BEFORE THE

PUBLIC SERVICE COMMISSION OF UTAH

DOCKET NO. 05-2302-1

SUR REBUTTAL TESTIMONY OF

DOUGLAS DUNCAN MEREDITH

December 14, 2005

TABLE OF CONTENTS

I. INTRODUCTION 3

II. RESPONSE TO DPU PROPOSED TEST PERIOD 7

III. RESPONSE TO SPECIFIC DPU PROPOSED REVENUE MODIFICATIONS 11

1. ITEM DPU 1 12
2. ITEM DPU 5 18
3. ITEM DPU 6 21

IV. RESPONSE TO SPECIFIC DPU PROPOSED RATE BASE MODIFICATIONS 23

4. ITEM DPU xx 24
5. ITEM DPU 8 26
6. ITEM DPU 9 39
7. ITEM DPU 11 42

V. RESPONSE TO SPECIFIC DPU PROPOSED EXPENSE MODIFICATIONS 48

8. ITEM DPU 2 49
9. ITEM DPU 4 52
10. ITEM DPU 9 59
11. ITEM DPU 10 60

VI. RATE OF RETURN AND INCOME TAX 69

12. RATE OF RETURN 69
13. INCOME TAXES 88

VII. SUMMARY 88

VIII. EXHIBITS 90

1 BEFORE THE

2 PUBLIC SERVICE COMMISSION OF UTAH

3 SUR REBUTTAL TESTIMONY OF DOUGLAS DUNCAN MEREDITH

4 DOCKET NO. 05-2302-1

5

6 **I. INTRODUCTION**

7

8 **Q: ARE YOU THE SAME MR. MEREDITH WHO FILED DIRECT TESTIMONY**
9 **IN THIS PROCEEDING?**

10 A: Yes.

11

12 **Q: WHAT IS THE PURPOSE OF YOUR REPLY TESTIMONY?**

13 A: The purpose of my reply testimony is to respond to the various testimonies filed in this
14 proceeding by the Division of Public Utilities Department of Commerce (DPU) and the
15 Committee for Consumer Services (CCS). In their testimonies these parties propose
16 modifications to Carbon/Emery's Supplement to Application for Rate Increase and USF
17 Eligibility (Supplement or Supplemental Filing). In this testimony, I recommend that the
18 Commission modify or reject many of these proposed modifications.

19

20 I have already provided a background of Carbon/Emery's petition and supplement in my
21 direct testimony. At the risk of being repetitive, I emphasize that this rate case for
22 Carbon/Emery has been necessary for a number of years. Carbon/Emery was formed to
23 acquire the Price, Helper and East Carbon exchanges from Qwest Corporation (Qwest) in

1 2001. Carbon/Emery has provided exceptional service to customers in its service area
2 since the purchase. On December 1, 2005 several customers, including Mayor Joe
3 Piccolo, Mayor of Price, expressed support and appreciation for Carbon/Emery's efforts
4 to provide service in their community. While much progress was noted at the public
5 hearing, the Mayor of Price noted there was still much to do to provide adequate
6 telecommunications service in the Price area. ("It's been a significant effort for
7 [Carbon/Emery] to take care of the responsibility of the economic liability that we have
8 had here. … [Efforts are] going on currently to clean up the west end of Price, which has
9 been a continual problem for connections or those types of business opportunities.")
10 (Public Hearing Tr. at 10) Neither have the activities of Carbon/Emery gone unnoticed
11 by the DPU. After its field visit, Mr. Anderson stated that "Carbon/Emery has striven to
12 bring the switches and outside plant up to industry standards to facilitate improved
13 service to its subscribers." (Anderson at 1) Carbon/Emery certainly is moving forward to
14 provide service to its customers, yet there is still much work to be done.
15
16

1 **Q: DOES CARBON/EMERY SEEK RATE INCREASES AND UTAH UNIVERSAL**
2 **SERVICE FUNDS TO FURTHER ITS PLANT UPGRADES AND NEW**
3 **INSTALLATIONS?**
4 A: Yes. It is well known that the infrastructure operated by Qwest in these exchanges was
5 antiquated and obsolete. Carbon/Emery needs rate increases and Utah universal service
6 funds to continue with the necessary upgrades to its facilities.
7
8 This rate case is Carbon/Emery's first rate case and is therefore a baseline rate case
9 intended to establish the rates necessary for Carbon/Emery to provide
10 telecommunications service and improve and expand its facilities used in these
11 exchanges.
12
13
14 **Q: WHY HASN'T A RATE CASE BEEN FILED BY CARBON/EMERY PRIOR TO**
15 **THIS PROCEEDING?**
16 A: Carbon/Emery had initiated the process to file a baseline rate case in 2003.
17 Carbon/Emery had reached a stipulation in principle with the DPU that would have
18 resulted in additional revenues to Carbon/Emery of $1,514,487 per year. The additional
19 revenues were to be funded from an increase in basic rates (to $13.50 for residential and
20 $23.00 for business), increases in access charges, and state universal service funding.

1 On February 5, 2004, the Utah Attorney General initiated a criminal investigation of
2 certain senior management of Emery Telcom. At that time, the DPU informed
3 Carbon/Emery that pending the Attorney General's investigation, the Carbon/Emery rate
4 case was being put on hold. On October 19, 2005, the Utah Attorney General informed
5 Emery Telcom that it had concluded its investigation as to Greg Killpack, Chief
6 Executive Officer and Ajay Tipnis, Chief Financial Officer, and that no charges would be
7 filed with respect to any of the allegations of wrongdoing which had been the subject of
8 its investigation. Out of approximately 35 allegations of criminal misconduct which the
9 Attorney General investigated, the only remaining allegation involves Mr. Gary Harrison,
10 Emery Telecom's Chief Operations Officer. This remaining issue is whether Emery
11 Telecom improperly billed the Utah Department of Transportation (UDOT) for fiber
12 installed to replace copper plant damaged or rendered useless in connection with UDOT's
13 SR-6 relocation project between Wellington and Price.
14
15 It is not an exaggeration to say that these allegations imposed significant hardship on the
16 operation and management of the company. Apart from the costs and expense associated
17 with the Attorney General's investigation, Carbon/Emery has lost over $3,000,000 in
18

1 revenues that it would have had if the 2003 rate case had been implemented.
2 Notwithstanding, Carbon/Emery has weathered these allegations and is now poised to
3 focus on efforts targeted to maintain and improve the services it offers its customers.
4
5 **II. RESPONSE TO DPU PROPOSED TEST PERIOD**
6
7 **Q: WHAT IS YOUR RESPONSE TO THE DPU'S STATEMENTS ABOUT THE**
8 **PROPOSED TEST PERIOD?**
9 A: In reading the DPU's testimony and in listening to comments by various DPU employees
10 during meetings with Carbon/Emery, I observe that many of its proposed modifications
11 use an interpretation of the allowed test period and rate period that differs from historic
12 practice. While this petition is based on an historic test period with limited known and
13 measurable plant additions, the DPU appears to "slide the test period scale" against
14 Carbon/Emery in order to inappropriately drive the rate case to a lower revenue
15 requirement. It also appears to me as well that the CCS test period theory is opportunistic
16 regarding several of its recommendations as will be discussed below.
17
18 **Q: WHAT IS AN HISTORIC TEST PERIOD?**
19 A: An historic test period is a prior period of time. The operations during this period of time
20 are evaluated and considered just and reasonable for a rate period in the future. Historic

1 test periods may allow for known and measurable plant additions added to it to reflect
2 additional facilities that are not reflected in the test period and are expected to be in place
3 before the rate period begins. Known and measurable changes may also include expense
4 and revenue adjustments to the test period in order to reflect better the rate period.
5
6 In this case, the historic test period for Carbon/Emery was the most recently available 12
7 month fiscal period at the time of filing which was calendar year 2004. This test period
8 was confirmed as necessary by the DPU in discussions with Carbon/Emery. In addition
9 to the 2004 test period, Carbon/Emery included known and measurable plant additions
10 which were anticipated to be completed prior to the starting of the rate period as well as
11 known and measurable expense adjustments.
12
13 **Q: DOES THE DPU ESPOUSE A DIFFERENT VIEW OF THE HISTORIC TEST**
14 **PERIOD?**
15 A: Yes. The DPU adjusts the known and measurable period to a period of time starting on
16 January 1, 2005 and ending in certain instances on either August 2005 or the time of
17 filing its testimony.
18
19 **Q: DOES THE DPU'S APPROACH REGARDING THE TEST PERIOD REQUIRE**
20 **CARBON/EMERY TO HAVE A RATE CASE EVERY YEAR?**

1 A: I understand that Utah Code Anno. § 54-4-4(3) provides Carbon/Emery the option to use
2 2004 as the test period for the purpose of setting rates and determining the appropriate
3 amount of support from USF in the proceeding. The year 2004 is the most recent 12-
4 month annual period and is an historic test period. Known and measurable changes
5 should reflect changes that are projected to occur prior to the rate period.
6
7 The rate period for this rate case will begin in early 2006 and may terminate less than
8 twelve months thereafter. After consideration of the DPU's approach in this case, I
9 believe it is necessary for Carbon/Emery to file a future test period rate case in early 2006
10 using projected data not exceeding 20 months. This necessity is precipitated by the
11 DPU's advocacy of proposed rate case reductions. By some of its proposed
12 modifications, the DPU has tilted its analysis so that Carbon/Emery will be disadvantaged
13 during the rate period. My response to the DPU's approach is to recommend
14 Carbon/Emery file a future test period rate case with projected rate case increases
15 designed to reflect the plusses as well as the minuses of operations during the rate period.
16
17 **Q: IT IS YOUR TESTIMONY THAT THE DPU AND CCS APPROACHES ARE**
18 **NOT AN HISTORIC TEST PERIOD WITH KNOWN AND MEASURABLE**
19 **ADJUSTMENTS?**
20 A: I don't believe their approaches are consistent with the statute which provides for an

1 historic test period, a future test period or a hybrid of historic and future projections.
2 Their approaches start with an historic test period and then selectively apply known and
3 measurable adjustments using different rationale to justify their reductions to the
4 Supplemental Filing.
5
6 **Q: DESPITE YOUR OBJECTIONS TO THE DPU'S ROLLING-FORWARD *PRO*
7 *FORMA* APPROACH, DO YOU ACCEPT USE OF THIS METHOD IN THIS
8 PROCEEDING?**
9 A: I recommend the Commission modify the DPU's approach to reflect known and
10 measurable additions to correspond to projects completed in 2005 and one project that is
11 under construction and will be completed in January 2006 – before the rate period begins.
12 My recommendation is consistent with the prior Commission decisions cited by Mr.
13 Huntsman. (Huntsman at 7: In citing *Qwest 1988 General Rate Case* "The [known and
14 measurable] change must have already occurred <u>or will occur before any increase in rates</u>
15 <u>occurs</u>." Emphasis Supplied) With the exception of one project expected to be
16 completed in January, this modification adjusts the treatment all known and measurable
17 adjustments, deprecation expense, and reserve balances and rolls these forward to
18 December 31, 2005. While I don't particularly agree with the approach under an historic
19 test period standard, at least the treatment is consistent for both sides.
20

1 **III. RESPONSE TO SPECIFIC DPU PROPOSED REVENUE**
2 **MODIFICATIONS**
3

4 **Q: PLEASE IDENTIFY THE DPU'S PROPOSED REVENUE MODIFICATIONS.**

5 A: The DPU has five (5) proposed revenue modifications, three (3) of which I believe
6 require modification. These three proposed DPU changes are identified as DPU 1, DPU
7 5 and DPU 6 on DPU Exhibit 1.2. Table 1 shows the DPU's proposed revenue
8 modifications as increases or decreases to the supplemental filling. The DPU's proposed
9 modifications are identified in the columns of Table 1.

10 Table 1
11 2004 Rate Case Revenues
12 Proposed DPU Changes
13

2004 Rate Case Revenues		DPU 1	DPU 5	DPU 6	DPU 7	DPU 12	
	TOTAL INTRASTATE ADJUSTED	Proposed Rate Change	Imputed LNP Revenue	Pole Attachment Revenue	Out of Period Revenue Adjustments	Misc Oper Exp. Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
LOCAL SERVICE	$ 2,688,535	$ 162,374	$ 18,990	$ 4,547			$ 2,874,446
STATE USF	0						0
INTERSTATE USF	0						0
STATE ACCESS	294,748	452,598			32,742		780,088
STATE SPECIAL ACCESS	364,688						364,688
MISC-INTRASTATE	278,440					11,007	289,447
STATE UNCOLLECT.	(41,082)						(41,082)
14 TOTAL OP REVENUE	$ 3,585,329	$ 614,972	$ 18,990	$ 4,547	$ 32,742	$ 11,007	$ 4,267,587

15

16 The DPU proposed changes have an overall effect of increasing revenues for
17 Carbon/Emery by $682,258 annually. While this amount represents an increase from
18 existing levels, it is a decrease of $147,376 from what Carbon/Emery proposed. (These

1 figures exclude the state universal service support requested in the Supplemental Filing.)

2 **1. ITEM DPU 1**

3

4 **Q: WHY DO YOU RECOMMEND THE COMMISSION MODIFY OR REJECT THE**
5 **DPU'S PROPOSED CHANGE FOR ITEM DPU 1?**

6 A: The DPU identifies its DPU 1 as a Carbon/Emery proposal; however, the testimonies
7 sponsored by Mssrs. Casey Coleman and Paul Anderson, cited below, change
8 significantly the company's filed position on local rates and intrastate access. The DPU
9 proposes rate change for basic local service and for intrastate access service as well as
10 additional studies and rate case requirements.

11

12 Mr. Coleman recommends the Commission increase the affordable base rates for
13 Carbon/Emery to $16.50 and $26.00 for residential and business customers respectively.
14 (Coleman at 5) This is the same rate level adopted by the Commission in its recent
15 UBTA-UBET Communications decision. (Docket No. 05-053-01) The existing
16 affordable base rates for most rural carriers are $13.50 and $23.50 for residential and
17 business customers respectively. Currently, Carbon/Emery charges $11.03 and 19.37 for
18 residential and business one-party service. Carbon/Emery has proposed that basic local
19 rates be raised to the current affordable base rate. I note Carbon/Emery customers also
20 pay $0.99 and $1.49 per month (residential and business) for extended area service

1 calling. Furthermore, customers also are required to pay a monthly federal end-user
2 carrier common line charge of $6.50 for residence and single line business and $9.20 for
3 multi-line business pursuant to its participation in the National Exchange Carrier
4 Association (NECA) Tariff F.C.C. No. 5. (*See* NECA Tariff F.C.C. No. 5 Section
5 17.5.1). The total mandatory monthly service charges seen by residential customers are:
6 $11.03 + $0.99 + $6.50 = $18.52. This amount does not reflect taxes and other
7 surcharges reflected on the customers' bills. The DPU recommends this monthly
8 residential service charge, seen by customers, be raised to: $16.50 + $0.99 + $6.50 =
9 $23.99.
10
11 It is important to report the EAS and federal end-user charges while comparing existing
12 and proposed rates to the affordable base rate because comparisons to other jurisdictions
13 may or may not have these components included in their reporting. For example, Mr.
14 Coleman cites the results from Table 13.1 and 13.2 of the Federal Communications
15 Commission's (FCC's) Trends in Telephone Service, released June 21, 2005. In those
16 tables, the FCC reports average rates for local service in urban areas. The FCC separates
17 the subscriber line charges from the representative monthly charge. However, when
18 making comparisons to the FCC's numbers we must recognize that EAS is generally
19 included in the representative monthly charge for urban customers and is not listed in the
20 category of "other charges." (*See* FCC Reference Book of Rates, Price Indices, and

1 Household Expenditures for Telephone Service, 2005.)

2

3 If the Commission were to set Carbon/Emery's affordable basic service rate at $16.50 and
4 $26.00 instead of the current $13.50 and $23.00 rates, I recommend the Commission
5 require the DPU to compare these rates with the combination of basic local service
6 charges and mandatory EAS charges to ensure these rate increases do not raise
7 affordability concerns for customers

8

9 **Q: DO YOU HAVE OTHER RECOMMENDATIONS FOR THE COMMISSION**
10 **REGARDING THE TESTIMONY OF MR. COLEMAN?**

11 A: In light of my recommendations hereinafter, I recommend the Commission authorize
12 raising Carbon/Emery local rates for the rate period to the affordable rate levels of $13.50
13 and $23.00 for residential and business customers respectively. I do not recommend the
14 Commission adopt the DPU suggestions to raise the affordable basic rates above these
15 levels. (*See* Coleman at 12)

16

17 **Q: CONTINUING WITH ITEM DPU 1, WHAT RECOMMENDATIONS DO YOU**
18 **HAVE REGARDING INTRASTATE ACCESS RATES?**

19 A: The DPU accepts the revenue level for intrastate access, but requests the Commission
20 order special studies to modify Carbon/Emery's intrastate rate structure. The DPU is

1 concerned that proposed local transport rate is too low. (Anderson at 7) The DPU
2 proposes the Commission order the use of the hypothetical HAI model to restructure
3 Carbon/Emery's intrastate access rates. I strongly disagree with this proposal. I
4 understand that the order referenced by the DPU (Docket No. 03-2403-02) addressed
5 reciprocal compensation obligations with Western Wireless, a CMRS provider.
6 Carbon/Emery was not a party to this proceeding when the HAI was examined.
7
8 As this Commission is aware, the federal rules for establishing a reciprocal compensation
9 rate differ from those for interstate access. Historically, intrastate access rates have been
10 set by the Commission at levels commensurate with the public interest. In its
11 Supplemental Filing, Carbon/Emery provided a detailed cost study supporting its
12 proposed rate structure. The DPU does not address this detailed cost study. Rather, it
13 argues that because the HAI is not "based on technologies," it is somehow better than
14 examining actual costs and well established cost study methodology to determine access
15 rate levels. (Anderson at 8) I do not see the advantage to performing an HAI model to
16 develop access rates for Carbon/Emery and I recommend the Commission reject the
17 request to require this type of study for a rate case.
18
19 The DPU suggests the Commission order a HAI study to be performed in approximately
20 one year. Further, it suggests that Carbon/Emery be barred from requesting another rate

1 case adjustment until this hypothetical study is conducted. I recommend the Commission
2 reject these requests. First, if the DPU wanted to submit an HAI model run for
3 Carbon/Emery, it could have done so during this proceeding. It elected not to perform
4 this study and make specific recommendations based on this analysis. Second, the DPU
5 wishes to extend the access rate development for another year which would be beyond the
6 statutory timeline for rate case review. Third, the DPU is vague, at best, on who would
7 be responsible to produce this study. Mr. Anderson states that Carbon/Emery should be
8 required to "provide data for the development of a cost study." (Anderson at 12) Yet in
9 other portions of his testimony he argues the model study be conducted prior to
10 November 30, 2006 and that Carbon/Emery be barred from requesting "consideration of a
11 further rate case or USF support filings by Emery Telcom or Carbon/Emery." (Anderson
12 at 9) Fifth, the DPU attempts to include Emery Telcom in this proceeding. Emery
13 Telcom is not a party to this proceeding. The Commission should not use a
14 Carbon/Emery rate case as a platform to address matters pertaining to other telecom
15 providers in Utah. I strongly urge the Commission to reject this request. I recommend
16 the Commission adopt the rate level and rate structure supported by Carbon/Emery.
17
18

1 **Q: WHAT DO YOU RECOMMEND THE COMMISSION DO WITH THE DPU'S**
2 **PROPOSED EAS RATES?**
3 A: The DPU does not propose new EAS rates for Carbon/Emery. (*See* Anderson at 10)
4 However, it wants the Commission to order yet another special study to evaluate
5 Carbon/Emery's EAS charge. I recommend the Commission reject this DPU request.
6 First, as with the intrastate access request, the DPU should have evaluated and proposed
7 rate changes in this proceeding. Instead it requests an extension of one-year to work on a
8 study. Second, the DPU seeks to include Emery Telcom in this matter without their being
9 a party to this proceeding. Third, the study proposed by the DPU is to perform "a traffic
10 study on all its central offices to determine minutes of use for calculating an accurate
11 stimulation factor for each exchange." (Anderson at 12) Having performed numerous
12 EAS studies for telephone companies, I do not see how a traffic study performed after
13 EAS has been implemented for years will yield a calculation for stimulation. Typically
14 stimulation is measured before and then after implementation of EAS. Furthermore, the
15 DPU request is burdensome in that it appears to desire an exchange-specific EAS charge
16 instead of a company-wide charge. Fifth, in the event the Commission increases
17 Carbon/Emery's affordable rate levels and adopts my recommendation to include EAS
18 charges as part of the basic rate for affordability comparisons, the EAS charge becomes
19 moot. There is no justification to order a time consuming "additional study" in order to
20 refine the EAS charge that for practical consumer purposes is part of the mandatory basic

1 rate. In light of these considerations, I recommend the Commission reject the DPU's
2 request for ordering an additional study.
3
4 **Q: ARE THERE ANY OTHER ISSUES OR CHANGES REGARDING DPU 1 YOU**
5 **WISH TO ADDRESS?**
6 A: No.
7
8 **2. ITEM DPU 5**
9
10 **Q: WHAT IS YOUR UNDERSTANDING OF THE PROPOSAL IDENTIFIED AS**
11 **DPU 5?**
12 A: The DPU recommends imputing an addition to Carbon/Emery's local service revenues of
13 $18,990. The DPU testimony of Mr. Croxford suggests that because of the requirement
14 to provide wireline-wireless intermodal number portability, Carbon/Emery was required
15 to implement LNP. (Croxford at 4) The DPU is mistaken as to the reason why
16 Carbon/Emery deployed LNP. Carbon/Emery deployed LNP was because of a request by
17 a wireless carrier. This request was in accord with 47 U.S.C. 215(b)(2). Accordingly,
18 Carbon/Emery deployed LNP during the latter part of 2004. Under governing FCC rules,
19 recovery of these costs is allowed on a levelized basis over five years. (*See* 47 CFR 52)
20

1 **Q: DO YOU AGREE WITH THE DPU'S ADJUSTMENT?**

2 A: No. I recommend the Commission modify the DPU's recommendation. The DPU
3 recognizes legitimate LNP costs incurred by Carbon/Emery. (Croxford at 4) These
4 expenditures are booked and amortized. There is no justification to treat LNP capital
5 expenditures as one-time expenses and offset these expenses with imputed revenue.
6 Second, the DPU incorrectly assumes that the capital expenditures involved with LNP
7 implementation increases the 2004 test period revenue requirement by an equivalent
8 amount. Lastly, the DPU did not go far enough in applying the FCC's highly prescriptive
9 process for calculating LNP rates for filing with the FCC in interstate tariffs.

10

11 **Q: IS THE DPU'S REFERENCE TO THE LNP COST RECOVERY ORDER**
12 **INCORRECT?**

13 A: This reference to the LNP Cost Recovery Order is a good start. However, a better starting
14 place is Section 52.33(a)(1)(iv) of the FCC Part 52 numbering rules. (47 CFR 52) This
15 section states:

> 16 The incumbent local exchange carrier shall levelize the monthly number-
> 17 portability charge over five years by setting a rate for the charge at which the
> 18 present value of the revenue recovered by the charge does not exceed the present
> 19 value of the cost being recovered, using a discount rate equal to the rate of return
> 20 on investment which the Commission has prescribed for interstate access services
> 21 pursuant to Part 65 of the Commission's Rules. (47 CFR § 52.33(a)(1)(iv))

22

1 **Q: DOES THE DPU'S APPROACH FOLLOW THE FCC'S RULE?**

2 A: No. The DPU's approach imputes $18,890 of annual end-user LNP charge revenue. The
3 correct annual amount under the FCC's rules is $13,793.

4

5 **Q: HOW DID YOU DETERMINE THIS AMOUNT?**

6 A: I used Reply Exhibit DDM-01 to calculate the LNP rate consistent with Section 52.33 and
7 also the methodology used by the National Exchange Carrier Association (NECA) for
8 LNP rate filings for NECA Tariff F.C.C. No. 5 interstate access tariff issuing carriers. JSI
9 routinely develops LNP rates for its clients either for filing in John Staurulakis, Inc. Tariff
10 F.C.C. No. 1 or for submission of data to NECA for filing in NECA Tariff FCC No. 5
11 using this algorithm.

12

13 **Q: WHAT IS YOUR RECOMMENDATION REGARDING DPU 5?**

14 A: I recommend the Commission modify DPU 5 to input the corrected amount of revenue
15 not received by Carbon/Emery for a one year period. The amount of imputed revenue is
16 based on the allowable LNP surcharge algorithm approved by the FCC. The amount of
17 imputed revenue Carbon/Emery would receive for a one-year period is $13,793.
18 Specifically, I recommend the Commission reverse the DPU adjustment and, if it wants to
19 impute LNP revenue in this case, include the correct calculation of imputed LNP annual
20 revenue. Rather than process this charge (approximately $0.12 per line per month)

1 through a specific tariff and line item, the Commission could add this amount to the basic
2 local rate level for Carbon/Emery for five years.
3
4 **3.ITEM DPU 6**
5
6 **Q: DO YOU AGREE WITH DPU 6 WHICH ADDRESS IMPUTED POLE**
7 **ATTACHMENT REVENUES?**
8 A: No.
9
10 **Q: WHY DON'T YOU AGREE WITH THE DPU PROPOSED CHANGE IN DPU 6?**
11 A: The DPU addresses alleged pole attachment revenues for 362 poles. The DPU uses
12 PacifiCorp's pole attachment rate to compute the amount of revenue Carbon/Emery
13 should have received in 2004 for unbilled pole attachments. However, the DPU does not
14 provide any support for using PacifiCorp's rate for the 334 poles not owned by
15 PacifiCorp. Not recognizing ownership of the poles is an omission which overstates the
16 imputation calculation. Table 1A shows the average rate charged to Carbon/Emery by all
17 pole owners is $5.54.
18

1 Table 1A
2 Weighted Average Pole Attachment Rate
3 Based on Prices Paid by Carbon/Emery

Paid To	*Quantity*	*Amount Per Pole*
Price	497	$ 2.50
Helper	152	$ 2.50
PacifiCorp	281	$ 12.56
W. Avg.	930	$ 5.54

4

5 Using this market-based weighted average pole attachment rate, I report the correct
6 imputed revenue in Table 1B.

7 Table 1B
8 Imputed Pole Attachment Revenue

Imputed To	*Quantity*	*Amount per Pole*	*Total*
PacifiCorp	28	$ 12.56	$ 351.68
CATV	334	$ 5.54	$ 1,850.24
Total			$ 2,201.92

9

10 The correct imputed amount should be $2,202, a reduction of $2,345 from the DPU's
11 $4,547 total. I recommend the Commission reverse the DPU adjustment and include
12 $2,202 as the imputed revenue for pole attachments.

13

14 **Q: IN SUMMARY WHAT REVENUE MODIFICATIONS DO YOU RECOMMEND**
15 **THIS COMMISSION ADOPT IN THIS PROCEEDING?**

16 A: I have prepared Table 2 which reflects my recommendations regarding revenues.

17

1 Table 2
2 2004 Rate Case Revenues
3 Carbon/Emery Response to Proposed DPU Changes

2004 Rate Case: Revenues		DPU 1	DPU 5	DPU 6	DPU 7	DPU 12	
	TOTAL INTRASTATE ADJUSTED	Proposed Rate Change	Imputed LNP Revenue	Pole Attachment Revenue	Out of Period Revenue Adjustments	Misc Oper Exp. Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
LOCAL SERVICE	$ 2,688,535	$ 377,036	$ 13,793	$ 2,202			$ 3,081,566
STATE USF	0						0
INTERSTATE USF	0						0
STATE ACCESS	294,748	452,598			32,742		780,088
STATE SPECIAL ACCESS	364,688						364,688
MISC-INTRASTATE	278,440					11,007	289,447
STATE UNCOLLECT.	(41,082)						(41,082)
TOTAL OP REVENUE	$ 3,585,329	$ 829,634	$ 13,793	$ 2,202	$ 32,742	$ 11,007	$ 4,474,707

4
5

6 Comparing Table 1 with Table 2, I recommend an increase of $207,120 in revenues
7 adjusted from the DPU's Exhibit 1.2. The amount of $4,474,707 is an increase of
8 $889,378 from current revenues and is a just and reasonable increase in current revenues.

9

10 **IV. RESPONSE TO SPECIFIC DPU PROPOSED RATE BASE**
11 **MODIFICATIONS**

12

13 **Q: WHAT RECOMMENDATIONS DO YOU HAVE REGARDING DPU CHANGES**
14 **TO CARBON/EMERY'S RATE BASE?**

15 A: The DPU proposes four (4) rate base changes: DPU xx, DPU 8, DPU 9 and DPU 11 for
16 which I recommend modification. I have listed the DPU's proposed changes in Table 3.

17

1 Table 3
2 DPU Proposed Rate Base Changes

2004 Rate Case: Rate Base		DPU xx	DPU 8	DPU 9	DPU 11	
	TOTAL INTRASTATE ADJUSTED	Correction Filed Error Rate Base	Plant Known & Measurable	Depreciation Expense Adj.	Depreciation Reserve Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
PLANT IN SERVICE	$ 23,771,864		$ (593,420)			$ 23,178,444
PLANT UNDER CONSTR.	90,444		(90,444)			0
DEPR. RESERVE	(15,690,969)			54,902	(1,474,467)	(17,110,534)
DEFERRED TAXES	-					-
CUSTOMER DEPOSITS	-					-
PREPAYMENTS	-					-
MATERIALS	-	34,019				34,019
RTB STOCK	-					-
WORKING CASH	195,466					195,466
TOTAL RATE BASE	$ 8,366,804	$ 34,019	$ (683,864)	$ 54,902	$ (1,474,467)	$ 6,297,394

3

4 The proposed DPU changes amounts to a reduction of rate base of $2,069,410 from that
5 which Carbon/Emery proposes. The majority of which involves the rolling-forward *pro*
6 *forma* approach adopted by the DPU and is reflected in DPU 11.

7

8 **4. <u>ITEM DPU xx</u>**

9

10 **Q: DO YOU AGREE WITH THE DPU'S CORRECTION OF THE CLERICAL**
11 **ERROR RELATED TO MATERIALS AND SUPPLIES IN THE RATE BASE**
12 **INDICATED AS DPU XX?**

13 A: I accept the need to correct for a clerical error whereby Materials and Supplies are not
14 carried across Supplemental Filing Schedule S-1 for inclusion in the revenue requirement
15 column. However, instead of correcting the clerical error by including in the test year the
16 average account balance, I propose reflecting the year end 2004 intrastate Materials and

1 Supplies balance of $40,701, an increase of $6,682 over the correction proposed by the
2 DPU.
3
4 **Q: ON WHAT BASIS DO YOU PROPOSE A CHANGE FROM AVERAGE**
5 **BALANCE TO YEAR-END BALANCE?**
6 A: The basis for my proposed treatment of Materials and Supplies is consistent with the
7 DPU's treatment of other Rate Base items. Other than Materials and Supplies, all of the
8 DPU's proposed rate base amounts are end-of-year balances. Carbon/Emery proposed
9 using average balances in its filing in accordance with the DPU provided template.
10 However, it appears that the DPU now prefers the end-of-year approach. Support for its
11 approach is the claim that the end-of-year approach is a better proxy for the average plant
12 balance for the year in which rates increases will go into effect. (*See* Huntsman at 5) I
13 report this adjustment in Table 3A.
14

1 Table 3A
2 Adjustment to Materials and Supplies Balance

MATERIALS AND SUPPLIES	S-9 and S-1 Column M A	Reverse Company Adjustments B	DPU Clerical Correction / Company Proposed Adjustment C	DPU Adjustment Column XX D
PER STAFF				Cols B + C
1 S9 Plant in Service	46,253	-	46,253	46,253
2	73.55%		73.55%	
3 S1 Plant in Service	34,019		34,019	34,019
PER COMPANY				
4 S9 Plant in Service	46,253		55,338	55,338
5	73.55%		73.55%	
6 S1 Plant in Service	34,019		40,701	40,701
7 Company Revised Intrastate Adjustments Over DPU Staff				6,682

3
4

5 I recommend the Commission reverse the DPU proposed change and apply the test year
6 intrastate Materials and Supplies balance of $40,701.

7

8 **5. ITEM DPU 8**

9 **Q: PLEASE IDENTIFY THE DPU'S PROPOSED CHANGES REGARDING DPU 8.**

10 A: The DPU proposes a reduction in the Rate Base to remove known and measurable plant
11 additions included by the company. Specifically, the DPU proposes reversal of the total
12 amounts of the known and measurable additions proposed by Carbon/Emery. (Thomson
13 at 5) Concomitant with the reversal, the DPU proposes allowing as known and
14 measurable adjustments to the 2004 Telecommunications Plant in Service balances plant
15 additions closed through August 31, 2005 together with one project in Account 2003,

1 Telecommunications Plant Under Construction (TPUC), the Fiber to Gordon Creek
2 Project. (Thomson at 4-6) Additionally, the DPU proposes assigning the costs for
3 parking lot resurfacing and gate replacement from treatment as a known and measurable
4 expense to treatment as a capitalized "land improvement." In total, as a replacement for
5 the amounts of known and measurable plant additions proposed by Carbon/Emery, the
6 DPU has proposed known and measurable plant additions that are $593,420 (intrastate)
7 below the amount proposed by Carbon/Emery in its Supplemental Filing: a reduction of
8 approximately 43 percent in the amount of known and measurable additions which should
9 be included in the rate base.
10
11 **Q: HOW DOES THE DPU TREAT ACCOUNT 2003, TPUC IN ITS PROPOSED**
12 **ADJUSTMENTS TO THE RATE BASE?**
13 A: The DPU proposes reversing the average 2004 balance of Account 2003. (DPU Exhibit
14 5.1) Instead, the DPU proposes including the August 31, 2005 balance for Account 2003
15 (net of the Fiber-to-Gordon Creek balance in Account 2003 included in the DPU's
16 proposal for Account 2001) as a plant addition subject to depreciation using a 5 percent
17 depreciation rate. I believe the DPU's approach to treating TPUC as subject to
18 depreciation for known and measurable additions is appropriate. However, I believe the
19

1 DPU's approach to TPUC should be extended to include all TPUC for the known and
2 measurable period.
3
4 **Q: WHAT ARE CARBON/EMERY'S PROPOSED ADJUSTMENTS TO THE TEST**
5 **YEAR RATE BASE?**
6 A: Since, I discussed this in my direct testimony, I will be brief. While the test period for
7 this rate case is 2004, Carbon/Emery's activities were evaluated to assess what plant
8 upgrades could be considered known and measurable as provided under the historic test
9 period statute. (Utah Code Anno 54-4-4(3)) Carbon/Emery proposed several plant
10 additions that it expected to be completed before the implementation of the rate period. I
11 expect that the rate period will not begin until early 2006 – after a Commission order.
12 Thus, the proposed plant additions for 2005 and January 2006 are to be completed prior
13 to the anticipated rate period. These additions are entitled to be treated as known and
14 measurable. The whole purpose of including known and measurable adjustments to a
15 historical test period is so that the conditions will more accurately reflect the conditions
16 which will exist during the rate period. The Supplemental Petition identified four major
17 categories of known plant adjustments: vehicles, $54,000; switching equipment,
18 $80,000; COE transmission, $295,965; and Cable and Wire Facilities, $1,537,553. These
19 additions totaled $1,967,518 for total company and $1,365,434 for intrastate.
20

1 **Q: WHY IS THIS TOTAL COMPANY NUMBER DIFFERENT THAN $2,056,607**
2 **TOTAL ADDITIONS REVERSED BY THE DPU IN CALCULATING DPU 8?**
3 A: The difference is $89,089. This amount represents an adjustment to the rate base to
4 reflect a full year for 2004 additions on the average-rate-base used by Carbon/Emery.
5 Carbon/Emery's average balance treatment is not necessary under the DPU's approach of
6 using end-of-year balances for Rate Base. Because the entire addition of $2,056,607 is
7 being reversed by both the DPU's proposed adjustment and Carbon/Emery's
8 recommended alternative adjustment, the $89,089 has no impact.
9
10 **Q: WHAT IS THE CURRENT STATUS OF THESE 2005 PLANT ADDITIONS?**
11 A: I have confirmed that there are three projects listed as known and measurable adjustments
12 for 2005 in Exhibit 5.2 of the Supplemental Filing that will not be started before the
13 beginning of the rate period. While the DPU correctly identified these projects, it also
14 proposed to remove other projects that will be complete before the rate period begins.
15 My recommendations are based on a January 31, 2006 known and measurable cut-off.
16 Thus, while I agree with the DPU that some of the original projects listed in the
17 Supplemental Filing will not qualify as known and measurable, there are other projects
18 that do qualify under the known and measurable standard chosen by the DPU. The
19 projects that will not qualify as DPU known and measurable include the microwave
20 transmission investment estimated to be $219,965 and two cable and wire facility projects

1 whose estimates total $268,425. (Supplemental Exhibit S-5.2 lines 6, 12 and 13) These
2 projects amount to a total of $488,390 in plant additions in this rate case. Inclusion of
3 these projects will need to wait until the 2006 rate case where these investments as well
4 as additional projected investments will be examined.
5
6 I disagree with the DPU's implication that these projects should not have been in the
7 petition. (*See* Thomson at 4) Carbon/Emery's filing naturally occurs far in advance of
8 the end of the known and measurable period. All of these known and measurable projects
9 are included in Carbon/Emery's approved budget. The budget process for Carbon/Emery
10 involves a total budget amount approved by the Board and not specific project budgets.
11 Hence, if the DPU looked for specific project budgets to determine whether projects are
12 on track to be completed, such information would not be available for the individual
13 projects included in the Supplemental Filing. Projects that are estimated are sometimes
14 delayed due to a variety of factors including the addition of unexpected high priority
15 projects. Therefore, known and measurable adjustments are
16

1 expected during the course of a rate case. Moreover, certain projects can be performed in
2 a relatively short period of time – even two months – depending upon the availability of
3 contractors' schedules.
4
5 **Q: WHAT KNOWN AND MEASURABLE STANDARD IS USED BY THE DPU?**
6 A: The DPU appears to use several standards for known and measurable status. First, there
7 is testimony suggesting that a project must be closed prior to the DPU testimony.
8 (Thomson at 3-4) Mr. Thomson claims that because of discussions with unidentified
9 company personnel in October, he recommends disallowing certain known and
10 measurable plant additions because they were in progress but not closed at the time of his
11 testimony. I do not know who provided this information to Mr. Thomson as he does not
12 identify his source. I have reviewed the known and measurable projects with
13 Carbon/Emery's management and aside from those three identified above, the known and
14 measurable projects will be completed before the rate period begins. Additionally, there
15 are known and measurable additions in 2005 that were not listed in its Supplemental
16 Filing. These additions qualify as known and measurable additions for this rate case.
17
18 The DPU has also used a 12 month known and measurable standard. (Thomson at 6)
19 The DPU believes that known and measurable additions should not go beyond 12 months
20 after the test period. While this is better than the arbitrary testimony cut-off date, I

1 recommend the Commission allow for known and measurable additions up to the
2 beginning of the rate period which begins after a Commission order even though the
3 project costs are estimated at the time of the preparation of testimony. Carbon/Emery
4 should not be penalized for the regulatory lag between the DPU testimony filing date and
5 the start of the rate period.
6
7 **Q: WHAT IS YOUR UNDERSTANDING OF THE DPU'S PROPOSALS RELATED**
8 **TO ADJUSTMENTS FOR KNOWN AND MEASURABLE PLANT ADDITIONS?**
9 A: Carbon/Emery included amounts for known and measurable additions for projects
10 planned to be completed prior to beginning of the rate period. The DPU rejects the
11 company's approach and apparently limits known and measurable adjustments to
12 Account 2001-Telecommunications Plant in Service to projects completed or, in the case
13 of the Fiber to Gordon Creek project, substantially completed by August 31, 2005 – the
14 time of the DPU on-site audit of the company.
15
16 **Q: YOU MENTION THERE WAS SOME ALLOWANCE FOR PROJECTS NOT**
17 **COMPLETED AS OF AUGUST 31, 2005. PLEASE EXPLAIN THIS**
18 **ALLOWANCE?**
19 A: The DPU provides an allowance for $468,449. (Reply Exhibit DDM 02) This amount
20 includes $120,000 representing the expense adjustment proposed by Carbon/Emery for

1 black top and gate replacement. As I will discuss later, I recommend the Commission
2 sustain Carbon/Emery's proposed treatment of this amount as a known and measurable
3 expense. The DPU also added $153,315 to the $172,363 already spent on the Gordon
4 Creek Fiber Project to bring the total known and measurable addition to the budgeted
5 level of $330,678. The DPU also effectively added an additional $172,363 because it
6 included the entire balance of Account 2003 TPUC of $240,027 notwithstanding that it
7 had already included $172,363 of the TPUC for the Gordon Creek Fiber Project. The
8 remainder of the $468,449, $17,772 is associated with six work orders not included by
9 Carbon/Emery in its Supplemental Filing. These six work orders were identified and
10 included by the DPU in its analysis.
11
12 **Q: IS THE DPU'S PROPOSAL REGARDING KNOWN AND MEASURABLE**
13 **PLANT ADJUSTMENTS REASONABLE?**
14 A: No. My assessment is that the DPU's approach is unreasonable and arbitrary. It is not
15 appropriate to limit known and measurable adjustments to an August 31, 2005 cut-off.
16 Such a limitation is confiscatory in that it is going to cause the company to forego forever
17 a return on the intrastate portion of this investment for the period between the effective
18 date for revised rates and the effective date for rates based on the next rate case. The
19 DPU's proposed adjustment for known and measurable additions omits $617,191 of total
20 company TPUC as of November 18, 2005 (See Reply Exhibit DDM-02). The intrastate

1 portion of this amount equals approximately $454,000. Moreover, the DPU's approach
2 also ignores a project underway totaling $409,292 and listed by Carbon/Emery in its
3 Supplemental Filing, with expected completion before January 31, 2006. If these
4 activities are not included as a known and measurable, return on this amount and
5 depreciation expense will be lost. The return and depreciation expense lost can never be
6 recovered.

7

8 **Q: ON PAGES 4 AND 5 OF HIS TESTIMONY, MR. THOMSON INDICATES THAT**
9 **CARBON/EMERY'S SUPPLEMENTAL FILING PROPOSED ADJUSTMENTS**
10 **FOR KNOWN AND MEASURABLE ADJUSTMENTS FALL FAR SHORT OF**
11 **REQUIRED STANDARDS UNDER UTAH STATUTES. DO YOU AGREE WITH**
12 **THIS ASSESSMENT?**

13 A. First, I would like to review the specific evaluation put forth by Mr. Thomson on pages 4
14 and 5 of his testimony.

15 "In its investigation, the Division encountered several unanswered questions.
16 How can the projects in the filing be considered as known and measurable plant
17 additions when they have in the most part not been started or completed through
18 October 31, 2005? Is it possible to fund, obtain material, construct, hire
19 contractors, or use a finite number of employees of Carbon/Emery to complete the
20 approximate $1.3 million dollars worth of projects, mentioned earlier, two months
21 before year end and even into early 2006? Known and measurable rate base
22 investment to have a return computed on it should be completed and the company
23 should have made the investment in the Rate Base as explained by Division
24 witness Wes Huntsman in his testimony. Again, a review of the Plant in Service
25 and Plant under Construction and the work orders not started indicates the

1 majority if not all of the projects added to 2004 Rate Base as known and
2 measurable in the filing are not known and measurable plant investment because
3 no investment has taken place. Also they are not used and useful and can not be
4 tested as to prudence of cost because total costs are not known. (Thomson at 3
5 and 5)

6

7 These arguments are disproved largely by the record of the post-August 31, 2005
8 construction activity undertaken by Carbon/Emery. On Reply Exhibit DDM-02 page 2, I
9 have analyzed activity for TPUC through November 18, 2005. As the schedule shows,
10 there has been $863,308 (Reply Exhibit DDM-02) of total company activity since August
11 31, 2005, successfully refuting the DPU's concern regarding whether construction can be
12 accomplished in such a short timeframe.

13

14 With respect to Mr. Huntsman's testimony regarding Utah Code 54-4-4(3), I believe that
15 the known and measurable plant additions, including both closures during 2005 to
16 Account 2001 and net additions to Account 2003, meet the requirements of Section 54-4-
17 4(3). Mr. Thomson apparently believes that known and measurable adjustments extend at
18 least 12 months, as that is the period for which reflected in his proposed adjustments to
19 depreciation expense and Account 3100, Accumulated Depreciation. I find that the DPU
20 wants it both ways. I believe that twelve months certainly meets the test for occurring
21 during a time period that is close in time to the test period. As the projects are now
22 completed or well underway, they are known in nature. Finally, they are measurable in

1 amount with respect to up-to-date expenditures and for budgeted amounts given the
2 eminent nature of the projects indicated on Reply Exhibit DDM-02. I acknowledge that
3 this exhibit differs from Supplemental Exhibit S-5.2; however, as the DPU finds the
4 activities such as depreciation expense and accumulated depreciation changes during all
5 twelve months of 2005 informative, so can Carbon/Emery.
6
7 **Q: DOES THE ALLOWANCE FOR FUNDS USED DURING CONSTRUCTION**
8 **("AFUDC") APPLY TO ANY OF THE COMPANY'S TELECOMMUNICATIONS**
9 **PLANT UNDER CONSTRUCTION?**
10 A: No. AFUDC does not apply to Account 2003, TPUC balances that are included in the
11 Rate Base. If included in the Rate Base, the capital tied up in the construction is allowed
12 a return. However, if for some reason TPUC is excluded from the rate base, it should
13 include AFUDC. The AFUDC, determined at either the specific project financing cost, if
14 available, or at the telephone companies capital cost rate is added to the work order
15 balance and eventually closed to Account 2001 with the rest of the costs of the work
16 order and is recovered through return and depreciation of the plant. AFUDC in principle
17 means that the investors should not be at risk because construction is not yet considered
18 used and useful.
19
20

1 **Q: MIGHT THERE BE DOUBT CONCERNING WHETHER THE POST-AUGUST,**
2 **31, 2005 ADDITIONS TO ACCOUNT 2001 OR ACCOUNT 2003 WILL BE USED**
3 **AND USEFUL?**
4 A: No. There is no DPU recommendation regarding whether any investment in plant made
5 by Carbon/Emery has failed the used and useful standard. As this Commission is aware,
6 it is axiomatic that Qwest rural properties acquired through Qwest divestiture require
7 upgrading.
8
9 **Q: WHAT IS CARBON/EMERY'S PROPOSAL THEN TO REPLACE THE DPU'S**
10 **ARBITRARY AUGUST 31, 2005 CUTOFF PROPOSED BY THE DIVISION?**
11 A: Carbon/Emery recommends the Commission modify the DPU's proposal. Carbon/Emery
12 recommends the Commission accepts the DPU's proposal to reverse the known and
13 measurable plant additions of $2,056,608. However, rather than use the DPU's truncated
14 calculations, Carbon/Emery recommends replacing this amount with known and
15 measurable adjustments for plant as shown on Reply Exhibit DDM-02, page 1. The total
16 amount is $1,914,037 ($1,393,845 intrastate).
17
18 **Q: DOES CARBON/EMERY'S PROPOSED ALTERNATIVE ADJUSTMENT FOR**
19 **KNOWN AND MEASURABLE ADJUSTMENTS INCLUDE THE DPU'S**
20 **RECLASSIFICATION TO PLANT OF CARBON/EMERY'S KNOWN AND**

1 **MEASURABLE EXPENSE ADJUSTMENT OF $120,000 FOR PARKING LOT**
2 **RESURFACING AND GATE REPLACEMENT?**
3 A: No. I discuss Carbon/Emery's opposition to Mr. Thomson's proposal regarding this later
4 in my testimony.
5
6 **Q: WHAT DOES YOUR PROPOSED ADJUSTMENT TO THE DPU'S PROPOSAL**
7 **FOR PLANT ADDITIONS INCLUDE?**
8 A: My proposal includes the DPU's adjustment with the addition for each of the DPU's
9 included work orders of expenditures after the DPU's cutoff of August 31, 2005 through
10 November 18, 2005. Where the DPU used an amount that reflected funds not spent as of
11 August 31, 2005, I have replaced the estimate with actual expenditures through
12 November 18th. Thus, my proposal includes all expenditures on the work orders through
13 November 18, 2005, of $1,504,745 (total company) plus $409,292 for the C Canyon fiber
14 project that was started in November and is proceeding apace for completion prior to the
15 rate period. Combined, these two numbers support Carbon/Emery's revised known and
16 measurable plant additions totaling $1,914,037 total company and $1,393,845 intrastate
17 (Reply Exhibit DDM-02 – pg. 1).
18
19 I recommend the Commission accept the known and measurable period as the period of
20 time from the test period to the start of the rate period and not an arbitrary testimony

1 deadline or a 12 month deadline. I also recommend the Commission reverse the DPU
2 known and measurable adjustment and apply the adjustments in Reply Exhibit DDM-02.
3
4 **6. ITEM DPU 9**
5
6 **Q: WHAT ARE THE DPU'S PROPOSED ADJUSTMENTS FOR ACCUMULATED**
7 **DEPRECIATION?**
8 A: The DPU's proposed adjustments to Accumulated Depreciation are reflected in DPU 9
9 and DPU 11.
10
11 **Q: PLEASE EXPLAIN YOUR MODIFICATION FOR DPU 9.**
12 A: The Accumulated Depreciation portion of DPU 9 represents the change to intrastate
13 Accumulated Depreciation associated with the DPU 9 depreciation expense on known
14 and measurable plant additions.
15
16 The DPU proposes an increase of $54,902 in the intrastate Accumulated Depreciation
17 proposed by the Company it its Supplemental Filing. (DPU Exhibit 5.2) DPU 9 is
18 reflective of the revised depreciation expense calculated by the DPU for the reduced
19 known and measurable plant additions. Additionally, as part of the DPU adjustment are
20 corrections to certain clerical errors.

As a result of the modifications made regarding known and measurable plant additions, I recommend the Commission reverse the DPU change and use my calculated adjustment of ($98,861) intrastate. I have incorporated corrections to certain clerical errors into this amount. I report my calculated adjustment on Reply Exhibit DDM-03.

Q: DOES THE CCS RAISE ISSUES RELATED TO DEPRECIATION ON KNOWN AND MEASURABLE ADDITIONS?

A: It appears that the CCS accepts Carbon/Emery's approach to proposing additional depreciation expense reflective of depreciation on the proposed known and measurable additions. The CCS does not object to the depreciation on additions for Microwave Transmission or Digital Electronic Switching (Dunkel at 14 and 15).

Because Carbon/Emery accepts the DPU's rolling-forward 2005 *pro forma* approach, it agrees to eliminate depreciation expense for accounts that will be or are fully depreciated by December 31, 2005, subject to the adjustment to restate Accumulated Depreciation to reflect the authorized depreciation rate for Digital Electronic Switching Equipment.

The CCS proposes that for such fully depreciated accounts, a separate depreciation rate must be established for new additions. (Dunkel at 10). I disagree. Based on the

1 experience of JSI, this request would be particularly burdensome to create and apply
2 different depreciation rates for the same asset account. Recall, Carbon/Emery is setting
3 out, subject to receiving additional revenues, to replace and improve its acquired plant. I
4 believe the capital recovery should continue at the flow comprehended by the existing
5 authorized depreciation rate applied to the total plant balance up to the point the
6 accumulated depreciation equals the plant investment: this is consistent with group plan
7 accounting (a/k/a mass asset accounting) in Part 32.200(2)(g)(2)(iii) and is the industry
8 standard. While Part 32 provides for alternatives to this treatment, these alternatives
9 require prior approval.
10
11 **Q. DOES THE CCS'S THEORY PROPOSING SUB ACCOUNTS FOR ADDITIONS**
12 **TO FULLY DEPRECIATED PLANT ACCOUNTS MINIMIZE DEPRECIATION**
13 **ON THOSE PLANT ADDITIONS BELOW A LEVEL WHICH WOULD HAVE**
14 **BEEN CALCULATED UNDER NORMAL APPLICATION OF PART 32?**
15 A: Yes. The plant accounts affected by the adjusted list of known and measurable additions
16 involves a fully depreciated account, the addition to Subscriber Circuit Equipment of
17 $28,452. (Reply Exhibit DDM-03) I propose a depreciation expense adjustment totaling
18 $28,452 because under Part 32, the depreciation rate of 12.5 percent would be applied to
19 the entire adjusted Account 2232 balance of $5,439,594, producing depreciation expense
20 of $679,949 that would in turn be reduced the maximum amount of the plant net of

1 accumulated depreciation, $28,452. After depreciation expense reaches $28,452, further
2 depreciation expense would be suspended until further additions are made. Furthermore,
3 since Subscriber Circuit Equipment is fully depreciated using the rolling-forward *pro*
4 *forma* 2005 year-end balance, I remove this amount from the depreciation calculation.
5 While not specifically mentioned above, a similar adjustment is being applied to Aerial
6 Cable.
7
8 If the Commission accepted the CCS theory, additional investment beyond the known and
9 measurable addition included in this filing would go to a special sub account. Then
10 Carbon/Emery would need to seek another rate case to adjust the depreciation rate. This
11 scenario is tremendously burdensome and is not industry practice except under very
12 unique exceptional regulatory circumstances where the company generally requests the
13 exceptional treatment. I recommend the Commission reject this approach.
14
15 **7. ITEM DPU 11**
16
17 **Q: WHAT DOES THE DPU CHANGE IN DPU 11?**
18 A: The DPU makes adjustments to Accumulated Depreciation calculated on DPU Exhibit
19 5.3.1. It recommends that deprecation reserve be reduced by $1,474,467.
20

1 **Q: DO YOU ACCEPT THE DPU'S PROPOSED ADJUSTMENT REGARDING**
2 **ACCUMULATED DEPRECIATION?**
3 A: I accept the DPU's approach for adjustment of accumulated depreciation as indicated on
4 DPU Exhibit 5.3.1. (Part of this adjustment was discussed with the DPU prior to the
5 filing of its testimony.) However, I do not agree with the DPU's treatment of Digital
6 Switching. Thus, the calculations related to Digital Switching need to be modified to
7 reflect the effect on accumulated depreciation for Carbon/Emery's proposed adjustments
8 to depreciation expense for 2001 through 2004 for Digital Switching Equipment.
9
10 **Q: WHAT IS THE NATURE OF THE DIGITAL SWITCHING ADJUSTMENT?**
11 A: Carbon/Emery booked digital switching investment in what appears to be an analog
12 account. Proper accounting suggests this be reclassified to the Digital Switching
13 Investment account. Additionally, the accumulated depreciation and depreciation
14 expense needs to be restated to reflect this restatement. Carbon/Emery inadvertently
15 booked these investments into an improper account and applied a 12.5 percent
16 depreciation rate when the depreciation rate for Digital Switching investment is 8.33
17 percent. In addition, the Account 2212 was depreciated using as 12.5 percent rate when
18 the Digital Switching deprecation is 8.33 percent. I have restated the affected accounts
19 back to 2001.
20

1 **Q: HOW WILL THIS ADJUSTMENT BE SHOWN ON CARBON/EMERY'S**
2 **BOOKS?**
3 A: Carbon/Emery will make this reclassification and other required changes on its books
4 prior to December 31, 2005 using a flow-through approach.
5
6 **Q: DOES THE CCS ADDRESS ACCUMULATED DEPRECATION?**
7 A: Yes. The CCS addresses accumulated depreciation in much the same manner as the DPU
8 although perhaps in a more overwrought fashion. The CCS titles its discussion as
9 "DEPRECIATION RESERVE-THE MISSING $2 MILLION". (Dunkel at 17) Although
10 the CCS concerns are moot because Carbon/Emery has accepted the DPU's adjusted
11 depreciation reserve, subject to the restatement of prior year depreciation expense for
12 Digital Electronic Switching Equipment, I believe it necessary to address the CCS
13 allegations individually.
14
15 Carbon/Emery has advanced during this proceeding that the 2004 test year, with
16 adjustment for known and measurable plant additions, is the best proxy for the rate
17 period. By way of accepting the significant erosion in rate base caused by adjustment of
18 the test year accumulated reserve balance for 2005 *pro forma* depreciation expense,
19 Carbon/Emery has already announced its intent to file a projected rate case in 2006 to
20 address its future plant upgrade program.

1

2 The CCS would have the Commission believe that Carbon/Emery's view of the test year
3 comes from left field. I note that Section 61.39 of the FCC's tariff filing rules allow for
4 use of an historic test period for filing of access charges. JSI prepares interstate cost
5 studies and tariff filings for rural carriers participating in JSI Tariff FCC No. 1 under
6 Section 61.39. Under Section 61.39, the historic test period used to develop access rates
7 is not adjusted other than for significant items. The average accumulated reserve from
8 the historic test year is not adjusted for prospective depreciation expense. JSI's
9 familiarity in performing Section 61.39 studies is unquestioned. While I disagree with the
10 approach the DPU is recommending, I accept the approach and have made the necessary
11 adjustments to align the rate case to the *pro forma* approach.

12

13 **Q: PLEASE EXPLAIN YOUR ADJUSTMENT TO THE DPU'S APPROACH.**

14 A: The DPU replaced 2004 depreciation expense with *pro forma* 2005 depreciation expense
15 reflective of a change in depreciation rate from the booked rate of 12.5 percent and a
16 proposed rate of 20 percent to 8.33 percent. Because of this change, I have restated the
17 Digital Switching account since acquisition to reflect this 8.33 percent rate. I discuss this
18 restatement in detail when addressing DPU 10 as it relates to an expense change.

19

20

1 **Q: YOU MENTION AUTHORIZED DEPRECIATION RATES, DOES THE DPU**
2 **ACCEPT ALL OF THE COMPANY'S PROPOSED DEPRECIATION RATES?**
3 A: Yes, with the exception of the rate for buildings. In its filing, Carbon/Emery requested an
4 increase in the depreciation rate for buildings from 3.33 percent to 5 percent. While the
5 DPU indicates that no rural carrier in Utah has an approved depreciation rate of 5 percent
6 for buildings, this Commission approved a five (5) percent rate for buildings in 1999 for
7 Manti. (*Manti Telephone Company Rate Case* Docket 99-046-01, 1999) This refutes the
8 DPU's claim that no carrier has a five percent depreciation rate for buildings. DPU
9 testimony indicates that at least one company has a four (4.0) percent depreciation rate for
10 buildings. (*See* Anderson at 11) In consideration of the above, I believe that
11 Carbon/Emery should be allowed at least the same four percent rate as afforded another
12 company in Utah, or the five percent rate afforded Manti Telephone. I believe both the
13 four and the five percent rates are reasonable and are consistent with prior Commission
14 treatment for rural telephone companies in Utah.
15
16 For the purposes of this testimony, I used a four (4) percent depreciation rate for
17 Buildings. (Reply Exhibit DDM-03) The impact of Carbon/Emery's proposed
18 adjustment is a decrease of $1,064,711 in the DPU recommended adjustments intended to
19 adjust the December 31, 2004 accumulated depreciation for *pro forma* 2005 depreciation
20 expense. The decrease in the adjustment results from replacing the DPU proposed

1 adjustment of ($1,474,467) with ($409,756). (Reply Exhibit DDM-05 page 2)

2

3 **Q: PLEASE SUMMARIZE YOUR RECOMMENDATIONS FOR RATE BASE**

4 **ADJUSTMENTS.**

5 A: I have prepared Table 4 to reflect the adjustments I have discussed above.

6 Table 4
7 Carbon/Emery Modifications to
8 DPU Proposed Rate Base Changes

2004 Rate Case: Rate Base		DPU xx	DPU 8	DPU 9	DPU 11	
	TOTAL INTRASTATE ADJUSTED	Correction Filed Error Rate Base	Plant Known & Measurable	Depreciation Expense Adj.	Depreciation Reserve Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
PLANT IN SERVICE	$ 23,771,864		$ 10,892			$ 23,782,756
PLANT UNDER CONSTR.	90,444		(90,444)			0
DEPR. RESERVE	(15,690,969)			(98,861)	(409,756)	(16,199,586)
DEFERRED TAXES	-					-
CUSTOMER DEPOSITS	-					-
PREPAYMENTS	-					-
MATERIALS	-	40,701				40,701
RTB STOCK	-					-
WORKING CASH	195,466					195,466
TOTAL RATE BASE	$ 8,366,804	$ 40,701	$ (79,552)	$ (98,861)	$ (409,756)	$ 7,819,336

9
10

11 This rate base represents a decrease of $547,468 from the Supplemental Filing and an

12 increase of $1,521,942 from the rate base changes proposed by the DPU.

13

14

1 **V. RESPONSE TO SPECIFIC DPU PROPOSED EXPENSE**
2 **MODIFICATIONS**
3
4 **Q: WHAT DPU PROPOSED EXPENSE CHANGES DO YOU RECOMMEND THE**
5 **COMMISSION MODIFY OR REJECT?**
6 A: I recommend the Commission modify four (4) DPU expense changes. These four DPU
7 expense proposals are DPU 2, DPU 4, DPU 9 and DPU 10. I have prepared Table 5 to
8 reflect the DPU's adjustments.

9 Table 5
10 2004 Rate Case Expenses
11 Proposed DPU Changes

2004 Rate Case: Expenses		DPU 2	DPU 3	DPU 4	DPU 9	DPU 10	DPU 12 - 17	
	TOTAL INTRASTATE ADJUSTED	Attorney Exp.	External Relations & Contributions	Projected Expense Adjustment	Depreciation Expense Adj.	Depreciation Expense Adj	Other Expense Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
PLANT SPECIFIC OP	$ 1,915,140			$ (180,266)			$ -	$ 1,734,874
DEPREC.& AMORT.	1,617,785				(52,918)	(802,655)	-	762,212
PLANT NONSPECIFIC OP	140,808						-	140,808
CUSTOMER OPERATIONS	369,671						-	369,671
CORPORATE OPERATIONS	908,013	(81,548)	(7,230)				31,815	851,050
OPERATING TAXES	85,915						-	85,915
OTHER INCOME & EXPENSE	-						-	-
TOTAL OP EXPENSE	$ 5,037,332	$ (81,548)	$ (7,230)	$ (180,266)	$ (52,918)	$ (802,655)	$ 31,815	$ 3,944,530

12
13
14 The DPU's overall operating expense adjustment is a reduction of $1,092,802 from that
15 proposed by Carbon/Emery in its Supplemental Filing.
16
17

1 **8.ITEM DPU 2**

2

3 **Q: WHAT DOES THE DPU PROPOSE WITH DPU 2?**

4 A: DPU 2 disallows certain attorney expenses and thereafter normalizes these expenses for
5 recovery over the DPU projected rate period.

6

7 **Q: DO YOU AGREE WITH THE OUT-OF-PERIOD AND NON-REGULATED**
8 **ADJUSTMENT PROPOSED BY MR. PAUL ALLEN HICKEN?**

9 A: Yes. Amounts related to these activities should be removed.

10

11 **Q: DO YOU AGREE WITH THE WAY THE DPU ADJUSTED OTHER LEGAL**
12 **EXPENSES?**

13 A: Not exactly. The DPU recommends the Commission assume that $23,263 in legal costs
14 reflect a normal year of operations. It then takes the amount of legal expense over this
15 level and spreads its recovery over two years (the apparent DPU rate period). This
16 approach makes two assumptions, both of which I disagree. First, since Carbon/Emery
17 has announced it will file a rate case using a proposed test period in 2006, the rate period
18 for this case is only one year, or less, depending upon the treatment of the next rate case.
19 (See Declaration of Intent to File, submitted by Carbon/Emery December 14, 2005)
20 Thus, any adjustment to legal expenses should be spread over one year instead of two

1 years. Second, the assumption that $23,263 is reflective of normal legal expenses appears
2 too conservative. In my discussions with Carbon/Emery management, I understand there
3 has been an increased need for legal services, independent of the Attorney General
4 investigation, which exceeds this $23,000 estimate. Furthermore, Carbon/Emery has
5 hired a part-time in-house counsel to address some of its legal matters. The salary plus
6 benefits alone of this employee allocated to Carbon/Emery exceeds this amount.
7
8 Furthermore, any adjustment to attorney expenses needs to reflect attorney expenses for
9 the present rate case. I cannot fault the DPU from not adding this known and measurable
10 expense. It isn't known until late in a rate case what the attorney fees will be due to the
11 many circumstances that may arise in a case. Now, however, Carbon/Emery has an
12 estimate of rate case attorney expenses. The attorney expenses for this rate case are
13 estimated to amount to $26,500 ($18,500 have been billed and $8,000 additional
14 expenses are expected to complete this rate case). These attorney expenses should be
15 included as rate case expenses and directly assigned as an intrastate expense. Since the
16 rate period is planned to be one year, these rate case expenses should be recovered during
17 the one-year rate period.
18
19

1 **Q: PLEASE IDENTIFY THE ATTORNEY EXPENSE ADJUSTMENT YOU**
2 **RECOMMEND.**
3 A: The attorney expense adjustment I recommend includes the DPU out-of-period and non-
4 regulated adjustment as well as attorney rate case expenses. I do not recommend the
5 Commission "amortize" these expenses over the proposed DPU two year period. The
6 rate period for this rate case will start in 2006 and will terminate when the projected test
7 period rate case is completed. Hence, there is no justification for allowing these expenses
8 and then effectively cutting them in half by spreading these expenses over two years when
9 the recovery period is estimated to be only one year. Table 5A shows the net adjustment I
10 recommend to the Commission.

11 Table 5A
12 Attorney Expense Adjustment

Item	Amount
DPU Out-of-Period and Non-Regulated Adjustments	($3,753)
Attorney Rate Case Expenses (Direct Assignment to State)	$26,500
NET CHANGE for one year recovery period	$22,747

13

14 The DPU's expense adjustment was a reduction of $81,548. Based on the foregoing, I
15 recommend the DPU adjustment be reversed and that attorney expenses increase by
16 $22,747 from Carbon/Emery's Supplemental Filing.
17
18

1 **9. ITEM DPU 4**

2

3 **Q: WHAT PORTIONS OF DPU 4 DO YOU RECOMMEND THE COMMISSION**
4 **MODIFY?**
5 A: DPU 4 identifies four (4) changes in operations expenses. I recommend the Commission
6 reject the change related to blacktop resurfacing and gate replacement and modify the
7 recommendation regarding rate case expenses. I don't recommend any changes to the
8 two other items raised by the DPU; namely, GPS expenses and power plant expenses.

9

10 **Q: WHAT CHANGE DOES THE DPU AND CCS PROPOSE REGARDING THE**
11 **PRICE PARKING LOT AND YARD BLACKTOP RESURFACING AND GATE**
12 **REPLACEMENT EXPENSES?**
13 A: I understand the DPU and CCS recommend that the items be treated as Land
14 Improvements and capitalized and depreciated over 15 years.

15

16 **Q: DO YOU AGREE WITH THEIR RECOMMENDATION?**
17 A: No. I disagree because the discussion and recommendation ignores the fact that these
18 items are normal repair and maintenance and are not substantial "Land Improvements".
19 The DPU and CCS attempt to classify these items with support of certain IRS guidelines.
20 While their specific reference was not included in their testimony, its likely they were

1 referencing Publication 946 Table B-1 Specific Depreciable assets Class 00.3. This
2 specific publication refers to major land improvements such as constructing a "*NEW*"
3 road on previously unimproved land and all costs associated with that "*NEW*" road such
4 as grading, gravel, compression, concrete or blacktop. Class 00.3 also refers to IRS Rev.
5 Rule 72-403 which implies that only "NEW" (initial) costs are capitalized and amortized.
6 These particular guidelines do not refer to "Replacement" or "resurfacing" of existing
7 assets. Further, in making their recommendation, the DPU and CCS ignore Part 32.2 (d)
8 of the FCC Rules and regulations that requires the retirement of original value of the
9 already existing property unit before a new unit may be capitalized with the exception
10 being minor item 32.2(d)(ii). Minor items include any part or element of plant which is
11 not designated as a retirement unit. The original cost of a minor item of property when
12 included in the specific or average cost for a retirement unit or units requires no specific
13 separate credit to the telecommunications plant account when such a minor item is
14 retired. "*The cost of replacement shall be charged to the account applicable for the cost*
15 *of repairs of the property.*" This accounting practice is also supported by the AICPA
16 exposure draft and AICPA FASB draft that deals with Property, Plant and Equipment.
17 Both drafts clearly state that in order to capitalize an item like Blacktop resurfacing, the
18 company would have to list it as a separate property unit and expense the remaining net
19

1 value of the property unit it is replacing. If the replaced item is not currently on the books
2 as a separate property unit, then the current item would be expensed as a normal business
3 operating expense in the current period.
4
5 Carbon Emery does not have the parking lots and gates listed as separate property units,
6 and their values are combined with the buildings or land accounts. As Qwest did not
7 provide a detailed continuing property record during the acquisition process, there is no
8 way to determine the cost of the parking lots and gates separate from the buildings and
9 land accounts and it would be unduly burdensome to attempt to establish the original
10 property value and date in order to determine the current net value. As stated in Part 32
11 above these items would be considered "minor items" and thus my recommendation is
12 these items be handled as normal repair and maintenance expenses in the current period
13 as filed by Carbon/Emery.
14
15 I recommend the Commission reverse the DPU's expense adjustments and corresponding
16 capitalized treatment of these expenses. While it is clear that blacktop resurfacing
17 expenses are not likely to occur every year, I believe it is reasonable to conclude that
18 Carbon/Emery will have miscellaneous operational expenses for replacement items such
19

1 as these every year. Hence, allowance of these known and measurable expenses is
2 reasonable.
3
4 **Q: NOW TURNING TO ANOTHER ASPECT OF DPU 4, WHAT DOES THE DPU**
5 **PROPOSE REGARDING RATE CASE EXPENSES?**
6 A: The DPU recommends dividing the intrastate portion of the rate case expenses by two to
7 reflect the DPU's presumed rate recovery period.
8
9 **Q: DOES THE CCS PROPOSE ADJUSTMENTS TO RATE CASE EXPENSES?**
10 A: Yes. The CCS recommends dividing the total amount of intrastate rate case expenses by
11 five (5) years. The selection of five years appears to represent the CCS presumed rate
12 recovery period.
13
14 **Q: HAVING CONSIDERED THESE RECOMMENDATIONS, WHAT DO YOU**
15 **RECOMMEND FOR THE COMMISSION REGARDING RATE CASE**
16 **EXPENSES?**
17 A: I have reviewed the CCS treatment for intrastate rate case expenses and agree that
18 intrastate rate case expenses should be removed from the interstate jurisdiction and
19 directly assigned to the intrastate jurisdiction. This means that rate case expenses should
20

1 be recovered from intrastate revenue sources. Hence, the first recommendation I have is
2 to assign all of the rate case expenses to the intrastate jurisdiction.
3
4 My second recommendation to this Commission is to adjust the proposed recovery period
5 for these allowable expenses. Carbon/Emery has already declared to the Commission and
6 all parties to this proceeding that it will seek apply for additional state universal service
7 support in the second quarter 2006. As such, Carbon/Emery's rate recovery period for
8 this rate case will be approximately 12 months. Thus, the allowable expenses accepted
9 by the DPU and CCS should not be divided by two, nor should they be divided by five.
10 Since the rate period will be one year, there is no rational justification for dividing these
11 expenses by five after the classifying these expenses as allowable expenses. I agree with
12 the DPU that these expenses should be spread over the expected recovery period – yet in
13 this case the recovery period is one year, not two. Table 5B shows the net change in rate
14 case expenses.

15 Table 5B
16 Rate Case Expenses

Item	Amount
Initial Carbon/Emery Rate Case Expense	$100,528
Adjusted Carbon/Emery Rate Case Expense	$160,000
NET CHANGE	$59,472

17
18

1 I recommend the Commission reverse the proposed DPU adjustments for blacktop and
2 rate case expenses totaling ($127,088) and add the net change of $59,472 as discussed
3 above.
4
5 **Q: DOES THE CCS PROPOSE ANY ADJUSTMENTS OTHER THAN THOSE**
6 **RELATED TO ADJUSTMENTS PROPOSED BY THE DPU?**
7 A: Yes, the CCS proposes making an adjustment to reduce accounting expense. The DPU
8 has not made any recommendations for adjustment to the 2004 accounting expense. The
9 CCS proposes an adjustment to reduce Carbon/Emery's accounting expense by $162,345.
10 These adjustments serve to remove the difference in 2004 accounting expense over 2003
11 accounting expense from the test year and add back one-fifth of the difference as
12 amortization of the difference over five years. It is difficult to follow this adjustment in
13 Mr. Dunkel's testimony, so I have analyzed the proposed adjustment based entirely on
14 Schedule W-3-Proprietary. Total 2004 accounting expense unadjusted is $612,714
15 compared with $405,315 for 2002 and $409,783 for 2003. The amount selected by the
16 CCS for reduction is the difference produced by subtracting the 2003 amount from the
17 2004 amount, $202,931. The CCS proposes amortizing this $202,931 over five years,
18 with a single year of amortization equal to $40,586. This results in an adjustment to
19

1 reduce the test year 2004 by $162,345, the net effect of the $202,931 reduction and the
2 $40,586 amortization.
3
4 **Q: DO YOU ACCEPT THE CSS'S PROPOSED ADJUSTMENT TO ACCOUNTING**
5 **EXPENSE?**
6 A: No. First, the DPU performed an extensive audit of the Company's books as part of this
7 rate case and did not propose such an adjustment. Second, the adjustment represents an
8 unfair approach to comparing 2004 expenses to prior years. Certain other operating
9 expenses have decreased since 2002 and 2003, but CCS makes not notice of those
10 differences nor proposes any increases to align them with its trending method. Third,
11 Carbon/Emery's level of accounting expense for 2005 indicates sustained increases over
12 prior years and provides support for reasonableness of the 2004 test period.
13
14 **Q: ON AN OVERALL BASIS, HOW DO 2004 EXPENSES COMPARE TO OTHER**
15 **YEARS?**
16 A: For each of the years, 2002-2004, operating expenses less depreciation expense has been
17 approximately $4.5 million.
18
19

Q: WHAT IS YOUR RECOMMENDATION REGARDING THE CCS PROPOSAL FOR A REDUCTION IN ACCOUNTING EXPENSE?

A: I recommend that it be ignored. The current annualized 2005 accounting expense indicates that the 2004 level of accounting expense will largely be sustained. Moreover, this rate case supports the expanded effort related to accounting undertaken by Carbon/Emery. It would be unreasonable to deny Carbon/Emery the resources to maintain its accounting and finance department at the level necessary to sustain records at their proper level.

10. ITEM DPU 9

Q: WHAT DOES THE DPU PROPOSE IN DPU 9 WITH RESPECT TO DEPRECIATION EXPENSE?

A: The DPU proposes to adjust downward by $52,918 the $89,569 proposed by Carbon/Emery for depreciation expense associated with adjustments to test year Telecommunications Plant in Service for additions. The lower depreciation expense on additions proposed by the DPU is reflective of the DPU's proposed adjustment downward in known and measurable plant additions discussed above.

Q: WHAT IS YOUR RECOMMENDATION IN RESPONSE TO DPU 9?

A: My response is related to the adjustments to the rate base discussed previously. I recommend the Commission reverse the DPU's ($59,918) adjustment and replace this adjustment with ($33,096) in depreciation expense.

11. ITEM DPU 10

Q: WHAT DOES THE DPU RECOMMEND WITH DPU 10?

A: The DPU reduces depreciation expense by $802,655. It claims that this reduction is justified because there are several asset accounts that are fully depreciated by year-end 2004 or year-end 2005. Using the rolling-forward approach I have described above, the DPU does not recognize any depreciation expense for these accounts. Furthermore, the DPU examined the Digital Switching asset account and determined it would be fully depreciated before year-end 2005. Hence, it removed reported depreciation expense from the 2004 test year for this account. (DPU Exhibit 5.3.1)

1 **Q: YOU MENTIONED CERTAIN ACCOUNTS HAVE BECOME FULLY**
2 **DEPRECIATED, PLEASE IDENTIFY THESE ACCOUNTS.**
3 A: There are four accounts affected by this treatment: Account 2362, Subscriber Circuit;
4 Account 2212, Digital Electronic Switching (discussed below); Account 2231 Microwave
5 Transmission equipment; and Account 2411 Poles.
6
7 **Q: DO YOU ACCEPT THE DPU'S PROPOSED CHANGE?**
8 A: I accept the DPU proposal to remove the 2004 actual depreciation expense for those
9 accounts that are fully depreciated by year-end 2004. I note that Carbon/Emery has a
10 planned Microwave construction project. This project was anticipated to be a known and
11 measurable construction project for this rate case but has been delayed.
12
13 As discussed above, I do not agree with the DPU's treatment of Digital Switching. In this
14 proposed change, the DPU replaced 2004 depreciation expense with *pro forma* 2005
15 depreciation expense reflective of a change in depreciation rate from a booked rate of
16 12.5 percent (proposed to be 20 percent) to the 8.33 percent rate. Since there is a
17 depreciation rate change for this account from its booked rate, I have restated the account
18 since the acquisition of the Price, Helper and East Carbon exchanges from Qwest in April
19 2001 to reflect the rate adjustment.
20

1 **Q: DO YOU HAVE RECOMMENDATIONS FOR THIS COMMISSION**
2 **REGARDING THE RESTATEMENT OF DIGITAL SWITCHING?**
3 A. Yes. I believe it is necessary to carefully examine the DPU's *pro forma* 2005 calculation
4 of depreciation expense. I recommend changes for three instances I believe require
5 modification. The first two have to do with depreciation by the company of acquired
6 investment in Account 2212 and its post acquisition investments in Account 2210.
7 Theses accounts were booked at 12.5 percent rate instead of the 8.33 percent rate. The
8 second has to do with proper accounting for the impact of known and measurable
9 additions on depreciation of accounts previously fully depreciated.
10
11 **Q: WHY DOES ACCOUNT 2210 NEED TO BE ADJUSTED WITH RESPECT TO**
12 **DEPRECIATION AND DEPRECIATION RESERVES?**
13 A: Carbon/Emery inherited from Qwest two sub accounts for Account 2210, Central Office
14 Switching Equipment. One account with a zero balance at April, 2001 and a depreciation
15 rate of 12.5 percent and a second account with a positive balance and a depreciation rate
16 of 8.33 percent. Carbon/Emery has booked $845,352 in additions to the Account 2210
17 with the 12.5 percent depreciation rate since 2001. (Reply Exhibit DDM-04) The
18 equipment added to Account 2210 is digital switching equipment. In review of this
19 matter subsequent to the DPU and CCS testimony, Carbon/Emery accepts that proper
20 accounting treatment calls for this Digital Switching equipment investment to be booked

1 to the Account 2212 with the 8.33 percent depreciation rate. To make this adjustment,
2 Carbon/Emery has to reclassify Account 2210 to Account 2212 for all years since its
3 acquisition and recalculate depreciation for the combined plant balances at the approved
4 depreciation rate for digital switching equipment of 8.33 percent. (*See* Reply Exhibit
5 DDM-04) Under this corrected treatment, the current balance in Account 2212 is not
6 fully depreciated until July 2010. Therefore the DPU's disallowance of depreciation
7 expense should be reversed.
8
9 **Q: IN ITS RESTATEMENT, DOES CARBON/EMERY NEED TO CREDIT THE**
10 **DIFFERENCE IN PRIOR YEARS?**
11 A: No. If a credit were to be applied, for prior years, a reversal of the credit would have to
12 be applied as a known and measurable adjustment. Therefore, no credit is necessary.
13 Furthermore, Carbon/Emery has no earnings in prior years so no adjustment is necessary
14 regarding concerns of over charging customers for the recovery of these assets.
15
16 **Q: WHAT IS YOUR PROPOSAL FOR ADDRESSING YOUR CONCERN WITH**
17 **DPU EXHIBIT 5.3.1?**
18 A: I recommend replacing DPU Exhibit 5.3.1 with Reply Exhibit DDM-05 page 1. This
19 exhibit adjusts DPU Exhibit 5.3.1 for the additional capital recovery for digital electronic
20 switching Account 2212, reversing the adjustment proposed by the DPU to eliminate

1 depreciation expense for Account 2212. Additionally, this exhibit adjusts the December
2 31, 2004 accumulated depreciation to reflect application of the authorized 8.33 percent
3 depreciation rate to digital switching equipment from April 2001 through December 31,
4 2004. (Also note I have used a 4.0 percent depreciation rate for buildings instead of the
5 current 3.33 percent rate proposed by the DPU.) Lastly, this exhibit corrects clerical
6 errors identified by the DPU and CCS.
7
8 The overall effect of this recommendation is an increase in intrastate depreciation
9 expense over that calculated by the DPU by $196,857. (Reply Exhibit DDM-05 page 2)
10
11 **Q: BEYOND THE DIFFERENCE IN THE AMOUNT FOR THE KNOWN AND**
12 **MEASURABLE PLANT ADDITIONS, WHAT OTHER DIFFERENCES EXIST**
13 **BETWEEN CARBON/EMERY'S CALCULATION OF DEPRECIATION**
14 **EXPENSE ON KNOWN AND MEASURABLE PLANT ADDITIONS?**
15 A: There are two additional differences. First, as discussed above, Carbon/Emery uses a 4.0
16 percent building depreciation rate instead of the 3.33 percent rate used by the DPU.
17 Carbon/Emery should be allowed the same 4.0 percent rate as discussed earlier.
18
19 The second difference involves depreciation on the known and measurable addition to
20 Account 2232, Subscriber Circuit Equipment of $32,517. The amount of this addition as

1 of August 31, 2005 reflected on DPU Exhibit 5.2.1 is $26,459. The additional increase is
2 due to charges to TPUC between August 31, 2005 and November 18, 2005. The DPU
3 calculated the depreciation on the known and measurable addition by multiplying the
4 addition by the approved depreciation rate of 12.5 percent, producing depreciation
5 expense of $3,307. However, when added to the plant account, depreciation will be
6 calculated by application of the 12.5 percent rate to the entire Account 2232 with the
7 resulting depreciation expense being the lesser of calculated depreciation or the amount
8 required to bring the net plant balance for Subscriber Circuit equipment back to zero.
9 This correct depreciation accounting procedure generates depreciation expense related to
10 the Subscriber Circuit equipment of $32,517. This treatment is consistent with Part 32
11 depreciation accounting. This difference is mooted by the DPU's pro forma rolling
12 forward approach in this case. A similar treatment applies to Aerial Cable. Thus, at the
13 end of 2005, the assets are fully depreciated. (Reply Exhibit DDM-03)
14
15 **Q: HAVE YOU REVIEWED THE CCS TESTIMONY FILED REGARDING**
16 **DEPRECIATION EXPENSE?**
17 A: Yes.
18
19

1 **Q: WHAT IS YOUR RESPONSE TO THE SPECIFIC RECOMMENDATIONS OF**
2 **THE CCS' TESTIMONY CONCERNING DEPRECIATION EXPENSE?**
3 A: The first concerns raised by the CCS have to do with dealing with clerical mistakes
4 contained in the Supplemental Filing. To some extent, these clerical errors stem from
5 following the format to breakdown the depreciation analysis provided by the DPU in
6 2003. No matter the circumstance, Carbon/Emery agrees to follow the format for
7 calculation of depreciation suggested by the DPU in its testimony whereby the test year
8 depreciation expense is actually that for 2005 instead of the adjusted 2004 depreciation
9 expense proposed by Carbon/Emery. (*See* DPU Exhibit 5.1.3 and Reply Exhibit DDM-
10 05)
11
12 The fresh start used by the DPU and to which I have recommended adjustments as
13 discussed above, in my mind, makes unnecessary a detailed review of the issues raised by
14 the CCS.
15
16 **Q: HOW ARE THE CLERICAL ERRORS MENTIONED BY CCS WITNESS MS.**
17 **MCCULLAR ADDRESSED BY THE DPU'S APPROACH TO DEPRECIATION?**
18 A: If the DPU's proposed approach to analyzing depreciation is used, the clerical errors
19 pointed out by the CCS are no longer part of the equation, so to speak. Exhibit S-6
20

1 which Ms. McCullar parses in her testimony is now replaced by DPU and Reply exhibits
2 correcting the matter.
3
4 **Q: ARE THERE ANY OTHER ISSUES RAISED BY CCS THAT HAVE ALREADY**
5 **BEEN ADDRESSED?**
6 A: Carbon/Emery accepts the DPU's acceptance of the depreciation rate increases proposed
7 by Carbon/Emery in the Supplemental Filing other than that for Buildings. As discussed
8 above, Carbon/Emery believes that either a four (4) percent or five (5) depreciation rate
9 should be deemed reasonable for Carbon/Emery.
10
11 **Q: IS THERE ANYTHING IN MS. MCCULLAR'S TESTIMONY WITH WHICH**
12 **YOU AGREE?**
13 A: Yes. I accept Ms. McCullar's recommendation that depreciation for all of
14 Carbon/Emery's Central Office Digital Electronic Switching Equipment be at the same
15 8.33 percentage rate for the reasons explained above. Correspondingly, I have applied
16 this prescribed depreciation rate for all of Digital Electronic Switching Equipment in my
17 restatement of the account since the acquisition of the Price, Helper and East Carbon
18 exchanges from Qwest in April 2001.
19
20

Q: PLEASE SUMMARIZE YOUR MODIFICATIONS TO THE DPU'S PROPOSED EXPENSE CHANGES.

A: I have prepared Table 6 to summarize the modifications necessary for each of the DPU modifications.

Table 6
2004 Rate Case Expenses
Modifications to the Proposed DPU Changes

2004 Rate Case: Expenses		DPU 2	DPU 3	DPU 4	DPU 9	DPU 10	DPU 12 - 17	
	TOTAL INTRASTATE ADJUSTED	Attorney Exp.	External Relations & Contributions	Projected Expense Adjustment	Depreciation Expense Adj.	Depreciation Expense Adj	Other Expense Adj.	TOTAL INTRASTATE ADJUSTED DPU PROPOSED
PLANT SPECIFIC OP	$ 1,915,140			$ 6,294			$ -	$ 1,921,434
DEPREC.& AMORT.	1,617,785				(33,096)	(605,798)	-	978,891
PLANT NONSPECIFIC OP	140,808						-	140,808
CUSTOMER OPERATIONS	369,671						-	369,671
CORPORATE OPERATIONS	908,013	22,747	(7,230)				31,815	955,345
OPERATING TAXES	85,915						-	85,915
OTHER INCOME & EXPENSE	-						-	-
TOTAL OP EXPENSE	$ 5,037,332	$ 22,747	$ (7,230)	$ 6,294	$ (33,096)	$ (605,798)	$ 31,815	$ 4,452,064

My recommendation increases rate case expenses by $507,534 over the DPU's proposed changes.

1 **VI. RATE OF RETURN AND INCOME TAX**

2

3 **12. RATE OF RETURN**

4

5 **Q: PLEASE EXPLAIN THE DPU RECOMMENDATION REGARDING THE**
6 **AUTHORIZED RATE OF RETURN FOR CARBON/EMERY.**

7 A: DPU witness George Compton, Ph.D. expresses the DPU position regarding the
8 authorized rate of return. Included in his testimony is a discussion about capital structure
9 for rate cases and a proposal for the authorized overall rate of return for this case.

10

11 The DPU recommends use of Carbon/Emery's actual debt/equity capital structure in this
12 proceeding. The DPU recognizes that the general industry practice is to use a capital
13 structure of 50 percent debt and 50 percent equity. (Compton at 4) In Utah, prior rural
14 telecommunications carrier cases before the Commission have used a hypothetical 50
15 percent debt and 50 percent equity approach. In fact, Emery Telcom in 2002 was
16 required to use a hypothetical 50 percent equity value when its equity percentage was in
17 excess of 50 percent. (*See* Division Audit Report of Emery Telcom, January 1, 2001 –
18 December 31, 2001, Docket 01-2272-01) In the past, this Commission has relied on a
19 hypothetical capital structure to balance the interests of customers and owners of the
20 company. In this case, the DPU discards this carefully crafted balance and advocates the

1 use of an actual capital structure, but it does this selectively. The DPU argues for actual
2 capital structure when equity is less than 50 percent of the capital structure, and it argues
3 for a hypothetical capital structure when equity exceeds 50 percent of the capital
4 structure. The DPU proposal in this proceeding is inapposite and contradicts how the
5 Commission treated Manti Telephone Company in 1999. (Manti Telephone Company
6 1999 Rate Case, Docket 99-046-01) In Manti, Manti's actual capital structure was
7 comprised of 100 percent debt and the DPU agreed to a return on equity of 12.5 percent
8 for a hypothetical 50 percent of rate base. In the Gunnison case, (Gunnison Telephone
9 Company 2000 Rate Case, Docket 00-043-01) the Commission approved a hypothetical
10 capital structure of 50 percent debt and 50 percent equity when Gunnison's actual capital
11 structure comprised of 93.5 percent equity. In this Carbon/Emery case, the DPU
12 recommends a departure from the approach used in the past by this Commission to
13 balance the interests of the consumer and the investor using a hypothetical 50:50 capital
14 structure for rural carriers. I note that the recent UBTA-UBET Communications case
15 referenced by the DPU isn't determinative because that case was settled between the DPU
16 and UBTA-UBET – the Commission did not have an opportunity to reinforce its
17 precedent of using a hypothetical 50:50 capital structure for rural carriers.
18
19

1 **Q: DO YOU AGREE WITH THE DPU REGARDING THE SELECTIVE USE OF A**
2 **HYPOTHETICAL CAPITAL STRUCTURE?**
3 A: No. I believe this selective use of capital structure disrupts the public policies holding the
4 interests of the owners and customers in balance. Using a sliding scale to determine what
5 is just and reasonable is not good public policy. This recommendation also provides very
6 few incentives to investors seeking to invest in the enterprise. In anticipation of
7 Carbon/Emery's capital expenditures planned for 2006 and 2007, I know that
8 Carbon/Emery is seeking an investment of approximately $8,000,000 in equity. Having
9 the Commission declare that no return on equity will be available to these investors is a
10 strong disincentive to invest in the enterprise. This is a real world example why using a
11 hypothetical 50 percent equity/debt capital structure for rate cases has strong appeal in
12 balancing investor and customer interests.
13
14 I believe the DPU implicitly recognizes this public policy balance when it says
15 Carbon/Emery should acquire equity the "old fashioned way." (Compton at 8) There is
16 no ability to acquire equity the so called "old fashioned way" if there is not a recognized
17 return component to attract the equity. I strongly recommend the Commission reject the
18 DPU's selective capital structure approach and use Carbon/Emery's approach of a
19 hypothetical capital structure: 50 percent equity, 50 percent debt.
20

1 The FCC has expressed this balance between investors and consumers in *Western Union*
2 Telegraph, Co. where it states:

3 "We do not propose to require RCAC or any other carrier to incur any particular
4 percentage of debt in meeting its capital requirements. However, it appears to us
5 that in fixing a rate of return we must keep in mind the capital structure which a
6 regulated carrier chooses to maintain in order to balance properly the requirements
7 of safety of investment, stability of dividends, and availability of capital, and an
8 obligation to maintain that rate structure which will, consistent with the foregoing,
9 result in minimum requirements from the rate-paying public. (Re Western Union
10 Telegraph Co., 25 F.C.C. 535, 600-01, 25 PUR3d 385, 464-65 (1958))

11

12 I believe the Commission should evaluate the capital structure selected by Carbon/Emery
13 and – given its market risks, its need to attract capital, and the consumers' reasonable
14 interest – determine a fair rate of return on that capital structure. This balance is
15 necessary to achieve an overall public policy outcome.

16

17 While it is not controlling to this case, the Supreme Court of Idaho has ruled on the Idaho
18 Commission's use of a hypothetical capital structure. In CITIZENS UTILITIES
19 COMPANY, Appellant, v. IDAHO PUBLIC UTILITIES COMMISSION, the Court
20 affirmed the use of a hypothetical capital structure.

21 "adopting a hypothetical capital structure is either the need to impute a parent's
22 capital structure onto a subsidiary as in General Telephone or an attempt by the
23 Commission to counter the effect of an equity-thick utility as in Citizens, 99 Idaho
24 at 173-74, 579 P.2d at 119-20. Both of these rationales have as the Commission's
25 purpose the **achievement of a proper balance between the interests of the**

1 **utility investor and the utility ratepayer**." 112 Idaho 1061 (1987) (Emphasis
2 supplied)

3

4 In his concurring opinion, Justice Bakes stated the need to uniformly apply a hypothetical
5 capital structure to achieve the balance of interests. He stated:

6 [w]here a utility does not have adequate equity in its debt-equity ratio, as was the
7 case in *Intermountain Gas Co. v. Idaho Public Utilities Comm'n*, 97 Idaho 113,
8 540 P.2d 775 (1975), the commission should logically adopt a similar 50-50
9 hypothetical capital structure for such a utility, increasing the equity and
10 proportionately reducing the debt, which would, in most cases, not only increase
11 the utility's rates in order to provide a return on the increased hypothetical equity,
12 but also increase the utility's rates in order to reflect the higher federal income tax
13 expense which would have resulted from the lower interest expense deduction for
14 federal income tax attributable to the reduced hypothetical debt structure. If the
15 commission's practice of adopting a hypothetical capital structure is going to be
16 applied evenhandedly, it should be applied to the benefit of those utilities which
17 have an undercapitalized equity structure, as well as to the detriment of those
18 which have an overcapitalized equity structure, as in the present case. If the
19 commission applies today's rule to the benefit of under-capitalized utilities as well
20 as to the detriment of over-capitalized utilities, then the Court's decision in this
21 case is arguably reasonable and fair. However, if the commission only applies
22 this hypothetical capital structuring rule to the detriment of those utilities which
23 have an excess equity capital structure, but not to the benefit of those utilities
24 which have an inadequate equity capital structure, then they have merely created
25 another "one-way street," *Washington Water Power Co. v. Idaho Public Utilities*
26 *Comm'n,* 105 Idaho 276, 668 P.2d 1007 (1983) (Bakes, J., concurring in the
27 judgment, at page 284, 668 P.2d 1007), and I would then concur with the
28 conclusion of Chief Justice Shepard in his dissent that such an action is arbitrary,
29 capricious, and an abuse of discretion on the part of the commission which would
30 amount to a taking of the utility's property without payment of just compensation.
31 (112 Idaho 1061 (1987) Concurring Opinion Justice Bakes) (Emphasis Supplied)

32

1

2 Balancing ratepayer and utility interests in establishing a hypothetical capital structure
3 when a utilities' capital structure is completely financed was the subject of a series of
4 decisions by the Arizona Corporation Commission (ACC) regarding Tucson Electric
5 Power Company (TEP). In January 1994, in Decision No. 58491, the ACC utilized a
6 hypothetical capital structure comprised of 44 percent equity for rate making purposes at
7 a time that TEP was 100 percent debt which was expressly intended to "provide an
8 opportunity for TEP to further improve its financial condition." In TEP's subsequent rate
9 case, its financial condition had improved sufficiently to allow the Commission to utilize
10 a hypothetical capital structure for rate making purposes that consisted of 37.5 percent
11 equity. (*See* Decision No. 59594 (March 26, 1996)) The ACC subsequently noted that
12 TEP's rates had been based on a hypothetical capital structure consisting of more equity
13 than the company actually had since the early 1990s. It determined that the hypothetical
14 capital structure allowed TEP to collect sufficient revenues from ratepayers to recover
15 from the brink of bankruptcy. (*See* Decision No. 67454 (January 4, 2005))

16

17 I urge this Commission to adopt a hypothetical capital structure for Carbon/Emery using
18 the industry norm and your prior hypothetical capital structure of 50 percent equity and 50
19 percent debt.

20

1 **Q: HAS THE UTAH COMMISSION USED A HYPOTHETICAL 50 PERCENT**
2 **EQUITY 50 PERCENT DEBT CAPITAL STRUCTURE BEFORE?**
3 A: Yes. The DPU cites instances where the Commission has adopted this capital structure.
4 However, the DPU fails to explain that the Commission has used an evenhanded
5 approach for all types of actual capital structure. (See Manti 1999 Rate Case) In 2002
6 the DPU used a hypothetical 50:50 capital structure for Emery Telcom when Emery
7 Telcom's equity was substantially greater than its debt. This approach reduced the
8 amount of state universal service support Emery Telcom received.
9
10 I strongly recommend the Commission continue to use an evenhanded approach to capital
11 structure and apply the hypothetical 50:50 debt/equity capital structure to Carbon/Emery.
12 In this case, the DPU seeks to depart from prior Commission precedent accepting
13 hypothetical capital structure for debt heavy companies. The DPU's effort appears to be
14 arbitrary.
15
16 **Q: IS THE DEBT STRUCTURE FOR CARBON/EMERY AND EMERY TELCOM**
17 **CONSOLIDATED FOR PURPOSES OF LOAN COVENANTS?**
18 A: Yes. I have examined the capital structure of these companies on a consolidated basis
19 and the consolidated enterprise has approximately 42 percent equity. If Emery Telcom is
20 required to use a 50:50 capital structure, then Carbon/Emery should use the same

1 approach even though these two companies are on opposite sides of this hypothetical
2 balance in terms of equity. Any other outcome would be – in the words of Justice Bakes
3 "arbitrary, capricious, and an abuse of discretion on the part of the Commission."
4
5 **Q: DOES THE DPU'S EXPRESSION ABOUT LOAN COVENANTS ADD**
6 **ANYTHING TO THE PUBLIC POLICY OF ATTRACTING EQUITY?**
7 A: No. Carbon/Emery has the debt rate it has because from a lending perspective, *i.e.*, from
8 CoBank's perspective, its loans are consolidated with Emery Telcom loans. If
9 Carbon/Emery were to seek loans independent of this CoBank approach, the rate it would
10 receive would be far in excess of its current note rates – assuming it could receive
11 financing in its current state.
12
13 **Q: DO YOU AGREE WITH THE LOAN COVENANT ANALYSIS PERFORMED BY**
14 **THE DPU?**
15 A: No. Loan covenant analysis is performed by lenders to assess the health of the borrower.
16 There are major problems with the DPU analysis in this respect. The analysis in DPU
17 Exhibit 2.1 ignores the total amount debt held by Carbon-Emery and how this debt is
18 financed. Instead, the DPU assumes that Carbon/Emery lenders are only concerned with
19 $6,297,394 of debt. This amount is the DPU's reported rate base calculation. However,
20 Carbon/Emery has over $20,000,000 in notes with CoBank. It is not logical to try to

1 analyze the loan covenants without putting yourself in the shoes of the lender and looking
2 at all of the debt obligations (and revenue) the company faces.
3
4 The total Carbon/Emery loan balances as of September 30, 2005 amounted to
5 $24,937,816. If a correct DOCFR analysis were performed on all of the debt, the current
6 DOCFR would be in excess of 26. The reason why CoBank doesn't have ulcers with this
7 DOCFR is because on a consolidated basis, viewed from CoBank's perspective, the
8 DOCFR is 4.59.
9
10 If the DOCFR analysis were to be performed on Carbon/Emery alone, Carbon/Emery
11 would need over $4 million in additional operating cash flow in order to meet its loan
12 covenant. This analysis shows why the DPU's discussion on loan covenants does not
13 reflect the reality of the loan covenants and should not be used in this proceeding.
14
15 The DPU appears to want to change how lenders examine loan covenants. It attempts to
16 justify avoiding an examination of total debt in relation to lenders' debt covenants by
17 stating "utilities are expected to get by on the basis of cost allowances and revenue
18 considerations that are deemed just and reasonable." (Compton at 8) I encourage the
19 Commission to reject the DPU's incomplete view of loan covenants. Utilities need to
20 face lenders' loan covenants with the total amount of debt they hold and cash flow they

1 receive. There are admitted difficulties in undertaking this examination. This is why
2 using a loan covenant analysis in lieu of an appropriate capital structure that balances the
3 interests of owners and customers makes no sense. Moreover, the incomplete loan
4 covenant analysis proposed by the DPU is of little or no assistance to this Commission
5 while facing the task of establishing an appropriate capital structure for Carbon/Emery. I
6 recommend the Commission adopt the generally accepted capital structure of 50 percent
7 equity and 50 debt for Carbon/Emery. This capital structure is designed to balance
8 competing interests while allowing the enterprise the opportunity to earn a reasonable rate
9 of return on investments. It will allow Carbon/Emery to attract the capital necessary for
10 investments in order to continue to provide telecommunications services to its customers.
11
12 **Q: WHAT IS YOUR UNDERSTANDING OF THE DPU'S PROPOSED COST OF**
13 **DEBT RATE?**
14 A: I understand that the DPU wishes to reduce the composite cost of debt on the debt
15 instruments with the patronage credit assigned to Carbon/Emery by its parent. The
16 composite cost of debt is 6.03 percent. This is the amount Carbon/Emery is obligated to
17 pay. Because of the consolidated nature of the CoBank notes, the consolidated entity
18 receives a patronage credit. Carbon/Emery is then assigned a patronage credit by its
19

1 parent. The DPU wants to treat this patronage credit as a reduction in Carbon/Emery's
2 interest rate, making the effective cost of debt 5.13 percent.
3
4 **Q: DO YOU AGREE WITH THE PROPOSED TREATMENT OF THE**
5 **PATRONAGE CREDIT?**
6 A: No. As I have expressed before in prior testimony, Carbon/Emery recommends using the
7 7.06 percent rate discussed with the DPU in 2003. Carbon/Emery used the rate structure
8 and rates discussed and nearly stipulated to by the DPU in 2003. I remind the
9 Commission that the only reason Carbon/Emery receives the 6.03 percent interest rate is
10 because of the strength and stability of its parent Emery Telcom. The rate received by
11 Carbon/Emery as a stand-alone entity would be higher – this is why the 7.06 percent rate
12 is reasonable. (Assuming that Carbon/Emery could be financed on a stand-alone basis)
13 Furthermore, the assignment of patronage credits to Carbon/Emery should not be viewed
14 as a reduction in Carbon/Emery's interest rate. Without the full backing of its parent,
15 Carbon/Emery would not have a loan from CoBank. So it is somewhat disingenuous to
16 claim Carbon/Emery should reflect a patronage credit without also recognizing that the
17 reason for this credit is the status of its owner – and apply the credit where credit is due.
18
19 I recommend the Commission determine that Carbon/Emery's proposed 7.06 percent rate
20 for its debt is just and reasonable. This rate reflects the financial conditions in today's

1 marketplace and recognizes the benefit Carbon/Emery receives because of its owner's
2 financial status. Moreover, I recommend the Commission treat the patronage credit as an
3 equity investment by Carbon/Emery's owner since it is the financial strength of its owner
4 that allows Carbon/Emery to receive its loans from this lender.
5
6 **Q: HAS THE DPU EXPRESSED ANY TESTIMONY ABOUT CARBON/EMERY'S**
7 **COST OF EQUITY CALCULATION OR YOUR RISK PREMIUM ANALYSIS?**
8 A: No. The DPU has not filed any testimony on cost of equity in this proceeding. It
9 recommends not using a cost of equity in this proceeding. I have already mentioned the
10 reasons why I recommend the Commission reject the DPU's position and adopt a more
11 balanced approach in regulating Carbon/Emery.
12
13 **Q: HAVE YOU REVIEWED THE CCS TESTIMONY REGARDING**
14 **CARBON/EMERY'S RATE OF RETURN?**
15 A: Yes.
16
17 **Q: WHAT IS YOUR RESPONSE TO CCS'S POSITION REGARDING THE COST**
18 **OF DEBT?**
19 A: CSS recommends adjusting the cost of debt by the patronage credit. It recommends the
20 Commission use 4.94 percent cost of debt. CCS reduces the weighted debt rate by the

1 amount of patronage credit booked to Carbon/Emery in 2004. I have already expressed
2 my objections regarding the treatment of consolidated patronage booked to
3 Carbon/Emery. I will not repeat these anew only to state again the 7.06 percent weighted
4 debt rate is a just and reasonable rate. I recommend the Commission recognize this
5 important aspect of Carbon/Emery's cost of debt and adopt my prior recommendations.
6
7 **Q: WHAT IS CCS'S POSITION REGARDING THE COST OF EQUITY?**
8 A: The CCS does not believe in the use of a hypothetical capital structure. (*See* Regan at 6)
9 Notwithstanding, CCS also suggests that Carbon/Emery's proposed 12.5 percent cost of
10 equity is unreasonably high.
11
12 **Q: WHAT IS YOUR RESPONSE TO CCS'S ANALYSIS LEADING TO ITS**
13 **UNREASONABLE CLAIM?**
14 A: CCS has engaged in a series of analyses apparently designed to attack the proposed 12.5
15 percent cost of equity. However, when it all boils down to a number, CCS calculates an
16 8.60 risk premium over the risk free rate. (Exhibit TMR-8) CCS recommends using a
17 three-month T-bill as the risk-free rate. My recommendation is to use the long-standing
18 10 year note yield. Mr. Regan gives no compelling reason to adopt the three-month T-bill
19 as opposed to the 10 year note yield. The three-month T-bill rate reported in the
20 November 30, 2005 Wall Street Journal is 3.97 percent. CCS proposes to use a three

1 month trailing average for the risk free rate. However, such averaging isn't necessary
2 especially in light of an ongoing flattening of the Treasury Yield Curve. I don't
3 recommend the Commission adopt a trailing average for the risk free rate. The current
4 risk-free yield provides all the information about the market necessary to evaluate the cost
5 of equity.
6
7 The Commission needs to decide whether the 4.03 percent risk-free rate I propose is
8 reasonable. CCS argues that the three-month T-bill rate is appropriate. (Exhibit TMR-9)
9 Its current yield is 3.97 percent, a difference of 6 basis points. The 10 year note yield is
10 currently 4.48 percent. I don't believe there should be controversy over my risk-free
11 proposal. Economic conditions in the nation are revealed in the flattening of the Treasury
12 Yield Curve – this suggests the short-term yields are increasing at a faster pace than the
13 loner-term treasury yields and are likely to continue in the near future. The 4.03 percent
14 risk-free rate appears reasonable. I recommend the Commission adopt 4.03 percent as the
15 risk-free rate to be used in a risk premium analysis.
16
17 **Q: HOW DOES THE CCS GENERATE AN 8.60 RISK PREMIUM RATE?**
18 A: The CCS attempts to use two methods to compute its risk premium. First, it uses a long
19 period of time in its estimate and second it relies on overall market risk premiums.
20 (Exhibit TMR-8) Both methods, in my estimation are faulty. First, the use of long

1 historic time series, in one instance nearing 200 years, does not in my opinion provide any
2 light to the question of what will be happening in the near future. In this proceeding, the
3 near future is 2006. The CCS does not provide any analysis regarding whether we are in
4 a period of high returns and how that affects the return to equity for Carbon/Emery in
5 2006. I have proposed a trailing twelve month average to capture the more near-term
6 activity realized in the market.
7
8 Second, the CSS does not acknowledge that small capitalization issues tend to be more
9 risky than large capitalization issues. CCS supports its 8.60 risk premium calculation
10 using exclusively an analysis of the overall market – as such I believe the CCS analysis is
11 biased downward.
12
13 **Q: HOW DOES THE CARBON/EMERY PROPOSAL COMPARE WITH YOUR**
14 **ANALYSIS AND WITH THE CCS ANALYSIS?**
15 A: Carbon/Emery's proposal is to use 12.50 percent as its cost of equity. As the
16 Commission is aware, cost of equity decisions require a certain amount of judgment
17 inasmuch as there is not one standard for measuring the cost of equity. The CCS cost of
18 equity value is 9.78 percent. Based on my Direct Testimony, my cost of equity estimate
19 is 15.67 percent. Carbon/Emery proposed 12.50 percent cost of equity to be used by this
20 Commission. Given these estimates, I believe the Carbon/Emery proposal is reasonable

1 and should be used as proposed particularly given the current capital structure which
2 signals higher risk for the investor.
3
4 **Q: DOES THE CCS ALSO SUGGEST ANOTHER METHOD OF CALCULATING**
5 **COST OF EQUITY?**
6 A: Yes. Mr. Regan suggests that using his historic valuation methods is problematic and
7 suggests using the actual market price and earnings (AMPE) method. Mr. Regan
8 suggests that this method "goes directly to the actual current market to get the actual
9 answer to the question, not just an estimate." (Regan at 20).
10
11 I respectfully disagree with Mr. Regan on this matter. The measure of using this method
12 can only be obtained for a company who has an actual price for an actual issue. Hence, if
13 Carbon/Emery were to have a stock market price then this new proposal by Mr. Regan
14 may have merit. However, Carbon/Emery does not have a market issue and therefore any
15 attempt to derive an "actual" value instead of an estimate is futile.
16
17 There are several technical items I do not accept regarding the AMPE method. The
18 largest assumption made by the AMPE is that all investors have full information on the
19 specific issue on which they are bidding. This so-called full information assumption has
20 been used in the past, particularly in the branch of economics sometimes called "rational

1 expectations" and is the root of the "efficient market hypothesis." This assumption has
2 been subject to increasingly severe criticism, particularly when dealing with an individual
3 issue, and in some instances has been outright rejected. Thus, reliance on investors
4 bidding on a stock price based on "all known information about a company" does not
5 reflect, in my judgment the cost of equity for Carbon/Emery to attract capital.
6
7 **Q: WHAT IS CARBON/EMERY'S REASONABLE RATE OF RETURN USED BY**
8 **THE FEDERAL COMMUNICATIONS COMMISSION?**
9 A: The overall interstate rate of return for Carbon/Emery is 11.25 percent. This rate was
10 reaffirmed by the Federal Communications Commission in 2002 as reasonable. (*See*
11 *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price*
12 *Cap Incumbent Local Exchange Carriers and Interexchange Carriers Federal-State Joint*
13 *Board on Universal Service Access Charge Reform for Incumbent Local Exchange*
14 *Carriers Subject to Rate-of-Return Regulation Prescribing the Authorized Rate of Return*
15 *for Interstate Services of Local Exchange Carriers*, 16 FCC Rcd 19613, FCC 01-304,
16 Corrected Release January 25, 2002). The rate proposed by Carbon/Emery in this case is
17 10.05 percent, or 120 basis points below the FCC's authorized overall rate of return. This
18 is additional evidence showing that Carbon/Emery's proposal is reasonable.
19
20

1 **Q: DOES THE FCC USE AN 11.25 PERCENT OVERALL RATE OF RETURN FOR**
2 **OTHER EVALUATIONS?**
3 A: Yes. Take for instance the LNP surcharge calculation. The FCC requires Carbon/Emery
4 to use the 11.25 percent overall rate of return. I have used this overall rate of return for
5 purposes of calculating my adjustment to the DPU's imputed LNP revenue in this case.
6
7 **Q: WHAT IS YOUR RECOMMENDATION REGARDING THE COST OF**
8 **EQUITY?**
9 A: I believe the Carbon/Emery cost of equity rate of 12.50 percent is reasonable and
10 recommend the Commission use the same to determine the overall rate of return. Using
11 the 7.04 percent cost of debt discussed above and the 12.50 percent cost of equity
12 adjusted for taxes in the proposed 50 percent debt/equity capital structure I calculate an
13 overall rate of return on 10.05 percent. This rate of return is reasonable and balanced. It
14 is lower than the current 11.25 percent rate used by the FCC for Carbon/Emery. I
15 recommend the Commission use this rate for purposes of this proceeding.
16
17 The Supreme Court of Utah has expressed its understanding of achieving balance in
18 capital structure: "[w]e call attention to *United Gas Pipe Line Company v. Louisiana*
19 *Public Service Commission*. There it was observed the fixing of rates involves a delicate
20 balancing of consumer and investor interests. The problem of a fair return is one of

1 economics and involves the application of a fair rate of return to a fairly constructed rate
2 base. Terra Utilities, Inc. v Public Service Commission of Utah, 575 P.2d 1029 (1978).
3
4 This Commission expressed the following in 1999 which I believe is consistent with my
5 recommendation:

6 The authorized rate of return on common equity, the Company's profit rate, is
7 determined by the return necessary to attract investment in the Company's
8 common stock. This determination is as much an art as it is a science. The
9 authorized rate of return set in this case will help determine the level of just and
10 reasonable prices charged … and will provide the Company with the opportunity
11 to earn a fair and reasonable return on its investment. There is no guarantee that
12 the Company will earn that return. Rather the intent is to give the Company a
13 legitimate opportunity to earn this return, assuming competent management and
14 normal market conditions. The authorized rate of return is not designed to insulate
15 the Company from business and financial risks, but is set in recognition of the
16 financial and business risks it faces. *PacifiCorp 1999 General Rate Case*, Docket
17 No. 99-035-1-0 (Emphasis Supplied)
18
19 **Q: HOW DOES YOUR RECOMMENDATION CHANGE THE DPU'S PROPOSED**
20 **REVENUE REQUIRMENT FOR CARBON/EMERY?**
21 A: The DPU does not recognize any rate of return on equity in its revenue requirement
22 proposal. The application of 10.05 overall rate of return to a 50:50 hypothetical capital
23 structure increases Carbon/Emery's revenue requirement by $462,787 over the DPU
24 proposed changes. I have prepared Reply Exhibit DDM 06 which supports this
25 calculation.
26

1 **13. INCOME TAXES**

2

3 **Q: HAVE YOU CALCULATED THE INCOME TAX EFFECT FOR THE EQUITY**
4 **RETURN USING THE 50 PERCENT EQUITY CAPTIAL STRUCTURE?**

5 A: Yes. Income taxes are estimated to be $290,731. This amount is also an increase over
6 the DPU's proposed revenue requirement for Carbon/Emery. Reply Exhibit DDM 06
7 supports this calculation.

8

9 **VII. SUMMARY**

10

11 **Q: PLEASE SUMMARIZE YOUR RECOMMENDATIONS REGARDING THE**
12 **PROPOSED DPU CHANGES TO CARBON/EMERY'S REVENUE**
13 **REQUIREMENT.**

14 A: The DPU proposes an increase of $682,618 in revenue requirement. I have presented
15 adjustments to the expense, revenue, return and tax components for Carbon/Emery. I
16 have prepared Table 7 to show the increases over the DPU values. The net increase
17 above the DPU value is $1,261,052. Combined the overall increase in the revenue
18 requirement for Carbon/Emery is $1,943,670.

19

1 Table 7
2 Summary of Carbon/Emery
3 Modifications to DPU Changes

Item	*Amount*
DPU Propsed Rev. Req. Increase	$ 682,618
Carbon/Emery Increases over DPU	
Expenses	$ 507,534
Return	$ 462,787
Income Taxes	$ 290,731
Total Increases	$ 1,261,052
DPU Propsed Rev. Req. Increase	$ 682,618
Carbon/Emery Rev. Req. Increase	$ 1,943,670

4

5 Carbon/Emery's proposed rate increases yield a total of $889,378 in local and intrastate
6 access revenue. Carbon/Emery's proposed Utah Universal Service Fund request amounts
7 to $1,055,293. This represents a decrease of $714,919 from its Supplemental Filing after
8 adjusting for DPU and CCS proposed changes.

9

10 **Q: DOES THIS CONCLUDE YOUR SUR REBUTTAL TESTIMONY?**

11 A: Yes.

VIII. EXHIBITS