BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of the Carbon-Emery Telephone's Application for an Increase in Utah Universal Service Fund Support	:	**Docket No. 15-2302-01 DPU Exhibit 2.0 SR (CONFIDENTIAL)**

SURREBUTTAL TESTIMONY

OF

JOSEPH HELLEWELL
STATE OF UTAH
DIVISION OF PUBLIC UTILITIES

September 18, 2015

I. INTRODUCTION

Q: Please state your name for the record.

A: My name is Joseph Hellewell.

Q: Are you the same Joseph Hellewell who provided direct testimony in docket number 15-2302-01?

A: I am.

II. PURPOSE AND SCOPE OF TESTIMONY

Q: What is the purpose of your surrebuttal testimony?

A: I will respond to the rebuttal testimony of Mr. Darren Woolsey and Mr. Douglas Meredith who are representing Carbon-Emery Telephone.

Q: Are you a legal expert?

A: No. I will however, use a layman's reading of relevant statutes and rules to explain how the Division's staff employs them in service of the state's UUSF and its telephone companies.

Q: Is it your layman's understanding that the Federal Communications Commission (FCC) has jurisdiction in matters pertaining to state rulemaking, UUSF distribution, or rate of return calculation before the Public Service Commission of Utah (Commission)?

A: While the FCC has an extensive history and knowledge of the telecommunication industry, its rules and mandates generally have no compulsory power with the Commission. Mr. Woolsey suggests that all of Title 47, Chapter I, Subchapter B, Part 32 is the State of Utah's preferred method for calculating and recording depreciation expense. (Woolsey Rebuttal Line 802) Only a portion of the FCC rules have been adopted by the Commission. Commission Rule R746-340-2 sub-section D it states:

> Uniform System of Accounts – The Uniform System of Accounts for Class A and Class B telephone utilities, as prescribed be the Federal Communications Commission at 47 CFR 32 is the prescribed system of accounts to record the results of Utah intrastate operations.

This section is the only section of part 32 the Commission has officially adopted. Carbon-Emery has admirably adhered to this rule. However both Mr. Meredith and Mr. Woolsey continue to insist that their preference for CFR 32 as a whole governs this proceeding. This, notwithstanding Utah Code §54-7-12.1:

> In determining the depreciation expense of a telephone corporation in any proceeding under Section 54-7-12, the commission shall consider all relevant factors, including the alteration of asset lives to better reflect changes in economic life of plant and equipment used to provide telecommunications services. A relevant factor to consider shall be the asset lives of existing and emerging competitive telecommunications providers. *Nevertheless, the commission shall retain the authority to determine the depreciation expense of telecommunications corporations for ratemaking purposes.* (Emphasis added)

While a request for additional UUSF support is not a ratemaking case, calculation of a revenue requirement is a similar task. The effect of the depreciation expense and method resulting from Carbon-Emery's adoption of group asset depreciation is to alter lives and rates established by the Commission and is not reasonable. The DPU's adjustment is to bring Carbon-Emery's depreciation expense into conformity with the Commission's rates and lives. The Division's main goal is to establish a reasonable depreciation expense that matches depletion of the asset's book value with its actual useful life. It also wishes to establish a level uniformity amount telephone companies.

Q: Why is it important to have a standardized way to apply for USF disbursement?

A: Every ILEC that qualifies for UUSF support should generally be evaluated by the same standards. The state statute creating the UUSF supports this conclusion:

> Operation of the fund (UUSF Fund) shall be nondiscriminatory and competitively and technologically neutral in the collection and distribution of funds, neither providing a competitive advantage for, nor imposing a competitive disadvantage upon, any telecommunications provider operating in the state. (Utah Code §54-8b-15(5))

Additionally, the state mandates "a mechanism for specific, predictable, and sufficient funds…" (Utah Code §54-8b-15(9). Depreciation expense is one of the largest expenses that a telephone company generates. This is why it is important that every company filing and petitioning for UUSF funds be audited and scrutinized using the same rules and the same standard. While different operation conditions and other factors may warrant deviation should generally be an exception. Mr. Meredith disagrees: "Having a standard across all companies provides little or no benefit." (Meredith Rebuttal Line 691) The DPU has generally acted consistently and applied the same depreciation adjustment to each company using group depreciation that has applied for UUSF funds. The Division's method is nondiscriminatory and predictable—a statutorily mandated benefit to the fund and companies

Additionally, given the relatively small staff maintained by the Division (and the Commission and Office of Consumer Services), the Division believes uniformity allows it to better manage its work of regulating companies, monitoring industry trends, and evaluating programs. While there may be justification for deviation from a single approach, Carbon-Emery has not shown its case justifies such a deviation. To the contrary, its proposed methods distort depreciation expense.

Q: What is the Division of Public Utilities' view on how the Utah Universal Service Fund should be disbursed?

A: The Division administers the UUSF to provide the level of funding to which a company is entitled under relevant statute and rules. The Division has not been charged by statute or rule with minimizing fund payouts, providing incentives for accelerated investment, or other matters. In other words, the Division seeks to establish the amount of funds to which a company is entitled. The Division then advocates that position. Carbon-Emery notes in testimony that a single asset straight line depreciation method would cost the state more UUSF funds in the long run. This is found in lines 825 (Woolsey) and 795 (Meredith) of their respective rebuttal testimonies.

Consistent with the Division's position on administering the fund, as long as the amount of UUSF funds received by Carbon-Emery Telephone is just and reasonable, in the public interest, and compliant with established Commission statutes and rules, the DPU is not concerned about the specific number of UUSF dollars Carbon-Emery receives. This is not to say that the Division advocates profligacy. Merely that it seeks accuracy. Mr. Meredith and Mr. Woolsey consistently state in their testimonies that the state will save money by allowing Carbon-Emery to continue using group depreciation. While it is possible that this is the case in certain circumstances, the Division is not convinced that companies[i] will let rate base dissipate dramatically when depreciation is effectively accelerated. Further, the Division does not have the resources to ensure that companies' UUSF distributions are constantly adjusted as assets leave their books on an accelerated basis.

Q: Is straight-line depreciation expense higher than group depreciation expense?

A: No, not necessarily. Mr. Woolsey's rebuttal testimony (line 819) and Mr. Meredith's rebuttal testimony (line 655) asserting this fact is incomplete. What Mr. Woolsey and Mr. Meredith fail to address is the continued investment in new plant, which they would also propose be depreciated using their method. This continued investment is noted by Carbon-Emery in Mr. Woolsey's rebuttal testimony when he refutes an adjustment made by Mr. Ostrander (BCO-8). Mr. Ostrander used calculations which excluded any sort of additional plant being added to existing depreciation groups. Mr. Woolsey says, "Continued investment is anticipated since the company is a going concern…" (Woolsey Rebuttal Line 743) However in his own exhibit 4, illustrating his view of group depreciation as less expensive, Mr. Woolsey omits any additions to the groups shown in his example. He fails to mention or show what happens when a company such as Carbon-Emery continues to add assets to those groups. To see these effects please refer to DPU Exhibit 2.1 and 2.2 filed in my direct testimony.

The cash flow benefits of Carbon-Emery's effectively accelerated depreciation expense inflate UUSF disbursement as Carbon-Emery uses that capital to put more assets into the group to be more quickly depreciated. This cycle repeats and repeats. Hypothetically, regulators might be able to identify and find imprudent any over-investment resulting from employing capital in this fashion. Given the concerns identified above that the Division lacks the resources to monitor company's books so closely, it is unwise to allow a depreciation method that effectively allows accelerated depreciation. Thus, while one specific asset's depreciation expense under Carbon-Emery's group depreciation might result in lower fund disbursement for that asset, the Division is not convinced that Carbon-Emery's proposed method would result in lower overall depreciation expense over time throughout the fund.

Q: Even if the Commission adopted FCC part 32 for depreciation purposes, would Carbon-Emery be compliant?

A: Not entirely. One requirement of Part 32 is that the depreciation be distributed under the straight line method over the service life of the property. The Commission-approved life has been effectively set aside by Carbon-Emery because it is used in a manner that adjusts the approved life. I noted this in my direct testimony and DPU Exhibit 2.1. Mr. Woolsey acknowledges this fact. Mr. Woolsey states in his rebuttal testimony, "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." (Woolsey Rebuttal Line 821) The entire premise of straight-line depreciation, which part 32 mandates (47 C.F.R. §32.200(g)(1)(i))[ii], is that depreciation expense is spread evenly across every year of the asset's depreciable life. Thus, under straight line depreciation each year's depreciation expense is the same.

One method to counteract this acceleration would be to revise estimated plant lives over Carbon-Emery's entire plant to prevent distortion of depreciation that is inherent in the group asset depreciation when lives are not reviewed and revised periodically. The intent of 47 CFR 32.2000(g)(1)(ii)[iii] seems to be to insure that when the percentage composite rate no longer properly represents the service life of any classification of plant, methods should be determined by the company to revise such rates to properly represent the remaining service life to the company. Carbon-Emery has not requested nor indicated a change in the service life of any plant. If this were to happen, the DPU would not advocate the full abandonment of group asset accounting. In fact, the Commission may wish to consider a more regular method for evaluating depreciation rates across regulated companies given the burden of a depreciation study on relatively small companies. However regardless of which depreciation method is prescribed by the Commission, if any, the DPU would encourage the Commission to be aware of pitfalls that are inherent when allowing group depreciation. Those pitfalls are that the plant lives and composite percentage rates require periodic review to ensure that depreciation expense is spread appropriately over the life of the property that the Commission has set.

Q: Would adjusting Carbon-Emery Telephone's group depreciation expense and accumulated depreciation for UUSF purposes be difficult to account for or show in annual reports?

A: Despite what was stated on line 242 of my direct testimony, Carbon-Emery telephone believes that the DPU is expecting it to change their accounting method. This is not the case. The DPU is making an adjustment to Carbon-Emery's depreciation expense based upon the single asset straight line depreciation method to establish the amount of UUSF support that is in the public interest.

Mr. Meredith has objected to the use of the straight line method, stating that there would be "a host of administrative issues related to keeping track of interstate group asset accounting and whether the asset is correctly accounted for between the interstate and intrastate jurisdictions." (Meredith Rebuttal Line 712) However, Mr. Woolsey recognizes the fact that if a company chooses not to adopt the state's methodology (should a new methodology be adopted by the commission) that the company "would be subject to reconciling and adjusting their books for state rate making purposes as necessary." (Woolsey Rebuttal Line 905) Carbon-Emery has offered its own solution, stating a simple journal entry is enough to reconcile its books with any requirements ordered by the commission. The "host of administration issues" Mr. Meredith refers to is the burden of Carbon-Emery as a company and its internal reporting.

The state is not required to ensure that Carbon-Emery recovers for and records adequately interstate and intrastate assets. Mr. Woolsey elaborates, "…there are two sources of 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…" (Woolsey Rebuttal Line 854) Since the State of Utah uses both the interstate and intrastate portion of the asset for rate base and UUSF calculation the onus of recovery is on Carbon-Emery. If the commission decides to place additional requirements for rate cases and UUSF disbursal it will be Carbon-Emery's responsibility to meet those requirements. Since Carbon-Emery already uses single asset straight line for the non-regulated portion of its business (Woolsey Rebuttal Line 424), it is the DPU's opinion that this should not cause any undue hardship to Carbon-Emery.

Q: **Do the proposed examples provided by Mr. Woolsey or the reasoning of Mr. Meredith about adopting a single asset straight line depreciation adjustment going forward have merit?**

A: No. Mr. Woolsey has stated in his rebuttal testimony on line 847 that the adjustment made by the DPU is essentially the "worst of both worlds." This is because the DPU's adjustment adjusts down the depreciation expense without re-adjusting the accumulated depreciation. This was done because Carbon-Emery had already realized a return through depreciation expense due to accelerated depreciation. To adjust the accumulated depreciation would essentially grant Carbon-Emery an additional return on a portion of plant for which they had already received a benefit. Additionally the DPU removed all assets that would have been fully retired under Commission-approved rates. This excluded them from Carbon-Emery's depreciation rate calculation. We also added back assets that were fully depreciated under Carbon-Emery's group method due to accelerated depreciation rates. The DPU's adjustment was done with due care to implement Commission approved rates into a depreciation system that had already generated an inflated return in prior years.

Carbon-Emery's depreciation expense has been accelerated for so long now, when asked to return to a normalized depreciation expense, Carbon-Emery baulks at the idea stating it will cause a "cash-flow squeeze" and to minimize this so Carbon-Emery can "continue to invest in infrastructure as identified in its planned capital budget." (Meredith Rebuttal Line 757) Carbon-Emery's capital budget is based around accelerated depreciation expense and the anticipated UUSF dollars it will bring in. All of Carbon-Emery's proposals are expressly designed to continue with accelerated depreciation for the assets already in place, which defers the normalization of depreciation expense and thus continues to allow Carbon-Emery to receive an inflated amount of UUSF funds. This is demonstrated in Mr. Woolsey's rebuttal testimony, where he states, "…the acceleration effect is present in the Aerial Cable account and can be maintained near current levels if disposals of the older assets at levels similar to additions are made." (Woolsey Rebuttal Line 787) Thus, the depreciation expense and UUSF distribution amount is dependent on whether or not Carbon-Emery continues to invest more plant into these accelerated groups. While such accelerated investment may be a valid or laudable public purpose, it is not a recognized use of the UUSF.

Q: Is group depreciation truly transparent?

A: No it is not. Group depreciation is not a GAAP approved method of depreciation. Carbon-Emery's method of group depreciation is specific to the telephone industry, but it is not used universally by all of the rural ILECs in Utah. The method of group depreciation used by Carbon-Emery is specific to Carbon-Emery. A similar method is used by other telephone utilities, but without standardization each company may implement its own version of group depreciation. It is the DPU's opinion that due to these circumstances group depreciation would be considered more obscure than transparent. That is to say that it could be understood, but only with familiarization of Carbon-Emery's unique set of rules. Mr. Meredith voices opposition to the single asset depreciation adjustment, saying it would be less transparent since a reconciliation schedule would be needed. (Meredith Rebuttal Line 719) Again, this schedule would be only for Carbon-Emery's internal reporting. No such report would be need on the annual report. Mr. Meredith's transparency concern is unfounded since the annual reports are not used for external purposes, Carbon-Emery's internal reports are not published, and all personnel at Carbon-Emery, the OCS, DPU and the Commission, "are capable of examining various systems of accounts." (Meredith Rebuttal Line 709) In addition, if these documents were subject to public scrutiny, single asset straight line offers the most transparent and easily replicated results.

Q: Does this conclude your surrebuttal testimony?

A: Yes it does.

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[i] The Division is not implying that Carbon-Emery, or any other company, would engage in any nefarious behavior. Rather, that the companies generally will seek to make capital investments when funds are available to do so.

[ii] 47 C.F.R. §32.200(g)(1)(i): Unless otherwise provided by the Commission, either through prior approval or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition of depreciation, *may be distributed under the straight-line method during the service life of the property*. (Emphasis Added)

[iii] 47 CFR 32.2000(g)(1)(ii): In the event any composite percentage rate becomes no longer applicable, revised composite percentage rates shall be computed in accordance with paragraph (g)(1)(i) of this section.