal, there will also be a

1216

1 rate increase that would be justified, most
2 probably?

3 A There would be the same potential for a
4 rate increase in the sense that the revenue
5 requirement would suddenly become higher than it
6 otherwise would be.

7 Q And then speaking of fooling ourselves,
8 this credit would be an order, but it is not based
9 on any particular revenue stream. Do you agree?

10 A Oh, I agree. But then neither is
11 imputation.

12 Q Well, there does exist currently a Yellow
13 Pages operation that produces revenue that we look
14 to when we set the credit.

15 A No, that's right.

16 Q Or the imputation amount.

17 A Certainly. And there will not be that
18 going ahead in the future. If the settlement is
19 approved, everyone will be committing to a given
20 revenue credit in each year going forward. So it's
21 no longer going to be tied to the fortunes of a
22 directory business.

23 But I think what is important is, under
24 the current imputation arrangement, if that were to
25 continue and if the whole Qwest mess hadn't

1217

1 occurred, and this was business as usual, you still
2 have a circumstance in which QC, in no real sense,
3 has a revenue stream attached to the credit.

4 QCII does. I mean, Qwest as a whole does
5 have that revenue stream. And all the sale does is
6 converts that revenue stream into one lump of \$7.05
7 billion.

8 That, by itself, is a matter of
9 indifference. When you get a stream going forward,
10 or you get the net present value of that stream at
11 the current point in time, is economically
12 indifferent.

13 What QCII does with that money, namely pay
14 down its debt, has certain effects. That is, as
15 Mr. Reynolds testified, it reduces the interest
16 costs. It reduces capital costs. And it allows
17 the company to go forward.

18 But all it has done is convert a stream of
19 net revenue from directory into a lump sum.

20 Q Yes. But if the result of all of that is
21 not to put QCII at all in a state where they
22 actually have something equivalent to that revenue
23 stream that can support the credits, that is, if
24 we're in column 2 and not column 1, we may have
25 fooled ourselves?

1218

1 A Well, I don't think so in the sense that
2 this is nearly -- this really just has to do with
3 how Qwest, QCII, and the whole family of Qwest
4 handles its internal financing. That is, would it
5 rather have a stream of money coming from directory
6 profits, and subject to all of the uncertainty of
7 future directory profits -- would it rather have
8 that stream, or would it rather have a fixed lump
9 of money determined at a point of sale today?

10 And I don't think there's any substantive
11 important economic difference between the two.
12 That is, the fact that going in the future under
13 the current circumstance, there is a stream of
14 money coming from directory business isn't really
15 that different from having, today, a lump of \$7.05
16 billion and trying to decide what the best thing
17 for the company is to do with that money.

18 Why are those two radically different?
19 Why does one make the company more risky or
20 anything than the other?

21 Q Well, now you are asking me questions.

22 A Well, let's pose that as a --

23 Q And one answer may be that QC and the rate
24 payers of Qwest have an interest established by
25 this Commission and by our State Supreme Court, in

1219

1 that Dex operation.

2 And so you are saying -- what you are
3 saying is what would the company rather have? Our
4 question is to look at it from the view of the
5 public interest, which includes the rate payers in
6 a very prominent role, although that's not the only
7 consideration. And there are questions of now and
8 in the future as well.

9 A Right. But, again, look at what the
10 alternative is. The alternative would be that if
11 we went forward business as usual, no sale, not
12 really a choice, but if that were to happen, QCII
13 would be receiving this stream of money which
14 supports the requirement that this Commission has
15 placed on QC. It would be receiving it, but it
16 would be receiving it over time in such a way that
17 QCII would then be financially much more at risk of
18 bankruptcy than if it could convert it to a lump
19 sum and reduce its debt. So that's the question.

20 Q Right. And in the -- on the subject of
21 alternatives, I have at least 12, and I'm not going
22 to resist asking you about each cell.

23 CHAIRWOMAN SHOWALTER: That's all the
24 questions I have. Thank you.

25 COMMISSIONER HEMSTAD: Mercifully, I don't

1220

1 have any questions.

2 COMMISSIONER OSHIE: I don't have any
3 questions either. And I won't be asked questions,
4 I guess.

5 CHAIRWOMAN SHOWALTER: We feel bad for
6 making you come all the way here, but on the other
7 hand, Judge Moss would not want us to go on too
8 long.

9 JUDGE MOSS: Any follow-up?

10 MR. TRAUTMAN: No, Your Honor.

11 JUDGE MOSS: Anything from --

12 MS. ANDERL: I could hardly justify any
13 redirect. I think that will do it.

14 Oh, I am sorry. I already moved the
15 exhibits.

16 JUDGE MOSS: Yes. Before Dr. Taylor
17 leaves us, are we going to stipulate as Staff
18 exhibits, or leave them not offered, or what are we
19 going to do? These are all, with one exception,
20 responses to Data Requests.

21 MS. ANDERL: We have no objection to any
22 of them, should Staff want them as part of the
23 record, except for 233.

24 MR. TRAUTMAN: We would move for admission
25 of 224 to 233. I believe Dr. Taylor referred to

1221

1 Liberty Media in his testimony. If I could have a
2 moment --

3 JUDGE MOSS: Well, we will admit 224
4 through 232, there being no objection to those.

5 (EXHIBITS 224 to 232 ADMITTED.)

6 JUDGE MOSS: What objection do you have to
7 233?

8 MS. ANDERL: Without any cross examination
9 on that exhibit, there's no showing that it's
10 relevant to this proceeding.

11 JUDGE MOSS: Where does it tie to his
12 testimony, Mr. Trautman?

13 MR. TRAUTMAN: If I can have a moment, Your
14 Honor.

15 (Pause in Proceedings.)

16 MR. TRAUTMAN: Your Honor, on page 11 of
17 the testimony there's a description of the process
18 by which Dex was sold. And there's a statement
19 that preliminary bids range from \$7 to \$10 billion,
20 and five groups are mentioned, one of which was
21 Liberty Media. And the exhibit simply contains
22 a company profile of Liberty Media to which the
23 witness has referred.

24 JUDGE MOSS: Does it speak to the bid in
25 any way?

1222

1 MR. TRAUTMAN: I am not sure that it
2 directly does, Your Honor.

3 JUDGE MOSS: On the one hand, I'm
4 hard-pressed to see that it has any particular
5 relevance; on the other hand, I am hard-pressed to
6 see that it could be particularly harmful to you,
7 Ms. Anderl.

8 MS. ANDERL: I was not anticipating that
9 it would be harmful; only that it was irrelevant.

10 MR. TRAUTMAN: It may be helpful for our
11 consultant, who is now in Boston, and he identified
12 it as an exhibit.

13 MS. ANDERL: That's the issue, Your Honor.
14 If there's no cross examination on it, Your Honor,
15 and it is not made clear on the record for what
16 purposes the document is intended to be used, I
17 essentially am not able to redirect this witness on
18 whatever interpretations or inferences the parties
19 wish to draw from the document.

20 And I do think that has the potential to
21 prejudice us if interpretations or inferences are
22 drawn on brief without the benefit of having heard
23 the witness' view.

24 JUDGE MOSS: I think the Bench is prepared
25 to rule. We will sustain the objection. So 233-A

1223

1 will not be admitted. The remaining ones I have
2 already ruled on.

3 Now, Dr. Taylor, with that, I apologize
4 for the delay, but you may step down. Thank you
5 very much.

6 JUDGE MOSS: Off the record.

7 (Discussion off the record.)

8 JUDGE MOSS: So let's be back on the
9 record, and Ms. Folsom is approaching the stand.
10 Raise your right hand.

11

12 KATHLEEN FOLSOM,
13 produced as a witness in behalf of Staff, having been
14 first duly sworn, was examined and testified as
15 follows:

16

17 JUDGE MOSS: Thank you. Please be seated.

18 Ms. Smith, I judge by the realignment of
19 Staff seating, you will be doing the examination?

20 MS. SMITH: I will, Your Honor. Thank
21 you.

22

23

24

25

DIRECT EXAMINATION

1224

1

2 BY MS. SMITH:

3 Q Good afternoon, Ms. Folsom. Would you
4 state your name and give your business address?

5 A Kathleen M. Folsom. My business address
6 is 1300 South Evergreen Park Drive, Southwest, PO
7 Box 47250, Olympia, Washington 98504.

8 Q Did you prepare prefiled direct testimony
9 in this matter?

10 A Yes, I did.

11 Q And is that testimony the testimony that
12 has been premarked for identification in this
13 matter as Exhibit 431?

14 A Yes, it is.

15 Q Do you have any changes or corrections to
16 make to your direct testimony?

17 A No, I don't.

18 Q Ms. Folsom, if I were to ask you the
19 questions that are contained in your testimony now,
20 would your answers be the same?

21 A Yes, they would.

22 MS. SMITH: I move the admission of
23 Exhibit 431.

24 (EXHIBIT 431 OFFERED.)

25 MR. SHERR: No objection.

1225

1 JUDGE MOSS: No objection. It will be
2 admitted as marked.

3 (EXHIBIT 431 ADMITTED)

4 MS. SMITH: Ms. Folsom is available for
5 cross examination.

6 JUDGE MOSS: Mr. Sherr.

7 MR. SHERR: Thank you, Your Honor.

8

9 CROSS EXAMINATION

10

11 BY MR. SHERR:

12 Q Good afternoon, Ms. Folsom. I am Adam
13 Sherr. I will try to be brief with you today.

14 A As well I.

15 Q Qwest served on Staff in this case a
16 number of Data Requests; is that correct?

17 A A No..

18 Q And due participate in responding to some
19 of those?

20 A Yes, I did.

21 Q As an example, could you please look at
22 what's been marked as Exhibit 433.

23 A It would be helpful if you tell me what
24 that Data Request number is.

25 Q 433 is Data Request No. 3 from Qwest.

1226

1 A Yes.

2 Q And do you see in the upper right-hand
3 side of that document it says Responder, Kathy
4 Folsom?

5 A Yes, I do.

6 Q Can I assume that for any Data Requests
7 that identifies you as the responder that you
8 participated in the response?

9 A Yes, I did.

10 Q Turning to a slightly more substantive
11 matter --

12 A Okay.

13 Q Perhaps only slightly, is it true that you
14 made a number of predictive statements in your
15 testimony regarding bankruptcy?

16 A Predicted for who, I guess?

17 Q Well, let me change my question.

18 Is it true that you made a number of
19 statements in your testimony regarding bankruptcy?

20 A I made a number of statements regarding
21 the effect that bankruptcy has had on PGE and its
22 customers.

23 Q And let's quickly take a look at some of
24 those. This is Exhibit 431, your testimony at
25 page 4.

1227

1 A I am there.

2 Q And I direct you to lines 2 through 4.

3 There you stated, "The PGE situation demonstrates
4 that QCII and QC are overstating the harm that come
5 to customers of the telephone, and to the telephone
6 company itself, should QCII make a bankruptcy
7 filing."

8 Did I read that correctly?

9 A Yes, you did.

10 Q And if you flip forward to page 8.

11 A (Complies.)

12 Q Starting on line 16, you, in response --
13 the question was, "If QCII were to seek bankruptcy
14 protection, would QC also need to declare
15 bankruptcy?" And the answer is, "No, not
16 necessarily. QC would likely have no reason to
17 seek bankruptcy protection, because it would be --
18 would remain a financially sound corporation. As
19 with PGE in the Enron bankruptcy, QC would be an
20 asset in a bankruptcy proceeding involving its
21 parent, QCII. The creditors may become the owners
22 of QC, but it would not be in their interest to
23 disrupt the telephone company operations which may
24 result in a possible decline in profits."

25 Did I read that correctly?

1228

1 A Yes.

2 Q Page 9, line 17 --

3 CHAIRWOMAN SHOWALTER: When you read, can
4 you slow down a little bit?

5 MR. SHERR: I will. Sorry.

6 BY MR. SHERR:

7 Q Page 9, starting at line 17, there's a
8 question, "Are you suggesting that whatever harm
9 would be imposed on QC and its customers by a
10 bankruptcy filing is already being felt?" And the
11 answer is, "Yes. QC's witnesses would have the
12 Commission believe that it should approve this sale
13 in order to avoid bankruptcy, which they imply
14 would be very harmful to customers. As explained
15 in greater detail by Staff witness Glen Blackmon,
16 QC and its customers are already being penalized by
17 virtue of QCII's ownership. There's no reason to
18 believe that a bankruptcy filing would make things
19 worse. Indeed, a bankruptcy filing may actually
20 improve circumstances for the telephone company and
21 its customers."

22 Did I read that correctly?

23 A You did.

24 Q I won't read anything else. Do you recall
25 Qwest serving a number of Data Requests on Staff in

1229

1 an attempt to ascertain your credentials to advise
2 the Commission on how bankruptcy works, and to
3 provide expert testimony on bankruptcy law and
4 procedures, and the impacts of bankruptcy on
5 interested persons?

6 A I recall questions about mine and
7 Dr. Blackmon's expertise in terms of bankruptcy
8 law, yes.

9 Q Let's take a look at those. The first one
10 is 442, which is, for your reference, Data Request
11 85.

12 A (Complies.)

13 Q And this Data Request --

14 CHAIRWOMAN SHOWALTER: Hold on. We don't
15 seem to have these.

16 JUDGE MOSS: They should be in the
17 books --

18 Let's go ahead.

19 MR. SHERR: Thank you.

20 BY MR. SHERR:

21 Q Looking at Exhibit 442, which is Qwest
22 Data Request 85, am I correct that this question
23 asked for your credentials to offer expert
24 testimony regarding bankruptcy law or procedure, or
25 the impact of bankruptcy on interested persons?

1230

1 A That's what the question says, yes.

2 Q And then went on to explain what Qwest
3 means by credentials?

4 A Yes.

5 Q And the response starts, that you have not
6 offered expert testimony on bankruptcy law or
7 procedure; is that correct?

8 A Yes.

9 Q If you could then turn to the next
10 exhibit, 443, which is Data Request 86, Qwest there
11 asked for your credentials to offer nonexpert
12 testimony regarding the same subjects; is that
13 correct?

14 A That's how the question reads, yes.

15 Q And your response was that you have
16 offered expert testimony in this docket on the
17 impact of bankruptcy on interested persons; is that
18 correct?

19 A That's what the sentence says, yes.

20 Q And you didn't explain -- or Staff didn't
21 explain any credentials regarding nonexpert
22 testimony regarding bankruptcy law or procedure; is
23 that correct?

24 A That's correct.

25 Q Am I correct that you are not a lawyer?

1231

1 A I am not a lawyer.

2 Q And that you have not obtained any degree
3 focusing primarily on bankruptcy process?

4 A No, I have not.

5 Q And that you haven't completed any course
6 of study on bankruptcy law, procedure, or the
7 impact of bankruptcy on interested persons?

8 A A course of study, you mean like a college
9 course? No.

10 Q And that you have not participated in an
11 employment-related capacity in any bankruptcy case
12 as a party, representative, creditor, trustee,
13 witness or in any other manner?

14 A No, I have not.

15 Q Are you a member of any association of
16 bankruptcy professionals?

17 A No.

18 Q Have you written any papers, articles, or
19 books regarding bankruptcy law or procedure?

20 A No.

21 Q Or on the impact of bankruptcy on
22 interested persons?

23 A Have I written any papers? No.

24 Q Papers, articles or books?

25 A No, I have not.

1232

1 Q In discovery do you recall Qwest asking
2 you whether you reviewed any other utilities'
3 bankruptcy?

4 A Yes.

5 Q And for your reference, that is Exhibit
6 441, which was Data Request 11. Are you there?

7 A I am there. Sorry.

8 Q And in response you stated that you are
9 generally aware of several bankruptcies; is that
10 correct?

11 A Yes.

12 Q But you didn't identify whether you had
13 reviewed any other bankruptcies in your analysis?

14 A For the purposes of my testimony, I
15 reviewed -- I did analysis of the effects of the
16 Enron and PGE, PGE with Enron on bankruptcy, and
17 the effect on those customers, and the company
18 itself.

19 Generally I, in my daily duties, are (sic)
20 aware of other bankruptcies, some of which are
21 identified here.

22 Q You would say you are generally aware of
23 those?

24 A I have looked at SEC filings,
25 publications, articles.

1233

1 Q Did you review Mr. Mabey's written
2 rebuttal testimony in this case?

3 A Yes.

4 Q Including his credentials?

5 A I read them, yeah.

6 Q Do you recall -- for your reference, I
7 don't know if you have it, Exhibit 211. This is
8 Mr. Mabey's testimony.

9 A (Looking at document.)

10 Q Do you have that with you?

11 A I do.

12 Q I am looking at Exhibit 211 at page 1.

13 A Just a minute please. Okay.

14 Q Are you aware that Mr. Mabey was a former
15 bankruptcy judge?

16 A As he states under his qualifications,
17 yes.

18 Q And that he has -- his law firm's
19 international corporate structuring and
20 bankruptcy --

21 MS. SMITH: Your Honor, I object to this
22 line of questioning about Mr. -- or Judge Mabey's
23 qualifications. I don't see how that is relevant
24 to this witness' testimony in this case.

25 JUDGE MOSS: Well, I assume you are going

1234

1 somewhere with this line of questions, Mr.
2 Sherr, and you will get there very shortly.

3 So I will overrule the objection.

4 MR. SHERR: I will. Thank you, Your Honor.

5 BY MR. SHERR:

6 Q And that Mr. Mabey has been a trustee
7 and/or attorney in major utility bankruptcy cases
8 and other complex bankruptcy cases?

9 A I don't know about the qualification, but
10 he lists some of the cases he's worked on.

11 Q And from reading this you are aware that
12 he's written scholarly articles on the subject of
13 bankruptcy?

14 CHAIRWOMAN SHOWALTER: Maybe you can get
15 there quicker.

16 JUDGE MOSS: I think we have enough
17 foundation on the point, Mr. Sherr.

18 BY MR. SHERR:

19 Q Were you present in the hearing room last
20 Friday when Mr. Mabey testified?

21 A Yes, I was.

22 Q Based on reading his testimony and
23 listening to his live testimony in the hearing
24 room, do you believe you are in a better position
25 than Mr. Mabey to opine as to bankruptcy law?

1235

1 A I'm not opining as to bankruptcy law. I'm
2 giving analysis of the effects of bankruptcy of the
3 Enron bankruptcy, and PGE on its customers. And
4 then an opinion of what the potential effect could
5 be on QC in the same situation.

6 Q And that was not my question. My question
7 is, do you feel you are in a better position to
8 opine as to bankruptcy law?

9 MS. SMITH: Your Honor, I object to that.
10 She answered that question. She said she did not
11 opine on bankruptcy law.

12 JUDGE MOSS: It was asked and answered,
13 Mr. Sherr. She did answer that.

14 BY MR. SHERR:

15 Q Do you believe you are in a better
16 position to opine as to bankruptcy procedure than
17 Mr. Mabey?

18 A As a general precip, just generally
19 speaking, do I know bankruptcy procedures better
20 than Mr. Mabey? No, probably not.

21 Q Do you believe you are in a better
22 position than Mr. Mabey to offer an opinion about
23 possible bankruptcy scenarios?

24 A I guess from my perspective not generally
25 speaking; but the specifics of this case, I may

1236

1 very well be. He indicated in many of his answers
2 he wasn't very familiar with the QCII-QC
3 circumstances. So as a general precip, maybe --
4 "Maybe" is probably not a good -- probably I am
5 not. But for purposes of my analysis, I think I
6 gave a reasonable opinion.

7 Q Okay. Do you believe you are in a better
8 position than Mr. Mabey to offer an opinion about
9 the role state regulators are permitted to play in
10 bankruptcy of a regulated utility?

11 A Can you show me where I mentioned the role
12 that state regulators are playing in a bankruptcy?

13 Q Well, I'm trying to ask you as a matter of
14 background if you believe you are in a better
15 position than Mr. Mabey. That's the question.

16 MS. SMITH: Your Honor, I will object to
17 this question. The witness didn't testify about
18 what a regulator's role would be in bankruptcy, or
19 how a bankruptcy of a regulated company might
20 affect a regulator.

21 She gave a real word analysis of a
22 regulated subsidiary that's parent company is in
23 bankruptcy. She didn't talk about how that would
24 affect the regulator. So I believe this question
25 is beyond the scope of her direct testimony.

1237

1 JUDGE MOSS: How does this relate to her
2 direct?

3 MR. SHERR: Thank you, Your Honor.

4 Ms. Folsom offers as an analogy that bears
5 the Enron-PGE situation to the QC-QCI situation,
6 and makes some very general statements, the ones I
7 read, apparently too quickly, before regarding how
8 QC and its rate payers may be better off if QCI
9 files bankruptcy.

10 And there are many implications, many
11 facets to an analysis that backs up that
12 statement. One of those would be the role that
13 regulators play in controlling, for instance, the
14 sale of QC, if it were sold through bankruptcy.

15 So I want to know if this witness has any
16 foundation or background to make such a statement.

17 MS. SMITH: That wasn't the question,
18 though, Your Honor. She was asked whether if she
19 was in a better position than Mr. Mabey to analyze
20 that. And perhaps the question should be what she
21 knows about it, as opposed to whether or not she's
22 in a better position than somebody else.

23 (Discussion at the Bench.)

24 JUDGE MOSS: Thank you. I am going to
25 overrule the objection.

1238

1 But Mr. Sherr, I am going to do that with
2 the caveat that I think you have probably developed
3 this line sufficiently for wherever you are taking
4 it, and you might want to move on to some more
5 substantive examples for this witness.

6 MR. SHERR: Thank you, Your Honor.
7 Fortunately I was at the end of those questions.

8 JUDGE MOSS: That always happens to me.

9 MR. SHERR: Perhaps Ms. Smith could have
10 objected earlier.

11 BY MR. SHERR:

12 Q I have one more. The topic is ring
13 fences. You testified, obviously, about Enron and
14 its subsidiary PGE; is that correct?

15 A Yes.

16 Q And is it your opinion that Enron-PGE is
17 an analogous situation between QCI and QC?

18 A I think that there's definitely of
19 commonality that could be derived in looking at the
20 QCI-QC situation in the way that I looked at the
21 Enron-PGE situation.

22 Q And are you aware that PGE has been ring
23 fenced by Enron?

24 A Yes.

25 Q Are you aware of what ring fencing is,

1239

1 generally?

2 A Yes.

3 Q Can you briefly describe to me what it is?

4 A Normally an otherwise healthy -- and when
5 I say healthy, I mean a financially healthy --
6 subsidiary, its credit rating is constrained by the
7 weaker rating of its financially distressed parent.
8 So in an attempt to insulate those effects, a ring
9 fence can be developed that the rating agent can
10 cite when it gives its corporate credit rating,
11 which, in fact, S&P did for PGE and others.

12 Q And as we just discussed, you were present
13 when Mr. Mabey testified, correct?

14 A Yes, I was.

15 Q Did you hear last Friday when he related
16 to the Commission that ring fences are not fool
17 proof, and that ring fenced companies sometimes
18 file bankruptcy?

19 A Yes, I did. But ring fencing deals with
20 insulation between the weaker parent company. And
21 the case of Enron-PGE being in bankruptcy doesn't
22 prevent other causes of bankruptcy, like poor
23 management decisions, or fraudulent accounting
24 practices, or constraints from capital market --
25 accessing capital, or even investing in nonutility

1240

1 businesses. There are other reasons that
2 corporations go bankrupt.

3 Q But sometimes ring fenced corporations go
4 bankrupt?

5 A Other than the exhibit -- the cross
6 exhibit that you showed me, that's the only one I
7 am aware of.

8 Q And you knew exactly where I was going
9 with this. If you could, looking at what has been
10 marked as Exhibit 448, that is an article from the
11 Daily Bankruptcy Review.

12 A Yes. That's what it purports to be. I
13 have never read that publication.

14 Q And have you reviewed this exhibit?

15 A I read it.

16 Q And if you would, just take a look at the
17 first and third paragraphs and answer -- well --

18 COMMISSIONER HEMSTAD: Perhaps you could
19 wait a moment while --

20 MR. SHERR: I apologize. I will wait.

21 (Pause in Proceedings.)

22 JUDGE MOSS: Okay. Go ahead.

23 BY MR. SHERR:

24 Q Can you take a look at the first and third
25 paragraphs?

1241

1 A Yes.

2 Q And does this -- do those paragraphs
3 indicate that PG&E is going to put a subsidiary
4 called National Energy Group into bankruptcy?

5 A It warns that it plans to file for
6 bankruptcy protection for its unregulated energy
7 business.

8 Q And that energy business is called
9 National Energy Group. I direct you to the third
10 paragraph.

11 A Yes.

12 Q Thank you. If you could also turn to
13 Exhibit 449?

14 A I have it.

15 Q And this is an excerpt from PG&E 2001
16 10-K; is that correct?

17 A I haven't read the entire document, or
18 even anything other than the excerpt when you gave
19 it to me. But that's what the cover page purports
20 to be.

21 Q And at page 2 of that exhibit, I am
22 looking at the lower right-hand corner for the
23 numbers.

24 A Okay. Not the one -- not the 1 on the
25 page, and the 2 on the page. Okay.

1242

1 Q If you look at the first paragraph, you
2 will see that a circle has been drawn; is that
3 correct?

4 A Yes.

5 Q Or an elipses, at least?

6 A A scribbled circle, yes.

7 Q The text around that elipses describe that
8 National Energy Group is a subsidiary of PG&E?

9 A It says that PG&E Corporation's other
10 significant subsidiary, PG&E, National Energy
11 Group, Inc.

12 Q And if you would turn to the next page,
13 page 3 in the lower right-hand corner, the first
14 full paragraph there, do you see that it says that
15 National Energy Group has been ring fenced by PG&E?

16 A It says, PG&E Corporation and Energy
17 completed a corporate restructuring --

18 COURT REPORTER: Wait. Slow down please
19 and repeat that.

20 THE WITNESS: It says, "PG&E Corporation
21 and PG&E NEG completed a corporate restructuring of
22 PG&E NEG notice of ring fencing transaction."

23 BY MR. SHERR:

24 Q You know, I only have one more question,
25 and that is to follow-up on that the question that

1243

1 I asked that Ms. Smith objected to. I was advised
2 that I didn't allow you to respond before moving
3 on, so I would ask you that question again.

4 Which is, do you believe you are in a
5 better position than Mr. Mabey to opine about the
6 role state regulators are permitted to play in the
7 bankruptcy of a regulated utility?

8 A And I believe I stated that I didn't
9 opine, and I haven't opined, and haven't thought
10 about whether I am in a better position or not.

11 MR. SHERR: Thank you, Your Honor. I have
12 no more cross.

13 I can move for the admission of cross
14 examination exhibits at this time, if you would
15 like me to.

16 JUDGE MOSS: Go ahead.

17 MR. SHERR: Move for the admission of
18 Exhibits 433 through 435, 438 through 444, 447
19 through 449. And I need to add to the list Exhibit
20 395. This was identified for Dr. Blackmon
21 mistakenly. It occurred to me only yesterday that
22 that indicates it's a Data Request Response. That
23 indicates that Ms. Folsom was the responder, and
24 not Dr. Blackman.

25 (EXHIBITS 395, 433-435,

1244

1 438-444, 447-449 OFFERED.)

2 MS. SMITH: May I ask a point of
3 clarification.

4 JUDGE MOSS: Staff's response to Data
5 Request No. 77.

6 MS. SMITH: Your Honor, I don't have any
7 objections to the exhibits that Mr. Sherr moved,
8 except perhaps that one. And I need to take a look
9 at that very quickly. And if I could have a moment
10 to do that, I will let you know whether I have an
11 objection to that.

12 JUDGE MOSS: All right. I'm going to go
13 ahead and admit 443 through 435, 438 through 444,
14 and 447 through 449 as previously marked.

15 (EXHIBITS 443- 435, 438-444,
16 447-449 ADMITTED)

17 MS. SMITH: I apologize. Was it Exhibit
18 395?

19 JUDGE MOSS: That is correct.

20 MS. SMITH: Staff has no objection. Thank
21 you, Your Honor.

22 JUDGE MOSS: Exhibit 395 will be admitted
23 as previously marked.

24 (EXHIBIT 395 ADMITTED)

25 JUDGE MOSS: Do we have questions?

1245

1 MR. HARLOW: I have none, Your Honor.

2 JUDGE MOSS: Questions from the bench?

3

4

EXAMINATION

5

6 BY CHAIRWOMAN SHOWALTER:

7 Q Yes. You seem to be drawing an analogy or
8 a comparison between PGE with respect to Enron, and
9 in the future QC with respect to QCII should QCII
10 file for bankruptcy.

11 A Yes.

12 Q And I would like to test just a little bit
13 the merits of that comparison. You have already
14 been asked several questions about ring fencing?

15 A Right.

16 Q But the aspect I would like to ask about
17 is the Yellow Pages dynamics. In the Enron-PGE
18 case, if the result of the bankruptcy were that PGE
19 lost revenues of the magnitude and proportion that
20 the Yellow Pages is to QC, would PGE's rate payers
21 be better off in a bankruptcy?

22 A First of all, just to clarify, there was a
23 lot of claims that I say that PGE is benefitted or
24 better off with Enron in bankruptcy, and that's not
25 my intention at all. It was simply to show the

1246

1 effects of bankruptcy, and how PGE has weathered
2 those effects.

3 And potentially going forward, I have an
4 opinion that PGE may be better off once it's sold
5 and out from under the Enron name. But that wasn't
6 my intent.

7 But in terms of your question about
8 whether there was large -- some sort of large
9 asset, I guess, that had been sold -- maybe you
10 could restate for me. I forgot. I am sorry.

11 Q All right. I will withdraw that question
12 and ask another. Turn to page 10 of your
13 testimony.

14 A Yes.

15 Q And lines 4 and 5 you say, "A bankruptcy
16 filing may actually improve circumstances for the
17 telephone company and its customers."

18 I read your testimony as drawing that
19 conclusion based on your view of what has happened
20 to PGE and Enron. Is that -- am I right or wrong?

21 A The sentence I have there basically
22 follows after the sentence -- sentence 1, which
23 that refers to Dr. Blackmon's testimony.

24 He sets forth all of the reasons that QC
25 might be better off with a QCII bankruptcy. So it

1247

1 was basically summarizing sort of what he has
2 presented.

3 And drawing the analogy that -- not that
4 PGE is better off. But that if you look at QC
5 today versus PGE, QC might be better off. It's
6 this fine line of, you know -- if you turn -- all I
7 am saying is that PGE, today, with the bankruptcy
8 of Enron still has access to capital markets, still
9 just had a rate decrease, still has stable
10 employment levels, those sorts of issues, given the
11 parent in bankruptcy.

12 QC appears to not have access -- well, I
13 know they don't have. They have very limited
14 access to financials markets, they haven't
15 certified their financial results. They have a
16 stream of negative activities that have been
17 already referenced by other witnesses. So they
18 appear to be worse off than PGE is, even though
19 PGE's parent is in bankruptcy.

20 Q So are we to take no more of your
21 testimony than it is possible for rate payers of a
22 utility in bankruptcy to be better off in some
23 dimensions than rate payers of a utility that is
24 not in bankruptcy?

25 A Yes. That's part of it. That's the --

1248

1 Q That's part of it. Then I want to know if
2 there's any more to it than that. Turn to page 94.

3 A (Complies.) I am there.

4 Q Line 6 and 7, you say "If QC's claims of
5 post bankruptcy doom are correct, then PGE today
6 would be in ruins."

7 Now, the first line of questions I want to
8 ask is, do you mean if QC's claims of post
9 bankruptcy doom for QC?

10 A Yes.

11 Q So then the question really, to me, is --

12 A And QCII both.

13 Q And QCII. What I am trying to get from
14 you is, what has PGE got to do with Qwest? What
15 implications can you go one way, from PGE to QC?
16 What implications can you go the other way, from
17 QCII and QC's situation to PGE, other than to say
18 they are two utilities owned by bigger companies
19 who are in financial straits.

20 What more can I derive out of those two
21 examples in relationship to each other?

22 A In relationship to --

23 Q Right.

24 A Like, are they in the same industry, those
25 sorts of questions?

1249

1 Q Well, I take your testimony -- and maybe I
2 took it wrongly -- as suggesting that because PGE
3 survived so far a bankruptcy, therefore QCI could.
4 And that's --

5 A And that's what I meant, along with
6 everything else I already said about the
7 demonstrated what has -- the actual effects that
8 PGE has experienced in almost two years of Enron's
9 bankruptcy.

10 Q Now, assuming that QCII files for
11 bankruptcy, and assume that the bankruptcy judge
12 sells the Yellow Pages because -- and also assume
13 that the Yellow Pages is not sold, and that's one
14 of the reasons that QCII is calling for bankruptcy.

15 A Assume that they have approval from the
16 bankruptcy court to sell the Yellow Pages?

17 Q Right.

18 A Okay.

19 Q Now, then, QC might be a viable entity for
20 the creditors to keep whole as a telephone company.
21 Do you agree with that?

22 A Uh-huh, yes. Entirely.

23 Q But that QC would not have the revenue
24 stream from the Yellow Pages. Do you agree?

25 A Under your scenario, yes.

1250

1 Q With my scenario. So in that scenario, do
2 you think the rate payers would be harmed, at least
3 in a relative sense, by not having available to
4 them the Yellow Pages revenue?

5 A I am trying to go through all the
6 parameters of your analogy, because I believe that
7 Dr. Blackmon's testimony suggests that it would be
8 sold even in a bankruptcy proceeding.

9 Q Yellow Pages, you mean?

10 A Because in a bankruptcy proceeding you are
11 looking to maximize the value of the assets. And
12 under that scenario, it might not be sold. But he
13 goes on, and speaks to that. But if you take
14 simply that it is sold, and, you know, just the
15 mere fact that it's gone would mean there are no
16 longer those revenues under your scenario. But I
17 don't believe the Staff has suggested that would be
18 the outcome.

19 Q So you think it's more likely than not
20 that the -- that if QCII files for bankruptcy, that
21 the Yellow Pages would not be sold and that -- is
22 that correct?

23 A I think that one thing Chapter 11
24 bankruptcy would offer is a chance for a company to
25 evaluate its entire enterprise without the

1251

1 immediate pressure of selling a valuable asset that
2 might have more benefit in the future. And to that
3 extent, you know, like I said, I believe
4 Dr. Blackmon addresses that.

5 Q But at least today's creditors of QCII
6 have settled on a plan in which the Yellow Pages is
7 sold?

8 A Their stockholders have, essentially. But
9 I don't know that their creditors have.

10 Q Isn't the ARCA agreement an agreement with
11 the company and its creditors to stretch out the
12 payment dates, and have a plan that includes the
13 sale of Yellow Pages?

14 A I believe it's an agreement with some of
15 the creditors that has provisions based on -- I
16 have not read the agreement. But based on what I
17 have heard from other witnesses that have alluded
18 to it, that the proceeds need to be used to pay
19 down QCII's debt. But I don't believe it's all the
20 creditors.

21 CHAIRWOMAN SHOWALTER: Thank you. I have
22 no further questions.

23 COMMISSIONER HEMSTAD: I have no
24 questions.

25

EXAMINATION

1252

1

2 BY COMMISSIONER OSHIE:

3 Q Ms. Folsom, I really only have one
4 question, and that is, you were here in the
5 courtroom when, I believe, Mr. Mabey testified?

6 A Yes, I was.

7 Q And I guess one thing that I was -- I
8 heard, if you will, him say was that if nothing
9 else, bankruptcy presents real risks to both QC and
10 QCII. And that those risks were -- at least he
11 could not predict the extent to which those risks
12 or the ways that the risk would manifest in the
13 event the bankruptcy were filed.

14 Do you agree with --

15 A With that point, that I can't predict the
16 risks?

17 Q Yes.

18 A Yes.

19 COMMISSIONER OSHIE: Thank you.

20 JUDGE MOSS: Did the Bench's questions
21 precipitate anything from Staff?

22 MS. SMITH: Yes, Your Honor. Just one.

23

24

25

REDIRECT EXAMINATION

1253

1

2 BY MS. SMITH:

3 Q Ms. Folsom, in response to a question from
4 Mr. Sherr with respect to a company that is ring
5 fenced, and I believe there was an article that
6 PG&E put a ring fenced company into bankruptcy.
7 Do you recall that line of questions?

8 A Yes, I do.

9 Q Can you think of any reasons why a company
10 that is ring fenced might find itself in
11 bankruptcy?

12 A Yes. It could be that it had poor
13 management decisions, that it was constrained from
14 capital markets, that it had fraudulent accounting
15 practices and/or disclosures, that it invested in
16 non -- in this case, nonutility business. Or even
17 that the rating agencies may have generally
18 reviewed a particular segment of an industry, and
19 downgraded companies within that industry, and the
20 downgrade may have precipitated a bankruptcy.

21 MS. SMITH: That's all. Thank you, Your
22 Honor.

23 JUDGE MOSS: I should have given Mr.
24 Sherr another chance.

25 MR. SHERR: Can I have one moment, Your

1254

1 Honor?

2 JUDGE MOSS: Yes.

3 MR. SHERR: Just one question.

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5 RE CROSS EXAMINATION

6

7 BY MR. SHERR:

8 Q Could you look back to Exhibit 448?

9 A Which was --

10 Q The Daily Bankruptcy Review article.

11 A If you would give me a second. I have it.

12 Q In response to your attorney's question,
13 you listed several other reasons why a ring fenced
14 the company may file bankruptcy.

15 A Yes.

16 Q I won't repeat the list here, but to your
17 knowledge, did the National Energy Group, PG&E's
18 subsidiary, do you know if any of those were the
19 reasons that it's filing?

20 A I did not review PG&E National Energy
21 Group at all, other than the exhibits that you
22 showed me.

23 Q Do you know why they are filing
24 bankruptcy?

25 A No.

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1 MR. SHERR: Thank you.

2 JUDGE MOSS: Okay I think that will
3 complete our examination of Ms. Folsom. We
4 appreciate your testimony. You can step down.

5 And I suppose that will complete our
6 business for today. We have Dr. Brosh -- I'm
7 sorry, it's Mr. Brosh, I guess, scheduled for
8 tomorrow morning, and then we have Dr. Blackmon,
9 and I believe that's it.

10 So that will be our plan for tomorrow.

11 MR. CROMWELL: Your Honor, it was my hope
12 that we might take Mr. Brosh after Dr. Blackmon.
13 To be quite candid, I have not met Mr. Brosh, or
14 had the opportunity to review his testimony with
15 him.

16 As you are aware of his schedule, I have
17 literally spoken with him maybe 15 minutes in the
18 last week because of his testimony in Arizona, and
19 his other commitments. I would appreciate some
20 time tomorrow morning, if it's possible, to meet
21 with him.

22 And I know he's literally coming into
23 Sea-Tac at midnight tonight. Mr. Butler will bring
24 him down here first thing in the morning. And I
25 was wondering if it would be a terrible

1256

1 inconvenience to have Dr. Blackmon go first?

2 (Discussion of the Bench.)

3 JUDGE MOSS: We have a counter proposal
4 for you. I think what we would like to do --

5 MR. CROMWELL: I am sure I'll find it
6 acceptable.

7 JUDGE MOSS: The Bench's preference would
8 be to start a little late and have a breakfast
9 meeting here in Olympia, would be a good plan to
10 suggest. We can start at 9:30. Would that give
11 you adequate time if you arranged a breakfast
12 meeting?

13 MR. CROMWELL: That would certainly help,
14 Your Honor. I think -- I mean, I guess I'm sort of
15 competing concerns in terms of being able to get
16 finished tomorrow.

17 JUDGE MOSS: We have that concern as well.

18 MR. CROMWELL: And I was thinking if we
19 could start with Dr. Blackmon, I could step out and
20 work with Mr. Brosh while that was happening. It's
21 obviously your decision.

22 MS. SMITH: And the same consideration
23 would hold true if we were to start at 9:30.
24 Perhaps Mr. Brosh and Mr. Cromwell can join us
25 after their meeting, as opposed to skipping out

1257

1 during the -- well, that wouldn't make any sense.

2 CHAIRWOMAN SHOWALTER: No. Mr. Brosh
3 wouldn't be there.

4 JUDGE MOSS: Let's be off the record for
5 the balance of this discussion

6 (Discussion off the record.)

7 JUDGE MOSS: We will back on the record.

8 We have had some off-the-record discussion
9 and have worked out that we will try to have
10 Mr. Brosh on the stand tomorrow morning at 9:30,
11 absent hearing a report back that it poses a
12 serious difficulty. And we will commence at that
13 hour.

14 And until then, we will be in recess.

15 Thank you.

16 ENDING TIME: 5:20

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