<u>BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH</u>

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	))	

REVISED REDACTED REBUTTAL TESTIMONY

OF

DARREN WOOLSEY

ON BEHALF OF CARBON/EMERY TELCOM, INC.

September 4, 2015
(Revised Per Commission Order October 26, 2015)

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ERRATA

1 **REBUTTAL TESTIMONY OF DARREN WOOLSEY**

2 **Q. What is your name?**

3 A. My name is Darren Woolsey.

4

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

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

7

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

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

12 • Emery Telecommunications & Video, Inc. (ETV) provides internet, circuits,
13 fiber transport, VOIP voice, customer premise equipment, and retail
14 computer sales and service.

15 • Emery Telcom Video, LLC (ETV LLC) provides cable tv, cable internet, and
16 local advertising.

17

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

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

23 Financial Statements, 2014 Journal Entries, and 2014 Audit Memorandum when
24 Carbon/Emery Telcom, Inc. received them from the auditors.
25
26 **Q. What is the purpose of your reply testimony?**
27 A. The purpose of my rebuttal testimony is to respond to the various testimonies filed
28 in this proceeding by the Division of Public Utilities (the "Division") and the Office
29 of Consumer Services ("Office"). In their testimonies, these parties propose
30 modifications to Carbon/Emery's Application for Increase in UUSF. In this
31 testimony, I recommend that the Commission modify or reject many of these
32 proposed modifications. Specifically, I will address the testimony of:
33 - William Duncan, Division of Public Utilities;
34 - Joseph Hellewell, Division of Public Utilities;
35 - Bion C. Ostrander, Office of Consumer Services; and
36 - David Brevitz, Office of Consumer Services.
37 **Q. Have you reviewed the testimony of the individuals you have identified**
38 **above?**
39 A. Yes.
40
41 **Q. Please identify the exhibits to your testimony.**
42 A. I am attaching the following Confidential Exhibits:
43 - Carbon/Emery Rebuttal Testimony of Woolsey - Cable Internet Migration -
44 Exhibit 1

45 • Carbon/Emery Rebuttal Testimony of Woolsey - A&G Allocator Analysis -
46 Exhibit 2
47 • Carbon/Emery Rebuttal Testimony of Woolsey - CSR Allocation - Exhibit 3
48 • Carbon/Emery Rebuttal Testimony of Woolsey - Depreciation - Exhibit 4
49

50 **Q. Could you please summarize your reply testimony?**

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

54 ▪ Adjustment BCO-2: Allocate Corporate Overhead Expenses from Carbon to
55 ETV/Nonregulated Affiliates
56
57 ▪ Adjustment BCO-3: Remove Prepayments from Rate Base
58
59 ▪ Adjustment BCO-4: Deduct Long-Term Liabilities from Rate Base
60
61 ▪ Adjustment BCO-5: Remove 50% of telephone plant under construction
62 (TPUC) from Rate Base
63
64 ▪ Adjustment BCO-6: Remove 50% of materials & supplies ("M&S") from Rate
65 Base
66 ▪ Adjustment BCO-7: Reverse Carbon's Projected Access Line Reduction
67 ▪ Adjustment BCO-8: Remove Depreciation on Fully Depreciated Assets
68 ▪ Division of Public Utilities' adjustment on Depreciation
69 ▪ Adjustment BCO-9: Adjust Income Tax Expense and Reflect Interest
70 Synchronization
71

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

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

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

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

94 Carbon's initial Application filing (-$[REDACTED] - $[REDACTED] + [REDACTED] - [REDACTED] =
95 -$[REDACTED] plus the tax reduction effect on these adjustments of -$[REDACTED].
96
97 **Q. Do you agree with Mr. Ostrander that UUSF proceedings warrant rigorous**
98 **analysis and oversight?**
99 A. Carbon/Emery Telcom consistently files annual reports with the Division of
100 Telecommunications and receives review and oversight. Furthermore, Carbon has
101 not filed for increased rates but has filed for an increase in distribution out of the
102 UUSF. Also, the Division and Office reviewed Emery Telcom and Carbon/Emery
103 Telcom in a similar proceeding in 2014. Mr. Ostrander's testimony discredits the
104 purpose of Universal Service by stating that no direct or measurable benefit
105 accrues to citizens in areas not receiving UUSF funding. The very concept of
106 Universal Service inherently recognizes the value of providing affordable service
107 to higher cost rural areas and connecting urban Americans to their rural
108 counterparts. Citizens in urban areas pay into the UUSF for the ability to call
109 citizens who live in high cost rural areas. Universal service benefits both urban
110 and rural customers and the Office of Consumer Services represents both urban
111 and rural consumers and is mandated to assess the impact of regulatory action on
112 all residential consumers and small businesses (both urban and rural). All
113 telephone customers pay into the UUSF. The desire to minimize the payments
114 into the UUSF should not outweigh the proper use of the funds to further the public
115 interest of providing service (including advanced services) to rural end user phone

116 customers and special access (small commercial) customers. Additionally, it is
117 critical to remember that carriers who receive UUSF funding also have carrier of
118 last resort and E911 obligations. Ubiquitous service in Carbon's area would not be
119 possible without federal and state universal service support.
120
121 **Q. Are you familiar with the Office's adjustment BCO-2 which purports to**
122 **allocate corporate overhead expenses from Carbon to non-regulated**
123 **affiliates?**
124 A. Yes. Mr. Ostrander proposes a modification of Carbon's A&G Allocation factor. In
125 Carbon's Application, Carbon applied an A&G Allocation factor of ███%[1] to
126 regulated operations and ███% to non-regulated operations. The A&G allocator
127 is used for several departments including CEO, Board of Directors and Public
128 Relations/Marketing (PR/MK). Mr. Ostrander proposes a change of the A&G
129 Allocation Factor to ███%/███% for CEO and Board of Directors and ███ reg
130 ███ non-reg for PR/MK.
131
132 **Q. Do you agree with this proposed adjustment?**
133 A. No. As I detail below, Carbon's allocation factors are accurate and no adjustment
134 is needed. Mr. Ostrander's analysis is cursory and flawed. Mr. Ostrander states

[1] In Table BCO-2 in Mr. Ostrander's testimony he correctly identifies the A&G Allocation Factor as ██%/██% 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 ██%/██% regulated/non-regulated.

135 that Carbon has inappropriately used allocators to overstate regulated allocated
136 expenses and understate non-regulated allocated expenses. However, much of
137 the analysis performed by Mr. Ostrander and included in his testimony in lines 738
138 to 779 was based on unconfirmed and inaccurate assumptions, and the data used
139 to perform many of the calculations was incorrect. This erroneous data was then
140 used to justify a proposal to change the CEO and Board allocations to 50% reg
141 50% non-reg.
142
143 **Q. Please explain.**
144 A. It is Mr. Ostrander's opinion that costs have been shifted from non-regulated
145 entities to the regulated entities. To support this opinion, Mr. Ostrander examined
146 the Consolidated Financial Statements and "other information" which is not
147 identified in Mr. Ostrander's testimony. The Office found that "certain financial data,
148 allocations, and changes in amounts from year to year appear unusual or appear
149 to favor the non-regulated affiliates," and concluded without explanation that "this
150 type of information lends support for my adjustment to reallocate some expenses
151 from regulated to non-regulated operations."
152
153 **Q Do you know what financial data, allocations, and changes in amounts from**
154 **year to year appeared unusual to Mr. Ostrander?**
155 A. The Office referred to the net income for the regulated companies, and found that
156 the net income for the regulated companies decreased from ████ to ████ from

157 2013 to 2014. However, these numbers are incorrect. Review of the Consolidated
158 Financial Statements shows that the correct numbers regarding the regulated
159 companies' net income are [REDACTED] and [REDACTED] for 2013 and 2014 respectively,
160 evidencing a reduction of regulated net income of [REDACTED] not [REDACTED] as stated
161 by Mr. Ostrander.
162
163 **Q. Were you able to determine where Mr. Ostrander's regulated net income**
164 **numbers came from?**
165 A. No, I was not, but I can explain the reduction in regulated net income, and clarify
166 why Carbon needs additional UUSF support. The decrease in regulated net
167 income was almost entirely recorded on the books of Emery Telcom (not Carbon)
168 as demonstrated below:
169
170 [CONFIDENTIAL TABLE REDACTED]
171 Source: 2013-14 audited financial statements as provided to the Office and DPU
172
173 As shown in the table above, the net income of Emery declined by [REDACTED]. The
174 decrease is not the result of shifting costs, as inferred by Mr. Ostrander, but
175 primarily the result of lost revenue of [REDACTED] and to a lesser extent the investment
176 in FTTH resulting in increased depreciation of [REDACTED]. The largest revenue
177 decrease was due to a federally dictated loss of reciprocal compensation revenue
178 associated with CAF-ICC reform [REDACTED]. Other state access revenues declined

179 by ██████, primarily as a result of this same CAF-ICC reform. Local service
180 revenues declined by ██████ due to declining local service customers. Billing
181 and collection revenue declined by ██████ as described in Emery's response to
182 DPU 4 2.2. Other revenue declines amounted to ██████. Emery Telcom did
183 experience some expense increases. Depreciation increased by ██████ as a
184 result of increased investment. All other expenses however only increased by
185 ██████. This accounts for the change in net income of ██████ on Emery
186 Telcom. The ██████ increase in all expenses excluding depreciation does not
187 support the offices premise that costs were shifted from the non-regulated entities
188 to the regulated entities.
189 The majority of the regulated decline in revenue highlighted by Mr. Ostrander was
190 due to revenue decreases on Emery. Carbon did evidence a smaller reduction in
191 net income of ██████ from 2013 to 2014 demonstrated in the chart below:
192
193 [CONFIDENTIAL TABLE REDACTED]
194
195 Source: 2013-14 audited financial statements as provided to the Office and DPU.
196
197 This chart illustrates that Carbon actually had some revenue gain (special access
198 less a partial offset from land line loss), and that the loss in net income was largely
199 due to additional depreciation associated with recent and ongoing plant additions.
200

201 **Q. So did expenses shift from the non-regulated companies to the regulated**
202 **companies?**
203 A. No. Expenses did not shift from non-regulated companies as suggested by Mr.
204 Ostrander. In fact, as shown, Carbon's "other expenses" only increased [REDACTED]
205 from [REDACTED] to [REDACTED].
206
207 **Q. What conclusions do you draw from a review of the net income numbers?**
208 A. The conclusions to be drawn from a top level financial analysis are as follows:
209
210 • there is no shift in allocated costs from the non-regulated entities
211 • actual non-depreciation expenses did not change significantly in Carbon or
212 Emery
213 • the decline in the net income of Carbon/Emery Telcom was not the result of
214 inappropriately allocating expenses in 2014, but rather it illustrates
215 consistency between the two years.
216
217 **Q. Did Mr. Ostrander's use of inaccurate numbers for regulated net income**
218 **affect his analysis?**
219 A. While I find it difficult to follow Mr. Ostrander's analysis, if his conclusion is that
220 "changes from year to year appear unusual", the "unusual" appearance could be
221 a result of his use of inaccurate numbers. In my opinion, the inaccurate numbers

222 and shallow analysis used by Mr. Ostrander make the analysis meaningless and
223 the conclusions reached unsupportable.
224
225 **Q. Why?**
226 A. The analysis is meaningless because Mr. Ostrander starts with inaccurate
227 numbers on regulated net income and these incorrect numbers flow through the
228 analysis causing Mr. Ostrander to incorrectly calculate the regulated companies'
229 profit margin. He then compares the inaccurate profit margin of the regulated
230 companies to his calculated profit margin on the non-regulated affiliates, which Mr.
231 Ostrander uses (in some unascertainable way) to support his adjustment to
232 reallocate "some expenses" between regulated and non-regulated operations. A
233 slightly deeper analysis than that performed by Mr. Ostrander, as discussed above,
234 evidences the reasons for the noted changes and shows why this course is not
235 supportable.
236
237 **Q. Are the regulated companies net income and profit margins the only**
238 **numbers Mr. Ostrander has stated incorrectly in his analysis?**
239 A. No. Mr. Ostrander identifies the ETV net income change from 2013 to 2014 as
240 ███. The actual decrease in net income was ███. Additionally, while
241 Mr. Ostrander correctly states the ETV net income in 2014 as ███, he misstates
242 ETV's percentage of total consolidated profit of ███%. Mr. Ostrander then
243 discusses expenses where he highlights an increase in RLEC expense of ███

244 (the operating expense increase is actually only [REDACTED]) and implies that this
245 increase in regulated expenses corresponds to a similar decrease in ETV
246 expenses of the same amount of [REDACTED] (Operating expense decrease was actually
247 [REDACTED]). The implication in Mr. Ostrander's testimony is that somehow this is
248 related to a shift of costs from non-regulated to regulated operations. This is
249 misleading due to the errors in the numbers. However, the increase in cost was a
250 result of increased amortization and depreciation, which are the result of company
251 specific plant investments. The remaining actual costs evidence only a slight
252 increase in regulated costs of [REDACTED] and a slight decrease in non-regulated
253 costs of [REDACTED]. Accounting for the change in DSL wholesale handling
254 (discussed below), non-regulated operating expense actually went up by [REDACTED]
255 which does not support Mr. Ostrander's conclusion.
256
257 **Q. What actually caused the decreases in ETV expenses and revenue?**
258 A. The decline in both revenue and expenses in ETV related to a change in
259 accounting for the DSL wholesale revenue charged by the regulated company to
260 the non-regulated company which occurred when our new billing system was
261 implemented in the fall of 2013. The new billing method avoids showing the
262 revenue and matching expense in separate accounts on ETV and just moves the
263 revenue to the regulated companies where it ultimately ends up under the old or
264 new method. This change resulted in a [REDACTED] decrease in ETV revenue and
265 corresponding expense in 2014. The remaining decrease in ETV revenue is

266 related to a decrease of DSL subscribers (ETV) as they moved to higher speed
267 Cable Internet (ETV LLC) between 2013 and 2014. This revenue shift can easily
268 be viewed in the trial balances of the two non-regulated companies.
269
270 **Q. Did the Office have the trial balances of the two companies?**
271 A. Yes. The Office had the trial balances of the two companies, the General Ledger
272 of all companies and the consolidated financial statements with consolidating
273 information from 2012 to 2014. However, in the testimony of Mr. Ostrander, he
274 states "it is possible that the decrease in ETV's expense of ███ and the
275 corresponding increase in regulated RLEC expenses of ███ was the result of a
276 favorable shift of allocated expense from non-regulated operations to regulated
277 operations, but that cannot be confirmed." The reality, however, is that the GL
278 detail and allocation detail for both years were provided to the Office, and the Office
279 could have confirmed that the decreases in non-regulated expenses did NOT
280 result from a favorable shift of allocated expenses to regulated operations. But Mr.
281 Ostrander either did not perform this analysis or did not like the results. Rather,
282 he relied on supposition and unsupported assumptions to justify a reduction in the
283 allocation factor from ███% regulated to ███% regulated.
284
285 **Q. Was there anything else in Mr. Ostrander's testimony related to his assertion**
286 **that Carbon overstates its regulated allocated expenses and understates its**
287 **non-regulated allocated expenses that troubled you?**

288 A. Yes. Mr. Ostrander suggests that because ETV has profit, it can readily absorb his
289 allocation adjustments. This seems to imply that ability to pay is a proper cost
290 allocation factor. This position is not reasonable; it is not supported by analysis;
291 and it should be rejected by the Commission. It is unreasonable to have profitability
292 drive allocations or adjustments.
293
294 **Q. Do you find it unusual that the company does not have any allocation factors**
295 **that allocate 50% or more of expenses to nonregulated operations?**
296 **A.** No. Because the company direct codes many costs, not all of the costs are subject
297 to an allocation factor. Additionally, I am very familiar with the drivers that were
298 used to develop the allocators. With a proper understanding and examination of
299 the cost drivers, and analysis of the company's direct coding to ensure the non-
300 regulated companies are not favored, the allocators are very reasonable. However
301 neither my subjective opinion, nor anyone else's, should be considered support for
302 a cost allocation. Rather, any cost allocation factor or method should be supported
303 by data, which Mr. Ostrander failed to provide. Carbon has provided that data in
304 response to various data requests to support its allocation factors.
305
306 **Q. Mr. Ostrander suggests that total revenue and expenses can be used to**
307 **determine the appropriate allocation factors. Do you believe the total**
308 **revenue and expenses are rational drivers of costs?**

309 **A.** No. Revenue could be an appropriate standard to use to allocate costs if a
310 company had homogenous products. For example, if the consolidated entity of
311 Carbon/Emery Telcom consisted solely of Emery Telcom, Carbon Emery Telcom,
312 and Hanksville Telcom offering similar products at similar prices, then revenue
313 could be used without significant distortion (see possible exception noted below).
314 However when a consolidated entity offers non-homogenous services, such as
315 cable television, broadband internet, long haul transport, and newsprint, as in the
316 case of the consolidated entities of Carbon/Emery Telcom, revenue is an illogical
317 basis to use when developing cost allocations.
318

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

320 **A.** As an example, consider this UUSF proceeding. Carbon/Emery Telcom is
321 requesting an additional [REDACTED] in UUSF funding. If Carbon is successful and
322 receives this additional revenue, a cost allocation based on revenue would result
323 in increased expenses going to Carbon Emery Telcom. At first this may seem
324 rational because a large amount of expenses were incurred to go through this
325 process (although those costs are not likely to continue). However, let's now
326 assume that Carbon incurs these same expenses and Carbon/Emery Telcom's
327 current USF of [REDACTED] is reduced to 0, as is being proposed by Mr. Ostrander.
328 A cost allocation based on revenue would then result in a reduction of cost to
329 Carbon/Emery Telcom. It is inappropriate to assume that the dollar result of a
330 UUSF proceeding should determine cost allocations. The fact that a UUSF case is

331 undertaken could be considered a reason for direct coding or maybe even a
332 temporary driver, but the result of the UUSF case should not be.
333
334 A second example is special access transport revenue earned from a route
335 provided significantly across ETV leased fibers from Grand Junction CO to Salt
336 Lake City, Utah. This route generates revenue with only a handful of customers
337 and related billing and compliance issues. The lease also provides for
338 maintenance, thus ETV is not allowed to work or manage work on the fibers under
339 such lease. As a result, this fiber generates revenue with no significant
340 management attention, billing complexity, compliance, or customer service. If
341 overhead costs were allocated on revenue ETV would receive an inappropriately
342 high level of costs unsupported by actual management time based on the revenue
343 from this route.
344
345 Similarly, but to a lesser extent, internet revenue generated by internet customers
346 on ETV and ETV LLC are much easier to manage as a one or two line item billing
347 compared to a phone customer with franchise fees, excise tax, sales tax, E911,
348 subscriber line charges, ARC charges, poison control, EAS, local service, call
349 features, universal service fees, and the associated billing and compliance
350 associated with all of these billing line items. These examples highlight the
351 inappropriateness of revenue as a cost driver. This example also begins to show
352 why the billing records are reflective of associated management time in managing

353 the complexity of regulated operations including compliance, regulatory changes,
354 proceedings, and oversight of CSR and administrative employees.
355
356 **Q. Do you believe expenses are a rational driver of costs?**
357 A. No. Expenses are not a rational driver of costs.
358
359 **Q. Why not?**
360 A. There are significant direct coded expenses that have no relationship to the
361 amount of time spent by the CEO, Board, Marketing/PR, or CSR's. One of the
362 best examples that illustrates the problem with using expense as a substitute for a
363 substantive cost driver can be seen with the expenses of Emery Telcom Video LLC
364 (ETV LLC). The single largest expense category on the non-regulated entities is
365 Cable TV programming costs in ETV LLC. These costs totaled [REDACTED] for 2014
366 (activity 73 in account 7962.61 in previously provided GL detail). This cost alone
367 is similar to [REDACTED], yet programming and negotiation is handled through
368 ETV LLC's association with the National Cable Television Cooperative (NCTC)
369 leaving very little management time related to cable TV programming. If expenses
370 were used as an allocation basis, significant costs would be inappropriately
371 allocated to ETV LLC. It simply is not logical that a random programming cost
372 increase would result in additional CEO cost allocation. There is no reasonable
373 correlation.
374

375 **Q. Do the "billing record" inputs to the company's A&G allocation factor have**
376 **a "direct" or "cost-causative" relationship to the expenses in the department**
377 **cost pool that they are used to allocate?**
378 A. Yes. Billing records are representative because they are representative of the -
379 types of services, number of customers, complexity of regulatory compliance, and
380 issues that the CEO/Board, and Marketing represent. Forward looking plans are
381 extensions of or improvements to the existing services and have focused primarily
382 of regulated issues since 2011 when CAF/ICC reform was implemented and
383 continues today with ACAM model based support proposals being considered by
384 the FCC. Billing records also reflect forward looking CEO plans board decisions,
385 and marketing efforts as these efforts can be measured in resulting customer
386 growth in new and existing areas. Extension of plant to new customers and areas
387 is also reflected in the billing records on a slight lag. This allocator is updated
388 frequently.
389
390 **Q. What is your assessment of the revised A&G allocator calculation performed**
391 **by Mr. Ostrander?**
392 A. Carbon/Emery Telcom is not opposed to the idea of considering other cost
393 causative drivers in addition to billing records to maintain the accounting and
394 general allocator. As was pointed out by Mr. Ostrander, drivers in addition to billing
395 records have been used by Carbon/Emery Telcom in the past. However, I do not

396 agree with all of the Offices proposed drivers, or its methodology in considering
397 those drivers.
398
399 **Q Which of the proposed drivers suggested by Mr. Ostrander to you reject?**
400 A. I reject the use of “Revenue” and “Expenses” as cost allocators. For the reasons I
401 discussed above “Revenue” and “Expenses” are not at all appropriate to use to
402 develop allocations.
403
404 **Q. Do you agree that Plant can be used as an input for developing cost**
405 **allocators?**
406 A. Yes. Carbon/Emery Telcom could consider Plant as a possible cost driver to
407 determine the accounting and general allocator. If “plant” were to be used, “Gross
408 Plant” would be a better indicator than “Net Plant” because the regulated entities
409 use group asset depreciation per FCC part 32 whereas the non-regulated entities
410 use single asset straight line depreciation. Because group asset depreciation has
411 had an accelerated effect on the regulated entities, use of net plant as an indicator
412 for cost allocation would result in an artificially low allocation to the regulated
413 entities to the extent of the accelerated depreciation.
414
415 Also, when using Plant as a proposed driver, shared assets need to properly
416 accounted for and shown on the books of the correct entity based upon allocation
417 of that asset, not ownership. As indicated in Carbon’s Application, to reduce

418 duplication of equipment and costs, the Carbon/Emery Telcom entities share
419 certain equipment, vehicles, and computers. This shared equipment is recorded
420 on the books of ETV. This cost of this shared equipment is then allocated to the
421 various related party entities based upon usage or other allocators. The shared
422 equipment is presented and discussed in the initial filing as Exhibit 7b – Shared
423 Assets and this exhibit was used as the basis for a rate base adjustment to include
424 the appropriate portion of shared equipment in the rate base of Carbon. Therefore,
425 an allocator based upon plant would need to reflect the portion allocated to each
426 entity to prevent the overstatement of assets on ETV and related understatement
427 on each of the other Carbon/Emery related entities. Mr. Ostrander's analysis of
428 plant as a driver does not take these issues into consideration.
429
430 **Q. Are there other inputs that Carbon agrees are appropriate?**
431 A. Yes. Carbon believes that records and payroll can also be valuable inputs in
432 determining the appropriate A&G Allocation factor.
433
434 **Q. Has the Office employed the proper methodology for considering these**
435 **allocation inputs?**
436 A. No. The calculation performed by Mr. Ostrander in "Confid. 15-2302-01 - Ostr. WP
437 1.3 - Adj. BCO-2 (OCS DR 2-40 CAM Alloc.).xlsx" uses an equal weighting of the
438 various dollar types and records. This method skews the allocation to the highest
439 dollars (revenue and net plant totaling [redacted]) and essentially gives no weight

440 to billing records ([REDACTED]). A more reasonable approach is to assume that
441 each of the drivers, if representative, should be given equal weighting. This can
442 be easily accomplished by taking the average of the resulting allocation
443 percentages of each appropriately identified driver.
444
445 **Q. Have you recalculated the Accounting and General Allocator using**
446 **additional inputs as suggested by Mr. Ostrander?**
447 A. Yes. Carbon recalculated the A&G Allocator using Gross Plant (properly adjusted
448 for shared assets), Monthly Records, and Payroll, and then weighted each
449 associated allocation percent equally. This produced essentially the same
450 allocation as was used by Carbon in the initial application [REDACTED]% Emery (ET),
451 [REDACTED]% Carbon/Emery (CT) and [REDACTED]% Hanksville (HT) (74.42% total to regulated
452 entities) as opposed to [REDACTED]% ET, [REDACTED]% CT, and [REDACTED]% HT ([REDACTED]% total to
453 regulated entities). This calculation can be viewed in Carbon/Emery Rebuttal
454 Testimony of Woolsey – A&G Allocator Analysis - Exhibit 2.xlsx.
455
456 Although the revised allocation would result in slightly greater expenses being
457 allocated to the regulated entities ([REDACTED]%), because of the insignificance of the
458 increase, I am of the opinion that the base year is representative and no adjustment
459 is necessary.
460

461 **Q. The Office proposed a different basis for Public Relations/Marketing**
462 **allocations. Do you agree with the proposed adjustment?**
463 A. No. Mr. Ostrander's proposed PR/MK adjustment premise is that because there
464 are three services and the one regulated service should be then allocated 33% of
465 the cost; he then randomly decides 25%. Neither the 33% or the 25% is backed
466 by substantive support. The three services considered by Mr. Ostrander were
467 IPTV, Internet, and Phone. The affiliated companies of Emery do not offer IPTV
468 but do offer Cable TV.
469 When considering how to allocate costs for marketing, if certain services are not
470 advertised at all they should get little or no allocation of costs, conversely if a
471 particular service appears more frequently it should receive an increased
472 allocation. With this in mind, only considering the number of services offered, is
473 over simplistic as it does not consider the focus or frequency of marketing efforts
474 of these services. If services are specifically non-regulated and do not contain
475 phone advertising they are direct coded as is the case with Moab advertising which
476 is all direct coded to non-regulated entities and reduces the actual amount of
477 PR/MK subject to the allocator. In the regulated operating areas, phone receives
478 a primary focus either directly or through bundles. Due to decreased interest in
479 land lines, the advertising of bundles is critical to the success and survival of
480 Carbon. Bundles in the regulated operating areas are designed to be Phone and
481 "something else" either LD, cable, internet provided over regulated plant, or
482 internet provided over non-regulated plant. Whenever a bundle is advertised and

483 sold the regulated entity benefits. This benefit is enhanced by the sale of long-
484 distance or DSL which are tied to the regulated entity due to the requirement to
485 have a land line or to allocate additional loop cost (DSL revenue requirement) for
486 standalone DSL. Thus, the actual sales (and advertising) of LD, DSL, and Bundles
487 in general, benefit the regulated entity and cost should reflect this.
488
489 As of December 31, 2015, nearly ████ of the customers in the Carbon serving
490 area are phone customers (████ phone vs ████ (internet and cable). Of the
491 internet customers ████ were DSL making them also regulated customers (ETV
492 purchases wholesale DSL special access service from Carbon). The number of
493 Carbon serving area customers being serviced by regulated plant is ████ or
494 ████%.
495
496 In the absence of a more appropriate allocation basis, the current use of the A&G
497 allocator by Carbon for PR/MK is reflective of the results of marketing efforts and
498 is comparable to the customers being served by regulated vs non-regulated plant.
499
500 **Q. In addition to the A&G Allocation change and PR/MK Adjustment, the Office**
501 **is proposing an adjustment to the CSR Allocator. Do you agree with the**
502 **proposed adjustment?**
503 A. No. Mr. Ostrander's proposed CSR adjustment contains a variety of errors.
504

505 **Q. What errors are contained in the CSR adjustment being proposed by the**
506 **Office?**
507 A. Mr. Ostrander states that the CSR allocator should be adjusted from ███%
508 regulated and ███% non-regulated to ███% regulated and ███% non-regulated.
509 However, Mr. Ostrander has not provided any data or evidence to support this
510 conclusion. There is no evidence that Mr. Ostrander's opinion of how CSR costs
511 should be allocated is more accurate than the time study performed by Carbon in
512 2010. In fact, it would appear that Mr. Ostrander did not verify any of his findings
513 related to CSR's in the Office data requests, and as a result, Mr. Ostrander made
514 several errors in his testimony related to the CSR Allocation factor.
515
516 **Q. Please identify the errors you are referring to.**
517 A. In Mr. Ostrander's calculation of CSR costs he uses ██████ total CSR dollars
518 as a basis for allocating 2014 CSR costs, the correct amount of total CSR costs is
519 ██████ which results in a 35% misstatement upfront and makes any resulting
520 proposed adjustment wrong. This data is a subset of total allocations given to the
521 Office in DR 2-40. Carbon has utilized an Excel pivot table to summarize the data
522 and demonstrate the error, see Carbon Emery Rebuttal Testimony of Woolsey –
523 CSR Allocation - Exhibit 3.xlsx. The error was limited to this one data point. From
524 the pivot table you can see that total expenses subject to allocation tie to Mr.
525 Ostrander's analysis showing ███ in total allocated expenses. The highlighted
526 green numbers on Carbon Emery Rebuttal Testimony of Woolsey – CSR

527 Allocation - Exhibit 3.xlsx also tie to amounts shown for Board, CEO,
528 Marketing/PR, and Human Resources. The CSR allocation amount does not tie
529 and should have been ███.
530
531 Mr. Ostrander states that there are ███ CSR's per DPU 1-4(b), then goes on to
532 state that "It is not clear why ███%, or a substantial majority of these CSR costs
533 would be allocated to regulated operations". DPU 1-4(b) does not indicate that
534 ███% of CSR costs were allocated to the regulated entities. It does however
535 clearly demonstrate that there were ███ different CSR's between January 31,
536 2012 and April 1, 2015. Mr. Ostrander failed however to notice that there were also
537 ███ additional "CSR/Advanced Trouble Shooting" employees making ███ total
538 CSR's that worked in any given month over the 40 month period presented. His
539 count does not consider turnover, part-time, or temporary employment. Mr.
540 Ostrander also failed to notice that there was a table at the bottom of this data
541 request that clearly demonstrates the number of employed employees in any given
542 month. The summary is presented below with highlights for the base year and a
543 summary at the bottom of the sheet:
544
545
546 [CONFIDENTIAL TABLE REDACTED]
547
548

549 Source: DPU DR 1-4b Emery & Carbon - Employee List.xlsx (highlights and summary of
550 CSR counts below data added)
551
552 **Q. Please explain this data.**
553 A. Though there were a total of [REDACTED] total different employees employed during the
554 40 month period the number employed in any given month was never more than
555 [REDACTED]. The average number of CSR's during the base period was [REDACTED] From this
556 [REDACTED] an adjustment needs to be made for part-time employees to arrive at full time
557 equivalents. There are [REDACTED] part-time employees, so a reduction of [REDACTED]
558 employees brings the FTE employee count average to [REDACTED]
559
560 **Q. Do all of the [REDACTED] FTE CSR employees use the CSR allocator for their primary**
561 **coding?**
562 A. No. Out of the [REDACTED] FTE employees there are [REDACTED] dispatch CSR's that primarily
563 use the dispatch allocator which more closely follows plant labor. There are also
564 [REDACTED] CSRs included in the advanced trouble shooting CSR group and [REDACTED] Moab
565 CSR who's coding is all to non-regulated entities (ETV and ETV LLC). This
566 essentially lowers the actual number of CSR's using the CSR allocator for their
567 primary coding to [REDACTED]
568
569 **Q. What other changes have you made with respect to CSRs?**

570 A. In conjunction with the establishment of the troubleshooting group, additional
571 plant troubleshooting software tools were given to the CSR group to diagnose
572 initial trouble calls. If a CSR determined that the trouble is not isolated to the
573 outside plant, the call is passed to the advanced trouble shooting group. This
574 greatly reduces the amount of time the CSR's spend with non-regulated
575 customers. These changes were made as DSL and Cable internet customers
576 increased, and despite the increased number of customers, the additional tools
577 and cooperation between advanced troubleshooting has allowed customers to be
578 served without requiring a significant increase in CSRs. The CSRs' actual time
579 can be reviewed with a Pivot table on DPU DR1-4a Emery & Carbon- Labor
580 Reports – testimony analysis.xlsx the pivot reveals the following:
581
582
583
584 [CONFIDENTIAL TABLE REDACTED]
585
586
587 Source: Carbon Response to DPU DR 1-4a Emery & Carbon-Labor Reports – testimony
588 analysis.xlsx
589
590 **Q. What does the Pivot table show?**

591 A. The Pivot table reflects the final disposition of all CSR Labor and shows use of
592 CSR, Dispatch, Directory, and Moab CSR distributions as well as direct coding.
593 The results indicate that more CSR time is actually coded to the non-regulated
594 entities than the regulated entities (███% non-reg vs ███% regulated). As the
595 current actual coding is highly non-regulated and combines the proper use of direct
596 coding and representative allocators based on real cost drivers, the hypothetical
597 allocator proposed by Mr. Ostrander is not appropriate and is wholly without basis.
598

599 **Q. The Office is proposing several adjustments to your rate base accounts.**
600 **How did you determine the rate base accounts used in Carbon's**
601 **Application?**
602 A. Carbon/Emery Telcom relied on pages 17 and 18 of the Incumbent Local
603 Exchange Carrier Annual Report to the Public Service Commission of Utah
604 (Annual Report) for guidance in determining appropriate rate base accounts.
605 Carbon's Annual Report for the period January 1, 2014 to December 31, 2014 was
606 submitted to the PSC and has been provided to the Office and DPU. Page 17 of
607 the Annual Report lists the net telecommunications plant in service by account.
608 Page 18 is entitled "Other Rate Base Accounts" and includes a listing of accounts
609 typically considered as part of the rate base. A snap shot of Carbon's 2014 report
610 is shown below as an example of the included accounts:
611 [CONFIDENTIAL EXCEPRT FROM ANNUAL REPORT REDACTED]
612

613

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

620

621

622 **Q. Mr. Ostrander has identified 4 adjustments to rate base including**
623 **Prepayments (BCO-3), Long-Term Liabilities (BCO-4), Telephone Plant**
624 **Under Construction (BCO-5), and Materials and Supplies (BCO-6). Do you**
625 **agree with any of these adjustments?**

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

635 that created the liability in prior years. However, the total liability needs to be
636 reduced by:

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

640 Considering these adjustments, [REDACTED] is the amount that should remain on
641 Emery, Carbon, Hanksville. Only Carbon's portion, in the amount of [REDACTED],
642 should be deducted from Carbon's rate base. This amount differs slightly from the
643 Part 36 amount identified by Mr. Ostrander due to the adjustments for other
644 comprehensive income mentioned above.
645

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

647 A. No. I reject the appropriateness BCO-3. The inclusion of prepaid expenses is
648 straight forward and allowed by practice. This policy should not be changed.
649

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

652 A. No. With respect to the adjustment BCO-5, Mr. Ostrander seeks to remove 50%
653 of TPUC in the amount of [REDACTED] and provides two reasons for its exclusion.
654 The first is his opinion that a normalized basis of TPUC would result in a lower and
655 more appropriate TPUC value. Though normalization conveniently reduces
656 TPUC, it does not recognize that these are actual capital expenditures, that TPUC

657 is directly tied to plant investment, and that a lower TPUC just means the assets
658 have moved to another rate base account (plant in service) or have not occurred
659 yet. Carbon is not proposing known and measurable plant additions in TPUC.
660 Rather, Carbon is only including <u>actual plant expenditures</u> which currently reside
661 in TPUC. This is not an account that should be normalized to find an "appropriate"
662 operating level. This account by its very nature accurately reflects actual plant
663 expenditures.
664

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

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

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

678 Mr. Ostrander's strange interpretation of mismatching does not provide adequate
679 basis for adjustment; by suggesting that Carbon should somehow project an offset
680 to the inclusion of TPUC of events that have not occurred. With respect to capital
681 expenditures I have never heard of projecting future revenues, affiliate
682 transactions, or disposals related to an asset addition that have not yet occurred
683 under the theory of matching. This would in fact be a violation of both the matching
684 principle which requires a transaction to be recorded in a correct period and also
685 a violation of a second GAAP principle which prevents the recognition of contingent
686 gains. Mr. Ostrander's arguments on removing 50% of TPUC should be rejected.
687

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

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

694 • Carbon is experiencing increased construction activity associated
695 with the FTTH curb and business district in Price;
696 • Carbon's lead time on fiber and fiber related products has increased.
697 Carbon is currently experiencing delivery delays of three to six
698 months.

699 • As a result of the increase lead times with vendors, Carbon is
700 required to keep more inventory on hand to prevent shortages, and
701 work stoppages that will result if required fiber and fiber facilities are
702 not on site.
703 The increased level of inventory is anticipated for at least the next five years and
704 is properly reflected in the rate base at full value.
705
706 **Q. The Office is proposing a depreciation adjustment on assets that the Office**
707 **believes are either fully depreciated or will be fully depreciated in about 2**
708 **years (BCO-8). Do you agree with this depreciation adjustment?**
709 A. No. Mr. Ostrander refers to his adjustment of BCO-8 as "remove depreciation
710 expense on fully depreciated assets". Carbon has not depreciated any asset in
711 excess of the book value of the asset. We assume that what Mr. Ostrander is
712 attempting to describe is the effect of group asset depreciation. As indicated in the
713 testimony of Douglas Meredith, group asset depreciation is an FCC prescribed
714 method of depreciation which can have an accelerating effect on depreciation in
715 cases where there are older assets included in the group subject to a depreciation
716 calculation. However, group asset depreciation only accelerates depreciation; it
717 does not result in over-depreciation (depreciation in excess of the book value) of
718 any asset.
719

720 **Q. What errors has Mr. Ostrander made in his depreciation adjustment**
721 **contained in BCO-8?**
722 A. Mr. Ostrander's BCO-8 claims to reduce "depreciation expense by [REDACTED] (and
723 corresponding increase in accumulated depreciation in rate base of [REDACTED] on
724 assets that are either fully depreciated or [sic] will be fully depreciated within about
725 [REDACTED] years." Mr. Ostrander provides no rationale for his recommendation to
726 exclude depreciation expense in the amounts [REDACTED] for Other Work Equipment
727 and [REDACTED] for Interexchange Circuit Equipment. He states that these accounts
728 became fully depreciated in 2014 so he just excludes the entire amount. This
729 position assumes no continuing investment which would result in the continuation
730 of depreciation. Continued investment is anticipated since the company is a going
731 concern, and I assert that the depreciation levels projected in the base year are
732 representative of expected levels for at least the next five years based upon this
733 investment.
734
735 **Q. Are there other accounts that Mr. Ostrander adjusted besides "Other Work**
736 **Equipment" and "Interexchange Circuit Equipment"?**
737 A. Yes. Mr. Ostrander concludes that the deprecation in accounts for Subscriber
738 Circuit Equipment and Aerial Cable is currently overstated and that it will largely
739 disappear in four years [REDACTED] years for the accounts subject to his adjustment).
740 This position again erroneously assumes no continued investment and no
741 disposals. Additionally, there is no determination whether the current depreciation

742 level of the chosen account groups is materially accelerated or is a representative
743 amount. A summary of data for the two targeted adjustment accounts is as follows:
744 [CONFIDENTIAL TABLE REDACTED]
745
746 Source: From Confid. - 15-2302-01 Ostr. WP 1.8 - Adj. BCO-8 - DPU 1-11 Deprec.
747 Exp.xlsx – tab Dep Calc. and FCC 481 filing.
748
749 **Q. What does the above table show with regard to Subscriber Circuit**
750 **Equipment?**
751 A. The first targeted account, Subscriber Circuit Equipment [REDACTED], with a GBV and
752 NBV of [REDACTED] and [REDACTED] respectively and a depreciation life of [REDACTED] years is
753 completely appropriate at its current depreciation level. The Subscriber Circuit
754 Equipment Account consists largely of legacy DSLAM type equipment which will
755 be replaced by FTTH network interface device equipment beginning in earnest in
756 2017. Taking the Gross Book Value (GBV) of [REDACTED] and dividing it by the asset
757 life of [REDACTED] years results in [REDACTED] of depreciation expense per year, which
758 evidences little acceleration from the current year actual depreciation at [REDACTED]
759 Because the legacy equipment is being disposed and replaced in the same year
760 the old equipment will be fully depreciated the current level of depreciation is
761 appropriate. This also shows that depreciation will remain very similar to current
762 levels in the short run, but will actually increase after five years based upon the

763 projected five year investment. The adjustment proposed by Mr. Ostrander is
764 entirely inappropriate.
765
766 [CONFIDENTIAL TABLE REDACTED]
767 Source: FCC 481
768
769 **Q. What does the above table show with regard to the Aerial Cable Account?**
770 A. With respect to the Aerial Cable, Carbon anticipates fixed asset additions to this
771 category of [REDACTED] over the next two years which will more than outpace the
772 depreciation expense levels currently projected by Mr. Ostrander in the five year
773 period. Though depreciation will not drop as projected by Mr. Ostrander, the
774 acceleration effect is present in the Aerial Cable account and can be maintained
775 near current levels if disposals of the older assets at levels similar to additions are
776 made. Carbon's current use of group asset depreciation does not result in an
777 inappropriate base level of depreciation, and (based upon anticipated additions
778 and disposals) future depreciation levels will not differ significantly from the current
779 2014 base year levels. A more appropriate and encompassing discussion of
780 depreciation methodology, potential acceleration, and both the expense and rate
781 base implications of changing the methodology is included in the Rebuttal
782 Testimony of D Meredith filed in this Docket.
783
784 **Q. Describe how Carbon calculates depreciation expense.**

785 A. Carbon calculates depreciation expense using a straight line calculation in
786 conformity with a group plan of accounting as prescribed by Federal
787 Communications Commission (FCC) in the Code of Federal Regulations, Title 47,
788 Chapter I, Subchapter B, Part 32. FCC part 32.2000 which states "(iii) Charges for
789 currently accruing depreciation shall be made monthly to the appropriate
790 depreciation accounts, and corresponding credits shall be made to the appropriate
791 depreciation reserve accounts. Current monthly charges shall normally be
792 computed by the application of one-twelfth of the annual depreciation rate to the
793 monthly average balance of the associated category of plant."
794
795 "Group plan" is defined as follows in FCC Part 32.9000; "Group plan, as applied to
796 depreciation accounting, means the plan under which depreciation charges are
797 accrued upon the basis of the original cost of all property included in each
798 depreciable plant account, using the average service life thereof properly
799 weighted, and upon the retirement of any depreciable property its cost is charged
800 to the depreciation reserve whether or not the particular item has attained the
801 average service life."
802
803 **Q. Does a group asset plan calculation of depreciation expense result in higher**
804 **depreciation?**
805 A. No. Using a group asset method to Calculate depreciation expense will always
806 result in the <u>same total depreciation expense</u> as calculated under any other

807 accepted method. Group asset depreciation is an accelerated depreciation
808 method. This means that group asset depreciation tends to produce a higher
809 depreciation expense in earlier years, and a lower depreciation expense in later
810 years. Conversely the rate base (NBV of associated assets subject to
811 depreciation) will be reduced more quickly resulting in a lower total disbursement
812 of UUSF based upon applying a rate of return on a lower NBV and over a shorter
813 (accelerated) asset life.

814

815 **Q. Is group asset an acceptable method of depreciation?**

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

822

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

ERRATA

829

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

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

836

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

844

845 **Q. How did the DPU calculate its depreciation adjustment?**

846 A. The DPU's proposed depreciation adjustment was calculated by applying single
847 asset straight line depreciation to individual asset detail provided in DPU DR1-11
848 Emery & Carbon – Assets and CY 2014 Depreciation.xlsx. Carbon recalculated
849 the DPU's single asset adjustment to within reasonable rounding differences of
850 [redacted], and has supplied our calculation in Carbon Emery Rebuttal Testimony of

851 Woolsey–Depreciation-Exhibit 4.xlsx. This exhibit also contains additional
852 calculations which will be discussed latter.
853
854 **Q. Are there issues with the DPU's proposed adjustment?**
855 A. Yes. The DPU proposed adjustment provides single asset straight line
856 depreciation as if had occurred from the in-service date through 2014, then
857 compared the 2014 recalculated expense to the expense recorded by Carbon to
858 arrive at a difference of [redacted]. The DPU methodology which resulted in lower
859 depreciation expense was applied to all depreciable assets (not just intrastate
860 assets). This ignores the fact that Carbon in fact used a higher depreciation
861 expense amount in its interstate filings upon which rate of return will be established
862 for interstate recovery mechanisms. On the associated rate base side of the
863 depreciation transaction, the DPU used the NBV which reflects the accelerated
864 group asset methodology (lower) then added back only the current year
865 depreciation difference of [redacted] as a proposed adjustment to NBV. Thus the
866 "worst of both worlds" occurred where the lowest possible NBV was used for rate
867 base and the lowest possible depreciation calculation (single asset straight line)
868 was used for expense.
869
870 **Q. Couldn't you just adjust the NBV to reflect historical application of the single**
871 **asset straight line depreciation proposed by the state to arrive at the correct**
872 **amount of return on rate base associated with their proposed adjustment?**

873 A. No. Because recovery of both depreciation expense and return on rate base has
874 already been received on the interstate portion of these assets in prior years. Any
875 calculation by the state would have to consider this effect.
876
877 **Q. How would you address the DPU's concern regarding depreciation**
878 **methodology?**
879 A. The preferred course of action, which results in an overall lower total UUSF
880 distribution (as discussed in testimony provided by Douglas Meredith), would be
881 to allow companies to continue to use group asset depreciation as an acceptable
882 methodology as prescribed by the FCC. This would not preclude other companies
883 from using a different methodology it would just be one of the acceptable methods
884 of calculation.
885
886 As an alternative, if the State feels strongly about a particular methodology for
887 calculating depreciation and wishes to establish rules regarding this, the best
888 approach would be to avoid the complications and recovery concerns of retroactive
889 application and apply the new methodology going forward on new asset
890 investments. If a company chooses to not follow the State methodology at that
891 point then they would be subject to reconciling and adjusting their books for state
892 rate making purposes as necessary.
893

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

897 A. I performed an analysis of the effects of making a prospective change to single
898 asset straight line depreciation as of January 1, 2014. In this analysis, Carbon
899 assumed that group asset depreciation would continue on historical assets as of
900 12/31/13, and single asset straight line methodology would apply to all 2014
901 additions and projected additions through 2019. For purposes of this analysis
902 Carbon used the projected capital improvements filed July 1, 2015 on FCC Form
903 481. From these assumptions, the analysis provided the following results:

904 • 2014 depreciation expense would have reduced by [REDACTED] from [REDACTED]
905 to [REDACTED] in the 2014 base year.
906 • The six year average depreciation expense is projected at [REDACTED] which is
907 [REDACTED] (4.3%) lower than the base year.
908 • The base year is materially representative of anticipated depreciation
909 expense levels as projected in this change scenario.

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

912

913 **Q. Is there another solution?**

914 A. The last solution would be an attempt to apply the DPU methodology in a way that
915 considers all aspects of the proposed change including depreciation expense, rate

916 base (NBV), and jurisdiction. Carbon has performed this calculation which is
917 included in Carbon Emery Rebuttal Testimony of Woolsey – Depreciation -Exhibit
918 4.xlsx. In this Exhibit Carbon starts by recalculating individual asset depreciation
919 using the single asset straight line method through 12/31/2013. This allows the
920 NBV at the beginning of the rate base period to be presented. 2014 depreciation
921 expense is then calculated in the same manner, and a resulting NBV for
922 12/31/2014 is calculated. These numbers are then totaled to see the current 2014
923 depreciation effect and cumulative NBV effect of the proposed depreciation
924 change. (See summary in rows 2531 to 2541 on the Carbon tab of the
925 spreadsheet). The depreciation change is calculated at [REDACTED] essentially the
926 same as the DPU calculation of [REDACTED]. In this section you can also see the
927 effect of adding back the cumulative NBV difference on rate base, which would
928 result in a UUSF impact of [REDACTED](using 10.50001% Carbon rate of return).
929 Carbon has already described the fault of using this calculation as a NBV/rate base
930 adjustment because it does not consider interstate return previously received on
931 these asset differences. The next step in the calculation is contained in rows 2543
932 to 2553 in which the two methodologies are applied to the asset mix with the group
933 methodology applied to interstate assets and the single asset methodology applied
934 to the intrastate assets. This results in a 2014 depreciation reduction adjustment
935 of [REDACTED]and a corresponding rate base/NBV increase adjustment of
936 [REDACTED] with an estimated corresponding UUSF impact of [REDACTED]. The net

937 decrease in the UUSF request resulting from this theoretically correct analysis
938 would be $[REDACTED]($-[REDACTED]+ [REDACTED].
939
940 **Q. Are there any downsides to the mixed calculation performed above?**
941 A. Yes. The intrastate/interstate mix of assets can and does change over time
942 making this calculation slightly inaccurate at any given point in time. Also, any
943 change from existing methodology (unless the books could be restated) will cause
944 differences in federal and state reporting that would not be easily tracked and
945 would result in less transparency from a reporting standpoint.
946
947
948 Again the best course of action is the choice of an acceptable methodology that is
949 then applied consistently over a single asset or group asset life for both interstate
950 and intrastate rate of return recovery. In the absence of agreement on
951 methodology by all parties in this proceeding, the focus should be on whether the
952 amount presented in the initial filing is a representative base year amount. I assert
953 that the base year amount is materially representative whether Carbon continues
954 to use the group method, or if a change to single asset straight line methodology
955 were made as of the beginning of the 2014 base year.
956
957

958 **Q. Mr. Hellewell describes six reasons why group asset depreciation is not**
959 **recommended. What is your response?**
960 A: I will address each of the six reasons:
961 • Depreciation by computer: The ease of calculation was not a determining
962 factor in the original choice of Carbon to use group asset depreciation. In
963 fact until our recent system upgrade, Carbon's accounting system would not
964 handle the group calculation.
965 • Asset Tracking: This argument is not really an issue for Carbon because
966 individual assets are tracked. Only our oldest assets are an issue (think
967 Qwest acquisition). Either method could be deployed with adequate
968 tracking.
969 • Disposal: With appropriate individual tracking the methodology has no
970 impact on disposals.
971 • Group Characteristics: The problem of classification exists in either method
972 of depreciation. Vehicles are not necessarily a problem as they are easily
973 identified and generally disposed at or near their depreciable life thus
974 reducing any possible group depreciation effect.
975 • Standardization: I do not disagree with Mr. Hellewell's general statement
976 here but would argue that we are among a majority of companies that use
977 group asset depreciation.

978 • Volatility: I agree that volatility risk is increased under a group methodology.
979 However this risk is mitigated through proper and timely disposals and
980 balanced continued investment as needed for aging assets.
981
982 **Q. Previously you indicated that Carbon is proposing a revenue adjustment to**
983 **account for the impacts of converting non-regulated cable customers to**
984 **regulated fiber internet customer. Can you tell us what the financial**
985 **statement impacts of this conversion are?**
986 A. This type of migration has two major financial statement impacts. First, there would
987 be a shift in the various components of interstate revenue requirement, and second
988 there would be an increase in rate base from the additional plant required to make
989 the conversion. We contacted Moss Adams, LLP, the CPA firm contracted to
990 produce our annual Cost Study, to do a sensitivity analysis of what would have
991 happened to our 2014 cost study assuming that all of our December 31, 2014 cable
992 internet customers in the Carbon ILEC service area had been converted to fiber
993 internet as of year-end. The following chart summarizes the results of the Moss
994 Adams Sensitivity Analysis which was performed at our company's cost study area
995 level (includes Emery, Carbon/Emery, and Hanksville which operates in the
996 boundary of SAC 502278):
997
998 [CONFIDENTIAL TABLE REDACTED]

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999 Source: Carbon Emery Rebuttal Testimony of Woolsey - Cable Internet Migration
1000 - Exhibit 1.xlsx
1001
1002 This analysis shows that the combined effects of the migration of cable internet
1003 customers to fiber internet would have a per customer UUSF impact of
1004 ($[REDACTED]) per month. In order to make an adjustment to this UUSF proceeding,
1005 Carbon used a three year anticipated conversion average (similar to land line loss)
1006 in which the [REDACTED] remaining cable internet customers in Carbon are
1007 converted to fiber, as projected in 2015 through 2017, with a resulting projected
1008 base year adjustment impact of [REDACTED]. Carbon presented this adjustment
1009 along with an updated calculation of the USF impact of landline loss covering the
1010 same period. The summary above and adjustments below are included in Carbon
1011 Emery Rebuttal Testimony of Woolsey - Cable Internet Migration - Exhibit 1.xlsx
1012
1013 [CONFIDENTIAL TABLE REDACTED]
1014 Source: Carbon Emery Rebuttal Testimony of Woolsey - Cable Internet Migration
1015 - Exhibit 1.xlsx
1016
1017 **Q. You also previously referred to a land line loss adjustment. Please explain.**
1018 A. The land line loss projection utilizes the same methodology used in the initial filing
1019 which incorporated a three projection of loss for business and residential
1020 customers and the application of current service rates for basic service. The initial

1021 filing for Carbon utilized 2013 and 2014 actual historical loss to project the loss
1022 forward to create a three year average. The Office rejected this adjustment, and in
1023 BCO-7 suggests that the land line loss projection should not be included as a
1024 decrease in revenue.
1025
1026 **Q. Do you agree with the Office's adjustment for land line loss in BCO-7?**
1027 A. No. It is not appropriate to completely eliminate the land line loss projection.
1028 However, actual land line losses through 8/1/2015 were less than the projection in
1029 the initial filing resulting in an increase in revenue in the amount of [REDACTED], with
1030 a corresponding decrease in the UUSF request of [REDACTED]. Carbon's proposed
1031 adjustment accurately reflects the positive effects of lower than anticipated land
1032 line loss, and is a more appropriate adjustment than the Office's BCO-7
1033 adjustment.
1034
1035 **Q. Is the adjustment made by Mr. Ostrander to adjust income taxes as a**
1036 **reflection of interest synchronization appropriate?**
1037 A. It is not appropriate.
1038
1039 **Q. Why isn't it appropriate?**
1040 A. With respect to the appropriateness of interest synchronization, I reject the
1041 assertion that this methodology is "common" or appropriate in cases of
1042 hypothetical capital structure. I am not aware of such an adjustment being adopted

1043 in current or historical Utah telecommunications proceedings or any FCC
1044 proceeding. I am also unaware of any such adjustment proposed or in practice in
1045 the traditional FCC rate making/cost study separation processes. The use of a
1046 hypothetical rate structure already penalizes Carbon to the extent the cost of debt
1047 is less than the cost of equity applied to any hypothetical capital structure of debt
1048 percent greater than its actual 0% debt. Effectively Carbon has been forced from
1049 actual capital structure to a lower rate of return hypothetical capital structure then,
1050 begrudging the already lower rate of return on debt, Mr. Ostrander proposes to
1051 take the return "hypothetically" lower again by adjusting for tax deductions that do
1052 not exist. The adjustment is not based upon Carbon's actual capital structure or
1053 tax deductibility. It has no precedence or place in this proceeding. If we are fully
1054 considering a hypothetical debt scenario, the very real result of hypothetical debt
1055 should be considered. In the case of Carbon debt would not be used to reduce
1056 equity, but rather the only reason Carbon would incur additional debt is to
1057 accelerate capital projects thus increasing rate base assets. Carbon has not
1058 projected hypothetical assets or even been aggressive in projecting "known and
1059 measurable" asset additions that have occurred to date in 2015. If all hypothetical
1060 consequences of a debt imputation are honestly considered then the positive
1061 effects of the scenario should be among them.
1062

1063 **Q. If you assume that interest synchronization is appropriate, has Mr. Ostrander**
1064 **calculated it correctly?**

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1065 A. No. It was incorrectly calculated by Mr. Ostrander.

1066

1067 **Q. In what ways?**

1068 A. Mr. Ostrander applied a theoretical imputation of interest related to rate base
1069 assets, and then calculated a tax impact of this interest amount of [REDACTED]. In
1070 this calculation he used an incorrect state rate of [REDACTED] (Exh.1D,A-11 Ostr. Tab from
1071 Master – OCS Exhibit 2D – 15-2032-01 Ostrander Rev.Req.xlsx) vs the correct
1072 Utah rate of 5%. Mr. Ostrander also uses a slightly incorrect tax gross up
1073 calculation. The correct gross up can be accurately represented by the unrounded
1074 formula [REDACTED] or rounded to [REDACTED].

1075

1076

1077 **Q. Have you calculated what the correct interest synchronization would be?**

1078 A. I am reluctant to provide the calculation because I don't think it is an
1079 appropriate adjustment. However, the correct numerical adjustment is not difficult
1080 to calculate. The correct UUSF/Tax amount, if we agreed with the adjustment in
1081 theory, would be [REDACTED] not the [REDACTED] calculated by Mr. Ostrander. I also
1082 disagree with the [REDACTED] debt to equity hypothetical capital structure that is
1083 factored into Mr. Ostrander calculation. If Carbon's actual capital structure were
1084 used this adjustment disappears, and if [REDACTED] debt is used the resulting calculation
1085 would only be [REDACTED]

1086

1087 **Q. In the Division of Public Utilities Calculation of Rate of Return, what is the**
1088 **appropriate input for the interstate rate?**
1089 A. As Mr. Coleman accurately states “The question of which rate to use is really a
1090 matter of whether Carbon participates in the Common Line Pool, or the smaller
1091 subset of companies that participate in both NECA’s Common Line and Traffic
1092 Sensitive pools.” Mr. Coleman states that he confirmed with Mr. Brandon Gardner,
1093 NECA Western Region Manager, that Carbon is not a Common Line Pool
1094 participant.
1095
1096 **Q. Is Carbon a Common Line Pool participant?**
1097 A. Yes.
1098
1099 **Q. Do you know how Mr. Coleman got this inaccurate information from Mr.**
1100 **Brandon Gardner of NECA?**
1101 A. Carbon/Emery Telcom is one of three ILECS reporting under Cost Study Area
1102 Code “502278 – Emery Consolidated” (together with Emery Telephone and
1103 Hanksville Telcom, Inc.). It is more typical for one ILEC to have multiple study
1104 areas than it is for one study area to have multiple ILEC’s. On September 4, 2015
1105 I spoke with Mr. Brandon Gardner, who indicated that he had a follow-up call with
1106 Casey Coleman and that he had clarified the inclusion of Carbon in the Emery
1107 consolidated filing and the participation of Carbon in NECA’s Common Line Pool.
1108 With this clarified understanding, it is appropriate to use 11.45% per the September

1109 30, 2014 FCC Form 492 filed by NECA as the interstate input when calculating
1110 allowed rate of return. Mr. Douglas Meredith will discuss this in more detail in his
1111 testimony.
1112
1113 **Q. Did you review the Testimony and curriculum vitae of Bion C. Ostrander?**
1114 A. Yes. Mr. Ostrander in his testimony and his curriculum vitae indicates he has
1115 maintained an uninterrupted permit to practice as a Certified Public Accountant
1116 ("CPA") in the State of Kansas since 1990. However, Mr. Ostrander footnotes
1117 this statement indicating that his permit to practice is pending renewal subject to
1118 meeting professional education hour requirements in Kansas. I reviewed the
1119 Kansas Board of Accountancy's website and database and determined that Mr.
1120 Ostrander has not held a permit to practice as a CPA in Kansas since June 30,
1121 2014.
1122
1123 **Q. Does this lapse in Mr. Ostrander's permit to practice concern you?**
1124 A. Yes. As a CPA myself, I am familiar with the rules regarding the profession.
1125 Kansas is a two-tiered state for CPA's. This means before practicing as a CPA
1126 or holding oneself out as a CPA, the individual must have a certificate of public
1127 accountancy and a permit to practice. Without meeting both requirements, an
1128 individual is not permitted to practice as a CPA in Kansas, or hold oneself out as
1129 a CPA.
1130

1131 **Q. Do you know if Mr. Ostrander is required to be a CPA to provide testimony**
1132 **in this case?**
1133 A. To my knowledge, Mr. Ostrander is not required to be a CPA to provide
1134 testimony in this case, but the fact that he held himself out as a CPA "for
1135 credential" purposes when he does not hold this credential is troubling to me as a
1136 certified public accountant. I believe this is unprofessional conduct and speaks
1137 to Mr. Ostrander's credibility as an expert witness.
1138
1139 **Q. To summarize, what is Carbon's current UUSF request?**
1140 A. $570,643. This amount reflects the effect of the five adjustments (and associated
1141 tax effect) discussed herein. This amount accurately represents the amount that
1142 Carbon is entitled to under Utah law.
1143
1144 **Q. Finally, are there any other adjustments that you have for your filing?**
1145 A: Yes. As is customary, legal and consulting fees are disbursed from the state USF
1146 on a lump sum basis after the proceeding is resolved. I won't know this amount
1147 until after the proceeding but wanted to include these items as a placeholder for
1148 resolution by the Commission.
1149
1150 **Q. Does this conclude your testimony?**
1151 A. Yes.

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