

**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
RICHARD G. PFEIFER
ON BEHALF OF
SPRINT NEXTEL CORPORATION**

JANUARY 6, 2006

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

[REDACTED VERSION]

1 **I. Introduction**

2 **Q. Please state your name, occupation, and business address.**

3 A. My name is Richard G. Pfeifer and my business address is 330 South Valley View
4 Boulevard, Las Vegas, Nevada 89107.

5 **Q. Did you file direct testimony previously in this proceeding?**

6 A. Yes, I filed direct testimony with the Washington Utilities and Transportation
7 Commission (the “Commission”) in this docket on August 26, 2005 on behalf of Sprint
8 Nextel Corporation (“Sprint”) and the Washington operations of United Telephone
9 Company of the Northwest (“United” or the “Company”).

10 **Q. What is the purpose of your rebuttal testimony?**

11 A. I am presenting rebuttal testimony to respond to and rebut the direct testimony of Michael
12 L. Brosch and Paula M. Strain regarding directory matters, Michael L. Brosch regarding
13 his proposed conditions relating to certain operating expenses, Stephen G. Hill regarding
14 statements on cost of debt, Betty A. Erdahl and Michael L. Brosch relating to Transition
15 Services Agreements (TSAs), and Betty A. Erdahl relating to Commercial Services
16 Agreements (CSAs) and intrastate rate of return.

17
18 **Q. Are you sponsoring any exhibits to your rebuttal testimony?**

19 A. Yes, I am sponsoring Exhibits RGP-10C, RGP-11HC and RGP-12C, which were
20 prepared by me or under my supervision.

1 **II. Response to Testimony of Michael L. Brosch and Paula M. Strain regarding**
2 **Directory Matters**

3
4 **Q. Staff witness Strain and Public Counsel witness Brosch propose to tie one-time**
5 **directory payments and an ongoing directory revenue imputation to the approval of**
6 **this transfer of control. How do you respond in general?**

7 A. These are two unrelated subject matters and there is no justification to address any one-
8 time payments or a directory revenue imputation at this time. The stock purchase of
9 Sprint Corporation’s directory publishing business has been known to Staff and Public
10 Counsel since 2002 and was completed in January 2003, nearly three years ago. Neither
11 Staff nor Public Counsel filed any petition requesting that the Commission review the
12 stock transaction at that time or at any time since then. Nor did the Commission open a
13 docket to review the matter. The transfer of control in this docket does not give rise to
14 any change in facts or circumstances relating to the directory transaction, rates or the
15 existing revenue imputation. United will continue to fulfill its tariff obligations to
16 provide directories as it has done in the past and as it is currently doing. In addition, the
17 existing directory imputation will remain in United’s rates subject only to a change as
18 authorized through a rate case proceeding.

19
20 As I discuss in my testimony, this matter can be properly addressed *only* in a rate case
21 setting. In future rate cases, the parties will have more than sufficient information to
22 make informed recommendations relating to directory revenue imputations. The fact that
23 Sprint will no longer be an affiliate of United does not change the regulatory obligations

1 of United, the regulated entity in the state of Washington. The parties will have more
2 than ample ability to present their recommendations for ratemaking adjustments,
3 including an ongoing revenue imputation, when the time is right to do so.

4
5 **Q. Please turn first to the testimony of Mr. Brosch on behalf of Public Counsel. He is**
6 **critical of United (and presumably the Commission) for not having an application**
7 **or docketed review of the directory stock purchase transaction at the time of the**
8 **transaction in 2003 and for not addressing a long-term directory revenue**
9 **imputation in this proceeding. Does his criticism have any basis?**

10 A. No, his criticism is unfounded. Clearly, if there were such a need, the Commission's
11 Staff and the Commission itself would have ensured that such a proceeding take place. In
12 addition, matters involving the ratemaking treatment of directory revenues can be
13 properly considered only in the context of a rate case. This proceeding is not the
14 appropriate place to review ratemaking matters.

15
16 **Q. Mr. Brosch suggests there is immediate need to make a determination regarding a**
17 **one-time payment and future revenue imputations, as a condition to the**
18 **Commission's approval of the transfer of control. Is there such a need?**

19 A. No. Mr. Brosch is proposing to award 100% of the gain allocable to Washington local
20 telephone operations to ratepayers in the form of a one-time revenue credit of [REDACTED]**
21 at the close of the separation and a directory revenue imputation, through the year 2018,
22 as a condition to Commission approval of this docket. He seems to be arguing that the
23 Commission needs to act *now* because once United becomes permanently separated from

1 Sprint, the Commission will “lose” the ability in future rate cases to determine a gain
2 amount and “replace” directory imputation amounts previously ordered by the
3 Commission.

4 This is simply not the case. The Company has been forthright in providing information
5 that would give Staff and Public Counsel the ability to formulate a position regarding any
6 allocable gain to the local telephone operations in Washington, and associated ratemaking
7 treatment, in any future rate proceeding. Thus, the parties already have the information
8 they need to make well informed recommendations during United’s next rate case. The
9 Company will continue to be cooperative in making information available. There is no
10 rational relationship between this transfer of control proceeding and the stock purchase
11 transaction and no pressing reason for the Commission to establish an amount of gain and
12 ratemaking treatment relating to the directory transaction.

13 **Q. Does your above testimony apply equally to the proposal of Ms. Strain, on behalf of**
14 **Staff?**

15 A. Yes. She proposes to award 100% of the gain allocable to Washington local telephone
16 operations to ratepayers in the form of [REDACTED]** at close of the separation plus an
17 amortization of [REDACTED]**, as a condition to Commission approval of this docket.
18 There is no justification or basis for addressing her proposal or the 2003 directory stock
19 purchase within the context of this proceeding.

1 **Q. Please explain further why there is no basis for the Commission to consider these**
2 **matters now.**

3 A. Rates are not changing as a result of this proceeding. United’s current rates are based
4 upon a revenue requirement developed in its last earnings review and rate restructuring
5 proceeding, in 1989, which includes a subsidy of approximately [REDACTED]** in “imputed
6 revenues.” (Refer to the testimony of Nancy L. Judy for a discussion of the history of
7 this imputation.) Mr. Brosch and Ms. Strain do not contest this number as evidenced by
8 their testimony and exhibits. This imputation will remain embedded in rates through the
9 time of United’s next rate case. Thus, there will be no “loss” of a directory imputation as
10 a result of the separation, or a need to “replace” it, as Mr. Brosch suggests.

11 Given the fact there is no immediate need to take action, there is too much potential for
12 harm and unfairness to justify making premature decisions of such great potential impact
13 to the Company.

14 **Q. What types of harm and unfairness could result?**

15 A. As I mentioned before, the set determination of a revenue subsidy, especially at the
16 significant level proposed here, could have an enormous financial impact on United. The
17 current imputation is not based on a real stream of revenues—nor would any one-time
18 payment or continuing imputation be based on a real amortization of gain on sale from
19 the stock purchase. United has not received, and will not receive in the future, any funds
20 to offset a directory subsidy. Thus, the Company would absorb any resulting loss in
21 earnings. In this regard, the overall testimony of both Staff and Public Counsel is
22 contradictory. On the one hand, they express concerns about the financial viability of

1 LTD Holding Company as a standalone entity and, on the other, they propose to continue
2 saddling United with a long term subsidy which the Company will never be able to
3 recover. As stated by Nancy Judy in her rebuttal testimony, a revenue loss resulting
4 from an imputation of the magnitude proposed by these parties will further erode
5 earnings that are already below a fair rate of return. To illustrate the magnitude of the
6 impact, an imputation which results in an immediate and permanent reduction in
7 revenues of [REDACTED]** annually, as suggested by Staff, would have reduced
8 intrastate adjusted rate of return from [REDACTED]* to a return as low as [REDACTED]* using
9 September 30, 2005 information per the Washington “Separated Operating Report.”
10 Refer to Exhibit RGP-10C attached to my testimony for an illustration of this calculation.

11 Based on the potential for adverse impact, it is inconceivable that the Commission would
12 make decisions of this magnitude without a very thorough review of the financial
13 position of the utility, the environment in which it is operating, the competitive landscape
14 and any changes in federal or state law and regulations, among other things. There are
15 too many areas in which the Commission would be required to second guess future
16 circumstances that it cannot possibly predict today and too much potential of locking in a
17 mechanism that could result in harming United financially in the future.

18 **Q. You referred to other problems that might result from making a decision of this**
19 **nature and magnitude outside of rate case proceedings. Please explain.**

20 A. As I understand, under Washington regulations, a determination of revenue requirement
21 is based on a full review of a utility’s financial results of operations as reflected by an
22 historic annual test year for which data is recently available, in the context of a rate case.

1 A review of one issue affecting revenue requirement in isolation and a decision on how
2 that issue will be treated in the context of a future rate case, without the benefit of all of
3 the then current facts and circumstances to consider, does not fit within this model.

4 These matters can be properly considered only in a rate case proceeding. Moreover, at
5 the time of a rate case, the Commission will have all of the relevant information
6 regarding United's financial condition, the status of competition and federal regulation,
7 and the level of regulation applicable to United, among many other factors.

8 **Q. Are there any other reasons why a rate case is the right setting to make definitive**
9 **rulings regarding these matters, and this case is not?**

10 A. Yes. Any amortization of gain, if determined appropriate, would involve a review and
11 establishment of an appropriate discount rate (equivalent to a utility's cost of capital) and
12 an amortization period. Cost of capital is one of the most complex and time-consuming
13 aspects of rate regulation. Yet Public Counsel and Staff ask the Commission to
14 determine a cost of capital for United in the form of a discount factor to be applied for
15 10-plus years to ratepayer share of gain in order to arrive at an annual revenue credit. It
16 is infeasible to come up with an appropriate discount rate outside of a cost of capital
17 proceeding.

18 Clearly there is no basis or ability, within the context of this case, to hold a rate
19 proceeding where a cost of capital is determined. Short cuts will not suffice to take the
20 place of a proper analysis of such an important and serious matter at the proper time.

21 Witness Brosch arbitrarily utilizes an [REDACTED]** discount rate by taking rates of return
22 established for Verizon and Puget Sound Energy "as a guide." Staff witness Strain uses a

1 factor of [REDACTED]**, which she borrows from Houlihan Lokey's weighted cost of capital
2 calculation. To her credit she utilizes information relating to LTD Holding Company
3 instead of two unrelated utilities, but her analysis is still inadequate to predict United's
4 cost of capital at the time of any future rate change. In fact, no amount of analysis at this
5 point in time can act as a proxy for a discount factor that would be appropriate to use at
6 the time of a future rate case. Current information is needed at the time rates are
7 changing and a much more detailed information and analysis than any party has provided
8 here.

9 Similarly, establishing an amortization period would require a review of market and other
10 factors existing at the time rates are changing. For example, the change in access lines
11 over time would be relevant information, both in the business and residential markets.
12 The Commission surely would be interested in knowing the effects of an imputation at
13 the time rates are changing—and understand the magnitude of a per-access line subsidy
14 and what result that could have on customer service prices. This would have an impact
15 not only on United but also presumably on carriers that are competing against the
16 Company for customers. Only in a rate case setting, would the Commission have the
17 applicable facts to make a reasoned evaluation.

18 **Q. Aside from the issue of an ongoing revenue imputation, what about Staff's proposal**
19 **that United be required to make a very substantial payment to ratepayers**
20 **immediately upon close of the separation?**

21 A. Staff proposes that Sprint make an [REDACTED]** up front cash payment to United as a
22 proportionate share of the gain from the directory transaction. This should be rejected.

1 Sprint Corporation sold the stock in its respective directory companies that conducted
2 directory operations in various states, and there was no separate investment or gain
3 calculated for the individual state operations. Thus, no gain was reported on the books of
4 United or any of the local telephone operations of Sprint Corporation. Nor would there
5 have been any gain because Sprint Corporation's local telephone operations, including
6 United, did not have any directory operations. Prior to the stock purchase, United relied
7 upon Sprint Publishing and Advertising to provide the functions associated with the
8 business of publishing a directory including marketing and sale of advertising,
9 compilation, composition, printing and distribution. Thus, United had no directory assets
10 to sell and, as a result, there was no gain attributable to United.

11
12 Additionally, Ms. Strain's proposal to require Sprint to make a cash payment to United of
13 ██████ ** goes well beyond any previous Commission action with regard to treatment of
14 directory proceeds and is patently unfair. While the Commission has a history of
15 requiring specific ratemaking treatment for directory proceeds, such treatment has
16 typically involved imputing certain revenue streams from non-regulated directory
17 operations into local exchange carrier's operating results when setting rates, as discussed
18 in the testimony of United witness Nancy Judy. Ms. Strain's proposal goes well beyond
19 a ratemaking adjustment and suggests that a very significant cash payment be made to
20 United by Sprint. As discussed in the testimony of Nancy Judy, the Commission has not
21 required such payments to be made in the past and has not required the corporate parent
22 that sold the business to transfer cash proceeds to the local telephone company

1 subsidiary. Instead, it has ordered an annual imputation amount consistent with the
2 historical approach for treating directory proceeds.

3 Ms. Strain attempts to justify her position by comparing Sprint's circumstances to those
4 of Qwest but provides no basis for proposing to treat United so much more severely than
5 Qwest. The rationale she gives for such uneven treatment is that, unlike Qwest, Sprint
6 was and is not on the "verge of bankruptcy" and has not been burdened with the
7 consequences of having been acquired by a company that has been "run into the ground"
8 through mismanagement and other transgressions. Ms. Strain's unequal proposal
9 suggests that companies subject to the misfortunes of irresponsible and imprudent
10 management should be treated more favorably than ones that are not. This is illogical
11 and should be rejected. Sprint should not be penalized for having managed its companies
12 well and keeping them financially healthy, as her proposal would suggest.

13 In addition, her proposal to couple an [REDACTED]** payment with an ongoing annual
14 imputation of [REDACTED]** fails to recognize that an annual imputation in the amount
15 of [REDACTED]** is already embedded in rates, even though she acknowledges this fact in
16 another section of her testimony. It is absolutely improper to double up on imputations.
17 Both amounts represent adjustments to United's booked revenues for the same purpose –
18 to artificially replicate profit streams from directory publishing operations. It is
19 misleading to portray her proposed imputation as [REDACTED]** when it is actually
20 [REDACTED]** and it is inappropriate to suggest that
21 one imputation should be stacked upon another.

1 In summary and as I have discussed throughout my testimony, this is a matter suited for
2 determination only in a rate proceeding. Sprint should not be forced to make this
3 unprecedented payment and Ms. Strain's proposal should be rejected.

4 **Q. Do you have any information that refutes Ms. Strain's claim that United would not**
5 **have given away its publishing rights if it had been a stand alone company at the**
6 **time of the directory transaction and not subject to the strategic direction of its**
7 **parent?**

8 A. Yes, there is market information regarding trends in the directory publishing arena that
9 renders her statement without merit. First, however, it is important to note that United
10 has never produced a directory. It has always contracted with another publisher –
11 affiliate or not – to fulfill its regulatory obligation to provide a white pages directory.
12 This regulatory obligation has never been that United is required to produce or publish
13 the directory itself. Thus, United gave away no right that it has exercised with respect to
14 the production of the directory.

15 Further, there is more and more evidence in the marketplace that the directory publication
16 business is diverging from the core local telephone business. Directory publication
17 companies affiliated with local exchange companies have been increasingly recognized
18 as flexible assets that are subject to restructure, sale or spin-off. For example, in addition
19 to Qwest and Sprint, Contel and Cincinnati Bell made decisions to divest themselves of
20 nonessential businesses to give them a better opportunity to focus on local
21 telecommunications and other network-related functions. Also, in a news release issued
22 by Verizon just recently, the company announced that it was reviewing strategic options

1 for spinning off or selling its directory publishing business to sharpen its focus on core
2 network-based businesses in the wireless, broadband and enterprise markets. These
3 decisions are being made for strategic reasons, to enable both local telephone companies
4 and directory companies to pursue their growth opportunities more effectively.

5 Therefore, in today's environment with the focus on maximizing financial flexibility and
6 growth initiatives, Ms. Strain's criticism is unfounded.

7
8 **Q. Please briefly summarize your position on the directory proposals of Staff and**
9 **Public Counsel.**

10 A. For all of the reasons I discussed earlier in my testimony, a decision that has the potential
11 to financially impact the Company in a very significant way can and should be made only
12 in the context of a rate case where the Commission has sufficient current and relevant
13 information upon which to determine a required level of revenues and an appropriate rate
14 design. Any determination of the ratemaking treatment of gain can only be determined
15 through facts, conditions and circumstances that exist near or at the time the rates
16 reflecting the treatment of the gain will take effect. Directory issues are not a part of the
17 transfer of control or relevant to the determination the Commission needs to make in this
18 case. The Commission should reject the positions of these parties and revisit the matter
19 only in the context of a future rate proceeding.

20
21 **III. Response to Testimony of Michael L. Brosch regarding Other Proposed Conditions**

22 **Q. Mr. Brosch states that there is expected to be an increase in expenses on a one-time**
23 **and continuing basis as a result of the separation, and recommends that certain**

1 **conditions be applied to approval of the transfer of control to mitigate the risk of**
2 **what he terms “unreasonable” cost impacts. Do you agree that there will be an**
3 **increase in operating expenses as a result of the separation and, if so, will they be**
4 **unreasonable?**

5 A. There is expected to be some increase in expenses but the expense increases will not
6 result in any significant or unreasonable impacts on ratepayers. First, I will address the
7 one-time costs he mentions. These consist of direct costs such as accounting fees, bank
8 fees, legal fees, document processing fees, filing and rating agency fees, and the like.
9 There will also be some marketing and public relations costs relating to the development
10 and communication of the new corporate brand. United will separately account for these
11 costs and will agree not to seek recovery of any of these “one-time” costs from ratepayers
12 in future rate cases.

13
14 In terms of ongoing expenses, LTD Holding Company may experience an increase
15 initially, but it is expected that these expense increases will not be significant or
16 permanent. LTD Holding Company's centralized management company will provide the
17 necessary administrative, managerial, finance, tax, human resources, legal and
18 operational support services to LTD Holding Company’s local operating companies,
19 including United, much like the Sprint United Management Company (“SUMC”)
20 provides to the Sprint local operating companies today. After the separation, there will
21 be some decrease in scale, but LTD Holding Company will still have significant
22 purchasing power and economies of scale. Thus, the local operating companies will
23 continue to benefit from the efficiencies associated with centralized support services.

1 While an increase in operating expenses is likely to occur during the time of transition
2 from the Sprint management company to the new one, any incremental increases will be
3 minimal and are expected to be reduced or offset through management efforts over time.

4 In fact, United's increase in expenses after the separation is estimated to be only [REDACTED] **
5 of its overall operating expenses for the year 2007 – which represents a ratio of the
6 United portion of expected net expense synergies to total United operating expenses.

7 Mr. Brosch overstates the magnitude of expected expense increases by utilizing the
8 wrong number in the denominator of the ratio. In arriving at his estimate of an [REDACTED]

9 [REDACTED] **, he utilizes only expenses that are allocated from the centralized
10 management company, which is merely a subset of total operating expenses. Thus, he
11 fails to take into account the total level of operating expenses of United, which is
12 necessary to arrive at a more complete picture of any cost impacts. Refer to Exhibit
13 RGP-11HC for an illustration and comparison of Mr. Brosch's calculation with Sprint's
14 more accurate manner of the calculation. As shown in this exhibit, the expected level of
15 operating expense increases is minimal. As I stated above, it is anticipated that these
16 minimal, incremental expense increases will be eliminated over time or offset through
17 reducing other expenses. Sprint management has been very successful in containing and
18 reducing operating expenses in the past, even in the face of an increasing competitive
19 telecommunications environment. There is every reason to believe that LTD Holding
20 Company will continue to achieve similar success after the separation.

1 **Q. In light of your testimony that any increases in operating expenses as a result of the**
2 **separation are likely to be minimal, how do you respond to Mr. Brosch’s proposed**
3 **conditions on pages 44 and 45 of his testimony?**

4 A. He offers three proposed conditions to lessen the impact of what he believes will be
5 unreasonable cost impacts of the separation. As I have shown above, any costs impacts
6 are expected to be insignificant and manageable over time. Therefore, they will not be
7 unreasonable. There is no need to place any conditions to guard against minimal expense
8 increases. Moreover, customer rates will not change as a result of the separation
9 transaction. At the time of any rate proceeding, the Commission will have an ample
10 opportunity to review items of expense, individually and in total. There is no justification
11 for isolating certain items of expense and locking in associated ratemaking adjustments
12 for future rate cases, as Public Counsel proposes. Nonetheless, I will respond to each
13 condition in turn.

14 1. As a first proposed condition, Mr. Brosch would like Sprint and LTD Holding
15 Company to segregate accounts for all separation-related expenditures charged or
16 allocated to United. He further proposes that any rate case using any of the 24 months
17 after the closing as a test year include a detailed monthly accounting of the amounts
18 charged to Washington accounts. This is unnecessary for all of the above reasons.
19 Earlier in my testimony, I committed that United will separately account for the one-time
20 direct costs of the separation and that none of these costs would be passed along to
21 Washington ratepayers in any future rate case. Placing any additional conditions on
22 United is unnecessary. At the time of any rate case, United will be responsible for

1 providing adequate information to support the level of expenses it is requesting to recover
2 to show that proposed rates will be “just and reasonable,” as it would in any rate
3 proceeding. United should be entitled to make its case for a reasonable and ongoing level
4 of centralized costs without artificial constraints. At that time, the parties will be able to
5 review the information and comment on whether they believe United has provided
6 sufficient supporting information and met its burden of demonstrating just and reasonable
7 rates. The Commission then will make a decision based on the evidence. This has been
8 the standard for all cases for a very long time. There is no need to set artificial, onerous
9 and burdensome standards over and above what the Commission’s regulations already
10 mandate.

11 2. Mr. Brosch proposes a second condition that if United files a rate case using any
12 of the 24 months after the closing as a test year, the Company should be required to fund
13 and submit an independent audit report to verify that costs of the separation were
14 accurately segregated and identified. Again, this is unnecessary for all of the above
15 reasons. In addition, an audit report would be extremely expensive, adding significantly
16 to the costs of the rate filing. Further, there is no need to impose this hardship on United.
17 Staff and Public Counsel will not be deprived of any of their existing rights to perform a
18 thorough audit of the costs and dispute the level of costs if they find them excessive. The
19 normal review and audit process will be sufficient to enable the parties to present their
20 positions and the Commission to review the matter at the appropriate time and make a
21 reasoned decision as to the level of expenses, as they do in every other rate case.

1 3. Mr. Brosch's final condition would have the Commission limit allocated charges
2 from centralized management services to an average of such allocated expense amounts
3 charged to United's operations in the years 2004 and 2005, if United files a rate case
4 using any of the 24 months after the closing as a test year. There are far too many
5 variables that could affect the level of allocated expenses, many of which would be
6 unrelated to the separation and extremely difficult if not impossible to isolate. For any
7 number of reasons, allocated expenses might change because of sound business decisions
8 to shift certain functions from centralized management to the local operations or vice
9 versa. The Commission should not make an isolated decision relating to one category of
10 expense that ignores other important expenses that normally would be considered in a
11 rate setting. Similar to the above two proposed conditions, locking in a potential
12 ratemaking adjustment now would wrongly fail to reflect actual circumstances at the time
13 of the rate case. This matter can be reviewed at the time of a rate case in its appropriate
14 context. I appreciate Public Counsel's desire to make its job easier in a future case.
15 However, there is simply no substitute for making determinations that best fit the
16 circumstances, market conditions and the overall needs of the Company at the time rates
17 are changing in order to achieve a proper evaluation of what is "just and reasonable."

18 The above conditions are far too onerous and burdensome to address an issue which is
19 likely to be insignificant or non-existent over time. There will be ample opportunity and
20 information for the parties to make evaluations of the appropriate level of operating
21 expenses at the time of United's next rate case. United should not be deprived of its right
22 to recover a proper and reasonable level of expenses because it is hampered with artificial

1 constraints that do not reflect actual circumstances at the time of a rate case. For all of the
2 above reasons, the Commission should reject all of Mr. Brosch's proposed conditions.

3 **IV. Response to Testimony of Stephen G. Hill on Cost of Debt**

4
5 **Q. On page 9, lines 15 - 23 of his testimony, Mr. Hill, on behalf of Public Counsel, states**
6 **that "the Company expects that its debt cost rate in the future will be substantially**
7 **higher than it has been in the past." Could you please respond to his statement and**
8 **the impact to local operations in Washington?**

9 A. All of the references to capital structure and debt level are references to the new parent
10 company's capital structure, not the capital structure of United. The cost of debt for
11 United is not expected to change at all as a result of the separation. The change in control
12 will not impact United's debt or equity levels, nor will it have an impact on United's
13 ability to generate revenues from its customers or meet its regulatory obligations in
14 Washington, assuming that the Commission does not accept Staff's and Public Counsel's
15 directory proposals.

16
17 To the best of my knowledge, the Washington Commission has historically established
18 rates based on the cost of capital of the local operations, not on the basis of the parent
19 company's capital structure. As a result, changes to the parent's capital structure will
20 have no impact on any of the rates that United charges for services.

21 **V. Response to Testimony of Betty A. Erdahl relating to Transition Services**
22 **Agreements (TSAs) and Commercial Services Agreements (CSAs) and to Testimony**
23 **of Michael L. Brosch on TSAs**

1 **Q. Ms. Erdahl, on behalf of the Commission Staff, and Mr. Brosch, on behalf of Public**
2 **Counsel, provide testimony relating to the TSAs. Before addressing some of the**
3 **concerns with those agreements, would you please discuss the status of local assets**
4 **and shared assets (including how they relate to the TSAs), upon close of the**
5 **separation?**

6 A. Yes. Today, the vast majority of United’s operations are supported by assets and
7 operational capabilities owned and operated by United in Washington state. All of the
8 assets that currently reside with United will remain with the company after separation and
9 on the books of the Company at their current net book value. United also utilizes certain
10 out-of-area “shared” assets that predominantly reside on the books of SUMC. These
11 include systems such as billing and information technology (IT) that are shared among
12 the local telephone operations of Sprint and other Sprint affiliated companies. Upon
13 separation, some of these assets will remain with Sprint and others will be transferred at
14 their current net book value to the LTD Holding Company based on an analysis of
15 several criteria such as the primary use of the asset, the physical location and
16 maintenance of the asset, etc. This method of distribution will ensure that the allocation
17 of assets is reasonable. The distribution of assets at the LTD Holding Company level will
18 be a transparent and seamless occurrence to customers and done in a manner to ensure
19 that current operational capabilities are continued after the separation.

20 The manner in which the shared assets are divided between Sprint and LTD Holding
21 Company will give rise to the need for transitional agreements in some instances,
22 depending on the functional requirements of one company or the other.

1 **Q. Has there been satisfactory progress in the development and documentation of the**
2 **TSA's to provide the Commission with reasonable assurances that LTD Holding**
3 **Company and United will possess operational capability upon separation?**

4 A. Yes. First, let me reiterate that these agreements are simply a means of documenting the
5 use of and payment for the *same* functions that LTD utilizes today to provide centralized
6 services to the local exchange companies of Sprint. As I mentioned before, the vast
7 majority of assets and operational capabilities are already contained within LTD Holding
8 Company and its local operating companies. For the limited number of functions that
9 require transitional use of functions that are currently shared by Sprint and LTD Holding
10 Company (and the local operations), the written TSAs will ensure the continuation of
11 existing capabilities for a long enough period of time to enable LTD Holding Company
12 and Sprint to develop their own capabilities. The transitional services subject to these
13 agreements will be priced at cost (although some of the services are provided at no cost)
14 and are generally expected to be in place for approximately one to two years.

15 Currently, 142 TSAs have been prepared and all but one of the agreements are
16 substantially complete. Eighty-three of the completed agreements involve services and
17 technical support for LTD Holding Company (e.g., IT support, employee payroll, real
18 estate services, long distance billing, wireless customer services, etc.) and fifty-eight
19 involve supporting services for Sprint (e.g., IT support, field support, billing services,
20 warehousing space/logistics, etc.). Sprint and LTD Holding Company began operating
21 under the TSAs as of the first of this year and will continue the process of testing and

1 confirming operational readiness through use of the TSAs prior to actual separation. All
2 141 of the substantially complete TSAs have been provided to Staff and Public Counsel.

3 As the TSAs are operationally implemented prior to the separation, only minimal changes
4 are expected. There may be an occasional need for adjustments to ensure that the
5 companies have the ability to capture data in the manner planned, or it may determined in
6 some instances that a TSA is not needed at all. However, there should be no material
7 changes to the information that has been provided to Staff and Public Counsel. As a
8 result, there is adequate assurance that LTD Holding Company and United will have
9 sufficient operational capabilities at the time of the separation.

10 **Q. Ms. Erdahl criticizes an early termination provision in the TSAs that would require**
11 **LTD Holding Company to pay any un-recovered “start up” costs incurred to**
12 **establish the provision of TSA services, and believes that ratepayers should not bear**
13 **these costs, if they occur. Do you have a response to her concern?**

14 A. Yes. Again, Staff will have the right to raise this issue at the time of United’s next rate
15 case, if any such costs are included in the test year. However, United should also have
16 the opportunity to present information showing that it is reasonable that these costs be
17 recovered through rates. For example, early termination might be a prudent course of
18 action if there are efficiencies to be gained by going to another provider of the service or
19 asset. The Commission will have an opportunity at the time rates are changing to make a
20 reasoned determination based on the evidence. For these reasons, it is not appropriate for
21 any rule or condition to be established at this time.

1 **Q. Turning now to Ms. Erdahl’s testimony on the CSAs, please generally describe their**
 2 **function and status.**

3 A. Below is a chart which summarizes these agreements and some key attributes. There are
 4 a number of inaccuracies in Ms. Erdahl’s description of the commercial agreements and
 5 this chart and my testimony below should clear up any confusion regarding the
 6 functionality of and differences among the contracts.

SIGNIFICANT COMMERCIAL SERVICE AGREEMENTS					
Contract	Parties	Market	Description	Retail Revenue	Impact on United
Long Distance (LD) Resale aka LD Wholesale	SLDI and Sprint	Consumer and Business Switched LD	LD branded as new company. SLDI pays Sprint rate/min. with volume discounts.	Booked to SLDI Price listed. Booked as non-regulated revenue.	United bills access to Sprint. United books regulated access revenue.
Wireless Service Resale (MVNO)	SLDI and Sprint	Consumer and Small Business Wireless	Wireless branded as New Co. SLDI buys airtime from Sprint.	Booked to SLDI as non-regulated revenue.	None.
Business Sales Agency	SLDI and Sprint	Business Wireless and Dedicated LD	SLDI can sell service on behalf of Sprint and collect sales commission.	Booked to Sprint.	None.
Services sold to Sprint	LTD Holding Co. and Sprint	Carrier	Calling Name Database Storage Calling Name Database Query	Booked to United. Non-regulated revenue.	Books non-regulated revenue and expense.

7

1 Three of the CSAs—LD Wholesale, Mobile Virtual Network Operator (MVNO) and
2 Business Sales Agency—are agreements that cover the provision of wholesale or resold
3 wireless and long distance services provided by Sprint to Sprint Long Distance, Inc.
4 (“SLDI”). United is not a party to these agreements but they will enable United and the
5 other local telephone operations of LTD Holding Company to continue to provide a full
6 portfolio of bundled services containing wireless and long distance on a seamless basis to
7 customers. The agreements are market-based, meaning that Sprint does provide these
8 types of arrangements to independent third parties besides SLDI. There is also a CSA that
9 covers services that LTD Holding Company will provide to Sprint including Caller Name
10 Database Storage and Caller Name Database Query.

11
12 **Q. Please further explain the MVNO.**

13 A. The MVNO will allow SLDI to buy wireless minutes from Sprint on a wholesale basis.
14 The Company, in conjunction with SLDI, will be able to offer customers access to a wide
15 array of wireless products and services under this agreement. Sprint is the acknowledged
16 industry leader in MVNO wholesale service arrangements. Sprint currently provides
17 wireless services under MVNO arrangements to [REDACTED]
18 [REDACTED]** An important term included in LTD Holding Company’s
19 MVNO agreement with Sprint is a Most Favored Nation (MFN) provision which ensures
20 that SLDI receives the lowest price available from Sprint.

1 **Q. Ms. Erdahl seems to have some concerns about the benefits of the CSAs, including**
2 **the MVNO. Could you please speak to the benefits of this agreement?**

3 A. Ms. Erdahl expresses concern regarding charges in the MVNO agreement upon any early
4 termination by SLDI and wants ratepayers to be insulated from costs that might affect
5 rates. The MVNO, however, does not include any provision relating to early termination
6 charges. More fundamentally, the agreement is between Sprint and SLDI, and United
7 and its ratepayers are not subject to any of the rates, terms or conditions in these
8 agreements. Finally, it should be noted that the services subject to this CSA are non-
9 regulated services. Any termination or other charges subject to those agreements would
10 be charged to non-regulated affiliates or non-regulated accounts and would not be passed
11 along to regulated ratepayers. Thus, there is no basis for her concerns.

12
13 She also is mistaken that SLDI is “required” to resell the wireless services to its
14 customers under the MVNO agreement. While there are many benefits of utilizing this
15 agreement to its fullest extent, as I discuss below, there is no requirement that SLDI,
16 much less United, is obligated to do so.

17
18 Contrary to Ms. Erdahl’s unsupported claims, there are a number of benefits to LTD
19 Holding Company and United that will result from the implementation of the MVNO.
20 First, as I already stated, this agreement will enable LTD Holding Company and its
21 affiliated local exchange companies, in conjunction with SLDI, to offer wireless products
22 as part of its full portfolio of services to customers. As a result, the Company will begin
23 to gain share of the lucrative wireless market by offering packages for both residential

1 and business customers that will be competitive with, if not better than, other major
2 wireless competitors' offerings. It will enable United to offer bundled packages of
3 services that would integrate the functionality of its wireless products with voice services
4 in a unique way. It will give United the ability to match these new offerings with its
5 customers' preferences and develop very competitive bundled and integrated products
6 and service offerings, under the Company's own brand. This is a positive benefit for the
7 Company, but even more so for its customers.

8 For all of these reasons, the MVNO arrangement with SLDI reflects a true market
9 transaction which other major companies with significant bargaining power have found
10 to be advantageous. Under these circumstances, it would be difficult to conclude that
11 such an arrangement would not be fair, reasonable and beneficial for LTD Holding
12 Company, as well as its local telephone operations and their customers.

13 **Q. What about the Long Distance Wholesale Agreement? Does that agreement contain**
14 **similar benefits to the MVNO?**

15 A. Yes, it does. This is an agreement under which SLDI can purchase long distance voice
16 and data products from Sprint. This agreement is also market based in nature and
17 contains a similar MFN provision. It therefore provides all of the same types of benefits
18 as the MVNO.

19 For the long distance commercial agreement, every effort was made to ensure a seamless
20 transition for the customer. Approximately [REDACTED]** customers within the serving
21 territory of LTD Holding Company's ILECs (including approximately [REDACTED]** in
22 United's Washington service territory) purchase a bundle of local and long distance

1 service today. It is vital that consistency for those customers in terms of their long
2 distance and local service availability, pricing, ordering, provisioning, billing, and
3 customer service offerings be maintained. This need for a seamless customer experience
4 was a primary driver in the overall decision to execute wholesale agreements for the
5 purchase of long distance services from Sprint.

6 There is a significant additional benefit associated with this arrangement. Upon the
7 separation, the existing residential long distance customers of Sprint Communications
8 Company L.P. in United's service area and existing business long distance customers of
9 Sprint Communications Company L.P. whose corporate headquarters are located in
10 United's service area will be given the opportunity to continue purchasing long distance
11 services under the same "one stop shop" terms and conditions they enjoy today. These
12 customers, upon the proper noticing, will become the customers of United's affiliate,
13 LTD Long Distance. As stated in my direct testimony and shown in Exhibit RGP-5HC,
14 this arrangement will also result in a substantial financial contribution to LTD Holding
15 Company of [REDACTED]** in annual net income from long distance products, thereby
16 adding to the overall financial health and viability of LTD Holding Company upon
17 separation.

18 **Q. Does Ms. Erdahl accurately portray the nature of this agreement?**

19 A. No, on page 12 of her testimony she states that the agreement covers business long
20 distance customers that will not be transferred to LTD Holding Company. She also states
21 that LTD will not "own" the customer. These are inaccurate statements. As I mention
22 above, under this arrangement, subscribers to the long distance services will become

1 customers of SLDI unless they choose another carrier. This applies equally to business
2 customers whose corporate headquarters are located in United's service area.

3 **Q. What about Ms. Erdahl's concern that ratepayers could pay higher rates if LTD**
4 **Holding Company experiences higher costs as a result of falling below the minimum**
5 **service commitment level set forth in the agreement?**

6 A. Her concern is too speculative. There is no indication this might happen, and SLDI, as
7 the purchaser of services under the agreement, will have every incentive to meet the
8 minimum service benchmarks. It should be noted that this agreement covers the
9 provision of long distance services. In the unlikely event SLDI falls below the minimum
10 service commitment level, it is questionable whether any such charges would be passed
11 along to SLDI customers given the highly competitive long distance market. Again, her
12 concern is not based on any actual circumstances or indications and, thus, it is unfounded.

13
14 **Q. What about the business sales agency agreement? Should the Commission have any**
15 **concerns about that arrangement?**

16 A. No, this agreement will give SLDI additional flexibility to act as Sprint's sales agent and
17 offer all Sprint wireless and long distance plans and services to business customers in
18 addition to or as an alternative to the MVNO or long distance resale arrangements. As
19 discussed above, this will enhance United's ability to offer a full portfolio of bundled
20 services to its customers, tailored to their local preferences.

21

1 Additionally, the sales agency agreement contains standard business compensation
2 arrangements and an MFN provision. Thus, the sales agency agreement, like the other
3 commercial agreements, is market-based and, similarly, is fair and reasonable.
4

5 **VI. Response to Testimony of Betty A. Erdahl relating to Intrastate Rate of Return**

6
7 **Q. Please respond to Ms. Erdahl's claims that FCC actions have resulted in a distortion**
8 **of interstate and intrastate rates of return for all regulated telephone companies;**
9 **and, as a result, United's reported intrastate rate of return for the year ended**
10 **December 31, 2004 is incorrectly stated.**

11 A. She is not correct. The FCC has taken actions, such as the freeze on the separations
12 factors used to allocate expenses and investment between jurisdictions and the
13 designation of Internet access services as interstate, over which United has no control.
14 The Washington Commission has followed the FCC's rules and has not promulgated any
15 different rules. In reporting its rate of return, United has followed the rules in accordance
16 with existing requirements. While Ms. Erdahl is not asserting that United has not
17 complied with existing separations and other rules, she does say that United's rate of
18 return is wrongly stated. If United is complying with the rules, this cannot be the case.
19 Furthermore, this is not a rate case proceeding. If Ms. Erdahl is suggesting through her
20 testimony that the Commission make an adjustment to United's rate of return, this is not
21 the time and place to make such an adjustment. Earnings, allocations and operating
22 expense levels, among others, are matters that are thoroughly reviewed and considered
23 during a rate case. The Commission will have all of the necessary flexibility to make

1 reasoned adjustments, if necessary and supported, when these matters are properly
2 brought before the Commission.

3 **Q. In Exhibit BAE-3C, Ms. Erdahl utilizes total company results in showing a trend of**
4 **earnings from 1998 through the twelve months ended June 2005. Do you agree with**
5 **the manner in which she portrays United’s financial results and earnings levels**
6 **during that time period?**

7 A. No, I do not. Ms. Erdahl incorporates all of the financial results and profits from
8 interstate operations to calculate rates of return on this exhibit, such that the results on
9 this exhibit are shown on a “total company” basis. This is an improper way of portraying
10 *intrastate* earnings. Her conclusion that United’s rate of return is reasonable presumably
11 is based on her use of interstate financial results, which are producing a much higher rate
12 of return than intrastate results. Washington regulations require the use of intrastate
13 results when reviewing the reasonableness of the earnings levels of regulated utilities and
14 for general ratemaking purposes. Thus, her exhibit which shows a trend in earnings from
15 [REDACTED] * in 1998 to [REDACTED] * in 2004, and [REDACTED] * at the twelve months ended June 2005,
16 completely and significantly overstates the earnings levels of United and cannot be relied
17 upon to draw any conclusions regarding level of United’s earnings and the
18 reasonableness of its rate of return for ratemaking purposes.

19 **Q. Do you have any information that shows the intrastate earnings levels of United**
20 **during the same time period?**

21 A. Yes, I do. Exhibit RGP-12C attached to my testimony shows the rate of return trending
22 from the period 1998 - 2005 on a total company and intrastate basis, using the separations

1 factors approved for use by the FCC and in the state of Washington. This exhibit
2 illustrates that United's earned rate of return for 2004 on an intrastate basis was [REDACTED] *
3 and for the twelve months ended September 30, 2005 was only [REDACTED] *. By any
4 measure, such a low level of earnings could warrant a rate case filing.

5 **Q. Are there any other issues of concern relating to Staff's testimony and rate of**
6 **return?**

7 A. Yes, I am significantly concerned about the even greater depletion in earnings that would
8 result from the implementation of the proposal by Staff to "rebalance" rates in a "revenue
9 neutral" way. Staff proposes to reduce access charges and increase local basic service
10 rates as part of its rate rebalancing. However, Staff also proposes that the imputed annual
11 directory payments should be recognized in the rebalancing process, even though United
12 will be unable to recover these imputed amounts through rates. As such, Staff's proposal
13 to unevenly decrease access rates and increase local service rates results in an immediate
14 and permanent net revenue reduction to United of [REDACTED]** on an annual
15 intrastate basis. Thus, Staff's proposal, which would immediately and permanently
16 reduce United's intrastate annual revenues by [REDACTED]**, would result in a further
17 deterioration of United's already seriously low earnings levels—as low as [REDACTED] * on an
18 intrastate basis, as I testified previously. Consequently, Staff's misnamed "revenue
19 neutral rate balancing" proposal must be rejected.

20 **Q. Does this complete your rebuttal testimony?**

21 A. Yes, it does.