- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

IN THE MATTER OF GUNNISON TELEPHONE COMPANY'S APPLICATION FOR RATE INCREASE AND INCREASE IN USF ELIGIBILITY	)))))))	DOCKET NO. 14-043-01

DIRECT TESTIMONY

OF

CURT HUTTSELL, PH.D.

ON BEHALF OF

GUNNISON TELEPHONE COMPANY

June 6, 2014

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I. IDENTIFICATION OF WITNESS

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

A. My name is Curt Huttsell. I am a Senior Regulatory Consultant for TCA, Inc. - Telcom Consulting Associates ("TCA"), 526 Chapel Hills Drive, Suite 100, Colorado Springs, Colorado, 80920.

Q. BRIEFLY DESCRIBE YOUR WORK EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. I joined TCA in June of 2011 after serving as Manager – Government and Regulatory Affairs at Frontier Communications for nearly twelve years. During my time with Frontier, I handled state regulatory and legislative affairs for Frontier in Arizona, Utah and New Mexico. Prior to my service with Frontier, I was a Senior Economic Analyst with INDETEC International where the clients I served included both domestic and international telecommunications companies. I have also served as a telecommunications economist on the staffs of the Utah Division of Public Utilities and the Missouri Public Service Commission.

My principal role at TCA has been advising the firm's many small, rural ILECs on matters involving state and federal regulatory matters.

Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?

A. My education includes Bachelor's and Master's degrees in economics from the University of Central Missouri and a Doctorate in economics from the University of Nebraska-Lincoln with a specialty in industrial organization and regulation.

Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THIS COMMISSION OR ANY OTHER A STATE REGULTORY COMMISSION?

A. Yes. I have previously testified before this Commission, and in addition I have testified before the state regulatory commissions of Arizona, Idaho, Iowa, Missouri, Montana, Nebraska, New Mexico and Washington.

II. SUMMARY

Q. ON WHOSE BEHALF ARE YOU PRESENTING TESTIMONY?

A. I am presenting testimony on behalf of Gunnison Telephone Company ("Gunnison" or "Company"), supporting its application for funding from the Utah Universal Public Telecommunications Service Support Fund ("UUSF").

Q. PLEASE SUMMARIZE YOUR TESTIMONY.

A. My testimony addresses the cost of equity capital to Gunnison. I estimate Gunnison 's cost of equity capital using an analytical technique known as the Capital Asset Pricing Model ("CAPM"). This is the same analytical technique that DPU Witness Casey Coleman utilized when arriving at a recommended cost of equity capital for Manti Telephone Company's request for UUSF support, *In the Matter of Manti Telephone Company's Second Amended Application for USF Eligibility* (Docket No. 08-046-01). It is also the same analytical technique I used when recommending the cost of equity capital for Manti in its latest request for UUSF funding, *In the Matter of Manti Telephone Company's Application for Increased USF Eligibility* (Docket No. 13-046-01). The CAPM is frequently used to determine the cost equity capital of individual firms and relies upon information obtained from public trades of the firms' stocks. Because Gunnison does not have publicly traded stock, I have selected a group of nine firms with publicly traded stock as proxies for Gunnison and estimate the cost of equity capital for each of those proxy firms individually using the CAPM technique. I then calculate the mean and median of the individual proxy estimates and add a small company risk premium. The individual company estimates are displayed in Gunnison Exhibit CH 1, and the final result is a recommended rate of return on equity capital for Gunnison of between 14.46 % and 14.52%.

III. APPLICATION OF CAPTIAL ASSET PRICING MODEL

Q. HOW DID YOU SELECT THE PROXY GROUP FOR YOUR CAPM ANALYSIS?

A. The nine firms I have selected as a proxy group are all rural ILECs with publicly traded stocks and for which Value Line publishes a beta value, a measure of individual firm risk. Betas measure the non-diversifiable part of risk and are essential elements of the CAPM. Value Line is a highly respected independent investment research and financial publishing firm.

Q. HOW DID YOU APPLY THE CAPM TECHNIQUE TO THE INDIVIDUAL PROXY FIRMS?

A. I applied the CAPM technique to the individual proxy firms using the following formula:

Ke = Rf + Beta(Rm – Rf), where
Ke is the cost of equity capital,
Rf is the risk-free rate of return,
Rm is the expected return from the stock market and
Beta is the variability of an individual stock's return relative to the variability of the stock market's return.

Q. WHAT DID YOU USE FOR A RISK-FREE RATE OF RETURN?

A. The theory behind the CAPM requires incorporating the return on short-term securities such as 90-day Treasury Bills. 90-day Treasury Bills carry virtually no risk of financial loss due to changes in interest rates. However, the interest rates on short-term securities are extremely low presently because of the Federal Reserve Bank's policy of keeping the Federal Funds rate low in order to stimulate the economy. The Federal Funds rate is the rate at which banks borrow from one another overnight and currently stands at less than a tenth of one percent. Consequently, I have selected the return on 10-year Treasury Bonds as the risk-free rate, but I have reduced that rate by the amount by which T-Bond returns have exceeded T-Bill returns historically, about 1.64% percentage points. This difference reflects the premium T-Bond holders demand for the increased interest rate risk associated with longer term securities.

Q. WHAT DID YOU USE FOR THE EXPECTED RETURN FROM THE STOCK MARKET?

A. I used the mean total return on large company stocks over the period 1926-2012 as published in the 2013 Ibbotson SBBI Risk Premia Over Time Report.

Q. WHERE DID YOU OBTAIN THE SMALL COMPANY SIZE PREMUIM INCORPORATED IN YOUR ANALYSIS?

A. I incorporated the small company size premium as reported in the 2013 Ibbotson SBBI Risk Premia Over Time Report for the period 1926-2012. Ibbotson estimates this premium to be 3.81%, and the premium itself represents the required return in excess of CAPM.

Q. DID DPU WITNESS CASEY COLEMAN INCORPORATE A RISK PREMIUM WHEN ARRIVING AT A RECOMMENDED COST OF EQUITY CAPITAL FOR MANTI IN DOCKET NO. 08-046-01?

A. Yes, he did, but DPU Witness Casey Coleman did not explain in his testimony how he arrived at the 2.0% figure. While recognizing the additional risk of small company size is a step in the right direction, I believe 2.0% understates the additional risk. The small company size premium of 3.81% incorporated in my testimony as calculated by Ibbotson removes the return due non-diversifiable (*i.e.*, systematic risk) and isolates the return attributable solely to size. Ibbotson's small company size premium is specifically and carefully calculated to represent the required return in excess of CAPM.

Q. DID YOU INCORPORATE A SMALL COMPANY RISK PREMIUM WHEN ARRIVING AT A RECOMMENDED COST OF CAPITAL FOR MANTI IN DOCKET NO. 13-046-01?

A. Yes. I incorporated the same small company risk premium as I have incorporated in this proceeding, 4.81%.

IV. RECOMMENDATION

Q. WHAT IS YOUR RECOMMENDATION FOR A FAIR RATE OF RETRUN ON EQUITY FOR MANTI?

A. In its application in this case, Gunnison requested a rate of return on equity of 12.5%. This is an eminently reasonable request in light of the fact that my calculations estimate both the mean and median cost of equity capital for the proxy group is approximately 14.5%. Even if the Commission were to adopt the small company risk premium of 2.0% previously recommended by DPU Witness Casey Coleman, my calculations would still show a cost of equity capital in the range of 12.65% to 12.71%, still in excess of the return on equity Gunnison has requested.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.