BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF THE APPLICATION OF CARBON/EMERY TELECOM INC. FOR AN INCREASE IN UTAH UNIVERSAL SERVICE FUND SUPPORT	Docket No. 15-2302-01 Hearing Redacted Volume 1

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P R O C E E D I N G S

HEARING OFFICER: Good morning. Today is Tuesday January 26, 2016. It is 9:00. This is the date and time set for the formal hearing in the matter of the application of Carbon/Emery Telecom Incorporated for an increase in Utah Universal Service Fund Support. This is Public Service Commission Docket 15-2302-01.

Let's go ahead and get appearances on the record. Carbon/Emery.

MS. SLAWSON: Thank you. My name is Kira Slawson. I represent Carbon/Emery Telecom Inc. as the attorney. With me, starting at the far end of counsel table is Brock Johansen, the CEO of Carbon/Emery Telecom Inc. Next to him, and next to me, is Darren Woolsey, the CFO of Carbon/Emery Telecom Inc. We also have another witness, Douglas Meredith from JSI.

HEARING OFFICER: Then you are also representing URTA, the intervener; is that correct?

MS. SLAWSON: I am, yes.

HEARING OFFICER: Thank you. Is anyone else here from URTA?

MS. SLAWSON: No -- well, Douglas Meredith is the witness for URTA, yes.

HEARING OFFICER: Thank you. And for the Division.

MR. JETTER: Good morning. I'm Justin Jetter. I'm with the Utah Attorney General's office and I represent the Utah Division of Public Utilities. With me at counsel table is William Duncan with the Utah Division of Public Utilities. And the Division intends to present two witnesses today who are seated in the back, Casey Coleman and Joseph Hellewell.

HEARING OFFICER: Thank you. And for the Office.

THE WITNESS: Robert Moore, Attorney General's office representing the Office of Consumer Services. Seated next to me is our witness Bion Ostrander. We also have a witness David Brevitz who will be testifying. And Michele Beck, the director of the Office of Consumer Services, is also present and she may speak to any policy issues that come up during the hearing.

HEARING OFFICER: Thank you. Just as we get started here, a couple of housekeeping matters. We are scheduled to break from the UUSF hearing this morning at noon to take any comments from any public witnesses who might appear. I don't know if any will be here or not. We haven't had any requests to call in, correct? So we'll see if anybody comes. If we don't see anybody for the public witness hearing then I think we could just continue with the UUSF hearing. We do need to be prepared to take public comments for a period of about an hour at least, but then at 1:00 we could take a lunch break. Does that sound all right?

Let's talk about witness and exhibit lists just briefly. All parties have filed those and the Office did a little amendment to it yesterday to remove information that related to testimony that's been withdrawn. Does any party have an objection to any other party's witness and exhibit list today? Carbon.

MS. SLAWSON: I guess it's not so much as an objection, but I wasn't aware that Ms. Beck was on the witness list for policy issues.

HEARING OFFICER: Do you object to her making a statement if she feels it is necessary?

MS. SLAWSON: We would obviously want the opportunity to cross examine on any statements.

HEARING OFFICER: All right. Thank you. Division, any objection?

MR. JETTER: The Division has no objection.

HEARING OFFICER: Office.

MR. MOORE: That's fine.

HEARING OFFICER: And you speak for URTA as well?

MS. SLAWSON: I do.

HEARING OFFICER: Thank you. So I think it would be appropriate, largely the exhibit and witness lists -- well, the exhibit lists just capture and summarize the prefiled testimony that's been submitted. So I believe all the parties have had a chance to look at all of that. I think it would be appropriate for me to just accept it into the record as filed and as marked and that might save us some time. Is that what the parties were expecting, or is that acceptable?

MS. SLAWSON: That's acceptable to the Company.

MR. JETTER: It's generally acceptable to the Division. We have some corrections that we would like to make that generally the witnesses will do at the beginning of their testimony. I'll walk through that with them.

HEARING OFFICER: Okay. Office, does that meet with your expectations?

MR. MOORE: That's fine. I had some exhibits that came up that might not have been on the exhibit list. I guess Ms. Slawson can object to them at that time if she feels.

HEARING OFFICER: Sure.

MR. MOORE: If she feels they're not appropriate.

HEARING OFFICER: But to the extent that we already have filed exhibits that are on that list, we'll accept them to the record as filed subject to correction during testimony and as premarked. Okay. I think that will save us some time.

The next thing I wanted to do for housekeeping is just note for the record that many of the exhibits do contain information that the parties have marked as confidential. Generally the confidential sections include financial information and numbers. I just wanted to make the parties aware and put on to the record Utah Code Section 54-3-21(4), which requires this hearing to be open to the public, including all records to be open to the public, except it says that the Commission may withhold from the public any information that it determines needs to be withheld in the best interest of the public. I can give you that. Do you want me to read it exactly what it says?

MS. SLAWSON: No, that's fine.

HEARING OFFICER: So I anticipate today that the parties will be discussing concepts and principles and polices and leave the numbers where they are, which is in the confident exhibits. If you find it necessary to talk about the numbers today and you want me to close the hearing for the purpose of doing that you're going to have to demonstrate that closing the hearing is in the public interest, which is an interesting concept. I just wanted to make the parties aware of that.

Then finally, the Commission issued a notice a few days ago on January 21st asking the parties to be prepared to address threshold questions that are raised in the statute specifically prohibiting any use of UUSF funds for support of unregulated activities or any activities that do not constitute basic telephone service. Do the parties have a preference as to how and when to address these issues?

MS. SLAWSON: The Company, Carbon/Emery would prefer that these issues be addressed in post hearing briefing. I think that affords the opportunity to look at the legal aspects of the statute after all the testimony has been entered so we can apply the legal aspects of the statute to the testimony as in the record.

HEARING OFFICER: Are you prepared to address it at all today?

MS. SLAWSON: I am.

HEARING OFFICER: Could you address it at least generally at the outset here, the threshold question, so if the statute isn't satisfied then that is perhaps as far as we need to go. If you could address it at least briefly at the beginning that would be helpful.

MS. SLAWSON: Okay.

HEARING OFFICER: Division.

MR. JETTER: I suppose we have a question for the Commission on this. We have a witness prepared to give a statement responding to those questions, but we weren't certain if you preferred that from counsel or -- it's kind of to some extent mixed questions of policy that may be more appropriate, at least from the Division's perspective, to have one of our policy folks discuss it. But the alternative is also I'm prepared to provide you with our position on it.

HEARING OFFICER: Perhaps you could just address it briefly upfront.

MR. JETTER: Okay.

HEARING OFFICER: And then we'll take your witness whenever you want to bring him or her.

THE WITNESS: Okay.

HEARING OFFICER: Office.

MR. MOORE: We'll address it briefly in the beginning. We also have a condensed written response that we would like to introduce as an exhibit if Ms. Slawson does not object. Also this is the reason we have Ms. Beck available to talk on policy questions if they arise.

HEARING OFFICER: All right. Thank you. So that is all that I wanted to discuss here as we get started in terms of housekeeping. Do the parties have any other questions that we need to talk about before we go into the meat of this matter? All right. It doesn't look like it. Are the parties ready to begin then with opening statements?

MS. SLAWSON: Basically I would introduce the witness and then each witness has prepared a summary of their testimony, so I didn't prepare any particular opening statement.

HEARING OFFICER: All right. The Division or the Office, you're fine to left Carbon just go ahead?

MR. JETTER: Yes. I think our general practice has not been to offer -- generally we don't have an opening or closing statement unless requested by the Commission.

HEARING OFFICER: All right. Very good.

MS. SLAWSON: I guess as a preliminary matter in light of what Mr. Jetter just said, we have requested through an e-mail communication with counsel and the with the ALJ that there be closing argument in this matter. And we suggested that our preference was to have that on a post hearing basis provided in a written form. But we are prepared if necessary and if time permits to do a closing argument also.

HEARING OFFICER: I think I responded and said we'll see how the hearing goes.

MS. SLAWSON: Exactly.

HEARING OFFICER: Very good. All right. Then under the rule Carbon/Emery, which is the applicant, has the burden of proof. Begin. Go ahead.

MS. SLAWSON: Thank you. I would like to call Darren Woolsey -- I'm sorry, I mean Brock Johansen to the stand.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MS. SLAWSON:

Q. Good morning, Mr. Johansen. Would you please state your name, employer and business address for the record?

A. Yes. Brock Johansen. I'm the chief executive officer of Carbon/Emery Telecom Inc. My business address is 445 East Highway 29, Orangeville, Utah, 84537.

Q. On behalf of the applicant Carbon/Emery you have participated in this record, correct?

A. Yes.

Q. Have you prepared and caused to be filed testimony in this record?

A. Yes.

Q. If you were asked those same questions here today that you prepared in written form, would your answers be the same?

A. Yes.

Q. Do you have any correction to the testimony that you gave in your prefiled testimony?

A. Yes, just one. Through this process the amount that Carbon/Emery has requested in UUSF distribution has changed. So lines 59 and 141 should be corrected to reflect the accurate amount of $570,643 which is the amount of Carbon/Emery's UUSF request.

Q. Do you have a summary of your testimony that you would like to give today?

A. Yes.

Q. Go ahead.

A. I filed direct testimony in support of Carbon/Emery's amended application for an increase in Utah Universal Service Fund distributions. The purpose of my testimony is to demonstrate that Carbon/Emery is a telephone corporation qualified to transact business and operate as a local exchange carrier providing telecommunications services within the State of Utah under authority issued to Carbon/Emery by the Utah Public Service Commission, which I will refer to as the Commission, and to testify that Carbon/Emery is an eligible telecommunications carrier pursuant to 47 U.S.C. Section 214(e) and is in compliance with Commission orders and rules.

I testify that Carbon/Emery conducted a thorough review of its operational expenses and revenues for test year 2014, adjusted for known and measurable changes, and determined that Carbon/Emery has a revenue deficiency, which pursuant to Utah Code Annotated Section

54-8b-15 and Utah Administrative Code R746-360 Carbon/Emery is entitled to receive additional disbursements from the Utah Universal Service Fund (UUSF). I testify that the increase of UUSF support will enable Carbon/Emery to continue providing affordable service to its customers, and to engage in construction of capital projects, while earning a reasonable rate of return as permitted by Utah Code.

I indicate in my testimony that Carbon/Emery's current rates for basic residential and commercial services are set at the current affordable base rate as determined by the Commission.

I identify Darren Woolsey, Carbon/Emery's Chief Financial Officer, and Douglas Meredith of John Staurulakis Inc. as individuals who will be providing additional testimony on behalf of Carbon/Emery. And I indicate I have reviewed the testimony and exhibits filed on behalf of Carbon/Emery in this case and that the testimony and exhibits filed on behalf of Carbon/Emery accurately reflect the financial and operational situation of the company.

I also present testimony that Carbon/Emery has not implemented any significant changes in its accounting procedures. I describe the collection and write-off policies for bad debt. And I identify immaterial penalties assessed to the company. I testify that the company has not received any revenue ruling requests, IRS responses or had any correspondence from the IRS other than periodic filing of payroll and tax forms.

Finally, I testify that the increase in UUSF support requested by Carbon/Emery is in the public interest and is just and reasonable to permit Carbon/Emery to continue to provide telecommunications services at just and reasonable rates to its customers. This concludes the summary of my testimony.

MS. SLAWSON: Mr. Johansen is now available for cross examination questions.

HEARING OFFICER: Mr. Jetter, anything?

MR. JETTER: No questions from the Division.

HEARING OFFICER: Mr. Moore?

MR. MOORE: No questions. Thank you.

MS. SLAWSON: Carbon/Emery would now like to call to the stand Darren Woolsey.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MS. SLAWSON:

Q. Would you please state your name, employer and business address for the record?

A. Yes. My name is Darren Woolsey. I'm employed by Carbon/Emery Telecom Inc. since April of 2006. The address of our corporation is 445 East Highway 29 in

Orangeville, Utah, 84537.

Q. Did you prepare and cause to be filed direct, supplemental rebuttal, surrebuttal and sur-surrebuttal testimony with attending exhibits in this case?

A. Yes.

Q. Do you have any substantive changes to the answers that you gave in the questions asked in the prefiled testimony?

A. I have no substantial changes, but there are three small corrections that I would like to make. At line 746 of my revised rebuttal testimony, which was dated September 4, 2015, there is a reference to aerial cable plant life which is dated at 20 years. And the correct life for that aerial cable plant should read 10 years. There is no subsequent calculations or additional testimony that rely on that correction.

The other two corrections are related to lines 402 in the sur-surrebuttal testimony dated December 18, 2015. There is a number here which needs to be corrected that was originally marked as confidential.

MS. SLAWSON: It's a number that was originally marked as confidential in the testimony. He just wants to make a change to that number. I'm not sure what the best way of making that change is since we want it to remain a confidential number.

HEARING OFFICER: If you want to give it to me in this matter you have to make some sort of explanation as to why we close the hearing for that purpose. Otherwise, you're going to have to provide it outside of this open meeting.

MS. SLAWSON: We would argue that the hearing should be closed for this limited purpose to state the number so that the confidential record would accurately reflect the correction that needs to be made. We think that the number that is being changed is a calculation with regard to depreciation expense, which is a confidential number which should remain confidential in this hearing.

HEARING OFFICER: And why is it in the public interest?

MS. SLAWSON: It's in the public interest because the confidential financial information of the company allows -- if in the hands of competitors it could cause a competitive advantage to the competitors and a competitive disadvantage to Carbon/Emery.

HEARING OFFICER: Does the Division agree or disagree?

MR. JETTER: I think it's generally been our practice to close these hearings when similar issues have come up for the same reasons that we would, I guess, allow the confidentiality of these type of numbers for purpose of encouraging the Company to be as forthcoming as possible with providing at least the Division with as much information as we request without having extensive discovery fights over that.

HEARING OFFICER: Mr. Moore.

MR. MOORE: We have no objection to going confidential. If it's simply a number that needs to be corrected there doesn't seem to be any strong public reason to have that information provided publically. The public won't gain much in weighing it against the loss of confidential information.

HEARING OFFICER: I'm persuaded by Mr. Jetter's argument that allowing any company to keep its financial information confidential is in the public interest because it fosters open disclosure to the Division and to the Commission, which allows for better decision making in these matters. So I will grant the request to close the hearing briefly in order to correct the number in Darren Woolsey's sur-surrebuttal testimony at line 402.

Ms. Slawson, is there anybody that you want to leave the room?

MS. SLAWSON: No.

HEARING OFFICER: Can you pause the stream? Okay. Go ahead.

HEARING OFFICER: Okay. We are back in the open portion of this hearing. Go ahead.

Q. (By Ms. Slawson) Do those two changes that you have identified confidentially affect the conclusions that you arrived at in your testimony?

A. They do not affect the conclusions we arrived at in the testimony.

Q. Do you have a summary of your testimony that you would like to give today?

A. I do.

Q. Go ahead.

A. Carbon/Emery Telecom filed an amended application for increase in UUSF support on April 2, 2015. Accompanying this filing was my direct testimony which is provided today to introduce the application and the associated exhibits. The application is based upon a calendar 2014 historical base year and ties directly to the Carbon/Emery 2014 trial balances and annual report submitted to the Public Service Commission of Utah. This is true with only four adjustments needed. One of them is a rate base exclusion. There are two known and measurable adjustments. Then there is the associated tax adjustments needed for these other changes. Based upon this information I recommend that the Commission adopt 2014 with the recommended adjustments as a representative test year for the effective period.

I testify that Carbon/Emery complies with FCC rules guiding the measurement, gathering, and allocation of the costs necessary to provide regulated telecommunications services, including the FCC rules contained in Part 32 and Part 64 as well as Public Service Commission Rule 746-340-2.

My direct testimony includes a general description of the process used in the application for Carbon/Emery's calculation of cost of capital. My testimony regarding this calculation describes the process by which costs are assigned to the interstate or intrastate jurisdiction, the imputation of 35 percent debt through use of a hypothetical capital structure, and the calculation of the authorized rate of return and revenue requirement.

I also provide additional testimony addressing various concerns identified by the Division and the Office in their prefiled testimony. Specifically, with the benefit of hindsight and to address concerns raised by the Office and Division with which I do not object, I accept four adjustments to Carbon/Emery's initial UUSF request.

These adjustments included a reduction in the original landline loss adjustment proposed by Carbon/Emery to reflect additional actual loss data experienced in 2015. The second item was an increase for nonregulated affiliate revenue projected for the anticipated migration of customers from cable internet to fiber to the home internet as our fiber to the home project progresses. So this is basically a move of customers from our nonregulated plant to our regulated plant. The third item is an increase in interstate revenue to Carbon/Emery related to interstate services provided by Carbon/Emery to its affiliate ET&V. This adjustment was evidenced on the July 2015 cost study, which was unavailable at the time of our original application. And finally, a decrease in rate base for the exclusion of long-term healthcare obligation liabilities consistent with FCC handling of these same liabilities.

The combination of the adjustments result in a decrease in the UUSF request of $246,266.

HEARING OFFICER: Can you give me that number again?

THE WITNESS: $246,266, which brings our revised UUSF request to $570,643.

I would like to briefly summarize key disputed issues that I think are remaining in this proceeding.

First of all, depreciation. Carbon/Emery's method of depreciation and calculated depreciation expense are at issue in this case. I have testified to the appropriateness of Carbon/Emery's group asset methodology in accordance with the FCC's Uniform System of Accounts, which is contained in Part 32. Specifically, Part 32 Section 32.2000(g)(i) promulgates depreciation expense be calculated using a group plan of accounting. This methodology has been consistently applied since Carbon/Emery's beginning in 2001 and is an industry accepted method of calculating depreciation. I testify that Carbon/Emery's test year depreciation expense contained in its application is representative of the effective UUSF period. As support, I testify that historical depreciation has remained consistent with recent increases reflecting plant replacement which is anticipated to continue for the next five to seven years.

Though the Division acknowledges that there are many different acceptable methods to calculate depreciation, the Division recommends that the Commission use a single asset depreciation method to calculate the appropriate depreciation expense in this case. I do not agree with the Division's recommendation, nor do I agree with their calculation under that method because the Division's method does not result in a depreciation expense number or a rate base number that is representative of the realized and effective period.

The Office does not question the group method of depreciation, but takes exception to the calculation of depreciation expense for certain accounts because of the asset lives of the group. I testify that the depreciation expense in the application is representative of the effective period, and that a switch of depreciation method is not needed. Any concerns raised by the Office or the Division with regard to depreciation expense can be addressed with adjustments to the remaining asset lives in certain groups used by Carbon/Emery as prescribed by the FCC method.

In the alternative, if the Commission decides to abandon group depreciation, I testify that such action should be taken on a prospective basis for assets added after the Commission establishes a different methodology.

The next outstanding issue that I would like to discuss briefly is the cost of capital used to calculate the required rate of return. With respect to cost of capital, and capital rate structure, I defer to Douglas Meredith who has provided testimony on this issue. My testimony on this issue is limited to using the 12.13 percent return on equity, which has been used by the Division in recent cases that we have been involved with.

My next topic is the exclusion of certain rate base items. Carbon/Emery's application for additional UUSF includes telephone plant under construction and materials and supplies as rate base items. These inclusions are allowed by the FCC in rate base at their full value, and I testify that the PSC has historically matched this treatment by recognizing these inclusions at their full rate value. The Office proposes a 50 percent reduction to both plant under construction and materials and supplies to which Carbon/Emery remains opposed.

I testify that Carbon/Emery's telephone plant under construction account represents the actual plant expenditures with no inclusion of future purchases or known and measurable adjustments. These plant expenditures, like any other properly documented actual plant expenditures, should be included in both federal and state base rate.

With respect to the materials and supplies, the Office argues that the materials and supplies account needs to be normalized because it is higher than historical levels. I testify that the increase in materials and supplies represents real purchases of materials and supplies, which are inventoried onsite, and that the increased levels are needed for current operations, including current construction projects. I also testify that the current level of materials and supplies will be needed for at least the next five years. No normalization adjustment is needed to this account.

The next issue I would like to discuss is expense allocations, including the CSR allocator and the accounting and general allocator. The Office proposes an adjustment to Carbon/Emery's CSR expense allocator between regulated and nonregulated operations, but the Office's proposed adjustment is based on faulty assumptions. CSR costs are allocated between regulated and nonregulated companies based first on the direct coding of CSR time to the regulated or nonregulated companies. The remaining time that is not direct coded is allocated using four cost allocation factors, including the CSR distribution currently at issue as well as three other allocators including the dispatch distribution, directory distribution, and Moab CSR distributions.

I testify that when all CSR coding is considered, more CSR labor in 2014 was coded to the nonregulated affiliates of Carbon/Emery Telecom than to the regulated affiliates -- that was 52 percent versus 48 percent -- and that the final disposition of CSR labor and associated other department costs are the result of direct coding as well as the use of these four different cost allocators and we feel that allocation is correct.

The Office also takes issue with the CSR distribution allocation factor because it was based on a time study from 2010. I have testified to changes in the CSR department, including the addition diagnostic tools and an advanced internet troubleshooting group. These changes have greatly reduced the amount of time spent by CSR's related to nonregulated customer service functions that they perform. And these changes have corresponded with increased internet customers from that 2010 date. So we feel like the original costs of our time study is still valid in this case.

With respect to the accounting and general allocator, I testify that the use of billing records as an indicator of costs is appropriate and results in a representative allocation factor. However, I also testify that with proper weighting and application, the use of plant, labor, and billing records could also be considered representative cost drivers. My testimony includes a recalculation and proper weighting and use of these three identified cost drivers, the billing records, the labor dollars, and the plant costs. The results of this calculation evidence essentially the same allocation percentages for Carbon/Emery as was determined by using just the billing records.

The next item with which we take issue is interest synchronization. In this issue I testify that interest synchronization in the Carbon/Emery proceeding is inappropriate. Because Carbon/Emery has no debt, the tax deductions related to interest expense therefore do not exist. We have no debt. No amount of debt imputation in a hypothetical capital structure is going to create that tax deduction. In the absence of any actual interest to synchronize, I maintain that this adjustment is not needed.

In doing that I want to be clear here, I concede that the imputation of hypothetical debt on Carbon/Emery will reduce its taxable income because they're going to get less tax in that calculation. So as a result there is less income taxes to be paid because there is less income made there. With interest synchronization, however, there is not any real tax deductions created by that synchronization. What this results in is a change in the amount of tax without having an actual or possibility of an actual interest deduction for tax purposes to offset that. So we have no possibility to ever recover through the UUSF process that interest synchronization. That concludes my summary really on that.

Q. (By Ms. Slawson) Thank you. Mr. Woolsey, in Carbon/Emery's application the Company requests that the reasonable costs incurred by Carbon/Emery in the UUSF application be recovered in a one time lump sum distribution to Carbon/Emery from the UUSF. Do you know what those costs are?

A. I do not at this time. The costs are continuing at this point. I would anticipate that Carbon/Emery could submit a bill for the costs of this proceeding, that we could submit those to the Commission much like an attorney would do for attorney's fees at the conclusion of a trial.

MS. SLAWSON: Mr. Woolsey is now available for cross examination.

HEARING OFFICER: Mr. Jetter.

CROSS EXAMINATION

BY MR. JETTER:

Q. Good morning, Mr. Woolsey. I do have a few questions.

A. Okay.

Q. I would like to ask you a few questions this morning related to depreciation and the depreciation method used by Carbon/Emery. I believe an accurate representation of the testimony both of yours and Mr. Meredith that you would agree that the method of group depreciation proposed by Carbon/Emery does in fact accelerate the depreciation of the assets in many of the listed groups?

A. Yes.

Q. I'm looking at Confidential Exhibit 1 that was filed by Carbon/Emery in the application. I'm going to avoid using the confidential numbers, but if you could take a quick look --

MR. JETTER: Could I have just a moment off the record to ask counsel for Carbon/Emery whether ratios between a few of these numbers would be something they consider confidential?

HEARING OFFICER: Sure.

(Off the record.)

MR. JETTER: I would actually request -- I think it's going to be a little bit more convenient for us to go off the record briefly for this. I shouldn't say off the record, but to go into a confidential mode here.

HEARING OFFICER: Go ahead.

HEARING OFFICER: Would you repeat your question, Mr. Jetter?

MR. JETTER: Yes.

Q. (By Mr. Jetter) I asked if the ratio of those two values indicate that the requested depreciation annual value results in a specific time period in which the entire proposed rate base currently in service would be fully depreciated?

A. I agree from that calculation that would be roughly five and a half years if that were a straight up calculation. There are certain components of that calculation which will extend out into the future, including conduit and buildings. The expenses that would become fully depreciated are going to be our cable accounts, both aerial and buried cable, as well as our subscriber equipment. This is actually very appropriate and it's a good starting point I think for discussion.

Our subscriber equipment only has an eight year life. We are into this equipment six years at this point from when we purchased the equipment shortly after Brock and I began our employment back in 2006. This equipment is no longer supported by our vender. It needs to be replaced. What we're doing with this replacement is we're corresponding this replacement with the fiber to the home upgrade. So the equipment will be upgraded with fiber to the home type of equipment.

Similarly, our buried and aerial cable plant is being significantly overhauled. Fiber to the home, we're actually doing drops to each of our existing customers, not to all homes that currently have copper to them, but to our existing customers. This process is anticipated to continue for the next five years, a little bit longer. We have some outlining areas that we will end up picking up past that point.

But this kind of demonstrates the fact that our plant is at the end of its life and it needs to be replaced and we're in the process of doing that. It's not as if this depreciation is the end of the depreciation, the 10 million, is scheduled to be replaced. We provided data showing that replacement in a methodical and a very measurable approach to a fiber to the home type replacement.

HEARING OFFICER: Can you help me understand what you mean when you say that your existing equipment is no longer supported by your vender?

THE WITNESS: I may not be the best person to describe this because I'm an accountant and not the plant guy. But it's electronic equipment that has software capability to it. And at some point the support for that equipment is no longer -- the equipment is no longer supported by the company that originally created the equipment so it requires upgrades to the existing equipment or replacement to the existing equipment. In this case we're moving specifically from the traditional copper based equipment to fiber equipment.

HEARING OFFICER: So it's the software component that is no longer supported?

THE WITNESS: Right. It's hardware as well. I guess it's a combination of hardware, software that works together to allow the copper -- the phone line at the end of the loop to talk back to the switch at the CO or to allow the transmission of IP data back for internet purposes, that kind of thing. So it's that software, hardware combination that allows that communication to occur.

HEARING OFFICER: Thank you. Mr. Jetter.

Q. (By Mr. Jetter) Thank you. I would like to ask you just a little bit more about that actually. The software you're discussing no longer being supported and the upgrades needed. Are the upgrades needed necessary for future service for the telephone service?

A. Yes.

Q. Are they also necessary for faster internet service?

A. They do both.

Q. Okay. Is part of your telephone service provided on essentially an internet type service than a switching done at -- I guess, through an IP type service rather than a traditional switch telephone service?

A. It is a packet base protocol. It is digital. But it isn't internet protocol phone, it is traditional phone.

Q. Are you aware of any other venders that may continue to support the equipment that you have going forward for other companies who are also using that same equipment?

A. The equipment could be updated, but it would be a cost similar to the fiber to the home equipment that we decided to replace it with.

Q. I'll ask a little bit more about this. The equipment that we're discussing is specifically items that

would be in a central office, such as your -- I guess, essentially they're computers that do the switching in a central office; is that right?

A.   Yes.

Q.   And that's not the actual cable itself?

A.   No.

MR. JETTER: I would like to, I think, go back into a confidential hearing for another brief time to discuss some more numbers.

HEARING OFFICER: Okay.

HEARING OFFICER: Would you recap where we are and what we're talking about?

Q. (By Mr. Jetter) To recap for those who were not available to participate in the confidential portion we just returned from, we're discussing the projected capital expenditures through 2019. We're discussing what those expenditures are for and what type of expected life the capital assets that will be acquired and put into service through those expenditures would have.

A. I do agree with the capital expenditures that are shown on this sheet. We do have again the benefit of hindsight. In 2015 our expenditures are going to come in above $2 million, so $1.8 million is a little bit light on capital expenditures there. But otherwise this is representative.

One thing that we need to be careful -- I indicated about 90 percent of the fiber to the home project would be completed by 2019. The remaining 10 percent is our outlining areas. It is costly. There will still be capital expenditures there to be incurred.

Then there is additional events that we can see coming. Our soft switch will need to be replaced. We actually -- because those are software based equipment, it's much cheaper than the traditional switch, but it does require updates and replacement on that type of equipment. Similar to the subscriber switching equipment, a 10 year life is actually -- 8 to 10 years is probably pretty representative of what that equipment will do. So it's fair to say that this is representative of what our five year plans are, but it's not the end of capital expenditures.

Q. Thank you. Most of the dollars that would be capitalized in those years are going to the actual installation of the fiber lines, the fiber drops to the customers, the needs of the customer premise, that type of thing?

A. That's correct.

Q. Do you expect that portion of these capital expenditures to last more than eight years?

A. The actual cabling?

Q. Yes.

A. The actual cabling will, yes.

Q. Do you have any estimate of what you think a typical lifespan of your fiber network, the fiber drops to the home is?

A. For the aerial plant we have a life of 10 years. For the buried plant we have 20 years. We're on the front side of this. So each of these asset lives are subject to examination each year. I would say it would at least last the prescribed lives that the Commission has established for these assets.

Q. In fact it would be pretty surprising, wouldn't it, if you are 10 years down the road and you're going to go out and replace all of your fiber again?

A. I would say that's true.

Q. And even then, it would be surprising probably if it was 20 years, wouldn't it?

A. I would disagree with that statement. The reason why is there are so many events that occur in the life of the fiber. What we found -- without working on our fiber to the home project we have averaged $1.8 million in capital expenditures each year, and that's to maintain our existing plant. We're going to see similar type of expenditures in the future on our fiber plant. We hope that they're less in some respects, but you always have fiber cuts. You have issues that are kind of beyond control of management to prevent. So there is always going to be a portion of the plant that needs to be replaced or upgraded as needed or subject to obsolescence in the case of subscriber equipment and that kind of thing.

Q. Do you expect your fiber network to be as reliable as your copper network?

A. More reliable.

Q. How old is the average age of your current aerial copper?

A. I don't have that calculation in front of me, but I think in the testimony we provided, that detailed list, and it is significantly aged.

Q. Significantly longer than 10 years?

A. Yes.

Q. And the same with your buried cable?

A. Yes.

Q. And the fiber should be more reliable than that infrastructure you currently have?

A. Yes.

Q. You have just testified a few minutes ago that you would expect through 2019 capital expenditures that would build out about 90 percent of this network upgrade?

A. Correct.

Q. So if we were to use the depreciation amount you have proposed here, and I'm going to try to avoid the numbers so we don't back into the confidential mode. You would in fact depreciate practically all of that by, it looks like it would be, a ballpark of 2021. Would you accept that subject to doing your own calculation?

A. Which plant are you referring to?

Q. All of the capital expenditures that you're going to be making in 2015, 2016, 2017, 2018, 2019,

continuing at the depreciation expense that you have proposed in your application.

A. No, I would disagree with that statement. The reason why is you excluded your existing asset base in that assumption. So maybe to shed some light on this, you have roughly $2.3 million a year on average that you're adding, and you're only taking out $2 million a year in depreciation based upon what I've testified. So you actually have a plant increase over that period of time. It won't be gone. It will actually be greater than it is now.

Q. I'm concerned that with some of your answers you're getting into confidential information that I'm trying to avoid.

A. Sorry.

Q. Ultimately, what you're saying is that the capital expenditures you have planned with the current depreciation estimate you've used have a slightly growing rate base through the end of 2019. And then that would begin to trail off fairly significantly at that point, would it not?

A. That is correct. I do want to point using the table you have referenced here that the majority of the expenditures in this project are subscriber equipment. It's not the aerial cable or the buried cable. Fiber cabling is much cheaper than copper cabling. And because we're not doing an entire overlay of the existing plant we're able to save significant amounts of money in the cable aspect of that project.

So if you're looking at what it is that we're spending money on, we have nearly $8 million in -- sorry. You have a large amount of dollars in subscriber equipment that has a very short life. We currently have two-thirds of that amount roughly on the books in subscriber equipment with that same eight year life. So the cycling of that equipment is actually very appropriate. It's matched what we have historically done. We don't foresee any real change in that account going forward.

So the rapid acceleration that is being alluded to, I think, in this question is very appropriate for the types of expenditures that we are projecting in the table that is being referenced.

Q. The types of subscriber equipment that you're referencing with very short life span, that's directly related to the choice to move to fiber; is that correct?

A. Correct. But as I've -- without using specific numbers, it's real similar to the expenditure we incurred to place that equipment in place, the existing copper equipment in place.

Q. If you will indulge my hypothetical here.

Hypothetically if your fiber network is rolled out by 2019 and your depreciation remains the same and your capital expenditures beyond 2019 drop significantly as you're not rolling out any new product or new network, approximately -- let's do the math here. You go about five years beyond that. So you're looking at about 2025, 2024. Is that where you would expect to see effectively a depreciation cliff?

MS. SLAWSON: I'm going to object to the question it calls for a speculation on a hypothetical. It's not based on the facts in evidence in this case.

HEARING OFFICER: I noted your objection. I think the information is useful and I'm going to ask the witness to go ahead and answer the question.

THE WITNESS: Can we go confidential again for a minute?

HEARING OFFICER: Are you going to talk about actual numbers?

THE WITNESS: Yes, as presented in the schedule.

HEARING OFFICER: Can you avoid talking about actual numbers, especially whether there will be a depreciation cliff in 2024, 2025 due to there being no further expenditures for infrastructure and basically having everything fully depreciated?

THE WITNESS: I would say no. The assumption that there is no additional capital expenditures is a faulty assumption.

HEARING OFFICER: Why is that?

THE WITNESS: You have to continue to maintain your telecommunications plant. Just because an upgrade is done doesn't mean that there will never be a future need for plant expenditures. There is a myriad of aspects to our plant, including our internal core network that consistently needs upgrades. We have the switching equipment that will need upgrades. The plant itself will require additional maintenance and repair over time. The subscriber equipment we anticipate will last eight years. If we're installing some of this equipment in 2016, it's possible that in 2022 or 2024 this equipment becomes obsolete and needs to be replaced again. So it's short sided to say that you do one upgrade and that's it. Historically we have averaged an amount slightly less than that projected in our application on average, and that was without a significant plant upgrade. And that's just to maintain and replace equipment as needed.

HEARING OFFICER: On a copper network?

THE WITNESS: On a copper network.

HEARING OFFICER: Thank you. You anticipate the costs will be essentially the same on a fiber network beyond --

THE WITNESS: During the build out period it jumps up. So for sure we see an increase in the activities of these accounts. We've also focussed the dollars on the replacement rather than the maintenance, so you see a shifting of dollars to that project. Once the project is completed there will be a shift back to normal maintenance and repair costs that have a life more than a year so we capitalize it. So there is an ongoing cost there. We hope it will be less, but in some respects there is always going to be additional maintenance and repair and upgrades to that equipment to maintain it.

HEARING OFFICER: How much fiber do you have laid currently?

THE WITNESS: That question may be better for Brock.

HEARING OFFICER: But there is some?

THE WITNESS: There is some, yes.

HEARING OFFICER: How long has it been in place?

THE WITNESS: Well, depending on the sections we actually started laying fiber to what we call fiber to the node or fiber to the curb three or four years ago. So some of the capital expenditures that we've incurred up to this point have been part of the future plan to take that all the way to the customer homes. So it's been quite some time since we really replaced copper. Unless there is a direct need it doesn't make sense to do that. Like trunk copper is about a sixth of the cost of the -- sorry. Fiber is a sixth of the cost of the equivalent copper. On a fiber drop it's about half the cost of a copper drop. So when that ages it doesn't make sense to replace it with copper anymore.

HEARING OFFICER: I guess what I'm struggling to understand is the cost to install the fiber in year one versus the cost to main it in year two. Are those costs the same?

THE WITNESS: No.

HEARING OFFICER: That's what I'm trying to understand as I listen to your testimony and you say that these costs that you're projected to due to build out will basically become costs to maintain the build out in subsequent years and there is no real change in the number. That's what I kind of hear you saying. Have I heard you incorrectly?

THE WITNESS: I've provided testimony that our historical average is --

HEARING OFFICER: Meaningful.

THE WITNESS: -- meaningful, yes. And it is increased by about $600,000 during this phrase. I anticipate that we'll probably go back down to that average prior to this phase. So our historical capital expenditures will probably remain consistent for this period of time. For the build out it's going to go up by about $600,000 for each of those years.

HEARING OFFICER: I'm sorry for jumping in. Mr. Jetter, please continue.

MS. SLAWSON: Your Honor, if it would be helpful to the process Mr. Johansen will probably be able to answer some of those questions.

HEARING OFFICER: He seems very eager to say something. Is that all right, Mr. Jetter?

MR. JETTER: I'm happy to recall -- I think I would prefer the best information from the best witness to answer this.

HEARING OFFICER: All right. That's fine. Go ahead.

MR. JOHANSEN: Do you want me to answer the same question?

HEARING OFFICER: I want you to say what is burning to be said.

MR. JOHANSEN: I don't know the confidential information. Darren knows that. The only other person probably in this room that understands this is Bill because we're the plant guys, right. We're getting things confused here from a plant standpoint. So let me back everybody up. When Darren says we're going to be 90 percent down, he's talking customers. But that's not 90 percent of the project. And everybody needs to understand that.

The first phase of the project is East Carbon, Wellington, Price and Helper. It's the main customers. Then we're going into Miller Creek, and Miller Creek is spread out. So you're not going to see the capital budget fall like Mr. Jetter is saying. Those customers have to be served too. And that's going to be an increase in cost because those customers are a lot further out. So we're not going to be serving -- if you know the Price area at all. Right now we're building -- and we have to separate trunk versus drop. Drops are most expensive. They cost us a lot of money.

There are a whole bunch of things going on here, and this is for your clarification in your question you asked Darren. When you go build a network it's not all -- you go out and you put the trunk in and then you have to drop to the customers and then you have the electronics, right. Different parts of that can go bad.

For those of you that have computers, they don't last very long. Seven, eight years and processors start failing, the hard drives start failing. That's what is on the end of this. That's your electronics. A seven year old electronic computer is old. It's going to get replaced. It's not going be supported. That's what is hanging on the end of this fiber and it's what is hanging on the end of the copper. It's a computer. And that computer will end life in about seven or eight years, which is exactly close to what is prescribed by the Commission for depreciated life.

Now you talk about the actual going out in the future. The Division is trying to say there is a cliff. We get done with these projections that Darren has out there and it is a cliff. It isn't. They only go into the hard reach areas. You have North Coal Creek -- and I would have loved to have had the Division or the Office come down and talk about this. None of them wanted to do a plant tour. They didn't come down to inspect --

HEARING OFFICER: I don't want to talk about those things.

MR. JOHANSEN: Okay. But if they want to talk about this issue and what's going to happen on our build out, we can talk about that. But the point I think that is important here is it's not going to drop. We're going to go into North Coal Creek. That's going to be one customer per half mile. That's an exaggeration probably. Then you're going to go into Miller Creek. Then you're going to go up above West Wood. Then you're going to go up into --

there are a bunch of outlining areas. So this project doesn't end in year five.

Then after that, Darren said there are a bunch of other parts of the network. Our core is getting dilapidated. We don't have money to put into the core. The core is a 10 year core that we updated a few years ago. It needs to go to a 100 gig core. It does. You're hanging all of this off from your output. So right now our money is going towards fiber deployment, we haven't gone back to the router. So now you're back to the core. So those have to be upgraded. Then there is fiber between some of the towns that needs to be upgrade that is old. It's 10, 15 years old now and we're starting to see errors on it. It's old -- there are actually different types of fiber, and it's an old fiber that we put in back in the day. So that needs to be replaced. So we have these lists of projects. They go out a lot further than what the Division is asking right here. It's not a cliff and we're just going to stop. There is a lot of capital expenditures to keep the network going and we're going to keep making those capital expenditures as long as we have the funding and they're necessary to provide telecommunications services. They are. That network is going to get old. The electronics are going to get old.

And then one other thing I think is important is -- I think everybody thinks when you put fiber in it's golden forever, especially on drops. That's not the case. Drops are a huge cost. Aerial drops get caught in the wind, they blow, they -- if you picture we have our strand that holds it pretty solid out on the trunk, but on the fiber drop it's kind of waving there because you don't have a strand holding it, it's just going from a pole over there. Those come, those break, and within about 10 years you're going to replace them. These are well established principles that I'm sure somebody took into account when the Commission gave us the lives. They should have. But the point is the fiber doesn't just stay there and is good forever. It doesn't. That's not how the plant works.

And the other point is there is not a cliff where, boom, we're not going to do anymore capital expenditures. We might have 90 percent of the customers, the last 10 are going to take years.

CROSS EXAMINATION

BY MR. JETTER:

Q. I would like to ask you some followup questions.

A. Sure.

Q. Those customers that you're discussing, the sort of the end of the line customers, are you currently serving those customers?

A. We are.

Q. And they currently have telephone service?

A. They do. On buried and copper networks it requires a lot of maintenance because -- especially since you figure a lot of those are going out. It's really interesting on how the plant works. A lot of buried copper, and because it's buried you're out in fields where moisture gets in, the lines get old, more moisture gets in. Those are our hardest to maintain, but we're trying to do the biggest bang for the buck. We're cutting the towns first and then we'll go into those areas, but they need to be cut because it's hard to provide telecommunications services when their lines aren't as good of quality, but they're hard to reach.

Q. When you say telecommunications service you mean internet and telephone?

A. No, I'm referring to basic telephone service. Even basic telephone service to serve these you've got to think the net plant. Of course you can put internet across it also, but for this rate increase purpose we're talking basic telephone services.

Q. And you testified though that you currently are providing that to all of those customers?

A. All of them?

Q. The customers that you're intending to replace

that with funding?

A. Yes. The project is only to replace current customers. We're not just going to run lines out to locations that aren't taking our services if that's what you mean, Mr. Jetter.

Q. I'm just talking about where you're rolling out your fiber.

A. We're going to roll out fiber -- I mean, the plan will be to everybody if possible to fiber eventually and get rid of those old copper lines that are hard to maintain.

Q. So the fiber should be cheaper; is that right?

A. Fiber is cheaper and it's actually -- the FCC said if we're going to replace something put fiber in because it is cheaper. If I went and ran new copper lines to Miller Creek it's going to cost me a lot more than running fiber to Miller Creek.

Q. And fiber is a lot cheaper to maintain; is that also correct?

A. I can't testify to that. The studies show that it should be, but we're just cutting. So I don't have a lot of data personally on that.

Q. But you don't project any reduction in the costs of maintaining it?

A. Well, those costs -- again, I think we're getting a little off topic here in that some of those will be realized way outside the effective time period of this rate case if at all. So you've got to remember this cut is going to take a couple years. If all of a sudden our expenses go down, when the Division is reviewing our costs then they can pull us back in. But there is no reason to say, okay, we'll -- we know that's not going to be until we get fiber project done, which is years out. So if at that point our costs of operation goes down pull us back in. That's the process. But we don't need to say in five years you're going to have decreased operations, so right now you're going to get penalized. I mean, pull us back in in five years. But I can't even project. They do say that those costs should go down dramatically, but we're not going to realize that for years. And Mr. Jetter, if the Division -- they review our numbers every year, and if they want to pull us back in, they can do it.

Q. Are you familiar with an accounting term called the matching principle?

A. No, I'm not an accountant.

Q. Maybe this is a question back for Darren.

A. Do you want to jump back? Your Honor, do you have any other questions about the plant?

Q. I do have some more questions about the plant.

HEARING OFFICER: Go ahead. I have one as well which is why the 10 gigabyte -- did you say core? Is that the term you used, 10 gigabyte --

THE WITNESS: Yes, core. There is --

HEARING OFFICER: -- is needed?

THE WITNESS: Yes. So there --

HEARING OFFICER: My question is is it needed for basic telephone or is it needed for --

THE WITNESS: Sure.

HEARING OFFICER: -- all of the other things?

THE WITNESS: No, definitely it is needed for that. The core -- again, it's an upgrade issue. So whether you upgrade to a bigger core or not you still have to upgrade those because those routers are still -- and they're expensive. They're -- I don't know. I think we just bought one and it was $120,000. But the core is again a computer, and that core is about six years old now. My IT guys have put in the capital budget every year, hey, the core is starting to take errors, we're having outages because of this. And I say, well, the project right now is fiber to the home. We'll put that behind fiber to the home. So it's just like other electronics. You're going to have to maintain it. These things you don't just put them in and they drive forever. You don't buy one computer and it lasts for your whole lifetime. It's not going to do that.

HEARING OFFICER: You say it's six years old currently?

THE WITNESS: I would have to go back and look, but I think we actually started the core project about the same time as some -- it might actually be a little older. Some of them might be -- I would have to go back. The router it's kind of -- you don't go in and replace the whole core. You'll say okay, I'm going to replace the main router. These are the main routers that are connecting the town and creating the core. So we'll say this year we're going to replace the Price router, this year we're going to replace the Helper router, this year we're going to replace the -- these are $120,000 to $150,000 computers. It's not cheap. And so there are things like that. There is the old DWM equipment. We can go on and on. The network isn't just the fiber. The DWM equipment is the actual -- across the fiber you split it into light weight lengths, and that DWM input is getting old and we're starting to have trouble maintaining it too. So it's all throughout. You maintain a network.

The point here that I want to make is, one, the project doesn't end when we get 90 percent of the towns done. We still have to go out and serve the hard to reach areas that are really the hardest for us to serve even with basic telephone services. Point number two is there are other projects. And point number three is if at any point they need to pull us back in that's the rule, they can.

HEARING OFFICER: Go ahead.

Q. (By Mr. Jetter) Thank you. When you're talking about 10 gigabyte or 100 gigabyte core we're talking about bits per second; is that correct?

A. Yes. In testifying again to what you asked Darren a minute ago, basic telephone now is packet based. So you're putting packets across that and that's all that goes across the core is IP network.

Q. Of the network that you're using now, and the one you intend to use, do you have an idea about what percentage of the bit rate is being taken up by basic telephone service?

A. I would not know that number.

Q. Do you think across your entire network you've ever used 10 gigabytes per second of basic telephone service transfer?

A. No. But again, Mr. Jetter, you're -- this is when it gets to be attorneys and lawyers talking about networks that they don't understand. A 10 gig core does not mean that you need a full 10 gigs because you're going to be using every core. It's called an MPLS network. Mr. Jetter, you probably don't know what an MPLS network is. But an MPLS network is put in so you actually create the circuit across an IP -- you have one 10 gig core and you're creating individual circuits between it. So even though you might not be maxing out the full 10 gig, you need the 10 gigs to create the different circuits. Those circuits used to run across old copper T1's, those T1's are now converted on to -- or DS3's or converted on to IP and they run across that. So we're not talking full capacity when you're saying do I need a 10 gig core. You have to look at the number of circuits inside that core and what they're carrying and how they're configured. So it's completely different than to just say -- you can't think of it like a -- a normal resident would say I have 10 meg at my house. That's not how these networks run. And it's a complete lack of understanding when people look at them that way. MPLS 10 gig core is completely different than just a 10 gig pipe.

Q. Are you expanding the number of circuits in --

A. Definitely. Everything single one of these -- every one of these nodes that is served by the fiber has to have an IP port back. It's a separate circuit back. That's how you talk to the switch out to an area where you're going to hang out these fiber OLT. The ONT is at the house. The OLT you could have a circuit between the core and each one of those is a different circuit. So that MPLS, the reason why that technology is developed is because as you add more and more of those on you need more and more circuits.

Q. And that's --

A. Don't look at it as a total capacity is what I'm saying. Don't say, oh, it's 10 gig. It's a lot more complex than that.

Q. Let me ask you this question. As you increase your core capacity does it increase your ability to sell higher band width internet?

A. Sure.

Q. The more internet you want to sell the larger capacity core you're going to need?

A. Sure. The internet definitely drives usage. But I'm saying don't look at as simple as that. You have to remember this includes specials also, specials are circuits across that, special access circuits.

Q. But ultimately the majority of the computation that is being done in the routing of those packets is primarily on a band width level for the internet services?

A. It kind of depends on which leg you're on that core. Some of those would be, some of those will be special circuit. It just kind of -- again, you can't look at one area. You can say on the Price router or on -- and I don't have the stats on that immediately. But you could say okay the Price router, what is the primary going across that and then you could look at the whole mountain or you could look at whatever, it might be special circuits or it might be customer voice. It just depends on what it is and where it's located.

MR. JETTER: I think that's the questions I have about the network upgrade.

THE WITNESS: Thank you, Mr. Jetter.

HEARING OFFICER: Mr. Moore.

MR. JETTER: I have more questions for Mr. Woolsey.

HEARING OFFICER: Go ahead.

CROSS EXAMINATION Resumed

BY MR. JETTER:

Q. Are you familiar with the matching principle in accounting?

A. Yes.

Q. Would you describe what that means to you generally?

A. The matching principle generally requires that events that occur within a period are matched to their associated expenses. So if you have a revenue transaction that occurs, you have a point of sale. We sell a computer or we sell phone service, you would match that to the associated costs for the same period. So if there is a cost of goods sold or an inventory transaction, those would also be recorded in conjunction with that.

Q. Thank you. So with respect to building out, for example, a fiber network would the matching principle generally suggest that the depreciation method chosen would be one that would spread the cost, if you will, spread the recognition of those costs through depreciation expense over effectively as close as you can get the life of that asset that you're capitalizing? I suppose being more specific, the period of time in which that asset that you're capitalizing being used to produce revenue?

A. That's correct. That really becomes the question that we're dealing with today. What is representative, what is the life of the asset.

Q. It is your testimony though that the depreciation rate that you have chosen is relatively in the ballpark of the annual capitalization of the network on an annual basis is appropriate?

A. Yes.

Q. One final followup question. If hypothetically you had reached a point of zero on your depreciation account head, taking your company's proposed rate plan of service to a value of zero before you had started to install the fiber network, so say you're starting from zero today, would it be appropriate to expense the fiber network costs annually as you go forward?

A. The portion that is related to depreciation expense for that matching principle, yes.

Q. I mean the expense -- the entire costs on an annual basis?

A. No.

MR. JETTER: Thank you. Those are all the questions I have, Mr. Woolsey. Thank you.

HEARING OFFICER: Mr. Moore.

MR. MOORE: Yes, I have a few questions. Before we get on to depreciation I would like you to quickly clear up some confusion I have in the record. I'm going to pass down to you Carbon/Emery's response to the Division's sixth set of discovery requests.

MS. SLAWSON: Mr. Moore, is this identified in your exhibit list?

MR. MOORE: It's not in the exhibit list. I can make it an exhibit if you would like or I can just ask questions of it.

MS. SLAWSON: I'll look through it.

CROSS EXAMINATION

BY MR. MOORE:

Q. I just have a quick question on this. Could you turn to the second page on request 6.2. Do you see that?

A. Yes.

Q. Could you read the question for the record please beginning, Mr. Woolsey states that a single asset straight line system?

A. Mr. Woolsey states that a single asset straight line system would be too burdensome for Carbon/Emery to use and implement. However, a single asset system is used by Carbon/Emery for all their nonregulated plant. Why is it too burdensome for the regulated sites, but not for the nonregulated sites?

Q. Thank you. Can you switch down to the second paragraph of your response and read the first two sentences?

MS. SLAWSON: Your Honor, I'm going to object at this point because there is a portion of the response before that that includes an objection to the question. So I think that should be part of the record too.

Q. (By Mr. Moore) Fine. Could you read from response to the first paragraph into the record and then go down to the second paragraph and read down until the first three lines, group asset depreciation?

A. Carbon objects to this data request because the premise of the question mischaracterizes Mr. Woolsey's surrebuttal testimony. Line 76 to 77 of Mr. Woolsey's surrebuttal testimony did not include the phrase too burdensome, but rather Mr. Woolsey testified that to treat these assets as individual units would be administratively burdensome. Carbon further objects to this data request as it implies that Carbon/Emery uses the single asset method of depreciation in its nonregulated plant. This is not accurate. The nonregulated company does use group asset depreciation.

Q. Can you now turn to page 20 of your revised confidential rebuttal testimony filed September 4, 2015. Could you read the question and the first part of the answer starting on line 407 and ending on line 413 with the words straight line depreciation?

A. So you want me to read from 309 to 313?

Q. I think it would make more sense if you would read from 407 to 413.

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

Yes. Carbon/Emery Telecom could consider plant as a possible cost driver to determine the accounting and general allocator. If plant were to be used, gross plant would be a better indicator than net plant because the regulated entities use group asset depreciation per FCC Part 32, whereas the nonregulated entities use single asset straight line depreciation.

Q. Is that sentence consistent with Carbon/Emery's response on 6.2?

A. It's a good question. We've had to define single asset depreciation for the term used by both the Division and ourselves, and now we need to probably clarify it with the Office. It appears to be in conflict. The methodology that we use doesn't take individual assets down to a minute separation. A good example may be the subscriber equipment that we talked about previously and that Brock discussed briefly. Part of that subscriber equipment is individual ONT's. It's the end piece of that communication network. We don't capitalize every single individual ONT. Similarly, on the nonregulated side the equivalent may be set-top boxes. We wouldn't capitalize individual set-top boxes, but we might capitalize a group of them that were purchased in a year. So when you use the term single asset, it may refer to a group of similar assets that were purchased in a period. So the difference between nonregulated and regulated side may be it's more of a difference in the nature of that group than it is strictly single assets.

So when we make the comment in this section of the testimony, we're saying single asset, describing that process that our nonregulated end uses. It doesn't get down to minute single assets, which is where it becomes burdensome and that's what the other testimony refers to. But in this case it refers to a period of time or a group of assets. And they're not -- that group doesn't span multiple years and constitute a functioning network like it would on the regulated side.

That may not have clarified it well for you. I don't know if I'm answering the question fully the way you want.

Q. Well, as Mr. Johansen said I'm just a lawyer here and this is accounting. But it seems to me that you stated in section 6.2 you use the term group asset depreciation, saying it does use group asset depreciation. And in your testimony you said that they don't use group asset depreciation. Is this just being uncareful with your terms?

A. No. I guess I feel like I've answered the question. We've done the same thing with the Division in pointing out their use of the term single asset doesn't really result in a true single asset reputation and it's the same clarification for us. The level that the Division goes down to in defining single asset is really what is in question here, but it's not a true single asset approach. To get to the separation of every single asset is where it becomes burdensome.

HEARING OFFICER: When you used the term single asset separate line depreciation in your prefiled testimony, is it equivalent or fairly equivalent to what you've described as vintage group depreciation?

THE WITNESS: It would be vintage, but it would be to a year level rather than to a two or three year level. If you look at depreciation on -- if we can use the term gray scale -- you could have a very theoretical and pure single asset straight line method and then you could get to the group method. Vintage, depending on how many years you choose and how you group it, it would be somewhere within that gray scale. Vintage is some level of in between, between those two levels.

So the difference in definition here is to the level it gets burdensome if it's very detailed minute single assets approach, and it's not even what the Division got to. It's more of a group of assets in a particular year or -- generally it's a project. So it might be a three month project where we have -- I don't know what a good example would be. Say we have a small construction build in one of our small towns and we capitalize that as a project to -- it might have a couple different categories, but it might need so many feet of fiber. So some of it goes to buried cable and some to subscriber equipment so we capitalize that. But we don't go down and capitalize every single piece of subscriber equipment, we capitalize it as a group on that project.

HEARING OFFICER: Mr. Moore.

Q. (By Mr. Moore) Just one more question. Is it your testimony that what you termed in your written testimony as single asset straight line depreciation is equivalent to what you said in your discovery requests, you described it as a group asset depreciation? Which one would be a closer description to what the Division uses in the single asset depreciation? Would it be closer to -- I'm sorry. Let me start over again.

For your nonregulated plant which you say does use group asset depreciation, is that the same group asset depreciation that you use in your general depreciation adjustment?

A. If I understand the question you're asking, the regulated -- I'm sorry. The nonregulated methodology that we're using would be similar to what the Division is proposing as single asset.

Q. All right.

A. So it's not --

HEARING OFFICER: And why do you not use the same method for regulated?

THE WITNESS: This goes back to industry practice and what has typically been prescribed by the FCC and what is common in the industry. We view certain assets in the network as a unit, as an operating network, and the components of that network don't operate separately from the other units of that network. So it operates as a telephone network or as a buried cable plant network. So we view it as one asset rather than pieces, a whole bunch of pieces. This really kind of bears itself out.

There is copper and fixes that we may have done in the last five years that will end up being replaced with the fiber project that we're doing now. They may not last the 20 year life that would be assigned to it. So when you look at it as an operating network, if that operating network becomes obsolete or it's replaced that entire asset becomes obsolete and replaced.

HEARING OFFICER: I think I understand that. You're going to have to forgive me because like many in the room I'm an attorney and not an accountant. But you're using the same network for both regulated and nonregulated activities, correct?

THE WITNESS: We do cost separations to prevent that from happening. The plant is used for -- so go back to maybe Justin's question. It's not just internet and phone. It's not that simple. The network carries a lot of data. And basic local service isn't our largest revenue source on the regulated side. We have special access. We have data circuits. They are not internet circuits, they are large circuits for Utah Division Network or for cell phone providers. We have special access and switch access transport where we provide a transport path for data and phone calls coming out of Moab, and yet that isn't revenue or those aren't customers directly in our area. So the regulated plant provides service in a lot of different capacities. That's why the core is required. I guess maybe -- did I misunderstand what you're saying?

HEARING OFFICER: I'm going to speak just very simply. I apologize if I'm oversimplifying. But when you talk about, for example, a machine that might have some older components and some newer components but it has to be depreciated as a whole, my question is aren't you using that machine for both regulated and unregulated activities, and if you are then why do you depreciate it in one way for your regulated activities, but depreciate it in another way for your nonregulated activities?

THE WITNESS: It would only be capitalized on one set of books. So it would be either a regulated asset or a nonregulated asset. We don't split that asset in the capitalization process. Then we have --

HEARING OFFICER: But in your testimony one of your primary objections is that the Division's recommended method of depreciation doesn't account for that split.

THE WITNESS: Maybe I'm not following the question. I'm sorry.

HEARING OFFICER: Go ahead.

THE WITNESS: One of the things that you need to be aware of too is our regulated plant has a much -- there is a different capitalization threshold. There are items that we would normally expense on the nonregulated side of our business that we may capitalize on the regulated side of the business. That's dictated by the FCC, and there are certain capitalization rules that we follow there. To the extent that we don't have the oversight in our nonregulated entities we may expense items that don't need to be tracked to that individual level and that minute level as well. So there is a difference in our capitalization process and I testified to that as well.

HEARING OFFICER: Mr. Moore.

Q. (By Mr. Moore) Moving to your -- we're going in this direction anyway -- to your cost separation procedure through your CAM. Can you explain to the judge what a CAM is?

A. It's a cost allocation manual. It provides the basis for the allocation of shared costs.

Q. In your CAM you use only one -- in your accounting and general -- can you describe what your accounting and general driver is in your CAM?

A. It's originally based upon billing records.

Q. That's applied to the CEO, board of directors, public relations and marketing?

A. Correct.

Q. And that led to dividing up the costs of 74 percent to the regulated operations and 26 percent to the nonregulated operations?

A. The results of that allocation -- yes, that's true, but only the costs that are subject to that allocation. So it's a little bit misleading to say that all the costs are allocated that way when you are only dealing with the costs that are subject to that allocation.

Q. The costs that are subject to allocation are your cost pools of the CEO, the board of directors, the public relations and marketing; isn't that correct?

A. Correct.

Q. And the OCS has proposed a change allocation to a 50/50 for the CEO and the board of directors and a 75 percent regulated and 75 nonregulated for public relations and marketing, is that correct?

HEARING OFFICER: I think you said 75 and 75. Did you mean 75 and 25?

MR. MOORE: It was 25 regulated -- it was 75 -- we changed it to 25 percent regulated and 75 percent nonregulated.

HEARING OFFICER: Right.

THE WITNESS: It's a good question. Why I want to separate or make a distinction on the costs subject to the allocation, payroll and marketing may be a good one to just to highlight one of the examples. This is true also in the CSR area, which we'll discuss I'm sure here in a minute.

We have certain areas of our serving area that are only nonregulated in nature. So we have all of our Moab area, it's a CLEC, it's nonregulated. The first step in the allocation process is if there is cost directly related to nonregulated operations we separate those out and code them directly to nonregulated entities. This is true whether it's CSR or marketing and public relations or whatever the allocator may be. So there are different levels of allocation that occur prior to what I would call the leftover costs that are allocated.

When you look at any of these allocators you have to look at what the end result is. Did we allocate enough cost to the nonreg side or not. If we pulled out certain sections of it and direct coded it, it's a little bit misleading to look only at what is left in the allocation and say we didn't do our job I guess. So you need to say okay what was the final results of all the costs and is it reasonable. And I think sometimes we get so focussed on one allocator that we forget the allocation process. We throw out the whole process instead of looking at what the process resulted in rather than just what that one allocator did.

Q. Did you direct code any expenses for the CEO cost pool?

A. I would have to check. I'm not sure. I think I could probably produce that number for you given 15 minutes or so if you want to take a -- the majority of the board and the CEO are allocated.

Q. Are allocated through --

A. But I don't know that for sure how much is direct coded.

Q. But the majority of the amount?

A. Yes, the majority.

Q. Is that true of public relations and marketing?

A. I wouldn't dare guess the exact number, but probably 70 percent is subject to allocation. We do have our Moab operation that are direct coded. So I'm not sure exactly what that percentage would be.

HEARING OFFICER: The answer is some of marketing is direct coded, but not all; is that right?

THE WITNESS: That's correct.

Q. (By Mr. Moore) I'm a little confused. Your allocation of 74 percent regulated and 26 percent nonregulated, that's done after direct coding?

A. Correct.

Q. This direct coding, your CAM, you relied on a

single cost driver of a number of billing records; is that correct?

A. In the original application, yes. I've also provided testimony to an examination of three different cost drivers.

Q. That includes direct billing records?

A. Yes.

Q. But that's not part of your CAM. That's something you just did after you read our testimony?

A. My CAM calculation, no. But the use of the three resulted in essentially the same percentages that we arrived at with using the billing records.

Q. Are you familiar with Mr. Ostrander's testimony that 35 years experience he's never seen a single cost driver of a number of billing records used for corporate overhead in a CAM?

A. I read the testimony.

Q. Do you acknowledge -- isn't it true that no one from Carbon was able to provide an example of a UUSF case where a regulatory commission issued an order using a single cost driver of billing records in their CAM?

A. I don't think we were asked to do so.

Q. Well --

A. Rephrase the question.

Q. Let me restate the question. Sitting here

today you can't point to a UUSF case where a regulatory commission has issued an order using the single asset driver of billing records in their CAM. Can you?

A. No, but the question is still vague to me. So you're saying am I aware of any other case where there is a single point CAM allocation -- actually I think it would be fairly common. I can't cite cases, but the CAM -- there may be an allocation that is based upon direct labor hours, and that's a single point of allocation, or it may be it's based upon -- I can't imagine that other companies don't identify their drivers and make some sort of allocation and that could be a single point driver.

Q. Yes, but that's not a billing record, the driver that you used, is it?

A. The one I used was billing records, yes.

Q. Right. The example you just gave me you were not using billing records in that example?

A. No, I agree.

Q. Isn't it true that data from the billing records on the cost -- the data you receive from your billing records is arrived from data from 2011, and not the test year 2014?

A. That's correct.

Q. Are you aware that FCC Part 64 Section 46.903 of the FCC cost allocation procedures requires the

allocation be current and updated annually on a consistent basis?

A. I am familiar with that section. And maybe a point and important distinction needs to be made here. We are actually exempt from the requirements of the CAM by that section. So to the extent we have a CAM it's in -- actually it goes further than what is required in that section for our size of company. The fact we don't have a glossy manual or an index or cover page is not relevant to the process which we have undertaken here.

Q. So your testimony here is that your CAM is exempt from Part 64 Section 54.903 of the cost allocation procedures?

A. I'm not saying that we don't use a similar methodology or that we don't follow the affiliate transaction rules described in that and the allocation process described in that section. We do follow those. I'm just saying the mechanics of the actual CAM are not a requirement that we're -- we're not required to file that. We do follow affiliate transaction rules.

Q. Would you agree there has been significant changes that have occurred in Carbon's operations since 2011?

A. With Carbon's operations directly?

Q. Yes. Including nonregulated, DSL, fiber

operations and increased revenues and expenses and plant assets?

A. Yes, there are changes every year. Some of those changes are offsetting. We've seen continued decreases we've demonstrated in our landlines, but we've maintained steady or actually increased in some instances in our special access, which has offset some of those losses? So there is give and take in those. And our billing records are somewhat reflective of those changes.

Q. But you do not use the test year 2014 billing records?

A. No. We do testify the allocation is representative.

Q. You think it's representative. All right.

MR. MOORE: I have some questions that may go into some numbers related to the distinction between the changes that occurred between 2011 and 2014. Would anybody object if I took about five questions?

HEARING OFFICER: About numbers, dealing with the confidential numbers?

MR. MOORE: Yes.

HEARING OFFICER: That's fine. We'll stop the streaming. Go ahead.

HEARING OFFICER: Go ahead.

Q. (By Mr. Moore) Those changes are not going to be reflected in your billing records, the number of billing records that constituted your allocation driver; is that correct?

A. That would be correct.

Q. In the billing records you have two types of billing records, general billing records and CAB records, which has a 25 percent gross; is that correct?

A. That's correct.

Q. Could you explain what is meant by CAB records?

A. It's carrier access billing records. We had to weight those a little bit differently and there is a reason why. If we included each line item of the accounts billing it would overweight the CAB section significantly and result in too much cost being allocated to the CAB side of the house. So when you look at a CAB records in detail it includes both terminating and originating special -- or switch access records and these records are in the millions.

So instead what we have done is we went back to a summary bill for purposes of weighting the CAB records. But because of the significant amount of time spent in CAB related issues we weighted those records by 25 percent.

So what we did is look at them and said what percentage of time do we spend in the tariff and rate making process for our special access, how much time do we spend working with interconnection agreements with long distance or cellular phone service providers, how much time do we spend looking at the regulated issues related to CAB's and special access which is your 499 reporting with the FCC and there is a great deal of compliance there.

To make sure CAB's gets a fair share of costs we had to weight that a little bit more heavily. That was a judgment call. Again, this is our cost allocation. We try to do the best we can to determine what drives our costs. And if we see a deficiency or a significant overstatement in the driver that we're using, we'll try to adjust that to be more reflective of what we feel is the appropriate level of cost allocation.

One thing with respect to CAB is we also have a CAB allocator specifically to address time spent that I would say was more direct coded to CAB. So this is one of the administrative functions. This would be myself and Brock, the CEO time, the board time. That's to deal with these additional issues related to special access and to our carrier access billing system.

Q. My understanding when you talk about the CAB billing section, you're talking about billing from other carriers using your plant, your equipment? If someone is calling from Paris to Carbon there would be a CAB bill in regards to that?

A. Yes. To clarify, it's not us billing for other carriers. We don't do billing and collection for other carriers. I think we stopped that 15 years ago. But it's the billing to the carrier to access our network. So if AT&T carries that call from Paris to Price, Utah there is a portion of our network that AT&T had to use to access our customer. So we would bill AT&T for the use of our network for that small portion that we have within that call stream.

Q. That's the basic concept of CAB?

A. Correct.

Q. All right. You do not -- as I understand your testimony you do not have any specific time or motion study or any other study to come up with the 25 allocator or gross number?

A. Specifically related to Brock's time and CEO time, that's correct.

Q. Did you provide any specific information about how you developed your net weighing factor?

A. The CAB weight function?

Q. Yes.

A. No. I didn't provide support to that. Just my verbal text within the CAM and then as asked or -- I guess it's not part of this proceeding, but we have discussed that with the Division and Office.

Q. Do you agree an allocation factor or driver must have a direct causal relationship to the expenses they are allocating to?

A. That they should or that they do?

Q. That they should. That's the purpose of it; isn't that correct?

A. Ideally, yes. If it's direct causal effect that is a better allocator than an indirect causal effect.

Q. What is your understanding of the term direct causal relationship?

A. If it's directly related my understanding it would be either directly tied or close enough of a tie to be considered direct. I don't know what the best example to use here would be. But if we're talking about billing records, and there are certain line numbers on a phone bill that represent significant compliance or significant work for the CEO or our board, then I would say that cost is fairly reflective of the work that is being performed. Is it the only driver of cost, no. Is it possible that direct coding could be done in some instances, yes. But to say that it doesn't relate is not true. To say that it's the best allocator basis is probably also not true. But we do the best we can to determine a method of allocation. So we go through the process to try to do that and then we step through it.

There is a hierarchy described in Part 64 that we discussed of how to approach these matters and we apply that. We look at the ability to direct code. We look at direct association of costs. Lower on the hierarchy is the use of the general allocator, like revenue or expenses. It's lower on the threshold. So we do examine those when we're making our cost allocators.

Q. Now let's look at the CEO cost pool.

Mr. Johansen doesn't keep daily timesheets indicating how much time he spends on regulated and nonregulated operations; isn't that true?

A. That's correct.

Q. If he did it would make this much easier?

A. If he direct coded?

Q. Yes.

A. Yes. Then there would be no need for an allocator, that's correct.

Q. The CEO cost pool has various types of expenses associated with it, including salary, benefits, cost, cell phone, NECA and URTA dues; is that correct?

A. Correct.

Q. By way of example, how would an increase in CAB bills in 2011 have direct causal relationship to NECA and URTA dues?

A. I guess if we're looking at NECA and URTA dues those should probably be direct coded 100 percent reg. We've probably given too much nonreg side on those to begin with. So let's start from that standpoint. We may have included cost in the pool that should have been 100 reg. So I'll have to look at that. We may need to either adjust for direct cost on some of those that we see or -- but the answer to your question, what is the direct causal relationship, the amount of billing line items associated with the phone bill versus an internet bill -- I don't know that -- just picture in your mind what you get at home on your phone bill maybe. But under the phone section you'll have 911 --

Q. Excuse me. I don't know if this is responsive.

A. I guess what I'm saying though is that all those regulatory matters, a lot of them are dealt with in the NECA arena and allocate interstate costs and compliance and FCC compliance and tariff and rate making with each of those line items that are reflected in the billing there is a relationship there. Now is it the best relationship, I don't know. I testified that there are other methods that we can use. I'm saying they're not unrepresentative or they're not unreflective.

Q. They're not unreflective. All right. The same would be true for an increase in CAB bill and possibly the CEO phone bill, mobile phone bill?

A. Yes. So if we have -- we have to file tariffs with the FCC every two years. A significant amount of time is spent by myself and Brock. We file -- we deal with regulatory change issues constantly and those are reflected on our bills in the form of CAB surcharges or subscriber line charges. Again, we deal with interconnection agreements that affect those phone bills on the CAB side of the house as well. And Brock spends time on those issues.

And those are the issues, especially recently with all the regulatory changes that are going on. A high percentage of Brock's time is associated with those types of changes.

We spent a significant amount of time in Washington trying to push through a waiver with the FCC this year. I would suggest that 74 percent is pretty reasonable for the amount of time that is spent on regulated operations.

Our fiber to the home project similarly is taking a lot of attention in our --

Q. I'm sorry. I'm going to have to object again for being nonresponsive. I'm trying to get specific here about your specific -- how your billing records specifically relate and constitute cost causative relationships between the number of expenses in the CEO pool and --

A. If I bill a tariff cost, then that means I've had to prepare a tariff. If I bill a tax, that means I have to prepare a tax return. If I bill a 499, a USAC, I have to prepare those forms. And that's all regulated. There isn't any tax on an internet charge. There is very little compliance associated with that. I don't have to file a tariff every two years on my internet charges. I rarely have to address that ever.

Q. Do you have to file the tariff every time you

have a CAB bill?

A. No.

Q. Do you have to go and work with -- what was the other example you used?

A. I'm saying that it's representative of the time we spend regulated versus nonregulated on all the issues that are related to those billing line items. So to me it is the causal relationship. I don't understand I guess how it couldn't be. I guess -- is there testimony that shows that there is no relationship there? You guys say there isn't, but why wouldn't there be? We have the burden of proof and we've tried to demonstrate and describe why we think those are related and I think we've done that.

HEARING OFFICER: Mr. Moore, I think --

THE WITNESS: I can go into more detail. We can throw a photo up on the wall. I can throw up the exact billing records and we can see what is involved with them.

HEARING OFFICER: I think it might be easier for me to understand the point that you're trying to make through the questioning of your own witness.

MR. MOORE: All right.

HEARING OFFICER: All right.

Q. (By Mr. Moore) Mr. Ostrander testified that the CEO, and for that matter the board of directors, would most likely spend a significant amount of time on forward

looking projects. Do you dispute that?

A. It's a combination of both. In any -- I would say the board time is directly tied to Brock's time because the issues that Brock deals with are the issues we discuss in our board meetings. So if time is spent in a particular area basically that time is reflective in our board meetings. So those two are very closely tried together.

There is an aspect to forward looking projects, yes. That is also reflective of billing records. They've gone a little bit of a lag. But when we build a new circuit, let's say a CAB circuit out to a cell phone tower, the weighting of that would probably -- if it's in our area, in our regulated area, it's going to pull a little bit of cost to the regulated side. If it's in an nonregulated area it pulls costs to the nonregulated side. But associated with that build is the actual construction that Brock is intimately involved with with the plant side to make sure that construction occurs, and again with forward looking plans as well. So yes.

Q. So yes, you do spend a significant amount of time, the CEO and the BOD board, reviewing future plans?

A. We do spend time. The definition of significant I guess we would have to define that.

Q. So it would depend on year to year I guess?

A. Right.

Q. And from 2011 to 2014 it would be different?

A. Correct.

Q. If the CEO spends time on forward looking projects that don't come to fruition until another year, there would be no billing records to reflect that in the test year; isn't that correct?

A. Yes, but is the existing customer reflective of that effort. I guess you're demonstrating that we're not keeping that up to date enough; is that correct?

Q. Yes.

A. I guess if this is the only issue that we're dealing with I can rerun the records and we could look at it. We updated that allocator in 2015, this year, and it's not significantly different. I can give you updated numbers if that's what you're getting at.

Q. Why don't we just stick with the record we have right now.

A. That's fine, but I'm saying we do adjust these allocators from time to time. And I can pull up our existing one and it would be based on newer records. It's not going to be a huge shift from what we have now. I would be happy to do that if that's where we're headed on this.

Q. I'm sorry. Are you saying you want to use a different allocator than the allocator you have in --

A. No, I think it's representative. I'm just saying there is not a big smoking gun here. If we change from 74 percent to 72 percent I would be surprised. I can pull that number if we need to. I don't know. It changes over time, it does. But this number was based upon the fall of 2011. The allocator that was in place at the beginning of 2014, there is a two and half years separation there. Is it significant? If we update it to the 2015 records and took a look at it, it wouldn't be significantly different.

Q. But you haven't done that?

A. I have done that. I don't have them with me today. But that's what I'm saying, I can pull that and give it to you and give it to the court today if we need to if that satisfies the concern here.

Q. Let me turn to your public relations and marketing allocator. You list 74 percent of your total hour costs to regulated service and only 26 percent to nonregulated service; is that correct?

A. That's not correct.

Q. What is correct?

A. The correct is we direct allocate a significant portion of costs before we get to that allocator. The costs that are left with that allocator are then allocated upon the percentages you just stated.

Q. What are the costs that are left?

A. It would be costs that are in the shared areas of service. So that would be within the combined service areas of Carbon/Emery Telecom, Emery Telecom and Hanksville.

Q. In your response to OCSDR34 you said your allocation factor was reasonable because regulated services benefit from the company's advertising for bundle services; is that correct?

A. Correct.

Q. You have one regulated service of basic phone service and two regulated services of internet and another regulated -- nonregulated service, excuse me, of internet and another nonregulated service IPTV; is that correct?

A. That is not correct.

Q. Why is that not correct?

A. We don't provide IPTV services.

Q. But for bundle services of regulated phone service, and let's take your position of internet, you still charge the 74/26 percent for that?

A. I'm sorry. Please repeat the question again.

Q. When you advertise your bundle services, which according to you, your testimony here is bundling regulated phone service with unregulated internet, you still use the 74 percent allocation to regulated service, the basic phone

services, and the 26 nonregulated services, the internet services, correct?

A. If that service is offered to our regulated area, yes, that would be true.

Q. But internet is not in your regulated area? I mean, internet is a nonregulated operation?

A. Service provided within that same area, correct, inside the serving area.

Q. Most of these customers in the service area -- let me just go back here. Does Carbon have any competition for basic phone services in the service area?

A. With the exception of cell phones, no.

Q. Isn't it true these customers that you're advertising your bundle services for generally already have local phone, basic phone service?

A. No, that's not necessarily true.

Q. But the majority of them?

A. No.

Q. Who do you advertise to?

A. We advertise to basically all the residents of the Carbon/Emery counties and Moab. Again, the Moab serving areas are directly coded to our nonregulated entities. Moab services include phone, internet, cable TV. Then in our regulated areas we have similar services that are offered both on our nonregulated plan and on our regulated plan. Those services are all advertised to the residents and businesses of that serving area.

HEARING OFFICER: I'm sorry. You said the direct allocators are done by geographic area?

THE WITNESS: By serving area, yes. We operate as an incumbent local exchange carrier in Carbon/Emery counties and in the Hanksville area. We operate as a competitive local exchange carrier in the Moab area as well as those services we also provide internet and cable TV.

HEARING OFFICER: In the areas where you're the ILEC you do the 74 percent allocation to regulated, and the areas where you're CLEC you do 100 percent to nonregulated?

THE WITNESS: That's correct.

HEARING OFFICER: And there is no additional allocation?

THE WITNESS: No.

Q. (By Mr. Moore) Isn't it true that the internet is significantly more profitable to Carbon than basic phone service?

A. Yes.

Q. So when you advertise the bundle service you have two services, one regulated which is not as profitable as the other nonregulated, correct?

A. That's correct.

Q. But you allocate the costs associated with this

bundle approximately three times higher on the nonregulated side than you do to the -- backward, to the regulated side than you do to the nonregulated side?

A.   We do those allocations at 74 percent, yes.

Q.   Do you think it's reasonable that the advertising -- let's take one step back. If you have two services, phone and internet, wouldn't it make more sense to divide them up at least 50/50?

A.   Is the phone being provided over regulated plant or nonregulated plant?

Q.   Let's take the regulated plant first.

A.   Okay. We closely tie those. And the reason why is is the loop used by the customer to provide phone service to that customer. The regulated side benefits from the internet usage of that phone line. It actually sures up the phone line. The phone line has become super critical for us to maintain both federal and state funding and it is critical to our customers and our ability to serve the customers is dependent upon the healthiness of that. We continue to promote those lines, continue to tie the bundles closely with the phone line and the reason why we do is because we understand that there is -- out of the two products, the internet definitely would be the most desirable or the most popular thing to have versus the traditional phone line. But all of our advertising -- the majority of the advertising I should say includes that bundle to tie to that regulated plant. So I guess it's not an easy question to answer because the ads aren't separated, they're tied together.

Q. That's my problem with your separation. It seems if we take the position you have of two services and you're advertising primarily for the internet, which is the more profitable aspect, why would the cost for that advertising be allocated 76 percent to regulated plant and 24 percent to nonregulated when you're advertising for the nonregulated and that's where your profit is going to come from?

A. Let's switch that example up a little bit. Let's move that to cable TV. Cable TV we don't make money at.

Q. I'm sorry. I'm going --

A. Are you saying --

Q. -- to object as nonresponsiveness again. We'll be here forever.

A. The ability to pay shouldn't be the basis for the allocation. So if the company is profitable it doesn't mean they should get more allocation cost.

Q. The cost --

A. Let's take profitability out of the question and then reask the question. It's not based upon the fact that the cable company makes no money and the internet company makes money. I mean if we switch up the example and say can our cable company afford advertising, no. They don't make any money. So it's not an ability to pay that drives the cost. It's the actual advertising. If we're getting to the root of the question, let's make sure we do that.

Q. But you're advertising primarily for internet?

A. We advertise for both.

Q. But primarily for internet. That's what the people want to purchase?

A. No, no. Internet kind of sells itself. We have to focus on -- we have to focus on telephone, to keep telephone numbers up. We have to show our customers why it's important to maintain the phone, for safety a line power in an emergency situation is going to be more reliable than cell phone. We spend significant time educating our customers that way. We also have requirements annually and ongoing to advertise life line services which is promoted by the state. There is no requirement for life line internet services. So we have additional advertising that has to be done separately and distinctly for life line. We do that through newspaper. We do that through our website. We have to post posters and --

Q. Objection, nonresponsive. I didn't ask about life line. I asked about advertising for bundle services.

A. It's phone service. Life line is phone service and we have to advertise for it. This is all part of that cost we're allocating. It goes to the question what are we doing with our advertising dollars. There is a lot of things that go to the advertising dollars.

MR. MOORE: I have no further questions.

HEARING OFFICER: Ms. Slawson, any followup?

MS. SLAWSON: Would it be possible to have a quick break?

HEARING OFFICER: Sure, that's fine.

(Off the record.)

HEARING OFFICER: We're back from our break and back on the record.

MS. SLAWSON: Thank you. Time for redirect?

HEARING OFFICER: Yes, go ahead.

REDIRECT EXAMINATION

BY MS. SLAWSON:

Q. Let's see. My first question is can you tell me what you consider the affected period of the UUSF application that Carbon/Emery has made in this case?

A. I would say between three and five years.

Q. You talked a little bit about -- this is back on the first question that was presented by Mr. Moore with

regard to the testimony on single asset versus group asset depreciation. You testified briefly there is a capitalization threshold difference. Can you explain to us why does the capitalization threshold differ between the regulated and nonregulated companies?

A. The threshold is established a little bit lower in regulated cases generally to allow for or prevent I should say, prevent the expenses from spiking in one year. If you were to expense certain items rather than capitalize them, you may have a year that is overstated by that expense. Whereas, capitalizing that same item, spreading it over a useful life, would smooth that expense. So to prevent spikes in the operations and the reporting of that operation.

With respect to the nonregulated entities that's not as big of a concern because it's not subject to a rate making process. A spike that would be material to a regulated entity could be considered nonmaterial for this nonregulated entity. Maybe a good example would be modems for the internet on the nonregulated side. We have significant purchases of those modems. They do have a three to five year life on them. But rather than capitalize those and track those in our asset records for five years each one of those modems, or even groups of modems, we go ahead and expense those groups of modems.

And because there is no associated rate making or reason to kind of normalize those expenditures, if that expense policy spikes our cost for modems in any one given year it's not material to the financial statements as a whole and so it's not considered necessary to track down to that level.

So that's kind of how we apply the capitalization policy. Once we meet that threshold then we get into that gray scale area that I talked about how you group those assets, whether it's single asset or a group of assets and what constitutes those groups and what point do you segregate the groups based on vintage or based upon the type of plant, that type of thing.

So I think there is a distinction there, first in the policy, and then within the policy, is it true single asset or is it a group. And so when I compared our nonreg entity capitalization similar to what the Division shows, there is a little bit of distinction, you have to get past that first capitalization threshold first. So we just capitalize less on the nonreg side. Then when we do it it follows somewhat close to what the Division is recommending on their straight line policy. I think maybe -- you might go ahead with the questions. Sorry.

Q. I guess what I'm wondering is could the regulated company, Carbon/Emery, adopt the Division's

proposed method of depreciation, this kind of single asset, maybe vintage, not true single asset, but method of depreciation?

A. It could. And generally what it requires from the interstate side is permission from FCC we found that the FCC has been a little bit lenient in granting to the states some leeway in the methodology. So we feel like it is a methodology that could be adopted. The issue that we take with the methodology isn't necessarily the method itself, but the implementation of it. We have provided testimony that if we're going to go that direction what the Division is proposing then we need to have a transition to that methodology. It can't just be a calculation of a historical number and then use that number. We need to say okay this has changed and we're going to transition to it. So we've provided some testimony to what we think that transition would look like.

Q. How do you see that transition?

A. What we have proposed is that -- our books are still open for 2015. So we have a little bit of leeway on how we report depreciation. We could do some extent of restatement, but what we've proposed is that -- basically from the time frame that we knew that the Division had a concern with our methodology, if we restated the assets from that point going forward it would be basically January

1, 2014. So if we at that point cut to a single asset straight line methodology as promulgated by the Division at this point and then allowed our existing groups as of 12/31/2013 to continue and run their course, let the depreciation finish out on those assets, and then project that forward, that would be the transition that we would suggest. And the projection forward is somewhat necessary to determine what the correct number is in this proceeding because it is a change from the methodology that we're using now.

Now I guess without getting into the confidential numbers again, that number would be slightly less than what we projected in our application, but it is materially close to that number. So there may be a slight reduction there, but not significant.

We think that satisfies the concerns of the Division going forward, but it also allows us a transition period into that. A lot of our decisions with respect to how we manage our books are based upon the certainty that's provided by the FCC and by the state. So if those things change it would change the decisions that we would make regarding the timing of the investments or how we -- I guess how we would make decisions based upon rate of return and weigh those decisions against similar decisions that we're making on our nonregulated plant.

So it's a choice scenario for us. Where do we put our new capital dollars this year. What type of rate of return are we going to get. Is that rate of return guaranteed or how much risk is involved with that rate of return. These capital type decisions are dependent upon some consistency. That's what we're --though we're not opposed to the methodology, we are opposed to the way it is being proposed in the findings. We would like some sort of transition or methodology to get to where they want us to be.

Q. We had a series of questions about the cost allocations, the various allocations that you have made. I want to ask you the allocators that you have identified, those are used to allocate costs; is that correct?

A. Correct.

Q. Does revenue correlate or is it representative of costs?

A. No.

MS. SLAWSON: I have no other questions.

HEARING OFFICER: Any recross?

MR. MOORE: No.

MR. JETTER: No recross from the Division. Thank you.

HEARING OFFICER: We just have a couple of minutes before the public witness portion of this hearing is supposed to begin. It's only been a few minutes since our last break, but let's go ahead and break until noon and we'll see if anybody appears. If not, we'll go ahead and continue unless someone appears.

(Off the record.)

HEARING OFFICER: We are back on the record and I am ready to begin the public witness hearing, which is scheduled for today at noon. Is there anyone here in the room who would like to give comments or provide testimony as a public witness today?

We are going to go ahead then and resume with our UUSF hearing for the next hour or so. We'll kind of keep a watch to see if anybody comes in to give a comment as a public witness. Then at 1:00 we will break for lunch. So Ms. Slawson, go ahead and you may call your next witness.

MS. SLAWSON: Thank you. Carbon/Emery calls Douglas Meredith.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MS. SLAWSON:

Q. Good after, Mr. Meredith. Would you state your name, your employer and your business address for the record?

A. Yes. My full name is Douglas Duncan Meredith.

I am employed by the firm John Staurulakis Incorporated. That is spelled S-T-A-U-R-U-L-A-K-I-S. My business address is 547 Oakview Lane, Bountiful, Utah. That's my office. The headquarters for JSI is in Greenbelt, Maryland.

Q. On behalf of the applicant Carbon/Emery Telecom Inc. have you participated in this record?

A. Yes.

Q. Did you prepare prefiled rebuttal and surrebuttal testimony and exhibits in this case?

A. Yes.

Q. Do you have any substantive changes to the answers you gave to the questions asked in the prefiled testimony?

A. No.

Q. Do you have a summary of your testimony that you would like to present us with?

A. Yes.

Q. Please go ahead.

A. Thank you. In my rebuttal and surrebuttal testimonies I address two topics: Carbon/Emery's authorized rate of return and the appropriate depreciation method to use, and in the alternative of using that method what transition should be used to move to a new depreciation method for Carbon/Emery.

Topic one, rate of return. I will summarize first the authorized rate of return for Utah USF purposes. My testimony and the exhibits I supply support Carbon/Emery's proposed overall authorized rate of return of 10.5 percent. For comparison, the current authorized interstate rate of return for Carbon/Emery is 11.25 percent.

I examine in my testimony the following items related to the calculation of the overall rate of return.

Item one, capital structure. The overall rate of return is calculated using a hypothetical capital structure. The Division and Carbon/Emery recommend that the Commission adopt the Division's sliding scale capital structure result. This method was developed by an industry task force that has been used frequently by the Division. This method represents a reasonable balancing of competing interests. The capital structure for Carbon/Emery assumed by the Division's sliding scale is 65 percent equity and 35 percent debt. The Office takes exception to the Division's long-standing practice and recommends a 50 percent equity and 50 percent debt capital structure. I recommend the Commission continue to use the Division's sliding scale method and adopt a 65 percent equity and 35 percent debt capital structure for Carbon/Emery in this proceeding.

Item two, the appropriate interstate rate of return. By Commission rule, companies are instructed to use in its application the applicable NECA form 492A for the most recently available year. I supply the NECA form 492A as an exhibit and the applicable form for Carbon/Emery yields a 11.45 percent interstate rate of return. The Division initially proposed an incorrect rate and subsequently revised its number. The Office recommends using a NECA form 492A that does not apply to Carbon/Emery. NECA applies two forms 492A based on individual company participation in NECA cost pools. I recommend the Commission use the applicable form 492A in my exhibit for Carbon/Emery which reports a 11.45 percent overall rate of return for interstate purposes.

Item three, the appropriate intrastate rate of return. Carbon/Emery, the Division, and the Office agree on the cost of debt used for intrastate rate of return calculations. This leaves the intrastate cost of equity or return on equity as a disputed item. The Division uses an unadjusted capital asset pricing model, CAPM, to calculate an intrastate rate of return for Carbon/Emery. The Division does not see any other model alternative available for use. I rebut the Division's claims suggesting that an unadjusted CAPM is not appropriate. I provide facts from credible capital finance authorities which support the need to adjust the textbook version of CAPM in the telecom sector. In the exhibits I provide that address telecom issues specifically, Drs. Heaton and Billingsley specifically examine the telecom industry and address this issue. These authorities recommend adjusting the textbook version of CAPM for telcos.

Dr. Heaton, in Exhibit 1, states that a small company premium is the minimum adjustment that should be applied when using the CAPM for real world applications. Dr. Billingsley, in Exhibit 2, recommends a small company premium developed by well established financial service research firms, such as Ibbotson & Associates or Duff & Phelps. These exhibits are unrebutted in this proceedings.

I provide another analysis filed at the FCC in Exhibit 3 which the Office takes exceptions to based on its author.

I explain on alternative to the CAPM that was proposed by Dr. Glass, formerly of NECA and now of Rutgers University, to overcome the common pitfalls of the discounted cash flow method. This method proposed uses a free cash flow approach instead of the discounted cash flow approach. This information is located in Exhibit 2. The benefit of this approach is that Dr. Glass uses actual rural telephone company data rather than large company peers to develop the appropriate discounted cash flow rate. I update this data in Exhibit 5. The Division remains silent on this alternative approach and the Office provides no rebuttal on this method.

The Office argues that the Utah Commission should adopt the results from a number of Kansas decisions. I respond by recommending the Commission give them very little, if any, weight.

There are serious mechanical problems with the Division's selection of publicly traded companies and the calculation of the risk free return used in its CAPM. I identify these problems and propose solutions for them.

All of this data and analysis support the 10.5 percent overall rate of return proposed by Carbon/Emery. And I recommend the Commission adopt the proposed and supported 10.5 percent overall rate of return for Carbon/Emery in this proceeding.

Topic two, depreciation method. I will briefly summarize the depreciation method proposed by the Division and Carbon/Emery. The Division seeks to change the standard and industry accepted group asset straight line depreciation method used by Carbon/Emery for Utah USF purposes. I observe that this approach will add administrative complexity to Carbon/Emery's accounting procedures. And in making such a change it should be fully vetted to ensure that the public interest is served. The claims made by the Division are not fully explained. Notwithstanding, if the Commission were to adopt the

Division's method, I recommend the Commission adopt this monumental policy change on a prospective basis for new assets that are purchased and placed into service. The test year 2014 is representative of forecasted depreciation expense for the next five years and so the transition that I describe is in the public interest. This concludes my summary.

MS. SLAWSON: Mr. Meredith is available for cross examination.

HEARING OFFICER: Mr. Jetter.

CROSS EXAMINATION

BY MR. JETTER:

Q. Thank you. Good afternoon, Mr. Meredith. I have a few questions and they're a little bit disjointed as far as we'll skip around just a little bit. I would like to just start out discussing the risk free rate of return. I'm looking at CE-4.0R, which is your revised rebuttal testimony dated September 4, 2015. And specifically I'm addressing your discussion of the risk free rate of return beginning on lines 271 through 279. Is it an accurate representation of your testimony there that you believe the better more accurate risk free rate of return to use in calculation of an ROE for this specific purpose is an average from 1990 through today?

A. That's what I have used. I observe that the

Division proposed a spot rate, which as I understand it was a rate on a particular day. I propose that that be trended a bit. I used 1990, 25 years from when this was prepared, but 20 or 25 would be an appropriate trending of the risk free rate.

Q. Were you in this room about 30 minutes to an hour ago when Mr. Woolsey testified about what he believed to be the term for which we would apply the findings of this particular case?

A. Yes. The effective period of the findings, yes, I was.

Q. Do you agree with him that it would be three to five years?

A. Yes, that's my understanding is that it would be a three to five years effective period.

Q. And it's still your testimony that using a 20 to 25 year trend of Treasury Bill average equally weighing for each year over that time is a better choice than the current actual risk free rate?

A. Yes, I do.

Q. I would like to jump a little bit now here to the factors that you discussed in promoting the -- in discussing the premium that you would assign as a small company premium to Carbon/Emery. In support of that is it correct, I believe it's lines 120 through 121 of this same

exhibit, that you rely on Morningstar/Ibbotson Annual Yearbook?

A. No, my sources for relying on the premium are related to Dr. Heaton and Dr. Billingsley. The Morningstar/Ibbotson Yearbook or the Morningstar/Ibbotson source and also Dr. Billingsley as I mention in the summary used the Duff & Phelps report that is identified on line 142 of my testimony.

Q. Let me direct you beginning at line 120 on page 5. Would you please read the first sentence in that paragraph?

A. Yes. The Morningstar/Ibbotson Annual Yearbook routinely reports an adjustment that would be applied to a company based on market capitalization.

Q. Is that publication something that is a reliable source for information on this type of item?

A. Yes. Morningstar/Ibbotson or Duff & Phelps are established research firms. Yes, they are.

Q. Thank you. Are you aware of what companies that the Morningstar/Ibbotson Annual Yearbook uses to calculate its small company premium?

A. Not specifically, no.

Q. To be more specific, are you aware if any of those companies have a government run program that subsidizes those programs in the event that they're not

earning their authorized rate of return?

A. No, I don't know any specifics about the companies or their operations.

Q. And such a type of government program would produce the risk to those companies; is that correct?

A. Can be, yes.

Q. I would like to hand you a photocopy of the 2015 Ibbotson SBBI Classic Yearbook and this is page 113.

MR. JETTER: May I approach the witness?

HEARING OFFICER: Yes.

MR. JETTER: This is not on my exhibit list. We can enter this as DPU Cross Exhibit 1.

HEARING OFFICER: Any objection?

MS. SLAWSON: No.

MR. MOORE: No.

HEARING OFFICER: DPU Cross Exhibit 1?

MR. JETTER: Yes.

HEARING OFFICER: Go ahead.

Q. (By Mr. Jetter) I think this will somewhat confirm what you have just answered, but would you please read what I have highlighted in yellow, a paragraph which is on the upper right hand corner of page 113 of that publication?

A. Yes. This is page 113. I don't have the title of the document, but it is page 113. Most criticisms of the use of the size premium do not address the underlying reason for its existence. Small cap stocks are still considered riskier investments than large cap stocks. Investors require an additional reward, in the form of additional return, to take on the added risk of an investment in small cap stocks. It is unlikely that in the future investors will require no compensation for taking on this additional risk. That's the end of the paragraph.

Q. Thank you for reading that. And you testified, is that correct, just a few moments ago that a program like the State Universal Fund for Utah reduces the risk that Carbon/Emery has as compared to the risk it would experience were it not eligible for such a program?

A. Yes, I did say that but it probably needs to be amplified just a bit that there are lots of risks associated with a telephone company or with a small company, it's not just the size. In fact Roger Ibbotson, and I quote him in my testimony, says that even liquidity risk is also very, very important. And I would argue quite strongly that liquidity risk is just as apparent or more apparent for a small rural telephone company operating in Price, Utah and no government operation is going to solve that liquidity risk.

Q. Let me ask you a few question about liquidity risk. Are you familiar the capital structure of

Carbon/Emery Telephone?

A. Yes, I am.

Q. Could you describe that briefly?

A. The actual capital structure is they are 100 equity.

Q. Who are the equity holders?

A. The shareholders, members of the cooperative I don't know. I don't have a list of all the holders.

Q. Are you aware of any recent attempts to increase the equity of the company, any sales of stock?

A. No. That question -- I reviewed the answer to that question that was asked by the Office to the company and there was no -- there have been no issuance of stock in the public sector.

Q. Are you aware of any of the current owners who have had a desire to sell and no ability to do such?

A. A desire to sell and would want to essentially cash out? I do not know of any. To the extent that some of those are cooperative members, I know other cooperatives that people have those desires, but I don't have specific information for Carbon/Emery.

Q. And you're aware that Carbon/Emery in fact makes decisions based on the certainty provided by the Universal Service Fund; is that correct?

A. No. The Company, just like any company, has an array of investment options both regulated, nonregulated, however it goes. And that array of investment options is before the decision makers and they can choose what investments to make.

Q. So do you disagree with Mr. Woolsey's testimony an hour or two ago when he said that they in fact do make decisions based on, I believe it's a quote, certainty provided by the FCC and state?

A. I didn't hear him say that. So I'll defer if he said that.

Q. Do you disagree with that statement?

A. Say the statement again please.

Q. That Carbon/Emery makes decisions based on the certainty provided by the FCC and state, and that was specifically referring to the subsidy programs for rural telephone.

A. Yes, without looking at the full transcript that's possibly one item that they use, but they still have the array of investment options.

Q. Based on how much risk is involved do you think it would in fact change the decisions that the company might make?

A. Certainly. The risk of a particular investment opportunity or plan to use capital, the risks associated with that endeavor will definitely be a factor in a decision.

Q. You further testified you believe they may also be capital constrained in the borrowing process by the nature of their size; is that right?

A. Yes. As far as borrowing goes, yes. Small companies are constrained. There are actual boutique lending firms that cater to small rural telephone companies. If you go to ABC bank down on Main Street, it's not likely that they're going to want to lend you money because of the -- because of all of these associated risks and the unmentioned risks that we haven't talked about. Liquidity in small companies are definitely considerations for a bank.

Q. Are you familiar with the most recent long term borrowing rate that has been used in this case?

A. No. I reviewed it. It's not a controversial item so I can't remember what the number is. I can look it up. It's on Mr. Coleman's exhibits.

MR. JETTER: Counsel, do you consider that a confidential number?

MS. SLAWSON: Tell me which one it is again.

HEARING OFFICER: The interest rate paid on --

MS. SLAWSON: That's not confidential.

Q. (By Mr. Jetter) Would it surprise you to know that rate is 5.64 percent?

A. No.

Q. Doesn't that seem like an awfully low amount compared to the Treasury Bond rate over the 20 year period, or 25 year period that you suggested being more appropriate for the term of effects of this case being 5.009 percent?

A. So we're talking about 50 paces points difference.

Q. Yes, between a risk free rate and the small company that you say has such a high risk that it needs significant risk premium to attract capital.

A. One, this is a cost of debt number that we just referred to. It's not the cost of equity. That's one important consideration. The other consideration when you're talking about debt is -- at least one of the -- the biggest focus of boutique firms is RUS, which is the rural utility service, which is a government lending program that produces rates that are very attractive for purposes of federal public policy. So I don't think you can compare the cost of debt and relate it to the cost of equity or the equity premium that should be applied.

Q. Well, the two of those are both based on risk, are they not?

A. Different types. A lender has different claims against a company than a stockholder. For example, if a company like Fairpoint, which is one of Mr. Coleman's examples, goes bankrupt there is a triage or a hierarchy of who has claim against assets that still exist. And the common stock shareholders are the last ones to get any claims. So there is a difference in valuation and weighting of risks and claims.

Q. Just in the abstract just let me ask you, would you expect a company with a higher variability in its revenue stream to be considered a higher risk company by a lender?

A. It really depends on cash flow. You're saying higher variability, but does it have enough cash flow to meet its obligations. And all lenders have certain thresholds, factors if you want to call them, that the companies have to meet in order to not be in breach of that loan. So they have safeguards, lenders have safeguards to address and principally -- a lot of them relate to cash flow, but there are others as well. But it's the ability to pay the loan off. It's just like if we were to buy a car the lender would want to know if you had enough money to pay off that car. The variability of your income may not be a factor because you may have plenty of money above the threshold that they're looking for.

Q. If you had a source as reliable as, for example, the State of Utah Universal Service Fund as well as the Federal Communications subsidy programs providing a

significant portion of that cash flow, would that indicate to you potentially a lower risk for that company as compared to a similar company without those resources to draw on?

A. Not in 2015 because there is great uncertainty in both programs, both the Utah USF dealing with the depreciation method that is now proposed and how it could affect the claim or the request from Carbon/Emery, and even more importantly the flows from Federal Universal Service as we are going through a major transformation at the federal level. There is not much certainty as to what is going to happen in very near terms with Federal Universal Service. So there is quite a bit of uncertainty in a market, I should mention, in a market that is traditionally over the long last 100 years has been relatively calm and stable. But ever since telecommunications back in 1996, and now the reform in 2011 at the FCC, there is quite a bit of uncertainty within the market.

Q. I think back to reiterate that question. If you're comparing let's say Carbon/Emery to one of the references that both you and Mr. Coleman have used, Shenandoah Valley Telecommunications, who I believe is in Virginia, which does not have a comparable universal service fund program. Between those two companies would you say is it more or less risky to have those types of

subsidy programs, the Utah Universal Service Fund, at your disposal?

A. It's hard to say because Shenandoah Valley it is in Virginia. I have just a small acquaintance with the company. It would be better for a company and for a lender or for an investor to look at the customer base and the customer structure and the stability of that customer base and customer structure rather than a government universal service program that may or may not exist, may or may not be cut. There is quite a bit of uncertainty. It is not a certain thing that USF exits in states, and as you mentioned in Virginia it doesn't exist.

Q. Is there something unique about their customers that you think make them more likely to remain customers or to remain more reliable than the customers of Carbon?

A. Well, I don't know if you've been to Shenandoah Valley, but it is a fairly dynamic economic space. I mean there is -- I would say, no offense, Brock, but Shenandoah Valley has more economic activity potential than Carbon and Emery counties in Utah.

Q. I'm talking about on a per customer basis. Do you think each individual customer is more reliable, more predictable?

A. I don't have any information to give you or to inform you on that question.

MR. JETTER: Thank you, Mr. Meredith. Those are all the questions I have.

HEARING OFFICER: Mr. Moore.

MR. MOORE: Just a few questions. Mr. Jetter took most of mine. Just for clarity shake --

THE WITNESS: Your Honor, I have a small hearing problem. So could the microphone be drawn a little closer so I can hear better.

MR. MOORE: How is this?

THE WITNESS: That's good.

CROSS EXAMINATION

BY MR. MOORE:

Q. In your summary you stated that you are not changing your proposed rate of return from your initial application; is that correct?

A. Correct. I am -- my recommendation is the Commission adopt the 10.5 percent overall rate of return for Carbon/Emery's application.

Q. That's including a 12.13 intrastate rate of return; is that correct?

A. Yes. According to the application that was the rate of return used for the intrastate portion.

Q. You didn't apply a small company premium?

A. What I did is I looked at several different methods, several different items and I'm recommending the

Commission adopt the 10.5 because all of those indicators show that if you were to do anything else, look at the different risks, liquidity premium risks, and small company premium risks, you would be in excess of that 12.13, I believe. So, therefore, the 10.5 percent is supported.

Q. How did you arrive at the 12.13?

A. 12.13 I didn't arrive at it. The Company used 12.13 because I understand the Division proposed and testified in 2014 that rate was just and reasonable and within the public interest in another case.

Q. Was that case taken to hearing?

A. That case was not taken to hearing. The Commission adopted in full the Division's recommendation.

Q. Through a settlement?

A. No, it wasn't settled. There was no dispute. The Office -- the Division created a petition, created testimony, filed the petition, and the Commission adopted it. That's how I understand the Hanksville case to have happened. There was no settlement because there was no issue in dispute.

MS. SLAWSON: Your Honor, if I may, I believe there actually was a hearing in that case, a hearing to adopt the stipulation just as a matter of record.

Q. (By Mr. Moore) But the stipulation didn't end from a settlement?

A. I did not participate. My understanding is that the Division prepared, produced, and supported the 12.13 percent in 2014, which incidentally is the same test year that we're dealing with today.

Q. But they haven't taken that position in this case?

A. No, they have not. They are recommending an adjustment.

Q. Could you turn to page 13 of your rebuttal testimony, your revised rebuttal testimony September 4, 2015?

A. Yes, I'm there. It starts with a graph?

Q. Yes. I have some questions about the graph. The fifth column entitled small stocks and lists various premiums or additions; is that correct?

A. Yes. This is by Roger Ibbotson from Ibbotson & Associates that we've been talking about, very credible professor at Yale University, or was. I don't know his status now. He is identifying premiums that are looked at in the real world.

Q. The first premium is a small stock premium, which is the small company premium we've been referring to; is that correct?

A. Yes, that's what I would understand that to be.

Q. Do you know of any USF case that has used a

small company premium?

A. No, most USF cases don't even address this issue. They use the 11.25 percent authorized rate of return that the FCC uses and that's the end of the discussion.

Q. Do they use an equity risk premium?

A. I'm sorry.

Q. Are you aware of ones that use a equity risk premium?

A. Well, the equity risk premium is the premium that is given as a market or risk premium, however you want describe it. That's used with a CAPM model. As I understand it from your witness's testimony that in some cases, although dated, that equity risk premium has been used in a CAPM model in Kansas.

Q. Do you have one from a bond horizon premium?

A. No, I don't know of any application of -- this is getting more into the -- the bond horizon premium I don't have any information on a state universal service program, or federal for that matter, addressing a bond horizon premium.

Q. Did you attempt to compute the required rate of return using this graph, adding up these various premiums for Carbon?

A. No, I did not. My testimony, I do state the liquidity premium and the small company premium are somewhat intertwined. The range, Dr. Billingsley's range or rate for small company such as Carbon/Emery is 6 or 7 percent small company premium. And I did not even go that far. I just took half of it and I took a 3 percent small company premium to address liquidity and small company and it exceeded the 12.3 generated that supported 10.5 so I did not have to extend my analysis further.

Q. Could you turn to page 12 of your testimony?

A. Sure.

Q. You have a table there, table 2. Did you prepare this table?

A. I did prepare the table.

Q. What is the source of your spot beta information on the table?

A. The spot beta was -- to date the spot beta in trying to replicate the information that Mr. Coleman of the Division used I have went to Yahoo.com and obtained the spot beta for these companies listed.

Q. Can you provide the source documentation?

A. Did I provide source documentation, no. It was the spot beta as of that date at Yahoo.com.

Q. What does the term CAM adjusted mean?

A. That's a very conservative straight -- CAPM.

Q. I'm sorry, CAPM.

A. It's the expected return using a risk free rate and then applying the data to a market premium.

Q. Where did you get the data for this CAPM adjustment?

A. The CAPM, the equation is the expected return equals the risk free rate. And the risk free rate in this calculation. Again as I said I used a very conservative -- actually not a textbook approach, but I used the T-bill rate, which is the rate that was found below. It's from 1990 to today as of the date of filing. So a 3.04 percent T-bill rate. Then I applied the -- then you add to that that risk free rate the beta multiplied by a risk premium. Mr. Coleman used a risk premium of about 6.8 percent. I opted to use an even more conservative number and I used the 5.01 percent number listed here as a T-bond rate trend as my risk premium. So it's a few, maybe a 150 paces points lower than Mr. Coleman. Doing it with the abundance of caution of get the lowest possible unadjusted CAPM.

This particular table is really not focussed on getting the CAPM number itself, but rather the adjustment. My whole testimony is there needs to be adjustments to a standard CAPM. You just don't do the standard CAPM for conditions that we have before us. And so that's why the -- so I used a very small -- that's the equation that I used in order to develop the column called CAPM unadjusted.

And that's why I think if you were to compare this to Mr. Coleman's those numbers would be different because I did not use his numbers. I used in the instance of the market premium, the equity premium, I used a lower rate than he did.

Q.   This is reflected in the third column of the --

A.   Yes.

Q.   You used the T-bill and the T-bond rates. Can you describe where the interest rates are inputted into the CAM asset pricing model?

A.   Sure. The T-bill rate is a 90 day T-bill. That information was obtained from the U.S. Department of Treasury. They have a series that gives this information. And the T-bond rate is the 20 year T-bond, Treasury Bond. Those numbers go into the column we were just describing. The first one, the T-bill, the 3.04, gives the risk free rate in the CAPM equation. The second one, the 5.01, is a conservatively low proxy for the risk market premium. That number is multiplied by the beta and the sum of that represents the CAPM.

Q.   These calculations created the leveraged CAPM in the last column?

A.   No. The levered -- if we go over to the far right.

Q.   The far right.

A. We have taxes and debt and equity percentages, and then we have a levered beta referenced by Dr. Heaton in Exhibit 1 as well. This adjusts for taxes and also debt and equity. So there is a formula that creates the lever and then you apply that lever to the unadjusted beta and you get a levered beta.

Q. The conclusion of the chart is your leveraged CAPM on the far right hand column?

A. Correct. That is a leveraged CAPM, which adjusts for taxes and debt and equity structure of the various proxy companies.

Q. You have Verizon and AT&T as your first two companies, correct?

A. Yes, Verizon.

Q. Is Verizon the same as --

A. Verizon is a Bell operating company, changed its name to Verizon in the 90's.

Q. Both Verizon and AT&T have very similar industry profiles, don't they?

A. Very similar --

Q. Industry profiles.

A. Industry profiles meaning their scope?

Q. Their size.

A. Their capital structure is very, very different. Verizon is highly leveraged and AT&T is not.

You can see that in the debt and equity percentage. You can take the percent debt divided by the percent equity which is reported in the third to last column, the Verizon number is 8.9 and AT&T is 0.88.

Q. But in terms of size, they're both remnants of the Bell company, they're competitors, aren't they?

A. Yes. Verizon and AT&T are competitors for certain services, for primarily their wireless services. They have a couple local exchange carriers, traditional local exchange areas that are not -- I wouldn't call them competitive with each other. There is some overlap. But what we see in the press most of the time is AT&T and Verizon fighting out signal coverage for wireless service across the United States map. So they're highly competitive in that market.

Q. In your last column how would you -- how does leveraged CAPM relate to cost of equity?

A. Okay. The leveraged CAPM is produced -- or the leveraged beta is produced by multiplying the beta times an equation or a function that addresses the tax structure of the company, and that tax piece is then multiplied by the debt and equity percentages. So the levered beta takes into account taxes and debt and equity structure all in one calculation.

Q. That's the second to the last column?

A. Correct.

Q. I'm asking about the last column.

A. Yes. Then the last column is the CAPM that uses instead of the spot beta, it uses the levered beta and creates a levered CAPM result.

Q. How does that relate to the cost of equity? Is there any relationship whatsoever?

A. Well, in this case the levered beta would reflect the equity premium that market analysts would expect from these companies based on their capital structure.

Q. The leveraged CAPM Verizon has over three times the number of AT&T; is that correct?

A. Correct. It's 25.7 and AT&T is 7.4. That again is a function of the very different capital structure of the two companies.

Q. Doesn't a levered CAPM of this magnitude cause some problems with competition?

A. With competition?

Q. Between AT&T and Verizon.

A. I don't think so. Competition would be on the demand side for services, seeking market share. And I don't know how the capital structure would be influenced by market share. I mean, investors are looking at market share because that is a risk assessment that they have to take as to whether the company has a desirable environment to operate with the potential for growth. So to that extent the competition could affect it, but I don't think it's direct.

Q. It's a cost though, isn't it? How can Verizon compete if they have a cost that is over three times higher than AT&T?

A. No, this is not a cost. There is a cost of capital if an analyst is looking at Verizon and AT&T, Verizon is growing a lot more than AT&T in some of its markets, in its wireless markets, for example. So from an investment standpoint you say okay I'll take that growth potential for Verizon. And AT&T is more of a stay company -- I hate to say that if anybody has any AT&T relatives. But they're a little bit more conservative and more of a dividend value company than Verizon is.

MR. MOORE: That's all I have. Thank you.

HEARING OFFICER: Any redirect?

REDIRECT EXAMINATION

BY MS. SLAWSON:

Q. Would you take a look at DPU Cross Exhibit 1?

A. Is this the Morningstar page 113?

Q. Yes.

A. Yes.

Q. Mr. Jetter questioned you on this wanting to

know -- I believe his questions were something along the lines of -- I'm not trying to restate them exactly -- whether a company that receives USF -- if the company receives USF would that offset a small company premium. Do you recall that?

A.   Yes, I recall that.

Q.   How would this size premium relate to the risk that Mr. Jetter was alluding to or the lower risks associated with USF?

A.   Say that again.

Q.   How would the risk factor that Mr. Jetter was identifying and the small company premiums that is identified here by Mr. Ibbotson, how would that relate to a company that receives USF distribution?

A.   As I look at page 113 there is a graph, 7.5, that shows essentially small company premium over time going back to 1945 and it various. There is some variability there. But I think the two take aways are one is positive, there is a small company premium that is generally applied in the real world, it's just not a straight CAPM, a traditional textbook CAPM. And then the number ranges right now in 2014 it looks like that's at about two and a half, I guess a fair read maybe a little north of two and a half percent small company premium.

Dr. Billingsley looked at small company

premium, and actually it was one of his criticisms of the FCC method they used in looking at whether they should re-prescribe the authorized rate of return of 11.25 percent and they produced a staff report. Mr. Billingsley used a small company premium in that case, and almost all of the companies that would be affected were federal universal service recipients. So it did not persuade Dr. Billingsley from using a small company premium even when you had this quote or this alleged government program for funds. So I think they are distinct and I don't think they offset one another.

MS. SLAWSON: Thank you. No other questions.

MR. JETTER: I do have some followup questions.

HEARING OFFICER: How much time do you anticipate?

MR. JETTER: Ten minutes.

HEARING OFFICER: Let's go ahead and break for lunch and do that when we come back. Is that okay? How long do you all want for lunch? We'll come back at 2:00.

(Off the record.)

HEARING OFFICER: Let's go back on the record. We are picking up where we left off before our lunch break. Mr. Jetter, I believe you had some recross for Mr. Meredith.

MR. JETTER: Yes. I have reconsidered and have decided not to recross.

HEARING OFFICER: All right. Mr. Moore, do you have any recross?

MR. MOORE: No, I do not.

HEARING OFFICER: Okay. Then Ms. Slawson, I think what I would do at this point is ask you to please address as well as you can the questions that the Commission posed in its notice.

MS. SLAWSON: I would be happy to do that, but I'm just wondering if it might be more appropriate at the end after all of the witnesses have testified so we know what all the testimony in the record is. I think a lot of the testimony, or some of the testimony that we might illicit through cross examination might go to some of those issues and not make those statements based on an incomplete record, but it's up to you.

HEARING OFFICER: I would like you to address what you can at this point.

MS. SLAWSON: Thank you. In the notice served by the Public Service Commission on January 21, 2016 the Commission notified parties that they should come prepared to discuss three issues. Do you want me to identify those issues for the record?

HEARING OFFICER: Sure.

MS. SLAWSON: Number one, Utah Code Section

54-8b-6 states, a telecommunications corporation providing intrastate public telecommunications services may not subsidize its intrastate telecommunications services which are exempted from regulation with the proceeds from other intrastate telecommunications services not so exempted. Disbursements from the UUSF constitute proceeds from regulated intrastate telecommunications operations. Are the parties satisfied that a continued or increased disbursement from the UUSF would not serve to subsidize the nonregulated operations of Carbon/Emery? Why or why not? Have I identified that issue correctly?

HEARING OFFICER: I believe so.

MS. SLAWSON: As the Commission has noted this is a threshold issue and the questions that this issue presents are addressed in the voluminous testimony filed in this case. The testimony specifically filed in this case identifies with particularity the uses for which Carbon/Emery will use or utilize its UUSF funds.

Each party in this matter has provided testimony on, for example, cost allocation between regulated and nonregulated activities. And so those issues are briefed for the Commission in terms of testimony. The Commission I would say has the obligation at this point to determine how those cost allocations should be made to avoid any subsidization.

We believe, Carbon/Emery believes and is satisfied that a continued and increased disbursement from the Utah Universal Service Fund would not serve to subsidize its nonregulated operations, and that the testimony they have provided on this case in this matter is clear on those points.

Carbon/Emery filed it's application for Utah Universal Service Fund and its requested revenue requirement has gone through a vigorous review process. The testimony or evidence in this case proves that Carbon/Emery is not using the UUSF funds to subsidize its nonregulated operations.

In order to be eligible for UUSF funds the Company must show that it is an eligible telecommunications carrier, that it is in compliance with Commission orders and rules. Did the Company complete a Commission review of its revenue requirement and other telecommunications service rate structure prior to any change in the UUSF, which is what we're doing here today, and then does not charge rates in excess of the affordable base rate. It must also show that it provides lifeline service and it is a facility based provider.

The testimony that's been provided in this case through the prefiled written testimony and the testimony illicit here today demonstrates that Carbon/Emery has met the requirements and the statute and rules and there is no evidence of subsidization in the extensive record.

Shall I go forward with issue two?

HEARING OFFICER: That's fine.

MS. SLAWSON: Issue two, Utah Code Section 54-8b-15(1)(a) states, a basic telephone service means local exchange service. Utah Code Section 54-8b-15(6)(a) states, the UUSF shall be designed to promote equitable cost recovery of basic telephone services. The question asked by the Commission are the parties satisfied that a continued or increased disbursement from the UUSF to Carbon/Emery would comply with this statutory language?

Each party in this case has supplied testimony as to the reasonable costs -- let me back up. Carbon/Emery has provided testimony and an application as to the reasonable costs associated with providing basic telephone services. Each of the other parties have provided testimony on this issue. At this point the record is robust and demonstrates through the testimony of the Company that the reasonable costs of providing basic telecommunications services are not met through rate recovery at the affordable base rate, and the Company is not earning the allowed rate of return.

And so we believe that the testimony shows that Carbon/Emery is entitled to additional UUSF funds to meet the reasonable costs of providing basic telecommunications for telephone services.

Issue three, Utah Code Section 54-8b-15(5) states, operation of the Utah Universal Service Fund shall be nondiscriminatory and competitively and technologically neutral in the collection and distribution of funds, neither providing a competitive advantage for, nor imposing a competitive disadvantage upon any telecommunications provider in the state. Are the parties satisfied that a continued or increased disbursement from the Utah Universal Service Fund to Carbon/Emery would comply with the statutory language? Why or why not?

As indicated previously in my statement, and as demonstrated in the testimonies of Brock Johansen and Darren Woolsey, Carbon/Emery has met the requirements of the statute outlining the eligibility for disbursement from the Utah Universal Service Fund. And therefore, is entitled to continued and increased disbursements from the fund. There has been no testimony, nor has there been to my knowledge any argument that the fund is not being administered neutrally.

So based on the testimony provided in the record Carbon/Emery's position is that Carbon/Emery is entitled to additional UUSF distribution from the fund and has met the requirements of the statute.

HEARING OFFICER: Thank you. And you have no more witnesses; is that correct?

MS. SLAWSON: That is correct.

HEARING OFFICER: Does the Division want to call its witness. Just so you know, I figure we'll go at this point until about 3:20, break for 15 or 20 minutes, and then we can go up to 5:00 as needed. Go ahead.

MR. JETTER: It's a little out of the order that the Company did, but if you would like I could address the same questions now just back to back.

HEARING OFFICER: That's fine.

MR. JETTER: Because it might be easier looking back at the record to see. And if it's acceptable I'll rely on Kira's reading on the questions and just address them as questions 1, 2, 3.

HEARING OFFICER: That's fine.

MR. JETTER: With respect to question one. In practically every incumbent local exchange carrier territory or companies in Utah are receiving Utah Universal Service Fund support. The telephone company receiving the support is under common ownership with its affiliate internet service provider. In most, if not all, cases the ILEC owns the facilities and sells access to the affiliated internet company. Generally the access fees paid by the internet company are based on the National Exchange Carrier

Association tariff rate, also referred to as NECA.

The NECA tariff rate is a cost based tariff derived from other similar ILEC costs. The Division has relied upon the NECA tariff or prior recommendations because it is a reasonable proxy established by an outside entity. To the extent to which UUSF funds may subsidize an affiliate in such circumstances is difficult to determine.

Most of the current plant additions that we're seeing in the ILEC territories are providing fiber to the home. Installation of fiber to the home is not necessary for basic telephone service. However, fiber network can and do provide basic telephone service as well as offer significantly improved availability of high-speed internet access for the affiliate internet provider.

In the event that the copper network is failing and must be replaced it is often most economical to replace facilities with fiber. The benefit of fiber is shared between the ILEC as well as the affiliate. Revenue increases generated from and received after the fiber install are likely to be received primarily by the internet and/or television affiliates.

What were once telephone companies traditionally that began to provide internet through an affiliate are often now predominantly internet and television companies that also happen to offer telephone service. However, all three services in the case of fiber networks can often use the same facility. And all of them will likely benefit from sharing of the costs of the facility.

Whether it can measure the benefit to the company's basic telephone service or to first determine whether the investment was necessary in order to continue basic telephone service is a critical question.

If, for example, the Commission were to take the view that the revenue increases or revenue derived from the value of the facility to each affiliate were indicative of whether subsidy were occurring, then the calculation of costs shared based on revenue would indicate that it is likely that an affiliate may be being subsidized. On the other hand, if the Commission views the test as whether it reduces the cost to provide basic telephone service by selling access to affiliates, it may be argued that because the affiliate contributes some dollars to defray the costs of the telephone service the Utah Universal Service Fund is not subsidizing the affiliate if that investment in the fiber or other upgrades was a prudent investment for the regulated ILEC.

With respect to the cost of operations the Division of Public Utilities periodically reviews all regulated telecommunications companies receiving Utah

Universal Service Fund support. This review includes a desk audit of the annual report filed by the companies with the DPU. If the desk audit indicates issues that need further investigation, the DPU then takes the appropriate action, which may include a more formal audit at the time if the Division has the ability to dedicate time and resources to that investigation.

Cases filed with the Commission that are ongoing tends to take precedence over those proactive audits. If a formal audit is conducted then the DPU will receive the cost allocation manual that the company is using to allocate costs between its regulated operations and unregulated affiliates. This has been a standard practice for several years.

The cost allocation manuals are normally developed based on the FCC Part 64 guidelines as there is no Utah specific Public Service Commission rules to use as guidance for these cost allocation manuals. If the cost allocation manual seems reasonable to the Division and the company appears to have made a good faith effort to allocate costs between regulated and nonregulated companies, then the Division will test to make certain that the cost allocation manual is being followed and practiced. If there is no cost allocation manual, or the cost allocation manual seems insufficient, then the Division will propose its own cost allocation method.

In the case of Carbon/Emery Telecom Inc. the Division has reviewed its cost allocation manual approximately five times in the last six to seven years during various Universal Service Fund requests. The DPU has found that Carbon/Emery Telecom's cost allocation manual seems to be fairly robust and it appears to be followed and practiced.

The only criticism of the cost allocation manual is that it is sometimes dated and could be reviewed and updated more often. The DUP recognizes that there are some inherent problems developing accurate cost allocation manuals.

If the Commission is interested in developing rules to provide more specific guidance in this area the DPU would welcome such an opportunity and would like to participate in an effort to do so.

With respect to question two. Yes, disbursements comply with this language. The DPU views the Utah Universal Service Fund as a cost recovery mechanism to be used were the total cost of providing basic telephone services exceed the revenues generated from those services. The calculation of that support is defined in Commission Rule 746-360-8.

If a telecommunications company is charging the affordable base rate as defined in Rule 746-360-2, then the Division believes that the Universal Service Fund is designed to fill in the gap between the total revenue and total expense for providing basic telephone service.

If the telecommunications company were not charging the affordable base rate, the Division would impute the revenue it would receive if it were charging the affordable base rate and reduce the Utah Universal Service Fund recommendation by that amount.

In this case Carbon/Emery Telecom is charging the affordable base rate and the Division believes that continued disbursement from the Universal Service Fund to Carbon/Emery Telecom for the cost recovery for the basic telephone communication services is appropriate to the extent that the actual cost of providing basic telephone service exceed the revenue generated. However, the Division is mindful of opportunities for effectively recovering for expenses that would benefit parts of the Company's business that are unregulated. Progressive replacement of infrastructure, such as copper cable that remain sufficient to provide basic telephone service, can allow the Company to recover for investments that have not been needed for the service of basic telephone. The Division recognizes that basic telephone service can benefit from these investments even if it did not require them.

Further to stave off customer departures, telephone companies attempt to retain customers with more advanced services. Given their affect on reducing customer losses and some incremental benefits, these investments have not been the subject of the Division's adjustments in this case.

Nevertheless, when the investment is recovered through accelerated depreciation the Division is unwilling to accept that accelerated recovery and has made adjustments in our recommendations to the Commission.

And with respect to question three, eligibility for Utah Universal Service Fund disbursement is defined in Commission Rule 746-360-6. To be eligible the company must be designated as an eligible telecommunications carrier pursuant to 47-USC-214(e).

Carbon/Emery Telephone is an eligible telecommunications carrier as described above and is an incumbent rate of return telephone corporation that is described in Rule 746-360-6. The Division, therefore, believes it is eligible to receive Universal Service Fund disbursements in the amounts that would be calculated appropriately.

While a variety of rules governing Utah Code 54-8b-15(5) might be permissible under the Commission's existing rules, Carbon/Emery Telephone is eligible subject to the establishment of Commission -- subject to the Commission's establishment of an appropriate amount.

There are other carriers competing in the Carbon/Emery service territories utilizing other technology such as wireless service. These carriers may be at a competitive disadvantage when competing with a carrier such as Carbon/Emery that receives Utah Universal Service Fund subsidy. However, as of yet these carriers have either chosen not to pursue ETC designation or their applications have been denied by the Commission for this territory.

Designation as an ETC may qualify them for Universal Service Fund disbursements. There are several wireless lifeline carriers that have received ETC designations from the Public Service Commission. These carriers as of yet have not requested Utah Universal Service Fund support, and in each instance they have agreed in stipulations to only seek Utah Universal Service Fund support after additional proceedings requesting it before the Commission. And that concludes the Division's responses.

HEARING OFFICER: That's very helpful. Thank you. Would you like to call your witness?

MR. JETTER: The Division would like to call first Mr. William Duncan.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MR. JETTER:

Q. Good afternoon, Mr. Duncan.

A. Good afternoon.

Q. Would you please state your name and occupation for the record?

A. Yes. My name is William Duncan. I am the manager of the Telecommunications and Water Section for Utah Division of Public Utilities.

Q. Thank you. In the course of your employment did you have the opportunity to review the application and testimony filed by the applicant in this case?

A. Yes.

Q. Did you create and cause to be filed with the Commission prefiled direct testimony?

A. Yes.

Q. I'll just read them all if that's okay. Direct testimony, rebuttal testimony, revised rebuttal testimony, and surrebuttal testimony along with the attending exhibits?

A. Yes, I did.

Q. If you were asked those same questions today would you answer them the same way?

A. Yes.

Q. Do you have some corrections that you would like to make to those?

A. Yes. On my rebuttal testimony, revised rebuttal and surrebuttal on page 1, the title page on each of those documents, I failed to change the name of Emery Telephone to Carbon/Emery Telecom Inc. The docket number is correct and the testimony is correct, but I evidently used the same testimony in the Emery case and inadvertently forgot to change the title page. So that's page 1 on each of those.

Q. Do you have any other changes that you would like to make?

A. Yes. During our final review of the exhibits prior to the hearing we discovered a calculation error in the rate of return calculation. After correcting the error the Division's position on the rate of return has been revised to 9.97 percent rather than the 9.85 percent that was submitted in previous testimony. Mr. Coleman will testify to the Division's position on that later today. That change has been considered by the Division and the Division has adjusted its recommendation from decrease in Utah Universal Service Fund of $14,458, which I believe was in my surrebuttal testimony, to an increase in Utah Universal Service Fund annually of $6,833. This increase would put the Division's position for a total annual UUSF disbursement of $1,045,547.

We have two exhibits that we have developed to replace two exhibits in my surrebuttal testimony. One of them is the template we used for calculating the Utah Universal Service Fund, which Carbon/Emery used in their application and then we used that template to put our adjustments in. So that one has been used before.

The second exhibit that we're passing out today -- actually there are two tables in my surrebuttal testimony that -- I didn't know the best way to handle this, so rather than replace them in a written format I just produced some Excel tables. One of them, the first table on line 54 of my surrebuttal, and the second one is on line 81 of my surrebuttal. But they both just show the revenue requirement and revenue deficiency that I previously spoke about of $6,833. So it's a fairly minor change, but one we had to correct when we found the error.

HEARING OFFICER: That's based on the change on the rate of return, correct?

THE WITNESS: Yes. The rate of return changed from 9.85 to 9.97.

HEARING OFFICER: That's the composite?

THE WITNESS: That's the composite, that's correct.

HEARING OFFICER: Thank you.

MR. JETTER: At this time I would like to hand out another hearing exhibit that is the correction made in another one of our witnesses, Casey Coleman's testimony, but it relates to the same issue so I thought it be reasonable to pass this out at the same time.

HEARING OFFICER: Go ahead.

MR. JETTER: I intend to have Mr. Coleman address this briefly.

HEARING OFFICER: Is there any objection? This is just a replacement of an exhibit on file?

MR. JETTER: It is.

MS. SLAWSON: I just want to make sure I'm seeing the corrections correctly on Mr. Coleman's testimony. I can ask him about this if there are any issues. We can keep going.

HEARING OFFICER: The Office has no objection?

MR. MOORE: No objection.

HEARING OFFICER: Did you want to ask Mr. Coleman about this now?

MR. JETTER: I can ask him about it when he is sworn in and we get it authenticated in the record at that time.

HEARING OFFICER: Okay. Go ahead.

MR. JETTER: I believe at this time the two exhibits that were first handed out, which are entitled at the top DPU Exhibit 1.1 Hearing and DPU Exhibit 1.2 Hearing and those relate to Mr. Duncan's testimony, that those be accepted into the record?

HEARING OFFICER: And there is no objection?

MS. SLAWSON: No objection.

MR. MOORE: No objection.

HEARING OFFICER: All right. We'll accept them as marked.

MR. JETTER: And with that that concludes my direct testimony of Mr. Duncan. He is available for cross.

HEARING OFFICER: Ms. Slawson, questions for Mr. Duncan?

MS. SLAWSON: Yes.

CROSS EXAMINATION

BY MS. SLAWSON:

Q. Good afternoon, Mr. Duncan. You provided summary testimony for the Division in this case, correct?

A. That is correct.

Q. As I have reviewed your testimony I've identified three issues that remain unresolved between the Company and the Division; is that correct?

A. That is correct.

Q. Those would be rate of return, correct?

A. Yes.

Q. The final figure for the adjustment for

migration of customers from cable internet to fiber to the home internet service, correct?
A. That is correct.
Q. And then the depreciation expense?
A. That is correct.
Q. With regard to the rate of return it's my understanding that the only issue between the Company and the Division at this point is on the appropriate cost of equity; is that correct?
A. That is correct.
Q. And it's my understanding that Mr. Coleman will be providing that testimony for the Division?
A. Yes.
Q. And with regard to the depreciation expense Joe Hellewell will be providing that testimony for the Division, correct?
A. Yes.
Q. Throughout this procedure the Division has propounded several sets of data requests in this matter; is that correct?
A. Yes.
Q. In addition to the data requests did you have telephone calls with the Company throughout this process?
A. Yes.
Q. If you were unclear about an issue or response

to a data request you would call the Company for clarification; isn't that accurate?

A. I don't know if we called them on every issue, but we certainly did on some.

Q. You felt as though you could call them on any issue?

A. Yes.

Q. Because you're providing the summary testimony I just have a couple questions for you. But I wanted to make sure in the testimony of Joe Hellewell there are several references to the proposition that the Utah Universal Service Fund should not be used as an incentive for increased infrastructure investments. Do you recall that testimony from Mr. Hellewell?

A. Yes, vaguely.

Q. I couldn't find any example when I looked through your testimony of where you testified that Carbon/Emery unnecessarily accelerated its plant investment by replacing assets before the end of their useful life; is that correct?

A. That's correct, I don't believe I testified on that.

Q. I just want to identify the last remaining issue between the Division and Carbon/Emery, and that was the cable migration number.

A. Yes.

Q. As I've reviewed your testimony the final figure with regard to the Division's adjustment for imputed revenue for migration of customers who currently receive their internet services through Carbon's cable affiliates to the new fiber to the home network that is being constructed by Carbon still needs final calculation which is dependent upon the rate of return authorized by the Commission, correct?

A. Correct, it's dependent upon the rate of return.

Q. So is it fair to say that once that rate of return has been determined by the Commission, the calculation and the methodology for that calculation would be finalized and the adjustment will be made, correct?

A. Yes. The adjustment is dependent upon whatever the final rate of return is.

Q. With regard to the rate of return the Company has proposed a return on equity of 12.13 percent, correct?

A. That is correct.

Q. Were you involved in the Hanksville Telecom UUSF proceeding which was filed by the Division in May 2014?

A. Yes.

Q. Did the Division prepare the confidential

exhibits attached to its Hanksville application?

A. I'm sure we did.

Q. Do you recall the return on equity that was used by the Division in that application?

A. Not specifically, but I -- if you say it was 12.13 I'll accept that.

Q. I think the Commission can take judicial notice of what that number was. At the time the Division was preparing the application in the Hanksville Telecom UUSF proceeding was the Division aware that Emery Telecom was also planning to file an application for UUSF?

A. I don't remember.

Q. In fact, Emery filed an application for an increase in UUSF in September 2014; is that correct? The first one.

A. Yes. I would say -- I would accept that's correct. I don't remember the date, but I remember the proceeding.

Q. Because you don't remember the proceeding I would just state that the Commission can take judicial notice that the return on equity number that was filed by Emery in September of 2014. Was the return on equity figure an issue that was contested by the Division in the Emery 2014 UUSF application?

A. I don't remember.

Q. Have you reviewed the adjustments identified by Mr. Ostrander in his surrebuttal testimony relating to allocation adjustments?

A. Not in depth.

Q. I didn't see it in your summary testimony. So the Division is not recommending that the Commission adopt those adjustments; is that correct?

A. No, we're not.

Q. With regard to the landline loss projection, is it your testimony that the Division supports and has adopted the calculation provided by the Company for landline loss projection?

A. I would say we adopted the amended landline loss numbers that came in, that Carbon/Emery developed and revised I'm going to say during testimony.

Q. With respect to the Division and Carbon/Emery there is no issue, remaining issue, as to the landline loss adjustment, correct?

A. No.

MS. SLAWSON: I have no other questions for the witness.

HEARING OFFICER: Mr. Moore.

CROSS EXAMINATION

BY MR. MOORE:

Q. Just a few short questions on the capital

structure issue. Mr. Duncan, the Division is recommending on its capital structure 35 debt and 65 percent equity in this case?

A. Yes.

Q. This capital structure was derived from a 2008 capital structure task force; is that correct?

A. Yes.

Q. In your testimony you stated that prior to 2008 the DPU used various hypothetical structures, including the 50/50 structure recommended by Mr. Brevitz; is that correct?

A. I wasn't here prior to 2008 so I can't -- the information I received is from others that over the years preceding 2008 the Division used a variety of capital structures.

Q. The point of the 2008 capital structure task force was to arrive at a capital structure that would provide the ILEC's with certainty making future investment decisions?

A. It was to provide some level of certainty in Utah Universal Service Fund applications.

Q. Since you've been here the Division has used that capital structure in its UUSF cases; is that correct?

A. Correct.

Q. In reading your testimony you seem to stress

that this was due to a policy of regulatory consistency?

A.   Yes, it was trying to provide some regulatory consistency.

Q.   On page 48 of your rebuttal testimony you stated that while DPU understands the OCS concerns with the 65/35 hypothetical capital structure, the DPU believes this is not the place to make a major policy change. Does that sound correct?

A.   Yes.

Q.   You went on to state, the DPU would support a much broader proceeding to examine the question that could ultimately result in consistent practices that could be applied globally; is that correct?

A.   Correct.

Q.   Now the 2008 capital structure task force did not result in a rule from the Commission, did it?

A.   That's correct.

Q.   In fact, October 27, 2008 the Commission sent a letter to DPU rejecting a rule?

A.   Correct.

Q.   I'm going to hand you -- I believe this is in our exhibit list, but there seems to be some confusion. So I'll just hand these down and just ask a question without putting it in the record unless there is an objection. Is this letter -- have you ever seen this letter before?

A. Yes.
Q. Is this the letter that I was referring to?
A. I believe so.
Q. In the last sentence of the major paragraph the Commission writes, it is also concerned that the impact of the rules that sets rates under title 54 where the Commission is required to make a determination based on evidence presented in an adjudicated proceeding based on circumstances facing each company and relevant to time the rates will be effective.
A. Correct, that's what it says.
Q. Now if you provided a policy based on regular consistency that's been in effect since 2008 and going to go in effect indefinitely, until I guess there is another global change, the capital structure is not as the Commission suggests, the Commission pronounces, relevant to time to which the rates take effect; isn't that true?
A. Can you restate that?
Q. I'm sorry. The Commission states that they rejected the rule because in part they feel like the capital structure should be based on evidence and circumstances facing each company, and importantly relevant to the time in which the cases will be effective.
A. Okay.
Q. My question is, if we have a stable global

policy that lasts from 2008 indefinitely that policy will run array the Commission's concern about having the capital structure in place relevant to the time with which the rate will be taking effect, won't they?

A. I don't think there is any prohibition on us not using this as a policy.

Q. No, but it's not the policy of the Commission, is it?

A. No, it's not. Obviously the rule was not adopted.

Q. Would you agree that there has been significant changes in the telecommunications business since 2008?

A. Yes. The telecommunication business is evolving continually.

Q. So the circumstances facing each company will evolve over time?

A. Correct.

Q. Isn't your policy contradictory to this last sentence of the first paragraph of the Commission's letter?

A. No, I don't believe so.

Q. Could you explain that?

A. In the Commission's letter it says in the sentence above that the general parameters of the rule accompanied by the variability attempted to be included in the rule proposed may be applied by the Division itself in its interactions with companies.

Q. But it goes on to say the Commission will not provide that as a rule due to concerns of timing and producing and looking at the evidence of a case by case basis?

A. That's correct. The Commission certainly has the authority to reject our use of that rule, or not rule, but that policy if they see fit.

MR. MOORE: That's all I have.

HEARING OFFICER: Any redirect, Mr. Jetter?

MR. JETTER: I have no redirect. Thank you.

HEARING OFFICER: Your next witness.

MR. JETTER: The Division would next like to call Casey Coleman and have him sworn in at this time.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MR. JETTER:

Q. Mr. Coleman, would you please state your name and occupation for the record?

A. My name is Casey J. Coleman. I'm an utility technical consultant with the Division of Public Utilities.

Q. Thank you. In the course of your employment have you had the opportunity to review the application filed by the applicant in this docket?

A. Yes.

Q. Did you prepare and cause to be filed with the Commission direct testimony of Casey Coleman as well as surrebuttal testimony of Casey Coleman?

A. Yes, I did.

Q. Do you have any corrections that you would like to make to either of those or the exhibits that were attached thereto?

A. Yes, I wanted to put into the record, which has already been provided and labeled DPU Exhibit 3.1 for the hearing, which is an updated calculation for what the Division is recommending for allowed rate of the return for Carbon/Emery which Mr. Duncan talked about earlier changed the rate from the 9.85 to 9.97. And I can go into more detail now or later with whichever makes sense.

Q. I think it would be a great time now to give a brief explanation of what was changed and for what reason.

A. Primarily on this, if you look at this compared to what we filed before, the only thing that changed is what would be the separation factor for intrastate and interstate. Previously what I had done before is I had x'd that out because we agreed with the calculation of Mr. Darren Woolsey as far as what that separation would be. When we first did the calculation we were going off of what his first filed numbers were. Then I believe about three weeks later he filed some amended numbers, which had these second set of numbers in there. Because for whatever reason those numbers didn't get translated through originally I went back in and created the confidential exhibit which now shows those numbers, which I believe are accurate. And if you just do the normal calculations across you will see what we believe would be the correct weighted cost and finally get to the 9.97. So that's the only change. We believe it was accurate to reflect the most recent information that was filed by the Company, which is what we were supporting.

And our other numbers don't change as far as what we believe the correct debt to be and also our recommendation for the cost of equity for the Company. If there are other questions, it's pretty straight arithmetic from there, but I can explain that further if need be.

Q. Thank you. With that slight change to your testimony on that exhibit, if you were asked the questions contained both in your direct and your surrebuttal testimony would the answers today be the same as they were?

A. Yes, they would be.

Q. Do you have any other edits or corrections that you would like to make today?

A. No.

Q. Have you prepared a brief statement summarizing your testimony?

A. Yes. As the witness for the rate of return for the Division, I went through and did a calculation to try to determine what we believe would be the appropriate allowed rate of return. And as discussed by Mr. Duncan and myself the Division believes the Commission should use the 9.97 percent rate.

We did agree with Carbon/Emery as far as the cost of debt and that is reflected in the information that I have provided. We also believe, as the Division has done in other times, that the policy of a hypothetical capital structure of 35 percent debt and 65 percent equity should be used. Carbon/Emery does not have any debt, but because of the policy we have done before we are recommending that hypothetical of 35/65. And as reflected on the new updated information we do agree with the separation calculations provided by Carbon/Emery for the weight in between intrastate and interstate there.

Where we do disagree and believe the number that should be accurate is for the cost of equity. The Division is recommending a 10.75 percent cost of equity with that. We come to that number by using a capital asset pricing model or CAPM, which has been discussed with that, and doing the same type of analysis which has been done in previous cases and for an extensive period of time by the Division.

We believe the Commission should continue to follow some of the same policy that has been done before, the same process that has been done before which is what we have done before and accept the 10.75 percent as a cost of equity and ultimately the 9.97 for the allowed rate of return for Carbon/Emery.

Q. Thank you. I would like to address something else briefly on direct testimony.

A. Sure.

Q. The Division recommended cost of equity in this case has varied slightly from some previous cases. Can you briefly explain why that is?

A. Sure. There has been discussion as far as the rate of return that was used in previous cases to now. The most simple way to explain that is we did an analysis according to when the information was filed. We went and looked at the beta rates that would be applicable for those companies, ones that were still in service and the ones we felt made sense, and then looked at what the risk free rate and risk free premium would be for that time. So there would be an adjustment just because the markets have changed and the scenario has changed a little bit. But our methodology and the way we went through the calculation was basically the same as what would have been done in previous times, it's just with updated information that we feel is applicable in this case and scenario to try to represent as I guess as best you can with what the market conditions would be as of the filing date for Carbon/Emery.

MR. JETTER: Thank you. Those are all the direct questions I have for Mr. Coleman. He is available for cross examination.

HEARING OFFICER: Ms. Slawson, any questions?

MS. SLAWSON: Yes. Thank you.

HEARING OFFICER: Go ahead.

CROSS EXAMINATION

BY MS. SLAWSON:

Q. Good afternoon, Mr. Coleman. I want to confirm that you reviewed the testimony and exhibits of Mr. Meredith, Mr. Woolsey and Mr. Johansen filed in this proceeding, correct?

A. Yes.

Q. In response to your direct testimony the Division is recommending that the Commission adopt the task force's hypothetical capital structure framework for this proceeding; is that correct?

A. Yes, we are.

Q. Just so I understand, and for benefit of the record, the task force's recommendation was not that the hypothetical capital structure of 35 percent debt and 65 percent equity should be used in all cases; is that

correct?

A. Yes, that's correct.

Q. In fact, I believe the task force's recommendation was it would be a sliding scale, correct?

A. Yes.

Q. And if a company has an actual capital structure with less than 35 percent debt, then 35 percent debt would be imputed to that company; is that correct?

A. Yes, that's correct.

Q. If the company has an actual capital structure of 45 percent debt, then the Division and the task force recommended that the Commission use the actual capital structure, correct?

A. Correct.

Q. In your testimony you identified NECA, that's the National Exchange Carrier Association; is that correct?

A. Yes, that's true.

Q. Did you rely on NECA as an authority to determine the interstate rate of return for Carbon/Emery?

A. I guess the best way to explain that is I didn't understand the form 492 as well as I would like to. So I called NECA to try to get a better understanding as far as what the information on there was and asked a variety of questions to help me get a better understanding of that. Through the conversations I came to understand why there were two different forms 492 and what that meant. So I don't know that I necessarily relied on their number, but I used their expertise as far as what the form was to help me come to the conclusion of what I felt was the right interstate return for Carbon/Emery in this proceeding.

Q. The revised exhibit that you provided here today shows that the interstate rate of return used by the Division in its calculation is 11.45 percent, correct?

A. Yes, that's correct.

Q. In your testimony, your direct testimony on line 157 you indicated there was no other viable alternative for calculating the appropriate cost of equity other than the CAPM. Do you recall that testimony?

A. You said line 157 of my direct testimony?

Q. Yes.

A. I'm not seeing that exact quote on line 157, but I might -- I said something similar to that. I don't know if the line matters specifically unless I'm looking at the wrong spot. Okay. Yes, I agree. Sorry.

Q. When writing your direct testimony were you aware of NECA's method that calculates the return on equity estimates from the NECA rate of return carriers involved in capital transactions using what Douglas Meredith has identified as free cash flow method?

A. I'm not aware of that.

Q. You weren't when you wrote your direct testimony, correct?

A. Yes.

Q. Now in reviewing the testimony you're aware of this approach, correct?

A. It is something that Mr. Duncan did provide as another alternative.

Q. Mr. Meredith?

A. Sorry. Yes.

Q. Would you agree that NECA's free cash flow method as identified by Mr. Meredith in his testimony estimates the cost of capital based on actual information conveyed by buyers and sellers of rural access lines rather than generalized market data and proxy companies?

A. To be honest with you, as I said before I reviewed it, but that doesn't mean that I'm an expert in that area. And part of what I said in my testimony that I think is still accurate is as the Division we're trying to find something where we can have publicly available information that will help us to be able to come to a rate of return that's acceptable. I don't know if all the information in that report, because I'm not an expert, is publicly available that we can get to it or not. I'm not familiar with the discounted cash flow and the different elements of it. But the reality of it is the Company didn't submit that as a proposal to begin with either. So I went with what was done previously before with what I felt was publicly available information that any party coming to this table could look at it and say that's accurate or not accurate.

Q. Okay. But after receiving the testimony in this case -- first of all, would it surprise you to know that information is publicly available?

A. It is possible that it is publicly available. It wouldn't surprise me.

Q. Would you agree that after receiving and reviewing the testimony in this case, particularly the testimony regarding NECA's free cash flow method, that you could have undertaken the evaluation of that approach, correct?

A. I could have, but I think the Division is comfortable with the quotes they did and it's the burden of proof of the Company to put forth something, and they could have done that analysis, but didn't.

Q. And wouldn't the free cash flow approach be valuable in assessing Carbon/Emery's cost of equity in this proceeding? Do you think that would have been a valuable exercise to undertake? Just yes or no.

A. If I had the information, sure.

Q. You have identified here in your testimony, in

your prefiled testimony and then in your testimony here today, that the Division recognizes NECA as an authority on certain rural carrier issues, correct?

A. I don't know that I ever said NECA was an authority on certain rural carrier issues. I understand we have to go to the form 492, which is filed through NECA to get some of that information.

Q. Let's look at your CAPM approach. In your surrebuttal testimony you argue that adjustments to the textbook CAPM shouldn't be made because telecommunications carriers, and specifically rural carriers receiving UUSF support or Universal Service Fund support, are different; is that correct?

A. Yes, that was part of my testimony.

Q. And it's your testimony that small company premium shouldn't apply to small carriers?

A. Correct.

Q. In forming your recommendation on small company premium did you review Douglas Meredith's rebuttal Exhibit 1 where Dr. Heaton from BYU addresses the small company premium?

A. Yes.

Q. Dr. Heaton's review and address of small company premium, specifically addresses small company premiums for the telecom sector; is that correct?

A. I believe so, yes.

Q. Doesn't Dr. Heaton recommend that small company premiums be a minimum adjustment for a CAPM use in the telecom sector?

A. He might have said that, yes.

Q. In forming your recommendation on small company premiums did you review Douglas Meredith's rebuttal testimony Exhibit 2 where Dr. Billingsley addresses the small company premium specifically for rural carriers?

A. Yes.

Q. Doesn't Dr. Billingsley recommend that small carriers receive a small company premium of 5.56 percent for the entire sample of rate of return carriers?

A. I don't know that I could give you the exact number. I reviewed it, but -- I'll agree if that's what number is in there then that's fine.

Q. In your surrebuttal testimony -- in your calculation of the CAPM what level of precision would you apply to your recommendation using the CAPM model?

A. I think my calculations were 100 percent accurate if that's the level of precision that you're going for.

Q. I'm not talking about the calculation itself, but the determination of the return on equity developed from the CAPM model. Is it precise?

A. I think as far as what I said in my testimony is we don't have a huge level of comfort with the CAPM, but we also as the Division were not able to come up with something that was publicly available information that would come to a higher level of precision.

Q. And correct me if I'm wrong, but I believe your surrebuttal testimony is silent on Mr. Meredith's proposed calculation of the risk free rate used in the CAPM; is that correct?

A. Yes. I didn't go that specifically to that aspect of this, but I don't think my being silent means I'm for or against it. His calculation and the way he did the CAPM would have been the same I did, and we could argue over if the rates are accurate or not. I don't know that was the substantial element of what we are getting at in this hearing.

Q. Are you aware that the Federal Reserve is ending its quantitative policy and is beginning to increase the federal funds interest rate?

A. I know that it slowly happens and it's been talked about for a period of time. Sometimes it hasn't happened as quickly as what they had been suggesting.

Q. As the Federal Reserve increases its interest rates what is your expectation in the future of interest rates?

A. Well, I think we don't know for sure. The beauty of it is the company can come in if the rates change and ask for an increase or decrease according to that. And we're dealing with the facts as far as what is happening now kind of similar to what Mr. Johansen testified earlier in this hearing.

Q. I want to discuss the peer group that you selected for your CAPM model. Were you aware that Hickory Tech was purchased by Consolidated in 2014?

A. Yes.

Q. Were you aware of that when you provided your testimony?

A. Yes.

Q. Are you aware that before it was purchased by Consolidated its service area included Southern Minnesota, including the Twin Cities, Northwest and Central Iowa?

A. I knew generally where it was serving, but I don't know the exact areas of where it was serving. So no, I don't know to that detail.

Q. Would you agree if it is accurate that the service areas included Southwest Minnesota, including the Twin Cities, Northwest and Central Iowa, would you agree that service territory is not comparable to Carbon/Emery?

A. Yes, that could be a true statement.

Q. Are you aware that the majority of Alteva's

revenues were generated from its voice operations and wireless partnerships and not its small ILEC operations?

A. I know that there was an amount of revenue that came from that, yes.

Q. And two of the other companies that you chose for your model, Earthlink and IDT, they don't have ILEC operations and don't provide basic local exchange services, do they?

A. That could be accurate, yes.

Q. Are you aware that Fairpoint, a company that you added in this proceeding, is a former Bell operating company that operates within three New England states?

A. Yes.

Q. Would it surprise you to know that Fairpoint provides service in 17 states?

A. Yes, that would be surprising.

Q. Would it surprise you to know that Fairpoint employs over 3,000 employees?

A. Sure.

Q. What about its annual revenues, would it surprise you to learn that Fairpoint had over $900 million in annual revenue in 2014?

A. No.

Q. You indicate on line 401 in your surrebuttal testimony that you added companies that would be considered

rural. But Cincinnati Bell is a dominant telephone company for Cincinnati, Ohio and it's nearby suburbs in the U.S. states of Ohio, Indiana, and Kentucky. Do you consider Cincinnati Bell to be a rural operating company?

A. I'm glad you asked that because I want to try to clarify what I tried to do with that.

Q. Let's answer my question first. Do you consider Cincinnati Bell to be a rural company?

A. I included it in my list, so I believe parts of it was rural.

Q. Consolidated Communications is included in your list. This is a family of companies providing advanced communication services in California, Kansas, Missouri, Illinois, Texas, and Pennsylvania; is that correct?

A. I'll agree with you. I didn't look at every single state, but sure.

Q. I don't think there is any dispute that none of the companies that you looked at were located in rural Utah, correct?

A. Correct. I would have loved to use that information, but it wasn't available.

Q. In your surrebuttal testimony lines 179 to 180 you were asked in that testimony if the Division's rate of return calculation is fair and reasonable. In your testimony in answering that question you refer to Docket

08-046-01 and state, in reviewing the details of Manti Telecom and Carbon I find nothing vastly different between those two companies that would warrant using a different methodology in this case; is that correct?

A. That was in my testimony, yes.

Q. And that docket was in 2008. I believe the hearing was in 2012; is that accurate, 2011, 2012?

A. Sounds correct, yes.

Q. Why did you consult a Manti Telecom docket to determine the appropriate return on equity rather than just adopting the return on equity proposed by the Division in Hanksville, which was approved by the Commission less than eight months before Carbon filed its application?

A. It's not the rate that we looked at, but instead the methodology that we looked at. And the Commission was pretty clear the Manti order they felt using a CAPM approach, which was the same approach we used in this rate, did produce just and reasonable rates. And so I believe because we need to also again find just and reasonable rates, and if the Commission has already said that way is appropriate to use then we should use that same methodology. And as has been asked before, the rates we used in the case before, which I believe was Hanksville, we did a similar type of approach, we just updated it for this time period. So it's not that we changed the approach and

I believe the Commission was pretty clear that was an approach that would lead to just and reasonable rates and so that's why we followed that.

Q. So your testimony is that you used the CAPM model in the Hanksville case?

A. We looked at a rate of return using a CAPM model or something like that to come up with what we would consider to be a reasonable rate for Hanksville.

Q. And that was developed in 2014, correct?

A. I believe so, yes.

Q. And when the company used that figure, and you're eight months later when it filed the application, your testimony here today is the rate had changed based on the model?

A. Yes, because what we did is looked at --

Q. Just yes or no.

A. Yes.

Q. Are you aware that the Utah Supreme Court has stated that the governing standard in determining return on equity is the cost of inducing capital markets to invest in utility, not the cost of inducing the utility to invest in Utah?

A. I'm not entirely sure what that means and I'm not an attorney. But if I could read it maybe I could better understand what it said, but just something that was read there.

Q. You haven't heard of that governing standard, is that what you're saying?

A. No.

MS. SLAWSON: I don't have any other questions.

HEARING OFFICER: Mr. Moore.

MR. MOORE: Yes, just a few questions.

CROSS EXAMINATION

BY MR. MOORE:

Q. Turning to the interstate rate of return for Carbon/Emery. Would you agree that the interstate rate of return is dependent on the proper legal construction in Utah Administrative Code Rule 746-360-8(A)(1)?

A. Can you direct me maybe to where that is?

Q. I can direct you to page 4 of your --

A. Rebuttal testimony or direct testimony?

Q. Your surrebuttal testimony.

A. Okay. You said page 4?

Q. Page 4 you cite the rule starting on line 76.

A. Okay. R476-360-8.

Q. Yes.

A. Now if you want to ask that question again so I know what you're asking.

Q. Would you agree that the appropriate interest rate of return is dependent upon proper legal construction

of this rule?

A. Yes.

Q. Now you have taken the position under this rule 746-360-8 that the proper rate of return in this case is 11.45, correct?

A. Yes, correct.

Q. Could you explain how you came to that conclusion?

A. Yes. I think there is some supporting documents to go along with that, but I can also just kind of tell generally. From our understanding there are two forms 492 that is applicable when four different carriers are going to be participating in the NECA. Some of those would be the ones that are going to be offering the variety of different services, and then there are another subset that would basically be providing -- I'm probably going to get the wording wrong, but in essence they're not providing all the services, they're only providing a certain subset of that. And as I looked at the form 492 and also looked at Carbon/Emery and the tariff that I provided basically shows that Carbon/Emery is only participating in the one pool.

Q. The common line pool?

A. Yes, the common line pool. I'm just going to grab that exhibit so I can talk about it a little bit more accurately. So there are different pools. There is the multiline business and user common line, there is the special access, Ethernet transport services, local switching, local transport and tandem switch transport. So there is a tariff that I provided in my surrebuttal that basically shows Emery Telephone company that would be participating in just the multiline business and user common line pool, but not the other ones that I said after that.

In my phone conversation with NECA in trying to determine what that meant, they basically said that the companies who are only participating in the multiline business and user common line would be the ones that would have the first form 492 that is 11.45 and it doesn't have the different interest rates in the interstate calculation for those other pools. And so that's why we believe that by following what the 492 has and that Emery, Carbon/Emery because the way NECA looks at that, again through the conversation I had, is they look at it as a study error. So they may only list Emery Telephone company, but to them that includes Emery, Carbon/Emery and Hanksville as far as that. So we felt as far as the Division that showed that they should be part of that original or the first form 492 that shows 11.45 for interstate.

Q. And that's a rate for the common line pool?

A. Correct, yes.

Q. You are also aware, however, that the common line pool only represents a minority of Carbon's business?

A. Correct, yes.

Q. They also have traffic sensitive pools and special access services, don't they?

A. Yes, they do.

Q. So the 11.45 percent rate of return is actually for just a minority of their business?

A. I guess the best way that I can explain it, I don't have an intimate knowledge of now NECA works. So do they receive 11.45 on all of it or a portion of it, I don't know. I do believe that that's the reference point on the form 492 that shows that's what they get. But I think also if you look in my surrebuttal testimony I do talk about how there could be a potential for an arbitrage position. Because I do agree with what Mr. Moore was saying, they do have other services that they are providing, but I don't know as far as the Division where we could go to a resource, nor does the rule allow to go to another point other than that.

And so that's why looking at the rule and the statute the way we did we felt that was the interstate rate not precluding part of what was brought up by the Office in that discussion. But we did feel that the rule, at least the way it was written at that point, would deal with that.

Q. That's not always been your position in this case, has it?

A. No. Originally because I had some misinformation or misunderstanding about the form 492 I thought that Carbon/Emery would be in all of the pools and so they would be applicable. That was our original testimony. And then as I understood the form more and had some discussions with Carbon/Emery and those type of classifications, it was really more of an error where I thought it was applicable only to Emery and not realizing that it was a study area versus that company because to me Emery Telephone means something different than Carbon/Emery. So that's why in my original testimony I suggested that it should be a different rate, and subsequently changed it in my surrebuttal testimony.

Q. Isn't it true that you initially believed that Carbon was not in the common line pool?

A. I don't know if I said they were not. I just know they weren't in the other pools. So the letter that was provided, and I don't remember the person's name, but basically from NECA to the FCC saying here is our report, they talk about how there are two different reports. I thought they should be in the second form 492 that includes all of the rates of interstate instead of just the one.

Q. That's right. So how did you reconcile these two positions?

A. I think I reconcile it just from how I explained it, that I had a misunderstanding from what Emery Telecom meant in the tariff for NECA that they had provided -- or the FCC tariff, sorry, and that meant something different than what Emery Telecom means to me as someone who works in Utah. They had made an entire study area that would incorporate Carbon/Emery, and Emery Telecom and Hanksville. So that's how I would reconcile it. I don't know that we changed our position, but our understanding of the form and what the information was providing changed and so that's why we went with the 11.45.

HEARING OFFICER: Did you change your interpretation of the rule?

THE WITNESS: No. And my interpretation of the rule didn't change. I believe we were following the rule as it's prescribed.

Q. (By Mr. Moore) Mr. Brevitz is proposing an interest rate of 9.4 percent, which would encompass all of Carbon/Emery business appropriate interest rate to use. Is that your understanding?

A. I don't have it right here in front of me, but I'll accept that that's accurate, yes.

Q. That's basically the --

A. Are you talking on interstate only?

Q. Interstate only.

A. I believe if I remember correctly that was the right rate for the blending of everything for interstate, yes.

Q. And that was what your initial --

A. Correct, yes.

Q. And that was when you did not believe that Emery was in the common line pool?

A. Correct, yes.

Q. So your interpretation of the rule provides that if a carrier is in the common line pool and not in the traffic sensitive pool you use the common line pool rate of return of 11.45 percent, but if the carrier is not in the common line pool and not in the other pools you use the blended interest rate of 9.4 percent?

A. This has come up before. Looking at the rule 492 when we were going through this discussion with different parties and not having as much knowledge of the 492 form, I thought it was just going to be one data point. It would be something that we could go to and look at and say there is the number and plug it into the rule. Having gone through this process a couple other times I now realize that there are more layers and complexity to it. I believe that the rule basically requires we have to use form 492(a), and I would think that it would be the one that is applicable for the company according to which pool is it in.

What has happened in other proceedings is if a company had all of those pools that they were getting these rates from NECA then we would use the lower interstate rate. If a company is only in the common line pool then we would use, and as we have recommended for Carbon/Emery here, the higher interstate rate of 11.45.

Q. And if the company is in none of the pools would you use the blended interstate rate of 9.4, which was what was initially --

A. No, I think the way the rule is read is that would come under a different portion of the rule where they would be like an average schedule company that is not part of the NECA pool. And then at that point we would have to determine an appropriate rate. The form 492 is only for those companies that are participating in the NECA pool and is -- I'll probably get this wrong. They're not an average schedule, they're a different type of company. So we have had -- in Manti Telecom they were not a -- we had to do something slightly different for them because of dealing with it. That may not have answered your question, but that's my understanding.

Q. Just one last question which is obvious,

neither you, nor the personnel at NECA you talked to are Utah lawyers?

A. Correct. I'm not a lawyer. I'm a utility technical consultant and that gets me in enough trouble.

Q. And you would agree --

A. And I don't believe the person from NECA was. I don't know for sure, but he was the Western Regional Representative for NECA. I don't know his background, but I wouldn't believe that he was an attorney.

MR. MOORE: I'm done. Thank you.

HEARING OFFICER: It is time for a break. Let's break for about 15 minutes. When we come back, Mr. Jetter, if you have any redirect we'll pick up with that.

(Off the record.)

HEARING OFFICER: Mr. Jetter, any redirect?

MR. JETTER: I do have a few questions, Your Honor. Thank you.

REDIRECT EXAMINATION

BY MR. JETTER:

Q. I would like to first start out by asking you if you could explain briefly why the Division relies on the 65/35 limits on both ends, and briefly describe the policy reasons behind that.

A. Sure. Thank you. The reason the Division relies on that is because of the capital structure task force and what we feel was a process that allowed interested parties, rural phone companies, other phone companies, and other players to have an opportunity to discuss -- although I don't know that I take issue, but at least an element that's out there.

I mean it is possible that a company like Carbon/Emery could come in with 100 percent equity and say we want to go all equity for our rate of return, which the Division was uncomfortable with because that's probably not -- I'm telling them how to manage their business, but from a financial perspective that may not be the most prudent choice for a company in the normal market. But we also had other companies who maybe had 100 percent debt.

It wouldn't be very fair for those companies for us to say, well, you know, we think all you should get is your cost of debt and that's your only allowed weighted average cost of capital. So with this task force and with this discussion what we were able to do was say those who are in a relative middle ground, somewhere between 35 and 65 private capital structure that for whatever reason they feel is appropriate for their company and is reflective of the market we would accept that. But for those who may be the outliners we're going to pull the high equity companies in, but also maybe provide a little bit more equity to the debt companies to help provide, one, a benefit to the state because they're not getting the full 100 percent equity of what a company would get, but also maybe for a company that is completely or extremely leveraged have a little bit more coming in from a rate of return that would allow them to get their equity portion to a level that I think everybody would agree in a financial community that would be a little bit more acceptable.

So part of the reason why the Division went forward with the proposal, even though maybe the Commission didn't accept it in rule, is that it was something that was widely accepted by all parties and it gave a level of comfort to companies coming in to know, okay, if we are 100 equity, this is probably what is going to happen is 65/35. So that's why we have adopted it and used it probably since that task force in most of the other cases where it made sense where we either had highly leveraged or a company that was using a high amount of equity to use that hypothetical structure.

Q. Thank you. I would like to ask you a couple followup questions also about the peer group of other telephone companies that you chose as comparable. Could you briefly discuss why you chose the grouping that you did and how you came to, I guess, narrow that group.

A. I think it's pretty clear in my testimony that

I don't -- I mean I'm not completely in love with the capital asset model because there are a couple challenges with it. But the reason where I think it creates value -- and this also comes back to the companies -- is we can at least look at some publicly available information and make a determination with the Commission.

In looking at the companies, unfortunately there is not very much small rural phone company that are available who are publicly traded. So what I tried to do in looking at the companies was to pick those that I felt at least would be serving in similar areas of the United States that could be considered rural. I know that's a very broad definition. But at least maybe they would have some of their services that they're providing that would be similar to what Carbon/Emery would be doing. I recognize that some of them may be in different lines than what Carbon/Emery was. But also what I was trying to do is if I only had two or three companies then the capital asset pricing model and getting an average for the company doesn't work very well because I could pick three outliers and come up with a rate that maybe wouldn't give us a certain level of comfort.

So even though maybe the companies weren't perfect matches for Carbon/Emery, I at least felt that they had some benefit in the fact they gave us data points and were at least offering some type of service that if you stretch the bounds of the definition a little bit could work to get us to a point to where we had a certain number of companies that would be acceptable. And the flip side of that is I've heard both parties who have been pretty unhappy with maybe my list of companies for somewhat valid reasons, but I've never heard anybody suggest other companies that should be included that would make sense. I mean, other than Mr. Meredith did put in AT&T and Verizon and a couple of those other companies, which I purposely excluded because, let's be honest, they're not anywhere close to what Carbon/Emery is doing.

And so if there are other companies that makes sense to include, I would be happy to redo a calculation with that. But I don't know of any of them out there that made sense. So I went off what was available at Yahoo and a few other different resources to try to find companies that were telecommunications companies that were at least serving in areas that may be rural.

Now grant it I don't know Cincinnati and the outlining areas very well, but sometimes to me Kentucky could be considered in my mind at least rural or some of the challenges that Carbon/Emery may be facing. So that's why the list was kind of compiled the way that it was.

Q. Thank you. I would actually like to ask you a

few more questions about that and direct you to page 12 of Exhibit CE-4.0R and looking at lines 324 and 325. This is the revised rebuttal testimony of Douglas Meredith. This is the calculation that he had compiled. I believe he had used the comparable companies that you had chosen and in addition added AT&T and Verizon; is that accurate?

A. Yes. I believe that's what he did with that, yes.

Q. Is it accurate to say that the smallest one on the list of any comparable presented here is the Shenandoah Telecommunications?

A. That would seem to be accurate, yes. As far as looking at the access line that would be the one that would be closet to my understanding what Carbon/Emery would have.

Q. If we were to walk through the calculations that Mr. Meredith did on that company, is it correct to state in column 4 he calculated an unadjusted CAPM of 8 percent?

A. Yes, that's correct.

Q. If we follow that through the debt to equity ratio in fact with Carbon/Emery it would be a zero; is that correct?

A. If I understand the way that he calculated the debt to equity that would be accurate because they are 100 percent equity.

Q. Using the Division's policy of making that adjustment, would that be approximately 0.538, meaning 35 divided by 65?

A. 5.38 would be -- for the debt to equity, yes.

Q. Would that be among the lowest debt to equity ratios of any company on there?

A. Yes, it appears that way.

Q. Just following that through with the zero ratio there, using that 8 percent, that would flow through into the leveraged CAPM actually used by Carbon/Emery? It would ultimately result again in 8 percent?

A. Yes.

Q. And then you would potentially add the 3 percent using his calculation of a small company premium; is that correct?

A. If you were to add a small company premium that he did, yes, the 3 percent would be added on that.

Q. And that would result in 11 percent?

A. Yes, 8 plus 3 is 11.

Q. And that's very similar or close to the 10.75 percent?

A. That is close to what we had, yes.

Q. Just to clarify to make sure this is accurate, in your calculation you did not add a small company premium; is that correct?

A. That is correct.

Q. But you also did not adjust for any reduced risk by having a Utah Universal Service Fund make up the gap?

A. Correct. Basically what I did is I did a straight CAPM calculation, or a textbook calculation to use the words of Mr. Meredith. I looked at the companies, I looked at what would be the beta and then did the math calculation and came up with an average to say this is what we felt the right rate was for Carbon/Emery.

Q. That was the same calculation that you used for Hanksville?

A. Yes.

Q. Same method?

A. Same method, yes.

Q. Do you know how large Hanksville is?

A. I don't know exact numbers, but I know they are a relatively small ILEC. I mean, we're talking less than 100 customers.

Q. In comparison Carbon/Emery is significantly larger?

A. Yes. That could be the AT&T versus Carbon/Emery, could be Carbon/Emery versus Hanksville analysis if you want to look at it that way.

MR. JETTER: That's the conclusion of my

redirect.

HEARING OFFICER: Ms. Slawson, any recross?

MS. SLAWSON: Yes, just a little bit.

RECROSS EXAMINATION

BY MS. SLAWSON:

Q. We were just looking at the table embedded in Mr. Meredith's testimony on page 12, table 2. This is the one that includes Verizon and AT&T. Do you have that in front of you?

A. Yes.

Q. In this table Mr. Meredith was focussing on adjustments that needed to be made to the CAPM model; is that correct?

A. That's what Mr. Meredith testified earlier in the hearing today, and I'll accept that as accurate.

Q. Let's look at your exhibit when you're analyzing that CAPM premium.

A. Okay.

Q. What is the market risk premium that you used?

A. Give me just one second so I can pull that up to make sure I have it accurate. It's Exhibit 3.2?

Q. Yes.

A. Okay. I have one here in front of me. Which area did you want to look at?

Q. The market risk premium that you used.

A. There is actually two different columns there. There is a T-bill CAPM and a 30 year CAPM. I did use the 30 year CAPM, which is looking at the bond. So that's the risk premium that would be in there that came up with the 10.75 percent.

Q. That's the 6.81 percent, correct?

A. Yes.

Q. Mr. Meredith used the T-bond, his rate was 5.01 percent; is that correct?

A. From what he shows on there I believe that is accurate, yes.

Q. Would you need to add the additional market risk premium to Mr. Meredith's numbers?

A. If you want to do that analysis you could.

Q. So I can compare apples to apples, right?

A. Sure.

Q. Mr. Meredith -- you just testified about Mr. Meredith's Shenandoah number and it was 10.66. What is the CAPM rate that you show for Shenandoah?

A. 13.35.

Q. And that's an unadjusted number, correct?

A. Yes.

MS. SLAWSON: I don't have any other questions.

MR. MOORE: No questions, Your Honor.

HEARING OFFICER: All right.

MR. JETTER: I have one followup question.

HEARING OFFICER: It's okay with me as long as there is no objection.

MR. MOORE: No objection.

MS. SLAWSON: I guess I want to hear the question before I insert my objection.

REDIRECT EXAMINATION (continued)

BY MR. JETTER:

Q. My question is just going to ask if the calculation is different between the two Shenandoah based on the beta used for that.

A. Am I okay to respond?

HEARING OFFICER: I think we can hear your response. Go ahead.

THE WITNESS: That kind of gets back to the heart of the capital asset pricing model because what you do is you take the beta and times that by basically a risk free rate -- sorry. You take the beta, you times that by a risk premium and add that on to a risk free rate. So if you look at what I have here for my beta for Shenandoah at the time period of July 29 versus what Mr. Meredith pulled as his beta for Shenandoah, I believe his is just barely below 1, which means it would be a little bit less risky, and I mine is 1.56. That would explain why there would be a significant difference between what he is showing and I'm showing. And I think it also emphasizes the problem if you're trying to look at just one or two companies, the CAPM starts to lose some of its strength and foundation and that's where with my trying to come up with a list of companies that it gets -- where you need enough reference points to come up with a level of comfort.

And that's really what my testimony talked about is with the CAPM is it perfect, no, I don't think so. But it at least gets us to a level of comfort where we think we're getting within the right range of what would be reasonable for the cost of equity for Carbon/Emery. So you can see just in that calculation right there and what we did right here, one company can make a significant difference. So getting enough companies on the list is important as well.

HEARING OFFICER: Ms. Slawson, anything you want to add or pursue?

MS. SLAWSON: One second please.

RECROSS EXAMINATION (continued)

BY MS. SLAWSON:

Q. You testified just now that the difference would be accounted for by the beta; is that correct?

A. I'm saying that's one potential reason why. I can tell you from a CAPM and if you do a straight mathematic if you take a beta times the risk free rate and add all that in there where if -- I have 1.56 as a number and I have .9 as a number, then the end result is going to be different. I have done the calculation here, and I don't know all the reasons why, but off the top of my head that would be a very easy thing to point to as far as why those percentages and rates of return are different.

Q. And another easy thing to point to would be the difference in the market risk premium provided by you and Mr. Meredith?

A. Sure. That would be another element of that as well, yes.

MS. SLAWSON: That's it for me. Thank you.

HEARING OFFICER: Still okay, Mr. Moore?

MR. MOORE: Still okay.

HEARING OFFICER: All right. Mr. Jetter, your next witness.

MR. JETTER: The Division would next like to call Mr. Joseph Hellewell.

(The witness is sworn in.)

DIRECT EXAMINATION

BY MR. JETTER:

Q. Mr. Hellewell, would you please state your name and occupation for the record?

A. My name is Joseph Hellewell. I'm a utility analyst for the Department of Public Utilities.

Q. Thank you. In the course of your employment with the Division of Public Utilities have you had the opportunity to review the application as well as the testimony filed by the applicant in this docket?

A. Yes, I have.

Q. Did you create and cause to be filed with the Public Service Commission direct, rebuttal, surrebuttal, and sur-surrebuttal testimony in this docket?

A. Yes, I have.

Q. Do you have any edits or corrections that you would like to make to your testimony?

A. No, I do not.

Q. If you were asked the questions that are contained in your prefiled written testimony that you filed today would your answers remain the same?

A. Yes, they would.

Q. Thank you. Have you prepared a brief statement summarizing your testimony in this docket?

A. Yes.

Q. Please go ahead.

A. At the time of Carbon/Emery Telecom's application I along with other DUP analysts reviewed the application and conducted our normal audit. During this time we reviewed the depreciation method used by Carbon/Emery Telecom and found it to be distorting annual depreciation expense. At this time an adjustment was made to Carbon/Emery's application based on a single asset straight line depreciation method. In our initial direct testimony we outline reasons why Carbon/Emery's group depreciation method was distorting and suggested alternative methods to remedy this. In addition to this depreciation adjustment we also made adjustments for customer migration and under collection based upon Carbon/Emery's tariff process.

MR. JETTER: Thank you. I have no further questions for Mr. Hellewell and he is available for cross examination.

CROSS EXAMINATION

BY MS. SLAWSON:

Q. Thank you. Good afternoon, Mr. Hellewell. I'll just jump right in. On lines 259 to 269 of your direct testimony you discuss the DPU adjustment for imputed revenue for migration of customers who currently receive their internet service through Carbon's cable affiliates to the new fiber to the home network that is being constructed by Carbon. Do you recall that testimony?

A. Yes, I do.

Q. Mr. Woolsey in his rebuttal testimony on lines 986 to 1017 describes an increase in revenue to Carbon/Emery that results from the migration of cable

internet customers to the fiber to the home network. My question is this, in performing the analysis of the impact per customer per month Mr. Woolsey uses a rate of return of 10.5 percent, which includes the Company's requested rate of return on equity of 12.13 percent. Am I correct in reviewing the Division's testimony that the Division agrees with the methodology employed by Mr. Woolsey, but does not agree with the rate of return used by Mr. Woolsey in his calculation?

A. Yes, I believe so.

Q. And so is it accurate that the Division of Public Utilities is no longer proposing the adjustment amount set forth in lines 259 through 269 of your direct testimony?

A. Yes.

Q. And is it fair to say that except for the rate of return element involved in this calculation this cable migration issue is not an open issue in the case?

A. Yes.

Q. The Division in your testimony has used what you call a single asset straight line method; is that correct?

A. Yes.

Q. And you have provided testimony on that calculation, which results in a depreciation adjustment --

I don't want to go into closed session here, so I'm going to say that adjustment found in column G of the Division of Public Utilities Exhibit 1.2SR. That's the exhibit offered by Mr. Duncan. Does that accurately reflect your depreciation adjustment?

MR. JETTER: May I have a moment to provide my witness with that?

MS. SLAWSON: Sure.

THE WITNESS: Yes, that's accurate.

Q. (By Ms. Slawson) And this reduces Carbon/Emery's depreciation expense for the test year, correct?

A. I'm sorry. Say that one more time.

Q. This adjustment decreases Carbon/Emery's depreciation expense for the test period, correct?

A. Yes.

Q. Is it your testimony that Carbon's reduced depreciation expense will remain constant at that number in 2015 after the test year?

A. Are you saying that Carbon/Emery's depreciation will remain exactly the same for 2014 and 2015?

Q. I'm asking if that's your testimony. Do you think it will remain the same for 2014 and 2015?

A. No.

Q. Do you think that the depreciation expense will

remain constant at the number adjusted in the test year in 2016?

A. No.

Q. 2017?

A. Of course not.

Q. And what about Carbon's rate base over the next few years, is it your testimony that that will remain constant?

A. No.

Q. Do you know what the calculated -- have you calculated the anticipated depreciation expense for Carbon/Emery going forward beyond the test year?

A. We've run projections, but it hasn't ever been entered into testimony.

Q. Do you know what happens with that depreciation expense?

A. From the projections that we have run the depreciation -- well, are you referring to Carbon/Emery's group depreciation method, what happens to the depreciation expense?

Q. Well, actually I'm wondering if you've done the calculation on what Carbon's depreciation expense will be going forward under either method.

A. Well, for the single asset straight line the expense will increase proportionately with what is being added to the rate with what is being capitalized. But under Carbon/Emery's group depreciation the expense is significantly more than it is with the single asset straight line method.

Q. But does it remain constant?

A. Do you mean is there a constant increase?

Q. No. I'm wondering if the test year is representative of the depreciation expense going forward?

A. Well, the -- no, it would not be. Carbon/Emery has provided known and measurable adjustments saying that they anticipate having additional assets capitalized that would increase the depreciation expense accordingly.

Q. I know theoretically it would increase the depreciation expense. But I'm wondering if you have done the calculation to know what the depreciation expense going forward will actually be so that we can identify whether the test year as proposed by Carbon/Emery or as proposed by the Division with its adjustment is representative of the depreciation expense in the future?

A. No. Carbon/Emery chose the test year. So we did calculations based upon the test year that Carbon/Emery has chosen.

Q. And you did not do any calculation to see what that depreciation expense would do after the test year?

A. Not that's been entered into testimony, no.

Q. So whether or not it's been entered into testimony do you know what the depreciation expense does after the test year? If you've performed the calculation do you know what that is?

A. I'm sorry. Say that one more time.

Q. You said you haven't entered that in testimony, but that you have performed the calculation. Is that an accurate reflection of your testimony?

A. Yes, that would be accurate.

Q. Even though it wasn't in previous testimony, I'm asking you what the depreciation expense for Carbon/Emery will be going forward?

A. I don't know the exact number.

Q. Do you have a range?

A. No.

Q. With regard to the depreciation expense you don't have a range and you don't know what the calculation is, can you say whether it's increasing or decreasing?

A. Our calculation show that depreciation expense will continue to increase.

Q. Okay.

A. Under both methods.

Q. It is your testimony that the -- on line 54 of your sur-surrebuttal testimony you indicate that the depreciation method chosen by the company has lasting

effects and must be chosen correctly, correct?

A. Yes.

Q. By way of example you testify that if the depreciation method chosen by the company accelerates depreciation expense it will also accelerate the rate at which accumulated depreciation accrues, thereby accelerating rate base reduction as well, correct?

A. Yes.

Q. You indicate that in prior accounting periods Carbon has reaped the reward of accelerated depreciation, but with that comes the burden of an accelerated accumulated depreciation count. What you see as the consequence or the burden of Carbon/Emery choosing the group method of depreciation is that the group method also accelerates reduction to Carbon/Emery's rate base; is that correct?

A. Yes.

Q. Your testimony is that the Division is permitted to make an adjustment to the depreciation expense going forward, but is not permitted to make an adjustment to the rate base. And I believe you testified that this would conflict with the basic tenant that the utility regulation is prospective, correct?

A. That is not accurate.

Q. Let's look at your testimony there. Starting

on line 54 of your surrebuttal testimony -- I'm sorry. Your sur-surrebuttal testimony.

A. I'm sorry. The first part was where you quoted the testimony that is accurate, however the second part of the question is not accurate.

Q. The second part where I said because it would conflict with the basic tenant that the utility regulation is prospective?

A. Right.

Q. You're saying that's not accurate?

A. Yes. The adjustment that we have proposed is simply an adjustment. We're not proposing that Carbon/Emery change their depreciation method. If the Commission asks Carbon/Emery to change their method then the repercussions of accumulated depreciation would have to be taken into effect on a prospective basis, meaning that we could not go back and change the accumulated depreciation based off the Commission's decision to ask Carbon/Emery to change their depreciation method.

Q. And you testified that the Division's depreciation expense adjustment was simply an adjustment of an unreasonably inflated depreciation expense to a reasonable depreciation expense that better matches the actual diminution of value of Carbon's assets during the test year; is that correct?

A. Yes.

Q. What is the actual diminution of value of Carbon's assets during the test year?

A. We feel that because of the acceleration that occurs naturally with the selection of group depreciation method is that the diminution of the assets occur on an accelerated level. So a different method must be chosen to more accurately reflect the assets diminution.

Q. Okay. I understand that you don't think that the group method selected by Carbon accurately reflects the actual diminution in value. But what I'm asking you is not about the method, I'm asking you what the actual diminution in value of Carbon/Emery's assets were during the test period?

A. Are you asking for the number?

Q. Yes, the number.

A. I don't have the number in front of me.

Q. If you don't know what the actual -- do you have it somewhere?

A. I'm going to read off some numbers or I can just tell you where they appear.

Q. Tell me where they appear and then we'll decide whether they need it to be in the record.

A. Exhibit DPU 1.1D William Duncan.

Q. Let me turn there before we move on. Where on

Exhibit 1.1D?

A.   It would be column F row 12. That is the proposed depreciation expense by Carbon/Emery. Our adjustment is column G row 12. So the diminution would be column I row 12.

Q.   Again, I hate to split hairs here, but you're talking about the depreciation expense, the depreciation. What I'm asking is what those assets -- how they actually diminished in value during the test year. Do you know what that is? Did you go and look at the plant?

A.   We went out and looked at the plant, but I'm not an appraiser so I wouldn't know.

Q.   Did you go out and look at Carbon/Emery's plant in this case?

A.   I don't recall. I don't remember.

Q.   So I guess my question is if you don't know what the actual diminution in value of Carbon's assets were during the test year, how do you know that your method of calculation calculating that depreciation expense better matches the actual diminish in value?

A.   The acceleration that occurs because of the method chosen on paper, given the test samples that we pulled, there is no way that it could diminish that quickly.

Q.   But you don't know what the actual diminish

value is; is that accurate?

A. Correct. Yes, that's accurate.

Q. Let's move on. You've noted that in choosing its depreciation method Carbon made a careful and informed decision to use -- well, you've noted that companies use or make a careful and informed decision on which method of depreciation to use; is that accurate?

A. Yes.

Q. And would it be reasonable to assume that Carbon also made the careful and informed decision to use its methodology for depreciation?

A. Yes.

Q. Is it reasonable -- Carbon/Emery has elected the group method of depreciation, correct?

A. Yes.

Q. And I think you testified just a minute ago that the Division is not recommending that Carbon use a different method of depreciation, you're just recommending that the Commission calculate the UUSF using a different method of depreciation; is that correct?

A. You're asking whether I -- can you restate the question one more time please?

Q. I believe you testified that the Division's position isn't that Carbon/Emery should change its depreciation method; is that correct?

A. Yes.

Q. Yes, that is correct?

A. Yes, that is correct.

Q. But you are recommending that for purposes of calculating the Universal Service distribution or disbursement in this case that the Commission should look at or reach the depreciation expense using a different method of depreciation; is that correct?

A. Whether the Commission uses group depreciation to arrive at what they believe is a correct expense, single asset straight line, vintage, the FCC method, that's entirely up to them. Our recommendation is that, yes, we adjusted the group depreciation expense down to a level that we felt was representative using a method that we have used for multiple companies across the state.

Q. Just so I understand the Division's recommendation, the Division is not suggesting that the single asset depreciation method be applied to assets that are added after the test period, but rather the Division is suggesting that when you looked at the single asset depreciation method you applied it, and I think your language was based upon each capitalized asset having depreciated under a single asset straight line approach since its inception; is that correct?

A. Yes.

Q. We have established here that Carbon/Emery chose the group asset method of depreciation and used that method to calculate what it believed is an accurate depreciation expense, correct?

A. Yes.

Q. And the Division is suggesting that that is not an accurate depreciation expense and that the single asset straight line method should be used, or at least was used by the Division to calculate the depreciation expense, correct?

A. Yes.

Q. So it seems to me that the Division is suggesting or is changing the rules in the middle of the game, effectively eliminating what you call the stable predictable depreciation expense under the group method that Carbon/Emery's management was using for forecasting and planning. Is that not -- are you not doing that?

A. Every single company to my knowledge that I have been involved with that has used group depreciation has had an according adjustment on the straight line method. Whether those cases have been settled in the court or out is up to each individual company, but each of those -- we have consistently applied the single asset straight line approach to companies practicing group depreciation, not because we have any fondness or preference over one depreciation method over another, we just feel that the single asset straight line is the most transparent, the most straightforward, the easiest one to duplicate, and the easiest one to communicate back to the companies.

Q. Okay. In addition to the single asset straight line method of depreciation that the Division uses to calculate the depreciation expense, in your testimony you identify several other methods of depreciation that you indicate would be Commission approved lives and rates and would be reasonable alternatives for calculating Carbon's revenue requirement; is that correct?

A. Yes.

Q. And in particular you identify what you call the FCC method as an acceptable method of calculating depreciation expense. So I want to look at that for a minute. On line 223 of your direct testimony you identify a formula that is used by the FCC to recalculate the depreciation rate based on the plant's remaining life, future net salvage, and depreciation reserve ratio. Did you calculate the depreciation expense for Carbon using the FCC method identified on line 223 of your direct testimony?

A. No, we did not.

Q. As I understand it, the FCC method applies such depreciation rates as will ratably distribute the difference between the net book cost of the plant account

and it's estimated net salvage during the known or estimated remaining service life of the plant; is that correct?

A.   Yes.

Q.   In other words, the FCC method looks at remaining asset lives to ensure that the depreciation rate is reasonable, correct?

A.   Yes.

Q.   And I want you to -- are you familiar with Utah Code 54-7-12.1?

A.   No.

Q.   I'll quote that section for you and you can read it together with Mr. Jetter.

A.   Sure.

Q.   The Commission shall consider all relevant factors including the alteration of asset lives to better reflect changes in the economic life of plants and equipment used to provide telecommunications services. Does that refresh your recollection as to 54-7-12.1?

A.   Okay.

Q.   I believe you referred to this section in your testimony, this section code in your testimony. Do you deny that?

A.   No, I don't deny.

Q.   The single asset straight line method that is

being recommended or that was used by the Division in calculating the depreciation expense in this case applies the consistent depreciation rate across the expected life of the asset, correct?

A.   I'm sorry. Say that one more time.

Q.   So the single asset straight line method applies a consistent depreciation rate across the expected life of an asset, correct?

A.   Yes.

Q.   And that depreciation rate is established at the time that the asset is installed, correct?

A.   Yes.

Q.   Are there factors that could affect the expected life of an asset?

A.   Yes.

Q.   What would those be?

A.   Any kind of substantial repairs, changes to the asset's nature, any kind of change in the conditions in which it was installed.

Q.   Obsolescence of the asset?

A.   Yes.

Q.   End of life, if a piece of equipment as Mr. Johansen has testified is no longer supported by the manufacturer that could reduce the life of the asset?

A.   Yes.

Q. And the single asset straight line method of depreciation doesn't account for these potential issues; is that correct?

A. In the calculation of the expense, no. However, common depreciation practice as implemented by an accountant accounts for these changes as they occur.

Q. How?

A. So if a company asset is all of a sudden struck by lightning then that asset would obviously need to be retired. Then it's removed from the book, it's removed from the asset base, and its corresponding accumulated depreciation is also removed.

Q. But as long as the asset stays in service -- you're talking about an adjustment that is made after the asset is retired from service, correct?

A. Yes.

Q. So doesn't 54-7-12.1 require the Commission to consider the alteration of asset lives to reflect changes in the economic life of plant and equipment?

MR. JETTER: I'm going to object to that to the extent that it calls for a legal conclusion.

HEARING OFFICER: Let's maybe handle it this way. That's what that section says. Are you asking for the Division to explain what it feels it means?

MS. SLAWSON: No. Mr. Hellewell identified this section in his testimony. So I was just asking him to -- Mr. Jetter is right. I've represented what that says so there is no question.

HEARING OFFICER: Okay.

Q. (By Ms. Slawson) You testified that identification of the remaining lives of the asset group on a periodic basis is critical to a properly configured group, correct?

A. Yes.

Q. In fact, on line 126 of your sur-surrebuttal testimony you criticize Carbon's group asset methodology because you state when additions are made to a group no adjustment is made to the depreciable life of the group; is that correct?

A. I'm sorry. Which line again?

Q. Line 126 of your sur-surrebuttal.

A. Yes.

Q. I want to look at that conclusion that you reach and I want to walk you through a depreciation example. It's very simple because I too -- I am a lawyer and not an accountant. So let's say you have an existing group asset that when you put it in service it costs $1,000. Its life in years is 10 years. What would the annual depreciation expense for that group be?

A. $100.

Q. Let's say in year nine you have accumulated depreciation of $900, correct?

A. Yes, under the straight line method.

Q. Under the straight line method, right. And you have a net book value -- well, yes, the group method applying straight line depreciation.

A. Okay.

Q. In year nine if you have accumulated depreciation of $900, what is the net book value of that asset?

A. $100.

Q. And what is the remaining life in years?

A. One year.

Q. Let's say that group has a piece of copper cable in it that stops working. You replace that copper cable for $200. So you add that to the group. At that point the entire value of the group asset when it was placed in service would be $1200, correct, the $1000 original plus the $200 that you have added?

A. Right, that would be the gross book value.

Q. And the life in years would remain the same, the straight line depreciation method would remain a 10 year depreciable life, correct?

A. It depends on what the addition does.

Q. So under group methodology what would the life

in years for that group be?

A. According to Carbon/Emery from what I understand the remaining life would still be one year in which they would depreciate $300 in the remaining year. No, no. Without doing the math it would be $1200 divided by 10. So it would be $120.

Q. Great. In year nine the accumulated depreciation of the group is still $900, correct?

A. Yes.

Q. And in year nine the net book value of the group with the $200 addition is now $300, correct?

A. The net book value is $300 with the addition, yes. It's a complicated example for being a simple one.

Q. How many years will it take to depreciate that remaining net book value using the annual depreciation expense of $120?

A. Roughly two and a half years.

Q. So it's not accurate to say that Carbon/Emery's group method doesn't make any adjustment to the depreciable life of the group, is it? We've just shown that it does add a year and a half to the plant life?

A. In the example you are correct. However, the groups -- when we see Carbon/Emery add things to a group, we don't know if it's a betterment or a repair that's extending the life. All we see is that a new asset is being added to the group. And oftentimes it's a substantial new asset. So we think that an entire new asset, an entire new $1000 asset is being added to the group. We don't know if it's a change or a repair or what. All we see is the capital additions.

Q. So it seems to me -- is it fair to say that your concern is that you're not sure whether Carbon/Emery is actually adjusting the depreciable life of the asset remaining, the actual remaining life of the asset?

A. Right. We see no adjustment on the life of an asset that's being repaired.

Q. That's different from what you just said because initially you said you're not sure if they're doing that. So is your testimony now that they're not doing that?

A. No. My testimony is not that they're not. We do not know.

HEARING OFFICER: The testimony is you see no evidence in the record that Carbon/Emery does adjust the life of an asset that has an addition?

THE WITNESS: Correct.

Q. (By Ms. Slawson) But you will agree that the example that I said was simple and you said turned out to be a little bit complicated shows that under the group method the depreciable life of the asset is increased by a

year and a half under that simple example, correct?

A. Yes. It is a simplified explanation, but yes.

Q. In Mr. Woolsey -- wouldn't the FCC method which specifically requires consideration of the average remaining life more closely align with Utah Code 54-7-12 than the single asset straight line method?

A. Each asset method is the business of the company that chooses it. I feel like each one could be -- as long as it's properly implemented each depreciation method is proper.

Q. But you testified here that one of the kind of sticking points is that the depreciable life should reflect the actual life?

A. Yes.

Q. And 54-7-12 also states, and I'll read it here, that the Commission shall consider all relevant factors including the alteration of asset lives to better reflect changes in the economic life of plant and equipment used to provide telecommunications services, correct?

A. Yes.

Q. And the FCC method also uses the calculation that includes adjusting the average remaining service life of the asset, correct?

A. Of the asset group, yes.

Q. And the single asset straight line method does

not make any adjustments of the asset lives?

A. The single asset approach is done again on a reactionary basis. So as betterments are made to the asset then the CFO or the accountant in charge would make a judgment call to see if that extended the life of the asset or not. It seems the FCC method is doing this as it goes along.

Q. Did the single asset straight line method that the Division used in this case to come up with depreciation expense make adjustments to the remaining asset lives of the asset, the remaining life of the asset? Did you make any adjustments?

A. No.

Q. In Mr. Woolsey's surrebuttal testimony he calculated the depreciation expense using the FCC method. Did you review that testimony?

A. Yes.

Q. And his testimony was filed on December 18, 2015, correct?

A. Yes.

Q. And you indicate in your sur-surrebuttal testimony that given Carbon/Emery's use of a new method at such a late date the Division was unable to fully review and investigate Mr. Woolsey's implementation of this method, correct?

A. Yes.

Q. I'm a little confused by that because in your direct testimony filed on August 21st it was you that identified the FCC method as a reasonable alternative for calculating Carbon's revenue requirement, wasn't it?

A. Yes.

Q. And didn't you have access to all of the data necessary to do the calculation prior to Mr. Woolsey doing the calculation in sur-surrebuttal testimony?

A. Yes.

Q. If you have never performed this calculation how do you know that the FCC method would be a reasonable alternative as you testified to in your direct examination?

A. Because it's a generally accepted depreciation method.

Q. And doesn't is also eliminate issues related to inaccurate depreciation life?

A. It could if done correctly.

Q. Since you haven't done the actual FCC calculation you can't say whether Mr. Woolsey's calculation using the FCC method was performed correctly or incorrectly, can you?

A. I'm not an employee of Carbon/Emery so I didn't do their depreciation for them, no.

Q. But you reviewed his calculation, correct?

A. His FCC method of calculation?
Q. Yes.
A. Not in its entirety, which is what my testimony reflects.
Q. And your testimony is that you couldn't review it in its entirety because you didn't have enough time, or why couldn't you review that in its entirety?
A. Time was definitely a substantial factor.
Q. But you testified that you had all the information you needed, you identified the method in August and you had a month before your sur-surrebuttal testimony was due; is that correct?
A. Yes.
Q. You did state on line 161 of your sur-surrebuttal testimony that Mr. Woolsey failed to include several asset groups, which are not included in the most recent depreciation expense calculation. Do you recall that in your testimony?
A. Yes.
Q. And you identified seven asset groups which you state contain assets and depreciation expense; is that correct?
A. Yes.
Q. And isn't it true, however, that none of those asset groups which you have identified have any remaining

book value to be depreciated?

A.   Under the group depreciation method they do not. However, using single asset straight line they do.

Q.   Right. But we're talking about the FCC method and adjusting, which is a group method, and adjusting for the average remaining life of the asset group, correct?

A.   I did not fully review Mr. Woolsey's FCC calculation, so I do not know.

Q.   So you don't know if it was correct or incorrect?

A.   A cursory glance shows that they're missing.

Q.   But those asset groups have no remaining book value, correct?

A.   I didn't go through every asset group and determine if they have book value or not.

Q.   Would you agree that if the asset groups have no remaining book value then they're not relevant to the FCC method calculation?

A.   That would be correct, except for the fact if a company is trying to persuade somebody to adopt their methodology then it would stand to reason that they would at least show that they themselves looked at the groups.

Q.   But you don't know if he looked at the group or he didn't look at the group, right?

A.   Yes, that's correct.

Q. You testified that the estimated service life is critical to these calculations, correct?

A. Sorry?

Q. Estimated remaining service life is critical to these calculations?

A. To the FCC method, yes.

Q. And you haven't offered any testimony that the service life as determined by Mr. Woolsey in his calculation do not properly represent the remaining service life of Carbon's assets; is that correct?

A. Yes.

Q. I just have a couple more issues here. I want to talk a little bit about the interstate affect that's been identified in the testimony. You haven't performed the depreciation calculation using the FCC method, but you have provided a calculation of the depreciation expense using what you call the single asset straight line method, correct?

A. Yes.

Q. And I believe you provided a calculation using what you call the vintage method of depreciation, correct?

A. Yes.

Q. Upon calculating the depreciation expense adjustments using either of those methods, did you make any adjustment for the interstate revenue associated with that

adjustment?

A. No.

Q. Would you agree that if you change a general expense item on the books of Carbon/Emery there is an interstate impact where the jurisdiction separations of the company -- I don't want to use confidential numbers here -- are divided between interstate and intrastate jurisdictions?

A. Yes.

Q. If you don't consider the interstate revenue impact of the depreciation expense adjustment, then next year if Carbon/Emery takes the lower depreciation expense that you're suggesting and applies the jurisdictional percentage to that adjusted lower number, Carbon/Emery will recover less on the federal interstate side for that adjusted depreciation expense; is that correct?

A. Sure.

Q. And if that happens, then under the total company approach adopted by the Commission Carbon/Emery would be entitled to seek recovery of the revenue shortfall on the interstate side from the state; is that correct?

A. Yes.

Q. One final issue. You identified in your summary testimony that you carefully examined the books and records of Carbon/Emery, correct?

A.   Yes.

Q.   And I've been through your testimony at length and you allude in several places that the UUSF should not be used as an incentive for increase infrastructure investment, but I couldn't find any example where you testified that Carbon/Emery actually did this. Is there anything like that in your testimony?

A.   Your conclusions are your own.

Q.   But you --

A.   My testimony it my testimony.

Q.   But there is nothing in your testimony about them doing that?

A.   No, absolutely not. There is no implication that Carbon/Emery is misusing any of the state USF funds.

MS. SLAWSON: I have no other questions.

HEARING OFFICER: Mr. Moore, you have a very big decision to make. We do need to close today at 5:00. So you can elect to conduct your cross examination of Mr. Hellewell if you have any right now or --

MR. MOORE: I have no questions.

HEARING OFFICER: All right. Mr. Jetter, you have a very big decision to make. You can elect to do redirect now, or depending on how much time you feel like you need and how much energy you have left, I will let you choose to begin with that tomorrow morning.

MR. JETTER: I actually have a fairly brief redirect, so it may be actually easier to press to do it now.

HEARING OFFICER: That's fine. Let's go to it.

REDIRECT EXAMINATION

BY MR. JETTER:

Q. I would like to just walk through a few questions with you on redirect.

A. Sure.

Q. Is it accurate to say that the depreciation number proposed by Carbon/Emery compared to their proposed rate base or the current book value of the assets in service would fully depreciate the entire company's remaining book value in about five years?

A. Yes.

Q. Is that even plausible, that could be the case? Based on --

A. Not unless everything was a computer.

MS. SLAWSON: I'm sorry. I didn't hear what you said.

THE WITNESS: I said not unless everything was a computer and has that asset life.

Q. (By Mr. Jetter) I would like to ask you quickly about the same hypothetical used by Ms. Slawson. In this hypothetical you have a gross book value of initial

asset on year one with a 10 year depreciation rate. Using Carbon/Emery's group method year 10 with no additions that would sum set to a zero annual depreciation; is that correct?

A. Yes.

Q. And let's say hypothetically in year 11 you add another thousand dollar investment that you capitalize in that same group, while the original thousand dollar capital investment remains in service, what would the depreciation be in year 12?

A. $200.

Q. So in fact that second asset now would be depreciating at twice the rate of the first asset even though theoretically they should have the same depreciation rate?

A. That's correct.

Q. And that's because leaving an asset in the group that has lived in that group beyond its service life begins to affect the depreciation of all other assets added later; is that correct?

A. Yes.

Q. And when you looked at the asset groups that Carbon has used, they include significant amounts in dollar value of assets that are beyond the calculated depreciation life?

A. Yes.

Q. And those are driving what we would consider significantly increased rates of depreciation?

A. Yes.

Q. Let me take my hypothetical one step further and let's say we get out to year 20. And now you have $2000 in gross value that is entirely depreciated based on the group method, but they both remain in service. Now let's say in year 21 you add another asset that would be a 10 year depreciable life and let's say its value is $220 to make the math easy. How quickly would that asset, which presumably under the Commission's 10 year depreciation rate or the company's 10 year depreciation rate, how fast would that asset actually be depreciated under the group method?

A. It would be depreciated in one year.

Q. And let's take that hypothetical and use it with straight line depreciation. You add your $1000 asset in year one. Year 10 that would depreciate $100 per year and that would reach zero in year 10; is that correct?

A. Yes.

Q. And now at year 11 add $1000, how would that depreciate over the next 10 years?

A. It would depreciate at $100 for the next 10 years.

Q. Would that be something you would consider

ratably distributing the $1000 capitalization over the 10 year depreciable life?

A. Absolutely.

Q. In the alternative, if you were depreciating that at $200 a year, you're depreciating that entirely over five years. Is it also ratably distributing the value over 10 years?

A. No.

Q. And finally with my hypothetical third investment at year 21, would depreciating the entire asset in one year ratably distribute it over a 10 year service life?

A. No.

MR. JETTER: That is all the redirect I have. Thank you.

HEARING OFFICER: Any recross, Ms. Slawson?

MS. SLAWSON: Yes, I have just a couple.

RECROSS EXAMINATION

BY MS. SLAWSON:

Q. You testified that Carbon's assets will -- if the depreciation expense provided by Carbon in its application is accurate, then Carbon's assets will fully depreciate in five years; is that correct?

A. That's assuming no additions and no increase to depreciation expense.

Q. And in fact Carbon is adding an additional plant, correct?

A. Yes. So a depreciation expense, therefore, should also unreasonably inflate.

Q. Are Carbon's -- one second please. If the company is adding an additional plant, but also making disposals, the statement that you just made would not be accurate; is that correct?

A. Yes. However, Carbon/Emery's disposals do not match in any way their additions. Their additions far exceed the amount at which they're disposing.

Q. Do you believe that Carbon's assets are going to fully depreciate in five years even with the additions?

A. Like I said, the situation was holding that everything stands still. I don't know the calculation, however I do feel very strongly that a depreciation cliff will happen somewhere in the future at which no matter what Carbon/Emery adds it will be depreciated in an unreasonably quick manner.

Q. So I have two issues on that. How far in the future do you think this depreciation cliff will happen?

A. I don't know.

Q. More than three years?

A. Possibly.

Q. More than five years?

A. Again, I don't know.

Q. Do you think it will happen in less than three years?

A. I don't know.

Q. That was my first question. My second question on this -- my second question is this. It seems that the overarching concern about Carbon's group method of depreciation that the Division has is that it does not accurately reflect the average remaining life of the assets in the group; is that correct?

A. Yes.

Q. And isn't it true that the FCC method would address this concern that the Division has?

A. If properly configured, yes.

Q. And by being properly configured you mean if the asset remaining lives are accurately reflected; is that correct?

A. Well, all of the components which go into the calculation using the FCC must be properly configured.

Q. So average remaining life?

A. That's the main sticking point. Because is it average remaining depreciable life, is it average remaining life as it exists in the field. That's the question that needs to be answered.

Q. What does the FCC formula say?

A. Average remaining life.

Q. Wouldn't it make most sense if you're actually trying to figure out when you should retire assets and what the depreciation rate should be, wouldn't it actually make the most sense to figure out what the average remaining life of the asset in the field is?

A. Yes.

Q. Mr. Jetter asked you about a lot of hypothetical examples. If the average remaining life -- wouldn't the FCC method address the concerns that the Division has with those hypotheticals?

A. Yes, in part.

MS. SLAWSON: I have no other questions.

HEARING OFFICER: We are going to adjourn for today. Mr. Jetter, do you have any other witnesses?

MR. JETTER: No, that would be the end of the Division's presentation.

HEARING OFFICER: So Mr. Moore, tomorrow --

MR. MOORE: We have two witnesses.

HEARING OFFICER: -- is all yours.

MR. MOORE: Fine.

HEARING OFFICER: Ms. Slawson, do you need the screen tomorrow?

MS. SLAWSON: I need the screen tomorrow. I didn't need it today.

HEARING OFFICER: Thank you. This room, I believe, will be locked and secured. I'm going to leave all of my things right where they are. So with that I think we can close.

(The hearing adjourned at 5:10 p.m.)

C E R T I F I C A T E

STATE OF UTAH)
:
COUNTY OF SALT LAKE)

I, Melinda J. Andersen, Certified Shorthand Reporter and Notary Public in and for the County of Salt Lake and State of Utah, do hereby certify:

That the foregoing proceedings were taken before me at the time and place herein set forth, and were taken down by me in shorthand and thereafter transcribed into typewritten under my direction and supervision:

That the foregoing 244 pages contain a true and correct transcription of my shorthand notes so taken.

WITNESS MY HAND and official seal at Salt Lake City, Utah this 5th day of February, 2016.

Melinda J. Andersen

My Commission Expires: February 10, 2018

Melinda J. Andersen, C.S.R.

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