32R (D. Reading)

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AZ CORP COMMISSION
DOCUMENT CONTROL

April 11, 2001

Docket Control Center
Arizona Corporation Commission
1200 W. Washington St.
Phoenix, AZ 85007-2927

Dear Sir or Madam:

I am enclosing for filing, an original and ten copies of Midvale Telephone Exchange, Inc.'s Rebuttal Testimony in Docket No. T-02532A-00-0512.

I am enclosing a self addressed stamped envelope and a copy of this letter. Please stamp the copy of the letter and return it to me to acknowledge receipt. We do not need a stamped copy of the application.

If you have any questions or comments, please give me a call.

Sincerely yours,

Conley Ward

Conley Ward

CEW/nlg
cc: Lane Williams (with encl.)
Karen Williams (with encl)
Don Reading (with encl.)

Arizona Corporation Commission
DOCKETED

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BEFORE THE
ARIZONA CORPORATION COMMISSION

IN THE MATTER OF MIDVALE TELEPHONE EXCHANGE, INC.'S APPLICATION FOR AUTHORITY TO INCREASE RATES AND FOR DISBURSEMENTS FROM THE ARIZONA USF	))))))	DOCKET NO. T-02532A-00-0512

REBUTTAL TESTIMONY

OF

DON C. READING, PH.D.

Q. PLEASE STATE YOUR NAME AND ADDRESS FOR THE RECORD.

A. Don Reading, 1227 El Pelar, Boise, Idaho 83702.

Q. WHAT IS YOUR PRESENT OCCUPATION?

A. I am a consulting economist and vice-president of Ben Johnson Associates, Inc.®, an economic research firm specializing in public utility regulation.

Q. HAVE YOU PREPARED OTHER PREFILED TESTIMONY IN THIS CASE?

A. Yes. My original prefiled direct testimony was filed in conjunction with Midvale's application in this proceeding.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A.. I am submitting rebuttal testimony in response to the testimony of various ACC Staff witnesses.

Q. PLEASE DESCRIBE GENERALLY THE METHODOLOGY THE STAFF USED TO ANALYZE MIDVALE'S FILING.

A. As I explained in my earlier direct testimony, Midvale constructed its filing using three scenarios: (1) a base case, (2) the base case plus EAS, and (3) the base case with EAS plus the extension of service to two new exchanges. The Staff's analysis used alternative number three as a base. It then reverses Midvale's pro forma adjustments reflecting the provision of EAS because Staff believes EAS is not in the public interest. Staff also backs out the pro forma adjustments for the unserved areas on the grounds that these changes are not "known and measurable." Finally, Staff makes a number of other miscellaneous adjustments based on a variety of rationales and considerations.

Q. DO YOU AGREE WITH THESE ADJUSTMENTS?

A. While Midvale continues to believe its EAS proposal is reasonable and in the public interest, I agree that the Staff's adjustments are appropriate and correct if the Commission rejects EAS. I do not, however, agree with the Staff's assertion that the pro forma adjustments for unserved areas should be rejected because they are not "known and measurable," nor do I believe their adjustments are properly calculated. Finally, as to the miscellaneous adjustments, I agree with some and disagree with others.

Q. HOW IS YOUR TESTIMONY ORGANIZED?

A. Following this introduction, I respond to the direct testimony of Staff witnesses Darron Carlson, Sonn Albrecht, Allen Buckalew, Joel Reiker, and Richard Boyles. With each witness, I will indicate my areas of agreement and disagreement with proposed adjustments, and explain my reasoning.

Q. LET'S START WITH THE TESTIMONY OF STAFF WITNESS DARRON CARLSON. DO YOU HAVE ANY RESPONSES TO HIS DIRECT TESTIMONY?

A. Yes. In addition to my disagreement with some of Mr. Carlson's revenue and expense adjustments, I take issue with his assertion that the Company was "uncooperative" when it did not understand or agree with the Staff's information requests. Staff sent Midvale six separate rounds of information requests, not counting those made during the on site audit, consisting of approximately 115 requests, many in multiple parts. More than a few of these requests were for data compilations including time periods long before the test year. Some, in fact, requested information from the inception of Midvale's Arizona service in 1993 through the test year.

Midvale complied with all these requests to the best of its ability until the sixth round of discovery when it finally objected to two or three requests on the grounds that the requested information was irrelevant and would be unduly burdensome to prepare. As to the specific example of lack of cooperation cited by Mr. Carlson, Midvale did not refuse to provide billing information as Mr. Carlson states. It in fact gave Mr. Carlson all of its raw billing data and invited him to make his own calculations.

Q. WHAT ABOUT THE DISCREPANCIES MENTIONED BY MR. CARLSON AT THE BEGINNING OF HIS DIRECT TESTIMONY. CAN YOU SUMMARIZE HIS CONTENTIONS?

A. Yes. Carlson states that staff has,

> 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. [Carlson Direct, p. 4]

Q. HOW DO YOU RESPOND THIS STATEMENT?

A. I believe Mr. Carlson did not fully understand my submission of exhibits accompanying my direct testimony. Let me summarize my earlier Direct Testimony describing the exhibits.

> Exhibit 2 contains a set of Schedules A-1 through H-5 that follow the Arizona Corporation Commission's Regulation R14-2-103 Rate Application Filing Requirements. Exhibits 3 through 5 contain a set of schedules indicating the impact of the base case, the EAS case, and the case involving serving unserved areas. [Reading Direct, p. 2]

Schedules A through H, those used by Mr. Carlson, represented the composite scenario and merged together the base case, the EAS case, and the unserved areas case. Most of the differences between those schedules and those submitted in Exhibit 5 are simply due to the format required by the schedules but not necessarily followed in Exhibit 5.

Q. WHAT ABOUT MR. CARLSON'S INABILITY TO RECONCILE THE WEIGHTED COST OF CAPITAL CITED IN YOUR DIRECT TESTIMONY TO THAT USED IN SCHEDULE A-1?

A. Mr. Carlson states that:

> 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. [Carlson Direct, p. 4]

Mr. Carlson is comparing apples to oranges. The composite scenario (including EAS and unserved areas assumptions used in completing Schedule A-1) has a different mix of debt and equity which results in a slightly lower rate of return (10.346 %)

than that used in the base case scenario which I referred to in my direct testimony (i.e., 11.2 %). The reduction in the cost of capital which is reflected in these calculations will only occur if Midvale borrows additional funds to expand into the unserved area.

Q. MR. CARLSON STATES THAT TAX RATE CHANGES RESULT IN A SLIGHTLY HIGHER INTRASTATE GROSS REVENUE CONVERSION FACTOR (GRCF) THAN THAT USED BY MIDVALE. DO YOU AGREE?

A. Yes. I agree that updating federal and state tax rates leads to a more appropriate GRCF of 1.7652.

Q. MR. CARLSON [DIRECT TESTIMONY, P. 17] CONTENDS MISCELLANEOUS INTEREST EXPENSE SHOULD BE A "BELOW THE LINE" EXPENSE. DO YOU AGREE WITH THIS ADJUSTMENT?

A. If miscellaneous interest expense is removed from the Company's expenses, a corresponding adjustment needs to be made to the capital structure. This changes our weighted cost of capital from .112 to .113. With this corresponding weighted cost of capital adjustment, we accept Staff's recommendation for the removal of interest expense.

Q. PLEASE TURN TO THE NEXT WITNESS, SONN ALBRECHT. HOW DO YOU RESPOND TO ALBRECHT'S RATE BASE TESTIMONY?

A. I agree that Adjustment E (removal of deregulated public telephone equipment plant) on Schedule SSA-2 is appropriate. This investment was inadvertently included in Midvale's initial filing.

Q. STAFF WITNESS ALBRECHT ALSO RECOMMENDS ADJUSTMENTS TO ACCUMULATED DEPRECIATION. DO YOU CONCUR WITH THESE ADJUSTMENTS?

A. Yes. Midvale accepts Ms. Albrecht's adjustments.

Q. WHAT ABOUT MS. ALBRECHT'S RECOMMENDED ADJUSTMENTS TO DEFERRED TAXES? DO YOU AGREE WITH THESE ADJUSTMENTS?

A. Ms. Albrecht's calculations of Deferred Income Taxes are reasonable, so Midvale does not quarrel with Staff's interpretations or adjustments.

Q. LET'S TURN NOW TO THE TESTIMONY FILED BY STAFF WITNESS ALLEN BUCKALEW. DO YOU AGREE WITH MR. BUCKALEW'S ASSESSMENT OF THE ECONOMICS OF PROVIDING SERVICE TO THE UNSERVED AREAS?

A. No. Mr. Buckalew, when discussing the unserved areas Midvale is proposing to serve, suggests that

> 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 per month in order to cover all expenses for providing services to these areas. [Buckalew Direct, p. 12].

The first problem with this statement is that Mr. Buckalew erroneously assumes that the newly served areas will immediately receive federal USF support. As a general rule, new service areas do not receive federal support revenues until approximately the first quarter of the third year of service. While I furnished Mr. Buckalew with the text of one FCC order that granted a waiver of the normal two year waiting period, there is no assurance that the FCC would grant such a waiver in this case (or that Midvale could cost effectively litigate such a request).

The second problem with his assumption is that it is flatly inconsistent with Staff witness Carlson's insistence that revenues and expenses for the unserved areas are not "known and measurable." On the one hand, the Staff rejects reliable estimates of the cost to serve Millsite and Silver Bell but then includes in its analysis federal USF revenues that are extremely improbable for at least two years after service commences.

Q. WHAT WOULD THE RESULT BE IF THE COMMISSION ACCEPTED MR. BUCKALEW'S ERRONEOUS ANALYSIS?

A. Midvale will incur significant revenue shortfalls for more than two years after commencing service to Millsite and Silver Bell.

Q. HAVE YOU QUANTIFIED THIS OMISSION?

A. Yes. Exhibit 7, Pages 3-4 is directly comparable to Mr. Buckalew's Exhibit AGB-1. It differs from his presentation in that it shows the impact of the newly served areas <u>not</u> receiving federal support for at least 3 years by removing the annual interstate USF amounts of $164,437 Mr. Buckalew included in his calculation of estimated non-local revenues. As shown on Page 4 of Exhibit 7, without federal support Midvale would have to charge more than $45.00 to cover all expenses for providing service to these areas. At the $24.00 rate recommended by Mr. Buckalew it would mean – using his estimates – that Midvale would lose more than $328,874 during the first 2 years of providing service to Millsite and Silver Bell. For a Company with annual revenues of just over $1 million in Arizona, this is a totally unsustainable loss.

Q. ARE YOU THEN RECOMMENDING A RATE OF $45.00?

A. No. The $45.00 rate is simply an example I used to demonstrate the flaws in Mr. Buckalew's argument. However, it is an accurate representation of the end use rate necessary to generate the actual revenue requirement associated with these unserved areas. Of course, pricing the service at this level would discourage some potential customers from signing up for the service. In turn, this would further increase the per line cost of serving those customers who could afford such a high rate. Accordingly, I am recommending that Midvale be allowed to charge a residential rate of $24.00, and to receive state universal funds to make up the remainder of its revenue requirement. Midvale cannot afford to expand into these unserved areas unless it receives a reasonable level of state universal service support.

Q. WHAT IS YOUR RESPONSE TO MR. BUCKALEW'S RATE DESIGN TESTIMONY?

A. Mr. Buckalew is concerned that Midvale's proposed percentage increase in local rates for the Young exchange is excessive. He states that:

> a one-time increase of almost 94 percent in residential service rates for the Young Exchange would create a sudden burden to those customers [Buckalew Direct, p. 22]

Q. IS MR. BUCKALEW CORRECT?

A. Actually residential customers in the Young exchange are paying a distance based zone charge, an addition to the base rate, which effectively made their rates either $13.50 or $15.70. Taking this into consideration, a rate of $24.00 would represent an actual increase of 53 to 78 percent, rather than the 94 percent figure quoted by Buckalew. While I concede that an increase of even 53 to 78 percent could be considered a significant burden, it should be noted that Qwest currently charges $16.18 ($13.18 + $3.00 zone charge) for basic local flat rate service for residential customers in exchanges exhibiting similar rural characteristics. Our revised recommendation of $21.00 for residential customers in Young is just 30% more than the current Qwest rate. It should also be noted that customers in the Young exchange have for some time been paying lower rates than they would have paid if they had remained customers of Qwest. Finally, as Mr. Buckalew himself points out when discussing access charges, 'higher than average rates" are warranted because "the Company provides service to a higher cost area." [Buckalew Direct, p. 24]

Q. LET'S TURN NOW TO MR. BUCKALEW'S DISCUSSION OF ACCESS CHARGES. HE STATES ON PAGE 23 OF HIS DIRECT TESTIMONY THAT HE DOES NOT BELIEVE A REDUCTION IN INTRASTATE ACCESS RATES IS APPROPRIATE. DO YOU HAVE ANY COMMENT?

A. Yes. As I stated on page 14 of my Direct Testimony, there is a growing gap between interstate and intrastate access rates and the line between local and long distance calls is becoming blurred. For instance, many wireless carriers are now offering plans in which local and long distance calls are identically priced. Given these trends, Midvale anticipates it will eventually be necessary to close the gap between intrastate and interstate access rates in order to remain competitive. However, if the Commission determines that this is not the time to reduce access charges, the Company can accept leaving intrastate access revenues at the current level.

Q. STAFF <u>DOES</u> SUPPORT A SINGLE ACCESS RATE FOR THE TWO EXCHANGES AS LONG AS "IT GENERATES THE SAME LEVEL OF ACCESS REVENUES." [BUCKALEW, DIRECT, P. 24.] IF THE COMMISSION DECIDES NOT TO CLOSE THE GAP BETWEEN STATE AND INTERSTATE ACCESS RATES, DO YOU AGREE WITH THIS RECOMMENDATION?

A. Yes. Melding Midvale's two distinct access charges, on a revenue neutral basis, would have the advantage of greatly simplifying its billing system, and it would ameliorate some of the concerns about extremely high access charges I expressed in my original direct testimony. The revenue neutral rate for uniform access charges is 11.141 cents.

Q. LET'S TURN TO STAFF'S COST OF CAPITAL WITNESS, JOEL REIKER. WHAT IS MR. REIKER'S COST OF EQUITY RECOMMENDATION?

A. He uses the comparable earnings, Discounted Cash Flow (DCF), and the Capital Asset Pricing Model (CAPM) methods to arrive at a recommended cost of equity for Midvale of 11.5 percent.

Q. WHAT ARE THE PROBLEMS WITH HIS ANALYSES?

A. In his comparable earnings analysis, Mr. Reiker concludes that 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 makeup, in that a high percentage of their revenues come from competitive telecommunications services. [Reiker Direct, p. 20]

Mr. Reiker then completely disregards these results on the grounds that:

> 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 are unreasonably high for use in determining the cost of equity for regulated telephone operations, and will exclude them. [Reiker Direct, p. 20]

Q. WHAT ABOUT HIS DCF ANALYSIS?

A. Mr. Reiker's DCF analysis produced results ranging from 4.6 percent to 16.5 percent [Reiker Direct, p. 20]. Although the DCF results using sustainable earnings were both 16.5 percent, he again decides to adjust his results downward, explaining that 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. [Reiker Direct, p. 21]

He then concludes:

> that the 11.8 percent DCF results using earnings growth are the most reasonable and reflect recent growth patterns.[Reiker Direct, p. 21]

Q. WHAT ARE THE RESULTS OF HIS CAPM ANALYSIS?

A. The CAPM analysis resulted in a current estimate of 12.0 percent and a projected estimate of 12.6 percent. However, Reiker again justifies making a downward adjustment

> because 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, 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 average of 10.4 percent. [Reiker Direct, p. 21]

Q. HOW DO THE RESULTS OF THESE ANALYSES TRANSLATE TO HIS ULTIMATE RECOMMENDATION OF 11.5 PERCENT?

A. They don't. In all three analyses, the results show that Midvale's cost of equity is considerably in excess of Mr. Reiker's proposed 11.5%. So he simply disregards the objective results, and substitutes his own judgment. But the studies themselves confirm that the 13% return on equity I recommended as reasonable for Midvale's regulated Arizona operations. While Mr. Reiker correctly questioned the anomalous Qwest data, his comparable earnings test would still have produced a cost of equity in excess of 13% even with Qwest's elimination. In fact, his Schedule JMR-5 indicates that no telecommunication company in his database had returns on common equity under 13% since 1993! In short, Mr. Reiker arrives at a result which is not consistent with the underlying data, and which does not provide a reasonable, balanced view of the capital costs associated with serving Midvale's low density, rural service area in Arizona.

Q. DOES MR. REIKER OFFER ANY OTHER RATIONALE FOR HIS PROPOSAL?

A. Mr. Reiker says that he adjusted the study results 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. [Reiker Direct, p. 21-22]

Q. HOW DO YOU RESPOND TO THESE ASSERTIONS?

A. While I can agree that some comparable companies are operating in competitive or deregulated markets, I cannot agree that companies like BellSouth and SBC Communications are less risky than a small firm like Midvale. In fact, the suggestion is absurd on its face. Mr. Reiker's comparable companies are very large, highly diversified firms which serve some of the largest, most economically stable areas in the country. BellSouth, for example, has 44 million customers, 103,900 employees, revenues of $26,200,000, a market capitalization of $78,000,000, and an A-, "Low Risk" ranking from Standard & Poor's. Midvale, on the other hand, has less than 2000 total customers (638 in Arizona), 32 employees (4 FTEs in Arizona), and under $3 million in revenue ($866,000 in Arizona). It is completely unreasonable to view Midvale as less risky than a company like BellSouth.

Moreover, Midvale, just like those companies in Mr. Reiker's data base, is facing the risks and uncertainties associated with increased competition and a changing industry structure. Midvale is attempting to remain viable in part through the development of unregulated, competition based subsidiaries. In this regard, Midvale and these larger carriers face similar problems. There is no valid basis for treating Midvale as being completely immune to competition and changing industry conditions. To the contrary, Midvale, like many small independents, faces unique challenges associate with competition. For example, a single collocated comptetitor could cherry pick the best customers and significantly increase the per line revenue requirement in a small exchange.

None of the evidence offered by Mr. Reiker supports his assumption that Midvale is somehow less risky than large, diversified incumbent carriers serving the nation's most populous areas. Even if Midvale had some sort of guarantee that it will not face any competitive threats, it would still face risks which are as great as, or greater than, those faced by the large carriers in Mr. Reiker's data base, if for no other reason than because Midvale serves such small, lightly populated geographic areas. Even minor fluctuations in economic conditions could potentially cause a substantial reduction in Midvale's customer base and revenue stream in Arizona, for the simple reason that it serves such a small number of customers, and most of these customers have very similar geographic, demographic and economic characteristics.

Under these circumstances, Midvale should receive a return on equity which is <u>higher</u> than the indicated cost of equity to the large telecommunications firms in Mr. Reiker's data base. Midvale's requested return on equity of 13% is quite reasonable and should be approved by the Commission.

Q. LET'S TURN TO THE FINAL STAFF WITNESS, RICHARD BOYLES. HOW DO YOU RESPOND TO MR. BOYLES' DEPRECIATION TESTIMONY?

A. The adjustments he recommends are acceptable, since they are in line with other rural LECs in Arizona.

Q. HAVE YOU SUMMARIZED YOUR ADJUSTMENTS IN AN EXHIBIT?

A. Yes. Pages 5-8 of my Exhibit 7 provide some updated estimates of Midvale's revenue requirement. The schedule is formated similar to staff witness Carslon's Schedule DWC-1 for ease of comparison. Page 8, column A, represents the base case scenario with the adjustments recommended by Staff. Page 8, column B represents the EAS and unserved areas scenario, with the adjustments recommended by Staff.

Q. CAN YOU SUMMARIZE THE ADJUSTMENTS INCORPORATED INTO EXHIBIT 7?

A. Yes. The adjustments to rate base include the removal of $5,619 related to deregulated public telephone equipment per Schedules SSA-1 and SSA-2, the accumulated depreciation adjustment of $224,220 per Schedule SSA-3, and the accumulated deferred tax adjustment of $156,381 referred to in Schedule SSA-1. The adjustments to operating income include the $49,757 net depreciation expense adjustment per DWC-4 and DWC-12, the removal of interest expenses per DWC-16, and the inclusion of allocated federal and state income taxes per DWC-17. Adjustments to the GRCF include revising tax rates per Schedule DWC-2.

Q. WHAT DOES EXHIBIT 7 SHOW AS THE REQUIRED RATE INCREASE?

A. Exhibit 7, Page 8,, line 8 shows Midvale's revenue requirement, which equates to a 9.14 % increase in rates for the base case, and a 26.65 % increase in rates in the scenario involving EAS and unserved areas.

Q. WHAT WAS THE ANALOGOUS INCREASE COMPUTED BY STAFF?

A. Schedule DWC-1, column B shows an increase of 2.38 % and is directly comparable to my Schedule 2, column A (i.e., 5.57 %).

Q. HOW DO YOU ACCOUNT FOR THE DIFFERENCE IN THE INCREASE?

A. The majority (there was a minor discrepancy in adjusted rate base) of the difference results from the use of a lower allowed rate of return by Staff. As discussed in Section 4, I don't believe Staff's recommended reduction to the cost of capital is appropriate for a small company like Midvale.

Q. DOES THIS CONCLUDE YOUR REBUTTAL TESTIMONY?

A. Yes, it does.

MIDVALE TELEPHONE EXCHANGE

CALCULATION OF COST OF CAPITAL - TOTAL ARIZONA

LINE	(A) DESCRIPTION	(B) CAPITAL AMOUNT	(C) CAPITAL RATIO	(D) COST	(E) WGT COST (C x D)
	LONG TERM DEBT				
1	RTFC CONST. LOAN YOUNG MITEL SWITCH	200,631	0.0966	0.0610	0.0059
2	RUS 5% CASCABEL	269,601	0.1298	0.0500	0.0065
3	OTHER		0.0000	0.0600	0.0000
4	TOTAL DEBT	470,232	0.2264		0.0124
5	EQUITY (CASCABEL & YOUNG)	1,606,651	0.7736	0.1300	0.1006
6	OTHER	-			

MIDVALE TELEPHONE EXCHANGE

CALCULATION OF COST OF CAPITAL - TOTAL ARIZONA

LINE	(A) DESCRIPTION	(B) CAPITAL AMOUNT	(C) CAPITAL RATIO	(D) COST	(E) WGT COST (C x D)
	LONG TERM DEBT				
1	RTFC CONST. LOAN YOUNG MITEL SWITCH	200,631	0.0602	0.0610	0.0037
2	RUS 5% CASCABEL	269,601	0.0810	0.0500	0.0040
3	OTHER (UNSERVED)	1,043,103	0.3132	0.0800	0.0251
4	TOTAL DEBT	1,513,335	0.4544		0.0328
5	EQUITY (CASCABEL & YOUNG, NEW)	1,816,869	0.5456	0.1300	0.0709
6	OTHER			-	
7	TOTAL EQUITY	1,816,869	0.5456		0.0709
8	TOTAL	3,330,204	1.0000		0.1037

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	251,726
Revenues						
	Estimated Operating Non Local Revenues[2]				171,516	
	Required Local Operating Revenue				80,211	
		Average Local Rate			24.04	
[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 based 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	

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	
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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%
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	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	251,726
Revenues				
	Estimated Operating Non Local Revenues[2]		99,864	
	Required Local Operating Revenue		151,862	
	Average Local Rate		45.52	

[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 based on Staff Adjusted Recommended Operating Revenues per line

	Network Access Service Revenues	206,624
	Interstate USF	0
	Directory Revenue	1,759
	Miscellaneous	22,081
	Uncollectible	(1,279)
	Total Non Local revenues	*229,185*
	Midvale's Current Lines	638
	Revenues per Line	359
	Estimated Number of Lines in Unserved Areas	278
	Estimated Operating Revenues	99,864

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)	05.02%	09.35%
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%	02.38%

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)	05.02%	09.35%
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)	1.7652	1.7652
8	Increase (Decrease) in Gross Revenue Requirements (Ln 6 x Ln 7)	$ 169,941	$ 17,391
9	Adjusted Test Year Operating Revenue	$ 841,123	$ 730,428
10	Recommended Operating Revenue (Ln 8 + Ln 9)	$ 1,011,064	$ 747,819
11	Percentage Increase (Decrease) in Operating Revenue (Ln 8 / Ln 9)	20.20%	02.38%

COMPUTATION OF INCREASE IN GROSS REVENUE REQUIREMENTS

LINE NO.	Description	[A] Per Company	[B] Per Staff
1	Adjusted Rate Base	$ 1,189,746	$ 1,244,841
2	Adjusted Operating Income (Loss)	$ 103,751	$ 116,375
3	Current Rate of Return (Ln 2/Ln 1)	08.72%	09.35%
4	Required Return on Rate Base (Ln 1 x Ln 5)	$ 133,252	$ 126,227
5	Required Rate of Return	11.200%	10.14%
6	Operating Income Deficiency (Ln 4 - Ln 2)	$ 29,501	$ 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)	$ 49,449	$ 17,391
9	Adjusted Test Year Operating Revenue	$ 670,193	$ 730,428
10	Recommended Operating Revenue (Ln 8 + Ln 9)	$ 719,642	$ 747,819
11	Percentage Increase (Decrease) in Operating Revenue (Ln 8 / Ln 9)	07.38%	02.38%

COMPUTATION OF INCREASE IN GROSS REVENUE REQUIREMENTS

LINE NO.	Description	[A] Base	[B] EAS & Unserved
1	Adjusted Rate Base [1]	$ 1,244,843	$ 1,846,227
2	Adjusted Operating Income (Loss) [2]	$ 102,831	$ 64,484
3	Current Rate of Return (Ln 2/Ln 1)	08.26%	03.49%
4	Required Return on Rate Base (Ln 1 x Ln 5)	$ 140,667	$ 191,454
5	Required Rate of Return	11.30%	10.37%
6	Operating Income Deficiency (Ln 4 - Ln 2)	$ 37,836	$ 126,970
7	Gross Revenue Conversion Factor [3] (Schedule DWC-2)	1.7652	1.7652
8	Increase (Decrease) in Gross Revenue Requirements (Ln 6 x Ln 7)	$ 66,789	$ 224,127
9	Adjusted Test Year Operating Revenue [4]	$ 730,428	$ 841,123
10	Recommended Operating Revenue (Ln 8 + Ln 9)	$ 797,217	$ 1,065,250
11	Percentage Increase (Decrease) in Operating Revenue (Ln 8 / Ln 9)	09.14%	26.65%

Notes:

[1] $5,619 of Public telephone equipment removed per SSA-1,2
$224,220 adjustment in accumulated depreciation per SSA-3
$156,381 accumulated deferred tax adjustment per SSA-1

[2] $49,757 net depreciation expense adjustment per DWC-4,12
$25,107 removal of interest expense per DWC-16 [A]
$80,130 removal of interest expense per DWC-16 [B]
$47,413 federal & state income taxes included per DWC-17

[3] tax rates revised per DWC-2

[4] Base case revenues [A]
Estimated EAS & Unserved revenues [B]

BEFORE THE
ARIZONA CORPORATION COMMISSION

IN THE MATTER OF MIDVALE TELEPHONE EXCHANGE, INC.'S APPLICATION FOR AUTHORITY TO INCREASE RATES AND FOR DISBURSEMENTS FROM THE ARIZONA USF	))))))	DOCKET NO. T-02532A-00-0512

REBUTTAL TESTIMONY

OF

LANE WILLIAMS

Q. PLEASE STATE YOUR NAME AND ADDRESS FOR THE RECORD.

A. My name is Lane R. Williams and my business address is 2205 Keithley Creek Road, P. O. Box 7, Midvale, Idaho 83645.

Q. BY WHOM ARE YOU EMPLOYED AND IN WHAT POSITION.

A. I am the General Manager of Midvale Telephone Exchange, Inc. ("Midvale") headquartered in Midvale, Idaho.

Q. HAVE YOU PREVIOUSLY FILED DIRECT TESTIMONY IN THIS PROCEEDING?

A. Yes.

Q. WHAT IS THE PURPOSE OF THIS TESTIMONY?

A. My testimony responds to three issues raised by the ACC Staff in its prefiled testimony. I will first discuss the Staff's position with regard to Midvale's proposal to provide service in currently unserved areas. I will then respond to the Staff's opposition to extended area service. Finally, I will discuss Staff's proposed adjustment to Midvale's rate case expenses.

Q. WHAT IS YOUR ASSESSMENT OF THE STAFF'S POSITION REGARDING SERVICE TO THE UNSERVED AREAS OF MILLSITE AND SILVER BELL?

A. My understanding of the Staff's position is that it supports the extension of telephone service to Millsite and Silver Bell. But it rejects inclusion of the cost of providing service to these areas in Midvale's revenue requirement on the grounds that such costs are not "known and measurable." It also objects to the use of the Arizona Universal Service Fund to defray part of the costs of this venture.

This simply doesn't make sense to me. For several years now, the Arizona Corporation Commission has been urging telephone companies to provide service to unserved areas. These areas are currently without telephone service primarily because they are not economic to serve at existing rates. If the Commission is serious about providing service to unserved areas, it must allow companies to include the cost of service extensions in their revenue requirement and, in most cases, provide at least interim support from the AUSF. Otherwise, the Commission is asking telephone providers to take on a relatively risky expansion of service at an economic loss that cannot be recouped and could exist indefinitely. In Midvale's case, the loss during the first two years of service to Millsite and Silver Bell would be approximately $328,874 (using Mr. Buckalew's calculations) if the Staff's position is accepted.

Midvale cannot provide service to the two new exchanges under these circumstances, and neither can anyone else. The simple fact is that bringing telephone service to high cost unserved areas requires economic support, either in the form of an increased revenue requirement or AUSF support. I cannot understand why the Staff opposes the use of the AUSF in a case such as this where the universal service goal could not be more clearly at issue. But if the Commission accepts the Staff's view and decides it is not willing to allow companies to recover their costs to build out new exchanges, then it should stop trying to entice companies into unserved areas. Continuing to pursue new service under the conditions the Staff recommends only wastes the telephone companies' time and resources and misleads the unserved communities with false hope.

Q. WHAT IS YOUR RESPONSE TO STAFF'S OPPOSITION TO MIDVALE'S EAS PROPOSAL?

A. I have previously stated the Company's position in support of EAS, and have little to add except to point out that the concern about EAS bridging could be resolved by providing EAS to Benson only.

Q. WHAT IS YOUR RESPONSE TO THE STAFF'S PROPOSED ADJUSTMENT TO MIDVALE'S RATE CASE EXPENSES?

A. To be perfectly blunt, I find it irritating. I could grudgingly accept the Staff's recommendation for capitalization of the engineering costs associated with the Millsite and Silver Bell exchanges, were it not for the fact that the Commission has actively solicited proposals to serve unserved areas. Engineering studies are a necessary predicate for such proposals. If the Commission does not allow us to serve these two new exchanges on a reasonable basis with AUSF support, then service will be impossible and Midvale will never recover capitalized costs incurred in an attempt to respond to the Commission' request.

The Staff's additional arbitrary reduction of rate case expenses is even more unreasonable. When Midvale filed its case, we budgeted $40,000 for rate case expenses, knowing this was perhaps a conservative figure. But nothing in the collective experience of Midvale's management and consulting professionals prepared us for anything like the costs we have incurred in this case. I have spent more years than I care to admit to in this business, and been involved in dozens of case in four jurisdictions, and I can truthfully say I have never seen a case that even remotely rivals this one for excessive costs.

By the time we finished our responses to the Staff's discovery requests, Midvale's out of pocket costs for the rate case were already more than $100,000, not counting the engineering costs challenged by the Staff. Since that time we have responded to dozens of additional requests during the onsite audit, to Qwest's and Citizens Utilities's formal discovery requests, and to additional informal requests by the Staff. We have also met with Staff, reviewed the Staff's filing, prepared this rebuttal testimony and, of course, we still face the cost of hearings. When all is said and done, I am sure Midvale's cost for this case will be in excess of $150,000, and this does not count the enormous cost incurred in the form of management and employee time devoted to this proceeding. All this for a rate case in which the Company's base case filing requested an increased revenue requirement of only $108,955 and Staff now recommends a $17,391 increase.

The biggest single factor in this expenditure has been the cost of responding to the Staff's discovery requests. All told, the Staff served a total of six rounds of written discovery on the Company, totaling more than 115 questions and information requests, most with multiple subparts. Many of these demands required expensive studies by our engineering and cost consultants. A number of others insisted on the production of detailed records and compilations all the way back to the beginning of Midvale's service in Arizona in 1993. In addition, the Staff conducted an onsite audit of the Company's books and records, and made a number of additional inquiries that used Company time and resources.

Q. DID MIDVALE INFORM STAFF OF THE UNREASONABLE COSTS IT WAS INCURRING IN THIS CASE?

A. Yes, but the response was that this level of detail was necessary for the Staff to perform its job. I have some problems with this justification for a variety of reasons, but even if true it is irresponsible for the Staff to create costs of this magnitude and then arbitrarily recommend that they be removed from the Company's expenses.

Q. WHAT DO YOU RECOMMEND AS A COUNTER TO THE STAFF'S PROPOSAL?

A Staff has proposed a three year amortization of rate case expenses. I can accept that proposal, but not the amount the Staff suggests. I believe the Company is entitled to a three year amortization of at least $40,000 per year. This equals the annual cost for a single year that we included in our original filing.

Q. DOES THIS COMPLETE YOUR TESTIMONY?

A. Yes.

CERTIFICATE OF SERVICE

I HEREBY CERTIFY that on the 11th day of April, 2001, I caused to be served a true and correct copy of the foregoing by the method indicated below, and addressed to the following:

Arizona Corporation Commission
1200 West Washington
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