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April 20, 2006

Ms. Beth A. O'Donnell
Public Service Commission
211 Sower Blvd.
P. O. Box 615
Frankfort, KY 40602-0615

RECEIVED
APR 21 2006
PUBLIC SERVICE COMMISSION

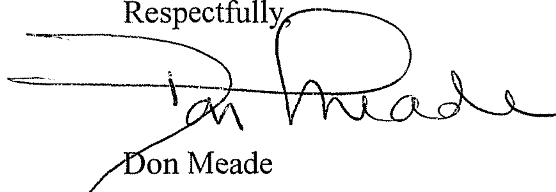
Re: Case No. 2005-00534 – Confidential Filing
Kentucky Alltel, Inc. and Alltel Kentucky, Inc.'s Intent to Transfer Assets to Valor Communications Group, Inc.

Dear Ms. O'Donnell:

The testimony of CWA/IBEW expert witness Debbie Goldman is enclosed. It is being filed under seal in the attached sealed envelope. This notice is sent pursuant to the parties' confidentiality and protective order. Confidential material is highlighted in the testimony. Exhibits entitled to protection are marked confidential.

A redacted version is being filed into the Commission's public record and is being furnished to parties not signatory to the protective order. Both a sealed and electronic copy of the confidential brief are being provided to parties signatory to the protective order.

Respectfully,



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CWA Statement 1

BEFORE THE
COMMONWEALTH OF KENTUCKY
PUBLIC SERVICE COMMISSION

RECEIVED
APR 21 2006
PUBLIC SERVICE
COMMISSION

In the Matter of Application for Approval of the Transfer of Control of Alltel Kentucky, Inc. and Kentucky Alltel, Inc. : Case No. 2005-00534

DIRECT TESTIMONY
OF
DEBBIE GOLDMAN

On Behalf of

Communications Workers of America
And
International Brotherhood of Electrical Workers

***** PUBLIC VERSION *****

April 21, 2006

1 ## Introduction and Summary

2 **Q. Please state your name, business address, employer and position.**

3 A. My name is Debbie Goldman. My business address is 501 Third St. N.W., Washington,
4 D.C. 20001. I am employed as a Research Economist for the Communications Workers
5 of America ("CWA").

6 **Q. Please describe your educational background and work experience.**

7 A. I received a Bachelors Degree from Harvard University in 1973, a Masters Degree in
8 Public Policy from the University of Maryland in 1996, and a Masters Degree from
9 Stanford University in 1975. I have been employed as a Research Economist at CWA
10 since 1992.

11 **Q. What are the duties and responsibilities of your present position?**

12 A. My primary responsibilities include telecommunications policy, financial analysis, and
13 regulatory intervention. I have provided testimony and formal comments on behalf of
14 CWA in more than 55 proceedings before the Federal Communications Commission
15 ("FCC"), the U.S. Department of Justice, and state regulatory proceedings.

16 **Q. What is the purpose of your testimony?**

17 A. I am presenting testimony on behalf of CWA and IBEW. My testimony will demonstrate
18 that the proposed spin-off and combination of Alltel Corporation's ("Alltel") wireline
19 business with Valor Communications Group, Inc. ("Valor") will result in an extremely
20 leveraged new company ("Windstream" a/k/a New Holding Company, NewCo, and the
21 Merged Wireline Business), one lacking in diversification and with questionable financial
22 wherewithal to fund needed capital expenditures to provide reliable service and to invest

1 in advanced services and infrastructure. The transaction, as currently structured, does not
2 provide any benefits to customers of Kentucky Alltel, Inc. ("KAI") and Alltel Kentucky,
3 Inc. ("AKI") (collectively "the Kentucky ILECs") and in fact would result in significant
4 harm. The Commission should not approve the Joint Application as filed.

5 **Q. Please summarize the major points of your testimony.**

6 A. I will demonstrate that Windstream will be a highly leveraged, financially weak
7 company, with fewer resources to invest in the Kentucky ILECs' networks and to provide
8 quality, reliable service to customers. The financial analysis provided by the Joint
9 Applicants contains overly optimistic financial projections. I will demonstrate that a
10 financial analysis based on more realistic projections indicates that Windstream will
11 likely experience severe financial constraints within just a few years after the proposed
12 transaction. The financial risk is exacerbated by the $2.4 billion "special dividend" that
13 Windstream must pay to Alltel.

14 The Kentucky ILECs' customers will experience considerable harm from this transaction
15 with no countervailing benefits. The proposed transfer as currently structured does not
16 serve the public interest.

17 **Q. What are your recommendations to the Commission?**

18 A. The Commission should condition any approval upon the following conditions to protect
19 consumers and ensure that a viable entity remains after separation:

20 • Windstream shall not be required to pay Alltel for its assets. Any proceeds
21 from bank or public debt shall be retained by Windstream for its
22 investment purposes.

1 • The Kentucky ILECs shall maintain a capital structure that contains at
2 least 65 percent common equity. The Kentucky ILECs shall be prohibited
3 from paying any dividend to its parent company that would reduce the
4 Kentucky ILECs' equity ratio to less than 65 percent.

5 • The Kentucky ILECs shall not pay any dividend to its parent company that
6 exceeds more than 75 percent of the Kentucky ILECs' net income and
7 shall not pay any dividend to its parent that exceeds 75 percent of cash
8 flow (defined as operating earnings after cash interest expense and cash
9 taxes).

10 • If Windstream's credit rating is downgraded below its initial credit rating,
11 it shall be required to reduce its dividend by 5 percent for each rating point
12 downgrade.

13 • The Kentucky ILECs shall provide a guaranteed minimum of $80 million capital
14 expenditures each year for the next five years.

15 • The Kentucky ILECs' reporting of service performance shall be posted on the
16 Commission website.

17 • The Commission shall require each District served by the Kentucky ILECs
18 (East, Central, and West) to clear 95 percent of out-of-service reports
19 within 24 hours; provide 95% of regular service installations within 5
20 days; and meet a trouble reporting objective of 2 or less per 100 lines. The
21 Commission shall adopt financial penalties for failure to achieve these
22 objectives in any District in any month.

23 • The Kentucky ILECs shall be required to maintain or grow current employment
24 levels and Windstream shall be required to maintain or grow current customer
25 service employment levels at existing call centers for the next five years. The
26 Kentucky ILECs shall be required to maintain employees currently working at the
27 Kentucky ILECs, with no reduction in compensation and benefits, and recognition
28 of union status and collective bargaining agreements.

29 • The division of pension fund assets between Alltel and Windstream shall
30 be proportional to the prospective pension fund liabilities of the two
31 entities.

32

1 **Windstream's Highly Leveraged, Risky Capital Structure**

2 **Q. Will the proposed transaction produce a material change to the financial condition**
3 **of the Kentucky ILECs? And if so, will the material change result in a stronger or**
4 **weaker company?**

5 A. The proposed transaction will produce a radical change in the financial condition of
6 Windstream from which the Kentucky ILECs will obtain capital to invest in their
7 business. As I discuss below, Windstream will be a much more leveraged, financially
8 weaker entity. Thus, the Kentucky ILECs after the transaction will transition from
9 affiliates that obtain financing from a financially strong entity to affiliates of a highly
10 leveraged, much weaker entity. This represents a negative and radical material change in
11 the financial condition of the Kentucky ILECs.

12 This can be seen by an examination of the pro forma balance sheets prepared by
13 Alltel. The pro forma balance sheets compare the financial condition of the operating
14 companies that will be separated from Alltel before the transaction ("Alltel Holding Co.")
15 and after the transaction ("Windstream"). Before the proposed transaction (as of
16 December 31, 2005), Alltel Holding Co. had **{Begin Confidential** XXXXX **End**
17 **Confidential}** in long-term debt and **{Begin Confidential** XXXXX **End Confidential}**
18 in retained earnings, with assets of **{Begin Confidential** XXXXX **End Confidential}**, of
19 which **{Begin Confidential** XXXXX **End Confidential}** consisted of goodwill and
20 intangibles.

21 In contrast, after the proposed transaction, Windstream will have over $5.5 billion
22 in long-term debt and **{Begin Confidential** XXXXX **End Confidential}** retained

1 earnings. Windstream's total assets will be $7.65 billion, of which **{Begin Confidential**
2 XXXXX **End Confidential}**—will be in the form of goodwill and intangibles. (Gardner,
3 Exh. 1, Gardner Testimony, page 12.)

4 As a result of the transaction, Windstream's debt will increase by $5.3 billion,
5 while assets (exclusive of goodwill and intangibles) will increase by only $1.1 billion.
6 And as already noted, retained earnings will go from a positive $2 billion to **{Begin**
7 **Confidential** XXXXX **End Confidential}**. Clearly, this represents a material change in
8 the financial condition of Windstream which will negatively impact the Kentucky ILECs.

9 In addition, the company has committed to pay out to its shareholders $474
10 million in annual dividends. (Gardner Testimony, page 9)

11 **Q. Is this high leverage and high dividend payout financing model seen elsewhere?**
12 A. The proposed capital structure and dividend payout plan is a relatively new innovation by
13 Wall Street for use in capitalizing landline telecommunications service companies.
14 Specifically, a handful of rural telephone companies marketed their stock by promising to
15 pay a high dividend. Iowa Telecom was the first firm to successfully employ this
16 approach in an initial public offering in early 2005. Alaska Communications Systems,
17 FairPoint Communications, and Valor later did the same thing. On the other hand, rural
18 incumbent local exchange carriers (ILECs) that do not pay a high dividend include
19 Century Tel and Commonwealth.

20 **Q. Are there risks in a high dividend financing structure?**
21 A. Yes. Carriers that commit large amounts of cash to paying out dividends may not have
22 enough cash for network investments in the face of changing competition and declining

1 revenues. Moreover, when interest rates go up, as they inevitably will, the attractiveness
2 of these high-dividend stocks will diminish.

3 **Q. Alltel contends that its proposed capital structure is reasonable and comparable to**
4 **those of other rural local exchange carriers. Do you agree?**
5 A. No, I do not. The comparables offered by Alltel are not really comparable at all since all
6 of the other rural local exchange carriers except Century Tel and Citizens are a tenth or
7 less the size of the new company. (Gardner, Exh. 2) Such comparisons are like
8 comparing the U.S. federal budget to that of Lichtenstein. Only Citizens and Century Tel
9 are rural ILECs of comparable size to Windstream. According to information provide by
10 Alltel, Century Tel's net debt equates to approximately 2.0 times operating income before
11 depreciation and amortization ("OIBDA"). This is significantly lower than Windstream
12 with net debt at 3.2 times OIBDA. (Gardner, Exh. 3). Moreover, as noted above, Century
13 Tel, unlike Windstream, does not restrict its financial flexibility by paying a high
14 dividend.

15 In fact, on almost every financial measure, Windstream is more highly leveraged
16 with less liquidity than either Citizens or Century Tel. In Table 1 below, I compare
17 Windstream with Citizens, Century Tel, and Alltel prior to the transaction on key
18 financial measures. On all but one measure, Windstream looks worse. (The figure in bold
19 indicates the worst performing entity.) As a result of the proposed transaction,
20 Windstream will be more highly leveraged than Citizens, Century Tel, and than Alltel
21 prior to the wireline spin-off.

22

Table 1. Comparisons of Proposed Windstream Capital Structure				
	Alltel	Windstream	Century Tel	Citizens
Debt/Total Capital				
Cash/Total Debt				
Cushion Ratio (Cash & Investments/Debt Service)				
Debt/CashFlow (EBITDA)				
Gross Debt/EBITDA				
Debt/Access Line				
Sources: For Alltel,SEC Form 10-K for the year ended 12/31/05. For Century Tel, and Citizens: yahoofinance.com. For Windstream: Exh. 1, Gardner Testimony.				

1

2 **Q. What are the implications of the proposed capital structure?**

3 A. In an investor conference call on January 20, 2006, Windstream's future CEO Jeffrey
4 Gardner stated that capital structures such as the one being proposed for Windstream are
5 dependent upon the cash generation abilities of the company, and that the long-term
6 sustainability of cash flows is what will make or break the model. Mr. Gardner continued
7 that companies with these capital structures need to be in a "good position to manage the
8 business from [the] expense side [and] drive incremental revenues." (Alltel Corp Q4
9 2005 Earnings Conference Call Transcript, page 15)

10 **Q. Given the stated need to control costs and increase revenues, what do the financial**
11 **projections for Windstream show for expenses and revenue growth?**

12 A. The financial projections for Windstream indicate **{Begin Confidential** XXXXX **End**
13 **Confidential}** in cost savings before additional needed expense of **{Begin Confidential**
14 XXXXX **End Confidential}** for total a transaction-related cost saving of only **{Begin**
15 **Confidential** XXXXX **End Confidential}.** The largest contributor to cost savings comes
16 from customer service, projected at **{Begin Confidential** XXXXX **End Confidential}**,
17 or **{Begin Confidential** XXXXX **End Confidential}** of the total transaction-related cost

1 savings. Another **{Begin Confidential** XXXXX **End Confidential}** in cost savings will
2 come from information systems. Alltel notes that **{Begin Confidential** XXXXX **End**
3 **Confidential}** of the cost savings will result from head count reductions. (CWA I-46.
4 Rating Agency Presentation: Wireline Spin-Off Review dated December 2005, page 35
5 attached as Schedule DG-6) Clearly, the two areas of customer service and information
6 systems have a direct impact on wireline consumers and services. Quality service
7 requires adequate staffing. Yet, in order to control costs, Windstream will cut staffing,
8 with negative impact on the ability of staff to respond to customer inquiries.

9 On the revenue side, the financial projections assume a decline in Windstream's
10 revenue from **{Begin Confidential** XXXXX **End Confidential}** in 2005 to **{Begin**
11 **Confidential** XXXXX **End Confidential}** in 2008. These projections assume an average
12 **{Begin Confidential** XXXXX **End Confidential}** percent annual decline in revenues
13 over this three-year period. (CWA I-57 , attached as Schedule DG-1) A more realistic
14 approach to projecting the future would reduce annual EBITDA going forward by five
15 percent. This is in fact what Alltel assumed in its projections in September 2005. (CWA
16 I-49, Discussion Materials Prepared for: Cardinal Regarding Wireline Spin-Off
17 Alternatives, Sept. 1, 2005, page 6) It is also the assumption used by Alltel's financial
18 advisor Duff & Phelps in a sensitivity analysis conducted to determine what would
19 happen to Windstream under a reasonable financial downturn. Duff & Phelps' modeled a
20 revenue decline of **{Begin Confidential** XXXXX **End Confidential}** per year through
21 20015 (Duff & Phelps, Alltel Wireline: Supporting Analysis Detail, May 4, 2006, page
22 V-B-1).

1 Under either scenario, Windstream will not "drive incremental revenues," a
2 condition, which according to its future CEO Jeffrey Gardner, is essential for a company
3 with its proposed capital structure to succeed.

4 **Q. Will Windstream have the cash flow needed to maintain and invest in its networks?**
5 A. As I already mentioned, Windstream intends to pay out dividends in the amount of $1 per
6 share. Mr. Gardner states that the dividend payout will be $474 million. (Gardner
7 Testimony, page 9) That is money that will not be available to maintain service or invest
8 in advanced networks, but is intended to attract investors. In future years, a higher
9 dividend may be required, either because of inflation or a rise in interest rates, or if more
10 shares are outstanding. (When interest rates go up, offering higher competitive yields, the
11 dividend must increase to remain attractive to investors.) Assuming that the dividends
12 keep up with annual inflation at three percent, which is a realistic assumption from an
13 investor's perspective, by 2008, the last year for which Alltel provides forecasts, the total
14 dividends would equal a $488 million cash drain.

15 As I noted earlier, future CEO Jeffrey Gardner in his presentation to investors said
16 that Windstream would "aggressively manage" its capital expenditures. This suggests
17 capital spending will be bare bones. In their own projections, capital spending for the new
18 entity is projected to decline from an estimated **{Begin Confidential** XXXX **End**
19 **Confidential}** in 2005 to **{Begin Confidential** XXXXX **End Confidential}** in 2007 and
20 2008. This amounts to a **{Begin Confidential** XXXXX **End Confidential}** annual
21 reduction in capital expenditures. (CWA I-46, Rating Agency Presentation dated
22 December 2005, page 13; CWA I-57 (Schedule DG-1))

1 **Q. Are Alltel's financial projections for Windstream realistic?**

2 A. No, they are not. The projections are highly aggressive. If any of the assumptions prove
3 wrong – if revenues decline more quickly, if the new entity increases the dividend to keep
4 up with inflation or higher interest rates, if the transaction-related cost savings are not
5 realized, or if competitive pressures and service needs require higher capital expenditures
6 – then Windstream will not be able to generate the cash from operations needed for
7 dividends, capital spending, interest, and taxes just one year after the transaction.

8 In Table 2 below, I have adjusted Alltel's projections based on the following
9 assumptions: annual EBITDA decline of 5 percent, **{Begin Confidential** XXXXX **End**
10 **Confidential}**; flat interest expense; no reduction in capital expenditures; annual
11 dividend pay-out increase of 3 percent to keep pace with inflation; and a 22 percent
12 income tax rate. Based on these more realistic projections, Windstream will fall short of
13 needed dollars to pay dividends, capital spending, interest and taxes in 2007, the year
14 after the transaction takes place. (Note that I have not included in these adjustments the
15 impact of rising interest rates and more difficult capital market conditions.) These
16 adjusted projections raise the very real question of whether Windstream will be able to
17 refinance the bank debt when it comes due in five and seven years, when interest rates are
18 likely to be higher. It should be noted that Alltel did not provide projections beyond
19 2008.

20

21

1

2 **{Begin Confidential**

Table 2. Windstream Adjusted Cash Flow Projections ($ XXXXX)				
	2005	**2006**	**2007**	**2008**
EBITDA				
Interest Expense				
Capital Expenditures				
Dividends				
Income Taxes				
Cash Flow				
Source for 2005: Gardner Exh. 1, ProForma Financial Statements. Other years: CWA calculations based on these assumptions: 1) 5% annual EBIDTA decline; 2) flat interest expense; 3) flat cap-ex; 4) dividend growth of 3% inflation rate; 5) income taxes at 22.1%				

3

4 **End Confidential}**

5 **Q. Are there any other transaction-related uses of cash that raise concerns?**

6 A. Yes. Alltel provided a statement of expected fees related to the proposed transaction. The
7 Summary of Fees shows total fees of **{Begin Confidential** XXXXX **End Confidential}**,
8 excluding fees related to structuring. Structuring fees were estimated at another **{Begin**
9 **Confidential** XXXXX **End Confidential}**, bringing total fees to **{Begin Confidential**
10 XXXXX **End Confidential}.** This amounts to **{Begin Confidential** XXXXX **End**
11 **Confidential}** the amount that Alltel projects as transaction-related cost savings. (CWA
12 I-60, Presentation to Alltel Corporation Summary of Fees, Dec. 6, 2005, attached as
13 Schedule DG-2) This is money that is going out of the company and therefore is not
14 spent to maintain or improve service to consumers.

1 **Q. Are there market indications that Windstream will be a more risky company than**
2 **Alltel?**
3 A. Yes. Bond prices and yields are a good reflection of the investment community's
4 perception of a company's risk. In Alltel's case, the bonds of the wireline business,
5 which depend upon the wireline business's profitability for repayment, have fallen in
6 price due to investors' concerns regarding credit quality. Specifically, prior to the spin-
7 off and merger announcement with Valor, Alltel Georgia's 6.5% notes of 11/15/13 traded
8 at about 107, providing investors a yield of 5.38% to maturity. On March 2, 2006,
9 according to the National Association of Securities Dealers (NASD), the same notes
10 dropped in price to 99.5, for a yield of 6.58%. This decline in price, and corresponding
11 increase in yield, clearly reflects investors' views that the notes are now riskier and thus
12 an increased yield is needed to compensate investors for credit risk. (NASD BondInfo,
13 "Time and Sales Search Results: Detail Trades," available at
14 http://www.nasdbondinfo.com/asp/time_salesresults.asp?symbon+AT.GB&statistic,
15 downloaded 3/18/06.)

16 **Q. Does Alltel's wireline business in Kentucky have any bonds which show the same**
17 **decline in price and increase in yield?**
18 A. Alltel does not have any long-term bond issues specifically relating to Kentucky which is
19 why the example of Georgia's senior notes has been used.

1 **Q. How did the credit rating agencies react to the announcement of the wireline spin-**
2 **off and Valor combination? How did they rate the bonds of Alltel Corp. and Alltel's**
3 **wireline operating companies after the transaction was announced? What do these**
4 **ratings indicate about investors' views of the credit risk of Windstream?**
5 A. Alltel is rated A- by Standard & Poor's, with a stable outlook (CWA I-47, "Standard &
6 Poor's Corporate Ratings," dated Jan. 18, 2006). According to Standard & Poor's, A
7 rated debt shows the obligor "has STRONG capacity to meet its financial commitment."
8 (CWA II-1, "Standard & Poor's Long-Term Credit Ratings," attached as Schedule DG-3)
9 Standard & Poor's has a negative watch on the landline operating companies' debt (CWA
10 I-47, "Standard & Poor's Corporate Ratings," dated Jan. 18, 2006) Although no ratings
11 have been issued on the new company, Alltel expects a rating in the BB range, or
12 speculative. (CWA I-49, "Presentation to Cardinal Overview of Non-Investment Grade
13 Covenants, Oct. 12, 2005, page 1). According to Standard & Poor's, "An obligor rated
14 BB is less vulnerable in the near term to nonpayment than other lower-rated obligors.
15 However, it faces major ongoing uncertainties and exposure to adverse business,
16 financial, or economic conditions which could lead to the obligor's inadequate capacity
17 to meet its financial commitments." Schedule DG-3.

18 On December 9, 2005, Fitch Ratings affirmed its A rating on Alltel, but
19 downgraded the ratings on operating company debt at the wireline business to BBB-.
20 (Fitch Ratings, "Fitch Affirms Alltel, Downgrades OpCo Debt", press release dated
21 Dec. 9, 2005, attached as Schedule DG-4) The rating progression is A, followed by A-,
22 then BBB+, BBB, and then BBB-. Fitch's rating on the regulated business was based on
23 capital structure and credit protection measures it did not view as consistent with the

1 current ratings of Alltel. Fitch expects continued EBITDA erosion and cites a concern
2 over the lack of growth opportunities and service diversification as a standalone wireline
3 operator. Fitch assigned a Rating Watch Negative, suggesting a further downgrade could
4 occur.

5 Alltel considered two alternative scenarios for the capital structure of
6 Windstream. Alltel rejected the scenario that would have resulted in an investment grade
7 bond rating in favor of the scenario that would result in a "non-investment grade bond
8 rating" due largely to its higher dividend pay-out. Alltel acknowledged the downside of
9 this alternative: restrictive debt covenants, increased risk for dividend cut in the event of
10 higher than expected EBITDA declines, greater exposure to interest rate fluctuations, and
11 less financial and operating flexibility. On the plus side, Alltel noted that this capital
12 structure would minimize the dividend burden on Wireless – a benefit to Alltel
13 shareholders, but not to customers of Windstream's affiliated companies. (CWA I-49,
14 "Discussion Materials Prepared for: Cardinal Regarding Potential Wireline Spin-Off
15 Alternatives, Sept. 2, 2005, page 2)

16 **Q. Another source of liquidity available to Alltel is the commercial paper market. Will**
17 **a BB rated company be able to issue commercial paper?**
18 A. No. Only investment grade companies can typically issue commercial paper. This
19 removes a funding source currently available to Alltel.

1 **Financing**

2 **Q. Please explain the terms of the new securities financing for Windstream.**

3 A. Immediately prior to the spin-off and merger, Windstream will borrow up to $4.2 billion
4 in senior secure credit facilities and no less than $1.54 billion in senior unsecured notes
5 (First Amendment to Joint Application and Securities Certificate, page 2) for a total of up
6 to $5.7 billion in new debt. On December 8, 2005, JP Morgan and Merrill Lynch entered
7 into a Commitment Letter with Alltel to provide the financing (Exh. A, First Amendment
8 to Joint Application). The Dec. 8, 2005 Commitment Letter requires that each affiliate of
9 Windstream, including the Kentucky ILECs, provide guarantees and first-priority liens
10 for the $4.2 billion in credit facilities and guarantees for the $1.5 billion in notes.

11 On April 12, 2006, Alltel through its attorney in this case notified this
12 Commission and the parties that it had reached an agreement with its lenders to amend
13 the original Commitment Letter. Specifically, the amended agreement "removes the
14 operating company guarantees and asset liens *for selected regulated subsidiaries* from its
15 previously proposed debt financing security package" (Mark R. Overstreet Letter to Ms.
16 Beth O'Donnell, Executive Director, Public Service Commission of Kentucky dated
17 April 12, 2006). According to the Amended Commitment Letter, the lenders will
18 continue to require operating companies to guarantee the loans, "provided that
19 Guarantees will not be required from any subsidiary to the extent that the Transaction
20 requires, or the granting of such Guarantee would require, the approval of any state
21 regulatory agency." (Alltel Corporation Senior Secured Credit Facilities Amendment to
22 Commitment Letter, dated April 12, 2006, page 1)

1 It is important to note that the lenders have not removed the requirement that
2 some Alltel operating companies guarantee the loans. Rather, it appears that Alltel and
3 the banks have agreed to transfer all the risk onto only those affiliated operating
4 companies located in states that are not subjecting the transaction to regulatory review.
5 The amended agreement can be seen as a means to side-step public oversight, rather than
6 as a sign that the lenders' have changed their minds about the level of credit risk involved
7 in this transaction.

8 **Q. Why are the banks imposing the guarantee and lien requirements?**

9 A. Alltel explains that the requirement that each affiliate assume joint and separate liability
10 for Windstream debt reduces the cost of the debt. Here, too, it is important to understand
11 that Alltel has chosen a highly leveraged, risky capital structure for Windstream. As a
12 result, lenders charge a higher interest rate on the debt. Alltel considered an alternative
13 capital structure, one that would have been less risky, and likely resulted in a lower cost
14 of borrowing. But Alltel rejected that financially more stable capital structure in favor of
15 one that, in its own words, would "minimize the dividend burden on Wireless," e.g.
16 Alltel. The Commission should understand that Alltel has chosen a capital structure that
17 favors the wireless company, and transfers the risk onto customers of the spun-off
18 wireline company. This may be a good deal for the remaining Alltel wireless company,
19 but it is a risky deal for the Kentucky ILECs and Kentucky consumers.

20 **Q. It appears that the Kentucky ILECs will no longer have to guarantee the new debt.**
21 **Should the Commission be reassured by this?**

22 A. No, it should not. As I explained above, the lenders continue to require that *some*
23 operating companies guarantee the debt, indicating a concern about the credit risk. The

1 underlying problem remains the same: Windstream will be a highly leveraged company,
2 with declining revenues and questionable ability to invest in its network and services.

3 **Q. What will Windstream do with the new debt?**

4 A. A portion of the debt will be used to re-finance existing debt of the wireline companies,
5 debt of the acquired Valor, or debt that is being transferred from Alltel to Windstream. In
6 addition, $2.4 billion of the new debt assumed by Windstream will be paid directly to
7 Alltel as a "special dividend."

8 **Q. How does Alltel justify the "special dividend" payment of $2.4 billion?**

9 A. Alltel states that the $2.4 billion special dividend payment is intended to approximate
10 Alltel's tax basis in the existing wireline assets (CWA I-61). Alltel does not provide
11 further information to explain how it arrived at the $2.4 billion number. Alltel has picked
12 the largest number that it can justify to make Windstream pay for its assets. Prior to the
13 spin-off, Alltel received cash in the form of dividend payments from its wireline
14 subsidiaries. After the spin-off, that source of cash will no longer be available. Therefore,
15 Alltel has created a capital structure for Windstream that requires Windstream to borrow
16 an additional $2.4 billion in order to transfer that cash to Alltel. Had Alltel chosen a
17 lower number for the "special dividend" payment – or chosen not to require Windstream
18 to pay any "special dividend" – then Windstream's capital structure would be less
19 leveraged, less risky, with a lower cost of borrowing. Instead, Alltel has chosen to impose
20 a $2.4 billion liability on Windstream which will be transferred as a $2.4 billion asset to
21 Alltel. In addition, as I discussed above, Alltel has chosen to transfer credit risk onto the
22 wireline operating companies in the states that are not reviewing this transaction in order

1 to lower the cost of borrowing that is a direct result of the risky capital structure that it
2 has chosen for Windstream.

3 **Employment and Service Quality**

4 **Q. Do you have any additional concerns regarding the impact of the proposed**
5 **transaction on service quality?**

6 A. Yes, I do. I have serious concerns that Windstream and its local operating companies,
7 including the Kentucky ILECS, will not have sufficient cash to invest in its local
8 networks and deploy sufficient trained, career employees to provide quality service.

9 The Commission was clearly concerned about Alltel's ability to provide quality
10 service to customers when it purchased Kentucky properties from Verizon in 2002. At
11 that time, the Commission, among other items, expressed concerns about Alltel's prior
12 service quality record. The Commission noted that Alltel had committed to hire and train
13 240 new customer service workers to avoid conversion difficulties in Kentucky and to
14 meet anticipated increase in call volume that the acquisition would generate. The
15 Commission also required Alltel to file monthly service quality reports, meet Verizon's
16 prior capital investment commitments, and report on employment changes. (In the Matter
17 of Petition by Alltel Corporation to Acquire the Kentucky Assets of Verizon South,
18 Incorporation, *Order*, Case No. 2001-00399, dated Feb. 13, 2009 attached as Schedule
19 DG-5)

20 Despite these reporting requirements and employment commitments, Alltel's
21 record in Kentucky in the three years since it purchased properties from Verizon is not
22 good. Since 2003 (the first full year Alltel operated the former Verizon properties in

1 Kentucky), Alltel has reduced its capital spending on local exchange services in the state
2 from $80.79 million in 2003 to $64.2 million in 2005, a cut of $ 16.6 million, or 20
3 percent. Over the same period, access lines declined by only 2.3 percent. (CWA I-28, I-
4 31). At a time when carriers should be investing in new digital equipment and broadband
5 networks, Alltel in Kentucky has reduced spending on its network. As a result, there
6 remain over 167,000 lines – about one-third of all lines served by the Kentucky ILECs --
7 that are not DSL-capable. Alltel notes that it currently has approximately 370,000 DSL
8 addressable lines out of a total 537,000 lines in the state. (CWA I-28; AG II-20.)

9 Alltel's Kentucky ILECs are also falling short in meeting Commission service
10 quality standards. In August and September 2005, the Kentucky ILECs failed to meet the
11 Commission's repair service installation objective (90% within 5 days) in the Central and
12 East Districts and barely met the objective in the West District, and failed to meet the
13 Commission's trouble clearing objective (85% cleared in 24 hours) in the East District in
14 September 2005. (Kentucky Alltel, 2005 PSC Objective Report, September 2005, CWA
15 I-37).[1]

16 The Kentucky ILECs are also failing to meet Alltel's internal service levels for its
17 customer service. As of September 2005, its year-to-date service level performance for
18 customer service was **{Begin Confidential** XXXXX **End Confidential}**, missing the 80
19 percent service level goal. Its September 2005 year-to-date internal service level
20 performance for Internet/DSL was **{Begin Confidential** XXXXX **End Confidential}**,
21 falling short of its 70 percent service level goal. (Alltel Wireline management
22 Presentation, Oct. 2005, page 43, CWA I-60.) Since January 2005, Alltel failed to meet

1 the 80 percent of calls answered within 20 seconds service level in seven of the past 14
2 months. (CWA I-36).

3 Quality service depends on a well-trained, adequately staffed workforce. Yet,
4 since 2002 when Alltel purchased Verizon properties, Alltel Kentucky Inc. ("AKI")
5 reduced staffing by 173 employees, or 20 percent. In 2002, AKI had 861 employees but
6 there were only 688 employees in 2005. AKI access lines declined only 6.4 percent over
7 the same period. It is simply not possible to provide quality service if there are not
8 enough technicians and customer service employees to install, repair, and maintain the
9 plant and to respond to customers. (CWA I-28)

10 Despite this serious reduction in employees over the past five years, Alltel
11 proposes to realize the bulk of the cost savings from this transaction by cutting headcount
12 in the customer service operation. (CWA I-46, Rating Agency Presentation, Dec. 2005,
13 page 35). The concerns the Commission expressed three years ago about conversion
14 difficulties are likely to occur during this transition if Alltel reduces customer headcount
15 among experienced employees. Kentucky ILEC customers currently are serviced by out-
16 of-state call centers. According to Alltel, this will continue to be the case after the
17 transaction is completed. Therefore, the Commission must ensure adequate staffing by
18 experienced customer service employees not only in Alltel's current calls centers but also
19 in the call centers that Alltel acquires from Valor as a condition for approval of this
20 transaction.

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[1] Alltel did not provide service quality data for Oct. – Dec. 2005 in response to CWA data request.

1 Alltel claims that "there are no plans to change either the number or types of
2 employees currently working at the Kentucky ILECs if the transaction is approved"
3 (CWA I-20). Alltel also states that it has "no plans to change the levels of compensation
4 and/or employees currently working at the Kentucky ILECs as a result of the transaction"
5 (CWA I-21). Alltel further states that "employee benefit plans will remain *substantially*
6 the same following the separation and merger (emphasis added) (CWA I-27). Further,
7 Alltel states that it will continue to recognize the collective bargaining agreement
8 between the Kentucky ILECs and CWA, and "the collective bargaining agreement will
9 not be affected by the proposed transaction" (CWAI-22).

10 CWA represents more than 1,000 Alltel employees, including approximately 350
11 employees in Kentucky. In addition, CWA represents approximately 700 Valor
12 employees, including customer service employees who appear targeted for headcount
13 reductions. (CWA I-46, Rating Agency Presentation, Dec. 2005, page 35) IBEW is the
14 authorized collective bargaining representative for more than 500 employees of various
15 subsidiaries of Alltel Corporation (Alltel Corp.), including approximately 130 employees
16 of Alltel Kentucky, Inc. (Alltel KY). IBEW also represents approximately 6391
17 employees who are consumers in Kentucky.

18 CWA is certainly pleased that Alltel has made a commitment to this Commission
19 that it will respect its collective bargaining agreements, continue to employ current
20 workers and maintain employment levels, and maintain current compensation. To protect
21 Kentucky workers and consumers, and to ensure that Alltel lives up to those
22 commitments, the Commission should condition any transaction approval upon a written
23 commitment that the Kentucky ILECs will abide by each of these commitments for a

1 minimum of five years after the transaction. In addition, as noted above, the Commission
2 must ensure adequate staffing by experienced customer service employees not only in
3 Alltel's current calls centers but also in the call centers that Alltel acquires from Valor as
4 a condition for approval of this transaction.

5 CWA also has deep concerns that all pension assets be divided between Alltel and
6 Windstream in a fair and equitable manner. According to the most recent actuarial report,
7 the Alltel pension plan which covers CWA-represented employees in Kentucky is
8 currently underfunded, at somewhere between 76.5 percent or 96.3 percent (depending on
9 the discount rate used). According to the Employee Benefits Agreement, pension plan
10 assets will be transferred to Windstream in accordance with IRS regulations and actuarial
11 assumptions and methodologies provided in Schedule IV attached to the Employee
12 Benefits Agreement (CWA I-18).

13 CWA is still reviewing the relevant pension documents, Employee Benefits
14 Agreement and schedule, and IRS regulations. During the course of that review, if CWA
15 discovers gaps in the relevant IRS regulations or provisions in the Employee Benefits
16 Agreements that do not ensure an equitable division of pension plan assets and liabilities,
17 CWA will bring such information to the attention of the Commission.

18 Conclusion

19 **Q. Please summarize your testimony.**

20 A. Windstream will be a financially weaker company after the separation, with much less
21 flexibility in the use of its cash resources. As a wholly owned subsidiary of Windstream,
22 the Kentucky ILECs will have more restricted access to capital, resulting in fewer

1 resources to provide quality service to customers and to invest in advanced services.
2 Windstream's plans to cut capital spending and customer service operations will result in
3 deterioration of service to the Kentucky ILECs' customers.

4 The proposed transfer is not in the public interest. The transaction will result in
5 serious harm to the Kentucky ILECs' quality of service to customers, and could result in
6 price increases.

7 **Q. What are your recommendations to the Commission?**

8 A. The Commission should condition any approval upon the following conditions to protect
9 consumers and ensure that a viable entity remains after separation:

10 • Windstream shall not be required to pay Alltel for its assets. Any proceeds
11 from bank or public debt shall be retained by Windstream for its
12 investment purposes.

13 • The Kentucky ILECs shall maintain a capital structure that contains at
14 least 65 percent common equity. The Kentucky ILECs shall be prohibited
15 from paying any dividend to its parent company that would reduce the
16 Kentucky ILECs' equity ratio to less than 65 percent.

17 • The Kentucky ILECs shall not pay any dividend to its parent company that
18 exceeds more than 75 percent of the Kentucky ILECs' earnings
19 attributable to common equity and the Kentucky ILECs shall not pay any
20 dividend to its parent that exceeds 75 percent of cash flow (defined as
21 operating earnings after cash interest expense and cash taxes).

22 • If Windstream's credit rating is downgraded below its initial credit rating,
23 Windstream shall be required to reduce its dividend by 5 percent for each rating
24 point downgrade.

25 • The Kentucky ILECs shall provide a guaranteed minimum of $80 million capital
26 expenditures each year for the next five years.

27 • The Kentucky ILECs' reporting of service performance shall be posted on the
28 Commission website.

1 • The Commission shall require each District served by the Kentucky ILECs
2 (East, Central, and West) to clear 95 percent of out-of-service reports
3 within 24 hours; provide 95% of regular service installations within 5
4 days; and meet a trouble reporting objective of 2 or less per 100 lines. The
5 Commission shall adopt financial penalties for failure to achieve these
6 objectives in any District in any month.

7 • The Kentucky ILECs shall be required to maintain or grow current employment
8 levels and Windstream shall be required to maintain or grow current customer
9 service employment levels at existing call centers for the next five years. The
10 Kentucky ILECs shall be required to maintain employees currently working at the
11 Kentucky ILECs, with no reduction in compensation, and full respect of union
12 status and collective bargaining agreements.

13 • The division of pension fund assets between Alltel and Windstream shall
14 be proportional to the prospective pension fund liabilities of the two
15 entities.

16 **Q. Does this conclude your direct testimony?**

17 A. Yes, it does.