BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

In the Matter of the	)	
	)	DOCKET NO. UT-051291
Request of Sprint Nextel Corporation for an	)	
Order Declining to Assert Jurisdiction Over	)	
or, in the Alternative, Application of Sprint	)	NARRATIVE SUPPORTING
Nextel Corporation for Approval of the	)	SETTLEMENT AGREEMENT
Transfer of Control of United Telephone	)	
Company of the Northwest and Sprint	)	
Long Distance, Inc. From Sprint Nextel	)	
Corporation to LTD Holding Company.	)	

1 Pursuant to 480-07-740(2)(a), Sprint Nextel Corporation ("Sprint Nextel"), United Telephone Company of the Northwest d/b/a Sprint ("United"), and Sprint Long Distance, Inc. ("SLDI") (collectively "Sprint"), Staff of the Washington Utilities and Transportation Commission ("Staff"), and the Public Counsel Section of the Washington Attorney General ("Public Counsel") (collectively "Parties" or individually a "Party") provide this Narrative Supporting Settlement Agreement ("Narrative"). The Narrative summarizes many aspects of the Settlement Agreement between the Parties ("Agreement") but is not intended to modify the Agreement or any of its terms.

Support for Agreement

2 The Agreement is supported by this Narrative, Sprint's Application filed on August 26, 2005, and the prefiled testimony and exhibits that the Parties stipulate to admission into the evidentiary record in this proceeding as modified and listed in Exhibit A to this Narrative.

Scope of the Underlying Dispute

3 The underlying dispute concerns the separation of Sprint's local telephone division operations, including United and SLDI, into a new company. During the course of the proceeding, Sprint filed pleadings and testimony contending that (1) the Commission should decline to assert jurisdiction over the separation because the transaction is occurring only at the parent company level and neither corporate parent operates or will operate as a public service company in Washington; and (2) if the Commission exercises jurisdiction, it should approve the separation without conditions because the transaction causes no harm and thus is consistent with the public interest. *See, e.g.*, Application and Direct Testimony of Nancy L. Judy, Richard G. Pfeifer, Glenn R. Daniel, and John W. Mayo.

4 Staff and Public Counsel filed testimony contesting Sprint's Application and proposing that the Commission either refuse to approve the proposed separation or base any such approval on several conditions. These conditions included distribution to ratepayers of Washington's share of the gain from the 2003 sale of Sprint's directory publishing affiliate, prohibition on United's ability to recover transition and transaction costs from its ratepayers, service quality reporting and remedies, several conditions related to the continued financial health of the local exchange telephone entity, and affiliated interest agreement restrictions. *See, e.g.*, Response Testimony of Wilford

Saunders, Kathleen M. Folsom, Paula M. Strain, and Betty A. Erdahl on behalf of Staff; Testimony of Michael L. Brosch and Steven G. Hill on behalf of Public Counsel.

5 Sprint filed testimony responding to Staff's and Public Counsel's arguments and explaining why, under Sprint's analysis, none of the proposed conditions were warranted and the Commission should approve the separation. *See* Rebuttal Testimony of Nancy L. Judy, Richard G. Pfeifer, Glenn R. Daniel, John W. Mayo, and Brian K. Staihr.

6 The Parties also filed additional testimony on the issue of distribution of the gain from the sale of Sprint's directory publishing affiliate. *See* Supplemental Response Testimony of Nancy L. Judy and Supplemental Response and Reply Testimony of Richard G. Pfeifer and Brian K. Staihr on behalf of Sprint; Supplemental Testimony of Paula M. Strain on behalf of Staff; and Supplemental and Supplemental Response Testimony of Michael L. Brosch on behalf of Public Counsel.

7 As discussed below, the Parties have reached an agreement that resolves (or renders moot) all of the issues in this proceeding. The Agreement does not adopt *all* the conditions proposed by the Parties, but the Parties have agreed to a set of conditions in the spirit of compromise and to facilitate a prompt resolution of this proceeding. The Agreement represents a fair and reasonable resolution of all issues in this docket, and accordingly, the Parties seek Commission approval of the Agreement without material change.

Overview of the Proposed Settlement Agreement

A. Substance of the Settlement Agreement

8 Pursuant to the Agreement, the Commission would approve the separation of Sprint's local telephone division operations, including United and SLDI, into a new company as being in the public interest subject to conditions contained in eight issue areas: (1) directory sale, (2) recovery of separation, branding and transition costs, (3) service guarantee, (4) service quality, (5) customer notice, (6) finance conditions, (7) affiliated interest agreements, and (8) broadband reporting. Please refer to Section E of the Settlement Agreement for the specific terms.

B. Procedure

9 The Parties understand that the Commission has discretion, consistent with applicable law, to establish the appropriate procedures for determining whether the Commission will approve the Agreement. The Commission has proposed, and the Parties have agreed, to conducting a hearing on the Agreement pursuant to WAC 480-07-740(1) on March 6, 2006. The Parties urge the Commission to accept the Agreement as the resolution of all issues in this docket by March 31, 2006.

Statement of Parties' Views

10 This Narrative, as required by WAC 480-07-740(2)(a), includes a "statement of parties' views about why the proposal satisfies both their interests and the public interest." Each Party has contributed the following separate statements:

A. Commission Staff

11 In a proceeding of this nature, the Commission staff as a statutory party is charged to represent the public interest through the fair, complete and professional analysis of all available information that may inform the Commission's decision. Commission staff seeks to promote and develop institutions and mechanisms that provide robust services at fair prices to the public. This means that it endeavors to protect the future as well as the present customers of regulated carriers, and to promote the long-term health of the companies whose hard work has built a communications network of which we can all be proud.

12 United Telephone Company of the Northwest has been a consistently strong, responsive, and responsible company in the Sprint years, and Commission staff fully expects that this tradition will continue under the Embarq banner. United makes up an essential part of Washington's communications network, serving diverse communities in the western and southern parts of the state, including many that present both technical and business challenges to a provider of high-quality, consistent service.

13 As may be seen in the stipulated record, Commission staff's study of the record and of discovery materials led us to conclude that the separation transaction as initially

proposed was flawed in several important respects. Commission staff believes that the transaction failed to adequately recognize the significance to the company of the recent sale of its directory publishing interests. The proposed transaction would leave United's parent with significant debt and potentially weak. Additionally, Commission staff was concerned about the effect of agreements entered into between Sprint and LTD/Embarq prior to spin off and the adherence to rules and practices relating to affiliated interest transactions, guarantees of quality service, and the company's rate structure.

14 Through dialogue with the company and the office of Public Counsel, and in light of the Commission's recent decision to limit the scope of this proceeding, we came to see that with a flexible approach by all parties a settlement could be reached. Such a settlement would adequately address issues raised by ourselves and Public Counsel, and allow the company to return its focus to providing quality telecommunications service. The paragraphs that follow describe why Commission Staff feels the settlement satisfies the public interest.

15 The settlement recognizes the value of the directory sale and preserves the gain on the record for consideration in a future proceeding. Section 1 of the Settlement Agreement contains the parties' agreement on the amount of gain attributable to ratepayers; the treatment of the gain in future rate proceedings; and provides for a one-time credit of $400,000 to today's retail customers. Commission staff agreed to two

elements of this provision – allocation of a portion of the gain to the company and payment of the one-time credit – solely in order to reach a compromise with the other parties. While these elements are contrary to its litigation position, Commission staff believes that the overall result achieved through this compromise is reasonable and should be approved by the Commission.

16 The Settlement Agreement's Section 2 prevents the Company from recovering the costs of separation, rebranding, and transition, including dissynergy costs, from Washington ratepayers. It addresses Commission staff concerns that the transaction will impose additional costs on United's ratepayers.

17 Sections 3 and 4 of the Settlement Agreement, address Commission staff's concern that the new owners provide high-quality service to its customers. The automatic credits for missed installation and repair appointments will both provide the company with a reasonable financial incentive to provide good service and compensate customers when service is inadequate.

18 Section 6 of the Settlement Agreement implements corporate finance commitments by the Company to protect the financial health of the local exchange carrier should the parent company or its affiliates experience financial distress. These commitments include financing restrictions, dividend restrictions, monitoring and reporting for a four-year period. Company actions and reports are triggered either by ratings agencies' evaluations or by internal company financial analysis (6.a.i and 6.a.ii).

The possibility of parent company financial distress is the biggest concern identified by Commission staff in its review of the proposed transaction, and the Section 6 measures address this concern.

19 In Section 7 of the Settlement Agreement, the Company has agreed to follow the Commission's affiliated interest rules with respect to the commercial and transitional agreements negotiated for services to be provided after the separation, to which United is a signing party. This provision requires that, for the duration of these contracts, Sprint Nextel and/or United will submit cost data when its rates are at issue. This provision will assuage Commission staff's concern that the services provided in these agreements will be provided at fair, just and reasonable prices.

20 As reviewed in the preceding paragraphs, the proposed conditions adequately address Commission staff's concerns with the separation transaction and its aftermath. We laud the flexibility of the other parties in assembling the comprehensive set of safeguards, sunsets, and reporting that bind this settlement together in a balanced whole.

21 Commission staff recommends that the Commission approve the proposed transaction with the conditions proposed by the parties in this settlement agreement.

B. Sprint

22 The Agreement satisfies Sprint's interest because it resolves the issues raised in this docket without further delay and avoids a decision (and perhaps protracted

litigation) over the more contentious issues. The Agreement also is in the public interest. Even without conditions, the proposed separation does no harm and produces significant benefits as discussed in Sprint's testimony. The conditions in the Agreement, however, address Staff's and Public Counsel's concerns with the proposed separation, thus removing all sources of doubt that the transaction is in the public interest.

C. Public Counsel

23 Public Counsel's position is that the Commission has jurisdiction over this proposed Separation, including the authority to reject Sprint Nextel's Application if it is not in the public interest. Public Counsel believes that the Application is not in the public interest because it increases customer risks without offering any real countervailing benefits.

24 Specifically, the proposed separation of the local exchange telephone operations from Sprint Nextel substantially increases the debt of those operations and the Application lacks sufficient ring fencing provisions to protect United's financial health in the new stand-alone holding company structure. Instead, the Application proposes a financial structure for United's new parent that would likely result in below investment-grade corporate credit ratings from major national ratings agencies and lead to a significantly higher price for United's cost of capital. A higher cost of capital could

lead to rate increases, and a much larger debt load could restrict the funds available for necessary construction and lead to service quality problems.

25 Additionally, Public Counsel is concerned that United's customers would inadvertently bear transaction or transition costs associated with the separation, including lost efficiencies or "dissynergies." This issue of "dissynergies," which refers to the additional ongoing administrative costs resulting from the separation, is discussed in more detail in the Direct Testimony of Michael L. Brosch, Ex. 34, at pp. 38-42.

26 Finally, the Application fails to account for the gain owed to United's Washington customers arising from the sale of its directory publishing business in 2003. Public Counsel seeks to establish United's regulatory liability in this regard before any transfer of control occurs.

27 The Agreement satisfies Public Counsel's interests because it sets forth sufficient conditions to mitigate many of the potential negative consequences of the separation. First, United will be subject to ring fencing provisions that protect customers' exposure in the case of lower corporate credit ratings for United's parent. United has agreed to hold customer rates harmless from higher capital costs caused by the transaction and has also agreed to limit cash transfers to the parent company from United in the event of financial troubles at the parent level. Second, United has agreed to service quality standards that exceed those required by Commission rules. Third, the Settlement

provides that United will not seek recovery from ratepayers of any separation, re-branding or transition costs in future rate cases and will not be allowed to recover dissynergies arising from the separation. Finally, the Settlement adopts Public Counsel's calculation of the gain on sale and allocation to Washington. It provides for a long-term annual revenue credit, in place of directory imputation, in the amount of $1.451 million per year for 10 years as well as up-front customer bill credits totaling $400,000. Public Counsel believes that the directory publishing provisions of the Settlement should help to bring important long-term stability to United's revenue requirement while creating immediate public interest benefits to customers.

Legal Points that Bear on the Proposed Settlement

28 The Parties do not believe that there are any legal points that require discussion under WAC 480-07-740(2)(a). Sprint stipulates that it does not challenge the jurisdiction of the Commission to approve the Separation of United as agreed in this Settlement Agreement.

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Conclusion

29 The Parties respectfully request that the Commission approve the Agreement.

DATED this ____ day of March, 2006

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Attorney General

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Gregory J. Trautman
Assistant Attorney General
Counsel for WUTC Staff

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SPRINT NEXTEL CORPORATION

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