Exhibit No. ___ T (WHW-1T)
Docket UT-082119
Witness: William H. Weinman

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the Joint Application of **EMBARQ CORPORATION AND CENTURYTEL, INC.** **For Approval of Transfer of Control of United Telephone Company of the Northwest d/b/a Embarq and Embarq Communications, Inc.**	**DOCKET UT-082119**

TESTIMONY

OF

WILLIAM H. WEINMAN

ON BEHALF OF THE STAFF OF WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

March 4, 2009

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is William H. Weinman. My business address is the Richard Hemstad Building, 1300 S. Evergreen Park Drive S.W., P.O. Box 47250, Olympia, WA 98504. My e-mail address is wweinman@utc.wa.gov.

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (commission) as Acting Assistant Director – Telecom Section.

Q. How long have you been employed by the commission?

A. I have been employed with the UTC since June 2007. I was also employed by the commission in a similar position from 1974 to 1978. I have been a Regulatory Analyst from June 2007 through September 30, 2008. I have been in the Acting Director position of the Telecommunications Section since October 1, 2008.

Q. Please state your educational and professional background.

A. I graduated from Washington State University in 1971 receiving a Bachelor of Arts in Business Administration with a major in accounting. I am a member of the American Institute of Certified Public Accountants.

My current responsibilities at the UTC generally include all issues in the Telecom section, e.g., assigning dockets to staff, analyzing financial and accounting issues, reviewing interconnection contracts between carriers, assuring compliance with commission orders, analyzing intrastate access issues, analyzing depreciation issues, providing analyses in general rate cases, reviewing tariff filings, and conducting rulemakings involving investor-owned telecommunications companies regulated by the commission. Over my career, I have provided expert testimony before the commission regarding electric, natural gas and telephone companies. Most recently, I reviewed and prepared testimony on depreciation and pole replacement in Avista's last general rate case, Dockets UE-070804 and UG-070805. I participated as the staff analyst in a settlement with PacifiCorp on depreciation rates and parameters that the commission adopted in Docket No. UE-071795. Over the past year, I have analyzed several company petitions for accounting orders.

Between my prior and current employments with the commission, I worked on utility regulatory and operational issues for the consulting firm R.W. Beck (1979), Elllensburg Telephone Company (1980-1984), Pacific Telecom, Inc. (1985-2003) and Integra Telecom (2004-2007). I testified and was involved with regulatory issues before the Oregon Public Utilities Commission as Vice President/General Manager for Pacific Telecom from 1992 to 2003.

Q. Please describe the scope of your testimony.

A. My testimony addresses the policy foundation of staff's position on the proposed transaction and provides context for the testimony of Ms. Betty A. Erdahl and for my own recommendations regarding conditions needed for staff to concur with the merger proposal.

II. SUMMARY OF TESTIMONY

Q. Please summarize your testimony.

A. Staff has studied the proposed transaction and considered it in light of Washington policy principles from statutes and commission precedent. Staff believes that the proposed transaction would result in an "indirect merger" (within the meaning of RCW 80.12.020) of Embarq Corporation and Century Tel, Inc.'s Washington public service company subsidiaries. Staff concludes that as proposed, the indirect merger of Embarq and CenturyTel's Washington operating companies is not in the public interest. In order to protect the public interest, staff recommends that the UTC should not approve the transaction without additional measures to protect the financial health of United of the Northwest d/b/a Embarq (United) and CenturyTel of Washington, Inc., CenturyTel of Cowiche, Inc. and CenturyTel of Inter Island, Inc. (CenturyTel LECs) and the quality of the regulated telecommunications services provided by those entities. Staff recommends, as a condition of approval of the merger, that the commission require:

- the continued application of various conditions that were applied to United as a result of the commission's final order in Docket UT-051291 (the "spin-off" case concerning the transfer of control of United from Sprint Nextel Corporation to LTD Holding Company),
- additional reporting to track changes in affiliated interest transactions between United and the CenturyTel LECs and their affiliates after closing,

- a quality of service guarantee for customers of the CenturyTel LECs based on the guarantee currently offered by United, plus additional service quality reporting,
- various “ring fence” financial conditions, similar to those already required of United as a result of the commission’s order in the spin-off case, Docket UT-051291, for both United and the CenturyTel LECs,
- a complete revenue requirement filing by United and the CenturyTel LECs as soon as the synergy savings of the merger are know, but not later than five years after closing, to include a plan for rate design changes that would reduce the number of rate groups, and
- a restriction on the companies’ recovery of merger costs in rates, and special accounting for those costs.

Q. Would you identify who will be the responsible witness for the summary items you have identified?

A. Ms. Erdahl will testify and make recommendations for the following items:

- continuation of various spin off conditions with respect to United,
- additional reporting to track affiliated interest transactions, and
- the customer service guarantee and service quality reporting.

I will testify to the remaining conditions necessary for staff to conclude that the transaction will cause no harm.

III. DISCUSSION

Q. Please identify and describe the parties

A. This proceeding concerns the consolidation of two holding companies and staff's concerns with the transaction proposed by the witnesses for the two companies. Both Embarq Corporation and CenturyTel, Inc. are publicly traded companies. Both companies offer traditional telecommunications in Washington through their Commission-regulated operating companies. United serves about 73,000 customers in Washington and the CenturyTel LECs serve approximately 147,000 customers.

The companies' service areas do not overlap and neither company competes for long distance service in the other's exchange areas through their respective interexchange companies, CenturyTel Long Distance, LLC, and Embarq Communications, Inc. For reference, I have attached Exh. No. ___ (WHW 2) showing the exchanges served by the merging companies' local exchange carriers in Washington.

Q. What is the nature of the proposed transaction?

A. Century Tel, Inc. and Embarq Corporation will be merged (specifically Embarq Corporation will be merged into a subsidiary of CenturyTel, Inc.). This merger will exchange 1.37 shares of CenturyTel, Inc. common stock shares for each share of Embarq Corporation common stock.

Q. Is there an advantage to CenturyTel, Inc. to issue common stock as compared to other financing options when acquiring a company?

A. The primary benefit to CenturyTel, Inc. is that the company does not have to expend any cash or issue debt to close the transaction. This allows the combined companies to have a balance sheet that is not overburdened with debt after the merger. The pro forma capital structure after merger estimates CenturyTel, Inc. would have a debt structure that is approximately fifty percent debt and fifty percent equity.

Q. Are there any negative consequences to the merger?

A. The merger of the CenturyTel, Inc. and Embarq Corporation into one company improves the balance sheet weaknesses the individual companies presently have. For example, the amount of goodwill on CenturyTel, Inc.'s balance sheet is a cause for concern. CenturyTel, Inc. has been a company that has achieved significant customer growth through acquisition. Each time CenturyTel has acquired another company, additional "goodwill" has been added to the company's balance sheet to represent the premium that CenturyTel shareholders paid, above book value, to acquire the other company. CenturyTel, Inc.'s goodwill before acquisition is approximately $4 billion while net plant is only $2.9 billion. Generally, net plant is the investment in telecommunications assets less accumulated depreciation.

Q. What is goodwill?

A. Goodwill is an intangible asset that has value, e.g. customer loyalty to the business. If the life of goodwill can be determined, it is amortized over the useful life. If the life of goodwill cannot be determined, it is considered to have an infinite useful life and not amortized to the income statement. Goodwill that has an infinite useful life is subject to impairment if the asset losses value. A write down of the asset to the income statement will be recorded in the accounting period the impairment becomes known.

Q. Does Embarq Corporation's balance sheet indicate there is a weakness?

A. Embarq Corporation's debt-equity ratio indicates the company has too much debt and not enough equity. Most of the utilities regulated by the UTC will generally have a debt to equity ratio ranging between 50 to 55 percent. Embarq's debt is approximately 99 percent. The problem with this debt ratio is the company has no flexibility because of the annual interest payments.

Q. Does the merged pro forma balance sheet cause any concerns?

A. The combined companies actually offset the individual weakness in both companies. The goodwill issue pertaining to CenturyTel, Inc. is improved because the goodwill to net plant changes from approximately 100 percent of net plant assets to approximately 75 percent. The weakness of Embarq's debt to equity ratio is substantially improved from 99 percent debt to approximately 50 percent debt after the companies are combined. The merger reduces the weakness of the individual companies.

Q. Do you believe the merger presents any financial risk for the merging holding companies that could result in higher rates or decreased service quality for customers of United or CenturyTel's LECs in Washington?

A. While the balance sheet of the combined companies is improved, there are other risks that do present issues to staff. On pages 8 and 9 of her testimony (Exh. No. ___ (BAE-1T), Ms. Erdahl describes potential circumstances that could cause a need to funnel cash from United and the CenturyTel LECs to the parent or other affiliated companies. Generally, staff is concerned about the estimated cost of $275 million to integrate systems, the magnitude or size of the acquisition compared to previous CenturyTel, Inc. mergers, and the possibility of management being distracted by the complexities of the integration.

This transaction is taking place during a period when CenturyTel, Inc. is facing serious competition from wireless, voice over internet providers, and other potential technologies. Both United and the CenturyTel LECs have been experiencing a decline in originating and terminating access minutes and access lines during the past five years. CenturyTel, Inc's witness describes other new technologies being acquired by the company, e.g., 700 MHz spectrum licenses for wireless service.

The size of the merger along with the deployment of new technologies may cause a significant strain on the management and cash requirements of CenturyTel, Inc.

Q. Does Staff recommend any conditions on the indirect merger of United and the CenturyTel LECs in Washington?

A. Yes, those recommendations will be discussed in detail later in my testimony. Washington law delegates broad authority to the Commission to review direct or indirect mergers of public service companies to ensure that such mergers are consistent with the public interest and do not result in harm to customers of the merging companies. This authority extends to the rates, services, facilities and practices of the entity or entities engaging within this state in the business of supplying utility service. In reviewing this proposed merger, the commission should continue to look to its broad authority for these types of transactions. Staff believes there is ample authority in the statute and in the precedent established in the Scottish Power, GTE-Bell Atlantic, Sprint, and the recent Puget Sound Energy transaction to support the protective conditions that staff recommends.

Q. What standard should the commission apply in determining the public interest?

A. The commission has held that it will disapprove a proposed transaction under RCW 80.12.020 if it finds the transaction would harm customers of the affected public service companies through an increase in rates or a degradation in service, among other considerations. This is generally referred to as the "no harm standard."

Q. In prior merger and transfer cases did the commission apply conditions to its approval?

A. Yes. In its order regarding Scottish Power's acquisition of PacifiCorp, Bell Atlantic's acquisition of GTE, Sprint's divestiture of United and, recently, Puget Holdings, LLC's acquisition of Puget Sound Energy, the commission generally required the companies to accept a "ring fence" architecture before approval of a merger or divestiture was approved. The purpose of the ring fence conditions was to reduce the risk of the kind of harms I describe above, i.e., removing money from the "cash cow" utility companies to improve the profitability of unregulated holding company. The term "ring fence" is used to refer to restrictions on a company's business operations and ability to dividend cash to the new parent corporation.

The ring fence generally requires the utility to be able to operate on a standalone basis without parent assistance. Systems and other business practices would not be integrated into a parent or another subsidiary of the parent. This ensures Washington ratepayers will continue to receive service and protection should something happen to the parent corporation.

Q. Is staff proposing a ring fence requirement as a condition to approve this merger?

A. Yes. However, unlike recent electric mergers, the operating companies cannot be totally isolated from the parent. Both CenturyTel, Inc. and Embarq Corporation have integrated into their respective parent companies systems that prevent the operating companies from providing service on a standalone basis. Consequently, the operating companies cannot be standalone companies and perform all the necessary functions without their parents' involvement. Under these circumstances, affiliated interest transactions between operating companies and the parent or other affiliates are considerable and those transactions present a greater opportunity than exists with respect to a standalone utility for the parent to remove cash from the operating company.

With this additional challenge in mind, staff is recommending ring fence conditions to restrict dividends and cash management to protect the Washington ratepayers of the operating companies.

Q. What are the ring fence requirements staff is proposing?

A. I recommend the finance conditions agreed to by the parties and imposed by the commission in the Sprint spin-off proceeding, Docket UT-051291. These should be required as a condition of this merger and should be extended not only to United, to which they currently apply, but also to the CenturyTel LECs. The ring fence conditions I recommend would be in effect for five years after the close date. The conditions are as follows (adapted from section six of the settlement agreement in UT-051291, with some changes):

1. United and the CenturyTel LECs (collectively, "operating companies") will limit payment of dividends on common equity distributed to any company holding shares of the operating company (including affiliates and subsidiaries of CenturyTel, Inc.) in any year to an amount not more than 50% of net income in any prior fiscal year. The operating companies will limit payment of dividends on common equity in any quarter to not more than one-fourth of the annual limitation amount.
2. The operating companies will file the account balances accrued in intercompany notes receivable or payable (if applicable) and intercompany accounts receivable or payable on a quarterly basis. The quarterly filing may alert staff to a situation requiring explanation from CenturyTel, Inc. due to a

growth of net intercompany receivables. Quarterly filings may show trends that indicate there is a cause for concern. Upon request from Staff, each operating company will provide a report that reconciles the cash management activities performed on a centralized basis by CenturyTel, Inc. on behalf of the operating companies. The reconciliation will demonstrate that intercompany receivables and payable accounts in the operating companies' financials properly recognize the sources and uses of cash that are attributable to the operating companies along with the effect of the dividend restrictions as described in a.

3. These conditions shall be in effect for not less than five years after the close of the merger transaction unless the operating companies are classified as competitive telecommunications companies in Washington under RCW 80.36.320. After expiration of the five-year period or upon classification as a competitive telecommunications company, the operating companies may petition the commission to remove or modify the conditions in these sections. In any such petition, the operating companies must demonstrate that the conditions are not necessary to maintain the financial integrity of the operating company and not necessary to protect the customers of the operating company.

4. Neither CenturyTel, Inc. nor the operating companies will pledge the assets of the operating companies to secure any borrowing undertaken by CenturyTel, Inc. (including affiliates and subsidiaries other than the operating companies) without explicit approval by the commission.

5. The operating companies will not advocate in any general rate case proceeding for a higher cost of capital as compared to what the operating companies' cost of capital would have been, using appropriate financial analysis assuming the merger had not occurred.

Q. Why do you believe these conditions, developed to address the circumstances of Sprint's divestiture of UTNW, are necessary under the circumstances of this merger transaction?

A. I believe that the risks of management distraction and increased cash requirements of CenturyTel, Inc., which are discussed in Ms. Erdahl's testimony and in my own testimony, above, make these restrictions necessary for the protection of customers of United and the CenturyTel LECs in Washington. Also, CenturyTel, Inc.'s appetite for growth through acquisition and the deployment of new technology could result in a management decision to finance these transactions with additional debt in the future. Additional debt results in additional interest expense that could result in a need for increased dividends from United and the CenturyTel LECs.

Q. Are there any other conditions staff would recommend with regard to the savings or synergies the companies expect to achieve as a result of the merger?

A. Yes. Staff has not asked for an earnings review at this time because the CenturyTel, Inc. witness has asserted the synergy savings are not known and cannot even be estimated at the state or operating company level. The company also asserts that it does not have a definitive plan for transition of systems, number of employees needed after close, and other details. The company has estimated there will be an ultimate annual savings of $400 million on a total system (nation-wide) basis.

Staff does not propose any sharing of the synergy savings at this time. There are other issues such as loss of access minutes and access lines that probably have a negative effect on the operating companies' earnings. Instead, staff recommends that the company be ordered to file an earnings review (using both restating and pro forma adjustments) of the operating companies when the synergy savings are known. The filing should be made no later than five years from the close date.

Staff would require three additional items to be included in the revenue requirement filings: (1) Digital Subscriber Line (DSL) plant and costs are to be removed from the intrastate operations in those filings, (2) the operating companies would present a rate design proposal to reducing the number of rate groups, (3) the company would present a plan, to be developed immediately, to merge rate centers for the conservation of numbers.

Q. Do you have a position on merger, transaction and branding expenditures?

A. Yes. Those costs should be borne by the stockholders, not by ratepayers of United and the CenturyTel LECs. In their response to a Public Counsel Data request (No. 17), the companies state, "the merged companies will not seek recovery of the one-time merger, branding or transaction costs in a future rate proceeding in Washington." Staff recommends that this be a condition of the merger.

The companies' response does not state these costs will not be allocated to United or the CenturyTel ILECs. Therefore, staff recommends, in addition, that

United and the CenturyTel LECs be required to confirm that these costs will not be recorded on their books or submit quarterly reports listing accounts and the amount accrued in those accounts for a period of five years. Should the transition be completed before five years, CenturyTel, Inc. or the Operating Companies can petition the commission to remove this reporting requirement.

IV. RECOMMENDATIONS

Q. Briefly summarize Staff's recommended conditions to be imposed upon the affected companies in order to approve of this merger.

A. Staff recommends the following conditions be required by the Commission for approval of the merger:

1. The ring fence restrictions and reporting requirements I describe above must be applied to United and the CenturyTel LECs in Washington.
2. United and the CenturyTel LECs must file results of operations with proper restating and pro forma adjustments no later than five years from the date of this order.
3. United and the CenturyTel LECs must not seek to recover merger costs in rates. If United and the CenturyTel LECs are being allocated merger, transaction or branding costs, those companies must make a quarterly report to Staff of the accounts and amounts of such expenditures recorded in each company.

4. United and the CenturyTel LECs must provide additional reporting regarding changes in affiliated interest transactions during the five year period the other conditions will be in effect, as described in Ms. Erdahl's testimony.

5. United and the CenturyTel LECs must offer a customer service guarantee modeled after United's Washington service guarantee and provide additional business office and repair answering system reporting, as described in Ms. Erdahl's testimony.

Q. Does this complete your testimony?

A. Yes, it does.