BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

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

REDACTED SUR-SURREBUTTAL TESTIMONY

OF

DARREN WOOLSEY

ON BEHALF OF CARBON/EMERY TELCOM, INC.

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SURREBUTTAL TESTIMONY OF DARREN WOOLSEY

Q. What is your name?

A. My name is Darren Woolsey.

Q. Are you the same Darren Woolsey that has filed previous testimony in this Docket?

A. Yes.

Q. What is the purpose of your testimony?

A. The purpose is to provide additional testimony regarding depreciation methods subsequent to the Utah Public Service Commission's Order on Motion for Partial Summary Judgment related to depreciation.

Q. Why Does Carbon/Emery use the Group Asset Depreciation Method?

A. As I have previously testified, Carbon/Emery consistently applies the prescribed FCC accounting method of group asset depreciation expense in accordance with 47 CFR Part 32, a method which is also prescribed by Utah Administrative Code R746-340-2.D. Carbon/Emery assigns asset units into groups based on the specific characteristics and use. Once these units are assigned to a group, the asset group becomes the asset for purposes of calculating depreciation. Carbon/Emery uses approved depreciation rates and utilizes straight-line depreciation applied to each "group asset."

Q. Is this group asset method widely accepted in the industry?

A. Yes. Group asset depreciation is the most widely accepted industry standard. Adjustments to this method, when deemed necessary, are generally accomplished using a FCC formula, which Joseph Hellewell identifies in his Testimony and which will be discussed herein.

Q. Why is Group Asset the Industry Standard for Depreciation?

A. Utilities use the group method for accounting for their assets because individual components of the telecommunications network systems are too numerous to practically track on an individual basis given the small relative value of each individual component asset. Additionally, utilities use the group method for component parts of larger assets such as fiber or cable lines which contain numerous component parts which are impractical to track separately. The nature of the assets in a telephone network makes it hard to separate various assets from the group. The assets are often so heavily intertwined that separated alone, they are irrelevant.

Q. Can you provide an example of what you mean by intertwined assets?

A. Yes. Yes. As an example, in 2003, UDOT did a road project from Airport Road to Wellington. As part of this project, Carbon/Emery was required to install new fiber and cable to replace the abandonment of 40,198 feet of copper in eleven sections. The following was abandoned:

Abandoned Cable:
200 x 19 gauge =596 feet
300 x 22 gauge = 596 feet
900 x 24 gauge =596 feet
300 x 22 gauge = 13,018 feet

200 x 24 gauge =18,698 feet
100 x 22 gauge = 274 feet
600 x 24 gauge = 274 feet
25 x 24 gauge = 464 feet
400 x 24 gauge = 1894 feet
200 x 24 gauge = 1894 feet
50 x 24 gauge = 1894 feet
Total Footage of abandoned cable = 40,198 feet

The newly installed copper was only useful because it was connected to the existing copper unaffected by the UDOT project (copper not on the UDOT right of way feeding the neighborhoods). This demonstrates the nature of the group. While part of the group was plant installed years earlier by Qwest, this relatively recent installation was integrated into the existing group. While this may result in the new copper being depreciated more quickly as part of the group than if it were an individual component depreciated at the unit level, the fact is that the component has no useful life outside of the group of components with which it was installed. In other words, the group should depreciate together, because it will likely be replaced or retired as a group at some point in time. The new additions serve to prolong such replacement, but will not be useful outside the group.

Q. Do you have any examples of equipment that is too numerous to track individually?

A. Yes. A good example of this scenario is subscriber circuit equipment or electronics on the customer's side of the plant. On the fiber network, Carbon/Emery installs either switches or Optical Line Terminals at the subscribers' premises. Carbon/Emery will purchase these in bulk in order to handle reasonable install times on service orders, and if a customer disconnects services, then Carbon/Emery retrieves the equipment and will

redeploy the equipment at other customers' locations. These pieces of equipment will usually be retired as a group when the electronics become obsolete and Carbon/Emery selects a new equipment line. To treat these assets as individual units would be an administratively burdensome. There would be multiple "in service" dates for each asset as they are installed, removed, and reinstalled in reaction to service orders. This is why the industry treats them as part of a telecommunications network group. They are selected as a group and will be retired as the group becomes obsolete or is no longer supported.

Q. In the Division's approach to depreciation, is the Division suggesting that each of those individual units be accounted for or tracked on an individual basis?

A. No. In fact, while the Division calls its method single asset, strictly speaking the Division is not drilling down to each individual asset unit. The Division is merely separating these various equipment units into smaller groups divided by year purchased, and then treats this smaller group as a single asset. The Division likely recognizes that it is not administratively prudent to maintain that level of detail. The Division's "Single Asset" method is not actually accounting for assets individually, but only in a different group. The question then becomes less about whether the group asset method is used but rather whether the group is configured correctly and the remaining life of the group is estimated correctly. Notwithstanding, the Division's proposal does not recognize the intertwined nature, character and use of network assets. I recommend the Commission reject the Division's proposed depreciation approach.

Consider a simple non-telecom example: imagine a business has a machine that it uses in its operations. When improvements and modifications are done to that machine, the improvements and modifications cannot exist or are of little value if they are not integrated into the machine. Similarly, much of the telephone plant is linked in a manner which only functions as a group.

Carbon/Emery employs the group method in accordance with industry standards and I submit its groups are properly configured. Carbon/Emery's depreciation methods are reviewed and audited each year; and Carbon/Emery submits reports to federal and state jurisdictions for review. This group method of accounting used by Carbon/Emery is prudent, just, and reasonable, and allows for a correct depreciation of assets.

Q. The Division takes issue with Carbon/Emery's group method, and proposes use of a single asset method. Do you agree with the Division's method?

A. No. First, as stated above, the Division is not using a true "single asset" method, but is using smaller groups of capitalized additions. This approach fails to reflect the nature of telephone equipment and the reasoning behind using group depreciation.

Second, the Division recalculation of depreciation is unfair and flawed. The Division goes back to the in-service date of each asset unit addition and recalculates all years of depreciation through 2014. Because the 1/1/14 beginning accumulated depreciation used by the Division differs from Carbon/Emery's actual audited and reported balance there is

not a way to implement its proposed methodology. Rather some transition to single asset straight line would need to be implemented that would account for the beginning balance of existing asset groups and accumulated depreciation with all new additions subject to the new single asset straight line methodology. I have calculated the depreciation expense using a transition and my calculation yields a five-year average depreciation of [redacted].

Third, the Division's supposed "single asset" methodology assumes no cumulative adjustment for rate base, which results in an artificially low depreciation expense in the test period.

Q. Why do you think the Division's depreciation expense is artificially low?

A. The Division wants to apply the accumulated effect of accelerated depreciation to bring down the rate base, but then wants to apply its "single asset" depreciation expense calculation to lower current year depreciation expense.

This reduces revenue requirement for both rate of return and expense, by the selective use of both methods. This is inconsistent with the "test period" approach stated in the Utah Code and used by the Commission and Division for rate cases and UUSF proceedings. Carbon/Emery's Application proposed to use 2014 as the test period adjusted for known and measurable changes. The Division's method clearly does not establish a correct test year. If depreciation is slowed using single asset depreciation beginning from the in-service date, then rate base will rise (assuming additions projected by

Carbon/Emery). This would make the "test period" non-representative. Further, as the rate base rises, eventually depreciation will rise from the artificially low number proposed by the Division, because the asset base will be increasing over time.

Q. The Division, in testimony, and in briefing filed in this case has indicated that it has not required Carbon/Emery to make any changes in its accounting. Rather, the Division has requested that the Commission adjust Carbon/Emery's depreciation expense, and the Division has used its alternative methodology to calculate the amount of the recommended adjustment. Do you have concerns with this approach?

A. Yes. I am very concerned with this approach because I believe it has significant consequences that may be unintended.

Q. What are those consequences?

A. If the Division (and ultimately the Commission) calculates the company's depreciation expense using a methodology that differs from Carbon/Emery's and Carbon/Emery does not change its accounting procedures to adopt this alternative depreciation methodology, problems will arise in the future. Carbon/Emery's rate base will be depreciated using a group method that may lead to an increase in depreciation expense, but Carbon/Emery will not be entitled to claim that higher depreciation expense associated with that rate base for state UUSF purposes. On the contrary, the Division, and the Commission if it adopts the Division's argument, will use the lower rate base achieved by the group method of depreciation, and the lower depreciation rate achieved by the single asset

method of depreciation. The consequence of this approach is that Carbon/Emery will be required to file an application for UUSF disbursement annually to ensure it is permitted to earn a rate of return on its rate base since the rate base is depreciating faster under the group method, but the depreciation expense is calculated using the alternate method.

Q. Can you demonstrate that the Division's number is artificially low?

A. Yes. Carbon/Emery has run depreciation and rate-base projections and over five years the depreciation will rise from the Divisions proposed [redacted] expense level to an average of [redacted], and rate base will rise from the filed level of [redacted] to [redacted]. This example illustrates that the Division's methodology does not project a representative "test period."

Q. Do you have other concerns with the Division's proposed method of depreciation calculation?

A. Yes. The Division's method does not address the changing asset mix from Intrastate to Interstate jurisdictions. (See Division Response to Data Request 1.1(a)), attached hereto as Carbon/Emery D Woolsey SSR Exhibit 1. Under the assumptions of the Division, the Interstate assets will be depreciated on a group basis and the Intrastate assets will be depreciated on a single-asset basis. However, these are actually the same assets and it is an assignment of percentages of each asset to each jurisdiction that is depreciated under different methods. Additionally, the interstate/intrastate percentage mix is changing each year, so differing portions of the assets would be depreciated different ways each year.

There is currently no accurate way to report these changing asset mixes or the cumulative rate base effect of differing and conflicting methods using the Annual Reports that have been designed by the Division. This would leave the Division unable to regulate and inspect the telephone companies under this dysfunctional dual method outside of a rate case. Also, in rate cases it would confuse and skew the "base year" to make it unrepresentative.

Q. Are there additional concerns you have with the Division method?

A. Yes. The Division's current methodology does not address:

- how asset disposals (with a different federal vs state basis) will be handled. Typically, any gain or loss on disposal is adjusted through group depreciation expense to prevent over or under expense recovery on the asset. This would require separate calculation and historical tracking to properly adjust for the state's method of depreciation expense.
- how the Division will view single-asset straight-line depreciation expense when it exceeds the group method (at some point each asset has to have a reversal of timing differences and/or remaining differences will be recognized on disposal).
- How the increased and cumulative rate base will be handled from the demarcation point, or date, from which the state requires single asset methodology. Previously, the Division has only considered the current year impact on rate base, but going forward, the Division (and the Commission) will have to recognize the cumulative rate base and individual asset difference from the point in time that the Commission no longer recognizes the group methodology for interstate assets.

- Why creating rate base differences, two bases for every asset, timing differences, jurisdictional reporting differences, additional tracking, loss of reporting transparency, and possible increases in total USF distributions is in the public interest. Though the Division says it is not requiring a change in methodology, any company interested in ensuring proper jurisdictional returns will either switch to the state prescribed methodology (with all associated interstate revenue impacts) or most certainly bear the administrative burden to track these differences to ensure correct state and interstate rate of return. However, the Company would risk being penalized by the faster depreciation of rate base than the slower depreciation expense calculated under the Division's method as stated above, if the Company did not file a rate case or UUSF application each year. The Company may be afraid that the regulators would say, "since you did not come in for a rate case or UUSF case, we assume you earned a proper rate of return on those assets." This approach is not prudent, and would encourage more frequent rate cases.

Q. Why does the Division's use of its depreciation method on a Total Company Basis skew the results when a company is using group for Interstate purposes?

A. The use of group depreciation for interstate purposes only skews the intrastate revenue requirement. Because group depreciation is above the Divisions' supposed "Single Asset", when the Division looks at the Interstate Revenues that were based on group depreciation, it appears that the revenues are high because the Division uses its "Single Asset" depreciation. Because the Division is looking at this on a "Total Company" basis,

the Division in effect reduces Carbon/Emery's revenue requirement on intrastate depreciation, because of the supposed artificially high (created by the Division's use of a differing method than the Interstate Jurisdiction) revenue recovery on the Interstate side. In other words, the Division wants the extra revenue from the Interstate side as a result of group depreciation, but wants the lower overall revenue requirement by use of its "single asset" method of depreciation.

Q. Does the Division address this issue in its calculations?

A. No. The Division ignores this issue. (See Division's Response to Data Request 1.1(a),(b)), attached hereto as Carbon/Emery D Woolsey SSR Exhibit 1.) The result is Carbon/Emery's Utah USF request is skewed downward.

In Carbon/Emery's Data Request DR1 to the Division, Carbon Emery identifies this revenue impact issue and asks for the DPU's calculation of interstate revenue as follows:

> "DR 1.1 In the filing of Carbon/Emery Telcom (Carbon) for UUSF funding on April 2, 2015, Carbon included total company depreciation of [redacted] utilizing a straight line depreciation methodology applied to group assets as prescribed by 47 CFR Part 32. This depreciation included both interstate and intrastate components. The interstate portion of the depreciation as calculated at the time of the UUSF filing, based upon the 2014 PSC annual report (2013 factors), was [redacted] or [redacted]%. Subsequently, the actual filed cost study filing for 2014 (2014 factors) evidenced [redacted] or [redacted]% interstate depreciation. The interstate separated depreciation amounts result in accompanying interstate revenue from various sources, which for Carbon include: Interstate Common Line Support, tariffed special access, switched access/ARC/CAF-ICC, and DSL. The revenue resulting from interstate depreciation has been realized or accrued in the 2014 financial statements and in the UUSF filing. The Division disagrees with Carbon's group

depreciation calculation, and has proposed a recalculated single asset approach applied to total (interstate and intrastate) company assets which results in a depreciation reduction of [redacted].

a. Please identify the amount of interstate revenue associated with the [redacted] depreciation adjustment and identify the steps the DPU has taken to ensure that the associated interstate rate of return revenue impact of the depreciation adjustment has been addressed."

The Division indicated in its response that it had not calculated the interstate revenue associated with their depreciation adjustment calculation. Though Carbon/Emery does not agree with the Division's depreciations adjustment, Carbon/Emery has performed the calculation of the interstate revenue impact and has determined that [redacted] of interstate revenue is associated with the Division's proposed depreciation expense adjustment of [redacted].

Q. When you say [redacted] of interstate revenue is associated with the Division's proposed depreciation expense adjustment of [redacted], what does that mean?

A. It means that if the Division's method of depreciation is used, Carbon/Emery's interstate revenue would be reduced by [redacted], and presumably, that amount of interstate revenue would be recovered from the State UUSF; or stated another way, if Carbon/Emery uses the Divisions method of depreciation for the Interstate side, Carbon/Emery will receive $246,858 less revenue from Interstate sources. This will then have to be recovered from Intrastate sources.

Q. Are you familiar with the other "acceptable" methods of depreciation identified in Mr. Hellewell's direct testimony?

A. Yes To determine if group depreciation is following appropriate remaining asset service lives for a given group, the FCC has provided a formula for recalculating depreciation while still maintaining the group (or mass asset) straight line methodology. The formula used for this calculation is correctly stated in 268678 Direct Testimony of Joseph Hellewell for DPU 8-21-2015 lines 230-231 as follows:

$$\text{Depreciation Rate} = \frac{100\%-\text{Accumulated Depreciation \%}-\text{Future Net Salvage \%}}{\text{Average Remaining Life}}$$

Two factors that require assumptions in the calculation are the date of the accumulated depreciation percentage and corresponding average remaining life as well as any assumptions surrounding the establishment of the average remaining life. Because the general methodology is maintained in the adjustment process and only the rate changes, this adjustment has generally been accepted without explicit FCC approval.

Q: You mention that the Division states that the FCC method is acceptable. Please indicate where this acceptance is mentioned by Mr. Hellewell.

A: Mr. Hellewell states on lines 201-203 of his Prefiled Direct Testimony that:

> "there is [sic] a variety of alternatives that Carbon-Emery Telephone could use that would use the Commission approved life and rates, and would be reasonable alternatives for calculating revenue requirement and Utah USF if correctly employed."

Lines 223-234 of Mr. Hellewell's testimony provide:

> "FCC Method: The FCC has developed a formula that has been used to recalculate the depreciation rate based on the plants average remaining life, future net salvage, and depreciation reserve ratio. This formula has been published in several orders. (FCC 00-306, FCC 96-485) From FCC 00-306, "The depreciation rate for an account is a function

of the associated plant's average remaining life, future net salvage, and depreciation reserve ratio. The depreciation rate is calculated using the following formula:

$$\text{Depreciation Rate} = \frac{100\% - \text{Accumulated Depreciation \%} - \text{Future Net Salvage \%}}{\text{Average Remaining Life}}$$

Both the average remaining life and the future net salvage factors are based upon estimates that require periodic review to ensure their reasonableness."

Q: To your knowledge, has the Division performed the calculations necessary to determine what the FCC method produces for Carbon/Emery?

A: The Division has not performed the FCC method for Carbon/Emery, despite confirming that it is an acceptable method. (See Division Response to Data Request 1.3(c)), attached hereto as Carbon/Emery D Woolsey SSR Exhibit 1.

Q. Did Carbon/Emery employ the FCC Method in its calculation of depreciation expense as filed?

A. No. Carbon/Emery did not use the FCC Method when calculating the depreciation expense in its application.

Q. Why not?

A. Historically, Carbon/Emery has not separately considered the average remaining life of the group of assets, but rather has simply applied the straight-line depreciation rate to the group of assets. This approach is reasonable because Carbon/Emery groups assets in manner that results in the assets having similar average lives. For example, copper cables that are added to repair a section of outside copper plant, are added to the outside copper plant group because they will typically be retired at the same time as the group.

Additionally, Carbon/Emery purchased its plant from Qwest. Many of the assets were not described in sufficient detail to make some of the calculations as precisely as Carbon/Emery would normally make. However, Carbon/Emery has made proper disposals over the year and has actually disposed of as many assets as it has added to the groups. The fact that the FCC Method calculations are similar (as shown below) to Carbon/Emery's current depreciation evidences that Carbon/Emery's method is reasonable.

Q. Have you calculated the depreciation expense for Carbon/Emery using the FCC Method identified in Mr. Hellewell's testimony?

A. Yes. I have reviewed Carbon/Emery's group depreciation methods. I believe our depreciation methods, as implemented accurately reflect the Company's depreciation expense. However, in an effort to corroborate our methods, we have recalculated our depreciation using the FCC formula.

Q. Please explain your calculation of the FCC method for Carbon/Emery.

A. There are two recalculations based on different date assumptions, attached hereto as Carbon/Emery D Woolsey SSR Exhibit 2 and Carbon/Emery D Woolsey SSR Exhibit 3. The first FCC formula recalculation was performed using the end of the test period year (12/31/2014) for purposes of establishing the accumulated depreciation percentage and average remaining asset life. The second recalculation used a mid-year date or average to determine the accumulated depreciation percentage and average remaining asset life. Under both recalculations:

- Depreciation expense for 2014 group additions were prorated depreciation based upon the number of month's in service,
- average useful lives for each group were calculated as a weighted average from historical in-service dates and the commission approved lives,
- FCC prescribed salvage values were utilized (including reclamation/disposal costs)[1]
- The calculation was applied to total company assets which then requires adjustment for the interstate portion of revenue affected by any proposed change

The results are as follows:

Table 1

FCC Method for Carbon/Emery

Item	As filed (as amended by testimony)	FCC Method Year End 2014	FCC Method Mid-Year Convention (June 30, 2014)
Depreciation Expense	[redacted]	[redacted]	[redacted]
Depreciation Diff from filed		[redacted]	[redacted]
Rate Base Impact @ 10.5%		[redacted]	[redacted]
Interstate Rev Impact (43.83%)		[redacted]	[redacted]
Revenue Requirement effect		[redacted]	[redacted]

[1] Federal-State Joint Board on Universal Service; Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, 14 FCC Rcd 20156, FCC 99-304, November 2, 1999, Errata: December 22, 1999, TENTH REPORT AND ORDER, Appendix A.

In 2014, the FCC rejected the elimination of its salvage values, stating that "Adopting a salvage rate of zero for certain asset classes, rather than a negative salvage rate, implicitly assumes that there is no cost associated with removing those assets at the end of their usable lives. Ignoring the fact that carriers face actual costs to remove certain assets would be akin to ignoring the cost of placing the asset and would result in a flawed estimate of cost recovery." FCC, Connect America Fund (Phase II Model-Based Support), 29 FCC Rcd 03964, (2014).

Total USF request	570,647	577,155	484,062

Q. Please summarize your calculations reported in Table 1?

A. The first recalculation using the FCC formula using a 12/31/14 date produced nearly identical results to Carbon/Emery's filed depreciation expense number. The level of depreciation expense is also consistent with forward looking annual FCC 481 additions as presented in previous exhibits of averaging [redacted] over the next 6 years (through 2020). With significant disposals also anticipated, depreciation (under any method) will be outpaced by plant additions and will grow over time.

The second FCC calculation using an average 2014 accumulated depreciation percentage and a 6/30/14 point in time to calculate the average remaining life resulted in a slightly lower level of depreciation expense of [redacted]. This calculation is very similar to the historical PSC annual reported average depreciation expense (2006 to 2014) of [redacted] as well as reported average additions and disposals for the same period of [redacted] and [redacted] respectively. I observe that Carbon/Emery's existing groups are near the end of their lives, and our large projected investments will be paired with significant disposals effectively refreshing these asset groups and I anticipate levels over the next six years to be similar to historical levels presented. Though single-asset straight-line depreciation could not be implemented as suggested by the Division (because the Division recalculated all assets from their in-service date) a projected 1/1/2014 change to single asset straight line going forward on actual additions from 2014

and FCC 481 projected assets would result in an average annual depreciation expense of [redacted] over the next six years.

Q. Has Carbon/Emery considered other depreciation methodologies?

A. Yes. We have considered numerous depreciation methods, many of which have been discussed with the Division in an attempt to at least separate the depreciation calculation into interstate and intrastate jurisdictions and thereby address the revenue impact discussed above.

Q. Does Carbon/Emery's group depreciation establish a correct "base" depreciation?

A. Yes, the goal of this proceeding is to establish a representative "base year" for purposes of determining an appropriate level of UUSF support. In reviewing the depreciation from 2006 through 2014, the depreciation has averaged [redacted]. In looking at the projected capital expenditures and plans of Carbon/Emery from 2015 to 2020, the average annual plant additions will be [redacted] and average depreciation will increase overtime accordingly. This is representative of the numbers filed by Carbon/Emery using group depreciation and the numbers stated in this testimony as recalculated using the FCC adjustment formula. The results clearly demonstrate that the number projected by the Division using its "Single Asset" method is artificially low and not representative of historical or anticipated Carbon/Emery operating levels.

My testimony confirms that even with the Commission's clarifications in its order allowing for adjustments to a group asset method does not alter materially the Carbon/Emery filling in this proceeding.

Q. Does this conclude your testimony.

A. Yes.