BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF GUNNISON	**)**	
TELEPHONE COMPANY'S	**)**	**Docket No. 14-043-01**
APPLICATION FOR RATE INCREASE	**)**	
AND INCREASE IN USF ELIGIBILITY	**)**	
GUNNISON TELEPHONE COMPANY,	**)**	
	)	
Applicant	**)**	

DIRECT TESTIMONY

OF

DANIEL MESZLER

ON BEHALF OF GUNNISON TELEPHONE COMPANY

June 6, 2014

DIRECT TESTIMONY OF DANIEL MESZLER

Q. What is your name?

A. My name is Daniel Meszler.

Q. By whom are you employed and in what capacity?

A. I am employed by TCA, Inc - Telcom Consulting Associates ("TCA"), as a Senior Regulatory Consultant. TCA provides financial, regulatory, marketing and management consulting services to small and mid-size carriers throughout the United States.

Q. Briefly describe your educational background and work experience.

A. I received a Bachelor of Arts degree in accounting from Fort Lewis College, Durango, Colorado in 2002. From 2002 to 2004 I was employed as an accountant for Jones Media Networks. From 2004 to 2007 I served as Chief Financial Officer of Majestic Paint and Body. In 2007-2008 I was employed as a Financial Adviser for Edward D. Jones Investments, having successfully passed Series 7 and 66 Securities and Exchange Commission examinations.

In 2008 I began employment with TCA. Some of my responsibilities at TCA have included but are not limited to: National Exchange Carrier Association ("NECA") interstate cost separations studies, High Cost Loop Support ("HCLS") fillings, federal and state compliance filings and interpretation of Federal Communications Commission ("FCC") and orders and rules. I have participated in previous Utah Universal Service

Fund ("UUSF") proceedings, as well as similar state high cost fund dockets in Oklahoma and Kansas. Most of these proceedings have involved the determination of jurisdictional revenue requirement for rate-of-return ("RoR") regulated local exchange carriers ("LECs"). I have worked directly with the companies in these proceedings on the measurement, gathering, and allocation of the costs necessary to provide regulated telecommunications services in compliance with FCC rules contained in Part 32 (Uniform System of Accounts), Part 64 (Subpart I, Allocation of Costs), and Part 36 (Jurisdictional Separations Procedures).

Q. On whose behalf are you presenting testimony?

A. I am presenting testimony on behalf of Gunnison Telephone Company ("Gunnison" or "Company") in support of its application for increased support from the UUSF.

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to provide detailed explanations for selected financial and statistical information supporting Gunnison's Application for increased UUSF eligibility. Specifically, I will provide testimony that will support Confidential Exhibits DM-8which are attached to this Testimony as Exhibits.

Dr. Curt Huttsell, also of TCA, will provide expert testimony addressing the proper authorized return on equity for Gunnison.

Q. Please identify the Exhibits to your testimony.

A. The individual Exhibits include:

- Gunnison DM 1 - Computation of Earnings Shortfall (Confidential)
- Gunnison DM 2 – Rate Base Summary (Confidential)
- Gunnison DM 3 – Rate Base Adjustments (Confidential)
- Gunnison DM 4 – Income Statement Summary (Confidential)
- Gunnison DM 5 – Income Statement Adjustments (Confidential)
- Gunnison DM 6 - Cost of Capital Summary
- Gunnison DM 7 – Depreciation Rates (Confidential)
- Gunnison DM 8 – EAS Rates

Q. Were the Exhibits referred to above and the supporting workpapers prepared by you or someone under your supervision?

A. Yes, they were.

Q. What is the proposed test period specified in the Application and how was it derived?

A. Pursuant to Utah Code Annotated Section 54-5-4(3), Gunnison proposes to use calendar year 2013 as the test period for the purpose of determining the appropriate amount of UUSF support. Accordingly, the Application and Confidential Exhibitss are based upon audited financial information for the 12 months ending December 31, 2013. This test period selection is consistent with the Commission's historic treatment of rural LECs in Utah.

This historical "test period" was then adjusted for "known and measurable" changes in operations, which more accurately reflect Gunnison's ongoing cost of providing telecommunications services. Additionally, Gunnison's operations were carefully scrutinized to ensure that all non-regulated operations were removed from the test period operating results. These pro forma adjustments, which are contained in Confidential Exhibits DM 3 and DM 5, comprise the focus of my testimony.

Confidential Exhibit Gunnison DM 1- Computation of Earnings Shortfall

Q. Have you calculated Gunnison's Revenue Deficiency?

A. Yes. Confidential Exhibit Gunnison DM 1 reflects a revenue deficiency of $142,898.

Q. How was Gunnison's revenue deficiency determined?

Gunnison is a rate-of-return regulated LEC in both federal and state jurisdictions. Accordingly, Gunnison maintains its accounting records in accordance with the FCC's Part 32 Uniform System of Accounts ("USOA"), as required by Commission Rules.[1] As a result, the Company's Application complies with FCC rules guiding the measurement, gathering, and allocation of the costs necessary to provide regulated telecommunications services, including the FCC rules contained in Part 32 and Part 64 (Subpart I, Allocation of Costs).

To determine Gunnison's revenue deficiency, first the Company's rate base was multiplied by a reasonable rate-of- return to determine the allowable return, which is reflected on Line 3 of Confidential Exhibit Gunnison DM 1. Next, the allowable return is reduced by the Company's operating income, resulting in the revenue deficiency, which is identified on Line 5 of Confidential Exhibit Gunnison DM 1. However, because the Company's allowable return is an after-tax amount - the revenue deficiency must also be "grossed up" to a level that will sustain the required return after Gunnison recognizes the associated federal and state income taxes. The calculation of the Net to Gross Multiplier is identified on Exhibit DM 1.1. The grossed up revenue deficiency is identified on Line 7 of Confidential Exhibit Gunnison DM 1.

Q. How does Gunnison propose to recover its revenue deficiency?

A. At $13.50 (R-1) and $23.00 (B-1) per line per month, Gunnison's local service rates for R-1 and B-1 service are currently below the Commission's UUSF affordable base rate benchmark. Accordingly, Gunnison proposes to increase its R-1 and B-1 rates to $16.50 and $26.00, respectively. At the same time, Gunnison proposes to decrease its current Extended Area Service ("EAS") rates to reflect the current costs for providing this service, as demonstrated in the EAS cost study discussed below. Because this

[1] PSC R746-340-2

"rebalancing" of local rates will not result in any increased revenues, in order to provide the Company the opportunity to earn a fair return on its investment in facilities to provide service, Gunnison proposes that its entire revenue deficiency be recovered through UUSF disbursements. This will enable Gunnison to continue providing service to its customers, and to initiate capital projects that have been delayed by the Company's current insufficient earnings.

Confidential Exhibit Gunnison DM 2 – Summary of Rate Base

Q. Have you calculated Gunnison's Rate Base for purpose of this proceeding?

A. Yes. Confidential Exhibit Gunnison DM 2, attached hereto, provides a calculation of the Company's total rate base. The Confidential Exhibit Gunnison DM 2 begins with historical book amounts and contains adjustments to produce a pro forma regulated rate base as of December 31, 2013.

Q. When describing Confidential Exhibit Gunnison DM 2 above, you indicate that it contains adjustments required to produce a pro-forma regulated rate base. Please describe those adjustments.

A. The adjustments to rate base are included in Confidential Exhibit Gunnison DM 3. I will identify and explain each adjustment to rate base contained in Exhibit 3 below.

Confidential Exhibit Gunnison DM 3 - Rate Base Adjustments

Q. Please explain Adjustment RB-1.

A. Adjustment RB-1 removes from rate base the cost of jointly used assets.

Q. Please discuss Adjustment RB-2.

A. Adjustment RB-2 calculates the Company's cash working capital allowance. In accordance with past DPU practice, Gunnison has used a 45-day allowance.

Confidential Exhibit Gunnison DM 4 – Test Year and Normalized Income Statement

Q. Have you calculated Gunnison's normalized earnings for purposes of this proceeding?

A. Yes. Confidential Exhibit Gunnison DM 4 calculates Gunnison's normalized earnings as specified in the Total Company Rule, R746-360-8. This Confidential Exhibit Gunnison DM 4 begins with historical book amounts and identifies and adjusts for fixed known and measurable items necessary to produce a pro-forma, regulated income statement as required and permitted by Utah Code Annotated Section 54-4-4 (3)(b)(ii)(B). The adjustments to Confidential Exhibit Gunnison DM 4 are identified in detail in Confidential Exhibit Gunnison DM 5. I will identify and explain each adjustment to normalize the income statement below.

Confidential Exhibit Gunnison DM 5 - Income Statement Adjustments

Q. Please explain Adjustment IS-1.

A. Adjustment IS-1 recognizes the "known and measurable" impact of the FCC's USF/ICC Transformation Order on the Company's access revenues. The FCC has mandated that LECs reduce all terminating intercarrier compensation ("ICC") rates to zero, which will significantly reduce Gunnison's regulated revenues. Because the FCC has established different transition periods for the various terminating rates to reach zero and has partially offset some of the revenue reductions with increased federal high-cost support and customer charges - the Company has calculated this revenue lost revenue by simply trending 2013 access revenues forward into 2014. In reality, this method of calculating the lost ICC revenues is quite conservative, as it only recognizes the current year losses, and excludes known losses in future years.

Q. Please describe Adjustment IS-2.

A. Adjustment IS-2 is a pro forma reduction in test period revenues from the Utah Education Network (**"**UEN"). UEN has been renegotiating contracts across the state. The Company anticipates UEN revenues may be further reduced in the coming year.

Q. Please describe Adjustment IS-3.

A. Adjustment IS-3 recognizes the annualized revenue impact of Gunnison's composite rate change. This will be addressed in further detail below.

Q. Please describe Adjustment IS-4.

A. Adjustment IS-4 normalizes the test period regulated payroll costs at the anticipated, ongoing level.

Additionally, adjustment IS-4 also allocates management and customer service compensation costs to non-regulated operations at an appropriate level.

The cumulative impact of these changes to pro forma payroll expense is a reduction in regulated expenses as identified in IS-4.

Q. Please explain Adjustment IS-5.

A. Adjustment IS-5 recognizes the "known and measurable" increase in healthcare and employee benefit costs for 2014.

Q. Please explain Adjustment IS-6.

A. Adjustment IS-6 calculates the Company's recoverable procedural costs. The Company's estimated legal and consulting fees associated with this Application have been amortized over a period of two years, which is consistent with the previous Commission Rate Case proceedings.

Q. Please discuss Adjustment IS-7.

A. Adjustment IS-7 calculates the Utah "net to gross multiplier" using both state and federal statutory tax rates. The long-established regulatory principle of "grossing up" revenue increases simply calculates the additional income tax expense Gunnison – or any other rural LEC in the state - will incur as a result of the increased revenue from the UUSF. By grossing up the revenue deficiency, Gunnison sustains the required return after calculation of actual taxes. Confidential Exhibit DM 1 contains the Utah "net to gross multiplier."

Exhibit Gunnison DM 6 - Cost of Capital

Q. What cost of capital has Gunnison used in this Application?

A. Gunnison used a composite cost of capital of 10.71% in calculating its UUSF revenue deficiency requirement.

Q. Please explain Gunnison's Cost of Capital.

A. In accordance with UUSF policy, Gunnison has calculated a blended cost of capital, which represents the weighted average of an interstate rate of return of 12.16% and a state rate of return of 9.77%. Gunnison's intrastate cost of capital was derived using the DPU's suggested imputed capital structure of 65% equity and 35% debt. For the individual components of its capital structure, Gunnison has used a cost of debt of 4.7% and a cost of equity of 12.5%, which results in a composite intrastate rate-of-return of 9.77%. The Company does not carry any long term debt; therefore the Company's cost of debt was derived from the actual cost of a similarly situated LEC as a reasonable replacement. Gunnison's requested cost of equity mirrors the cost of equity used in other recent UUSF proceedings. Dr. Curt Huttsell has provided direct testimony in this proceeding stating that the Company's requested cost of equity in the Application of 12.5% is quite conservative – and that a more appropriate cost of equity under today's economic conditions would be in the range of 14.5%.

The interstate return of 12.16% is derived from NECA's Form 492 filing with the FCC on September 30, 2013 for calendar year 2012 pool participants.

Q. Please explain how the Company's blended Cost of Capital was derived.

A. The Commission's Total Company Rule requires a "blending" of the authorized cost of capital costs in the state and interstate jurisdictions. This weighting of the jurisdictional capital costs is typically done based upon the jurisdictional separation of the LEC's rate base in accordance with the FCC's Part 36 rules. However, Gunnison is an "average schedule" company in the interstate jurisdiction – and unlike "cost" companies - it does not perform an annual jurisdictional cost separation study.

Accordingly, Gunnison has used NECA's composite jurisdictional allocation of all rural LECs participating in the NECA cost study process.[2] NECA uses the jurisdictional allocations of "cost" companies as a surrogate for "average schedule" LECs in determining their interstate cost recovery. Accordingly, the allocation of Telephone Plant

[2] See NECA's *2013 Modification of Average Schedules,* filed annually with the FCC (updated March 8, 2013).

in Service contained in NECA's report is representative of the appropriate jurisdiction allocation (state or interstate) of the Gunnison's rate base. The Company's Weighting Percentage is contained on Line 6 of Confidential Exhibit Gunnison DM 6.

Confidential Exhibit Gunnison DM 7– Depreciation Rates

Q. Have you provided Gunnison's Depreciation Rates and Depreciation Lives for purposes of this proceeding?

A. Yes. Confidential Exhibit Gunnison DM 7, incorporated herein by reference, contains Gunnison's Depreciation Rates and Lives as required by Utah Code Ann. §54-7-12.1.

Q. Has Gunnison performed a depreciation study?

A. No. Gunnison has not completed a depreciation study. Gunnison is not proposing any depreciation rate changes in this proceeding.

Confidential Exhibit Gunnison DM 8 – EAS Rate

Q. What is Gunnison's current EAS rate?

A. Gunnison's current mandatory EAS rate is $3.59 per line per month. However, Gunnison's current mandatory EAS rate was developed in 2006 and no longer reflects the costs of providing EAS. TCA, together, with Gunnison, have conducted a current EAS cost study. The costs associated with providing EAS have decreased over the years based on the significant reduction in access rates (which reduces lost access revenues), the depreciation of the trunks providing the service, and the switching capabilities of the smart switch installed by the company.

Q. What are the results of the updated EAS study?

A. Confidential Exhibit Gunnison DM 8 reflects a significant reduction in Gunnison's cost to provide EAS service. Accordingly, Gunnison proposes reducing the EAS rate to $.48 per customer per month to reflect the current costs of providing this service.

Q. How will this impact Gunnison's customers?

A. Gunnison's customers will see an increase in R1 and B1 rates from $13.50 and $23.00 to $16.50 and $26.00. The EAS rates will be reduced from $3.59 to $0.48 per line per month. Thus, the Gunnison customers will see a small composite rate decrease of $0.11 per month.

Q. Does that conclude your direct testimony?

A. Yes it does.