Docket No. 08-046-01
DPU Exhibit 3.0 SR
Paul A. Hicken
November 9, 2012

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Increase of Rates And Charges and Increase in USF Eligibility for Manti Telephone Company	:	**Docket No. 08-046-01** **DPU Exhibit 3.0 Surrebuttal** **(REDACTED)**

SURREBUTTAL TESTIMONY

OF

PAUL A. HICKEN
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

NOVEMBER 9, 2012

I. INTRODUCTION

Q: Please state your name for the record.

A: My name is Paul Allen Hicken.

Q: Have you previously filed testimony in this docket?

A: Yes, I previously filed direct testimony on behalf of the Division of Public Utilities (DPU).

II. PURPOSE AND SCOPE OF TESTIMONY

Q: What is the purpose of your surrebuttal testimony in these proceedings?

A: My surrebuttal testimony will respond to the rebuttal testimonies of Dallas Cox and Ray Hendershot from Manti Telephone Company (MTC).

Surrebuttal to Dallas Cox

Q: Mr. Cox disagrees with your assessment of Billing and Collections as a single operation for MTC and MTCC customers. Can you comment on this?

A: The DPU does not object to Billing and Collections by MTC for the non-regulated companies. The point of this adjustment was that MTC does not make any direct allocations to non-regulated expense for employees and resources used in the B&C process. As outlined in the Cost Allocation Manual (CAM), some of these expenses should have been allocated to the affiliates because they are directly assignable or directly attributable. Mr. Cox mentions a B&C agreement and a tariff service rate. We reviewed the Manti tariff and there is no mention of B&C services. I am not sure what tariff he is referring to. He also indicates that B&C payments are invoiced to MTCC. The DPU reviewed all of the MTC invoices for 2011 and could not find any invoices for B&C services. We also asked for all agreements or leases between MTC and MTCC. We were not provided with a copy of the agreement for B&C services. The 2011 general ledger does indicate that some B&C revenues were collected, mostly from Manti Long Distance (MLD). MTC believes that because MTCC apparently pays a tariff service charge for B&C, nothing more should be allocated to it. It is the DPU's belief that any tariff amount recovered by MTC for B&C services is not representative of the costs for this operation. DPU believes other allocations could be made in order to more accurately distribute the cost for this service. (DPU Adjustment 3.1)

Q: Mr. Cox does not agree with your analysis regarding salvage value. Can you respond to his testimony?

A: DPU agrees that some assets such as buried copper are difficult to retrieve and retire, and some assets stay in service longer than their intended life. This is not the point. The accounting standards for straight line depreciation say that an asset goes on the books at the net value; that is cost minus estimated salvage value. Manti was booking their assets at full cost without consideration of salvage value. Some assets may not have any salvage value at the end of their lives, but according to FCC part 32, a company should keep records that will enable them to estimate a reasonable salvage value on assets for the purpose of depreciation. Manti failed to do this with their accounting. (DPU adjustment 3.3)

Q: Mr. Cox states that prior to 2010 capitalized labor was based on a percentage of regulated to non-regulated. Work orders were not used because they were not required for an average schedule company. Can you respond to this comment?

A: It is not accurate to state that capitalized labor is based on a percentage of regulated to non-regulated. This ratio was not considered as a factor for labor capitalization. Prior to 2010 capitalized labor was an estimated percentage of total labor. I am not sure what the percentage was based on and there are no records to back up the capitalized labor percentages. Time sheets were not consistently filled out and were unreliable. Based on the CPR detail, the average percentage of capitalized labor prior to 2010 was about """ """""""""""" In 2011, the percentage of capitalized labor in the CPR detail was about """" """""""""""""" I don’t know how MTC came up with that figure because the time keeping system was not fully functional until the latter part of 2011. Up until the latter half of 2011, time and labor records were unreliable. DPU required a work order system because MTC was not providing accurate time keeping records and capitalized labor estimates were not reliable. (DPU Adjustment 3.4)

Q: Mr. Cox states that the copper system is not redundant and should remain in rate base. How would you respond to this statement?

A: The DPU does not disagree that the copper is still used on a daily basis. The point of this adjustment is that MTC has the copper system in the rate base and it also has the fiber system in the rate base capable of serving about 86 percent of the customers at the present time. There are essentially two expensive networks in the rate base, both providing phone service and both earning a return from the ratepayers. The DPU is not advocating the removal of the copper network entirely, but believes it is inappropriate for MTC to earn a return on rate base for the full value of both systems operating concurrently. Since MTC is migrating customers from the copper network to the fiber network, the DPU felt it was more appropriate to adjust a portion of the copper network from rate base. It is assumed that this network will be retired in the next few years as customers are moved to the fiber network. Consequently, an adjustment was made to remove a portion of the copper network from the rate base. (DPU Adjustment 3.6)

Q: Mr. Cox objects to your analysis and adjustments of charges for equipment leased by MTC from MTCC. What is your response to this objection?

A: The DPU does not object in principle to a lease agreement for equipment rather than purchasing the equipment if the terms of the lease fair and reasonable. The terms of the lease are largely unknown and the information that is available suggests that the lease rates are unreasonable.

The terms of the lease are largely unknown because there is no written agreement. MTC did not provide a copy of the equipment lease and the terms and arrangements were not clearly defined. MTC has also failed to produce any evidence that the equipment being leased is either necessary, in regular use, or has ever been used. The limited records that were kept relating to MTC’s equipment use do not clearly differentiate the equipment owned by MTC from the MTCC equipment. The CPR detail does not list equipment by VIN numbers so it is impossible to tell which company owns the equipment that was in use. Additionally, no monthly invoices were provided that would show equipment usage during the month. Furthermore MTC has not shown the need to lease equipment that duplicates equipment it already owns, nor has it shown that it needs to lease equipment so regularly that it is prudent to maintain a monthly lease rather than make daily or weekly leases for the times when its own equipment may not be sufficient. The lease payments were simply made each month whether or not the equipment was actually used.

In addition to the lack of evidence that the equipment has been used by MTC or that the use is sufficient to warrant a continuous leasing, the rate of the lease is also unreasonable. The DPU reviewed local values for equipment and found that similar pieces could be purchased relatively inexpensively and paid off in a short period of time. This raises the question whether a continuous lease of equipment is appropriate. While some lease arrangements might add value in terms of servicing and maintaining equipment, that does not seem to be the case here. Based on the responses to data requests and Mr. Cox's testimony, it appears that in addition to the monthly lease rates, MTC is also responsible for all maintenance on the equipment. As such the DPU cannot agree that, even if the equipment were regularly used and necessary, the lease with MTCC is reasonable. (DPU Adjustment 3.7)

Q: Mr. Cox believes the adjustment for vehicle registration and expense is inappropriate. Can you respond to this objection?

A: DPU acknowledges that MTC has numerous vehicles, equipment and trailers. All vehicles, trailers and equipment owned by MTC should be listed on the company's asset detail report or continuing property records. DPU believes it is inappropriate for MTC to pay the vehicle registrations or expenses associated with those vehicles if they are not owned and listed on the company asset records. This adjustment was made because DPU found invoices and payments by MTC for registration of vehicles that were not identified on MTC's continuing property record. Initially, the DPU discovered documentation of registration payments for ten vehicles not on MTC property records. Upon further review, the DPU found additional documentation of vehicle registration payments for three additional vehicles. These vehicles are listed in the DPU Exhibit 3.8 SR. This makes a total of thirteen vehicles not listed in the MTC asset inventory where registration and expenses were paid for by MTC and accumulated in MTC's vehicle clearing account. (DPU Adjustment 3.8)

Q: Regarding the adjustment for warehouse rental space, Mr. Cox believes this is unwarranted because there is no comparable warehouse space available in Sanpete county. How would you respond to this statement?

A: The DPU is not suggesting that MTC lease warehouse space in Utah County. The adjustment was made for two reasons. The first reason is that the lease agreement states that MTC is leasing 12,000 square feet of space. Upon inspection it was found that MTC was only leasing about 8,000 square feet of space and the other portion of the 12,000 square foot warehouse was used by the Cox family for personal storage. MTC intended to simply keep the same lease payments while accepting a much smaller lease area. The second reason for the adjustment was that the rate of the lease was found to be unreasonably high based on comparable properties available. The market information for real estate leases in Manti is limited and the DPU found it necessary to look outside the immediate area to find comparable properties. The lease rate for comparable space in surrounding areas was much lower, about """""""""" """""" """""""""" lower than what P&C Rental was charging MTC for the warehouse space. Based on these reasons, the DPU adjusted the lease rate to what comparable lease rates in surrounding areas would be for the facility MTC is leasing. (DPU Adjustment 3.9)

Surrebuttal to Ray Hendershot

Q: Mr. Hendershot asserts that DPU required MTC to do more accounting than was necessary. He specifically cites work orders as an unnecessary requirement. What is your response to this?

A: The DPU felt work orders were a necessary requirement in order to make possible the identification of property records as mandated in 47 CFR 32.2000(f)(5). This requirement was one of several made in the stipulation agreement dated January 20, 2011. DPU made these accounting requirements because of deficiencies encountered while reviewing MTC's accounting records. Prior to this time, the company did not maintain an accurate timekeeping system and labor and overhead on projects were not consistently monitored or accurately recorded. Labor was capitalized in the CPR by simply estimating a percentage based on best recollection at some latter point in time. There were no records to back up the estimates. Any part of an asset that is entered in the CPR, including labor, materials and plant overhead should be tracked and recorded accurately. FCC part 32 specifically mentions work orders as a method to identify and describe property record units.

Q: Mr. Hendershot states that salvage value does not need to be considered for calculating depreciation of assets. What is your understanding of this statement?

A: That is not correct. Mr. Hendershot confuses the issue by mentioning part 32 of the federal code and bringing up group asset depreciation and over depreciation. This is not the same issue as salvage value in the depreciation calculation. In PSC Docket # 94-046-01 annual depreciation rates were established for MTC. There was no mention in this docket of salvage values, only the setting of annual rates for asset classes. Mr. Hendershot assumes that salvage value was excluded from the depreciation calculation because of technology and obsolescence. The docket and the accompanying recommendation from the DPU did not provide any language or discussion on this matter. In the administrative code R746-340-2(D) it says, “The Uniform System of Accounts for Class A and Class B telephone utilities, as prescribed by the Federal Communications Commission at 47 CFR 32 is the prescribed system of accounts to record the results of Utah intrastate operations.” The depreciation method prescribed in FCC part 32 is straight line depreciation which includes a salvage component. It says, “Companies…will ratably distribute on a straight line basis the difference between the net book cost of a class or subclass of plant and its estimated net salvage during the known or estimated remaining service life of the plant." It also says, "The company shall keep such records of property and property retirements as will allow the determination of the service life…also allow the determination of the percentage of salvage value and cost removal for property retired from each class of depreciable plant." [47 CFR 32.2000(g)] (DPU Adjustment 3.3)

Q: Mr. Hendershot disagrees with your allocation methodology for regulated and non-regulated assets and expenses. He claims MTC is following FCC part 32 guidelines. Do you agree with this statement?

A: No. Non-regulated activities are discussed in 47 CFR 32.23 which says when assets and resources are commonly used to produce regulated and non-regulated services, telephone carriers must account for these activities separately. Direct cost companies do this with annual cost studies. MTC does not perform cost studies because they are an average schedule company and therefore exempt from this requirement. The DPU believes that while average schedule companies may be exempt from cost studies for the federal program, Utah statutes require that regulated service, when bolstered by payments from the state fund, not subsidize services that are exempted from regulation (See U.C. 54-8b-6). Also, state USF regulators are required to determine eligibility of all companies on a level playing field regardless of whether they are cost based or average schedule oriented. As stated in direct testimony, the Utah USF program requires that the funds be used to provide basic telephone service only and that the funds may not provide a competitive advantage or disadvantage to any provider. The only reasonable application of this standard is to require all telecommunication companies eligible to receive state USF funding to allocate their investment between regulated and non regulated activities. The FCC requirements are not a basis for the DPU to allow some companies to exploit the state USF program.

Mr. Hendershot mentions the tariff rate paid by MTCC for use of MTC's facilities. The DSL line charge set in tariff is '''' '''''''''' per month per line. This charge was placed in the tariff at a time when the copper network was the primary system for delivery of services, several years prior to the company's large investment in a fiber network overlay. The fiber network overlay significantly increases the bandwidth available for DSL and is largely responsible for the ability of MTCC to offer DSL speeds that are competitive. The network that MTCC is now leasing simply is not the same facility as it was when the '''' per month tariff was instituted and the rates are not reflective of the changes. The DPU does not believe that this access charge represents an equitable recovery of cost for unregulated services.

MTC has been unwilling or unable to provide the information necessary to properly evaluate the relationship between MTC and MTCC. As such the DPU does not have enough information to make line by line adjustments and to allocate every cost to MTCC. It is clear however that the allocation is necessary in order to prevent UUSF funds from being used to subsidize unregulated competitive affiliates. The allocation methodology used by the DPU is one way to separate costs between regulated and non-regulated services. Increasing the tariff rate for DSL line charge would be another way. A third method was that done by OCS in imputing revenue from MTCC to MTC. Other methods might also be appropriate in the absence of adequate information. As a final point I would note OCS' method of allocation done independently from DPU resulted in relatively similar results. (DPU Adjustment 3.2)

Q: Does this conclude your surrebuttal testimony?

A: Yes.