

**BEFORE THE WASHINGTON  
UTILITIES AND TRANSPORTATION COMMISSION**

In the Matter of the

Request of Sprint Nextel Corporation for an Order Declining to Assert Jurisdiction Over or, in the Alternative, Application of Sprint Nextel Corporation for Approval of the Transfer of Control of United Telephone Company of the Northwest and Sprint Long Distance, Inc. From Sprint Nextel Corporation to LTD Holding Company.

DOCKET NO. UT-051291

**REBUTTAL TESTIMONY OF  
JOHN W. MAYO  
ON BEHALF OF  
SPRINT NEXTEL CORPORATION**

**JANUARY 6, 2006**

1 **Q. Please state your name and business address.**

2 A. My name is John W. Mayo. My business address is Georgetown University,  
3 McDonough School of Business, Old North Building, 37<sup>th</sup> and O Streets, N. W.,  
4 Washington, D.C. 20057.

5  
6 **Q. Did you provide Direct Testimony in this proceeding?**

7 A. Yes.

8

9 **Q. Have you reviewed the testimonies of Mr. Saunders and Ms. Erdahl of the Staff  
10 and Mr. Michael Brosch on behalf of Public Counsel regarding the proposed  
11 corporate restructuring of Sprint?**

12 A. Yes. They express a number of concerns ranging from the financial structure of the  
13 proposed restructuring to the quality of services that will be provided by the Company in  
14 the wake of the restructuring.

15

16 **Q. Did these witnesses substantively address the benefits of the restructuring that  
17 you identified in your Direct Testimony?**

18 A. No. As I indicated in my Direct Testimony, a complete public interest assessment in this  
19 case requires not only a legal but also an economic lens through which to view the  
20 proposed restructuring. In this regard, I find that the proposed restructuring represents a  
21 very natural consequence of the firm seeking ways to organize itself in a manner that is  
22 most efficient. Similar restructurings have rather routinely been favorably received by  
23 financial markets. The reasons for this favorable evaluation typically include an  
24 increased ability of managers to strategically focus on more manageable markets, and the

1 ability to sharpen managerial incentives through refined, more targeted compensation  
2 schemes.

3  
4 In the specific case at hand, these benefits are quite likely to occur as the separation will  
5 permit United and LTD Holding Company to focus more clearly on their core strategic  
6 assets – local customers – and for shareholders to more keenly discern the successes and  
7 failures of managers to nurture that asset base. As I noted in my Direct Testimony, “This  
8 heightened focus and reliance on its local customers for its financial success means that  
9 the company will have maximal incentives to create valued and innovative services for  
10 these customers” (page 9). Similarly, when separated from United and its other local  
11 wireline companies, Sprint Nextel (with its strong wireless base) will have the  
12 opportunity to clearly and strategically turn toward pursuing telecommunications  
13 customers’ patronage regardless of where they are located. And, for its part, United will  
14 offer a portfolio of telecommunications services (including *de novo* wireless and long  
15 distance services and plans that are targeted at its local customer base), effectively  
16 increasing consumer choice and competition. Thus, the separation will certainly create  
17 benefits to Washington consumers by heightening competition for their business.

18  
19 In sum, this change in structure creates the considerable promise of a more efficient  
20 corporate organization and a more satisfied base of customers and shareholders.

21 Unfortunately, Messrs. Brosch and Saunders and Ms. Erdahl have either ignored or  
22 convoluted these benefits.

1 **Q. Can you provide a specific example of how the prospective benefits of the proposed**  
2 **restructuring have been ignored?**

3 A. Yes. Mr. Saunders indicates (page 9) that an examination of the public interest includes a  
4 consideration of the effects of the restructuring on competition, and cites the legislative  
5 declaration that it is the policy of the state to, *inter alia*, “Promote diversity in the supply  
6 of telecommunications services and products I telecommunications markets throughout  
7 the state.”<sup>1</sup> Yet despite the acknowledged public interest benefits that stem from  
8 increased competition and from a diversity of supply, Mr. Saunders provides virtually no  
9 consideration of the effects of his proposed restructuring in this regard. The fact is,  
10 however, that the proposed restructuring will put Sprint Nextel in a position to compete  
11 for the United customers’ business and for United to compete vigorously by offering a  
12 portfolio of telecommunications services under its own name that will compete against  
13 any and all comers, including Sprint Nextel. The restructuring unequivocally enhances  
14 competition and the diversity of supply.

15  
16 **Q. Given, then, that these witnesses have not substantively addressed the**  
17 **affirmative benefits of the proposed restructuring, are you persuaded by their**  
18 **concerns that the proposed restructuring is not in the public interest?**

19 A. No. Aside from the fact that their analyses virtually ignore the benefits I have described  
20 above, the concerns they express are often mis-framed. Moreover, these testimonies  
21 collectively engage in exactly the sort of arm-chair quarterbacking that I warned of in my

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<sup>1</sup> Saunders, page 10, footnote 11 quoting RCW 80.36.300 Policy Declaration.

1 initial testimony.<sup>2</sup> Finally, I am concerned that their policy perspectives and  
2 prescriptions are either irrelevant to this proceeding or actually counterproductive to the  
3 public interest. Consequently, I recommend that the Commission give no weight to their  
4 concerns.

5  
6 **Q You say that the concerns expressed by Messrs. Brosch and Saunders and Ms.  
7 Erdahl are often mis-framed. Can you provide an example?**

8 A. Yes. Mr. Saunders indicates that a “key concern” for Staff is that LTD management will  
9 have less flexibility to change its business model than it has today, because of the long-  
10 term contracts that it will have with its previous parent. In fact, however, the decision to  
11 purchase Sprint Nextel long distance and wireless services creates an immediate benefit  
12 to both consumers and United, relative to a costly search and implementation process for  
13 a *de novo* provider of these services, by ensuring continuity of the underlying carrier for  
14 these services. Moreover, in this instance this continuity is complemented by the price  
15 and quality protections afforded by the presence of actively competitive long distance and  
16 wireless markets. Specifically, the fact that Sprint Nextel sells long distance and wireless  
17 services in actively competitive markets ensures that its price and quality offerings for  
18 these services will generate consumer benefits. Indeed, as described in Mr. Pfeifer’s  
19 testimony, I understand that contracts will include a Most Favored Nation provision that  
20 will provide Sprint Long Distance, Inc. (“SLDI”) various mechanisms to ensure that it is  
21 receiving the lowest available price from Sprint Nextel, thereby ensuring that SLDI will  
22 be in a position to offer the lowest prices possible to its customers for these services.

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<sup>2</sup> See, Direct Testimony of John W. Mayo, August 26, 2005, page 7.

1 And finally, contracting for the inputs necessary to supply wireless and long distance  
2 service, rather than a business model of outright ownership of these assets (which are  
3 often economically sunk costs) certainly creates more of the business “flexibility” that  
4 Mr. Saunders seeks. In sum, the fact that LTD Holding Company is ensuring the  
5 continuity of supply for long-distance and wireless with Sprint Nextel is not worrisome  
6 and should not be the basis for denying or conditioning approval of the proposed  
7 transaction.

8  
9 **Q. Are there instances in which other witnesses mis-frame the merits of the**  
10 **restructuring?**

11 A. Yes. On page 45 of his testimony, Mr. Brosch expresses the concern that the restructuring  
12 may adversely affect the service quality levels offered by United. Similarly, Ms. Erdahl  
13 (pages 19-24) also expresses concern that the proposed restructuring will result in  
14 reduced service quality for United customers. Their arguments rest solely on a perceived  
15 financial weakness of the restructured United that they contend would harm its ability to  
16 invest in, and service, its network. While other Company witnesses address the financial  
17 strength of the restructured company to fund necessary investment and maintenance  
18 projects, it is important to point out that regardless of the current level of the quality of  
19 service, the restructuring will significantly increase the incentives of the Company to  
20 provide high, and as warranted, improved customer service. Thus, Staff and Public  
21 Counsel err in their views that the restructuring threatens future quality levels for  
22 Washington consumers. Apart from the public commitments of United’s management to  
23 the ongoing provision of quality telecommunications services, the restructuring itself

1 should provide increased comfort that the firm will maintain high quality service that  
2 benefits Washington consumers.

3  
4 **Q. Are there other examples in which witnesses have mis-framed the benefits of the**  
5 **restructuring?**

6 A. Yes. Unfortunately, Mr. Brosch's testimony manages simultaneously to overlook the  
7 significant benefits that are most likely to come from the proposed restructuring while at  
8 the same time elevate disproportionately concerns about the restructuring. A prominent  
9 example in this testimony involves the expenses associated with the restructuring. As  
10 described initially by Mr. Pfeifer, these expenses are projected to be entirely manageable  
11 within the larger context of the benefits created by the corporate restructuring. Operating  
12 expenses in the initial stages of the restructuring are projected to increase by a *de*  
13 *minimus* amount. Regrettably, Mr. Brosch portrays these costs as significant (by virtue of  
14 a misleading calculation refuted by Mr. Pfeifer) and a principal reason that he believes  
15 that the restructuring is not in the public interest. By ignoring the benefits of the  
16 restructuring that I have described while inflating the costs well beyond their substantive  
17 weight, Mr. Brosch has grossly distorted the relevant benefit and cost calculus associated  
18 with this restructuring. When properly viewed, the recurring, ongoing benefits that stem  
19 from the profound changes in corporate organization and managerial incentives, while  
20 not easily calculable, will almost certainly and quickly overwhelm any one-time or initial  
21 cost dis-synergies that may be associated with the restructuring.

1 **Q. You mentioned the propensity of witnesses to engage in "arm-chair**  
2 **quarterbacking". Can you provide an example?**

3 A. Yes. Mr. Saunders (page 12) states his concern that the restructuring's creation of a  
4 strategic local focus is "unusual within the telecommunications industry," and that it is  
5 "evidence only of good intent." With all due respect to Mr. Saunders, however, his  
6 second-guessing regarding the strategic decision to restructure to create a local focus for  
7 United and to free United from Sprint Nextel's focus on its wireless, nationwide offerings  
8 is best described as "hand-wringing."

9  
10 The entire technology, demand and regulatory dimensions of the telecommunications  
11 industry are in a matter of considerable flux and, as I explained in my initial Testimony,  
12 that rapid change is likely to give rise to alternative emergent strategies depending on the  
13 initial set of assets under the control of different companies. Thus, while surely the  
14 restructuring and the consequent local focus that comes from it may reasonably be  
15 projected as evidence of "good intent," it is neither uninformed nor capricious within the  
16 context of a rapidly evolving industry. The rationale for Sprint to reorganize itself in the  
17 manner requested is motivated by its desire to organize its assets and resources in a way  
18 to maximize their efficient use. Moreover, the change in organizational form that will  
19 accompany the restructuring can reasonably be expected to alter managerial incentives in  
20 ways that benefit both the company and the consumer.

21 Within the context of Sprint's merger with Nextel that has created a significant imbalance  
22 between its wireless and wireline assets, and within the context of a very dynamic and



1 increasingly competitive marketplace, the restructuring has a compelling business logic  
2 to it. Thus, Mr. Saunders' observation that the restructuring and subsequent local focus  
3 is "unusual" is not persuasive. Indeed, I am reminded that upon the divestiture of AT&T  
4 from the Bell operating companies, many believed that the Bell operating companies –  
5 each operating as a stand-alone locally focused telephone company – would be at a  
6 significant disadvantage in the marketplace. Yet, twenty years later we see that those  
7 companies have emerged as highly successful enterprises. What we can comfortably  
8 know is that in the wake of the restructuring United will be a fully capable  
9 telecommunications provider for a base of Washington customers and will have  
10 heightened incentives to serve those customers well.

11  
12 **Q. How might the concerns expressed by Mr. Saunders and Mr. Brosch be either**  
13 **irrelevant to the merits of the proposed restructuring or actually**  
14 **counterproductive?**

15 A. Public Counsel and Staff witnesses offer a variety of "conditions" that they wish to  
16 impose on the restructuring that are both anachronistic and, arguably, perverse to the  
17 public interest. For example, Mr. Brosch seeks to condition the restructuring on the  
18 requirement that United file monthly statistical reports on the level of capital  
19 expenditures by functional category and also employment levels by functional category.  
20 Additionally, Ms. Erdahl proposes a regulatorily-imposed service guarantee for United.  
21 As I have already described, however, the underlying motivation for these additional  
22 regulatory requirements is absent. That is, aside from the public commitments that  
23 United has made regarding service quality, the actual effect of the restructuring will be to  
24 enhance the focus on United's local customers and on the quality with which they receive

1 telecommunications services. Regulatory oversight, including price and service  
2 regulation of United will continue in full force in the wake of the restructuring. Such  
3 regulatory oversight should be fashioned to promote and complement the efficiency of  
4 the firms they oversee. The imposition of mandated increases in regulatory reporting and  
5 obligations, however, act to constrain the ability of the firm to seek the most efficient  
6 mode of operating and will be directly contrary to the pro-efficiency aims of modern  
7 regulatory oversight.

8  
9 **Q. Are there other recommendations that are excessively interventionist?**

10 A. Yes. Public Counsel and Staff wish to use the occasion of the restructuring to have the  
11 Commission impose a variety of regulatory requirements on United that currently do not  
12 exist. For example, Mr. Saunders introduces conditions that appear to have virtually  
13 nothing to do with the proposed restructuring. Typical of these, Mr. Saunders expresses  
14 the view that the Commission should dictate a rate rebalancing as a condition of the  
15 approval of the corporate restructuring. The debate over the merits of rebalancing local  
16 rates and access charges structuring is, however, independent of the proposed  
17 restructuring and should not stand as the grounds upon which to either deny or condition  
18 the Sprint restructuring.<sup>3</sup> While the goal of establishing cost-based and efficient rates is  
19 well understood, the tethering of such requirements to the approval of the proposed  
20 transaction makes precious little sense. Should the Commission wish to pursue, refine or  
21 accelerate such efforts, it is free to do so. But conjoining such efforts with or conditioning

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<sup>3</sup> An alternative, but no less meritorious interpretation of Staff's plea for rate rebalancing is found in its overly paternalistic argument that the company's rates create an unsustainable business model that leave it financially unsound on a forward-going basis. (page 15) This view, however, ignores the incentives of management to structure rates and services in such a way to maximize its financial viability.

1 the approval of the restructuring on such measures has more of a “hostage taking” than  
2 “rational public policy making” feel to it.

3

4 **Q. Does this conclude your rebuttal testimony?**

5 A. Yes.