

-BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH-

In the Matter of the Application for Increase) DOCKET NO. 05-053-01
In USF Eligibility for Uintah Basin)
Telecommunications Association, Inc. and)
UBET Telecom, Inc.)

DIRECT TESTIMONY
OF
RAYMOND A. HENDERSHOT
ON BEHALF OF
UINTAH BASIN TELECOMMUNICATIONS ASSOCIATION, INC.
AND
UBET TELECOM, INC

Q.PLEASE STATE YOUR NAME AND BUSINESS ADDRESS.

A.My name is Raymond A. Hendershot. My business address is 2270 LaMontana Way, P.O. Box 25969, Colorado Springs, Colorado 80936.

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

A.I am a Vice President for GVNW Inc./Management (“GVNW”).

Q.PLEASE DESCRIBE YOUR EDUCATIONAL BACKGROUND AND WORK EXPERIENCE.

A.I graduated from Brigham Young University with a Bachelor’s Degree in Accounting in 1972 and a Master’s Degree of Accounting in 1973. I received a CPA Certificate from Texas. Upon graduation, I was employed by General Telephone and Electronics (“GTE”), where I served in a variety of positions within the financial area of the

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company. In 1985, I joined GVNW. GVNW provides a wide variety of management services within the telecommunications industry. My primary areas of responsibility include the development of rates and tariffs, preparation of toll cost separation studies and depreciation rate studies, consulting on acquisitions and sales of telephone properties, and providing various other management services.

Q.HAVE YOU PREVIOUSLY TESTIFIED BEFORE ANY REGULATORY COMMISSIONS?

A.Yes. I have provided testimony on telecommunications issues before this Commission on numerous occasions in various telephone company filings and generic regulatory proceedings. I have also testified in various telephone company filings and generic regulatory proceedings before the Arizona Corporation Commission, the Idaho Public Utilities Commission, the Nevada Public Utilities Commission, the Texas Public Utilities Commission, the Washington Utilities and Transportation Commission, the Wisconsin Public Service Commission, the Wyoming Public Service Commission.

Q.FOR WHOM ARE YOU APPEARING IN THIS PROCEEDING?

A.I am appearing on behalf of Uintah Basin Telecommunications Association, Inc. (“UBTA”) and UBET Telecom, Inc. (“UBET”), the Applicants in this case. Since the Public Service Commission of Utah (“Commission”) has previously approved the merger, consolidation and combination of UBTA and UBET, I have treated this filing on a consolidated basis of UBTA-UBET combined anticipating that it will be completed in the near future.

Q.WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A.My testimony explains why UBTA-UBET is applying for an increase in Utah Universal Service Fund (“Utah USF”) Eligibility. I will include testimony and exhibits regarding UBTA-UBET’s financial condition and I will calculate a pro forma revenue requirement for the company. Finally, I will use this financial information to quantify the additional amount of annual Utah USF distributions UBTA-UBET is entitled to receive.

Q.PLEASE DESCRIBE THE GENERAL METHODOLOGY UTILIZED IN CALCULATING UBTA-UBET’S REVENUE DEFICIENCY.

A.This filing has been prepared following the pattern used by other local exchange companies when filing for rate

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increases. The first step is to list 2004 booked plant balances, expenses, and revenues, and make proforma changes to these amounts. The resulting numbers reflect balances as of the end of 2004. Revenues and expenses are calculated, adjusted for proforma changes, and then separated between jurisdictions using the methodology of the Federal Communications Commission (“FCC”) Part 36 and 69 rules and procedures. We then develop a cost of capital for the company to determine the appropriate earnings level for intrastate investment. This rate of return is applied to the intrastate rate base to determine a return on rate base. The estimated net income from end of period financials is then subtracted from the return to determine a return deficiency. The resulting shortfall is grossed up for uncollectibles and taxes. Exhibits 1 through 4 attached hereto (which were attached to the Application for USF Eligibility) quantify these steps in analysis.

Q.WHAT TEST YEAR IS THE COMPANY USING IN THIS FILING?

A.The test year used in this filing is the 12 months ending December 31, 2004 or the calendar year 2004. Proforma adjustments have been made in the case for known and measureable items

Q.PLEASE DESCRIBE EXHIBIT NO. 1, WHICH IS ENTITLED “2004 RATE CASE – REVENUE REQUIREMENT CALCULATION”.

A.This exhibit identifies the 2004 intrastate revenues and expenses and corresponding intrastate rate base balances and adjustments made which are shown in columns D through J. Lines 1 through 12 identify the Company’s 2004 intrastate revenues and proforma adjustments. Lines 14 through 22 identify the 2004 intrastate booked expenses and proforma changes. Proforma adjustments to revenues and expenses are shown in columns D through J. Lines 32 through 47 identify the Company’s 2004 intrastate rate base and proforma changes. Line 48 identifies the Company’s return on rate base. Exhibit 1.1 provides the details to the notes to the adjustments made in Columns D through J. Column L shows the additional revenues required by the UBTA-UBET to earn its rate of return.

Q.PLEASE DESCRIBE EXHIBIT 2, WHICH IS ENTITLED “SUMMARY OF INTRASTATE REVENUE SOURCES”.

A.This exhibit identifies the source of proposed intrastate revenues in this case.

Q.PLEASE DESCRIBE EXHIBIT 3, WHICH IS ENTITLED “2004 TEST YEAR RATE CASE – REVENUE REQUIREMENT CALCULATION”.

A.This exhibit calculates the Company’s projected total net income after income taxes. Lines 1 through 12 identify the Company’s 2004 revenues and proforma adjustments. Lines 14 through 22 identify the 2004 booked expenses and proforma changes. Proforma adjustments to revenues and expenses are shown in columns D through J. Lines 32 through 47 identify the total Company rate base. Line 48 identifies the Company’s return on rate base. Exhibit 3.1 provides the details to the notes to the adjustments made in Columns D through J.

Q.PLEASE EXPLAIN THE PROFORMA ADJUSTMENTS TO REVENUES.

A.There are three proforma adjustments to intrastate revenues in Exhibit 1: (1) a \$48,188 decrease in providing 911 service revenues to reflect the current agreement; (2) a \$25,866 decrease in interconnection revenues to reflect current interconnection agreements signed during the past year and (3) an increase of \$29,508 in uncollectible to reflect the average of the past three years.

Q.WOULD YOU PLEASE PROVIDE A LITTLE MORE OF AN EXPLANATION OF THE PROFORMA ADJUSTMENTS TO REVENUES?

A.Yes. The company has been working with Qwest to reach an agreement on the amount that each company is entitled to in providing the 911 services to the counties in the Uintah Basin area (“Basin”). Since the acquisition of the Qwest exchanges in the Basin by UBTA, UBTA-UBET has been collecting of the money from the counties for 911 services. During the past year, UBTA-UBET has signed an agreement with Qwest on the amounts that each company was entitled to in providing the 911 services to the counties in the Basin.

This past year the company has signed interconnection agreements with the wireless carriers providing service in the UBTA-UBET service area. Prior to a signed interconnection agreement, the company billed access to the wireless providers. The rates paid under the interconnection agreements are less than access charges.

The uncollectible adjustment is necessary, as the company has experienced wide variance in the amounts recorded in the uncollectible account during the past three years. Strong efforts have been made during the past year to recover

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some of the uncollectible amounts from prior years. The actual amount recorded during the past year reflects the efforts put forth by the company to recover amounts written off in prior years. It was felt that an average of the past three years was more representative of the appropriate amount to use in a rate filing.

Q.WOULD YOU PLEASE EXPLAIN THE PROFORMA ADJUSTMENTS TO 2004 EXPENSES IN EXHIBIT 1?

A.Column H shows a \$329,141 increase in intrastate expenses. The increase is for health and dental insurance, the current year increase in wages for cost of living, reclassification of some employees from hourly to salaried, one new employee added for the year and the expenses for the rate case for legal and consulting services. The rate case expense for legal and consulting services are based on a two-year amortization of the total cost.

Q.ARE THESE NORMAL PROFORMA ADJUSTMENTS?

A.Yes. The Commission has accepted these types of proforma adjustments in rate case cases as a normal part of business. The Commission has accepted a two-year amortization of rate case expenses in the past.

Q.ARE THE EXPENSES OF THE COMPANY REASONABLE?

A.Yes. The expenses of UBTA-UBET are comparable and reasonable for a rural telephone company. I have reviewed the data and done some comparisons to other independent telephone companies and they are comparable and in some areas more efficient because of economies of scale.

Q.ARE THERE ANY PROFORMA ADJUSTMENTS FOR PLANT ADDITIONS IN EXHIBIT 1?

A.Yes. The capital budget of \$3,954,484 for the company reflects normal additions in capital expenditures for vehicle replacement, work equipment, switching upgrades, computer upgrades, etc. along with funds for normal construction activity planned and underway for the current year. The capital budget includes \$623,029 for fiber construction projects planned to keep up with demand in the area.

Since the price for oil has increased significantly over the last few months, exploration for oil has likewise boomed during this corresponding period. New jobs have been created and families have relocated to the area. The Vernal city council has approved the development of some new subdivisions to keep up with the growth of people moving into the area as a result of the oil boom. Construction funds of \$1,040,000 have been added to the

normal capital budget to meet the needs for these new subdivisions.

Q.ARE THERE ANY OTHER PROPOSED CONSTRUCTION PROJECTS IN THE FILING?

A.Yes. The company has added funding for an alternate route out of the Uintah Basin. During the past two years the UBTA-UBET fiber route to Salt Lake City has been cut a total of four (4) times leaving the Uintah Basin area without a communication connection to the outside world. As recently as within the last 60 days (May 19, 2005) the fiber route was cut and service was down for over eight (8) hours. Even the 911 circuits have been out of service. These outages have had a significant impact on the Uintah Basin service area. Customers have been without 911 service creating a risk for health and safety issues, Utah Education Network (“UEN”) has been down likewise impacting education, and numerous complaints reported to the company during these outages creating an economic impact on the community. Service outages of this nature have an impact on the community, on the potential businesses considering relocating to the area, on the educational community in the Basin consisting of local school districts and the technical and university extension branches in the Basin and on the telephone customers as a whole. In today’s world, people expect the availability of communication services seven days a week and 24 hours a day.

Q.HOW IS THE COMPANY PROPOSING AN ALTERNATE ROUTE OUT OF THE BASIN?

A.The company has evaluated four scenarios from constructing an alternate route to leasing existing facilities. The economical results of the evaluation shows that the lease cost option is to lease dark fiber or facilities from Qwest Classic and NC Telecom thus providing an alternate route out of the Basin to Salt Lake City. It is essential for the Basin to have reliable communication services that customers can depend upon.

The alternate route will provide the same level of service that is currently available on the existing fiber network to Salt Lake City. Once the alternate route is in service, traffic will be routed over the existing fiber route and the alternate route to Salt Lake City. When a cut or break occurs in the fiber route, customers will not experience any outage, as traffic will continue over the alternate or remaining connection to Salt Lake City.

Q.WHAT IS THE PROFORMA ADJUSTMENT IS COLUMN J ON EXHIBIT 1?

Q. A.A proforma adjustment has been included in the rate case for the plant adjustment resulting from the purchase of the Qwest exchanges. A representative from the company will discuss this in more detail.

Q. ARE YOU AWARE AT ANY TIME THAT THIS COMMISSION HAS ISSUED AN ORDER WHERE A COMPANY COULD EARN ON THE PLANT ADJUSTMENT?

A. I have attached Exhibit 5 in which the UPSC issued an order in Docket No. 91-035-17 instructing Pacificorp dba Utah Power & Light Company how to record an acquisition of some generating resources from Colorado-Ute Electric Association. The order states in its Findings of Fact and Conclusions of Law paragraph 7 "...that an acquisition adjustment should not be disallowed for ratemaking purposes simply because it is an acquisition adjustment."

The order continued as follows:

... "The Commission also recognizes, however, that there may be exceptions to this general rule should sufficient benefits accrue to the acquiring public utility and its ratepayers to justify deviations from net book value treatment. It should be emphasized that this exception would be an unusual circumstance and would be evaluated on a case-by-case basis."

In paragraph 8, the order said: "The Commission continues to recognize that an acquisition adjustment should not be disallowed for ratemaking purposes simply because it is an acquisition adjustment. The costs of the assets to be acquired from Colorado-Ute, including the amounts recorded an acquisition adjustment, will be included in rate base if and to the extent the Commission finds, . . . , the assets purchase to be in the public interest."

I believe that the Commission has the ability to consider some or all of the plant adjustment of UBTA-UBET in rate base. The company has expended significant resources in the Basin for the acquired exchanges to provide the level of service expected by the customers and required in today's environment. Everything that UBTA-UBET has done in the Basin has been in the public interest to the benefit of the customers, the educational community, and the economic welfare of the communities.

Culmination of events in the regulatory arena, accounting standards changes and business community have transpired since the purchase of the Qwest exchanges that have impacted the original business plan of UBTA-UBET such

Q that the company needs relief and inclusion of some or all of the plant adjustment is warrant and would be in the public interest.

Q.WOULD YOU PLEASE EXPLAIN HOW YOU DEVELOPED YOUR COST OF CAPITAL?

A.Yes. During past few years the Commission has used one rate of return for all of the Independent Local Exchange Carriers. A few years ago the Division developed a hypothetical 50/50 capital structure to provide a fair basis in determining an appropriate capital structure for the Independent telephone companies since they generally do not have stock traded on the stock exchange. Since the stock of Independent companies is not traded, it is more difficult to determine a stock value. The hypothetical 50/50 capital structure allows a fair basis to determine a cost of capital. I have used the cost of equity that was used in the last case that UBTA-UBET filed before this Commission. The result is a weighted cost of capital, which is utilized in determining the allowable return for the company.

Q.PLEASE EXPLAIN THE COMPONENTS OF THE WEIGHTED COST OF CAPITAL.

A.The cost of debt calculation is very straightforward. The company's debt structure is significantly greater than used in the cost of capital calculation. At year end the capital structure of UBTA-UBET was 98% debt and 2% equity. Since we are using a hypothetical 50/50 capital structure, we assume that debt is 50% of the capital structure and the equity is likewise 50% of the capital structure. The average cost of debt for the company is used in the calculation of the cost of debt. Likewise a cost of equity is used in the calculation of the cost of equity. This calculation weights the cost of debt and equity to come up with a total weighted cost of capital for the company to provide an allowable rate of return for the company.

Q.HOW DID YOU ARRIVE AT A 12.5 PERCENT EQUITY COST?

A.This was the cost of equity used in the last rate filing case before this Commission.

Q.WHY IS THE COMPANY'S DEBT EQUITY RATIO SO HIGH?

A.The company has experienced significant write downs of the plant acquisition adjustment or goodwill as a result of changes in the accounting industry policies. This will be discussed in more detail by a representative of the

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company.

Q.PLEASE EXPLAIN EXHIBIT 2, WHICH IS ENTITLED “SUMMARY OF INTRASTATE REVENUE SOURCES”.

A.This exhibit shows the company’s current revenue streams (column A), the changes in revenue that will occur as the results of this filing being implemented (column B), and the sources of the company’s revenues in the future (column C). Since the company’s current rates are at the state USF threshold, the revenues in this case would come from the State USF.

Q.ARE YOU PROPOSING ANY CHANGES TO UBTA-UBET’S TARIFFS?

A.No. In the last case before this Commission implementing Basin wide Extended Area Service (“EAS”), the local rates for UBTA-UBET were equalized and set at the state USF qualifying threshold levels so the company would be eligible for state USF. The company is not proposing any changes in rates in this filing.

Q.DURING THE LAST CASE BEFORE THIS COMMISSION IMPLEMENTING EAS SERVICE IN THE BASIN, WERE ANY OTHER RATES CHANGED?

A.Yes. In the EAS implementing Basin wide EAS, all of the tariff rates for the two companies UBTA and UBET were made the same. The local rates, access rates and special access rates were made the same. This was done to prepare the companies to merge and to make it is easier in future rate filings.

Q.DOES THAT CONCLUDE YOUR TESTIMONY?

A.Yes, it does.