

THE STATE CORPORATION COMMISSION
OF THE STATE OF KANSAS

STATE CORPORATION COMMISSION

Before Commissioners: Brian J. Moline, Chair
Robert E. Krehbiel
Michael C. Moffet

FEB 01 2006

 Docket Room

In the Matter of the Application of Sprint Nextel Corporation for Approval of the Transfer of Control of United Telephone Company of Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of Southcentral Kansas, Sprint Missouri, Inc. d/b/a United Telephone Company of Southeastern Kansas, and Sprint Long Distance Inc., from Sprint Nextel Corporation to LTD Holding Company.)
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Docket No. 06-SCCC-200-MIS

DIRECT TESTIMONY
OF
BION C. OSTRANDER

ON BEHALF OF
THE CITIZENS' UTILITY RATEPAYER BOARD

February 1, 2006

PUBLIC VERSION

Confidential information redacted

I. INTRODUCTION

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Q. PLEASE STATE YOUR NAME, TITLE, AND BUSINESS ADDRESS.

A. My name is Bion C. Ostrander. I am President of Ostrander Consulting. My business address is 1121 S.W. Chetopa Trail, Topeka, KS 66615-1408.

Q. WHAT IS YOUR OCCUPATION?

A. I am an independent regulatory consultant specializing in telecommunications issues, and I am a practicing Certified Public Accountant (CPA).

Q. WHO ARE YOU REPRESENTING IN THIS DOCKET?

A. I am testifying on behalf of the Citizens' Utility Ratepayer Board (CURB).

Q. WHAT IS YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND?

A. Please see Attachment BCO-1 for more information regarding my professional experience and educational background. In summary, I am an independent regulatory consultant and a practicing CPA with a specialization in telecommunications financial, costing, and policy issues. I have over twenty-five years of regulatory and accounting experience. I have addressed regulatory issues in numerous state jurisdictions and on an international basis.

I started my regulatory consulting practice, Ostrander Consulting, in 1990 after leaving the Kansas Corporation Commission (KCC or Commission). From 1986 to 1990 I served as the Chief of Telecommunications for the KCC, and from 1982 to 1985 I was the Chief Auditor for the KCC and I addressed telecommunications, gas, electric, water, and transportation cases. In addition, I have worked for international and regional accounting

1 firms, including Deloitte, Haskin and Sells (which is now a member firm of Deloitte &
2 Touche USA LLP). On behalf of the CPA firms, I addressed issues related to regulation,
3 income taxes, banking, manufacturing, real estate, construction, retail, insurance,
4 universities, and not-for-profit organizations.

5
6 I received a Bachelor of Science degree in Business Administration with a major in
7 Accounting from the University of Kansas in 1978. I am a member of the American
8 Institute of CPAs (AICPA) and the Kansas Society of CPAs (KSCPA).

9
10 **Q. WHAT TYPE OF TELECOMMUNICATION ISSUES HAVE YOU ADDRESSED?**

11 A. I have addressed most telecommunications regulatory issues in my career. My
12 experience includes addressing issues related to alternative regulation/price cap plans,
13 rate cases, applications under Section 271 of the Telecommunications Act, management
14 audits, audits of universal service funds, and audits of relay centers for the speech and
15 hearing impaired.

16
17 I have addressed a broad range of telecommunications and regulatory issues related to
18 regulatory accounting, sales/acquisitions of LECs, affiliate transactions, competition
19 policy, cost models, unbundled network elements (UNEs), Cost Allocation Manual
20 (CAM) non-regulated services/costs, cross-subsidization, rate design, Yellow Pages, FCC
21 separations, quality of service, universal service, affordable local service, Lifeline,
22 depreciation, infrastructure development, excess capacity/resources, access charge
23 restructure, FCC policy issues, DSL issues, and other matters.

24
25 I have addressed issues related to all of the Regional Bell Operating Companies
26 (RBOCs), Sprint, AT&T, MCI, and rural LECs.

1 I have provided such services in numerous state and international jurisdictions.

2

3 **Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?**

4 A. The purpose is to address Sprint's application to spin-off its local exchange companies as
5 a separate entity called LTD. I address the problems with the application and how it fails
6 to meet the public interest.

7

8 **Q. WILL YOU IDENTIFY THE PRINCIPAL PARTIES IN THIS PROCEEDING?**

9 A. Sprint Nextel Corporation (Sprint) filed its application with the KCC on August 31, 2005.
10 This application requests approval to transfer control of United Telephone Company of
11 Kansas, United Telephone Company of Eastern Kansas, United Telephone Company of
12 Southcentral Kansas, Sprint Missouri, Inc. d/b/a United Telephone Company of
13 Southeastern Kansas (hereinafter, United or United Kansas LECs) to an entity to be
14 formed in the future, currently called LTD Holding Company (LTD). In addition, Sprint
15 will transfer control of Sprint Long Distance to the LTD entity, and I will refer to this
16 entity as LTD Long Distance (or LTD LD) throughout this testimony in order to associate
17 the new long distance company with its new LTD parent, and avoid confusing it with the
18 Sprint operations and Sprint's long distance operations. Finally, Sprint Communications
19 Company L.P. (which currently provides long distance service and is certificated as a
20 Competitive Local Exchange Company (CLEC) in Kansas), will remain with Sprint
21 operations and will be referenced as Sprint L.P. or Sprint CLEC in my testimony.

22

23 **Q. WHAT IS YOUR UNDERSTANDING OF SPRINT'S REQUEST IN THIS**
24 **APPLICATION?**

25 A. Sprint Corporation, the historic parent company of United Kansas LECs, and Nextel
26 Communications have merged to form a new company as of August 2005 – Sprint Nextel

1 Corporation (Sprint Nextel). It is the intention of Sprint Nextel to focus on the wireless
2 operations¹ of the new company - - so wireless operations and long distance operations
3 will remain with Sprint Nextel.² However, the wireline/local service operations are being
4 spun-off under a new entity currently called LTD Holding Company (LTD) - - although
5 existing Sprint Nextel shareholders will retain ownership in this new entity. However,
6 the shareholder ownership and make-up will be subject to change once the stock becomes
7 subject to trading. In this application, Sprint seeks Commission approval to change the
8 control of the United Kansas LECs from Sprint Nextel to LTD.

9
10 **Q. WHAT IS CURB'S RECOMMENDATION REGARDING THIS APPLICATION?**

11 A. CURB believes the application should be denied because it is not in the public interest, it
12 fails to address and disclose significant information that could negatively impact United
13 Kansas LEC operations and its related Kansas customers, and much information is still
14 not known about the transaction due to documents that have not been filed with state or
15 federal agencies³, including the Securities and Exchange Commission (SEC).⁴ A major
16 part of the application relies on estimated financial or operational impacts that could
17 change significantly when the conditions and impacts of the master separation and
18 distribution agreement become known, and as other transactions and agreements are

¹ Sprint sometimes uses the phrase "wireless-centric" to express its focus on wireless operations.

² In some states, such as Kansas, there will be a Competitive Local Exchange Company (CLEC) operation that will remain with Sprint Nextel, and this entity will be referred to as Sprint LP or Sprint CLEC.

³ See Attachment BCO-2.

⁴ For example, LTD's Form 10 filed with the SEC on January 23, 2006, provides an "Exhibit Index" that identifies many important documents that have not been made available yet. One of the most important documents not provided yet is the "Separation and Distribution Agreement", which is described at page 5 of the SEC Form 10, "Before the distribution date, we and Sprint Nextel will enter into a separation and distribution agreement that will contain the key provisions relating to the separation of our business from Sprint Nextel and the distribution of our shares of common stock. The separation and distribution agreement will identify the assets to be transferred, liabilities to be assumed and contracts to be assigned to us by Sprint Nextel in the spin-off and describe when and how these transfers, assumptions and assignments will occur."

1 finalized. It would be both premature and unreasonable to approve the application due to
2 its significant shortcomings and inadequate documentation.

3
4 Denial of the transfer of control application could produce the following possible
5 outcomes⁵:

- 6
- 7 1) the United Kansas LECs would remain with Sprint Nextel as a separate division;
 - 8 2) the United Kansas LECs would be spun-off as a separate company subject to
9 different conditions and financial arrangements than the current LTD operations;
10 or
 - 11 3) the United Kansas LECs would be sold to another entity.
- 12

13 The spin-off of LTD, as currently proposed in the Kansas application, could impose
14 significant costs and risks⁶ upon Kansas customers of the United Kansas LECs, and this
15 could lead to:

- 16 1) significant and arbitrary increases in customer rates;
- 17
18 2) reductions in capital expenditures that could result in degradation of service
19 quality and the failure to introduce necessary and timely services;
- 20
21 3) an anti-competitive situation that favors Sprint over United Kansas LECs, because
22 Sprint's structuring of this transaction favors its interests over that of United
23 Kansas LECs, and Sprint has the confidential knowledge of United's operations to
24 provide them a competitive advantage; and
25
- 26 4) all of the above jeopardize public safety and convenience, because emergency or
27 necessary services could be impaired or interrupted by the financial instability of
28 LTD and its member LECs.

⁵ Staff DR 41 asked Sprint how the company would proceed with the planned spin-off if the current application was denied. Sprint filed an objection to this data request on the grounds that, "the request for hypothetical information calls for speculation and will not lead to relevant information pertaining to matters at issue in this proceeding. No responsive information for this request is being supplied."

⁶ For example, a lengthy and detailed list of "Risk Factors" is identified at LTD's SEC Form 10, beginning at page 9.

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Q. DOES CURB HAVE ANY ALTERNATIVE RECOMMENDATIONS?

A. Yes. There are two other alternatives:

First, the application could be suspended until additional documentation becomes available that will allow a more detailed and thorough evaluation of the potential impacts of this transaction. Examples of this documentation will be provided later, but one key example is the final master separation and distribution agreement.

Second, if the Commission decides to approve the application, the Commission should approve all of the “conditions” that I recommend in this testimony. These conditions act as safeguards and controls to support the public interest, balance the interests of the company and the public, and will help minimize potential negative impacts and risks of this transaction.

Q. IS SPRINT OR LTD MAKING DECISIONS REGARDING THIS TRANSACTION?

A. Sprint Nextel personnel, or personnel that are directly responsible to Sprint Nextel management and Board of Directors, are making all decisions regarding this transaction.⁷ LTD’s recently filed SEC Form 10 confirms this arrangement as a “risk”, and states that agreements between LTD and Sprint Nextel “may involve, or appear to involve, conflicts of interest” because LTD personnel negotiating agreements with Sprint still have an obligation to serve the interests of Sprint Nextel and its subsidiaries.⁸ This change of control transaction is driven primarily by Sprint’s interests in becoming a wireless-

⁷ Sprint has named the officers for LTD, and because Sprint has made decisions regarding officer assignment to LTD this is an indication of Sprint’s influence on this transaction.

1 focused entity, and it is not driven by the desire of LEC wireline operations to become a
2 separate entity because the wireline operations do not have the legal authority to initiate a
3 spin-off. Therefore, any of Sprint's alleged benefits or costs that might accrue to LEC
4 wireline operations (the new LTD), are of secondary interest to Sprint.

5
6 **Q. WHY IS THIS A CONCERN REGARDING THIS TRANSACTION?**

7 A. Sprint and LTD will be competitors if or when this transaction receives final
8 authorization and LTD stock is publicly traded. Sprint will have a significant competitive
9 advantage over other competitors that attempt to compete with LTD LECs, because they
10 have had access to virtually all highly confidential data affecting the LECs and have had
11 final authority over the LEC's business plans and operations. Sprint could use its CLEC
12 affiliate to compete with LTD LECs, and without some of the costs and dissynergies it
13 has passed on to LTD. I will address these competitive issues later in more detail.

14
15 Because Sprint is making all decisions regarding this transaction, it has a natural
16 incentive to place its interests over those of LTD and make decisions that favor Sprint
17 from a competitive standpoint. I believe that Sprint has made decisions that unduly favor
18 its interests over those of LTD. That is why this transaction is not in the public interest
19 and why it should be denied outright, or strong conditions should be attached if the
20 transaction is approved as a least favorable alternative to denial.

21
22 In a very best case scenario for both Sprint and LTD, both entities move forward and
23 operate with some success if this transaction is approved. Under a worse case scenario,

⁸ LTD SEC Form 10, filed January 23, 2006, page 11, under the "Risk Factors" section.

1 Sprint has strategically positioned itself to be an acquisition target⁹ and it will survive the
2 market. On the other hand, under a worse case scenario, LTD's financial position has
3 been greatly compromised by this transaction and it may have to seek increases in rates
4 for local and other services from state regulatory agencies, it may suffer service quality
5 degradation, employees and their livelihoods may be compromised by lay-offs and
6 inadequate pension/benefits funding. Also, if LTD faces financial deterioration in the
7 future, as a final act of salvaging its operations, it could seek premature deregulation of
8 its local service operations through legislation or other means. This would allow LTD to
9 achieve rate increases without regulatory agency intervention, and this outcome
10 negatively impacts LTD's customers and universal service, and is not in the public
11 interest.

12
13 **Q. WAS STATE-SPECIFIC INFORMATION PROVIDED IN ORDER TO ASSESS**
14 **THE IMPACT OF THIS SPIN-OFF ON UNITED KANSAS LEC OPERATIONS**
15 **AND ITS CUSTOMERS?**

16 A. No. Sprint's primary supporting conclusions and calculations regarding the impact of the
17 change of control transaction are based almost exclusively on the aggregated data of the
18 Sprint LEC operations in 18 states¹⁰, and it does not appear to be based on any specific or
19 detailed assessment of United Kansas LEC operations or how this transaction could
20 impact the Kansas operations and its related customers. Sprint objected to providing
21 CURB with important Kansas-specific information. Without this Kansas-specific
22 information, I am unable to determine if Sprint's conclusions about the impact of the

⁹ Through this transaction, Sprint is relieving itself of shared costs with the LECs, increasing its cash flow from the debt it is requiring LTD to issue, and realizing other residual synergies.

¹⁰ The August 30, 2005, Application, p. 3, refers to Sprint ILEC operations in 18 states, with about 7.7 million local access lines.

1 spin-off on aggregated Sprint LECs is the same as that reached for the United Kansas
2 LEC operations.

3
4 Later in this testimony I will provide examples of state-specific information that was not
5 provided, as well as a list of important documents that affect this transaction and which
6 have not been finalized or provided.

7
8 **Q. CAN YOU PROVIDE AN ANALOGY OF THE IMPLICATIONS OF SPRINT'S**
9 **FAILURE TO PROVIDE COMPLETE AND SPECIFIC UNITED KANSAS LEC**
10 **INFORMATION?**

11 A. Yes. Sprint expects the Commission to approve a transaction based almost solely on
12 conclusions reached on the aggregated data of the 18 Sprint LECs, without knowing the
13 impact on United Kansas LEC operations. An analogy would be for Sprint to file a rate
14 case in Kansas based on the aggregated data of the 18 Sprint LECs, but not tell the
15 Commission or other parties the specific revenue requirements of the United Kansas
16 LECs - - or whether the United Kansas LEC data supported a rate increase or a rate
17 decrease. In the rate case analogy, and in this spin-off application, the results of the
18 United Kansas LECs could range anywhere within or outside the results of the
19 aggregated data of the 18-state Sprint LECs. The conclusions reached for the aggregated
20 18-state Sprint LECs, is not necessarily the same for each individual LEC making up the
21 aggregated results.

22
23 Sprint's failure to provide specific information for United Kansas LEC operations is
24 contrary to the public interest and the impact on Kansas customers and Kansas operations
25 cannot be properly evaluated.

26

1 **Q. CAN THE COMMISSION APPROVE THIS SPIN-OFF WITHOUT KNOWING**
2 **THE SPECIFIC IMPACT ON UNITED KANSAS LEC OPERATIONS AND ITS**
3 **CUSTOMERS, AND YET APPLY THE PUBLIC INTEREST STATUE IN**
4 **KANSAS?**

5 A. I am not an attorney, so I cannot address this from a legal perspective. It would seem
6 very awkward to try and apply a Kansas public interest statute to aggregated information
7 of Sprint LECs in 17 other states, especially when the Commission does not have
8 regulatory jurisdiction in these 17 other states.

9
10 My experience from regulatory proceedings in various state jurisdictions is that the
11 burden of proof generally resides with the applicant. In matters of increased magnitude
12 such as this case, the burden of proof becomes even more important. It would appear
13 inherently difficult to reach a conclusion that this transaction is in the public interest in
14 Kansas if complete and specific information for the United Kansas LEC's operations and
15 its customers is not available to evaluate.

16
17 Some of the problems with Sprint's spin-off application could have been mitigated with
18 the provision of United Kansas LEC-specific information and impacts, although serious
19 concerns remain with financial and operational issues.

20
21 **Q. DOES THE SEC FORM 10 THAT SPRINT RECENTLY FILED RAISE**
22 **POTENTIAL CONCERNS FOR THIS COMMISSION REGARDING THE SPIN-**
23 **OFF?**

24 A. Yes. The SEC Form 10 that was filed on January 23, 2006, in the name of LTD Holding
25 Company, raises numerous potential concerns and risks regarding the financial and
26 operational structure of the spin-off. The Commission should keep these risks in mind as

1 it reviews the application and considers the testimony in this proceeding. In addition,
2 these risks would suggest a high level of caution be exercised by the Commission. If the
3 Commission decides to approve this transaction, then the associated risk factors set forth
4 below serve to further justify the various protective conditions that I recommend and
5 which are absolutely critical to the public interest.

6
7 I have set forth some of the risks that LTD identifies in the “Risk Factors” section of the
8 SEC Form 10, beginning at page 9.

- 9
- 10 1) LTD may experience increased costs after the spin-off that could impact overall
11 profitability.
 - 12 2) The loss of Sprint Nextel’s strong brand, reputation and capital base could adversely
13 affect the business and profitability.
 - 14 3) If the distribution does not qualify as a tax-free transaction, tax could be imposed on
15 both Sprint Nextel shareholders and Sprint Nextel, and LTD may have to indemnify
16 Sprint Nextel.
 - 17 4) A tax-sharing agreement with Sprint Nextel imposes certain restrictions on LTD that
18 could affect strategic and operating flexibility.
 - 19 5) LTD will incur significant indebtedness that will subject it to various restrictions that
20 could limit its operating flexibility.
 - 21 6) The agreements that LTD is entering into with Sprint Nextel may involve, or may
22 appear to involve, conflicts of interest, and they may be subject to early termination
23 that could have an adverse effect on the business.
 - 24 7) Competition may reduce market share and harm financial performance.
 - 25 8) Capital raising may adversely affect holders of common stock through the issuance of
26 more senior securities or through dilution.
 - 27 9) LTD may not have access to capital on acceptable terms.
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1 10) The designated executive team has not previously worked together to lead an
2 independent company.
3

4 11) The market price and trading volume of LTD's common stock may be volatile.
5
6

7 **CAPITAL STRUCTURE AND DEBT CONCERNS**
8

9 **WHAT ARE THE ANTICIPATED BOND RATINGS OF LTD AT SPIN-OFF?**

10 **Q.**

11 A. Bond rating agencies Moody's (dated July 13, 2005) and Fitch (dated July 12, 2005) have
12 provided tentative bond ratings for LTD that are near the ***BEGIN
13 CONFIDENTIAL*** [REDACTED]
14 ***END CONFIDENTIAL*** and these ratings are shown
15 at Table BCO-1 below. Sprint's response to Staff DR 1 states that the spin-off
16 application was not provided to Standard & Poors (S&P) because Sprint believes that
17 S&P has adopted a negative outlook towards the entire LEC industry.

18 However, ***BEGIN CONFIDENTIAL*** [REDACTED] ***END
19 CONFIDENTIAL*** bond rating agency believes that the LTD spin-off could result in
20 bond ratings ***BEGIN CONFIDENTIAL*** [REDACTED]
21 [REDACTED]
22 [REDACTED] ***END CONFIDENTIAL***.

23 The bond ratings are shown below:
24 [REDACTED]

¹¹ Sprint Response to Staff DR 33 (Sprint's response to Public Counsel's Data Request No. 8, Attachment 8.2, per the November 30, 2005, testimony of Stephen G. Hill on behalf of Public Counsel, before the Washington Utilities & Transportation Commission in Docket No. UT-051291 regarding the Sprint-Nextel merger)

1 **TABLE BCO-1:**

2 *****BEGIN CONFIDENTIAL*****

[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

3

4 *****END CONFIDENTIAL*****

5

6 **Q. WHAT IS THE SIGNIFICANCE OF THESE BOND RATINGS?**

7 A. These bond ratings affect the ***BEGIN CONFIDENTIAL [REDACTED]
8 [REDACTED]
9 [REDACTED]
10 [REDACTED]
11 [REDACTED]
12 [REDACTED]
13 [REDACTED] ***END CONFIDENTIAL***

14

15 **Q. WILL YOU EXPLAIN THE DEBT LEVELS OF LTD AT SPIN-OFF?**

16 A. LTD's SEC Form 10¹² indicates that at spin-off, Sprint will require LTD to transfer cash
17 and new unsecured notes of about \$6.6 billion to Sprint, and Sprint will transfer control
18 of the local telecommunications division assets to LTD. The \$6.6 billion arrangement
19 will appear on LTD's books as \$4.1 billion of notes payable to Sprint (and this could

¹² SEC Form 10, January 23, 2006, pages 5 and 6, and also page 42.

1 range upwards to \$4.6 billion) and \$2.5 billion of debt (possibly bank debt from one or
2 more third parties, and this could range downward to \$2.0 billion). It is not known yet
3 whether the \$4.125 billion of notes will be a public or private offering. In addition, due
4 to the transfer of assets to LTD, Sprint will receive shares of capital stock of LTD. Once
5 again, it is important to remember that it is Sprint management, and not LTD, that is
6 determining the level of debt that LTD will have at spin-off.

7
8 The SEC Form 10 continues to explain that when the spin-off is completed, LTD will
9 have total debt of about \$7.25 billion, consisting of the new debt of \$6.6 billion along
10 with about \$.65 billion of existing debt (current \$1.1 billion of existing debt before spin-
11 off, offset by an amount of inter-company debt to be retired at spin-off). This will leave
12 LTD with total debt that is about seven times greater than the amount currently carried on
13 the books of these same LECs before they were spun-off.

14
15 Although Sprint has not said with certainty what it will do with the \$4.125 billion of
16 notes it will require from LTD at spin-off, Sprint has the option of selling these notes on
17 the market.

18
19 Although LTD faces a certain level of risk with the debt level that Sprint will require
20 LTD to assume at spin-off, Sprint has stated that it will not ***BEGIN

21 CONFIDENTIAL*** [REDACTED]

22 [REDACTED] ***END CONFIDENTIAL***.

¹³ Sprint Response to Staff DR 45.

1

2 **Q. DOES SPRINT HAVE TO REQUIRE LTD TO INCUR \$6.6 BILLION IN NEW**
3 **DEBT IN ORDER TO SPIN-OFF LTD?**

4 A. No. It is possible for Sprint to spin-off LTD with no additional debt or less debt. The
5 stock of LTD could be issued and distributed to Sprint shareholders without any
6 additional debt, or with debt at much lower levels.

7

8 **Q. CAN SPRINT USE THESE POTENTIAL CASH PROCEEDS OF \$6.6 BILLION**
9 **FROM THE LTD SPIN-OFF TO REDUCE ITS DEBT?**

10 A. Yes. Sprint has the flexibility to use these cash proceeds to reduce its debt and improve
11 its financial position to the detriment of LTD's financial position. I believe that Sprint's
12 first priority was to devise a manner to reduce its debt, and now Sprint attempts to justify
13 these actions by claiming that debt levels imposed on LTD are not excessive and will
14 result in a reasonable capital structure for LTD.

15

16

17

18 **Q. WILL SPRINT'S REQUIRED DEBT LEVELS FOR LTD AT SPIN-OFF CREATE**
19 **NEGATIVE EQUITY ON LTD'S BOOKS?**

20 A. Yes. I have calculated a negative equity balance of about \$1.3 billion based on public
21 information from the recently filed LTD SEC Form 10. Because LTD is assuming
22 significant new debt of \$6.6 billion at spin-off, this means that liabilities will exceed
23 assets on the balance sheet of LTD and this creates a situation called "negative equity" on
24 the books. Normally the value of liabilities (such as debt and other short-term liabilities)

1 and shareholder equity (common stock and retained earnings) are equal to the value of
2 assets on the balance sheet and there is no negative equity.

3
4 **Q. CAN YOU SHOW HOW YOU CALCULATED THIS NEGATIVE EQUITY**
5 **AMOUNT?**

6 A. Yes. The calculations are shown in the table below and are based on information from
7 LTD's recently filed SEC Form 10, using financial information from the aggregated LEC
8 operations at September 30, 2005.

9 **TABLE BCO-2:**

Description	LTD Negative Equity – All Information from SEC Form 10
Total LTD Assets at September 30, 2005	\$9.103
Less LTD Current Liabilities at September 30, 2005	(\$.973)
Less: LTD Deferred Taxes, Postretirement and Other Benefits, and Other Noncurrent Liabilities at September 30, 2005	(\$2.154)
Less: New LTD Debt from Spin-Off, plus Existing Debt	(\$7.250)
Total LTD Liabilities	(\$10.377)
Negative Equity Balance – Liabilities Exceed Assets	(1.274) or \$1.3 billion rounded

10
11
12 **Q. IS YOUR CALCULATION OF NEGATIVE EQUITY REASONABLE?**

13 A. Yes. It is based on the best information available to date from the January 23, 2006,
14 SEC Form 10 of LTD. The calculation uses actual financial information for the
15 aggregated LEC operations at September 30, 2005, and then substitutes in the new debt
16 balance of \$7.25 billion (confirmed by Sprint in this application) resulting from the LTD
17 spin-off. The \$7.25 billion of LTD debt replaces the September 30, 2005 debt balance

1 shown for the aggregated LEC operations at the SEC Form 10. I agree that there could
2 be some minor changes in various assets and liabilities at the time of the spin-off, but I
3 believe my calculations are reasonable

4 *****BEGIN CONFIDENTIAL*****

5 [REDACTED]

6 [REDACTED]

7 [REDACTED]

8 [REDACTED]

9 [REDACTED]

10 [REDACTED]

11 [REDACTED]

12 [REDACTED]

13 [REDACTED]

14 [REDACTED]

15 [REDACTED]

16

17 [REDACTED]

[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]

18

1 [REDACTED]
2 [REDACTED]
3 [REDACTED]

4 [REDACTED]
5 [REDACTED]
6 [REDACTED]

7
8 *****END CONFIDENTIAL*****

9
10 **Q. WOULD THE NEGATIVE EQUITY AMOUNT THAT YOU CALCULATED BE**
11 **EVEN GREATER USING THE FCC'S REGULATORY ACCOUNTING**
12 **PRINCIPLES THAT ARE APPLICABLE TO THE LEC'S?**

13 A. Yes. If the FCC's regulatory accounting principles, the Uniform System of Accounts
14 Part 32 (USoA), are used then the actual negative equity amount of \$1.3 billion would
15 increase by about another \$420 million, to a total of \$1.7 billion. This is because the
16 FCC did not require telecom utilities to implement FASB 143 in year 2003, and \$420
17 million is the impact of FAS 143 according to Sprint's response to CURB DR 2.16. This
18 is relevant because if LTD or the United Kansas LECs file financial information with
19 state or federal regulatory agencies, they would use the FCC's USoA Part 32 accounting
20 system which did not adopt FAS 143.

21
22 **Q. HOW DOES SPRINT ATTEMPT TO RATIONALIZE THE DEBT AND**

23 *****BEGIN CONFIDENTIAL*** [REDACTED] ***END**

24 **CONFIDENTIAL*** LEVELS OF LTD AT SPIN-OFF?**

25 A. Sprint hired Mr. Daniel to perform a market valuation of LTD assets. Mr. Daniel's
26 market valuation assigns a higher value to LTD's assets than what exists on the actual
27 financial books. This valuation makes it appear that LTD's asset values exceed its

1 liabilities and that *****BEGIN CONFIDENTIAL***** [REDACTED]
2 *****END CONFIDENTIAL***** from a market perspective. Sprint's incentive is to
3 calculate: _____

- 4 1) "market" asset values that are high enough to *****BEGIN CONFIDENTIAL*****
5 [REDACTED] *****END CONFIDENTIAL***** and
6 2) market asset values that are high enough to justify assigning maximum debt levels
7 to LTD, but maintaining debt levels that are *****BEGIN CONFIDENTIAL*****
8 [REDACTED] *****END CONFIDENTIAL*****
9 [REDACTED]

10 Mr. Daniel's valuation methods assign an average value to assets in a range of
11 *****BEGIN CONFIDENTIAL***** [REDACTED] *****END**
12 **CONFIDENTIAL*****. This is *****BEGIN CONFIDENTIAL***** [REDACTED]
13 [REDACTED] *****END CONFIDENTIAL***** than actual assets on the books of the LECs before
14 spin-off, with book asset values of *****BEGIN CONFIDENTIAL***** [REDACTED]
15 [REDACTED] *****END CONFIDENTIAL***** after adjustments, as
16 shown in Mr. Harper's Exhibit No. MDH-5.

17
18 **Q. WILL YOU COMPARE ASSET "BOOK" VALUES TO MR. DANIEL'S**
19 **"MARKET" VALUE OF ASSETS, AND SHOW THE RESULTING ***BEGIN**
20 **CONFIDENTIAL***** [REDACTED] *****END**
21 **CONFIDENTIAL***?**

22 **A.** Yes. These amounts are shown in Table BCO-4 below (previous Table BCO-3 was a
23 confidential table). Column B of Table BCO-4 shows a *****BEGIN**

1 CONFIDENTIAL*** [REDACTED] ***BEGIN

2 CONFIDENTIAL*** Columns C and D show an equity balance ranging from

3 ***BEGIN CONFIDENTIAL*** [REDACTED] ***END

4 CONFIDENTIAL*** using Mr. Daniel’s “market” valuation approach. Thus, Sprint
5 attempts to use the increased “market” values of assets for two reasons:

- 6 1) to justify the final debt levels arrived at for LTD of \$7.25 billion; and
- 7 2) to arrive at a reasonable equity balance, ***BEGIN CONFIDENTIAL***
8 [REDACTED] ***END CONFIDENTIAL*** balance that
9 results from using actual book values.

10

11 **TABLE BCO-4:**

12 ***BEGIN CONFIDENTIAL***

[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

13

14 [REDACTED]
15 [REDACTED]
16 [REDACTED]
17 [REDACTED]
18 [REDACTED]

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END CONFIDENTIAL

20

21 **Q. WHAT IS THE PROBLEM WITH RELYING UPON MR. DANIEL'S**
22 **"MARKET" VALUE OF ASSETS?**

23 A. Sprint desires the best of both worlds. Sprint wants parties to rely on their surrogate
24 market value of assets when this approach is beneficial to their arguments, and they want
25 parties to rely on their book/GAAP value of assets when this treatment is beneficial to
26 their interests. Sprint cannot have it both ways.

27

28 Sprint's response to Staff DR 44 explains that if this spin-off transaction were treated as a
29 sale (instead of a tax-free separation), assets would be sold at the "market" values that
30 Mr. Daniel determined and the excess of the "market" value of the assets over the book
31 value of the assets would be recorded on the company's books as "goodwill." Thus,
32 Sprint argues, LTD would not have any ***BEGIN CONFIDENTIAL***

1 *****END CONFIDENTIAL***** if this transaction were treated as a sale, and if
2 the resulting market value of the assets were recorded on LTD's books as "goodwill."

3
4 Sprint's response to Staff DR 44 also explains that because this transaction will be treated
5 as a tax-free separation, and not a sale, accounting rules require that assets be recorded on
6 LTD's books at actual book values and not market values. Sprint claims that if it weren't
7 for accounting rules then LTD would not have ***BEGIN CONFIDENTIAL***

8 *****END CONFIDENTIAL***** However, if it were not for accounting
9 rules, then companies could record transactions as they desire, manipulate their books for
10 tax and other purposes, and there would be no reporting consistency for investors to rely
11 upon in comparing financial results of companies. In short, there would be accounting
12 chaos. Sprint's argument that blames "accounting rules" for LTD's ***BEGIN
13 CONFIDENTIAL*** *****END CONFIDENTIAL***** balances on
14 the books, is not a valid or reasonable assertion.

15
16 Also, Sprint claims that five of the six comparable firms used in Mr. Daniel's market
17 valuation analysis would have ***BEGIN CONFIDENTIAL*** *****END CONFIDENTIAL*****
18 ***END CONFIDENTIAL*** balances on their books if they were not required to
19 record goodwill as a result of sales transactions. Therefore, Sprint claims that these other
20 comparable firms would look just like LTD without goodwill, and that this justifies the
21 ***BEGIN CONFIDENTIAL*** *****END CONFIDENTIAL*****
22 balance that will appear on the books of LTD. Once again, the LTD spin-off is not a
23 "sales transaction", so Sprint should not be able to argue the benefits of a "sales

1 transaction” as a means to justify the ***BEGIN CONFIDENTIAL*** [REDACTED]

2 ***END CONFIDENTIAL*** balances of LTD.

3
4 Therefore, Sprint wants the best of both worlds in trying to justify this spin-off
5 transaction and the high debt levels that LTD will incur as a result of Sprint’s decisions.

6 Sprint will treat this transaction as a “tax-free separation” in order to gain the obvious tax
7 advantages, and this means that the currently structured transaction will result in

8 ***BEGIN CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL***

9 balances on LTD’s books. On the other hand, Sprint wants the KCC to view this
10 transaction as a “hypothetical” sale of a utility in order to show that there is no

11 ***BEGIN CONFIDENTIAL [REDACTED] ***END CONFIDENTIAL*** and to

12 justify the assignment of higher debt levels to LTD. Because Sprint has chosen to treat
13 this transaction as a tax-free separation, it would not be appropriate for the Commission
14 to allow Sprint to interpret this transaction as a sale and impose the higher debt levels and

15 ***BEGIN CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL***

16 position upon LTD.

17
18 **Q. WHAT CONDITIONS DO YOU RECOMMEND REGARDING CONCERNS**
19 **WITH THE CAPITAL STRUCTURE AND DEBT LEVELS OF LTD WHICH**
20 **COULD IMPACT THE UNITED KANSAS LECs?**

21 **A.** If the Commission does not deny this application, then the Commission should adopt
22 certain conditions addressing capital structure and debt issues that relate to the United
23 Kansas LECs. Attachment BCO-2 is a comprehensive list of conditions that I
24 recommend. Some of the “general” conditions that I recommend are also applicable to

1 this issue, because the debt levels and capital structure proposed by Sprint could
2 ultimately have a negative impact on customer rates and other issues. However, I have
3 not repeated those same general conditions in this section. The Commission should
4 require the following conditions to serve the public interest:

5
6
7 **Condition 1 Regarding Capital Structure** – The United Kansas LECs should not be
8 able to seek a return to rate-of-return regulation or seek rate relief from other alternative
9 regulatory practices in order to cure problems that result from the spin-off, including
10 excessive debt levels, cash flow constraints, and other matters.

11
12 **Condition 2 Regarding Capital Structure** – If there is some remote situation that
13 would result in the United Kansas LECs seeking rate relief, then the Commission should
14 use the actual debt intensive capital structure of this LEC to determine an appropriate
15 ROR. A hypothetical capital structure that assigns higher levels of equity or levels of
16 debt should not be used.

17
18 **Condition 3 Regarding Capital Structure** – All final debt instruments, or other means
19 used to assign debt or obligations to LTD by Sprint, should be provided to the
20 Commission as soon as possible and subject to Commission oversight. To the extent
21 documents and actions impose unforeseen conditions that negatively impact the United
22 Kansas LECs, then the Commission should open another investigation to address and
23 monitor these issues. The final “separation and distribution” agreement should be filed
24 with the Commission and subject to the review of Staff, CURB and other parties to

1 determine if there are any additional concerns to address in subsequent proceedings. The
2 Commission could leave the current docket open for these purposes.

3
4 **Condition 4 Regarding Capital Structure -** The Company should inform the
5 Commission if its bond rating should decline, and the Company should be required to
6 explain the reasons for the bond rating change and provide copies of appropriate
7 documents from bond rating agencies.

8
9 **Condition 5 Regarding Capital Structure -** None of the assets of the United Kansas
10 LECs should be used to secure any debt that is issued by LTD.

11
12 **Condition 6 Regarding Capital Structure -** The Company should inform the
13 Commission prior to taking any extraordinary measures to address financing or capital
14 attraction issues. For example, if the Company begins to liquidate any assets or sell off
15 its local exchanges in Kansas or other states in order to address financial-related
16 concerns, then the Commission should be informed of all plans.

17
18 **CASH FLOW CONCERNS**

19
20 **Q. SPRINT CLAIMS THAT LTD WILL HAVE SUFFICIENT CASH FLOW AND**
21 **CASH BALANCES AFTER THE SPIN-OFF, BUT DOES SPRINT PROVIDE**
22 **DOCUMENTATION TO SUPPORT THIS SAME CLAIM FOR THE UNITED**
23 **KANSAS LECs?**

1 A. No. Sprint witnesses primarily focus on the cash flow status of LTD after spin-off, but
2 fail to provide adequate information demonstrating the United Kansas LECs will have
3 sufficient cash flow or cash balances after the spin-off. Mr. Harper refers to the 2004
4 financial statements of United Kansas LEC's (which do not include any adjustments for
5 the impact of the spin-off) and he states that, "Because there will be no significant change
6 to United's operations and financial status as a result of the separation, United will
7 continue to have the financial capability to invest in its network, generate sufficient cash
8 to pay all expenses and pay a dividend to its shareholder."¹⁴ However, Mr. Harper's
9 Exhibit No. MDH-3 only shows a historical financial cash flow statement based on 2004
10 actual book amounts for the United Kansas LECs, and he does not adjust this cash flow
11 statement to reflect the impacts of the spin-off.

12
13 In contrast, Mr. Harper does show some minimal adjustments at Exhibit No. MDH-6 that
14 reflect the impact of the spin-off on the cash flow operations of LTD. Therefore, Mr.
15 Harper does attempt to show some impact that the spin-off will have on the cash flows of
16 LTD, but he ignores the impact that these same spin-off adjustments will have on the
17 cash flows of the United Kansas LECs. Mr. Harper does not show consistent cash flow
18 impacts for both LTD and the United Kansas LECs, and no other Sprint witness
19 addresses cash flow impacts for the United Kansas LECs.

20
21 Similar to Mr. Harper's approach to cash flow analysis, Mr. Daniel also focuses on the
22 cash flow of LTD. Mr. Daniel appears to conclude that LTD's cash flow after the spin-
23 off is sufficient, and he states that LTD should be able to pay its debts as they mature,
24 continue to generate sufficient cash to re-invest in the business and maintain current level

¹⁴ Harper Direct Testimony, p. 9, lines 5 to 8.

1 of service, and pay dividends.¹⁵ Mr. Daniel does not make any statements or provide any
2 analysis or projections regarding the cash flows of the United Kansas LECs after spin-off.

3
4 Perhaps Sprint fails to adequately address and show the impact of the spin-off on cash
5 flows of the United Kansas LECs because these cash flow balances are already very thin
6 and do not leave much margin for error - - even before considering the impacts of the
7 spin-off. I will address this issue later in more detail. The bottom line is that the spin-off
8 transaction could result in inadequate cash flows and cash flow balances for Kansas.
9 This could result in the United Kansas LECs having to make significant cuts in their
10 capital expenditures and this could result in sacrifices of modernization and service
11 quality for Kansas customers. Sprint shows projected reductions in LTD capital
12 expenditures after the spin-off and this frees up more cash flow to pay for the significant
13 debt levels imposed on LTD. I will address this issue later in my testimony.

14
15 In this respect, Sprint has failed to show that the spin-off serves the public interest in
16 Kansas because Sprint does not show that the United Kansas LECs will have sufficient
17 cash flows and cash balances to maintain reasonable capital expenditure levels and
18 preserve service quality in Kansas.

19
20 **Q. IS IT REASONABLE TO IGNORE THE IMPACT OF THE SPIN-OFF ON THE**
21 **CASH FLOWS AND CASH BALANCES OF THE UNITED KANSAS LECs?**

22 A. No. I previously addressed why it is necessary for the Commission to have Kansas-
23 specific information and to know the impact that this spin-off will have on the United
24 Kansas LEC operations, and I will not address all of these issues again. However, just
25 because the Sprint witnesses assert that the 18 aggregated state jurisdictions of LTD

¹⁵ Daniel Direct Testimony, p. 8, lines 2 to 8.

1 operations will have adequate cash flow and cash balances, this does not mean that the
2 United Kansas LECs (and other state operations) will have adequate cash flow and cash
3 balances. Sufficient cash flows and cash balances in other states may be masking
4 deficient (or near deficient) cash flows and cash balances in Kansas and other individual
5 states.

6
7 I understand that Sprint's contract with Mr. Daniel and his firm may have only required
8 that they address the aggregated LTD operations, and that may be why Mr. Daniel did not
9 address the issue of cash flows and cash balances for Kansas operations. However, Mr.
10 Harper and other Sprint witnesses also failed to provide cash flow calculations similar to
11 that which they provided for LTD in order to address the cash flows and cash balances of
12 the United Kansas LECs. In this proceeding, it is most relevant to determine if the
13 United Kansas LECs will have sufficient cash flow and cash balances after spin-off. This
14 is because it is my understanding that the KCC only has jurisdiction over Kansas utilities
15 (and not the aggregated LTD operations or the other 17 state jurisdictions) and only the
16 Kansas public interest statute¹⁶ is being addressed in this proceeding (and not the public
17 interest standards of the other 17 state jurisdictions of LTD).

18
19 **Q. SPRINT CLAIMS THAT LTD CASH FLOWS WILL IMPROVE WITH THE**
20 **SPIN-OFF. DO THE CASH FLOW ANALYSIS OF SPRINT WITNESSES SHOW**
21 **CONFLICTING RESULTS?**

22 **A. Yes. Mr. Harper's Exhibit MDH-6 shows that LTD's cash balance will improve by**

23 *****BEGIN CONFIDENTIAL*****
24 

¹⁶ Sprint's August 31, 2005, Application, at p. 2, paragraph 3, and p. 6, paragraph 11, both refer to the K.S.A. 66-136, the applicable Kansas statute which has been interpreted to require a public interest inquiry.

1 [REDACTED]
2 ***END CONFIDENTIAL*** paid by LTD to its shareholders.¹⁷

3 However, as I will address later, Mr. Harper failed to include many of the cash outflows
4 (or reductions to cash) that result from the spin-off. Some of these cash outflows may not
5 be known yet, but this does not make them less important or less relevant.

6
7 In contrast, Mr. Daniel's Report¹⁸ shows that LTD cash balances will remain at
8 ***BEGIN CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL*** after
9 the spin-off, for both years 2006 and 2007. This is because Mr. Daniel's analysis
10 includes some other cash flow impacts from the LTD spin-off that Mr. Harper did not
11 include in his calculations (although there are other impacts still missing from Mr.
12 Daniel's analysis). In addition, Sprint's response to Staff DR 79 confirms that
13 ***BEGIN CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL*** in
14 cash will remain with LTD at the first day of spin-off.

15
16 The relevant point is that LTD's cash balance remains at ***BEGIN
17 CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL*** both before the
18 spin-off (December 31, 2004 per books) and after the spin-off (2006 and 2007 projected
19 years), because Mr. Daniel's projections include cash flow adjustments not included in
20 Mr. Harper's analysis. Because LTD cash balances remain the same both before the
21 spin-off and for at least two years after the spin-off, this indicates that cash balances of
22 LTD or the related LECs have not been improved by the spin-off.

¹⁷ Also, see Harper's Direct Testimony at pp. 28 and 29.

¹⁸ Mr. Daniel's report provided at Sprint Response to CURB DR 1.31, page titled, "SpinCo (Excludes North Supply) 2004-2007 Financial Projections."

1 **Q. ARE THE LTD CASH FLOW CALCULATIONS OF BOTH SPRINT**
2 **WITNESSES INCORRECT, BECAUSE THEY FAIL TO INCLUDE MANY**
3 **ITEMS THAT WILL REDUCE CASH FLOW?**

4 A. Yes. The table below provides a list of some of the cash reductions (cash outflow) and
5 cash increases (cash inflow) that are missing from one or both of the cash flow analysis
6 of Mr. Harper and Mr. Daniel.¹⁹ Also, because neither Mr. Harper nor Mr. Daniel
7 performed a cash flow analysis for Kansas United LEC operations, none of this
8 information is included in a Kansas-specific analysis.

9

10 It is difficult to identify the impacts of these items because Sprint has either objected to
11 providing these amounts or Sprint does not know the impact of these cash flow items.
12 However, because of these negative cash flow items, the resulting spin-off transaction
13 may produce cash flows for Kansas, LTD, and other LEC operations that are not
14 adequate. This could negatively impact capital expenditures, service quality, the ability
15 of LTD to pay for significant debt levels imposed by Sprint, and the ability to pay
16 adequate dividends to shareholders.

17

18 In the table below, an “X” in the column indicates that the cash flow item is missing from
19 a witnesses cash flow analysis.

20

21

22

¹⁹ The cash flow analysis of Mr. Harper is shown at MDH-6, and the cash flow analysis of Mr. Daniel was provided in Sprint Response to CURB DR 1.31, Report page titled, “SpinCo (Excludes North Supply) 2004-2007 Financial Projections” or the page titled “LTD/SpinCo Projections 2005-2007 (excludes North Supply).”

1 **TABLE BCO-5:**

2

Description	United Kansas LEC Cash Flow	LTD Cash Flow - Harper	LTD Cash Flow - Daniel
1) Principal payments on new \$2.5 b debt - (decrease cash flow)	X – not included	X – not included	Not clear if entire amount is deducted
2) Principal payments on new \$4.1 b debt - (decrease cash flow)	(a)	(a)	(a)
3) Sprint Adj. 1 – Reflect interest expense on new debt - (decrease cash flow)	X		
4) Spin-Off costs - (decrease cash flow)	X	X	X
5) Payment from LTD/KS to Sprint for transferring long distance customers - (monitor cash flow)	(b)	(b)	(b)
6) Put cash in unfunded post-retirement benefit accounts (FAS 106) – (monitor cash flow)	(b)	(b)	(b)
7) Fund pensions – (decrease cash flow)	X	X	(c)
8) Payments from LTD/KS to Sprint for various transition and commercial service agreements – (decrease cash flow)	X	X	X
9) Sprint Adj. 2 - Reflect adjustment in dividends paid by KS. to LTD for spin-off - (increase cash flow)	X		
10) Capital expenditures for KS. – (decrease cash flow)	X		
11) Reflect adjustment in capital expenditures for KS. – (increase cash flow)	X		
12) Sprint Adj. 3 - Reflect adjustment in revenues from long distance customers – (increase cash flow)	X		

3


1 (a) – This item is subject to further review. Sprint’s response to Staff DR 47 does not
2 show principal payments for this debt for the period 2006 to 2010, and this would be a
3 significant reduction to cash flow. This is addressed later in this testimony.

4 (b) – These issues should be monitored for potential impact on cash flows.

5 (c) - A reduction for pensions is included, but it is not clear if this is related to a different
6 issue.

7
8 **Q. CAN YOU EXPLAIN IN MORE DETAIL SOME OF THE ADJUSTMENTS TO**
9 **THE SPRINT CASH FLOW ANALYSIS THAT ARE NECESSARY?**

10 A. Yes. In most cases Sprint either objected to providing the Kansas-specific impact of these
11 adjustments or Sprint did not have the information to determine the Kansas or LTD
12 impact. Therefore, I do not have a specific dollar impact for these adjustments, although
13 I have attempted to estimate the impact by applying a Kansas allocation factor²⁰ of 1.71%
14 to the LTD amount. I agree that use of the 1.71% allocation factor may not be
15 appropriate in all cases, in some cases the adjustment would likely be greater and
16 sometimes smaller. I am merely trying to provide some element of scope to these
17 potential adjustments because Sprint would not provide this information. Because the
18 Kansas cash balance at December 31, 2004, was only \$1.4 million, many of the cash flow
19 adjustments addressed below would exceed this amount and impair cash flow. Some of
20 the potential cash flow adjustments are explained below:

21
22 1) **Principal payments on new \$2.5 billion debt applicable to Harper’s LTD cash**
23 **flow and Kansas cash flow** – The reductions in cash flow for principal payments
24 were not reflected in Mr. Harper’s LTD cash flow analysis and are not included in
25 any Kansas cash flow analysis. It is not clear if the entire amount is included in Mr.
26 Daniel’s LTD cash flow analysis, because he deducts *****BEGIN**
27 **CONFIDENTIAL**
28 
29 *****END**
30 **CONFIDENTIAL***** Sprint did not provide the portion of this debt that United
31 Kansas LECs would reimburse to LTD through a dividend payment. If the Kansas
32

²⁰ The Kansas allocation factor is from Sprint Response to Staff DR 25, and is based on the number of Kansas access lines to total LTD access lines.

1 allocation factor of 1.71% (provided by Sprint) was applied to the three-year average
2 debt principal of *****BEGIN CONFIDENTIAL***** [REDACTED]

3 *****END**

4 **CONFIDENTIAL***** Because the Kansas cash balance is only \$1.4 million at
5 December 31, 2004, this adjustment is large enough to significantly impact Kansas
6 cash flows and cash balances. It will be necessary to review the debt instrument
7 when it is available to confirm the amounts, terms, and impacts on LTD and Kansas
8 operations.
9

10 **2) Principal payments on new \$4.1 billion debt applicable to LTD and Kansas cash**
11 **flow** – The reductions in cash flow were not reflected in Mr. Harper’s or Mr. Daniel’s
12 LTD cash flow analysis, and were not included in any Kansas cash flow analysis.
13 Staff’s DR 47.1 does not show any principal payments projected for 2006 to 2010,
14 although interest payments of *****BEGIN CONFIDENTIAL***** [REDACTED]
15 *****END CONFIDENTIAL***** per year are shown. It is not clear why no principal
16 payments are not shown or applicable to this significant debt, perhaps because this is
17 subject to re-negotiation or will be re-sold. At some point, the principal portion of
18 this debt will require significant capital expenditures, but these amounts are not in
19 either of the two Sprint witnesses cash flow analysis. Because the Kansas cash
20 balance is only \$1.4 million at December 31, 2004, this debt payment could be large
21 enough to significantly impact Kansas cash flows and cash balances. As a condition
22 of any potential approval, it will be extremely important to review this debt
23 instrument when it becomes available to confirm the amounts, terms, and impacts on
24 LTD and Kansas operations.
25

26
27 **3) Interest payment on new debt of \$2.5 billion and \$4.1 billion applicable to**
28 **Kansas cash flow** – This interest payment is reflected in the LTD cash flow analysis
29 of Sprint witnesses via Adjustment No. 1, but no amounts are reflected in any Kansas
30 cash flow analysis. The total interest expense of *****BEGIN CONFIDENTIAL*****
31 [REDACTED]

32
33
34
35 *****END CONFIDENTIAL***** This adjustment is large enough to impact Kansas
36 cash flows and cash balances.
37

38 **4) Spin-Off Costs applicable to Harper’s LTD cash flow and Kansas cash flow** –
39 The spin-off costs as shown at Mr. Daniel’s cash flow, net-of-tax, are shown below
40 and are not reflected in Mr. Harper’s cash flow or any Kansas cash flow analysis. If
41 the Kansas allocation factor of 1.71% was applied to the average balance of
42 *****BEGIN CONFIDENTIAL***** [REDACTED]

43 *****END CONFIDENTIAL***** This adjustment is large
44 enough to impact Kansas cash flows and cash balances.
45
46
47

1 **TABLE BCO-6:**

2
3 *****BEGIN CONFIDENTIAL*****

4

5
6 *****END CONFIDENTIAL*****

7
8 **5) Payment from LTD/KS to Sprint for transferring long distance customers**
9 **applicable to Harper and Daniel LTD cash flow and Kansas cash flow** – Mr.
10 Harper’s cash flow analysis for LTD includes Adj. 3 to reflect revenues from long
11 distance customers, but the adjustment does not appear to include the amount that
12 LTD/KS will pay Sprint to transfer these long distance customers to the LEC
13 operations. Attachment 1.14a of CURB DR 1.14 addresses payment from LTD to
14 Sprint for the transfer of long distance customers based upon a *****BEGIN**
15 **CONFIDENTIAL***** [REDACTED] *****END**

16 **CONFIDENTIAL***** Sprint’s response to Staff DR 63 and 79 appears to state
17 that this purchase price is properly *****BEGIN CONFIDENTIAL***** [REDACTED]

18 [REDACTED]
19 [REDACTED]
20 [REDACTED]
21 *****END CONFIDENTIAL***** The response does indicate that this transaction
22 has not been recorded on the books of any company yet. Sprint provided no
23 estimated impact of this transaction. Even if this transaction does not affect cash
24 flow, it should be reviewed as a condition for approval of the spin-off. It will be
25 important to review this transaction to assess the transfer price paid for long
26 distance customers, and other terms and impacts on LTD and Kansas operations.

27
28 **6) Requirement of Sprint to fully fund any accrued obligations for other**
29 **postretirement employee benefits (OPEB) accounts of LTD/Kansas**
30 **employees** – This issue will be addressed later in more detail. I recommend that
31 Sprint reimburse LTD/KS for adequate cash to place in a trust/account to fund
32 any accrued unfunded obligations for these retiree health care, life insurance and
33 prescription drug costs. I would propose that this transaction not impact cash
34 flows of LTD/KS and that this be handled through the inter-company affiliate
35 accounts at the time of spin-off. If this issue does negatively impact Kansas cash
36 flow, then Sprint should allow Kansas operations to keep additional cash balances
37 at spin-off to fund these OPEBs.

38
39 **7) Pension funding** – Some of these concerns are similar to the prior OPEB issue.
40

1 **8) Payments from LTD/KS to Sprint for various commercial service and**
2 **transition agreements, and this is applicable to Harper and Daniel LTD cash**
3 **flow and Kansas cash flow** – There are various commercial service and
4 transition agreements that require payments back and forth between LTD/KS and
5 Sprint for various services/products. These impacts should be disclosed and
6 reflected in all cash flow analysis. As a condition of any approval of this spin-off,
7 Sprint should be required to disclose the payments, terms, and conditions for all
8 transition agreements. If this issue does negatively impact Kansas cash flow, then
9 Sprint should allow Kansas operations to keep additional cash balances at spin-off
10 to address these transition agreements.

11
12 **Q. CAN YOU EXPLAIN THE CONSTRAINED CASH FLOW AND CASH**
13 **BALANCES OF THE UNITED KANSAS LECS?**

14 A. Yes. The change in cash flows and the ending cash balances for the United Kansas LECs
15 are shown in the table below, and these amounts are from CURB DR 2.10. This table
16 shows that for two of the last three years, the United Kansas LECs have had a decrease in
17 cash flow, or a negative cash flow of ***BEGIN CONFIDENTIAL*** [REDACTED]
18 [REDACTED] ***END CONFIDENTIAL***. A negative cash flow
19 generally means that cash outflows for capital expenditures and payments to Sprint
20 Corporate (dividends) have exceeded the cash coming in from customers or other
21 sources. Also, the ending cash balance for each year is very low, and it was a negative
22 amount of ***BEGIN CONFIDENTIAL*** [REDACTED] ***END CONFIDENTIAL***
23 as recent as 2003. The United Kansas LEC's cash balance or cash flow at 2004 is only
24 about 1% of annual revenues and operating expenses, whereas LTD's cash balance and
25 cash flow is three times greater on a ratio basis (on a dollar basis, LTD's cash balances
26 and cash flow are much greater than the same amounts for the United Kansas LECs as
27 shown at Table BCO-8). The United Kansas LECs have cash balances and cash flow that
28 are very low compared to LTD (and the other state LEC operations) on a ratio basis.

29
30
31

1 aggregated LECs revenues, and 1.11% is about one-third of the 3.3% ($3.3\%/1.11\% =$
2 2.97). The LTD operating expenses ratio of 4.5% is about three times greater than the
3 Kansas operating expenses ratio of 1.41% ($4.5\%/1.41\% = 3.2$ times). This means that to
4 put Kansas cash balances on equal standing with LTD cash balances in order to help
5 avoid cash flow problems, the Kansas cash balances should be increased by at least three
6 times their current balance of \$1.4 million. This would result in Kansas Cash balances
7 equaling about \$4.2 million ($\1.4×3) at a minimum.

8
9 **TABLE BCO-8:**

10
11 *****BEGIN CONFIDENTIAL*****

12

[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]

13
14 *****END CONFIDENTIAL*****

15
16 (a) – Information is from Harper’s Exhibit MDH-1 and MDH-3, showing United Kansas
17 LEC information using 2004 books amounts before any adjustments for the spin-off.
18

1 (b) – Information is from Harper’s Exhibit MDH-4 and MDH-6, showing LTD/LEC
2 aggregated information using 2004 book amounts before any adjustments for the
3 spin-off.
4

5 **Q. WHY ARE THE UNITED KANSAS LEC’S CASH BALANCES AND CASH**
6 **FLOW SUCH A SMALL AMOUNT?**

7 A. The United Kansas LECs do not retain their cash balances, but instead pay a periodic
8 “dividend” to Sprint which essentially includes all free cash flow except amounts retained
9 by the United Kansas LECs to pay their operating expenses, capital expenditures, and
10 other miscellaneous cash outflows. The term “dividend” in this respect, merely means
11 all excess cash balances of the United Kansas LECs. The “dividend” paid by the United
12 Kansas LECs to Sprint is not to be confused with the typical meaning of “dividends” - -
13 which relates to the amounts paid to shareholders by Sprint Corporate. The “dividend”
14 amounts paid by the United Kansas LECs to Sprint, are used by Sprint to pay for capital
15 expenditures for wireless and other affiliates, dividend payments to shareholders, pay for
16 debt principle/interest and other miscellaneous cash outflow. Sprint’s response to CURB

17 DR 2.7 and 2.8 *****BEGIN CONFIDENTIAL***** [REDACTED]

18 [REDACTED] *****END CONFIDENTIAL*****

19
20 **Q. IN THIS PROCEEDING, WHAT IS THE RELEVANCE OF THE “DIVIDENDS”**
21 **PAID TO SPRINT BY THE UNITED KANSAS LEC’S?**

22 A. This means that over all prior years, the United Kansas LECs have not accumulated cash
23 reserves of their own to pay for future obligations, large capital expenditures programs,
24 emergency needs that may arise, and other cash uses. This is unlike most companies
25 which accumulate cash balances over time and keep these idle funds invested until they
26 need them for specific purposes. Sprint has greatly benefitted from keeping all of the

1 excess cash flow balances of the United Kansas LECs in the past, and Sprint has used
2 these funds to pay down debt balances in prior years.

3
4 It is not fair or reasonable for Sprint to now impose debt upon LTD, when Sprint has
5 retained the cash of the United Kansas LECs from prior years that would have supplanted
6 the need for debt. Not only did Sprint gain the advantage of being able to use the cash
7 flows of the United Kansas LECs to pay for its capital expenditures and debt balances in
8 the past, Sprint now seeks to impose additional debt on the United Kansas LECs and then
9 “again” take these \$6.6 billion proceeds to pay for capital expenditures for debt. It is not
10 reasonable to impose more debt on the United Kansas LECs, Sprint has already
11 benefitted significantly from prior year cash flows it has retained from the United Kansas
12 LECs.

13
14 In a fair transaction, the United Kansas LECs would have retained some reasonable level
15 of cash. However, because Sprint has stripped these cash balances away on a continuing
16 basis, the United Kansas LECs are left with only \$1.4 million in cash at December 2004.
17 The United Kansas LECs should be allowed to retain a reasonable level of cash flow, but
18 additional debt should not be imposed on them.

19
20 **Q. WHAT CONDITIONS DO YOU RECOMMEND REGARDING CONCERNS**
21 **WITH CASH FLOW ISSUES?**

22 A. If the Commission does not deny this application, then the Commission should adopt
23 certain conditions regarding potential cash flow issues impacting the United Kansas
24 LECs. I have addressed conditions related to cash flow concerns with capital
25 expenditures later in this testimony. Attachment BCO-2 is a comprehensive list of
26 conditions that I recommend. Some of the “general” conditions that I recommend at

1 Attachment BCO-2 are also applicable to this issue, because the cash flow issues could
2 ultimately have a negative impact on customer rates and other issues. However, I have
3 not repeated those same general conditions in this section. The Commission should
4 require the following conditions to serve the public interest:

5
6
7 **Condition 1 Regarding Cash Flow** – The Commission should require Sprint (not the
8 new LTD) to leave the United Kansas LECs with adequate free cash balances.

9
10 **Condition 2 Regarding Cash Flow** - The United Kansas LECs should not be allowed to
11 seek any form of rate relief for regulated services in the future due to cash flow
12 deficiencies that result from the spin-off and that are related to the LEC's inability to
13 service its debt, its inability to pay dividends to LTD, its inability to make capital
14 investments, and its inability to pay spin-off related costs and other costs.

15
16 **Condition 3 Regarding Cash Flow** – The United Kansas LECs cannot use cash flow
17 deficiencies or constraints as a reason for failing to introduce services on a timely basis
18 that are state-of-the-art, reasonably priced or competitively priced (where appropriate) to
19 similar services offered by Sprint Nextel and other competitors.

20
21 **Condition 4 Regarding Cash Flow** - The United Kansas LECs (and to the extent this
22 indirectly impacts LTD) should not have to use their cash flow to pay for the transfer of
23 long distance customers from Sprint, and should not have to fund accrued obligations for
24 FAS 106 OPEBs. Sprint has indicated that the transfer of long distance customers will
25 not impact cash and this will be handled through an inter-company settlement at spin-off,

1 so United Kansas LEC (and LTD) cash should not be negatively impacted. Also, I have
2 previously stated that OPEB obligations should be cash-funded before spin-off with the
3 cash of Sprint and not LTD. If the United Kansas LECs and LTD would not have had to
4 “pay” dividends to Sprint in the past in the form of most of their residual cash balances,
5 then both the United Kansas LECs and LTD would have the cash reserves to fund these
6 OPEB amounts. However, because Sprint has taken most of the cash reserves from the
7 United Kansas LECs in the past, Sprint should be required to cash-fund OPEB amounts.

8 **CAPITAL EXPENDITURE CONCERNS**

9
10 **Q. HOW DO SPRINT WITNESSES ADDRESS THE IMPACT OF THE SPIN-OFF**
11 **ON CAPITAL EXPENDITURES OF LTD AND THE UNITED KANSAS LECs?**

12 A. Both Mr. Harper²¹ and Mr. Daniel²² similarly state that LTD will have adequate cash
13 after the spin-off to attract capital, pay dividends, and invest in capital expenditures at a
14 level necessary to maintain the current level of service.

15
16 Mr. Harper also states that after the spin-off, the United Kansas LECs will have sufficient
17 cash to invest in its network, pay expenses, and pay a dividend to shareholders.²³
18 However, neither of these Sprint witnesses provides documentation or an adjusted cash
19 flow study to show that the Kansas United LECs will have adequate cash to make capital
20 expenditures at a reasonable level.

21

²¹ Harper Direct Testimony, p. 30, lines 6 to 9.

²² Daniel Direct Testimony, p. 4, lines 18 to 27, p. 8, lines 2 to 8, and p. 10, lines 20 to 23.

1 Sprint witnesses make general statements about capital expenditures but do not provide
2 adequate testimony or analysis to address:

- 3
4 1) the specific amounts and reasons for the levels of capital expenditures that should be
5 included in an LTD or United Kansas LEC cash flow analysis;
6
7 2) the specific levels of capital expenditures and how they will affect the cash flow of
8 either LTD or the United Kansas LECs;
9
10 3) the projected capital expenditure levels included in the cash flow analysis and how
11 these amounts compare to historical levels of capital expenditures, in order to explain
12 if the projected reductions in capital expenditures for LTD (or the United Kansas
13 LECs) are due to inadequate cash and cash flows of LTD and the United Kansas
14 LECs after the spin-off or if the reductions in capital expenditures would have taken
15 place without the spin-off of LTD; and
16
17 4) how the projected reduction in capital expenditures will serve the public interest and
18 provide for adequate service quality, meet customer needs, and allow LTD to
19 compete with Sprint in the future.
20

21
22 In conclusion, Sprint witnesses have not adequately addressed the issue of capital
23 expenditures. Therefore, the Commission should deny this application. However, in the
24 event the Commission approves the application, I have identified conditions that are
25 necessary to adopt at the end of this section.
26

27 **Q. ARE YOU CONCERNED THAT SPRINT MAY HAVE CUT LTD'S CAPITAL**
28 **EXPENDITURES BECAUSE OF CASH FLOW CONSTRAINTS IMPOSED BY**
29 **THE SIGNIFICANT DEBT LEVELS AND OTHER COSTS OF THE SPIN-OFF?**

30 A. Yes. This is a concern. I am concerned that Sprint reduced the level of capital
31 expenditures for LTD in the future in order to make the cash flow situation of LTD
32 appear better than the actual results after the spin-off.
33

1 Because inadequate capital expenditure levels are difficult to assess in advance of the
2 resulting problems, this may have been the one cash flow item that was easiest to reduce
3 in order to mask any cash flow constraints imposed upon LTD by the significant debt
4 levels and other costs of the spin-off. I cannot determine with any certainty whether the
5 reductions in LTD capital expenditures were caused by cash flow constraints of the spin-
6 off, or whether these reductions in capital expenditures would have occurred regardless,
7 due to reduced customer demand, completion of necessary modernization plans, or other
8 reasons. Sprint's response to CURB DR 2.23 states that reductions in United Kansas
9 LEC capital expenditures are due to decreased customer demand and completion of
10 certain mandate modernization programs in Kansas, but there is no specific analysis to
11 support these conclusions.

12
13 For example, Sprint's response to CURB DR 2.23 and CWA DR 33 objected to
14 providing information regarding the United Kansas LEC's expenditure for DSL plant in
15 Kansas. This causes me concern because DSL is one critical area where the impacts of
16 future expenditures in Kansas could have been more easily evaluated. DSL provisioning
17 has been an important issue subject to evaluation in KCC proceedings involving both
18 Southwestern Bell of Kansas and the United Kansas LECs. Sprint's objection to
19 providing this DSL information raises concerns regarding the timing and adequacy of
20 plant expenditures in Kansas.

21
22 Most importantly, Sprint did not provide any information regarding projected capital
23 expenditures for the United Kansas LECs, precluding any reasonable or adequate
24 evaluation of this important issue.

25

1 **Q. WHAT CONDITIONS DO YOU RECOMMEND REGARDING CAPITAL**
2 **EXPENDITURE LEVELS FOR KANSAS IN THE FUTURE?**

3 A. If the Commission does not deny this application, the Commission should adopt specific
4 conditions regarding United Kansas LEC capital expenditures. Attachment BCO-2 is a
5 comprehensive list of conditions that I recommend. Some of the “general” conditions
6 that I recommend at Attachment BCO-2 are also applicable to this issue, because the
7 capital expenditures issue could ultimately have a negative impact on service, quality,
8 customer rates, cash flows, and other issues. However, I have not repeated those same
9 general conditions in this section.

10
11 The United Kansas LECs should be required to expend a minimum level of capital for
12 each of the next three years equal to *****BEGIN CONFIDENTIAL*****

13
14 *****END CONFIDENTIAL*****. This is based on the average
15 capital expenditures for the two most recent years 2003 and 2004, identified in Sprint’s
16 response to Staff DR 31.

17
18 An example of an appropriate expenditure requirement occurred in Vermont, where the
19 Vermont Public Service Board (Vermont Board) has required Verizon to make minimum
20 capital investments each year in Vermont in the two successive incentive regulation
21 plans. The most recent incentive regulation plan adopted by the Vermont Board in
22 Docket No. 6959 on September 26, 2005, requires that Verizon invest \$40 million
23 annually.²⁴

24

²⁴ Vermont Board’s Order, dated September 26, 2005, in Docket No. 6959. The \$40 million capital investment requirement is set forth at Appendix B of the Order, Section IV. “Infrastructure Investment.”

1 The Commission should adopt the following conditions to satisfy the public interest:

2
3 **Condition 1 for Capital Expenditures** – The United Kansas LECs should be required to
4 expend a minimum level of capital for each of the next three years equal to **the amount**
5 **previously set forth.** This is based on the average capital expenditures for the two most
6 recent years 2003 and 2004, identified in Sprint’s response to Staff DR 31. The United
7 Kansas LECs should make a specific filing with the KCC by March 31st of each of the
8 next three years to certify the capital expenditure level, and to explain the capital
9 expenditure amounts by account description and type of capital expenditure. This would
10 include a description of the status of DSL expenditures, the number of customers by
11 exchange that have DSL available to them, and the manner in which DSL is provisioned
12 to customers. If service quality concerns arise over this period, then a separate
13 investigation of this issue would be warranted.

14
15 **Alternative Condition 1 for Capital Expenditures** - If the Commission does not decide
16 to establish a minimum level of capital expenditures, then the Commission should still
17 require the United Kansas LECs to make a specific filing with the KCC by March 31st of
18 each of the next three years to certify the capital expenditure level, and to explain the
19 capital expenditure amounts by account description and type of capital expenditure. This
20 should be treated as a docketed proceeding to allow customers of United Kansas LEC
21 customers and interveners to address public interest issues, service quality issues, the
22 availability of services, and other relevant issues.

23
24

1 **SPIN-OFF TRANSACTION COSTS AND MERGER COSTS CONCERNS**

2
3 **Q. CAN YOU EXPLAIN THE SPIN-OFF TRANSACTION COSTS THAT LTD**
4 **WILL INCUR AS A RESULT OF THIS TRANSACTION?**

5 **A.** Yes. LTD will incur certain transaction costs in order to implement the spin-off. Sprint's
6 response to Staff DR 25 states that LTD will probably be assigned some portion of these
7 spin-off transaction costs, although the amounts to be assigned to LTD have not been
8 determined. Based on this response, it appears some portion of these costs will be
9 allocated to United Kansas LEC operations using the Kansas allocation factor of 1.71%.
10 Although Sprint's response to Staff DR 25 indicates that some portion of these spin-off
11 transaction costs will "in all probability" be assigned to LTD, Mr. Daniel has "definitely"
12 assigned these same transaction costs to LTD in his cash flow and operating statement
13 projections that were provided in Sprint's response to CURB DR 1.31.

14
15 The projected amount of spin-off transaction costs are shown in Mr. Daniel's
16 "LTD/SpinCo Projections 2005-2007 (excludes North Supply)". The total spin-off
17 transaction amounts included in Mr. Daniels 2006 projections include *****BEGIN**

18 **CONFIDENTIAL*****

19
20
21 *****END CONFIDENTIAL*****

22
23 Examples of spin-off transaction costs include: 1) rebranding and advertising costs
24 (includes consulting fees and costs of rebranding/new logo for LTD); 2) retention
25 bonuses (bonuses payable to employees); 3) launch costs (expenses to celebrate launch
26 of new company, stock option awards for non-E-grade employees vesting over 2 years);

1 4) expense dissynergies; and 5) other costs. These and other spin-off related costs could
2 include accounting fees, legal fees, filing fees, bank facility fees, investment banker &
3 broker fees, economist fees, fees for witnesses in spin-off application cases, rate agency
4 fees, advisor fees, and other professional fees and costs.

5
6 **Q. HOW SHOULD THE SPIN-OFF TRANSACTION COSTS BE TREATED?**

7 A. The United Kansas LECs should not be allowed to recover any of these costs in rates,
8 through price caps (and exogenous cost provisions), rate cases, alternative regulation, or
9 other means. These costs should not be recovered from the Kansas Universal Service
10 Fund (KUSF) or in any wholesale/unbundled network element (UNE) proceedings.
11 These costs should not be allowed to be recovered in rates because they are non-
12 recurring, extraordinary, and were imposed upon LTD and the United Kansas LECs by
13 Sprint's actions to spin-off LTD and LEC operations. In addition, it appears that many of
14 these costs do not directly benefit services or the customers of local or regulated services.
15 It is not clear that Sprint provided any spin-off transaction costs that it will incur, so
16 Sprint may be attempting to allocate all or most of these costs to regulated LECs.

17
18 **Q. ARE THERE OTHER COSTS THAT SHOULD BE TREATED CONSISTENTLY**
19 **WITH THE SPIN-OFF TRANSACTION COSTS?**

20 A. If other non-recurring, extraordinary, or similar costs are incurred, then they should be
21 treated the same as I previously recommended for spin-off transaction costs. This might
22 include severance costs or other work-force reduction costs.

23
24 **Q. HOW SHOULD MERGER COSTS BE TREATED?**

25 A. Merger costs related to the merger between Sprint and Nextel should not be included in
26 the operating financial statements of the United Kansas LECs, and if any of these costs

1 are present they should be treated the same as my recommendation for spin-off
2 transaction costs.


3

4 **Q. DID SPRINT-NEVADA (THE LEC) STIPULATE IN NEVADA THAT IT**
5 **WOULD NOT SEEK TO RECOVER FROM RATEPAYERS CERTAIN**
6 **MERGER AND SPIN-OFF TRANSACTION COSTS?**

7 A. Yes. In the Nevada spin-off application, the October 2005 stipulation in Docket No. 05-
8 8032 states that Sprint Nevada will not seek to recover from ratepayers any direct costs of
9 the merger or spin-off/separation. The stipulation also requires this treatment for
10 severance costs and the costs for branding.²⁵

11

12 **Q. WHAT COMMENTS DO YOU HAVE REGARDING MR. HARPER'S**
13 **ASSERTIONS ABOUT THE MATERIALITY LEVEL OF TRANSITION**
14 **EXPENSES?**

15 A. Mr. Harper states that, initially, the operating expenses may increase by ***BEGIN
16 CONFIDENTIAL***  ***END CONFIDENTIAL*** which is not significant to
17 either United or LTD. Even if the costs that I identified fall below this threshold, they
18 should still be excluded from operations of the United Kansas LECs. Also, it seems
19 contrary to logic that a certain "percentage" of expenses that is deemed to be insignificant
20 by United or LTD is considered to be "confidential". If a "percentage" is not material,
21 why would it be deemed confidential? The confidentiality element raises concerns for
22 me about the validity of the percentage, so removing these type of costs is a reasonable
23 policy.

²⁵ Nevada Stipulation, before the Public Utilities Commission of Nevada, Docket No. 05-8032, executed October 24, 2005 between Sprint of Nevada and the Office of the Attorney General, Bureau of Consumer Protection, re: *Application of Central Telephone Company – Nevada d/b/a Sprint of Nevada ("CTC-N") for approval of the change of control of CTC-N from Sprint Nextel Corporation to LTD Holding Company*, see page 3, items 2 through 6 of the Agreement section.

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Q. WHAT CONDITIONS DO YOU RECOMMEND REGARDING THESE SPIN-OFF TRANSACTION COSTS AND OTHER RELATED COSTS?

A. Attachment BCO-2 is a comprehensive list of conditions that I recommend. Some of the “general” conditions that I recommend at Attachment BCO-2 are also applicable to this issue, because the spin-off transaction costs could ultimately have a negative impact on customer rates and other issues. However, I have not repeated those same general conditions in this section. The Commission should adopt the following conditions to satisfy the public interest:

Condition 1 for Spin-Off and Related Costs – All spin-off transaction costs, merger costs, force reduction costs, and other similar costs should not be allowed to be recovered in customer rates via rate cases, price caps (exogenous costs), or in proceedings affecting the KUSF and wholesale/UNEs. This treatment applies to expenses and capitalized amounts.

Condition 2 for Spin-Off and Related Costs – The spin-off, merger, and similar costs should be written off the regulatory books immediately, and should not be amortized or carried forward on the regulatory books for future rate recovery. The United Kansas LECs should provide an annual monitoring report showing and describing these types of costs, and showing that these costs have been written off of the regulatory books in Kansas. This treatment applies to expenses and capitalized amounts.

1 **TRANSITION AND COMMERCIAL SERVICES AGREEMENT CONCERNS**

2
3 **Q. CAN YOU EXPLAIN CONCERNS WITH TRANSITION AND COMMERCIAL**
4 **AGREEMENTS?**

5 A. Transition Service Agreements (TSAs) and Commercial Service Agreements (CSAs) will
6 be entered into by Sprint and LTD. According to Sprint's response to Staff DR 5, the
7 majority of TSAs will be no more than one year, and a few will have a duration no more
8 than two years. This same data request includes a list of TSAs. According to Staff DR
9 78, the Master TSA contains provisions addressing early termination.

10
11 **Q. ARE THESE CONTRACTS BEING ENTERED INTO BY SPRINT AND LTD AS**
12 **AN ARMS-LENGTH TRANSACTION?**

13 A. No. Sprint management is making decisions regarding the transition agreements and the
14 spin-off generally, and the LTD entity does not exist as a separate legal entity at this time
15 to represent independent interests. The TSAs and CSAs should be closely scrutinized
16 because they fail to represent an arms length negotiation between two parties, and LTD
17 and its customers are the party at risk because they are subject to the preferred interests of
18 Sprint. Therefore, the contracts should be carefully scrutinized because of Sprint's
19 obvious conflict of interest.

20
21 Sprint's SEC Form 10 filed on January 23, 2006, confirms these concerns as "risks." The
22 risk factors section beginning at page 9 states, "The agreements that we are entering into
23 with Sprint Nextel may involve, or may appear to involve, conflicts of interests." In
24 addition, some of these agreements may be subject to early termination.

25

1 The SEC form indicates that certain transactions entered into could be viewed being
2 subject to a conflict of interest because LTD employees negotiated these agreements
3 while LTD was still a wholly owned subsidiary of Sprint Nextel and these same
4 employees, officers or directors still have an obligation to serve the interests of Sprint
5 Nextel.

6
7 **Q. WHAT CONCERNS DO YOU HAVE REGARDING THESE TSAS AND CSAS?**

8 A. Attachment BCO-2 is a comprehensive list of conditions that I recommend. Some of the
9 “general” conditions that I recommend at Attachment BCO-2 are also applicable to this
10 issue, because the problems with transition and commercial service agreements could
11 ultimately have a negative impact on customer rates and other issues. However, I have
12 not repeated those same general conditions in this section. I have set forth some of these
13 concerns below:

14
15 1) **Wireless Service Resale – ***BEGIN CONFIDENTIAL*****

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20 *****END CONFIDENTIAL*****

21
22 I am concerned with these provisions. LTD should not have to pay any

23 *****BEGIN CONFIDENTIAL*****
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[REDACTED] *****END**

CONFIDENTIAL***

2) **TSAs – ***BEGIN CONFIDENTIAL***** [REDACTED] *****END**

CONFIDENTIAL***

I am concerned with these *****BEGIN CONFIDENTIAL**** [REDACTED] *****END**

CONFIDENTIAL***

3) **Long Distance Service Resale – ***BEGIN CONFIDENTIAL***** [REDACTED]

[REDACTED]

[REDACTED] *****END CONFIDENTIAL*****

1 I am concerned that the terms are excessive and do not allow LTD to
2 competitively bid this service with independent carriers that may provide them
3 better contractual terms than Sprint.

4
5 **Q. WHAT CONDITIONS DO YOU RECOMMEND REGARDING THESE TSAS,
6 CSAS AND AGREEMENTS BETWEEN SPRINT AND LTD?**

7 A. The Commission should adopt the following conditions to satisfy the public interest:

8
9 **Condition 1 for Related Party Contracts** – All unusual costs and elements should not
10 be subject to recovery in rates of regulated services before the Commission. LTD should
11 be required to file documents with the KCC on an annual basis to specifically explain the
12 terms and payments made between Sprint and LTD until the contract expires.

13
14 **Condition 2 for Related Party Contracts** – LTD should be required to provide a
15 separate report with the KCC on an annual basis that compares the wholesale rates
16 provided by Sprint to LTD, and how these rates compare to the market and average retail
17 rates. Regulated ratepayers should not experience a rate increase for long distance
18 service due to affiliated contracts that favor one party's interests over another party and
19 when the terms may harm competition.

20
21 **Condition 3 for Related Party Contracts** – LTD should be required to file independent
22 reports to show if the transactions between Sprint and LTD are reflected at the lower of
23 cost or market when Sprint is providing pricing and services to LTD, or if based on
24 reasonable tariff pricing. If the pricing is based on the higher of cost or market, then
25 Sprint should have to explain and justify the rationale for this pricing and explain how
26 this comports with affiliate transaction guidelines of the FCC.

1 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

2 A. Yes.

3

4

BION C. OSTRANDER, CPA

General

Mr. Ostrander is an independent regulatory consultant, a practicing CPA, and has twenty-five years of regulatory and accounting experience with a specialization in telecommunication issues. Mr. Ostrander's firm, Ostrander Consulting, has been providing consulting services since 1990. Previously, Mr. Ostrander served as the Chief of Telecommunications for the Kansas Corporation Commission ("KCC") from 1986 to 1990, and served as Chief Auditor for the KCC on gas, electric and telecom cases from 1983 to 1986. Mr. Ostrander also worked for two CPA firms, and directed audits of utility companies and other entities for Deloitte, Haskins and Sells (now Deloitte & Touché). Mr. Ostrander has investigated matters related to Bell Atlantic/GTE/Verizon, Southwestern Bell, U S WEST, Sprint, Ameritech, BellSouth, numerous independent local exchange companies ("ILECs"), AT&T, MCI, Relay Service Providers, and others.

Mr. Ostrander has conducted revenue requirement reviews (rate cases), alternative regulation/price cap plans and management audits. Mr. Ostrander has addressed a broad range of regulatory issues including: revenue requirement accounting issues, cost allocation between regulated/nonregulated operations, compensation/benefits review, affiliate interest issues, review of cost allocation manuals ("CAM"), FCC separations issues, cross-subsidization, competition policy, UNE cost studies, universal service cost studies, rate design, depreciation, slamming policy, audits of universal service funds, affordable local service, quality of service, infrastructure development, access charge restructure and other matters. Mr. Ostrander has no conflict of interest issues because his clients consist primarily of state consumer advocate offices and public service commissions.

~~Recent Experience - Major Cases~~
Recent Experience - Major Cases

~~2005 - LTD & Sprint/Nextel Change of Control - Kansas: On behalf the Citizens' Utility Ratepayer Board ("CURB") of Kansas, Mr. Ostrander is evaluating the separation and creation of a new local service holding company and the potential impact on customers, rates, competition, service quality, etc.~~

~~2005 - LTD & Sprint/Nextel Change of Control - Nevada: On behalf of the Nevada Board of Consumer Protection, Mr. Ostrander addressed the same issues for Nevada as the Kansas case above.~~

~~2005 - Saudi Arabia Communications and Information Technology Commission (CTIC): Assess Saudi Telecom's proposed accounting separation and allocations manual on behalf of the CTIC.~~

~~2005 - Various Alaska LECs - Alaska: Reviewed the intrastate revenue requirements of these LECs making rate case-type adjustments and addressing rate design issues.~~

~~2005/2004 - Verizon Vermont: On behalf of the Vermont Department of Public Service, Mr. Ostrander evaluated Verizon Vermont's revenue requirements, Yellow Pages, affiliate transactions, work force reductions, depreciation issues, infrastructure/modernization, and policy issues as part of a new alternative regulation plan ("ARP") to go in place in 2005, after the expiration of the current plan. Mr. Ostrander previously conducted an earnings review and evaluation of the prior ARP five years ago in Vermont.~~

~~2005 - Verizon Maine: On behalf of AARP, Mr. Ostrander is currently addressing the revenue requirements of Verizon Maine, and addressing issues such as Yellow Pages and affiliate transactions.~~

- 2005 – Southwestern Bell Kansas: On behalf of the CURB, Mr. Ostrander assisted with the review of SWBT’s request for deregulation of local and other services in certain metro exchanges. As a result, basic local residence and business service was not deregulated, and SWBT was only granted regulatory “flexibility” on bundled services and deregulation on some high-end business services.
- 2005 - 2003 – Cable & Wireless Barbados (“C&W”): On behalf of the Fair Trading Commission (“FTC”), the regulatory agency in Barbados, Mr. Ostrander evaluated a proposal by C&W in 2003/2004 to move away from flat-rate local service to introduce “measured or usage-based” local service at increased rates, as well as policy issues to expand cellular competition. Mr. Ostrander addressed the revenue requirements of C&W, proposed significant revisions to these revenue requirements, and reviewed the C&W cost model and the costs of local, cellular, and other services. The FTC’s final decision in July 2004 rejected the C&W proposal, and maintained local rates at existing levels without a switch to measured service.
- 2004/2003 – Cable & Wireless Eastern Caribbean States: On behalf of the Eastern Caribbean Telecommunications Authority (“ECTEL”), the regulatory agency for certain Caribbean nations, and the nations of St. Lucia, Grenada, St. Vincent, St. Kitts/Nevis, Mr. Ostrander evaluated policy to introduce and expand cellular competition in these Caribbean nations, and reviewed C&W cost models, evaluated the cost of fixed local and cellular service, price caps, and other issues. This project resulted in substantial regulatory concessions to customers and significant reductions in retail cellular calling rates.
- 2005 - 2002 – Verizon Maryland: Assisted the Maryland Office of Public Counsel in evaluating revenue requirements and a new ARP to settle contested proceedings in Case No. 8918 and prior year price cap reduction cases. Mr. Ostrander conducted the earnings review of Verizon Maryland in the Case No. 8918.
- 2004/2003 – FCC Triennial Order: On behalf of the Michigan Attorney General, Special Litigation Dept. (“MAG”) and the Kansas CURB, Mr. Ostrander evaluated the impacts of the TRO for Michigan and Kansas in generic proceedings.
- 2004/2003 – Michigan SBC/Ameritech UNEs: Evaluated cost studies and UNEs on behalf of the MAG.
- 2003 – Verizon, BellSouth, and Sprint – Florida: Addressing the impact of proposed rate rebalancing, rate design, and universal service issues for the Florida Attorney General, Office of Public Counsel.
- 2002/2003 – Verizon Maryland Price Caps/Earnings Review: Evaluated price cap plan, earnings/revenue requirements, and deregulation issues on behalf of the Maryland Office of Public Counsel.
- 2003 – Monitor DSL Provision of SWBT Kansas: Evaluating SWBT’s failure to comply with provisioning DSL in Kansas per a prior year Stipulation and Agreement on behalf of CURB.
- 2002/2001 – Western Resources/KP&L Affiliate Interest Issues: Evaluated the allocation of costs between regulated and non-regulated operations, compensation/benefits issues, examined flight logs in regards to improprieties, and other rate case adjustments in this rate case on behalf of CURB.
- 2002 – Ameritech Michigan 271 Application: Evaluated Ameritech’s 271 application in Michigan on behalf of MAG.
- 2002 - Sprint Nevada Earnings Review/Alternative Regulation Plan: Evaluated revenue requirements/earnings and alternative regulation plan of Sprint Nevada on behalf of the Nevada Office of Attorney General, Bureau of Consumer Protection (“NBCP”).
- 2002 – Kansas Generic Price Cap Case: Addressed update of price cap factors and issues for CURB.

Work History

**Ostrander Consulting -
Principal**

Ostrander Consulting principally addresses regulatory issues on behalf of public advocates, Attorney Generals, state public service commissions and other state regulatory agencies. Services include those related to rate cases, competition assessment, alternative regulation/price cap plans, cost studies/cost allocation, management audits, infrastructure studies, relay audits and special investigations.

**Kansas Corporation Commission -
Chief of Telecommunications**

Supervised staff and directed all telecommunications-related matters including assessment of rate cases of SWBT, United/Sprint and rural LECs. Also, directed actions regarding alternative regulation plans, establishing access charge policy, transition to intrastate competition, depreciation filings, establishment of the Kansas Relay Center, filings with the FCC, billing standards, quality of service, consumer complaints, staff training and over one hundred docketed regulatory matters per year. Mr. Ostrander was the lead witness on all major telecommunications matters.

**Kansas Corporation Commission -
Chief Auditor**

Directed rate cases of gas, electric and telecom companies prior to promotion to Chief of Telecommunications.

**Mize, Houser, Mehlinger and Kimes (now Mize Houser & Company Professional Association) -
Auditor – CPA firm**

Performed auditing, tax and special projects for various industries.

**Deloitte, Haskins and Sells (now Deloitte & Touché) -
Auditor – CPA firm**

Performed auditing, tax and special projects in industries such as utilities, savings and loan, manufacturing, retail, construction, real estate, insurance, banking and not-for-profit.

Education

University of Kansas - B.S. Business Administration with a Major in Accounting, 1978.

Professional License and Affiliations

- Maintains a permit to practice as a CPA in Kansas
- Member of the American Institute of CPAs (AICPA)
- Member of the Kansas Society of CPAs (KSCPA).

International

- Mr. Ostrander addressed issues regarding revenue requirements, rate design, and competition on behalf of the Fair Trading Commission in Barbados and the Eastern Caribbean Telecommunications Authority (“ECTEL”), representing the nations of St. Lucia, St. Vincent, Grenada, St. Kitts/Nevis, and Dominica.
- Mr. Ostrander addressed competition, utility and regulatory issues for Russian and Ukrainian regulatory and utility entities in association with a Ukrainian entity.

CURB PROPOSED CONDITIONS APPLICABLE TO THE
UNITED KANSAS LECs REGARDING THE LTD SPIN-OFF

CURB recommends that the Commission deny the spin-off application. The following conditions should be included in any Commission order that approves the application. The Commission could grant the application subject to these attached conditions that act as safeguards and controls, and which are consistent with the public interest. These conditions should bind Sprint, LTD and the United Kansas LECs.

A. REGULATION/RATES:

1. The LECs will remain subject to price cap rules until the Commission determines otherwise in a separate proceeding. The LECs will not use this spin-off transaction to propose a return to ROR regulation (traditional regulation). The term “propose” is intended to mean that the LECs will not file documents or applications with the Commission to propose a return to ROR regulation, and the LECs will not propose changes in Kansas legislation or rules.

B. COSTS NOT RECOVERED:

2. The LECs will not seek to recover from ratepayers, competitors (such as via wholesale/unbundled network element proceedings), the KUSF, in any regulatory proceeding (including price cap plans with exogenous provisions) any costs or impacts resulting from the spin-off transaction. The costs or impacts that cannot be recovered include:
 - a. any increased cost of capital, equity or debt (or overall ROR) that is attributed to increased costs, risk, or leverage, decreased debt ratings, or other factors resulting from the impacts of the spin-off transaction;
 - b. any spin-off transaction costs that include (but are not necessarily limited to) professional fees, accounting fees, bank facility fees, banker, broker and investment banker fees, legal fees, document processing fees, outside economist advisor fees, filing fees, rating agency fees, other outside professionals used by Sprint, LTD or the LECs regarding the spin-off transaction and subsequent advisement thereafter (any such costs should be written off as soon as possible, and no amounts should be amortized or carried forward on any Kansas state regulatory books of the LECs);
 - c. any spin-off or related costs related to the development, communication, and launching of the LECs new name, brand, logo, etc.

- d. any force reduction costs, separation costs, job placement fees/services, benefits, and similar costs related to downsizing related to the spin-off;
 - e. any retention bonuses or other incentives paid to management or employees as an incentive to move to, or remain with, the LTD/LECs;
 - f. any losses from valuation, losses from the sale or exchange of assets, and losses related to allocation of shared assets with and generally related to the spin-off transaction;
 - g. any increased pension costs or other post-employment benefit costs that are a result of the spin-off;
 - h. any increases in corporate overhead costs or shared costs among affiliates and former affiliates, using a comparison of these amounts (by type of cost) before and after the spin-off as a basis for determining increases in cost; and
 - i. any capital costs or amortized costs related to the previous amounts cannot be recovered.
3. All shared assets that cannot be specifically located at spin-off will be written-off, or the LECs will not record these amounts on their books or not reimburse Sprint or LTD for these assets before or subsequent to the spin-off.
4. The LECs will not attempt to recover any costs of the spin-off transaction by imposing miscellaneous fees, regulatory fees, or other similar fees on monthly customer bills (such as unauthorized increases in the federal EUCL, PICCs, or other similar charges).

C. CAPITAL STRUCTURE ISSUES (from testimony):

5. **Condition 1 Regarding Capital Structure** – The United Kansas LECs should not be able to seek a return to rate-of-return regulation or seek rate relief from other alternative regulatory practices in order to cure problems that result from the spin-off, including excessive debt levels, cash flow constraints, and other matters.

Condition 2 Regarding Capital Structure – If there is some remote situation that would result in the United Kansas LECs seeking rate relief, then the Commission should use the actual debt intensive capital structure of this LEC to determine an appropriate ROR. A hypothetical capital structure that assigns higher levels of equity or levels of debt should not be used.

Condition 3 Regarding Capital Structure – All final debt instruments, or other means used to assign debt or obligations to LTD by Sprint, should be provided to the Commission as soon as possible and subject to Commission oversight. To the extent documents and actions impose unforeseen conditions that negatively

impact the United Kansas LECs, then the Commission should open another investigation to address and monitor these issues. The final “separation and distribution” agreement should be filed with the Commission and subject to the review of Staff, CURB and other parties to determine if there are any additional concerns to address in subsequent proceedings. The Commission could leave the current docket open for these purposes.

Condition 4 Regarding Capital Structure - The Company should inform the Commission if its bond rating should decline, and the Company should be required to explain the reasons for the bond rating change and provide copies of appropriate documents from bond rating agencies.

Condition 5 Regarding Capital Structure - None of the assets of the United Kansas LECs should be used to secure any debt that is issued by LTD.

Condition 6 Regarding Capital Structure - The Company should inform the Commission prior to taking any extraordinary measures to address financing or capital attraction issues. For example, if the Company begins to liquidate any assets or sell off its local exchanges in Kansas or other states in order to address financial-related concerns, then the Commission should be informed of all plans.

D. CASH FLOW (from testimony):

6. **Condition 1 Regarding Cash Flow** – The Commission should require Sprint (not the new LTD) to leave the United Kansas LECs with free cash account balances adequate to meet all working capital requirements for at least one year.

Condition 2 Regarding Cash Flow - The United Kansas LECs should not be allowed to seek any form of rate relief for regulated services in the future due to cash flow deficiencies that result from the spin-off and that are related to the LEC’s inability to service its debt, its inability to pay dividends to LTD, its inability to make capital investments, and its inability to pay spin-off related costs and other costs.

Condition 3 Regarding Cash Flow – The United Kansas LECs cannot use cash flow deficiencies or constraints as a reason for failing to introduce services on a timely basis that are state-of-the-art, reasonably priced or competitively priced (where appropriate) to similar services offered by Sprint Nextel and other competitors.

Condition 4 Regarding Cash Flow - The United Kansas LECs (and to the extent this indirectly impacts LTD) should not have to use their cash flow to pay for the transfer of long distance customers from Sprint, and should not have to fund accrued obligations for FAS 106 OPEBs. Sprint has indicated that the transfer of long distance customers will not impact cash and this will be handled through an inter-company settlement at spin-off, so United Kansas LECs (and

LTD) cash should not be negatively impacted. Also, as previously stated in Mr. Ostrander's testimony, OPEB obligations should be cash-funded before spin-off with the cash of Sprint and not LTD. If the United Kansas LECs and LTD would not have had to "pay" dividends to Sprint in the past in the form of most of their residual cash balances, then both the United Kansas LECs and LTD would have the cash reserves to fund these OPEB amounts. However, because Sprint has taken most of the cash reserves from the United Kansas LECs in the past, Sprint should be required to cash-fund OPEB amounts.

E. CAPITAL EXPENDITURES:

7. **Condition 1 for Capital Expenditures** – The United Kansas LECs should be required to expend a minimum level of capital for each of the next three years equal to the amount set forth in Mr. Ostrander's testimony. This is based on the average capital expenditures for the two most recent years 2003 and 2004, identified in Sprint's response to Staff DR 31. The United Kansas LECs should make a specific filing with the KCC by March 31st in each of the next three years to certify the capital expenditure level, and to explain the capital expenditure amounts by account description and type of capital expenditure. This would include a description of the status of DSL expenditures, the number of customers by exchange that have DSL available to them, and the manner in which DSL is provisioned to customers. If service quality concerns arise over this period, then a separate investigation of this issue would be warranted.

Alternative Condition 1 for Capital Expenditures - If the Commission does not decide to establish a minimum level of capital expenditures, then the Commission should still require the United Kansas LECs to make a specific filing with the KCC by March 31st in each of the next three years to certify the capital expenditure level, and to explain the capital expenditure amounts by account description and type of capital expenditure. This should be treated as a docketed proceeding to allow customers of United Kansas LEC customers and interveners to address public interest issues, service quality issues, the availability of services, and other relevant issues.

F. RELATED PARTY CONTRACTS AND TRANSACTIONS:

8. **Condition 1 for Related Party Contracts** – All unusual costs and elements should not be subject to recovery in rates of regulated services before the Commission. LTD should be required to file documents with the KCC on an annual basis to specifically explain the terms and payments made between Sprint and LTD until the contract expires.

Condition 2 for Related Party Contracts – LTD should be required to provide a separate report with the KCC on an annual basis that compares the wholesale rates provided by Sprint to LTD, and how these rates compare to the market and

average retail rates. Regulated ratepayers should not experience a rate increase for long distance service due to affiliated contracts that favor one party's interests over another party and when the terms may harm competition.

Condition 3 for Related Party Contracts – LTD should be required to file independent reports to show if the transactions between Sprint and LTD are reflected at the lower of cost or market when Sprint is providing pricing and services to LTD. If the pricing supports the higher of cost or market then Sprint should have to justify these actions.

G. SERVICES:

9. On the day after the spin-off transaction, the LECs will offer the full range of products and services that are offered the day prior to the spin-off transaction, at the same prices, and subject to the same rules, terms, conditions, and tariffs. Any changes to the LECs product portfolio, prices, terms or conditions after the first day of the spin-off transaction will be subject to Commission review and approval. The Commission has the authority to address and determine if any proposed changes in prices, terms or conditions have a negative impact on customers that was caused by the spin-off transaction. If any negative impacts are related to the spin-off transaction, then the Commission has the authority to deny any such negative impacts.
10. Terms and prices for existing wholesale and resale services, including interconnection agreements and the LECs access tariff, will remain unchanged until such time as the Commission determines otherwise in a separate proceeding or until the interconnection agreement expires. Sprint Nextel and the LECs will continue to file and provide the Commission with all Kansas-related interconnection and wholesale agreements with non-affiliated entities/competitors, and will not consider these to be "commercial" agreements in order to avoid filing subject to Section 252 of the Federal Telecom Act. In addition, for agreements and transactions between Sprint Nextel (and its affiliates) and LTD (and its affiliates, including the Kansas LECs), the parties will file with the Commission copies of all "transition" service agreements and any subsequent interconnection agreements, wholesale agreements, and commercial agreements.

H. SERVICE QUALITY:

11. The spin-off transaction will have no adverse effect on the quality of service of the LECs in Kansas. The Commission has the authority to initiate a proceeding to determine if changes in service quality are related to the spin-off, and to implement additional service quality conditions and controls. If negative impacts on service quality are a result of the spin-off, the LECs will provide refunds, rate

reductions, and other necessary reimbursement to LEC customers on a retroactive basis.

12. Customers will continue to call existing numbers to obtain new services, report problems, and address billing or other customer care issues.

I. COMPETITION:

13. The spin-off transaction will not be used by Sprint Nextel to gain a competitive advantage for regulated, non-regulated, and bundled services over the LECs. Sprint Nextel and its affiliates will agree that before these entities compete with the LECs for local and bundled services in the same Kansas City area exchanges and other exchanges, that they will first compete with Southwestern Bell Telephone Company of Kansas for similar services in the Kansas City metropolitan area.
14. The spin-off transaction will not be used to create another entity to duplicate recovery of state universal service funds for the same customer groups in the existing Kansas LEC territories.

J. CPNI:

15. Employees of Sprint Nextel (and affiliates) and the LECs that before the spin-off have access to and knowledge of customer proprietary network information (CPNI) of the LECs, cannot be employed in positions with Sprint Nextel and affiliates that would allow this information to be used to the competitive advantage of Sprint Nextel against the LECs. The controls are intended to follow the intent of those set forth under the Federal Telecom Act. For example, certain information related to the LECs customers cannot be retained by Sprint Nextel and affiliates (or their employees), such as customer databases, locations, names, addresses, phone numbers, services provided, network information, etc.

K. OTHER:

16. The LECs will continue to provide free in-bound 800 service to certain schools and county governments in accordance with 02-GIMT-272-GIT.
17. All signatory parties agree that they will continue to be subject to all previous existing KCC orders, stipulations, policy, rules and applicable statutes.
18. The signatory parties will provide Commission Staff and CURB with copies of long distance customer choice letters, prior to these letters being sent to customers.

19. Sprint Nextel, LTD, and the Kansas LECs will file monitoring reports regarding the spin-off transaction.

This concludes these conditions.

VERIFICATION

STATE OF KANSAS)
)
COUNTY OF SHAWNEE)

ss:

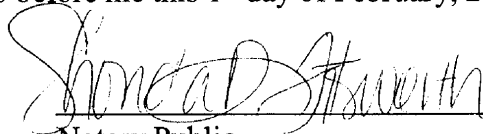
I, Bion C. Ostrander, of lawful age, being first duly sworn upon his oath states:

That he is a consultant for The Citizen's Utility Ratepayer Board; that he has read the above and foregoing testimony, and, upon information and belief, states that the matters therein appearing are true and correct.



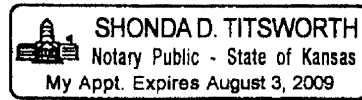
Bion C. Ostrander

SUBSCRIBED AND SWORN to before me this 1st day of February, 2006.



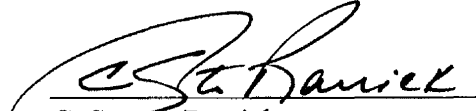
Notary Public

My Commission expires: 8-3-2009



CERTIFICATE OF SERVICE
06-SCCC-200-MIS

I, the undersigned, hereby certify that a true and correct copy of the above and foregoing "redacted" document was hand-delivered to the Commission's docket room this 1st day of February, 2006.


C. Steven Rarrick