Exhibit No. ___ HCT (RTA-1HCT)
Docket UT-081393
Witness: Rick Applegate
REDACTED VERSION

BEFORE THE WASHINGTON UTILITIES AND TRANSPORTATION COMMISSION

Verizon Select Services, Inc.; MCImetro Access Transmission Services, LLC; MCI Communications Services, Inc.; Teleconnect Long Distance Services and Systems Co. d/b/a Telecom USA; and TTI National, Inc., **Complainants,** **v.** **United Telephone Co. of the Northwest,** **Respondent.**	**DOCKET UT-081393**

***REVISED* TESTIMONY**

OF

Rick Applegate

STAFF OF
WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION

July 15, 2009

HIGHLY CONFIDENTIAL PER PROTECTIVE ORDER

average balances maintained by the company over the past two years. Accordingly, Staff advocates a total debt percentage of [redacted].

Q. Do you agree that the cost of debt should be [redacted]?

A. No. Staff believes the cost is unreasonable for the following reasons:

1. The value is greater than the proposed cost of equity, which implies that United's creditors would expect higher levels of investment risk than United's owner, Embarq Corp. (Embarq).
2. The value substantially exceeds Embarq's effective interest rate on long-term debt for 2007, which was 7.2 percent. See FORM 10-K, Annual report pursuant to section 13 or 15(d) of the Securities Exchange Act of 1934 for the fiscal year ended December ~~31~~ **13**, 2007, Page 46. It also exceeds the total return provided by the Wall Street Journal on May 20, 2009 for triple-B-rated bonds, which is 7.78 percent. Embarq currently maintains a triple-B rating with Standard & Poor's and an investment grade rating with the other two major rating agencies. Allowing United a cost of debt significantly higher than that of Embarq would afford the companies with an exploitable arbitrage opportunity because United receives debt financing from Embarq. United's proposal would provide a windfall to the parent company by allowing it to charge the operating company [redacted] for financing that costs substantially less.
3. The value assumes that 100 percent of forward-looking financing would come from the issuance of a ten-year note and it omits the cost savings that can be achieved from using other sources, such as short-term arrangements. In Exhibit

Q. **Why do you advocate a [redacted] cost for other liabilities and deferred credits?**

A. [redacted] represents the value calculated when United's ~~**2008**~~ **2007** interest expense is divided by the average of the company's total liabilities at the end of 2007 ~~**and 2008**~~. Staff offers this value as an estimate for the varied and potentially costless capital sources that are attributable to this category of liabilities, which includes noncurrent deferred operating federal income tax, other long-term liabilities, and other deferred credits. Under ideal circumstances, the cost of each source would be known and appear as part of the weighting calculation; sources with zero cost would offset the company's plant and rate base investment levels and would not appear as part of the cost weighting calculation. However, Staff advocates this costing approach because it balances the need to assign a significantly lower cost than United's long-term cost of debt with the risk of assuming a blanket value of zero.

III. CONCLUSION

Q. Please summarize your conclusions.

A. Having examined the ECM cost of capital, Staff believes the ECM overstates United's cost of service. Dr. Blackmon's testimony identifies other ways in which the ECM overstates United's cost of service and explains why Staff believes United has failed to justify its current access charge levels with its model.

Q. Does this complete your testimony?

A. Yes, it does.