Witness OCS – 1S Ostrander

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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

Revised as Ordered by the Public Service Commission

NON-CONFIDENTIAL VERSION - REDACTED

December 17, 2015

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INTRODUCTION

Q. WHAT IS YOUR NAME AND BUSINESS ADDRESS?

A. My name is Bion C. Ostrander. My business address is 1121 S.W. Chetopa Trail, Topeka, Kansas 66615-1408.

Q. HAVE YOU PREVIOUSLY FILED TESTIMONY IN THIS MATTER ON BEHALF OF THE OFFICE OF CONSUMER SERVICES ("OCS")?

A. Yes. I previously filed direct testimony but I did not file rebuttal testimony regarding revenue requirement issues related to Carbon/Emery Telcom ("CT", "Carbon", or "Company").

Q. DO YOU HAVE EXHIBITS SUPPORTING YOUR TESTIMONY?

A. Yes. OCS Exhibits 1S-1 through 1S-3 which are attached to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR SURREBUTTAL TESTIMONY?

A. I am presenting the revised overall revenue requirement for Carbon as recommended by the OCS for the test period ending December 31, 2014.[1] As part of this process, I will address the rebuttal testimony of Carbon witness Darren Woolsey.

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[1] The overall revenue requirement also includes rate of return ("ROR") surrebuttal testimony and recommendations of David Brevitz, the other expert witness appearing on behalf of the OCS.

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

A. My direct testimony included OCS adjustments that produced excess earnings of $1,896,798, and concluded that Carbon should not receive any of its proposed UUSF increase of $816,909 or any of its current UUSF of $1,038,714 (total UUSF of $1,855,623).

I have changed my revenue requirement to reflect adjustments that I have withdrawn, revised for various reasons, or do not contest.[2] My surrebuttal testimony and related adjustments result in a revised revenue requirement surplus of $1,245,716, which means that Carbon should not receive any of its proposed UUSF increase of $816,909 and it should only receive $609,907 of its existing UUSF of $1,038,714 ($1,245,716 – ($816,909+$1,038,714) = $609,907). The bottom line is that Carbon should only receive total UUSF of $609,907.

Q. PLEASE SUMMARIZE THE ADJUSTMENTS YOU ARE CURRENTLY PROPOSING.

A. Below is an updated list of adjustments that I have withdrawn, revised, or continue to support:

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[2] Some of these adjustments in Carbon's rebuttal testimony agree with my position but may reflect a slightly revised amount for which I either agree with or do not contest because the difference is not significant.

Withdrawn Adjustments:

- Adjustment BCO-1: Allocate Fiber/Internet-Related Common Costs from Carbon to Emery Telecom Video, LLC ("ETV")/Nonregulated Affiliates. I am withdrawing this adjustment which removed 50% of internet-fiber related common costs from Carbon's regulated operations. An agreement was reached with Carbon on the treatment of this issue for this case.
- Adjustment BCO-3: Remove Prepayments from Rate Base. Because Mr. Woolsey has accepted Adjustment BCO-4 to deducted long-term liabilities from rate base, I am willing to withdraw Adjustment BCO-3 for this case.

Revised Adjustments:

- Adjustment BCO-4: Deduct Long-Term Liabilities from Rate Base. My direct testimony deducted long-term liabilities from rate base of [redacted] consistent with Carbon's treatment in its FCC/NECA filed Part 69/36 cost studies in this proceeding, and Mr. Woolsey has accepted this adjustment but slightly modified the adjustment to [redacted] and I will not contest that amount.[3] Carbon has included this adjustment in its rebuttal revenue requirement, and because I start with Carbon's rebuttal revenue requirement amount it is not

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[3] Woolsey Rebuttal – p. 4, lines 89-91 and p. 33 lines 652-653.

necessary for me to include this adjustment in the OCS revenue requirement calculation.

- Adjustment BCO-7: Remove Carbon's Revenue Reduction for Projected 3-Year Access Line Loss. The changes to this adjustment simply reflect the changed request stated in Carbon's reply comments. My reasoning and objections remain the same as described in a later section.
- Adjustment BCO-8: Remove Depreciation Expense on Fully Depreciated Assets. This adjustment is revised to reflect the withdrawal of Adjustment BCO-1.
- Adjustment BCO-9: Adjust Income Tax Expense and Reflect Interest Synchronization. I corrected relatively immaterial calculation errors and updated for the current adjustments.

New Adjustments:

- Adjustment to Impute Revenues for Cable TV Affiliate Customers Migration to Internet Affiliate. I have accepted Mr. Hellewell's proposed Adjustment that increases revenues by [redacted] (and I have offset this amount by a related amount of [redacted] from Mr. Woolsey's rebuttal testimony) to reflect the migration of customers from Carbon's cable TV affiliate to its internet affiliate.[4]

[4] Hellewell Direct – p. 10, lines 252-263.

- Adjustment to Reflect True-Up of Wholesale Revenues: I have also accepted Mr. Hellewell's proposed adjustment to increase revenues by [redacted] to reflect a true-up of wholesale DSL revenues from an updated 2014 cost study. However, it was not necessary to show this as an adjustment in the OCS revenue requirement because Carbon also accepted this adjustment and already included it in their rebuttal revenue requirement which is the starting point for the OCS revenue requirement.

Unchanged Adjustments:

- Adjustment BCO-2: Allocate Corporate Overhead Expenses from Carbon to ETV/Nonregulated Affiliates.
- Adjustment BCO-5: Remove 50% of Telephone Plant Under Construction (TPUC) from Rate Base.
- Adjustment BCO-6: Remove 50% of Materials & Supplies ("M&S") from Rate Base.

Rebuttal to Mr. Woolsey - Adjustment BCO-2: Revise the Corporate Overhead Allocation Factor (Exhibit IS-1, Sch. A-3)

Q. MR. WOOLSEY CRITICIZES THE REVISED ALLOCATION FACTORS THAT YOU RECOMMEND, ARE YOUR ADJUSTMENTS

CONSERVATIVE AND INDICATIVE OF OTHER PROBLEMS WITH CARBON'S COST ALLOCATION MANUAL?

A. Yes. First, I have only revised two of Carbon's nine company-wide allocation factors[5] and I have only proposed adjustments to four of Carbon's ten Department cost pools. And although I have concerns with some of Carbon's other allocation factors that would impact the remaining five Department cost pools, I have not proposed an adjustment for these issues in this proceeding. Therefore, my approach and related adjustments to the four Department cost pools are conservative and reasonable.

Second, my adjustments related to cost allocation factors are indicative of other problems with Carbon's CAM. Carbon's CAM is not a CAM in the traditional sense based on the requirements of the FCC's Part 64 cost allocation procedures or consistent with the best practices that I have observed in my thirty-five years of experience in reviewing CAMs of other telcos. The CAM[6] that was filed with Carbon's application consists of merely ten PDF-formatted pages.[7]

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[5] There is another allocation factor that only allocates costs between the regulated telcos of Carbon, Emery, and Hanksville.

[6] Proprietary Exhibit A of Mr. Woolsey's Direct Testimony, the CAM is Exhibit 9 (consisting of ten pages, 9 through 9i).

[7] These PDF-formatted pages are Excel spreadsheets, although a working Excel version complete with formulas and underlying documents was not provided with the Company's original filing.

Also, Carbon's CAM is not an instructive "Manual" document; it is merely ten individual spreadsheets. Below are some of the deficiencies with Carbon's CAM and ways in which it is inconsistent with CAMs that are more representative of standard utility practices.

1) It is not constructed as a Manual that can be easily used. It does not have a cover page, table of contents, a description of nonregulated activities by affiliate, organization chart, description of transactions with affiliates and other sections typically included in a CAM.

2) There is no explanation of the FCC's Part 64 (or FCC's Part 32 Affiliate Transaction Rules at § 32.27) procedures or requirements to which it is intended to comply.

3) There is no detailed written explanation of the allocation factors and related underlying inputs, assumptions, and calculations. It is not possible to test "compliance" with a CAM or to evaluate changes in a CAM if the underlying documentation is not present. Furthermore, if a CAM is not properly documented, then inputs and assumptions can be easily changed from year-to-year in order to manipulate results and achieve biased or desired outcomes.

4) There is no description or list of Department cost pools.

5) There is no explanation of cost apportionment principles or methods for each of the Department cost pools.

6) There is no explanation of time reporting procedures for different types of employees.

7) There are no underlying studies, calculations (Excel spreadsheets, etc.) or supporting documentation that were filed with the original CAM and which should be part of the actual CAM document.

Q. PLEASE EXPLAIN THE PROCESS OF OCS RECEIVING THE SUPPORTING DOCUMENTATION AND CALCULATIONS FOR THE CAM.

A. Carbon did not provide all this supporting documentation early in this proceeding as requested in OCS data requests, but instead Carbon has either piecemealed this information to OCS over the course of this proceeding or not provided the requested information. In fact, certain supporting documents for allocation factors were seen for the first time in Mr. Woolsey's rebuttal testimony.

For example, OCS 2-36/2-40[8] asked Carbon to provide all underlying documentation, supporting calculations, and cost pools that are used in determining the allocation factors in the CAM, along with showing the amount and percent of each cost pool allocated to each affiliate. Carbon's response to OCS 2-36/2-40 on June 8, 2015 did not include a written answer that identified or described the amount or percent of cost pool allocated to each affiliate. Instead, Carbon merely cited to three attached Excel documents and placed the burden on OCS to search and sort thousands of fields in these documents to try and identify the proper amounts.

One of these cited Excel documents is a searchable database document ("OCS 2-40 Cost Allocation Support 2014" - "Cost Pool Detail" tab), and Carbon's response did not identify the specific fields or explain how this

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[8] OCS 2-36 for Carbon and OCS 2-40 for Emery are the same data request with the same response from the respective companies.

document could be sorted to find the requested information among tens of thousands of fields and numerous sort options. Carbon did not provide a “pre-sorted” example spreadsheet showing how the Department cost pool amounts could be determined.

Thus, to the extent Mr. Woolsey claims that I identified the wrong amount of CSR costs, this information was never previously provided to OCS although it was requested in OCS 2-36/2-40. I will address this issue later regarding cost allocation matters.

Q. HAVE YOU SEEN OTHER COMPANIES USE “BILLING RECORDS” AS THE ONLY INPUT TO A CORPORATE OVERHEAD ALLOCATION FACTOR AS PROPOSED BY CARBON?

A. No. Mr. Woolsey supports the use of “billing records” as the only input to the corporate overhead allocation factor. I have reviewed CAMs and corporate overhead allocation factors for many large and small telcos in my thirty-five years of experience, and I do not recall having seen “billing records” used as the only input to a corporate overhead allocation factor. Because corporate overheads include a wide variety of different types of costs, a single-factor billing records allocator would not accurately reflect a reasonable allocation of these costs on a “direct” or “cost-causative” basis as required by the Federal Communications Commission (“FCC”) Part 64 allocation of costs and CAM. In most cases that I am familiar with a corporate overhead allocator is based on a number of varying inputs such as payroll, net plant, revenues and expenses - - which are all included in my proposed corporate overhead allocation factor for Carbon.

Q. DID MR. WOOLSEY CITE TO ANY PRECEDENT FOR CARBON'S USE OF THE SINGLE-INPUT "BILLING RECORDS" CORPORATE OVERHEAD ALLOCATION FACTOR?

A. No. Mr. Woolsey did not cite to any precedent for his single-input billing records corporate overhead allocation factor and he did not identify any current or previous cases in Utah or other jurisdictions where this approach was used or adopted.

Q. IS IT BETTER TO USE THE OCS MULTIPLE INPUTS TO THE CORPORATE OVERHEAD ALLOCATOR THAT ARE ALL "CURRENT" INSTEAD OF USING CARBON'S "OUTDATED" BILLING RECORDS INPUT?

A. Yes. Carbon's corporate overhead allocation factor uses outdated billing record inputs from August and September 2011, and since that time frame the number of regulated local service customers has declined and the number of nonregulated internet service customers has increased. The combination of a decline in regulated customers and increase in internet customers should result in "decreased" regulated billing records and "increased" nonregulated billing records, and this should result in a revised allocation factor that would drive a greater percentage of costs to nonregulated operations. However, Carbon has not updated this factor for these changes, and a proper CAM should routinely update allocation factor inputs to avoid bias and manipulation of the results. In contrast to the outdated billing records data that Carbon uses in its corporate overhead allocation factor, all of the multiple inputs that I use are based on the latest available December 31, 2014 financial data. Also, Carbon has never fully justified why the billing records input gives an extra [redacted] weighting (versus a [redacted] or some other weighting factor) to CABS bills, which tends to drive more costs to regulated operations.[9]

Q. MR. WOOLSEY STATES THAT "BILLING RECORDS" HAVE A DIRECT OR COST-CAUSATIVE RELATIONSHIP TO THE CORPORATE OVERHEAD EXPENSES,[10] DO YOU AGREE?

A. No. Mr. Woolsey has not provided an actual example to specifically show how the number of billing records directly causes, drives, or impacts the numerous types of expenses included in the corporate overheads category. I do not believe that billing records (or any single input) has a direct or cost-causative relationship to these varied types of expenses. This diverse group of corporate overhead expenses would be more accurately allocated by an allocation factor that includes multiple inputs to remove the bias of a single-input allocation factor.

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[9] Ostrander Direct, p. 43, lines 921-926. (See Revised Ostrander Direct lines 629 – 634).

[10] Woolsey Rebuttal, p. 19, lines 390-403.

Corporate overhead expenses include a wide variety of expenses including payroll and benefits of the CEO, Board of Director fees and health insurance, Marketing and Public Relations employee payroll and benefits, NTCA Coop and URTA membership dues, donations, advertising, and other overheads tied to all of the above (seminars, business lunches, supplies and other costs). I do not believe the number of bills to local service customers or internet customers has a specific and direct impact (or drives) how the CEO, Marketing/Public Relations employees, and Board of Directors personnel spend their time on various issues and services. Also, I don't think the converse is true either, that the time spent by these personnel on various issues and services has a specific and direct impact on the number of customer bills for each service.

Mr. Woolsey's testimony does not give a specific example to show that Mr. Johansen's (CEO) time on various services and issues is driven by the number of billing records of various services. In fact, [redacted], so there is no documentation in support of any such claims by Mr. Woolsey.[11] In addition, because the Company's billing records input is based on outdated 2011 data, using this method to allocate the time and

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[11]Carbon's response to DPU 3-22 states [redacted]

costs of Mr. Johansen, the Board, and Marketing/Public Relations personnel implies that all of these parties have not changed their percentage of time spent on regulated compared to nonregulated affiliates for the past five years. I do not believe that is possible because the fiber construction program that drives significant nonregulated retail internet revenues of ETV has become a higher priority in recent years, and has likely required more planning and implementation time and resources.

Mr. Woolsey states that billing records reflect forward looking CEO plans, board decisions, and marketing efforts.[12] I do not agree. It is not possible to bill (or create a billing record) for a future customer of a future service that is not actually being provided yet, as Mr. Woolsey would imply. Therefore, no billing records would exist to support or drive the time spent by Carbon personnel on future services. Thus, billing records that do not even exist cannot be an indicator of future services or customers.

Q. MR. WOOLSEY DISAGREES WITH INCLUDING REVENUE AND EXPENSE AS AN INPUT TO THE CORPORATE OVERHEAD ALLOCATOR,[13] WHAT IS YOUR OPINION?

A. The use of revenues and expenses as an input is reasonable, especially when they are combined with other inputs like payroll and net plant for use

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[12] Woolsey Rebuttal, p. 19, lines 399-401.
[13] Woolsey Rebuttal, pp. 16 – 18, lines 320 – 388.

in a corporate overhead allocations factor. Arguably almost every "single" allocation input has some downside and that is why it is more appropriate to use multiple allocator inputs to mitigate the intentional or unintentional bias of a single-input allocator. In fact, [redacted] Allocator[14] used revenues as the only input to this allocation factor until this was changed to [redacted] in May 2014.

Mr. Woolsey states that revenue is only an appropriate input if a company has homogenous products, but it is not appropriate for the consolidated operations of Carbon affiliates which offer multiple services like cable television, broadband internet, long haul transport, and other services.[15] I do not agree. If Mr. Woolsey's argument is accurate, then it would also be accurate to reject the use of billing records for the same logic. For example, different services have different types and volumes of billing records that are created (with different levels of detail and supporting documents). Under Mr. Woolsey's argument, if services have to be identical or similar to use a "revenue" input, then services would also have to be identical or very similar to use a "billing" records input.

Mr. Woolsey also states that revenues as an input is not reasonable due to changes in different types of revenues among Carbon and its affiliates.[16] I

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[14] Carbon's CAM, Exhibit 9b.
[15] Woolsey Rebuttal, pp. 16, lines 320 – 331.
[16] Woolsey Rebuttal, pp. 16, 17, and 18, lines 333-369.

disagree. The primary advantage of using revenues as an input is that this may be the only financial input that is not easily manipulated. This is because revenues are booked to specific account numbers for services and affiliates and it is not easy to shift revenues between other services and affiliates. In contrast, some other financial input factors could be more easily manipulated and shifted between services and affiliates.

Q. WHY IS EXPENSE A REASONABLE ALLOCATION INPUT, ESPECIALLY WHEN USED WITH OTHER INPUTS?

A. Mr. Woolsey states that expenses are not a good input because they have no relationship to the amount of time spent by the CEO, Board members, or Marketing/Public Relations personnel.[17] Again, expenses and any single input has its problems and that is why I recommend multiple inputs to balance all of these concerns as it relates to the varying types of costs included in corporate overhead expenses.

Mr. Woolsey states that the single largest expense of the nonregulated entities is the Cable TV programming costs of ETV LLC, and this cost is not reasonably driven or allocated by an expense factor, but this type of expense is also not reasonably driven by billing record inputs either.[18]

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[17] Woolsey Rebuttal, pp. 18-19, lines 371-388.
[18] Woolsey Rebuttal, p. 18, lines 379-382.

Rebuttal to Mr. Woolsey: Adjustment BCO-2 to Revise the Customer Service Representative ("CSR") Allocation Factor (Exhibit 1S-1, Sch. A-3)

Q. MR. WOOLSEY STATES THAT YOUR CSR ALLOCATION ADJUSTMENT BEGINS WITH THE INCORRECT AMOUNT OF CSR COSTS, DO YOU AGREE?

A. Mr. Woolsey states that the total 2014 CSR costs that I used as the starting point for allocations of [redacted] is incorrect and the amount should be [redacted].[19] However, I am unable to validate or test Mr. Woolsey's amount and related calculation because he has not provided adequate supporting documentation or explanation for his CSR costs. Mr. Woolsey indicates his CSR calculation of [redacted] is a subset of total allocations given to the Office in data request OCS 2-40[20] and that he has included a "pivot table" with his rebuttal testimony (Carbon Emery Rebuttal Testimony of Mr. Woolsey – CSR Allocation - Exhibit 3.xlsx) to support his calculations.[21]

First, Carbon's original response to OCS 2-40, along with Exhibit 3 of his rebuttal testimony that includes this document (including the tab cited as

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[19] Woolsey Rebuttal, pp. 25-26, lines 534=538.
[20] Woolsey Rebuttal, p. 26, lines 538-539
[21] Woolsey Rebuttal, p. 26, lines 539-541.

"2014 Alloc Det OCS DR 2-40") did not provide a "sorted" version to OCS that shows CSR costs of [redacted]. Instead Carbon merely provided the voluminous Excel database with the response to OCS 2-40, and Carbon did not sort this document to specifically show Department cost pool amounts for CSR (or any other cost pools) as OCS 2-40 had requested. In effect, Carbon placed the burden on OCS to sort the Excel document and determine the proper amounts.

Second, I reviewed Exhibit 3 and the "pivot table" that Mr. Woolsey cites to at the "Summary" tab, but this is a hard-coded and non-working pivot table which does not show formulas, sources, how the amounts were determined, and I cannot sort the pivot table in any manner. In other words, the CSR cost of [redacted] that is included at the pivot table is merely that number typed (or plugged) into a field, and there is no other underlying information or formulas to validate the amount or to show how the amount was determined.

Q. COULD THIS ISSUE OF CONFLICTING CSR AMOUNTS BETWEEN OCS AND CARBON HAVE BEEN EASILY AVOIDED AT A MUCH EARLIER DATE?

A. Yes. If Carbon's response to OCS 2-40 on June 8, 2015 would have specifically identified and provided the amount of Department cost pools as was originally requested by OCS, then there would not be any dispute regarding the proper amount. Instead, Carbon merely attached the Excel schedules to the response to OCS 2-40 and placed the burden on OCS to sort and identify the proper amounts of Department cost pools. Carbon did not pre-sort the Excel files or provide a written response that identified the amount of Department cost pools to be found in the attached Excel schedule.

Q. HAVE YOU SORTED ALL OF THE COST POOL AMOUNTS IN A CONSISTENT MANNER AT OCS 2-40?

A. Yes. I have sorted all of the Department cost pools of CSR, CEO, BOD, and PR/MK at the sortable Excel document provided at OCS 2-40 to arrive at the amounts included in my allocation adjustment, and Mr. Woolsey concurs that all the Department cost pool amounts that I used are correct except for the CSR amount.[22] Because I have sorted all cost pools in a consistent manner it is not clear why the CSR costs would be incorrect and the other cost pools would be correct, and Mr. Woolsey does not adequately address this issue. In fact, using Mr. Woolsey's Exhibit 3, I have sorted the tab "2014 Alloc Det OCS DR 2-40" for CSR costs in Department 10, and it shows the same CSR costs of [redacted] in my testimony. If there is separate additional analysis that is necessary to arrive at the amount of Mr. Woolsey's CSR costs, then this information should have been documented

[22] Woolsey Rebuttal, p. 26, lines 541-546.

in Carbon's CAM and it should have been provided in Carbon's original response to OCS 2-40. This conflict could also have been resolved with proper documentation and support in Carbon's CAM.

Q. BECAUSE OF THE PREVIOUS CONCERNS REGARDING THE CORRECT AMOUNT OF DEPARTMENT COSTS, ARE YOU PROVIDING A "PDF" SORTED VERSION OF THE FOUR DEPARTMENT COST POOL EXPENSES THAT YOU HAVE ADJUSTED?

A. Yes. I am providing a sorted "PDF" copy from Carbon's response to OCS 2-36/2-40 so that the actual amount of the Department expenses can be viewed.[23] If I provide a working Excel copy, then the document may revert back to its original unsorted version that does not show the appropriate amounts. This information is located at Exhibit 1S-2 as follows:

Exhibit 1S-2 – Sch. A - Chief Executive Officer Department expenses.
Exhibit 1S-2 – Sch. B - Board of Directors Department expenses.
Exhibit 1S-2 – Sch. C - Public Relations/Marketing Department expenses.
Exhibit 1S-2 - Sch. D - Customer Service Representative Department expenses.

Q. MR. WOOLSEY PROVIDES AN EXPLANATION OF THE NUMBER OF CSRS,[24] DOES THIS CHANGE THE AMOUNT OF YOUR ADJUSTMENT?

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[23] Both OCS and Carbon have previously provided an Excel working version of OCS 2-36/2-40 in the record.
[24] Woolsey Rebuttal, pp. 26-28, lines 549-582.

A. No. Regardless of the number of full-time, half-time, and average number of CSRs addressed by Mr. Woolsey, my adjustment is primarily driven by the "amount" of CSR costs subject to allocation and the related allocation factors and not any interpretation of the number of CSRs.

Q. MR. WOOLSEY STATES THAT DSL CUSTOMERS ARE REGULATED, DO YOU AGREE AND DOES THIS IMPACT THE COMPANY'S ALLOCATION FACTORS?

A. Mr. Woolsey states that at December 31, 2015,[25] the combined phone and internet customers in the Carbon serving area are about one-half phone customers [redacted] and about one-half are internet customers [redacted], and that [redacted] of the internet customers are "regulated" DSL customers and so the number of "regulated" customers being served by regulated plant is [redacted] ([redacted] phone customers and [redacted] DSL customers)."[26] It appears that Mr. Woolsey is asserting that DSL is a "state/intrastate" service that is regulated by the Utah Commission, I do not agree and this is inconsistent with Carbon's position on other issues. First, Carbon's Part 69 cost study shows DSL and its related costs as an "interstate" service and not an interstate service. Second, "state" regulatory agencies do not regulate prices or service quality of DSL because it is an "interstate" service", and

[25] The cite to "2015" appears to be a typographical error, and presumably this is December 31, 2014.
[26] Woolsey Rebuttal, p. 24, lines 506-511. Mr. Woolsey's rebuttal is addressing my testimony related to the Public Relations/Marketing allocation factor and costs.

there is no "state" tariff filed with the Utah Commission for this "interstate" service. However, if Carbon's corporate allocation factor (and related "billing records" input), CSR allocation factor, and other allocations factors treat DSL as a "state" regulated service, then this would appear to be improperly allocating costs to the regulated operations. It is not reasonable for Carbon to argue that DSL/internet service is a regulated service for "allocation factor purposes", but is an interstate regulated service for other purposes. This issue is another reason to reject Carbon's allocation factors.

Q. IF MR. WOOLSEY IS CORRECT REGARDING THE AMOUNT OF CSR COSTS, HOW WOULD YOUR ADJUSTMENT BE REVISED UNDER VARIOUS SCENARIOS?

A. If the correct amount of CSR costs is [redacted] as indicated by Mr. Woolsey, then my adjustment for CSR costs would need to be revised per the following possible scenarios:

1) If the total amount of CSR costs is reduced to Mr. Woolsey's amount, but if my revised allocation factor of 65% nonregulated and 35% regulated is still retained, then my proposed adjustment for only the CSR department would decline from [redacted] to [redacted], a reduction of [redacted]

2) If the total amount of CSR costs is reduced to Mr. Woolsey's amount, and my proposed allocation factor is changed to 50% nonregulated and 50% regulated, then my proposed adjustment for only the CSR department would decline from [redacted] to [redacted], a reduction of [redacted].

Rebuttal to Mr. Woolsey – Adjustment BCO-5 and BCO-6 - Remove 50% of Telephone Plant Under Construction and Materials and Supplies

(Exhibit 1S-1, Sch. A-6 and A-7)

Q. DOES MR. WOOLSEY APPEAR TO AGREE WITH YOU THAT INCREASED FIBER INVESTMENT AND ACTIVITY IS DRIVING INCREASED LEVELS OF MATERIALS AND SUPPLIES ("M&S") AND PRESUMABLY TELEPHONE PLANT UNDER CONSTRUCTION ("TPUC")?

A. Yes. Mr. Woolsey acknowledges that Carbon is experiencing higher than historical levels of M&S due to increased construction activity associated with FTTH curb and business district in Price.[27] Presumably this same assumption also applies to TPUC levels for the same reasons. Thus, Mr. Woolsey appears to support my argument that these high levels of M&S (and presumably TPUC) are temporary and not proven to be permanent or long-term. Thus, these temporary inflated costs should not be permanently built into UUSF revenue requirements because this would provide Carbon with excessive UUSF revenues when TPUC and M&S balances decline in the future.

Q. DO YOU AGREE WITH MR. WOOLSEY'S OTHER ARGUMENTS REGARDING TPUC AND M&S?

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[27] Woolsey Rebuttal, p. 35, lines 705-708.

A. No. Mr. Woolsey argues that because the increased levels of TPUC reflect "actual plant expenditures which currently reside in TPUC", then no adjustment is necessary.[28] I do not understand Mr. Woolsey's logic. I agree with Mr. Woolsey that TPUC almost always reflects eventual actual plant expenditures, but that reason by itself does not justify the inclusion of temporary excessive levels in rate base.

Rebuttal to Mr. Woolsey - Adjustment BCO-7: Remove Emery's Adjustment for Projected Decline in Access Lines (Exhibit 1S-1, Sch. A-8)

Q. DO YOU OPPOSE MR. WOOLSEY'S REVISED ADJUSTMENT TO PROJECTED ACCESS LINE LOSS?

A. Yes. Mr. Woolsey reduced the projected reduction in access line revenues from [redacted] to [redacted], a reduction of [redacted].[29] Mr. Woolsey acknowledges that his original projection included in his direct testimony was incorrect because it overstated the amount of lost access lines.[30] Mr. Woolsey's statement about his inaccurate projections confirms the concerns that I addressed in my direct testimony, that this adjustment and the related projected access lines are not known and measurable. This

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[28] Woolsey Rebuttal, p. 34, lines 671-672.
[29] Woolsey Rebuttal, p. 4, lines 76-78 and pp. 52, the table between lines 1027 and 1028, and lines 1028-1035. Also, p. 53, lines 1036-1047.
[30] Woolsey Rebuttal, p. 53, lines 1042-1043.

adjustment should be rejected for the same reasons indicated in my direct testimony.[31]

Rebuttal to Mr. Woolsey - Adjustment BCO-8: Remove Depreciation Expense on Fully Depreciated Assets (Exhibit 1S-1, Sch. A-9)

Q. DOES OCS AND DPU BOTH OFFER THE COMMISSION TWO REASONABLE DEPRECIATION EXPENSE ADJUSTMENT ALTERNATIVES DESPITE CARBON'S OPPOSITION?

A. Yes. Carbon criticizes the depreciation adjustment and approach both myself and Mr. Hellewell uses.[32] However, both adjustments and related methods are reasonable when considering the concerns and problems that we have both identified with Carbon's depreciation expense calculation and underlying Continuing Property Records ("CPRs"). The OCS and DPU offer the Commission two reasonable depreciation expense adjustment alternatives. I have used an approach that is more consistent with the FCC's USoA Part 32 regulatory mass asset/group depreciation accounting methods and Mr. Hellewell's approach is more consistent with traditional non-regulatory depreciation treatment.

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[31] Ostrander Direct, pp. 61-62, lines 1305-1333 (See Ostrander Revised Direct, lines 1013 – 1041).

[32] Woolsey Rebuttal pp. 36-40, lines 719-796 rebuts Mr. Ostrander's depreciation expense adjustment and related method. Woolsey Rebuttal pp. 42-49, lines 844-996 and Meredith Rebuttal pp. 22-29, lines 608-836 rebuts Mr. Hellewell's depreciation expense adjustment and related method.

Q. IS THERE AN ERROR IN MR. WOOLSEY'S REBUTTAL TESTIMONY?

A. Yes. Mr. Woolsey's depreciation table[33] shows an incorrect Aerial Cable life of [redacted] years (which equals a [redacted] depreciation rate), but the correct life and depreciation rate of 10 years and 10% is shown at Carbon's response to DPU 1-11 and is also cited at Mr. Hellewell's testimony that refers to the original Commission order establishing these depreciation rates.[34] Thus, Mr. Woolsey's testimony can give the incorrect impression that these Aerial Cable assets have a longer life and lower depreciation expense than they actually do. To the extent Mr. Woolsey's arguments rely on this incorrect information, his arguments are invalid.

Q. IS MR. WOOLSEY'S PRIMARY ARGUMENT NEGATED BY THE FACT THAT YOU DO NOT PROPOSE TO PERMANENTLY STOP DEPRECIATION EXPENSE ON "FUTURE" PLANT ADDITIONS OF THE TWO ACCOUNTS THAT YOU ADJUST?

A. Yes. Mr. Woolsey primarily argues that my adjustment to amortize depreciation expense on these two accounts is not reasonable because Carbon plans to add assets to these accounts in future years.[35] However, it appears that Mr. Woolsey does not completely understand my position.

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[33] Woolsey Rebuttal, p. 38, the "table" is located between lines 757 and 758.
[34] Hellewell Direct, p. 5, lines 122-125.
[35] Woolsey Rebuttal, pp. 37, lines 750-754 and the table shown at p. 38 between lines 757 and 758. Also, p. 38, lines 767-769 and p. 40, lines 784-787.

Mr. Woolsey appears to believe that I am proposing to permanently stop depreciation forever on both accounts 2232 Subscriber Circuits and 2421 Aerial Cable. And he appears to argue that it is not reasonable to permanently stop depreciation on these accounts because plant additions will be made to both of these accounts in the future and it will be necessary to depreciate those new assets.

I am not proposing that depreciation expense be permanently stopped on these two accounts forever. I am only proposing that Carbon's depreciation expense for these two accounts that are included in its filing, and which is based on "historical" plant balances that are mostly fully depreciated, be amortized over a five-year period. I could have proposed that this related depreciation expense be removed entirely from this filing which is more consistent with Mr. Hellewell's approach, but I am proposing a more conservative approach of amortizing these remaining balances to ensure that Carbon does not recover excess UUSF revenues in the future when these "historical" assets become fully depreciated.

Clearly, I am not proposing to stop depreciation expense for new plant additions in future years, Carbon can continue to record this depreciation expense on its books when it acquires these assets. I am simply addressing how to adjust depreciation expense on problems related to "historical" assets that are primarily fully depreciated; I am not proposing a method to stop depreciation for any future plant additions. Therefore, Mr. Woolsey's arguments about future plant additions are not relevant, the Company can continue to depreciate these assets in the future.

Q. IF CARBON WANTS TO RECOVER THE DEPRECIATION EXPENSE RELATED TO NEW PLANT ADDITIONS IN FUTURE YEARS, CAN IT FILE ANOTHER UUSF CASE?

A. Yes. When, or if, Carbon adds new plant additions to the Subscriber Circuit and Aerial Cable accounts in future years, it can file another UUSF case to recover this depreciation expense. There is absolutely nothing in my proposal that prevents Carbon from recovering depreciation expense on these two accounts when new plant additions are made in the future.

Q. WHAT OTHER REASONS NEGATE MR. WOOLSEY'S ARGUMENT TO RELY ON PROJECTED FUTURE PLANT ADDITIONS?

A. It is inconsistent with the use a historical 2014 test period in this case. Carbon had the option of making a "forecasted" filing if it wanted its projected future plant additions to be relied on to some degree. Also, these plant additions are not known and measurable, otherwise they would be included in the test period telephone plant in service account.

Q. IS YOUR DEPRECIATION EXPENSE ADJUSTMENT FOR AERIAL CABLE CONSERVATIVE?

A. Yes. Carbon's filing includes 2014 depreciation expense for account 2421 Aerial Cable of [redacted] my adjustment allows Carbon to recover $84,296 of related depreciation expense, so my adjustment is $56,479. Mr. Hellewell states that Aerial Cable was fully depreciated at the end of January 2014,[36] and I do not necessarily disagree with his conclusion under his assumptions. But if I relied on his conclusion, then I would be justified in removing all Aerial Cable depreciation expense of $140,775 instead of just the $56,479 that I actually removed in my adjustment. So my adjustment is conservative in this regard.

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[36] Hellewell Direct, p. 7, line 177-178.

Q. WILL YOU CONTINUE TO EXPLAIN WHY YOUR DEPRECIATION EXPENSE ADJUSTMENT FOR AERIAL CABLE IS CONSERVATIVE?

A. Yes, I will explain how I relied on the information in the table below.[37]

Table 1 – Aerial Cable Analysis:

	A	B	C	D	E
			Aerial Cable		
	Aerial Cable Account	Year	Amount	%	
Lne	**Part 1**				
1	**Total Copper Aerial**	[redacted]	[redacted]	[redacted]	fully deprec.
2	Fiber Aerial	[redacted]	[redacted]	[redacted]	mostly fully deprec.
3	Fiber Aerial	[redacted]	[redacted]	[redacted]	
4	**Total Fiber Aerial**	[redacted]	[redacted]	[redacted]	
5	Total Copper & Fiber Aerial	[redacted]	[redacted]	[redacted]	
6					
7	**Part 2**				
8	Fiber Aerial		[redacted]		[redacted]
9	Deprec. rate		[redacted]		
10	Deprec. expense		[redacted]		
11	Total Aerial Cable Deprec. Expense per Co.		[redacted]		
12	Adjust Deprec. Exp.		[redacted]		
13					
14	**Part 3**				
15	Copper Aerial	[redacted]	[redacted]	[redacted]	[redacted]
16	Copper Aerial	[redacted]	[redacted]	[redacted]	[redacted]
17			[redacted]	[redacted]	

[37] Information from this table is from Carbon's CPR records provided at the response to DPU 1-9, these records can be sorted by type of asset, age/years, and company.

Table 1 shows that Carbon's books include both much older vintage "Copper" Aerial cable and more recent "Fiber" Aerial cable. And from [redacted] only Copper Aerial of [redacted] (Col. C, line 1) was added to the books and then from [redacted] only Fiber Aerial of [redacted] (Col. C., line 4) has been added to the books [redacted] Carbon continues to record depreciation expense on all of the much older Copper Aerial, along with the new Fiber Aerial. Although mass asset depreciation accounting combines these two types of assets together in one account for purposes of depreciating these assets (using the same depreciation rate of 10%), these assets are clearly two separate technologies. Fiber has the capability to provide all of the deregulated broadband services that copper cannot provide. The legacy Copper Aerial is no longer being added to the books or network of Carbon because it is essentially obsolete. These differences provide the basis for treating these two groups of assets separately for depreciation purposes, especially when the Copper Aerial is essentially fully depreciated. I use this information to test the reasonableness of my depreciation expense adjustment.

For purposes of this reasonableness test, I am not calculating depreciation expense on [redacted] of Copper Aerial [redacted] because these assets have far exceeded their depreciation life of 10 years and I am treating them as fully depreciated. I am also treating Fiber Aerial of [redacted]

[redacted] the same because these assets are mostly fully depreciated. This calculation is shown at Part 2 of the Table. If I allow depreciation expense on only the Fiber Aerial of [redacted] (added in 2014), then this results in allowed depreciation expense of [redacted] and when this amount is deducted from Carbon's total Aerial Cable depreciation expense of [redacted], this results in an adjustment of [redacted] Although this method would remove Aerial Cable depreciation expense of [redacted], my proposed adjustment only removes depreciation expense of [redacted], thus demonstrating that my adjustment is conservative.

Q. ARE YOU CONCERNED THAT OLDER VINTAGE COPPER AERIAL CABLE IS REDUNDANT TO THE NEW FIBER AERIAL CABLE AND ESSENTIALLY DUPLICATES DEPRECIATION EXPENSE?

A. Yes. The Fiber Aerial is intended to overlay and replace the Copper Aerial plant because Carbon is moving towards a fiber embedded network.[38] Although this fiber will also provide basic local service, it will not provide any substantive "new" basic local service to customers - - so clearly the focus is on expanding and providing new broadband services. However, it is not reasonable for the Company to recover depreciation expense on two networks, the legacy Copper Aerial assets and the new Fiber Aerial assets because this is redundant, duplicative, and excessive. Carbon's Copper

[38] However, I do not know how much Copper facilities would be redundant.

Aerial assets that are fully depreciated are not improperly increasing rate base, but Carbon is still calculating depreciation expense on these duplicate and related redundant assets.

Another issue compounding this concern is that it does not appear that Carbon is retiring the Copper Aerial plant as Fiber Aerial replaces it. I have reviewed Carbon's Annual Reports, and it appears that plant retired for all of Account 2410 is [redacted] for 2011 and 2013, and only [redacted] for 2014.[39] It does not appear that Carbon has retired essentially any Copper Aerial or even any cable and wire facilities of any kind for the three-year period 2011, 2013, and 2014. It appears especially unusual that Carbon added [redacted] of Fiber Aerial plant in 2014 (which has the same value as [redacted] of the existing Copper Aerial plant on the books) and did not retire any copper or other plant related to these additions. This information supports my concern about Carbon's redundant Copper and Fiber network and is yet another reason to adopt the depreciation expense adjustment that I propose.

Q. IS ALL OF THE OLDER VINTAGE COPPER AERIAL CABLE ON THE BOOKS STILL BEING USED AND CAN IT BE PHYSICALLY LOCATED AND IDENTIFIED?

A. I don't know the answer to that, but it is a concern. I understand that the current Carbon management team inherited CPRs that had problems, and

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[39] I did not have the 2012 Annual Report information.

that they have cleaned up the CPRs to some degree by removing certain assets that did not exist or could not be located. However, that same issue could still exist to some degree in regards to Copper Aerial plant. As Table 1 shows, the Company asserts that some Copper Aerial plant as far back as [redacted] is still in service, still being used, and can be located. Furthermore, as Part 3 of Table 1 shows, [redacted] of the Copper Aerial is from [redacted] years old, and only [redacted] of this plant is [redacted] years old or less. Clearly, these actual asset ages exceed the 10 year depreciable life of this related plant

Q. MR. WOOLSEY STATES THAT YOU HAVE NOT PROVIDED ADEQUATE SUPPORT TO REMOVE DEPRECIATION ON OTHER ASSETS. DO YOU AGREE?

A. No. Mr. Woolsey states that I have not provided adequate rationale to remove depreciation expense of [redacted] for Other Work Equipment and [redacted] for Interexchange Circuit Equipment.[40] It was not necessary to provide as much support for these two assets because it is easier to make a case for suspending depreciation expense for these assets. Carbon's records clearly show that these assets are fully depreciated with "$0" net book value at December 31, 2014, there are not any net assets remaining to be depreciated.[41] Mr. Woolsey claims that Carbon will continue to make additions to these plant accounts in future years, but he did not identify the amount of additions or provide any support for this statement. I reviewed

[40] Woolsey Rebuttal, p. 37, lines 738-740.
[41] This information is from DPU 1-11.

Carbon's FCC Form 481 projected budget, and Carbon only projects [redacted] of additions for 2016 to 2017 for Other Work Equipment, and only projects [redacted] for 2016 to 2017 for Interexchange Circuit Equipment. This is not significant and does not change my position. Regardless, as I previously stated, I am only suspending depreciation on historic balances, which does not prevent Carbon from recording depreciation expense on new additions in future years if they occur.

Rebuttal to Mr. Woolsey - Adjustment BCO-9: Adjust Income Tax Expense and Reflect Interest Synchronization (Exhibit 1S-1, Sch. A-10 and A-11)

Q. MR. WOOLSEY STATES THAT THE INTEREST SYNCHRONIZATION METHOD USED BY OCS IS NOT APPROPRIATE IN CASES OF "HYPOTHETICAL" CAPITAL STRUCTURES,[42] DO YOU AGREE?

A. No. Whether a hypothetical capital structure is or is not used in a case is not relevant, but the interest synchronization method is always relevant if the capital structure calculation includes a debt component with a weighted cost of debt. In this case, both Carbon and OCS have used a hypothetical capital structure that includes a debt component and a related weighted cost of debt. The fact that Carbon and OCS disagree on the "weighting" of debt and equity in the hypothetical capital structure is not relevant to the interest synchronization method, and the OCS has actually used Carbon's cost of

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[42] Woolsey Rebuttal, pp. 53-54, lines 1049-1075.

debt of [redacted][43] in its hypothetical capital structure and proposed rate of return ("ROR") calculation.

The only circumstances in which it would not be appropriate to use the interest synchronization method is if there is no debt component included in the actual or hypothetical ROR calculation or if a company's revenue requirement is determined using a Times Interest Earned Ratio (TIER)[44] method instead of a typical ROR method.

Q. WILL YOU EXPLAIN THE UNDERLYING REGULATORY CONCEPTS BEHIND THE INTEREST SYNCHRONIZATION METHOD?

A. It is important to understand the basic underlying regulatory concept behind the interest synchronization method, including the following:

1) Interest expense is deducted from taxable income in the determination of income tax expense, so it is important to include an interest expense component in any calculation of income tax expense for regulatory purposes. Carbon's income tax calculation does not include a deduction for interest expense.

2) Interest expense is not treated as an expense to reduce operating income in a rate filing because a company is compensated for this debt cost component (interest expense) through the cost of debt that is included in the ROR calculation that is applied to rate base.

3) This is the most important concept to understand. It is very important to synchronize and use the same cost of debt (interest expense cost) in

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[43] Woolsey Direct Testimony, Confidential Exhibit 3 of Confidential Exhibit A, the debt component in the "Cost of Capital" column.

[44] The TIER method is sometimes used for companies with a significant amount of long-term debt and the party holding the debt requires that a company's earnings be a multiple of its interest expense cost in order to avoid foreclosure or violations of the debt covenant.

> the ROR calculation with the same cost of debt (interest expense) included in the income tax expense calculation to be fair and equitable to all parties' interests.

Q. WHY IS THIS METHOD OF INTEREST SYNCHRONIZATION OBJECTIVE AND FAIR TO ALL PARTIES?

A. The interest synchronization method is that it is objective, not easily manipulated by any party, and it does not pick winners or losers between the sometimes competing interests of companies and ratepayers. In some years the interest synchronization method will increase a company's revenue requirement and in some years it will decrease a company's revenue requirement. A consistent interest synchronization calculation can produce either an increase[45] or decrease[46] in the revenue requirement, but if the same calculation method is used in each case over the long-run then it does not favor either the company or ratepayers.

Q. MR. WOOLSEY STATES HE IS NOT AWARE THAT INTEREST SYNCHRONIZATION IS USED IN CASES OF HYPOTHETICAL CAPITAL STRUCTURES OR OTHER CASES IN UTAH.[47] WHAT ARE YOUR COMMENTS?

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[45] An increase in a company's revenue requirement results when the interest expense that is calculated using interest synchronization is less than interest expense used in the company's income tax return.

[46] A decrease in a company's revenue requirement results when the interest expense that is calculated using interest synchronization is greater than interest expense used in the company's income tax return.

[47] Woolsey Rebuttal, p. 53, lines 1054-1057.

A. The Utah Commission approved a stipulation between DPU and Gunnison Telephone Company whereby a 50% equity/50% debt hypothetical capital structure was used and the interest synchronization method was used for calculating interest expense on the hypothetical capital structure. This Order is provided at OCS Exhibit 1S-3 and relevant language from the Order is noted below:[48]

> 4. Rate of return on rate base: Applicant's current capital structure is comprised of 6.5 percent debt to 93.5 percent equity. By use of a hypothetical capital structure, Applicant and the Division agreed to a return on equity of 12.5 percent (on 50 percent of rate base) and a return on debt of 7.6 percent (on 50 percent of rate base), which results in an overall 10.05 percent return on rate base.
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> 5. Income tax calculation: Applicant and the Division stipulated to an income tax calculation that reflects the impact of a *pro forma* adjustment as well <u>as a tax synchronization adjustment for interest expense resulting from the use of a hypothetical capital structure. (emphasis)</u>

Q. WHAT OTHER COMMENTS DO YOU HAVE REGARDING MR. WOOLSEY'S REBUTTAL ON TAX ISSUES?

A. I agree with Mr. Woolsey that I inadvertently used an incorrect state income tax rate in the interest synchronization calculation and that I used a slightly different gross-up factor.[49] I have made these corrections which are relatively immaterial.

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[48] Before the Public Service Commission of Utah, Docket No. 00-043-01, Order issued July 3, 2000, Order ¶ 4 and 5.
[49] Woolsey Rebuttal, p. 55, lines 1084-1086 and lines 1090-1093.

Adoption of DPU Adjustments

Q. ARE YOU ADOPTING TWO OF DPU'S ADJUSTMENTS TO INCLUDE IN YOUR REVENUE REQUIREMENT CALCULATION?

A. Yes. I am adopting Mr. Hellewell's adjustment to increase revenues by [redacted] to reflect the revenue imputation for Carbon's cable affiliate customers migrating to the broadband/internet affiliate,[50] and his adjustment to increase revenues by [redacted] to reflect a true-up of wholesale DSL revenues from an updated 2014 cost study.[51] Mr. Hellewell's DSL revenue true-up adjustment was adopted by Carbon and included in Mr. Woolsey's Rebuttal revenue requirement.[52] Therefore, it is not necessary for me to make this additional adjustment because the amount is already included in Carbon's revised rebuttal revenue requirement that was the beginning point for my proposed revenue requirement adjustments.

Q. DOES THIS COMPLETE YOUR PREFILED SURREBUTTAL TESTIMONY?

A. Yes.

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[50] Hellewell Rebuttal, p. 10, lines 257-269.
[51] Hellewell Rebuttal, pp. 10-11, lines 271-282.
[52] Woolsey Rebutal, p. 4, lines 82-88.