

- BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH -

IN THE MATTER OF THE)	DOCKET NO. 11-2180-01
APPLICATION FOR USE)	
ELIGIBILITY FOR ALL WEST)	DPU Exhibit No. 2.0
COMMUNICATIONS INC.		

DIRECT

TESTIMONY

OF

CLAIR OMAN

**DIVISION OF PUBLIC UTILITIES
DEPARTMENT OF COMMERCE
STATE OF UTAH**

October 17, 2011

1 **I. IDENTIFICATION OF WITNESS**

2
3 **Q. PLEASE STATE YOUR NAME, BUSINESS ADDRESS AND**
4 **POSITION WITH THE DIVISION OF PUBLIC UTILITIES.**

5 A. My name is Clair Oman. My business address is Heber M. Wells
6 Building, 160 East 300 South, 4th Floor, Salt Lake City, Utah. I am
7 employed as a Utility Analyst for the State of Utah in the Division of
8 Public Utilities. I am testifying on behalf of the Division of Public
9 Utilities (DPU).

10 **Q. WHAT IS YOUR EDUCATIONAL BACKGROUND?**

11 A. I received a Bachelor of Science degree from Utah State University and
12 am a Licensed CPA in the state of Utah.

13 **Q. BRIEFLY DESCRIBE YOUR EMPLOYMENT EXPERIENCE?**

14 A. I began my career as an accountant for a manufacturing company
15 following which I was employed by small CPA firm as an audit
16 supervisor. My next position was Chief Financial Officer for an ILEC.
17 for ten years. I have been employed by the Division of Public Utilities
18 for five years. I am currently serving on the NARUC sub-committee for
19 Accounting and Finance.

20
21 **Q. HAVE YOU PREVIOUSLY TESTIFIED BEFORE THE UTAH**
22 **PUBLIC SERVICE COMMISSION?**

23 A. Yes, I have testified before the Commission as an expert witness
24 representing the DPU in Dockets 02-2270-01, 07-2419-03, 10-052-01
25 and 08-046-01.

26

27 **II. PURPOSE OF TESTIMONY**

28

29 **Q. PLEASE STATE THE PURPOSE OF YOUR TESTIMONY.**

30 A. The purpose of my testimony is to present the Division of Public
31 Utilities (DPU) basis and methodology of All West Communications
32 Inc. (AWC) depreciation expense amounts filed in this docket and the
33 two issues that remain after settlement negotiations by AWC and the
34 DPU. The first item at issue is the AWC calculation of the routine or
35 periodic depreciation being applied to the current years operations as a
36 representation of the decline in value of the asset or the production
37 capacity lost or used. The second issue being the calculation of the
38 depreciation normalization (known and measurable) amounts that are
39 necessitated by plant being added during the test year period and
40 therefore an adjustment is necessary to bring depreciation to the
41 amount expected in 2011.

42

43 **Q. PLEASE DESCRIBE THE ITEMS OF ISSUE IN THE AWC**
44 **CALCULATION OF THE PERIODIC DEPRECIATION FOR THE**
45 **TEST YEAR ENDING 12-31-2010 THAT BRINGS THIS MATTER**
46 **BEFORE THE COMMISSION.**

47 **A.** AWC is not following the requirements of the Uniform System of
48 Accounts as found at 47 CFR 32 and prescribed for use by companies
49 under the jurisdiction of the Utah Public Service Commission, see
50 R746-340-2(D). The failure of AWC to follow this requirement of 47
51 CFR 32.2000(g)¹ causes an acceleration of the depreciation for the test
52 year and if unresolved by the Commission will cause continued
53 acceleration in future years. The explanation of this acceleration of
54 depreciation is portrayed by Exhibit 2.1. This exhibit is a theoretical
55 portrayal of the effect of the three methods, even though the numbers
56 are from AWC records the numbers do not represent exactly the
57 amounts or balances in the rate case application or settlement
58 conference worksheet. The plant balances represented in this work
59 sheet are actuals from worksheets provided by AWC to the DPU in
60 Data Request 3.2. As is shown on line 11 of Exhibit 2.1 the account

¹ (g) *Depreciation accounting-(1) Computation of depreciation rates.* (i) Unless otherwise provided by the Commission, either through prior approval or upon prescription by the Commission, depreciation percentage rates shall be computed in conformity with a group plan of accounting for depreciation and shall be such that the loss in service value of the property, except for losses excluded under the definition, may be distributed under the straight-line method during the service life of the property. (ii) In the event any composite percentage rate becomes no longer applicable, revised composite percentage rates shall be computed in accordance with paragraph (g)(1)(i) of this section.

61 2212, CO Equipment Digital Switching is fully depreciated as of 12-31-
62 2009. Yet during the January, 2010 time frame [REDACTED] of plant was
63 added to 2212, CO Equipment Digital Switching. For the 2010
64 depreciation calculation purposes the plant balance was [REDACTED]
65 and the annual depreciation calculated by AWC under the current
66 procedures would be approximately [REDACTED]. This accelerated amount
67 of depreciation is a mathematical product of the plant balance
68 multiplied by the current approved depreciation rate of [REDACTED]. The
69 accelerated depreciation amount is the result of the depreciation being
70 calculated on the plant balance that is already fully depreciated. This
71 distorts the depreciation life of the additions, reducing the depreciated
72 life. The additions are being depreciated over [REDACTED] years rather than the
73 [REDACTED] year life approved by the Commission.

74 **Q** **COULD THE 47 CFR PART 32 BE INTERPRETED TO ALLOW**
75 **THIS DEPRECIATION AS ACCEPTABLE?**

76

77 **A.** No. The AWC depreciation approaches do not fully comply with the
78 intent of the Uniform System of Accounts promulgated by the FCC and
79 adopted by the Commission. One requirement of Part 32 is that the
80 depreciation be distributed under the straight line method over the
81 service life of the property. The Commission approved life in this

82 instance is [REDACTED] years and in continuing property record documents
83 provided by AWC to the DPU there are numerous instances where
84 individual plant items remain in service well beyond the estimated life
85 of such plant. These instances indicate the need for a revision of
86 estimated plant lives over the entire plant of AWC in order to prevent
87 distortion of depreciation that is inherent in the group asset
88 depreciation when lives are not reviewed and revised periodically.
89 The intent of 47 CFR 32.2000(g)(1)(ii) is to insure that when the
90 percentage composite rate no longer properly represents the service life
91 of any classification of plant, methods should be determined by the
92 company to revise such rates to properly represent the remaining
93 service life to the company. AWC has not requested nor indicated a
94 change in the service life of any plant with the exception of buried
95 cable-metallic. The DPU is not advocating the abandonment of the
96 group asset accounting concept for depreciation. However the DPU
97 encourages the Commission to be aware that the same pitfalls that are
98 present in the energy utilities are also present in the rate of return
99 regulated telecommunication utilities². Those pitfalls are that the
100 plant lives and composite percentage rates require a periodic review to
101 ensure that depreciation expense is spread appropriately over the life
102 of the property. The FCC has a formula that is used to recalculate the

² AWC is a rate of return regulated telecommunication utility for purposes of receiving USF.

103 depreciation rate based on the plants average remaining life, future
104 net salvage, and depreciation reserve ratio. This formula has been
105 published in several orders. (FCC 00-306, FCC 96-485) From FCC 00-
106 306 “The depreciation rate for an account is a function of the
107 associated plant’s average remaining life, future net salvage, and
108 depreciation reserve ratio. The depreciation rate is calculated using the
109 following formula:

110

111 Depreciation rate = $\frac{100\% - \text{accumulated depreciation \%} - \text{future net salvage \%}}{\text{average remaining life}}$
112
113

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

117 This method is used in DPU Exhibit 2.1 under the section titled FCC
118 Method. This method approximates the method used by the DPU in its
119 adjustment of those plant classifications that are fully depreciated
120 with no changes in the estimated remaining life and with no salvage
121 value. This disparity in depreciation expense calculation indicates the
122 need and urgency for a depreciation study by AWC. The review could
123 be in the form of a requirement by the Commission that the company
124 performs a periodic depreciation study which is submitted for
125 Commission approval.

126 As indicated in 54-7-12.1, “Nevertheless, the commission shall retain
127 the authority to determine the depreciation expense of
128 telecommunications corporations for ratemaking purposes.”

129

130 **Q. WHAT ADDITIONAL AWC PLANT CLASSIFICATIONS ARE**
131 **ALSO FULLY DEPRECIATED?**

132

133 **A.** There are six plant classifications that have balances that are fully
134 depreciated as of 12-31-2009 according to AWC depreciation records.

135 Those plant classifications and the fully depreciated amounts are:


136

Utah


137

2112 Vehicles 


138

2116 Other Work Equipment (large) 


139

2116 Other Work Equipment (small) 

140

2122 Furniture and Office Equip. 

141

2212 CO Equipment Digital Switch 

142

2411 Aerial Cable 

143

Coalville

144

2411 Aerial Cable 

145

There are other classifications of AWC plant that are above 80%

146

depreciated that increases the necessity of a depreciation study.

147

148 **Q. WILL YOU DESCRIBE THE METHOD THE DPU HAS USED TO**
149 **CALCULATE STRAIGHT LINE DEPRECIATION AMOUNTS?**

150 **A.** The method of adjustment that the DPU has applied to bring AWC's
151 depreciation back to a true straight line method over the life approved
152 by the Commission, is to remove the fully depreciated balance from the
153 depreciation calculation. Exhibit 2.1 under the section titled DPU
154 Method provides a worksheet example of the theoretical application of
155 the DPU Method. If the fully depreciated balance is not removed from
156 the depreciation calculation that fully depreciated balance causes the
157 accelerated depreciation on any addition to the balance. There can be
158 no disputing that the plant classification balances have been fully
159 depreciated or the amount that has been fully depreciated because
160 these facts are taken from records provided by AWC. This method
161 provides an accurate method of calculating depreciation only on plant
162 amounts that are not fully depreciated. As noted above this method
163 approximates the FCC rate formula when the remaining life and
164 salvage value remain at the present AWC numbers approved by the
165 Commission. The DPU adjustment to AWC 2010 depreciation is a
166 reduction in the amount of [REDACTED].

167

168 **Q. WHAT ADDITIONAL METHODS ARE AVAILABLE TO BRING**
169 **THE COMPOSITE PERCENTAGE RATES INTO AN**
170 **ACCEPTABLE RANGE?**

171 **A.** An industry accepted method to insure proper composite percentage
172 rates is the Depreciation Study, the Commission has required this
173 method in energy dockets.³ If the DPU method of adjustment is not the
174 method preferred by the Commission, the Commission should order
175 AWC to provide a Depreciation Study for the review of the Commission
176 and use the DPU adjustment method until such time as the
177 Depreciation Study is completed and approved by the Commission.

178

179 **Q. ARE YOU AWARE OF STATES THAT REQUIRE**
180 **DEPRECIATION STUDIES TO VALIDATE DEPRECIATION**
181 **RATES FOR TELECOMMUNICATION COMPANIES?**

182 **A.** In a survey taken by the Public Service Commission of Wisconsin in
183 2008 there were five states that either performed or required periodic
184 depreciation studies for rate of return regulated telecommunication
185 companies. In the majority of telecommunication companies that were
186 under alternative forms of regulation depreciation studies were not
187 required.

³ The Utah Public Service Commission has ordered depreciation studies in Dockets 05-057-T01, 02-057-02 and 07-035-13

188

189 **Q. PLEASE DESCRIBE THE AWC CALCULATION OF**
190 **NORMALIZATION OF DEPRECIATION.**

191 **A.** The AWC calculation incorrectly assumes that a calculation of
192 depreciation on the 12-31-2010 year end plant balance at the approved
193 rate would be the appropriate known and measurable depreciation for
194 calendar year 2011. There were errors in this assumption that
195 overstates the proper amount of depreciation. The first error of this
196 assumption being that this calculation would produce the proper
197 depreciation for the additions to plant throughout the year. This
198 theory when tested did not produce proper results when plant
199 additions and retirements were included in the mix. The other
200 assumption that negated the acceptability of this method was the fully
201 depreciated plant described above. Some plant would have been
202 depreciated beyond the plant balance, or the plant being over
203 depreciated. (The accumulated depreciation balance after the
204 calculation being larger than the plant balance.) When these
205 differences became apparent the DPU determined to calculate the
206 normalizing adjustment using a different approach.

207

208 **Q. WHAT IS THE METHOD THAT THE DPU USED TO**
 209 **CALCULATED THE NORMALIZED DEPRECIATION**
 210 **AMOUNT?**

211 **A.** The DPU used the AWC plant addition amounts provided by AWC
 212 through data request and calculated depreciation on those additions as
 213 if they had been in service the entire year, which approximates the
 214 depreciation that would be accrued during the 2011 calendar year.
 215 Using this method the normalization adjustment is [REDACTED] compared
 216 with AWC normalization adjustment of [REDACTED]. When netted with
 217 the additional depreciation created through a decrease in the life of
 218 buried cable – metallic of [REDACTED] the net normalization adjustment
 219 amount is [REDACTED].

220	DPU calculated normalization adjustment	[REDACTED]
221	AWC calculated normalization adjustment	[REDACTED]
222	Effect of increased depreciation rate Buried Cable-met	[REDACTED]
223	Net downward normalization adjustment	[REDACTED]

224 **Q. DOES THIS CONCLUDE YOUR TESTIMONY?**

225 **A.** Yes it does.

226

227