

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
)	

REBUTTAL TESTIMONY

OF

MICHAEL P. PETROUSKE

ON BEHALF OF

GRAFTON TELEPHONE COMPANY

OFFICIAL FILE

ILL. C. C. DOCKET NO. 00-0233/0335
Grafton Telephone Co
Exhibit No. 4.0
Witness [Signature]
Date 6/20/01 Reporter [Signature]

June 12, 2001

Offer of Proof

1 Q. Please state your name and business address.

2 A. My name is Michael P. Petrouske. My business address is 850 Pluto Street, Geneseo,
3 Illinois 61254.

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

5 A. I am a Vice President of Gridley Consulting Services, Inc. For purposes of this
6 testimony, Gridley Consulting Services, Inc. has been hired by Grafton Telephone
7 Company.

8 Q. Are you the same Michael P. Petrouske who filed testimony in this proceeding for
9 Leaf River Telephone Company, Home Telephone Company and Tonica Telephone
10 Company on April 20, 2001?

11 A. Yes I am.

12 Q. What is the purpose of your rebuttal testimony?

13 A. The purpose of my testimony is to providing^e policy recommendations based on an
14 embedded economic cost study for Grafton Telephone Company that represents the
15 cost of supported services. I also address the issue of implicit subsidies in access.

16 Q. Please summarize your rebuttal testimony.

17 A. Based on the embedded economic cost study, Grafton Telephone Company proves a
18 need for funding, and meets the statutory requirement of showing that its economic
19 costs exceed its affordable rate plus recovery from other Federal Universal Service
20 Funding Programs. Since Grafton Telephone Company has met the statutory
21 requirement based on this embedded cost analysis, the company should receive state
22 Universal Service Funding based on either its company-specific Rate of Return
23 showing or the company's embedded economic cost study. The company's state

1 universal service support should not be phased down to the Staff's or AT&T's
2 proposed HAI level of support. Grafton Telephone Company is also providing
3 information in this testimony that compares its state switched access revenues to the
4 embedded economic cost for state switched access. This comparison is provided to
5 meet the statutory requirement for identifying subsidies in state switched access.

6 **Q. Mr. Petrouske, what do you recommend as the appropriate method for**
7 **determining economic cost for Grafton Telephone Company in this case?**

8 A. Historical embedded costs are the appropriate method for determining the economic
9 costs of the supported services for Grafton Telephone Company in this docket. In an
10 order in FCC Docket 96-45 adopted May 10, 2001, the FCC has rejected the use of
11 forward-looking cost models for determining universal service requirements for rural
12 carriers. Specifically, the FCC said in paragraph 177 of that Order that "Because the
13 Commission has not developed rural inputs and it is not possible to determine
14 forward-looking costs for rural carriers at this time, we find that rural carriers should
15 continue to receive support based upon their embedded costs while the five-year plan
16 adopted in this Order is in place." (emphasis added).¹ The Commission should follow
17 the FCC's lead and use historical embedded costs rather than forward-looking costs as
18 the basis for cost determination and universal service funding.

¹ While the specific cost model analyzed in the Rural Task Force Recommendations, which the FCC was relying upon, was the FCC's Synthesis Model, rather than the HAI model which has been presented in this docket, the FCC's finding that forward looking costs cannot be determined at this time due the lack of appropriate inputs for rural carriers is equally applicable with respect to the HAI model. AT&T witness Clark, in his Direct Testimony in this docket, recognizes that the inputs for the HAI model are substantially similar to the inputs in the FCC's Synthesis Model when he states on pages 10 and 11 from his Direct Testimony "the default expense figures in the HAI 5.0a model are supported by forward-looking evidence, and their validity has generally been affirmed by the collection of expense factors that has been adopted by the FCC for its Synthesis model. The FCC developed these

1 Q. Has Grafton Telephone Company had an embedded cost analysis prepared for
2 use in this case to show embedded costs of the supported services based on their
3 year 2000 cost separations study?

4 A. Yes. Mr. Gordon Kraut of GVNW has prepared such an embedded cost analysis and
5 has presented it with his rebuttal testimony in Grafton Telephone Company Exhibit
6 3.0, Schedules 3.01 and 3.02.

7 Q. Have you reviewed Grafton Telephone Company's embedded cost study?

8 A. Yes. I have reviewed the results generated by this embedded cost study. I am
9 familiar with the format Mr. Kraut used to provide this embedded cost study, as he
10 and I worked cooperatively with others from our respective firms to develop this
11 format for use in this proceeding. I have prepared and sponsored similar studies for
12 other small telephone companies in this proceeding.

13 Q. Does Mr. Kraut's embedded cost study contained in Exhibit 3.0, Schedule 3.01
14 appear to represent a reasonable statement of the embedded costs of the
15 supported services for Grafton Telephone Company?

16 A. Yes. This study appears to be a reasonable representation of Grafton Telephone
17 Company's embedded costs of supported services. Schedule 3.01 was developed
18 using Grafton Telephone Company's year 2000 annual cost separations study run
19 without the weighted interstate DEM factors. Using the unweighted DEM factors in
20 the cost study run, the study results properly reflect the revenue requirement
21 associated with local switching support as a cost assigned to the local jurisdiction.

expense factors using its own statistical regression analysis, and these factors yield expense levels that match very

1 This is an appropriate approach for purposes of generating the true local service costs
2 for the company. The economic cost study also eliminates the costs associated with
3 non-supported ancillary services. With this adjustment for ancillary service
4 investment and related expenses, the embedded cost study reasonably represents the
5 economic cost of the supported local services.

6 **Q. What does this Schedule 3.01 show with respect to the economic costs of**
7 **supported services for Grafton Telephone Company?**

8 A. Schedule 3.01, Page 1, shows that Grafton Telephone Company has economic costs
9 of providing the supported local services that exceed the revenues received from its
10 affordable local rate and federal universal service support mechanisms. This
11 Schedule proves that Grafton Telephone Company satisfies the economic cost test
12 contained in the statute and therefore qualifies for support from the state universal
13 fund.

14 **Q. Turning back to Grafton Telephone Company's Schedule 3.01 and focusing on**
15 **the IUSF Eligibility amount, can you determine what Grafton Telephone**
16 **Company's IUSF support need for supported services will be based on its Year**
17 **2000 embedded economic cost study?**

18 A. Yes. The results of this embedded economic analysis show that Grafton Telephone
19 Company has a revenue deficiency that would generate an Illinois Universal Service
20 Funding eligibility for supported services in the amount of \$145,440.

1 Q. How does the result from the embedded economic cost study compare to the
2 Rate of Return analysis filed by Grafton Telephone Company in this proceeding
3 on April 20, 2001?

4 A. The Rate of Return analysis filed by the company demonstrated a deficiency of
5 \$223,441 in order to meet the IITA/Staff's proposed rate of return of 11.21%.

6 Q. What is your recommendation to the Illinois Commerce Commission with
7 respect to the "economic cost" element of this proceeding, and the appropriate
8 level of universal service support funding for the Grafton Telephone Company?

9 A. Since Grafton Telephone Company has met the statutory requirement based on this
10 embedded economic cost analysis, the company should receive state Universal
11 Service Funding based either the company-specific Rate of Return showing or its
12 embedded economic cost study, and, not be phased down to the Staff's or AT&T's
13 proposed HAI level of support. I understand that the company's counsel intends to
14 argue in this case that my recommendation could be accomplished through a finding
15 that the embedded cost analysis is the "economic cost" of the supported services
16 contemplated by the statute, or a finding that either the Rate of Return analysis or the
17 embedded economic cost analysis can be used as a reasonable proxy for determining
18 the company's need for universal service funding.

19 Q. Mr. Petrouske, in your opinion does the Rate of Return analysis and/or the
20 embedded economic cost analysis represent a more reasonable representation of
21 the company's need for universal service support than the HAI model?

22 A. Most certainly.

1 Q. Do you have any specific reasons why the HAI analysis should not be used to
2 determine the universal service funding for Grafton Telephone Company?

3 A. Yes. Despite the suggestions to the contrary by Staff witness Mr. Koch in his direct
4 testimony, the HAI model or any other forward-looking cost model will overestimate
5 the costs of some companies and underestimate the costs for others. AT&T witness
6 Mr. Clarke specifically recognizes this point at lines 23-25 on page 4 of his direct
7 testimony. This conclusion is also consistent with my understanding of the findings
8 of the FCC's Rural Task Force in their Recommendations to the Federal State Joint
9 Board on Universal Service adopted on September 22, 2000 in CC Docket No. 96-45.
10 (pp. 17-18)

11 In addition, the evidence of the various parties in this proceeding that have addressed
12 the HAI issue shows that the results on an individual company basis vary widely
13 based on making a small number of input changes in the default values. In adjusting
14 the input values to more closely reflect actual company circumstances, the results
15 from the model can be extremely different from the results produced with the default
16 values. The ICC Staff's HAI proposal for Grafton Telephone Company relies heavily
17 on the default values resident in the model and accepts proposed adjustments by
18 AT&T witness Mr. Clarke which he states more accurately reflect the defaults in
19 more current versions of the model while rejecting the majority of the proposed input
20 and default adjustments made by Mr. Schoonmaker ~~and myself~~. AT&T witness Mr.
21 Clarke, in his direct testimony, relies heavily on the FCC's inputs for its Synthesis
22 Model and how closely those inputs compare to the HAI default inputs. ICC Staff

1 witness Mr. Koch accepts the justifications by Mr. Clarke as reasonable in accepting
2 most of his input adjustments for the Staff revised HAI model runs.

3 The difficulty for this Commission in considering the use of the HAI model for
4 Grafton Telephone Company, when there is a reasonable embedded economic cost
5 analysis in the record, is that the FCC has recently stated that the inputs in the existing
6 forward-looking cost models are not appropriate for modeling the costs of the rural
7 carriers at this time. The FCC went so far as to say "it is not possible to determine
8 forward-looking costs for rural carriers at this time." Because the results from
9 forward-looking cost models do not work for small rural carriers, the FCC has
10 adopted the use of embedded costs for the rural carriers to be used for the purpose of
11 determining universal service support for the next five years. Since the justification
12 by both AT&T and the ICC Staff for their proposed inputs to the HAI model are
13 reliant on the FCC's adoption of the Synthesis Model for non-rural carriers, the recent
14 FCC decision with respect to the rural carriers essentially renders their HAI model
15 results meaningless and unreliable.

16
17 **Q. Have you done an investigation of Grafton Telephone Company's intrastate**
18 **switched access costs and revenues to determine whether or not there are any**
19 **implicit subsidies?**

20 **A. Yes.** Schedule 3.01, Page 3 displays the intrastate switched access revenue
21 requirement and the intrastate switched access revenues for Grafton Telephone
22 Company for the year 2000. The schedule displays the difference between the net

1 intrastate switched access revenue requirement and the switched access revenues
2 received by the company. In the 2000 embedded cost study, Grafton's intrastate
3 switched access revenues are \$19,774 over its embedded costs, as shown on Line 5 of
4 this Schedule. These revenues are the result of usage sensitive intrastate switched
5 access rates that mirror Grafton Telephone Company's federal switched access rates.
6 The rates are set in this mirrored fashion based upon the policy decision of the Illinois
7 Commerce Commission in the 4th Interim Order in ICC Docket No. 83-0142.

8 **Q. What do you recommend the Commission do about Grafton Telephone**
9 **Company's intrastate switched access revenue surplus?**

10 A. Nothing at this time. Contrary to AT&T's position, the statute does not disqualify a
11 LEC from Universal Service Funding simply because its current intrastate access
12 revenues exceed intrastate access costs. This issue should be addressed in detail in
13 the next phase of this proceeding. The FCC is currently reviewing access changes and
14 evaluating various proposals regarding access charge reform. I recommend that the
15 Commission make no changes in access rates in this docket.

16 **Q. Would it serve the policy of the Universal Service Funding provision to adopt a**
17 **pass-fail test for intrastate access subsidies as proposed by AT&T?**

18 A. Absolutely not. Under AT&T's proposal, as I understand it, a carrier can have \$1.00
19 in intrastate access subsidy and lose several hundred thousand dollars in needed
20 support. It would completely defeat the purpose of Universal Service and run
21 contrary to the Commission's policy in Fourth Interim Order of 83-0142 in which
22 carriers were supposed to mirror interstate access rates in the intrastate jurisdiction.

1 As I understand the statute as a non-lawyer, there is nothing in the Act that can be
2 interpreted to deny funding to a carrier who otherwise demonstrates a need.

3 Q. Does this conclude your testimony?

4 A. Yes.

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