Witness OCS - 1D Ostrander

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Carbon/Emery Telcom's Application for Increase in Utah Universal Service Fund Support	)))))))	**Docket No. 15-2302-01** **Direct Revenue Requirement Testimony of Bion C. Ostrander For the Office of Consumer Services**

NON-CONFIDENTIAL – REDACTED VERSION

August 21, 2015

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Bion C. Ostrander. I am an independent regulatory consultant and have maintained an uninterrupted permit to practice as a Certified Public Accountant ("CPA") in the State of Kansas since 1990.[1] I am President of Ostrander Consulting. My business address is 1121 S.W. Chetopa Trail, Topeka, Kansas 66615-1408.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS AND EXPERIENCE.

A. I am an independent regulatory consultant with a specialization in telecommunications regulatory accounting and policy issues. I have over thirty-five years of regulatory and accounting experience. My firm Ostrander Consulting has been operating for twenty-four years. I previously worked for the public accounting firm Deloitte, Haskins and Sells (now "Deloitte"). And before starting my own firm, I previously served as the Chief of Telecommunications and the Chief Auditor for the Kansas Corporation Commission. I have addressed issues in numerous state jurisdictions and an international basis. I have addressed rate cases alternative regulation plans, state universal service funds, affiliate transactions, cost allocation,

[1] Mr. Ostrander's current permit to practice it pending renewal subject to meeting the continuing professional education hours requirement in Kansas. Mr. Ostrander does not provide any services that "require" a permit to practice, this is maintained primarily for credential purposes.

wholesale and retail cost studies, compensation issues, taxes, universal service, specialized regulatory accounting issues, competition policy, and many other matters.

Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached OCS Exhibit 1D-1, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Ostrander Consulting (and subcontractor David Brevitz) were retained by the Utah Office of Consumer Services ("OCS") to review Carbon/Emery Telcom ("CT", "Carbon", or "Company") revenue requirements regarding its application for increased Utah Universal Service Funds ("UUSF"). Accordingly, I am appearing on behalf of the OCS.

Q. HAVE YOU EVER TESTIFIED BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH ("COMMISSION" or "PSC")?

A. Yes. I filed direct, rebuttal, and surrebuttal testimony on behalf of the OCS in Manti Telephone Company's request for UUSF in 2012,[2] and appeared as a witness before this Commission. In addition, I have assisted and

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[2] In the Matter of the Application for the Increase of Rates and Charges by Manti Telephone Company, Docket No. 08-046-01.

advised the OCS in UUSF applications by other rural local exchange companies ("RLECs"), although I did not file testimony or appear as a witness in these other cases which were ultimately resolved through stipulation.[3] A list of other prior UUSF proceedings in which I assisted the OCS is listed below:

- ✓ Manti Telephone Company – Docket No. 08-046-01
- ✓ Manti Telephone Company – Docket No. 13-046-01
- ✓ Hanksville Telephone Company – Docket No. 14-2303-01
- ✓ Beehive Telephone Company – Docket No. 14-051-01
- ✓ Emery Telephone Company – Docket No. 14-042-01

Q. DO YOU HAVE EXHIBITS SUPPORTING YOUR TESTIMONY?

A. Yes. OCS Exhibits 1D-1 through 1D-5 which is attached to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am addressing policy issues, adjustments, and presenting the overall revenue requirement for Carbon as recommended by the OCS for the test period ending December 31, 2014. The overall revenue requirement also includes rate of return ("ROR") testimony and recommendations of David Brevitz, the other expert witness appearing on behalf of the OCS.

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[3] The OCS was not a signatory to the related stipulation in all of these other UUSF cases.

Q. CAN YOU EXPLAIN THE CURRENT AND PROPOSED INCREASE IN UUSF SOUGHT BY CARBON?

A. Carbon currently receives annual UUSF revenues of $1,038,714 ($86,560 per month), and in this proceeding Carbon is seeking another $816,909, for a total of $1,855,623 in UUSF revenues.[4]

Q. WHAT IS THE OCS RECOMMENDED REVENUE REQUIREMENT AND HOW DOES THIS COMPARE TO CARBON'S POSITION?

A. Carbon's filing shows a revenue requirement deficit of $816,909 and a proposed increase in UUSF revenues of the same amount. The OCS adjustments currently produce a revenue requirement surplus (also called excess earnings/profits) of $1,896,798 ($1.9 m). Because Carbon's excess earnings of $1,896,798 are greater than its combined requested and existing UUSF of 1,855,623 (requested UUSF of $816,909 and existing UUSF of $1,038,714), OCS recommends that Carbon not receive any UUSF funds. However, OCS is not proposing that any remaining excess earnings (over the requested and existing UUSF) be used for any rate reductions or other actions.

[4] Darren Woolsey, Amended Direct Testimony, p. 6, lines 136-138.

OCS is also aware that the Division of Public Utilities ("DPU") is proposing some additional adjustments which the OCS may support or adopt,[5] and this will produce an even greater revenue requirement surplus.

Q. WHAT ADJUSTMENTS ARE YOU PROPOSING?

A. Below is a list of adjustments that I am supporting:

Adjustment BCO-1: Allocate Fiber/Internet-Related Common Costs from Carbon to Emery Telecom Video, LLC ("ETV")/Nonregulated Affiliates

Adjustment BCO-2: Allocate Corporate Overhead Expenses from Carbon to ETV/Nonregulated Affiliates

Adjustment BCO-3: Remove Prepayments from Rate Base

Adjustment BCO-4: Deduct Long-Term Liabilities from Rate Base

Adjustment BCO-5: Remove 50% of Telephone Plant Under Construction (TPUC) from Rate Base

Adjustment BCO-6: Remove 50% of Materials & Supplies ("M&S") from Rate Base

Adjustment BCO-7: Reverse Carbon's Projected Revenue Reduction for Access Line Loss

Adjustment BCO-8: Remove Depreciation Expense on Fully Depreciated Assets

Adjustment BCO-9: Adjust Income Tax Expense and Reflect Interest Synchronization

Q. PLEASE SUMMARIZE THE OCS' FINAL POSITION.

A. After making the adjustments above and reflecting the proposed rate of return ("ROR") of Mr. Brevitz, the OCS' final position shows a significant

[5] In order to be more efficient, the OCS will not sponsor testimony which duplicates some of the adjustments of DPU, and we will support some of those adjustments.

revenue requirement surplus (or excess earnings/profits) for Carbon of $1,896,798, and this means that Carbon should not receive either the additional annual UUSF of $816,909 that it seeks in this proceeding nor its existing annual UUSF of $1,038,714. The primary reason for Carbon's excess earnings,[6] (and which reduces the revenue requirement by about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**) is the Company's excessive allocation of both common internet/fiber plant facility costs and corporate overhead expenses to Carbon operations[7] (and to the other two regulated companies) and the corresponding understatement of the same allocated common costs to ETV and other nonregulated affiliates. Carbon's cost allocation procedures are not consistent or compliant with regulatory best practices and safeguards which are intended to help ensure that a regulated telecom company (such as Carbon) does not subsidize the operations of its nonregulated affiliates (such as ETV). OCS has proposed adjustments that are consistent and compliant with these regulatory best practices that include Section 254(k) of the Federal Telecom Act, Utah Code 54-8b-6, FCC Part 32 Affiliate Transaction Rules, and FCC Part 64 Cost Allocation Procedures.

Per Adjustment BCO-1, Carbon has significant fiber/internet-related facilities on its books that are used by ETV/nonregulated affiliates to provide

[6] This consists of OCS proposed Adjustments BCO-1 and BCO-2.
[7] Along with excessive common cost allocations to the other two regulated RLECs of Emery and Hanksville.

retail internet and other nonregulated services to their customers, yet Carbon is not properly reimbursed by affiliates (or in the alternative, there is not proper allocation of these costs from Carbon to the nonregulated affiliates). Also, from a fairness standpoint, nonregulated affiliates should not be allowed to use the fiber-related facilities of Carbon for free because it is unlikely that Carbon would receive reciprocal treatment and be able to use these same facilities for free if they were transferred to the books of nonregulated affiliates. The affiliate's free use of fiber-related assets on Carbon's books (without even a contract in place) is clearly not consistent with a typical third-party transaction, and it is unlikely that Carbon would make these same fiber-related assets available to third parties under the same free arrangement that is provided to its affiliates.

Per Adjustment BCO-2, the Company substantially overstates the amount of corporate overhead expenses allocated to Carbon (and the regulated RLECs) in the amount of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and it substantially understates the corporate overhead expenses allocated nonregulated affiliates in the same amount. The Company has allocated corporate overhead expenses **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated operations. The OCS adjustment corrects this allocation to some degree and allocates **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to total regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to total nonregulated operations. The Company incorrectly uses the **[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]** as the input to its **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** Allocation Factor to allocate **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of corporate overhead expenses to regulated operations for the related Department cost pools of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.However, the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** is not related to how personnel in these departments spend their time on regulated and nonregulated operations. There is no direct or cost-causative[8] basis for this factor. Instead of using Carbon's **[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]** of corporate overhead expenses to regulated operations for these related Department cost pools, I have used a broad-based general allocator[9] which equally allocates 50% of corporate overhead expenses to both regulated and nonregulated operations for the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** cost pools.[10] Two of the inputs that I have used in my

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[8] FCC Part 64 supports a direct or cost-causative basis for cost allocations.

[9] The broad-based allocator that I recommend uses the Company's billing records as one input, but most importantly it balances this allocation by using inputs for revenues, expenses, net plant in service, and payroll.

[10] Also, for the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** Department cost pool, I have allocated 25% of costs to regulated operations (75% to nonregulated) instead of using the Company's **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocator.

broad-based allocator, Total Revenues and Total Expenses, each support an approximate **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of regulated and nonregulated costs, yet the Company does not even use these two common inputs in any of their allocation factors.

Per Adjustment BCO-8, OCS also proposes a significant adjustment to decrease depreciation expense by **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to remove depreciation expense on some fully depreciated assets and to amortize remaining depreciation expense on some other assets that will be fully depreciated within about three years. If this OCS adjustment is not adopted and this excessive level of depreciation expense is built into the amount of UUSF that Carbon receives in this case, then after three years Carbon will continue to improperly recover this depreciation expense from the UUSF although it will not be incurring any depreciation expense on these fully depreciated assets at that time.

Per Adjustments BCO-3, 4, 5, 6 and 7, OCS proposes to reverse Carbon-proposed adjustments, correct amounts included in rate base, and make Carbon's UUSF filing consistent with the components included in its Part 36 and 69 cost studies that it also relies upon in this proceeding.

The adjustments proposed by OCS are reasonable and supports the Office's recommendation that no UUSF support is required for Carbon.

Q. DO UUSF PROCEEDINGS WARRANT RIGOROUS ANALYSIS AND OVERSIGHT?

A. Yes. A telco should be required to meet a rigorous standard in a UUSF proceeding because it is seeking "public" funds from a UUSF that is funded by a significant number of citizens from all over Utah that do not get any direct or measurable benefit from the telco or its related services because they are served by other communication companies.[11] A further concern is that these consumers are being asked to fund service and capacity which they themselves cannot receive, i.e., FTTH. The broader expanse of citizens that are contributing to the UUSF (but receiving no direct benefit from the rural telcos receiving UUSF funding) at least deserve the benefit of a rigorous review of the telcos that are seeking public UUSF funds.

Q. WILL YOU DESCRIBE THE SERVICES PROVIDED BY CARBON AND ITS AFFILIATES?

A. Yes. The consolidated operations of Emery Telcom[12] consist of three regulated LECs (providing what is mostly traditional regulated services) and

[11] Other communication companies may mean other telco, cable, broadband/internet, and other entities.

[12] Technically, Emery Telcom, Inc.(the Holding Company), is the holding company for the taxable operating companies in the group which include all affiliates except the cooperative of Emery Telcom. Regardless, all of the taxable and non-taxable companies

three nonregulated affiliates (providing nonregulated services) as shown below:

Regulated:

Emery Telephone (dba Emery Telcom) – provides basic local service via copper and fiber facilities to end users, access to long distance, and DSL/fiber wholesale services to ET&V.

Carbon Emery Telecom, Inc. - provides basic local service via copper and fiber facilities to end users, access to long distance, and DSL/fiber wholesale services to ET&V.

Hanksville Telephone – provides basic local service, access to long distance, and other services.

Nonregulated:

Emery Telecommunications & Video, Inc. (ET&V) – Provides fiber transport services, ISP to fiber broadband and copper DSL customers, end user circuits and constructed facilities outside of existing regulated exchange area boundaries, VOIP phone service, retail sales, computer repair and maintenance, key systems, CPE and voicemail.

Emery Telecom Video, LLC (ETV LLC) - Provides cable internet, cable TV, cable, and advertising services through the operation of a local newspaper, news website, and local TV content.

Emery Telcom Long Distance (ETLC) – Provides intrastate and interstate long distance service.

OCS PROPOSED ADJUSTMENTS

Q. ARE YOU ADDRESSING ADJUSTMENTS RELATED TO ALLOCATION OF COSTS BETWEEN CARBON AND ITS AFFILIATES, AND WHAT REGULATORY BEST PRACTICES ARE YOU RELYING UPON IN THIS REGARD?

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are affiliates that share significant common costs.

A. Yes, I am proposing two significant adjustments to address two types of allocation problems between Carbon and its nonregulated affiliates that cause Carbon's regulated costs to be overstated and the nonregulated affiliate costs to be understated (and Mr. Brevitz is also providing economic support for these adjustments) as shown below:

1) Adjustment BCO-1 - Adjust and allocate fiber/internet-related common costs (including related fixed assets and plant/operations related expenses) from Carbon to ETV/nonregulated affiliates for use of Carbon's plant to provide internet service to its retail customers.

2) Adjustment BCO-2 - Allocate additional corporate overhead/common expenses from Carbon to nonregulated operations.

The underlying justification for my allocation adjustments is supported by regulatory best practices and guiding principles that are summarized below, all of which are intended to promote competition, prevent a regulated company (or regulated line of business) from "cross-subsidizing" a nonregulated company (or nonregulated line of business), and promote universal service.

1) Part 47, Section 254(k) of the Federal Telecom Act of 1996.[13]

2) Utah Code Title 54 Public Utilities, Chapter 8b Public Utilities Law, Section 6 Prohibition n Subsidization of Telecommunications Services ("Utah Code 54-8b-6").

3) The Federal Communications Commission's ("FCC") Uniform System of Accounts ("USoA") Part 32 Affiliate Transaction Rules.

4) The FCC's Part 64 Allocation of Costs and Cost Allocation Manual.

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[13] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act), amending the Communications Act of 1934 (the Act). 47 U.S.C. § 254(k).

Q. DOES SECTION 254(K) OF THE 1996 FEDERAL TELECOM ACT ("FTA") PROTECT AGAINST CROSS-SUBSIDIZATION AND PROMOTE COMPETITION?

A. Yes, both the FCC's 1997 order that codified Section 254(k) of the FTA (Code of Federal Regulation – Title 47) and actual Section 254(k) of the FTA are addressed below:

The opening paragraph of the FCC's 1997 order that codified Section 254(k) of the FTA in its Part 64 rules states:

> In conjunction with its overarching goal of promoting competition in the telecommunications industry, the 1996 Act specifically prohibits telecommunications carriers from subsidizing competitive services with services that are not.[14]

In addition, Section 254(k) of the FTA states:

> A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services, shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that service included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.[15]

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[14] Before the FCC, *In the Matter of Implementation of Section 254(k) of the Communications Act of 1934, as Amended*. Order Adopted May 8, 1997 and released May 8, 1997.

[15] 47 U.S.C. § 254 – Universal Service.

Section 254(k) makes it very clear that the Utah Commission has the regulatory jurisdiction and discretion to make decisions regarding cost allocation and related safeguards to prevent Carbon from subsidizing its nonregulated affiliates for the specific kinds of allocation concerns and related adjustments that I am addressing in this proceeding - - both of which relate to "common costs"[16] used to provide services to both the regulated operations of Carbon and to the nonregulated affiliates.

Q. DOES UTAH LAW ALSO PROTECT AGAINST CROSS-SUBSIDIZATION?

A. Yes, Utah Code 54-8b-6 is essentially consistent with the Section 254(k) and under the section titled "Prohibition on subsidization of telecommunications services" it states that subsidization is prohibited both directions, the regulated intrastate services cannot subsidize nonregulated intrastate services (exempted from regulation) and nonregulated intrastate services cannot subsidize intrastate regulated services as indicated below:

> A telecommunications corporation providing intrastate public telecommunications services may not subsidize its intrastate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract under authority of this chapter with proceeds from its other intrastate telecommunications services not so exempted or made subject to a price list or competitive contract. Similarly, proceeds from intrastate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract as authorized

[16] The "common costs" relate to my adjustments addressing the allocation of fiber/internet-related common assets and expenses in Adjustment BCO-1 and allocation of corporate overhead expenses in Adjustment BCO-2.

> by this chapter may not subsidize other intrastate telecommunications services not so exempted or made subject to a price list or competitive contract.

Q. CAN YOU EXPLAIN THE FCC'S PART 32 AFFILIATE TRANSACTION RULES THAT HELP PREVENT REGULATED CARRIERS FROM SUBSIDIZING THEIR NONREGULATED AFFILIATES?

A. The purpose of the FCC's USoA Part 32 Affiliate Transaction rules ("FCC § 32.27") is to protect the customers of regulated carriers from manipulative or improper practices between the regulated carrier[17] and its nonregulated affiliates. These Affiliate Transaction rules are intended to keep nonregulated affiliates from improperly shifting their costs to regulated carriers and gaming the system to recover these costs via the regulatory process in either a rate case or universal service fund proceeding. These Affiliate Transaction rules also keep nonregulated affiliates from shifting their costs to regulated carriers to subsidize their competitive operations, reduce their retail prices, and gain an unfair economic advantage over their competitors that do not or cannot subsidize their operations.

In summary, these rules primarily require the regulated company like Carbon to record the effect of transactions with its affiliates at the higher of

[17] I use the term "regulated" carrier, but this is intended to refer to the incumbent local exchange carrier that has historically provided regulated basic local service (although some or all of these local services may be subject to some form of price or other deregulation in various states). Although I use the term "regulated" carrier for simplicity purposes, technically it is the specific services of a carrier that are either regulated or nonregulated in part.

cost or fair market value (for services/assets sold or transferred "to" an affiliate) or at the lower of cost or fair market value (for services/assets purchased or transferred "from" an affiliate).

Q. PLEASE EXPLAIN THE FCC'S PART 64 ALLOCATION OF COST RULES THAT HELP PREVENT REGULATED CARRIERS FROM SUBSIDIZING THEIR NONREGULATED AFFILIATES?

A. The FCC's Part 64 Allocation of Costs and Cost Allocation Manual ("FCC § 64.901 - .904") requires carriers to separate their regulated costs from nonregulated costs and use the attributable cost method, whereby costs shall be directly assigned to either regulated or nonregulated activities as a first priority. Costs that cannot be directly assigned are called "common costs" and are grouped in homogenous cost categories (or "cost pools") to facilitate allocation based on direct analysis of the purpose for which the cost was incurred or based on a cost-causative link.[18]

Q. HAS CARBON (AND ITS NONREGULATED AFFILIATES) PROPERLY IMPLEMENTED THESE AFFILIATE TRANSACTION BEST PRACTICES AND RELATED SAFEGUARDS?

A. No, that is why I am proposing two significant cost allocation adjustments, and I will explain how the Company's implementation of the cost allocations

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[18] Carbon's original Application was not compliant in providing proper supporting documentation for its Part 64 Cost Allocation Manual, and the OCS requested this underlying supporting documentation via various data requests.

is problematic when I address those specific adjustments in this testimony. Both of the cost allocation adjustments that I am addressing are related to "joint and/or common costs" that are shared and allocated between Carbon, Emery, Hanksville, and the three nonregulated affiliates. Section 254(k) of the FTA requires that local service[19] of regulated LECs bear no more than a reasonable share of joint and common costs. In this case, Carbon's costs include an excessive amount of joint and common costs that should be removed via allocation from Carbon's costs in this proceeding.

Q. REGARDING YOUR TWO COST ALLOCATION ADJUSTMENTS, ARE YOU RECOMMENDING THAT NONREGULATED AFFILIATES BE REQUIRED TO RECORD THESE COMMON COSTS ON THEIR BOOKS OR ADJUST THEIR RETAIL INTERNET RATES?

A. I am only recommending that these common costs be adjusted and removed from Carbon's "regulated" costs in this filing via typical rate case type adjustments, and I am not recommending that these common costs be placed on the books of the nonregulated affiliates or that any retail rates be adjusted.

[19] The FTA actually refers to all services in the "Universal Service" category, which is primarily basic local service for Carbon and the LECs.

<u>Adjustment BCO-1: ALLOCATE FIBER/INTERNET-RELATED COMMON COSTS FROM CARBON TO NONREGULATED OPERATIONS</u>

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT BCO-1?

A. Carbon has not properly allocated fiber/internet-related common costs from its regulated operations to nonregulated affiliates providing internet/broadband operations. Therefore, I have allocated and removed 50% of the "intrastate" only portion of these common fiber costs from Carbon's regulated operations, and I am proposing two possible adjustment options for allocating these costs.

Option 1 removes 50% of the "intrastate" common switching, along with cable and wire facility ("C&WF") plant costs and related expenses, and this has an impact of reducing the revenue requirement by about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**

Option 2 removes 50% of the "intrastate" fiber-related C&WF common plant costs and related expenses, and this has an impact of reducing the revenue requirement by about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** I am only removing the "intrastate" portion of plant and expense common costs, which makes my adjustment conservative.

Q. WHY IT IS NECESSARY TO ALLOCATE AND REMOVE A REASONABLE PORTION OF INTRASTATE FIBER/INTERNET-

RELATED COMMON COSTS FROM CARBON'S REGULATED OPERATIONS?

A. It is necessary to allocate a reasonable portion of fiber/internet-related common costs from Carbon's regulated operations to the nonregulated affiliate operations providing retail internet/broadband services to be compliant with both Part 32 Affiliate Transaction rules (allocate the higher of cost or market related costs to affiliates sharing in the costs) and Part 64 (properly allocate common costs between regulated and nonregulated operations). Significant fiber/internet-related common costs are being recorded on Carbon's books, and these same assets are being used to provide both basic local service on Carbon's books (regulated service) and internet service (nonregulated service) on ETV/nonregulated affiliate books.

These significant fiber/internet-related common costs that are recorded on the books of Carbon are not generating any "new" revenues for Carbon's basic local service customers, they continue to get essentially the same basic local services[20] as they had with copper facilities at the same rates. However, customers of ETV/nonregulated affiliates benefit significantly from these same fiber/internet-related common costs on Carbon's books, because they get faster internet,[21] internet TV, and other expanded services. Carbon admits that **[BEGIN CONFIDENTIAL]** [redacted]

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[20] Although the basic local service can provide better service quality.
[21] Internet service that is faster than any previous internet service provided via copper-based DSL service.

[redacted] **[END CONFIDENTIAL]**[22] Therefore, a reasonable portion of these fiber/internet-related common costs on the books of Carbon should be allocated to ETV/nonregulated affiliates (or ETV/nonregulated affiliates should reimburse Carbon for a reasonable portion of these costs).

Q. WHAT PORTION OF CARBON'S INTRASTATE FIBER/INTERNET RELATED COMMON COSTS HAS CARBON ALLOCATED TO ITS NONREGULATED AFFILIATES?

A. ETV does not reimburse Carbon for any "intrastate" common fiber costs (and Carbon does not allocate any of these costs to ETV). ETV only reimburses Carbon a relatively small amount of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[23] that is related to **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** in the 2014 Part 69 cost study (Carbon refers to this as "wholesale" DSL/internet service), and which is used in part by ETV to provide its Internet service

[22] See OCS Exhibit 1D-3, Carbon's response to OCS 2-28.
[23] This amount from the 2014 Part 69 cost study also approximates the amount in the 2013 Part 69 cost study, although the 2013 amount is somewhat larger.

[BEGIN CONFIDENTIAL] [redacted] **[END CONFIDENTIAL]**

Q. EXPLAIN WHY CARBON'S INTRASTATE FIBER/INTERNET-RELATED COMMON COSTS SHOULD NOT BE PROVIDED FREE TO ITS NONREGULATED AFFILIATES?

A. It is not reasonable that ETV/nonregulated affiliates get free use and benefit of Carbon's significant "intrastate" investment in fiber/internet-related common costs on its books, especially without so much as even a contract to establish reasonable terms, conditions, and prices as would be necessary with a third-party user of these assets. This transaction does not approximate or resemble a third-party or independent transaction because no <u>intrastate</u> fiber/internet-related common costs are allocated to ETV/nonregulated affiliates.

Q. WOULD CARBON MAKE ITS FIBER/INTERNET-RELATED COMMON COSTS AVAILABLE TO THIRD-PARTIES FOR FREE?

A. I do not believe that Carbon would make these same significant and valuable fiber/internet-related common costs available to another third-party for free and without any contractual terms or conditions as it does with its nonregulated affiliate ETV. If Carbon was acting in an arms-length manner, it would require reasonable payment from ETV/nonregulated affiliates for the use of these valuable common fiber facilities. It is my understanding that Carbon does not have a tariff on file for these same common fiber facilities, and this may be one way in which Carbon avoids any exposure of providing notice and availability of these same facilities to third-party vendors at the same free arrangement that ETV/nonregulated affiliates obtain.

Q. IS THERE AN ECONOMIC BASIS FOR CONCERN WITH NONREGULATED AFFILIATES FREE USE OF CARBON'S INTRASTATE FIBER/INTERNET-RELATED ASSETS?

A. Yes. Mr. Brevitz addresses the "alternative cost avoidance" approach and other principles in regards to jointly used facilities.[24]

Q. IF ETV/NONREGULATED AFFILIATES AVOID PAYING FOR THE FIBER/INTERNET-RELATED COMMON COSTS, THEN SHOULD THIS SAME OPTION BE AVAILABLE TO CARBON?

A. This is a basic fairness issue. If it is fair for ETV to avoid paying for Carbon's intrastate fiber/internet-related common costs, then it should also be fair to transfer these same common assets to the books of ETV and let Carbon enjoy the use of these common assets for free. I know this example is hypothetical, but a fairness and common sense standard should prevail on such issues. There is no logical reason why the interests of a nonregulated affiliate should be favored over the interests of a regulated affiliate, unless

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[24] David Brevitz Direct Testimony, pages 18-26.

the primary incentive is for the regulated entity to subsidize the operations of the nonregulated entity. As I previously indicated, because ETV gets more value in terms of long-term revenue growth with its internet service (versus Carbon's stagnant local revenues despite significant FTTH and other fiber investment), this means that ETV should bear a larger proportion of such common fiber costs - - or should at least bear 50% of these costs at the very minimum.

Q. DOES ETV PAY CARBON FOR ANY INTERNET RELATED COSTS?

A. The cost allocation amounts in the table below shows the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** "revenue requirement" based payment from ETV to Carbon is based upon the cost of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, the related rate-of-return on this plant of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, and related interstate operating expenses and income taxes of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** from Carbon's 2014 Part 69 cost study.

In addition, the table shows the two options that I recommend. Option 1 removes 50% of the "intrastate" only common plant costs[25] **[BEGIN**

[25] These plant costs include switching and other outside plant common cost facilities

CONFIDENTIAL][redacted] **[END CONFIDENTIAL]** from rate base and removes 50% of related intrastate outside plant and depreciation expenses on these same plant costs **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and this has an impact of reducing the revenue requirement by about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. Option 2 removes 50% of the "intrastate" fiber-related cable and wire facility ("C&WF") common plant costs **[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]** from rate base and removes 50% of related intrastate C&WF and depreciation expenses on these same plant costs **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and this has an impact of reducing the revenue requirement by about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**

[BEGIN CONFIDENTIAL]

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that would be necessary for utilization of the fiber-related cable and wire facility costs, although this does not include any "support" assets such as land, buildings, vehicles, etc.

Table BCO-1: Allocation of Fiber Common Costs:

A	B	C	D	E
	Allocation of Common Costs	Emery Method DSL Interstate	OCS Option 1 Intrastate	OCS Option 2 Intrastate
1	Common assets to be allocated	[redacted]	[redacted]	[redacted]
2	ROR (11.25% Company/8.45% OCS)	[redacted]	[redacted]	[redacted]
3	Return	[redacted]	[redacted]	[redacted]
4	Common expenses to be allocated	[redacted]	[redacted]	[redacted]
5	Revenue requirement before TIC	[redacted]	[redacted]	[redacted]
6	Interstate TIC	[redacted]	[redacted]	[redacted]
7	**Revenue Requirement**	[redacted]	[redacted]	[redacted]
8	**50% Allocator between Carbon & Nonreg.**	[redacted]	[redacted]	[redacted]
9	**Rev. req. (treated as payment method)**	[redacted]	[redacted]	[redacted]
10		[redacted]		[redacted]
11	**Assets (treated as allocation method)**	[redacted]	[redacted]	[redacted]
12	**Allocator**	[redacted]	[redacted]	[redacted]
13	**Assets allocated 50/50 Carbon & Nonreg.**	[redacted]	[redacted]	[redacted]
14		[redacted]	[redacted]	[redacted]
15	**Expenses (treated as allocation method)**	[redacted]	[redacted]	[redacted]
16	**Allocator**	[redacted]	[redacted]	[redacted]
17	**Expenses allocated 50/50 Carbon & Nonreg.**	[redacted]	[redacted]	[redacted]

[END CONFIDENTIAL]

Q. HOW DID YOU DETERMINE THE INTRASTATE AMOUNT OF INTERNET/FIBER-RELATED COMMON COSTS (FROM CARBON'S BOOKS) THAT IS INCLUDED IN BOTH OPTION 1 AND 2 OF YOUR PROPOSED ADJUSTMENTS?

A. I relied on information from Carbon's books and Part 36 and 69 cost studies. However, I note that Carbon could not reconcile amounts from its financial records to its cost studies[26] so it is possible that there are problems with the cost study data that I relied upon.

Q. WHY IS IT REASONABLE TO ALLOCATE 50% OF INTERNET/FIBER-RELATED COMMON COSTS TO BOTH CARBON AND ETV/AFFILIATE OPERATIONS?

A. The 50/50 sharing of these common costs is very reasonable and conservative for the following reasons:

1) ETV receives a significantly disproportional benefit by having these fiber/internet common costs recorded on the books of Carbon instead of the books of ETV. For example, even with all of these fiber/internet-related common costs recorded on the books of Carbon (and even when additional FTTH costs are recorded on Carbon's books in the future), Carbon will still generate about the same annual regulated local revenues of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**[27] as it generates today because the fiber will not generate any significant new services for Carbon local service

[26] For example, OCS 2-12(d) and 3-19(a) asked Carbon to reconcile the amount of its 2013 and 2014 interstate DSL/internet costs in its Part 69 cost study (the support for ETV's payment to Carbon) to the specific account balances on its financial statements. Carbon stated that it **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**. (See OCS Exhibits 1D-3 and 1D-5 for data request responses.)

[27] Carbon 2014 Annual Report, Local Network Service Revenues.

customers, and the related local rates will also stay the same and not generate new revenues. However, with the assistance of these common fiber costs on Carbon's books, ETV is generating at least **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[28] in internet related revenues in 2014. I understand that ETV also has significant fiber assets on its books that assist in generating these revenues. Thus, while Carbon's local revenues will stay relatively flat or even decline as more fiber costs are put on Carbon's books, ETV will reap the continued benefit of increased internet revenues and this is not reasonable without a proper allocation of these common fiber costs to ETV's books.

2) Mr. Brevitz's testimony explains that up to 95% of the fiber common costs on Emery's books could be allocated to ETV (and only a 5% allocation to Emery's books) if relative capacity use of the fiber was used as an allocator.[29] Thus, the 50% allocation of fiber common costs to ETV is very reasonable when the allocator could be as high as 95%.

3) Both Option 1 and 2 of my proposed allocation adjustments only allocate a portion of Carbon's "intrastate" fiber/internet-related common costs to

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[28] There is 2014 fiber and internet revenues of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** on ETV's books) per ETV's income statement provided in response to OCS 3-13(a). (See OCS Exhibit 1D-5.)

[29] David Brevitz Direct Testimony, page 23.

ETV, and do not allocate any interstate costs. All or most of the interstate revenue requirement should be recovered from federal Interstate Common Line Support ("ICLS"), the End User Common Line ("EUCL"), and other revenue sources - - so I did not allocate any additional interstate fiber common costs to ETV.

Q. WHAT IS THE PROBLEM WITH USING ONLY CARBON'S [BEGIN CONFIDENTIAL] [redacted] **[END CONFIDENTIAL] AS THE PROPER COST ALLOCATION METHOD (OR PROPER REVENUE REIMBURSEMENT AMOUNT)?**

A. This underlying method is not consistent with cost allocation best practices, because it does not represent proper amounts to be allocated under Part 32 Affiliate Transaction rules (it is not the higher of cost or market) or Part 64 (it only allocates some **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**, and not allocate any intrastate common fiber costs). Carbon's approach is primarily based on the prior method it used for the settlements process when it previously participated[30] in the National Exchange Carrier's Association ("NECA") DSL/broadband pool process with other NECA carriers. Under that process, Carbon's interstate Part 69 wholesale DSL/internet revenue requirement was used in determining the amount of DSL revenues it received from the companies participating in the NECA

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[30] Carbon participated in the NECA DSL pool up through June 2013.

pool, and NECA in turn provided Carbon with the wholesale DSL/broadband rate it should bill to its affiliate ETV. However, Carbon has now voluntarily exited that pool and it no longer uses the prescribed NECA wholesale DSL/internet tariff rate, but instead now uses a monthly rate of **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]**[31] Thus, it is clearly inappropriate for Carbon to rely on this prior method in these proceedings after it has exited the NECA pool.

Q. CAN YOU EXPLAIN THE PROBLEMS WITH RELYING ON CARBON'S PRIOR NECA SETTLEMENTS PROCESS AS A METHOD FOR PROPER COST ALLOCATION WITH AFFILIATES?

A. The prior process for DSL cost recovery under the NECA pooling process should not be relied upon at this stage. NECA is an organization that is owned and run by LEC interests, and so its policies can be favorable towards the LECs and can be contrary to consumer interests or reasonable cost allocation procedures. In addition, NECA is not a regulatory agency and it does not have any specific jurisdictional rights over state regulatory agencies and regulatory proceedings.

In fact, the NECA method that tells carriers to allocate DSL costs to the intrastate jurisdiction was rejected by the Regulatory Commission of Alaska

[31] This rate is the interstate wholesale DSL revenue requirement for combined companies Carbon, Emery and Hanksville divided by the number of DSL/internet customers of ETV.

("RCA"), and these DSL costs were required to be shifted to the interstate jurisdiction in Alaska regulatory proceedings. However, the NECA policy that calls for allocating DSL costs to the intrastate jurisdiction is apparently still in place per Carbon's response to OCS 3-19.[32]

Q. ARE YOU RECOMMENDING THAT THE COMMISSION REQUIRE CARBON TO INCREASE ITS WHOLESALE DSL/BROADBAND RATE CHARGED TO ETV TO REFLECT A PROPER COST-BASED RATE?

A. No. It is more important that the Commission adopt an allocation adjustment as I propose for regulatory purposes to properly allocate costs consistent with the Section 254(k), Utah law, Part 32 affiliate transaction rules, and 64 cost allocations between regulated and nonregulated entities. Even Carbon has proposed a Part 64-type adjustment in this proceeding to allocate shared support assets from ETV to Carbon, so it is clear that the Commission can make offsetting adjustments to properly allocate costs away from Emery for regulatory purposes.

Adjustment BCO-2: ALLOCATE GENERAL AND ADMINISTRATIVE EXPENSES FROM CARBON TO NONREGULATED OPERATIONS

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT BCO-2?

[32] The NECA policy states that if costs for ADSL and SDLS services are ordered out of an intrastate tariff, then the related costs should be allocated to the intrastate jurisdiction. See OCS Exhibit 1D-5 for the data request response to OCS 3.19.

A. I have revised two of the Company's CAM allocation factors that were applied to four different Departments (also called "cost pools"), and this resulted in an adjustment to decrease expenses of **[BEGIN CONFIDENTIAL]**[redacted].**[END CONFIDENTIAL]**[33] These two allocation factors are used to allocate the related Department cost pool between the three regulated RLECs (Emery, Carbon, and Hanksville) and the three nonregulated affiliates (ETV, ETV-LLC, and ETLD).[34] Although this adjustment primarily impacts both the Customer Operations and Corporate Operations expenses, for simplicity purposes I will periodically refer to this group of combined expenses as corporate overhead expenses.[35] The two expense allocation factors that I am revising are shown below:

[BEGIN CONFIDENTIAL][redacted] **[END CONFIDENTIAL]**

The four different Departments and the related adjustments that I am proposing to reduce Carbon's corporate overhead expenses are shown below:

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[33] **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]**

[34] I am not recommending that any expenses actually be shifted to nonregulated operations on the books, my adjustment is the same as other regulatory adjustments that remove or reduce expenses for regulatory purposes only. However, I will show how the reduction in regulated expenses impacts nonregulated expenses and related allocation factors.

[35] Customer Operations includes Marketing (account 6610) and Services (account 6620) expenses and Corporate Operations includes Executive and Planning (account 6710) and General and Administrative (account 6720) expenses.

1) **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

2) **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

3) **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

4) **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**

The table below shows the percentage of expenses allocated between regulated and nonregulated operations for each Department, and it compares the Company's allocation factors to the OCS revised allocation factors that I am supporting in this testimony.

Table BCO-2: OCS Proposed Change in Allocation Factors
[BEGIN CONFIDENTIAL]

	Per Company			**Per OCS**		
Department & Allocator	Co. Reg.	Co. Nonreg	Co. Total	OCS Reg.	OCS Nonreg.	OCS Total
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[END CONFIDENTIAL]

Q. WILL YOU EXPLAIN THE COMPANY'S COST ALLOCATION FACTORS AND COST POOLS?

A. The table below shows the Company's nine allocation factors used to allocate expenses in the ten Department/Cost Pools. Some allocation factors are used to allocate several of the Department expenses, and the table below is not intended to show which allocation factors are applied to each specific Department.

Table BCO-3: List of Allocation Factors and Department Cost Pools

[BEGIN CONFIDENTIAL]

[redacted]

[END CONFIDENTIAL]

The Department cost pools may include expenses from numerous USoA expense accounts. However, a Department cost pool should only aggregate homogenous expenses that have a cost-causative relationship to the related allocation factor that is used to allocate the expenses. My testimony will explain and show that there is not a cost-causative relationship between some of the allocation factors and the related Department cost pools, and this is one of the reasons supporting my adjustments.

Q. EXPLAIN THE IMPACT OF THE ALLOCATION ADJUSTMENTS YOU MADE ON CARBON AND RELATED REGULATED AND NONREGULATED OPERATIONS?

A. The table below shows the revised allocation factor percentage and the related impact on expenses for Carbon (this agrees to my adjustment) and all other affiliates. I will explain in more detail the impact of my allocation adjustment on Carbon, as well as regulated and nonregulated operations, following the table below.

Table BCO-4: OCS [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL]

Allocation Adjustment

[BEGIN CONFIDENTIAL]

	A	B	C	D	E	F	G	H	I
		Per Company and Books				**OCS Adjustment**			
		Total Expenses (No Deprec. or Taxes)	Total Direct & Alloc.	Expenses Subject to Alloc.	% Alloc. By Company	OCS Allocation Adjustment	Expenses Subject to Alloc.	% Alloc. By Company	Change in Alloc. %
1	Emery	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2	Carbon	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
3	Hanksville	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
4	Total Reg.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
5	ETV	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
6	ETV-LLC	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
7	ETLD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
8	Total Nonreg.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
9	**Grand Total**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[END CONFIDENTIAL]

My proposed adjustment decreases the amount of corporate overhead expenses allocated to Carbon by **[BEGIN**

CONFIDENTIAL][redacted]**[END CONFIDENTIAL]**[36] (Column F, line 2)[37] and decreases the percentage of these expenses allocated to Carbon from **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (Column H, line 2).[38] Although the impact of my allocations adjustment does not directly impact Emery or Hanksville in this proceeding, the total impact of my adjustment would decrease the amount of corporate overhead expenses allocated to regulated operations (Emery, Carbon, and Hanksville) by **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (Column F and I, line 4, respectively).

The amounts in Column B called "Total Expenses (No Depreciation)"[39] reflect both the direct and allocated expenses (total expenses) for each company (excluding depreciation expense).[40] These Total Expenses,[41] are provided only to show that the expenses that were allocated to all affiliates of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (Column D, line 8) represents about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of the total expenses (expenses that are allocated and

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[36] Column F, line 2 shows the decrease in **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** expenses allocated to Carbon
and related offsetting increase is re-allocated to the other nonregulated companies.

[37] There is a small $2.00 rounding error in the amounts shown at this table and my related adjustment.

[38] Per Column E, line 2 less Column H, line 2, equals the change in Column I, line 2.

[39] These expenses also do not include any income taxes.

[40] These amounts are per the 2014 Audited Financials, Consolidated Statement of Income and Comprehensive Income.

[41] These Total Expenses are not used in calculating my corporate overhead expense adjustment.

directly assigned) of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[42] for all affiliates. Thus, a substantial amount of the combined total expenses of all companies (**[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]**) is subject to some allocation factor to spread these costs to the various regulated and nonregulated affiliates, so it is possible for the Company to use allocation factors to significantly impact earnings, revenue requirements, and the amount of requested UUSF for the regulated companies.

The expenses in Column D[43] are more relevant for this adjustment because they reflect the total expenses that the Company has allocated to each regulated and nonregulated entity using its cost allocation factors. Prior to my corporate overhead allocations adjustment, the Company allocated **[BEGIN CONFIDENTIAL]**[redacted]**END CONFIDENTIAL]** (Column E, line 4) of total allocable expenses to regulated operations (**[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, the largest share by a significant amount to Carbon) and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (Column E, line 8) to nonregulated operations. For corporate overhead expenses allocated to the regulated companies, both the amount of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**

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[42] These excludes exclude depreciation expense and income tax expense.
[43] The amounts in Column D are from Carbon's response to OCS 2-36. See OCS Exhibit 1D-3 for Carbon's response to OCS 2-36.

(Column D, line 4) and the related percentage of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** appear to be unusually high.

After reflecting the impact of my corporate overhead allocations adjustment, the adjusted corporate overhead expenses reflect a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation to regulated expenses and a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation to nonregulated expenses. Although I believe this is a more reasonable allocation of expenses between regulated and nonregulated operations, the expenses allocated to regulated operations are still somewhat excessive and there are additional adjustments that I have not made at this time.

Q. DID YOUR ANALYSIS RAISE CONCERNS THAT REGULATED ALLOCATED EXPENSES ARE OVERSTATED AND NONREGULATED ALLOCATED EXPENSES ARE UNDERSTATED?

A. Yes. I reviewed and compared several years of Consolidated Financial Statements and other information, and determined that certain financial data, allocations, and changes in amounts from year-to-year appear unusual or appear to favor the nonregulated affiliates over the regulated affiliates. This type of information lends support for my adjustment to re-allocate some expenses from regulated to nonregulated operations.

From 2013 to 2014, the regulated RLECs net income **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and profit margin[44] **[BEGIN CONFIDENTIAL]** xxxxxxxxx [redacted] **[END CONFIDENTIAL]**, yet for the nonregulated affiliates net income stayed **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** with a profit margin of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**. ETV's net income only **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** from 2013 to 2014, yet its net income of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** of the total profit among all of the regulated and nonregulated companies. In addition, from 2013 to 2014, the regulated RLECs expenses **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and ETV's expenses **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** by about this same amount of **[BEGIN CONFIDENTIAL]** [redacted]. **[END CONFIDENTIAL]** And although ETV's revenues **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** from 2013 to 2014, its profits **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** as the prior year due to the **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**. From 2013 to 2014, all other entities realized **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in expense, except ETV was the only entity that realized

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[44] Profit margin is net income divided by revenues.

a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in expense,[45] and its **[BEGIN CONFIDENTIAL]**[redacted]**END CONFIDENTIAL]** was significant.

ETV's actual earned rate of return on rate base ("ROR") was a rather **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2013 and 2014, respectively[46] - - especially when compared to the regulated companies ROR's of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** for these same years. The **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2014 (and corresponding increase in regulated company expenses of about this same amount) played a role in ETV's **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** ROR.

It is possible that the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in ETV's expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and the corresponding **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in regulated RLEC expenses of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** was the result of a **[BEGIN CONFIDENTIAL]**[redacted]

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[45] ETLD realized a relatively small decrease in expense.
[46] The ROR for all combined nonregulated companies was also **[BEGIN CONFIDENTIAL]**[redacted][**END CONFIDENTIAL]** respectively.

[redacted] **[END CONFIDENTIAL]**, but that cannot be confirmed. Most importantly, because ETV does not bear a reasonable portion of either fiber-internet-related common plant costs (Adjustment BCO-1) or common corporate overhead expenses (Adjustment BCO-2), the related ETV profits and ROR appear **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** after consideration of the analysis that I performed. ETV's profits and ROR are **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** the cost of the more reasonable cost allocations that I propose in Adjustment BCO-1 and BCO-2.

Q. DID YOU FIND IT UNUSUAL THAT THE COMPANY DID NOT HAVE ANY ALLOCATION FACTORS THAT ALLOCATE 50% OR MORE OF EXPENSES TO NONREGULATED OPERATIONS?

A. Yes, I did find this unusual. It appears that the **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** allocation factor may be the highest nonregulated allocation factor of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** although this factor does not have much impact on overall allocations because **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** expenses are relatively small.

I also find this unusual because there are numerous important financial amounts that approximate a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** between regulated and nonregulated operations, yet these amounts do not appear to have been used in any Company allocation factor. For example, the split between Total Revenues is about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, although I don't believe that revenues were used as an input in any Company allocation factor. If Total Revenues was adopted as an allocator for some expense, it would have been the only allocation factor that actually drove **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated operations versus regulated operations. This raises concerns about the bias of the Company's allocation factors.

Also, Total Operating Expenses (excluding depreciation and income taxes) are split **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** Thus, the use of both or either of the Total Revenue and Total Expense inputs in allocation factors would have **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated operations, but for some reason these two significant financial drivers do not appear to have been used by the Company in any allocator that drives significant expenses or costs.

Q. WHAT IS THE COMPANY'S [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL] ALLOCATION FACTOR, AND WHAT REVISED FACTOR DO YOU RECOMMEND?

A. The Company's **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** factor allocates about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of the related Department cost pool expenses to regulated operations and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated operations, and Carbon receives about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of the allocated expenses included in the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** regulated total.[47] I revised the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor and included inputs that serve to balance and provide equity to this factor, and this includes inputs related to billing records, revenues, operating expenses[48], net plant, and payroll. This results in my revised recommended **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor that allocates 50% of related corporate overhead expenses to regulated operations and 50% to nonregulated operations. More details are provided in Table BCO-5 later in this testimony.

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[47] The remaining regulated expenses are allocated to Emery and Hanksville.
[48] Operating expenses exclude depreciation and income taxes.

Q. WHAT ARE THE INPUTS TO THE COMPANY'S [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL] ALLOCATION FACTOR AND DID YOU IDENTIFY AN [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL] FACTOR USED IN PRIOR YEARS WITH INPUTS THAT ARE MORE SIMILAR TO YOUR PROPOSED [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL] FACTOR?

A. The Company's **[BEGIN CONFIDENTIAL]**xxxx**[END CONFIDENTIAL]** allocation factor appears to be based upon the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** for each regulated and nonregulated company, although this analysis is somewhat **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** because it is based on information from **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]**[49] The Company's**[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]** allocation factor includes a number of estimates with no specific and current supporting documentation or calculations, and it gives the CABS counts an **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** I believe this approach of using **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** is flawed in relation to the Department cost pools which it is used to allocate.

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[49] The **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor is set forth at Exhibit 9 of Carbon's filed application.

OCS 2-36 asked Carbon to provide supporting documentation for all CAM allocation factors, and when I reviewed the underlying Excel spreadsheets there was an **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor that was calculated using a different method in the period **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.[50] The previous **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor method uses a weighting of the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. The revised **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor that I propose uses inputs that are more similar to this prior Company approach, because I have used additional inputs besides **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** that serve to balance the allocation and make it more equitable among regulated and nonregulated companies.

Q. DO THE [BEGIN CONFIDENTIAL] [redacted] **[END CONFIDENTIAL] INPUTS TO THE COMPANY'S [BEGIN**

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[50] This other **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor may have been used in prior years or by a previous management team. See OCS Exhibit 1D-3 for data request response for OCS 2.36.

CONFIDENTIAL] [redacted] **[END CONFIDENTIAL] ALLOCATION FACTOR HAVE A “DIRECT” OR “COST-CAUSATIVE” RELATIONSHIP TO THE EXPENSES IN THE DEPARTMENT COST POOL THAT THEY ARE USED TO ALLOCATE?**

A. No. The use of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** in the **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** allocation factor is not compliant with Part 64 cost allocations, because **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** do not have either a “direct” cost relationship or a “cost-causative” relationship with the expenses in the related Department cost pools driven by the **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** factor. The **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** allocation factor used by Carbon is applied to vastly different types of Department cost pools, including the Departments of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** Also, Emery’s response to OCS 2-36 shows that the **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** factor is applied to some other departments[51] **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** at the Department List at DPU 1-7,[52] and

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[51] Some of these departments include **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** and others. See OCS Exhibit 1D-3 for data request response for OCS 2.36.

[52] The Company’s printed response to DPU 1-7 is incorrectly labeled as DPU 1-6.

these other departments cannot be sorted at the financial records provided in response to OCS 2-36.

I don't believe that the number of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]**" (used as the only input in the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** factor) has a direct, cost-causative, or even much of any relationship as a driver for the expenses in the Departments to which it is applied, such as the departments of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. For example, the amount of time spent on regulated or nonregulated issues by the executive/management officers (**[BEGIN CONFIDENTIAL]**[redacted]) **[END CONFIDENTIAL]**[53], the members of the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**) and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**) is unlikely to be affected by the number of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.

For example, I believe a CEO's time is spent more on forward-looking policy and plans, and especially issues related to nonregulated services such as

[53] This includes primarily the salary and other related overhead costs of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**

internet that particularly drive total consolidated company profits, cash and ROR - - and this is not driven by the number of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. Also, regarding the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs, a review of the Board of Director minutes appears to indicate that a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, and there is no reasonable relationship to the number of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. Finally, **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs would appear to be more closely tied to promoting those **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and this has no reasonable relationship to the number of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.

Q. HOW DID YOU DETERMINE YOUR PROPOSED [BEGIN CONFIDENTIAL][redacted]**[END CONFIDENTIAL] ALLOCATION FACTOR**

THAT WAS APPLIED TO [BEGIN CONFIDENTIAL][redacted]**[END CONFIDENTIAL] DEPARTMENT COST POOLS?**

A. I used an approach that is more similar to a prior **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** factor methodology used by the Company. My understanding is that the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor should be more of a "general or all-encompassing" allocator (instead of a specific allocator based on **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**) with diverse inputs that can be used to justify allocation of a wide variety of expenses in various Departments, and that is the approach that I used to calculate a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor as shown in Table BCO-5 below.

Table BCO-5: OCS Proposed [BEGIN CONFIDENTIAL][redacted]**[END CONFIDENTIAL] Allocation Factor**

[BEGIN CONFIDENTIAL]

A	B	C	D	E	F	G	H		I	J	K
		Co. [redacted] Allocator	Revenues %	Expenses %	Net Plant %	Records %	Payroll %		Grand Total	**OCS [redacted] Allocator Calc.**	**OCS [redacted] Allocator Proposed**
1	Emery	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
2	Carbon	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
3	Hanksville	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
4	**Total Reg.**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	**50%**
5	ETV	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
6	ETV-LLC	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
7	ETLD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	
8	**Total Nonreg.**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	**50%**
9	Grand Total	100.00%	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	**100%**	**100%**

[END CONFIDENTIAL]

Table BCO-5 shows that I assigned the specific amounts of revenues, expenses[54], net plant, payroll, and billing records[55] to each regulated and nonregulated entity. Then I totaled these input amounts for all companies at Column I and calculated the percentage of these combined inputs for each regulated and nonregulated entity as shown at Column H at Table BCO-5. These calculations result in **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocated to total regulated operations (**[BEGIN CONFIDENTIAL]**[redacted]**END CONFIDENTIAL]** to Carbon) and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocated to nonregulated operations (Column J), compared to the Company's **[BEGIN CONFIDENTIAL]**[redacted] (**[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to Carbon) and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in Column C, respectively. However, I have revised these factors to a 50% allocation to regulated operations and 50% allocation to nonregulated operations (Column I), to reflect approximate downward adjustments to regulated expenses, plant, and payroll costs that I have made in this proceeding.[56] My allocations adjustment is reasonable and further adjustments could be made to other Department cost pools.

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[54] These expenses exclude depreciation and income taxes.

[55] These amounts are primarily from the 2014 Audited Financial Statements, along with additional records and information provided by Emery in other data request responses.

[56] The inputs to Table BCO-5 are based on the Company's unadjusted financial amounts before adjustments that I have proposed in this proceeding.

Q. WHAT ALLOCATION FACTOR DID YOU APPLY TO CARBON'S [BEGIN CONFIDENTIAL][redacted][END CONFIDENTIAL] DEPARTMENT COST POOL AND WHY?

A. I did not apply my revised **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor[57] to **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** expenses as I did for the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** Department cost pools. Instead, I used a factor that allocates **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** expenses **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated operations, because the Company's**[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** nonregulated is clearly unreasonable. The Company's unreasonable allocation of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** expenses is best illustrated by the fact that it allocates almost **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of its total **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs (for both regulated and nonregulated operations) to Carbon, whereas its internet

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[57] My revised **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocator splits related expenses 50/50 between regulated and nonregulated operations.

affiliate ETV is **[BEGIN CONFIDENTIAL]**[redacted] of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs.

The Company's response to OCS 3-4 appears to indicate that **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of total **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** is allocated to regulated operations because regulated local service receives a benefit from its inclusion with **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** However, the **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** At the very maximum, it would appear that regulated local service should only be allocated **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of the total **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs instead of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of the costs, because local service represents **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. The Company's response to OCS 3-4 was unable to adequately explain or justify the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** expenses to regulated operations and the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of such costs to nonregulated operations. The Company is purchasing and placing significant fiber plant in the exchanges of its RLECs for the related benefit of its nonregulated affiliates in providing growth-oriented and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** nonregulated services such as internet and IPTV (compared to the stagnant and even declining revenues for local service). However, the Company's allocation of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs attempts to give the incorrect impression that most of this fiber is to benefit basic local service customers, and so the Company allocates **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs to the regulated RLECs. The Company's skewed allocation of its **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** costs may be one of the best examples of its unreasonable allocation factors that are non-compliant with Part 64.

Q. WHAT ARE THE PROBLEMS WITH THE COMPANY'S [BEGIN CONFIDENTIAL][redacted]**[END CONFIDENTIAL] FACTOR THAT IS USED TO ALLOCATE COSTS OF [BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]?**

A. The Company's **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor allocates expenses **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END**

CONFIDENTIAL] to nonregulated, and I have essentially reversed these percentages and allocated **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to nonregulated.

There are numerous problems with Carbon's **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocator as I will explain.

First, the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocator study is outdated and appears to be based on a **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]**[58] The **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** may have changed significantly since **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** because the number of internet and local service customers served by fiber has **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, and the amount of fiber in the network should have reduced service quality calls and complaints. Carbon has not been able to provide any evidence that the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** is still relevant and accurate today.

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[58] This information is included in Carbon's Exhibit 9i filing with its Application.

Second, OCS 2-36 asked Carbon to provide supporting documentation and calculations regarding the CAM and related allocation factors. However, Carbon did not provide any written explanation or reconciliation to show how the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** regulated and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** nonregulated **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor reconciles to the various Excel spreadsheets and the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** that was provided. Carbon did not provide any written response to OCS 2-36 other than to refer to the Excel spreadsheets that include thousands of fields of numbers, and I was not able to validate or reconcile the numerous amounts in these Excel spreadsheets to the related **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factors. Thus, Carbon has not met a reasonable burden of proof to support its **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factors.

Third, Carbon's response to OCS 2-36 includes a tab called "**[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**" showing how various **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** For example, the type of calls included in the category of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (and within other categories) are assigned to various services such as **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and various other services. As one example, the service category groupings of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** are not explained, and the treatment of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in these groupings are not explained. However, **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** are both "nonregulated" services so it is not clear why the nonregulated services of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** have been **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. It is not clear if **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** related to this category are assigned to the nonregulated or regulated category, but this could make a significant difference in the determination of the final **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor. And if these **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** were related to both **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** services, it is not clear how the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** assigned these calls to the regulated and nonregulated categories to influence the outcome of the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor. Again, adequate supporting documentation and explanation has not been provided by Carbon to justify the **[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]** allocation factor.

Fourth, The Company has a **[BEGIN CONFIDENTIAL]** [redacted]**END CONFIDENTIAL]**, with **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** per the response to DPU 1-4(b) (See OCS Exhibit 1D-4). It is not clear why **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** or a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of these **[BEGIN CONFIDENTIAL]**[redacted]**END CONFIDENTIAL]** costs would be allocated to regulated operations when Emery and Carbon regulated access lines and related local revenues are declining or stagnant and fiber/internet related nonregulated services are **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** - - and the Company continues to place fiber in the network. Carbon has not provided any explanation for the **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and why their costs are being **[BEGIN CONFIDENTIAL**[redacted]**[END CONFIDENTIAL]** to regulated operations, although this appears unusual. Based on the previously identified concerns, I propose a **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** allocation factor of 35% regulated and 65% nonregulated.

Adjustment BCO-3: Remove Prepayments From Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-3?

A. Carbon has improperly included prepayments of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in rate base, and I have made an adjustment to remove these amounts from rate base. Carbon has not provided any explanation, documentation, or cited to any precedent for including prepayments in rate base.

In addition, both Carbon's 2013 and 2014 Part 36 cost studies (which it relies on in this proceeding) do not include prepayments in rate base. Thus, it is not clear if it is Carbon's intent to have two separate regulatory positions on prepayments in this filing, but this does indicate a fundamental inconsistency in Carbon's filing.

Adjustment BCO-4: Deduct Long-Term Liabilities From Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-4?

A. Carbon has failed to deduct long-term liabilities from rate base, so I have made an adjustment of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[59] to properly deduct these amounts. In addition, both Carbon's 2013 and 2014 Part 36 cost studies (which it relies on in this

[59] This is the amount from Carbon's 2014 Part 36 cost study.

proceeding) show that long-term liabilities are deducted from rate base, consistent with my position. It is not clear if it is Carbon's intent to have two separate regulatory positions on long-term liabilities in this filing, but this does indicate a fundamental inconsistency in Carbon's filing.

Adjustment BCO-5: Remove 50% of Telephone Plant Under Construction from Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-5?

A. This adjustment removes 50% of the telephone plant under construction ("TPUC") balance of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, resulting in a reduction of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** from Carbon's proposed rate base. I am removing 50% of TPUC from rate base for the reasons that follow.

First, Carbon's TPUC balance for 2014 is overstated on a normalized basis and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** presumably due in part to Carbon's current fiber construction program. For example, TPUC has increased **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in just a two-year period from **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2012 to **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2014 (and **[BEGIN**

CONFIDENTIAL][redacted]**[END CONFIDENTIAL]** in 2013).[60] TPUC has also been as low as **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2010.[61] When Carbon's fiber program reaches an endpoint, then the TPUC balances should decrease to more reasonable levels. If Carbon's draw from the UUSF is established with an unusually high level of TPUC from this proceeding, then Carbon will over-recover these costs in future years from the UUSF when its TPUC balance begins to decline with the conclusion of the fiber construction program.

Second, most of this TPUC appears to be fiber-related, and Carbon has not provided certain requested information in response to OCS 2-37(b) to show other related impacts of this TPUC that may be relevant regarding corresponding adjustments to be consistent with the regulatory "matching" principle.[62] The potential corresponding impacts of TPUC as set forth below have not been identified by Carbon:

1) Increased revenues related to payments by affiliates to Carbon use of the fiber included in TPUC, federal support revenues, and revenues from new services.

2) It is not clear if the TPUC included in this case will result in subsequent retirement of replaced copper (or other replaced assets), but at this time

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[60] Amounts are per Carbon's Annual Reports.
[61] Amounts is per Carbon's Annual Reports.
[62] The matching principle is also sometimes referred to as "synchronization", whereas the full impact of a transaction should be reflected in a related adjustment and the adjustment should not be limited to only the positive or negative impacts of the transaction. Thus, if TPUC increases, then the corresponding related impacts on revenues, expenses and other issues should be considered in any related adjustment. See OCS Exhibit 1D-3 for Carbon's response to OCS 2.37(b).

the Company has not made a corresponding adjustment related to this TPUC.

Adjustment BCO-6: Remove 50% of Materials and Supplies from Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-6?

A. This adjustment removes 50% of the materials and supplies ("M&S") balance of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, resulting in a reduction of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** from Carbon's proposed rate base. I am proposing this adjustment for most of the reasons set forth for the previous TPUC adjustment. Carbon's M&S balance for 2014 is overstated on a normalized basis and is **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** presumably due in part to Carbon's current fiber construction program. For example, M&S has increased **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** from **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2013 to **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]** in 2014. M&S has also been as low as around **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2010 and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in 2011. When Carbon's fiber program reaches an endpoint, then the M&S balances will decrease to more reasonable levels. If Carbon's draw from the UUSF is established with an unusually high level of M&S from this proceeding, then Carbon will over-recover these costs in future years from the UUSF when its M&S balance begins to decline with the conclusion of the fiber construction program.

Adjustment BCO-7: Reverse Emery's Adjustment for Projected Decline in Access Lines

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-7?

A. This adjustment increases revenues by **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** to reverse Carbon's proposed adjustment to decrease revenues based on its 3-year projected decline in access lines through December 31, 2017. I am reversing this adjustment for the reasons set forth below.

First, the projection of access line loss through the three-year projected period ending December 2017 is too far beyond the test period to be allowed, and the adjustment is not known and measurable. Carbon's response to OCS 2-8 admits that this line loss **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, but that any **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[63] If Carbon cannot provide more evidence regarding this adjustment, then it should be rejected.

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[63] See OCS Exhibit 1D-3 for Carbon's response to data request question 2-8.

Second, Carbon's adjustment is not known and measurable, and even if it was accepted there is a possibility that the line loss would be offset by increased revenues related to a Commission decision to increase the affordable rate for customers. Also, Carbon is installing FTTH for its local service customers and this can have the effect of slowing down the loss of customer lines, although Carbon has not considered this impact in its adjustment.

Third, Carbon did not provide any written or detailed explanation or analysis supporting this adjustment.

Adjustment BCO-8: Remove Depreciation Expense on Fully Depreciated Assets

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-8?

A. This adjustment reduces depreciation expense by **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (and corresponding increase in accumulated depreciation in rate base of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** on assets that are either fully depreciated or will be fully depreciated within about 3 years. The depreciation adjustment of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** is net of depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** that I already removed in Adjustment BCO-1 (Option 2), but if the Commission does not adopt

Adjustment BCO-1 then the gross amount of this depreciation expense adjustment would be **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.

I am relying on information at Carbon's depreciation work papers at DPU 1-11 in regards to this depreciation expense adjustment. Carbon's total net assets of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** will be fully depreciated within about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** years, based on an annual depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]. **[END CONFIDENTIAL]**[64] This raises concerns about the amount of depreciation expense included in this filing, although I am not proposing to adjust all depreciation accounts. I am removing the full amount of depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** on the current fully depreciated assets of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**, respectively.

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[64] Total Net Book Asset Value of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** divided by annual Depreciation Expense of **[BEGIN CONFIDENTIAL**[redacted]**[END CONFIDENTIAL]**. See OCS Exhibit 1D-7.

I am also adjusting depreciation expense on two other asset categories of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** because these assets will be fully depreciated in about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** years.[65] If Carbon's depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** on these accounts is approved in this proceeding, then they will recover annual depreciation expense and related UUSF of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** in each of the next three years. However, when these assets are fully depreciated in about **[BEGIN CONFIDENTIAL]**[redacted] years, Carbon will continue to recover the same amount of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** annually from the UUSF although they may not be recording any depreciation expense on the books for these accounts - - so after three years Carbon could be over-recovering UUSF of about **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** annually.

I have taken the annual depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** and divided this by 1.67 years (or the 3-year depreciation expense total of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** divided by 5 years)

[65] Total Net Book Value of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** divided by annual Depreciation Expense of **[BEGIN CONFIDENTIAL]**[redacted] **[END CONFIDENTIAL]**

to allow Carbon to recover **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** of annual depreciation expense from the UUSF in the next 5 years (instead of recovering **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** annually before and after the assets are fully depreciated). However, if Carbon does not come in for another UUSF proceeding after 5 years and it stops depreciation expense on these accounts after 5 years, then it would only be over-recovering annual depreciation expense and UUSF of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** instead of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**. But my proposal to delay Carbon's over-recovery of depreciation expense from the UUSF from a period of three years (if no action or adjustment is made in this proceeding) to a period of five years (if my adjustment is adopted) is more reasonable - - albeit with some risk after the fifth year.

My proposal results in an adjustment of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**[66] to depreciation expense for these two accounts, but this is reduced by depreciation expense of **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]** (I already removed this depreciation expense in Adjustment BCO-2 - Option 2) for a net adjustment of **[BEGIN CONFIDENTIAL]**[redacted]**[END**

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[66] Total depreciation expense of **[BEGIN CONFIDENTIAL**[redacted]**[END CONFIDENTIAL]** less allowed amount of**[BEGIN CONFIDENTIAL]** [redacted]**[END CONFIDENTIAL]**, equals **[BEGIN CONFIDENTIAL]**[redacted]**[END CONFIDENTIAL]**.

CONFIDENTIAL]. However, if the Commission did not adopt my proposed Adjustment BCO-2, then this depreciation expense adjustment would be the gross amount of **[BEGIN CONFIDENTIAL]** [redacted] **[END CONFIDENTIAL]** for these two accounts.

Adjustment BCO-9: ADJUST INCOME TAXES AND REFLECT INTEREST SYNCHRONIZATION

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-9?

A. This adjustment calculates income taxes on the OCS-proposed earnings as a stand-alone adjustment and it does not adjust from Carbon's calculated income tax income tax expense amount. Although I do not completely agree with Carbon's tax calculation methodology, I have used that same method for this proceeding only, except I have also deducted interest expense in the calculation of income tax expenses using the generally accepted "interest synchronization" approach.

The purpose of the "interest synchronization" approach is to deduct from income tax expense the amount of interest expense[67] cost that is included as a weighted-debt cost component in the rate-of-return ("ROR") that is applied to rate base. This approach properly "synchronizes", or matches, the interest expense deduction for income tax expense purposes with the same interest expense/debt cost that is included in the ROR component

[67] This is because interest expense is a significant reduction to "taxable income" in the calculation of income tax expense and interest expense is not otherwise included in operating expenses used in calculating the revenue requirement.

applied to rate base. Although Carbon does not have any debt or interest expense on its books, it does use a hypothetical capital structure and related ROR that includes a weighted cost of debt, and both the Carbon and OCS ROR calculation use the same cost of debt in their respective calculations (although OCS uses a different "weighting" of 50% equity and 50% debt in its hypothetical capital structure). Thus, it is reasonable to use an interest synchronization approach using either a hypothetical or actual capital structure. The interest synchronization approach is a commonly used regulatory practice by both companies and regulatory agencies in rate filings, thus it is reasonable to use in this proceeding.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes.