**BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH**

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**In the Matter of the Application for ) DOCKET NO. 05-2302-01**
**Increase of Rates and Charges and USF ) Exhibit No. DPU 1.0**
**Eligibility for Carbon/Emery Telecom, Inc. ) Direct Testimony Of**
**) WESLEY D. HUNTSMAN**
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**FOR THE DIVISION OF PUBLIC UTILITIES**
**DEPARTMENT OF COMMERCE**
**STATE OF UTAH**

**November 16, 2005**



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## EXHIBITS

Exhibit DPU 1.1 - Resume of Wesley D. Huntsman

Confidential Exhibit DPU 1.2 - Division Adjustments to Carbon/Emery Revenue Requirement

Confidential Exhibit DPU 1.3 - Division Adjustment to Local Service Rate Development

## Testimony of Wesley D. Huntsman

**Introduction:**

**Q. Please state your name and business affiliation.**

A. Wesley D. Huntsman. I am employed by the Utah Division of Public Utilities (Division) as Manager of the Telecommunications Section. My business address is 160 East 300 South, Salt Lake City, Utah 84114.

**Q. How long have you been employed by the Division of Public Utilities?**

A. Since February 22, 1982.

**Q. What are your current responsibilities?**

A. Since November 2004, I have supervised the Division staff responsible for providing analysis and recommendations relating to telecommunications utilities regulated by the Commission. For the prior seven years, I supervised the Division staff which provided internal and external customer service. Those responsibilities included processing inquiries and complaints filed with the Division, consulting on technical and management issues within the Division, and coordinating administrative support. Also, in March 2000, I assumed responsibility for supervising water and sewer utility regulation on behalf of the Division. Prior to that time, for 15 years, I performed and supervised management, cost, financial and economic analyses on behalf of the Division. In these capacities, I have participated in numerous evaluations of utility functions and have testified in many proceedings before the Utah Public Service Commission (Commission).

**Q. What is your educational background, expertise and experience?**

A. I have a Bachelor of Science degree with emphasis in Accounting, and I am a licensed Certified Public Accountant. Over the last 33 years I have participated in audits and investigations ranging from small rural government facilities to nationwide programs. I have participated in many utility rate cases and directed major investigations into utility practices and management. I have presented papers, evaluation results, investigation reports, and appeared as an expert witness on utility matters for more than 23 years. I have attached my professional resume as Exhibit DPU 1.1.

**Q. What is the purpose of your testimony in this case?**

A. I will summarize the Division's analysis and recommendations in response to the Carbon/Emery Telecom, Inc. (Referred to herein as Carbon/Emery, Applicant, or Company) request for a $377,036 local service rate increase and a $1,770,212 increase in State Universal Service Fund (USF) support resulting from the Intrastate revenue deficiencies in their application. I will discuss the overall concerns the Division has with the Companies' application, highlight positions that Division witnesses are taking in this case, and summarize the Division's recommendations in this case.

**Summary:**

**Q. Please summarize your testimony.**

A. The Division has examined the Carbon/Emery application for an increase in local service rates and additional support from the State USF high cost fund. Our review identified major flaws in known and measurable adjustments proposed by the Company and additional known and measurable adjustments which should have been made. Additionally, the Division proposes numerous accounting adjustments which are appropriate in computing the revenues, expenses and rate base used to compute the revenue requirement in support of any additional cost recovery authorized from either increased local service rates or from the State USF.

The Division re-examined our past assumptions and practices regarding USF support payments to assure that our recommendations were consistent with the purposes and policies expressed in both the federal and state guidelines. Additionally, the Division provides alternatives to the current rate-of-return model used for most rural Independent Local Exchange Carriers (ILECs) in response to the Commission's request to address concerns about capital costs for small rural telephone companies. Based upon the Division's evaluation of the application and the current circumstances relating to the telecommunications industry in Utah, the Division believes that the revenue requirement deficiency can be covered entirely from increases in local service rates of $1.00 per month to residential and business customers. Therefore, the Division recommends that the Commission not authorize any State USF support to Carbon/Emery at this time.

**<u>Division Computed Revenue Requirement and USF Support Recommendation:</u>**

**Q. Are there any unique or unusual circumstances associated with the Division's evaluation of the Carbon/Emery request for additional USF support in this case?**

A. Yes. Prior to the Companies' filing, the Commission held a Technical Conference in October, 2004 to discuss its concerns about the way equity costs and return on equity had previously been handled in rate cases and requests for USF support by rate of return regulated ILECs. The Commission specifically expressed concern about the cooperative ILECs in situations where retained margins partially or wholly achieved from USF support payments may be returned to ratepayers/owners through capital credits and patronage refunds.

At the Technical Conference, the Division expressed its view that the appropriate rate of return for ILECs and whether actual or hypothetical capital structure was appropriate for rate-making would be more appropriately evaluated in individual cases where actual facts and circumstances were available. Given the Commission's stated desire to address these issues, Dr. George Compton has developed several revenue requirement scenario alternatives using “rate of return” (ROR), “times interest earned” (TIER) and “debt to operating cash flow” methodologies to compute revenue requirement. He will also address the policy issue of regulated companies requesting that rates be set using a hypothetical 50/50 capital structure, in lieu of their actual capital structure, in computing their revenue requirement and State USF support requirements.

**<u>Division Position on Known and Measurable Changes</u>**

**Q. Does the Company’s application contain assumptions or known and measurable adjustments with which the Division has concerns?**

A. Yes. The Division believes that the Company has erred in proposing a historical test year with excessive known and measurable increases to rate base and insufficient known and measurable reductions to depreciation expense. In both instances, the errors produce revenue requirement effects favorable to the Company’s request. In his testimony, Company witness Douglas Meredith references Utah Code 54-4-4(3), which states that the Commission may determine just and reasonable rates based upon a future test period with projected data up to 20 months from the date a request is filed or upon a historical test period with known and measurable changes. However, the Division believes that Carbon/Emery’s application contains proposed rate base additions that are characterized as “known and measurable” which do not meet the statute’s requirement that such changes: “(i) occur during a time period that is close in time to the test period; (ii) are known in nature; and (iii) are measurable in amount.” Clearly, the statute anticipated that the Commission would allow “known and measurable” adjustments to a historical test period which occurred during some period less than the 20 months allowed under the future test period option. Problematically, the further away from the historical test year that out-of-period adjustments are allowed, the greater the possibility that the balance between investment, revenues, and expenses for the selected test period will be lost. The need to preserve this test year matching principle was recognized by the Commission when it adopted the Annualization of Test year Data policy in Administrative Rules R746-407.

**Q. Has the Commission issued any recent decisions which you feel directly reflect upon the proper interpretation of what out-of-test-period changes should be considered as known and measurable?**

A. Yes. In its order (Docket No. 01-049-75) in a recent ruling relating to a formal complaint against Qwest by several Utah Counties regarding property taxes, the Commission provided a substantial discussion on its interpretation of what is required to meet the criteria for changes to test year data to be considered as known and measurable adjustments:

> 9.In Qwest's 1988 general rate case, the Commission, in considering proposed adjustments to 1988 salaries and wages, referred to the *Report to the Public Service Commission of the State of Utah by the Task Force on Annualization of Test Year Data*, dated May 14, 1986, submitted by the Division, Utah Power and Light Company, Qwest and Mountain Fuel Supply Company. *See* Report and Order, *In the Matter of the Investigation into the Reasonableness of the Rates and Charges of the Mountain States Telephone and Telegraph Company*, Docket No. 88-049-07 (Utah PSC, Oct. 18, 1989) ("*1988 Order*") at 20-24. With regard to the application of the known and measurable standard to proposed test year adjustments, the "Recommended Annualization Policy" of May 14, 1986 included the following points that the Commission quoted with approval in the *1988 Order*:
>
> 3.The changes must be specific in that it occurs at a known moment or moments in time.
>
> 4.The effects of the change must be measurable.
>
> . . . .
>
> 6.The change must have already occurred or will occur before any increase in rates occurs.
>
> Thereafter, the Commission adopted these same standards as a rule. Utah Admin. Code R746-407-3.
>
> 10.The Commission has discussed the known and measurable standard in other decisions. *See, e.g., Re PacifiCorp*, Docket No. 97-035-01, 1999 WL 218118 (Utah P.S.C. Mar. 4, 1999) (denying utility's attempt to include an income tax contingency, stating in part: "The record shows that possible future tax assessments [after audit] for the 1997 tax year are unknown at this time."); *see also id*. (refusing to approve expenses for a dam removal "since . . . the outcome of negotiations is unknown, removal of the dam is an uncertain event. We conclude that this is a post-test-year event. The costs of removal are merely estimates, presented by the Company, grounded in this uncertain future event. . . . We find that the estimates do not satisfy the known and measurable standard."); *see also In re Little Plains Water Co*., Docket No. 96-2178-01, 1996 WL 769262, (Utah P.S.C. August 7, 1996)).

**Q. What specific known and measurable adjustments has Carbon/Emery proposed in their application that the Division is contesting?**

A. On page 24 of his testimony, Mr. Meredith states that known and measurable plant additions for 2005 and early 2006 have been made to the 2004 historical test year investments. However, the Company did not specify in its application when the plant additions listed in Company Exhibit S-5.2 would be completed. Division witness David Thomson has proposed disallowing projected "known and measurable" plant additions for which no measurable cost has been booked or budgeted by the Company at the end of 2005. Additionally, the Division has based its recommendations on end-of-year 2005 rate base rather than the average 2004 rate base with adjustments in the Company's application. The Division believes that the Commission has clearly expressed the policy that "known and measurable" plant adjustments to the historical test year data should be verifiable by amount and date of occurrence, and should be more than mere projections.

**Q. Is the Division proposing any known and measurable adjustments to the filed test year which the Company did not propose?**

A. Yes. The Depreciation Expense and Accumulated Depreciation Reserve amounts in the Company's application were not adjusted to reflect the fact that a substantial amount of plant investment became fully depreciated at the end of the 2004 test period and an additional substantial plant amount became fully depreciated in August 2005. Division witness David Thomson has proposed "known and measurable" adjustments to reflect these substantial changes to the 2004 test year amounts which were not proposed by the Company even though they proposed plant investment adjustments for additions in early 2006.

**Q. Has the Division proposed additional accounting adjustments to the revenue requirement model filed by the Company in support of its proposed rate increases and request for USF support?**

A. Yes. The 10.05% weighted return on rate base in the Company's application assumes a 7.6% cost on debt**.** Note (f) to Exhibit S-1 filed by the Company supporting its application indicates that the rate represents "the maximum allowable cost of debt". Division witness Chris Luras will discuss this issue in more detail and explain why the Commission should base rates upon the most recent known and measurable actual cost of debt in 2005. He also proposes to reduce the Company's cost of debt to reflect the patronage capital refund which

Q. Carbon/Emery has received each year from CoBank and booked as a credit to interest expense on their books.

A. Division witness Casey Coleman will discuss the historical basis for providing USF support to high cost ILECs and the underlying policies expressed in the Commission rules and Federal guidelines. He will also examine the current affordable base rate being charged by the Applicant, and provide his justification for the recommended increase in the affordable base rate when it is cost justified.

Division witnesses Mary Cleveland, Bart Croxford, David Thomson, Paul Hicken and John Gothard will each discuss revenue, expense and rate base adjustments to the test year intrastate operations and the Company's assumptions and adjustments in the application. Many of the relatively minor adjustments also reflect out-of-period known and measurable changes.

**Q. Assuming that the Commission adopts the adjustments and modifications the Division has recommended in this case, what are the revenue, expense and rate base amounts for the test period?**

A. The Commission has historically based USF high cost fund support payments to ILECs upon the lower revenue requirement computed using either Intrastate or Total Company operations. In this case, the Division used the adjusted Intrastate results of operations in calculating its recommendations in lieu of the Total Company revenue requirement because adjusted Intrastate operations resulted in a lower revenue requirement recommendation. I have attached Confidential Exhibit <u>DPU 1.2</u>, which details the revenue, expense and rate base adjustments recommended by Division witnesses to the Intrastate model.

Division witness Dr. George Compton used the resulting Division recommended Intrastate revenue, expense and rate base amounts in computing the revenue requirement and associated local service rate increase and USF support amount for each of the return scenario alternatives shown in his exhibits.

## <u>Conclusion & Recommendations:</u>

**Q. Should the Commission authorize Carbon/Emery to increase rates?**

A. Yes. Based upon Division witness Paul Anderson's testimony, I believe that the increase in local transport and local switching access rates requested by the Company should be allowed. However, the Division does not believe that Carbon/Emery's revenue deficiency justifies the increase in local service rates requested by the Company. Based upon Division witness Dr. George Compton's testimony, I believe that the Commission should authorize an increase of $162,374 in local revenue as shown in Confidential Exhibit DPU 1.3. The recommended increase allows the Company's proposed changes in non-recurring charges and result in a monthly increase in one-party local service rates of $1.00 for Carbon/Emery's business and residential customers. The Division's analysis shows that the Company's revenue deficiency can be remedied without exceeding the existing affordable base rate let alone the proposed increase in the affordable base rate proposed by the Division. Consistent with Division witness Casey Coleman's testimony, the Commission should consider raising Carbon/Emery's affordable base rate before it considers authorizing any USF support for the Company.Q. **Does that conclude your testimony?**

A. Yes.