

**BEFORE THE WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION**

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:
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 TESTIMONY
OF
MICHAEL L. BROSCH
ON BEHALF OF PUBLIC COUNSEL**

FEBRUARY 6, 2005

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

2 A. My name is Michael L. Brosch. My business address is 740 Northwest Blue
3 Parkway, Suite 204, Lee's Summit, Missouri 64086.

4 **Q. Are you the same Michael L. Brosch who previously submitted Direct**
5 **Testimony in this Docket on behalf of the Washington Attorney General's**
6 **Office, Public Counsel Section ("Public Counsel")?**

7 A. Yes. My qualifications are set forth in my Direct Testimony that was filed on
8 November 30, 2005.

9 **Q. What is the purpose of your Supplemental Testimony?**

10 A. This testimony is intended to provide additional detail and explanation regarding
11 the basis of my previous testimony regarding the regulatory treatment of directory
12 publishing matters in this Docket, with an emphasis upon how my recommended
13 Washington ratepayer share of the gain on sale and Schedule of Customer Credits,
14 as set forth in my Revised Highly Confidential Exhibit No. ____ (MLB-5HC),
15 were calculated.¹ I understand that the Commission desires additional
16 information on four specific issues:

- 17 • How the ratepayer versus shareholder share of the gain realized by Sprint
18 upon sale of its directory publishing affiliate was determined,
19 • How the Washington State share of the gain realized by Sprint upon sale of its
20 directory publishing affiliate was determined,
21 • How Public Counsel's recommended amortization schedule for future
22 accounting of the Company's regulatory liability for this revenue was
23 determined, and
24 • How the "discount" or "interest" rate employed to translate the gain on sale
25 into a stream of future period benefits was determined.

¹ As described later in this supplemental testimony, I have revised Exhibit No. ____ (MLB-5HC) to reflect Sprint's Supplemental Response to Public Counsel Data Request No. 35.

1 **Q. Were these issues addressed in your Direct Testimony?**

2 A. The first issue was not directly addressed. The other three issues are briefly
3 addressed at pages 30, 31 and 32 of my Direct Testimony. I will respond to the
4 shareholder/ratepayer “sharing” issue at this time, and will also clarify my
5 previous discussion of the Washington allocation, the recommended “Schedule of
6 Customer Credits” and the discount rate issue.

7 **Q. Have you provided an updated version of your Exhibit No. ____ (MLB-5HC)**
8 **to this supplemental testimony?**

9 A. Yes. I have provided a revised version of Exhibit No. ____ (MLB-5HC). The
10 revision is to line 3 “selling and administrative expenses” and is caused by
11 changes set forth in Sprint’s supplemental response to Public Counsel Data
12 Request No. 35. Supplemented PC-35 is included here as Exhibit No. ____ (MLB-
13 7HC). This revision to line 3 results in slight increases to line 12 “Washington
14 Share of Sprint Publishing Gain – Post Tax” and line 14, “Pretax Washington
15 Value for Customer Attribution as of January 3, 2003.” Given the insignificant
16 change in this result, I have not modified the “Schedule of Customer Credits”
17 table at lines 15 through 32.

18 **Q. What information did you use to calculate the gain on sale that Sprint**
19 **realized when it sold the Sprint Publishing and Advertising Publishing**
20 **(“SPA”) business to R.H. Donnelley?**

21 A. I utilized information provided by Sprint in response to Public Counsel Data
22 Request No. 35, which is attached to this supplemental testimony as Exhibit No.
23 ____ (MLB-7HC). This data request asked the Company to provide detailed
24 calculations of the realized pre- and post-tax gain resulting from the SPA sale, as
25 well as Sprint’s calculation of the allocation of the gain on sale to Washington.
26 Data provided by Sprint regarding the overall gain on sale from SPA is shown in

1 lines 1 through 4 of Revised Exhibit No. ____ (MLB-5HC). An allowance for
2 Federal income tax is subtracted at line 5, based upon the statutory Federal
3 corporate tax rate.

4 **Q. Should the gain on sale that Sprint realized when it sold the Sprint**
5 **Advertising and Publishing (“SPA”) business to R.H. Donnelley be “shared”**
6 **between shareholders and ratepayers?**

7 A. No. The entire gain on sale arises from the transfer of the SPA directory
8 publishing business and the long-term future right to serve as the official
9 publisher for Sprint’s incumbent local exchange subsidiaries, including United
10 Telephone Company of the Northwest (“UTNW” or “United”). There is no basis
11 for attributing any of the gain on sale associated with the SPA transaction to
12 shareholders, for all of the reasons set forth in Section IV of my Direct
13 Testimony, where the regulatory asset status of the directory publishing business
14 is described. My Direct Testimony at page 13 stated that “the gain on sale should
15 be attributed to ILEC customers, rather than shareholders” because of the origin
16 of such value and because of the history of regulatory treatment by the
17 Commission, but I did not elaborate upon reasons why shareholders are not
18 entitled to participate in any of the gain.

19 **Q. Have shareholders borne any risks or cost burdens associated with directory**
20 **publishing operations in Washington?**

21 A. No. Through ratemaking imputation adjustments, ratepayers in Washington have
22 borne all of the historical risks and costs associated with United’s involvement in
23 directory publishing in Washington. This is because rate case imputation
24 adjustments were based upon actual achieved earnings and return levels that fully

1 reflected the Washington allocated share of all publishing risks and costs.²
2 Whenever additional costs were incurred to produce directories, or when
3 competition in directory advertising markets served to limit profits achievable by
4 United or its publishing affiliates, the amounts of directory imputation would be
5 negatively impacted. Conversely, whenever United, through its publishing
6 affiliate, was able to increase advertising prices, reduce publishing costs or
7 expand advertising sales volumes, directory imputation calculations would serve
8 to pass the Washington share of improved profits through to ratepayers.

9 Washington regulatory policy requires imputation of directory publishing
10 income based upon the actual earnings and returns of the publishing affiliate. *In*
11 *Re The Petition of U S West Communications, Inc.*, UT-980948, Fourteenth
12 Supplemental Order, ¶¶ 172-173 (July 2000). This policy served to transfer all
13 risks and cost burdens associated with directory publishing to ratepayers.
14 Accordingly, each time a rate case occurred, the imputation calculations were
15 subject to updating to reflect actual revenues, costs and profits associated with
16 directory publishing. The fact that United has not initiated a rate case seeking
17 increased pricing in Washington for many years does not change the fact that a
18 filing could be made at any time by United to update directory imputation
19 calculations to reflect actual figures as well as all other elements of its revenue
20 requirement.

21 **Q. You have explained how ratepayers were exposed, through the imputation**
22 **process, to all of any directory publishing risks and costs while United and its**
23 **affiliates operated the publishing business. Are shareholders entitled to any**
24 **of the gain on sale because they might bear significant risks or financial**

² In Docket No. U-89-3067-SI, such an imputation adjustment was included in determining United's revenue requirements in Washington.

1 **burdens associated with potential declines in the market value of the**
2 **directory publishing business enterprise at the time it was sold?**

3 A. No. Sprint's shareholders were never exposed to any serious risk of losing its
4 investment because the incumbent directory business is not capital intensive and
5 achieves most of its value from its exclusive relationship with the local telephone
6 company, as more fully described in my Direct Testimony.³ Business valuation
7 asset risk relationships can be observed in the confidential "Sale Proceeds for
8 Sprint Publishing & Advertising" amount shown at line 1 of Revised Exhibit
9 No. ____ (MLB-5HC), which translated almost completely into the large "Gain on
10 Sale" at line 4, because of the absence of any significant at-risk investment in the
11 business. In fact, the much smaller amount captioned "Book Investment in Assets
12 Sold" at line 2 illustrates the extremely small amount of capital that was at risk in
13 relation to the market value of the business enterprise.

14 Having considered the very favorable actual outcome in the SPA sale
15 transaction, it should be acknowledged as conceivable that Sprint could have
16 mismanaged its incumbent directory publishing opportunity so seriously that a
17 much smaller gain was achievable upon sale of SPA in 2003. However, even in
18 this hypothetical case, ratepayers would now be exposed to a much smaller gain
19 on sale for regulatory consideration in my Revised Exhibit No. ____ (MLB-5HC),
20 which again passes the risk of economic loss to ratepayers.

21 **Q. How did you determine the Washington share of the SPA gain on sale?**

22 A. The sale of SPA to RHD involved the exchange of the entire publishing business
23 for a single, unitary price. Without a disaggregated purchase price, an allocation
24 is required to apportion the sale proceeds and gain among Washington and the
25 other states in which SPA conducted its business. As noted in my Direct

³ Exhibit No. ____ (MLB-1T) Section IV, pages 16-19 and 22-28.

1 Testimony, Sprint did not maintain any directory publishing profitability data by
2 state or by individual directory that would enable an allocation based upon the
3 SPA-Washington income and cash flow stream that was being monetized.
4 Therefore, relative directory advertising revenue in Washington as a percentage of
5 total SPA publishing revenue was used as a basis for allocation. Revised Exhibit
6 No. ____ (MLB-5HC) shows at lines 7 through 11 that my recommended
7 allocation employs revenue data for two years, 2001 and 2002, that was provided
8 by Sprint in response to Public Counsel Data Requests 18a and 20, so as to
9 smooth out any unusual data in any single year. However, as evidenced by the
10 similarity in percentage results across the two years, the Washington share of SPA
11 revenues is stable. (Sprint's Responses to Public Counsel Data Request Nos. 18a
12 and 20 are attached as Exhibit No. ____ (MLB-9HC) and Exhibit No. ____ (MLB-
13 10C), respectively).

14 **Q. Please describe how you arrived at your recommended "Customer Credit"**
15 **schedule for future accounting of the Company's regulatory liability for this**
16 **revenue in highly confidential Revised Exhibit No. ____ (MLB-5HC) and the**
17 **related amortization schedule.**

18 **A.** On page 31 of my Direct Testimony I discuss my recommendation for distributing
19 the revenues associated with Sprint's gain on directory sale. I will take this
20 opportunity to discuss exactly how I arrived at the "Customer Credit" schedule
21 proposed in lines 15-32 of highly confidential Revised Exhibit No. ____ (MLB-
22 5HC), including my proposal for amortizing distribution of the gain over a period
23 of twelve years. First, since the Company no longer had directory sales revenue
24 to impute beginning in 2003, I assume for accounting purposes that a portion of
25 the gain on sale replaced the imputed revenue stream established in Docket No.
26 U-89-3067-SI on a dollar for dollar basis until 2006. These are the amounts

1 referred to as “embedded imputation.”⁴ Second, I recommend a one-time
2 customer credit per access line totaling \$800,000. A one-time customer bill credit
3 provides an immediate direct and tangible benefit to consumers and could assist
4 the Commission in reaching a finding that the proposed transfer of control is
5 consistent with the public interest, if the other concerns raised by Public Counsel
6 can be adequately addressed. The amount of this proposed credit is proportional
7 to the portion of the Qwest Dex gain on sale of Qwest’s directory business that
8 was agreed to in a multiparty settlement and approved by the Commission in that
9 transaction.

10 **Q. Once the \$800,000 is distributed in a one-time credit per access line, what do**
11 **you recommend should be done with the remaining revenue?**

12 A. I recommend that the remaining amount of revenue credits available from
13 Washington’s share of the gain on sale be distributed for accounting purposes as a
14 “Customer Credit” towards any future revenue requirement established in any rate
15 case prior to the year 2019. In other words, the remaining revenue would be
16 amortized over twelve years. This twelve year period would terminate credits
17 after year 2018, the same time period agreed to in the multiparty settlement in the
18 Qwest Dex sale and approved by the Commission in that transaction.

19 **Q. Why have you proposed a higher amount in the first four years of the**
20 **“Customer Credit”/Amortization schedule than in the later eight years?**

21 A. As discussed on page 32 of my Direct Testimony, the purpose of the high/low
22 structure to the credits is patterned after the Qwest Dex arrangement. Higher
23 credits in the first four years can serve to mitigate any negative cost impacts

⁴ Exhibit No. ____ (MLB-11C) is a copy of Sprint’s response to Staff Data Request No. 12 which shows the embedded imputation amount calculations.

1 associated with the transfer of control by deterring the Company from filing a rate
2 case shortly after the spin-off.

3 **Q. Why is it necessary to employ a discount/interest rate in these calculations?**

4 A. Sprint received the proceeds from the directory sale in a lump sum. Whenever
5 distribution of a lump sum amount of money is deferred to a later date or
6 distributed over future time periods, it is necessary to account for the loss of value
7 or the “time value of money” associated with receiving the money in the future.

8 **Q. What is the basis for the 8.5 percent discount/interest rate you used to**
9 **translate the Washington share of the gain into a stream of imputation and**
10 **customer credits at lines 15 through 32 of Revised Exhibit No. ____ (MLB-**
11 **5HC)?**

12 A. This value was selected based upon two recent utility cost of capital findings
13 approved in Washington, as more fully explained at page 32 and in footnote 36 of
14 my Direct Testimony.

15 **Q. Have you appended as new Exhibits any additional materials supportive of**
16 **your calculations within highly confidential Revised Exhibit No. ____ (MLB-**
17 **5HC)?**

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21 /////

1 A. Yes. Copies of certain non-voluminous Sprint responses to data requests that are
2 relied upon in my Direct Testimony are attached as the following exhibits:
3

Exhibit Number	Data Request	Relevant Topic Addressed
MLB-7HC	Sprint Response to PC DR 35	Calculation of Gain on Sale of SPA
MLB-8HC	Sprint Response to Staff DR 41	Book Investment in Asset Sold (see Attachment Staff DR41a3)
MLB-9HC	Sprint Response to PC DR 18a	SPA Consolidated Net Income Stmt
MLB-10C	Sprint Response to PC DR 20	WA Directory Publishing Revenue
MLB-11C	Sprint Response to Staff 12	Current directory imputation included in UTNW's intrastate WA revenues

4

5 **Q. Does this conclude your Supplemental Testimony?**

6 A. Yes.