BEFORE THE

PUBLIC SERVICE COMMISSION OF UTAH

DIRECT TESTIMONY OF DOUGLAS DUNCAN MEREDITH

DOCKET NO. 05-2302-1

I. INTRODUCTION

Q. PLEASE STATE YOUR FULL NAME, PLACE OF EMPLOYMENT AND BUSINESS ADDRESS.

A. My full name is Douglas Duncan Meredith. I am employed by John Staurulakis, Inc. (JSI). JSI is a telecommunications consulting firm headquartered in Greenbelt, Maryland. My office is located at 547 Oakview Lane, Bountiful, Utah 84010.

Q. PLEASE DESCRIBE YOUR PROFESSIONAL EXPERIENCE AND EDUCATIONAL BACKGROUND.

A. At JSI, I am the Director of Economics and Policy. In this capacity, I assist clients with the development of policy pertaining to economics, pricing and regulatory affairs. I have been employed by JSI since 1995. Prior to my work at JSI, I was an independent research economist in the District of Columbia and a graduate student at the University of Maryland – College Park.

In my employment at JSI, I have participated in numerous proceedings for rural and non-rural telephone companies. These activities include, but are not limited to, the creation of

forward-looking economic cost studies, the development of policy related to the application of the rural safeguards for qualified local exchange carriers, the determination of Eligible Telecommunications Carriers, and the sustainability and application of universal service policy for telecommunications carriers.

In addition to assisting telecommunications carrier clients, I have served as the economic advisor for the Telecommunications Regulatory Board of Puerto Rico since 1997. In this capacity, I provide economic and policy advice to the Board Commissioners on all telecommunications issues that have either a financial or economic impact.

I am participating or have participated in numerous national incumbent local exchange carrier and telecommunications groups, including those headed by NTCA, OPASTCO, USTA, and the Rural Policy Research Institute. My participation in these groups focuses on the development of policy recommendations for advancing universal service and telecommunications capabilities in rural communities and other policy matters.

I have testified or filed pre-filed regulatory testimony in various states including South Carolina, Vermont, New Hampshire, New York, Michigan, North Dakota, South Dakota, Texas and Wisconsin. I have also participated in regulatory proceedings in many other states that did not require formal testimony, including Florida, Louisiana, Mississippi,

North Carolina, Puerto Rico, Utah, and Virginia. In addition to participation in state regulatory proceedings, I have participated in federal regulatory proceedings through filing of formal comments in various proceedings and submission of economic reports in an enforcement proceeding.

I have a Bachelor of Arts degree in economics from the University of Utah, and a Masters degree in economics from the University of Maryland – College Park. While attending the University of Maryland – College Park, I was also a Ph.D. candidate in Economics. This means that I completed all coursework, comprehensive and field examinations for a Doctorate of Economics without completing my dissertation.

Q. ON WHOSE BEHALF ARE YOU PRESENTING THIS PRE-FILED DIRECT TESTIMONY?

A. I am testifying on behalf of Carbon/Emery Telecom, Inc. (Carbon/Emery or the Company), a Utah corporation qualified to transact business and to operate as a local exchange carrier in the State of Utah.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. The purpose of my testimony is to support Carbon/Emery's Application for Rate Increase and USF Eligibility (Application) and the associated Supplement to Application for Rate Increase and USF Eligibility (Supplement).

II. BACKGROUND OF APPLICATION AND SUPPLEMENT

Q. PLEASE DESCRIBE THE CIRCUMSTANCES SURROUNDING THE APPLICATION.

A. Carbon/Emery, a subsidiary of Emery Telcom, was formed to acquire the Price, Helper and East Carbon exchanges from Qwest Corporation (Qwest) in 2001. This rate case is Carbon/Emery's first rate case and is therefore a baseline rate case intended to establish the rates necessary for Carbon/Emery to provide telecommunications service in these exchanges.

Carbon/Emery had discussions with the Division of Public Utilities (DPU) in 2003 to initiate a baseline rate case inasmuch as it was apparent after the acquisition that Qwest rates were too low to support the new investment and ongoing operations required for the

newly formed company. Due to unforeseen circumstances, the Application was not able to be filed until June 17, 2005.

Q. WHY IS CARBON/EMERY SEEKING APPROVAL FOR A RATE INCREASE AND USF ELIGIBILITY?

A. The proposed rate increases and application for Utah universal service fund support is necessitated by a variety of factors. Foremost is the initial adjustment from prior Qwest rates to rates that reflect the cost of service in these exchanges. As a former Bell Operating Company, Qwest's regulation, including rate development, was established on a statewide basis. Carbon/Emery, on the other hand, is a small incumbent LEC that is regulated under rate-of-return regulation and participates in the National Exchange Carrier Association ("NECA") pooling process. Calculations performed pursuant to rate-of-return regulation demonstrate that an increase in rates is justified.

In addition to a rate increase, Carbon/Emery also seeks a determination of USF eligibility in order for the purpose of improving telephone plant in service and to accommodate increased costs in the industry generally. In contrast to Qwest, which is a large regional telephone company, Carbon/Emery is a small rural telephone company. As such, the costs are spread among significantly fewer customers. Further, as a small company, Carbon/Emery does not have the scale or scope enjoyed by Qwest.

Q. WHAT IS THE PROPOSED TEST PERIOD SPECIFIED IN THE APPLICATION AND HOW WAS IT DERIVED?

A. Pursuant to Utah Code Anno. § 54-4-4(3), Carbon/Emery proposes to use 2004 as the appropriate test period for the purpose of setting rates and determining the appropriate amount of support from USF. This is the most recent 12-month annual period. While the Utah statute provides for public utilities to project up to 20 months into the future for a test period, Carbon/Emery declines to add additional expense and time to the process in selecting a forecasted test period. (See Utah Code Anno. § 54-4-4(3)) Instead, Carbon/Emery proposes a historic 12-month annual period as the period to best reflect the rate period. This test period selection is consistent with the Commission's historic treatment of rural telephone companies in Utah. The company has elected to forego projections in recurring costs, such as increased labor costs for the future, Instead it has elected only to add known and measurable costs to the historic test period.

Carbon/Emery is aware of an ongoing Test Period Task Force conducted by the Division of Public Utilities to examine the test period selection of public utilities. It is also aware that the DPU's position in that task force was that an historic test period was its preferred test period for public utilities. This preference by the DPU is a motivating factor for Carbon/Emery to use an historic test period. Further motivation is the avoidance of the

expense and time required to prepare a forecasted test period – especially when the DPU's task force recommendations have not been finalized. It has been common practice for the Commission to permit rural telephone companies to make known and measurable adjustments to historic test period calculations, and this option is now codified in the above-referenced state statute.

Q. WHY IS A SUPPLEMENT TO THE APPLICATION NECESSARY?

A. When the Application was filed, it proposed an increase in basic local service and business rates to $13.50 and $23.00 respectively (consistent with the Commission's previously established Base Affordable Rate). In addition, the Application showed an annual intrastate USF distribution of $1,584,519 required for Carbon/Emery to recover its cost of service and a reasonable return on the value of its property devoted to public use. Due to four factors Carbon/Emery has filed a Supplement to its Application.

The first change reflected is Carbon/Emery's use of newly finalized 2004 cost study factors. Previously, Carbon/Emery used 2003 allocation factors for the 2004 test period because the 2004 cost study was not finalized. The 2004 cost study was completed subsequent to the filing. Moreover, the 2004 cost study is part of the record for this

proceeding by way of the recent responses to discovery requests for copies of the 2004 cost study. Consequently, the Supplement contains updated exhibits which reflect calculations based on 2004 factors from the cost study.

Second, additions have been made to known and measurable adjustments. Subsequent to its filing in June, Carbon/Emery's Board approved additions, modifications and changes that were not reflected in the initial application. These revisions are now detailed in the exhibits attached to the application. In addition to plant investment and expense entries, Carbon/Emery is adding its consulting fee estimate for the preparation and support of the rate case.

Third, the treatment for all known and measurable investment has changed. Initially a mid-year convention was used to determine the investments, deprecation expense and investment reserves. Carbon/Emery changes this convention to reflect a full year of expenses attributable to this investment. This change allows the application to reflect the planned plant in service and reserve balances as of January 1, 2006.

The fourth change is a correction to the adjustment for excess depreciation expense in the Application. (*See* Exhibit S-7). In calculating excess depreciation expense, a negative number was used when the positive value of the number should have been used to

calculate the annual revenue requirement. In the preparation of testimony used to support the Supplement, this calculation error was identified and corrected.

Combined, these revisions cause the intrastate revenue requirement shortfall to increase from the $2,235,441 reflected in the Application to $2,599,846 reflected in the Supplement to the Application – an increase of $364,405. Because the initial submission reflected increases in basic local rates to the Commission's Base Affordable Rates, the increased revenue requirements does not alter Carbon/Emery's proposed rate increases for basic local service. The increased revenue requirement causes an increase in the proposed intrastate access revenues from the original request for a $351,580 increase to a revised increase of $452,593, a change of $101,018. After consideration of local and access rate increases, the increased revenue requirement increases Carbon/Emery's request for Utah USF distribution by $185,693 based on a supplemental calculation of the USF amount of $1,770,212 in comparison with the original submission of $1,584,519.

Q. WHY DOES THE SUPPLEMENT HAVE MORE EXHIBITS THAN THE NUMBER SUBMITTED AS ATTACHMENTS TO THE APPLICATION?

A. In accordance with Utah Code Anno. § 54-8b-15 and R746-360, the Application contains the necessary exhibits and schedules which show the operational activities of Carbon/Emery for the test period and the known and measurable adjustments proposed by

Carbon/Emery. These exhibits and schedules show the proposed rate changes and request for Utah universal service support Carbon/Emery requires in order to have the opportunity to earn a rate of return of 10.05 percent.

As is the case in other rate case applications filed by Utah ILECs, the principle exhibits submitted in the Application were the Intrastate Revenue Requirement Calculation (Exhibit S-1) and the Total Company Revenue Requirement Calculation (Exhibit S-9) along with supporting exhibits. These two exhibits and supporting exhibits are contained in the Supplement.

III. EXPLANATION OF SUPPORT FOR REQUEST FOR RATE INCREASE

Q. WHAT IS CARBON/EMERY'S INTRASTATE REVENUE REQUIREMENT AND HOW WAS IT DERIVED?

A. The test year revenue requirement for Carbon/Emery is based on the axiomatic formula for revenue requirement determination for utilities subject to economic regulation: expenses plus return on capital investment. Expenses include operating expenses and income taxes. Investment or "rate base" on which the return is calculated includes operating plant investment offset by related reserves for accumulated depreciation and

deferred income taxes, investment in materials and supplies, prepayments and cash working capital required to sustain day to day operations. Return includes both an equity return component and a debt return component. Because the required return on investment is in after-tax dollars, the return is grossed up to a level that will sustain the required return after calculation of actual taxes.

For Carbon/Emery, the proposed adjusted test year intrastate revenue requirement is $6,185,175. (*See* Exhibit S-1, Column M, Line 10). This revenue requirement comprises $5,037,332 in operating expenses excluding income taxes, a return of $840,864, and $306,979 in operating income taxes. (*See* Exhibit S-1, Column M, Lines 20, 29 and 27 respectively).

Because Carbon/Emery and all ILECs maintain books under the Federal Communications Commission's (FCC's) Part 32 Uniform System of Accounts (USOA) (*See* 47 C.F.R. § 32.1 *et seq*.) on a total company basis, determination of the intrastate portion of expenses and investment requires calculations under the Separations Manual adopted jointly by state regulators and the FCC codified as Part 36, Jurisdictional Separations. (*See* C.F.R. § 36.1 *et seq.*) For purposes of determining intrastate expenses and investment for the test year, Carbon/Emery has applied the intrastate factors from the Carbon/Emery 2004 cost

study submitted to the National Exchange Carrier Association (NECA) in July. These factors represent the percentage of total balances that were allocated to intrastate.

Q. PLEASE EXPLAIN THE TWO METHODS USED TO CALCULATE THE PROPOSED INTRASTATE REVENUE REQUIREMENT.

A. Two methods are used in the exhibits to calculate the proposed intrastate revenue requirement. The first method, which is used in Exhibit S-1, calculates the annual revenue requirement based on intrastate only expenses and investment, excluding interstate revenues, expenses and investments. The intrastate revenues are identifiable from the discrete intrastate revenue accounts from the Company's general ledger which also agree to amounts reported in Carbon/Emery's annual report to the Public Service Commission of Utah. Included in this exhibit (*See* Exhibit S-1), the intrastate expenses and investment are based on application of the latest intrastate jurisdictional separations factors.

The second method, used in Exhibit S-9, treats the intrastate revenue requirement as a residual revenue requirement. As a residual revenue requirement, the intrastate revenue requirement is equal to the total company revenue requirement for all jurisdictions less interstate revenues. For purposes of determining a total intrastate revenue requirement, the residual method ensures that the benefit of any "overearnings" for interstate revenue,

to the extent they may exist, accrue to the benefit of the intrastate ratepayers. This is sometimes referred to as the residual method.

According to Commission rules, the Application and Supplement use the lowest annual revenue requirement – in this case, this is the intrastate method. The difference in methods can best be observed by comparing the state USF requirement on Exhibit S-2, which is calculated based on intrastate only, with the state USF requirement on Exhibit S-10, which is calculated on the residual method. The Exhibit S-2 amount is $1,770,212 while the Exhibit S-10 amount is slightly higher at $1,895,660.

Q. HOW DOES CARBON/EMERY PROPOSE TO EARN A FAIR RATE OF RETURN ON INVESTMENT?

A. In order to earn a fair return on its investment, including initiating capital projects delayed by current significant underearning, Carbon/Emery proposes achieving the required $2,599,846 increase in intrastate revenue by a combination of increases in local rates of $377,036, increases in intrastate switched access rates of $452,598 and application for state universal service funding of $1,770,212. (See Exhibit S-2).

Q. WHAT IS THE OVERALL RATE OF RETURN USED IN THE APPLICATION AND SUPPLEMENT?

A. Both the Application and the Supplement use a rate of return of 10.05 percent. This percentage was discussed informally with the Company and the Division in 2003. At that time, I understand there appeared to be no controversy over the level of this rate. I have reexamined this percentage and support its use in this proceeding.

Q. WHAT ANALYSIS HAVE YOU PERFORMED THAT SUPPORTS YOUR RECOMMENDATION?

A. Before, I explain the return on equity method I used to judge whether the 10.05 percent was reasonable, I believe it is necessary to explain the rate of return calculation. The rate of return has two components: the cost of debt and the cost of equity. These two components are weighted based not of what is the actual debt/equity structure of the company; rather, it is based on a representative debt/equity structure. In the Application and the Supplement, debt and equity are each assumed to represent 50 percent of the company's capital structure.

The cost of debt reflects the interest paid on debt outstanding for the company. Today, Carbon/Emery's debt is at a composite interest rate of 6.03 percent.

The long history of return to equity even predates Federal Power Commission v. Hope Natural Gas Company. In Hope, the Supreme Court stated that "the return to the equity owner should be commensurate with the returns on investments in other enterprises having corresponding risks."[1] In Bluefield Water Works, the Court expressed "a public utility is entitled to such rates as will permit it to earn a return on the value of the property which it employs for the convenience of the public equal to that generally being made available at the same time and in the same general part of the country on investments in other business undertakings which are attended by corresponding risks and uncertainties."[2]

There are many acceptable methods of calculating a reasonable return on equity estimate. Because Carbon/Emery is a small local exchange carrier, I collected data on five local exchange carriers for whom there are published *Beta* values. (These companies are HickoryTech, New Ulm, Warwick Valley, CT Communications, and North Pittsburgh. These companies are relatively small compared to the regional Bell Operating Companies and large holding companies like CenturyTel, Inc. with operations spanning multiple states.) Generally, a *Beta* for a publicly traded stock is a measure of volatility vis-à-vis the relevant market. Technically, the *Beta* is the covariance of a stock in relation to the

[1] Federal Power Comm'n v. Hope Natural Gas Co., 320 U.S. 591 (1944).
[2] Bluefield Water Works & Improvement Co. v. Public Service Commission of West

rest of the relevant stock market.[3] Most every method of estimating a return on equity involves some tradeoffs. The Discounted Cash Flow analysis, for example, requires the estimation of dividend and earnings growth. When dealing with smaller companies, many times these estimates do not exist or are based on few observations. I decided not to use a DCF method for my reasonableness check. For purposes of determining whether the 10.05 percent overall rate of return is reasonable, I used the Risk Premium method. With company *Beta* values, I can compute the return on equity for each of these five companies using the Risk Premium method. Based on the risk free rate and the Dow Jones US Small cap trailing twelve month (TTM) percentage change as reported in today's Wall Street Journal, the average Risk Premium estimate for return on equity for these five companies equals 15.67 percent. Using the weighted average for debt and equity, discussed above, the estimated overall rate of return for Carbon/Emery is 10.85 percent. This estimate is higher than the 10.05 percent value used in the Application and Supplement. The Risk Premium method confirms that using the 10.05 percent value as the rate of return for Carbon/Emery is reasonable.

Virginia, 262 U.S. 673 (1923).

[3] Downes, John and Goodman, Jordan Elliott, Finance and Investment Handbook, 4th Edition, Barrons (1995), page 198.

Q. HOW IS THE PROPOSED USF CALCULATED?

A. The proposed state universal service funding of $1,770,212 is based on the total required revenue increase of $2,599,846 less the proposed local service revenues of $377,036 and the proposed intrastate access revenues of $452,598.

Q. WHAT RATE INCREASES ARE PROPOSED FOR RESIDENTIAL AND BUSINESS LOCAL EXCHANGE RATES?

A. The local rate increases totaling $377,036 include increasing basic service from the current rates for basic service to $13.50 and $23.00 for, respectively, residence and business one-party service. These represent increases from the respective current tariffed rates of $11.03 and $19.37 of $2.47 and $3.63 respectively. The portion of the overall rate increases that will be produced by raising basic rates to the capped amounts is $334,196. The remainder of the $377,036 increase is based on proposed increases in non-recurring charges totaling $42,840 annually. (*See* Exhibit S-2.1)

Q. WHAT IS THE PROPOSED INCREASE IN INTRASTATE ACCESS?

A. The intrastate access increases totaling $452,598 are based on setting and tariffing intrastate switched access end office rates based on calculation of the discrete revenue requirements for local switching and transport on adjusted test year balances and application of both the intrastate factors mentioned above and intrastate FCC Part 69

factors from the 2004 cost study. The following are Carbon/Emery's proposed intrastate access rate charges: the local switching rate (access) is increased from $0.010800 to $0.03690 in the Carbon/Emery exchanges; the composite local transport charge (access) is increased from $0.001061 to $0.00560 in the Carbon/Emery exchanges; the Carrier Common Line originating and terminating charges are eliminated. (*See* Exhibit S-8). These proposed changes are from prior Qwest rate that were established on a statewide basis. The proposes rates are comparable to or less than existing rates for other independent carriers in Utah.

FCC Part 69 represents the FCC's rules for allocation of interstate costs among access elements in support of tariffed charges paid by interexchange carriers and end users. While Part 69 is not a product of joint state and federal prescription as is Part 36, most states follow Part 69 for purposes of development of intrastate switched access charges. This makes sense because the end office switching and common transport functions are carried out by the same equipment and operations as for interstate. The difference is that the input for Part 69 for intrastate access purposes is based on the intrastate instead of interstate toll and private line revenue requirements determined by the Part 36 jurisdictional separations process.

Q. WHAT COMPRISES THE OPERATING EXPENSES?

A. Intrastate operating expenses of $5,037,332 includes the test year booked expenses of $4,417,187 and adjustments for known and measurable changes totaling $620,145. The return of $840,864 is that calculated based on the weighted debt and equity rate of return of 10.05 percent applied to the adjusted test year net investment of $8,366,804. (*See* Exhibit S-3, Page 2) The net investment of $8,366,804 for the test year comprises $7,185,509 calculated based on booked amounts and adjustments to average investment totaling $1,181,295. Finally, operating income taxes are the result of actual rates applied to revenues less operating expenses.

Q. WHAT COMPRISES THE TOTAL REVENUE INCREASE THAT WOULD RESULT FROM THE PROPOSED INCREASES IN RATES?

A. The request for an overall increase in intrastate revenues of $2,599,846 is based on the adjusted test year revenue requirement less adjusted test year intrastate revenue, $6,185,175 less $3,585,329. (*See* Exhibit S-3, page 2 for the adjusted test year revenue requirement calculation and Exhibit S-1, Column K, Line 10 for the adjusted test year intrastate revenue). Adjusted test year intrastate revenues are tied to the post-audit trial balance plus known and measurable changes. The only known and measurable adjustment for intrastate revenues reflected in the filing is a removal of an intrastate special access revenue overstatement of $60,636.

The $6,185,175 intrastate revenue requirement is the combination of adjusted test year intrastate expenses and return and taxes. Return is calculated based on adjusted test year intrastate investment. In order to sustain the required return after application of income taxes, the return is "grossed up" to produce the amount of revenue required to cover both income taxes and return after taxes. Such a calculation is standard for determination of revenue requirements of utilities subject to rate calculation**.** (*See* Exhibit S-3, Page 2)

Q. WHAT COMPRISES THE KNOWN AND MEASURABLE PLANT INVESTMENT AND EXPENSE ADDITIONS?

A. As mentioned above, Carbon/Emery has proposed adjustments to the 2004 test year for both expenses and investment. Combined adjustments to intrastate operating expenses total $620,145. This net number comprises $285,383 in plant specific operations expense, $10,450 in plant nonspecific operations expense, $100,528 in corporate operations expense and $223,784 in depreciation expense adjustments.

The $285,000 in plant specific operations expense is the intrastate portion of $416,000 in known plant specific operations expenses. Apportionment to intrastate is based on the individual 2004 intrastate factors for the various expenses comprising the $416,000. The $416,000 comprises $96,000 in aggregate monthly charges for GPS service for company

vehicles, $120,000 in parking lot and yard blacktop resurfacing and gate restoration, and $200,000 in plant maintenance. The plant maintenance includes increased maintenance for buried cable. The intrastate factors used are the 64.02% factor for General Support Assets and the 73.55% factor for Cable and Wire Facilities maintenance. (These expenses are summarized on Exhibit S-5.3).

The $10,450 in plant nonspecific operations expense is the intrastate portion of $16,323 in power plant maintenance, allocated at the Plant Nonspecific Expense factor of 64.02%.

The Corporate Operations expense adjustment of $100,528 is the intrastate portion of $160,000 in rate case expenses. The allocation is based on the General and Administrative Expense factor of 62.83%.

Q. WHAT COMPRISES THE DEPRECIATION EXPENSE ADJUSTMENTS?

A. The $146,888 in depreciation expense adjustments represents the combination of three sets of adjustments: additional depreciation expense from plant additions totaling $89,569; increased depreciation of $38,358 due to use of a lower than authorized depreciation rate and addition of $95,857 for the effect of proposed increases in depreciation rates.

The $38,358 adjustment is for Central Office Switching equipment depreciation for which Carbon/Emery has used the Emery Telcom approved rate of 12.5% since the time of the acquisition from Qwest instead of the Carbon/Emery rate of 20%. The difference in annual depreciation is $63,401, with the intrastate portion of $38,358 calculated based on the intrastate factor for depreciation expense. Aside from the proposed rate changes discussed herein, all other depreciation rates proposed by Carbon/Emery are the same as those authorized for use by Carbon/Emery. In addition to adjusting depreciation expense, the depreciation reserve has also been adjusted. (*See* Exhibit S-7 for analysis of the effect of unauthorized depreciation rates.)

Carbon/Emery is proposing in this proceeding adjusting five of the nineteen depreciation rates applicable to its plant accounts. For Buildings, Carbon/Emery proposes increasing the depreciation rate from 3.33% to 5%. For Underground Cable, Carbon/Emery is proposing increasing the depreciation rate from 4% to 5%. For Buried Cable, the proposed increase is from 4.5% to 5%, For Intrabuilding Network, the company is also proposing an increase from 4.5% to 5%. Finally, the Carbon/Emery is proposing an increase in the depreciation rate for Conduit Systems from 2.0% to 3.33%. The combined total company effect of proposed changes in depreciation rate is $158,442. The $95,857 intrastate portion of the increase is based on application of the intrastate depreciation expense factor. (*See* Exhibit S-6).

Q. HAS THE COMPANY PERFORMED A DEPRECIATION STUDY?

A. Carbon/Emery has not performed a depreciation study. Carbon/Emery proposes depreciation rates changes are limited to five out of the nineteen individual rates. Carbon/Emery has selected accounts for proposed depreciation rate increases based generally on the apparent deficiency in current reserve levels in relation to the plant balance. I believe a full depreciation study would be unduly burdensome in both time and expense for a company of Carbon/Emery's size.

Q. EXHIBIT S-1 INCLUDES AN ADJUSTMENT FOR "QWEST DS3." PLEASE EXPLAIN THIS ADJUSTMENT.

A. Carbon/Emery and Qwest jointly provide a DS3 for exchanging frame relay traffic. Carbon/Emery bills the underlying carriers for the capacity usage on that DS3. The revenue from Qwest should be treated as a balance sheet flow-through transaction only. The adjustment indicating the removal of the Qwest revenue is shown on both Exhibits S-1 and S-9.

Q. WHAT MAKES UP THE INCREASE IN INTRASTATE NET INVESTMENT?

A. The $1,181,295 net increase in intrastate investment results from the following adjustments: known and measurable plant additions totaling $1,382,953; reserve

additions related to the known and measurable plant additions totaling $92,928; addition to the accumulated depreciation reserves of $38,358 concomitant with the adjustment for understated depreciation expense mentioned previously; and addition to the accumulated depreciation reserves of $99,454 associated with the depreciation expense for the plant addition adjustments.

The known and measurable intrastate plant additions totaling $1,382,953 is the intrastate portion of total additions of $2,056,607. An analysis of the total additions and the allocation to intrastate can be found on Exhibit S-5. The $2,056,607 total adjustment for additions includes two sets of adjustments. The first set of adjustments is that for giving full year effect to the 2004 additions net of retirements. The total adjustment for this purpose is $127,779, equal to 50 percent of the net 2004 change in Plant in Service. Exhibit S-5.1 summarizes calculations for this adjustment. The second set of adjustments for known and measurable plant additions totals $1,967,518. (See Exhibit S-5.2).

The $1,967,518 in known and measurable plant additions for 2005 and early 2006 includes $54,000 for addition of trucks, $80,000 for upgrading of the Price DMS 100 switch for Caller ID Trunk capabilities, $76,000 for electronics, $219,000 for replacement of radio equipment for the Castle Dale to Price route and $1,537,553 in fiber installations. (Exhibit S-5.2 provides detail on plant additions).

Q. WHY DOES INVESTMENT INCLUDE AN AMOUNT FOR CASH WORKING CAPITAL AND HOW IS IT CALCULATED?

A. Where jurisdictions prescribe rate bases for purposes of determination of required return on investment for regulated telecommunications carriers, the prescriptions typically include an allowance for cash working capital. Carbon/Emery uses a cash working capital allowance based on the method prescribed by the FCC for small telephone companies in Section 65.820(d) of the FCC's rules for purposes of calculation of interstate access revenue requirements who opt not to undertake the burdensome time and expense of a full lead-lag study.[4]

The FCC described the process for calculation of the cash working capital allowance in a 1997 access tariff order.

> To determine the carrier's working capital allowance under the standard 15-day allowance method, the carrier's total annual cash operating expenses must be divided by 365 days to determine the average daily cash operating expenses. A carrier's average daily cash operating expense must then be multiplied by the standard cash working capital allowance of 15

[4] See 47 C.F.R. § 65.820(d).

days to derive its cash working capital allowance. [5]

In 1989 the FCC prescribed a 15 day allowance period for Class B telephone companies.

> This standard lead or lag would be applied to an individual Class B carrier's cash operating expense to determine its CWC. Our review of the data available at this Commission which relate carrier CWC and operating expenses indicates that a 15 day lag period is an appropriate standard for the present.[6]

It is JSI's experience that the time commitment and cost for a full lead lag study for a company of the size of Carbon/Emery is far out of proportion with what we would expect to be a minimal change in result.

Q. WHAT IS YOUR RECOMMENDATION TO THIS COMMISISON?

A. In preparing and reviewing Carbon/Emery's rate case support, I believe that the proposed revenue requirement increase is just and reasonable and should be approved expeditiously.

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[5] *1997 Annual Access Tariff Filings*, CC Docket No. 97-149, Memorandum Opinion and Order, 13 FCC Rcd 3815 (1997) at para. 226.

[6] Amendment of Part 65 of the Commission's Rules to Prescribe Components of the Rate Base and Net Income of Dominant Carriers, CC Docket No. 86-497, Order on Reconsideration, 4 FCC Rcd 1697 (1989) at para. 14. See Id at note 18 ("We consider 15 days to be a reasonable allowance based on our analysis of the CWC requirements contained in the 1988 Tariff Review Plans (TRPs) of the Tier 1 carriers. The 15 days of cash operating expenses represent the equivalent of what the Tier 1 carriers receive").

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes.