

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

**IN THE MATTER OF UBTA-UBET)
COMMUNICATIONS, INC.'S)
(DBA STRATA NETWORKS))
APPLICATION FOR UTAH)
UNVERSAL SERVICE FUND)
SUPPORT)
)**

Docket No. 15-053-01

STRATA EXHIBIT 2

Applicant

DIRECT TESTIMONY

OF

KARL SEARLE

ON BEHALF OF STRATA NETWORKS

April 6, 2015

**STRATA EXHIBITS 2.1 – 2.6 ATTACHED HERETO CONTAIN INFORMATION
WHICH IS CONFIDENTIAL SUBJECT TO UTAH PUBLIC SERVICE COMMISSION
RULE R746-100-16**

DIRECT TESTIMONY OF KARL SEARLE

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Q. Please identify yourself.

A. My name is Karl Searle.

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

A. I am employed by UBTA-UBET Communications, In. dba STRATA Networks (“STRATA”) as Chief Financial Officer.

Q. Briefly describe your educational background and work experience.

A. I have been employed by STRATA since 2005. I began my telecommunications career in 1986. I spent 19 years at a telecommunications company in Idaho prior to joining STRATA. I attended college from 1982-1986 and graduated with a Bachelors in Business Administration, and in 1988 I was certified as a Certified Public Accountant.

Q. On whose behalf are you testifying?

A. I am testifying on behalf of STRATA in support of its application for additional support from the Utah Universal Support Fund (“UUSF”).

Q. What is the purpose of your testimony?

A. The purpose of my testimony is to explain the financial and statistical data that support STRATA’s Application for UUSF support. I provide testimony that supports the confidential STRATA Exhibits which are attached to my testimony.

24 **Q. Please identify the Exhibits to your testimony.**

25 A. The individual Confidential Exhibits include:

26	STRATA Exhibit 2.1 Confidential	USF Request Calculation
27	STRATA Exhibit 2.2 Confidential	Rate Base Calculation
28	STRATA Exhibit 2.3 Confidential	Cost of Capital / Rate of Return Calculations
29	STRATA Exhibit 2.4 Confidential	Known and Measurable Pro Forma Adjustments
30	STRATA Exhibit 2.4a Confidential	Pro Forma Adjustment – Federal USF
31	STRATA Exhibit 2.4b Confidential	Pro Forma Adjustment – Network Revenues
32	STRATA Exhibit 2.4c Confidential	Pro Forma Adjustment – Local Service Revenues
33	STRATA Exhibit 2.4d Confidential	Pro Forma Adjustment – Labor Expenses
34	STRATA Exhibit 2.4e Confidential	Pro Forma Adjustment – Investment 2015
35	STRATA Exhibit 2.5a Confidential	Cash Working Capital - 2014
36	STRATA Exhibit 2.5b Confidential	Cash Working Capital - 2013
37	STRATA Exhibit 2.6 Confidential	Audited Financial Statements 2014

38

39 **Q. Were these Exhibits and supporting work papers prepared by you or prepared**
40 **under your supervision?**

41 A. Yes, I prepared them or they were prepared under my supervision.

42

43 **Q. Why are the Exhibits confidential?**

44 A. The Exhibits contain confidential financial information related to STRATA and its
45 operations. The information is highly sensitive and public disclosure would be harmful to
46 STRATA.

47

48 **Q. What is the test period STRATA is using in its Application?**

49 A. STRATA is using calendar year 2014 as the test year to determine the appropriate
50 amount of UUSF support. I believe that this test year, after being adjusted for known and
51 measurable changes, reflects the conditions STRATA will face following this proceeding.
52 Therefore, the Application and the Exhibits are based on audited financial information for

53 the 12 months ending December 31, 2014. This is consistent with previous Commission
54 cases affecting rural local exchange carriers. The test year is then adjusted for known and
55 measurable changes in operations which more accurately reflects STRATA's current and
56 future costs of providing telecommunications services. All of these adjustments are
57 included in the Exhibits.

58

59 **Q. Have you calculated STRATA's revenue deficiency?**

60 A. Yes. STRATA Exhibit 2.1 Confidential shows a revenue deficiency.

61

62 **Q. How did you calculate STRATA's revenue deficiency?**

63 A. As a rate-of-return incumbent telephone corporation STRATA keeps its accounting
64 records in accordance with the FCC's Part 32 Uniform System of Accounts.¹ To
65 determine the revenue deficiency, I multiplied STRATA's rate base by a reasonable rate-
66 of-return to reach the allowable return, which is reflected on line 6 of STRATA Exhibit
67 2.3 Confidential. Then I reduced the allowable return by the Company's operating income,
68 which left the revenue deficiency of \$3,422,053 identified in STRATA Exhibit 2.1
69 Confidential.

70

71 **Q. Are you proposing that STRATA recover this revenue deficiency from the UUSF?**

72 A. Yes. Receipt of this additional amount from the UUSF will enable STRATA to continue
73 providing telecommunications services within its service territory.

74

¹ Utah Admin. Code Rule R746-340-2.

75 **Q. Have you calculated STRATA's rate base for this proceeding?**

76 A. Yes. STRATA Exhibit 2.2 Confidential shows the calculation for STRATA's total rate
77 base. I started with historical plant balances for the beginning of 2014 and plant balances
78 for the end of 2014 and then calculated an average. I adjusted the average rate base for
79 known and measurable changes to determine STRATA's adjusted rate base.

80

81 **Q. What known and measurable changes to the rate base did you make?**

82 A. The adjustments I made to rate base are shown in STRATA Exhibit 2.2.

83

84 **Q. What cost of capital is STRATA using in its Application?**

85 A. STRATA used an overall composite rate of 9.50 percent.

86

87 **Q. Please explain how you arrived at STRATA's Cost of Capital.**

88 A. In accordance with UUSF policy, STRATA calculated a blended cost of capital, which
89 represents the weighted average of an interstate rate of return of 11.45 percent and a state
90 rate of return of 8.17 percent. STRATA's intrastate cost of capital was derived using
91 STRATA's actual capital structure (approximately 50 percent equity and 50 percent
92 debt). For the individual components of its capital structure, STRATA has used a cost of
93 debt of 2.57 percent and a cost of equity of 14.01 percent,² which results in a composite
94 intrastate rate-of-return of 9.50 percent.

95

² The cost of equity is based on a recent study. See *Comments of the National Exchange Carrier Association, Inc., NTCA—The Rural Broadband Association, USTELCOM, Eastern Rural Telecom Association, and Western*

96 The consolidated Company cost of debt was derived from debt that existed during the
97 2014 base year. STRATA's debt carried a stated rate of 2.57 percent as shown on
98 STRATA Exhibit 2.3 Confidential.

99
100 The interstate return of 11.45 percent is derived from NECA's Form 492 filing with the
101 FCC on September 30, 2014 for calendar year 2013 pool participants.³

102
103 **Q. Please explain how the Company's blended Cost of Capital was derived.**

104 A. The Commission's Total Company Rule requires a blending of the authorized cost of
105 capital costs in the state and interstate jurisdictions.⁴ This weighting of the jurisdictional
106 capital costs was based upon the jurisdictional separation of STRATA's rate base in
107 accordance with the FCC's Part 36 rules. STRATA's jurisdictional percentages
108 (intrastate and interstate) are contained in STRATA Exhibit 2.3 Confidential, and are
109 applied to the intrastate and interstate costs of capital to determine the Weighted Cost of
110 9.50 percent as contained in that Exhibit.

111
112 **Q. Will you describe STRATA Exhibit 2.1 Confidential?**

113 A. Yes. STRATA Exhibit 2.1 Confidential is the calculation of STRATA's revenue
114 deficiency showing the inputs to make that calculation.

115

Telecommunications Alliance, GN Docket No. 09-51, et al., July 25, 2013, page 29 and Dr. Billingsley's statement page 10.

³ Utah Admin. Code Rule R746-360-8(A)(1)(a)(i).

⁴ Utah Admin. Code Rule R746-360-8(A)(1).

- 116 **Q. Please describe STRATA Exhibit 2.2 Confidential.**
- 117 A. STRATA Exhibit 2.2 Confidential is the calculation of STRATA's rate base in this case.
- 118
- 119 **Q. Please describe STRATA Exhibit 2.3 Confidential.**
- 120 A. STRATA Exhibit 2.3 Confidential illustrates STRATA's rate of return calculation and
- 121 STRATA's cost of debt.
- 122
- 123 **Q. Please describe STRATA Exhibit 2.4 Confidential.**
- 124 A. STRATA Exhibit 2.4 Confidential enumerates all of the known and measurable
- 125 adjustments for 2015 that STRATA made to the 2014 test year in this case.
- 126
- 127 **Q. Please describe STRATA Exhibit 2.4a Confidential.**
- 128 A. STRATA Exhibit 2.4a Confidential shows the calculation for the federal USF known and
- 129 measurable adjustments used in STRATA Exhibit 2.4 Confidential.
- 130
- 131 **Q. Please describe STRATA Exhibit 2.4b Confidential.**
- 132 A. STRATA Exhibit 2.4b Confidential shows the calculation for the network revenues
- 133 known and measurable adjustment that STRATA used in STRATA Exhibit 2.4
- 134 Confidential.
- 135
- 136 **Q. Please describe STRATA Exhibit 2.4c Confidential.**

137 A. STRATA Exhibit 2.4c Confidential is the calculation for the local service revenues
138 known and measurable adjustment STRATA made to the 2014 test year in STRATA
139 Exhibit 2.4 Confidential.

140

141 **Q. Please describe STRATA Exhibit 2.4d Confidential.**

142 A. STRATA Exhibit 2.4d Confidential gives the detail for the known and measurable
143 change in operating expenses in 2015 shown in STRATA Exhibit 2.4 Confidential that
144 STRATA applied to the 2014 test year.

145

146 **Q. Please describe STRATA Exhibits 2.4e Confidential.**

147 A. STRATA Exhibit 2.4e Confidential shows the calculation for the known and measurable
148 change in investments in 2015 that STRATA applied to the 2014 test year shown in
149 STRATA Exhibit 2.4 Confidential.

150

151 **Q. Please describe STRATA Exhibits 2.5a Confidential and 2.5b Confidential.**

152 A. STRATA Exhibit 2.5a Confidential is STRATA's calculation for cash working capital in
153 2014. STRATA Exhibit 2.5b Confidential makes the same calculation for 2013.
154 STRATA proposes to use a 27-day period for its working capital days. This period is
155 based on its most recent lead-lag study.

156

157 **Q. Please describe STRATA Exhibit 2.6 Confidential.**

158 A. STRATA Exhibit 2.6 Confidential is a copy of STRATA's audited financial statements
159 for 2014.

160 **Q. Is it your testimony that the increase STRATA is seeking in its annual UUSF support**
161 **is just and reasonable and in the public interest?**

162 A. Yes.

163

164 **Q. Does this conclude your direct testimony?**

165 A. Yes. In the event I discover any material changes to my testimony and exhibits, I request
166 that I be given the opportunity to amend and supplement this testimony.