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

SUPPLEMENTAL REBUTTAL TESTIMONY OF

RICHARD G. PFEIFER

ON BEHALF OF
SPRINT NEXTEL CORPORATION

February 6, 2006

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

[HIGHLY CONFIDENTIAL VERSION]

[REDACTED VERSION]

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

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

Q. Did you file direct and rebuttal testimony previously in this proceeding?

A. Yes, I filed direct and rebuttal testimony with the Washington Utilities and Transportation Commission (the "Commission") in this docket on August 26, 2005 and January 6, 2006, respectively, on behalf of Sprint Nextel Corporation ("Sprint") and the Washington operations of United Telephone Company of the Northwest ("United" or the "Company").

Q. What is the purpose of your supplemental rebuttal testimony?

A. I am presenting supplemental rebuttal testimony to respond to the request of the Commission for additional information relating to the stock purchase of Sprint Corporation's directory publishing business by R.H. Donnelley Corporation in January 2003. Specifically, I will explain how Sprint Corporation calculated gain from the stock purchase transaction and discuss the manner in which the Commission should assign a portion of the gain to the telephone operations of United if it decides to do so in these proceedings.

Q. Are you sponsoring any exhibits to your supplemental rebuttal testimony?

A. Yes, I am sponsoring Exhibit RGP-14HC and RGP-15HC, which were prepared by me or under my supervision.

Q. Does your supplemental rebuttal testimony change your positions in any of the previous testimony you submitted in this docket?

A. No. This testimony, together with the supplemental rebuttal testimony of United witnesses Nancy Judy and Brian Staihr, is responsive to the request for further information and recommendations relating to the calculation of gain and other effects of the directory publishing transaction. I am still very concerned about the potential financial impact of any Commission decision to order United to impute revenues or extend consumer credits outside of a rate case for all of the reasons in my rebuttal testimony. As I have stated before, I strongly believe that any decision on the treatment of gain should be made only in the context of a rate case where the Commission has sufficient current and relevant information upon which to determine a required level of revenues, an appropriate cost of capital and a proper rate design. United's ratepayers will be protected until this matter can be properly reviewed in a rate case because the existing directory imputation will remain in United's rates.

Q. Turning to the request for additional information, please explain how Sprint Corporation calculated the gain from the sale of its directory operations.

A. Please refer to the first eight lines of Exhibit RGP-14HC, as well as the supporting "reference" information contained in Exhibit RGP-15HC which consists of certain data responses supplied by United in discovery in this proceeding. Sprint Corporation calculated the gain on the stock purchase of total directory operations by subtracting the investment in directory operations from net sales proceeds. Net sales proceeds of ** ** are derived by taking the stock purchase price of $2.3 billion and subtracting a net working capital adjustment of ** **. This amount was then reduced for selling and administrative expenses in the amount of ** **, to arrive at net sales proceeds of ** **. After subtracting total investment in directory operations of ** ** from net sales proceeds, Sprint Corporation recognized a pre-tax gain of ** ** on its books.

Q. Was a separate book gain determined for Sprint Corporation's directory operations or for the local telephone operations in any of the states in which Sprint has such operations, including Washington?

A. No. The Stock Purchase Agreement reflects a total purchase price for all of Sprint's directory operations. Sprint Corporation sold its stock in the holding companies that conducted directory operations in various states, and there is no separate investment or gain calculated for the individual state directory operations. The agreement does not separately appraise, value or otherwise determine sales proceeds attributable to any particular state for directory operations, or specify a method for doing so. Thus, no gain was reported for or recorded on the books of any of the directory operations of Sprint.

Nor was there any gain reported for or recorded in the books of the local telephone operations of Sprint Corporation, including United. Prior to the stock purchase, United relied upon Sprint Publishing & Advertising, Inc. (SPA) to provide all of the functions associated with directory operations including, but not limited to marketing and sale of advertising, manufacturing, compilation, composition, printing and distribution. United had no directory assets and, thus, there was no "sale" that occurred at that level. As a result of no sale, there was no gain to United.

Q. If the Commission determines that it must make definitive rulings on the assignment and treatment of gain in this docket—even though you disagree with doing so as stated in your rebuttal testimony—what is your recommendation?

A. If the Commission believes it must make a theoretical assignment of the gain from the stock purchase to United, and determine the regulatory treatment of such gain, I recommend that the Commission adopt the following steps and calculation. Please refer to Exhibit RGP-14HC which illustrates this approach, as well as the supporting "reference" information contained in Exhibit RGP-15HC which consists of certain data responses supplied by United in discovery in this proceeding.

1. <u>Identify total pre-tax gain</u>. As I discussed previously, the overall pre-tax gain on the stock purchase of total directory operations, ** **, is shown on line 8 of Exhibit RPG-14HC ("Total Pre-tax Gain."). It is my understanding that Staff and Public Counsel agree with this number.

2. <u>Identify the assignment of the total pre-tax gain to United</u>. Exhibit RGP-14HC shows the "Amount Allocated to Sprint - Washington" on line 13. This number is calculated by applying an allocation percentage of ** **(line 12), which represents the

ratio of the average of Washington 2001 and 2002 directory publishing revenues to the average of 2001 and 2002 directory publishing revenues for total Sprint directory operations. When applied to the Total Pre-Tax Gain amount, it produces an amount of pre-tax gain theoretically assignable to United of ** **. It is my understanding that Staff and Public Counsel agree with this amount.

3. <u>Identify the portion of the assignment of pre-tax gain, if any, which should be shared with ratepayers</u>. There is a lack of justification for sharing any gain with ratepayers, as discussed in the testimony of Dr. Brian Staihr. However, if the Commission disagrees, it should adopt no greater than a "50/50" sharing, consistent with the recommendation of Dr. Staihr. For illustration purposes, the assignment of gain resulting from an equal level of sharing is ** **, as shown on Exhibit RGP-14HC at line 15.

4. <u>Establish a time period and discount factor to amortize ratepayer share of gain in order to arrive at an annual revenue credit.</u> For the reasons I stated in my rebuttal testimony, it is not appropriate to set an amortization period and discount factor outside of a rate case setting. However, if the Commission must do so and decides to utilize a 50% sharing of gain with ratepayers, an amortization period of ten years would represent a fair and reasonable amount of time. It should begin any amortization of ratepayer share of gain as of January 1, 2003 because that was the date on which the transaction closed.

I used a discount factor of ** ** (line 17 of RGP-14HC) which is the percentage of the weighted average cost of capital that Houlihan Lokey utilized in the valuation of LTD Holding Company. As I discussed in my rebuttal testimony, this rate does not reflect a proper analysis of United's cost of capital and, therefore, is inadequate to predict United's cost of capital at the time of any future rate change. However, it is the best information available at this time. Application of a ten-year amortization period and the above discount factor results in an annual revenue imputation in the amount of ** ** for the years 2006 through 2012. The current ** ** annual imputation amount would be left in place during 2003 through 2005. See RGP-14HC on page 2 of 2.

Q. Please explain the use of the two different annual imputation amounts in your schedule.

A. The current embedded imputation amount would remain in place for 2003, 2004 and 2005. This is reasonable because those time periods have already passed and the current imputation amount was in place and absorbed during each of those years. In addition, the Commission is reviewing the directory stock purchase matter coincident with this proceeding. Thus, it is reasonable that any new annual replacement imputation would be incorporated on a going forward basis from the time of the actual separation—2006 through 2012.

Q. Why is your proposed approach—as illustrated in Exhibit RGP-14AHC—a reasonable one?

A. The level of the proposed annual imputation of ** ** is very similar to the amortization currently embedded in rates. Therefore, if substituted for the current imputation in a future rate case, customers would experience a minimal impact. Similarly, the Company would experience a minimal financial impact because it is already absorbing a comparable annual level of imputation. Thus, the proposed imputation amount would be fair to customers and the Company.

Q. United's rates currently include an annual directory revenue imputation of ** **. Should any new annual revenue credit replace this amount or be in addition to this amount?

A. It should replace the current level of imputation. It would be improper to double up on imputation amounts. The fact that any newly developed imputation would be based on gain on the stock purchase transaction, rather than the profits of an ongoing concern, makes no difference. Either amount represents an adjustment to United's booked revenues for the same purpose—to artificially replicate profit streams from directory publishing operations. The current directory imputation is not based on a real stream of revenues—nor would any continuing imputation reflect a real amortization of gain on sale from the stock purchase. In theory, an imputation based on gain from a sale represents the value, or profitability, of the business. The same would be true if the affiliated directory business had continued operations: an ongoing imputation theoretically would be based on the expected profitability of the directory business. Therefore, one is a replacement for the other, not an additive.

Q. Does this complete your supplemental rebuttal testimony?

A. Yes, it does.