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MEMORANDUM

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AZ CORP COMMISSION  
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TO: Docket Control  
FROM: Ernest G. Johnson  
Director  
Utilities Division

DATE: January 9, 2004

RE: STAFF REPORT FOR THE MIDVALE TELEPHONE EXCHANGE, INC. APPLICATION FOR AUTHORIZATION TO PROVIDE FACILITIES-BASED, BASIC LOCAL EXCHANGE SERVICE AND TOLL ACCESS TELEPHONE SERVICE TO CURRENTLY UNSERVED RESIDENTIAL DEVELOPMENTS KNOWN AS CROSSROADS RANCH, POQUITO VALLEY AND BREEZY PINE (DOCKET NO. T-02532A-03-0017)

Attached is the Staff Report for the Midvale Telephone Exchange, Inc. Application For Authorization To Provide Facilities-Based, Basic Local Exchange Service And Toll Access Telephone Service To Currently Unserved Residential Developments Known As Crossroads Ranch, Poquito Valley And Breezy Pine. This Staff Report is submitted in compliance with Decision No. 66510 in which the Commission required Staff to evaluate information produced by Qwest Corporation, Midvale Telephone Exchange, Inc. and Table Top Telephone Company.

EGJ:RLB:WMS:red

Originator: Richard L. Boyles and Wilfred Shand, Jr.

Attachment: Original and thirteen copies

Arizona Corporation Commission  
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Docket No. T-02532A-03-0017

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**MIDVALE TELEPHONE EXCHANGE, INC.**

**DOCKET NO. T-02532A-03-0017**

**APPLICATION FOR AUTHORIZATION TO PROVIDE FACILITIES-BASED, BASIC  
LOCAL EXCHANGE SERVICE AND TOLL ACCESS TELEPHONE SERVICE TO  
CURRENTLY UNSERVED RESIDENTIAL DEVELOPMENTS KNOWN AS  
CROSSROADS RANCH, POQUITO VALLEY AND BREEZY PINE**

**JANUARY 2004**

## STAFF ACKNOWLEDGMENT

The Staff Report for the Midvale Telephone Exchange, Inc. Application For Authorization To Provide Facilities-Based, Basic Local Exchange Service And Toll Access Telephone Service To Currently Unserved Residential Developments Known As Crossroads Ranch, Poquito Valley And Breezy Pine, Docket No. T-02532A-03-0017 was the responsibility of the Staff members listed below. Richard Boyles was responsible for the engineering and technical analysis. Wilfred Shand, Jr. was responsible for the analysis regarding facility cost recovery.



Richard L. Boyles  
Utilities Engineer



Wilfred Shand, Jr.  
Public Utility Manager

**EXECUTIVE SUMMARY**  
**MIDVALE TELEPHONE EXCHANGE, INC.**  
**DOCKET NO. T-2532A-03-0017**

In Decision No. 66510, The Commission found that the record was insufficient to approve two-way EAS between Midvale, Table Top and Qwest. The Commission further found that the EAS portion of Midvale's application and Table Top's EAS request should be set for hearing. In compliance with Decision No. 66510, this Staff Report provides Staff's evaluation of the information produced by Qwest, Midvale and Table Top concerning the costs associated with implementing two-way EAS between their exchanges.

Assuming that 273 customers will be provided with EAS, Staff (based on information provided by Midvale) estimated that the investment necessary to provide EAS to Midvale's Millsite customers is \$70,620. Staff estimates that the additional monthly per customer cost to recover the investment in facilities will be \$5.20. To develop this estimate, Staff used Midvale's cost of capital estimate of 8.00%. If the Commission authorized 10.37% rate of return is used, Staff estimates that the additional monthly per customer cost to recover the investment in facilities will be \$6.10.

Assuming that 529 customers will be provided with EAS, Staff estimated that the addition to rate base necessary to provide EAS to Midvale's Millsite customers is \$104,650. Staff estimates that the additional monthly per customer cost to recover the investment in facilities will be \$3.98, assuming Midvale's cost of capital estimate of 8.00%. If the Commission authorized rate of return of 10.37% is used, Staff estimates that that the additional monthly per customer cost to recover the investment in facilities will be \$4.67.

Table Top withdrew its request for two-way EAS on October 30, 2003. Therefore no cost recovery analysis was performed for its customers.

Qwest facility costs are, in Staff's opinion, *de minimus*. Therefore Staff did not estimate a cost recovery amount for its customers.

**TABLE OF CONTENTS**

**PAGE**

INTRODUCTION .....1  
FACILITY COSTS .....1  
FACILITY COST RECOVERY .....3

**EXHIBIT**

EXHIBIT .....S-1

## **Introduction**

In Decision No. 66510, the Commission granted Midvale Telephone Exchange, Inc.'s (Midvale's) application to extend its existing Certificate of Convenience and Necessity to include new areas in its Millsite Exchange. Midvale asserted that public interest considerations support the establishment of EAS between the new service area and Qwest Corporation's (Qwest's) Prescott local calling area and asked that the Commission require the provision of two-way EAS between those areas. Staff recommended approval of EAS between Midvale's service area and Qwest's service area. Staff also recommended that EAS be established between Midvale's service area and Table Top Telephone Company's (Table Top's) Inscription Canyon Ranch Exchange, given its proximity to Midvale's and Qwest's service areas.

Based on the information provided, the Commission found that the record was insufficient to approve two-way EAS between Midvale, Table Top and Qwest. As a result, the Commission required Qwest, Midvale and Table Top to submit the necessary documentation to Staff so that Staff could evaluate the costs associated with implementing two-way EAS between their exchanges. The Commission further found that the EAS portion of Midvale's application and Table Top's EAS request should be set for hearing.

In compliance with Decision No. 66510, this Staff Report provides Staff's evaluation of the information provided by Qwest, Midvale and Table Top concerning the costs associated with implementing two-way EAS between their exchanges. Staff will file another report on March 9, 2004, in compliance with Decision No. 66510, which will address, at a minimum the following issues:

- (a) The community of interest between Midvale, Table Top and Qwest's Prescott Local Calling Area;
- (b) The costs associated with providing two-way EAS between Qwest and Midvale, Qwest and Table Top, and Midvale and Table Top;
- (c) The financial impact on the customers of Midvale, Table Top and Qwest if two-way EAS is ordered;
- (d) Its recommendation as to how the costs of EAS should be collected; and
- (e) Whether a substantial majority of the present and future customers of Midvale, and the customers of Table Top, understand the potential impact of establishing two-way EAS and support it.

## **Facility Costs**

Engineering has reviewed the filings by the Companies regarding estimated facility costs to implement two-way EAS between Midvale's Millsite rate center, Qwest's Prescott rate center (Prescott local calling area) and Table Top's Inscription Canyon Ranch rate center and provides the following comments.

### Table Top

Table Top did not file cost information since it had withdrawn its request for two-way EAS in exceptions filed on October 30, 2003. In general, Table Top stated it was unwilling to assume two-way EAS costs requested by Qwest; such as Qwest's costs for additional trunking and recurring transit charges. In its Staff Report on Midvale's CC&N extension application, Staff recommended that two-way EAS be established between Table Top and Midvale and that two-way EAS between Table Top and Qwest be deferred to a subsequent rate case or other appropriate filing. Many of the concerns and issues raised by Table Top may also be applicable to EAS between Table Top and Midvale. Therefore, Staff now recommends deferral of two-way EAS between Table Top and Midvale to a subsequent rate case or other appropriate filing also.

### Qwest

Because Table Top had withdrawn its request for two-way EAS, in its December 10, 2003 filing, Qwest provided a cost estimate for Midvale only<sup>1</sup>. Qwest's estimate assumes that 1) Midvale would interconnect to Qwest's Prescott end office and 2) a single DS-1 trunk group would be required initially. In its comments, Staff adds a further assumption that Midvale would make use of tandem functionality in the Prescott switch. Staff understands that this would eliminate the need to establish a separate facility to the Qwest's Chino Valley and would also facilitate the routing of calls to other carriers with prefixes in the Prescott local calling area.

Qwest stated that its capital costs have a linear relationship with the number of DS-1s provisioned (i.e. 2 DS-1s are twice the cost of 1 DS-1, etc.). Approximately 23 percent of the identified expense costs are for translation activity that appears to be only required for the initial turn up of the trunk group. The capital and expense costs to Qwest for establishment of a two-way EAS trunk group consisting of one DS-1 are both *de minimus* and within reasonable bounds.

### Midvale

Midvale requested that its September 9, 2003 late filed exhibit be utilized as its cost estimate. The facility costs in the estimate are for full build out. Based upon the data provided, Staff estimated the initial capital cost for facilities as follows:

<b>Redcom</b>		
Shelf & common cards <sup>2</sup> (C.O.)	1 @ 22,000	\$ 22,000
DS-1 cards	1 @ 2,000	\$ 2,000
Misc. materials	1 @ 350	\$ 350
Labor (install, programming, travel)	20 hrs @ 75.00	\$ 1,500
Total		\$ 25,850

<sup>1</sup> Documentation provided to Staff was marked as Qwest Confidential.

<sup>2</sup> Each shelf can hold up to 3 DS-1 cards.

<b>Advanced Fiber Communications</b>		
Shelf & common cards (C.O. & meet point)	2 @ 4,300	\$ 8,600
T1X cards	2 @ 700	\$ 1,400
Labor (install, programming, travel)	8 hrs @ 75.00	\$ 600
<b>Total</b>		<b>\$ 10,600</b>
<b>Engineering, planning, coordination</b>	10 hrs @ 75.00	\$ 750
<b>Total</b>		<b>\$ 37,200<sup>3</sup></b>

The above table represents the estimated minimum initial capital cost for Midvale provided facilities to establish two-way EAS for its Millsite service customers. As plant is deployed in other non-contiguous service areas of the exchange<sup>4</sup>, and customers are added, additional DS-1s would be incrementally provisioned to meet call volume requirements. Staff believes the unit costs provided by Midvale are within reasonable bounds.

Staff notes that the filings by Midvale and Qwest do not indicate whether there would be any recurring expense to Midvale from Qwest for facilities necessary to interconnect with Qwest.

### Facility Cost Recovery

The \$37,200 minimum investment could serve 75 to 80 customers. Midvale currently has 30 customers in the Millsite exchange. Staff estimates that the additional monthly per customer cost to recover the investment in facilities (assuming that 75 customers would be served) will be \$9.97, assuming an 8.00% rate of return and a 1.765 Gross Revenue Conversion Factor.<sup>5</sup> If the Commission authorized rate of return of 10.37% is used, Staff estimates that that the additional monthly per customer cost to recover the investment in facilities will be \$11.70.<sup>6</sup>

In its application, Midvale provided a forecast of the number of customers that it expects to serve in the Millsite exchange. At the end of the first year, Midvale would provide two-way EAS to 273 customers and Midvale would provide two-way EAS to 596 in year six. Assuming that 273 customers will be provided with two-way EAS, Staff (based on information provided by Midvale) estimated that the addition to rate base necessary to provide two-way EAS to Midvale's Millsite customers is \$70,620, Staff estimates that the additional monthly per customer cost to recover the investment in facilities will be \$5.20.<sup>7</sup> To develop this estimate, Staff used

<sup>3</sup> Add \$ 3,400 if 2 DS-1s are provided and \$6,800 if 3 DS-1s are provided.

<sup>4</sup> As of December 1, 2003, 30 customers were receiving service in the Henderson Valley service area. Midvale anticipates it will begin to provide service in the Millsite service area during 1Q2004. At this time, Midvale anticipates that service would next be provided to the Crossroads Ranch service area in early 2005. The Poquito Valley service area would be subsequent to Crossroads Ranch.

<sup>5</sup> See Exhibit S-1, Page 1.

<sup>6</sup> See Exhibit S-1, Page 2.

<sup>7</sup> See Exhibit S-1, Page 3.

Midvale's cost of capital estimate of 8.00%. Staff also used a Gross Revenue Conversion Factor of 1.765 which was used in Midvale's last rate case (Decision No. 64011). The Commission's authorized rate of return for Midvale set in its latest rate case is 10.37%, however, interest rates have declined since that time. If the Commission authorized rate of return is used, Staff estimates that that the additional monthly per customer cost to recover the investment in facilities will be \$6.10.<sup>8</sup>

In its Late Filed Exhibits submitted on September 9, 2003, Midvale indicated that at full build out, it would serve 529 customers. Assuming that 529 customers will be provided with two-way EAS, Staff (again based on information provided by Midvale) estimated that the addition to rate base necessary to provide two-way EAS to Midvale's Millsite customers is \$104,650. Staff estimates that the additional monthly per customer cost to recover the investment in facilities will be \$3.98, assuming an 8.00% rate of return and a 1.765 Gross Revenue Conversion Factor.<sup>9</sup> If the Commission authorized rate of return of 10.37% is used, Staff estimates that that the additional monthly per customer cost to recover the investment in facilities will be \$4.67.<sup>10</sup>

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<sup>8</sup> See Exhibit S-1, Page 4.

<sup>9</sup> See Exhibit S-1, Page 5.

<sup>10</sup> See Exhibit S-1, Page 6.

**End of Year One using 8.00% and zero for "Other Operating Expense"**

Addition to Rate Base		\$40,600.00	
<i>times</i> authorized return on rate base	8.00%	\$3,248.00	from Decision No. 64011 (rate case)
<i>times</i> Gross Revenue Conversion Factor	1.7652	\$5,733.37	from Decision No. 64011 (rate case)
<i>plus</i> depreciation expense	10 years	\$4,060.00	from Decision No. 64011 (rate case)
<b>Equals</b> Investment Related Rev Req		\$9,793.37	
<i>plus</i> Other Operating Expense	0.0000	\$0.00	
<b>Equals</b> Annual Revenue Requirement		\$9,793.37	
<i>divided</i> by number of customers		273	from Amended Application, Exhibit F
<b>Equals</b> Annual per customer Rev Req		\$35.87	
<i>divided</i> by 12			
<b>Equals</b> Monthly per customer Rev Req		\$2.99	

**End of Six Years using 8.00% and zero for "Other Operating Expense"**

Addition to Rate Base		\$104,650.00	
<i>times</i> authorized return on rate base	8.00%	\$8,372.00	from Decision No. 64011 (rate case)
<i>times</i> Gross Revenue Conversion Factor	1.7652	\$14,778.25	from Decision No. 64011 (rate case)
<i>plus</i> depreciation expense	10 years	\$10,465.00	from Decision No. 64011 (rate case)
<b>Equals</b> Investment Related Rev Req		\$25,243.25	
<i>plus</i> Other Operating Expense	0.0000	\$0.00	
<b>Equals</b> Annual Revenue Requirement		\$25,243.25	
<i>divided</i> by number of customers		529	from Midvale Late Filed Exhibits
<b>Equals</b> Annual per customer Rev Req		\$47.72	
<i>divided</i> by 12			
<b>Equals</b> Monthly per customer Rev Req		\$3.98	

**End of Year One using 10.37% and zero for "Other Operating Expense"**

Addition to Rate Base		\$40,600.00	
<i>times</i> authorized return on rate base	10.37%	\$4,210.22	from Decision No. 64011 (rate case)
<i>times</i> Gross Revenue Conversion Factor	1.7652	\$7,431.88	from Decision No. 64011 (rate case)
<i>plus</i> depreciation expense	10 years	\$4,060.00	from Decision No. 64011 (rate case)
<b>Equals</b> Investment Related Rev Req		\$11,491.88	
<i>plus</i> Other Operating Expense	0.0000	\$0.00	
<b>Equals</b> Annual Revenue Requirement		\$11,491.88	
<i>divided</i> by number of customers		273	from Amended Application, Exhibit F
<b>Equals</b> Annual per customer Rev Req		\$42.09	
<i>divided</i> by 12			
<b>Equals</b> Monthly per customer Rev Req		\$3.51	

**End of Six Years using 10.37% and zero for "Other Operating Expense"**

Addition to Rate Base		\$104,650.00	
<i>times</i> authorized return on rate base	10.37%	\$10,852.21	from Decision No. 64011 (rate case)
<i>times</i> Gross Revenue Conversion Factor	1.7652	\$19,156.31	from Decision No. 64011 (rate case)
<i>plus</i> depreciation expense	10 years	\$10,465.00	from Decision No. 64011 (rate case)
<b>Equals</b> Investment Related Rev Req		\$29,621.31	
<i>plus</i> Other Operating Expense	0.0000	\$0.00	
<b>Equals</b> Annual Revenue Requirement		\$29,621.31	
<i>divided</i> by number of customers		529	from Midvale Late Filed Exhibits
<b>Equals</b> Annual per customer Rev Req		\$55.99	
<i>divided</i> by 12			
<b>Equals</b> Monthly per customer Rev Req		\$4.67	