

In the Matter of the Application for Increase in the USF Eligibility for Utah Bank Telecommunications Association, Inc., and URET Telecom, Inc.

DOCKET NO. 06-031-06
TARIFF NO. 06-031-06
Direct Testimony of
JOHN H. GOUGHAN, JR.

FOR THE DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH

CONFIDENTIAL PUBLIC VERSION

September 9, 2005

Testimony of John H. Goughan, Jr.

Introduction

Q. Please state your name and business affiliation:

A. John H. Goughan, Jr. I am employed by the Utah Division of Public Utilities (Division), 100 East 300 South, Fourth Floor, Salt Lake City, Utah 84114.

Q. How long have you been employed by the Division of Public Utilities?

A. Since January 9, 2003.

Q. What are your current responsibilities?

A. I am a Utility Analyst assigned to the Telecommunications Section. I am a member of the audit team responsible for investigation of the instant application by Utah Bank Telecommunications Association, Inc., and URET Telecom, Inc. (collectively the "Company").

Q. What is your educational background, expertise and experience?

A. I have a Bachelor of Science degree in accounting and finance and a Joint Doctor of Law and Certified Public Accountant licensed in Utah since 1973 and in California since 1987. I am also an attorney admitted to practice in Utah since 1980 and in California since 1983. My legal career included complex civil litigation, estate planning and tax matters. Immediately prior to joining the Division, I was a solo practitioner in Salt Lake City, Utah. My resume is attached as EXHIBIT DPU 11.1.

Q. What is the purpose of your testimony in this case?

A. I will discuss the Company's division of "*****" assets from its regulated operation to its unregulated wireless subsidiary, discussion of its history providing its operation as a cooperative and in particular the prohibition of any investment income on capital credits, its payment of patronage refunds to members when it is being made and in default of its loan covenants, its failure charitable contributions based on operating expenses by its limited liability to the extent of "*****" failure to comply with the statutory requirements concerning uncollected capital credits, and the adjustments and recommendations appropriate to these issues.

Utah Bank Telecommunications

Q. How did the Company divert assets from its regulated operation to its unregulated wireless subsidiary?

A.

Q. Why do you object to this transfer?

Q. Did UETA Wireless have a negative equity position at the end of 2002?

Q. Was the Board of Directors notified by the company?

Q. How does this additional stock affect UETA's ownership interest in URET Wireless?

A. Yes, I believe the conversion of the

Q. What is the practical effect of this transaction?

A. URET Wireless was already a wholly owned subsidiary of the regulated company when the loan was converted to capital stock. Essentially

Q. Why is this important to your suit?

A. The Company is seeking \$7.2 Million in USF in the instant decision in its testimony at page 6, near the end of the first paragraph, Brink Trial notes that "following the acquisition of the Western, Dataswitch and Broadview exchanges, UETA and URET Telecom expanded substantial resources to upgrade the quality of the facilities in those exchanges. These expenditures have depleted the capital and operating resources of the company to the extent that neither has the financial ability to meet the requirements for new capital projects." (Emphasis added.) This begs the question: If the Company's capital was so depleted, what was its management doing when it bought

Q. How much of the Company's capital did the loan represent?

A. As of December 31, 2004, UETA's Total Member's Equity was only

Q. Is this transaction a prohibited activity of an unregulated affiliate?

A. Yes, whether interstate or intrastate, which does not satisfy requirements the services provided by the wireless subsidiary

Utah Code Section 54-6b provides:

"Prohibition on substitution of telecommunications services. A telecommunications corporation providing public telecommunications services may not substitute its interstate 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 interstate telecommunications services not so exempted or such subject to a price list or competitive contract. Similarly, proceeds from interstate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract as authorized by this chapter may not substitute other interstate telecommunications services not so exempted or such subject to a price list or competitive contract."

Utah Code Section 54-6b(2) provides:

"Substitution of Competitive Services Prohibited. A telecommunications carrier may not use services that are not competitive to substitute services that are subject to competition. The Commission, with respect to interstate services, and the State, with respect to intrastate services, shall establish guidelines to ensure that services included in the definition of regulated services bear no more than a reasonable share of the joint and common costs of facilities used to provide those services."

Q. Do you have any recommendations to the Commission regarding the Company's division of funds to its unregulated subsidiary?

A. Yes. The Commission should order that the Company may not make any loans, equity injections or any other expenditures to its downstream affiliates and/or subsidiaries, either directly or indirectly, in excess of \$100,000 in any given year without first requesting and receiving approval from the Commission for any such downstream investment and/or loan in accordance with Utah Code Section 54-6-26.

Company Records

Q. In the Company preparing to pay patronage refunds?

A. Yes,

Q. How are the payments of patronage refunds distributed?

A. Typically, patronage refunds are returned to persons not of standing in a ratio that such members' patronage bears to the revenues that contribute to such earnings.

Q. How are patronage refunds reported, if at all, to law or regulators?

A. As a non-regulated cooperative registered under the applicable Utah Statutes, the payment of patronage refunds are governed by the cooperative's By-Laws. Article VIII of UETA's Communications Amended By-Laws and Amended Articles of Incorporation govern the Non-Profit Operation of the cooperative and contain the following relevant provisions:

"The Commission shall at all times be reported as a cooperative may profit from the initial benefit of its members. The amount of dividend shall be paid as possible to the Cooperative or any capital (Emphasis added)

This section is highly relevant to the Director's position, discussed at length by Division

Witness George Congdon, that the hypothetical capital structure proposed by the Company in this case is wholly inappropriate. The members do not expect any payment to the Cooperative's By-Laws, are entitled to any interest or dividends on their capital.

Section 3.2 provides:

"In the event of dissolution or liquidation of the Cooperative, after all outstanding indebtedness of the Cooperative shall have been paid, the remaining capital credits shall be treated without priority on a pro rata basis before any payments are made on account of property rights of members. If, at any time prior to the dissolution or liquidation, the Board shall determine that the financial condition of the Cooperative will not be improved thereby, the capital then credited to members' accounts may be retired in full or in part. All such allocations and retirements of capital shall be made by such method or basis, in such order and with such priority as the Board of Directors, in its discretion, determines to be in the best interest of the Co-Op and its members." (Emphasis added.)

Q. Based upon your review of the Company's By-Laws in the Company permitted to pay patronage dividends?

A. No, as can be seen by the italicized section quoted above, the Company's By-Laws contain no provision for the payment of patronage refunds. All of the member's account of operating costs and expenses are treated as though it were distributed to the members which immediately contributed the amounts back to the Cooperative as capital with an actual exchange of cash taking place. Additionally, any review of the entire By-Laws attached herein as DPU Exhibit 11.1 reveals that patronage refunds are not authorized by any other sections of the By-Laws.

Q. If any amount results in patronage refunds are the members ever notified or make a representation or other disclosure of their capital credits?

A. Yes, Section 3.2 quoted above provides for the retirement of capital credits upon dissolution or liquidation.

Q. In dissolution or liquidation of the Co-Op the only way that the members will ever receive their capital credits is cash?

A. No, Section 3.3 also permits the retirement of capital credits prior to liquidation or dissolution, provided that "the Board shall determine that the financial condition of the Cooperative will not be improved thereby, the capital then credited to members' accounts may be retired in full or in part." (Emphasis added.)

Q. How would such a retirement of capital credits be determined?

A. Once again, Section 3.3 of the By-Laws provides: "All such allocations and retirements of capital shall be made by such method or basis, in such amount and with such priority as the Board of Directors, in its discretion, determines to be in the best interest of the Co-Op and its members."

Q. What does the standard for capital credits retirement?

A. With the Board's considerable discretion, under the alternative they imposed upon it by Section 3.3 of the By-Laws, it was only retro capital credits when the "financial condition of the Cooperative will not be improved thereby."

Q. Does this distribution of "patronage refunds" impact the financial condition of the Cooperative?

A. Yes. The distribution of "*****" to its members, after giving effect of the disbursements of capital credits to its unregulated wireless subsidiary, depletes almost entirely the remaining Retained Earnings of the Company. As of December 31, 2004 the Company had

Q. How does the Company determine which capital credits to retire?

A. Once again, the Board has considerable discretion. "The allocation and retirements of capital shall be made by such method or basis, in such priority as the Board of Directors, in its discretion, determines to be in the best interest of the Co-Op and its members." (Emphasis added.)

Q. How do the Company and the best interests imposed upon the Board by the Co-Op By-Laws?

A. No. Given the stated obligation of the Cooperative's capital credits to the benefit of its unregulated entity, its current default in the overall loan covenants imposed on the Company by the Collateral loans, and the Company's admitted inability to "meet the requirements for new capital projects" (Emphasis added) at all of its members is hardly in the Co-Op's best interests.

Q. Do the patronage refunds approved by the Board meet the standards for a proper refund of capital credits?

A. In my opinion, definitely not. The financial condition of the Cooperative does not warrant any refund of capital credits. Neither does it appear that such refund the method of which substitutes the Company obligated to and refused to respond to DPU Order Report 123) is in the best interests of either the Co-Op or its members. An amended issue fully by Division Witness, Worthy Hartman, the Company is currently in default of numerous financial conditions of its loans from Citibank.

Q. What should the Commission do about these patronage refunds?

A. If not yet paid, the Commission should order that no such patronage refund be paid since the Company's By-Laws do not permit such a distribution. Neither should a retirement of capital credits to be permitted based upon the impairment of the Company's financial condition mandated imposed by the Company's By-Laws.

Q. What should the Commission do about the retirement of Capital Credits?

A. Once again, the Commission should order that no retirement of capital credits shall be permitted unless and until the Company has cured all of its loan defaults and has met all conditions imposed by its lenders with respect to its equity requirements. Additionally, no further capital credits retirement should be permitted without express application to, and approval by, the Commission of the payment of any such capital retirement to bring to the Company in meeting any support from the USF.

Other Contributions

Q. Did the Company propose to make charitable contributions that were not fully disclosed in its application?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

Q. Are contributions allowed in rate making?

A. No. The commission has ruled on numerous occasions that charitable contributions are not to be treated by rate payers and must be a below the line deduction chargeable to the equity holders.

Q. Are you proposing any adjustment for this undisclosed charitable contribution?

A. Yes,

A. Yes. There proposed and presented an increased adjustment to plant specific operations in the amount of €***** before application of the State Abolition Factor of 68.234%.

Q. Why did you choose plant specific operations as the place for this abatement adjustment?

A. ***** It seems most appropriate that the types of resources used would be most similar to the resources the Company would employ in plant specific operations. I should point out that although materials are listed among the in-kind contributions, I have chosen not to make any adjustment to them here. Materials and assets for Commission will advise the Company to ensure that all such materials donated for the Research***** project are properly accounted for as a contribution when they are used in that project.

Unrelated Capital Credits

Q. Why do you believe that the Company has failed to comply with the statutory requirements concerning unrelated capital credits?

A. Unk Revised Code Section 54-3-3(a) provides:

"Each electric and telephone cooperative shall: (1) retain capital credits given to customers of electric and telephone cooperatives in this state that remain unclaimed for a period of three years after the end of the year in which the credit is given; (2) use the unclaimed credits to (a) assist low-income persons to pay their utility bills; and (b) provide scholarships to local graduating high school seniors; (3) establish guidelines based on factors such as income or special needs to determine persons who qualify; and (4) submit copies annually to the Public Service Commission of (a) the Cooperative's guidelines; and (b) accounts and disposition of unclaimed capital credits by individual recipients."

During an on-site audit, I reviewed copies of the Company's guidelines and annual reports to the Commission. The Company was unable to produce any such guidelines or reports and I was not helped by East North's contention that, in fact, such guidelines and reports did not exist. OCV Data Request 3.2(a) requested copies of all documents that described and supported the Company's compliance with the abatement statute. The Company objected to the request and failed to respond thereto. After investigation I was confirmed by Commission staff that no such annual reports have been filed with the Commission by the Company as required by the Statute.

Q. Why do you believe it is important to audit this stat?

A. This is essentially an unrelated liability which affects the Company's financial condition. As of December 31, 2009 the Company's equity accounts reflect balances of €*****

***** The total of these two accounts is €***** which may only be repaid in accordance with the abatement statute. In effect these are trust funds which may not be used by the Cooperative for any other purpose other than that dictated by the statute. If you consider these amounts in the calculation listed above in my discussion of the Company's requirement of its capital in connection with the proposed "percentage refund" the Company's remaining available retained earnings minus negative territory in the amount of €*****

Q. What do you propose that the Commission do about this?

A. I believe the Commission should order the Company to fully comply with the statute and bring all required reports up to date. Depending upon the information contained in these reports, the Commission may also want to order the Company to reorganize funds sufficient to meet its obligations under the statute given the lack of management control evidenced in this case as more fully discussed by other Division Witnesses.

Q. How did you conduct your testimony?

A. Yes.