BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF CARBON/EMERY TELCOM, INC.'S APPLICATION FOR AN INCREASE IN UTAH UNIVERSAL SERVICE FUND SUPPORT	))))	**Docket No. 15-2302-01**
Applicant	))	

ERRATUM REDACTED REBUTTAL TESTIMONY

OF

DARREN WOOLSEY

ON BEHALF OF CARBON/EMERY TELCOM, INC.

September 15, 2015

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REBUTTAL TESTIMONY OF DARREN WOOLSEY

Q. What is your name?

A. My name is Darren Woolsey.

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

A. I am employed by Carbon/Emery Telcom, Inc. as its Chief Financial Officer.

Q. There are numerous references to various affiliated entities in the testimony, can you please identify the affiliated entities and the abbreviations you will use in this testimony to refer to each?

A. Yes. The affiliated entities and the abbreviations I will use to refer to each are:

- Emery Telecommunications & Video, Inc. (ETV) provides internet, circuits, fiber transport, VOIP voice, customer premise equipment, and retail computer sales and service.
- Emery Telcom Video, LLC (ETV LLC) provides cable tv, cable internet, and local advertising.

Q. Have you previously provided Direct Testimony in this matter?

A. Yes. With the filing of Carbon/Emery Telcom's Application for Increase in UUSF on April 2, 2015 ("Application"), I filed direct testimony in support of the Application. My testimony included Confidential Exhibits 1-14 (with subparts). I also provided Supplemental Direct Testimony on April 24, 2015 to include the 2014 Audited

Financial Statements, 2014 Journal Entries, and 2014 Audit Memorandum when Carbon/Emery Telcom, Inc. received them from the auditors.

Q. What is the purpose of your reply testimony?

A. The purpose of my rebuttal testimony is to respond to the various testimonies filed in this proceeding by the Division of Public Utilities (the "Division") and the Office of Consumer Services ("Office"). In their testimonies, these parties propose modifications to Carbon/Emery's Application for Increase in UUSF. In this testimony, I recommend that the Commission modify or reject many of these proposed modifications. Specifically, I will address the testimony of:

- William Duncan, Division of Public Utilities;
- Joseph Hellewell, Division of Public Utilities;
- Bion C. Ostrander, Office of Consumer Services; and
- David Brevitz, Office of Consumer Services.

Q. Have you reviewed the testimony of the individuals you have identified above?

A. Yes.

Q. Please identify the exhibits to your testimony.

A. I am attaching the following Confidential Exhibits:

- Carbon/Emery Rebuttal Testimony of Woolsey - Cable Internet Migration - Exhibit 1

- Carbon/Emery Rebuttal Testimony of Woolsey - A&G Allocator Analysis - Exhibit 2
- Carbon/Emery Rebuttal Testimony of Woolsey - CSR Allocation - Exhibit 3
- Carbon/Emery Rebuttal Testimony of Woolsey - Depreciation - Exhibit 4

Q. Could you please summarize your reply testimony?

A. My testimony will focus on the particular adjustments that the Division of Public Utilities and the Office of Consumer Services are recommending in the testimonies filed on their behalf. Specifically, I will address:

- 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 Access Line Reduction
- Adjustment BCO-8: Remove Depreciation on Fully Depreciated Assets
- Division of Public Utilities' adjustment on Depreciation
- Adjustment BCO-9: Adjust Income Tax Expense and Reflect Interest Synchronization

Q. What else will you address in this rebuttal testimony?

A. Carbon/Emery Telcom is proposing four adjustments to the UUSF request contained in the initial filing which I will discuss in detail below. However, by way of summary, the four adjustments are:

- A decrease in the three year land line loss projection to reflect actual land line losses experienced through August 1, 2015. This adjustment reduces Carbon's UUSF request by [redacted].
- An increase in revenue resulting from anticipated additional fiber to the home (FTTH) customers. This adjustment is [redacted] increase in revenue. This adjustment reduces Carbon's UUSF request by [redacted].
- An adjustment to the amount of revenue requirement recognized by Carbon/Emery Telcom (Carbon) for interstate special access services referred to as "DSL revenue requirement". This adjustment accounts for DSL revenue requirement reflecting the 2014 Interstate Cost Study filed in July 2015, which was not available at the time of the initial filing. Carbon's portion of this adjustment resulted in an increase of revenue in the amount of [redacted] resulting in a decrease in the UUSF request.
- An adjustment related to long term liabilities in the amount of [redacted] with a corresponding UUSF impact of [redacted] (10.5001% Carbon filed rate of return).

As indicated, I discuss these adjustments in detail below, the combination of the four proposed adjustments would result in a decrease of [redacted] from

Carbon's initial Application filing (-$[redacted] - $[redacted] + [redacted] - [redacted] = -$[redacted] plus the tax reduction effect on these adjustments of -$[redacted].

Q. Do you agree with Mr. Ostrander that UUSF proceedings warrant rigorous analysis and oversight?

A. Carbon/Emery Telcom consistently files annual reports with the Division of Telecommunications and receives review and oversight. Furthermore, Carbon has not filed for increased rates but has filed for an increase in distribution out of the UUSF. Also, the Division and Office reviewed Emery Telcom and Carbon/Emery Telcom in a similar proceeding in 2014. Mr. Ostrander's testimony discredits the purpose of Universal Service by stating that no direct or measurable benefit accrues to citizens in areas not receiving UUSF funding. The very concept of Universal Service inherently recognizes the value of providing affordable service to higher cost rural areas and connecting urban Americans to their rural counterparts. Citizens in urban areas pay into the UUSF for the ability to call citizens who live in high cost rural areas. Universal service benefits both urban and rural customers and the Office of Consumer Services represents both urban and rural consumers and is mandated to assess the impact of regulatory action on all residential consumers and small businesses (both urban and rural). All telephone customers pay into the UUSF. The desire to minimize the payments into the UUSF should not outweigh the proper use of the funds to further the public interest of providing service (including advanced services) to rural end user phone customers and special access (small commercial) customers. Additionally, it is critical to remember that carriers who receive UUSF funding also have carrier of last resort and E911 obligations. Ubiquitous service in Carbon's area would not be possible without federal and state universal service support.

Q. In his testimony on behalf of the Office of Consumer Services ("Office"), Mr. Ostrander proposes two significant adjustments related to what Mr. Ostrander perceives as "allocation problems" between Carbon and its non-regulated affiliates. Mr. Ostrander identifies those adjustments as BCO-1 (allocate fiber/internet-related common costs from Carbon to its non-regulated affiliates) and BCO-2 (allocate corporate overhead expenses from Carbon to non-regulated affiliates). Does your testimony address both of these adjustments?

A. No. Douglas Meredith addresses adjustment BCO-1 which purports to allocate fiber/internet related common costs from Carbon to its non-regulated affiliates.

Q. Are you familiar with the Office's adjustment BCO-2 which purports to allocate corporate overhead expenses from Carbon to non-regulated affiliates?

A. Yes. Mr. Ostrander proposes a modification of Carbon's A&G Allocation factor. In Carbon's Application, Carbon applied an A&G Allocation factor of [redacted]%[1] to regulated operations and [redacted]% to non-regulated operations. The A&G allocator is used for several departments including CEO, Board of Directors and Public Relations/Marketing (PR/MK). Mr. Ostrander proposes a change of the A&G Allocation Factor to [redacted]%/[redacted]% for CEO and Board of Directors and [redacted] reg [redacted] non-reg for PR/MK.

Q. Do you agree with this proposed adjustment?

A. No. As I detail below, Carbon's allocation factors are accurate and no adjustment is needed. Mr. Ostrander's analysis is cursory and flawed. Mr. Ostrander states that Carbon has inappropriately used allocators to overstate regulated allocated expenses and understate non-regulated allocated expenses. However, much of the analysis performed by Mr. Ostrander and included in his testimony in lines 738 to 779 was based on unconfirmed and inaccurate assumptions, and the data used to perform many of the calculations was incorrect. This erroneous data was then used to justify a proposal to change the CEO and Board allocations to 50% reg 50% non-reg.

[1] In Table BCO-2 in Mr. Ostrander's testimony he correctly identifies the A&G Allocation Factor as [redacted]%/[redacted]% regulated to non-regulated. However, in Table BCO-4, and on line 711 of Mr. Ostrander's testimony, Mr. Ostrander incorrectly identifies the A&G Allocation Factors as [redacted]%/[redacted]% regulated/non-regulated.

Q. Please explain.

A. It is Mr. Ostrander's opinion that costs have been shifted from non-regulated entities to the regulated entities. To support this opinion, Mr. Ostrander examined the Consolidated Financial Statements and "other information" which is not identified in Mr. Ostrander's testimony. The Office found that "certain financial data, allocations, and changes in amounts from year to year appear unusual or appear to favor the non-regulated affiliates," and concluded without explanation that "this type of information lends support for my adjustment to reallocate some expenses from regulated to non-regulated operations."

Q Do you know what financial data, allocations, and changes in amounts from year to year appeared unusual to Mr. Ostrander?

A. The Office referred to the net income for the regulated companies, and found that the net income for the regulated companies decreased from [redacted] to [redacted] from 2013 to 2014. However, these numbers are incorrect. Review of the Consolidated Financial Statements shows that the correct numbers regarding the regulated companies' net income are [redacted] and [redacted] for 2013 and 2014 respectively, evidencing a reduction of regulated net income of [redacted] not [redacted] as stated by Mr. Ostrander.

Q. Were you able to determine where Mr. Ostrander's regulated net income numbers came from?

A. No, I was not, but I can explain the reduction in regulated net income, and clarify why Carbon needs additional UUSF support. The decrease in regulated net income was almost entirely recorded on the books of Emery Telcom (not Carbon) as demonstrated below:

[CONFIDENTIAL TABLE REDACTED]

Source: 2013-14 audited financial statements as provided to the Office and DPU

As shown in the table above, the net income of Emery declined by [redacted]. The decrease is not the result of shifting costs, as inferred by Mr. Ostrander, but primarily the result of lost revenue of [redacted] and to a lesser extent the investment in FTTH resulting in increased depreciation of [redacted]. The largest revenue decrease was due to a federally dictated loss of reciprocal compensation revenue associated with CAF-ICC reform [redacted]. Other state access revenues declined by [redacted], primarily as a result of this same CAF-ICC reform. Local service revenues declined by [redacted] due to declining local service customers. Billing and collection revenue declined by [redacted] as described in Emery's response to DPU 4 2.2. Other revenue declines amounted to [redacted]. Emery Telcom did experience some expense increases. Depreciation increased by [redacted] as a result of increased investment. All other expenses however only increased by [redacted]. This accounts for the change in net income of [redacted] on Emery Telcom. The [redacted] increase in all expenses excluding depreciation does not support the offices premise that costs were shifted from the non-regulated entities to the regulated entities.

The majority of the regulated decline in revenue highlighted by Mr. Ostrander was due to revenue decreases on Emery. Carbon did evidence a smaller reduction in net income of [redacted] from 2013 to 2014 demonstrated in the chart below:

[CONFIDENTIAL TABLE REDACTED]

Source: 2013-14 audited financial statements as provided to the Office and DPU.

This chart illustrates that Carbon actually had some revenue gain (special access less a partial offset from land line loss), and that the loss in net income was largely due to additional depreciation associated with recent and ongoing plant additions.

Q. So did expenses shift from the non-regulated companies to the regulated companies?

A. No. Expenses did not shift from non-regulated companies as suggested by Mr. Ostrander. In fact, as shown, Carbon's "other expenses" only increased [redacted] from [redacted] to [redacted].

Q. What conclusions do you draw from a review of the net income numbers?

A. The conclusions to be drawn from a top level financial analysis are as follows:

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- there is no shift in allocated costs from the non-regulated entities
- actual non-depreciation expenses did not change significantly in Carbon or Emery
- the decline in the net income of Carbon/Emery Telcom was not the result of inappropriately allocating expenses in 2014, but rather it illustrates consistency between the two years.

Q. Did Mr. Ostrander's use of inaccurate numbers for regulated net income affect his analysis?

A. While I find it difficult to follow Mr. Ostrander's analysis, if his conclusion is that "changes from year to year appear unusual", the "unusual" appearance could be a result of his use of inaccurate numbers. In my opinion, the inaccurate numbers and shallow analysis used by Mr. Ostrander make the analysis meaningless and the conclusions reached unsupportable.

Q. Why?

A. The analysis is meaningless because Mr. Ostrander starts with inaccurate numbers on regulated net income and these incorrect numbers flow through the analysis causing Mr. Ostrander to incorrectly calculate the regulated companies' profit margin. He then compares the inaccurate profit margin of the regulated companies to his calculated profit margin on the non-regulated affiliates, which Mr.

Ostrander uses (in some unascertainable way) to support his adjustment to reallocate “some expenses” between regulated and non-regulated operations. A slightly deeper analysis than that performed by Mr. Ostrander, as discussed above, evidences the reasons for the noted changes and shows why this course is not supportable.

Q. Are the regulated companies net income and profit margins the only numbers Mr. Ostrander has stated incorrectly in his analysis?

A. No. Mr. Ostrander identifies the ETV net income change from 2013 to 2014 as [redacted]. The actual decrease in net income was [redacted]. Additionally, while Mr. Ostrander correctly states the ETV net income in 2014 as [redacted], he misstates ETV’s percentage of total consolidated profit of [redacted]%. Mr. Ostrander then discusses expenses where he highlights an increase in RLEC expense of [redacted] (the operating expense increase is actually only [redacted]) and implies that this increase in regulated expenses corresponds to a similar decrease in ETV expenses of the same amount of [redacted] (Operating expense decrease was actually [redacted]). The implication in Mr. Ostrander’s testimony is that somehow this is related to a shift of costs from non-regulated to regulated operations. This is misleading due to the errors in the numbers. However, the increase in cost was a result of increased amortization and depreciation, which are the result of company specific plant investments. The remaining actual costs evidence only a slight increase in regulated costs of [redacted] and a slight decrease in non-regulated costs of [redacted]. Accounting for the change in DSL wholesale handling (discussed below), non-regulated operating expense actually went up by [redacted] which does not support Mr. Ostrander's conclusion.

Q. What actually caused the decreases in ETV expenses and revenue?

A. The decline in both revenue and expenses in ETV related to a change in accounting for the DSL wholesale revenue charged by the regulated company to the non-regulated company which occurred when our new billing system was implemented in the fall of 2013. The new billing method avoids showing the revenue and matching expense in separate accounts on ETV and just moves the revenue to the regulated companies where it ultimately ends up under the old or new method. This change resulted in a [redacted] decrease in ETV revenue and corresponding expense in 2014. The remaining decrease in ETV revenue is related to a decrease of DSL subscribers (ETV) as they moved to higher speed Cable Internet (ETV LLC) between 2013 and 2014. This revenue shift can easily be viewed in the trial balances of the two non-regulated companies.

Q. Did the Office have the trial balances of the two companies?

A. Yes. The Office had the trial balances of the two companies, the General Ledger of all companies and the consolidated financial statements with consolidating information from 2012 to 2014. However, in the testimony of Mr. Ostrander, he states "it is possible that the decrease in ETV's expense of [redacted] and the corresponding increase in regulated RLEC expenses of [redacted] was the result of a favorable shift of allocated expense from non-regulated operations to regulated operations, but that cannot be confirmed." The reality, however, is that the GL detail and allocation detail for both years were provided to the Office, and the Office could have confirmed that the decreases in non-regulated expenses did NOT result from a favorable shift of allocated expenses to regulated operations. But Mr. Ostrander either did not perform this analysis or did not like the results. Rather, he relied on supposition and unsupported assumptions to justify a reduction in the allocation factor from [redacted]% regulated to [redacted]% regulated.

Q. Was there anything else in Mr. Ostrander's testimony related to his assertion that Carbon overstates its regulated allocated expenses and understates its non-regulated allocated expenses that troubled you?

A. Yes. Mr. Ostrander suggests that because ETV has profit, it can readily absorb his allocation adjustments. This seems to imply that ability to pay is a proper cost allocation factor. This position is not reasonable; it is not supported by analysis; and it should be rejected by the Commission. It is unreasonable to have profitability drive allocations or adjustments.

Q. Do you find it unusual that the company does not have any allocation factors that allocate 50% or more of expenses to nonregulated operations?

A. No. Because the company direct codes many costs, not all of the costs are subject to an allocation factor. Additionally, I am very familiar with the drivers that were used to develop the allocators. With a proper understanding and examination of the cost drivers, and analysis of the company's direct coding to ensure the non-regulated companies are not favored, the allocators are very reasonable. However neither my subjective opinion, nor anyone else's, should be considered support for a cost allocation. Rather, any cost allocation factor or method should be supported by data, which Mr. Ostrander failed to provide. Carbon has provided that data in response to various data requests to support its allocation factors.

Q. Mr. Ostrander suggests that total revenue and expenses can be used to determine the appropriate allocation factors. Do you believe the total revenue and expenses are rational drivers of costs?

A. No. Revenue could be an appropriate standard to use to allocate costs if a company had homogenous products. For example, if the consolidated entity of Carbon/Emery Telcom consisted solely of Emery Telcom, Carbon Emery Telcom, and Hanksville Telcom offering similar products at similar prices, then revenue could be used without significant distortion (see possible exception noted below). However when a consolidated entity offers non-homogenous services, such as cable television, broadband internet, long haul transport, and newsprint, as in the case of the consolidated entities of Carbon/Emery Telcom, revenue is an illogical basis to use when developing cost allocations.

Q. Please explain why revenues are not a rational driver of costs.

A. As an example, consider this UUSF proceeding. Carbon/Emery Telcom is requesting an additional [redacted] in UUSF funding. If Carbon is successful and receives this additional revenue, a cost allocation based on revenue would result in increased expenses going to Carbon Emery Telcom. At first this may seem rational because a large amount of expenses were incurred to go through this process (although those costs are not likely to continue). However, let's now assume that Carbon incurs these same expenses and Carbon/Emery Telcom's current USF of [redacted] is reduced to 0, as is being proposed by Mr. Ostrander. A cost allocation based on revenue would then result in a reduction of cost to Carbon/Emery Telcom. It is inappropriate to assume that the dollar result of a UUSF proceeding should determine cost allocations. The fact that a UUSF case is undertaken could be considered a reason for direct coding or maybe even a temporary driver, but the result of the UUSF case should not be.

A second example is special access transport revenue earned from a route provided significantly across ETV leased fibers from Grand Junction CO to Salt Lake City, Utah. This route generates revenue with only a handful of customers and related billing and compliance issues. The lease also provides for maintenance, thus ETV is not allowed to work or manage work on the fibers under such lease. As a result, this fiber generates revenue with no significant management attention, billing complexity, compliance, or customer service. If overhead costs were allocated on revenue ETV would receive an inappropriately high level of costs unsupported by actual management time based on the revenue from this route.

Similarly, but to a lesser extent, internet revenue generated by internet customers on ETV and ETV LLC are much easier to manage as a one or two line item billing compared to a phone customer with franchise fees, excise tax, sales tax, E911, subscriber line charges, ARC charges, poison control, EAS, local service, call features, universal service fees, and the associated billing and compliance associated with all of these billing line items. These examples highlight the inappropriateness of revenue as a cost driver. This example also begins to show why the billing records are reflective of associated management time in managing the complexity of regulated operations including compliance, regulatory changes, proceedings, and oversight of CSR and administrative employees.

Q. Do you believe expenses are a rational driver of costs?

A. No. Expenses are not a rational driver of costs.

Q. Why not?

A. There are significant direct coded expenses that have no relationship to the amount of time spent by the CEO, Board, Marketing/PR, or CSR's. One of the best examples that illustrates the problem with using expense as a substitute for a substantive cost driver can be seen with the expenses of Emery Telcom Video LLC (ETV LLC). The single largest expense category on the non-regulated entities is Cable TV programming costs in ETV LLC. These costs totaled [redacted] for 2014 (activity 73 in account 7962.61 in previously provided GL detail). This cost alone is similar to [redacted], yet programming and negotiation is handled through ETV LLC's association with the National Cable Television Cooperative (NCTC) leaving very little management time related to cable TV programming. If expenses were used as an allocation basis, significant costs would be inappropriately allocated to ETV LLC. It simply is not logical that a random programming cost increase would result in additional CEO cost allocation. There is no reasonable correlation.

Q. Do the "billing record" inputs to the company's A&G allocation factor have a "direct" or "cost-causative" relationship to the expenses in the department cost pool that they are used to allocate?

A. Yes. Billing records are representative because they are representative of the - types of services, number of customers, complexity of regulatory compliance, and issues that the CEO/Board, and Marketing represent. Forward looking plans are extensions of or improvements to the existing services and have focused primarily of regulated issues since 2011 when CAF/ICC reform was implemented and continues today with ACAM model based support proposals being considered by the FCC. Billing records also reflect forward looking CEO plans board decisions, and marketing efforts as these efforts can be measured in resulting customer growth in new and existing areas. Extension of plant to new customers and areas is also reflected in the billing records on a slight lag. This allocator is updated frequently.

Q. What is your assessment of the revised A&G allocator calculation performed by Mr. Ostrander?

A. Carbon/Emery Telcom is not opposed to the idea of considering other cost causative drivers in addition to billing records to maintain the accounting and general allocator. As was pointed out by Mr. Ostrander, drivers in addition to billing records have been used by Carbon/Emery Telcom in the past. However, I do not agree with all of the Offices proposed drivers, or its methodology in considering those drivers.

Q Which of the proposed drivers suggested by Mr. Ostrander to you reject?

A. I reject the use of "Revenue" and "Expenses" as cost allocators. For the reasons I discussed above "Revenue" and "Expenses" are not at all appropriate to use to develop allocations.

Q. Do you agree that Plant can be used as an input for developing cost allocators?

A. Yes. Carbon/Emery Telcom could consider Plant as a possible cost driver to determine the accounting and general allocator. If "plant" were to be used, "Gross Plant" would be a better indicator than "Net Plant" because the regulated entities use group asset depreciation per FCC part 32 whereas the non-regulated entities use single asset straight line depreciation. Because group asset depreciation has had an accelerated effect on the regulated entities, use of net plant as an indicator for cost allocation would result in an artificially low allocation to the regulated entities to the extent of the accelerated depreciation.

Also, when using Plant as a proposed driver, shared assets need to properly accounted for and shown on the books of the correct entity based upon allocation of that asset, not ownership. As indicated in Carbon's Application, to reduce duplication of equipment and costs, the Carbon/Emery Telcom entities share certain equipment, vehicles, and computers. This shared equipment is recorded on the books of ETV. This cost of this shared equipment is then allocated to the various related party entities based upon usage or other allocators. The shared equipment is presented and discussed in the initial filing as Exhibit 7b – Shared Assets and this exhibit was used as the basis for a rate base adjustment to include the appropriate portion of shared equipment in the rate base of Carbon. Therefore, an allocator based upon plant would need to reflect the portion allocated to each entity to prevent the overstatement of assets on ETV and related understatement on each of the other Carbon/Emery related entities. Mr. Ostrander's analysis of plant as a driver does not take these issues into consideration.

Q. Are there other inputs that Carbon agrees are appropriate?

A. Yes. Carbon believes that records and payroll can also be valuable inputs in determining the appropriate A&G Allocation factor.

Q. Has the Office employed the proper methodology for considering these allocation inputs?

A. No. The calculation performed by Mr. Ostrander in "Confid. 15-2302-01 - Ostr. WP 1.3 - Adj. BCO-2 (OCS DR 2-40 CAM Alloc.).xlsx" uses an equal weighting of the various dollar types and records. This method skews the allocation to the highest dollars (revenue and net plant totaling [redacted]) and essentially gives no weight to billing records ([redacted]). A more reasonable approach is to assume that each of the drivers, if representative, should be given equal weighting. This can be easily accomplished by taking the average of the resulting allocation percentages of each appropriately identified driver.

Q. Have you recalculated the Accounting and General Allocator using additional inputs as suggested by Mr. Ostrander?

A. Yes. Carbon recalculated the A&G Allocator using Gross Plant (properly adjusted for shared assets), Monthly Records, and Payroll, and then weighted each associated allocation percent equally. This produced essentially the same allocation as was used by Carbon in the initial application [redacted]% Emery (ET), [redacted]% Carbon/Emery (CT) and [redacted]% Hanksville (HT) (74.42% total to regulated entities) as opposed to [redacted]% ET, [redacted]% CT, and [redacted]% HT ([redacted]% total to regulated entities). This calculation can be viewed in <u>Carbon/Emery Rebuttal Testimony of Woolsey – A&G Allocator Analysis - Exhibit 2.xlsx</u>.

Although the revised allocation would result in slightly greater expenses being allocated to the regulated entities ([redacted]%), because of the insignificance of the increase, I am of the opinion that the base year is representative and no adjustment is necessary.

Q. The Office proposed a different basis for Public Relations/Marketing allocations. Do you agree with the proposed adjustment?

A. No. Mr. Ostrander's proposed PR/MK adjustment premise is that because there are three services and the one regulated service should be then allocated 33% of the cost; he then randomly decides 25%. Neither the 33% or the 25% is backed by substantive support. The three services considered by Mr. Ostrander were IPTV, Internet, and Phone. The affiliated companies of Emery do not offer IPTV but do offer Cable TV.

When considering how to allocate costs for marketing, if certain services are not advertised at all they should get little or no allocation of costs, conversely if a particular service appears more frequently it should receive an increased allocation. With this in mind, only considering the number of services offered, is over simplistic as it does not consider the focus or frequency of marketing efforts of these services. If services are specifically non-regulated and do not contain phone advertising they are direct coded as is the case with Moab advertising which is all direct coded to non-regulated entities and reduces the actual amount of PR/MK subject to the allocator. In the regulated operating areas, phone receives a primary focus either directly or through bundles. Due to decreased interest in land lines, the advertising of bundles is critical to the success and survival of Carbon. Bundles in the regulated operating areas are designed to be Phone and "something else" either LD, cable, internet provided over regulated plant, or internet provided over non-regulated plant. Whenever a bundle is advertised and sold the regulated entity benefits. This benefit is enhanced by the sale of long-distance or DSL which are tied to the regulated entity due to the requirement to have a land line or to allocate additional loop cost (DSL revenue requirement) for standalone DSL. Thus, the actual sales (and advertising) of LD, DSL, and Bundles in general, benefit the regulated entity and cost should reflect this.

As of December 31, 2015, nearly [redacted] of the customers in the Carbon serving area are phone customers ([redacted] phone vs [redacted] (internet and cable). Of the internet customers [redacted] were DSL making them also regulated customers (ETV purchases wholesale DSL special access service from Carbon). The number of

Carbon serving area customers being serviced by regulated plant is [redacted] or [redacted]%.

In the absence of a more appropriate allocation basis, the current use of the A&G allocator by Carbon for PR/MK is reflective of the results of marketing efforts and is comparable to the customers being served by regulated vs non-regulated plant.

Q. In addition to the A&G Allocation change and PR/MK Adjustment, the Office is proposing an adjustment to the CSR Allocator. Do you agree with the proposed adjustment?

A. No. Mr. Ostrander's proposed CSR adjustment contains a variety of errors.

Q. What errors are contained in the CSR adjustment being proposed by the Office?

A. Mr. Ostrander states that the CSR allocator should be adjusted from [redacted]% regulated and [redacted]% non-regulated to [redacted]% regulated and [redacted]% non-regulated. However, Mr. Ostrander has not provided any data or evidence to support this conclusion. There is no evidence that Mr. Ostrander's opinion of how CSR costs should be allocated is more accurate than the time study performed by Carbon in 2010. In fact, it would appear that Mr. Ostrander did not verify any of his findings related to CSR's in the Office data requests, and as a result, Mr. Ostrander made several errors in his testimony related to the CSR Allocation factor.

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Q. Please identify the errors you are referring to.

A. In Mr. Ostrander's calculation of CSR costs he uses [redacted] total CSR dollars as a basis for allocating 2014 CSR costs, the correct amount of total CSR costs is [redacted] which results in a 35% misstatement upfront and makes any resulting proposed adjustment wrong. This data is a subset of total allocations given to the Office in DR 2-40. Carbon has utilized an Excel pivot table to summarize the data and demonstrate the error, see Carbon Emery Rebuttal Testimony of Woolsey – CSR Allocation - Exhibit 3.xlsx. The error was limited to this one data point. From the pivot table you can see that total expenses subject to allocation tie to Mr. Ostrander's analysis showing [redacted] in total allocated expenses. The highlighted green numbers on Carbon Emery Rebuttal Testimony of Woolsey – CSR Allocation - Exhibit 3.xlsx also tie to amounts shown for Board, CEO, Marketing/PR, and Human Resources. The CSR allocation amount does not tie and should have been [redacted].

Mr. Ostrander states that there are [redacted] CSR's per DPU 1-4(b), then goes on to state that "It is not clear why [redacted]%, or a substantial majority of these CSR costs would be allocated to regulated operations". DPU 1-4(b) does not indicate that [redacted]% of CSR costs were allocated to the regulated entities. It does however clearly demonstrate that there were [redacted] different CSR's between January 31, 2012 and April 1, 2015. Mr. Ostrander failed however to notice that there were also [redacted] additional “CSR/Advanced Trouble Shooting” employees making [redacted] total CSR’s that worked in any given month over the 40 month period presented. His count does not consider turnover, part-time, or temporary employment. Mr. Ostrander also failed to notice that there was a table at the bottom of this data request that clearly demonstrates the number of employed employees in any given month. The summary is presented below with highlights for the base year and a summary at the bottom of the sheet:

[CONFIDENTIAL TABLE REDACTED]

Source: DPU DR 1-4b Emery & Carbon - Employee List.xlsx (highlights and summary of CSR counts below data added)

Q. Please explain this data.

A. Though there were a total of [redacted] total different employees employed during the 40 month period the number employed in any given month was never more than [redacted]. The average number of CSR’s during the base period was [redacted] From this [redacted] an adjustment needs to be made for part-time employees to arrive at full time equivalents. There are [redacted] part-time employees, so a reduction of [redacted] employees brings the FTE employee count average to [redacted]

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Q. Do all of the [redacted] FTE CSR employees use the CSR allocator for their primary coding?

A. No. Out of the [redacted] FTE employees there are [redacted] dispatch CSR's that primarily use the dispatch allocator which more closely follows plant labor. There are also [redacted] CSRs included in the advanced trouble shooting CSR group and [redacted] Moab CSR who's coding is all to non-regulated entities (ETV and ETV LLC). This essentially lowers the actual number of CSR's using the CSR allocator for their primary coding to [redacted]

Q. What other changes have you made with respect to CSRs?

A. In conjunction with the establishment of the troubleshooting group, additional plant troubleshooting software tools were given to the CSR group to diagnose initial trouble calls. If a CSR determined that the trouble is not isolated to the outside plant, the call is passed to the advanced trouble shooting group. This greatly reduces the amount of time the CSR's spend with non-regulated customers. These changes were made as DSL and Cable internet customers increased, and despite the increased number of customers, the additional tools and cooperation between advanced troubleshooting has allowed customers to be served without requiring a significant increase in CSRs. The CSRs' actual time can be reviewed with a Pivot table on DPU DR1-4a Emery & Carbon- Labor Reports – testimony analysis.xlsx the pivot reveals the following:

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[CONFIDENTIAL TABLE REDACTED]

Source: Carbon Response to DPU DR 1-4a Emery & Carbon-Labor Reports – testimony analysis.xlsx

Q. What does the Pivot table show?

A. The Pivot table reflects the final disposition of all CSR Labor and shows use of CSR, Dispatch, Directory, and Moab CSR distributions as well as direct coding. The results indicate that more CSR time is actually coded to the non-regulated entities than the regulated entities ([redacted]% non-reg vs [redacted]% regulated). As the current actual coding is highly non-regulated and combines the proper use of direct coding and representative allocators based on real cost drivers, the hypothetical allocator proposed by Mr. Ostrander is not appropriate and is wholly without basis.

Q. The Office is proposing several adjustments to your rate base accounts. How did you determine the rate base accounts used in Carbon's Application?

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A. Carbon/Emery Telcom relied on pages 17 and 18 of the Incumbent Local Exchange Carrier Annual Report to the Public Service Commission of Utah (Annual Report) for guidance in determining appropriate rate base accounts. Carbon's Annual Report for the period January 1, 2014 to December 31, 2014 was submitted to the PSC and has been provided to the Office and DPU. Page 17 of the Annual Report lists the net telecommunications plant in service by account. Page 18 is entitled "Other Rate Base Accounts" and includes a listing of accounts typically considered as part of the rate base. A snap shot of Carbon's 2014 report is shown below as an example of the included accounts:

[CONFIDENTIAL EXCEPRT FROM ANNUAL REPORT REDACTED]

Generally the asset accounts listed in the Annual Report are added to the rate base and certain liability accounts are deducted from the rate base. Carbon included these accounts in the Rate Base in its Application as has been the practice in the previous proceedings before the PSC. Carbon has not departed from the accounts prescribed by the Utah PSC in their Annual Report nor changed the common practice with respect to rate case or UUSF filings.

Q. Mr. Ostrander has identified 4 adjustments to rate base including Prepayments (BCO-3), Long-Term Liabilities (BCO-4), Telephone Plant

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Under Construction (BCO-5), and Materials and Supplies (BCO-6). Do you agree with any of these adjustments?

A. Yes, one. I believe that deducting the Long-Term Liabilities from Rate Base (BCO-4) is appropriate. Carbon originally did not consider the deduction of a post retirement benefit obligation because it was not specifically identified as a liability account on the PSC report. Upon examination of the nature of this account as well as the handling for interstate purposes as noted by Mr. Ostrander, I agree that a reduction from rate base should be made. I do not, however, agree with Mr. Ostrander's Part 36 value used for this adjustment. The Long-Term liability represents post-retirement health care related obligations and is appropriately removed from rate base because the company has already recovered the expense that created the liability in prior years. However, the total liability needs to be reduced by:

- the portion created through non-income statement adjustments (other comprehensive income); and
- the portion that was allocated to other non-regulated entities.

Considering these adjustments, [redacted] is the amount that should remain on Emery, Carbon, Hanksville. Only Carbon's portion, in the amount of [redacted], should be deducted from Carbon's rate base. This amount differs slightly from the Part 36 amount identified by Mr. Ostrander due to the adjustments for other comprehensive income mentioned above.

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Q. Do you agree with BCO-3 related to prepayments?

A. No. I reject the appropriateness BCO-3. The inclusion of prepaid expenses is straight forward and allowed by practice. This policy should not be changed.

Q. Do you agree that telephone plant under construction (TPUC) should be excluded from rate base (BCO-5)?

A. No. With respect to the adjustment BCO-5, Mr. Ostrander seeks to remove 50% of TPUC in the amount of [redacted] and provides two reasons for its exclusion. The first is his opinion that a normalized basis of TPUC would result in a lower and more appropriate TPUC value. Though normalization conveniently reduces TPUC, it does not recognize that these are actual capital expenditures, that TPUC is directly tied to plant investment, and that a lower TPUC just means the assets have moved to another rate base account (plant in service) or have not occurred yet. Carbon is not proposing known and measurable plant additions in TPUC. Rather, Carbon is only including actual plant expenditures which currently reside in TPUC. This is not an account that should be normalized to find an "appropriate" operating level. This account by its very nature accurately reflects actual plant expenditures.

Q. What is the second reason that Mr. Ostrander gives for removing 50% of TPUC?

A. Mr. Ostrander also suggests that we should consider the “matching principle” which is a GAAP principle not a “regulatory” principle. Matching attempts to align the financial impact of actual events to the periods in which they occur. As examples:

- a retail sale should match corresponding reductions in inventory and recognition of cost of goods sold in the same period;
- expensing of a prepaid should be ratably over the periods of benefit;
- in the case of assets, they are not depreciated until they are placed in service;
- likewise existing assets that new assets are to replace are not reduced on the books until they incur an impairment or are actually taken out of service.

Mr. Ostrander’s strange interpretation of mismatching does not provide adequate basis for adjustment; by suggesting that Carbon should somehow project an offset to the inclusion of TPUC of events that have not occurred. With respect to capital expenditures I have never heard of projecting future revenues, affiliate transactions, or disposals related to an asset addition that have not yet occurred under the theory of matching. This would in fact be a violation of both the matching principle which requires a transaction to be recorded in a correct period and also a violation of a second GAAP principle which prevents the recognition of contingent gains. Mr. Ostrander’s arguments on removing 50% of TPUC should be rejected.

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Q. Do you agree with the Offices' proposed adjustment for Materials and Supplies contained in BCO-6?

A. No. In BCO-6, Mr. Ostrander has proposed a reduction in materials and supplies to a "normalized" lower level arguing that the current level is artificially high. While the current level of materials and supplies on site is higher than historical levels, the higher level is real, on site, and necessary due to several factors:

- Carbon is experiencing increased construction activity associated with the FTTH curb and business district in Price;
- Carbon's lead time on fiber and fiber related products has increased. Carbon is currently experiencing delivery delays of three to six months.
- As a result of the increase lead times with vendors, Carbon is required to keep more inventory on hand to prevent shortages, and work stoppages that will result if required fiber and fiber facilities are not on site.

The increased level of inventory is anticipated for at least the next five years and is properly reflected in the rate base at full value.

Q. The Office is proposing a depreciation adjustment on assets that the Office believes are either fully depreciated or will be fully depreciated in about 2 years (BCO-8). Do you agree with this depreciation adjustment?

A. No. Mr. Ostrander refers to his adjustment of BCO-8 as "remove depreciation expense on fully depreciated assets". Carbon has not depreciated any asset in excess of the book value of the asset. We assume that what Mr. Ostrander is attempting to describe is the effect of group asset depreciation. As indicated in the testimony of Douglas Meredith, group asset depreciation is an FCC prescribed method of depreciation which can have an accelerating effect on depreciation in cases where there are older assets included in the group subject to a depreciation calculation. However, group asset depreciation only accelerates depreciation; it does not result in over-depreciation (depreciation in excess of the book value) of any asset.

Q. What errors has Mr. Ostrander made in his depreciation adjustment contained in BCO-8?

A. Mr. Ostrander's BCO-8 claims to reduce "depreciation expense by [redacted] (and corresponding increase in accumulated depreciation in rate base of [redacted] on assets that are either fully depreciated or [sic] will be fully depreciated within about [redacted] years." Mr. Ostrander provides no rationale for his recommendation to exclude depreciation expense in the amounts [redacted] for Other Work Equipment and [redacted] for Interexchange Circuit Equipment. He states that these accounts became fully depreciated in 2014 so he just excludes the entire amount. This position assumes no continuing investment which would result in the continuation of depreciation. Continued investment is anticipated since the company is a going concern, and I assert that the depreciation levels projected in the base year are representative of expected levels for at least the next five years based upon this investment.

Q. Are there other accounts that Mr. Ostrander adjusted besides "Other Work Equipment" and "Interexchange Circuit Equipment"?

A. Yes. Mr. Ostrander concludes that the deprecation in accounts for Subscriber Circuit Equipment and Aerial Cable is currently overstated and that it will largely disappear in four years [redacted] years for the accounts subject to his adjustment). This position again erroneously assumes no continued investment and no disposals. Additionally, there is no determination whether the current depreciation level of the chosen account groups is materially accelerated or is a representative amount. A summary of data for the two targeted adjustment accounts is as follows:

[CONFIDENTIAL TABLE REDACTED]

Source: From <u>Confid. - 15-2302-01 Ostr. WP 1.8 - Adj. BCO-8 - DPU 1-11 Deprec. Exp.xlsx</u> – tab Dep Calc. and FCC 481 filing.

Q. What does the above table show with regard to Subscriber Circuit Equipment?

A. The first targeted account, Subscriber Circuit Equipment [redacted], with a GBV and NBV of [redacted] and [redacted] respectively and a depreciation life of [redacted] years is completely appropriate at its current depreciation level. The Subscriber Circuit Equipment Account consists largely of legacy DSLAM type equipment which will be replaced by FTTH network interface device equipment beginning in earnest in 2017. Taking the Gross Book Value (GBV) of [redacted] and dividing it by the asset life of [redacted] years results in [redacted] of depreciation expense per year, which evidences little acceleration from the current year actual depreciation at [redacted] Because the legacy equipment is being disposed and replaced in the same year the old equipment will be fully depreciated the current level of depreciation is appropriate. This also shows that depreciation will remain very similar to current levels in the short run, but will actually increase after five years based upon the projected five year investment. The adjustment proposed by Mr. Ostrander is entirely inappropriate.

[CONFIDENTIAL TABLE REDACTED]

Source: FCC 481

Q. What does the above table show with regard to the Aerial Cable Account?

A. With respect to the Aerial Cable, Carbon anticipates fixed asset additions to this category of [redacted] over the next two years which will more than outpace the depreciation expense levels currently projected by Mr. Ostrander in the five year period. Though depreciation will not drop as projected by Mr. Ostrander, the acceleration effect is present in the Aerial Cable account and can be maintained

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near current levels if disposals of the older assets at levels similar to additions are made. Carbon's current use of group asset depreciation does not result in an inappropriate base level of depreciation, and (based upon anticipated additions and disposals) future depreciation levels will not differ significantly from the current 2014 base year levels. A more appropriate and encompassing discussion of depreciation methodology, potential acceleration, and both the expense and rate base implications of changing the methodology is included in the Rebuttal Testimony of D Meredith filed in this Docket.

Q. Describe how Carbon calculates depreciation expense.

A. Carbon calculates depreciation expense using a straight line calculation in conformity with a group plan of accounting as prescribed by Federal Communications Commission (FCC) in the Code of Federal Regulations, Title 47, Chapter I, Subchapter B, Part 32. FCC part 32.2000 which states "(iii) Charges for currently accruing depreciation shall be made monthly to the appropriate depreciation accounts, and corresponding credits shall be made to the appropriate depreciation reserve accounts. Current monthly charges shall normally be computed by the application of one-twelfth of the annual depreciation rate to the monthly average balance of the associated category of plant."

"Group plan" is defined as follows in FCC Part 32.9000; "Group plan, as applied to depreciation accounting, means the plan under which depreciation charges are accrued upon the basis of the original cost of all property included in each depreciable plant account, using the average service life thereof properly weighted, and upon the retirement of any depreciable property its cost is charged to the depreciation reserve whether or not the particular item has attained the average service life."

Q. Does a group asset plan calculation of depreciation expense result in higher depreciation?

A. No. Using a group asset method to Calculate depreciation expense will always result in the same total depreciation expense as calculated under any other accepted method. Group asset depreciation is an accelerated depreciation method. This means that group asset depreciation tends to produce a higher depreciation expense in earlier years, and a lower depreciation expense in later years. Conversely the rate base (NBV of associated assets subject to depreciation) will be reduced more quickly resulting in a lower total disbursement of UUSF based upon applying a rate of return on a lower NBV and over a shorter (accelerated) asset life.

Q. Is group asset an acceptable method of depreciation?

A. Yes. Group asset depreciation is an acceptable method of depreciation that is used for, and approved by the FCC. Carbon/Emery Telcom is using an accepted methodology in the calculation of depreciation in accordance with the guidance provided by the FCC, consistent with Carbon's historical practice, and consistent with the method of depreciation used by many other rural ILEC's in the State of Utah.

In the absence of rulemaking at the state level dictating the method of depreciation to be employed by rural telecommunication providers in the State of Utah, group asset depreciation should continue to be allowed by the Commission. Carbon's base year depreciation calculated using the group asset method is not abnormally high and is consistent with anticipated investment levels and should not be modified.

Q. Mr. Hellewell from the Division of Public Utilities proposed an adjustment of [redacted] to reduce depreciation expense. Can you speak to the appropriateness of this proposed adjustment?

A. The calculation is essentially a "worst of both worlds" approach to applying what otherwise would be an acceptable depreciation methodology if consistently and historically implemented.

Depreciation effects rate of return calculations in two ways: first by the depreciation expense recorded in any given period; and second by the allowed rate of return applied to the NBV of these associated assets. In addition to these two components there are two sources of potential return – State and Federal. These two jurisdictions as well as the methodology have to be closely examined when any change is considered to ensure proper jurisdictional return (no loss of recovery or double recovery).

Q. How did the DPU calculate its depreciation adjustment?

A. The DPU's proposed depreciation adjustment was calculated by applying single asset straight line depreciation to individual asset detail provided in DPU DR1-11 Emery & Carbon – Assets and CY 2014 Depreciation.xlsx. Carbon recalculated the DPU's single asset adjustment to within reasonable rounding differences of [redacted], and has supplied our calculation in Carbon Emery Rebuttal Testimony of Woolsey–Depreciation-Exhibit 4.xlsx. This exhibit also contains additional calculations which will be discussed latter.

Q. Are there issues with the DPU's proposed adjustment?

A. Yes. The DPU proposed adjustment provides single asset straight line depreciation as if had occurred from the in-service date through 2014, then compared the 2014 recalculated expense to the expense recorded by Carbon to arrive at a difference of [redacted]. The DPU methodology which resulted in lower depreciation expense was applied to all depreciable assets (not just intrastate assets). This ignores the fact that Carbon in fact used a higher depreciation expense amount in its interstate filings upon which rate of return will be established for interstate recovery mechanisms. On the associated rate base side of the depreciation transaction, the DPU used the NBV which reflects the accelerated group asset methodology (lower) then added back only the current year depreciation difference of [redacted] as a proposed adjustment to NBV. Thus the "worst of both worlds" occurred where the lowest possible NBV was used for rate base and the lowest possible depreciation calculation (single asset straight line) was used for expense.

Q. Couldn't you just adjust the NBV to reflect historical application of the single asset straight line depreciation proposed by the state to arrive at the correct amount of return on rate base associated with their proposed adjustment?

A. No. Because recovery of both depreciation expense and return on rate base has already been received on the interstate portion of these assets in prior years. Any calculation by the state would have to consider this effect.

Q. How would you address the DPU's concern regarding depreciation methodology?

A. The preferred course of action, which results in an overall lower total UUSF distribution (as discussed in testimony provided by Douglas Meredith), would be to allow companies to continue to use group asset depreciation as an acceptable methodology as prescribed by the FCC. This would not preclude other companies from using a different methodology it would just be one of the acceptable methods of calculation.

As an alternative, if the State feels strongly about a particular methodology for calculating depreciation and wishes to establish rules regarding this, the best approach would be to avoid the complications and recovery concerns of retroactive application and apply the new methodology going forward on new asset investments. If a company chooses to not follow the State methodology at that point then they would be subject to reconciling and adjusting their books for state rate making purposes as necessary.

Q. If single asset straight line methodology was prescribed by the State and adopted by Carbon on a go-forward basis, how would depreciation expense compare to the base year?

A. I performed an analysis of the effects of making a prospective change to single asset straight line depreciation as of January 1, 2014. In this analysis, Carbon assumed that group asset depreciation would continue on historical assets as of 12/31/13, and single asset straight line methodology would apply to all 2014 additions and projected additions through 2019. For purposes of this analysis Carbon used the projected capital improvements filed July 1, 2015 on FCC Form 481. From these assumptions, the analysis provided the following results:

- 2014 depreciation expense would have reduced by [redacted] from [redacted] to [redacted] in the 2014 base year.

- The six year average depreciation expense is projected at [redacted] which is [redacted] (4.3%) lower than the base year.
- The base year is materially representative of anticipated depreciation expense levels as projected in this change scenario.

See Carbon Emery Rebuttal Testimony of Woolsey - Dep Est Single Asset 2014 to 2019 - Exhibit 5.xlsx

Q. Is there another solution?

A. The last solution would be an attempt to apply the DPU methodology in a way that considers all aspects of the proposed change including depreciation expense, rate base (NBV), and jurisdiction. Carbon has performed this calculation which is included in Carbon Emery Rebuttal Testimony of Woolsey – Depreciation -Exhibit 4.xlsx. In this Exhibit Carbon starts by recalculating individual asset depreciation using the single asset straight line method through 12/31/2013. This allows the NBV at the beginning of the rate base period to be presented. 2014 depreciation expense is then calculated in the same manner, and a resulting NBV for 12/31/2014 is calculated. These numbers are then totaled to see the current 2014 depreciation effect and cumulative NBV effect of the proposed depreciation change. (See summary in rows 2531 to 2541 on the Carbon tab of the spreadsheet). The depreciation change is calculated at [redacted] essentially the same as the DPU calculation of [redacted]. In this section you can also see the effect of adding back the cumulative NBV difference on rate base, which would result in a UUSF impact of [redacted](using 10.50001% Carbon rate of return). Carbon has already described the fault of using this calculation as a NBV/rate base adjustment because it does not consider interstate return previously received on these asset differences. The next step in the calculation is contained in rows 2543 to 2553 in which the two methodologies are applied to the asset mix with the group methodology applied to interstate assets and the single asset methodology applied to the intrastate assets. This results in a 2014 depreciation reduction adjustment of [redacted]and a corresponding rate base/NBV increase adjustment of [redacted] with an estimated corresponding UUSF impact of [redacted]. The net decrease in the UUSF request resulting from this theoretically correct analysis would be $[redacted]($-[redacted]+ [redacted].

Q. Are there any downsides to the mixed calculation performed above?

A. Yes. The intrastate/interstate mix of assets can and does change over time making this calculation slightly inaccurate at any given point in time. Also, any change from existing methodology (unless the books could be restated) will cause differences in federal and state reporting that would not be easily tracked and would result in less transparency from a reporting standpoint.

Again the best course of action is the choice of an acceptable methodology that is then applied consistently over a single asset or group asset life for both interstate and intrastate rate of return recovery. In the absence of agreement on methodology by all parties in this proceeding, the focus should be on whether the amount presented in the initial filing is a representative base year amount. I assert that the base year amount is materially representative whether Carbon continues to use the group method, or if a change to single asset straight line methodology were made as of the beginning of the 2014 base year.

Q. Mr. Hellewell describes six reasons why group asset depreciation is not recommended. What is your response?

A: I will address each of the six reasons:

- Depreciation by computer: The ease of calculation was not a determining factor in the original choice of Carbon to use group asset depreciation. In fact until our recent system upgrade, Carbon's accounting system would not handle the group calculation.
- Asset Tracking: This argument is not really an issue for Carbon because individual assets are tracked. Only our oldest assets are an issue (think Qwest acquisition). Either method could be deployed with adequate tracking.
- Disposal: With appropriate individual tracking the methodology has no impact on disposals.

- Group Characteristics: The problem of classification exists in either method of depreciation. Vehicles are not necessarily a problem as they are easily identified and generally disposed at or near their depreciable life thus reducing any possible group depreciation effect.
- Standardization: I do not disagree with Mr. Hellewell's general statement here but would argue that we are among a majority of companies that use group asset depreciation.
- Volatility: I agree that volatility risk is increased under a group methodology. However this risk is mitigated through proper and timely disposals and balanced continued investment as needed for aging assets.

Q. Previously you indicated that Carbon is proposing a revenue adjustment to account for the impacts of converting non-regulated cable customers to regulated fiber internet customer. Can you tell us what the financial statement impacts of this conversion are?

A. This type of migration has two major financial statement impacts. First, there would be a shift in the various components of interstate revenue requirement, and second there would be an increase in rate base from the additional plant required to make the conversion. We contacted Moss Adams, LLP, the CPA firm contracted to produce our annual Cost Study, to do a sensitivity analysis of what would have happened to our 2014 cost study assuming that all of our December 31, 2014 cable internet customers in the Carbon ILEC service area had been converted to fiber

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internet as of year-end. The following chart summarizes the results of the Moss Adams Sensitivity Analysis which was performed at our company's cost study area level (includes Emery, Carbon/Emery, and Hanksville which operates in the boundary of SAC 502278):

[CONFIDENTIAL TABLE REDACTED]

Source: <u>Carbon Emery Rebuttal Testimony of Woolsey - Cable Internet Migration - Exhibit 1.xlsx</u>

This analysis shows that the combined effects of the migration of cable internet customers to fiber internet would have a per customer UUSF impact of ($[redacted]) per month. In order to make an adjustment to this UUSF proceeding, Carbon used a three year anticipated conversion average (similar to land line loss) in which the [redacted] remaining cable internet customers in Carbon are converted to fiber, as projected in 2015 through 2017, with a resulting projected base year adjustment impact of [redacted]. Carbon presented this adjustment along with an updated calculation of the USF impact of landline loss covering the same period. The summary above and adjustments below are included in <u>Carbon Emery Rebuttal Testimony of Woolsey - Cable Internet Migration - Exhibit 1.xlsx</u>

[CONFIDENTIAL TABLE REDACTED]

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Source: Carbon Emery Rebuttal Testimony of Woolsey - Cable Internet Migration - Exhibit 1.xlsx

Q. You also previously referred to a land line loss adjustment. Please explain.

A. The land line loss projection utilizes the same methodology used in the initial filing which incorporated a three projection of loss for business and residential customers and the application of current service rates for basic service. The initial filing for Carbon utilized 2013 and 2014 actual historical loss to project the loss forward to create a three year average. The Office rejected this adjustment, and in BCO-7 suggests that the land line loss projection should not be included as a decrease in revenue.

Q. Do you agree with the Office's adjustment for land line loss in BCO-7?

A. No. It is not appropriate to completely eliminate the land line loss projection. However, actual land line losses through 8/1/2015 were less than the projection in the initial filing resulting in an increase in revenue in the amount of [redacted], with a corresponding decrease in the UUSF request of [redacted]. Carbon's proposed adjustment accurately reflects the positive effects of lower than anticipated land line loss, and is a more appropriate adjustment than the Office's BCO-7 adjustment.

Q. Is the adjustment made by Mr. Ostrander to adjust income taxes as a reflection of interest synchronization appropriate?

A. It is not appropriate.

Q. Why isn't it appropriate?

A. With respect to the appropriateness of interest synchronization, I reject the assertion that this methodology is "common" or appropriate in cases of hypothetical capital structure. I am not aware of such an adjustment being adopted in current or historical Utah telecommunications proceedings or any FCC proceeding. I am also unaware of any such adjustment proposed or in practice in the traditional FCC rate making/cost study separation processes. The use of a hypothetical rate structure already penalizes Carbon to the extent the cost of debt is less than the cost of equity applied to any hypothetical capital structure of debt percent greater than its actual 0% debt. Effectively Carbon has been forced from actual capital structure to a lower rate of return hypothetical capital structure then, begrudging the already lower rate of return on debt, Mr. Ostrander proposes to take the return "hypothetically" lower again by adjusting for tax deductions that do not exist. The adjustment is not based upon Carbon's actual capital structure or tax deductibility. It has no precedence or place in this proceeding. If we are fully considering a hypothetical debt scenario, the very real result of hypothetical debt should be considered. In the case of Carbon debt would not be used to reduce equity, but rather the only reason Carbon would incur additional debt is to accelerate capital projects thus increasing rate base assets. Carbon has not projected hypothetical assets or even been aggressive in projecting "known and measurable" asset additions that have occurred to date in 2015. If all hypothetical consequences of a debt imputation are honestly considered then the positive effects of the scenario should be among them.

Q. If you assume that interest synchronization is appropriate, has Mr. Ostrander calculated it correctly?

A. No. It was incorrectly calculated by Mr. Ostrander.

Q. In what ways?

A. Mr. Ostrander applied a theoretical imputation of interest related to rate base assets, and then calculated a tax impact of this interest amount of [redacted]. In this calculation he used an incorrect state rate of [redacted] (Exh.1D,A-11 Ostr. Tab from Master – OCS Exhibit 2D – 15-2032-01 Ostrander Rev.Req.xlsx) vs the correct Utah rate of 5%. ~~Then after specifically calculating this as a "tax effect" of~~ [redacted]~~, he includes this amount (see line 12 included in -~~ [redacted]~~) in his summary at column "D" of the Exh.1D-2, A-1 Ostr. Tab of Master – OCS Exhibit 2D – 15-2032-01 Ostrander Rev.Req.xlsx, and proceeds to inappropriately gross the tax back up by~~ [redacted] ~~to~~ [redacted] ~~(included in line 16 –~~ [redacted]~~). He~~ Mr. Ostrander also uses a slightly incorrect tax gross up calculation. The correct gross up can be accurately represented by the unrounded formula [redacted] or rounded to [redacted].

Q. Have you calculated what the correct interest synchronization would be?

A. I am reluctant to provide the calculation because I don't think it is an appropriate adjustment. However, the correct numerical adjustment is not difficult to calculate. The correct UUSF/Tax amount, if we agreed with the initial adjustment in theory, would be [redacted] not the [redacted] calculated by Mr. Ostrander. I also disagree with the [redacted] debt to equity hypothetical capital structure that is factored into Mr. Ostrander calculation. If Carbon's actual capital structure were used this adjustment disappears, and if [redacted] debt is used the resulting calculation would only be [redacted]

Q. In the Division of Public Utilities Calculation of Rate of Return, what is the appropriate input for the interstate rate?

A. As Mr. Coleman accurately states "The question of which rate to use is really a matter of whether Carbon participates in the Common Line Pool, or the smaller subset of companies that participate in both NECA's Common Line and Traffic Sensitive pools." Mr. Coleman states that he confirmed with Mr. Brandon Gardner, NECA Western Region Manager, that Carbon is not a Common Line Pool participant.

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Q. Is Carbon a Common Line Pool participant?

A. Yes.

Q. Do you know how Mr. Coleman got this inaccurate information from Mr. Brandon Gardner of NECA?

A. Carbon/Emery Telcom is one of three ILECS reporting under Cost Study Area Code “502278 – Emery Consolidated” (together with Emery Telephone and Hanksville Telcom, Inc.). It is more typical for one ILEC to have multiple study areas than it is for one study area to have multiple ILEC’s. On September 4, 2015 I spoke with Mr. Brandon Gardner, who indicated that he had a follow-up call with Casey Coleman and that he had clarified the inclusion of Carbon in the Emery consolidated filing and the participation of Carbon in NECA’s Common Line Pool. With this clarified understanding, it is appropriate to use 11.45% per the September 30, 2014 FCC Form 492 filed by NECA as the interstate input when calculating allowed rate of return. Mr. Douglas Meredith will discuss this in more detail in his testimony.

Q. Did you review the Testimony and curriculum vitae of Bion C. Ostrander?

A. Yes. Mr. Ostrander in his testimony and his curriculum vitae indicates he has maintained an uninterrupted permit to practice as a Certified Public Accountant (“CPA”) in the State of Kansas since 1990. However, Mr. Ostrander footnotes this statement indicating that his permit to practice is pending renewal subject to meeting professional education hour requirements in Kansas. I reviewed the Kansas Board of Accountancy's website and database and determined that Mr. Ostrander has not held a permit to practice as a CPA in Kansas since June 30, 2014.

Q. Does this lapse in Mr. Ostrander's permit to practice concern you?

A. Yes. As a CPA myself, I am familiar with the rules regarding the profession. Kansas is a two-tiered state for CPA's. This means before practicing as a CPA or holding oneself out as a CPA, the individual must have a certificate of public accountancy and a permit to practice. Without meeting both requirements, an individual is not permitted to practice as a CPA in Kansas, or hold oneself out as a CPA.

Q. Do you know if Mr. Ostrander is required to be a CPA to provide testimony in this case?

A. To my knowledge, Mr. Ostrander is not required to be a CPA to provide testimony in this case, but the fact that he held himself out as a CPA "for credential" purposes when he does not hold this credential is troubling to me as a certified public accountant. I believe this is unprofessional conduct and speaks to Mr. Ostrander's credibility as an expert witness.

Q. To summarize, what is Carbon's current UUSF request?

A. $570,643. This amount reflects the effect of the five adjustments (and associated tax effect) discussed herein. This amount accurately represents the amount that Carbon is entitled to under Utah law.

Q. Finally, are there any other adjustments that you have for your filing?

A: Yes. As is customary, legal and consulting fees are disbursed from the state USF on a lump sum basis after the proceeding is resolved. I won't know this amount until after the proceeding but wanted to include these items as a placeholder for resolution by the Commission.

Q. Does this conclude your testimony?

A. Yes.