Witness OCS – 3D Brevitz

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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In the Matter of Manti Telephone Company's Second Amended Application for USF Eligibility	)	**Docket No. 08-046-01**
	)	
	)	**Direct Testimony of David Brevitz For the Office of Consumer Services**
	)	

REDACTED

October 18, 2012

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REDACTED

INTRODUCTION

Q. PLEASE STATE YOUR NAME, OCCUPATION AND BUSINESS ADDRESS.

A. My name is David Brevitz. My business address is Brevitz Consulting Services, 3623 SW Woodvalley Terrace, Topeka, KS, 66614.

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

A. I am an independent regulatory consultant serving state regulatory commissions, Attorney's General offices, and consumer organizations. In this proceeding, I am testifying on behalf of the Utah Office of Consumer Services (OCS).

Q. PLEASE STATE YOUR EXPERIENCE AND PROFESSIONAL QUALIFICATIONS.

A. Over my thirty-one year career I have worked on numerous telecommunications dockets and cases, as the marketplace and regulatory environment has continued to change. In that time span there have been numerous milestone events, and many subsequent to the Federal Telecommunications Act of 1996, including the rise and fall of CLEC competition for residential consumers, development of "one stop shop" service bundles for consumers, deregulation, and continued partnerships, consolidations and acquisitions in the telecommunications industry leading to greater market concentration.

My interest in telecommunications began while studying at the Institute of Public Utilities in the Economics Department at Michigan State University. While at Michigan State, I earned an undergraduate degree in Justice, Morality and

Constitutional Democracy from James Madison College (a residential college at MSU) and an MBA in Finance (1980). Since that time, I have worked on a variety of issues beginning with the detariffing of inside wiring and CPE (customer premise equipment) and changes to jurisdictional separations to the more current issues of competition and deregulation, substitute services and intermodal competition, alternative regulation plans/price caps/quality of service, bundled services, access charges, price floors and imputation, jurisdictional cost allocations including direct assignments, and requirements of the Telecommunications Act of 1996 including competition, interconnection requirements, resale, unbundled elements, TELRIC/cost studies, wholesale quality of service standards, and Section 271 applications. Prior to entering the consulting field, I served as Chief Telecommunications Analyst for the Kansas Corporation Commission from late 1984 to early 1987, where I was responsible for regulation and policy recommendations regarding the larger telephone companies in the state (Southwestern Bell, United Telephone and Continental Telephone) as well as approximately 45 independent telephone companies in Kansas. Then I served as Director-Regulatory Affairs of Kansas Consolidated Professional Resources (KCPR) – an organization serving Kansas independent telephone companies. In February 1994 I began work as an independent consultant in telecommunications, serving state utility commissions and consumer counsels, including serving the Kansas Corporation Commission on telecommunications matters. As a result of these assignments, I have current expertise regarding competitive markets and regulatory issues in telecommunications. A description of my background and experience in telecommunications is provided on Appendix 1.

Q. DO YOU HAVE OTHER RELEVANT QUALIFICATIONS?

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

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to convey the results of my review and analysis of Manti Telephone Company’s (MTC) Application for additional funding from the Utah Universal Service Fund (UUSF). In particular I focused on the areas of MTC’s financial records (i.e., General Ledger and Continuing Property Records), MTC’s Fiber to the Home project, MTC’s Cost Allocation Manual and transactions between affiliates, division of revenues, expenses and investment between MTC and its nonregulated affiliates, items MTC proposes to include in rate base via Construction Work in Progress (CWIP), and MTC’s proposed revenue adjustments.

Q. WHAT INFORMATION DID YOU REVIEW AND CONSIDER FOR THIS TESTIMONY?

A. My review was focused on MTC's Application for Additional UUSF, as filed April 24, 2012, as well as MTC's testimony and revised Application filed September 21, 2012. MTC's Cost Allocation Manual was one document included with its Application. In addition I reviewed MTC's responses to OCS and Division of Public Utilities (DPU) data requests. Finally, I reviewed and considered information gained from discussion with MTC management and its consultant during the July 23-27 Site Visit to MTC offices.

CONFIDENTIAL INFORMATION

Q. PLEASE DESCRIBE MTC'S CONFIDENTIALITY CLAIMS REGARDING THE INFORMATION YOU REVIEWED IN THIS MATTER.

A. Essentially all documents provided by MTC were claimed confidential in their entirety. MTC's standard "boilerplate" to its responses to data requests states "All Attachments to this response are confidential subject to Commission Rule R746-100-16", and "The following are Manti Telephone Company's Confidential Responses to the Office of Consumer Services Data Requests". Thus, all attachments and responses are claimed confidential by MTC, without any attempt to narrow or distinguish what is truly confidential information from what is not confidential. This essentially unlimited confidentiality claim is overbroad and excessive. It leads to absurd results like a claim of purported confidentiality of company tariffs which by their nature are fully public. It is obvious to me that the confidentiality claims could be much narrower but instead MTC has chosen a blanket claim of confidentiality for essentially all documents provided in this case.

Q. WHAT DIFFICULTIES DOES MTC'S OVERBROAD CONFIDENTIALITY CLAIMS CREATE FOR YOUR TESTIMONY AND FOR THE COMMISSION'S TRANSPARENT CONDUCT OF THIS CASE?

A. MTC's overbroad confidentiality claims make it very difficult to produce properly redacted public testimony that permits the Commission to address this case affecting the UUSF and the surcharge charged to Utah consumers generally in transparent fashion. My standard and longstanding practice is to adhere to confidentiality agreements and accord any claimed confidential information confidential treatment in testimony. But taking that practice to the letter of MTC's confidentiality claims would have resulted in my testimony looking like "swiss cheese", and rendered the public redacted version worthless—beyond considering the burden of creating such redacted "swiss cheese" testimony in the first place. Nonetheless I have designated confidential information in this testimony as best as possible given MTC's overbroad designation of confidential information. To aid the conduct of the hearing and this proceeding, the Commission may wish to require MTC to produce documents (data requests, attachments, etc.) with confidential information properly designated, along with accompanying redacted versions of those documents.

Q. BEFORE ADDRESSING INDIVIDUAL ADJUSTMENTS THAT YOU PROPOSE BE ADOPTED BY THE COMMISSION, DO YOU HAVE ANY OVERALL OBSERVATIONS REGARDING MTC'S ACCOUNTING AND COMPLIANCE WITH REQUIREMENTS ASSOCIATED WITH BEING A TELEPHONE PUBLIC UTILITY?

A. Yes. As the Commission is aware, this case has been pending for four years. This extended pendency of the case is due in substantial part to MTC's overall lack of proper accounting and failure to adhere to established regulatory requirements. Many of these accounting and regulatory issues have been documented in correspondence between the Department of Public Utilities and MTC and other documents in this matter.[1] These accounting and regulatory issues are also described and discussed in Mr. Ostrander's testimony. I commend DPU staff for its efforts over the past four years to bring MTC's accounting and regulatory compliance to acceptable levels. DPU even went so far as to include additional UUSF funding for MTC to hire an accounting manager to work on correcting the various accounting problems. Despite DPU's support and assistance, MTC's accounting is still problematic. In particular, MTC failed to use the UUSF funding earmarked for hiring an accountant. Also, MTC has a Cost Allocation Manual (CAM) which it professes to adhere to (and was filed as confidential in its entirety), but can provide no workpapers or substantiation that it in fact has implemented and adhered to the CAM for cost apportionment and

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[1] See for example the 2011 Stipulation in this matter which documents some accounting concerns and deficiencies.

transactions between affiliates.[2] At least for this case, the CAM is merely window-dressing. Due to continuing inadequate accounting and lack of adherence to regulatory requirements by MTC, it is necessary to utilize 2011 financial results for the test period rather than MTC's proposed projected test period for reasons described in Mr. Ostrander's testimony, and to make numerous adjustments to eliminate items which should not be presented as part of a regulated revenue requirement, or to accomplish necessary and appropriate allocations between MTC and its affiliates which MTC has failed to recognize or implement. This should not have been necessary after four years of work on MTC's accounting and regulatory compliance.

<u>PROPOSED ADJUSTMENTS</u>

Q. PLEASE OUTLINE THE ADJUSTMENTS PROPOSED IN YOUR TESTIMONY, AND THE TEST PERIOD TO WHICH THESE ADJUSTMENTS PERTAIN.

A. The adjustments proposed in my testimony are to Manti Telephone Company's 2011 financial results, for reasons stated in Mr. Ostrander's testimony. The adjustments I propose in this testimony are numbered in sequence and consist of:

1. OCS Adjustment 3.1: Imputed revenue to MTC for use of its FTTH network by nonregulated services.

[2] See for example MTC's response to OCS 10-12, where MTC was asked to "provide specific studies and supporting documentation to show how [the CAM] has been used to assign, allocate, and separate specific expenses and costs between MTC and MTCC". MTC's response is five words **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**, and MTC provided none of the requested documentation to show how it has been used in the development of the proposed revenue requirement in this case.

2. OCS Adjustment 3.2: Removal of depreciation expense and investment for obsolete and fully depreciated copper and Quest plant.
3. OCS Adjustment 3.3: Removal of depreciation expense and investment associated with various assets providing nonregulated services.
4. OCS Adjustment 3.4: Removal of expenses for payments to affiliates for various internet services.
5. OCS Adjustment 3.5: Removal of rental payments to an affiliate.
6. OCS Adjustment 3.6: Removal of motor vehicle expenses paid to an affiliate.
7. OCS Adjustment 3.7: Reduce Local Revenues to recognize rate changes.
8. OCS Adjustment 3.8: Reduce Lifeline/Link-up revenues to recognize FCC Order.
9. OCS Adjustment 3.9: Reduce Special Access Revenues to recognize volume reductions.
10. OCS Adjustment 3.10: Reduce Access Revenues to recognize impact of FCC Access Charge/USF Order.
11. OCS Adjustment 3.11: Reduce Access Revenues to recognize impact of reduced NECA settlements per FCC Access Charge/USF Order.
12. OCS Adjustment 3.12: Increase Access Revenues to recognize imposition of the Access Recovery Charge per FCC Access Charge/USF Order.
13. OCS Adjustment 3.13: Reduce revenues and rate base to reflect removal of Voice Mail service which is nonregulated.
14. OCS Adjustment 3.14: inclusion of proposed Construction Work in Progress in rate base.

OCS ADJUSTMENT 3.1

IMPUTE FTTH REVENUE TO MTC

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT 3.1?

A. Adjustment 3.1 imputes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in revenues from affiliates of MTC for their use of the vast broadband capacity provided by MTC's program to deploy Fiber to the Home (FTTH). In 2008, MTC began a program to replace essentially all of its copper local distribution facilities with FTTH. In contrast to copper plant, Fiber to the Home local distribution facilities supports multiple services, at least two of which are nonregulated services.[3] FTTH is designed to support Internet Protocol (IP) networking and service applications including basic voice, IPTV, and broadband internet access. FTTH by its nature enables major new service applications beyond voice services to ride the network, as compared to previous copper based, circuit switched telephone networks. Under MTC's current organization, MTC provides basic voice services, and MTCC provides IPTV and broadband internet access on a nonregulated basis using MTC's FTTH network. Thus the FTTH network is jointly used by regulated and nonregulated services. Utah statutes and PSC rules limit the use of UUSF funds to the support of basic voice service. Therefore, only the basic voice portion of the FTTH may be supported by MTC's regulated rates and its draw from the Utah Universal Service Fund.

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[3] Copper local distribution plant was generally designed and placed to support provision of voice services, and also could support dial up internet access via modem. Investment was later added to the copper plant (splitters and DSLAMs) to permit the provision of DSL over copper facilities, within certain distance limitations.

Thus some allocation of FTTH facilities between regulated and nonregulated services is required. Imputation of revenues from the nonregulated affiliates which depend on these facilities to provide services achieves this division.

Q. HOW DOES IMPUTATION OF REVENUES ACHIEVE A DIVISION OF FTTH FACILITIES BETWEEN REGULATED AND NONREGULATED SERVICES?

A. While the full capital, operating and overhead costs of the FTTH assets remain on MTC's books, imputation of revenues from MTCC assigns revenue responsibility for a portion of those assets to MTCC, given the substantial use of, and dependence on those FTTH assets by MTCC. Consistent with the FCC's Affiliate Transaction Rules and CAM requirements as explained by Mr. Ostrander, revenue responsibility for the FTTH assets is therefore divided among the entities which use and benefit from placement of the FTTH assets, and no more than a reasonable share of the facilities costs is recovered from the UUSF for basic voice service.

Q. DOESN'T LEAVING THE FULL CAPITAL, OPERATING AND OVERHEAD COSTS OF THE FTTH ASSETS ON MTC'S BOOKS INFLATE MTC'S ASSETS?

A. No. As long as these jointly used FTTH assets are properly apportioned by some mechanism MTC's asset base is not inflated. Assuming the methodologies are correctly and consistently applied it is a matter of indifference whether the assets are on MTCC's books and it charges MTC for use of the assets to provide voice services, or vice versa where MTCC is charged by MTC for use of the facilities to provide internet access and IPTV. In either case, whichever entity has the assets on its books has a portion of those joint costs covered by revenues from the other entity which uses and benefits from the assets deployed for joint use.

Q. WHAT IS YOUR UNDERSTANDING OF THE DEFINITION AND IMPORTANCE OF THE TERM "BASIC SERVICE" IN UTAH?

A. Similar if not identical to other states, in Utah "Basic Telephone Service" is equivalent to local exchange service which "means the provision of telephone lines to customers with the associated transmission of two-way interactive, switched voice communication" as defined in 54-8b-2 (10) of the Utah Statutes. Based on universal service policy considerations, basic service is supported by the Utah Universal Service Fund in order to maintain affordability of this service to "all" consumers. The UUSF is designed to "promote equitable cost recovery of basic telephone" per 54-8b-15 (6) (a) of the Utah Statutes.

Q. WHAT DO YOU MEAN BY THE USE OF THE TERM "AFFILIATE" ABOVE?

A. Throughout this testimony I use the term "affiliate" to refer to any of three entities which are in effect or actuality commonly operated by or for Manti Telephone Company, as indicated by MTC's Cost Allocation Manual and other information received during the course of this review. These three entities are Manti Tele Communications Company, P&C Rental, and Manti Long Distance. While in legal form these entities may not be affiliated, in substance the affiliates are operated jointly with Manti Telephone Company. **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** There does not appear to be any meaningful separation or independence regarding planning decisions, such as FTTH, between these affiliates. For example, MTC Board Minutes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as MTC is planning for its FTTH program.[4] There can be no doubt that the FTTH project was planned and undertaken by MTC with full knowledge of its benefit for MTCC, or perhaps even planned with MTCC as the primary intended beneficiary. Please see Mr. Ostrander's testimony for further discussion on the term "affiliate".

Q. IS MTCC PAYING FOR USE OF THE FTTH FACILITIES TODAY?

A. MTCC is paying what I characterize as a de minimis and non-cost-based amount for use of the FTTH facilities placed and owned by MTC. In 2011, MTC's books show MTCC paid **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** based on a tariffed "DSL Line Charge" of $5 per line. This de minimis payment is fully inadequate against the cost of placing and operating FTTH facilities. I have calculated this cost to be **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** on direct cost basis (investment and direct expense, but no overheads). It follows that since MTCC is not paying a reasonable share of

[4] MTC Response to OCS 8-10.

FTTH costs, MTC is seeking to recover those costs from the UUSF in this case, due to the total company revenue requirement presented by MTC.

Q. IS IT PERMISSIBLE FOR A REGULATED ENTITY TO PAY COSTS ON BEHALF OF AN NONREGULATED ENTITY?

A. No. This would be “cross-subsidization” where costs of a nonregulated line of business are improperly assigned to regulated services. For valid policy reasons, such cross subsidization is prohibited by 54-8b-6 of the Utah Statutes, “Prohibition on subsidization of telecommunications services”, which states

> A telecommunications corporation providing intrastate public telecommunications services may not subsidize its intrastate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract under authority of this chapter with proceeds from its other intrastate telecommunications services not so exempted or made subject to a price list or competitive contract.

Part 47, Section 254(k) of the US Code requires that “the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that service included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.”[5]

Q. DOES THE FACT THAT YOU PROPOSE THIS ADJUSTMENT TO THE COMMISSION MEAN YOU CHALLENGE MTC’S BUSINESS DECISION TO DEPLOY AN FTTH NETWORK?

A. Absolutely not. I do not take issue with MTC's decision to pursue FTTH deployment. However, especially because recovery of FTTH costs is a very important issue in this case it is unfortunate that any business case and projected financials that were present in MTC's Loan Application to RTFC is not available to OCS, DPU and the Commission[6] to show how MTC intended to recover the costs associated with its business decision to deploy FTTH. The adjustment proposed in this testimony is intended to address how the joint costs of the FTTH deployment should be apportioned and recovered. MTC's Application in this case assumes recovery of essentially all of the cost of the FTTH network from the UUSF and basic voice services. This is clearly an inappropriate division of costs between regulated and nonregulated services, and one which the Commission should not accept.

Q. PLEASE DESCRIBE THE CALCULATION OF THIS ADJUSTMENT.

A. The adjustment was calculated using the following steps:

1. I referred to the December 31, 2011 plant and accumulated depreciation balances contained in the Continuing Property Records provided by MTC in response to OCS 2-9.
    a. I isolated the fiber optic cable related accounts of 2421.20 (Aerial Fiber), 2423.20 (Buried Fiber), 2422.20 (Underground Fiber), circuit equipment related to fiber plant in account 2230 (Central Office Equipment – Transmission), equipment related to fiber plant in account

[6] See for example, MTC response to DPU 26-7, and OCS 2-33.

2210 (Central Office Equipment), one fiber cable related item in account 2114 (Tools and Other Work Equipment), and account 2441 (Conduit).

b. Per above, from MTC's CPRs:

  i. gross fiber optic related plant totaled **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

  ii. corresponding accumulated depreciation totaled **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

  iii. yielding a net plant balance of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** related to FTTH.

c. Investment for FTTH-related CWIP per OCS Adjustment 3.24 is an additional **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** of fiber related plant planned to be constructed, installed and placed on MTC's books, for a total of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** on a net plant basis.

d. I applied a gross of taxes rate of return of 12.80% to this balance to yield a return on net plant of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

e. To this is added annual depreciation expense using the company's rates **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** annual property taxes related to fiber optic plant **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and operating expenses associated with the fiber plant **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

f. The total of return on rate base plus expenses is **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** before taxes.

g. Taxes at 37.15% are an additional **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** for a total gross revenue imputation of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

2. This total cost of fiber optic facilities provides for three general categories of services: basic voice service, internet access (broadband) services, and cable TV services (IPTV). Only one of these services is regulated and subject to cost reimbursement from the UUSF—the basic voice service—so I applied an allocator of 2/3 (66%) to determine the portion of the FTTH revenue requirement yielding an imputed nonregulated revenue requirement of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

3. This is much greater than the amount MTC charged MTCC for access to its FTTH distribution network **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** based on a $5 per line "DSL charge"). Subtracting one from the other yields the proposed imputation adjustment of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** These calculations are shown in more detail at OCS Exhibit 3.1D Brevitz.

Q. DOES THIS ADJUSTMENT DEPEND ON THE RATE OF RETURN ESTABLISHED IN THIS CASE?

A. Yes. As noted above, I use a pre-tax rate of return of 12.80% which is based on OCS's recommended rate of return of 8.01% multiplied by a tax factor of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** If the Commission establishes a different rate of return than that recommended by OCS the adjustment will need to be recalculated, which is easily done.

Q. HOW DID YOU DETERMINE WHAT AMOUNT OF OPERATING EXPENSE IS APPLICABLE TO FTTH?

A. MTC does not maintain subaccounts to capture maintenance expenses for fiber optic versus copper cable, so it is not possible to draw maintenance expense amounts for fiber optic cable directly off the books. Therefore I applied the ratio of FTTH-related net plant to total net plant for the categories of outside plant, central office transmission, and central office switching to the respective total expense main accounts. For example, Account 6410 (Outside Plant) shows **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in total expense for 2011. Outside plant is composed of both copper and FTTH plant. Net FTTH plant as a percentage of total net outside plant is **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent. **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** times **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent equals **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and this is the amount I included to calculate annual FTTH expense for outside plant. I used the same method to calculate FTTH expense for the central office transmission and central office switching main accounts (6230 and 6210, respectively).

Q. IS MTC'S $5 PER LINE "DSL CHARGE" COST BASED OR ADEQUATE TO ACCOMPLISH AN APPROPRIATE DIVISION OF FTTH COSTS BETWEEN REGULATED AND NONREGULATED SERVICES?

A. No. OCS requested that MTC provide the cost basis for the $5 per line "DSL charge" during the July 23-27 site visit, and it was confirmed that there is no cost basis for this tariffed charge. As indicated by its name, the charge goes back 10 years or more to a time when DSL was the main technology used to provide consumer internet access via deployment of incremental equipment (splitters and DSLAMs) on the copper-based local distribution network. This "DSL charge" is now outdated and not applicable for its current use by MTC as compensation from MTCC for use of the FTTH network. The inadequacy of the "DSL charge" as compensation for MTCC use of the FTTH network is demonstrated above by the very large difference between the cost of the FTTH network, and the proceeds generated by application of the "DSL charge".

Q. DID YOU CONSIDER ANY OTHER ALLOCATION ALTERNATIVES, BEYOND THE ONE THIRD/TWO THIRDS ALLOCATION?

A. Yes. I considered an allocator based on the relative capacity use of the fiber by these three services. In theory, this would be most appropriate since the allocation of the costs should follow the capacity use of the FTTH facilities. Basic voice service uses a very minimal portion of the vast capacity of the FTTH facilities, on the order of 3-5%. So in theory, it would be appropriate to allocate 95% of the cost of the FTTH distribution network to nonregulated services, and only 5% of the costs to basic service and the UUSF. Despite the theoretical appeal of this allocation approach, I elected to use a service based allocator for my proposed adjustment since use of the theoretically appropriate allocator would have resulted in a much higher indicated MTC "surplus" in this case.

Q. DOES SECTION 254(k) OF THE FEDERAL TELECOMMUNICATIONS ACT REQUIRE AN ADJUSTMENT SUCH AS THE ONE YOU PROPOSE IN THIS CASE?

A. Yes. If such an adjustment is not made in this case, basic voice services would be required to bear "more than a reasonable share of the joint and common costs of facilities used to provide those services". This is prohibited by Section 254(k) of the Federal Telecommunications Act as contained in the U.S. Code.

Q. HOW IS MTC FUNDING THE FTTH CONSTRUCTION PROGRAM?

A. MTC sought and obtained a loan from the Rural Telephone Finance Cooperative (RTFC) in the amount of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** with the requirement that MTC purchase RTFC Subordinated Capital Certificates in the amount of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** from the loan proceeds.[7] Thus, MTC received a net amount of

[7] RTFC Loan Agreement provided in response to OCS 2-33.

[BEGIN CONFIDENTIAL] [redacted] **[END CONFIDENTIAL]** million from the RTFC for the FTTH construction program. It should be noted that cash is fungible, and MTC expended **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** million for wireless spectrum in the first quarter of 2008 as well.

Q. WERE YOU ABLE TO REVIEW MTC'S LOAN APPLICATION TO RTFC FOR THE FUNDING FOR THE FTTH NETWORK?

A. No. MTC was not able to produce a copy of its RTFC Loan Application for the FTTH program that it made in 2008. It would have been very useful to OCS and the PSC to review the loan application, as I expect it would have contained some information regarding the business case for the FTTH program, such as projected financials including what revenues were expected from what sources (e.g., MTCC, UUSF) over time to pay back the loan while paying regular interest charges to RTFC. However, MTC was not able to produce or for some reason did not retain loan application documentation pertaining to a current, very material debt obligation on its books. OCS 2-33 and DPU 26-7 requested a copy of MTC's RTFC Loan Application. MTC provided the RTFC <u>Loan Agreement</u> in response to OCS 2-33 without any explanation of why it provided this document (which OCS requested in the following data request, 2-34) or of why it did not provide the requested loan application. MTC's response to DPU 26-7 provides an **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** but makes no explanation of why MTC did not retain a copy of the Loan Application for its own records. MTC's Board of Directors Minutes from 2008 clearly show **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** To date there has been no credible explanation of why the loan application which was completed only 4 years ago cannot be produced.

<u>OCS ADJUSTMENT 3.2</u>

<u>REMOVE OBSOLETE COPPER PLANT</u>

Q. PLEASE SUMMARIZE OCS ADJUSTMENT 3.2.

A. OCS Adjustment 3.2 addresses obsolete copper plant which MTC has included in its revenue requirement proposed for this case. Given MTC's company-wide FTTH program, copper plant for customers served via FTTH should no longer be included in revenue requirement as MTC moves to serving those customers via FTTH. Approximately **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent of customer lines are provisioned via FTTH, so **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent of copper plant should be retired and removed from revenue requirements.

Q. WHAT STEPS DID YOU TAKE TO CALCULATE THIS ADJUSTMENT?

A. I identified the total copper plant balances per MTC's CPR for accounts 2421.21 (Aerial Copper), 2422.21 (Underground Copper), and 2423.21 (Buried Copper). Total Gross Plant for these three subaccounts totals **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** related accumulated depreciation totals **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and annual depreciation expense totals **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Since **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent of MTC's customer base is now served by FTTH, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent of this amount and related depreciation expense should be adjusted out of revenue requirements as plant which is not used or required to be used for utility service. Therefore, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in gross copper plant, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in accumulated depreciation, and **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in related annual depreciation expense should be removed from revenue requirement. This adjustment is shown in more detail in OCS Exhibit 3.2D Brevitz.

Q. DOES MTC'S CPR ENTRIES CONTAIN ADDITIONAL INFORMATION WHICH MIGHT PERMIT A MORE GRANULAR ANALYSIS REGARDING THE ACTUAL LOCATION OF THE COPPER FACILITIES, AND OBVIATE THE NEED FOR USE OF THE BROAD [BEGIN CONFIDENTIAL] [redacted] **[END CONFIDENTIAL] PERCENT FACTOR?**

A. No. MTC's CPR entries contain only the date at which the cost was placed on the CPR, and exchange information. There is no information about particular feeder or distribution routes to which the copper expenditure relates. Therefore it is necessary to use the broad **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** percent figure to calculate the adjustment.

Q. DOES THE TREND OF MTC'S COPPER INVESTMENT SINCE THE INCEPTION OF THE FTTH PROGRAM CONFIRM THIS ADJUSTMENT IS APPROPRIATE?

A. Yes. As shown by the table below, new investment in copper plant has essentially stopped in the underground and buried copper accounts, and aerial copper additions have been minimal since the inception of the FTTH program. **[BEGIN CONFIDENTIAL]** [redacted]

[END CONFIDENTIAL]

Q. WITHOUT THIS ADJUSTMENT, WHEN DOES MTC PLAN TO RECOGNIZE THE OBSOLESCENCE OF ITS COPPER PLANT, AND REMOVE IT FROM REVENUE REQUIREMENTS?

A. MTC's response to DPU 27-23 states **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** There are at least three problems with this approach. First, there clearly is a substantial amount of copper plant that is not being used because the customers have been moved over to the new FTTH facilities. Second, MTC has an application before the Commission for a large increase in UUSF. Since a material portion of the copper plant has been abandoned in concert with MTC's move of a material portion of its customer base to FTTH, the obsolescence of copper plant should be recognized in this case. Non-recognition of this fact would create duplicative plant cost recovery from the UUSF. This should not be permitted. Finally, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** is an inappropriate trigger for retirement of copper plant that is no longer used to serve customers. This trigger is much too uncertain and subject to company discretion of when it deems the network **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** During that time period and up to the point MTC deems the network **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC would continue recovery from the UUSF for duplicative plant. The longer MTC stretches out the FTTH program, the longer it would continue recovery for duplicative plant from the UUSF. This would incent delay and excess recovery from the UUSF. Therefore, the Commission should remove unused copper plant from revenue requirements as recommended in this adjustment.

OCS ADJUSTMENT 3.3

REMOVE VARIOUS NONREGULATED ASSETS AND RELATED DEPRECIATION EXPENSE

Q. PLEASE SUMMARIZE OCS ADJUSTMENT 3.3.

A. Review of MTC's accounting books indicates that those books include various assets that are used to provide nonregulated services, including some assets which are no longer in use. Specifically, review of MTC's Continuing Property Records provided in response to OCS 2-9 indicates the following items are included on MTC's books: **[BEGIN CONFIDENTIAL]**

[redacted]

REDACTED

- [redacted] **[END CONFIDENTIAL]**

Neither MTC's accounting processes nor Cost Allocation Manual processes have operated to prevent these items from being included in MTC's proposed revenue requirements. Therefore it is necessary to make an adjustment to remove these items. In total, this adjustment removes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** The details of this adjustment are provided in OCS Exhibit 3.3D Brevitz.

OCS ADJUSTMENT 3.4

REMOVE PAYMENTS TO AFFILIATE FOR BROADBAND SERVICES, WIFI ACCESS, DOMAIN HOSTING, ETC.

Q. PLEASE SUMMARIZE OCS ADJUSTMENT 3.4.

A. This adjustment is intended to address transactions between affiliates whereby MTCC bills MTC for various internet related items, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

Without demonstration that this rate is intended to represent fair market value and is lower than the cost of the related services, this is contrary to the FCC requirement that transactions from an affiliate to the telephone company be recorded at the lower of cost or fair market value. OCS 2-23(b) asked MTC for documentation regarding the goods or services that it purchases from affiliates that demonstrates if the lower of cost or fair market value (or prevailing tariff) is used, and provide supporting documentation for cost and fair market value. MTC's response was a reference to its response to a different question, which did not answer or address documentation supporting particular charges were indeed the lower of cost or fair market value. In the absence of cost information, there is no alternative to recommending that the entire expense amount be removed from revenue requirements. MTC has not met its burden of demonstrating that charges from affiliates are at the lower of cost or fair market value. In addition, there is a **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** payment to MTCC recorded September 30, 2011 which is unsupported. OCS Adjustment 3.4 removes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** from expenses to eliminate these unsupported charges from an affiliate. OCS Exhibit 3.4D Brevitz shows the details of this adjustment.

<u>OCS ADJUSTMENT 3.5</u>

<u>REMOVE RENTAL PAYMENTS TO AFFILIATE</u>

Q. PLEASE SUMMARIZE OCS ADJUSTMENT 3.5.

A. MTC pays a flat monthly charge of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** to an affiliate for warehouse space. MTC could produce no documentation to demonstrate that its payment to an affiliate met the test of being "the lower of cost or fair market value". **[BEGIN CONFIDENTIAL]**
[redacted]
[END CONFIDENTIAL] During the site visit on July 23 – 27, we were provided a

tour of portions of the two warehouses[8] that are included in this rental charge. In addition, a third warehouse not owned by P&C Rental[9] was included in the tour. From this tour, it was clear that much of the warehouse space was devoted to personal items and non-utility related items, including various collections of old telephone gear. Therefore, MTC could do with paying for much less space than provided in the three warehouses for which it is currently paying. But in any event, the rental charge has not been demonstrated to meet the "lower of cost or fair market value" test that is required for transactions between affiliates. Finally, the lease agreement demonstrates that it is not an "arms-length transaction", as the signatories on behalf of each entity are **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC has recorded 13 months of rental payments on its books during 2011 therefore **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** should be removed from revenue requirement. In addition, utilities paid by MTC for the warehouses should be removed. MTC provided August 2012 utility bills for the warehouses in response to OCS 8-2 which total **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC further states **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Therefore, 12 months of expense would be **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** for a total

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[8] There were locked areas of the warehouses that we were not allowed to see, indicated to be space which MTC was not renting or paying for. This cannot be documented from the Lease Agreement with P&C Rental since rented space **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**.

[9] See MTC Response to DPU 27-19.

adjustment reducing test year expenses of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

Q. ON WHAT BASIS DO YOU CALL P&C RENTAL AN AFFILIATE OF MTC?

A. Both entities share common ownership. One can infer that the name P&C Rental is derived from the names of MTC's owners. Also, MTC's CAM **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

Q. IS THERE A CONTRACT OR LEASE AGREEMENT WHICH DOCUMENTS THIS LEASE ARRANGEMENT?

A. Yes. MTC provided a Commercial Property Rental Agreement in response to DPU 23-10. This agreement was executed **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** This rental agreement is attached as OCS Exhibit 3.5D Brevitz.

Q. DO YOU CONSIDER THIS LEASE AGREEMENT TO BE AN "ARMS LENGTH TRANSACTION"?

A. No.

OCS ADJUSTMENT 3.6

REMOVE PAYMENTS TO AFFILIATE FOR MOTOR VEHICLES

Q. PLEASE SUMMARIZE OCS ADJUSTMENT 3.6.

A. This adjustment is intended to address transactions between affiliates whereby MTCC bills MTC for various vehicles that are then cleared to particular expense accounts. MTCC bills MTC **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Under the FCC requirement that transactions from affiliates to a telephone company be recorded at the lower of cost or fair market value, MTC is required to demonstrate that these charges meet that standard. OCS 2-23(b) asked MTC for documentation regarding the goods or services that it purchases from affiliates that demonstrates if the lower of cost or fair market value (or prevailing tariff) is used, and provide supporting documentation for cost and fair market value. MTC's response was a reference to its response to a different question, which did not answer or address documentation supporting particular charges were indeed the lower of cost or fair market value. In the absence of cost information and the required demonstration, there is no alternative to recommending that the entire expense amount be removed from revenue requirements. MTC has not met its burden of demonstrating that charges from affiliates are at the lower of cost or fair market value. OCS Adjustment 3.6 removes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** from 2011 expenses to eliminate these unsupported charges from an affiliate. OCS Exhibit 3.6D Brevitz shows the details of this adjustment.

Revenue Adjustments and MTC Rate Proposals

OCS ADJUSTMENT 3.7

ANNUALIZE LOCAL RATE CHANGES

Q. PLEASE ADDRESS MTC'S PROPOSAL TO ANNUALIZE LOCAL RATE CHANGES, AND YOUR PROPOSED OCS ADJUSTMENT 3.7.

A. MTC received Commission approval in Docket 11-046-T01 to increase its residential and business rates (R1 and B1) to the "affordable rate" to reduce its Countywide EAS rate to $0.75 per month, and to eliminate the zone charge for customers in the Sterling exchange. These rate changes were effective October 1, 2011, and therefore 2011 test period revenues reflect only three months of these changed rates. MTC proposes an adjustment of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** to reflect these rate changes on an annualized basis. This is a reasonable adjustment based on the fact that it is a known rate change which has been implemented through PSC approval, and is reflected in OCS Adjustment 3.7 to reduce revenues by that amount. Since this Adjustment accepts MTC's proposed adjustment, no OCS exhibit is necessary.

ELIMINATE EAS CHARGE

Q. PLEASE ADDRESS MTC'S PROPOSAL TO INCLUDE EAS IN LOCAL RATES, AND ELIMINATE THE EAS CHARGE.

A. MTC proposes to eliminate the EAS charge, and include EAS in the existing local rate. The annualized impact of this proposal is a revenue reduction of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as calculated by MTC. This proposed adjustment would eliminate the EAS rate and provide free EAS to MTC customers, and have the UUSF pay for that reduction. This is not appropriate, and the Commission should not accept this MTC proposal.

OCS ADJUSTMENT 3.8

REDUCE LIFELINE/LINK-UP REVENUES

Q. PLEASE ADDRESS MTC'S PROPOSAL TO REDUCE LIFELINE AND LINK-UP REVENUES, AND YOUR PROPOSED OCS ADJUSTMENT 3.8.

A. MTC proposes to reduce projected revenues from the FCC's Lifeline/Link-up programs, with an adjustment to reduce revenues by **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** The FCC Lifeline Reform Order (FCC 12-11) eliminates the Link-up program (which provides for reduced service connection charges to low income consumers) beginning in April 2012, and reduces the Lifeline support amount from $10 to $9.25 per line per month, beginning in August, 2012. While the Lifeline reduction is well outside the 2011 test period, in this instance I can support Commission adoption of this adjustment because it is a known change that has been implemented from an FCC Order. OCS Adjustment 3.8 reduces revenues by **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as proposed by MTC. Since this Adjustment accepts MTC's proposed adjustment, no OCS exhibit is necessary.

REDUCE LIFELINE REVENUES TO PROVIDE AT NO COST

Q. PLEASE ADDRESS MTC'S PROPOSAL TO REDUCE LIFELINE REVENUES, AND PROVIDE THE SERVICE AT NO COST.

A. MTC proposes a revenue reduction of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** to reflect the provision of lifeline service to its customers at no cost. It is not appropriate to use the UUSF to provide free lifeline service to a particular company's customers. The Commission should not adopt MTC's proposal.

OCS ADJUSTMENT 3.9

SPECIAL ACCESS REVENUE REDUCTION

Q. PLEASE ADDRESS MTC'S PROPOSAL TO ADDRESS SPECIAL ACCESS REVENUES, AND YOUR PROPOSED OCS ADJUSTMENT 3.9.

A. MTC states it is losing special access revenues due to competition, and presents a calculation of the impact based on comparing special access revenues from its 2011 PSC annual report to calculated special access revenues at a point subsequent to that time. The MTC calculation yields a proposed revenue reduction adjustment of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** I reviewed the MTC proposed adjustment against special access revenue recorded to MTC's books in the first four months of 2012, based on MTC's General Ledger 2012 Year-to-Date as provided in response to OCS 2-5. If this special access revenue is annualized (four month total times 3), it can be seen that more revenue for special access has been booked in 2012 than estimated by MTC's separate calculation which is not based on actual booked revenues. A revenue adjustment of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** is indicated from this analysis, and is shown in OCS Exhibit 3.9D Brevitz.

OCS ADJUSTMENT 3.10

FCC REFORM/STATE ACCESS REVENUE REDUCTION

Q. PLEASE ADDRESS MTC'S PROPOSAL TO ADDRESS THE STATE ACCESS CHARGE IMPACT OF FCC ACCESS CHARGE REFORM, AND YOUR PROPOSED OCS ADJUSTMENT 3.10.

A. As the Commission is aware, the FCC adopted an order in November 2011 to reform federal universal service and intercarrier compensation mechanisms.[10] MTC originally proposed an adjustment to reduce revenues of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** which included both originating and terminating minutes, and reduced transport and switching rates to $0.005 per MOU. This is well beyond what is required now and in the near future by the FCC transition. The current portion of the FCC transition applies only to terminating minutes, and reduces those rates by half the difference between state and interstate rates. In Mr. Hendershot's testimony filed September 21, 2012 along with revised exhibits, MTC has proposed a revised adjustment to reduce revenues by **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

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[10] *Connect America Fund; A National Broadband Plan for Our Future; Establishing Just and reasonable Rates for Local Exchange Carriers; High-Cost Universal Service Support; Developing a Unified lntercarrier Compensation Regime; Federal-State Joint Board on Universal Service; Lifeline and Link-Up; Mobility Fund;* WC Docket Nos. 10-90, 07-135, 05-337, 03-109, CC Docket Nos. 01-92, 96-45, GN Docket No. 09-51, WT Docket No. 10-208, *Report and Order and Further Notice of Proposed Rulemaking* (Nov. 18, 2011).

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which corresponds to the reduction which it has already filed with the Commission. This adjustment is reasonable because it is a known change that has been implemented by the PSC as pursuant to the stated transition in the FCC Order, and shown as OCS 3.10. Since this Adjustment accepts MTC's proposed adjustment, no OCS exhibit is necessary.

OCS ADJUSTMENT 3.11

FCC REFORM/NECA SETTLEMENT REDUCTION

Q. PLEASE ADDRESS MTC'S PROPOSAL TO ADDRESS REDUCTIONS TO NECA SETTLEMENTS DUE TO FCC ACCESS REFORM, AND YOUR PROPOSED OCS ADJUSTMENT 3.11.

A. MTC proposes a revenue adjustment to reduce revenues by **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** to recognize the impact of reduced average schedule settlements from NECA pursuant to the FCC's Access Charge/USF Reform Order. This proposed adjustment is reasonable because it is a known change that has been implemented by NECA pursuant to FCC Order, and reflected as OCS 3.11. Since this Adjustment accepts MTC's proposed adjustment, no OCS exhibit is necessary.

OCS ADJUSTMENT 3.12

ANNUALIZED ACCESS RECOVERY CHARGE REVENUE

Q. DID MTC INCLUDE ACCESS RECOVERY CHARGE REVENUE AS PART OF ITS ADJUSTMENT TO RECOGNIZE THE IMPACTS OF FCC ACCESS REFORM?

A. No. The FCC Access Charge/USF Reform Order permits imposition of a new rate, the “Access Recovery Charge” or “ARC” which is intended to offset impacts of other rate reductions associated with access charge reform. Therefore it is necessary to recognize both components of this access charge reform impact. The maximum ARC is $0.50 per line per month for residence, and $1.00 per line per month for business. The ARC is allowed to transition up annually for five years on July 1st of each year, so for example, July 1, 2013, MTC’s residential ARC can be $1.00 per line per month. MTC began billing this charge effective July 2012, but has not reflected this increased revenue in its proposed adjustment. OCS Adjustment 3.12 is to increase test period revenues by the annualized impact of the first year ARC which MTC is already billing, **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** The development of this adjustment is shown in OCS Exhibit 3.12D Brevitz.

PROVISION OF FREE CALLER ID AND VERTICAL FEATURES

Q. PLEASE ADDRESS MTC’S PROPOSAL TO INCORPORATE CALLER ID AND VERTICAL FEATURES INTO THE LOCAL SERVICE RATE.

A. MTC proposes to eliminate its current tariffed charges for Caller ID, Call Waiting, 3 Way Calling and Call Forwarding, and include those services within the existing local rate. This proposed adjustment reduces revenues by **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** It is not appropriate to use the UUSF to provide free vertical features to a particular company’s customers. The Commission should not adopt MTC’s proposal.

OCS ADJUSTMENT 3.13

REMOVE NONREGULATED VOICE MAIL REVENUES

AND RATE BASE

Q. PLEASE ADDRESS MTC'S PROPOSAL TO REMOVE REVENUES FROM VOICE MAIL, AND YOUR PROPOSED OCS ADJUSTMENT 3.13.

A. MTC's 2011 financial data includes costs and expenses for voicemail, which is a nonregulated service. MTC's invoice for the voice mail equipment included in its Application in this matter shows an installation date of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Thus there would only be voicemail revenue in the latter part of the 2011 period. MTC's proposed revenue adjustment is based on MTC's proposed projected test period and proposes revenue reduction of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** The date of placement of the voicemail equipment and beginning of revenue streams is addressed by MTC's annualization method and use of a forecasted test period. However since OCS proposes use of a 2011 historic test period for reasons described in Mr. Ostrander's testimony, the OCS adjustment to remove voicemail revenues is not the same amount as MTC's proposed adjustment. I attempted to find the voicemail revenues for the latter months of 2011 using MTC's General Ledger as of December 31, 2011 as provided in response to DPU 21-2. However, voicemail revenues were not separately identifiable from this review of General Ledger entries. Therefore an alternative approach to calculating the adjustment is required. Since based on the date of installation the voicemail equipment was in place for the last **[BEGIN CONFIDENTIAL]** [redacted] **[END**

CONFIDENTIAL] full months of 2011, a rough calculation of 2011 voicemail revenue would be to take **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** of MTC's proposed annualized voicemail revenue, or **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** This proposed adjustment amount no doubt overstates MTC's actual voicemail revenue for that period due to customer growth for a newly introduced service and thus benefits MTC to that extent, but is still reasonably represents this revenue adjustment considering materiality. The Commission should adopt this adjustment to remove nonregulated service revenue which should not be included in ratemaking for regulated services. It is reflected in OCS Adjustment 3.13.

Q. IS THERE VOICE MAIL EQUIPMENT CURRENTLY IN RATE BASE THAT SHOULD BE REMOVED AS WELL?

A. Yes. MTC recognized this in a proposed adjustment in its application. OCS Adjustment 3.13 also reduces rate base in the amount of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as proposed by MTC.

<u>OCS ADJUSTMENT 3.14</u>

<u>PROPOSED CONSTRUCTION WORK IN PROGRESS</u>

<u>2012 PLANT ADDITIONS</u>

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT 3.14?

A. MTC proposes to adjust its revenue requirement to include "proposed asset purchase and construction activity planned for 2012"[11] along with related increases in property tax and depreciation expenses. These plant additions are composed of vehicle replacement (2 vans); continued fiber installation associated with MTC's FTTH program; separate but related special projects for fiber installation associated with MTC's FTTH program in certain subdivisions; and procurement and installation of various items of equipment. Total 2012 planned plant additions are stated to be **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**[12] OCS Adjustment 3.14 addresses each of the individual components separately and removes MTC's proposed CWIP adjustments where MTC has indicated plans have changed, or where it is in fact not known that the plant additions will occur as projected by MTC. OCS Adjustment 3.14 proposes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in total for CWIP in this case. Assets are to be included in rate base at an average of the beginning and ending year balances. Arguably, CWIP should only be included at 50% of its costs. For now, I am including CWIP at its full cost, subject to revision in future testimonies for this issue and related depreciation expense, accumulated depreciation, and property tax impacts.

[11] Direct Testimony of Raymond Hendershot on behalf of Manti Telephone Company, at page 7, lines 113-125.
[12] Application, Revised Exhibit 1.1, 2012 Plant Additions.

Q. PLEASE ADDRESS MTC'S PROPOSED INCLUSION OF TWO NEW CARGO VANS IN REVENUE REQUIREMENT AS AN ELEMENT OF ITS PROPOSED CWIP ADJUSTMENT.

A. MTC proposes to include two 2012 Chevy Cargo Vans with MSRP of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** for a total of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC includes information on the equipment options it intends to include. OCS has no objection to inclusion of this item in revenue requirement, but the inclusion and recovery from the UUSF should be conditioned on MTC demonstrating that it indeed did purchase these vehicles to prove that these amounts are known (it appears the amount is mostly measurable with some revision).. MTC was previously allowed UUSF funds in advance to hire an accountant, which position remains vacant and unfilled to this day. Given that it did not follow through on its part of the bargain associated with previous agreement to allow funding for items that are not known, MTC should not be given any significant advance funding from the UUSF for vehicle purchase in this case. Furthermore, the amount allowed should not be the "sticker" price of the vehicles, as it is expected MTC would be able to negotiate that amount down. The amount of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** should be allowed in revenue requirement as a rate base item, as the amount for two vehicles, splitting the difference between "sticker" and invoice cost per NADA as included in the Application.

Q. PLEASE ADDRESS MTC'S PROPOSED INCLUSION OF ADDITIONAL INVESTMENT FOR FIBER INSTALLATION AS AN ELEMENT OF ITS PROPOSED CWIP ADJUSTMENT.

A. MTC includes a "Fiber Installation Projection for 2012" of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as a component of its proposed CWIP adjustment to rate base. This amount is indicated to extend FTTH to **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** additional existing customer locations. While the objective is understood, it is not clear that MTC will be able to achieve its plan of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** additional customer locations via FTTH in 2012. It was clear from presentation and discussion during the July 23rd site visit that the build-out schedule is somewhat aggressive. However, MTC is certainly proceeding in that direction and therefore I can support inclusion of the proposed amount in revenue requirement, with one important observation—this plant adjustment will also be subject to the imputation calculation proposed in OCS Adjustment 3.1 for costs of the FTTH network.

Q. PLEASE ADDRESS MTC'S PROPOSED INCLUSION OF FTTH INSTALLATION COSTS FOR DON THOMPSON AND SURROUNDING SUBDIVISIONS AS AN ELEMENT OF ITS PROPOSED CWIP ADJUSTMENT.

A. MTC proposes **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in total investment cost (additional rate base) to install buried FTTH facilities in these subdivisions. On a per subscriber basis, this appears to be **[BEGIN**

CONFIDENTIAL] [redacted] **[END CONFIDENTIAL]** times as costly as the general FTTH program. We were provided a tour of the service area (including these subdivisions) and description of capital budget plans during our site visit the week of July 23-27. The tour made clear why this project would be more costly to accomplish—housing in the subdivisions has been largely built out, and there is substantial landscaping already in place in a rocky environment. OCS Data Request 8-7 requested copies of work orders associated with this project, and the date at which MTC planned to have the project complete. The MTC response was **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** It appears that the completion of this project is uncertain, and the PSC should not allow a CWIP adjustment to revenue requirement for a project which has not started and has various uncertainties and plant deployment difficulties associated, including when it can reasonably be expected to be started and completed. Essentially, this is not known and measurable, and the facilities are not shown to be used and useful to customers at this time.

Q. PLEASE ADDRESS MTC'S PROPOSED INCLUSION OF GENBAND EQUIPMENT IN REVENUE REQUIREMENT AS AN ELEMENT OF ITS PROPOSED CWIP ADJUSTMENT.

A. MTC includes the GenBand equipment in its proposed CWIP, “to provide added security to our CS15K switch” and “allow MTC improved monitoring, and reporting of its network for trouble shooting”, per MTC response to OCS 8-8. In that same response MTC states it **[BEGIN CONFIDENTIAL]** [redacted]” **[END CONFIDENTIAL]** Finally, OCS noted that the price quotation provided by MTC in support of the amount proposed to be included in revenue requirements was **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC stated in response to OCS 8-8 **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** While MTC’s planned acquisition of this equipment appears reasonable, the cost of the equipment and its installation date are uncertain. Therefore the PSC should not permit a CWIP adjustment to revenue requirement for this item at this time.

Q. PLEASE ADDRESS MTC’S PROPOSED INCLUSION OF “FORCE 10” AND RELATED EQUIPMENT IN REVENUE REQUIREMENT AS AN ELEMENT OF ITS PROPOSED CWIP ADJUSTMENT.

A. MTC’s proposed 2012 plant additions includes equipment related to **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** MTC’s response to OCS 8-9 indicates

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it has since determined based on further evaluation it would be better to proceed under a different plan. Thus, it is not necessary to address this proposed adjustment any further. It is not clear why Mr. Hendershot's September 21st testimony supporting the application still includes this amount in the proposed CWIP. In any event, based on MTC's response to OCS 8-9, the Commission should not consider Mr. Hendershot's proposal to include this amount in revenue requirements via CWIP.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes.