COMMONWEALTH OF KENTUCKY

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PUBLIC SERVICE COMMISSION

BEFORE THE PUBLIC SERVICE COMMISSION

CASE NO. 2005-00534

APPLICATION FOR APPROVAL OF THE TRANSFER OF CONTROL OF ALLTEL KENTUCKY, INC. AND KENTUCKY ALLTEL, INC.

PRE-FILED REDACTED TESTIMONY

OF

DAVID BREVITZ

On Behalf Of

THE OFFICE OF THE ATTORNEY GENERAL
FOR THE COMMONWEALTH OF KENTUCKY

APRIL 21, 2006

BEFORE THE PUBLIC SERVICE COMMISSION OF KENTUCKY

CASE NO. 2005-00534

DIRECT TESTIMONY OF

DAVID BREVITZ

Q. PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A. My name is David Brevitz. My business address is Brevitz Consulting Services, 3623 SW Woodvalley Terrace, Topeka, Kansas.

Q. BY WHOM AND IN WHAT CAPACITY ARE YOU EMPLOYED?

A. I am an independent consultant serving state regulatory commissions, Attorney's General Offices, and consumer organizations. I am testifying on behalf of the Office of the Attorney General of Kentucky.

Q. DO YOU HAVE SPECIFIC EXPERIENCE, EXPERTISE AND DIRECT KNOWLEDGE REGARDING THE SUBJECTS WHICH ARE CONTAINED IN YOUR TESTIMONY?

A. Yes. Over my twenty-four year career I have worked on numerous telecommunications dockets and cases, as the marketplace and regulatory environment has changed to the current date. In that time span there have been numerous milestone events, most recently including the Federal Telecommunications Act of 1996, the rise and fall of CLEC competition, attempted development of "one stop shop" service bundles for consumers, and continued partnerships, consolidations and acquisitions in the industry leading to greater market concentration. I recently completed work for the Bureau of Consumer Protection within the Nevada Office of Attorney General in which I assessed and addressed issues pertaining to the proposed spin-off of LTD Holding Company (later named "Embarq") from Sprint Nextel Corporation.

Q. PLEASE STATE YOUR EXPERIENCE AND PROFESSIONAL QUALIFICATIONS.

A. My career has been in telecommunications. My interest in telecommunications began while studying at the Institute of Public Utilities in the Economics Department at Michigan State University. While at Michigan State, I earned an undergraduate degree in Justice, Morality and Constitutional Democracy from James Madison College (a residential college at MSU) and an MBA in Finance (1980). Since that time, I have worked on a variety of issues beginning with the detariffing of inside wiring and CPE

(customer premise equipment) to the more current issues of competition and deregulation, substitute services and intermodal competition, alternative regulation plans, bundled services, access charges, price floors and imputation, jurisdictional cost allocations including direct assignments, and requirements of the Telecommunications Act of 1996 including competition, interconnection requirements, resale, unbundled elements, TELRIC/cost studies, and Section 271 applications. Prior to entering the consulting field, I served as Chief Telecommunications Analyst for the Kansas Corporation Commission from late 1984 to early 1987, and then served as Director-Regulatory Affairs of Kansas Consolidated Professional Resources (KCPR)-an organization serving Kansas independent telephone companies. In February 1994 I began work as an independent consultant in telecommunications, serving state utility commissions and consumer counsels. I am currently serving on the Kansas Corporation Commission Advisory Staff on telecommunications matters.

Since beginning work as an independent consultant, I have performed a variety of assignments and tasks related to formulation of telecommunications policy and cost study review for many state utility commission projects. As a result of these assignments, I have current expertise regarding competitive markets issues in telecommunications, and the detailed tasks associated with implementing the Federal Telecommunications Act of 1996, pricing and costing, interconnection, network unbundling, resale, number portability, etc. A complete description of my background and experience is provided on Exhibit DB-1.

Q. DO YOU HAVE OTHER RELEVANT QUALIFICATIONS?

A. Yes. In 1984 I was designated as a Chartered Financial Analyst by the Institute of Chartered Financial Analysts ("ICFA"), which later became the CFA Institute. The CFA Institute is the organization which has defined and organized a body of knowledge important for all investment professionals. The general areas of knowledge are ethical and professional standards, accounting, statistics and analysis, economics, fixed income securities, equity securities, and portfolio management.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to address:

- Financial and public interest considerations and "proper purposes" associated with Alltel's application for approval of a change of control of the Kentucky Alltel ILECs (Incumbent Local Exchange Companies); and,
- Financial and public interest considerations and "proper purposes" associated with the proposed merger of Valor Communications with the Alltel ILECs, including proper performance by the utility of its service to the public with the proposed $5.92 billion in corporate debt.

Q. PLEASE SUMMARIZE YOUR UNDERSTANDING OF THE APPLICATION IN THIS MATTER.

A. Alltel Corporation is the corporate entity which as currently structured operates four main lines of business:

- Incumbent local exchange operations in 15 states, including Kentucky. Alltel Kentucky and Kentucky Alltel are two separate entities operated by Alltel in Kentucky that comprise 18% of the Alltel ILEC total access lines. Internet/DSL (Digital Subscriber Line) service is also included in association with the ILEC business.
- Alltel Communications Products, which is an unregulated subsidiary that procures and sells telecommunications equipment to ILECs, competitive local exchange carriers (CLECs) and others.
- Alltel Publishing Corporation, which publishes directories for various ILECs and CLECs.
- Alltel Communications Inc., which is largely in the wireless service business but also operates long distance and Alltel CLEC functions.

Alltel Corporation made a determination to separate the wireless business and the landline ILEC business. To accomplish that separation, Alltel Corporation set up new corporate entities to hold the ILEC business and its assets along with the publishing, telecommunications equipment, long distance and CLEC businesses.[1] A "Distribution

[1] Consistent with Mr. Powell's description, I will refer to this as the "wireline business", in contrast to the "wireless business" which will remain with Alltel Corporation.

Agreement" between Alltel Corporation and the new holding company was used to divide assets between the two entities. Immediately prior to the merger with Valor Communications, Alltel Corporation will "contribute" its stock in the ILEC businesses to the new holding company, and in exchange the new holding company will provide to Alltel Corporation its common stock to be distributed to Alltel Corporation shareholders via the spin off, along with a "special dividend" of approximately $2.4 billion. The two entities will also "swap" debt, such that the new holding company takes on additional debt to permit Alltel to retire existing debt. In order for the new holding company to provide these funds and debt securities to Alltel Corporation, it will be necessary for the holding company to incur a substantial amount of debt. Exhibit 6 to the Application shows $5.921 billion in debt proposed for the new holding company ($4.2 billion in senior secured credit facilities, $1.54 billion in senior unsecured notes, and $181 million in existing Alltel ILEC debt). This debt will be below "investment grade" due to a high ratio of debt to annual earnings, which causes higher costs of capital for the holding company[2].

Immediately following the additional debt borrowing, payment of the special dividend to Alltel Corporation and exchange of stock and notes/debt between Alltel Corporation and the holding company, the holding company will merge with and into Valor Communications, with Valor being the surviving corporation. The holding company stock will be converted into Valor Communications shares of stock, with each share of Alltel ILEC stock being exchanged for approximately 1.04 shares of Valor Communications stock. The result at that moment in time will be that Alltel ILEC shareholders will be the same as Alltel Corporation stockholders, and will hold 85% of Valor Communications. As stock in the merged ILEC business begins trading, the composition of stockholders will immediately begin to diverge from that position. It

[2] In the first restated application, this same condition carried with it an associated requirement from the lenders that the debt be guaranteed by the ILEC subsidiaries including Kentucky Alltel and Alltel Kentucky. Beyond that, the debt was to be secured by liens against the assets of the ILEC subsidiaries. By letter dated April 12, 2006, the Joint Applicants informed the Commission that the lenders had agreed "to remove the operating company guarantees and asset liens for selected regulated subsidiaries from its previously proposed debt financing security package."

appears that the great majority of the senior management positions of Valor Communications will be occupied by managers from Alltel Corporation and its affiliates. In proposing approval of these matters, Alltel avers that net synergies will occur from merger of the wireline businesses through "increased purchasing power" and elimination of duplicate capabilities. Much of the "eliminated duplication" appears to be from consolidation of staffing and reductions of combined existing staff levels.

Q. HAVE YOU REVIEWED PRIOR COMMISSION DECISIONS IN OTHER MERGER APPLICATIONS?

A. Yes. I have reviewed and considered the Commission orders in the Duke Energy case (Case No. 2005-00228) and the Kentucky American Water Company case (Case No. 2002-00317).

Q. HAVE YOU REVIEWED THE STATUTES UNDER WHICH ALLTEL'S APPLICATION WAS FILED?

A. Yes. Although I am not an attorney, I have reviewed KRS 278.020 and KRS 278.300 since Alltel submitted its first restated application under those statutes. By letter dated April 12, 2005, the Joint Applicants stated that it had "entered into an agreement with its lenders to remove the operating company guarantees and asset liens for selected regulated subsidiaries from its previously proposed debt financing security package." Joint Applicants went on to state that "because no guarantees or liens will be required with respect to any Kentucky regulated entity, it does not appear approval is required under KRS 278.300." Based on my reading of those statutes, it appears that it must be demonstrated that the New Holding Company has the financial, technical and managerial abilities to provide reasonable service, the proposed transactions will not impair the ability of the utility to perform its service to the public, and that the transactions are made for a proper purpose and are in the public interest. Furthermore, if the Commission approves the transactions, it may do so with conditions, as evidenced by the prior orders of the Commission that I reviewed.

Q. PLEASE SUMMARIZE THE REGULATORY MECHANISMS CURRENTLY IN PLACE FOR THE ALLTEL ILECS IN KENTUCKY.

A. Kentucky Alltel was acquired by Alltel from Verizon in 2002, and price cap regulation of Kentucky Alltel at the FCC level has been retained. In the state jurisdiction Kentucky Alltel is currently rate of return regulated. This will be a critical fact for the Commission to consider in this matter as will be demonstrated in this testimony. Kentucky Alltel is by far the largest rate of return regulated ILEC in the 15 state Alltel operating area. The second Alltel ILEC operating in Kentucky—Alltel Kentucky—is much smaller, and is rate of return regulated in the FCC jurisdiction and under alternative regulation in the state PSC jurisdiction.

Q. PLEASE STATE THE CONCLUSIONS YOU HAVE DRAWN FROM YOUR REVIEW OF THE APPLICATION, TESTIMONY, RESPONSES TO DISCOVERY QUESTIONS, STATUTES, AND PRIOR COMMISSION ORDERS, AND RELATED RESEARCH.

A. I conclude and recommend that the Commission should not approve the Application as filed, for the following reasons:

- Alltel has chosen to put an excessive level of debt burden on the New Holding Company;
- Excessive debt levels originally necessitated securing the New Holding Company debts with operating company guarantees and liens against operating company assets, and subsequently the guarantee obligation was removed at this time but the excessive debt levels remain;
- Excessive debt levels prevent the debt from receiving "investment grade" bond ratings;
- Excessive debt levels conflict with the New Holding Company's own financial goals;
- Excessive debt levels have consequences that are more serious for Kentucky Alltel (since it is a rate of return regulated company) than any other Alltel ILEC operating company;

- Alltel presents conflicting claims regarding merger synergies, and in any event the Commonwealth of Kentucky is not likely to receive any tangible or material benefits from the claimed merger synergies; and,
- Alltel's claims regarding "increased buying power" of the New Holding Company are not demonstrable, and in any event the Commonwealth of Kentucky is not likely to receive any tangible or material benefits from the claimed "increased buying power".

Q. CAN DECISIONS RELATED TO THE SPIN OFF OF THE ALLTEL ILEC OPERATIONS BE PROPERLY CHARACTERIZED AS BEING "ARMS-LENGTH" BETWEEN THE WIRELINE AND WIRELESS ENTITIES?

A. No. The Commission should not consider the transactions as structured by Alltel Corporation and presented in the Application to be "arms-length" in nature. The New Holding Company has not demonstrated ability to take independent views and actions in the structure of the spin off. The New Holding Company only gains its independence after the spin off, and then it will be too late to reverse material decisions made when Alltel Corporation was in control of the process. The most striking example would be that after spin off, the New Holding Company cannot require Alltel Corporation to "take back" any of the $5.92 billion in debt that it has placed on the New Holding Company in its proposed consummation of the spin off and merger transactions. The Commission should consider the lack of a true "arms length" relationship in the proposed transaction when it evaluates the Application under the "public interest" and "proper purpose" provisions of the statutes cited in the Application.

<u>Choice to Put Excessive Debt Burden on the New Company and Security Implications</u>

Q. PLEASE SHOW ALLTEL'S PROPOSED DEBT FOR THE NEW HOLDING COMPANY INCLUDING VALOR COMMUNICATIONS, THE "MERGED WIRELINE BUSINESS" ("MWB").

A. According to Exhibit 6 of the First Amended and Restated Application in this matter, the proposed $5,921,000,000 debt for the MWB is broken down as follows:

• Senior Secured Credit Facilities	$4,200,000,000
• Senior Unsecured Notes	$1,540,000,000
• Assumed Existing ILEC Debt	$ 181,000,000
• Valor Senior Notes	$ 400,000,000

Q. IS IT A MISNOMER TO LABEL THIS DEBT AS "THE NEW HOLDING COMPANY DEBT"[3]?

A. Yes. While technically the debt may be in the name of the new holding company, as a practical matter this debt is the operating companies' debt. The New Holding Company derives the great preponderance of its income from the operating companies, has no substantial businesses operated at the holding company level, and the subsidiary operating company income and cash flow is to be used to service the proposed debt and pay dividends to shareholders.[4] The Commission should look past the fact that the debt is nominally held by the New Holding Company, to the reality that it is ultimately the operating companies that are responsible for the debt. This is how the lenders had viewed it originally, with the proposed requirement that the operating companies guarantee and secure the New Holding Company debt contained in the first financing structure and offer.[5]

Q. $5.92 BILLION SEEMS LIKE A LOT OF MONEY. HOW CAN IT BE PUT IN THE CONTEXT OF THE ILEC OPERATING COMPANIES?

A. There are several measures by which the size of the proposed debt can be considered. First of all, this debt amounts to encumbering each Kentucky access line with at least $1,741 in debt ($5.921 billion divided by 3,400,000 MWB lines), or $947 million in total for Kentucky. This is substantially more debt per access line—78% more—than Sprint Nextel placed on the Embarq access lines with its spin-off transaction. ($7.25 billion in

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[3] See for example, the Initial Testimony of Jeffrey Gardner, page 13, line 20.

[4] Some income is projected to be earned from other subsidiaries such as the directory publishing and telecommunications product distribution subsidiaries. The Alltel wireline business currently generates over 90% of its net income from the ILEC operations (Valor S-4, page F-24), and this percentage will go up with the addition of the Valor ILEC operations to create the MWB.

[5] See for example, Exhibit 6 to the First Amended and Restated Application, and Joint Applicants Response to AG 2-93 **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

debt divided by 7.4 million access lines is $980 per line).[6] Also, the debt per access line significantly exceeds the company's net investment per access line in Kentucky. The debt per access line of $1,741 is substantially greater than net investment per access line of $1137 in Kentucky[7]--a 53% difference. Also, the proposed debt can be compared to the level of debt that was carried by the Alltel ILECs prior to the spin-off. Existing ILEC debt is $262,000,000 as of December 31, 2005, per Joint Applicants response to AG 2-69. This amount was sufficient apparently to support the operations of the ILEC line of business prior to the spin off, and is approximately 4% of the proposed debt level for the MWB. Finally, the annual capital investment budget of the MWB[8] is dwarfed by the size of the debt proposed in the Application (Alltel ILEC budgeted capital expenditure is $345 million for 2006, and the MWB "budgeted" capital expenditure is **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** per year for the years 2006-08). Alltel's ILECs have been able to fund annual capital investments internally from operating cash flow. As stated in the Alltel Corporation 2005 Form 10-K (page F-31):

> Each of Alltel's operating segments in 2005 generated positive cash flows sufficient to fund the segments' day-to-day operations and to fund their capital requirements. The Company expects each of the operating segments to continue to generate sufficient cash flows in 2006 to fund their operations and capital requirements.

Debt at the level proposed to be placed on the MWB is clearly not necessary for operating or capital requirements. This is one indication that the debt is not being incurred for a "proper purpose".

Q. COULD THE DEBT PER ACCESS LINE AMOUNT BE MORE OR LESS FOR KENTUCKY SUBSCRIBERS THAN THE $947 MILLION YOU HAVE STATED ABOVE?

A. Yes. We do not know the actual amount since the Joint Applicants were asked twice by the Kentucky Attorney General's office to provide this figure, and the Joint Applicants

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[6] LTD Holding Company Form 10, filed with the Securities and Exchange Commission on January 23, 2006. http://www.sec.gov/Archives/edgar/data/1350031/000119312506010042/0001193125-06-010042-index.htm

[7] Joint Applicant response to AG Supplemental DR No. 12c.

[8] See for example, Joint Applicants responses to AG 2-7 & 2-8, and AG 1- 47.

twice refused to provide the requested information. See the Joint Applicants responses to AG 1-34, and AG 2-46. Distribution of the debt responsibility is based on relative assets among the subsidiaries. I do not know the asset definition or amounts that would be used to perform this distribution, but total plant assets by state were provided in response to AG 2-23. If an asset measure akin to Gross Telephone Plant in Service is used, then approximately **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** of the debt responsibility would be allocated to Kentucky. If an asset measure akin to Net Telephone Plant in Service is used, then approximately **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** of the debt responsibility would be allocated to Kentucky. Subsequently, by letter dated April 12, 2005, Joint Applicants have indicated that the guarantee and lien provisions of the financing package have been eliminated by the lender for states where Commission approval of same is required. We have not had the opportunity to verify that Joint Applicants will not seek at a later date to reimpose the guarantee and lien provisions.

Q. PLEASE DISCUSS THE GUARANTEES AND LIENS ASSOCIATED WITH THE PROPOSED DEBT IN THE JOINT APPLICANTS' FIRST AMENDED AND RESTATED APPLICATION.

A. According to the December 8, 2005 Commitment Letter, attached as Exhibit 7 to the Application, the debt facilities being provided through JP Morgan and Merrill Lynch are to be guaranteed by the operating subsidiaries of the new holding company (including the Kentucky operating companies), and are to be secured by first liens on substantially all the assets of each subsidiary. Joint Applicants' response to CWA 1-4 states in part that "AKI and KAI and the other New Holding Company subsidiaries will be required to place liens on their property for up to $4.2 billion of the New Holding Company debt." In addition, Alltel and Valor have existing indebtedness, which will be assumed by the New Holding Company. Joint Applicants' response to CWA 1-9 states that the existing debt is not presently secured or guaranteed, but that "all affiliates of the Merged Wireline Business, in accordance with the terms of the existing debt, will be required to guarantee the obligations under the senior notes. The liens would be required to apply equally and

ratably to secure the obligations thereunder." Joint Applicants' response to CWA 1-7 states:

> The Guarantees and Liens reduce the interest rate associated with the secured debt by 100-200 basis points. This reduced interest rate applied to the approximate value of the secured debt of $2.5 billion results in an annual reduction of approximately $25-$50M in interest expense. Actual interest expense savings will exceed the amount above in the event the secured debt is greater than $2.5 billion.

By letter dated April 12, 2006, the Joint Applicants informed the Commission that the lenders had agreed "to remove the operating company guarantees and asset liens for selected regulated subsidiaries from its previously proposed debt financing security package." However, the letter does not state any of the other terms and conditions of the debt package that were changed to compensate for the elimination of the guarantee and lien provisions. The Joint Applicants' response to CWA 1-7 demonstrates that at least one consequence of the elimination of the guarantees and liens is materially higher interest rates and annual interest expense. The financial projections provided by Joint Applicants in responses to discovery requests have depended on interest rates and interest expenses associated with the secured debt terms on the Commitment Letter as a basic input. Higher interest costs from the changes referred to in Joint Applicants' April 12th letter would be material, and are not factored into the previously provided financial projections. As indicated by the response to CWA 1-7, "guarantees and liens reduce the interest rate associated with the secured debt by 100-200 basis points." By letter dated April 13, 2005, the Office of Attorney General made clear to Joint Applicants its belief that the removal of the guarantee and lien obligations was a material change likely accompanied by other material changes to the facts and circumstances of the pending Application. By that same letter, the Office of Attorney General sought the new updated documents that would be associated with this material change to the debt financing package, and update of any discovery responses that would be implicated by this material change of facts, circumstances and financial projections. At this time, Joint Applicants have not provided updated financial projections, bond rating agency presentations, board presentations or solvency opinions to the parties, and have not provided the fully executed, new agreement with the lenders which would amend or replace the

Commitment Letter that was attached as Exhibit 7 to the First Amended and restated Application.

Q. WITHOUT THIS INFORMATION, DO YOU BELIEVE THE COMMISSION AND THE INTERVENORS HAVE A COMPLETE AND UP TO DATE SET OF FACTS NECESSARY TO ADDRESS THE APPLICATION IN THIS MATTER?

A. No. The change made by Joint Applicants by letter dated April 12, 2005 is a material change which should be accounted for in the information that has been provided. This change would have consequences that should appear in financial projections, bond rating agency presentations, board presentations, and solvency opinions requested by Joint Applicants. My testimony has been based on those items as previously provided by Joint Applicants, and we have no information as to how those items have changed by the removal of the security obligation and unstated other impacts on credit terms and conditions. The original commitment letter package was an interrelated collection of terms and conditions, which were bargained between borrower and lender. I consider it unlikely that such a package would contain a material, but extraneous provision that could be removed a few months later without consequence to other terms and conditions.

Q. IF THE DEBT PROPOSED TO BE PLACED ON THE NEW COMPANY IS NOT FOR THE PURPOSE OF ITS OPERATING OR CAPITAL INVESTMENT NEEDS, WHAT IS THE PURPOSE OF THE EXCESSIVE DEBT BURDEN ON THE NEW COMPANY?

A. Documents provided in response to many data requests[9] make clear that the purpose of this excessive debt burden on the new company is to relieve the wireless business (Alltel Corporation) of its debt and equity burden. The greater the debt burden that is placed on the new holding company by Alltel, the more proceeds Alltel has to eliminate its own debt and equity. For example, the following is drawn from Joint Applicants' responses to CWA 1-47 and 1-48:

- December 14, 2005 Fitch Ratings Credit Update for Alltel Corporation: a Key Credit Strength is the "significant deleveraging resulting from the planned spin-off", "Fitch

[9] E.g, **[BEGIN CONFIDENTIAL]** [redacted], **[END CONFIDENTIAL]** CWA 1-47 and CWA 1-48.

- expects Alltel's leverage to approximate 1.0x by the end of 2006";
- January 18, 2006 Standard & Poor's Corporate Ratings for Alltel Corporation: "pro forma for the spin-off of Alltel's wireline business, including an associated debt exchange, Alltel will have about $4 billion of debt before implementation of an anticipated $1 billion post spin-off debt reduction plan". "The company is expected to be very conservatively leveraged, pro forma for the spin-off of the wireline business, with a debt to EBITDA of around the low-1x area."
- December 9, 2005 Stifel Nicolaus Analysis for Alltel Corporation: "following the close of the [spin off and merger], and in line with our previously stated thesis, we believe this transaction dresses Alltel up for a possible acquirer, such as Verizon or Sprint Nextel. The remaining wireless business will be <u>essentially debt free</u> ..." (<u>emphasis added</u>);
- December 12, 2005 UBS Analysis for Alltel Corporation: "Proceeds of $4.2 billion from the wireline transaction will be used to retire debt and buy back shares." "Leverage at the wireless business is expected to be roughly 1 times EBITDA..."
- December 9, 2005 Citigroup Analysis for Alltel Corporation: "we believe the post-spin wireless business is <u>under-levered</u> at roughly 0.6 times our 2006 wireless EBITDA". (<u>emphasis added</u>)
- December 9, 2005 Baird/US Equity Research Analysis for Alltel Corporation: "the pro forma wireless entity will have a debt to EBITDA ratio of under 1.0x, providing significant flexibility for future transactions." "Alltel could be a good strategic fit for one of the nationwide wireless carriers over the long term, with Verizon Wireless and Sprint seemingly being the best fits along technology lines."
- December 12, 2005 Bank of America Equity Research for Alltel Corporation: "After the spin of the wireline business, Alltel will be the only large cap pure play wireless growth company and should enjoy <u>exceptionally low leverage</u> at 0.4x." "The real fundamental story at Alltel wireless will be how the company plans to extract value from its <u>exceptionally under-levered balance sheet</u>..." "With an <u>exceptionally under-levered balance sheet</u>, Alltel not only represents an attractive merger candidate for a

larger wireless company but has substantial leeway to boost dividends, increase buyback and/or pursue accretive M&A". (emphasis added)

Also, in the Joint Applicants response to AG 2-139 Joint Applicants state that Alltel Corporation has an announced $1 billion debt reduction plan.

Q. DO THE DISCUSSION MATERIALS AND BOARD PRESENTATIONS PERTAINING TO THE PROPOSED TRANSACTIONS SHOW THAT THE PURPOSE OF PLACING THE DEBT BURDEN ON THE WIRELINE BUSINESS IS TO DE-LEVER THE WIRELESS BUSINESS?

A. **[BEGIN CONFIDENTIAL]** [redacted]

[redacted]

[END CONFIDENTIAL]

Q. DO THESE MATERIALS ALSO SHOW AN UPWARD TREND OVER TIME IN THE AMOUNT OF DEBT PROPOSED FOR THE WIRELINE BUSINESS?

A. Yes. Please see Exhibit DB-2. It shows an increase from **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

Q. DID THE JOINT APPLICANTS ADMIT THIS FACT?

A. No. Joint Applicants stated that the entire increase was due to the Valor acquisition. In response to AG 2-105, Joint Applicants stated "in the September 1, 2005 presentation "Cardinal Regarding Potential Wireline Spin-Off Alternatives", the structures presented only contemplated the spin and did not include the merger with Valor." As demonstrated above, this is clearly not accurate, and has the effect of obfuscating the matter. Valor's debt assumed in the merger is $1.175 billion, which does not account for even a majority of the difference. In addition, Valor's current leverage ratios are 4.2x EBIDTA, so Joint Applicants cannot claim that the merger provided additional debt capacity given this ratio. In fact, Valor also obtains "de-leveraging" benefits from the transaction, since its leverage ratio declines from 4.2x to 3.2x.[10] In response to CWA 1-48, Joint Applicants provide a Stifel Nicolaus report which notes "the new company's leverage will fall from

[10] See Joint Applicants response to AG 2-15 for the Valor Board presentations which discuss this aspect of the transaction.

Valor's current 4.4x to approximately 3.2x". In response to CWA 1-47, Joint Applicants provide a S&P report, which references Valor's current 4.3x leverage.

Q. WHAT IS THE PROFILE OF THE EXISTING ALLTEL DEBT?

A. **[BEGIN CONFIDENTIAL]**

[redacted]

[END CONFIDENTIAL]

Q. WHAT IS THE ASSUMED DEBT PROFILE AFTER THE TRANSACTIONS?

A. **[BEGIN CONFIDENTIAL]**

[redacted]

[redacted]

[END CONFIDENTIAL]

Q. WHAT IS THE APPROXIMATE MAXIMUM LEVEL OF DEBT THE NEW HOLDING COMPANY COULD BEAR, AND STILL HAVE A REASONABLE OPPORTUNITY TO OBTAIN AN "INVESTMENT GRADE" CREDIT RATING?

A. The Board presentation materials provided in response to AG 1-47 suggest a level of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Confirmation and/or refinement of this figure was sought in AG 2-6. Joint Applicants responded that "the agencies ratings are highly discretionary, and Joint Applicants cannot speculate as to the maximum debt level to receive an investment grade rating." I do not consider this response to be completely forthcoming or responsive, since Joint Applicants have received and used credit statistic information to determine expected credit ratings.[11] Attached to that response is "RLEC Credit Comps", which shows among other things that CenturyTel has an investment grade bond rating (BBB+), and a debt/EBITDA ratio of 2.2x, compared to the New Holding Company's pro forma ratio of 3.3x. If the 2.2x ratio is used, this implies a total debt level for the New Holding Company of $3.68 billion, or $1.829 billion less in debt.

Q. WHAT ARE THE CONSEQENCES OF THE EXCESSIVE LEVEL OF PROPOSED DEBT?

A. There are several critical consequences that stem from the level of debt proposed by the Joint Applicants. They include:

- Higher financial risk;

[11] See for example, Joint Applicants response to AG 1-47, **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

- Increased interest rate risk;
- Lower bond ratings;
- Higher dividends;
- Higher cost of capital;
- Creation of a tier of capital investment projects that cannot be given approval due to higher costs of capital;
- Preemption of cash resources for use to pay debt, interest and dividends; and,
- Consequently less cash available to promote and enhance universal service, widespread deployment of broadband, and future technology opportunities.

Q. PLEASE DEFINE "FINANCIAL RISK".

A. Financial risk is that portion of total corporate risk, over and above basic business risk, that results from using debt. Financial risk is the additional risk that is introduced by the use of financial leverage. Financial leverage has two edges, when used successfully (e.g, increasing sales and profits) it increases returns to shareholders, but if used unsuccessfully (e.g, decreasing sales and profits) difficulty in meeting the fixed charge obligations of the firm occur with resulting financial distress.

Q. WHAT IS THE LEVERAGE RATIO OF THE MWB ASSUMING THE PROPOSED DEBT LEVELS?

A. Per information from SEC filings (the Valor Form S-4, and Alltel 2005 Form 10-K), the debt/equity ratio for the MWB would be 1063%, compared to the current debt/equity ratio of the parent of 44%,[12] as follows:

Alltel Corporation (as of 12/31/05)

Debt	$ 5,782,900,000
Equity	$ 13,015,500,000
Debt/Equity Ratio	44.43%

MWB (as of 12/31/05)

[12] Joint Applicants provided this public information in response to AG 2-68, but claimed it to be confidential and proprietary.

Debt	$	5,516,000,000
Equity	$	518,900,000
Debt/Equity Ratio	1063.02%	

Although there are some intervening steps it is clear that the equity of the Alltel ILECs that had been built up over time is substantially dissipated (and remains with the parent) and replaced with a debt burden as the wireline business is spun off. The higher debt burden proposed to be placed on the MWB has negative consequences such as lowered bond ratings and increased cost of capital.

Q. IS THE NEW COMPANY EXPOSED TO HIGHER INTEREST RATE RISK?

A. Yes. The proposed new debt for the holding company is to be carried at a variable interest rate, at least in part. Under the Commitment Letter, at Annex I (filed as Exhibit 7 to the First Amended and Restated Application), the proposed debt bears interest at a variable rate based on a chosen short term interest period (1, 2, 3, or 6 months as selected by the borrower) for the London Interbank Rate ("LIBOR") plus an additive margin, or an interest rate that appears to be fixed based on a "prime rate" plus an additive margin. The risk in this context is that interest rates will continue to rise, thus causing the new holding company to bear increased fixed charges associated with higher interest for the debt which is carried at the variable rate. These higher interest expenses must be paid, and would preempt cash use that had been planned for other purposes (e.g., dividends or capital investment). The new company may "lock in" interest rates for at least some of the borrowing at the time of issuance, but the extent of that is not clear, nor is the interest rate at which such borrowing would occur known at this time.[13]

Q. IS THE STOCK PRICE ALSO EXPOSED TO ADDITIONAL RISK FROM HIGHER INTEREST RATES?

A. Yes. The New Holding Company proposes to posture its stock as a "yield based" investment due to the high payout dividend level. As a yield based investment, the stock

[13] See Joint Applicants response to AG 2-112: "it is likely that [the new holding company] will fix a large portion of its floating rate debt upon issuance."

will therefore be affected negatively by rising interest rates—the stock price will tend to decline with increasing interest rates.

Lower (Non-Investment) Grade Bond Ratings

Q. HAS THERE BEEN ANOTHER RECENT SPIN OFF OF ILEC OPERATIONS FROM A LARGE PREDOMINANTLY WIRELESS COMPANY?

A. Yes. As referenced above, Sprint Nextel has recently proposed to spin off its local telecommunications division from the Sprint Nextel Corporation. Sprint and Nextel were required to obtain Federal Communications Commission approval for the proposed merger of those two companies. Spin off of the Sprint local telecommunications division was contemplated by the merging companies, and the spin off was addressed by the FCC as part of the merger application. FCC Commissioner Adelstein addressed the financial health of the spin off ILEC company as follows:

> I also appreciate the company's efforts to address my concerns about the financial health of the spin-off of the incumbent local telephone operations. In a recent filing, the Chief Executive Officers of both Sprint and Nextel indicated that the new local telephone company "will receive an equitable debt and asset allocation at the time of its proposed spin-off so that the company will be a financially secure, Fortune 500 company." This positive step will protect Sprint's wireline employees and ensure millions of primarily rural wireline customers continue to see a high level of service and investment in advanced services.[14]

Accordingly, in state regulatory proceedings for approval of the spin off of the local division Sprint Nextel committed that LTD Holding Company (later named "Embarq") would be spun off in a position to achieve investment grade debt ratings. This Sprint Nextel commitment explains at least in large part the differing debt levels per access line between that proposed by Joint Applicants versus that proposed by Sprint, as noted above.

Q. ARE THE DIFFERENCES BETWEEN THE SPRINT NEXTEL AND THE ALLTEL APPROACHES NOTED IN THE RESEARCH MATERIALS?

[14] Statement of Commissioner Jonathan S. Adelstein, *In the Matter of Applications of Nextel Communications, Inc. and Sprint Corporation for Consent to Transfer Control of Licenses and Authorizations*, WT Docket No. 05-63, FCC 05-148, Released August 8, 2005.

A. Yes. For example, Bank of America notes that "there is some discrepancy between Alltel's approach to the spin and Sprint's approach, with Sprint taking a more conservative payout and leverage posture, claiming the need to assuage state regulators." [15] This "discrepancy" is critical to Kentucky ratepayers. Joint Applicants' proposed structure imposes a large debt burden on ratepayers, imposes burdensome and increased interest expenses of non-investment grade debt, imposes a large dividend obligation, and sets up conflict with company financial goals, as described in more detail below.

Q. PLEASE PROVIDE A BRIEF DESCRIPTION OF THE BOND RATING CLASSIFICATIONS.

A. There are three major bond rating entities: Moody's Investors Service, Standard & Poor's Ratings Services, and Fitch Ratings. The purpose of bond ratings is to assess the credit risk of the bond issuer and its industry. Credit risk is the risk that the issuer will default or be unable to make principle or interest payments when due. Description of the tiered long term debt rating systems used by these three entities was provided by Joint Applicants in response to CWA 2-1. The bond rating scales and definitions used by each company are somewhat different, but the general structure and import is the same. There is one important division in this rating system, bonds rated "BBB" or above are considered to be "investment grade", while those with ratings below that level ("BB" and lower) are considered to be "non-investment grade", "speculative", "high yield" or "junk" bonds. The bond rating classifications are as follows:

	Moody's	Standard & Poors	Fitch
Highest Quality	Aaa	AAA	AAA
High Quality	Aa	AA	AA
Upper Medium	A	A	A
Medium	Baa	BBB	BBB
Speculative	Ba	BB	BB, B
Highly Speculative	B, Caa	B, CCC, CC	CCC, CC, C
Default	Ca, C	D	DDD, DD, D

[15] Joint Applicants' response to CWA 1-48, Bank of America Equity Research for Alltel Corporation, December 12, 2005, page 4, emphasis added.

Q. WHAT CONSEQUENCES DOES A NON-INVESTMENT GRADE BOND RATING HAVE?

A. Among other things, a non-investment grade rating means that certain types of investors (e.g., pension funds and other institutions) are precluded from purchasing such bonds. The market in which the bonds can be sold is therefore notably diminished. A non-investment grade bond rating means that there is a greater credit risk associated with the bonds, investors must be compensated for assuming greater risk, and therefore the interest rate associated with the bond must be higher. Non-investment grade bonds have a higher risk of default than do investment grade bonds. Investment grade bonds are less likely to have their ratings downgraded than are non-investment grade bonds. According to a Moody's 2002 study over the period 1970-2001, Baa bonds (bottom "rung" of investment grade) experienced a 1.6% default rate, while Ba (top "rung" of non-investment grade) bonds experienced a 8.2% default rate, or over five times the default rate. B-rated bonds experienced a 19.6% default rate.[16] Capital market access and/or pricing can be volatile for non-investment grade capital structures, while market access for investment grade is continuous.

Q. HAS ALLTEL PROVIDED INFORMATION REGARDING THE BOND RATINGS IT EXPECTS FOR THE PROPOSED DEBT OF THE MWB?

A. In the testimony supporting the Application, Alltel states that "because the New Holding Company has not yet begun its operation and the proposed debt has not yet been issued, the proposed debt has not been rated by a rating agency."[17] The testimony goes on to make comparisons with rated debt issued by "other RLECs" (Rural Local Exchange Companies) and concludes that "the New Holding Company debt is likely to receive a debt rating somewhere between BB- and BB+, or slightly below investment grade."[18] The Joint Applicants have proposed a capital structure in this matter that will yield below investment grade bond ratings, while in the Sprint Nextel spin off applications, a capital structure that permitted achievement of investment grade debt ratings was proposed.

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[16] 5-Year Corporate Bond Rating/Default Transition Rates, 1970-2001, Moody's 2002, as cited at http://personal.fidelity.com/products/fixedincome/risks.shtml

[17] Initial Testimony of Jeffrey Gardner, page 13, line 4.

[18] Id, at line 20.

Q. HAVE THE JOINT APPLICANTS SOUGHT TO OBTAIN "INDICATIVE RATINGS" FROM BOND RATERS TO ASSESS THE ANTICIPATED BOND RATING FOR MWB AS PROPOSED?

A. No. According to the response to AG 2-5, apparently no such indicative ratings have been sought. The response states that "Management met with Moody's Fitch and Standard and Poor's on April 4th and 5th to discuss the upcoming transactions. The New Holding Company expects to receive credit ratings by the end of May." The timing of this meeting also suggests to me that the removal of security requirements (guarantees and liens) from the debt terms would have been known and discussed, since the Commission received a letter in the public domain dated April 12th notifying it of such removal. Therefore, the Commission has no objective basis to know whether the proposed debt will be "BB" (speculative) or "B" (highly speculative) or lower as a result of removal of the security (guarantee/liens) provisions.

Q. DID SPRINT NEXTEL SEEK INDICATIVE BOND RATINGS FOR THE DEBT IT PROPOSED TO PLACE ON THE SPUN-OFF LOCAL TELECOMMUNICATIONS DIVISION, LATER NAMED EMBARQ?

A. Yes. Sprint Nextel did seek and receive such indicative ratings, which indicated that the Embarq debt would be considered "investment grade". This fact was made known by Sprint Nextel to the state regulatory agencies in its filed applications.

Q. IS THE INTEREST RATE TO BE CHARGED ON THE DEBT OF JOINT APPLICANTS UNDER THE TERMS CONTAINED IN THE COMMITMENT LETTER DEPENDENT ON THE BOND RATING OF THE DEBT?

A. Yes. Higher interest rates apply if the bond rating is less than BB (Standard and Poor's) <u>and</u> Ba2 (Moody's), in each case with a Stable outlook. If the bond ratings fall below <u>either</u> threshold, higher interest rates and expenses will occur.

Q. DO THE JOINT APPLICANTS ATTEMPT TO SUPPORT PLACING EXCESSIVE DEBT ON THE NEW HOLDING COMPANY WITH REFERENCE TO RURAL LOCAL EXCHANGE COMPANIES (RLECS) THAT ARE "PEERS" TO THE NEW HOLDING COMPANY?

A. Yes. In the Application, it is stated that "the debt to equity ratio of the parent company will provide sufficient leverage to produce specific benefits for the Merged Wireline business and the resulting debt leverage will be among the lowest in the RLEC industry.[19]

Q. WHAT ENTITIES DID JOINT APPLICANTS USE FOR PURPOSES OF THAT COMPARISON?

A. CWA 1-68 sought the "complete documentation support" for that statement. Joint Applicants provided a one-page attachment showing a "comparison of the capital structure of the Merged Wireline Business and its publicly traded RLEC peers." It is attached as Exhibit DB-3. The "peer" companies listed here are:

- Commonwealth Telephone Enterprises (CTCO)
- CenturyTel (CTL)
- NewCo
- Citizens Communications (CZN)
- Iowa Telecommunications Services (IWA)
- Consolidated Communications Holdings (CNSL)
- Cincinnati Bell (CBB)
- Fairpoint Communications (FRP)

Q. WHAT DOES THIS COMPARISON SHOW?

A. It shows the critical importance of what companies are considered to be "peers". The two companies on the left hand side of the graph (Commonwealth and CenturyTel) have leverage ratios that are consistent with "investment grade" bond ratings. The remaining companies are considered to be below investment grade. This distinction is also shown in the "Presentation to the Board of Directors/Separation of Alltel Wireline", dated December 2005, provided in response to AG 1-47 where the companies are **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

Q. ARE "PEER" COMPANIES CONSISTENTLY USED IN THE JOINT APPLICANTS' ANALYSIS?

[19] Application, at paragraph 26, emphasis added.

A. No. "Peer" companies vary noticeably throughout the analysis. For example, Cincinnati Bell is not included in the "comparable companies" displayed on Exhibits 2 and 3 to the Gardner testimony. Also, the Board presentation **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** In response to AG 2-69, Joint Applicants consider "comparable companies" to be CenturyTel, Citizens, AT&T, BellSouth, Qwest, Verizon and Sprint. This choice of comparables is made for computing weighted average cost of capital, and Citizens and Qwest are excluded from the analysis "to avoid distortion" since both companies have debt/equity ratios exceeding 100%.[20] These comparables are much different than those presented in the Application and testimony.

Q. DOES DUFF & PHELPS REACH ANY CONCLUSIONS REGARDING COMPARABLE COMPANIES IN ITS SOLVENCY ANALYSIS?

A. Yes. In its response to AG 2-95, Joint Applicants provided **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

Q. SHOULD THE COMMISSION ACCEPT THE APPROPRIATENESS OF THE "PEER" COMPANIES IDENTIFIED BY JOINT APPLICANTS?

A. No. The Application and the Gardner testimony use comparisons that are not appropriate from the standpoint of Kentucky ratepayers. These comparable companies appear to have been selected after the choice was made to propose the New Holding Company as a high debt, high yield RLEC. The testimony at page 9 references "existing similarly

[20] Yet, Joint Applicants propose the New Holding Company have a debt to equity ratio exceeding this as well.

situated publicly traded RLECs" which are "presently operating successfully". The Commission should note that the Joint Applicants proffered peer comparison omits any discussion of investment grade peers versus non-investment grade peers, and fosters a perception that the New Holding Company should be considered comparable to companies which have high debt, financial losses, and non-investment grade bond ratings. Alltel's own internal analysis characterizes many of these companies in a fashion that is not positive for universal service. The Board presentation titled **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** characterizes each of the non-investment grade companies that the Joint Applicants allege are "comparable", "peer" companies.

Q. DO BOARD PRESENTATION MATERIALS SHOW ALTERNATIVES BETWEEN "INVESTMENT GRADE" VERSUS "NON INVESTMENT GRADE" DEBT STRUCTURES?

A. Yes. It appears that investment grade versus non-investment grade comparisons were presented to the Board in September 2005, and that some time in **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

<u>Conflicts with New Holding Company Financial Goals</u>

Q. CAN THE FINANCIAL PROFILE OF THE NEW HOLDING COMPANY REASONABLY BE CHARACTERIZED AS "HIGH DEBT, HIGH DIVIDEND"?

A. Yes.

1 **Q. WHAT ANTICIPATED DIVIDEND FOR THE NEW HOLDING COMPANY HAS**
2 **BEEN STATED?**
3 A. Per Mr. Gardner's testimony at page 9, line 20: "The New Holding Company plans to set
4 its dividend at $1.00 per share". This dividend is projected to provide an 8% dividend
5 yield at the outset.[21]
6 **Q. EARLIER IN YOUR TESTIMONY YOU HAVE DISCUSSED HOW THE "HIGH**
7 **DEBT" ASPECT OF THE PROFILE CAME FROM THE GOAL OF**
8 **DELEVERAGING THE WIRELESS COMPANY. PLEASE DESCRIBE YOUR**
9 **UNDERSTANDING OF THE "HIGH DIVIDEND" ASPECT OF THE PROFILE.**
10 A. It appears to me that the level of the dividend was established to provide equivalent
11 combined dividend levels for Alltel shareholders, before and after the spin off and
12 merger. "For Alltel shareholders, the move will increase the collective dividend by $0.01
13 per share from $1.54 to $1.55 with $.50 coming from wireless and $1.05 coming from
14 wireline".[22] Since the total is the key, to the extent the wireless business reduces its
15 dividend, the New Holding Company must pick up the difference to maintain this
16 equivalence.[23] Furthermore, the high dividend is intended to establish a dividend yield
17 hoped to be attractive to investors. Finally, the high debt leverage and the lower than
18 investment grade ranking of the New Holding Company debt drives a higher required
19 dividend.[24]
20 **Q. IS THERE A RATIONALE FOR STABLE DIVIDEND LEVELS OVER TIME?**
21 A. Yes. There is reason to expect that a stable dividend policy will lead to higher stock
22 prices. Investors can be expected to value more highly dividends that are relatively
23 certain versus dividends which are believed to be variable or subject to being cut.
24 Shareholders who depend on dividends for income can also be expected to value stable
25 dividend paying shares versus dividends that are believed to be variable. "In view of

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[21] E.g, Joint Applicants Response to AG 1-30, and Joint Applicants Response to CWA 1-48, Bank of America Equity Research Report, December 12, 2005.
[22] Joint Applicants Response to CWA 1-48, Bank of America Equity Research Report, December 12, 2005, page 6.
[23] See also, page 12 of the Board presentation on the separation of Alltel Wireline, dated December 2005, provided in response to AG 1-47.
[24] Joint Applicants response to AG 2-86 is incorrect in this regard, when it states "the total dividend paid is $474 million, regardless of credit rating."

investors' observed preference for stable dividends and of the probability that a cut in dividends is likely to be interpreted as forecasting a decline in earnings, stable dividends make good sense."[25] Reduced dividends suggest a reduced stock price.

Q. WHAT EXPECTATIONS EXIST REGARDING THE NEW HOLDING COMPANY DIVIDEND?

A. At least one analyst expects the split of the wireline and wireless businesses, and consequent wireline dividend to "allow the wireline entity to focus on maximizing dividend returns to income investors and the wireless entity to focus on balancing growth and returns to equity."[26]

Q. THE JOINT APPLICANTS' TESTIMONY INDICATES THAT THE "NEW HOLDING COMPANY IS IN THE PROCESS OF OBTAINING A SOLVENCY OPINION FORM DUFF & PHELPS, LLC". HAS SUCH AN OPINION BEEN OBTAINED, AND HAVE YOU REVIEWED IT?

A. Yes. In response to AG 2-95, the Joint Applicants provided **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

Q. PLEASE PROVIDE YOUR FINDINGS FROM THIS DOCUMENT.

A. The Commission should find the conclusions and assumptions from this document to be so troubling that it would cause the Application to be denied by the Commission. The information contained therein makes clear to me that the transactions if approved would seriously jeopardize the ability of the Kentucky operating companies to continue to provide and expand universal service in Kentucky, as well as expand availability of high speed internet access and other services. **[BEGIN CONFIDENTIAL]** [redacted]

[25] Managerial Finance, Weston and Brigham, Sixth Edition, 1978, at page 809.

[26] Joint Applicants Response to CWA 1-48, Bank of America Equity Research Report, December 12, 2005, page 3, emphasis added.

[redacted]. **[END CONFIDENTIAL]** Relevant pages from the Duff & Phelps analyses are attached as Exhibit DB-4 (confidential).

Q. THE JOINT APPLICANTS STATE THAT "THE NEW HOLDING COMPANY WILL HAVE APPROXIMATELY $200 MILLION OF EXCESS CASH FLOW PER YEAR" IN RESPONSE TO AG 2-51, AND THIS SAME FIGURE IS

REPEATED ELSEWHER. PLEASE ADDRESS THE ACCURACY OF THIS STATEMENT.

A. This response suggests a constant level of "excess" cash flow, and lends the impression that this level of free cash flow is expected to be constant for future years. In fact this is completely undercut and contradicted by the Joint Applicants own projections. Free cash flow is materially less than that indicated by the Joint Applicants' statement. Joint Applicants response to AG 2-93 indicates that free cash flow after dividends is **[BEGIN CONFIDENTIAL]**

[redacted].

[END CONFIDENTIAL] The management projections included in the Duff & Phelps analysis indicates comparable figures for free cash flow after dividends:

[BEGIN CONFIDENTIAL]

[redacted]. **[END CONFIDENTIAL]** This also clearly explains why Duff & Phelps predicts and assumes that **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

<u>Excessive Debt has More Serious Consequences for Kentucky</u>

Q. WHY DOES THE EXCESSIVE DEBT PROPOSED BY JOINT APPLICANTS IN THIS MATTER HAVE MORE SERIOUS CONSEQUENCES FOR KENTUCKY, THAN OTHER ALLTEL STATES?

A. Kentucky Alltel is by far the largest rate of return regulated operating company among the Alltel ILECs. Kentucky also is the second largest Alltel ILEC state, closely behind

Georgia. At the point which any financial distress for the New Holding Company was foreseen by it, the company would be able to file a rate case in Kentucky in order to attempt to generate increased revenues and cash for its financial obligations. Absent Commission refusal to go along with rate increases, Kentucky stands out as the place where the New Holding Company could go to raise revenues and cash. One dollar per access line increase would generate over $6 million in additional cash. The Commission would have a real dilemma on its hands with the company claiming some level of financial distress on the one hand, and concerns about universal service and the fact that the financial distress was both foreseeable and "self-inflicted" on the other hand.

Q. DO THE TRANSACTIONS PROPOSED IN THIS MATTER LIKELY CAUSE A HIGHER REQUESTED RATE OF RETURN ON RATE BASE?

A. I would expect the company to request a higher rate of return than it would need to absent the transaction, in any future rate of return proceeding. The non-investment grade debt in the capital structure would be one source of higher cost of capital. Joint Applicants have stated in response to CWA 1-7 that "the Guarantees and Liens reduce the interest rate associated with the secured debt by 100-200 basis points." These guarantees have been removed at this point, so cost of debt would increase all other things equal. Joint Applicants have also indicated in response to AG 2-3 that the cost of non-investment grade debt is 41-70 basis points, or more, than the cost of the lowest notch of investment grade debt. Other factors related to this proposed transaction (e.g, dividend yield, higher financial risk) would likely be used as well to propose a higher required return on equity. **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]**

Q. DID YOU SEEK TO ASSESS THIS HIGHER COST OF CAPITAL MORE SPECIFICALLY IN THE CONTEXT OF PREVIOUS ALLTEL RATE OF RETURN SUBMISSIONS?

A. Yes. Since Kentucky Alltel is rate of return regulated, in AG 2-88, a copy of the most recent testimony and attachments filed at any state utility commission addressing Alltel's recommendation of the appropriate cost of capital and capital structure was sought. Joint

Applicants response was vague and non-responsive in that such testimony was not provided, and a non-specific reference stating the "information is publicly available" was made. Not even any state, dates or docket numbers pertaining to cost of capital testimony were provided. My experience is that unless the state, date, and docket number is known, searching for a particular document is like searching for a needle in a haystack. There is no cost or time effective way to locate such a document without that information, especially given the tight procedural schedule of this case. In contrast, Alltel would obviously have internal knowledge of where, when and in what case it filed the most recent cost of capital testimony. (Several dockets irrelevant to the question were provided in the response, for some reason that is unclear.) Therefore, I was not able to recast a previous Alltel cost of capital analysis with the higher capital costs stemming from the application in this matter.

Q. DO YOU RECOMMEND THAT THE COMMISSION BE CONCERNED ABOUT THE FINANCIAL CONDITION OF THE KENTUCKY COMPANIES GOING FORWARD, GIVEN THE PROPOSED TRANSACTIONS?

A. Yes. The information provided by Joint Applicants, particularly in response to AG 2-93 to 2-95, suggests that **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

1 **"Merger Synergies"**

2 **Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF "MERGER SYNERGIES"**
3 **IN THIS CASE.**

4 A. Joint Applicants state through the Gardner testimony that as part of the merger process,
5 Valor and Alltel have "identified approximately $40 million of possible net savings".
6 This estimate has not changed in any of the materials provided in this matter. But, per
7 the response to AG 2-40, the cost savings presented in the Application are not yet
8 finalized. "Joint Applicants do not have an anticipated date for finalization of cost
9 savings. Most current draft is attached...." [27]
10
11 Many if not all of these net savings come from elimination of duplicate functions and
12 operations—one example provided by Joint Applicants is taking two corporate offices
13 down to one. The term "net" is needed because there are costs to achieve the savings, for
14 example severance or termination payments from eliminating personnel and positions.
15 Joint Applicants expect these net savings to be achieved at the holding company level,
16 and not the operating company level. No direct cost savings are planned or identified for
17 Kentucky operations. Nor do Joint Applicants intend to flow through any savings to the
18 operating companies. In response to AG 1-7b, Joint Applicants state "the expected
19 annual corporate shared service allocations to the operating companies in the Merged
20 Wireline Business are expected to be roughly the same as they are today, before the
21 contemplated transaction. Therefore, Joint Applicants do not expect there to be any
22 material synergy savings passed on to their customers."

23 **Q. PLEASE ADDRESS THIS LACK OF MATERIAL SYNERGIES SAVINGS?**

24 A. The Joint Applicants state that merger synergies savings will not flow through to the
25 operating companies in any material way. The lack of material synergy savings is noted
26 by some analysts. According to Bank of America, "at this early stage, the merger with
27 Valor does not seem to generate any real synergy ($40 million estimate annually)".[28]

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[27] Claimed merger net synergies have already been reduced $500,000 due to a calculation error. See Joint Applicants response to AG 2-30.

[28] Joint Applicants Response to CWA 1-48, Bank of America Equity Research Report, December 12, 2005, page 3.

Therefore, the Commission should not accord the merger net synergy claims any weight as it considers the public interest. Merger synergy claims are estimates at best, and experience has showed that it is extremely difficult to get a utility to quantify actual merger savings at a later date some years after the merger has already been approved, or flow through any such savings to consumers. Claimed merger net synergies tend to disappear in the course of business and with the passage of time, or become subject to claims of great difficulty to quantify actual merger net savings. The non-material, estimated merger net synergy savings are not likely to provide any benefits to the public. It appears that any benefits to be realized will be private benefits flowing to shareholders and management.

Q. DO THE MERGER NET SYNERGIES SAVINGS ACCOUNT FOR THE LOST MARGIN FROM PROVISION OF BILLING AND BACK OFFICE FUNCTIONS FOR VALOR?

A. No. Based on the responses to AG 1-7 and 2-27, the merger net synergies savings estimations do not appear to account for the margin that is being earned today from the provision of billing and back office functions to Valor, but that will be lost when the two entities merge. In 2005, Alltel earned $16 million in revenues from Valor for performing these functions. I believe Alltel would have included some level of margin over and above cost in the charges to Valor that generate this revenue. Alltel would not provide this service without earning some margin. If the margin charged were 10%, then the lost margin upon merger would be approximately $1.5 million. This lost margin is not reflected in the calculation of $40 million net merger synergies, yet it will be a real bottom line loss that should be offset against other savings to calculate net merger synergies. Accordingly, the $40 million claimed net merger synergies appears to be overstated by the amount of the lost margin pertaining to charging Valor for billing and back office functions.

Q. DO THE JOINT APPLICANTS ADDRESS OR INCLUDE ANY OF THE TRANSACTION COSTS ASSOCIATED WITH THE SPIN OFF AND MERGER?

A. No, transaction costs are accorded no mention in the Application or testimony. Transaction costs are claimed to be confidential to the extent they have been provided in this matter. Joint Applicants response to AG 1-18 contains an estimation of what appears to be a subset of the transaction costs, or **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Fees and costs associated with financing are not mentioned or included either. Joint Applicants' response to AG 2-4 indicates **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]** These fees and costs associated with financing the transactions are not mentioned or offset against the claimed net merger synergies. The Commission should note that these costs are part of the entire transaction and should be recognized along with any net merger synergies.

"Increased Buying Power" from the Proposed Merger

Q. PLEASE ADDRESS THE "INCREASED BUYING POWER" CLAIMED BY JOINT APPLICANTS TO BE A "BENEFIT" ASSOCIATED WITH THE PROPOSED TRANSACTIONS.

A. Commission staff 1-2 sought explanation of how increased scale and scope of the new company as claimed in the Gardner testimony would be beneficial to Kentucky ratepayers. In response to that interrogatory, the Joint Applicants state that the size of the new company "will provide the Merged Wireline Business with increased buying power which translates into lower costs of equipment, network, materials and supplies".[29] Joint Applicants appear to be stating that an unspecified increase in size of the company will yield lowered costs of equipment procurement through increased purchase discounts for procurement through Alltel Communications Products, Inc. (ACP). This is the first time that the claimed benefit appears, as it was not directly claimed in the Application itself, or the supporting testimony. The claim is vague as to what entities are being compared—is Alltel Corporation as a whole included within this, or is it simply a comparison of Alltel

[29] This claim is repeated verbatim within Joint Applicants response to AG 1-8a.

wireline to the Merged Wireline Business? Therefore, since this claim was not discussed in testimony or the application, and since the nature and materiality of the claimed benefit was not clear, additional information was sought via AG 2-63.

Q. PLEASE DESCRIBE YOUR UNDERSTANDING OF THE CURRENT PURPOSE OF ALLTEL COMMUNICATIONS PRODUCTS, INC.

A. According to the Alltel Corporation 2005 Form 10-K (page 24), ACP is a distributor of telecommunications equipment and materials. ACP offers a large variety of telecommunications-related products for sale. Inventoried products include "single and multi-line telephone sets, wireless handsets, local area networks, switching equipment modules, interior cable, pole line hardware, and various other telecommunications supply items."

Q. HOW MUCH OF ALLTEL COMMUNICATIONS PRODUCTS, INC.'S GROSS SALES WAS ASSOCIATED WITH SALES TO ALLTEL WIRELESS IN 2005?

A. According to the Joint Applicant's response to AG 2-63, in 2005 ACP had gross sales revenue for "equipment, network, materials and supplies" of $2,021.6 million. Of this total amount, $1.447.9 million was for sales to Alltel's Wireless business, consisting of "handsets, accessories and network infrastructure". This equates to the wireless business composing 72% of ACP's sales in 2005.

Q. WILL ALLTEL COMMUNICATIONS PRODUCTS INC. PROVIDE "EQUIPMENT, NETWORK, MATERIALS AND SUPPLIES" TO ALLTEL WIRELESS AFTER THE LOCAL SPIN OFF AND MERGER WITH VALOR, AS IT DID PRIOR TO THOSE TRANSACTIONS?

A. No. The Joint Applicants response to AG 2-63 indicates that Alltel Wireless sales volume will no longer be available to ACP. Alltel Wireless purchases of handsets, accessories and network infrastructure will no longer be procured through ACP.

Q. WHAT ARE THE IMPLICATIONS OF THE FACT THAT ALLTEL WIRELESS WILL NO LONGER PROCURE SUCH ITEMS THROUGH ACP INC.?

A. This provides important context for the Joint Applicants statements regarding "increased purchasing power". The "increased purchasing power" is dependent upon what point in

time it is measured against. The "increased purchasing power" is clearly not being measured against the pre-spin off business of ACP, as the sales dollar volume and presumably some measure of buying power is lost with the spin off. With the spin off, ACP sales revenue will decline 72% as the wireless purchase/sales volume is removed. Alltel Communications Products will be spun off from Alltel Corporation and merged into the New Holding Company as an entity within it. ACP overhead costs will be spread over a smaller sales volume unless and until such costs can be reduced or eliminated. Any "increased purchasing power" appears to result from adding Valor procurement to the residual business of ACP after the wireless component is removed. The Joint Applicants estimate $3 million in "purchasing power savings".[30] This would be only one half of one percent of ACP's residual (post-transaction) sales volume ($2,021 million minus $1,447 million = $574 million. $3 million/$574 million = .52%). Under the Joint Applicant's proffered materiality threshold of 5%,[31] these "purchasing power savings" are not even close to being material. Furthermore, there is no assurance that these savings will flow through to consumers in retail rates, rather than increase the unregulated margins of ACP Inc. Finally, the capital expenditures for wireline operations have been decreasing in recent years, and this has reduced wireline purchases from ACP.[32] This would tend to offset any increased purchase volume from the merger and acquisition of Valor. Accordingly, the Commission should accord no weight to Joint Applicant claims of "increased purchasing power" as one of the "benefits" from the proposed transactions. Consumers will likely see no benefits from this claimed aspect of the transaction, and the Commission should therefore accord it no weight in its considerations regarding the public interest.

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[30] This information was sought by supplier and type of product, but the Joint Applicant's response to AG 2-63 did not provide such information.

[31] See for example Joint Applicant's response to AG 2-31, where "material" is defined as "a change greater than 5%". Joint Applicants appear to have used this threshold consistently in responses to initial and supplemental data requests.

[32] See for example, page F-30 of the 2005 Alltel Corporation Form 10-K.

Summary of Conclusions

Q. PLEASE SUMMARIZE YOUR CONCLUSIONS REGARDING THIS MATTER BEFORE THE COMMISSION.

A. I conclude that the transactions as proposed are clearly not in the public interest. As outlined above, the Commission has reasons to be extremely concerned regarding the financial viability of the New Holding Company, due to the high fixed costs of projected interest expenses associated with excessive debt, and cash used to pay dividends. Cash resources are preempted by the Joint Applicants' proposed capital structure to pay debt and interest, and dividends. In turn, given the substantial preemption of cash for financing purposes, these concerns about the future financial viability of the New Holding Company seriously diminish the likelihood that Joint Applicants will be able to continue efficient and sufficient provision of universal service at just, reasonable and non-discriminatory rates.

The Joint Applicants' own information demonstrates that the excessive level of debt proposed to be placed on the New Holding Company is not incurred for a proper purpose related to operating or capital investment needs of the local exchange companies engaged in the provision and expansion of universal service to their ratepayers. The excessive debt is proposed to be incurred for an improper purpose—to eliminate debt and equity from the balance sheet of a deregulated enterprise, Alltel Wireless, with the effect among other things of better positioning it for acquisition by another party.

It is likely that the New Holding Company would experience later financial distress under the proposed capital structure. This financial distress would increase the cost of capital of an entity that is rate of return regulated (Kentucky Alltel), would likely present the Commission with the inconsistent prospect of increasing basic service rates to pay for heavy debt incurred for the benefit of a deregulated unaffiliated enterprise, and would set back the ability of the companies in Kentucky to invest in broader deployment of high

speed internet access and other future technology opportunities. The excessive debt on the New Holding Company also would make it more difficult if not impossible for a "white knight" acquirer to acquire the New Holding Company in an attempt among other things to mitigate the financial impacts of already high debt leverage on the company.

The Commission should accord no weight to Joint Applicant claims of "increased purchasing power" as one of the "benefits" from the proposed transactions. Consumers will likely see no benefits from this claimed aspect of the transaction, and the Commission should therefore accord it no weight in its considerations regarding the public interest.

Neither should the Commission give any weight to claims of "net merger synergies" since the Joint Applicants have indicated the synergies will not have material effect or be passed through to benefit customers. Furthermore, Joint Applicants have not included all costs which will serve to offset any net benefits, such as eliminated margins from services previously provided to Valor or financing fees and transactions costs, all of which substantially diminish net benefits from the transactions.

Q. HAVE THE FACTS IN THIS MATTER BEEN TRANSPARENTLY PRESENTED TO THE COMMISSION BY THE JOINT APPLICANTS?

A. No. The Joint Applicants have stated or implied many times in many places that this matter will be "transparent" to consumers, and that the proposed capital structure will have no impact on the ability of Joint Applicants to continue to provide telecommunications services in Kentucky and elsewhere. This testimony demonstrates that the Joint Applicants own documents show that the proposed capital structure would have significant detrimental impact on the financial viability of the New Holding Company, and by extension its ability to continue provision of efficient and sufficient universal service at just, reasonable and non-discriminatory rates. The Commission should note that while Joint Applicants claim "$200 million in annual free cash flow", the Joint Applicants own documents demonstrate that this is substantial overstatement and

inaccurate. Furthermore, presenting the Commission and the intervenors with a material change of facts and circumstances at the eleventh hour makes the Application less than transparent. The Commission should consider this lack of transparency as it weighs public interest considerations in this matter.

Recommendations

Q. WHAT ARE YOUR RECOMMENDATIONS TO THE COMMISSION IN THIS MATTER?

A. I recommend that the Commission deny the application as filed for the reasons stated above. It is my conclusion that the spin-off and merger transactions are ill-conceived from the standpoint of Kentucky ratepayers. The primary beneficiary of the proposed transactions is Alltel's wireless business. The large amount of proposed debt is not incurred for a "proper purpose" and is therefore not consistent with the public interest.

In concert with this, a further overriding concern is that the Joint Applicants have substantially and materially modified the facts and circumstances underlying the Application, essentially at the "eleventh hour", without making corresponding substantive and material amendments or updates to the Application itself, the Exhibits attached to it, the supporting testimony for the Application, and the numerous responses to interrogatories that are substantially and materially changed by the change in facts and circumstances. Critically, the Joint Applicants have refused to provide any timely information regarding the changed facts and circumstances as requested in the Office of Attorney General's immediate (April 13, 2006) response to the Joint Applicant's April 12, 2006 letter notifying the Commission of the "last minute" material change to the facts and circumstances underlying the First Amended and restated Application dated January 23, 2006.

This means, among other things, that the Commission and intervenors have no knowledge of the give and take that occurred in connection with the lenders' agreement

to remove the applicability of guarantees and first liens in the presumably arms length negotiations; no explanation of how a material provision of a previously negotiated package in favor of the lenders can be removed without other change (e.g., loan term or composition, prices) favoring the lenders; no clear proof that interest costs to the New Holding Company have not increased in some fashion (or not been reduced as they otherwise should have been); no provision of updated information or financial projections that have been provided to the Company boards, rating agencies, or Duff & Phelps in connection with this change; or no certainty that Joint Applicants will not seek to reimpose the guarantees and liens in a filing at a later date.

Q. IF THE COMMISSION DETERMINES INSTEAD TO APPROVE THE APPLICATION, SHOULD STRONG CONDITIONS BE REQUIRED BY THE COMMISSION?

A. Yes. The Attorney General's Office may have other conditions to recommend that are not included in this testimony that might arise as a result of the hearing process. Those additional conditions would be addressed in the brief in this matter filed by the Attorney General's Office. The Commission should at minimum condition any approval as follows:

1. Approval of the change of control application should be conditioned on the New Holding Company bearing no more than $3.2 billion in long term debt on its opening balance sheet, or less if necessary to obtain investment grade credit ratings.
2. Approval of the change of control application should be conditioned on the requirement that the Kentucky operating companies of the New Holding Company shall not assume responsibility for the liabilities of the New Holding Company or its successor directly or indirectly as guarantor, endorser, surety, through pledging of assets or stock, or otherwise with respect to the securities of the New Holding Company or its successor.

3. Approval of the change of control application should be conditioned on any additional costs of non-investment grade debt (rated below BBB-) are not to be recovered from Kentucky ratepayers.
4. Approval of the change of control application should be conditioned on the use of the capital structure as it exists on the accounting books for ratemaking and rate of return purposes.
5. Approval of the change of control application should be conditioned on the New Holding Company's operating companies in Kentucky not filing for any increase to basic local rates prior to a calendar year 2011 test period.
6. Approval of the change of control application should be conditioned on Kentucky ratepayers not being required to bear, either directly or indirectly, any costs, liabilities or obligations incurred in connection with the proposed spin off and merger transactions. In other words, Kentucky's ratepayers should not unnecessarily be subjected to any risk of the transaction.
7. Approval of the change of control application should be conditioned on any compensation, remuneration, bonus, benefit or otherwise paid to any officer, executive, or board member of the Joint Applicants as a consequence of, or related to the consummation of this transaction, shall be paid only by way of stock option redeemable no sooner than 2011. In other words, said individual will bear similar risks of the viability of the surviving companies as the ratepayers and new shareholders.
8. Approval of the change of control application should be conditioned on agreement that the new company will notify the Commission and parties to this docket of any downgrading of the New Holding Company or any subsidiary's debt within seven days of such downgrade, and will include with such notice the complete report of

the issuing bond rating agency. In addition, the New Holding Company shall report whether the conditions driving the change in credit rating are anticipated to result in a short-term or long-term deterioration of credit metrics, and shall address the New Holding Company's liquidity and provide an explanation of the financial condition of the New Holding Company that is verified and attested to by a corporate officer.

9. Approval of the change of control application should be conditioned on the requirement that the New Holding Company will provide to the Commission and the parties to this docket any initial credit rating agency reports within 15 days of issuance.

10. Approval of the change of control application should be conditioned on the requirement that the New Holding Company will provide to the Commission and the parties to this docket copies of any opinion received from outside tax counsel regarding the tax-free status of the transactions proposed in the Application within five days of the receipt of such opinions. In addition, the New Holding Company will provide a copy to the Commission and the parties to this docket of any IRS letter asserting an issue with the transaction as a tax-free transaction.

11. Approval of the change of control application should be conditioned on the New Holding Company's continued investment in wireline based high speed internet access capabilities in the Kentucky operating company areas. 75% of access lines in the Kentucky operating company areas will be DSL-addressable by December 31, 2006. 85% of access lines in the Kentucky operating company areas will be DSL-addressable by December 31, 2008. All central offices in the Kentucky operating area will be equipped for DSL by December 31, 2007.

12. Approval of the change of control application should be conditioned on the New Holding Company and its Kentucky operating companies employing and continuing to employ adequate resources to meet the quality of service standards established by the Commission.
13. Approval of the change of control application should include any other conditions to which the Joint Applicants have agreed to within this proceeding.
14. Approval of the change of control application should include any other conditions which are imposed by other state commissions, or agreed to by the Joint Applicants in other jurisdictions.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.

Commonwealth of Kentucky
Before the Public Service Commission

In the Matter of:

APPLICATION FOR APPROVAL OF)		
THE TRANSFER OF CONTROL OF)		Case No. 2005-00534
ALLTEL KENTUCKY, INC. AND)		
KENTUCKY ALLTEL, INC. AND)		
FOR AUTHORIZATION TO)		
GUARANTEE INDEBTEDNESS)		

* * * * * * * * * * * * * *

Comes the Affiant, David Brevitz, and being duly sworn, swears or affirms that the testimony presented is, to the best of his information, true and accurate, and that all exhibits submitted with the testimony were prepared by him or under his supervision and direction.

David Brevitz

State of Kansas
County of Shawnee

Subscribed and sworn to before me this the 21st day of April, 2006, by _____.

Vermona E. Runnebaum
Notary Public

My commission expires: February 18, 2010

Seal

Vermona E. Runnebaum
Notary Public - State of Kansas
My Appt. Expires February 18, 2010

EXHIBIT DB-1

David Brevitz, C.F.A.
3623 SW Woodvalley Terrace
Topeka, Kansas 66614
785-266-8769, dbrevitz@cox.net

General

Mr. Brevitz is an independent telecommunications consultant, a Chartered Financial Analyst and has more than twenty-four years of experience in government affairs and telecommunications regulation/de-regulation. He previously served in management positions with industry regulatory organizations. He is a former Chief of Telecommunications for the Kansas Corporation Commission ("KCC"). He is familiar with the details of the FCC's implementation of the Telecommunications Act of 1996, and has provided expert testimony on numerous issues including competition, industry and market structure, service bundles, substitutability of VoIP and wireless for local exchange service, resale, unbundled elements, TELRIC/cost studies, network modernization, access charges, rate design, cost allocations, universal service and other matters.

Professional Designation

Mr. Brevitz has achieved designation as Chartered Financial Analyst from the Institute of Chartered Financial Analysts ("ICFA") in 1984. The ICFA is the organization which has defined and organized a body of knowledge important for all investment professionals. The general areas of knowledge are ethical and professional standards, accounting, statistics and analysis, economics, fixed income securities, equity securities, and portfolio management.

Recent Relevant Experience

- **2005 Rate and Revenue Requirement Review of Saco River and Pine Tree Telephone Companies**: On behalf of the Maine Public Advocate's Office, Mr. Brevitz addressed revenue requirement levels for both companies, including detailed review of expense levels and trends, expanded calling plan criteria and data, and detailed review of holding company organization and charges between affiliates.

- **2005 Price Deregulation of Basic Local Exchange Service**: On behalf of AARP, Mr. Brevitz provided comments before the Public Utilities Commission of Ohio regarding final rules to implement procedures for addressing price deregulation applications. The comments addressed the need for effective competition to be demonstrated before approving price deregulation of BLES; market segmentation between stand-alone BLES and service bundles; barriers to entry; current competitive market conditions and whether "many sellers" exist; functionally equivalent and substitute services; and other related matters.

- **2005 Spin off of "LTD Holding Company" from Sprint Nextel**: On behalf of the Nevada Bureau of Consumer Protection, Mr. Brevitz led a team to analyze the proposed spin-off from a technical and public interest perspective under Nevada statutes. Issues addressed included: asset transfers to LTD Holding Co.; levels of debt to be placed on LTD Holding Co.; "normal" levels of debt for Sprint's Local Telecommunications Division; financial and cost of capital implications of the spin off; impact on LTD's ability to compete and other competitive trends; and accounting issues such as division of pension assets and pension liabilities.

- **2005 Intrastate Deregulation Proposal of SBC Oklahoma**: On behalf of AARP, Mr. Brevitz filed testimony addressing SBC Oklahoma's proposal to deregulate pricing of almost all intrastate services (E911 and access services were excepted). The testimony responded to SBC Oklahoma assertions regarding significant retail competition on a widespread basis, openness of markets, barriers to entry and exit, reasonable interchangeability of use of cellular and VoIP services for basic residential services, market share analysis, and competitive trends including CLEC responses to the elimination of UNE-P, access line losses. The testimony further analyzed the actions, opportunities, and competitive

responses of SBC Oklahoma and its corporate affiliates, observed public safety deficiencies of cellular and VoIP services, and market trends converging on duopoly.

- **2004 to 2005: Alternative Regulation Plan Filing by Verizon Vermont:** Mr. Brevitz assisted the Vermont Department of Public Service in assessing matters included in the Vermont Public Service Board's assessment of proposed changes to the Alternative Regulation Plan applicable to Verizon Vermont. Prefiled testimony addresses matters including assessment of competition and modes of competition, VoIP/wireless substitution, continuation of direct assignment practices under the FCC's separations freeze, jurisdictional cost allocations, rate flexibility, and UNE availability and commercial agreements with CLECs.

- **2005 UNE Loop Cost Proceeding**: On behalf of the Arkansas Public Service Commission General Staff, Mr. Brevitz filed testimony which analyzed SBC Arkansas' proposed increased UNE loop rates, and UNE loop model and shared and common cost model inputs and outputs, including fill factors, defective pairs, IDLC, DSL expenses, and retail related costs.

- **2005: Telecom Egypt/Market opening:** As part of a USAID project, participated in interviewing key telecommunications players regarding opening the international gateway to competition and rate issues (settlement rates and local rates). Additional issues included the need to provide for additional private ownership of Telecom Egypt, and to address growth in VoIP traffic outside the settlement regime.

- **2004 Mass Market Switching Reviews under the FCC Triennial Review Order**: Separately for the Arkansas Public Service Commission staff, and the New Mexico Attorney General's office, Mr. Brevitz provided analysis and two-step evaluation under the FCC's Triennial Review Order ("TRO") of impairment in access to local circuit switching for mass market customers. The evaluations were done on a granular, market-specific basis. The evaluations determined whether unbundled local circuit switching (and by extension, the UNE-Platform) must continue to be provided as an Unbundled Network Element by incumbent local exchange companies.

- **2004 OSIPTEL/Peru**: Worked with OSIPTEL (telecom regulator in Peru) to analyze barriers to competition in Peru. Presented workshop and training materials regarding the Economic Aspects of Competition Regulation for Public Utilities, which addressed concepts of market power, dominance, cross subsidies, essential facilities, ex ante versus ex post regulation, asymmetric regulation.

- **2003 to 2005: Cable & Wireless Rate Adjustment/Barbados Fair Trading Commission**: Mr. Brevitz is advising the FTC and its staff regarding the application of C&W Barbados to increase domestic revenues and institute local measured service, and providing related analyses. The Company's filing is in part designed to enable Price Cap regulation, and opening the market to competitors. As such, Price Cap and competitive issues are necessarily considered along with revenue requirements and tariff/pricing issues.

- **2003 CenturyTel Rate Case/Arkansas PSC:** Mr. Brevitz led a team providing analysis and testimony on behalf of PSC staff in the CenturyTel of Northwest Arkansas rate case, in which the Company sought to treble local rates. Mr. Brevitz provided an analysis of CenturyTel of Northwest Arkansas' ("CNA") modernization programs and provision of DSL services from the perspective of basic local service ratepayers, and also addressed the local competition claims of the Company.

- **2002 Maryland Office of People's Counsel:** Maryland PSC's Case No. 8918 is to review Verizon's Price Cap regulatory plan, after Verizon had operated five or more years under it. Topics addressed included the proper productivity factor to use in the price Cap formula, and any necessary amendments to the structure of the price cap plan. Mr. Brevitz provided expert testimony on the proper formulation and terms for the price cap formula, competition, and other matters related to the extension of price cap regulation.

- **1999-Current, Kansas Corporation Commission Advisory Staff:** Mr. Brevitz is serving as advisor to the Commissioners on telecommunications technical and policy matters, including application of price cap regulation to Southwestern Bell-Kansas; designation of wireless carriers and other entities as Eligible Telecommunications Carriers; arbitrations between carriers pursuant to the Federal Telecommunications Act; Southwestern Bell–Kansas' Section 271 application; pricing and costing of unbundled network elements for Southwestern Bell and Qwest; modification of the Kansas Universal Service Fund to be cost based consistent with state and federal law; adaptation of the FCC cost proxy model for intrastate use; rate rebalancing and DSL deployment; Digital Subscriber Line (DSL) matters; legislative issues; advanced services; access charge restructure; collocation; and, toll dialing parity and carrier of last resort as examples.

- **2001 Maine Office of Public Advocate–Verizon Maine 271 Review:** Review of Verizon's Section 271 filing before the Maine Public Service Commission, and Declaration filed on behalf of the Public Advocate which addresses Checklist Item #13 (Reciprocal Compensation), and Verizon's proposed performance measurement metrics and proposed Performance Assurance Plan.

- **2001 Vermont Department of Public Service–Verizon Vermont 271 Review:** Review of Verizon's Section 271 filing assertions of compliance with the "14 Point" competitive checklist and non-discrimination obligations of the Telecommunications Act of 1996, before the Vermont Public Service Board. Mr. Brevitz filed a Declaration on behalf of the DPS which addresses Checklist Item #13 (Reciprocal Compensation), and Verizon's proposed performance measurement metrics and proposed Performance Assurance Plan.

- **2001 Public Utility Research Center (PURC)/University of Florida:** Presentation of two seminar modules and an interconnection case study as staff training for the Panamanian telecommunications regulatory body, ERSP. Mr. Brevitz developed course content and presentation materials for the seminar, under the auspices of PURC, on the topics of the "US Experience in Telecom Competition" and "Consumer Issues in Telecom Competition". These topics were presented by Mr. Brevitz in the seminar at Panama City, Panama on March 29-30, 2001.

- **2001-2002 Michigan Attorney General's Office–Federal District Court Litigation Support**: Mr. Brevitz supported the Attorney General's office in its defense of lawsuits by Ameritech and Verizon against the PSC and the Governor regarding recently passed state legislation. The state legislation eliminated the intrastate EUCL being charged by both companies, expanded local calling areas, and froze the application of the Price Cap Index for a period of time.

1999-2000 Delaware Public Service Commission Staff–Evaluation of Bell Atlantic-Delaware's Collocation Tariff Filing: On behalf of the Staff, Mr. Brevitz reviewed BA-Delaware's Collocation tariff filing, and prefiled testimony on behalf of Delaware PSC staff. Issues addressed include non-discriminatory provisioning of collocation; collocation intervals; utilization of "best practices" for terms, conditions and pricing; and costing.

- **1999-2000 Vermont Department of Public Service–Evaluation of Carrier to Carrier Wholesale Quality of Service :** On behalf of the Vermont DPS, Mr. Brevitz was engaged in the review of quality of service standards related to Verizon's wholesale activities of provisioning Unbundled Network Elements and resold services. The work effort was conducted within a workshop of the parties, and was drawn on the similar activity for BA-NY and a number of other states including Massachusetts and Virginia. Measures, standards and benchmarks were to be determined, along with an appropriate remedy plan in the event those items are not met by the incumbent carrier. This matter was resolved in the context of Verizon's Section 271 case.

- **1999-2000 Vermont Department of Public Service–Investigation of Geographically Deaveraged Unbundled Network Prices:** On behalf of the Vermont DPS, Mr. Brevitz testified before the Vermont Public Service Board regarding the appropriateness and extent of geographic deaveraging of rates for Unbundled Network Elements (UNEs) in Vermont. In formulating these positions, it was necessary to consider FCC Orders, competitive policy implications, and related issues such as distribution of federal

high cost support. The FCC had spotlighted the linkages between high cost support and geographic deaveraging determinations. Consequently the testimony also considered federal high cost support distribution implications and local rate impacts stemming from geographic deaveraging determinations to be made by the Board.

- **1999 Vermont Department of Public Service–Evaluation of Bell Atlantic Proposed Alternative Regulation Plan, Wholesale Quality of Service Standards, and Cost of Service:** Mr. Brevitz served as project manager and lead consultant in the DPS review of Bell Atlantic's proposed Price Point Plan and proposed appropriate modifications. Those modifications included moving rate reductions forward to the inception of the plan, and aligning the plan more closely to the status of competition in Vermont by allowing streamlined regulation only for truly new services, not bundles of existing services.. Mr. Brevitz also supported the immediate implementation of detailed wholesale quality of service standards along with a remedies structure. Mr. Brevitz addressed the cost of service issues of reciprocal compensation and local number portability, and proposed rate design changes to effect the return of $16 million in excess revenues.

- **1998-99 Delaware Public Service Commission Geographic Deaveraging of Bell Atlantic UNE Loop Rates:** Mr. Brevitz worked for PSC staff to analyze cost and policy issues associated with geographic deaveraging of UNE loop rates. Methodology and policy to determine geographic zones was reviewed for BA-Del, and compared to all other Bell Atlantic states. BA-Del cost data was reviewed to assess closeness of fit between BA-Del's proposed population of zones with existing exchanges to the loop costs of those exchanges. After review of comments of interested parties, Mr. Brevitz prepared and submitted a report and recommendation to the PSC regarding modification of BA-Del's proposal to implement geographically deaveraged UNE loop rates. The PSC adopted the report and recommendation in its Order in the matter.

- **1998 Vermont Department of Public Service- Evaluation of Proposed Special Contracts for Toll and Centrex Services for Compliance with Imputation Requirements:** Mr. Brevitz worked for the DPS in this matter, which was an evaluation of four individual customer toll contracts, and two individual customer Centrex contracts, under the Vermont Public Service Board's price floor and imputation requirements. This evaluation included analysis of whether Bell Atlantic had appropriately followed the Board's imputation requirements; whether the imputed costs had been appropriately calculated and included all relevant costs; and, whether undue price discrimination would result from approval of Bell Atlantic's proposed prices. Mr. Brevitz analyzed the Company's filed testimony and costing information provided in support of the contract pricing; drafted staff discovery and analyzed responses of other parties in the matter; and, supported pre-filed rebuttal and surrebuttal testimony before the Board under cross examination. Hearings in this matter were held in November and December of 1998 and January 1999.

1998 Delaware Public Service Commission- Re-classification of Residential ISDN as "Competitive": Mr. Brevitz worked for Delaware Public Service Commission staff in this case (Docket 98-005T), which was a filing by Bell Atlantic to move Residential ISDN ("R-ISDN") from the basic service classification to the competitive service classification, pursuant to the Telecommunications Technology Investment Act and related Commission rules to implement the Act. Bell Atlantic filed an application before the PSC stating that R-ISDN met the statutory and rule conditions for moving the service to the competitive class of services, along with market information in support of that statement. Mr. Brevitz analyzed the company's filing and the comments of other parties in the matter from an economic and public policy perspective, analyzed the Company's compliance with applicable provisions of the TTIA and Commission rules, drafted staff discovery and analyzed discovery responses of other parties, and presented testimony under cross examination before the Commission. The hearing in this matter was held July 9, 1998.

1997 Delaware Public Service Commission - Costing and Pricing of Residential ISDN Service: Mr. Brevitz assisted the Delaware PSC staff in this case (Docket 96-009T) by reviewing the prefiled testimony of all parties; reviewing the cost studies supporting Bell Atlantic's proposed R-ISDN pricing; comparing those costs to Bell Atlantic's UNE rates and costs; reviewing Bell Atlantic's contribution analyses and demand forecasts for the R-ISDN service; reviewing and comparing two Bell Atlantic local usage studies (the second of which more than tripled the costs of the earlier study); providing an analytic report on the usage cost studies to PSC staff and rate counsel; assisting in the preparation and conduct of cross-examination; and assisting staff rate counsel in preparation of the brief in this matter. The hearing in this matter concluded in January 1998.

1997 Georgia Public Service Commission - Unbundled Network Elements Cost Study Review: Mr. Brevitz was a lead consultant in this engagement. The GPSC opened a cost study docket to determine the cost basis for BellSouth UNE rates, following arbitration hearings involving BellSouth and several competitors. Introduced for the first time by BellSouth, and considered in the hearing was BellSouth's "TELRIC Calculator". Also considered in the hearing, as sponsored by AT&T/MCI was Hatfield Model Versions 3 and 4. Mr. Brevitz prepared and provided to GPSC staff an "Issues Matrix" which listed the issues, party positions on the issues, and a suggested staff position. Also on behalf of GPSC staff, Mr. Brevitz analyzed cost inputs and outputs pertaining to both models. No testimony was provided in this matter as GPSC staff did not testify in the hearing. Hearings on the matter concluded in September 1997.

1995, 1996 and 1997 Wyoming Public Service Commission - Competition Rules: Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz is actively involved in writing and implementing comprehensive competition rules in Wyoming which consider the new 1995 Telecommunications Act in Wyoming and the 1996 Federal Telecommunications Act. These rules address interconnection/unbundling, universal service, service quality, price caps/alternative regulation, privacy, resale, intraLATA dialing parity, TSLRIC/cost study methods; access charge rate design; number portability, reciprocal compensation, rights-of-way and other matters.

1995 and 1996 Wyoming Public Service Commission - U S WEST Pricing Plan: Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz has evaluated and filed testimony regarding U S WEST's pricing plan, competition issues, universal service and U S WEST cost study issues.

1996 Oklahoma Corporation Commission - Seminar on 1996 Federal Telecom Act: Mr. Brevitz presented a seminar on the 1996 Federal Telecom Act to the Oklahoma Corporation Commission Staff.

1995 and 1996 Georgia Public Service Commission - Local Number Portability and Competition Policy: Mr. Brevitz was the Project Manager and a lead consultant for this engagement. Mr. Brevitz assisted the GPSC in implementing rules related to the new 1995 Telecommunications Act in Georgia and the 1996 Federal Telecom Act. Mr. Brevitz was primarily involved in initiating and coordinating the Number Portability Task Force and guiding the industry workshop on permanent number portability. The PSC has accepted the industry workshop recommendation. As a result, Georgia will be one of the first states to implement full number portability. Assistance was also provided on other competition issues.

1996 California Public Service Commission - Pricing of Unbundled Elements and Resale services: Mr. Brevitz assisted Sprint in the pricing (second) phase of the California Commission's OANAD proceeding. Testimony was presented regarding proper pricing of unbundled network elements, given previous a PUC decision on UNE costs. The cost (first) phase involved the development of cost study principles, performance of TSLRIC cost studies of unbundled network elements by Pacific Bell and GTEC, and performance of avoided cost studies for retail services for resale.

1995 to 1996 Kansas Telecommunications Strategic Planning Committee - Kansas Corporation Commission: Mr. Brevitz served as the Kansas Corporation Commission representative on this legislative committee, which was organized in mid-1994 to research and recommend any needed

changes to the telecommunications statutes and state policies. The TSPC issued its final report to the Governor and the legislature in January 1996.

1995 Chairperson of Kansas Corporation Commission Working Groups: Mr. Brevitz was appointed to the Cost Studies and Universal Service Working Groups for the KCC's general competition investigation, subsequent to the KCC's May 1995 Phase I competition order. He was also active in other Task Forces including Unbundling, Number Portability and Local Resale.

Kansas Corporation Commission - Infrastructure/Competition Report: Produced a special report on Kansas telecommunications infrastructure/competition issues which was provided to the 1995 Kansas legislature.

1994 Kansas Corporation Commission - Alternative Regulation Legislation: In 1994 the Kansas Legislature passed House Bill 3039, which extended SWBT's "TeleKansas" alternative regulation plan for two years. Mr. Brevitz provided substantial assistance in negotiating the detailed provisions for the KCC's implementation of the bill.

Kansas Corporation Commission - Southwestern Bell Telephone Infrastructure Analysis: Investigated SWBT's infrastructure/modernization budget and addressed construction requirements, tariffs, rates, terms and conditions for SWBT's provision of interactive television ("ITV") to all Kansas schools at deep discount prices for the benefit of the Kansas infrastructure.

Work History

Independent Telecommunications Consultant

Following a significant engagement with the Kansas Corporation Commission, extensive professional services have been provided to state public utility commissions, as indicated above under "Recent Relevant Experience".

A variety of duties and tasks have been performed for the Kansas Corporation Commission, including providing staff support for Statewide Strategic Telecommunications Planning Committee, composed of 17 members (legislators, state agency heads, private enterprise); assisting in KCC implementation of House Bill 3039 ("TeleKansas II", extension of alternative regulatory plan for Southwestern Bell Telephone); and providing analysis and testimony for communications general investigations into competition in the local exchange and other markets. Those general investigations included General Competition, Competitive Access Providers, Network Modernization, Universal Service, Quality of Service, and Access Charges.

Kansas Consolidated Professional Resources -
Director of Regulatory Affairs

Duties included monitoring of and participating in state regulatory affairs on behalf of twenty independent local exchange companies in Kansas that compose the partnership of KCPR. Active participation in statewide industry committees in the areas of access charges, optional calling plans/EAS, educational interactive video, dual party relay systems and private line/special access merger.

Kansas Corporation Commission -
Chief of Telecommunications

Duties included supervising the formulation of staff testimony and policy recommendations on matters such as long distance competition, access charges, telephone company rate cases, and deregulation of CPE and

Inside Wiring; analyzing Federal Communications Commission and Divestiture court decisions; supervising and performing tariff analysis; and testifying before the Commission as necessary. SWBT's $120 million "Divestiture rate case" was completed in this time period, as were several other large rate cases. Active member of the National Association of Regulatory Utility Commissioners (NARUC) Staff Committee on Communications.

Arizona Corporation Commission -
Chief Rate Analyst - Telecommunications

Duties included supervision of staff and formulation of policy recommendations on telecommunications cases, along with production of analyses and testimony as required.

Kansas Corporation Commission -
Economist - Research and Energy Analysis Division

Duties included research, analysis and production of casework and testimony regarding gas/electric and telecommunications matters.

Education

Michigan State University - Graduate School of Business
East Lansing, Michigan
Master's Degree in Business Administration-Finance, 1980.

Michigan State University/James Madison College
East Lansing, Michigan
Bachelor of Arts Degree in Justice, Morality and Constitutional Democracy, 1979.

EXHIBIT DB-2

Testimony of David Brevitz
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Redacted
Case No. 2005-00534

Wireline Debt Levels

Presentation

Date	Source	Existing Debt	New Bank Debt	New Term Debt	Total Wireline	Cash
1-Sep-05	AG 47					
6-Sep-05	AG 47					
16-Sep-05	AG 47					
16-Sep-05	AG 47					
12-Oct-05	AG 47					
15-Oct-05	AG 47					
18-Oct-05	AG 47					
9-Nov-05	CWA 60					
21-Nov-05	AG 47					
Dec-05	AG 47					
Dec-05	AG 47					

Testimony of David Brevitz
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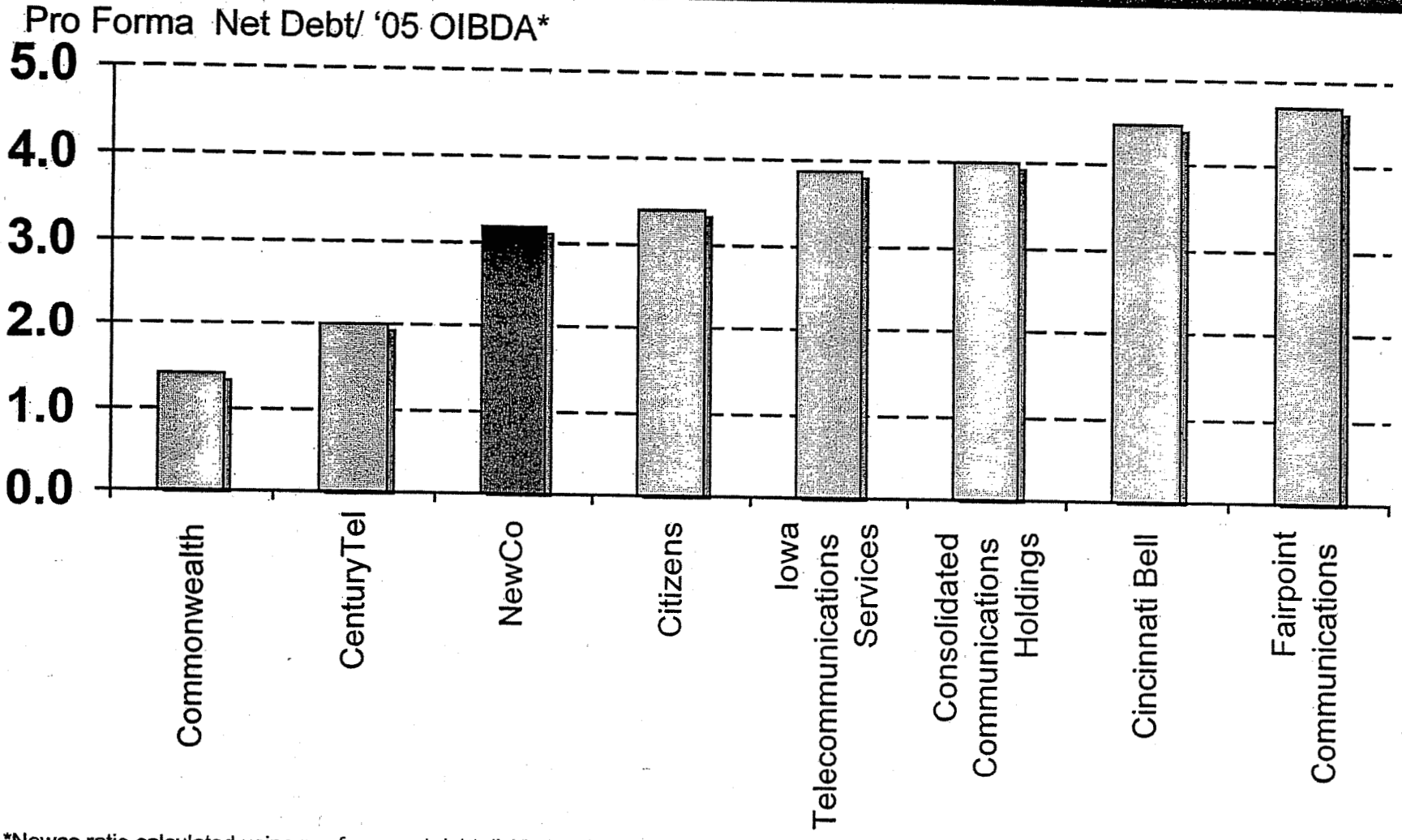
Wireless Debt Levels

		Total Wireless	Cash
1-Sep-05	AG 47		
6-Sep-05	AG 47		
16-Sep-05	AG 47		
18-Oct-05	AG 47		
(net debt)			
(net debt)			
(net debt)			
(net debt)			
9-Nov-05	CWA 60		
Dec-05	AG 47		

EXHIBIT DB-3

Proposed Wireline Capital Structure



*Newco ratio calculated using pro forma net debt divided by '05 OIBDA.

EXHIBIT DB-4

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