Exhibit No. ___T (WS-1T)
Docket No. UT-051291
Witness: Wilford Saunders

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

TESTIMONY

OF

WILFORD SAUNDERS

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

November 30, 2005

Revised February 6, 2006 (ERRATA February 7, 2006)
pursuant to the Commission's Bench Order of January 30, 2006

(Changes shown in legislative format)

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I. INTRODUCTION

Q. Please state your name and business address.

A. My name is Wilford J.H. Saunders Jr.; my address is 1300 South Evergreen Park Drive Southwest, P.O. Box 47250, Olympia, Washington 98504. My business e-mail address is wsaunders@wutc.wa.gov

Q. By whom are you employed and in what capacity?

A. I am employed by the Washington Utilities and Transportation Commission (Commission) as Assistant Director, Telecommunications. My participation in this matter is on behalf of Commission Staff.

Q. What are your professional, education and experience qualifications?

A. I hold a JD from the University of Maine and am admitted to the bar in the states of Maine and Washington. I am a member of the American Bar Association's Section of Administrative, Transport and Communications Law. I also hold an AB in History from Bowdoin College. I have held my current appointment at the Commission since October 1st 2005. Prior to my appointment to the Commission, I was employed in private industry as a regulatory manager at General Dynamics Network Systems and before that at V-SAT Telecom, Inc.

Q. What is the scope of your testimony at this time?

A. My testimony addresses the policy foundation of Staff's position on the proposed transaction, and provides context for the more specific testimony of Ms. Folsom on the financial impact of the proposed separation, of Ms. Erdahl on affiliated interest and service quality, and of Ms. Strain on the directory publishing operations sale~~, and of Mr. Zawislak on rate rebalancing~~.

II. SUMMARY

Q. Please summarize your testimony.

A. Staff has studied the proposed transaction, considered Washington policy principles from legislation and statute to Commission precedent, and concludes that, as proposed, the separation and transfer of control of United Telephone Company of the Northwest from Sprint to the newly-created LTD Holding Company is not in the public interest. In order to protect the public interest, Staff recommends that the Commission should not approve the transaction without additional measures to:

- protect the financial health of the new company,
- ~~rebalance rates,~~
- better allocate proceeds from the substantial gain realized by Sprint in selling its directory publishing business,
- monitor the initial set of proposed contracts between the affiliated entities of Sprint, LTD and United, and
- implement an incentive program to maintain service quality.

III. DISCUSSION

Q. Please identify and describe the parties

A. This case principally concerns and Staff testimony describes the following companies:

Sprint Nextel Corporation

Sprint Nextel Corporation is a publicly-traded Kansas corporation and a global communications company providing wireless, long distance, and local communications services. It came into being upon the merger of

Sprint Corporation and Nextel Communications, Inc. in August of this year.[1] Sprint Nextel Corporation is also known in Staff testimony as "Sprint," and "Sprint-Nextel."

United Telephone Company of the Northwest

United Telephone Company of the Northwest is a registered telecommunications company and the incumbent local exchange carrier (ILEC) for approximately 80,000 Washington customers in a number of service areas, including Poulsbo and Hood Canal, Stevenson, Goldendale and Sunnyside. For a map of United's service areas, please see my Exhibit ___WS1. United is an Oregon corporation with headquarters in Hood River, and a wholly-owned subsidiary of Sprint Nextel Corporation. In Staff and company testimony it is known variously as "United", "UTNW", and "United Telephone"

Sprint Communications Company L.P.

Sprint Communications Company L.P. is Sprint Nextel Corporation's long distance arm for customers in Washington using Sprint™long distance, including customers of United Telephone Company of the Northwest[2]

[1] Application of Sprint Nextel Corporation, pp. 2-3

Sprint Long Distance Inc. / LTD Long Distance

Sprint Long Distance Inc. is a newly-created subsidiary of Sprint Nextel Corporation. Its purpose is to provide resold long-distance services[3] to customers of United Telephone Company of the Northwest as part of the LTD Holding Company structure.[4] Although identified as "Sprint Long Distance Inc." in the Application, it is otherwise universally referred to as "LTD Long Distance".

LTD Holding Company

LTD Holding Company is a newly-created subsidiary of Sprint Nextel Corporation, intended to be the post-spin-off parent for the companies listed in the Application. It is a Delaware corporation with headquarters in Kansas City. In certain company documents LTD Holding Company is referred to as "Spinco" and recently in the press it has been identified as "Embarq"[5]. For convenience, both Staff and the company frequently shorten the name to "LTD."

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[2] Application of Sprint Nextel Corporation, p. 7 ¶ 15.
[3] *See* WUTC docket UT-051259.
[4] Application of Sprint Nextel Corporation, p. 7 ¶ 15.
[5] The company announced on February 1, 2006, that the new company officially will be known as Embarq Corp., and expects to have its shares traded on the New York Stock Exchange under the ticker symbol "EQ."

Sprint's exhibits NLJ-2 and NLJ-3 provide a similar overview of the parties and a graphical overview of the existing and proposed relationships among them.

Q. What is the nature of the proposed transaction?

A. Following its merger with the wireless company Nextel, Sprint wishes to get out of the local exchange telephony business and divest itself of all its local exchange carrier subsidiaries in a spin-off transaction.

Sprint proposes to transfer all of the stock of its wholly-owned subsidiary, United Telephone Company of the Northwest, along with a newly-created long distance resale company (Sprint Long Distance Inc.) to LTD Holding Company, whose shares are or will be distributed among Sprint's shareholders.

Sprint intends that the new company will operate independently, free of the pressures of working in a corporate environment focused on wireless, long-distance and internet. Sprint asserts that when this in fact comes to pass and the company succeeds, there will be significant potential benefits for Washington in the form of robust competition and a uniquely "local" management focus.

As explained in Ms. Folsom's testimony, Sprint Nextel will benefit significantly from the transaction in the form of additional cash from the debt to be issued by LTD.

Q. Does Staff believe that the Commission has jurisdiction to review the proposed transaction?

A. Yes. This case concerns the transfer of control of United, a regulated telecommunications company. Staff feels that there is ample authority in statute and decided precedent in the Scottish Power[6] and GTE-Bell Atlantic[7] line of cases to make the Commission's jurisdiction in this case sure and well-grounded.

Washington law delegates broad authority in charging the Commission to "Regulate in the public interest, … the rates, services, facilities, and practices of all persons engaging within this state in the business of supplying any utility service or commodity to the public for compensation, and related activities; including, but not limited to, telecommunications companies."[8] In order to fulfill the broad scope of its

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[6] *In the Matter of the Application of PacifiCorp and Scottish Power PLC*, WUTC Docket UE-981627.
[7] *In the Matter of the Application of GTE Corporation and Bell Atlantic Corporation for an Order Disclaiming Jurisdiction or, in the Alternative, Approving the GTE Corporation–Bell Atlantic Corporation Merger*, Docket No. UT-981367, Fourth Supplemental Order.
[8] RCW 80.01.040

mandate under law, the Commission can, should and does take a broad rather than narrow view of its authority.

In the GTE-Bell Atlantic merger case the Commission, citing the previous Scottish Power case, concluded that the proposed merger transaction was jurisdictional. It held that the proposed merger in that case resulted in a change of control of GTE's regulated subsidiary and therefore the Disposition clause of RCW 80.12.020 required GTE to obtain approval for the disposition of its properties or facilities necessary and useful in the performance of its duties to the public. Pursuant to WAC 480-143-170, the Commission is required to determine whether "the proposed transaction is not consistent with the public interest," and, if the transaction is not consistent with the public interest, must deny the application.[9] Similarly, the transaction proposed in this case represents a change of control of United, a regulated company, along with all its assets, and must be reviewed under a public interest standard as stated in RCW 80.12.020 and WAC 480-143-170.

Furthermore, the direct testimony of Dr. Mayo for Sprint suggests that this type of transaction is to be frequently expected during periods of change within the industry.[10] For the Commission to conclude that it has no

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[9] *GTE-Bell Atlantic Merger*, Fourth Supplemental Order, at p. 6 ¶ 1.
[10] Direct Testimony of John W. Mayo, pp 4-5

jurisdiction over this matter would be inconsistent with established precedent, and would cut off review of transactions affecting millions of captive utility customers in Washington.

Q. What standard should be applied in determining the public interest?

A. Staff agrees with Sprint's proposal that the Commission should apply the public interest standard announced in the Scottish Power / PacifiCorp case[11], which means that the Commission will not allow the proposed transaction if it harms the interests of the people of Washington.

Q. What principal policy criteria did Staff consider in developing its recommendation?

A. Staff's fundamental policy approach starts from the Commission's mandate to regulate public service companies in the public interest. Within the realm of that mandate, the Commission has promoted competition in telecommunications for some fifteen years, and we considered the potential effect of this case on competition. The Commission reviews affiliated interest transactions involving utilities to prevent unfair use of the utility's

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[11] *In the Matter of the Application of PacifiCorp and Scottish Power*, Docket No. UE-981627, Third Supplemental Order on Prehearing Conference at 2 (Apr. 2, 1999).

captive ratepayer revenues, and Staff considered whether fair use of United's assets and incumbent position will flow from the transaction as proposed. The Commission regulates rates to ensure that they are reasonable and cover costs, and Staff considered the effect of the proposed transaction on future ratemaking for the parties and their customers.

Finally and fundamentally, Staff feels that the public interest of the state of Washington will be best served by a telecommunications sector composed of healthy, well-managed companies that are able to respond to a changing marketplace while continuing to provide reasonably-priced, quality service to Washington residents and businesses. [12]

IV. RECOMMENDATION

Q. Should the Commission approve the separation and transfer of control as proposed in the Application?

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[12] *See* RCW 80.36.300 Policy Declaration: The legislature declares it is the policy of the state to: (1) Preserve affordable universal telecommunications service; (2) Maintain and advance the efficiency and availability of telecommunications service; (3) Ensure that customers pay only reasonable charges for telecommunications service; (4) Ensure that rates for noncompetitive telecommunications services do not subsidize the competitive ventures of regulated telecommunications companies; (5) Promote diversity in the supply of telecommunications services and products in telecommunications markets throughout the state; and (6) Permit flexible regulation of competitive telecommunications companies and services.

A. No. As initially proposed, the spin-off of United would harm the public interest in a number of ways:

1. It would create a weak and over-leveraged parent for the regulated Washington utility with an optimistic and risky financial position, to the detriment of captive local ratepayers. <u>It would deprive United of the benefits of operating as a unit within a more diversified company, thereby increasing the likelihood that United's own outdated and uneconomic business model will lead to financial distress of the regulated company.</u> It would profit Sprint Nextel and burden United and its associated companies with some $7.25 billion in debt. My colleague Ms. Folsom addresses these and other financial aspects of the proposed transaction in her testimony.
2. It would tie the hands of United's future management team by locking it into contracts with Sprint Nextel that were not negotiated at arms' length and that restrict the new company's ability to pursue alternatives to Sprint Nextel services. Ms. Erdahl's testimony addresses the affiliated interest aspects of the transaction as proposed, and separately covers quality of service matters.
3. It fails to adequately allocate to United or the local telephone division the gain realized by Sprint in selling its directory publishing business, which

was conveyed away for a lump sum to a third party with whom United is pledged not to compete.

~~4. It perpetuates an outdated, existing system of retail rates and access charges that threatens the long-term viability of the company's business, discourages competition, and runs contrary to the policy of this state to replace implicit subsidies with explicit support.~~

Q. In Staff's opinion, would it be feasible for the company to modify the transaction so as to avoid harming the public interest?

A. Yes. Staff believes that the company could modify the proposed transaction to implement safeguards that would protect the public interest from harm. Staff has developed and proposes in testimony a set of modifications that we feel could satisfy the public interest standard set forth in the Scottish Power case. We feel that these modifications are feasible for the company.

Q. Sprint has presented testimony suggesting that significant benefit will accrue to Washington ratepayers from increased flexibility and local focus of the spin-off company; does Staff agree?

A. No. Sprint's "local focus" argument is, to say the least, unusual within the telecommunications industry. Incumbent local exchange companies are typically not shedding their diversified lines of business. To the contrary, the typical argument is that companies, especially incumbent local exchange companies, need to diversify to retain their customers' business. Indeed the proposed organizational structure of the LTD group of companies attempts to offer a diversified set of services by reselling the same Sprint services United is offering now.

Even taken in an optimistic light, Sprint's testimony is evidence only of good intent, not necessarily of actual or even probable benefit; nor does it in fact allay Staff's concerns regarding financial health of the spin-off and inflexible contracts with Sprint Nextel as a former affiliate. A local focus and able management team, while admirable, are meaningless if the company wherein they reside lacks the financial wherewithal to raise money and act on its best intentions, or is locked into long-term contracts that punish deviation from the Sprint Nextel group of services and companies.

Q. In your review of the business plan for LTD/United, did you find that it reflects the promised focus on local exchange service?

A. No. LTD plans to offer the wireless and long-distance services that its parent company offers today. Indeed, a key concern for Staff is that LTD's management will actually have less flexibility to change its business model than it has today, because of the long-term contracts that it will have with its previous parent.

Q. In Staff's estimation, would the proposed separation of United and LTD from Sprint Nextel provide tangible benefit to United's customers?

A. No. The separation as proposed benefits Sprint Nextel and provides no actual or tangible benefit to LTD, United, or their customers. It allows Sprint Nextel to exit a line of business that it considers to be unattractive and to do so on financial terms advantageous to Sprint, as described by Ms. Erdahl and Ms. Folsom. Sprint Nextel will leave LTD in a precarious position, with negative shareholder equity on the balance sheet, a restricted and declining scope of business opportunity, and continuing contractual obligations. Even within the core business left to LTD, the transaction leaves the new company with a rate structure that is outmoded, cross-subsidized, and very likely unsustainable. There is no evidence from the applicants that LTD's operating costs will be lower, that its business options will be broader, or that its opportunities to create value for its customers and its shareholders will be greater.

~~V. RATE REBALANCING~~

Q. Is Staff proposing to require that United revise its rate structure as a condition of this transaction?

A. No. Staff has withdrawn this proposal at the direction of the Commission. Staff recognizes that the problems with United's current rate structure can be addressed later. However, it is important for the Commission to understand that the subsidiary that Sprint is seeking to get rid of has a vulnerable business model and scrutinize the transaction accordingly. Granted, this business risk exists today, but it is borne by a more diversified and less leveraged company than the one Sprint proposes to create through this spin-off. The Commission should be concerned that Sprint is proposing to spin off a company that may not have the sustained ability to provide adequate service at reasonable rates.

Q. Please explain why the Staff believes that the Commission ~~must address~~ should consider United's business plan ~~retail rate structure~~ as part of this case.

A. The first question that the Commission must answer before it can approve this transaction is whether the new company will be able to fulfill its responsibilities as a public service company and, specifically, to provide telecommunications services to Washington customers that are fairly priced and reliable. If the new company's business model is unsustainable, then the transaction is not in the public interest. Staff is concerned that this ~~is the case with respect to the company's existing retail rate structure. The company has a pattern of local and exchange access rates that do not come close to matching the cost of providing the specific services in specific locations. This~~ transaction leaves United with significant business risk from regulatory or competitive activities that could take away its higher margin services, such as exchange access service and local exchange service in its larger communities. ~~Just as the Commission would require the new owner to clean up a company that had service quality problems, it should in this case require Sprint to clean up its rate structure before it separates the local business unit.~~

~~Mr. Zawislak's testimony discusses in detail the mechanics of rebalancing Sprint's rate structure.~~

~~As discussed Mr. Zawislak's testimony, United's intrastate originating and terminating access charges are too high; they discourage competition and export parts of Sprint's costs to interexchange carriers and toll callers.~~

~~It is the policy of the state of Washington and the repeated opinion of this Commission that access rates should be fair, just and reasonable. Staff has analyzed Sprint's access charges and found them to be too high based on the nature and current condition of the telecommunications market in Washington. Overly high access charges have been found by the Commission to improperly limit or bar entry of competitive service providers, stifle competition among providers already operating in the region, and improperly allow cross-subsidies within companies.~~

~~Sprint's access charges are also detrimental to the efficient operation of the new company because they are outdated and no longer reflect the realities of the telecommunications market in Washington. Services priced above cost are vulnerable to competition and arbitrage, jeopardizing revenue flows used to maintain low local service rates and thus the stability of the public service utility.[13] In order to promote competition in the public interest, the new company cannot be allowed to operate on the basis of anti-competitive access rates. The new company's access charges will have to be adjusted to assure a healthy competitive environment.~~

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[13] Access Reform (Jim Sichter, Sprint, August 6, 1999 presentation to 41st NARUC annual regulatory studies program)

~~It is the policy of the state of Washington and of the nation as a whole that phone rates be based on costs and that implicit subsidies should, where practicable, be replaced with explicit ones. To this end we have nationwide support for rural utilities, a federal universal service fund, and targeted, named subsidies for programs like E911. Excessive access rates generate implicit subsidies for other areas of the carrier's operations, which is contrary to policy and the precedents of the Commission.~~

~~It is admittedly difficult to face the short-term consequences of this policy when the benefits of denial often accrue to Washington citizens in the form of somewhat lower monthly local exchange phone rates. However, we should remember that we pay for those lower monthly numbers in higher long-distance rates, and in the barrenness of the competitive landscape in many parts of the state.~~

VI. SERVICE QUALITY, CONTRACTS, AND THE DIRECTORY SALE

Q. What has Sprint's service quality record been in recent years?

A. As described in Ms. Erdahl's testimony, Sprint's record for service quality has been good, and absent major reorganization of the company Staff might have little concern about the future. Reorganization, however, is proposed, and Staff feels that without minimal safeguards and incentives such as a missed-appointment credit, service quality is likely to decline.

Q. Please describe the significance for this case of Sprint's sale of its Directory Publishing business.

A. As Ms. Strain describes in her testimony, Sprint sold its interest in its directory publishing arm, SPA, to the R. H. Donnelley Corporation (Donnelley) in 2003, and required its Washington regulated subsidiary, United, to sign long-term non-compete and services contracts with Donnelly. United did not receive any benefit from this transaction. In the simplest terms, United's future business opportunities were sold off and the cash went to Sprint. If United is now separated from Sprint as proposed, the transaction would leave United and LTD weak for the loss of an important business unit and boxed-in by long-term contracts that were never negotiated at arm's length. This weakness would place an increased pressure on rates to make up for the lost directory revenue and deny the ratepayers the relief of a diversified local exchange business.

Q. Is Staff concerned about similar commitments in the present transaction?

A. Yes. As Ms. Erdahl discusses in her testimony, Staff is concerned about several of the Temporary Service Agreements and Commercial Service Agreements proposed to be signed by LTD and United, which drive the new company into purchasing some or all of its mobile, long distance, and database services from Sprint. These contracts between presently affiliated entities were not negotiated at arm's length, and appear to again prospectively limit United's business opportunities for the benefit of Sprint.

Q. Does this conclude your testimony?

A. Yes.