**BEFORE THE WASHINGTON**
**UTILITIES AND TRANSPORTATION COMMISSION**

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| In the Matter of the<br><br>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

# DR. BRIAN K. STAIHR

**ON BEHALF OF**
**SPRINT NEXTEL CORPORATION**

**FEBRUARY 6, 2006**

**Q. Please state your name.**

A. My name is Brian K. Staihr.

**Q. Are you the same Brian K. Staihr who filed rebuttal testimony in this proceeding on January 6, 2006?**

A. Yes, I am.

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

A. The purpose of this testimony is to provide the economic rationale behind Sprint's proposal regarding the distribution of gains from the sale of Sprint's directory publishing business. Specifically, if the Commission decides the gains from the directory sale should be shared between shareholders and ratepayers, my testimony addresses what a reasonable allocation should be.

**Q. Does Sprint believe that the gains from the sale should be shared between ratepayers and shareholders?**

A. No. As outlined in detail in my rebuttal testimony, economic principles dictate that the gain from the sale of an asset should go to the party that either incurred risk associated with the asset or bore the financial burden associated with the asset. It is a clear fact that local ratepayers in Washington incurred no risk associated with Sprint's directory publishing business, and they bore no financial burden associated with it either. The shareholders incurred all of the risk and bore all of the financial burden, and thus according to economic principles, the shareholders should receive all of the gain from the sale of Sprint's directory publishing business.

**Q. Despite these economic principles, if the Commission decides that the gains from the sale should be allocated between shareholders and ratepayers, what is a reasonable allocation?**

A. If the Commission declines to follow these economic principles and decides to allocate a portion of the gains from sale to ratepayers, a reasonable allocation would distribute no more than 50% of the gains to ratepayers. Sprint believes that an allocation of no more than 50% comes closest to accurately reflecting the various sources of value associated with the directory publishing business, including the value of the business associated with the United's ILEC status. Under no circumstances should more than 50% of gains be allocated to ratepayers. I discuss the basis for this allocation in detail below.

**Q. What have the other parties in this proceeding advocated regarding the gains from sale of Sprint's directory publishing business?**

A. Both the Commission Staff (see testimony of Ms. Paula Strain, page 10) and Public Counsel (see testimony of Mr. Michael Brosch, page 13) believe that Washington ratepayers are due 100% of the proceeds of the sale, in one form or another. They believe that shareholders should receive nothing.

**Q. Are the positions of Ms. Strain and Mr. Brosch based on the same economic principles that are mentioned above, and addressed in your rebuttal testimony?**

A. No. The economic principles of property rights do not appear to enter into either Ms. Strain's or Mr. Brosch's arguments as to why they believe shareholders should be excluded. Ms. Strain's justification for rewarding ratepayers is found on page 3 (lines 1-2) and page 10 (lines 4-19) of her testimony, and focuses on compensation for lost value. Mr. Brosch also emphasizes compensation for lost value, on page 16 lines 1-2 of his testimony. They also make references to affiliation with the local telephone company as a *source* of value. But neither Mr. Brosch nor Ms. Strain make any showing that United's ratepayers incurred any risk associated with the directory publishing business. Nor do they demonstrate that ratepayers incurred any financial burden pertaining to the business.

**Q. Is compensation for lost value, or serving as a source of value, a reasonable way to determine who has claims to a gain from the sale of an asset?**

A. Not necessarily. Consider a very simple example: If you are selling your house, and your neighbor beautifies his or her yard with new plants and flowers, your neighbor has contributed to the value that you can receive from the sale of your house. Yet I doubt anyone would assume that the neighbor is entitled to a share of the proceeds from the sale, despite the fact that his actions were a source of value. Similarly, if your neighbor trashes his house and yard, he has cost you value because now your house will sell for less; yet I doubt there would be any compensation to you for the lost value.

Nevertheless, because Mr. Brosch and Ms. Strain use this approach, I address the concept of gains from sale using the same value-based approach.

**Q. Setting aside the discussion of whether or not ratepayers are due any share of the gain from sale at all, do either Mr. Brosch or Ms. Strain explain in their testimony why 100% is the correct figure? In other words, do either Mr. Brosch or Ms. Strain explain why they believe ratepayers should receive 100% of the gain from sale rather than 25%, 50%, or 75%?**

A. They attempt to. On page 13 of his testimony, Mr. Brosch writes that "Directory publishing rights arising from ILEC operations represent a regulatory asset for all of the reasons I describe in the next section of my testimony. When this regulatory asset is sold or transferred to a third party buyer, the gain on such sale should be attributed to the ILEC customers, rather than shareholders." For clarification, on page 18 Mr. Brosch defines the "regulatory asset" as "the directory publishing opportunity arising from United Telephone Company of the Northwest's ILEC business." Similarly, on page 13 of her testimony Ms. Strain writes that "the directory operations that were sold to Donnelly appear to be limited to the publication and distribution of local telephone company directories which is related entirely to regulated operations. Therefore it is appropriate to attribute 100% of the gain to ratepayers in this case."

**Q. Do either of these explanations fully justify allocating 100% of the gain from sale of Sprint's directory publishing business to ratepayers?**

A. No, they do not. Obviously there is a relationship between the directory publishing business and the local exchange business. Mr. Brosch describes this as directory publishing "arising from" the LEC business; Ms. Strain simply says directory is "related entirely to" the LEC business. But what neither Mr. Brosch nor Ms. Strain explains is why they believe the mere existence of this relationship is complete justification for excluding shareholders entirely from realizing any gain from sale of the asset that they (the shareholders) own. Such a suggestion completely flies in the face of economic fundamentals: If the owner of an asset is denied the ability to gain from the asset, what exactly is the point of owning the asset?

**Q. Please discuss the nature of the relationship between the ILEC business and the directory business.**

A. The ILEC business is a necessary condition for the directory business, just as the computer business is a necessary condition for the software business. In fact, we can apply Mr. Brosch's and Ms. Strain's exact descriptions of directory/ILEC relationship to both situations: The software business "arises from" the computer business, and is "related entirely to" the computer business. But this does not mean that the software business derives its entire value from the computer business. And similarly, the directory business does not derive its entire value from the local exchange business, despite what Mr. Brosch and Ms. Strain have written in their testimonies.

LECs are obligated to ensure that directories are published. Mr. Brosch and Ms. Strain prefer to characterize that obligation as a "right" or, in Mr. Brosch's case, an "opportunity." But that obligation does not automatically ensure that directories will have value, and the mere obligation (or "right", or "opportunity") does not create the value of the directory business. As stated in my testimony, the value of the directory business is a function of the demand for advertising which produces cash flows. If there is sufficient demand for advertising, and the publishing company can meet that demand in a cost-effective way, the directory will be profitable and the business will be valuable.

**Q. But aren't ILECs in a unique position regarding directory publishing simply because they are ILECs?**

A. Certainly. But simply being in the position of "being an ILEC" with the "right" to publish a directory is not the thing that determines the value of a directory business. If it was, every directory published by an ILEC would have essentially the same value (on a common-denominator basis), since every ILEC is in a "unique position" with the "right" to publish a directory. The value of a directory business is a function of cash flows, and cash flows are affected by many things. For example, Ms. Strain, on page 10 of her testimony, mentions the right to identify the directory as the "official" directory. This right could certainly affect the demand for advertising and, as a result, cash flows. But there is no evidence to suggest that this factor (the attractiveness of advertising in the "official" directory) has a greater impact on demand than any other factor, such as (for example) the impact of long-term relationships established by salespeople who are not ILEC employees and are not related to the ILEC operations.

**Q. But doesn't Mr. Brosch, in his testimony, offer a reference from the Washington State Supreme Court that discusses the relationship between the ILEC business and the profitability?**

A. Yes he does. That reference, found on page 21 of Mr. Brosch's testimony, includes the following interesting statement: "The yellow pages publication business is a lucrative revenue-producing asset which was developed as a result of the Company's (U.S.West) long de facto monopoly dominance of the telephone business in Washington." Although I am not an attorney, an economist's reading of this statement clearly supports the notion of the existence of a relationship. However, it offers no support for the argument that the *only* reason the yellow pages is lucrative is because of the company's situation as a "de facto monopoly." Moreover, Mr. Brosch omits the Court's first reference to how Qwest's "de facto" monopoly affected the development of the directory. And in doing so omits the Court's explicit recognition of the distinguishing fact in the Qwest case; that the Qwest directory was created by *ratepayer* funds. The Court states, "the concern was that the utility not transfer the business an asset created by ratepayer funds…" *US West v. WUTC*, 134 Wn.2d 74, at 96 (1997). This, of course, is completely different from the case at hand: ratepayer funds had nothing to do with the development of Sprint's directory publishing business. As explained in detail in my rebuttal testimony, United's ratepayers bore no financial burden associated with Sprint's directory publishing business. Therefore, while it may be argued that the reference cited by Mr. Brosch supports the concept of imputing revenues or, alternately, imputing gains from a sale, it certainly does not support imputing *all* gains from sale, and completely excluding shareholders from sharing any gains, particularly when ratepayers bore no financial burden.

Mr. Brosch's argument as to why shareholders should be excluded is that directory publishing is a regulatory asset. However, his own definition of regulatory asset describes this as the "opportunity" to publish a directory. Similarly, Ms. Strain refers to it as the "right" to publish a directory. But the important fact is that the value of a directory business is much more than the "opportunity" or "right" to publish a directory; it is also what one *does* with that opportunity. The value of Sprint's directory publishing business included both 1) having the opportunity to publish and 2) everything that Sprint had done to build on that opportunity. The first factor is what Mr. Brosch and Ms. Strain cite as justification for compensating ratepayers. The second factor is the reason that the compensation cannot be 100%.

For Mr. Brosch and Ms. Strain to suggest that ratepayers should receive 100% of the gain from sale means that they believe management, representing shareholders, had no role in driving the value of the directory business; that management decisions played no part in building value; that the efforts of the salespeople selling advertising had no impact on cash flow or value; that the relationships developed by (non-United) Sprint employees over years of doing business with clients added no value. Such suggestions simply ignore reality. The price that Sprint received for its directory publishing business reflected all of these contributions to the value of the directory business. Accordingly, even if one ignores the fact that Sprint's directory was not created with ratepayer funds, the value of the business and the value of the gain is not 100% attributable to ratepayers.

Alternatively, perhaps Mr. Brosch and Ms. Stain believe that all of these contributions—management decisions, the efforts of salespeople, the long-standing relationships—did add value, but they simply deserve no compensation. If so, then we must return to the question I asked above: If the owner of an asset is prevented from realizing a gain on that asset, what exactly is the point of owning it?

**Q. Given that the value of the directory business, and the value of the gain from sale, was a function of many factors beyond the "rights" and "opportunities" discussed by Ms. Strain and Mr. Brosch, what is the proper allocation of the gain from sale between ratepayers and shareholders?**

A. Unless it can be shown, quantitatively, that a particular factor accounted for a particular percentage of the value of the gain, there is no *a priori* reason to believe that ratepayers are entitled to more of the gain than shareholders. Hence, it would be equitable to allocate equally between ratepayers and shareholders. This would suggest an equivalent allocation of 50/50. Certainly neither Mr. Brosch nor Ms. Stain has presented any specific quantification in their respective testimonies. Given this fact, under no circumstances should the Commission allocate more than 50% of the Washington-related gain from sale of Sprint's directory publishing business to ratepayers in Washington.

**Q. Is there evidence to suggest that the Commission should allocate no more than 50% of the value of gain from the sale to ratepayers?**

A. Yes there is. As mentioned above, multiple factors contributed to the value of the directory publishing business. On page 27 of my rebuttal testimony I presented a quote from R.H. Donnelly (which was also included in Mr. Brosch's testimony) which discussed the competitive advantages of being the official provider of directory for the ILEC. Donnelly specifically cites three factors that they believe have value: brand recognition, higher usage, and long-standing relationships with advertisers. Of these three factors, two are clearly not attributable to United's ILEC operations: the Sprint brand, and the long-standing relationship between demanders of advertising and suppliers of advertising.

As discussed in my rebuttal testimony, the Sprint brand was developed years before it was ever associated with the Sprint ILECs such as United. The Sprint brand—including the famous "pin drop" which even now exists in a stylized version in the new Sprint Nextel brand—was developed to reflect the clarity associated with Sprint's long distance fiber optic network. Sprint's ILEC operations played no role in establishing the brand; consequently there is nothing about the Sprint brand that derives its value from Sprint's ILEC operations.

Also as discussed earlier, the long-standing relationships that Donnelly refers to as a source of value were not relationships with United employees. Rather, the relationships existed between Sprint Publishing and Advertising (SPA) employees and various businesses who demanded advertising. It is the efforts of these SPA employees that produced the relationships that Donnelly valued, and these SPA employees were not acting as agents of the incumbent LEC, nor were they negotiating on behalf of the incumbent LEC.

Of the three sources of value specifically referenced by Donnelly, two have nothing to do with Sprint's ILEC operations. In the absence of being able to conduct some sort of quantification which identifies the portion of value that each of these factors—plus any others—accounts for, the Commission should allocate based on the understanding that ratepayers were far from the lone source of value for Sprint's directory publishing business. Therefore, using the "value-based" approach utilized by Mr. Brosch and Ms. Strain in their respective testimonies, we can see that if the Commission insists on allocating gain from the sale of Sprint's directory publishing business between ratepayers and shareholders, the proper allocation is no more than 50% to ratepayers. Under no circumstances should the allocation exceed 50% without an explicit quantification of the factors that created value for the directory publishing business.

**Q. Are you aware of any other situations where the Commission arrived at Sprint's proposed allocation, no more than 50% to ratepayers?**

A. Yes. Although I am not an attorney, I understand from conversations with counsel that in a recent Avista power case, the Commission arrived at an allocation of 50/50 after referring to the same principles I addressed in my rebuttal testimony, those contained in the *Democratic Central* decision.[1]

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

A. Yes, it does.

[1] *In the Matter of the Application of Avista Corp. et al.*, Docket Nos. UE-991255, UE-991262 and UE-991409, Second Supplemental Order (March 2000).