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BEFORE THE ARIZONA CORPORATI

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF MIDVALE TELEPHONE EXCHANGE, INC. FOR AUTHORITY TO INCREASE RATES AND FOR DISBURSEMENTS FROM THE ARIZONA UNIVERSAL SERVICE FUND.

DOCKET NO. T-02532A-00-0512

STAFF'S NOTICE OF FILING DIRECT TESTIMONY

The Arizona Corporation Commission Staff ("Staff") hereby files the Direct Testimony of Darron W. Carlson, Joel Reiker, Sonn S. Ahlbrecht, Richard Boyles and Al Buckalew.

RESPECTFULLY SUBMITTED this 15th day of March, 2001.

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DIRECT

TESTIMONY

OF

DARRON W. CARLSON
SONN S. AHLBRECHT
ALLEN G. BUCKALEW
JOEL M. REIKER
RICHARD L. BOYLES

DOCKET NO. T-02532A-00-0512

March 15, 2001

CARLSON

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF MIDVALE TELEPHONE EXCHANGE FOR A HEARING TO DETERMINE THE EARNINGS OF THE COMPANY, THE FAIR MARKET VALUE OF THE COMPANY FOR RATE MAKING PURPOSES, TO FIX A JUST AND REASONABLE RATE OF RETURN THEREON, TO APPROVE RATE SCHEDULES DESIGNED TO DEVELOP SUCH A RETURN AND TO CONSIDER THE REQUEST TO EXTEND THE COMPANY'S CERTIFICATE OF CONVENIENCE AND NECESSITY TO INCLUDE NEW SERVICE AREAS	)	DOCKET NO. T-02532A-00-0512

DIRECT

TESTIMONY

OF

DARRON W. CARLSON

SENIOR RATE ANALYST

UTILITIES DIVISION

MARCH 15, 2001

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EXECUTIVE SUMMARY
OF THE
DIRECT TESTIMONY
OF
STAFF WITNESS
DARRON W. CARLSON
REGARDING
MIDVALE TELEPHONE EXCHANGE
DOCKET NO. T-02532A-00-0512

The direct testimony of Staff witness, Darron W. Carlson, addresses the Company's operating revenues and expenses and the Company's revenue requirement. Staff recommends intrastate operating revenue of $747,819. Staff's recommended intrastate operating revenue is $17,391 more than the Test Year revenue and $275,295 less than the $1,023,114 intrastate operating revenue proposed by the Company. Staff's recommended intrastate operating revenue reflects Staff's adjustments to operating expenses, rate base, and cost of capital. Staff's primary operating revenue and expense adjustments are as follows:

1. Midvale's Requested Extended Area Service ("EAS")

Staff adjustments increased two revenue accounts by a total of $32,877. Staff removed Midvale's pro forma adjustments reducing these accounts due to EAS based on Staff witness, Mr. Allen G. Buckalew's recommendation to deny approval of the EAS request.

2. Midvale's Requested Unserved Areas

Staff's adjustments decreased six revenue accounts by a total of $143,572. Also, Staff's adjustments decreased seven expense accounts by a total of $183,992. This results from Staff's removal of all of Midvale's pro forma adjustments increasing these accounts due to its inclusion of estimated revenues and expenses expected from the new unserved areas. Staff believes the inclusion of these estimates is not appropriate in a rate case filing as they are not "known and measurable".

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3. Depreciation Expense

Staff's adjustment increased depreciation expense by $29,690. Staff's adjustment reflects the new depreciation rates recommended by Staff witness, Mr. Richard Boyles on a going-forward basis.

4. Corporate Operations Expense

Staff's adjustment decreased corporate operations expense by $13,543. Staff's adjustment reflects Staff's belief that the Company claimed rate case expenses are excessive and included items not associated with the rate case. Staff's adjustment reflects its reasonable determination of the proper level of rate case expense.

5. Miscellaneous (Interest Expense)

Staff's adjustment decreased miscellaneous (interest expense) by $15,948. Staff's adjustment reflects Staff's belief that interest expense is a "below-the-line" expense item and should not be included in the calculation of operating income.

6. Federal and State Income Tax

Staff's adjustment increased federal and state income tax by $47,413. Staff's adjustment was necessary because Midvale failed to claim any income tax liability, an operating expense. Staff calculated Test Year income tax based on the adjusted jurisdictional revenues and expenses.

INTRODUCTION

Q. Please state your name and business address for the record.

A. My name is Darron W. Carlson. My business address is 1200 West Washington, Phoenix, Arizona 85007.

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

A. I am employed by the Utilities Division of the Arizona Corporation Commission ("ACC" or "Commission") as a Senior Rate Analyst.

Q. How long have you held this position?

A. I have held this position since August of 1995. Prior to that, I was a Utilities Auditor III for one and a half years and a Utilities Auditor II for two and a half years.

Q. Please describe your educational background and professional experience.

A. I hold a Bachelor of Arts degree in both Accounting and Business Management from Northeastern Illinois University in Chicago, Illinois. I have participated in a number of seminars and workshops related to utility rate-making, cost of capital and similar issues, sponsored by the Commission, the National Association of Regulatory Utility Commissioners ("NARUC") and others.

Prior to my employment with the Commission, I was employed as a Program Compliance Auditor III with the Arizona Department of Agriculture for seven years. My other work experience ranges from Military Payroll Auditor to Controller in private corporations.

Q. What are your duties as a Senior Rate Analyst at the Commission?

A. I am responsible for the examination and verification of financial and statistical information included in utility rate applications. I analyze the financial condition of utilities and prepare reports and recommendations on financial and accounting matters, cost of capital, revenue requirements and rate design. I also review requests for financing, and the financial considerations of requests for Certificates of Convenience and Necessity ("CC&N"). My responsibilities also include providing expert testimony in formal hearings before the Commission on all of the aforementioned matters.

PURPOSE OF TESTIMONY

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

A. The purpose of my testimony in this proceeding is to present a portion of Staff's position and recommendations regarding the Midvale Telephone Exchange ("Midvale" or "Company") rate application. This application, dated July 14, 2000, and docketed as sufficient on August 11, 2000, requests permanent adjustments to rates and charges for utility service. The application also includes a request to extend the Company's CC&N to include new unserved areas. On August 28, 2000, a Commission hearing officer issued a Procedural Order setting filing deadlines and various dates for an eventual hearing on this matter. A revised Procedural Order was issued on February 1, 2001. My testimony presents Staff's recommendations pertaining to total Company test year operating revenues and expenses and the intrastate revenue requirement.

Q. Was this testimony prepared by you or under your direction and supervision?

A. Yes.

GENERAL INFORMATION

Q. What other Staff witnesses are involved in the presentation of Staff's recommendations or have provided substantial relevant information that you relied upon?

A. Mr. Richard Boyles is responsible for the engineering and technical analysis along with the new Staff proposed plant depreciation rates. Ms. Sonn S. Ahlbrecht is responsible for the analysis and recommendations on rate base. Mr. Allen G. Buckalew is responsible for the separations and allocations analysis, the CC&N extension and the rate design to include the Extended Area Service ("EAS") requested by the Company. Mr. Joel Reiker is responsible for the cost of capital analysis. All of the aforementioned are Staff witnesses and are providing pre-filed testimony in this case.

Q. As part of your assigned duties at the Commission, did you perform a regulatory audit of Midvale as a part of your analysis of the rate increase request?

A. Yes, I did. I examined the accounting books and records, tested revenue, verified selected expenditures and reviewed the asset and liability accounts. My work also included a review of the Commission's records of Midvale's filings. In addition, I made oral and written requests for data and engaged in discussions with Midvale representatives. As a result of Staff's audit and the recommendations of the aforementioned Staff witnesses, I am recommending adjustments to Midvale's rate increase request.

Q. What is the general condition of Midvale's accounting records?

A. Staff's examination revealed that the Company's accounting records are maintained in a satisfactory manner. Amounts in Midvale's general ledger are accurate and generally reliable as verified by supporting documentation. Midvale's representatives were generally responsive to Staff's requests for data but were uncooperative if they did not understand and/or agree with Staff's needs for information. As an example, Staff requested that the Company provide billing information to allow Staff to evaluate the need for annualization adjustments of its revenue and expenses so that Staff could utilize an end of Test Year customer count to match an end of Test Year rate base, which is Staff's normal procedure for most utilities. The Company refused to provide the requested information and questioned Staff's failure to accept the average Test Year information as filed by the Company. If the Company had provided the requested information, Staff could have evaluated whether annualization of revenues and expenses would have provided a more accurate picture of the Company's financial position on a going-forward basis. Staff recommends that the Company be ordered to file as part of its application, detailed monthly billing data, in any future rate cases, to allow a proper evaluation as to whether annualization of revenues and expenses is appropriate.

Staff identified some inconsistencies between the narrative testimonies of the Company's witnesses and the actual numbers produced by calculations on the "A" through "H" schedules. Also the Company's filing included numerous other schedules/exhibits that do not reconcile with the "A" through "H" schedules. Throughout my testimony, where these discrepancies exist, I have utilized the amounts in the "A" through "H" schedules to represent the Company's proposal. For instance, Company witness, Dr. Don Reading's direct testimony, on page 8, sets the weighted cost of capital at 11.2 percent; however, Schedule A-1 of the Company's filing reflects 10.346 percent as the rate of return. I used the rate of return on Schedule A-1, 10.346 percent, as the Company's proposed rate of return.

Q. Is the Company current on its payment of property taxes and sales taxes?

A. Yes.

SUMMARY OF ADJUSTMENTS

Q. Please summarize the recommendations and adjustments addressed in your direct testimony.

A. My direct testimony addresses the following issues:

<u>Local Service Revenues</u> – This adjustment decreases the Company's intrastate operating revenues by $81,599. This adjustment reflects Staff's removal of the Company's pro forma inclusion of revenues associated with the unserved areas.

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Network Access Service Revenues – This adjustment decreases the Company's intrastate operating revenues by $43,425. This adjustment reflects Staff's removal of the Company's pro forma inclusion of revenues associated with the unserved areas and Staff's removal of the Company's pro forma adjustment associated with its EAS request.

Interstate Universal Service Fund Revenues – This adjustment increases the Company's intrastate operating revenues by $15,687. This adjustment reflects Staff's removal of the Company's pro forma adjustment associated with its EAS request.

Miscellaneous Revenues – This adjustment decreases the Company's intrastate operating revenues by $2,073. This adjustment reflects Staff's removal of the Company's pro forma inclusion of revenues associated with the unserved areas.

Uncollectible Revenues – This adjustment increases the Company's intrastate operating revenues by $715. This adjustment reflects Staff's removal of the Company's pro forma inclusion of uncollectibles associated with the unserved areas.

Plant Specific Expenses – This adjustment decreases the Company's intrastate operating expenses by $17,638. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas.

Other Plant Expenses – This adjustment decreases the Company's intrastate operating expenses by $11,480. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas.

Depreciation Expense – This adjustment decreases the Company's intrastate operating expenses by $30,673. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas and also reflects Staff's proposed depreciation rates instead of the Company's current rates.

Customer Operations Expense – This adjustment decreases the Company's intrastate operating expenses by $15,820. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas.

Corporate Operations Expense – This adjustment decreases the Company's intrastate operating expenses by $51,501. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas and Staff's adjustment of the Company's proposed rate case expense and its related amortization period.

Property Taxes and Other Taxes – This adjustment decreases the Company's intrastate operating expenses by $5,782. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas.

Miscellaneous (Interest Expense) – This adjustment decreases the Company's intrastate operating expenses by $50,899. This adjustment reflects Staff's removal of the Company's pro forma inclusion of expenses associated with the unserved areas and Staff's removal of interest expense, as interest expense is a "below the line" item not included in the calculation of operating income.

Federal & State Income Tax – This adjustment increases the Company's intrastate operating expenses by $47,413. This adjustment increases the Company's proposed income tax expense to reflect Staff's recommended Test Year revenues and expenses.

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REVENUE REQUIREMENTS

Q. Please summarize the results of your analysis of Midvale's application and state Staff's recommended revenue requirement.

A. Staff is recommending an intrastate revenue requirement of $747,819 for Midvale. Staff's recommended revenue requirement represents a $17,391 increase from the adjusted Test Year revenue of $730,428. Staff's recommended intrastate revenue requirement is $275,295 less than the Company's proposal of $1,023,114. Schedule DWC-1, presents the calculation of the recommended intrastate revenue requirement.

GROSS REVENUE CONVERSION FACTOR

Q. Please summarize the results of your analysis of Midvale's application and state Staff's recommended gross revenue conversion factor.

A. Staff recommends using 1.7652 as the intrastate gross revenue conversion factor. Staff's recommended gross revenue conversion factor represents a 0.089 increase in Midvale's proposed Test Year intrastate gross revenue conversion factor of 1.6762.

Q. Why do the Company and Staff gross revenue conversion factors differ?

A. The gross revenue conversion factors differ because Midvale used out-dated and/or incorrect income tax rates to calculate its conversion factor.

The Company used 8.0 percent for the Arizona corporate income tax rate. Staff used the new rate for Arizona corporate income tax, effective January 1, 2001, of 6.968 percent. The change in the Arizona income tax rate is known and measurable. Therefore, the newest tax rate is the correct rate to use in deriving the revenue requirement on a going-forward basis.

The Company used a federal corporate income tax rate of 35 percent that applies to taxable income exceeding $10,000,000 to calculate its gross revenue conversion factor.

Based on Staff's recommended revenue requirement, the effective federal corporate income tax rate is 26.9 percent. However, the incremental federal corporate income tax rate that is applicable to the revenue increase recommended by Staff is 39 percent. Therefore, Staff used 39 percent for the calculation of the gross revenue conversion factor.

Schedule DWC-2, presents the calculation of Staff's recommended intrastate gross revenue conversion factor.

OPERATING INCOME

Operating Income Summary

Q. What are the results of your analysis of Test Year revenues, expenses and operating income?

A. As shown on Schedule DWC-3, my analysis resulted in Test Year intrastate revenues of $730,428, Test Year intrastate expenses of $614,053 and Test Year intrastate net operating income of $116,375.

Operating Income Adjustment No. 1 – Local Service Revenues

Q. What has Midvale proposed for Test Year local service revenues?

A. In addition to the Company's Test Year amount of $172,369 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $81,599 for the total Company to reflect its request to include estimated revenues expected from the unserved areas. The Company's total adjusted Test Year local service revenues are $253,968.

The effects of the Company's proposed increase in local service revenues are reflected on the income statement, Schedule C-1, of the Company's filing.

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Q. Do you agree with the Company's pro forma adjustment to increase local service revenues?

A. No. The Company's proposal is based on the inclusion of estimated revenues from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for local service revenues?

A. As shown on Schedule DWC-5, Staff recommends decreasing intrastate local service revenues by $81,599.

Operating Income Adjustment No. 2 – Network Access Service Revenues

Q. What has Midvale proposed for Test Year network access service revenues?

A. In addition to the Company's Test Year amount of $563,821 for the total Company, Midvale is proposing a pro forma adjustment to decrease this amount by $17,190 for the total Company to reflect its removal of access revenue associated with its EAS request. Midvale is also proposing a pro forma adjustment to increase this amount by $120,908 for the total Company to reflect its request to include estimated revenues expected from the unserved areas. Midvale's total Company adjusted Test Year network access service revenues are $667,539. The effects of the Company's proposed increase in network access service revenues are reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustments to increase network access service revenues?

A. No. The Company's proposal is based on the assumption that the EAS request would be granted. Staff witness, Mr. Allen G. Buckalew, has recommended that the EAS request not be granted in this case. It is also based on the inclusion of estimated revenues from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for network access service revenues?

A. As shown on Schedule DWC-6, Staff recommends decreasing intrastate network access service revenues by $43,425.

<u>Operating Income Adjustment No. 3 – Interstate Universal Service Fund Revenues</u>

Q. What has Midvale proposed for Test Year interstate universal service fund revenues?

A. In addition to the Company's Test Year amount of $107,050 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $221,824 for the total Company to reflect its increased funding due to the lifting of federal caps on universal service funds. Also, Midvale is proposing a pro forma adjustment to decrease this amount by $15,687 for the total Company to reflect its removal of universal service funding potentially lost in association with its EAS request. Midvale's total Company adjusted Test Year interstate universal service fund revenues are $313,187. The effects of the Company's proposed adjustments are reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustments to increase interstate universal service fund revenues?

A. No. The Company's proposal is based on the assumption that the EAS request would be granted. As stated previously, Staff has recommended that the EAS request not be granted, therefore, Staff believes the removal of the adjustment, related to the EAS request, is necessary.

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Q. What adjustment is Staff recommending for interstate universal service fund revenues?

A. As shown on Schedule DWC-7, Staff recommends decreasing intrastate federal universal service fund revenues by $15,687.

Operating Income Adjustment No. 4 – Miscellaneous Revenues

Q. What has Midvale proposed for Test Year miscellaneous revenues?

A. In addition to the Company's Test Year amount of $22,081 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $2,073 for the total Company to reflect its request to include estimated revenues expected from the unserved areas. Midvale's total Company adjusted Test Year miscellaneous revenues are $24,154. The effect of the Company's proposed increase in miscellaneous revenues is reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase miscellaneous revenues?

A. No. The Company's proposal is based on the inclusion of estimated revenues from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for intrastate miscellaneous revenues?

A. As shown on Schedule DWC-8, Staff recommends decreasing intrastate miscellaneous revenues by $2,073.

Operating Income Adjustment No. 5 – Uncollectible Revenues

Q. What has Midvale proposed for Test Year uncollectible revenues?

A. In addition to the Company's Test Year uncollectible revenue of $1,279 for the total Company, Midvale is proposing a pro forma adjustment to recognize an additional $715 for the total Company to reflect its request to include estimated revenues expected from the unserved areas. Midvale is proposing $1,994 as total Company adjusted Test Year uncollectible revenues. The effect of the Company's proposed increase in uncollectible revenues is reflected on the income statement, Schedule C-1 of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase uncollectible revenues?

A. No. The Company's proposal is based on the inclusion of estimated revenues from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable"

Q. What adjustment is Staff recommending for uncollectible revenues?

A. As shown on Schedule DWC-9, Staff recommends decreasing intrastate uncollectible revenues by $715.

<u>Operating Income Adjustment No. 6 – Plant Specific Expenses</u>

Q. What has Midvale proposed for Test Year plant specific expenses?

A. In addition to the Company's Test Year amount of $127,720 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $27,462 for the total Company to reflect its request to include estimated expenses expected from the unserved areas. The Company's total adjusted Test Year plant specific expenses are $155,182. The effect of the Company's proposed increase in plant specific expenses is reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase plant specific expenses?

A. No. The Company's proposal is based on the inclusion of estimated expenses from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for plant specific expenses?

A. As shown on Schedule DWC-10, Staff recommends decreasing intrastate plant specific expenses by $17,638.

Operating Income Adjustment No. 7 – Other Plant Expenses

Q. What has Midvale proposed for Test Year other plant expenses?

A. In addition to the Company's Test Year amount of $62,925 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $21,595 for the total Company to reflect its request to include estimated expenses expected from the unserved areas. The Company's total adjusted Test Year other plant expenses are $84,520. The effect of the Company's proposed increase in other plant expenses is reflected on the income statement, Schedule C-1 of the Company's filing.

Q. Do you agree with the Company's pro forma adjustments to increase other plant expenses?

A. No. The Company's proposal is based on the inclusion of estimated expenses from the unserved areas and Staff believes they are not appropriate is a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for other plant expenses?

A. As shown on Schedule DWC-11, Staff recommends decreasing intrastate other plant expenses by $11,480.

Operating Income Adjustment No. 8 – Depreciation Expense

Q. What has Midvale proposed for Test Year depreciation expense?

A. In addition to the Company's Test Year amount of $186,282 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $101,161 for the total Company to reflect its request to include estimated expense expected from the unserved areas. Midvale's total Company adjusted Test Year depreciation expense is $287,443. The effect of the Company's proposed increase in depreciation expense is reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase depreciation expense?

A. No. The Company's proposal is based on the inclusion of estimated expenses expected from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Additionally, Staff Engineering has determined that the Company's current depreciation rates should be adjusted to better reflect individual plant lives. Staff witness, Mr. Richard Boyles has reviewed the Company plant and current depreciation rates and has designed an alternative depreciation rate schedule that Staff recommends on a going-forward basis. Please refer to Mr. Boyle's direct testimony for further details of his analysis.

Q. Has Staff prepared a schedule showing the calculation of depreciation expense using Staff's proposed depreciation rates by plant account?

A. Yes. Schedule DWC-4, shows the calculation of Staff's proposed depreciation expense.

Q. What adjustment is Staff recommending for intrastate depreciation expense?

A. As shown on Schedule DWC-12, Staff recommends decreasing intrastate depreciation expense by $30,673.

<u>Operating Income Adjustment No. 9 – Customer Operations Expense</u>

Q. What has Midvale proposed for Test Year customer operations expense?

A. In addition to the Company's Test Year amount of $96,131 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $20,968 for the total Company to reflect its request to include estimated expense expected from the unserved areas. Midvale's total Company adjusted Test Year customer operations expense is $117,099. The effects of the Company's proposed increase in customer operations expense are reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase customer operations expense?

A. No. The Company's proposal is based on the inclusion of estimated expense expected from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for customer operations expense?

A. As shown on Schedule DWC-13, Staff recommends decreasing intrastate customer operations expense by $15,820.

Operating Income Adjustment No. 10 – Corporate Operations Expense

Q. What has Midvale proposed for Test Year corporate operations expense?

A. In addition to the Company's Test Year amount of $254,880 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $56,051 for the total Company to reflect its request to include estimated expenses expected from the unserved areas. Midvale is also proposing a pro forma adjustment to increase this amount by $40,000 for the total Company to reflect its estimated rate case expenses involved in this proceeding. Midvale's total Company adjusted Test Year corporate operations expense is $350,931. The effect of the Company's proposed increase in corporate operations expense is reflected on the income statement, Schedule C-1 of the Company's filing.

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Q. Do you agree with the Company's pro forma adjustment to increase corporate operations expense?

A. No. The Company's proposal is based on the inclusion of estimated expense expected from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

The Company's proposed corporate operations expense also includes the Company's estimated rate case expense. At Staff's request the Company provided an updated estimate of its rate case expense. In Staff's opinion, the Company's estimate of $149,000 is not reasonable. The Company's estimated rate case expense includes $41,610 of engineering costs. The Company has not demonstrated how these costs are related to the rate case. Costs related to the CC&N extension should be capitalized instead of recognized as rate case expense. Staff recommends $60,000 for rate case expense. Staff amortized this $60,000 expense over three years to arrive at an annual rate case expense of $20,000. Staff's pro forma adjustment reflects this level of expense.

Q. What adjustment is Staff recommending for corporate operations expense?

A. As shown on Schedule DWC-14, Staff recommends decreasing intrastate corporate operations expense by $51,501.

<u>Operating Income Adjustment No. 11 – Property Taxes and Other Taxes</u>

Q. What has Midvale proposed for Test Year property taxes and other taxes?

A. In addition to the Company's Test Year amount of $81,282 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $9,103 for the total Company to reflect its request to include expenses from the unserved areas. The Company's total adjusted Test Year property taxes and other taxes are $90,385. The effect of the Company's proposed increase in property taxes and other taxes is reflected on the income statement, Schedule C-1 of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase property taxes and other taxes?

A. No. The Company's proposal is based on the inclusion of estimated taxes expected from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Q. What adjustment is Staff recommending for property taxes and other taxes?

A. As shown on Schedule DWC-15, Staff recommends decreasing intrastate property taxes and other taxes by $5,782.

Operating Income Adjustment No. 12 – Miscellaneous (Interest Expense)

Q. What has Midvale proposed for Test Year miscellaneous (interest expense)?

A. In addition to the Company's Test Year amount of $25,107 for the total Company, Midvale is proposing a pro forma adjustment to increase this amount by $55,023 for the total Company to reflect its request to include estimated expense expected from the unserved areas. The Company's total adjusted Test Year miscellaneous (interest expense) is $80,130. The effect of the Company's proposed increase in miscellaneous (interest expense) is reflected on the income statement, Schedule C-1, of the Company's filing.

Q. Do you agree with the Company's pro forma adjustment to increase miscellaneous (interest expense)?

A. No. The Company's proposal is based on the inclusion of estimated expenses from the unserved areas and Staff believes they are not appropriate in a rate case filing as they are not "known and measurable".

Additionally, Staff believes that interest expense is a "below the line" expense item and should not be included in the calculation of operating income.

Q. What adjustment is Staff recommending for miscellaneous (interest expense)?

A. As shown on Schedule DWC-16, Staff recommends decreasing intrastate miscellaneous (interest expense) by $50,899.

Operating Income Adjustment No. 13 – Federal and State Income Tax

Q. What has Midvale proposed for Test Year intrastate federal and state income tax?

A. The Company's filing did not include any income tax expense in the presentation of Test Year operating income. However, the Company's general ledger shows Test Year intrastate federal and state income tax of a negative $3,040.

Q. Do you agree with the Company's failure to recognize intrastate federal and state income tax for the Test Year?

A. No. Staff believes that, for taxable entities such as Midvale, income tax expense should be recognized on a stand-alone basis. That is, income tax for the Test Year should be calculated based on the adjusted jurisdictional revenues and expenses. Staff used the Arizona jurisdictional revenues and expenses to calculate the Test Year income tax liability.

Q. What adjustment is Staff recommending for Test Year intrastate federal and state income tax?

A. As shown on Schedule DWC-17, Staff recommends increasing intrastate federal and state income tax by $47,413.

RECOMMENDATIONS

Q. Please summarize Staff's primary recommendations.

A. Staff's primary recommendations are reflected on Schedule DWC-1.

. . .

. . .

Staff recommends authorization of a $17,391 (2.38 percent) increase in revenue to provide a 10.14 percent return on an Original Cost Rate Base of $1,244,841.

Staff further recommends the rates and charges as presented in the testimony of Staff witness, Mr. Allen G. Buckalew.

Staff further recommends the approval of the Company's request to extend its Certificate of Convenience and Necessity, as reviewed in the testimony of Staff witness, Mr. Allen G. Buckalew.

Staff further recommends that the Company be ordered to include, in any future rate case filing with this Commission, detailed monthly billing data to facilitate necessary evaluations.

Q. Does this conclude your direct testimony?

A. Yes, it does.

MIDVALE TELEPHONE EXCHANGE **Schedule DWC-1**
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

COMPUTATION OF INCREASE IN GROSS REVENUE REQUIREMENTS

LINE NO.	DESCRIPTION	[A] PER COMPANY	[B] PER STAFF
1	Adjusted Rate Base	$ 1,807,096	$ 1,244,841
2	Adjusted Operating Income (Loss)	$ 90,689	$ 116,375
3	Current Rate of Return (Ln 2/Ln 1)	5.02%	9.35%
4	Required Return on Rate Base (Ln 1 x Ln 5)	$ 186,962	$ 126,227
5	Required Rate of Return	10.346%	10.14%
6	Operating Income Deficiency (Ln 4 - Ln 2)	$ 96,273	$ 9,852
7	Gross Revenue Conversion Factor (Schedule DWC-2)	1.6762	1.7652
8	Increase (Decrease) in Gross Revenue Requirements (Ln 6 x Ln 7)	$ 181,991	$ 17,391
9	Adjusted Test Year Operating Revenue	$ 841,123	$ 730,428
10	Recommended Operating Revenue (Ln 8 + Ln 9)	$ 1,023,114	$ 747,819
11	Percentage Increase (Decrease) in Operating Revenue (Ln 8 / Ln 9)	21.64%	2.38%

References:

Column [A]: Company Schedules A-1, B-1, C-1, C-3 and D-1

The Company's proposed increase in gross revenue on line 8 is not mathematically correct. That is, it is not equal to the operating income deficiency times the gross revenue conversion factor which is $161,374.

Column [B]: Staff Schedules DWC-2, DWC-3, SSA-1 and JMR-1

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-2

GROSS REVENUE CONVERSION FACTOR
INCOME TO REVENUE MULTIPLIER

LINE NO.	DESCRIPTION		
1	Gross Intrastate Revenue		1.0000
2	Less: Uncollectible Revenue		0.00175
3	Total Revenue (Ln 1 - Ln 2)		0.99825
4	Less: Taxes on Local Revenue Service		0.0000
5	Taxable Income (Ln 3 - Ln 4)		0.99825
6	State Income Tax Rate	0.06968	
6a	Less: State Income Tax (Ln 5 x Ln 6)		0.06956
7	Federal Income Tax Base (Ln 5 - Ln 6a)		0.92869
7a	Federal Income Tax Rate (Incremental)	0.39000	
7b	Less: Federal Income Tax ((Ln 5 - Ln 6a) x Ln 7a)		0.36219
8	Net Operating Income (Ln 7 - Ln 7b)		0.56650
9	Income to Revenue Multiplier (1/Ln 8)		**1.7652**

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-3

OPERATING INCOME STATEMENT

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJS	REF	[C] STAFF ADJUSTED	[D] INTERSTATE AS ADJ	[E] INTRASTATE AS ADJ
	REVENUES:						
1	Local Service Revenues	$ 253,968	$ (81,599)	1	$ 172,369	$ -	$ 172,369
2	Network Access Service Revenues	667,539	(103,718)	2	563,821	357,197	206,624
3	Interstate USF	313,187	15,687	3	328,874	-	328,874
4	Directory Revenue	1,759	-		1,759	-	1,759
5	Miscellaneous	24,154	(2,073)	4	22,081	-	22,081
6	Uncollectible	(1,994)	715	5	(1,279)	-	(1,279)
7	**Total Operating Revenues**	**$ 1,258,613**	$ (170,988)		$ 1,087,625	$ 357,197	$ 730,428
	EXPENSES:						
8	Plant Specific	$ 155,182	$ (27,462)	6	$ 127,720	$ 45,685	$ 82,035
9	Other Plant	84,520	(21,595)	7	62,925	29,474	33,451
10	Network Operations	-	-		-	-	-
11	Access Expense	-	-		-	-	-
12	Total Plant Non-Specific (Lines 9 - 11)	84,520	(21,595)		62,925	29,474	33,451
13	Depreciation Expense	287,443	(51,404)	8	236,039	95,195	140,844
14	Customer Operations	117,099	(20,968)	9	96,131	23,600	72,531
15	Corporate Operations	350,931	(76,051)	10	274,880	88,731	186,149
16	Other Operating Income & Expenses	-	-		-	-	-
17	Property Taxes & Other Taxes	90,385	(9,103)	11	81,282	29,652	51,630
18	Miscellaneous	80,130	(80,130)	12	-	-	-
19	Total Selling, General & Administrative	925,988	(237,656)		688,332	237,178	451,154
20	**Total Operating Expenses:**	$ 1,165,690	$ (286,713)		$ 878,977	$ 312,337	$ 566,640
21	**INCOME (LOSS) FROM OPERATIONS**	**$ 92,923**	**$ 115,725**		**$ 208,648**	**$ 44,860**	**$ 163,788**
	TAXES:						
22	Federal & State Income Tax (Reflects Intrastate portion only)	$ -	47,413	13	47,413	-	47,413
	NET OPERATING INCOME						**$ 116,375**

References:

Column [A]: Company Schedule C-1
Column [B]: Staff Schedules DWC-5 through DWC-17
Column [C]: Column [A] plus Column [B]
Column [D]: Column [C] minus Column [E]
Column [E]: Column [C] times separations rate derived from Company Schedule C-1

Adjustment No. 1: Schedule DWC-5
Adjustment No. 2: Schedule DWC-6
Adjustment No. 3: Schedule DWC-7
Adjustment No. 4: Schedule DWC-8
No. 5: Schedule DWC-9
No. 6: Schedule DWC-10
No. 7: Schedule DWC-11
No. 8: Schedule DWC-12
No. 9: Schedule DWC-13
No. 10: Schedule DWC-14
No. 11: Schedule DWC-15
No. 12: Schedule DWC-16
No. 13: Schedule DWC-17

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

SCHEDULE DWC-4

NEW DEPRECIATION RATES

LINE NO,	ACCOUNT NO.	DESCRIPTION	[A] AMOUNT	[B] % RATE	[C] ANNUAL DEPR. EXP.	[D] INTERSTATE	[E] INTRASTATE
1	2111.54	Land - Young	$ 20,207	0.00%	$ -		
2	2111.55	Buildings - Young	14,347	2.50%	359		
3	2112.33	Vehicles - Cascabel	29,645	14.00%	4,150		
4	2112.55	Vehicles - Young	24,900	14.00%	3,486		
5	2116.33	Other Work Equip - Cascabel	21,980	10.00%	2,198		
6	2122.55	Office Furn & Equip - Young	500	9.30%	47		
7	2124.33	Gen. Use Computers - Cascabel	6,971	20.00%	1,394		
8	2124.55	Gen. Use Computers - Young	1,972	20.00%	394		
9	2212.33	Dig. Elec. Switch - Cascabel	172,859	10.00%	17,286		
10	2212.55	Dig. Elec. Switch - Young	314,991	10.00%	31,499		
11	2230.33	Cent. Office Trans - Cascabel	304,025	10.00%	30,403		
12	2230.33	Cent. Office Trans - Young	563,115	10.00%	56,312		
13	2423.33	Buried Cable - Cascabel	766,075	5.65%	43,283		
14	2423.55	Buried Cable - Young	800,504	5.65%	45,228		
15	Totals and Composite Rate:		$ 3,042,091	7.7591%	$ 236,039	$ 95,195	**$ 140,844**

References:

Column [A]: Staff Schedule SSA-2
Column [B]: Staff Schedule RLB-1
Column [C]: Column [A] times Column [B]
Column [D]: Company Schedule C-1 (separations factor)
Column [E]: Column [C] minus Column [D]

Line 15: Schedule DWC-12

MIDVALE TELEPHONE EXCHANGE **Schedule DWC-5**
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

OPERATING INCOME ADJUSTMENT NO. 1
LOCAL SERVICE REVENUES

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENT**	**STAFF AS ADJUSTED**
1	Total Company Local Service Revenues	$ 253,968	$ (81,599)	$ 172,369
2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
3	Intrastate Local Service Revenues	$ 253,968	$ (81,599)	**$ 172,369**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-6

OPERATING INCOME ADJUSTMENT NO. 2
NETWORK ACCESS SERVICE REVENUES

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
	INTERSTATE ACCESS:			
INTER-1	Total Company Access Service Revenues	$ 440,637	$ (63,636)	$ 377,001
INTER-2	Intrastate Allocation Factor (Rounded)	5.25%	5.25%	5.25%
INTER-3	Intrastate Network Access Service Revenues	$ 23,147	$ (3,343)	$ 19,804
	INTRASTATE ACCESS:			
INTRA-1	Total Company Access Service Revenues	$ 226,902	$ (40,082)	$ 186,820
INTRA-2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
INTRA-3	Intrastate Network Access Service Revenues	$ 226,902	$ (40,082)	$ 186,820
	COMBINED TOTAL:			
COMBO-1	Total Company Access Service Revenues	$ 667,539	$ (103,718)	$ 563,821
COMBO-2	Intrastate Allocation Factor	NMF	NMF	NMF
COMBO-3	Intrastate Network Access Service Revenues	$ 250,049	$ (43,425)	**$ 206,624**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-7

OPERATING INCOME ADJUSTMENT NO. 3
INTERSTATE UNIVERSAL SERVICE FUNDS

		[A]	[B]	[C]
LINE NO.	**DESCRIPTION**	**COMPANY AS FILED**	**STAFF ADJUSTMENT**	**STAFF AS ADJUSTED**
1	Total Company U.S.F. Revenues	$ 313,187	$ 15,687	$ 328,874
2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
3	Intrastate Interstate U.S.F. Revenues	$ 313,187	$ 15,687	**$ 328,874**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-8

OPERATING INCOME ADJUSTMENT NO. 4
MISCELLANEOUS REVENUES

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Miscellaneous Revenues	$ 24,154	$ (2,073)	$ 22,081
2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
3	Intrastate Miscellaneous Revenues	$ 24,154	$ (2,073)	**$ 22,081**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-9

OPERATING INCOME ADJUSTMENT NO. 5
UNCOLLECTIBLE REVENUES

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Uncollectible Revenues	$ (1,994)	$ 715	$ (1,279)
2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
3	Intrastate Uncollectible Revenues	$ (1,994)	$ 715	**$ (1,279)**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-10

OPERATING INCOME ADJUSTMENT NO. 6
PLANT SPECIFIC EXPENSES

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Plant Specific Expenses	$ 155,182	$ (27,462)	$ 127,720
2	Intrastate Allocation Factor	64.23%	64.23%	64.23%
3	Intrastate Plant Specific Expenses	$ 99,673	$ (17,638)	**$ 82,035**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-11

OPERATING INCOME ADJUSTMENT NO. 7
OTHER PLANT EXPENSES

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Total Company Other Plant Expenses	$ 84,520	$ (21,595)	$ 62,925
2	Intrastate Allocation Factor	53.16%	53.16%	53.16%
3	Intrastate Other Plant Expenses	$ 44,931	$ (11,480)	**$ 33,451**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-12

OPERATING INCOME ADJUSTMENT NO. 8
DEPRECIATION EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Depreciation Expense	$ 287,443	$ (51,404)	$ 236,039
2	Intrastate Allocation Factor	59.67%	59.67%	59.67%
3	Intrastate Depreciation Expense	$ 171,517	$ (30,673)	**$ 140,844**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-13

OPERATING INCOME ADJUSTMENT NO. 9
CUSTOMER OPERATIONS EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Customer Operations	$ 117,099	$ (20,968)	$ 96,131
2	Intrastate Allocation Factor	75.45%	75.45%	75.45%
3	Intrastate Customer Operations Expense	$ 88,351	$ (15,820)	**$ 72,531**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-14

OPERATING INCOME ADJUSTMENT NO. 10
CORPORATE OPERATIONS EXPENSE

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Corporate Operations	$ 350,931	$ (76,051)	$ 274,880
2	Intrastate Allocation Factor	67.72%	67.72%	67.72%
3	Intrastate Corporate Operations Expense	$ 237,650	$ (51,501)	**$ 186,149**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE **Schedule DWC-15**
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

OPERATING INCOME ADJUSTMENT NO. 11
PROPERTY TAXES AND OTHER TAXES

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Property and Other Taxes	$ 90,385	$ (9,103)	$ 81,282
2	Intrastate Allocation Factor	63.52%	63.52%	63.52%
3	Intrastate Property Taxes and Other Taxes	$ 57,412	$ (5,782)	**$ 51,630**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-16

OPERATING INCOME ADJUSTMENT NO. 12
MISCELLANEOUS (INTEREST EXPENSE)

LINE NO.	DESCRIPTION	[A] COMPANY AS FILED	[B] STAFF ADJUSTMENT	[C] STAFF AS ADJUSTED
1	Total Company Miscellaneous (Interest Exp.)	$ 80,130	$ (80,130)	$ -
2	Intrastate Allocation Factor	63.52%	63.52%	63.52%
3	Intrastate Miscellaneous (Interest Expense)	$ 50,899	$ (50,899)	$ -

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

MIDVALE TELEPHONE EXCHANGE
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule DWC-17

OPERATING INCOME ADJUSTMENT NO. 13
FEDERAL AND STATE INCOME TAX (INTRASTATE PORTION ONLY)

		[A]	[B]	[C]
LINE NO.	DESCRIPTION	COMPANY AS FILED	STAFF ADJUSTMENT	STAFF AS ADJUSTED
1	Total Company Federal & State Income Tax	$ -	$ 47,413	$ 47,413
2	Intrastate Allocation Factor	100.00%	100.00%	100.00%
3	Intrastate Federal and State Income Tax	$ -	$ 47,413	**$ 47,413**

References:

Column [A]: Company Schedule C-1

Column [B]: DWC Direct Testimony

Column [C]: Column [A] minus Column [B]

AHLBRECHT

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF MIDVALE TELEPHONE EXCHANGE, INC., FOR AUTHORITY TO INCREASE RATES AND FOR DISBURSMENT FROM THE ARIZONA UNIVERSAL SERVICE FUND	)))))	DOCKET NO. T-02532A-00-0512

DIRECT

TESTIMONY

OF

SONN S. AHLBRECHT

RATE ANALYST II

UTILITIES DIVISION

MARCH 15, 2001

Jbc128t

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EXECUTIVE SUMMARY
MIDVALE TELEPHONE EXCHANGE, INC.
DOCKET NO. T-02532A-00-0512
RATE BASE
SONN AHLBRECHT

The testimony of Staff witness, Sonn S. Ahlbrecht, addresses the Company's rate base. Staff recommends an intrastate rate base of $1,244,841, or $562,255 less than the $1,807,096 rate base proposed by the Company. The primary components of Staff's adjustments to rate base included the following:

- Reclassification of $5,619 in public telephone equipment due to deregulated status.

- Removal of proforma plant in the amount of $1,087,603 related to unserved areas.

- Decrease to Cascalbel Accumulated Depreciation by $9,195 based upon depreciation expense recalculated by Staff at approved rates for that exchange.

- Reduction of Young Accumulated Depreciation by $215,025 due to Staff's recalculation of depreciation expense based upon depreciation rates originally approved for Qwest for that exchange.

- Increase to Accumulated Deferred Income Taxes of $156,381 as reflected in the general ledger of Midvale that are attributable to Arizona operations.

INTRODUCTION

Q. Please state your name and business address for the record.

A. My name is Sonn S. Ahlbrecht. My business address is 1200 West Washington, Phoenix, Arizona 85007.

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

A. I am employed by the Utilities Division of the Arizona Corporation Commission ("Commission") as a Rate Analyst II.

Q. Please describe your educational background and professional experience.

A. I graduated from Arizona State University with a Bachelor of Science Degree in Accounting. I was granted Certified Public Accountant certification in the State of Arizona in July of 1997. In 1998, I obtained certification from the Maricopa County Community College District to teach accounting at community colleges within the Maricopa County District.

I have attended many seminars related to auditing, revenue requirement, and rate design. Since joining the Commission, I have participated in several regulatory training seminars sponsored by the National Association of Regulatory Utility Commissioners ("NARUC"), Utilitech, Inc., the Arizona Corporation Commission, the Internal Revenue Service, and the Arizona Department of Revenue. I also have been required to complete Continuing Professional Education credit hours to retain my designation as a CPA.

I have been employed by the Commission as a regulatory auditor and a rate analyst since July of 1998. Prior to joining the Commission, I worked in a variety of industries including public accounting, education, health care, and manufacturing.

. . .

. . .

Q. Please describe your duties and responsibilities as a Rate Analyst II.

A. My responsibilities include examination and verification of utility accounting records in conjunction with rate applications. In addition, I analyze data for ratemaking purposes, evaluate the utility's current rate structure, propose rates and service charges based upon information analyzed during my regulatory audit, and prepare written reports, testimony, and schedules that include recommendations to the Commission. My responsibilities also include testifying at formal public hearings regarding audit findings and recommendations, as well as providing information regarding those recommendations before the Commissioners in Open Meeting.

PURPOSE OF TESTIMONY

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

A. I am presenting Staff's analysis and recommendations regarding the Original Cost Rate Base ("OCRB") in Midvale Telephone Exchange, Inc.'s ("Midvale" or "Company"), application for an increase in permanent rates. Staff witness, Darron Carlson, is presenting Staff's recommendations regarding revenue requirement. Staff witness, Alan Buckalew, is presenting Staff's recommendations regarding separations and rate design. Staff witness, Joel Reiker, is presenting Staff's recommendations regarding Staff's cost of capital, and Staff witness, Richard Boyles, is presenting Staff's engineering analysis.

Q. Was this testimony prepared by you or under your direction?

A. Yes, it was.

Q. What is the basis of your recommendations?

A. I performed a regulatory audit of the Company's records to determine whether sufficient, relevant and reliable evidence exists to support the proposals in Midvale's rate application. The regulatory audit consisted of examining and testing accounting ledgers, reports and supporting documents, checking the accumulation of amounts in the records, tracing recorded amounts to source documents, and verifying that the accounting principles applied were in accordance with the Federal Communication Commission ("FCC") Uniform System of Accounts for telecommunications companies.

SUMMARY OF ADJUSTMENTS

Q. Please summarize the recommendations and adjustments addressed in your testimony.

A. My testimony will address five adjustments to OCRB resulting in a total decrease of $1,025,383 before Intrastate separations as illustrated in Schedule SSA-1.

The first adjustment removes non-regulated pay telephone assets from Plant in Service related to the Young exchange. Another adjustment was made to remove the Proforma additions of plant for Unserved Areas the Company proposes to serve. Two adjustments were made to Accumulated Depreciation for both the Cascabel and Young exchanges. The final adjustment to OCRB includes Deferred Taxes attributed to the Arizona exchanges.

ORIGINAL COST RATE BASE

Q. Has the Company prepared a Schedule showing the elements of Reconstruction Cost New Rate Base Net of Depreciation ("RCND")?

A. No. The Company did not file RCND Schedules. Therefore, Staff evaluated the Original Cost Rate Base also as the Fair Value Rate Base ("FVRB").

Q. What is the amount of OCRB Staff is recommending?

A. As shown on Schedule SSA–1, Staff is recommending an Intrastate Original Cost Rate Base of $1,244,841. Staff's recommended OCRB is a decrease of $562,255 from Midvale's proposed Intrastate Original Cost Rate Base of $1,807,096.

. . .

. . .

Q. Please explain the five adjustments Staff made to Midvale's unseparated OCRB amount.

A. As shown on Schedule SSA–1, Staff made two adjustments, A and B, to Plant in Service resulting in a total decrease of $1,093,222. Please refer to the section of this Testimony entitled Original Cost Plant in Service for further analysis regarding these two adjustments.

Q. Did Staff make any adjustments to Accumulated Depreciation?

A. Yes. Adjustments C and D decrease Accumulated Depreciation by $224,220. Please refer to the section of this Testimony entitled Accumulated Depreciation for a detailed illustration of these two adjustments.

Q. Did Staff make any other adjustments to unseparated OCRB?

A. Yes. Adjustment E, increased Accumulated Deferred Income Taxes by $156,381. Staff recommends this adjustment to include Deferred Income Taxes reflected in the general ledger of Midvale attributable to Arizona operations.

Q. Please summarize your adjustments to OCRB.

A. When Staff decreases Company proposed OCRB of $2,968,117 by $1,025,383, the result is the unseparated Staff recommended amount of $1,942,734. The Intrastate allocation factors are then applied to the individual components that comprise Staff's recommended amount to calculate Intrastate Original Cost Rate Base for Arizona as $1,244,841.

ORIGINAL COST PLANT IN SERVICE

Q. Please explain the adjustments Staff made to Original Cost Plant in Service reflected on Schedule SSA-2.

A. Staff recommends five adjustments that result in a decrease of $1,093,222 to unseparated Plant in Service.

. . .

Adjustments A, B, C, and D, reduce the respective plant balances to remove Proforma additions related to Unserved Areas proposed by the Company. Midvale's application reflects a total of $1,087,603 in plant additions required to be installed for the Unserved Areas. Staff consistently does not allow Proforma plant in OCRB, as it does not meet either the criteria of "used and useful", or "known and measurable". These four adjustments to Plant in Service equate to Adjustment B, on Schedule SSA-1, for Unserved Areas.

Adjustment E, on Schedule SSA-2, reduced the Public Telephone Equipment account for the Young exchange by $5,619 as a result of an April 1997 ruling by the Federal Communications Commission deregulating pay telephones. This adjustment corresponds to Adjustment A, on Schedule SSA-1, for the Young exchange.

Q. What is the result of Staff's adjustments to Original Cost Plant in Service?

A. Staff's adjustments result in a decrease of $1,093,22, from Midvale's proposed $4,135,313 to Staff recommended $3,042,091. Further, this amount requires separation between Interstate and Intrastate, resulting in $1,945,021 for total Midvale Intrastate Original Cost Plant in Service.

ACCUMULATED DEPRECIATION

Q. Please explain Staff's adjustments to Accumulated Depreciation as illustrated on Schedule SSA-3.

A. Midvale's application reflects $1,167,196 for Average Accumulated Depreciation for Test Year Ended December 31, 1999; $373,775 of that amount is attributed to the Cascabel exchange, and $793,421 to the Young exchange.

Staff's reduction for the Cascabel exchange, Adjustment A, in the amount of $9,195, was calculated by summing depreciation expense for each year since inception in August of

1993 though the end of the Test Year. Based upon Staff's analysis, Accumulated Depreciation at December 31, 1999, is $404,849. To remain consistent with the format presented by the Company, Staff then averaged the December 31, 1999 balance, with the Accumulated Depreciation balance as of December 31, 1998, or $324,311. Staff recommends an Average Accumulated Depreciation balance for Test Year Ended December 31, 1999, for the Cascabel exchange of $364,580, a reduction of $9,195 as reflected on Schedule SSA-3, as Adjustment A, and Schedule SSA-1, as Adjustment C.

Staff's reduction for the Young exchange, Adjustment B, in the amount of $215,025, was calculated by summing depreciation expense for each year since acquisition from Qwest (f/k/a US WEST) in April of 1995, though the end of the Test Year. Based upon Staff's analysis, Accumulated Depreciation at December 31, 1999, is $514,326. To remain consistent with the format presented by the Company, Staff then averaged the December 31, 1999 balance, with the Accumulated Depreciation balance as of December 31, 1998, or $642,466. Staff recommends an Average Accumulated Depreciation balance for Test Year Ended December 31, 1999, for the Young exchange of $578,396, a reduction of $215,025 as reflected on Schedule SSA-3, as Adjustment B, and Schedule SSA-1, as Adjustment D.

Q. Why is the Accumulated Depreciation adjustment for the Young exchange substantially larger than the adjustment to the Cascabel exchange?

A. Staff discovered that Midvale was using the Cascabel depreciation rates for the Young exchange from the time of purchase from Qwest. Since Midvale recorded the Young exchange at Qwest's original cost and offset that amount by Qwest's accumulated depreciation, Midvale should have continued to apply Qwest's authorized depreciation rates after the purchase. This would serve to maintain consistency as the Young depreciation rates are what the present service rates were based upon for that exchange. The decrease in Accumulated Depreciation for the Young exchange is attributed the

Company utilizing higher depreciation rates than those approved for that exchange.

Q. What is Staff's recommendation for total Accumulated Depreciation?

A. Staff recommends a decrease in Accumulated Depreciation of $224,220 from the Company proposed amount of $1,167,196 to Staff calculated $942,976 as depicted on Schedule SSA-3. Additionally, Staff applied the Intrastate factor of 63.69 percent to that amount to arrive at a Staff recommended Intrastate Accumulated Depreciation balance of $600,581.

Q. Does this conclude your direct testimony?

A. Yes, it does.

Executive Summary
of the Testimony of
Allen G. Buckalew

Mr. Buckalew was asked by the Staff of the Arizona Corporation Commission to provide an analysis of the rate design and separations issues in Midvale's applications for increases in rates.

Mr. Buckalew's first task was to analyze whether Midvale Telephone Company complied with the FCC rules on separation found in Part 36 of the Code of Federal Regulations for Telecommunications. Part 36 of the Code outlines the procedures for the determination of the appropriate allocation of property costs, revenues, expenses, taxes, and reserves, as recorded on the company's books or to estimated values, to intrastate and interstate jurisdictions. The procedures are necessary because a characteristic of an integrated telecommunications system is that a large portion of total costs are common or joint in nature and therefore can be used for either intrastate or interstate services. After reviewing the studies for Part 36, Mr. Buckalew determined that Midvale Telephone Company complied with the rules and properly allocated telephone plant costs, revenues, expenses, and taxes to the Arizona jurisdiction. The Company's procedures are correct and consistent with the procedures found in the FCC rules.

The Company claimed a revenue deficiency of $108,955. The Company proposed to eliminate this deficiency by increasing the rates for residential and business customers in local service revenues by $61,210, and obtaining $147,567 from the Arizona Universal Service Fund. The Staff has revised the requested revenue requirement and after some adjustments in the rate base, accumulated depreciation, income-to-revenue multiplier, and exclusion of the EAS and Unserved Areas proposals, it has determined that an increase of $17,391 in revenues is needed. Mr. Buckalew's second task was to analyze Midvale's proposed rate design and to propose an alternative design if necessary. Mr. Buckalew determined that it was necessary to propose an alternative rate design.

Mr. Buckalew agrees with the Company's proposal to consolidate the rate structure under one rate design for all of its customers as far as possible. Mr. Buckalew's proposed business rate is $30 per month. In the area of residential rate design, Mr. Buckalew recommends no change in local rates for Cascabel residential customers and an increase to $17.15 for Young local exchange residential customers.

The Company proposes to include custom calling services in basic service. Mr. Buckalew disagrees; custom calling is not part of basic service and must have a separate price. Mr. Buckalew suggests a rate of $2.00 for the bundled group of custom calling services.

The Company also proposes to decrease access charge rates. Mr. Buckalew finds no reason to decrease access charge rates, especially for a Company with higher service area costs.

Mr. Buckalew recommends that the Company's request for extension of its CC&N into Millsite and Silver Bell be approved. Mr. Buckalew also recommends a basic local exchange rate of $24.00 for residential and $30.00 for business customers in Millsite and Silver Bell. After the facilities are built and customers are being served, the Company should apply for Federal high cost support and return to the Commission for a determination of the permanent local exchange rates and whether any AUSF is necessary.

MIDVALE TELEPHONE EXCHANGE, INC.
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule SSA-1

ORIGINAL COST RATE BASE

Line No.		Company as Filed	Staff Adjustment	Ref	Staff as Adjusted	Intrastate Per Staff
	Plant in Service:					
1	Cascabel	$ 1,301,555	$ -		$ 1,301,555	$ 850,143
2	Young	$ 1,746,155	$ (5,619)	A	$ 1,740,536	$ 1,094,878
3	Unserved Areas	$ 1,087,603	$ (1,087,603)	B	$ -	$ -
4	**Total Plant in Service**	**$ 4,135,313**	**$ (1,093,222)**		**$ 3,042,091**	**$ 1,945,021**
	Less Accumulated Depreciation:					
5	Cascabel	$ 373,775	$ (9,195)	C	$ 364,580	$ 232,201
6	Young	$ 793,421	$ (215,025)	D	$ 578,396	$ 368,380
7	Unserved Areas	$ -	$ -		$ -	$ -
8	**Total Accumulated Depreciation**	**$ 1,167,196**	**$ (224,220)**		**$ 942,976**	**$ 600,581**
	Net Plant:					
9	Cascabel	$ 927,780	$ 9,195		$ 936,975	$ 617,942
10	Young	$ 952,734	$ 209,406		$ 1,162,140	$ 726,498
11	Unserved Areas	$ 1,087,603	$ (1,087,603)		$ -	$ -
12	**Total Net Plant**	**$ 2,968,117**	**$ (869,002)**		**$ 2,099,115**	**$ 1,344,440**
	Deductions:					
13	Plant Advances	$ -	$ -		$ -	$ -
14	Contributions Gross	$ -	$ -		$ -	$ -
15	Accumulated Deferred Income Taxes	$ -	$ 156,381	E	$ 156,381	$ 99,599
16	**Total Deductions**	$ -	$ 156,381		$ 156,381	$ 99,599
	Additions:					
17	Inventory	$ -	$ -		$ -	$ -
18	Prepaid Arizona Expenses	$ -	$ -		$ -	$ -
19	**Total Additions**	**$ -**	**$ -**		**$ -**	**$ -**
20	**AVERAGE RATE BASE**	**$ 2,968,117**	**$ (1,025,383)**		**$ 1,942,734**	**$ 1,244,841**

Explanation of Adjustments:

A Please refer to Schedule SSA-2
B Please refer to Schedule SSA-2
C Please refer to Schedule SSA-3
D Please refer to Schedule SSA-3
E To reflect Deferred Income Taxes on the records of Midvale related to Arizona operations.

MIDVALE TELEPHONE EXCHANGE, INC.
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule SSA-2

ORIGINAL COST PLANT IN SERVICE

Line No.			Company as Filed	Staff Adjustment	Ref	Staff as Adjusted	Intrastate %	Intrastate Per Staff
1	2111.54	Land - Young	$ 20,207	$ -		$ 20,207	64.1200%	$ 12,957
2	2111.XX	Land - Unserved Areas	$ 20,000	$ (20,000)	A	$ -	64.1200%	$ -
3	2111.55	Buildings - Young	$ 14,347	$ -		$ 14,347	64.1200%	$ 9,199
4	2111.XX	Buildings - Unserved Areas	$ 50,000	$ (50,000)	B	$ -	64.1200%	$ -
5	2112.33	Vehicles - Cascabel	$ 29,645	$ -		$ 29,645	64.1200%	$ 19,008
6	2112.55	Vehicles - Young	$ 24,900	$ -		$ 24,900	64.1200%	$ 15,966
7	2114.33	Special Purpose Vehicles - Cascabel	$ -	$ -		$ -	64.1200%	$ -
8	2114.55	Special Purpose Vehicles - Young	$ -	$ -		$ -	64.1200%	$ -
9	2116.33	Other Work Equipment- Cascabel	$ 21,980	$ -		$ 21,980	64.1200%	$ 14,094
10	2116.55	Other Work Equipment- Young	$ -	$ -		$ -	64.1200%	$ -
11	2122.33	Office Furniture & Equip - Cascabel	$ -	$ -		$ -	64.1200%	$ -
12	2122.55	Office Furniture & Equip - Young	$ 500	$ -		$ 500	64.1200%	$ 321
13	2123.55	Official Station Equip - Young	$ -	$ -		$ -	64.1200%	$ -
14	2124.33	General Purpose Computers - Cascabel	$ 6,971	$ -		$ 6,971	64.1200%	$ 4,470
15	2124.55	General Purpose Computers - Young	$ 1,972	$ -		$ 1,972	64.1200%	$ 1,265
16	2212.33	Digital Electronic Switch - Cascabel	$ 172,859	$ -		$ 172,859	25.7700%	$ 44,546
17	2212.55	Digital Electronic Switch - Young	$ 314,991	$ -		$ 314,991	25.7700%	$ 81,173
18	2212.XX	Digital Electronic Switch - Unserved Areas	$ 350,188	$ (350,188)	C	$ -	25.7700%	$ -
19	2230.33	Central Office Trans - Cascabel	$ 304,025	$ -		$ 304,025	69.8600%	$ 212,392
20	2230.55	Central Office Trans - Young	$ 563,115	$ -		$ 563,115	69.8600%	$ 393,392
21	2230.XX	Central Office Trans - Unserved Areas	$ 667,415	$ (667,415)	D	$ -	69.8600%	$ -
22	2351.33	Public Telephone Equip - Cascabel	$ -	$ -		$ -	0.0000%	$ -
23	2351.55	Public Telephone Equip - Young	$ 5,619	$ (5,619)	E	$ -	72.5300%	$ -
24	2423.33	Buried Cable - Cascabel	$ 766,075	$ -		$ 766,075	72.5300%	$ 555,634
25	2423.55	Buried Cable - Young	$ 800,504	$ -		$ 800,504	72.5300%	$ 580,605
26	2003.33	TPUC - Cascabel	$ -	$ -		$ -	0.0000%	$ -
27	2003.55	TPUC - Young	$ -	$ -		$ -	0.0000%	$ -
28	2007.56	Res Amt Young Plant Acq	$ -	$ -		$ -	0.0000%	$ -
29		**TOTAL AVERAGE PLANT IN SERVICE**	**$4,135,313**	**$ (1,093,222)**		**$3,042,091**		**$ 1,945,021**
30		**Average Cascabel Plant**	**$1,301,555**	**$ -**		**$1,301,555**		**$ 850,143**
31		**Average Young Plant**	**$1,746,155**	**$ (5,619)**		**$1,740,536**		**$ 1,094,878**
32		**Average Unserved Areas Plant**	**$1,087,603**	**$ (1,087,603)**		**$ -**		**$ -**

Explanation of Adjustments:

A To remove Proforma Adjustment related to Unserved Areas.
B To remove Proforma Adjustment related to Unserved Areas.
C To remove Proforma Adjustment related to Unserved Areas.
D To remove Proforma Adjustment related to Unserved Areas.
E To remove assets related to pay telephone service due to ruling by the Federal Communications Commission dated April of 1997 deregulating pay telephones.

MIDVALE TELEPHONE EXCHANGE, INC.
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule SSA-3

ACCUMULATED DEPRECIATION

Line No.	Description	Company as Filed	Staff Adjustment	Ref	Staff as Adjusted	Intrastate %	Intrastate Per Staff
1	12/31/99 Balance - Cascabel	$ 373,775	$ (9,195)	A	$ 364,580	63.6900%	$ 232,201
2	12/31/99 Balance - Young	793,421	(215,025)	B	578,396	63.6900%	$ 368,380
3	**12/31/99 Balance - Total Arizona**	**$ 1,167,196**	**$ (224,220)**		**$ 942,976**		**$ 600,581**

Computation to arrive at Adjustment A:

Line No.	Description			
4	Depreciation Expense for 1993	$ 20,710		
5	Depreciation Expense for 1994	54,713		
6	Depreciation Expense for 1995	58,731		
7	Depreciation Expense for 1996	61,029		
8	Depreciation Expense for 1997	63,389		
9	Depreciation Expense for 1998	65,740		
10	Depreciation Expense for 1999	80,538		
11	Accumulated Depreciation - 12/31/99		$ 404,849	
12	Accumulated Depreciation - 12/31/98		$ 324,311	
13	Cascabel Average Accumulated Depreciation - 12/31/99			$ 364,580

Computation to arrive at Adjustment B:

Line No.	Description			
14	Accumulated Depreciation Balance-at time of purchase from US West/Qwest dated April 14, 1995		$ 556,685	
	Add:			
15	Depreciation Expense for 1995	$ 51,473		
16	Depreciation Expense for 1996	90,411		
17	Depreciation Expense for 1997	106,696		
18	Depreciation Expense for 1998	109,207		
19	Depreciation Expense for 1999	118,404	$ 476,191	
	Less:			
20	Retirements for 1995	$ (201,134)		
21	Retirements for 1996	(67,228)		
22	Removal of Accumulated Depreciation related to reclassification of pay telephone assets	(3,644)		
23	Retirements for 1998	-		
24	Retirements for 1999	(246,544)	$ (518,550)	
25	Accumulated Depreciation - 12/31/99		$ 514,326	
26	Accumulated Depreciation - 12/31/98		$ 642,466	
27	Young Average Accumulated Depreciation - 12/31/99			$ 578,396
28	**Staff determined Average Accumulated Depreciation at Test Year End - December 31, 1999**			**$ 942,976**

BUCKALEW

BEFORE THE
ARIZONA CORPORATION COMMISSION

In the Matter of the Midvale Telephone Exchange, Inc.'s Application for Authority To Increase Rates and for Disbursements from the Arizona USF.	)))))	DOCKET NO. T-02532A-00-0512

TESTIMONY OF

ALLEN G. BUCKALEW

ON BEHALF OF

THE ARIZONA CORPORATION COMMISSION

MARCH 15, 2001

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<u>Executive Summary</u>
<u>of the Testimony of</u>
<u>Allen G. Buckalew</u>

Mr. Buckalew was asked by the Staff of the Arizona Corporation Commission to provide an analysis of the rate design and separations issues in Midvale's applications for increases in rates.

Mr. Buckalew's first task was to analyze whether Midvale Telephone Company complied with the FCC rules on separation found in Part 36 of the Code of Federal Regulations for Telecommunications. Part 36 of the Code outlines the procedures for the determination of the appropriate allocation of property costs, revenues, expenses, taxes, and reserves, as recorded on the company's books or to estimated values, to intrastate and interstate jurisdictions. The procedures are necessary because a characteristic of an integrated telecommunications system is that a large portion of total costs are common or joint in nature and therefore can be used for either intrastate or interstate services. After reviewing the studies for Part 36, Mr. Buckalew determined that Midvale Telephone Company complied with the rules and properly allocated telephone plant costs, revenues, expenses, and taxes to the Arizona jurisdiction. The Company's procedures are correct and consistent with the procedures found in the FCC rules.

The Company claimed a revenue deficiency of $108,955. The Company proposed to eliminate this deficiency by increasing the rates for residential and business customers in local service revenues by $61,210, and obtaining $147,567 from the Arizona Universal Service Fund. The Staff has revised the requested revenue requirement and after some adjustments in the rate base, accumulated depreciation, income-to-revenue multiplier, and exclusion of the EAS and Unserved Areas proposals, it has determined that an increase of $17,391 in revenues is needed. Mr. Buckalew's second task was to analyze Midvale's proposed rate design and to propose an alternative design if necessary. Mr. Buckalew determined that it was necessary to propose an alternative rate design.

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I. QUALIFICATIONS AND INTRODUCTION

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

A. My name is Allen G. Buckalew. I am an Economist specializing in the telecommunications industry at J.W. Wilson & Associates, Inc. Our offices are at 1601 North Kent Street, Rosslyn Plaza C – Suite 1104, Arlington, VA 22209.

Q. PLEASE OUTLINE YOUR EDUCATIONAL BACKGROUND.

A. I hold an A.A. and a B.S. degree with high honors, both from the University of Florida, and a M.S. degree from George Washington University. My major areas of concentration were economics and telecommunications.

Q. HOW HAVE YOU BEEN EMPLOYED IN THE PAST?

A. Before I entered the University of Florida, I worked for four years in Naval Telecommunications. After graduating from the University of Florida, I worked for four years at the Federal Communications Commission ("FCC") as an Industry Economist in the Common Carrier Bureau and was employed extensively in areas involving telecommunications, economics, accounting, engineering, and policy matters. For example, one of my major projects was "The Economic Implications and Interrelationships Arising from Policies and Practices Relating to Customer

Interconnection, Jurisdictional Separations and Rate Structures," (Docket 20003). This case opened the terminal equipment (e.g., telephone sets, and private branch exchanges ("PBXs")) market in the United States to competition. I also provided economic analysis in several rate cases. For example, "Communications Satellite Corporation, Investigation into Charges, Practices, Classifications, Rates and Regulations," (Docket 16070). My major responsibility was to serve as economic advisor and analyst for the Common Carrier Bureau.

After the FCC, I was appointed Associate Director for Telecommunications Research of the National Regulatory Research Institute ("NRRI") at Ohio State University. My responsibilities at NRRI focused on telecommunications policy as seen from an analytical perspective that combined accounting, engineering, and economic disciplines. During my employment at the Institute, I completed several studies for state public utility commissions, including "The Impact of Measured Telephone Rates on Telephone Usage of Government and Nonprofit Organizations" (for the Public Utilities Commission of Ohio) and "Toward An Analysis of Telephone License Contracts and Measured Rates" (for the Maryland Public Service Commission).

In addition, I have provided several state Commissions with technical and economic assistance. This assistance was related to identifying, explaining and analyzing major issues in telecommunications cases. Since joining J.W. Wilson &

Associates, Inc. in May 1980, I have provided economic analysis in numerous proceedings in most of the States of the United States, Canada, Bolivia, Nepal, Egypt, and Tanzania. I have provided analysis for the Federal Communications Commission and the United States Department of Justice. For example, I analyzed the separation process of the FCC in September 1980, in the report entitled: "A Study of Jurisdictional Separations to Compare AT&T's Interstate Settlements Information System with the Separations Manual and Division of Revenue Process." In addition, I testified on behalf of the Department of Justice in the case that broke up the Bell system. In addition, I have worked for numerous State Attorneys General. For example, I evaluated the merger proposal of Bell Atlantic and NYNEX for the National Association of Attorneys General, the Bell Atlantic and GTE merger proposal for the Pennsylvania Attorney General. I also analyzed and the merger proposal of MCI and WorldCom for the California Public Utilities Commission.

Q. ARE YOU A MEMBER OF ANY PROFESSIONAL ORGANIZATIONS AND HONOR SOCIETIES?

A. Yes. I am a member of the Society of Depreciation Professionals, the American Economic Association, Omicron Delta Epsilon (an international honor society in economics) and Beta Gamma Sigma (an honor society in business).

Q. COULD YOU BRIEFLY SUMMARIZE YOUR PROFESSIONAL RESPONSIBILITIES TO DATE?

A. Yes. My primary responsibilities have been to supervise and actively participate in public utility regulatory policy research, especially in the telecommunications field. These responsibilities require the use and application of economic, accounting, and engineering analyses.

Q. ON WHOSE BEHALF ARE YOU TESTIFYING?

A. I present this testimony on behalf of the Staff of the Arizona Corporation Commission ("Staff").

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I have been asked by the Staff to provide an analysis of the rate design and separations proposals in Midvale's application for an increase in rates, including the proposed implementation of new extended area service ("EAS") and proposed provision of service to unserved areas.

Q. HOW ARE YOU GOING TO ADDRESS THIS TASK?

A. I am going to start by presenting my analysis of the separation process, explaining briefly the procedures outlined in Part 36 and Part 69 of the Code of Federal Regulation ("CFR") for Telecommunications. Next, I will address the

Company's proposal regarding the provision of service to currently unserved areas by Midvale. Then I will discuss why the Commission should not allow the Company to implement extended area service as proposed, and what alternative should be considered instead. Finally, I will review the Company's proposed rate structure, and present my recommendations regarding rates.

II. JURISDICTION SEPARATION COST STUDIES

Q. COULD YOU EXPLAIN THE PURPOSE OF THE SEPARATION PROCEDURE OUTLINED IN PART 36 OF THE CODE OF FEDERAL REGULATIONS FOR TELECOMMUNICATIONS?

A. Part 36 of the Code of Federal Regulations for Telecommunications outlines the procedures for the determination of the appropriate allocation of property costs, revenues, expenses, taxes, and reserves, as recorded on the company's books or to estimated values, to intrastate and interstate jurisdictions. The procedures are necessary because a characteristic of an integrated telecommunications system is that a large portion of total costs are common or joint in nature and therefore can be used for either intrastate or interstate services.

Q. WHAT IS THE FUNDAMENTAL BASIS FOR THE SEPARATION PROCEDURES IN PART 36?

A. The separation of property costs, revenues, expenses, etc., between the intrastate and interstate jurisdictions follows, fundamentally, the use of the telecommunications plant in each of the operations.[1] Therefore, the first of the two steps is to divide the cost of the plant into categories. Then, the next step is to divide the categories into state and federal jurisdictions by direct assignment when possible, and by the application of the appropriate use factors to all the remaining cost.

Q. NOW, COULD YOU DESCRIBE THE PRINCIPLES THAT UNDERLINE THE PROCEDURES IN PART 36?

A. Section 36.2 of the Code of Federal Regulations, Telecommunications, describes the fundamental principles that underlie the separation procedures in Part 36. These general principles are:

> "(1) Separations are intended to apportion costs among categories or jurisdictions by actual use or by direct assignment.
>
> (2) Separations are made on the 'Actual use' basis, which gives consideration to relative occupancy and relative time measurements.

[1] The classification to accounts of such amounts is that prescribed by the Federal Communications Commission's Uniform Systems of Accounts for Telecommunications Companies. Code of Federal Regulations, Telecommunications §36.1 (f).

(3) In the development of 'actual use' measurements, measurements of use are (i) determined for telecommunications plant or for work performed by operating forces on a unit basis (e.g., conversation-minute-kilometers per message, weighted standard work seconds per call) in studies of traffic handled or work performed during and (ii) applied to overall traffic volumes, i.e., 24-hour rather than busy hour volumes."

Q. WHAT ARE THE KEY ELEMENTS IN THIS SEPARATION PROCESS?

A. The key elements in the entire separation process are the separation of the plant cost and the measurement of actual usage; these two factors drive the separation process.

Q. HOW DOES PART 36 CLASSIFY THE TELECOMMUNICATIONS PLANT?

A. Part 36, §36.2 (b) describes the telecommunications plant as segregable into two broad classifications: (i) the interexchange plant, which is used to provide toll services, and (ii) the exchange plant, used primarily to provide local services. Furthermore, we find three broad types of plant in the interexchange classification – the operator systems, the switching plant, and the trunk transmission equipment. In the case of the exchange classification, four broad types of plant are found, the operator systems, switching plant, trunk equipment, and subscriber plant.

Q. COULD YOU DESCRIBE THE APPORTIONING PROCESS FOR PART 36 FOLLOWED BY MIDVALE TELEPHONE COMPANY?

A. Midvale Telephone Company used the Revenue Management System ("RMS") in preparing the cost allocation studies that allegedly follow the process indicated in Part 36 of the Code of Federal Regulations for Telecommunications. The RMS is software that follows the principles and steps I just briefly described.

Q. HAVE YOU ANALYZED THE COST ALLOCATION STUDY PRESENTED BY MIDVALE TELEPHONE COMPANY FOR PART 36?

A. Yes, I have. Midvale provided both a paper copy and an electronic copy of the Part 36 Cost Study. Using this information we were able to fully understand the Company's procedures and assumptions. We were also able to corroborate the allocation basis for the distribution of property costs, revenues, expenses, and taxes against the procedure outline in Part 36.

Q. WHAT WERE YOUR FINDINGS AFTER REVIEWING THE COMPANY'S STUDY?

A. We were able to track the allocation basis presented in the study for each of the telecommunication accounts, which I find in accordance with the separation procedures for telecommunications companies outlined in Part 36. The separation of the costs of the telephone plant among categories is presented in the FCC rules in the Code of Federal Regulations, Part 36.

Q. YOU HAVE ALSO MENTIONED COST ALLOCATION STUDIES FOR PART 69. COULD YOU BRIEFLY INDICATE THE OBJECTIVE OF THE PROCEDURES DESCRIBED IN PART 69 OF THE CFR?

A. Part 69 of the Code of Federal Regulations for Telecommunications establishes the rules for access charges for interstate services provided by telephone companies.[2] There is a relationship between Part 36 and Part 69. Part 36 separates the jurisdictional cost and Part 69 takes the jurisdiction costs and constructs rates. I used Part 69 as a further check of the allocation in Part 36.

Q. WHAT ARE THE CHARGES INCLUDED IN THE ALLOCATION PROCESS OF PART 69?

A. The charges for access service are for the End User Common Line element, and for line port costs in excess of basic, analog service. They shall include charges for each of the following elements: (i) Carrier common line; (ii) Local switching; (iii) Information; (iv) Tandem-switching transport; (v) Direct-trunked transport; (vi) Special access; (vii) Line information database; (viii) Entrance facilities; (ix) Universal Service Fund; and (x) Lifeline assistance.[3]

Q. HAVE YOU ANALYZED THE COST ALLOCATION STUDY PRESENTED BY MIDVALE TELEPHONE COMPANY FOR PART 69?

A. Yes, I have. The Company provided the electronic version of the cost study for Part 69. I followed the same procedure as I did with the cost study for Part 36, and I was able to track the general sources of each of the elements allocated as presented in the cost study filed by the Company for Part 69.

Q. WHAT WERE YOUR FINDINGS AFTER REVIEWING THE COMPANY'S COST ALLOCATION STUDY?

A. I agree that the allocation basis ("source," as they call it) is defined according to the outline presented in Part 69 of the Code of Federal Regulations for Telecommunications. Thus, the outlined process is consistent with the steps described in Subpart B, D, and E of Part 69 of the CFR for Telecommunications.

Q. WHAT ARE YOUR CONCLUSIONS REGARDING THE ALLOCATION AND SEPARATION FACTORS IN THE PART 36 ANALYSIS?

A. After reviewing the cost studies for Part 36, and considering all available information for my analysis, I did not find any problem in the allocation methodology for telephone plant costs, revenues, expenses, and taxes of the

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[2] Code of Federal Regulations, Telecommunications §69.1.

[3] Code of Federal Regulations, Telecommunications §69.4.

Arizona jurisdiction. They are correct and consistent with the procedures presented in the FCC rules.

III. UNSERVED LOCAL AREAS

Q. WHAT IS THE COMPANY PROPOSING IN REGARD TO UNSERVED AREAS?

A. The Company has proposed three revenue requirement scenarios. The first two, the base case and the EAS case, are discussed later. The third scenario relates to unserved areas, where Midvale Telephone Company would provide service to the unserved exchanges of Millsite and Silver Bell, which have an estimated 200 and 185 customers, respectively. The Company expects to invest about $1.45 million, and would like to draw $221,360 annually from the AUSF to support its unserved areas scenario.

It is the Company's opinion that such areas have always been a business objective if they were financially viable. However, the Company has not examined in detail the provision of service without AUSF support (Lane Williams' Testimony, page 6 line 4. and page 5, line 10-13).

Q. WHAT IS YOUR OPINION ABOUT THE COMPANY'S PROPOSAL IN THE "UNSERVED AREAS SCENARIO"?

A. The Commission's rules do not allow drawings from the AUSF without an embedded cost study for the support area for which AUSF funding is being requested (Article 12. Arizona Universal Service Fund, R14-2-1202, Calculation of AUSF Support). The Company's proposal for extension of its CC&N into Millsite and Silver Bell should be approved. I have developed a rate for service in these unserved areas that can be implemented as service is provided to customers.

Q. HAVE YOU CALCULATED THE MONTHLY COST THE CUSTOMERS SHOULD PAY IN THESE UNSERVED AREAS?

A. Yes. Exhibit AGB-1 shows an annual revenue requirement, calculated from the estimated cost that the Company has filed in regard to the unserved areas. This amount does not consider relief from the Federal USF high cost fund like the Company will receive for the Young exchange. If the Millsite and Silver Bell customers have about the same toll, other service usage, access charges and Federal revenues as Midvale's existing exchanges, the local exchange rate would have to be about $ 24.00 per month in order to cover all expenses for providing service to these areas. This rate would be lower and closer to the Company-wide rates if it were to receive payments from the Federal USF equal to Young. I suggest a local residential rate of $24.00 and business rate of $30.00. All other rates, for example, custom calling and access, would be the same as my recommendation for the Company's existing service areas. These rates will be allowed until the unserved area is fully developed and the Company is providing service. At that time the Company will present its actual costs to the Commission.

HOW WOULD YOU COMPARE THE COST PER LINE OF THE UNSERVED AREAS WITH RESPECT TO MIDVALE'S CURRENT COST?

A. The Staff has calculated that the just and proper revenue requirement for Midvale's exchanges in Young and Cascabel is $747,819. Based on that, I determined that the average residential rate would be about $18.45 per line. The projected cost of unserved areas exceeds the average cost of providing local service in the other exchanges.

Q. HOW COULD THE COST OF UNSERVED AREAS BE FINANCED?

A. My analysis of the costs to provide service to the unserved areas of Millsite and Silver Bell suggests that it can be done with very little or no support from the AUSF. The rates for Millsite and Silver Bell should be set to reflect the higher cost of serving these customers. The rate should also reflect support from Federal USF.

Q. SO THE RATES FOR UNSERVED AREAS ARE NOT GOING TO BE THE SAME AS THE OTHER MIDVALE'S EXCHANGES IN ARIZONA,

CORRECT?

A. Yes. I suggest that the rates for Silver Bell and Millsite be set based on the Company's initial cost projections. The suggested local exchange rate is $24.00 for residential and $30.00 for business customers. Costs for Millsite and Silver Bell (once the plant is in-place) will be determined and may be combined with the rest of the Company, and a new rate will be determined in conjunction with USF support.

Q. CAN YOU SUGGEST OTHER SOURCES OF REVENUES IN ORDER TO FINANCE SERVICE TO UNSERVED AREAS?

A. Yes. Staff recognizes the importance of providing basic service to people who lack phone service. The Company should seek Federal USF support. If that support is similar to the amount the Company receives for Young, then I would expect that the rate for the unserved areas may be lower than the initial projection. In addition, once customers are being served then Midvale can return to the Commission to propose a level of AUSF funding. For now, based on the Company's cost projections and assuming the Company's current level of access charges and other service revenue, I recommend a rate of $24.00 for residential local service (see Exhibit AGB-1).

IV. <u>EXTENDED AREA SERVICE ("EAS")</u>

Q. HAVE YOU ANALYZED MIDVALE'S PROPOSAL FOR EXTENDED AREA SERVICE?

A. Yes, I have. As I stated earlier, in its application, Midvale presents three proposed revenue requirements. One revenue requirement is for its base case that does not include either EAS or additional service areas. The second proposed revenue requirement adds EAS and will be discussed in this section of my testimony. And, the third adds the unserved service areas to the EAS revenue requirement that I just discussed.

The base scenario proposes an increase in revenue requirement that the Company estimates to be $108,955 per year (Midvale's Application, Part V, page 3). The EAS Case scenario adds the revenue requirement for the provision of extended area services between the Company's Cascabel exchange and the towns of Benson and San Manuel in the U S WEST exchange to its base case. This scenario produces an additional required increase in revenues of $35,751. The impact above the base case comes from a reduction in Interstate USF and Intrastate access revenues due to the decrease in toll calls and increase in local calls.

Q. ARE THERE ANY GUIDELINES TO FOLLOW FOR CONSIDERING

NEW EXTENDED AREA SERVICE?

A. In the 1993 U S WEST request for EAS, the ACC Staff recommended that the Commission set up a process for reviewing EAS without adopting a specific calling volume criterion to define the existence of a community of interest. However, the Staff recommended that the Commission "consider calling volumes, socio-economic linkages, contiguity and public input as factors in determining whether a community of interest exists" (Decision No. 58927, U S WEST Rate Case – 1993, Docket No. E-1051-93-183. Section IX. Other Rate Issues, Subsection A. Extended Area Service, page 115, lines 16-18, 20-23). In addition, the Staff suggested that a review of EAS should be considered at least 10 percent of the customers in the exchange or 200 customers, which ever is less, submitted a petition to the Commission. The idea behind the Staff's suggestions is to determine whether consumers want the service and that the public interest is served by any additional EAS routes. Once a sufficient community of interest has been established, then the cost and rate design issues must be considered. Then consumers and the Commission can make a reasonable choice on the benefits of EAS versus the cost. The Commission should consider all of the elements which might indicate that EAS is beneficial to all of these subscribers, i.e., that there exists a qualifying community of interest between the exchanges. Additionally, since the cost is proposed to be shared by all subscribers in the Company's region and other Arizona consumers, the Commission should be presented with some real benefits from this plan prior to its approval. Commissions generally look at traffic studies, rate analysis, market research, customer's education regarding the ramifications of EAS, costs and other evidence.

Q. HAS THE COMPANY PRESENTED SUFFICIENT JUSTIFICATION FOR THE IMPLEMENTATION OF THE NEW EAS, ACCORDING TO THESE CONCERNS?

A. No. The Company has failed to present data that would show that consumers want the EAS, that call volumes between these exchanges is significant or that a strong community of interest exists. In other words, the Company has not filed customer petitions or studies that would suggest such interest. Although it has provided call volumes from its customers to these exchanges, these are not sufficient indicators of a strong community of interest between Cascabel and the communities of San Manuel and Benson. The alleged need of Cascabel's customers to call schools, businesses, medical facilities, law enforcement offices, etc., in those towns does not justify higher local rates for all customers. It also seems that the community of interest in Cascabel is divided between (a) the North of Cascabel and San Manuel, and (b) the South of Cascabel and Benson.

Q. HOW IS THE COMPANY PLANNING TO FUND THE COST FOR NEW EAS?

A. Although the Company is proposing the same rates for the EAS case as for the base scenario, the loss in revenue due to the reduction of interstate USF and Intrastate access charges will be funded by an increase in the amount of AUSF requested by the Company. Witness Don C. Reading at page 24, lines 1-3, states that the Company proposes to draw $ 225,567 from the AUSF (an increase of $78,000 above the base case). The AUSF (established by the Commission on September 22, 1989) is a funding mechanism to help local telephone companies to provide basic local service to customers in high cost rural areas. I would not recommend the use of AUSF funds to support toll calling in general and specifically in this case where a few customers make a large number of calls. The use of AUSF funds without more justification is not appropriate. In other words, I do not see a valid reason to tax all Arizonans for the expansion of a few customers' local calling areas. Basic service and toll services are available and currently used in these areas. The proposed increase in AUSF, due only to EAS in order to benefit 163 customers in the Cascabel exchange, represents a subsidy of $39.88 per line per month. All telephone customers in Arizona would be required to pay for a subsidy for the provision of EAS to these customers.

Q. WHAT IS YOUR RECOMMENDATION REGARDING MIDVALE'S PROPOSED EXTENDED AREA SERVICE TO BENSON AND SAN MANUEL?

A. The Company has not performed any socioeconomic studies. Neither has it presented customer petitions to demonstrate the benefits that extended calling area service with Benson and San Manuel could bring to Cascabel customers. Therefore, based on the information they have provided, I would recommend that the Commission deny Midvale's petition.

In addition, implementation of extended area service to San Manuel or Benson is too expensive. The Company's revenue requirements associated with EAS translate into almost $40 per customer. The data suggests that only a few customers are responsible for the large volume of calls. Less than 20 percent of customers make most of the calls to San Manuel or Benson.

Q. CAN YOU SUGGEST OTHER ALTERNATIVES FAVORABLE TO CASCABEL CUSTOMERS?

A. If the Commission were to approve an optional EAS calling plan that would be offered to only those customers who would pay for this service, it would be so expensive that none of Cascabel customers would take it. Furthermore, there are already reasonable optional toll plans offered to these customers that are less expensive than EAS. Cascabel customers already have less costly alternatives to call Benson and San Manuel. For example, Cascabel, Benson and San Manuel are in the same LATA, and Qwest offers a 10 cents per minute, 24 hours 7 days, instate calling plan for residential customers. Exhibit AGB-2 shows toll calling plans that Qwest offers to businesses at no more than 14 cents per minute; other competitive carriers have similar plans. Therefore, most of Cascabel's customers would find toll charges, based on their call volumes, much lower than a compensatory rate for EAS. Converting the existing toll usage into local usage via EAS is not beneficial to the existing customers with little usage, nor to other ratepayers in the State.

V. RATE DESIGN

Q. PLEASE DESCRIBE THE APPROACH FOLLOWED BY THE COMPANY.

A. Dr. Reading says that the Company's rates, if they were to cover all the cost of service, would endanger universal service. He proposes to increase basic exchange rates to $24.00 for residential and $32.00 for business customers. The Company proposes to increase basic rates by 94 percent for the Young exchange customers and 14 percent for Cascabel. The Company proposes to increase basic service rates for residential customers (from $12.40 in the Young exchange and

$21.00 in the Cascabel exchange) to the same rate throughout the Company of $24.00. The Company proposes to increase the business rate from $21.00 in Cascabel to $32.00, equal to the current rate in Young.

Q. HAVE YOU REVISED THE RATE DESIGN THAT THE COMPANY HAS PROPOSED IN ORDER TO REACH THE INCREASE IN REVENUE REQUIREMENTS PROPOSED BY STAFF?

A. Yes, I have. In the Company's proposed base case revenue requirement it claims a revenue deficiency of $108,955 after all adjustments. It proposes to eliminate this deficiency mainly by increasing the rates for residential and business customers in local service revenues by $61,210, and drawing $147,567 from the Arizona Universal Service Fund (Midvale's Exhibit 3, Schedules 5 and 6). The Staff's recommended revenue requirement is $747,819, a deficiency from adjusted test year operating revenue of $17,391. In order to recover this deficiency I propose that local basic rates for Young and Cascabel be set at $30.00 for business, that the residential rate in Cascabel remains at $21.00, and that Young's residential rate be increased to $17.15.

The Company's proposed rate structure in order to eliminate unnecessary differences in the same categories seems reasonable, and I support such a move. However, in order to accomplish increased revenues, I do not agree with the drastic rate increase that the Company proposes. As I have stated, a one-time increase of almost 94 percent in residential service rates for the Young exchange would create a sudden burden to those customers. Even at the level that I recommend the increase for Young customers is significant at almost 38 percent. I agree that rates should be moved towards costs and that the current rates need to be increased for Young.

Q. WHAT DO YOU RECOMMEND FOR SERVICES OTHER THAN BASIC LOCAL EXCHANGE SERVICE?

Generally, custom calling is a good source of additional revenues, but the demand of such services by Midvale customers is not significant. For this reason, the Company, instead of modifying the rates, proposes to bundle the services into the basic rates. I disagree with the Company's custom calling proposal. Custom calling is not part of basic service and should have a separate price. The demand for these services is low and may be due to the rates currently being charged. I also agree with the Company that the costs to offer the customer calling services are very low. I recommend a rate of $2.00 which covers costs and will encourage usage.

The Young exchange has several categories that the Company will consolidate in order to simplify pricing with insignificant results from a revenue prospective. I agree that this is appropriate, although it has very little revenue impact.

The Company also proposes to lower intrastate access rates, which are different for the two exchanges. I do not believe that this access reduction is appropriate. It costs more to provide service in these two exchanges; high access charges help compensate for that high cost. I do agree that a single access rate is appropriate provided it generates the same level of access revenues. Although it is true that the current rates for Intrastate Access are at levels that are higher than average rates, the Company provides service to a higher cost area. There has been no reason presented (other than the rates are higher) for this decrease. I believe it is reasonable to charge higher access rates for a company with higher costs. Therefore, I suggest that the Commission deny Midvale's rate reduction in intrastate access charges.

Exhibit AGB-3 presents my suggested changes in the Company's existing rates.

Q. DOES THIS CONCLUDE YOUR TESTIMONY?

A. Yes; it does.

Unserved Areas

Number of lines 278

Summary of Rate Base

Plant Description	*Unserved*	*Intrastate*	*Interstate %*
Land	20,000	12,824	35.88%
Buildings	50,000	32,060	35.88%
Dig Elect Switch	350,188	90,243	74.23%
Central Office Trans	667,415	466,256	30.14%
Rate Base	1,087,603	601,384	
Required Rate of Return	10.14%	10.14%	
Required Return on Rate Base	110,283	60,980	
Required Return on Rate Base & Income Taxes[1]	122,497	67,734	
Operating Expenses			
Plant Specific	27,462	17,639	35.77%
Other Plant	21,595	11,480	46.84%
Dep. and Amortization	101,161	60,363	40.33%
Customer Operations	20,968	15,820	24.55%
Corporate Operations	56,051	37,958	32.28%
Other Operating Taxes	9,103	5,782	36.48%
Miscellaneous	55,023	34,951	36.48%
Total Operating Expenses	291,363	183,992	
Requirement for Unserved Areas	413,860	251,726	
Revenues			
Estimated Operating Non Local Revenues[2]		171,516	
Required Local Operating Revenue		80,211	
Average Local Rate		24.00	

[1] Based on 25% equity, 11.5% cost of equity, and 8% cost of debt. Income to Revenue Multiplier equals to 1.7652

[2] Non Local Revenues were calculated base on Staff Adjusted Recommended Operating Revenues per line

Network Access Service Revenues	206,624
Interstate USF	164,437
Directory Revenue	1,759
Miscellaneous	22,081
Uncollectible	(1,279)
Total Non Local Revenues	*393,622*
Midvale's Current Lines	638
Revenues per Line	617
Estimated Number of lines in Unserved Areas	278
Estimated Operating Revenues	171,516

MIDVALE TELEPHONE EXCHANGE

LOCAL RATE AND REVENUE SUMMARY - TOTAL ARIZONA

(A)	(B) DESCRIPTION	(C) 12/31/1999 UNITS	(D) CURRENT RATE	(E) MONTHLY REV. @ CURRENT	(F) ANNUALIZED REV. @ CURRENT	New UNITS	(G1) PROPOSED RATE	(H1) MONTHLY REV. AT PROPOSED	(I1) ANNUALIZED REV. AT PROPOSED	(J1) ANNUAL REVENUE INCREASE
	LOCAL									
Y	RESIDENCE- R1	363	$ 12.40	$ 4,501.20	$ 54,014.40	367	$ 17.15	$ 6,294.05	$ 75,528.60	$ 21,514.20
~~Y~~	~~RESIDENCE- Zone 1 Charge~~	~~0~~	~~$ 1.10~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RESIDENCE- Zone 2 Charge~~	~~0~~	~~$ 3.30~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RESIDENCE- Flat 2 Party~~	~~4~~	~~$ 10.76~~	~~$ 43.04~~	~~$ 516.48~~		~~$~~	~~$~~	~~$~~	$ (516.48)
Y	BUSINESS - B1	58	$ 32.00	$ 1,856.00	$ 22,272.00	61	$ 30.00	$ 1,830.00	$ 21,960.00	$ (312.00)
~~Y~~	~~BUSINESS - Zone 1 Charge~~	~~0~~	~~$ 1.10~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~BUSINESS - Zone 2 Charge~~	~~0~~	~~$ 3.30~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
Y	BUSINESS - pay	3	$ 21.00	$ 63.00	$ 756.00	3	$ 21.00	$ 63.00	$ 756.00	$ -
~~Y~~	~~BUSINESS - Flat 4 Party~~	~~1~~	~~$ 24.20~~	~~$ 24.20~~	~~$ 290.40~~		~~$~~	~~$~~	~~$~~	~~$ (290.40)~~
~~Y~~	~~KEY SYSTEM~~	~~0~~	~~$ 32.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~PBX - Zone 1~~	~~0~~	~~$ 45.80~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~PBX - Zone 2~~	~~2~~	~~$ 44.70~~	~~$ 89.40~~	~~$ 1,072.80~~		~~$~~	~~$~~	~~$~~	~~$ (1,072.80)~~
~~Y~~	~~PAL~~	~~0~~	~~$ 69.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
Y	Foreign Exchange	1	$ 250.00	$ 250.00	$ 3,000.00		$ 250.00	$ -	$ -	$ (3,000.00)
Y	VACATION - Zone 1 Charge	3	$ 6.75	$ 20.25	$ 243.00	5	$ 10.50	$ 52.50	$ 630.00	$ 387.00
~~Y~~	~~VACATION - Zone 2 Charge~~	~~2~~	~~$ 7.85~~	~~$ 15.70~~	~~$ 188.40~~		~~$~~	~~$~~	~~$~~	~~$ (188.40)~~
								$ -		
C	RESIDENCE- R1	172	$ 21.00	$ 3,612.00	$ 43,344.00	172	$ 21.00	$ 3,612.00	$ 43,344.00	$ -
C	BUSINESS - B1	30	$ 21.00	$ 630.00	$ 7,560.00	30	$ 30.00	$ 900.00	$ 10,800.00	$ 3,240.00
C	BUSINESS - pay	0	$ 21.00	$ -	$ -	0	$ 21.00	$ -	$ -	$ -
~~C~~	~~KEY SYSTEM~~	~~0~~	~~$ 30.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~C~~	~~PBX~~	~~0~~	~~$ 30.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~C~~	~~PAL~~	~~0~~	~~$ 52.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
C	VACATION	0	$ 10.50	$ -	$ -	0	$ 10.50	$ -	$ -	$ -
	NON-RECURRING CHARGES									
Y	SERVICE ORDER	55	$ 10.00	$ 550.00	$ 550.00	55	$ 10.00	$ 550.00	$ 550.00	$ -
C	SERVICE ORDER	15	$ 10.00	$ 150.00	$ 150.00	15	$ 10.00	$ 150.00	$ 150.00	$ -
Y	LINE CONNECTION	55	$ 12.00	$ 660.00	$ 660.00	55	$ 25.00	$ 1,375.00	$ 1,375.00	$ 715.00
~~Y~~	~~LINE CONNECTION - Zone 1~~	~~35~~	~~$ 33.25~~	~~$ 1,163.75~~	~~$ 1,163.75~~		~~$~~	~~$~~	~~$~~	~~$ (1,163.75)~~
~~Y~~	~~LINE CONNECTION - Zone 2~~	~~20~~	~~$ 75.25~~	~~$ 1,505.00~~	~~$ 1,505.00~~		~~$~~	~~$~~	~~$~~	~~$ (1,505.00)~~
C	LINE CONNECTION	15	$ 15.00	$ 225.00	$ 225.00	15	$ 25.00	$ 375.00	$ 375.00	$ 150.00
Y	PREMISE VISIT	55	$ 24.50	$ 1,347.50	$ 1,347.50	55	$ 30.00	$ 1,650.00	$ 1,650.00	$ 302.50
C	PREMISE VISIT	15	$ 30.00	$ 450.00	$ 450.00	15	$ 30.00	$ 450.00	$ 450.00	$ -
	OTHER RATES & CHARGES									
	CUSTOM CALLING									
Y	CUSTOM CALLING BUNDLE					20	$ 2.00	$ 40.00	$ 480.00	$ 480.00
~~Y~~	~~RES. CALL WAITING~~	~~8~~	~~$ 5.00~~	~~$ 40.00~~	~~$ 480.00~~		~~$~~	~~$~~	~~$~~	~~$ (480.00)~~
~~Y~~	~~BUS. CALL WAITING~~	~~0~~	~~$ 7.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES. CALL FORWARDING~~	~~7~~	~~$ 2.74~~	~~$ 19.18~~	~~$ 230.16~~		~~$~~	~~$~~	~~$~~	~~$ (230.16)~~
~~Y~~	~~BUS CALL FORWARDING~~	~~0~~	~~$ 4.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES 3-WAY CALLING~~	~~5~~	~~$ 3.52~~	~~$ 17.60~~	~~$ 211.20~~		~~$~~	~~$~~	~~$~~	~~$ (211.20)~~
~~Y~~	~~BUS 3-WAY CALLING~~	~~0~~	~~$ 4.20~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES, 8 NO. SPEED CALLING~~	~~0~~	~~$ 1.74~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~BUS., 8 NO. SPEED CALLING~~	~~0~~	~~$ 3.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES, 30 NO. SPEED CALLING~~	~~0~~	~~$ 1.74~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~BUS., 30 NO. SPEED CALLING~~	~~0~~	~~$ 3.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES. FIXED CALLING~~	~~0~~	~~$ 2.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~BUS. FIXED CALLING~~	~~0~~	~~$ 2.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~RES. LINE BUSY DIV.~~	~~0~~	~~$ 1.85~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~BUS. LINE BUSY DIV.~~	~~0~~	~~$ 8.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~ANY 2 (20% DISCOUNT)~~	~~1~~	~~$ 6.19~~	~~$ 6.19~~	~~$ 74.28~~		~~$~~	~~$~~	~~$~~	~~$ (74.28)~~
	~~ANY 3 (25% DISCOUNT)~~	~~0~~	~~$~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	~~ANY 4 (30% DISCOUNT)~~	~~0~~	~~$~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	~~ANY 5 (35% DISCOUNT)~~	~~0~~	~~$~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	MISCELLANEOUS									
C	VACATION RATE	0	$ 10.50	$ -	$ -		$ -	$ -	$ -	$ -
Y	VACATION RATE - Zone 1	3	$ 6.75	$ 20.25	$ 243.00	5	$ 10.50	$ 52.50	$ 630.00	$ 387.00
~~Y~~	~~VACATION RATE - Zone 2~~	~~2~~	~~$ 7.85~~	~~$ 15.70~~	~~$ 188.40~~		~~$~~	~~$~~	~~$~~	~~$ (188.40)~~
	PAYPHONE-LOCAL	0	$ -	$ -	$ -		$ -	$ -	$ -	$ -
Y	PRIVATE LINE EXTENSION	8	$ 7.00	$ 56.00	$ 672.00	8	$ 7.00	$ 56.00	$ 672.00	$ -
	INTRACHANGE P/L MILEAGE	0	$ -	$ -	$ -		$ -	$ -	$ -	$ -

(A)	(B) DESCRIPTION	(C) 12/31/1999 UNITS	(D) CURRENT RATE	(E) MONTHLY REV. @ CURRENT	(F) ANNUALIZED REV. @ CURRENT	New UNITS	(G1) PROPOSED RATE	(H1) MONTHLY REV. AT PROPOSED	(I1) ANNUALIZED REV. AT PROPOSED	(J1) ANNUAL REVENUE INCREASE
Y	OFF-PREMISE EXTENSION	2	$ 4.00	$ 8.00	$ 96.00	2	$ 4.00	$ 8.00	$ 96.00	$ -
	EMERG. RPT -MAIN STATION	0	$ -	$ -	$ -		$ -	$ -	$ -	$ -
	EMERG. RPT-ADD'L STATION	0	$ -	$ -	$ -		$ -	$ -	$ -	$ -
Y	TRUNK HUNTING FEATURE	2	$ 8.00	$ 16.00	$ 192.00	2	$ 8.00	$ 16.00	$ 192.00	$ -
Y	BUSINESS CHANNEL TERM - Dedicated Channel	1	$ 6.50	$ 6.50	$ 78.00	1	$ 6.50	$ 6.50	$ 78.00	$ -
Y	BUSINESS CHANNEL TERM - Dedicated Trunk	6	$ 24.42	$ 146.52	$ 1,758.24	6	$ 24.42	$ 146.52	$ 1,758.24	$ -
Y	TRUNK TERMINATION	2	$ 26.70	$ 53.40	$ 640.80	2	$ 26.70	$ 53.40	$ 640.80	$ -
Y	PBX NUMBER BLOCK	5	$ 2.00	$ 10.00	$ 120.00	5	$ 2.00	$ 10.00	$ 120.00	$ -
~~Y~~	~~TRANS MIL FIX 27%~~	~~1~~	~~$ 2.29~~	~~$ 2.29~~	~~$ 27.48~~		~~$~~	~~$~~	~~$~~	~~$ (27.48)~~
~~Y~~	~~FIXED MILEAGE 20%~~	~~1~~	~~$ 4.98~~	~~$ 4.98~~	~~$ 59.76~~		~~$~~	~~$~~	~~$~~	~~$ (59.76)~~
~~Y~~	~~TRANS MIL FIX 41%~~	~~2~~	~~$ 4.98~~	~~$ 9.96~~	~~$ 119.52~~		~~$~~	~~$~~	~~$~~	~~$ (119.52)~~
~~Y~~	~~TRANS MIL FIX 20%~~	~~2~~	~~$ 1.70~~	~~$ 3.40~~	~~$ 40.80~~		~~$~~	~~$~~	~~$~~	~~$ (40.80)~~
~~Y~~	~~61X1.10 20%~~	~~1~~	~~$ 13.42~~	~~$ 13.42~~	~~$ 161.04~~		~~$~~	~~$~~	~~$~~	~~$ (161.04)~~
~~Y~~	~~58X1.10 MILEAGE 27%~~	~~1~~	~~$ 17.23~~	~~$ 17.23~~	~~$ 206.76~~		~~$~~	~~$~~	~~$~~	~~$ (206.76)~~
~~Y~~	~~25X.85 MILEAGE 20%~~	~~1~~	~~$ 8.71~~	~~$ 8.71~~	~~$ 104.52~~		~~$~~	~~$~~	~~$~~	~~$ (104.52)~~
~~Y~~	~~25X.85 MILEAGE 41%~~	~~2~~	~~$ 8.71~~	~~$ 17.42~~	~~$ 209.04~~		~~$~~	~~$~~	~~$~~	~~$ (209.04)~~
	~~80X1.10 MILEAGE 20%~~	~~1~~	~~$ 17.60~~	~~$ 17.60~~	~~$ 211.20~~		~~$~~	~~$~~	~~$~~	~~$ (211.20)~~
Y	56K SPECIAL ACCESS	0	$ 188.50	$ -	$ -	0	$ 188.50	$ -	$ -	$ -
C	TOLL RESTRICTION - RES	3	$ 2.00	$ 6.00	$ 72.00	3	$ 2.00	$ 6.00	$ 72.00	$ -
~~C~~	~~TOLL RESTRICTION - BUS~~	~~0~~	~~$ 3.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
Y	TOLL RESTRICTION - RES	4	$ 2.00	$ 8.00	$ 96.00	4	$ 2.00	$ 8.00	$ 96.00	$ -
~~Y~~	~~TOLL RESTRICTION - BUS~~	~~0~~	~~$ 2.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
C	ADD'L BUS LIST	0	$ 1.50	$ -	$ -	9	$ 1.00	$ 9.00	$ 108.00	$ 108.00
Y	ADD'L BUS LIST	3	$ 1.25	$ 3.75	$ 45.00	11	$ 1.00	$ 11.00	$ 132.00	$ 87.00
~~C~~	~~ADD'L RES LIST~~	~~9~~	~~$ 1.00~~	~~$ 9.00~~	~~$ 108.00~~		~~$~~	~~$~~	~~$~~	~~$ (108.00)~~
~~Y~~	~~ADD'L RES LIST~~	~~8~~	~~$ 1.00~~	~~$ 8.00~~	~~$ 96.00~~		~~$~~	~~$~~	~~$~~	~~$ (96.00)~~
	ADDITIONAL INFORM	0	$ -	$ -	$ -		$ -	$ -	$ -	$ -
C	FOREIGN LISTING - RES	0	$ 2.00	$ -	$ -	0	$ 2.00	$ -	$ -	$ -
~~C~~	~~FOREIGN LISTING - BUS~~	~~0~~	~~$ 2.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
Y	FOREIGN LISTING - RES	1	$ 1.00	$ 1.00	$ 12.00	1	$ 2.00	$ 2.00	$ 24.00	$ 12.00
~~Y~~	~~FOREIGN LISTING - BUS~~	~~0~~	~~$ 1.25~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
C	NON-LIST	5	$ 2.00	$ 10.00	$ 120.00	5	$ 2.00	$ 10.00	$ 120.00	$ -
Y	NON-LIST	9	$ 1.20	$ 10.80	$ 129.60	9	$ 2.00	$ 18.00	$ 216.00	$ 86.40
C	NON- PUBLISHED	17	$ 2.00	$ 34.00	$ 408.00	17	$ 2.00	$ 34.00	$ 408.00	$ -
Y	NON- PUBLISHED	30	$ 1.50	$ 45.00	$ 540.00	30	$ 2.00	$ 60.00	$ 720.00	$ 180.00
~~C~~	~~PUBLIC ACCESS LINE (PAL)~~	~~0~~	~~$ 52.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
~~Y~~	~~PUBLIC ACCESS LINE (PAL)~~	~~0~~	~~$ 69.50~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	CREDIT CARD SERVICE FEE	0	$ -	$ -	$ -	0	$ -	$ -	$ -	$ -
	DIRECTORY ASSISTANCE	0	$ -	$ -	$ -	0	$ -	$ -	$ -	$ -
C	LINE LEASE + ACCESS CHARGE	0	$ 21.00	$ -	$ -	0	$ 21.00	$ -	$ -	$ -
C	INSTALL CHG.	0	$ 25.00	$ -	$ -	0	$ 25.00	$ -	$ -	$ -
Y	LINE LEASE + ACCESS CHARGE	2	$ 8.25	$ 16.50	$ 198.00	2	$ 21.00	$ 42.00	$ 504.00	$ 306.00
Y	INSTALL CHG.	0	$ 22.00	$ -	$ -	0	$ 25.00	$ -	$ -	$ -
~~Y~~	~~EXTENSION CONTINUOUS~~	~~0~~	~~$ 4.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	MISC. REVENUE	0	$ -	$ -	$ -	0	$ -	$ -	$ -	$ -
	RETURN CHECK CHARGE	0	$ -	$ -	$ -	0	$ -	$ -	$ -	$ -
~~C~~	~~INSIDE WIRE MAINTENANCE~~	~~0~~	~~$ 1.00~~	~~$~~	~~$~~		~~$~~	~~$~~	~~$~~	~~$~~
	TOTAL			$ 17,818.44	$ 147,257.53			$ 17,890.47	$ 164,635.64	$ 17,378.11
	YOUNG			$ 12,674.84	$ 94,609.33			$ 12,344.47	$ 108,808.64	$ 14,199.31
	CASCABEL			$ 5,126.00	$ 52,437.00			$ 5,546.00	$ 55,827.00	$ 3,390.00

SUMMARY OF LOCAL REVENUES	Arizona	Young	Cascabel
CURRENT ANNUALIZED REVENUES (COL F)	147,258	94,609	52,437
- UNCOLLECTIBLE (W/S 2)	(1,279)	(284)	(995)
NET REVENUES	145,979	94,325	51,442
+ PROPOSED INCREASE (COL K)	17,378	14,199	3,390
TOTAL ANNUALIZED REVENUES FROM RATES	163,357	108,525	54,832

REIKER

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARC SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF) MIDVALE TELEPHONE EXCHANGE, INC.,) FOR AUTHORITY TO INCREASE RATES AND) FOR DISBURSEMENT FROM THE ARIZONA) UNIVERSAL SERVICE FUND))	DOCKET NO. T-02532A-00-0512

DIRECT

TESTIMONY

OF

JOEL REIKER

SENIOR RATE ANALYST

UTILITIES DIVISION

MARCH 15, 2001

Jbc129t

EXECUTIVE SUMMARY
MIDVALE TELEPHONE EXCHANGE, INC.
DOCKET NO. T-02532A-00-0512
RATE OF RETURN
JOEL REIKER

1. Staff recommends a capital structure consisting of 22.60 percent long-term debt and 77.40 percent common equity.

2. Staff recommends a cost of long-term debt of 5.47 percent.

3. Staff recommends an 11.50 percent cost of equity capital. The 11.50 percent figure is based on the results of Staff's cost of equity analysis, which used both the DCF and CAPM methodologies.

4. Based on the results of Staff's capital structure, cost of equity, and debt analyses, Staff recommends a 10.14 percent cost of capital for Midvale. This figure represents the weighted cost of both the Company's debt and common equity.

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Introduction

Q. Please state your name, occupation, and business address.

A. My name is Joel M. Reiker. I am a Senior Rate Analyst employed by the Arizona Corporation Commission ("ACC" or "Commission") in the Utilities Division. My business address is 1200 West Washington, Phoenix, Arizona 85007.

Q. Briefly describe your responsibilities as a Senior Rate Analyst.

A. In my capacity as a Senior Rate Analyst, I provide recommendations to the Commission on mergers, acquisitions, financings and sales of assets. I also perform studies to estimate the cost of capital for utilities that are seeking rate relief.

Q. Please describe your educational background and professional experience.

A. In 1998, I graduated Cum Laude from Arizona State University, receiving a Bachelor of Science degree in Global Business with a specialization in Finance. My course of studies included classes in corporate and international finance, investments, accounting, and economics. In 1999, after working as in internal auditor for one year, I was employed by the Commission as an Auditor III, in the Accounting & Rates Section's Financial Analysis Unit. Since that time, I have attended various seminars and classes on general regulatory and business issues, including cost of capital and energy derivatives. In December of 2000, I was promoted to a Senior Rate Analyst.

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

A. I will address the appropriate capital structure, as well as the appropriate cost of debt and equity to be recommended for setting rates for Midvale Telephone Exchange, Inc. ("Midvale" or "Company").

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Economic Summary

Q. How does the economic environment affect the cost of capital of Midvale?

A. The cost of capital for any company is influenced by the economic conditions, in which it operates and seeks to obtain capital. The overall health of the economy affects both the availability and cost of capital. Because the cost of equity capital is forward-looking, the outlook for the National and Arizona economies should be reviewed. The results of this review should then be considered when recommending a cost of equity capital for Midvale. Schedule JMR-2, shows the economic indicators reviewed for this testimony.

Q. What economic indicators and forecasts have you examined in your determination of the cost of capital for Midvale?

A. I reviewed inflation as measured by the Consumer Price Index ("CPI"), Gross Domestic Product ("GDP") and various interest rates. I also reviewed the *Value Line Selection & Opinion, Blue Chip Financial Forecasts* and *Arizona's Economy,* for an indication of the conditions economists are projecting for the national and local economies.

Q. How would you characterize the current level of inflation?

A. Staff would characterize inflation, as measured by the CPI, as low to moderate at present. From 1990 to 1995, inflation declined steadily from 6.1 percent to 2.5 percent. In 1996, however, it rose to 3.3 percent. Since 1997, it has slowly risen from 1.7 percent to its current level of 3.4 percent.

Q. What is the current rate of growth in the U.S. economy?

A. At the end of 2000, the rate of growth in the U.S. economy, as measured by GDP, was 5.0 percent, the highest level in over ten years.

Q. What are current interest rate levels?

Summary of Testimony and Recommendations

Q. Briefly summarize how your cost of capital testimony is organized.

A. My cost of capital testimony is organized into six sections. First, I will discuss the current and projected economic environment and how it influences Midvale's cost of capital. Second, I will discuss Midvale's risk. Third, I will compare my recommended capital structure with the Company's proposed capital structure, and the financial risk faced by Midvale. Fourth, I will explain my recommended cost of debt. In the next section, I will present the findings of my cost of equity capital analysis, in which I utilized the discounted cash flow ("DCF"), capital asset pricing model ("CAPM"), and comparable earnings methodologies. I will then present my recommended cost of equity for Midvale, as well as my recommended weighted cost of capital. Finally, I will comment on Midvale's cost of capital testimony. Schedules JMR-1 through JMR-9 support my cost of capital analysis.

Q. Please summarize the recommendations and adjustments that you will address in your testimony.

A. Capital Structure – Staff recommends a capital structure consisting of 22.60 percent long-term debt and 77.40 percent common equity.

Cost of Debt – Staff recommends a cost of long-term debt of 5.47 percent.

Cost of Equity Capital – Staff recommends an 11.50 percent cost of equity capital based primarily on the results of the DCF and CAPM methodologies.

Cost of Capital – Using the results of Staff's analysis of capital structure, cost of debt and equity, Staff recommends a 10.14 cost of capital for Midvale. This represents the weighted cost of both the Company's debt and equity.

. . .

A. Short-term interest rates have risen modestly in the past year, from 4.7 percent in 1999, to a current level of 5.7 percent. Interest rates on 30-year Treasury's have remained steady in the range of 5.4 percent to 5.9 percent since falling from 6.6 percent in 1997. The Prime rate has risen to the 9.5 percent level, up from 8.0 percent in 1999.

Q. What is the outlook for the national and state economies?

A. Nationally, sustained growth in Real GDP in the 3.3 percent to 3.6 percent range, decreasing interest rates in the next year, as well as decreased inflation.[1] The following Quote from the December 22, 2000, *Value Line Selection & Opinion* illustrates this:

> "The reluctance of most consumers now to buy at any price is further indication that we are not on the cusp of a new round of inflation."
>
> "For now, we think the most likely scenario is that the economy, with the help of one or more interest rate cuts in the new year, will grow by 3%, or so. We place odds that a recession will evolve in 2001 at only 25%-35%."

Arizona's economy continues to remain strong. According to the Fall 2000 edition of *Arizona's Economy*, published by the Eller Graduate School of Management at the University of Arizona, "White hot or red hot—the economy is still smoking. Even so, inflation remains subdued and has actually cooled in recent months." In Arizona, the economy should continue to grow. Gains in personal income are expected to be in the range of 6.6 percent for 2001, and job growth is expected to grow at 3.5 percent. The 5-year economic outlook for Arizona reflects below average rates of growth as the economy is expected to cool off.[2]

Thus, in accordance with a promising outlook of sustainable economic and population growth, there do not appear to be any unusual conditions in the Arizona economy that would negatively affect Midvale's earnings.

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[1] Long-term Consensus Forecast, *Blue Chip Financial Forecasts*, November 1, 2000.
[2] *Arizona's Econoomy*, Eller College of Business and Public Administration, The University of Arizona. Pp. 7-9.

Risk

Q. Please define Business Risk.

A. Business risk is the risk associated with the fluctuation in earnings due to the basic nature of the firm's business.

Q. Why is it important to determine the level of business risk an investment offers when determining the cost of equity capital?

A. Investors require a higher rate of return from an investment that bears a high level of risk and a lower rate of return from an investment that bears a lower level of risk. A Company's cost of equity is the return expected and required by investors that motivates them to invest in that company. It is based upon prospective investors' evaluation of the risk associated with the investment. Therefore, risk is an important factor to examine when estimating the cost of equity capital.

Q. What factors contribute to investors' risk perception of an investment in local telecommunications service utilities?

A. Factors such as capital structure, competition, capital expenditures, growth prospects, size, and ability to enter the capital markets contribute to the perception of risk.

Q. What type of competitive pressures does Midvale face?

A. According to the Company's response to Staff data request AGB-65, "The Company is not aware of any facilities based competitors in either the Young or Cascabel exchanges."

Q. How does the competitive environment faced by Midvale compare to the competitive environment currently faced by large telecommunications services companies such as Qwest Communications?

A. Qwest Communications, the largest telecommunications provider in Arizona, is currently facing limited competition in some areas. Cox Communications is offering basic local service in several residential areas in direct competition with U S WEST. In downtown Phoenix and Tucson, there are several telecommunications services providers who are seeking to provide service to business customers.

Midvale currently experiences none of this competition. No other local service providers, other than wireless, are providing service within Midvale's service area.

Q. Is Midvale planning any significant plant additions?

A. Schedule JMR-3, illustrates the Company's historical and projected levels of plant. It can be seen that Midvale added approximately $460,000 in net plant in 1998, or approximately 17 percent of total plant, followed by approximately $25,000 in 1999.

The Company's rate application seeks authority to amend its Certificate of Convenience and Necessity ("CC&N") to include the currently unserved "Millsite" and "Silver Belle" areas. If the Commission approves the Company's request to extend its CC&N, additional capital will be required to finance plant. According to its application, the Company plans to issue approximately $1.08 million in new debt and $260,000 in equity to finance plant in the currently unserved areas. The plant additions depicted in Schedule JMR-3 include the additional capital related to the Millsite and Silver Belle service areas. In 2000, the Company is projecting an increase of approximately $1.2 million in net plant, an increase of approximately 42 percent.

Q. Has Midvale's customer base experienced much growth?

A. Yes, it has. From 1995 to 1999, the average number of access lines grew approximately 39 percent. The Company's average annual growth has exceeded growth in the counties in which it operates. Schedule JMR-3, shows that the Company's four-year growth rate (1995-1999) was 8.7 percent, compared to a 3.0, 2.7, and 2.8 percent growth rate for Gila, Cochise, and Pima Counties, respectively. According to its application, the

Company expects to add approximately 385 customers over the next three years as a result of serving the Millsite and Silver Belle areas. Most of the Company's customers are residential; who traditionally are a source of relatively stable revenues.

Q. How does a high rate of customer growth translate into increased business risk?

Rapidly growing companies typically have high cash flow requirements for incremental plant investment and often are unable or unwilling to pay dividends. Rapidly growing companies often find it more difficult to obtain debt financing due to the increased strain it places on their cash flow. The use of an historical test year in rate-making means that the shareholders of these companies bear most of the risk of placing plant in service in anticipation of additional customers.

These risks as they relate to Midvale are somewhat reduced. In the event that financing is needed to fund additional plant, Midvale, like many other rural telecommunications services utilities, benefits from the below-market-cost debt, offered by the Rural Telephone Finance Cooperative ("RTFC"). The RTFC is a private, member-owned cooperative finance organization offering alternative financing to rural telecommunications utilities.

Q. Please distinguish between business risk and financial risk.

A. Business risk is the risk associated with the fluctuation in earnings due to the basic nature of the firm's business. Financial risk is the risk to shareholders caused by a firm's reliance on debt financing.

Q. What is the relationship between business risk, financial risk and capital structure?

A. Generally, firms with a high variability in earnings will choose to have a higher proportion of equity in their capital structures. However, equity financing is generally more expensive than debt financing. Therefore, a firm must balance its capital structure between the less risky equity and the more economical debt. Utilities, for the most part, have more debt in their capital structures than firms in other industries. Regulated operations tend to have lower business risk, allowing for increased levels of debt in the utilities' capital structures.

Q. What is the Company's proposed Test Year capital structure?

A. The company proposes a capital structure consisting of 22.20 percent long-term debt, 1.78 percent short-term debt, and 76.02 percent common equity.

Q. Is this the same capital structure reported in Midvale's 1999 Annual Report, filed with the Commission?

A. No, it is not. The Company's December 31, 1999 Annual Report on file with the Commission, reflects a capital structure consisting of approximately 80.0 percent long-term debt and 20.0 percent equity.

Q. Please explain this difference.

A. The capital structure reported in the Company's 1999 Annual Report on file with the Commission, reflects the entirety of Midvale's multi-state operations, whereas, the Company's proposed capital structure in this rate case reflects the capital amounts allocated to its Arizona operations.

Q. On what basis has the Company calculated its Arizona-specific capital structure?

A. The debt portion of Midvale's Arizona-specific capital structure reflects the total portion of its RTFC and Rural Utility Services ("RUS") loans, as well as short-term debt, allocated to Arizona. The total of this amount equals $506,912.

The Equity portion of Midvale's proposed Arizona-specific capital structure, was calculated by subtracting the sum of Arizona-specific long-term debt and other payables from the sum of Arizona-specific plant and other assets. Total equity allocated to Arizona under this method is $1,606,651.

Q. What is Staff's recommended capital structure for Midvale?

A. Staff is adopting the Company's allocated capital structure, with the exception of short-term debt. Staff's recommended capital structure consists of 22.60 percent long-term debt and 77.40 percent equity.

Q Please explain the difference between the Company's and Staff's capital structure recommendation.

A. The Company included $37,695 in short-term debt in its capital structure. Staff did not adopt this component.

According to Schedule A-3, of the Company's application, short-term debt hasn't been included in the Company's capital structure since 1997, indicating that short-term debt does not appear to be a permanent method of financing.

Q. How does Midvale's capital structure compare with that of other investor-owned local telecommunications services companies?

A. Schedule JMR-4, Pages 1 and 2, shows the capital structures of five publicly traded telecommunications services companies followed by *Value Line,* as well as Midvale for 1998 and 1999. Compared to the five publicly traded telecommunications services companies shown in the Schedule, Midvale's Arizona-specific capital structure reflects much less financial risk due to it's greater reliance on equity financing.

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Q. You mentioned previously that if Midvale receives approval to serve the Millsite and Silver Belle service areas, it plans to issue approximately $1.08 million in additional debt and $260,000 in equity to finance the additional plant. How will this affect its capital structure?

A. According to the Company's application, the total investment in the unserved areas is expected to be approximately $1.45 million. The Company plans to issue approximately $260,000 in equity and intends to borrow approximately $1.08 million from the RTFC at an expected interest rate of 8 percent. The addition of the $1.08 million in debt will have the affect of balancing the capital structure, resulting in approximately 40-50 percent debt, and 50-60 percent equity.

Q. How would you characterize Midvale's overall risk exposure related to its local exchange service?

A. Due to the aforementioned factors, Staff would characterize Midvale's overall risk exposure related to its local exchange operations as moderate. As mentioned before, Midvale experiences little or no competition, RTFC funding is available at below-market cost, and the Company's Arizona capital structure exhibits less financial risk than larger telecommunications services providers.

The Cost of Debt

Q. What is the Company's proposed cost of debt?

A. The Company has proposed a weighted cost of short and long-term debt of 5.51 percent.

Q. What is Staff's proposed cost of debt for Midvale?

A. Staff is recommending that a cost of long-term debt of 5.47 percent be adopted. This represents the cost rates on the Company's RTFC and RUS loans. This is the same cost of debt proposed by the Company after accounting for Staff's removal of the $37,695 in short-term debt.

The Cost of Equity

Q. What standards do you apply in your determination of the allowed return on common equity for Midvale?

A. The return on common equity should fairly compensate Midvale's equity investors for the risk incurred in investing in the Company. The fair return on equity can be determined through the use of two market-based models, the discounted cash flow ("DCF") model, and the capital asset pricing model ("CAPM"). In the case of Midvale, which does not have publicly-traded stock and, therefore, lacks the information necessary for the application of the market-based models, a group of similar, publicly-traded utilities must be used as proxies.

Q. What companies did you select as proxies or comparables for Midvale?

A. I selected the five publicly traded telecommunications services companies previously discussed in the capital structure section of this testimony. They are Alltel Corp., BellSouth, GTE Communications, SBC Communications, and U S WEST.

Q. Why have you chosen to use these particular companies as comparables to Midvale?

A. I have chosen these particular companies primarily because local exchange services contribute a significant portion of revenue to their operations, they are followed by *Value Line*, making reliable data readily available, and investors are more likely to associate these particular firms with local telephone operations than other telecommunications services companies.

Comparable Earnings

Q. What are the underlying assumptions for the comparable earnings standard?

A. There are two underlying assumptions. First, as the cost of equity is based upon investors' expectations, investors may use recent historical returns as a basis for expected returns. The second assumption is that an investor in a utility should be allowed to earn a return comparable to that earned by an investor in other firms of comparable risk. Therefore, earnings of similar telecommunications services companies were examined to determine comparable returns for Midvale.

Q. What return on equity ("ROE") did the comparable telecommunications services companies earn in 1998 and 1999?

A. Schedule JMR-5, illustrates the returns on common equity earned by the comparable companies for the past ten years. As a group they have earned between 11 and 27 percent return on equity. For the past two years, 1998 and 1999, the mean ROE for the comparable companies was 24.3 percent and 26.7 percent, respectively. For many of these firms, regulated local telephone operations comprise less than half of their total revenues. The majority of their revenues reflect amounts earned by unregulated competitive operations, which traditionally yield higher returns than basic local telephone service.

Q. Did investors consider 1999 ROE for the publicly traded telecommunications companies sufficient?

A. Yes. Column 4, of Schedule JMR-6, depicts the market-to-book ratio of the comparable companies. It indicates that, on average, investors are willing to pay 8.10 times the book value per share for these telecommunications services company stocks. A market-to-book ratio greater than 1.00 is generally considered to be adequate to attract new equity capital. In order for a company to have the ability to attract new equity capital without diluting the value of the existing shares, it must have a market-to-book ratio greater than 1.00. Ratios greater than 1.00 also serve to ensure the marketability of a new equity issue (p. 250)[3] All of the five comparables used in my analysis have a market-to-book ratio greater than 1.00. Therefore, the 26.7 percent ROE earned by the comparables in 1998

[3] Morin, Roger A. Regulatory Finance: Utilities' Cost of Capital. Public Utilities Reports, Inc., Arlington VA, 1994.

was more than adequate to compensate investors for the risk of investing in the telecommunications services utility industry.

Discounted Cash Flow

Q. Please provide a brief summary of the theory upon which the DCF method of estimating the cost of equity is based.

A. The DCF method of estimating the cost of equity is based upon the theory that the market price of an asset (stock) is equal to the present value of all expected future cash flows (dividends). Through a mathematical restatement, the discount rate, or cost of capital, can be derived from the cash flows, asset price, and a growth rate. The formula is generally applied to a sample of companies that exhibit similar risk to the company in question and the resulting estimates for the discount rates are then averaged. This process tends to balance out the inevitable errors that occur when estimating the cost of capital using only a single company.[4]

Q. What is the DCF formula used in your analysis?

A. The formula used in my analysis is:

$$k = D_1/P_0 + g$$

Where,

k = the cost of equity

D_1 = the current annualized dividend (D_0) multiplied by $(1 + g)$

P_0 = the market price of the stock

g = the expected growth rate

The DCF model shown above assumes that a company has a constant payout ratio and its earnings are expected to grow at a constant rate. Thus, if a stock has a market price of

[4] Brealy, Richard A. and Stewart C. Myers. Principles of Corporate Finance. McGraw-Hill, Inc., New York, NY, 1991, page 54.

$10 per share and an expected annual dividend of $1 per share, and if its earnings were expected to grow 3 percent per year, then the cost of equity for the company is 13.0 percent (the 10 percent dividend yield plus the growth rate of 3 percent per year).

Q. How did you determine the dividend yield component (D_1/P_0) of the DCF formula?

A. The yield component of the DCF formula was determined in two ways. The first was determined by multiplying the most recent annualized dividend by one plus the growth factor (discussed below), then dividing that product by the average of the 2000 high and low stock price of the comparable company, as reported in the July 7th edition of *Value Line*. The second yield was determined in the same manner but was divided by the most recent stock price reported in the July 7th edition of *Value Line.*

Q. Why have you chosen to use data from the July 7th edition of *Value Line*, instead of a more recent edition?

A. Data from the Telecommunications Services industry is only updated by *Value Line* twice in the final six months of 2000, in July, and again in October. Between July and October of this year both U S WEST and GTE Corp. completed mergers. U S WEST was purchased by Qwest Communications, and GTE merged with Bell Atlantic to form Verizon. Thus, the October edition of *Value Line* did not contain the relevant data on these companies required to complete my analysis. Rather than use only three comparables in my cost of equity analysis (Alltel Corp., BellSouth, and SBC Communications), I chose to use data from the July 7th edition. I should also note that as of this writing, the stock prices for the remaining firms (Alltel Corp., BellSouth, and SBC Communications) have not moved significantly since July 7th.

Q. How was the growth (g) component of the DCF formula determined?

A. The DCF model is based upon expected dividend growth. In order to determine expected dividend growth, historical dividend growth is examined under the assumption that recent historical trends reflect investors' future expectations of dividend growth. The dividends per share of the comparable companies from 1995 through 1999 were subjected to a log-linear regression analysis in order to determine the historical annual growth rate of dividends for the most recent five-year (1995 to 1999) period. The results of the regression analyses are shown in Schedule JMR-7. An examination of the results indicates an average five-year growth rate of 2.31 percent.

Q. What dividend growth rate did *Value Line* project for the comparable companies?

A. Schedule JMR-7, shows the average of the projected dividend growth rates for the five comparable companies to be 2.60 percent over the next five years. This rate is slightly higher than the five-year historical rate.

Q. Did you use any other method to determine the growth component other than historical dividend growth?

A. Yes, I did. Because dividend growth does not occur independently, it must be examined in a larger context. Dividend growth can only be maintained through growth in earnings. It would be virtually impossible for dividend growth to exceed earnings growth over the long run, as it would ultimately lead to payout ratios in excess of 100 percent, which simply are not sustainable. The company would effectively have to issue new debt or equity in order to support its dividend payments. This situation would likely result in eventual financial distress. Conversely, if earnings growth consistently exceeds dividend growth, it follows that dividends will be raised. Therefore, growth in earnings per share should also be examined in the estimation of g. Schedule JMR-7, also shows the average rate of growth in earnings per share. The five-year earnings per share growth rate was 9.31 percent.

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Q. What earnings growth rate did *Value Line* project for the comparable companies?

A. Schedule JMR-7, shows the average of the projected earnings growth rates for the eleven comparable companies followed by *Value Line* to be 12.7 percent over the next five years. This rate is well above the 9.31 percent five-year historical earnings growth rate.

Q. Aside from earnings and dividend per share growth, what other growth rate did you consider for g?

A. Another method of determining *g* for the DCF model is the sustainable growth rate. The sustainable growth rate is simply the product of the percentage of earnings retained by the company and the expected return on equity. This concept is based upon the theory that dividend growth can only be achieved if a company retains and reinvests a portion of its earnings in itself to earn a return.

Q. What is the formula for the sustainable growth rate?

A. The sustainable growth rate formula is:

$$g = br$$

Where

g = sustainable growth

b = expected return on equity

r = the retention ratio (1-dividend payout ratio)

Q. What sustainable growth rate did you calculate for the comparables?

A. The average five-year sustainable growth rate was 13.87 percent. The rate was calculated by multiplying return on equity (b) by the retention ratio (r) and then averaging the results over a five-year period.

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Q. What are the results of your DCF analysis?

A. Schedule JMR-8 depicts the results of my DCF analysis. The results range from 4.6 percent to 16.5 percent.

Capital Asset Pricing Model

Q. Please describe the Capital Asset Pricing Model ("CAPM").

A. The CAPM provides an estimate for the expected return on an investment (stock). The model assumes that the expected return is a combination of the prevailing risk-free interest rate and a market risk premium adjusted for the riskiness of the investment relative to the market. Thus, there is an assumed relationship among the returns of the risk-free interest rate, the return on the stock market and the return on an individual stock. The expected return generated by the CAPM is then used as a proxy for the cost of equity capital for that company.

Q. What is the CAPM formula?

A. $K = R_f + \quad (R_m - R_f)$

Where:

K =Expected rate of return (cost of equity)

R_f =Risk-free rate of interest

=Beta coefficient

R_m =Expected rate of return on the market

$(R_m\text{-}R_f)$ =Expected risk premium on the market

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Q. How have you implemented the CAPM in your analysis of the cost of equity for Midvale?

A. The CAPM described in Chapter 8, of Principles of Corporate Finance[5], provides the basis for the model. The cost of equity estimates generated by the CAPM are used to supplement the estimates produced by the DCF model explained above, rather than as the primary determinant of the cost of equity.

Q. What is the risk-free rate of interest?

A. The risk-free rate is the current yield-to-maturity on U.S. Treasury Bills ("T-Bills"). All U.S. securities are considered to be free of default risk, but the 90-day T-Bill is the only one that is considered to be free of interest rate risk as well. This is due to its short holding period. However, most investors have holding periods exceeding 90 days.

The CAPM allows for intermediate-term and long-term estimates through the use of longer-term risk-free securities. Five-year Treasury notes (intermediate-term) and 30-year Treasury bonds (long-term), are used to provide estimates that more closely match investors' holding periods. Ninety-day T-Bills are also used in order to provide a range of investor holding periods. The 90-day T-Bill, five-year Treasury note and 30-year Treasury bond rates used, from the December 29th *Wall Street Journal* were 5.71 percent, 5.01 percent, and 5.44 percent, respectively.

Forecasted yields on the same risk-free instruments found in the January 1, 2001, *Blue Chip Financial Forecasts* were also used in order to obtain a sense of interest rate expectations. The projected short-term interest rates are slightly lower than the current rates indicating that there is a consensus opinion of a decrease in these rates in the near

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[5] Brealy, Richard A. and Stewart C. Myers. Principles of Corporate Finance. McGraw-Hill, Inc., New York, NY, 1991.

future. However, the intermediate and longer-term rates are projected to be slightly higher.

Q. Please describe the beta ( ) coefficient.

A. Beta is a measure of the sensitivity of an investment's price to market movements—a measure of relative risk. However, because Midvale is not a publicly-traded company, Staff employed the average beta of the five publicly-traded sample utility companies, as a proxy for Midvale's beta. Schedule JMR-6, shows the average beta for the *Value Line* sample companies is 0.82.

It is important to note that the average beta is more reflective of the betas of competitive companies than of regulated companies. Typically, betas of water utility companies between 0.50 and 0.60 are more representative of operations that are close to 100 percent regulated utility operations.

Q. Please describe the expected risk premium on the market (R_m-R_f).

A. The expected risk premium on the market is the amount of additional return that investors expect from investing in the market over the return on the risk-free asset, T-Bills, Treasury notes, and Treasury bonds. The equity risk premium used in my analysis was obtained from Ibbotson Associates for the 73-year period from 1926 to 1999 and represents the arithmetic average difference between S&P 500 and government security returns. The 73-year period is used to eliminate shorter-term biases, while at the same time including unexpected past events. The average risk premia are shown under the (Rp) column of Schedule JMR-9; Rp is simply (R_m-R_f).

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Q. What are the results of your CAPM analysis?

A. Schedule JMR-9 shows the results of my CAPM analysis. They range from 12.0 percent to 13.5 percent using current interest rates. Using consensus-forecast estimates from *Blue Chip Financial Forecasts*, results range from 12.3 percent to 13.3 percent.

Recommendations

Q. What are the results of your cost of equity analysis?

A. The results of my comparable earnings, DCF, and CAPM analyses are shown in Schedules JMR-8 and JMR-9.

Q. Please summarize your recommendations.

A. The comparable earnings method results in historical earned returns ranging from 24.3 to 26.7 percent. These high returns are indicative of the riskier nature of the sample companies' business make-up, in that a high percentage of their revenues come from competitive telecommunications services. The results of the comparable earnings method are also skewed by U S WEST's reported ROE of 199.7 percent and 130.8 percent in 1998 and 1999. Staff believes that the results of the comparable earnings method are unreasonably high for use in determining the cost of equity for regulated telephone operations, and will exclude them.

The DCF model, using various combinations of spot and average stock prices and earnings, dividend and sustainable growth, produced results ranging from 4.6 percent to 16.5 percent. Staff usually adopts the results derived from using dividend growth because they are most consistent with DCF theory. In this case, the results derived from using dividend growth with the average and spot stock price were both 4.6 percent, well below the company's cost of debt and the current prime rate. Rather than increasing dividends consistent with rises in earnings in recent years, large telecommunications services companies have been retaining an increasing proportion of earnings to invest in competitive operations such as wireless and broadband services. Staff, therefore, believes that the results using dividend growth are unreasonably low, and will exclude them.

The DCF results using sustainable earnings with the average and spot stock price were both 16.5 percent. Staff believes that these results are unreasonably high due to U S WEST's reported ROE of 199.7 percent and 130.8 percent in 1998 and 1999, respectively, and will exclude them. The DCF results using earnings growth with the average and spot stock price were both 11.8 percent. Staff believes that these results are the most reasonable and reflect recent growth patterns.

Staff also considered the CAPM results for the intermediate-horizon on the basis that they reflect average holding periods of investors. In this case, The CAPM results are 12.0 percent and 12.6 percent. However, the beta factor utilized in these results reflects the impact of high-risk competitive telecommunications services. Staff believes that a lower beta factor of 0.60 (as explained previously), would better reflect the risks associated with Midvale's regulated telecommunications services and would produce results using the intermediate horizon of 10.1 percent and 10.7 percent, with a resulting overall average of 10.40 percent.

Q. What is Staff's recommendation for Midvale's cost of equity?

A. Staff is recommending a cost of equity of 11.50 percent for Midvale.

Q. What is the basis for Staff's recommendation?

A. The basis for Staff's 11.50 percent cost of common equity is the DCF result of 11.80 percent based upon earnings growth. Staff has adjusted this number downward to account for the decreased financial risk related to Midvale's Arizona capital structure, as well as the Company's risk associated with it's operations, in that a significant portion of the comparable companies' earnings are derived from unregulated, competitive operations. This downward adjustment is further reinforced by the CAPM results of 10.40 percent, using a beta factor of 0.60, which is more representative of 100 percent regulated operations.

Q. What is Staff's recommendation for a weighted average cost of capital ("WACC") to be used as the return on rate base?

A. Staff's recommendation for an overall WACC is 10.14 percent.

Comments on Direct Testimony of Don Reading, Ph.D.

Q. What methodologies did Dr. Reading use to arrive at his estimation for the cost of equity capital for Midvale?

A. Dr. Reading used the comparable earnings, DCF, and risk premium approaches to arrive at his estimate of Midvale's cost of equity.

Q. Which method has the Commission consistently adopted in the past?

A. The Commission has consistently adopted the results of the annual DCF model because its results are market-based.

Q. How does Dr. Reading arrive at his estimated cost of equity of 13.0 percent?

A. According to his pre-filed direct testimony, Dr. Reading recommends that the Commission concentrate on the mid-range of his estimates; 10.9 percent to 12.25 percent for the DCF method, 11.0 percent to 12.25 percent for his risk premium calculation, and 12.0 percent to 14.0 percent for the comparable earnings approach.

Q. Please describe the comparable earnings approach used by Dr. Reading and its shortcomings.

A. Dr. Reading's comparable earnings approach utilizes ROE data for three sets of companies; Standard & Poor's index of 400 industrials, the Federal Trade Commission's "All Manufacturers" group, and a group of approximately 900 companies monitored by *Business Week.*

Staff believes that this methodology is flawed and results in excessive cost of equity estimates for Midvale. Staff questions the use of industrials and manufacturing firms as comparable to Midvale's regulated local telephone operations. A major assumption of the comparable earnings approach is that an investor in a utility should be allowed to earn a return comparable to that earned by an investor in other firms of *comparable risk.* Dr. Reading has examined the earnings of groups of unregulated firms, "which do not exert large amounts of monopoly power". By nature, regulated operations such as Midvale's are characteristic of monopolies, that is why they are regulated. Staff therefore, calls in to question the comparability between utilities, such as Midvale, and industrials/manufacturers, who are subject to competition and do not have protected service territories.

Q. Does Staff have comments on the other two methodologies utilized by Dr. Reading in his estimate of Midvale's cost of equity?

A. Yes. Dr. Readings DCF results, which utilized market data from the Regional Bell Operating Companies and various other telecommunications firms ranged from 10.9 percent to 12.25 percent, with a midpoint of 11.58 percent. Dr. Reading's other market-based model, which was the risk premium approach, ranged from 11.0 percent to 12.25 percent, with a midpoint of 11.63 percent. Both of these market-based models resulted in estimates that were close to my recommended cost of equity of 11.50 percent for Midvale. Staff believes that this similarity reinforces the soundness of the market-based approaches.

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Q. Does this conclude your direct testimony?

A. Yes, it does.

Midvale Telephone Exchange
Capital Structure
And Weighted Cost of Capital
December 31, 1999

Staff Recommended

	Amount	Weight (%)	Cost	Weighted Cost
Long Term Debt				
RTFC Const. Loan Cascabel	$ 200,631	9.66%	6.10%	0.59%
RUS Cascabel	$ 268,586	12.94%	5.00%	0.65%
Total Long Term Debt	$ 469,217	22.60%	5.47%	1.24%
Equity (Cascabel & Young, Ne	$ 1,606,651	77.40%	11.50%	8.90%
Total Equity	$ 1,606,651	77.40%		
Total Capital	$ 2,075,868	100.00%		10.14%

Economic Indicators
1990 to Present

YEAR	CHANGE IN CPI	CHANGE IN GDP*	3-MONTH T-BILLS	PRIME RATE	30-YR T-BONDS	DOW JONES IND. AVG.
1990	6.1%	1.8%	7.5%	10.0%	8.6%	2,634
1991	3.1%	-0.5%	5.4%	8.5%	8.1%	3,169
1992	2.9%	3.0%	3.5%	6.3%	7.7%	3,301
1993	2.7%	2.7%	3.0%	6.0%	6.6%	3,754
1994	2.7%	4.0%	4.3%	7.1%	7.4%	3,834
1995	2.5%	2.7%	5.5%	8.8%	6.9%	5,117
1996	3.3%	3.6%	5.0%	8.3%	6.7%	6,448
1997	1.7%	4.4%	5.1%	8.4%	6.6%	7,908
1998	1.6%	4.4%	4.8%	8.4%	5.6%	9,181
1999	2.7%	4.2%	4.7%	8.0%	5.9%	11,497
Current	3.4%	5.0%	5.7%	9.5%	5.4%	10,869

1990-Current CPI, GDP, and Prime Rate = *Economic Indicators*, 01/01 (Data Through February 7, 2001)
1990-1999 DJIA is the year-end close from http://averages.dowjones.com/
1990-1999 3-Month T-Bills, 30-Yr T-Bonds from http://www.bog.frb.fed.us/releases/h15/data.htm
Current 3-Month T-Bill, Prime Rate, 30-Year T-Bond, and DJIA from WSJ, 12/29/00
*GDP revised by Bureau of Economic Analysis now uses chained, 1996 dollars

Midvale Telephone Exchange

Plant Additions, Access Lines, and Population

1997 to 2002

	Plant	Net Plant Additions	Change		Average Number Of Access Lines	Change	Gila	Coshise	Pima
							Population Growth by County		
1997	$ 2,573,354			1995	429		44,525	112,000	758,575
1998	3,034,757	$ 461,403	17.93%	1996	476	11.0%	45,300	114,925	780,750
1999	3,060,664	25,907	0.85%	1997	511	7.4%	47,450	119,650	789,650
Projected *2000	4,350,269	1,289,605	42.13%	1998	544	6.5%	49,175	123,750	823,900
Projected *2001	4,427,177	76,908	1.77%	1999	600	10.3%	50,150	124,575	845,775
Projected *2002	4,513,285	86,108	1.94%						
		4-Yr. Annual Growth '95-'99			8.7%		3.0%	2.7%	2.8%

* Includes the budget for serving unserved areas.

Source: Midvale's Schedule A-4
Annual Reports on file with the Commission
Company responses to Staff's data requests

Midvale Telephone Exchange

Capital Structure of Publicly Traded Telecommunications Companies
Fiscal Year 1998

Name	Long-Term Debt	Preferred Stock	Common Equity	Total
Alltel Corp	51.6%	0.0%	48.4%	100.0%
BellSouth	35.1%	0.0%	64.9%	100.0%
GTE Corp	63.7%	0.0%	36.3%	100.0%
SBC Communications	45.7%	3.9%	50.3%	100.0%
U S West	92.0%	0.0%	8.0%	100.0%
Average	52.9%	1.1%	46.0%	100.0%
Midvale Telephone	22.60%	0.00%	77.40%	100.0%

Source: July 7, 2000 Value Line
Midvale's application

Midvale Telephone Exchange

Capital Structure of Publicly Traded Telecommunications Companies
Fiscal Year 1999

Name	Long-Term Debt	Preferred Stock	Common Equity	Total
Alltel Corp	47.1%	0.0%	52.9%	100.0%
BellSouth	38.1%	0.0%	61.9%	100.0%
GTE Corp	56.3%	0.0%	43.7%	100.0%
SBC Communications	38.7%	2.2%	59.1%	100.0%
U S West	89.0%	0.0%	11.0%	100.0%
Average	48.1%	0.9%	51.0%	100.0%
Midvale Telephone	22.6%	0.00%	77.4%	100.0%

Source: July 7, 2000 Value Line
Midvale's application

Publicly Traded Telecommunications Companies
Return on Common Equity - Year End

Company	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
Alltel Corp	18.7%	17.0%	17.8%	15.6%	18.6%	17.3%	17.4%	18.1%	17.7%	18.0%
BellSouth	12.9%	11.5%	12.0%	12.0%	14.6%	18.8%	19.0%	18.4%	20.2%	25.6%
GTE Corp	16.3%	15.6%	17.7%	17.7%	21.8%	36.8%	38.0%	34.8%	28.4%	31.5%
SBC Communications	12.8%	13.1%	14.0%	14.0%	19.7%	30.2%	30.7%	34.0%	32.2%	27.8%
U S West	0.0%	0.0%	0.0%	0.0%	34.6%	31.8%	29.7%	25.0%	199.7%	130.8%
Maximum	18.7%	17.0%	17.8%	17.7%	34.6%	36.8%	38.0%	34.8%	32.2%	31.5%
Minimum	0.0%	0.0%	0.0%	0.0%	14.6%	17.3%	17.4%	18.1%	17.7%	18.0%
Mean	12.1%	11.4%	12.3%	11.9%	21.9%	27.0%	27.0%	26.1%	24.6%	25.7%
Truncated Average	10.5%	10.1%	10.9%	10.4%	15.0%	20.2%	19.9%	19.4%	24.3%	26.7%

Source: Value Line Investment Survey, July 7, 2000

Midvale Telephone Exchange
Docket No. T-02532A-00-0512
Test Year Ended December 31, 1999

Schedule JMR-6

Publicly Traded Telecommunications Companies
Financial Information
12/31/1999

Line No.	Company	Market Price Per Share: Current	Market Price Per Share: 00 High	Market Price Per Share: 00 Low	Mkt To Book	98 Revs. (000)	99 Revs. (000)	98 Total Cap. (000)	99 Total Cap. (000)	Int. Cov.	Beta	99 ROE
1	Alltel Corp	62.000	82.900	55.900	3.72	5,194	6,302	3,276	7,958	5.70	0.75	18.0%
2	BellSouth	44.000	53.500	34.900	5.42	23,123	25,224	25,276	24,319	6.90	0.85	25.6%
3	GTE Corp	64.000	76.700	55.800	5.75	25,473	25,336	26,168	26,050	5.70	0.90	31.5%
4	SBC Communications	45.000	50.000	34.800	5.39	28,785	48,960	25,392	45,201	7.10	0.85	27.8%
5	U S West	84.000	92.900	63.700	20.24	12,378	13,182	9,397	11,444	4.30	0.75	130.8%
	Maximum				20.24	$28,785	$48,960	$26,168	$45,201	7.10	0.90	130.8%
	Minimum				3.72	$5,194	$6,302	$3,276	$7,958	4.30	0.75	18.0%
	Mean				8.10	$18,991	$23,801	$17,902	$22,994	5.94	0.82	46.7%
	Truncated Average											26.7%

Current price = Most recent price as reported in July 7, 2000 Value Line Investment Survey
Market to Book ratio = Current price divided by book value per share as of 6/30/2000 per 10Q data
Int. Coverage, Beta, Total Cap., Revenue, and ROE from July 7, 2000 Value Line

Earnings Per Share, Dividends Per Share and Sustainable Growth Rates
Five Years Ending Fiscal Year 1999

Company	Earnings 5 Year	Dividends 5 Year	Sustainable 5 Year
Alltel Corp	7.22%	5.95%	8.11%
BellSouth	15.04%	1.51%	10.23%
GTE Corp	6.66%	0.00%	12.45%
SBC Communications	8.75%	4.09%	15.95%
U S West	8.87%	0.00%	22.60%
Maximum	15.04%	5.95%	22.60%
Minimum	6.66%	0.00%	8.11%
AVERAGE(1)	9.31%	2.31%	13.87%
Value Line Forecast	12.70%	2.60%	

(1) Excludes negative results

Results of Cost of Equity Analysis
And Staff's Recommendation

Publicly Traded Telecommunications Companies

METHOD					
Comparable Earnings (Return on Common Equity)					**RESULT**
Comparable Publicly Traded Telecom Utilities: 1998					24.3%
Comparable Publicly Traded Telecom Utilities: 1999					26.7%
DISCOUNTED CASH FLOW	D_1/P_0	+	g	=	k
5 Year D.P.S. Growth & Avg. Stock Price	2.3%	+	2.3%	=	4.6%
5 Year E.P.S. Growth & Avg. Stock Price	2.5%	+	9.3%	=	11.8%
5 Year Sust. Growth & Avg. Stock Price	2.6%	+	13.9%	=	16.5%
5 Year D.P.S. Growth & Spot Stock Price	2.3%	+	2.3%	=	4.6%
5 Year E.P.S. Growth & Spot Stock Price	2.5%	+	9.3%	=	11.8%
5 Year Sust. Growth & Spot Stock Price	2.6%	+	13.9%	=	16.5%
DCF Using Value Line's Projected Earnings and Projected Dividend Growth					
5 Year D.P.S. Growth & Avg. Stock Price	2.3%	+	2.6%	=	4.9%
5 Year D.P.S. Growth & Spot Stock Price	2.3%	+	2.6%	=	4.9%
5 Year E.P.S. Growth & Avg. Stock Price	2.6%	+	12.7%	=	15.3%
5 Year E.P.S. Growth & Spot Stock Price	2.6%	+	12.7%	=	15.3%
Company Estimate					13.00%
Staff Recommendation					11.50%

Results of Cost of Equity Analysis
Capital Asset Pricing Model

Capital Asset Pricing Model using Average Beta for Publicy Traded Telecommunications Companies

	Rf	+	β	x	(Rp)	=	RESULT k
Short-horizon Cost of Equity - Current	5.71%	+	0.82	x	9.50%	=	13.5%
Intermediate-horizon Cost of Equity - Current	5.01%	+	0.82	x	8.50%	=	12.0%
Long-horizon Cost of Equity - Current	5.44%	+	0.82	x	8.10%	=	12.1%
Short-horizon Cost of Equity - Projected	5.50%	+	0.82	x	9.50%	=	13.3%
Intermediate-horizon Cost of Equity - Projected	5.60%	+	0.82	x	8.50%	=	12.6%
Long-horizon Cost of Equity - Projected	5.70%	+	0.82	x	8.10%	=	12.3%

Capital Asset Pricing Model using Typical Beta for Publicy Traded Water Utility Companies

Short-horizon Cost of Equity - Current	5.71%	+	0.60	x	9.50%	=	11.4%
Intermediate-horizon Cost of Equity - Current	5.01%	+	0.60	x	8.50%	=	10.1%
Long-horizon Cost of Equity - Current	5.44%	+	0.60	x	8.10%	=	10.3%
Short-horizon Cost of Equity - Projected	5.50%	+	0.60	x	9.50%	=	11.2%
Intermediate-horizon Cost of Equity - Projected	5.60%	+	0.60	x	8.50%	=	10.7%
Long-horizon Cost of Equity - Projected	5.70%	+	0.60	x	8.10%	=	10.6%

Expected equity risk premium is estimated as the simple difference between the historical arithmetic mean equity return and the historical arithmetic mean on U.S. Treasury Bill total returns (Short-horizon), intermediate-term government bond income returns (Intermediate-horizon), or long-term government bond income returns (Long-horizon), described in Chapter 8 of the SBBI 2000 Yearbook, published by Ibbotson Associates.

The current risk-free rate is the yield-to-maturity on 90-day U.S. Treasury Bills (Short-horizon), 5-year U.S. Treasury Notes (Intermediate-horizon), or 30-year U.S. Treasury Bonds (Long-horizon), *Wall Street Journal*, October, 30, 2000.

The projected risk-free rate is the consensus forecast for the yield on 3-month U.S. Treasury Bills (Short-horizon), 5-year U.S. Treasury Notes (Intermediate-horizon), or 30-year U.S. Treasury Bonds (Long-horizon), *Blue Chip Financial Forecasts*, January 1, 2001

BOYLES

BEFORE THE ARIZONA CORPORATION COMMISSION

WILLIAM A. MUNDELL
Chairman
JIM IRVIN
Commissioner
MARK SPITZER
Commissioner

IN THE MATTER OF THE APPLICATION OF MIDVALE TELEPHONE EXCHANGE, INC., FOR AUTHORITY TO INCREASE RATES AND FOR DISBURSEMENT FROM THE ARIZONA UNIVERSAL SERVICE FUND	))))))	DOCKET NO. T-02532A-00-0512

DIRECT

TESTIMONY AND EXHIBITS

OF

RICHARD L. BOYLES

UTILITIES ENGINEER - TELECOMMUNICATIONS

UTILITIES DIVISION

March 15, 2001

Jbc130t

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EXECUTIVE SUMMARY

The Direct Testimony of Staff witness, Richard L. Boyles, addresses the Company's performance with respect to service quality, discusses issues of plant modernization and utilization and sponsors Staff's recommendations with regards to the depreciation rates that should apply to each of the Company's plant accounts. In Staff's opinion, the Company is providing acceptable levels of service and sufficient plant capacity to accommodate growth and seasonal variations in its number of customers. When applied to the Company's unadjusted end of test year plant balances, Staff's depreciation recommendation results in a composite depreciation rate of 7.75 percent and an annual depreciation accrual of $237,334. In this analysis, the proposed rates increase the annual depreciation accrual by $32,113.

INTRODUCTION

Q. Please state your name and business address.

A. My name is Richard L. Boyles. My business address is 1200 West Washington, Phoenix, Arizona 85007.

Q. By whom are you employed and what is your position?

A. I am employed by the Arizona Corporation Commission ("the Commission") in its Utilities Division. My title is Utilities Engineer - Telecommunications.

Q. Briefly describe your responsibilities as a Utilities Engineer - Telecommunications.

A. I work in the Engineering Section of the Utilities Division and I am responsible for providing technical assistance to the Commissioners and to other Utilities Division staff members on matters that come before the Commission involving telecommunications service providers operating in the State.

Q. Please summarize your educational background and professional experience.

A. I graduated from the University of Washington in 1978 with a Bachelor of Science Degree in Electrical Engineering. Prior to joining the Commission in March of 2000 as a Utilities Engineer, I worked for a telephone operating company for twenty-one years, where I held management positions in Network Engineering, Central Office Maintenance, Network Monitoring and Switch Technical Support.

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

A. The purpose of my testimony is to address Midvale Telephone Exchanges, Inc.'s, ("Midvale" or "Company") performance with respect to service quality. I will also discuss the issues of plant modernization and plant utilization in my testimony. Finally, I will sponsor Staff's recommendations with regard to the depreciation rates that should apply to each of Midvale's plant accounts on a going forward basis.

SERVICE QUALITY

Q. Did Staff review the service quality results for the exchanges and, if so, what service results did Staff review?

A. Yes. A review of Commission complaints for the years of 1997 through January 2001 was performed. A total of three informal complaints were found and they can be categorized as follows: New Service (1), Service (1) and Quality of Service (1). Of the three service related complaints, one occurred in 1998, one in 1999 and one in 2000. There have been no informal complaints during 2001. In the opinion of Consumer Services, Midvale appears to be responsive to customer complaints and there are no formal complaints on file with Docket Control.

The interval for clearing customer trouble reports is another measure of service quality. Midvale's objective for this measurement is for 100 percent of customer reported trouble to be cleared within 24 hours. This objective was met in the Cascabel exchange in 1999, and the Young exchange in 1996, 1998 and 1999. Overall, for 1996 through June, 2000, Midvale cleared 94.1 percent of customer reported trouble within 24 hours. This result demonstrates that, for the two exchanges, only 17 trouble tickets were not cleared within the objective time frame.

Q. Does Midvale monitor its network alarms from a centralized location so that service-impacting problems can be responded to quickly?

A. No. Due to the small size of the exchanges, alarm monitoring is not centralized. However, Midvale personnel can access each switch remotely from a computer terminal to perform certain maintenance and repair functions.

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Q. Has the Commission received any comments from Midvale customers regarding the Company's filing?

A. The Company notified customers of its rate increase request on or about February 20, 2001. As of the date of preparation of this Testimony, one petition with 206 signatures has been docketed in opposition to the Company's proposed rate increase for the Young exchange.

PLANT MODERNIZATION

Q. Has Midvale taken actions to modernize their switching network?

A. Yes. The central office switches in each exchange are digital technology. Digital switches provide performance reliability and the flexibility to easily expand when more capacity is required. The switches can be equipped to offer a range of capabilities including local and toll, 2 PIC Equal Access, and custom calling features such as call forwarding and call waiting. In addition, the Young digital switch can provide Centrex features and SS7 based services such as Caller ID, etc., to provide new revenue generating opportunities.

Q. Has Midvale upgraded its inter-office facilities?

A. The inter-office facility between the Cascabel and Young exchanges and Qwest is on fiber optic cable. Placement of the fiber cable in the Young exchange replaced an analog microwave radio system.

Q. What has the Company done to improve the quality of its outside plant facilities?

A. There is no open wire outside plant in either the Cascabel or Young exchange. The Company has also rebuilt certain outside plant cables in the Young exchange to improve service quality.

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Q. Are there other actions that Midvale has taken to improve the infrastructure of its network?

A. Yes. Digital Line Concentrators ("DLC's") locations have been constructed to provide service to customers that previously had not had service.

PLANT UTILIZATION

Q. Was the capacity of the switching network reviewed to determine if margins were sufficient for reasonable growth?

A. Yes. Staff reviewed the working versus equipped (available) line quantities in the serving central office switch and in the loop plant of each exchange. The switching composite ratio for the company was 0.81. Staff believes this ratio is within reasonable expectations given the modular nature of the switches and is similar to that of other carriers.

A similar review was performed for the subscriber carrier systems. The composite ratio for the three systems reviewed was 0.55 which Staff believes is reasonable for pair gain systems in rural exchanges with low customer density and is one, which provides for adequate growth.

Q. Was a review of fill factors for feeder and distribution cable in the outside plant also performed?

A. Yes. The composite ratio for the fiber and copper feeder routes reviewed was 0.50 and 0.70 for the copper distribution loop. Staff believes these ratios are reasonable for feeder distribution in these rural exchanges and are ones that provide for adequate growth.

Q. Although the fill factors were all found to be adequate for growth, do you have any concerns that excessive capacity might have been deployed in Midvale's network?

A. No. In my opinion unnecessary excess capacity has not been constructed.

Q. Were field inspections performed to validate that plant records were accurate and that network equipment was installed and maintained in a reasonable manner?

A. Yes. Engineering Staff visited each exchange and performed a plant inspection. In general, the plant inspections looked for network elements for which a major capital expenditure was identified. The condition of the facilities was evaluated to make a determination whether adequate maintenance was being performed. It is Staff's opinion that Midvale is taking appropriate actions to maintain its facilities in a manner that will provide quality service to its customer base.

DEPRECIATION

Q. What are the current depreciation rates that Midvale is using?

A. Midvale was authorized to utilize its current depreciation rates for the Cascabel exchange pursuant to Decision No. 58048, dated October 29, 1992. These are listed under column D on Schedule 1. In the Direct Testimony of Don C. Reading, the Company states it has used these same rates in the Young exchange since the purchase of that exchange from U S WEST pursuant to Decision No. 58736, dated September 1, 1994.

Q. What are the depreciation rates that Midvale is proposing in its rate application?

A. The Company did not propose revised rates in its application.

Q. Does your analysis concern only those depreciation rates that should be used going forward?

A. Yes.

Q. What other information is presented in Schedule 1?

A. Schedule 1 also shows the depreciation rates by plant account for Arizona Telephone Company (column C), Table Top Telephone Company (column E), Citizens Utilities Rural Company (column F), Citizens Communications Company of the White Mountains (column G), Qwest Communications (column H) and Southwestern Telephone (column I). Arizona Telephone Company and Table Top Telephone Company ("Table Top") were selected because these rural companies had, in recent years, filed rate cases that included a review of depreciation rates.

Q. What information is presented in Schedule 2?

A. Schedule 2 is a comparison of the depreciation that results when depreciation rates that have been approved for several other rural telephone companies in Arizona and Qwest are applied to the Company's test year (12/31/99) plant balances (Application Exhibit 3, Schedule 2). Also listed in Schedule 2, are the rates Midvale is currently using (response to data request DWC-53).

Q. Why did Staff prepare a comparative analysis of depreciation rates.

A. It is Staff's opinion that it is appropriate to look at the rates of other rural exchange carriers in Arizona. Staff believes this will provide the proper balance between the interests of the ratepayer and those of the Company while at the same time taking technical obsolescence and competitive considerations into account. For purposes of this analysis, Staff utilized unadjusted end of test year plant balances and the same depreciation rates for each exchange.

Q. Describe the methodology that Staff used in its analysis.

A. First, Staff became familiar with Midvale's network and service area while conducting its analysis in this case. Staff reviewed the rates used by the other Arizona rural exchange carriers. Staff then selected a rate in each plant account that it thought was reasonable based upon network considerations, service area considerations, similarities between carriers and other considerations. Using the December 31, 1999 plant balances that were provided by Midvale with its filing, each of the depreciation rate scenarios (as listed in Schedule 1) were calculated to determine what impact the scenario would have on the amount of accrual change required. This provided a way of determining the incremental impact of the various rates when applied to Midvale's plant investment. This last step was used primarily to gauge the reasonableness of Staff's proposed rates.

Q. Does Staff agree with the depreciation rates that Midvale is proposing in its rate application?

A. No. Staff believes that some increase in depreciation rates is appropriate to maintain relative parity with rates used by other rural carriers and to encourage continued investment in infrastructure improvements.

Q. What is Staff's recommendation regarding the depreciation rates that should apply to Midvale plant accounts on a going forward basis?

A. The depreciation rates shown under column K, on Schedule 1, are the rates Staff is recommending for the Cascabel and Young exchanges and any new service areas that may result from the Company's Application. Staff's recommended rates produce a composite rate of 7.75 percent compared to Midvale's current composite rate of 6.71 percent. In this comparative analysis, Staff's proposed rates increase the annual depreciation accrual by $32,113. These are increases over the projected current accrual amount and are based on the un-adjusted 1999 Test Year (12/31/99) plant balances in Midvale's initial filing. Schedule 2, shows the calculation of the annual depreciation accruals.

Q. What rationale did Staff use to select the rates it is recommending for each plant account?

A. The proposed rate for account 2116 (Work Equipment), is the same as that approved for Arizona Telephone Company. The rate for this account varies widely between the companies; however, in Staff's opinion, the rate selected represents a reasonable compromise and expected life.

Midvale's currently authorized rates were selected for accounts 2124 (General Purpose Computers) and 2212 (Digital Switching). The rate for account 2124, is the same as that recently approved by the Commission for Table Top. Staff believes continuation of the current rate for account 2212, is appropriate given the age of the digital technology deployed in the Cascabel exchange. In addition, Staff believes the Cascabel switch may be more limited its capabilities when compared to newer generation switching technologies.

For the remaining accounts Staff recommends the depreciation rates approved for Table Top Telephone in Decision No. 62840, dated August 24, 2000. These rates were found to be reasonable for a small rural telephone carrier and Midvale is similarly situated.

Q. Can you explain why the depreciation expense shown for Midvale on Schedule RLB-2 may be different that the depreciation expense used by other Staff witnesses to calculate the Company's revenue requirement?

A. Yes. The purpose of Schedule RLB-2 is to provide a comparison of the depreciation expense that would result from my recommended depreciation rates and the depreciation rates currently authorized for other telephone companies when applied to Midvale's plant. The comparison is presented to show a reasonable order of magnitude of relative depreciation expense for the various companies; not specific amounts. I used the Company's unadjusted test-year-end plant balances in my analysis. For purposes of calculating the revenue requirement, other Staff witnesses may have used different plant balances and historical depreciation rates to calculate depreciation expense.

CONCLUSIONS

Q. What are your conclusions regarding Midvale's service quality and the adequacy of its network?

A. Service quality in these exchanges, based upon Consumer Services and Company data, appears to be good. Midvale is offering many of the latest services and calling features to its customers. Midvale plant additions provide sufficient capacity to accommodate reasonable growth and the seasonability of its customer base.

Q. Would you please summarize Staff's depreciation recommendation?

A. Staff recommends that the rates in Schedule 1, under column K, be adopted. These rates would result in a composite depreciation rate of 7.75 percent and an annual depreciation accrual of $237,334. Staff believes these rates are reasonable because they are comparable to rates used by other rural exchange carriers in Arizona.

Q. Is Midvale in compliance with previous Commission Orders?

A. Yes.

Q. Does that conclude your direct testimony?

A. Yes, it does.

MIDVALE TELEPHONE
DEPRECIATION RATE COMPARISON

	A	B	C	D	E	F	G	H	I	K
Note #	Midvale Account	Description	Arizona Telephone	Midvale Telephone	Table Top 8/2000	Citizens Rural	Citizens White Mtns.	Qwest 5/2000	Southwestern Telephone	Staff Proposed
	2111	Land	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	2112	Vehicles	18.00	20.00	14.00	21.20	25.50	4.90	8.55	14.00
	2116	Work Equip.	10.00	20.00	5.90	1.78	13.70	15.90	8.55	10.00
	2111	Buildings	2.60	3.33	2.50	3.88	6.70	3.00	2.45	2.50
	2122	Office Equip./Furn.	4.75	14.29	9.30	4.22	11.50	20.10	5.10	9.30
2	2123	Commun. Equip.	14.29	20.00	11.20	1.93	6.70	6.10	8.57	11.20
	2124	Gen. Purp. Comp.	20.00	20.00	20.00	24.60	22.10	9.40	13.01	20.00
	2212	Digital Switching	8.25	10.00	9.00	5.47	7.80	11.00	10.59	10.00
3,4	2230	Circuit. Equip.	10.25	8.33	10.00	5.02	14.80	9.80	10.59	10.00
5	2351	Public Tel. Equip.	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	2423	Buried Cable	5.25	4.17	5.65	5.10	6.40	12.00	4.31	5.65
1		Composite Rate	7.41	6.71	7.56	5.41	9.40	10.96	7.20	7.75

Notes:
1. Based upon Midvale test year plant balances.
2. Column F, G and H, used 2123.20 - Communications Equipment.
3. Column F, used 2232.40 - Circuit Equipment.
4. Column H, used Circuit Equipment - Digital.
5. Account 2351 is fully depreciated.

MIDVALE TELEPHONE
DEPRECIATION EXPENSE COMPARISON

Midvale Account	Comparative Account	Description	12/31/99 Plant In Service	SWT Current Rate	SWT Current Expense	Qwest 1991 Rate	Qwest 1991 Expense	Qwest 5/2000 Rate	Qwest 5/2000 Expense	Citizens Rural Rate	Citizens Rural Expense
2111.54	2111.XX	Land	20,207	0.0000	0	0.0000	0	0.0000	0	0.0000	0
2112.XX	2112.XX	Vehicles	54,545	0.0855	4,664	0.1050	5,727	0.0490	2,673	0.2120	11,564
2116.XX	2116.XX	Work Equipment	21,980	0.0855	1,879	0.0590	1,297	0.1590	3,495	0.0178	391
2111.XX	2121.XX	Buildings	14,347	0.0245	352	0.0340	488	0.0300	430	0.0388	557
2122.XX	2122.XX	Furniture	500	0.0510	26	0.0760	38	0.2010	101	0.0422	21
2123.XX	2123.XX	Communication Equip	0	0.0857	0	0.1120	0	0.0610	0	0.0193	0
2124.XX	2124.XX	Gen Purpose Comp.	8,943	0.1301	1,163	0.1740	1,556	0.0940	841	0.2460	2,200
2212.XX	2212.XX	Digital COE	497,160	0.1059	52,649	0.0780	38,778	0.1100	54,688	0.0547	27,195
2230.XX	2232.XX	Ckt Equip - Toll	870,783	0.1059	92,216	0.0880	76,629	0.0980	85,337	0.0502	43,713
2351.XX	2351.XX	Public Telephone Equip	5,619	0.0000	0	0.0000	0	0.0000	0	0.0000	0
2423.XX	2423.XX	Buried Cable - Metallic	1,566,579	0.0431	67,520	0.0520	81,462	0.1200	187,989	0.0510	79,896
		Composite	3,060,663	**0.0720**	220,468	**0.0673**	205,975	**0.1096**	335,553	**0.0541**	165,536

MIDVALE TELEPHONE
DEPRECIATION EXPENSE COMPARISON

Midvale Account	Comparative Account	Description	Citizens White Mtn Rate	Citizens White Mtn Expense	Arizona Telephone Rate	Arizona Telephone Expense	Midvale Telephone Rate	Midvale Telephone Expense	Table Top 8/2000 Rate	Table Top 8/2000 Expense	Staff Proposed Rate	Staff Proposed Expense
2111.54	2111.XX	Land	0.0000	0	0.0000	0	0.0000	0	0.0000	0	0.0000	0
2112.XX	2112.XX	Vehicles	0.2550	13,909	0.1800	9,818	0.2000	10,909	0.1400	7,636	0.1400	7,636
2116.XX	2116.XX	Work Equipment	0.1370	3,011	0.1000	2,198	0.2000	4,396	0.0590	1,297	0.1000	2,198
2111.XX	2121.XX	Buildings	0.0670	961	0.0260	373	0.0333	478	0.0250	359	0.0250	359
2122.XX	2122.XX	Furniture	0.1150	58	0.0475	24	0.1429	71	0.0930	47	0.0930	47
2123.XX	2123.XX	Communication Equip	0.0670	0	0.1429	0	0.2000	0	0.1120	0	0.1120	0
2124.XX	2124.XX	Gen Purpose Comp.	0.2210	1,976	0.2000	1,789	0.2000	1,789	0.2000	1,789	0.2000	1,789
2212.XX	2212.XX	Digital COE	0.0780	38,778	0.0825	41,016	0.1000	49,716	0.0900	44,744	0.1000	49,716
2230.XX	2232.XX	Ckt Equip - Toll	0.1480	128,876	0.1025	89,255	0.0833	72,536	0.1000	87,078	0.1000	87,078
2351.XX	2351.XX	Public Telephone Equip	0.0000	0	0.0000	0	0.0000	0	0.0000	0	0.0000	0
2423.XX	2423.XX	Buried Cable - Metallic	0.0640	100,261	0.0525	82,245	0.0417	65,326	0.0565	88,512	0.0565	88,512
		Composite	**0.0940**	287,831	**0.0741**	226,718	**0.0671**	205,221	**0.0756**	231,461	**0.0775**	237,334

MIDVALE TELEPHONE EXCHANGE

ARIZONA

LOCAL ACCESS TARIFF

2000

SCHEDULE OF RATES AND CHARGES

TOGETHER WITH RULES AND REGULATIONS

APPLICABLE TO TELEPHONE SERVICE

PROVIDED IN THE TERRITORY SERVED BY THE

MIDVALE TELEPHONE EXCHANGE, INC.

WITHIN THE STATE OF ARIZONA AS FOLLOWS:

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DEFINITIONS

Access Line

The circuit which travels from the Central Office to the subscriber's premises, terminating at the protector which provides direct access to the local exchange and the toll switching networks.

Channel

The electrical path provided by the Telephone Company between two or more locations.

Circuit

A channel used for the transmission of electrical energy in the furnishing of telephone service.

Connecting Company

A corporation, association, partnership, or individual owning or operating one or more exchanges and with whom traffic is interchanged.

Contract

The service agreement between a subscriber and the Company under which services and facilities are furnished in accordance with the provisions of the applicable Tariffs.

Customer Provided Equipment (CPE)

Devices, apparatus, and their associated wiring provided by a subscriber for use with facilities furnished by the Company.

Direct Dialing

The capability for a subscriber to dial anywhere in the United States with a series of numbers without operator assistance.

Exchange Area

The territory served by an Exchange.

DEFINITIONS (continued)

Extension and PBX. Station Mileage

The charges made for the additional circuit required to furnish such stations beyond the allowable distance from the main station or PBX switchboard.

Extension Station

An additional station connected on the same circuit as the main station and having the same telephone number as the main station.

Extra Listing

Any listing of a name or information in connection with a subscriber's telephone number beyond the single listing provided with regular service.

Foreign Exchange Directory Listing

An alphabetical and directory listing in the directory of an exchange other than the exchange in which a subscriber is furnished local service.

Individual Line

An exchange line designed for the connection of a single access line.

Installation Charge

A nonrecurring charge made for the placing or furnishing of telephone equipment, which may apply in place of or in addition to Service Connection Charges and other applicable charges for service or equipment.

Key System

An arrangement of key-equipped instruments capable of providing intercommunication and multi-trunk communication with the general exchange and interexchange network.

Local Exchange

That portion of a channel which connects a station to the interexchange channel; it also applies to a channel connecting two or more stations within an exchange area.

DEFINITIONS (continued)

Local Exchange Service

Telephone service furnished between subscriber's stations located within the same local service area.

Local Message

A communication between subscribers' stations within the same Local Service Area.

Local Service Area

That geographical area throughout which a subscriber obtains telephone service without the payment of a toll charge.

Main Station

A suitable telephone instrument or station which is connected to a network access line through a Central Office and has a unique telephone number.

Premises

All of the building or the adjoining portions of a building occupied and used by the subscriber; or all of the buildings occupied and used by the subscriber as a place of business or residence, which are located on a continuous plot of ground not intersected by a public highway or thoroughfare.

Primary Station

Synonymous with Main Station.

Private Branch Exchange (PBX)

An arrangement of equipment used by a subscriber and connected directly to a central office by means of trunk access lines, from which connection is made to stations at various locations or customer premises, thereby providing telecommunications between these stations as well as communication with the general exchange system.

DEFINITIONS (continued)

Private Line

A circuit provided to furnish communication only between the two or more telephones directly connected to it, and not having connection with either central office or P.B.X. switching apparatus.

Public Telephone

An exchange station equipped with a coin collecting and/or card accepting device which is installed for the convenience of the public at a location chosen or accepted by the Company.

Subscriber

A person or agency subscribing for telephone service at a particular location. As used in this Tariff, subscribership is associated with a specific location or continuous property where service is furnished, not with a particular individual or firm. If such individual or firm requests service at multiple locations, each such location requires a separate subscription, even within a single Exchange. The privileges, restrictions, and rates established for a subscriber to any class of service are limited to the service at one location; and no group treatment of the multiple subscriptions undertaken by any one individual or firm is contemplated or to be implied, except when definitely provided for in the schedules.

Tariff

The document filed by the Company with the Public Utilities Commission that lists the communication services offered by the Company and the associated rates and charges.

Telecommunications Station

A suitable telecommunications instrument, consisting of a transmitter, receiver, and associated apparatus, so connected as to permit the transmission and reception of voice and/or data telecommuncations.

DEFINITIONS (continued)

Tie Trunk

A circuit connecting two PBX systems for the purpose of intercommunicating between the stations connected with such PBX switching apparatus. The circuit is not intended to provide general exchange service through either of the PBX systems with which it connects.

Toll Message

A message, typically between stations in different local service areas, for which a per-message or per-minute charge is levied.

Toll Service

Originating and/or terminating telecommunications service rendered by the Company between stations in different local service areas.

Trunk

A telecommunications channel (a) between two ranks of switching equipment in the same central office, (b) between central office units in the same switching center, or (c) between two switching centers.

GENERAL RULES AND REGULATIONS

A APPLICATION

The rules and regulations specified herein apply to the intrastate services and facilities of the Midvale Telephone Exchange, Inc., hereinafter referred to as the Company. Failure on the part of the subscribers to observe these rules and regulations of the Company, after due notice of such failure, automatically gives the Company authority to discontinue service.

In the event of a conflict between any rate, rule, regulation, or provision contained in these General Rules and Regulations and any rate, rule, regulation or provision contained in the specified tariffs, the latter shall prevail.

These tariffs cancel and supersede all other tariffs of the Company issued and effective prior to the effective date of these tariffs.

B OBLIGATIONS OF THE COMPANY

1. Availability of Facilities

   The Company's obligation to furnish telephone service is dependent upon its ability to secure suitable facilities and to provide such service without unreasonable expense.

2. Interruption of Service

   An allowance will be made upon notice and demand to the Company following an interruption of service not due to subscriber negligence, provided the interruption continues for more than twenty-four (24) hours from the time it is reported to or detected by the Company. The allowance will be the prorated portion of the monthly rate for the service made inoperative.

3. Directory Errors and Omission

   The Company endeavors to list accurately in the local telephone directory the names of customers, their telephone numbers, and other customer information that has been properly requested. The Company will waive the tariff rate for special directory services in cases in which the company is responsible for directory listing errors.

GENERAL RULES AND REGULATIONS (continued)

B. OBLIGATIONS OF THE COMPANY (continued)

4. Use of Connecting Company Lines

Lines of other connecting companies may be used to reach points outside the Company area when suitable arrangements can be made.

5. Defacement of Premises

The Company will repair or replace any defaced or damaged subscriber property when such defacement or damage results from the Company's negligent installation, placement, or removal of Company property.

6. Adjustment of Charges

In case of overbilling, where when the amount of overcharge can be determined,. the Company will make a full refund. In the case of underbilling, the Company reserves for a period of three years the right to backbill for the deficiency charges.

C. USE OF SERVICE AND FACILITIES

1. Ownership and Use of Equipment

All equipment and lines furnished by the Company are the property of the Company even though located on the subscriber's premises. Company agents or employees shall have the right to enter said premises at any reasonable hour to install or maintain equipment, make collections, or remove equipment.

The Company may refuse to install or maintain any service at locations which are hazardous to Company employees. If such service is furnished, the subscriber may be required to install and maintain such service, holding the Company harmless from any claims for damage by reason of the installation and maintenance of this service.

GENERAL RULES AND REGULATIONS (continued)

C. USE OF SERVICE AND FACILITIES (continued)

2. Interconnection Policy

Subscriber-provided terminal equipment may be used and subscriber-provided communication system may be connected with the facilities furnished by the Company for telecommunications services subject to regulations outlined in other parts of this tariff. In case any unauthorized attachment is made, the Company shall have the right to disconnect, suspend, or terminate the service.

3. Use of Subscriber Services

Subscriber telephone service is furnished only for the use by the subscriber, his family, and associates. The Company may refuse to install or permit such service to remain on premises of public or semi-public character. The equipment may be installed at such locations if it is located so it is not accessible for public use.

4. Tampering with Equipment

The Company may refuse to furnish telephone service when company equipment shows any evidence of tampering for the purpose of obtaining service without payment of charges applicable to the service rendered by the Company.

5. Use of Improper Language or Impersonation of Another

The Company may refuse service to anyone who uses or permits abusive or obscene language over Company facilities or impersonates another individual with fraudulent or malicious intent.

6. Governmental Objections to Service

The Company may refuse service or discontinue service to anyone upon objection to such service by or behalf of any governmental authority.

7. Indiscriminate Use of Facilities

The Company may refuse to furnish service or require upgrading of services provided to any subscriber who allows indiscriminate use of Company facilities, except in case of emergencies.

GENERAL RULES AND REGULATIONS (continued)

D. ESTABLISHMENT AND FURNISHING OF SERVICE

1. Application for Service

Application for service must be made on the Company's standard form, which becomes a contract when accepted in writing by the Company or upon establishment of service. The subscriber may be required to pay in advance all charges for the first billing period and connection charge if applicable. The conditions of such contracts are subject to all provisions of this and other applicable tariffs. Requests for additional service may be made verbally, if provided in the original contract, and no advance payment will be required. A move within the exchange area is not considered to terminate the contract, and orders for such may be made orally or in writing.

2. Telephone Numbers

The customer has no property right in the telephone numbers assigned by the Company and no right to continuance of service through any particular central office. The Company may change the telephone number or central office designation of a customer whenever such change is considered desirable in the conduct of the Company's business. When existing service is continued for a new customer, the telephone number assigned to the former customer may be retained by the new customer only: (a) if the former customer consents and properly notifies the Company in writing; and (b) if arrangements acceptable to the Company are made by the new customer to pay all charges against the service to the company.

3. Alterations

The subscriber agrees to notify the Company of any alterations which will necessitate changes in the Company's wiring; and the subscriber agrees to pay the Company's current charges for such changes.

4. Payment of Service

The subscriber is required to pay all charges for services rendered by the Company, both exchange and tall in accordance with provisions contained elsewhere in this tariff. The subscriber is responsible for all charges for service rendered at his telephone, including collect charges.

GENERAL RULES AND REGULATIONS (continued)

D. USE OF SERVICE AND FACILITIES (Continued)

5. Maintenance and Repairs

The Company shall bear the expense of all repair and maintenance of its facilities, except where damage or destruction of its facilities is due to the gross neglect of the subscriber. The subscriber may not rearrange., remove, or disconnect any Company facilities without consent of the Company.

6. Line Extensions

Lines will be extended to permanent customers in accordance with the guidelines established in the Construction Charge section.

Where required by the conditions, applicants may be required to provide to the Company suitable private right- of-way parallel to the public highway.

7. Unusual Installation Costs

When special conditions or special requirements of the subscriber involve unusual construction or installation costs, the subscriber may be required to pay a reasonably proportionate share of such cost. Title to all facilities constructed and paid for wholly or in part by the subscriber is vested in the Company.

E. TELEPHONE DIRECTORIES

The Company will furnish to its subscribers, without charge, only such directories as it deems necessary for the efficient use of the service. Other directories will be furnished at the discretion of the Company at a reasonable charge.

F. ESTABLISHMENT AND MAINTENANCE OF CREDIT

1. Deposits

The Company adopts by reference the Rules and Regulations promulgated by the Arizona Corporation Commission and all amendments to those rules which may be hereafter adopted by the Arizona Corporation Commission. Copies of these Rules and Regulations are on file in the business office and are available for public inspection.

GENERAL RULES AND REGULATIONS (continued)

F. ESTABLISHMENT AND MAINTENANCE OF CREDIT (continued)

2. Interest to be Paid on Deposits

Simple interest, at the rate provided by the Arizona Corporation Commission, shall accrue from the date of deposit until the date of refund or application to the customer's telephone bill.

3. Reconnection Charge

Where service has been terminated by the Company in accordance with the Arizona Corporation Commission Rules and Regulations, the regular non-recurring charges (Refer to section: Service Connection, Move and Change Charge) shall apply for reconnection of service.

G. MINIMUM CONTRACT PERIODS

Except as hereinafter provided, the minimum contract period for all services and facilities is one month at the same location.

The length of contract period for directory listings, where the listing actually appears in the directory, is the directory period. The directory period is from the day on which the directory is first distributed to the subscribers to the day on which the succeeding directory is first distributed to subscribers.

The Company may require a minimum contract period longer than one month at the same location in connection with special (nonstandard) types or arrangements of equipment, or for unusual construction necessary to meet special demands and involving extra cost.

H. TERMINATION OF SERVICE

1. Early Termination of Service at Subscriber's Request

Service may be terminated prior to the expiration of the minimum contract period upon notice to the Company and payment of any applicable termination charges in addition to any applicable balance due for service which has been furnished.

In the case of service for which the minimum contract period is one month, termination will require payment of the balance due for the minimum period.

GENERAL RULES AND REGULATIONS (continued)

H. TERMINATION OF SERVICE (continued)

1. Early Termination of Service at Subscriber's Request (continued)

In the case of directory listings where the listing has appeared in the directory or where an unlisted or unpublished listing has been properly omitted, the charges are due to the end of the directory period, except that in the following cases charges will be continued only to the date of the termination of the extra listing or proper omission with a minimum charge of one month.

(1) The Contract for the main service is terminated.

(2) The listed party becomes a subscriber to some other class of exchange service.

(3) The listed party moves to a new location.

(4) The listed party dies.

For special equipment, the charges will be based on the individual circumstances in each case as agreed upon at the time of installation.

Contracts for periods longer than one month covering services whose installation required line extensions may be terminated upon payment of all charges that would accrue to the end of the contract period, or the contract will be transferred to a new applicant who is to occupy the same premises and will subscribe to the service effective on the day following termination by the original subscriber.

2. Subsequent Termination of Service at Subscriber's Request

Service may be terminated after the expiration of the initial contract period upon notice to the Company and payment of all charges due to the date of termination. .

3. Termination of Service by the Company

The Company adopts by reference the Rules and Regulations promulgated by the Arizona Corporation Commission (specifically, A.A.C. R-14-2-5 and A.A.C. R-14-2-11) and all subsequent amendments thereto. Copies of these Rules and Regulations are on file in the business office and are available for public inspection.

GENERAL RULES AND REGULATIONS (continued)

I. PAYMENT FOR SERVICE AND FACILITIES

1. Date Payment Due

The subscriber shall pay for service and facilities monthly in advance and shall pay all duly incurred toll and one-time charges when billed. Failure to receive a bill does not relieve the subscriber of the responsibility for payment in accordance with the provisions set forth herein.

All bills for service are due and payable at the office of the Company on or before the 20th day following the postmarked date of the statement. After the 20th day, bills are delinquent and the service is liable to termination. A delinquent bill is subject to a late charge of 1.5% per month, and the Company may apply any deposit towards the outstanding balance.

2. Returned Check Policy

A charge of $15.00 will be made for any dishonored check returned to the Company. If two returned checks are received from a subscriber within a 12-month period, the Company may require that all subsequent payments be made by cash, money order, or certified check.

J. SPECIAL SERVICES AND FACILITIES

Extraordinary special services and facilities not otherwise provided for in this Tariff may be furnished or leased pursuant to special contract for such period as may be agreed upon, provided such special service or facility or the use made thereof is not unlawful and does not interfere with the Company's telephone service. Applicable charges will be determined by the Company's revenue requirements for each individual system. In the event any such special service or facility or the use made thereof is found to interfere with the Company's telephone service, the Company may terminate such contract and cease to furnish such special service or facility upon thirty days written notice--provided further that the Commission may terminate such contract whenever it deems public interest requires it.

K.. TAXES

The Company will charge and collect any privilege, sales or use tax or impositions based on gross revenues. The tax requirements charged and collected will be in addition to normal rates and charges.

NETWORK ACCESS LINE SERVICE

RATES

	MONTHLY RATES	
	Residence (R-1)	Business (B-1)
Local Service R-1	$24.00	$32.00

CONDITIONS

The above rates apply to the provision of network access lines which, when connected to a suitable telephone instrument provides access to the telephone network.

Instruments must be provided by the subscriber, subject to the conditions described in the Connection With Subscriber-Owned Equipment portion of this tariff.

Additional instruments may be attached to network access lines. The Company reserves the right to limit the number of instruments connected to an access line if they cause interference with the normal operation of the line.

Business Rates Apply:

At any location where activities are of a business, trade, or professional nature.

At any location where the listing of service at that location indicates a business, trade, or profession.

Where only one network access line is provided at a location which is both a residence and a business.

At schools, hospitals, libraries, churches, and other similar institutions.

Residence Rates Apply:

In private residences where business listings are not provided and telephone service is not used for the conduct of business.

In the place of residence of a clergyman, or of a physician or other medical practitioner, provided the subscriber does not maintain an office in the residence.

SERVICE CONNECTION, MOVE AND CHANGE CHARGES

RATES

	Business	Residence
Service Order	$12.00	$12.00
Line Connection	$15.00	$15.00
Premises Visit	$30.00	$30.00

CONDITIONS

These charges are intended to cover the expense incurred by the Company in conjunction with the following:

Establishment of service;
Change in location of a service to other premises;
Transfer of service from one customer to another;
Change of telephone number at customer's request;
Installation of auxiliary equipment;
Restoration of service disconnected for nonpayment or failure to establish credit.

Charges shown are in addition to installation charges shown under other Tariff schedules.

Charges shown in this schedule are based on work being performed during regularly scheduled working hours of the Company's employees. Work performed with overtime labor costs will be performed at direct cost to the customer.

DEFINITIONS

Service Order

Applicable to work done in receiving, recording, and processing information necessary to execute a customer's request for the establishment of service. It is also applicable to work responsive to a customer's request for additions, moves, or changes to existing service.

SERVICE CONNECTION, MOVE AND CHANGE CHARGES (continued)

DEFINITIONS (continued

Premises Visit

Applicable if a Company employee must visit the customer's premises to move or change a service drop or standard network interface at the customer's request. Not applicable when a Company employee is on the customer's premises for any other business purpose.

Line Connection

Applicable to work done in the Central Office or work involving Central Office equipment necessary to provide a network access line or make changes to an existing network access line.

If service requires work in more than one Central Office area, a separate charge applies to the work in each office.

OFF-PREMISES EXTENSION SERVICE

RATES

	Installation Charge	Monthly Rate
Continuous Property	Actual Cost	No Charge
Continuous Property - Additional Network Interface	Applicable Nonrecurring Charges	$4.00
Discontinuous Property Each Location	Applicable Nonrecurring Charges	Applicable Access Line Rate

CONDITIONS

Off-premises extension service, where the extension is located in a different building on the same continuous property as the main access line termination, may be installed by the Company. The installation charge will be negotiated between the subscriber and the Company. The subscriber is responsible for the maintenance of any subscriber-owned wiring. No recurring monthly charge will apply in this situation.

Continuous property extensions are defined as those where the drop to the additional access point comes directly from the premises of the main access line termination and does not come out of the distribution cable.

Continuous property extensions requiring an additional network interface are defined as those where the drop to the additional access point comes out of the distribution cable and requires an additional network interface.

When off-premises extension service is provided on Discontinuous property, each location is treated as an access line termination and the applicable access line rates will apply at each location. Installation will be performed based on all applicable Nonrecurring service connection elements.

INTRAEXCHANGE SPECIAL ACCESS

RATES

	Installation	Monthly Rate
Per Channel Termination	Actual Cost	Business Access Line Rate

CONDITIONS

The Company will furnish and maintain Special Access, where facilities are available and within the Exchange Area, for communication between stations not connected to the telephone network.

The channel terminal rate will apply for each termination within the Exchange Area.

DIRECTORY LISTINGS

RATES

		Monthly Rate
Additional or Alternate Listing -	Business	$1.50
	Residence	1.00
Cross Reference or Duplicate		1.00
Extra Lines, per line		1.00
Unlisted		2.00
Unpublished		2.00
Foreign Exchange		2.00

CONDITIONS

The regulations for directory listings, as provided in this section, apply only to that section of the directory containing the regular alphabetical list of names of subscribers.

Primary Listing

One listing without charge, termed the Primary Listing, is provided as follows:

1. For each separate subscriber service. When two or more main station lines or PBX trunk lines are consecutively operated, the first number of the group is considered the primary listing.

B. Unlisted telephone numbers are listed in the information file, but are not listed in the Company's directory. They will be given out upon request.

C. Unpublished numbers are not listed either in the directory or the information file and will not to be given out to anyone unless such disclosure is authorized by a court of law.

DIRECTORY LISTINGS (continued)

Restrictions

Names in directory listings shall be limited to the following:

1. In connection with residence service:
   (a) The individual names of the subscriber, or
   (b) The individual name of a member of the subscriber's family, or
   (c) The individual name of a permanent member of the subscriber's household, or
   (d) Dual (joint) listings for customers with the same surname residing at the same address.
2. In connection with business service.
   (a) The individual name of the subscriber, or
   (b) The name under which the subscriber is actually doing business, or
   (c) The name under which a business is actually being conducted by someone other than the subscriber and which the subscriber is authorized by such other to use, or
   (d) The individual names of the officers, partners, or employees of the subscriber, or
   (e) The names of departments when such listings are deemed necessary from a public reference viewpoint.

The Company may require that the subscriber provide the Company with written permission for the insertion or continuance of listings. The Company may refuse to accept or may delete listings of a business which the subscriber claims to represent. The Company may refuse to accept or may delete a listing which includes the trade name of another.

CUSTOMER-PROVIDED PAY TELEPHONE SERVICE

RATES

Public Access Line (PAL) $32

CONDITIONS

1. Customer-provided coin-operated telephones must comply with the requirements including, but not limited to, the following:

   (a) The telephone instrument must be registered under Part 68 of the FCC Rules and Regulations or be connected behind a protective coupler registered under Part 68 of the FCC Rules and Regulations.

   (b) The telephone instrument must comply with the requirements of all applicable federal, state, and local laws and regulations concerning disabled, handicapped, and/or hearing-impaired persons.

   (c) The telephone instrument must allow coin-free operator and emergency 911 access in any exchange where 911 service is available. Where 911 service is not available, detailed instructions for completing coin-free emergency calls must be posted on the pay telephone instrument.

2. Extensions to a pay telephone permitting third-party access to conversations are prohibited.

3. Instruments shall be located in a well-lighted location and provided at all times with a current telephone book in legible condition.

4. On the instrument itself, or in clear view in close proximity to the instrument, the following information must appear:

   (a) Name, address and telephone number of owner;

   (b) The procedure for reporting service difficulties and the method of obtaining refunds:

   (c) A statement that the instrument is not owned by the Local Exchange Company and that charges for calls made on the instrument are not regulated;

CUSTOMER-PROVIDED PAY TELEPHONE SERVICE (continued)

CONDITIONS (continued)

(d) Dialing instructions;

(e) Relevant operational characteristics such as pre-pay or post-pay; and

(f) Emergency dialing information, including dial-tone first, coin-free 911, or other emergency access.

5. The PAL customer of record is responsible for compliance with Tariff conditions, as well as the installation and maintenance of instrument(s).

6. In addition to the rates and charges above, Public Access Lines shall bear all charges related to business access line service such as maintenance of service, toll, and Directory Assistance.

   The owner is responsible for payment of all billings. The Company may require as a condition of connection a mandatory security deposit to ensure payment.

7. Directory listings for subscribers to Public Access Line service are provided under the regulations governing the furnishing of listings to business access line customers.

8. Owners must apply for service on an application form provided by the Company.

9. When an alternate operator services provider is utilized for any customer-owned telephone, a notice to its customers must be posted, identifying the operator service provider and stating the following: (1) the procedure for obtaining rate information; (2) the procedure for reporting service difficulties; (3) a method for obtaining refunds; (4) emergency dialing information; and (5) instructions for accessing the Local Exchange Company operator. Failure to comply with notice requirements may result in disconnection of service.

CONSTRUCTION CHARGES

1. GENERAL

Charges under this tariff are for facility extensions to prevent the unreasonable burdening of the general body of existing customers.

All plant facilities will be owned and maintained by the Company. However, by mutual agreement with the Company, the applicant or subdivider/developer, may clear the right-of-way, furnish and install the underground supporting structure, or open and close a trench for buried services -- all in accordance with the Company's construction specifications. The Company in these cases may furnish and install the fixtures and wire or cable at its expense. Ownership of facilities, structures, etc., so provided by applicant shall be vested in the Company.

Nonrecurring charges under this tariff are payable in advance, are non-interest-bearing, and are not refundable except as specified in this Tariff.

2. LINE EXTENSIONS

A. Facilities provided without Construction Charge

Under normal conditions, the Company, without charge, will extend its lines for up to 300 feet in order to reach applicants.

B. Construction Charges for Line Extensions of Excess Length

1. If line extension requirements exceed 300 feet, a construction charge will apply. In the case of a group of applicants, the charge will be apportioned equally among members of the group.

2. Any such construction charge shall be paid in advance.

3. Payments for line construction are nonrefundable, and no credit will be allowed for future installation or line extensions constructed under the above regulations.

4. Plant extensions to provide service on a basis other than as covered above will entail construction charges as determined by the Company from the conditions.

CONSTRUCTION CHARGES (continued)

2. LINE EXTENSIONS (continued)

C. Actual cost determination

1. In those circumstances where extensions to facilities exceed the 300 foot allowance, the customer, in addition to any material or labor to be furnished by him, will pay in advance the estimated total cost of the Company's construction as prescribed in a contract executed between the Company and the customer.

2. Should the amount advanced by the customer exceed the actual cost, a refund will be made after completion of the Company's construction.

3. In no instance will the Company charge more than the actual cost at the closing of the job order.

4. When the construction provided includes provisions for additional future customers (at Company option), the charges assessed to current applicants shall be based upon a proration of the cost to their services, not upon the actual total cost of the job order.

D. Exceptional circumstances

1. Where construction involves unusual conditions such as unusual terrain, or where extraordinary charges applicable to government land crossings, forestry permits, etc., are involved, the Company's charges may depart from those specified in this schedule.

2. Where the type of construction requested by the customer differs from that normally provided by the Company, the customer will bear any additional cost or receive any savings associated with the construction. Company concurrence with the customer request will be provided only in accordance with standard utility construction specifications.

3. When the application of this schedule appears impracticable or unjust, the Company or the customer may, prior to commencing construction, refer the matter to the Arizona Corporation Commission for a special ruling on or for approval of mutually agreed upon special conditions.

CONSTRUCTION CHARGES (continued)

3. COLLECTIVE APPLICATIONS AND GROUPING OF APPLICANTS

When construction is required to serve a new applicant, a survey shall be made of all prospects who might be served from the new construction or an extension thereof and who might benefit from inclusion in the project. Allowances will be made only for those prospective customers signing contracts for service at the time the project is initiated.

Where not more than one-half mile of proposed construction separates successive applicants, they will be grouped in a single project. Otherwise, distinct projects will be established.

An applicant at any premises will receive only one plant facility extension allowance, regardless of the number of services ordered at that premises.

4. TEMPORARY OR SPECULATIVE PROJECTS

Plant facilities to provide service to an applicant engaged in temporary or speculative projects shall be provided in accordance with terms specified in a contract executed between the customer and the Company.

Charges for such a temporary or speculative project may include the construction and removal of telephone facilities.

5. REAL ESTATE SUBDIVISIONS

A subdivision or real estate development is defined as improved or unimproved land under a definite plan of development wherein it can be shown that there are reasonable prospects within the next five years for four or more customers for nontemporary main telephone line services.

Line extensions and/or additions into real estate subdivisions will be made by the Company, provided 100% of the estimated total cost for facilities to provide service is advanced to the Company by the subdivider.

After completion of construction the Company will review annually, over a period of five (5) years, the permanently established service connections within the development and will refund to the customer a prorated portion of the advance that was based on 100%

CONSTRUCTION CHARGES (continued)

5. REAL ESTATE SUBDIVISIONS (continued)

occupancy. Each succeeding year's refund will be based on connections added in that year only.

Should the developer or subdivider fail to provide for the distribution facilities as provided for in this condition, customers residing in the subdivision or development will be treated either as individuals or as collectively grouped applicants, as is appropriate.

6. CHARGES TO SUBSEQUENT APPLICANTS

When a subsequent applicant is secured who can be served f rom an existing project within five years of the initial date of same project, the new applicant will pay to the Company a prorated portion of the facility charge paid by the original applicants to that project.

When a customer discontinues service and service is reestablished for a new applicant at the same location, and the facilities remain in place, the new applicant will not be required to pay additional charges.

7. DISCONNECTS

When one or more customers on a project disconnect within the five-year term, no refund on the nonrecurring facility charge will be made to the disconnected customers. Charges to remaining customers are unaffected by disconnects.

8. MOVE OR CHANGE OF FACILITIES AT CUSTOMER'S REQUEST

If the Company changes or moves facilities on a Customer's property at the customer's request, the Company will charge the customer the actual cost incurred. The Company reserves the right to deny any such request.

CONNECTION WITH SUBSCRIBER-OWNED EQUIPMENT

RATES

Monthly Rate

Local line access will be supplied at the rates described in the "Network Access Line Service" section of this Tariff.

Service Call

If a trouble report results in a service call and the trouble is found to be in the customer- provided equipment: $30.00

CONDITIONS

Customer-provided terminal equipment or communication systems (CPE) used in conjunction with telephone service shall not interfere with any of the service offerings of the Company, endanger Company employees or the public, damage or require the alteration of Company facilities, interfere with the proper functioning of Company facilities, or impair the operation of the telephone network. Upon notice from the Company that the CPE is causing or is likely to cause such hazard or interference, the customer shall make whatever changes are necessary to correct the problem.

The Company shall not be responsible for the installation, operation, or maintenance of any CPE. Where a service difficulty or trouble report from customer-provided equipment or facilities results in visits by the Company to the customer premises, the customer shall be responsible for the payment of all associated Company charges.

Where CPE is connected to Company facilities, the responsibility of the Company shall be limited to the furnishing, operation, and maintenance of such facilities in a manner suitable for telephone service. The Company shall not be responsible for the through transmission of signals generated by the CPE, or for the quality of, or defects in, such transmission, or the reception of signals by the CPE.

The Company shall not be responsible to the customer if changes in any of the facilities, operations, or procedures of the Company render any CPE obsolete or require modification or alteration of such equipment or otherwise affect its use or performance.

Where CPE is used with telephone service in violation of any of these conditions, the Company will take whatever action is necessary to protect the network and will promptly

CONNECTION WITH SUBSCRIBER-OWNED EQUIPMENT (continued)

CONDITIONS (continued)

notify the customer of the violation in writing. The customer shall discontinue use of the equipment or correct the violation. Written confirmation of the corrective action taken will be supplied to the Company within10 days following receipt of notice of the violation by the customer. Failure of the customer to comply with these requirements shall result in suspension of the customer's service until the customer complies with the provision of this Tariff.

OPTIONAL TRUNK HUNTING SERVICE ARRANGEMENTS

RATES

	Monthly Rate
Optional Hunting Service per line or Trunk in a group so arranged	.5 x Business Access Line Rate

CONDITIONS

Trunk hunting service arrangement permits calls to be transferred automatically to a predetermined alternate number or to the next available line of a customer's group of hunting lines, when the line associated with the called number of the customer is busy. These arrangements can be made or modified only at the central office. This charge is in addition to the network access line rate.

When a special number is reserved or specific sequential numbers are reserved at a customer's request for the customer's future use of additional lines, there will be a monthly charge of 1/3 the business access line rate.

MESSAGE RESTRICTION-LOCAL EXCHANGE SERVICE

RATES

	Monthly Rate
Long Distance Message Restriction - Residence	$2.00
- Business	$3.00
Miscellaneous Message Restriction - Residence	$2.00
- Business	$3.00

CONDITIONS

1. Long Distance Message Restriction - Local Exchange Service is an arrangement which permits Local Exchange Service line users to dial local service area calls but prevents the origination of long distance calls. In addition, this arrangement denies the user access to "zero" (operator) dialing.

2. Long Distance Message Restriction - Local Exchange Service is provided for use only on individual network access lines and only where the customer has other network access line service on the same premises arranged for unrestricted use of the telecommunications network.

3. The acceptance of collect call messages is not restricted by this arrangement.

4. Where available, Miscellaneous Message Restriction - Local Exchange Service is an arrangement whereby the subscriber's exchange access line is prohibited from dialing selective services (for example, 976 service).

EMERGENCY REPORTING SYSTEM

RATES

	Monthly Rate	Installation or Move Charge
Basic system including one main system	$10.00	Applicable Nonrecurring Charges
Additional stations, each	$10.00	Applicable Nonrecurring Charges

CONDITIONS

The service offered in this Rate is designed for use by unattended emergency reporting departments. A party calling the listed emergency reporting number activates a conference circuit which rings telephones, enabling the caller to report the emergency to answering parties.

Remote answering terminals permit individuals away from home, upon hearing the emergency siren, to call a designated telephone number which will connect them to the emergency reporting system. ***This feature requires an unpublished business line. It will handle up to three simultaneous calls.***

The siren control circuit is a private line, suitable for supervisory control, from the emergency reporting system common equipment to the siren.

SECOND NUMBER SERVICE

RATES

	Monthly Rate
Second Number Service - Residence	$3.00
Second Number Service - Business	$4.00

DESCRIPTION

Second Number Service allows a single subscriber line to be used for two distinct purposes. Calls to the primary number activate a single long ring; calls to the second number activate two short rings. Thus the second number can serve as a teen number (for a residence subscriber), a different department or business (for a business subscriber), or a fax number (when the subscriber uses a fax machine with distinctive ring capability).

CONDITIONS

1. The customer must have primary number service on the same premises.

2. Second Number Service is provided subject to the availability of existing facilities.

3. The Second Number Charge and all third party and collect calls will be billed to the primary number.

4. Regulations, rates, and charges as described elsewhere in this Tariff apply as appropriate.

OPERATOR VERIFICATION/INTERRUPTION SERVICE

RATES

Verification, per request	$1.50
Interrupt, per request	2.10

DESCRIPTION

1. Customers may obtain assistance in determining if a called line is in use (herein called *verification*) or in interrupting a conversation in progress due to an urgent or emergency situation (herein called *interrupt*) by calling the "0" operator.

2. Verification and interrupt service is furnished where and to the extent that facilities permit.

3. The customer shall indemnify and save the Company harmless against all claims that may arise from either party to the interrupted call or any person.

REGULATIONS

1. Verification:

   A charge shall apply each time the operator verifies a called line and hears voice communication.

2. Interrupt:

   A charge shall apply each time an operator interrupts a conversation that is in progress on the called line.

3. If an operator both verifies the condition of the line and interrupts conversation on the same request, only the interrupt charge shall apply.

4. The charge for interrupt shall apply whenever the operator interrupts the conversation even though one or the other of the interrupted parties refuses to terminate the conversation in progress.

5. Charges for verify/interrupt service may be billed to a Calling Card. Charges may not be billed on a collect basis.

OPERATOR VERIFICATION/INTERRUPTION SERVICE (continued)

REGULATIONS (continued)

6. The charges for verify/interrupt service are in addition to any applicable rates (e.g., operator assistance charges or calling card messages charges).

7. If, as a result of interrupt, the line is cleared and, at the calling party's request, the operator completes the call, the applicable operator assistance charges, and/or calling card message charges shall apply in addition to the interrupt charges.

8. The verify charge shall not apply if the number verified is not in use and the operator completes the call.

9. No verification or interrupt charge shall apply if the requesting customer truthfully declares that the call is from an authorized Public Emergency Agency--defined as a government agency operated by the federal, state or local government possessing the capability and legal authority to provide prompt aid to the public in an emergency.

10. No charge shall apply if the operator encounters a trouble condition or has reason to believe a trouble condition exists.

11. Verification and interrupt service is furnished to coin and non-coin customers.

12. Person-to-Person service is not offered.