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

DR. BRIAN K. STAIHR

ON BEHALF OF
SPRINT NEXTEL CORPORATION

JANUARY 6, 2006

HIGHLY CONFIDENTIAL
PER PROTECTIVE ORDER IN DOCKET NO. UT-051291

[REDACTED VERSION]

1 **I. BACKGROUND/PURPOSE**

2

3 **Q. Please state your name, title, and business address.**

4 A. My name is Brian K. Staihr. I am currently employed by Sprint Nextel
5 Corporation ("Sprint Nextel") as Senior Regulatory Economist in Sprint Nextel's
6 Department of Law and External Affairs. My business address is 6450 Sprint
7 Parkway, Overland Park, Kansas 66251.

8

9 **Q. Following the separation of the local telephone companies from Sprint Nextel**
10 **what will be your title?**

11 A. I will be Director-Policy/Economist for the new stand-alone company, referred to
12 in this proceeding as LTD Holding Company.

13

14 **Q. Please briefly describe your educational background and work experience.**

15 A. I hold a B.A. in Economics from the University of Missouri-Kansas City, and an
16 M.A. and Ph.D. in Economics from Washington University in St. Louis. My field
17 of specialization is Industrial Organization, which includes both Regulation and
18 Theory of the Firm.

19

20 I began working with Sprint Corporation's (Sprint Nextel predecessor in interest)
21 Regulatory Policy Group in 1996. In my current position I am responsible for the
22 development of state and federal regulatory and legislative policy for all
23 subsidiaries of Sprint Nextel, including the company's various incumbent local

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1 telephone companies, its wireless entities, and its long distance and competitive
2 local exchange carrier services. I am also responsible for the coordination of
3 policy across business units. My specific responsibilities include 1) ensuring that
4 Sprint Nextel's policies are based on sound economic reasoning, 2) undertaking
5 or directing economic/quantitative analysis to provide support for Sprint Nextel's
6 policies, 3) advocating those policies, and 4) conducting original research. The
7 specific policy issues that I address include universal service, pricing and costing,
8 cost of capital, access reform, reciprocal compensation, local competition
9 including interconnection and unbundling issues, and more.
10
11 In my position I have testified before Congress on telecommunications issues, and
12 my research has also been used in Congressional oversight hearings. I have also
13 served as Sprint's representative in closed Senate workshops on telecom reform.
14 Since the passage of the Telecommunications Act of 1996 I have appeared before
15 the Commissions or Boards of the following states: Texas, Florida, Kansas, New
16 Jersey, Pennsylvania, North Carolina, South Carolina, Nevada, Illinois,
17 Tennessee, California, Georgia, New Mexico, Virginia, Minnesota, Nebraska, and
18 Missouri. I have also worked extensively with the Federal Communication
19 Commission's ("FCC") staff and presented original research to the FCC.
20
21 In January 2000 I left Sprint temporarily to serve as Senior Economist for the
22 Federal Reserve Bank of Kansas City. There I was an active participant in the
23 Federal Open Market Committee process, the process by which the Federal

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1 Reserve sets interest rates. In addition, I conducted original research on
2 telecommunication issues and the effects of deregulation, particularly in rural
3 areas. Portions of that research are available publicly at
4 http://www.kc.frb.org/RuralCenter/mainSt2000.htm. I returned to Sprint in
5 December 2000.
6
7 For the past nine years I have also served as Adjunct Professor of Economics at
8 Avila University in Kansas City, Missouri. There I teach both graduate and
9 undergraduate level courses.
10
11 Prior to my work in Sprint's Regulatory Policy Group I served as Manager-
12 Consumer Demand Forecasting in the marketing department of Sprint's Local
13 Telecom Division. There I was responsible for forecasting the demand for
14 services in the local market, including basic local service, and producing elasticity
15 studies and economic and quantitative analysis for business cases and opportunity
16 analyses.
17
18 **Q. What is the purpose of your testimony?**
19 A. The purpose of my testimony is two-fold. First, I address certain issues raised in
20 the Direct Testimonies of Mr. Stephen G. Hill (filed on behalf of Public Counsel)
21 and Ms. Kathleen M. Folsom (filed on behalf of Washington Utilities and
22 Transportation Commission ("WUTC") Staff). Both testimonies were filed on
23 November 30, 2005. These issues center around certain misperceptions and

1 inaccuracies contained in their respective testimonies regarding the proposed
2 capitalization of the LTD Holding Company and its relative debt level.
3
4 The second purpose of my testimony is to respond to certain directory issues
5 contained in the November 30, 2005 Direct Testimonies of Ms. Paula M. Strain
6 on behalf of the Staff of the WUTC, and of Mr. Michael L. Brosch on behalf of
7 Public Counsel. As discussed in the testimony of Sprint witness Mr. Richard
8 Pfeifer, the directory issues raised by Ms. Strain and Mr. Brosch are far beyond
9 the scope of this docket and their proposals for regulatory treatment are better
10 suited for review and determination in a future ratemaking proceeding. Sprint
11 strongly believes that any action by the Commission responding to those
12 recommendations is not appropriate at this time. My testimony supports the
13 testimony of Sprint witnesses Mr. Richard Pfeifer and Ms. Nancy Judy.
14
15 **II. CAPITALIZATION OF THE LTD HOLDING COMPANY / DEBT LEVEL**
16
17 **Q. On page 4 of his testimony Public Counsel witness Hill writes that the LTD**
18 **Holding Company will be capitalized with "…an amount of new debt [that]**
19 **is [shaded] the amount of the debt that is currently on the books of the local**
20 **exchange operations" (lines 7-8). Does it make sense to compare the debt**
21 **that is currently on the books of the local companies with the proposed debt**
22 **level for LTD Holding Company?**

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1 A. Absolutely not. Mr. Hill's comparison is a classic case of comparing apples with
2 oranges. First, the starting point that Mr. Hill uses to make his comparison is
3 wrong. The separation of Sprint Nextel's local service operations from its parent
4 company represents the creation of a new stand-alone company. Right now, the
5 local operations of Sprint do not constitute a separate company-within-a-
6 company. Rather, they are distinct subsidiaries that roll up to a parent
7 corporation, a parent that also has wireless subsidiaries and long-distance
8 subsidiaries. Because of this, the way these local companies are capitalized—
9 their relative amounts of debt and equity—are not representative of a true stand-
10 alone corporation. In particular, if we were to roll up all of the local companies
11 into one unit, the combined capitalization of that unit (which we often call the
12 Local Telecom Division of Sprint Nextel) is not representative of how a stand-
13 alone company is or should be capitalized.
14
15 The separation requires that we re-capitalize the new local company, and that we
16 re-capitalize it in a way that achieves two specific goals. The first goal is to have
17 a capital structure that is comparable to other firms in this industry. The second
18 goal is to have a capital structure that minimizes the company's cost of capital,
19 which has the effect of maximizing the value of the firm itself. The amount of
20 debt and the capital structure that are contained in the application accomplish both
21 these goals. The amount of debt (and associated capital structure) that Mr. Hill is
22 referring to "currently on the books" does not accomplish either of these goals.
23

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1 Second, by looking only at the debt on the books of the individual telephone
2 companies Mr. Hill ignores the fact that much of the debt that Sprint's existing
3 local companies – including United – have helped to service for years is parent
4 company debt, Sprint Corporation debt, which is not included in Mr. Hill's
5 starting point found on page 12 of (what he refers to as) the Sprint Report. Given
6 this fact, comparisons between the two numbers are misleading because it is
7 simply incorrect to suggest that Sprint's local companies, including United, would
8 go from servicing approximately [shaded] to servicing [shaded] that
9 amount after the separation.
10
11 The reality is that the local companies have *always* helped to service more debt
12 than [shaded]. The importance of this point cannot be overstated. The [shaded]
13 [shaded] amount of debt that Mr. Hill is referring to exists at the parent company
14 level, not at the telco level. If Mr. Hill examined the Sprint Nextel merger
15 document he would see that, at the point in time that the merger was
16 consummated, the amount of debt at the parent level was [shaded] the
17 amount of debt at the telco level.
18
19 This debt at the parent level has nothing to do with United's activities. It does not
20 affect United's books or its day-to-day operations; it does not affect United's
21 ability to generate revenue from its customers or its commitment to meeting the
22 obligations it has in Washington. The reason this fact is important is, over the
23 past decades, United's *existing* parent – Sprint Corporation – had made many

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1 changes to its capital structure. It has taken on debt and retired debt; it has
2 increased and decreased its relative equity positions. These changes did not affect
3 the finances of United. In fact, these changes did not affect the finances of any of
4 Sprint's incumbent local providers, nor were they a cause of concern for
5 regulatory commissions.
6
7 It is true that a portion of cash flows from all of Sprint's local companies –
8 including United – have been used in the past to help service the parent
9 company's debt, just as they will be used to help service the debt component of
10 the new company's capital structure. But the new parent company's debt imposes
11 no different obligation on United than the obligations it has had in the past
12 regarding Sprint Corporation's debt. The debt is not secured by United's assets,
13 and the debt does not affect United's rates. And most importantly, Mr. Hill is
14 simply factually incorrect when he writes that "…the debt load supported by those
15 [ILEC] assets will increase [redacted] (page 13 lines 18-19). It will not.
16
17 **Q. Are there any other reasons why it is incorrect to focus on the comparison**
18 **that Mr. Hill is making on page 4, lines 7-8?**
19 A. Yes. The [redacted] referenced by Mr. Hill would represent a tremendous
20 degree of *under-leverage* if it was, indeed, the only debt associated with LTD
21 Holding Company. Based on the midpoint of the valuation contained in the
22 Houlihan Lokey analysis discussed above, [redacted] in debt would produce an
23 equity-to-capital ratio of [redacted] for LTD Holding Company, dramatically out of line

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1 with any of the comparable firms contained in that analysis. Even using
2 (inappropriate) book values, [shaded] of debt would produce an equity-to-
3 capital ratio of well over [shaded]. Simply stated, the fact that approximately [shaded]
4 [shaded] of debt exists on the books of Sprint's local companies today does not
5 mean that [shaded] is right, or correct, or reasonable, or part of a proper
6 capital structure, or that the proposed capital structure represents a massive
7 increase in obligations for the local companies.
8
9 Finally, as discussed at length in the testimony of Mr. Glenn Daniel, the relative
10 debt and capital structure of the LTD Holding Company are both comparable to
11 those of other firms operating in the industry and, in many ways, conservative.
12
13 **Q. In his testimony Mr. Hill presents a discussion of market values v. book**
14 **values, particularly with regard to the equity of the parent company (pages**
15 **13-14). He claims that book values of the parent company matter for**
16 **purposes of regulation. Are his observations accurate?**
17 A. Mr. Hill makes many different (and sometimes conflicting) observations
18 regarding book values v. market values. In some cases his observation is
19 completely accurate and consistent with standard finance theory, but the
20 implications of his observations are completely ignored. I address a few such
21 inconsistencies below.
22

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1 First, on page 10 of his testimony Mr. Hill discusses the "way in which a firm is
2 most economically capitalized" (lines 3-4). In this section it is clear he
3 understands that the creation of the LTD Holding Company does indeed represent
4 the capitalization of a new, stand-alone corporation. On lines 12-19 of that page
5 he also makes clear his position that there is some combination of debt and equity
6 that will have the effect of minimizing a firm's overall cost of capital. Both of
7 these observations are consistent with the intended goals of re-capitalizing the
8 LTD Holding Company that I discussed above (minimizing the cost of capital,
9 maximizing the value of the firm).
10
11 However, Mr. Hill ignores the fact that accepted finance theory dictates that,
12 when capitalizing a firm to minimize its cost of capital and therefore maximize
13 the value of the firm, the cost of capital calculation must use *market* value
14 weights, not book value weights. As Professor Aswath Damodaran states
15 unequivocally in his well-known text on valuation, "Every textbook is categorical
16 that the weights in the cost of capital calculation be market value weights."[1]
17 Similarly, Michael Ehrhardt's text on measuring cost of capital states, "Using
18 book values instead of market values can lead to substantial errors in estimating
19 the weights" for a weighted average cost of capital.[2] Consequently, when
20 determining what the "right" amount of debt and equity are for the LTD Holding
21 Company, we must look at their market values, not their book values. Yet Mr.
22 Hill insists on referring to book values in his testimony (for example, page 12

[1] Damodaran, *Investment Valuation*, p. 388.
[2] Ehrhardt, *The Search for Value*, p. 75.

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1 lines 19-20) despite the fact that finance theory tells us book values are
2 inappropriate for the very thing that Mr. Hill acknowledges is taking place here:
3 the re-capitalizing of a company.
4
5 The reason this is significant is that Mr. Hill goes on to state that it is the parent's
6 capital structure "that will determine the cost of capital and impact the ability of
7 the operating company to raise capital to meet its public service obligation" (page
8 13 lines 10-12.) Now, it is vitally important to acknowledge a distinction here.
9 As discussed in the testimony of Richard Pfeifer, the parent company's capital
10 structure – and associated cost of capital – do not affect the rates that United
11 charges, and do not enter into the rate-making process in any way. However, Mr.
12 Hill is correct that the parent company's capital structure does affect the parent's
13 ability to invest in new projects and products that will benefit United's customers.
14 Therefore, it is best *for United's customers* if the parent company has a capital
15 structure that minimizes the parent's cost of capital. As stated above, that was
16 Sprint's primary goal in determining the capitalization of the new firm.
17
18 Next, Mr. Hill also displays certain inconsistencies when he discusses financial
19 risk as reflected in "the capital structure that appears on the books of the parent
20 company" (page 14 line 15). Simply stated, he is incorrect to assume that
21 financial risk is accurately reflected by book values of a capital structure. For
22 example, as shown in the Houlihan Lokey report on page 7, four of the six
23 comparable firms have interest coverage ratios that are significantly below the

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1 interest coverage ratio for LTD Holding Company. Regardless of their book
2 value capital structures, these firms have fewer dollars in earnings to cover their
3 interest obligations than LTD would. Similarly, four of the six have lower fixed
4 charge coverage ratios than LTD would. *By definition*, those firms have a higher
5 level of financial risk than would LTD Holding Company.
6
7 More importantly, of the six comparable firms contained in the Houlihan Lokey
8 report, five of the six have positive book values of equity on their balance sheets
9 only because they have included goodwill among their assets. In five of six cases,
10 the dollar value of goodwill exceeds the dollar value of shareholder equity;
11 without this goodwill shareholder equity would adjust to be negative. Yet this
12 goodwill has absolutely no bearing on the amount of financial risk exhibited by
13 the firm. Goodwill on a balance sheet does not magically enable a firm to meet
14 an interest payment, or a fixed charge obligation. Yet it does affect the book
15 value of a capital structure. The important point here is this: Mr. Hill is incorrect
16 to suggest that book values of a capital structure can be categorically relied upon
17 to accurately reflect relative financial risk. And it would be equally incorrect to
18 suggest that the mere existence of negative book equity in a capital structure is
19 evidence of greater financial risk than that faced by another firm with positive
20 book equity.
21
22 **Q. On pages 15-17 of his testimony Mr. Hill discusses certain information**
23 **provided by major bond rating agencies regarding the LTD Holding**

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1 **Company. In that section he discusses indicative credit ratings received by**
2 **LTD, and expresses concern that LTD could, under some hypothetical**
3 **scenario, "…be in danger of losing its investment grade bond rating" (page**
4 **16 lines 28-29). Does the LTD Holding Company have the ability to**
5 **determine whether or not it receives and maintains an investment grade**
6 **rating for its debt?**
7 A. Not really. The LTD Holding Company has always been committed to
8 maintaining investment grade characteristics for its debt. In fact, the application
9 for transfer of control that was filed in Washington explicitly states that the
10 company would strive to maintain such characteristics. Establishing such
11 financial characteristics is a *necessary condition* for achieving an actual
12 investment grade rating but it is not, in and of itself, a *sufficient condition* for
13 achieving an investment grade rating. The reason it is not a sufficient condition is
14 because obtaining an investment grade rating is actually dependent on a wide
15 variety of conditions, many of which are beyond the direct control of the
16 company.
17
18 For example, when the rating agency Moody's determines whether a company
19 will receive an investment grade, it places significant weight on both the
20 competitive environment and the regulatory environment in which the company
21 operates. All else held equal, the more firms that are in a market, the harder it is
22 for a company to achieve an investment grade. And the more unpredictable the

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1 regulatory environment, the more difficult it is to achieve an investment grade.
2 Both factors, of course, are things over which the firm has no real control.
3
4 An example of the impact of these uncontrollable factors can be viewed in a
5 recent press release from the rating agency S&P (issued November 10, 2005),
6 which I have attached as Exhibit BKS-2. This press release discusses the LTD
7 Holding Company and states, "Despite the relatively moderate proposed capital
8 structure, strong EBITDA margins, and good discretionary cash flow
9 characteristics, we are concerned about industry-wide business risk …." The
10 statement could not be clearer; it is not the financial characteristics of LTD
11 Holding Company that concern S&P. Rather, it is the industry in which we
12 operate. Such a point of view has led S&P to issue the public statement that Mr.
13 Hill cites on pages 15 of his testimony, which states, "industry-wide business-risk
14 concerns about rising cable telephony and wireless competition will make it
15 difficult for this unit to obtain an investment grade rating as a standalone entity,
16 *regardless of the resulting capitalization*" (emphasis supplied).
17
18 Simply stated, the LTD Holding Company can only make commitments regarding
19 things that are within its control. Maintaining investment grade financial
20 characteristics is in the company's control, but achieving the actual rating is not.
21 Furthermore, LTD Holding Company cannot change the business it is in. We are
22 an incumbent LEC, and we will continue to be an incumbent LEC offering a
23 complete portfolio of services including wireless. However, it is entirely possible

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1 that a rating agency such as S&P could adopt the opinion that (for example) the
2 regulatory obligations that incumbent LECs must operate under are a competitive
3 disadvantage, and therefore no incumbent LEC will be given an investment grade
4 rating for its debt.
5
6 The problems with Mr. Hill's arguments on this subject are that he makes the
7 error of confusing concerns about the LEC industry as a whole with concerns
8 about LTD Holding Company's specific capitalization. For example, the Fitch
9 letter that Mr. Hill references on page 15 line 25 of his testimony explicitly
10 mentions a [redacted] available to LTD Holding Company.
11 But that fact has nothing to do with LTD Holding Company's financials, or its
12 relative amounts of debt and equity. In fact, the Fitch letter goes on to state that
13 they (Fitch) [redacted]
14 [redacted]
15
16
17 Similarly, the Moody's letter that Mr. Hill cites on page 15 line 25 states quite
18 clearly that [redacted]
19 [redacted]. Mr. Hill does present a reference from the Moody's letter that suggests
20 LTD's rating could decline if [redacted]
21 [redacted]
22 But the first condition is an industry phenomenon, and would not be mitigated or
23 avoided in any way by changing the proposed financials. As for the second

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1 condition, Mr. Hill has no reason to believe – nor has he provided any evidence to
2 suggest – that such a scenario is even remotely possible, much less likely.
3
4 **Q. Why is it important to separate the rating agencies' concerns about the LEC**
5 **industry from any potential concerns about LTD Holding Company's**
6 **proposed financials?**
7 A. Because the issue before this Commission is whether the separation is in the
8 public interest *given the state of the LEC industry*. The separation cannot and will
9 not change market fundamentals for ILECs; there will continue to be competition
10 from cable companies, and there will continue to be a struggle to retain
11 customers. These challenges will not be affected by whether or not United
12 separates from Sprint Nextel. What *will* be affected is United's ability to
13 successfully meet these challenges. A separate LTD Holding Company will have
14 the independence and the autonomy to meet those challenges in a way that it
15 cannot as part of a large, nationwide, wireless-focused entity. If Moody's is
16 concerned about then the Commission should ask itself, "Is
17 United better able to prevent that from happening if it is part of an autonomous,
18 locally-focused corporation, or if it is a part of a wireless company called Sprint
19 Nextel?" The major bond rating agencies do not have problem with LTD Holding
20 Company's proposed financials, debt levels, or capital structure. They do have
21 concerns about the marketplace challenges facing the company. The best way for
22 this Commission to ensure investment grade ratings is to give United and LTD

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1 Holding Company the independence it needs to successfully compete; not to
2 attempt to adjust financials that the agencies already consider "strong."
3
4 **Q. On pages 11-12 of his testimony Mr. Hill discusses the capitalization of**
5 **United's existing parent company, Sprint Nextel. Is there any *a priori* reason**
6 **to believe it makes sense for the capital structure of LTD Holding Company**
7 **and the capital structure of Sprint Nextel to be the same or similar?**
8 A. No. Because the companies each operate with a different strategic emphasis, each
9 will represent a different level and type of risk to any potential investor.
10 Therefore, because any investor's expected return is a function of risk, each
11 company will require a different return to its respective equity or debt investors.
12 This suggests that each will have a different cost of equity and cost of debt;
13 accordingly, each will have a different capital structure that minimizes the overall
14 weighted cost of capital. This means each will have a different capital structure
15 that maximizes the value of the firm. Unless Mr. Hill has undertaken an analysis
16 where he has determined that the same capital structure for both firms minimizes
17 each firm's cost of capital, and therefore maximizes the value of each firm, there
18 is no justification for believing that it makes any sense at all for the two firms –
19 LTD Holding Company and Sprint Nextel – to have similar capital structures.
20
21 **Q. On pages 24-26 of his testimony Mr. Hill produces a checklist of conditions**
22 **that he feels should be met if the Commission recommends approval of the**
23 **application. Are his conditions reasonable?**

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1 A. No they are not. Below I address each condition briefly.

2

3 His first condition is that LTD Holding Company be required to maintain
4 investment grade ratings for its debt from two out of three rating agencies. As I
5 explained above, this is simply beyond the control of LTD Holding Company.
6 The things that *are* in our control – such as maintaining financial characteristics
7 that are consistent with investment grade ratings – we have committed to do. The
8 second half of his first condition is that if these ratings are not maintained, the
9 LTD Holding Company should limit its dividend payout to one third of net
10 income. Although I am not an attorney, it is my understanding from talking with
11 counsel that the Commission does not have jurisdiction over United's parent
12 company dividend policy. Beyond that, reducing an already conservative
13 dividend sends the wrong signal to capital markets.

14

15 His second condition on page 25 is that United will not seek a rate increase in
16 Washington for reasons related to the health of the parent company. This
17 condition is simply unnecessary. There is no mechanism within the standard
18 procedure for a rate case through which the parent company's health enters into
19 the rate making decision. There is nothing about the parent company's financial
20 status that enters into any calculation of a revenue requirement for United.

21

22 His third condition is that LTD Holding Company agrees that the assets of United
23 would not be pledged to secure any borrowing at the parent level. This condition

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1 is also unnecessary; we have explicitly stated in the application that the debt of
2 LTD Holding Company will not be secured using any ILEC assets.
3
4 His fourth condition is that United should not be allowed to participate in any
5 inter-corporate short term money pooling arrangement. This condition is
6 unreasonable for two reasons: it is based on an incorrect and unsupported
7 assumption, and it would simply be an extremely unwise business decision. Mr.
8 Hill attempts to suggest that any benefits that come from a corporate money
9 pooling arrangement are "minimal." He does not define "minimal" nor does he
10 produce any data, numbers, analysis, or evidence to support this claim. His claim
11 is simply wrong. United enjoys significant economies of scale by being able to
12 participate in a cash management process through its parent. United benefits from
13 discounts on equipment and material purchases to systems implementation by
14 having cash management take place at the parent level. If Mr. Hill is sincerely
15 worried, as he suggests on page 25 lines 20-21, about cash from United's
16 regulated operations being used to subsidize unregulated operations – such as, for
17 example, Sprint Nextel's nationwide wireless business – he should be strongly
18 encouraging this separation, rather than recommending it not be approved. This is
19 discussed further in a section below.
20
21 His last condition, on page 26, is that in the event of a LTD Holding Company
22 bankruptcy there should be no payment of dividends or cash transfers from United
23 to LTD Holding Company. First, this condition is predicated on a complete

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1 hypothetical that Mr. Hill has given us no reason to believe is at all probable or
2 likely. But setting that point aside, in the event that his unsupported, unlikely,
3 foundationless hypothetical were to actually occur, accumulating a larger cash
4 balance at the United level would do *absolutely nothing* to help ratepayers in
5 Washington. To see why this is so, consider the following: When new fiber is
6 put into the ground in Washington the fiber is paid for by LTD Holding
7 Company, not United. When an employee in Hood River receives his or her
8 monthly paycheck the money comes from LTD Holding Company, not United.
9 And when a maintenance truck that serves Poulsbo is in the shop, the repair is
10 paid for by LTD Holding Company, not United. In the event that Mr. Hill's
11 doomsday scenario actually occurred, this system would not change *and the*
12 *reason it would not change is because it is the most efficient system.* A company
13 in bankruptcy does not change systems to become less efficient. United is simply
14 not going to start buying its own switches, or entering into its own negotiations
15 with equipment vendors. And even if it did, it would not be able to achieve
16 anywhere near the favorable terms that LTD Holding Company achieves. Mr.
17 Hill's final condition would not produce a single benefit.
18
19 **Q. Turning now to the testimony of Ms. Kathleen Folsom, on pages 23-25 of that**
20 **testimony Ms. Folsom discusses what she views as ways to "protect**
21 **ratepayers from the additional financial leverage utilized by LTD." Do**
22 **United's ratepayers need protecting from LTD's leverage?**

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1 A. No, they do not. This appears to be a misperception shared by Mr. Hill and Ms.
2 Folsom both. As I discussed above, United's parent company's capital structure
3 has no impact on United's day-to-day operations. It has no impact on the rates
4 that United charges for its services. It has no impact on United's ability to
5 generate revenues from it customers. In the past, as mentioned above, United's
6 existing parent has changed its leverage many, many times. For example, in the
7 late 1990s United's parent company changed its capital structure from less than
8 40% debt to well over 60% debt. This change had no impact on United's
9 ratepayers in Washington, or on any of Sprint's local customers.
10
11 **Q. Given the fact that the parent company's capital structure has no impact on**
12 **United, how do you respond to Ms. Folsom's suggestion regarding "ring-**
13 **fencing" on page 24 of her testimony?**
14 A. It is somewhat ironic that Ms. Folsom is concerned about ring-fencing now. For
15 decades there has been nothing to prevent the dividends that United pays to its
16 parent from being used for exactly the type of unregulated activities she is
17 concerned about. And for decades United's parent has engaged in activities
18 ranging from building a long-distance network, to major CLEC operations, to
19 major wireless operations, to cable partnerships, to international partnerships. Yet
20 there appears to be no evidence on record that Ms. Folsom had concerns about
21 ring-fencing when United's parent was engaging in all these activities in the past.
22 Her testimony talks about using ring-fencing to reduce the likelihood that
23 "business or management failures at the parent company would harm the

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1 regulated company." Yet United's existing parent committed substantial
2 resources on an unsuccessful CLEC offering, which could legitimately be
3 considered a "business or management failure" of sizable proportion, and there
4 was no cry for ring-fencing. Under the status quo there is nothing to stop
5 United's existing parent from committing significant resources on unregulated
6 activities. Yet when we proposed to create a new parent that will *focus* on more
7 regulated activities, Ms. Folsom has concerns about ring-fencing.
8
9 The fact is that the separation itself provides for the ultimate ring-fencing.
10 Without the separation, dollars that come from United ratepayers will flow to a
11 parent whose primary interests include (for example) expanding cell tower
12 capacity in New York City, or Los Angeles. But *with* the separation, dollars that
13 come from United ratepayers will flow to a parent whose primary interest is in
14 meeting the needs of the customers in its local serving territories. After the
15 separation, it is assured that when dividend dollars flow from United to LTD
16 Holding Company, they will be used to develop new products that United's own
17 customers will enjoy. The same cannot be said under the status quo.
18
19 **Q. Please briefly summarize your responses to Mr. Hill and Ms. Folsom.**
20 A. The concerns of Mr. Hill and Ms. Folsom regarding the LTD Holding Company's
21 capitalization, leverage, etc., are misplaced and baseless. And the restrictive
22 conditions they advocate to address the baseless concerns are unreasonable and
23 unnecessary. The applicants have demonstrated that LTD Holding Company will

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1 be a financially secure, Fortune 500 company with a reasonable capital structure,
2 comparable to other firms in the industry, able to meet the needs of its customers.
3 And neither Mr. Hill nor Ms. Folsom has presented anything to disprove this,
4 other than conjecture. Dramatic statements about "possible bankruptcy" or
5 "protecting ratepayers" are meaningless unless there is evidence, analysis, or data
6 to suggest they should be considered seriously. Neither Mr. Hill nor Ms. Folsom
7 has presented any such evidence. The Commission should approve the
8 application without conditions. The customers in United's serving territory will
9 be better served by doing so.
10
11 **III. DIRECTORY ISSUES**
12
13 **Q. What is your understanding of the basis of the recommendations presented**
14 **by Commission Staff and Public Counsel in this proceeding?**
15 A. It is my understanding that Staff and Public Counsel believe that the Commission
16 should take some action in this proceeding to identify a Washington-specific
17 portion of gain resulting from the sale of the stock of Sprint Corporation's
18 directory publishing operations to R.H. Donnelley. It is my further understanding
19 that Staff and Public Counsel believe that ratepayers are due 100% of the
20 Washington-specific portion of the gain because they somehow created the value
21 of the directory business.
22

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1 **A. THE VALUE OF THE STOCK OF SPRINT CORPORATION'S**
2 **PUBLISHING OPERATION WAS NOT CREATED BY UNITED'S**
3 **LOCAL TELEPHONE SERVICES.**
4

5 **Q. Both Ms. Strain and Mr. Brosch testify that there is something of a cause-**
6 **and-effect relationship between local telephone operations (and local**
7 **telephone customers (or ratepayers)) and the success of a directory**
8 **publishing business. Ms. Strain writes that "[t]he ability to publish and**
9 **distribute the "official" directories to United's ratepayers, and to sell**
10 **advertising in those directories has value because of United's status as the**
11 **dominant local service provider in its serving areas" (Strain Direct page 10).**
12 **Mr. Brosch writes that the value of the directory business is a regulatory**
13 **asset that "arises from UTNW's status as a major ILEC, which creates the**
14 **opportunity and indeed a regulatory expectation that telephone directories**
15 **be published containing commercial advertising…" Are these claims**
16 **correct?**

17 A. Not at all. It appears that both Ms. Strain and Mr. Brosch would have the
18 Commission believe that the value of the directory publishing business, and the
19 reason for its success, were created as direct functions of United fulfilling its
20 obligations as a local telephone provider. This is incorrect, for the reasons I will
21 explain below.
22

23 **Q. Are Ms. Strain and Mr. Brosch correct in their beliefs that United's local**
24 **telephone services created the gain which Sprint Corporation realized as a**
25 **result of the sale of the stock of its publishing operations?**

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1 A. No. United did not create the value of the gain which Sprint Corporation realized
2 as a result of the sale of the stock of its publishing operations. The value
3 expressed in this gain was created by several other major factors, primarily (but
4 not limited to): 1) the value of the Sprint brand; 2) the value of the relationships
5 developed over the years between yellow pages advertising personnel and
6 customers who purchase yellow pages advertising; and 3) the value of the
7 directory publishing operation itself.
8
9 **Q. Did the local telephone company in Washington create the value of the Sprint**
10 **brand through its relationships with its end user customers?**
11 A. No. The value of the Sprint brand was created primarily by Sprint
12 Communications Company, L.P., the Sprint company which developed Sprint's
13 long distance telecommunications company begun by Southern Pacific Railroad –
14 Southern Pacific Railroad Internal Network, starting in the mid-1970s. The Sprint
15 name was originally developed by the railroad's long distance telephone
16 corporation and was subsequently transferred to GTE Corporation, and then to
17 Sprint Corporation.
18
19 Sprint Corporation allowed this brand to be used by the Sprint/United and local
20 telephone companies beginning in the mid-1990's. The former United local
21 telephone companies did little if anything to increase the already established value
22 of the Sprint brand. To see why this is true, we must look briefly at Sprint's
23 history.

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1

2 The company that currently exists as Sprint had its origins as a small local
3 telephone company in Abilene, Kansas, in 1899. And that local telephone
4 operation increased in size and relative importance over the next several decades
5 until, by the 1950s, it had become the second-largest non-Bell telephone company
6 in the country. However, during this time the company was known as United
7 Utilities. In the 1970s the company changed its name to United
8 Telecommunications and was still primarily a local telephone company.
9
10 In 1986, following United's acquisition of Sprint from GTE Corporation (the
11 successor to Southern Pacific Railroad's Sprint operation) the company officially
12 started offering domestic long-distance service. At that point in time the "Sprint"
13 brand name was used only for the long-distance division. In 1992 United
14 Telecommunications adopted the name Sprint for the entire corporate entity and
15 became Sprint Corporation.
16
17 There is no doubt that the Sprint brand name and trademark represent part of the
18 value of Sprint Corporation's directory publishing business. But that value is not
19 the result of anything having to do with local telephone customers in Washington.
20
21 **Q. In addition to the value of the Sprint brand that you just discussed, what**
22 **other factors contributed to the value of Sprint Corporation's directory**
23 **publishing business?**

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1 A. The value of any directory business (not just Sprint's) is a function of the demand
2 for advertising. If there is a large enough demand for advertising, and the
3 publishing company can meet that demand in a cost-effective way, the directory
4 will be profitable and the business will be valuable. Now, Ms. Strain and Mr.
5 Brosch seem to believe that because it is local businesses (ratepayers) that
6 advertise in the directory, they somehow help create the value of the directory
7 business. In other words, local ratepayers demand what the directory business
8 supplies: advertising. That is true. It is also true that local ratepayers demand
9 what the corner grocery store supplies: groceries. And it is true that local
10 ratepayers demand what the corner gas station supplies: gasoline. But the fact
11 that they have this demand has nothing to do with being local ratepayers. In other
12 words, it is not because they are local ratepayers that the grocery or the gas station
13 or the directory is valuable. If it was, then any and every business would be
14 valuable because every business serves local ratepayers. Rather, a directory
15 publishing business is valuable because its employees put forth the time and effort
16 to establish and nurture relationships with demanders of advertising and were able
17 to meet that demand in an efficient way that created profits.
18
19 **Q. How has the yellow pages sales operation been a major source of value of**
20 **Sprint Corporation's directory publishing business?**
21 A. The value of a directory publishing business is a direct function of the established
22 relationships between the directory publishers and directory customers who
23 purchase advertisements. The value is a product of the labor of a sales force that

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1 markets advertising to customers, and therefore has every incentive to make every
2 effort to grow and nurture these relationships. The local telephone operations and
3 ratepayers did not build the relationships, nor did they bear the expenses of
4 developing those relationships. The value of the directory has not been enhanced
5 by the mere existence of ratepayers.
6
7 **Q. Mr. Brosch refers to comments in R.H. Donnelley's 2004 10-K Report as**
8 **evidence that the affiliation with the ILEC is what creates the value of the**
9 **directory business. Are R.H. Donnelley's comments inconsistent with your**
10 **perspective that ratepayers did not create the value of the directory**
11 **business?**
12 A. No. The comments of R.H. Donnelley are entirely consistent with the position
13 that the value of the directory business flows from: 1) the value of the brand; 2)
14 the value of the relationships between the directory publishers and directory
15 customers who purchase advertisements and 3) the value of the directory
16 operations. The following quote from R.H. Donnelley's 10-K, included in Mr.
17 Brosch's testimony, demonstrates that Donnelley's view of what creates the value
18 of the directory business is consistent with Sprint's view:
19 "We believe that acting as the exclusive, official incumbent publisher of
20 directories for the incumbent local telephone company (SBC and Sprint)
21 in our markets provides us with a competitive advantage over independent
22 publisher competitors due to better recognition of our brands, higher usage

1 of our directories by consumers and our longer relationships with
2 advertisers in our markets."
3
4 **Q. What about Public Counsel's statements regarding the nature of the**
5 **intangible regulatory assets that arise from the connection between the**
6 **directory's official status and the brand awareness created by the local**
7 **telephone operations?**
8 A. Neither United nor any of the other Sprint local telephone companies hold any
9 Sprint trademark licenses or branding rights. These trademarks are assets of
10 Sprint Communications Company, L.P. For purposes of the directory transaction,
11 those rights were placed in an entity called Sprint Directory Trademark Company,
12 LLC. It was Sprint Directory Trademark Company, LLC that granted the
13 trademark and branding rights to R.H. Donnelley, not United. As I explained
14 earlier, the trademark and brand were not created and developed through the
15 interactions of United and its customers and thus are not intangible assets held by
16 the local telephone operations of Sprint.
17
18 In terms of United's customers, the telephone subscriber list, consisting of
19 information regarding United's local telephone customers, is not an intangible
20 asset. Any publisher could obtain subscriber information from United at FCC-
21 mandated prices, terms and conditions. If they do not wish to do so, they can scan
22 the directories to obtain the listing information, as well as information regarding

1 the businesses that advertise in the directories. Since there is no inherent value to
2 subscriber lists, there is no intangible asset being held by United.
3
4 **Q. Ms. Strain claims that United's ratepayers are due compensation for**
5 **"publishing rights" which were sold by its parent company. How do you**
6 **respond?**
7 A. As I have explained previously in my testimony, the value of the directory
8 business is not derived from the mere existence of ratepayers as Ms. Strain
9 suggests. Furthermore, due to the FCC's requirement that subscriber listing
10 information be made available on a non-discriminatory basis, the mere fact that
11 United could produce its own directory does not automatically mean that such a
12 directory would have value. United has never produced its own directory and the
13 value of the directory business that Sprint Corporation sold to R.H. Donnelley did
14 not result from actions taken by United or its ratepayers.
15
16 **Q. Please summarize your opinion regarding whether the gain realized from the**
17 **stock transaction resulted from United's relationships with its local**
18 **ratepayers.**
19 A. The local telephone business is a necessary condition for a directory publishing
20 business, just like the computer business is a necessary condition for the software
21 business. But this does not – in any way – suggest that local telephone service is
22 the source of value created in a directory publishing business. Nor does it suggest
23 that local telephone service is the cause for gain realized from a stock transaction.

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1 Both Ms. Strain and Mr. Brosch would have this Commission believe that simply
2 because revenues from the directory business have historically been used to offset
3 some of the costs of basic service, somehow basic service has created the value of
4 that directory business. This "link" simply does not exist; their position is nothing
5 more than a non sequitur.
6
7 **B. ECONOMIC THEORY AND LEGAL PRECEDENT PROVIDE NO**
8 **SUPPORT FOR THE RECOMMENDATIONS PRESENTED BY**
9 **STAFF AND PUBLIC COUNSEL TO ALLOCATE 100% OF THE**
10 **GAIN TO WASHINGTON RATEPAYERS.**
11
12 **Q. What economic theory applies to the issue of determining an allocation of the**
13 **gain on the sale of Sprint Corporation's directory publishing business?**
14 A. This issue goes to the fundamental economics of property rights. The concept of
15 property rights is a multi-dimensional concept in economics but it is defined, in
16 essence, as a party's ability to gain from an asset through direct consumption or
17 through exchange. When a party has property rights over an asset the party is in
18 a position to reap potential benefits from the asset, but the party also incurs any
19 risk associated with the asset. The "risk" associated with any asset has to do with
20 the randomness of its return and the possibility that an actual return differs from
21 an expected return. An asset that is risk-free has a return that is (essentially)
22 guaranteed, and therefore has no random component.
23

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1 **Q. Is there any established precedent that is related to the consideration of the**
2 **allocation of the gain on Sprint Corporation's sale of its directory publishing**
3 **business?**
4 A. In a federal court case, *Democratic Central Committee of the District of Columbia*
5 *v. Washington Metropolitan Transit Commission*, 485 F.2d 786 (D.C. Cir. 1973),
6 two principles were discussed that are consistent with the economic theory I just
7 described.[3] The first principle set forth in *Democratic Central* is that the party
8 that bears the risk of loss on an asset is the party that should receive the benefit
9 from the sale of the asset. The second principle is that, if it is impossible to
10 determine which party bears the risk of a loss on an asset, the party that bears the
11 financial burden of a particular activity should reap the benefits. It should be
12 noted that the issue addressed in *Democratic Central* specifically involved utility
13 assets and utility activity, and there are legitimate questions (addressed by Sprint
14 witness Mr. Pfeifer) as to whether the directory issue has to do with utility assets
15 or utility activity.
16
17 **Q. The principles in *Democratic Central* are based on legal precept, rather than**
18 **economic analysis. In your opinion do the two principles from this case**
19 **provide a reasonable foundation or rationale from an economic point of**
20 **view?**
21 A. Yes. The principles in *Democratic Central* are consistent with the fundamental
22 economics of property rights. The first principle put forth in *Democratic Central*

[3] The purpose of my testimony is not to provide any legal opinion or analysis. My references to legal opinions or documents are made only with regard to the economics involved.

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1 could be viewed simply as a restatement of the characteristics of property rights:
2 In economic terms, the party in both cases (incurring a loss, enjoying a gain) is
3 the party that has property rights over the asset. The second principle is a
4 straightforward extension of the first.
5
6 **Q. In this instance do both shareholders and ratepayers incur the risk of being**
7 **affected by a loss on the asset?**
8 A. No. In this instance, if a loss were incurred on the asset there is virtually a 100
9 percent probability that shareholders would be affected by the loss. But there is a
10 much lower probability – approaching zero percent – that Washington ratepayers
11 would ever be affected by the loss, or any loss, on this asset. Therefore the
12 relative risk that shareholders incur in this case is extremely high, and the relative
13 risk that ratepayers incur is virtually nonexistent.
14
15 **Q. Did the relationship between local telephone service and directory publishing**
16 **that Ms. Strain and Mr. Brosch discuss in their testimonies create risk for**
17 **Washington residential customers?**
18 A. No, it did not. There is (and was) no risk to United's ratepayers associated with
19 the directory publishing business. Sprint Corporation's directory publishing
20 business was not a part of United's operations. At no point in time did payments
21 collected from United's ratepayers flow to the directory publishing business, and
22 at no point in time did the directory publishing business ever turn to United's
23 ratepayers for assistance. The only conceivable way that ratepayers could ever

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1 incur risk is in the purely hypothetical situation where the directory publishing
2 activities were a part of United's rate base, and Sprint filed a rate case to recover
3 some (hypothetical) loss. Neither of these conditions ever occurred.
4
5 **Q. But surely the potential for a loss on the asset – in this case, the directory**
6 **publishing business – existed. Doesn't that account for some level of risk on**
7 **the part of ratepayers?**
8 A. If one were to rely on that argument, which the court in *Democratic Central*
9 clearly did not, then the appropriate question becomes one of relative risk. And as
10 I stated above, with regard to the potential for loss, the relative risk is much
11 greater for the shareholder than for any United ratepayer.
12
13 **Q. Please explain in detail why the relative risk that shareholders incur in this**
14 **instance is so much higher than the risk incurred by ratepayers.**
15 A. It is a generally accepted economic fact that the stock market (and the capital
16 market in general) is among the most "efficient and complete" markets that exist
17 today. In economic terms, a market that is "efficient and complete" is one in
18 which information is readily available, and in which information generally flows
19 without barriers, and one in which participants can use contingencies to prepare
20 for possible outcomes. In a complete and efficient market buyers can always find
21 a seller and sellers can always find a buyer. When markets are "efficient and
22 complete" it is a fact that the prices in those markets accurately reflect the
23 information that is known about the good or service being sold. That is why the

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1 price of a stock is generally considered to reflect the expected flows of net
2 revenues that result from owning that stock. If that flow of net revenues is
3 enhanced, because of a gain, the stock price reflects that gain. But if the flow of
4 net revenues is reduced, because of a loss, the stock price reflects that loss. With
5 regard to the issue at hand, the potential for loss, the reason why shareholders
6 incur so much risk is that losses are accurately reflected in the stock price. So
7 shareholders are directly affected by losses if ever (or whenever) they occur, in
8 every case. That is why, in this instance, the probability that a shareholder will
9 be affected by a loss is virtually 100 percent.
10
11 In contrast, the only time ratepayers could possibly be affected by a potential loss
12 on this asset is if a very unique set of circumstances fell into place. To see why
13 this is so, recall that the "benefit" that United's ratepayers enjoyed from the
14 directory publishing business was paying below-cost rates for local service, rates
15 that were cross-subsidized by revenues from the directory business. (From an
16 economic standpoint it is highly debatable whether customers actually benefit
17 from cross-subsidies in an increasingly competitive market, but that is a separate
18 issue.) The only way that ratepayers could ever be affected by a potential loss on
19 this directory asset would be if the rates they paid for basic service were somehow
20 affected by the loss. Because the directory publishing business is not a part of
21 United's rate base, that has never happened. But for that to ever happen, a set of
22 four events would all have to take place (all assuming that somehow the directory
23 publishing business became part of United's rate base):

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1) The loss would need to be sufficiently large to put United's overall return below a level allowed by this Commission; then…
2) United would have to make a conscious decision to seek relief on the loss from this Commission; then…
3) The Commission would have to grant United's request for relief; then…
4) The relief would have to take the form of an adjustment to United's basic rates.

If any of these events did not occur – if the loss did not lower the overall return sufficiently, if United did not seek relief, if the Commission did not grant it – ratepayers would not be affected by the loss on the asset. Any loss would fall totally on the shareholders. That is why the relative risk to shareholders is so much higher than the relative risk to ratepayers; shareholders are affected by a loss in every case, but ratepayers would only be affected by a loss if a complex set of conditions are met in a hypothetical situation.

Q. What about the second principle contained in *Democratic Central*, the party that bears the financial burden of the asset is the party that should reap the gains?

A. An application of this second principle, consistent with the arguments in *Democratic Central*, provides even less support for allocation of the gain to ratepayers.

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1 Dollars that ratepayers pay for local service did not (and do not) support the
2 directory business in Washington. In fact, dollars that ratepayers pay for local
3 service in Washington do not even support the provision of basic local service.
4 Basic local service is subsidized by, among other things, the directory publishing
5 business. It is economically (and logically) impossible for the dollars that come
6 from ratepayers to "support" another service when they do not even fully support
7 (cover the cost of) the service they are purchasing. If anything, it is more
8 accurate to say that the purchasers of directory services bore the financial burden
9 of United's local telephone operations.
10

11 **Q. How is the issue of financial burden addressed in *Democratic Central*?**
12 A. Exactly as I have presented it above: Do the dollars that come out of ratepayers
13 pockets support the other activity in question. In the case of *Democratic Central*
14 because it was a transportation company the ratepayers were "fare-payers" and
15 the "other activity" was a conversion from streetcars to buses. In that case the
16 court found that ratepayers (or fare payers) did incur the financial burden of the
17 other activity. However, this finding was based on numerous examples of dollars
18 paid by ratepayers (fare payers) actually being used to finance the other activity in
19 question. For example, the court in *Democratic Central* stated that, "And, lest we
20 forget, the financial burden of the conversion was, in its entirety, placed upon
21 those who rode the Transit's vehicles." The opinion also discusses advantages
22 secured "at the expense of the traveling public" through fare increases.
23

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1 Simply put, in the case of *Democratic Central*, ratepayers (or fare payers)
2 incurred the financial burden because dollars that came out of their pockets for the
3 purchase of transportation services were used by the company to finance another
4 activity, the conversion. Applying that same criteria to the case here, if it could
5 be demonstrated that dollars that came out of the pockets of ratepayers were used
6 to finance the activities of directory publishing there would be support for a
7 finding that ratepayers incurred a financial burden. But that cannot be
8 demonstrated, and in fact the opposite is true: Dollars that came out of the
9 pockets of directory customers (purchasers of ads) were used to finance basic
10 local service.
11
12 **Q. Is there any economic or legal basis on which allocation of 100% of the gain**
13 **on the sale of Sprint Corporation's directory publishing business should be**
14 **allocated to ratepayers as advocated by Ms. Strain and Mr. Brosch?**
15 A. Based on both the economics of property rights and the principles laid out in
16 *Democratic Central*, Commission Staff and Public Counsel's proposals to exclude
17 shareholders completely are totally without foundation. Although Ms. Strain and
18 Mr. Brosch both discuss what they believe to be a linkage between directories and
19 local service, neither suggests that ratepayers incurred any risk associated with the
20 directory business, nor do they suggest that ratepayers bore any financial burden
21 associated with the directory business. Rather, they appear to suggest that the
22 mere existence of a relationship between the two is sufficient reason to allocate

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1 100% of the gains to ratepayers. Their position that ratepayers are the source of
2 value of the directory business is fundamentally flawed.
3
4 **Q. Given that ratepayers bore no financial burden and no risk, what is the**
5 **proper allocation of gains from sale in this instance?**
6 A. The correct allocation between ratepayers and shareholders depends on whether
7 we look at actual risk and actual financial burden, or whether we consider the
8 concept of "potential" risk, which the court in *Democratic Central* clearly did not.
9 If we set aside the possibility of "potential" risk, and rely on the principle of
10 actual risk or financial burden, the facts in this case clearly demonstrate that
11 ratepayers did not bear any actual risk or financial burden associated with the
12 directory publishing business. Accordingly, there should be no allocation
13 between ratepayers and shareholders and the gains from sale should fall to
14 shareholders. If, however, this Commission accepts the concept of "potential"
15 risk, the risk is still virtually non-existent. Any potential risk requires a
16 hypothetical situation – Sprint Corporation's directory business being a part of
17 United's rate base – and a complex set of circumstances falling into place:
18 incurring a loss, the loss large enough to lower United's return below its allowed
19 return, United seeking relief in a rate case, the Commission granting the relief,
20 and the relief taking the form of higher local rates.
21

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1 **Q. Is there any economic justification for the Commission taking actions in this**
2 **proceeding which could result in future ratemaking treatment of a portion of**
3 **the gain realized from the stock transaction?**
4 A. No. If the decision regarding gains from sale is based on the criteria that any
5 gains should go to the party that incurred risk or incurred financial burden – then
6 there is no economic justification for ratepayers to share in the gains from the
7 sale. Ratepayers in Washington incurred no risk and bore no financial burden
8 with regard to Sprint's directory publishing activities.
9
10 **Q. Does this conclude your testimony?**
11 A. Yes, it does.

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