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PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Telecommunications Division **RESOLUTION T-16968**
Carrier Branch **January 26, 2006**

R E S O L U T I O N

Resolution T-16968. The Siskiyou Telephone Company. (U-1017-C). General Rate Case Filing In Compliance With G. O. 96-A, Paragraph VI

By Advice Letter No. 331, Filed July 15, 2005.

Summary

This resolution addresses the General Rate Case (GRC) Request filed by Siskiyou Telephone Company by Advice Letter (AL) 331 filed on July 15, 2005. In AL 331, Siskiyou proposes: a) no change to its rates or charges, b) an intrastate Rate of Return (ROR) of 10.00%, the same granted in its previous 2002 GRC, and c) an increase in its CHCF-A draw for 2006 by 143% or an increase of $3,098,032 from its 2005 draw of $2,165,535 Siskiyou was scheduled to file a GRC for test year 2007 but filed early because the intrastate rate of return for the company declined significantly.

This resolution authorizes California High Cost Fund-A (CHCF-A) support for The Siskiyou Telephone Company (Siskiyou) of $4,712,634 for the year 2006. This amount represents an increase of $2,276,805 or 93.5% increase from the CHCF-A 2006 support of $2,435,559 to Siskiyou. The 2005 CHCF-A support of 2,165,535 was increased by $270,024 to offset a decrease in the federal Universal Service Fund support. This resolution authorizes an overall Intrastate Rate of Return of 10.00% for test year 2006, resulting in an intrastate revenue increase of $1,369,861 from present rates.

Appendix A to this resolution compares the Telecommunications Division (TD) and the Siskiyou's Test Year 2006 Total Company Results of Operations before any CHCF-A increase. Appendix B compares TD's and Siskiyou's Interstate and Intrastate Results of Operations before any CHCF-A increase while Appendix C compares TD's and Siskiyou's Intrastate Results of Operations estimates after Siskiyou's proposed

CHCF-A increase and after TD's proposed revenue, expense, and rate base adjustments. Appendix D shows TD's calculation of the Net-to-Gross Multiplier and the change in the gross intrastate revenue requirement based on the recommended intrastate rate of return of 10.00%.

Background

The Siskiyou Telephone Company is a local exchange carrier (LEC) providing telephone service to portions of Siskiyou and Humboldt counties. Its current headquarters is in Etna, CA. Siskiyou serves approximately 4,700 access lines in seven exchanges: Etna, Fort Jones, Hamburg, Happy Camp, Oak Knoll, Sawyer Bar-Forks of Salmon, and Somes Bar.

The last GRC filed by Siskiyou was in December 21, 2001 by AL No. 225 and its latest intrastate results of operations were authorized by Resolution T-16707 dated December 17, 2002 for test year 2003.[1]

Normally, Siskiyou would be on a four-year rate case cycle and would file in December 2005 for a 2007 test year. However, Siskiyou experienced a drop in intrastate ROR and curtailed expenses and investment spending. After discussion with TD, Siskiyou filed early for a general rate case review. The reasons for this are discussed later. In AL 331, Siskiyou proposes: a) no changes to its rates and charges, b) an intrastate ROR of 10.00%, the same rate granted in its previous GRC filing in 2002, and c) an increase in its CHCF-A draw for 2006 by 143% or an increase of $3,098,032 from its 2005 draw of $2,165,535.

Notice/Protests

Siskiyou states that a copy of the Advice Letter was mailed to competing and adjacent utilities and/or other utilities. Notice of AL 331 was published in the Commission Daily Calendar of July 18, 2005. No protest to this Advice Letter has been received.

Staff of the TD held a Public Meeting in Etna, CA, on September 21, 2005, to explain Siskiyou's filing to its customers and its customers were also given an opportunity to ask questions of Siskiyou's management personnel and the TD staff. Siskiyou notified customers of the rate review request and public meeting by a bill insert. Only one customer attended the public meeting. During the meeting the customer, who is also an ex-employee of Siskiyou Telephone Company, praised the service quality of the company and also expressed full satisfaction with the company's customer service.

[1] In Resolution T-16707, Siskiyou was granted the following: No change in its rates and charges, a net revenue amount of $1,157,973, a rate base amount of $11,579,733, and an intrastate Rate of Return of 10.00%.

Discussion

Need for rate review

Siskiyou experienced a decline in its intrastate rate of return and requested to file for its general rate case review a year earlier than the normal schedule. TD agreed to consider Siskiyou's filing. According to Siskiyou, the reason for the lower intrastate rate of return was due to higher plant investments and higher expense levels including the expense associated with a consultant's review of Siskiyou's outside plant design. Also, Siskiyou indicated that it made an inadvertent error in classifying some interstate revenues as intrastate causing the CHCF-A draw to be about $200,000 lower than it should have been. In response to the lower intrastate rate of return, Siskiyou curtailed its expenditures.

Results of Operations

Appendix A compares Siskiyou's total company results of operations for test year 2006, as estimated by the TD staff and Siskiyou.

Total Operating Revenues

Siskiyou's estimate of total company operating revenues at $10,927,662 is lower than TD's estimate of $10,953,216 by $25,554 or -0.23%. The draft resolution inadvertently included the $270,024 change in federal USF fund as a difference in revenue. Differences between TD's and Siskiyou's estimates are described below.

Siskiyou's estimate of total company Local Network Service Revenues at $1,191,500 is $20,556 lower than TD's estimate at $1,212,056. The Local Network Service revenues are derived from basic local exchange telephone service. In determining the test year total company Local Network Service revenues, Siskiyou forecasted each revenue account either by utilizing historical growth information, regression analysis or judgment. In the case of its Basic Area Revenues account, defined as basic local exchange flat and measured rate services, Siskiyou annualized four months of 2005 revenues to forecast the 2006 amount, and made an assumption that reduction in access lines seen from 2004 to 2005 would continue leading to reduced revenues in 2006. The company indicated that much of the increases that Siskiyou had in access lines for years prior to 2002 were in second lines to existing customers. Siskiyou found that one of the main reasons for the increase in second lines was a way for customers to access the internet during this time period. The last three years, and what the company believes is expected to occur in the future, show a drop or no growth in access lines because customers have dropped their second lines and instead, are using Digital Subscriber Line (DSL) to access the internet.

Based on field inspection and the most current six months 2005 revenue data available, TD does not foresee any significant growth in the number of access lines for the 2006 test year. However, TD believes that utilizing a historical revenue trend of three years, beginning with the year in which access lines began its decline, would provide a more accurate forecasting methodology because it would reflect the current condition and trend facing the company. TD's calculation of a three-year average growth rate for 2001-2004 on the Basic Area Revenue account results in an average rate decline of -0.23%. Based on forecasting the revenue account with the -0.23% average rate, TD now recommends a 2006 test year Basic Area Revenue of $1,022,256, which is $7,256 or 0.71% greater than Siskiyou's current proposal of $1,015,000.

TD does not concur with Siskiyou's methodology of forecasting the Other Local Revenues account. The company annualized four months 2005 revenues and made an assumption from reducing trends to estimate test year revenues of $118,000 for the Other Local Revenues account. TD however believes that the use of the regression methodology to forecast test year revenues would be more accurate for this account because the regression analysis produced a very high coefficient of determination of 97%. The coefficient of determination measures the strength of the relationship between the actual historical access lines and time. A coefficient of determination closer to one (100%) indicates a greater degree of relationship; while a coefficient of determination closer to zero indicates a lesser degree of relationship. Therefore, with such a high coefficient of correlation, TD recommends forecasting based on the regression methodology, which results in a 2006 test year Other Local Revenues of $131,300.

For the Directory Revenues account, although the historical trend in 2001-2004 shows a steady decline, Siskiyou believes that the directory revenues will increase in the future as shown from the 2005 four months revenue data annualized. Based on the company's assumption, Siskiyou forecasted test year Directory revenues at $51,000. TD's assumption of forecasting directory revenues is similar to Siskiyou but provides a more accurate projection of the revenues for 2005 and 2006. TD annualized six months (instead of four months) of 2005 Directory revenues that resulted in $55,998. TD believes that in the absence of historical trends, forecasting the test year revenues based on utilizing most recent data available would more closely reflect future projections. Therefore, TD recommends a 2006 test year Directory revenues of $55,998.

Expense

Siskiyou's estimate of total company operating expenses of $5,436,144 (less depreciation, amortization and taxes) is greater than TD's estimate of $5,059,931 by $376,213 or 7.44%. A comparison of TD's and Siskiyou's estimates of total company operating expenses for test year 2006 is shown in Appendix B. Differences between TD's and Siskiyou's estimates are described below.

For operating expenses, Siskiyou used 1999-2004 actual expense data and ran regression analysis on each account, and estimated the 2005 and 2006 expenses based on the regression analysis. The expense accounts are separated into four general categories. These categories are Plant Specific, Plant Non-Specific, Customer Operations and Corporate Operations. Within each of these are sub-accounts that are separated into each of the components, such as payroll, benefits and rents. Siskiyou then included an additional expense column to indicate the need for additional staff in 2006, as Siskiyou management indicated that they could not continue with the existing personnel counts.

TD however disagrees with Siskiyou's regression analysis. Twelve out of fifteen expense accounts regressions had coefficient of determination results that were too low (4.27% to 73.02%) for TD to accept. TD therefore provides a more detailed methodology in forecasting the test year expenses. First, TD reviewed each sub-account and made ratemaking adjustments where appropriate to each of the historical expense accounts. TD removed any expenses that were one-time occurrences, as well as expenses that were associated with newly non-regulated services such as internet and DSL services. Siskiyou currently keeps expenses related to internet and DSL separate from expenses for regulated services. After minimizing the expense fluctuations in the historical trends, TD then examined several forecasting methodologies, such as utilizing regression analysis, the Constant Dollar Methodology, as well as utilizing growth averages. TD determined the yearly percentage growth rate change for the recorded expenses for the three periods from 2001-2004. TD then calculated a three-year growth average from the three periods, and applied the three-year average rate to the 2004 recorded expenses to forecast the 2006 test year expense. TD chose a three-year average growth rate because three years is a reasonable length of time to normalize large fluctuations outside of the ratemaking adjustments, and TD also believes that utilizing three data points to forecast from historical data is both recent and sufficient enough to produce an accurate forecast.

Siskiyou included six additional staff positions in the amount of $498,867 for its 2006 test year because the company believes that they could not continue with the existing personnel counts. TD's initial review of the staff additions showed that there are two staff positions that should not be allowed in the test year expense. The first staff addition is an Installer Repairman position whose primary responsibility is for installing and repairing DSL and internet services. The total annual labor cost is expected to be $95,930 for this employee. The other staff addition is a Chief Technician position, with an expected annual labor cost of $81,078, whose primary responsibility is related to DSL and Internet Protocol services. TD believes that these positions should be excluded from the test year expense because the purpose for the two staff additions is to address Siskiyou's non-regulated services (DSL and Internet). The FCC recently indicated that States do not regulate rates for DSL services. TD believed that Siskiyou can continue maintaining its regulated operations with four of the six staff additions requested, and therefore, TD estimates 2006 test year staff additions of $321,859 for the four new positions. After considering the comments, the two technicians were included. (See discussion on page 13.)

Based on forecasting the test year expense with a three-year average growth rate for each of the four major accounts, Plant Specific, Plant Non-Specific, Customer and Corporate Operations, and including adjustments to the staff additions, TD now recommends a 2006 test year intrastate expense of $3,611,142 (less depreciation), which is $220,037 or 5.74% lower than Siskiyou's current proposal of $3,831,179 (less depreciation). This estimate includes the $40,000 amortization of the rate case expense in the corporate operations expense that was requested in Siskiyou's comments.

Taxes

The differences in the tax estimates between Siskiyou and TD are due to differences in each party's estimate of income, revenues and expenses including interest expense. TD and Siskiyou both used a Corporate State Franchise Tax (CCFT) rate of 8.84% and a federal income tax rate of 34.00%. TD calculated taxes with a different deduction for interest reflecting the imputed capital structure as discussed below.

TD calculated an interest expense for taxes based on the weighted cost of debt multiplied by the rate base. The weighted cost of debt was the 40 percent debt multiplied by the estimated cost of debt of 7.30%. However the Draft Resolution (DR) inadvertently included the original interest deduction estimated by Siskiyou and did not have the adjustment. This was corrected in this final resolution. In addition in response to Siskiyou's comments the recorded cost of debt of 6.3% was used in the calculation.

Rate Base

Siskiyou hired a consultant to review the outside plant and design an integrated, modern telephone system. Outside plant is a portion of the total plant for Siskiyou. While Siskiyou was planning to hire the consultant during the prior general rate case review, it did not have any estimates of the amount nor the timing of payments to the consultant. Therefore, Siskiyou did not make a request for this expense for its last test year, 2003. The timing was such that the consultant was paid all the payments during 2003 in the amount of approximately $375,000. This payment by Siskiyou was enough to reduce the intrastate rate of return for the test year significantly. Because Siskiyou began the more aggressive plant investments, the rate base increased which subsequently further depressed its intrastate rate of return.

Much of Siskiyou's current outside plant is old and obsolete. There are some bottlenecks and problems in this plant. The consultant recommended replacing much the outside plant to bring the plant and transport to modern standards, and have DSL available to all customers. Siskyou's service area is rural with rough terrain and extreme seasonal weather conditions make construction expensive. The consultant had recommended implementing the plant replacement over an eight year period beginning in 2003. The consultant's estimate for the total recommended plant replacement is over $26 million. Siskiyou has extended the replacement period from 10 to 15 years[2]. If the $26 million is spread evenly over 15 years it would be about $1.75 million per year. TD believes that a 15-year outside replacement program is more reasonable. Nevertheless this is a very large investment for the small number of customers Siskiyou serves.

Siskiyou began its outside plant upgrade in 2003 and chose to use existing cash flow to fund the plant additions (internally generated funds). Siskiyou did not wish to finance the plant additions with debt as they believed the Commission had wanted the amount of debt reduced. In 2003, the Town of Etna was replacing its sewer system and the streets had to be excavated. Siskiyou realized that by sharing the trenching costs with the town, it could save considerable expense in construction and restoration of pavement costs. Consequently, Siskiyou began the consultant recommended plant replacement program in Etna.

Siskiyou, by having a coherent design plan for the entire system, could save money and reduce problems in the future. When areas of the outside plant need to be replaced, they are often designed on a piecemeal basis. The overall system design may not be properly integrated. Since Siskiyou has a whole system design, any outside plant replacement is expected to fit into the overall design.

This is a very aggressive plant investment program for a small telephone utility with only about 4,700 customers. The proposed plant investment for 2005 is over $10 million. The estimated plant additions for test year 2006 total over $8.5 million. The plant additions for 2004 totaled $2,147,600. Many utilities have large plant additions during periods of growth; however, Siskiyou is not experiencing growth and may be facing declining numbers of access lines.

TD reviewed the capital budgets and justification for 2005 and 2006. The justifications were reasonable and the requested plant additions are needed. However, there should be some practical limitation on investment for the small number of customers.

The outside plant -- cable and wire facilities additions total over $7.5 million. There are other plant additions that are needed. In the 2006 budget Siskiyou projects cable and

[2] Telephone conversation with Jim Lowers on October 14, 2005.

wire facilities additions of $4.4 million. Also in 2006, Siskiyou needs to replace the system-wide microwave radio facilities for $2,087,100. The current microwave system is obsolete and parts are not available. Siskiyou has been able to buy salvage units to keep its current system operating, but this cannot continue for very long.

TD reviewed historical plant additions and determined that the historical average of plant addition in current dollars was about $4 million per year. The plant additions have varied greatly from year to year. In 2004 the plant additions were below the average partly due to the curtailment of investment and expenses when faced with a lower intrastate rate of return. TD started with the average of $4 million and then added an amount for the plant replacement program and to make up some for the curtailed investment from the past year.

TD chose not to evaluate each project and thus micromanage the plant replacement program for the company. Nevertheless, TD believed that the plant additions were too extensive for the current conditions; particularly as Siskiyou has come in a year early for a GRC rate review. TD wanted to give Siskiyou guidance on the level of plant additions while trying to trying to balance the need for upgraded plant with the amount of investment per customer over time. To achieve this TD used the historical plant addition amount and added an amount for the outside plant replacement and an amount to represent deferred additions from the past year. The difference was then rounded.

Therefore, TD reduced the 2005 additions by $2,050,000 and an additional $150,000 reduction for plant additions related to unregulated DSL. Siskiyou had indicated that in their plant accounting, any plant related to interstate or information service is not charged the California regulated expense. Although DSL service is beneficial for customers, particularly in rural service areas such as Siskiyou's, the FCC recently classified DSL as an information service and is therefore not regulated. Many of the facilities are used both for transport and DSL or are equipment that serves as both a concentrator and for DSL. After considering the comments, the $150,000 was restored to the plant additions. (See discussion of comments on page 13.)

For 2006, TD reduced the plant additions by $1,000,000. TD made the adjustments to the Telephone Plant Under Construction account so that the adjustments would not be tied to any particular project or affect any account and associated depreciation reserve. In this manner, Siskiyou can prioritize the construction and complete what it believes are the most critical and cost effective projects.

Siskiyou estimated Materials and Supplies based on a percentage of the total plant. This is a reasonable method since the inventory of parts and supplies usually increases with the plant. However, TD used a smaller percentage of the plant based on historical experience to estimate Materials and Supplies for the test year. As the older plant is replaced with newer plant the ratio of materials and supplies should decrease. Much of the materials and supplies are needed to have inventory for replacing failed components. As the plant is replaced the need for maintenance should decrease.

Siskiyou used a simplified method for calculating working cash for 2006 based on Commission standard practice U-16. Since it is based on expense levels the model should calculate the working cash with the staff estimates for expenses.

Separations

Siskiyou provides both intrastate and interstate telecommunications services, subject to the regulation of the CPUC and FCC, respectively. Because Siskiyou's property serves both jurisdictions, the utility's revenues, expenses, taxes, investments, and reserves are allocated between interstate and intrastate services.

Separations is the process of apportioning a telephone company's property costs, related reserves, operating expenses and taxes, and revenues between the state and interstate jurisdictions. It is a method by which a telephone company can separately identify the amount of expenses and investments associated with the production of a given service. These apportionments are made on the basis of relative usage and direct assignment whenever possible. The costs to be apportioned are identified in the FCC Part 36 separations manual, according to the classification of accounts as prescribed by the FCC's Part 32, Uniform System of Accounts (USOA) for Telecommunications Companies.

TD has examined Siskiyou's separation factors and finds them reasonable. Siskiyou used the factors from the most recent recorded year. TD considered using averages over three or five years, but in the majority of cases the differences were very slight. Therefore, TD used the separation factors provided by the company to separate its estimates of total company expenses and plant to derive TD's estimate of Siskiyou's intrastate results of operations.

Appendix B compares Siskiyou's and TD staff's interstate and intrastate results of operations for test year 2006 using these separation factors, where applicable.

Cost of Capital

Siskiyou requests an overall intrastate rate of return of 10.00%, the rate of return authorized under Resolution T-16707 for the 2003 test year and T-16006 for its 1997 test year.

TD believes that the Return on Equity (ROE) for all rural ILECs would be the same since the systematic and non-diversifiable risks faced by all rural ILECs are similar. However, as a matter of practice, D.97-04-036 in A.95-12-073[3] adopted an 'overall' rate of return of 10.00% for all rural ILECs. Based on information provided, TD recommends that the Commission approve Siskiyou's request for an overall rate of return of 10.00% at this time. This approval should not set a precedent for any future or pending small ILEC GRC proceeding.

Siskiyou has a capital structure with about 14.14% debt and 85.86% equity. This appeared to TD to be too high of an equity ratio. The prior resolution T-16707 did not mention the capital structure which was 18.56% debt. TD discussed this with Siskiyou and found that Siskiyou relied on a statement in Resolution T-16006 which noted that:

> However we do find STC's [Siskiyou's] proposed common equity ratio is at the low end of the reasonable range of common equity for small telephone companies, providing a reasonable balance of benefits between customers and shareholders (customers with a reduced revenue requirement for the company as a result of reduced income tax expense and shareholders with an additional source of funding for capital expenditures).

At that time Siskiyou's equity was at 59.47% with a return on equity of 12.56% which was within the range for ROE for other decisions. Subsequent to this resolution, Siskiyou has reduced its debt. A comparison of other small LECs in California reveals a range of debt ratios. TD believes that the statement in Resolution T-16006 is mistaken and it is not in the best long-term interest of the ratepayers for Siskiyou to pursue what could ultimately become a 100% equity capital ratio.

The statement of a reasonable range for equity implies that there is both a low end and a high end for the range. Return on equity is more costly to the ratepayers because there is income tax due on the gross return. Rate payers pay more on a high equity company while a high debt company faces higher risks. In intermediated range such as about 50% equity and 50% debt will provide a better balance of risk and return.. We realize that there are many factors that affect the ratio of equity of debt and the attempt to optimize it for the benefit of ratepayers. With too much debt there is higher risk which may result in higher debt cost. With too much equity the cost of the return on equity is high. Siskiyou must have $1.66 of gross revenue to provide $1.00 of net income after taxes. Since interest on debt is deductible from income for tax purposes on a dollar per dollar basis, the effect on gross revenue is less than for a return on equity.

The availability of debt depends on the creditworthiness of the company. Siskiyou appears to be a creditworthy company. Companies will increase debt when they have

[3] In D. 97-04-036 the Commission authorized California-Oregon Telephone Company a 10.00% return on rate base for its 1997 test year as requested in A. 95-12-073 (California-Oregon's 1997 General Rate Case application).

capital expansion programs or if interest rates decline. Siskiyou has had both of these conditions. When expanding plant investment, the source of funds can be increased debt or increased investment in equity. Many companies will issue additional stock to raise capital. Small telephone utilities are privately held corporations and tend not to issue additional stock.

Siskiyou has indicated that it is expecting to redeem its RTB stock and will use these funds for the capital improvement program. Additionally, Siskiyou is attempting to sell its interest in a wireless telecommunications company and plans to use these funds for the capital improvement program. Both of these will increase the equity ratio for the company. TD believes that the company should increase the amount of debt to achieve a better balance of benefits between ratepayers and shareholders.

Because of these market conditions with regard to interest rates, TD believes that a capital structure of 40% debt and 60% equity would be beneficial to the rate payers and will impute that capital structure on the company. This will increase the interest deduction and reduce the income taxes.

The debt for Siskiyou includes Rural Telephone Bank Stock. Resolution T-16006, Ordering Paragraph 8 states:

> 8. When The Siskiyou Telephone Company redeems any Rural Telephone Bank stock, it shall file an application with this Commission to request a determination for the gain on the redemption of the Rural Telephone Bank Stock.

While Siskiyou stated that it plans to invest the proceeds from the stock redemption in the capital improvement program, there are still issues that may need to be addressed including the equity ratio as the redemption of the stock will reduce the debt. Siskiyou should file the application as ordered in Resolution T-16006.

Net-to-Gross Multiplier

The net-to-gross multiplier indicates the unit change in gross revenues required to produce a unit change in net revenues. Appendix D shows TD’s computation of Siskiyou’s net-to-gross multiplier. The net-to-gross multiplier of 1.66207 means that a change of $1.66207 in gross revenue would be required to produce a change of $1.00 in net revenue. For Siskiyou, based on an adopted state rate base of $18,868,263 and an adopted rate of return of 10%, the adopted intrastate revenue requirement change is an increase of $2,276,805.

CHCF-A Support

Siskiyou's CHCF-A support for test Year 2006 at present rates of $2,435,559 was derived using Siskiyou's 2005 draw of $2,165,535, adding the $2,008,218 projected USF Federal support for 2002 then deducting Siskiyou's projected 2006 USF Federal support of $1,738,194.[4]

Siskiyou had included an additional calculation at the end of the net to gross calculation that would add $40,000 to amortize costs of this general rate case. When the higher amount is included, the rate of return for Siskiyou would exceed 10.00%. The $40,000 of amortized rate case expense should be included in the corporate operations expense.

The intrastate results of operations at present rates show that Siskiyou registers an intrastate rate of return of 2.74% (Appendix B, column F).

Appendix C shows Siskiyou's intrastate results of operations using the 10.00% intrastate rate of return.

For test year 2006, TD 's computation of Siskiyou's CHCF-A requirement is $4,712,364 based on TD's projected revenues (including rate design), expenses, rate base and overall intrastate rate of return of 10%

Comments

The draft resolution of the Telecommunications Division on this matter was mailed to the parties in accordance with PU Code Section 311 (g)(1).

Siskiyou filed timely comments. Siskiyou pointed out an error in the difference of revenues on Appendix A and also requested that since TD used the revised depreciation study factors in calculating depreciation that the resolution should address the reasonableness of the revised depreciation study.

Siskiyou also objected to the disallowance of the amortized expense of the rate case which is $40,000 per year.

Siskiyou commented that the resolution improperly disallows a portion of Siskiyou's investment and expenses on the basis that they are related to unregulated DSL based on the FCC order. However, Siskiyou points out in its comments that while facilities based carriers are permitted to offer broadband internet service on a non-regulated basis that

[4]Based on Data provided by the National Exchange Carrier Association Inc. on October 14, 2005.

the order permits wireline companies to continue to provide broadband services on a regulated common carrier basis. Siskiyou plans to offer its DSL service on a regulated interstate service and will bill through a NECA tariff. Siskiyou claims that since the FCC decision permits wireline carriers to offer broadband (DSL) on a regulated basis that it should continue to offer the service and rely on the separations process to continue to keep the costs and investments separate following the guidelines of FCC Part 36 separation rules.

The resolution also disallows two employees who would do some DSL and internet related work. The staff mistakenly believed that these two employees would primarily work on DSL related work. Siskiyou labeled the employees as DSL technicians because they need to have knowledge of DSL and packet switching. Nevertheless, they will also work on switching and network services. The expense of these employees will be allocated to interstate (DSL) and intrastate expense based on the FCC Part 36 allocation procedures.

On the issue of capital structure, Siskiyou states that the Commission has historically adopted a rate of return of 10% for small ILECS and continues to adopt this ROR in this case regardless of the capital structure of the company. By adopting a ROR and then specifying a capital structure, the DR improperly backs into outcomes that do not have adequate justification. The Commission has focused on overall ROR and must necessarily forgo the analysis necessary for a particular capital structure and the debt/equity ratios.

The DR compounds this fundamental methodological problem by reversing years of precedent and suggesting that a 40-60 debt/equity ratio is now the preferred capital structure. No authority is cited for this finding. This reverses a finding in 1997 that Siskiyou's equity level was too low at approximately 60%.

Siskiyou requests that the discussion of requirement of resolution T-16006 for Siskiyou to file an application to consider the redemption of RTB stock be eliminated from the draft resolution.

In response to the comments, TD corrected the errors and included the amortization of the rate case expense. TD had reviewed the updated depreciation study provided in the workpapers and found it to be reasonable.

Since the FCC separations process would properly account for the investment categorization as interstate and intrastate, the $150,000 of investment related to interstate DSL service was restored.

The two technicians that would have knowledge of DSL service were restored to the expenses since the allocation of the expense would be based on the FCC Part 36 separation process. Since these employees are in plant-specific expenses, the allocation method is based on the plant separation process under Part 36.

The capital structure was not adjusted based on Siskiyou's comments. TD believes that there is an optimal capital structure that balances the higher cost of equity with the risk of increased debt. Siskiyou should have an incentive to move toward that capital structure. However, the cost of debt will be reduced to reflect Siskiyou's current cost of debt.

The discussion of the redemption of the RTB stock while somewhat related to the capital structure is nevertheless more concerned with the disposition of the gain on sale of the stock. Therefore, we will leave the discussion in the resolution.

We find TD's current revisions and estimates reasonable.

Commission approval is based on the specifics of this Advice Letter and does not establish a precedent for the contents of any future filings by small ILECs.

Findings

1. Siskiyou filed its GRC on July 15, 2005, with a Test Year of 2006.

2. Siskiyou requests the following for test year 2006:

    - No change in its rates and charges,
    - An intrastate rate of return of 10.00%, the same return granted to them in their 2003 test year, and
    - An increase in its CHCF-A draw for 2006 by 143% or $3,098,032 for a 2006 CHCF-A support of $5,263,567.

3. The Telecommunications Division recommends the following for Siskiyou for test year 2006:

    - No changes in its rates or charges;
    - A total intrastate rate base amount of $18,868,263;
    - An Intrastate Rate of Return of 10.00%;
    - A capital structure reflecting 40% debt;
    - A revenue requirement increase of $2,276,805 over present rates; and
    - A California High Cost Fund-A (CHCF-A) support of $4,712,364.

4. The differences in the estimates of Siskiyou and TD result from the use of different methodologies and assumptions for estimating revenues, expenses, and rate base.

5. We find TD's methodology of using the average growth rates in estimating expenses reasonable and adopt TD's recommended test year 2006 expenses contained in Appendix A.

6. We find TD's methodology in estimating revenues reasonable. We therefore, adopt TD's recommended intrastate revenues as shown in Appendix C.

7. Siskiyou should file an application to consider the redemption of RTB stock as ordered in Resolution T-16006.

8. We accept TD's recommended overall rate of return of 10.00% for Siskiyou.

9. The capital structure of Siskiyou should include more debt. We are imputing a ratio of 40% debt and 60% equity for test year 2006 for ratemaking purposes.

10. We find TD's recommended $4,712,364 CHCF-A support for Siskiyou for 2006 acceptable. The $4,712,364 CHCF-A support is based on our adoption of TD's Intrastate Results of Operations for Siskiyou for test year 2006.

THEREFORE, IT IS ORDERED that:

1. The intrastate revenues, expenses, and rate base amounts for test year 2006 identified in Appendix C, column (e) are adopted for The Siskiyou Telephone Company.

2. The overall intrastate rate of return of 10.00% is adopted for Siskiyou for test year 2006.

3. A capital structure of 40% debt and 60% equity is adopted for Siskiyou for ratemaking purposes.

4. Siskiyou Telephone Company's CHCF-A draw for 2006 shall be $4,712,364.

This Resolution is effective today.

I hereby certify that this Resolution was adopted by the Public Utilities Commission at its regular meeting on January 26, 2006. The following Commissioners approved it:

STEVE LARSON
Executive Director

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Appendix A
Siskiyou Telephone Company
Total Company Results of Operations
At Present Rates
Test Year 2006

		Siskiyou	TD	Utility Exceed Staff Amount	Percentage Difference
		(a)	(b)	(c)=a-b	(d)= c/b
	OPERATING REVENUES:				
1	Local Network Services	1,191,500	1,212,056	(20,556)	-1.70%
2	Local Services - CHCF-A	2,165,535	2,435,559	(270,024)	-11.09%
3	Interstate USF	2,008,218	1,738,194	270,024	15.53%
4	Long Distance Network	96,577	96,577	-	0.00%
	Network Access Svces:		-		
5	Intrastate	1,080,000	1,080,000	-	0.00%
6	Interstate	4,242,546	4,242,546	-	0.00%
7	Miscellaneous	186,113	191,111	(4,998)	-2.62%
8	LESS: Uncollectible Rev.	(42,827)	(42,827)	-	0.00%
9	Total Oper. Revenues	10,927,662	10,953,216	(25,554)	-0.23%
	OPERATING EXPENSES:				
10	Plant Specific	2,089,699	2,073,781	15,918	0.77%
11	Plant NSpecific (less depr.)	940,795	739,912	200,883	27.15%
12	Depreciation & Amortization	3,474,769	3,369,709	105,060	3.12%
13	Customer Operations	545,850	541,203	4,647	0.86%
14	Corporate Operations	1,859,800	1,705,034	154,766	9.08%
15	Total Oper. Expenses	8,910,913	8,429,640	481,273	5.71%
	OPERATING TAXES:				
16	Operating State Inc. Taxes	137,433	148,406	(10,973)	-7.39%
17	Operating Fed Income Taxes	481,860	520,333	(38,473)	-7.39%
18	Taxes Other Than Inc.(AFUDC)	233,681	214,480	19,201	8.95%
19	Total Operating Taxes	852,974	883,219	(30,245)	-3.42%
20	Net Operating Revenue	1,163,775	1,640,357	(476,582)	-29.05%
	RATE BASE (Beginning + End of Year Average)				
21	Telephone Plant-in-Service	58,592,924	56,042,924	2,550,000	4.55%
22	Tel. Plt Under Construction	309,034	309,034	-	0.00%
23	Mat & Supplies	570,480	490,000	80,480	16.42%
24	Working Cash	698,092	664,327	33,765	5.08%
25	Less: Deprec. Res.	(31,789,650)	(31,676,337)	(113,313)	0.36%
26	Def. Taxes	57,952	57,952	-	0.00%
27	Customer Deposit	(277)	(277)	-	0.00%
28	RTB Stock	591,700	591,700	-	0.00%
29	Total Rate Base	29,030,255	26,479,323	2,550,932	9.63%
			-		
30	Rate of Return	4.01%	6.19%		

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Appendix B
Siskiyou Telephone Company
Results of Operations At Present Rates
Interstate and Intrastate
Test Year 2006

		Siskiyou			TD		
		Subject To Separations (a)	Interstate (b)	Intrastate (c)	Subject To Separations (d)	Interstate (e)	Intrastate (f)
OPERATING REVENUES:							
1	Local Network Services	1,191,500		1,191,500	1,212,056	-	1,212,056
2	Local Services - CHCF-A	2,165,535		2,165,535	2,435,559	-	2,435,559
3	Interstate USF	2,008,218		2,008,218	1,738,194	-	1,738,194
4	Long Distance Network	96,577		96,577	96,577	-	96,577
	Network Access Svces:						
5	Intrastate	1,080,000		1,080,000	1,080,000	-	1,080,000
6	Interstate	4,242,546	4,242,546	-	4,242,546	4,242,546	-
7	Miscellaneous	186,113	987	185,126	191,111	987	190,124
8	LESS: Uncollectible Rev.	(42,827)		(42,827)	(42,827)	-	(42,827)
9	Total Oper. Revenues	10,927,662	4,243,533	6,684,129	10,953,216	4,243,533	6,709,683
OPERATING EXPENSES:							
10	Plant Specific	2,089,699	644,127	1,445,572	2,073,781	639,220	1,434,561
11	Plant NSpecific (less depr.)	940,795	302,127	638,668	739,912	237,615	502,297
12	Depreciation & Amortization	3,474,769	1,010,028	2,464,741	3,369,709	979,490	2,390,219
13	Customer Operations	545,850	107,864	437,986	541,203	106,946	434,257
14	Corporate Operations	1,859,800	550,847	1,308,953	1,705,034	465,007	1,240,027
15	Total Oper. Expenses	8,910,913	2,614,993	6,295,920	8,429,640	2,428,279	6,001,361
OPERATING TAXES:							
16	Operating State Inc. Taxes	137,433	132,233	5,200	148,406	139,400	9,006
17	Operating Fed Income Taxes	481,860	463,631	18,229	520,333	488,757	31,576
18	Taxes Other Than Inc.(AFUDC)	233,681	69,408	164,273	214,480	63,705	150,775
19	Total Operating Taxes	852,974	665,272	187,702	883,219	691,862	191,357
20	Net Operating Revenue	1,163,775	963,268	200,507	1,640,357	1,123,392	516,965
AVERAGE RATE BASE							
21	Telephone Plant-in-Service	58,592,924	17,404,501	41,188,423	56,042,924	16,647,046	39,395,878
22	Tel. Plt Under Construction	309,034	91,795	217,239	309,034	91,795	217,239
23	Mat & Supplies	570,480	149,707	420,773	490,000	128,587	361,413
24	Working Cash	698,092	436,474	261,618	664,327	405,258	259,069
25	Less: Deprec. Res.	(31,789,650)	(9,897,231)	(21,892,419)	(31,676,337)	(9,861,952)	(21,814,385)
26	Def. Taxes	57,952	24,685	33,267	57,952	24,685	33,267
27	Customer Deposit	(277)	(118)	(159)	(277)	(118)	(159)
28	RTB Stock	591,700	175,759	415,941	591,700	175,759	415,941
29	Total Rate Base	29,030,255	8,385,572	20,644,683	26,479,323	7,611,060	18,868,263
30	Rate of Return	4.01%	11.49%	0.97%	6.19%	14.76%	2.74%

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Appendix C
Siskiyou Telephone Company
Intrastate Results Of Operations
At Adopted Rates
Test Year 2006

		Siskiyou Proposed (a)	TD Proposed (b)	Utility Exceed Staff Amount (c)=a-b	Percentage Difference (d)	Adopted (e)
OPERATING REVENUES:						
1	Local Network Services	1,191,500	1,212,056	(20,556)	-1.70%	1,212,056
2	Local Services - CHCF-A	5,263,567	4,712,364	551,203	11.70%	4,712,364
3	Interstate USF	2,008,218	1,738,194	270,024	15.53%	1,738,194
4	Long Distance Network	96,577	96,577	-	0.00%	96,577
	Network Access Svces:					
5	Intrastate	1,080,000	1,080,000	-	0.00%	1,080,000
6	Interstate	-	-	-		-
7	Miscellaneous	185,126	190,124	(4,998)	-2.63%	190,124
8	LESS: Uncollectible Rev.	(42,827)	(42,827)	-	0.00%	(42,827)
9	Total Oper. Revenues	9,782,161	8,986,488	795,673	8.85%	8,986,488
OPERATING EXPENSES:						
10	Plant Specific	1,445,572	1,434,561	11,011	0.77%	1,434,561
11	Plant NSpecific (less depr.)	638,668	502,297	136,371	27.15%	502,297
12	Depreciation & Amortization	2,464,741	2,390,219	74,522	3.12%	2,390,219
13	Customer Operations	437,986	434,257	3,729	0.86%	434,257
14	Corporate Operations	1,308,953	1,240,027	68,926	5.56%	1,240,027
15	Total Oper. Expenses	6,295,920	6,001,361	294,559	4.91%	6,001,361
OPERATING TAXES:						
16	Operating State Inc. Taxes	279,065	210,275	68,790	32.71%	210,275
17	Operating Fed Income Taxes	978,446	737,258	241,188	32.71%	737,258
18	Taxes Other Than Inc.(AFUDC)	164,273	150,775	13,498	8.95%	150,775
19	Total Operating Taxes	1,421,784	1,098,308	323,476	29.45%	1,098,308
20	Net Operating Revenue	2,064,457	1,886,819	177,638	9.41%	1,886,819
RATE BASE (Beginning + End of Year Average)						
21	Telephone Plant-in-Service	41,188,423	39,395,878	1,792,545	4.55%	39,395,878
22	Tel. Plt Under Construction	217,239	217,239	-	0.00%	217,239
23	Mat & Supplies	420,773	361,413	59,360	16.42%	361,413
24	Working Cash	261,618	259,069	2,549	0.98%	259,069
25	Less: Deprec. Res.	(21,892,419)	(21,814,385)	(78,034)	0.36%	(21,814,385)
26	Def. Taxes	33,267	33,267	-	0.00%	33,267
27	Customer Deposit	(159)	(159)	-	0.00%	(159)
28	RTB Stock	415,941	415,941	-	0.00%	415,941
29	Total Rate Base	20,644,683	18,868,263	1,776,420	9.41%	18,868,263

30	Rate of Return	10.00%	10.00%	10.00%

Appendix D
Siskiyou Telephone Company
Adopted Net-To-Gross Multiplier
Intrasate Revenue Requirement And CHCF-A Support

1	Gross Revenues		1.00000
2	Uncollectibles(None as CHCF-A is source)		-
3	Net Revenues		1.00000
4	State Income Tax (Tax Rate times ln 3.)	8.84%	0.08840
5	Federal Taxable Income(ln 3. less ln 4.)		0.91160
6	Federal Income Tax (Tax Rate time ln 5.)	34.00%	0.30994
7	Net Income (ln 5. less ln 6.)		0.60166
8	**NET TO GROSS MULTIPLIER (ln 1. divided by ln 7.)**		**1.66207**
	Intrastate Revenue Requirement		
9	Adopted State Rate Base		18,868,263.0
10	Net Revenues Adopted at 10.00% ROR (ln 9. times 10%)		1,886,826
11	Net Revenues at present rates		516,965
12	Change in net revenues (ln 10. less ln 11.)		1,369,861
13	**GROSS REVENUE CHANGE REQUIRED (ln 12. times ln 8.)**		**2,276,805**
	CHCF-A Support		
14	2006 CHCF-A Support at present rates		2,435,559
15	**2006 CHCF-A Support Request**		**4,712,364**
16	Recovery of Rate Case Expenditures (3-year amortization)		-
17	**Adjusted 2006 CHCF-A Support Request**		**4,712,364**