

STATE OF ILLINOIS

ILLINOIS COMMERCE COMMISSION

ILLINOIS INDEPENDENT TELEPHONE ASSOCIATION)	
)	
Petition for initiation of an investigation of the necessity of and the establishment of a Universal Service Support Fund in accordance with §13-301(d) of the Public Utilities Act)	Docket No. 00-0233
)	
Illinois Commerce Commission On Its Own)	
)	
Investigation into the necessity of and, if appropriate, the establishment of a Universal Support Fund pursuant to Section 13-301(d) of the Public Utilities Act.)	Docket No. 00-0335
)	

DIRECT TESTIMONY

OF

GORDON J. KRAUT, JR.

ON BEHALF OF

MONTROSE MUTUAL TELEPHONE COMPANY

April 20, 2001

OFFICIAL FILE

ILL. COM. COM. 00-0233/0335
Montrose Mutual Telephone Co.
Date 6-19-01 Reporter CB

1 **Q. Please state your name and business address.**

2 A. My name is Gordon J. Kraut, Jr. and my business address is 3220 Pleasant Run,
3 Springfield, Illinois 62707.

4 **Q. By whom are you employed?**

5 A. I am the consulting manager with GVNW Consulting, Inc. GVNW Consulting, Inc.'s
6 principal business is telecommunications consulting for small independent telephone
7 companies and we have provided consulting services to Montrose Mutual Telephone
8 Company for several years.

9 **Q. Please describe your educational background.**

10 A. I graduated from Edgewood College in May of 1988 with a Bachelor of Science
11 Degree in business with an emphasis in accounting. I earned a master's in business
12 administration from Edgewood College in 1991.

13 **Q. Please provide your background in telecommunications.**

14 A. In 1988 I began my telecommunications career with TDS, Inc. as an internal auditor.
15 In 1993 I was promoted to Senior Internal Auditor and in 1994 I was promoted to
16 Associate Manager of Accounting in TDS Telcom. Early in 1996 I was promoted to
17 the position of Manager of Revenue and Earnings in the Government and Regulatory
18 Affairs Group. I joined GVNW, Inc. on October 20, 1997 and in my current position
19 I consult with independent telephone companies and provide financial analysis and
20 management advice in the areas of concern to these companies.

21 **Q. On what company's behalf is this testimony submitted?**

22 A. This testimony is submitted on behalf of Montrose Mutual Telephone Company.

1 **Q. Have you prepared the Illinois Universal Service funding calculations for**
2 **Montrose Mutual Telephone Company using the format agreed to by the Staff**
3 **and the IITA?**

4 **A. Yes, I have. It is attached as Montrose Mutual Telephone Company Exhibit 1,**
5 **Schedule 1.01 and consists of 3 pages.**

6 **Q. Did you complete Montrose Mutual Telephone Company Exhibit 1, Schedule**
7 **1.01 in accordance with the instructions and based on Montrose Mutual**
8 **Telephone Company's ICC Form 23A or other information filed with the**
9 **Commission for the year ended December 31, 2000?**

10 **A. Yes. Montrose Mutual Telephone Company Exhibit 1, Schedule 1.01, was based on**
11 **the ICC Form 23A filed with the Commission.**

12 **Q. Were these entries on Exhibit 1, Schedule 1.01 taken from books and records**
13 **kept by the company in the normal course of its business and recorded at the**
14 **time of the event?**

15 **A. Yes.**

16 **Q. Is Montrose Mutual Telephone Company Exhibit 1, Schedule 1.01 true and**
17 **correct to the best of your knowledge, information and belief?**

18 **A. Yes it is.**

19 **Q. Based on the responses and content of Montrose Mutual Telephone Company**
20 **Exhibit 1, Schedule 1.01, has Montrose Mutual Telephone Company provided**
21 **Staff with certain additional documents?**

1 A. Yes. I have provided the Staff with a copy of Montrose Mutual Telephone
2 Company's December 31, 2000, Trial Balance which we have requested be treated as
3 confidential and proprietary.

4 **Q. Have you provided the requisite information from Montrose Mutual Telephone**
5 **Company Exhibit 1, Schedule 1.01 to Mr. Schoonmaker for his use in compiling**
6 **the composite results for all companies seeking funding in connection with his**
7 **testimony?**

8 A. Yes, I have.

9 **Q. Does page 1 of Montrose Mutual Telephone Company Exhibit 1, Schedule 1.01**
10 **reflect any adjustments being proposed by Montrose Mutual Telephone**
11 **Company?**

12 A. Yes. All adjustments are summarized in Schedule 1.02. I have made two (2) standard
13 adjustments on Montrose Mutual Telephone Company's Exhibit 1, Schedule 1.01.
14 The first adjustment that was made is on line 14 for an increase in Federal High Cost
15 Loop (HCL) Revenues that Montrose is currently receiving in 2001. This is listed as
16 standard adjustment #5 in Bob Schoonmaker's testimony. Montrose received
17 \$12,990 in Federal HCL funding in 2000 per information that appears on quarterly
18 filings that the Universal Service Administration Corporation (USAC) made with
19 Federal Communication Commission. Per these same filings for the first two quarters
20 of 2001 annualized, Montrose is receiving \$0. This results in a decrease in Federal
21 funding of \$12,990 and is a known and measurable decrease in Montrose's revenue
22 streams.

1 The second adjustment is standard adjustment #3 as listed in Bob Schoonmaker's
2 testimony for out-of-period adjustments. This adjustment, also on line 14, removes
3 \$18,573 of prior period revenue booked in 2000 and can be found in account number
4 03-5082.55, LSS Prior Period CCL. These two standard adjustments, taken together,
5 total the (\$31,563) reflected on lines 14, 16 and 20.

6 **Q. Have you made any of non-standard adjustments that were not agreed upon**
7 **between the IITA and Staff?**

8 A. Yes, I have.

9 **Q. Please describe the non-standard adjustment that you have made to Montrose**
10 **Mutual Telephone Company, Exhibit 1, Schedule 1.0.**

11 A. I have made one (1) non-standard adjustments on Montrose Mutual Telephone
12 Company's Exhibit 1, Schedule 1.01. This adjustment is summarized in Schedule
13 1.02. This adjustment is to bring \$282,717 of general support assets on to the books
14 of Montrose Mutual Telephone Company. Montrose Mutual Telephone Company is
15 a wholly owned subsidiary of Respond Communications, Inc. and Respond Services,
16 Inc. is also a wholly owned subsidiary of Respond Communications, Inc. At the
17 beginning of 2000, Montrose Mutual Telephone Company moved its General Support
18 Assets from the telephone company books to that of Respond Communications, Inc.
19 and Respond Services, Inc. for asset protection reasons. They have then allocated the
20 costs such as depreciation and other maintenance activities to the telephone company
21 and other subsidiaries at cost per Section 32.27 (c) of the F.C.C. rules which states
22 that "...services received by a carrier from its affiliate that exists solely to provide

1 services to members of the carrier's corporate family shall be recorded at fully
2 distributed cost." Respond Communications, Inc. and Respond Services, Inc. are
3 allocating the costs of the general support assets directly to their subsidiaries without
4 any mark-up or "return". Therefore, the only profit that Respond Communications,
5 Inc. and Respond Services, Inc. are showing is for interest income. Since Respond
6 Services, Inc. and Respond Communications, Inc. are not "marking up" the costs to
7 get a fair return on their assets, Montrose has brought these assets on the books to
8 earn a fair return on the investment. Respond Communications, Inc. and Respond
9 Services, Inc. have allocated costs and related assets back to Montrose Mutual
10 Telephone Company based on general usage of the general support assets. As you
11 can see from Schedule 1.02, we have compared the costs that were on Montrose
12 Mutual Telephone's books at year end 1999 to what was brought back on the books
13 for earnings purposes. The additions mainly relate to the remodeling of the Montrose
14 Mutual Telephone office building.

15 **Q. What percentage of the assets does the \$282,717 represent?**

16 A. I have made an adjustment by taking only 94% of the net regulated plant owned by
17 Respond because those assets are slightly used by other wholly owned subsidiaries of
18 Respond Communications, Inc.

19 **Q. Based on the format agreed to by the Staff and the IITA, what was Montrose
20 Mutual Telephone Company's rate of return for the calendar year 2000?**

21 A. .96% or slightly less than 1%.

1 Q. Does Montrose Mutual Telephone Company concur with Mr. Schoonmaker's
2 recommendation that its affordable rate be established at the current weighted
3 average rate for residential and business service?

4 A. Yes.

5 Q. Does that conclude your direct testimony on behalf of Montrose Mutual
6 Telephone Company?

7 A. Yes it does.

Montrose Telephone Company
Illinois Universal Service Funding Calculation
Based upon ICC Form 23A Report Data for December 31, 2000

<u>Line #</u>	<u>Description</u>	<u>Source</u>	<u>Amount</u>	<u>Adjustment</u>	<u>Adjusted Amount</u>
1	Net Regulated Plant	Form 23A, P 8, Net Plant	\$ 1,591,246	\$ 282,717	\$ 1,873,963
2	Materials and Supplies Inventory	Page 2, 13-Month Average	73,848		73,848
3	Customer Deposits	Form 23A, P 8, 4040	3,880	-	3,880
4	ADIT - Regulated Plant	Form 23A, P 8, 4100 + 4340	266,596	-	<u>266,596</u>
5	Rate Base before Working Capital	line 1 + line 2 - line 3 - line 4			1,677,335
6	Working Capital Requirement				
7	Total Operating Expenses	Form 23A, P 14, Total	1,444,446	-	1,444,446
8	Less: Depreciation Expense	Form 23A, P 13, 6560	<u>372,249</u>	-	<u>372,249</u>
9	Total WC Operating Expense	line 7 - line 8	<u>1,072,197</u>	-	<u>1,072,197</u>
10	WC OE Requirement	line 9 * 45 / 360			134,025
11	Commission-Ordered Cash Balance Requirement		-	-	-
12	Total Working Capital Requirement	line 10 + line 11			<u>134,025</u>
13	Total Rate Base	line 5 + line 12			<u>1,811,360</u>
14	Total Operating Revenues	Form 23A, P 11, Total	1,826,663	(31,563)	1,795,100
15	Less: Illinois High Cost Fund		<u>315,964</u>	-	<u>315,964</u>
16	Net Operating Revenues	line 14 - line 15	1,510,699	(31,563)	1,479,136
17	Total Operating Expenses	Form 23A, P 14, Total	1,444,446	-	1,444,446
18	Other Operating Inc and Exp - Net	Form 23A, P 15, 7100	-	-	-
19	Other Operating Taxes	Form 23A, P 15, 7240	<u>6,430</u>	-	<u>6,430</u>
20	Net Op Inc before Income Taxes	line 16 - lines 17, 18, & 19	59,823	(31,563)	28,260
21	Income Tax Expense	line 34			<u>10,948</u>
22	Net Operating Income	line 20 - line 21			<u>17,312</u>
23	Return on Rate Base	line 22 / line 13			<u>0.96%</u>
24	After-tax Cost of Capital				<u>11.21%</u>
25	Target Net Operating Income	line 24 * line 13			<u>203,053</u>
26	Adj to Achieve Target Return on RB	line 25 - line 22			185,741
27	Gross Revenue Conversion Factor	line 35			<u>1.6324</u>
28	ROR Funding Deficiency Including Inc Taxes	line 26 * line 27			<u>303,204</u>
29	Calculation of Income Tax Expense				
30	Net Op Inc before Inc Taxes	line 20			28,260
31	Illinois Inc & Rep Tax Expense	line 30 * 7.18%			<u>2,029</u>
32	Net Op Inc before Fed Inc Tax	line 30 - line 31			26,231
33	Federal Income Tax Expense	line 32 * 34.00%			<u>8,919</u>
34	Total Imputed Income Tax Expense	line 31 + line 33			<u>10,948</u>
35	Gross Revenue Conversion Factor	1 / ((1 - .0718) * (1 - .34))			<u>1.6324</u>

Montrose Telephone Company
Illinois Universal Service Funding Calculation
Based upon ICC Form 23A Report Data for December 31, 2000
Material & Supplies Worksheet and Other Information

Line #		
1	December-99	\$60,497
2	January-00	\$79,627
3	February-00	\$85,970
4	March-00	\$84,414
5	April-00	\$72,128
6	May-00	\$73,917
7	June-00	\$72,638
8	July-00	\$71,438
9	August-00	\$70,820
10	September-00	\$74,463
11	October-00	\$68,888
12	November-00	\$72,355
13	December-00	\$72,866
14	13 Month Average	\$73,848

Sale/Lease Back Arrangement

The company does not have any sale(s)/lease back arrangement.

The company does have sale(s)/lease back arrangement and has provided additional information to staff.

Lease Agreement with Affiliates

The company does not have any lease agreements with affiliates.

The company does have lease agreements with affiliates and has provided additional information to staff.

Trial Balances

The Company has provided a copy of its 12/31/2000 trial balance in support of the attached exhibits.

Montrose Telephone Company
Illinois Universal Service Funding Calculation
 Based upon ICC Form 23A Report Data for December 31, 2000
 Operating Revenues By Category

<u>Line #</u>		<u>Source</u>	<u>Amount</u>
		Form 23A, P 10, Total Local	
1	Local Revenues	Network Service Revenues	\$ 151,828
2	State Subscriber Line Charges	Trial Balance 12/31/00	\$ 224,611
3	State Access Revenues	Trial Balance 12/31/00	\$ 431,795
4	State High Cost Support	Exhibit 1.01, Page 1, Line 15	\$ 315,964
5	State Special Access Revenues	Trial Balance 12/31/00	\$ 64,499
6	Total State Access & Local Revenues	Sum (Ln 1 - 5)	\$ 1,188,697
7	Federal Subscriber Lines Charges	Trial Balance 12/31/00	\$ 75,031
8	Federal Access Revenues	Trial Balance 12/31/00	\$ 301,981
9	Federal High Cost Support	Trial Balance 12/31/00	\$ 138,406
10	Federal Special Access Revenues	Trial Balance 12/31/00	\$ 13,569
11	Total Federal Access Revenues	Sum (Ln 7 - 10)	\$ 528,987
12	Misc Revenues	Trial Balance 12/31/00	\$ 108,980
13	Total Operating Revenues	Ln 6 + Ln 11 + Ln 12	<u>\$ 1,826,664</u>

Montrose Telephone Company
 Summary of Adjustments

	Dr.	Cr.
Adjustment 1		
2001 Projected HCL Revenue	-	
2000 HCL Revenue	<u>12,990</u>	
Decrease in HCL Revenue	\$ (12,990)	
Universal Service Adjustments	12,990	

Adjustment to record increase in Federal High Cost Loop Fund.

Adjustment 2

To adjust out the 1998 LSS True-up that appeared in the 2000 Financial Statements.

Prior Period 1998 LSS True-Up	18,573
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Respond Communications
 Summary of General Assets

	Company Ind.	12/31/1999 Balance	12/31/2000 Balance	Amount Allocated to Telephone Operations	12/31/2000 Accumulated Depreciation	Allocated to Telephone Operations
Land	(1) (a)	21,665	21,665	20,365	-	-
Vehicles	(b)	102,771	118,801	111,673	(93,601)	(87,985)
Other Work Equipment	(b)	112,518	112,518	105,767	(74,218)	(69,765)
Buildings	(a)	268,096	314,184	295,333	(125,868)	(118,316)
Furniture	(b)	12,424	13,802	12,974	(9,849)	(9,258)
Office Support Equipment	(b)	21,272	21,272	19,996	(20,490)	(19,261)
Company Communications Equip	(b)	9,473	9,473	8,905	(4,737)	(4,453)
General Purpose Computers	(b)	46,207	68,988	55,449	(41,178)	(38,707)
		<u>594,426</u>	<u>670,703</u>	<u>630,462</u>	<u>(369,941)</u>	<u>(347,745)</u>

Amount of General Support Assets carried forward to worksheet

\$ 282,717

(1) (a) is if asset on Respond Communications or (b) if on Respond Services

Montrose Telephone Company
Illinois Universal Service Funding Calculation
 Based upon ICC Form 23A Report Data for December 31, 2000

Line #	Description	Source	Amount	Adjustment	Adjusted Amount
1	Net Regulated Plant	Form 23A, P 8, Net Plant	\$ 1,591,246	\$ 282,717	\$ 1,873,963
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3	Customer Deposits	Form 23A, P 8, 4040	3,880	-	3,880
4	ADIT - Regulated Plant	Form 23A, P 8, 4100 + 4340	266,596	-	<u>266,596</u>
5	Rate Base before Working Capital	line 1 + line 2 - line 3 - line 4			1,677,335
6	Working Capital Requirement				
7	Total Operating Expenses	Form 23A, P 14, Total	1,444,446	-	1,444,446
8	Less: Depreciation Expense	Form 23A, P 13, 6560	<u>254,139</u>	-	<u>254,139</u>
9	Total WC Operating Expense	line 7 - line 8	<u>1,190,307</u>	-	<u>1,190,307</u>
10	WC OE Requirement	line 9 * 45 / 360			148,788
11	Commission-Ordered Cash Balance Requirement		-	-	-
12	Total Working Capital Requirement	line 10 + line 11			<u>148,788</u>
13	Total Rate Base	line 5 + line 12			<u>1,826,123</u>
14	Total Operating Revenues	Form 23A, P 11, Total	1,826,663	(31,563)	1,795,100
15	Less: Illinois High Cost Fund		<u>315,964</u>	-	<u>315,964</u>
16	Net Operating Revenues	line 14 - line 15	1,510,699	(31,563)	1,479,136
17	Total Operating Expenses	Form 23A, P 14, Total	1,444,446	-	1,444,446
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19	Other Operating Taxes	Form 23A, P 15, 7240	<u>6,430</u>	-	<u>6,430</u>
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21	Income Tax Expense	line 34			<u>10,948</u>
22	Net Operating Income	line 20 - line 21			<u>17,312</u>
23	Return on Rate Base	line 22 / line 13			<u>0.95%</u>
24	After-tax Cost of Capital				<u>11.21%</u>
25	Target Net Operating Income	line 24 * line 13			<u>204,708</u>
26	Adj to Achieve Target Return on RB	line 25 - line 22			187,396
27	Gross Revenue Conversion Factor	line 35			<u>1.6324</u>
28	ROR Funding Deficiency Including Inc Taxes	line 26 * line 27			<u>305,905</u>
29	Calculation of Income Tax Expense				
30	Net Op Inc before Inc Taxes	line 20			28,260
31	Illinois Inc & Rep Tax Expense	line 30 * 7.18%			<u>2,029</u>
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- The company does not have any sale(s)/lease back arrangement.
 The company does have sale(s)/lease back arrangement and has provided additional information to staff.

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 Operating Revenues By Category

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Montrose Telephone Company
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		Dr.	Cr.
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2000 HCL Revenue	12,990		
Decrease in HCL Revenue	\$ (12,990)		
Universal Service Adjustments		12,990	

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Respond Communications
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	(1)	Balance	Balance	Allocated to	Accumulated	Telephone
				Telephone	Depreciation	Operations
				Operations		
Land	(a)	21,665	21,665	20,365	-	-
Vehicles	(b)	102,771	118,801	111,673	(93,601)	(87,985)
Other Work Equipment	(b)	112,518	112,518	105,767	(74,218)	(69,765)
Buildings	(a)	268,096	314,184	295,333	(125,868)	(118,316)
Furniture	(b)	12,424	13,802	12,974	(9,849)	(9,258)
Office Support Equipment	(b)	21,272	21,272	19,996	(20,490)	(19,261)
Company Communications Equip	(b)	9,473	9,473	8,905	(4,737)	(4,453)
General Purpose Computers	(b)	46,207	58,988	55,449	(41,178)	(38,707)
		<u>594,426</u>	<u>670,703</u>	<u>630,462</u>	<u>(369,941)</u>	<u>(347,745)</u>

Amount of General Support Assets carried forward to worksheet

\$ 282,717

(1) (a) is if asset on Respond Communications or (b) if on Respond Services