Witness OCS - 1D Ostrander

BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

In the Matter of Emery Telephone's Application for an Increase in Utah Universal Service Fund Support	)))))))	**Docket No. 15-042-01** **Direct Revenue Requirement Testimony of Bion C. Ostrander For the Office of Consumer Services**

NONCONFIDENTIAL – REDACTED VERSION

August 27, 2015

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INTRODUCTION

Q. WHAT IS YOUR NAME, OCCUPATION AND BUSINESS ADDRESS?

A. My name is Bion C. Ostrander. I am an independent regulatory consultant and have maintained an uninterrupted permit to practice as a Certified Public Accountant ("CPA") in the State of Kansas since 1990.[1] I am President of Ostrander Consulting. My business address is 1121 S.W. Chetopa Trail, Topeka, Kansas 66615-1408.

Q. PLEASE SUMMARIZE YOUR PROFESSIONAL QUALIFICATIONS AND EXPERIENCE.

A. I am an independent regulatory consultant with a specialization in telecommunications regulatory accounting and policy issues. I have over thirty-five years of regulatory and accounting experience. My firm Ostrander Consulting has been operating for twenty-four years. I previously worked for the public accounting firm Deloitte, Haskins and Sells (now "Deloitte"). And before starting my own firm, I previously served as the Chief of Telecommunications and the Chief Auditor for the Kansas Corporation Commission. I have addressed issues in numerous state jurisdictions and an international basis. I have addressed rate cases alternative regulation plans, state universal service funds, affiliate transactions, cost allocation,

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[1] Mr. Ostrander's current permit to practice it pending renewal subject to meeting the continuing professional education hours requirement in Kansas. Mr. Ostrander does not provide any services that "require" a permit to practice, this is maintained primarily for credential purposes.

wholesale and retail cost studies, compensation issues, taxes, universal service, specialized regulatory accounting issues, competition policy, and many other matters.

Q. HAVE YOU PREPARED AN EXHIBIT SUMMARIZING YOUR QUALIFICATIONS AND EXPERIENCE?

A. Yes. I have attached OCS Exhibit 1D-1, which is a summary of my regulatory experience and qualifications.

Q. ON WHOSE BEHALF ARE YOU APPEARING?

A. Ostrander Consulting (and subcontractor David Brevitz) were retained by the Utah Office of Consumer Services ("OCS") to review Emery Telcom[2] (ET", "Emery", or "Company") revenue requirements regarding its application for increased Utah Universal Service Funds ("UUSF"). Accordingly, I am appearing on behalf of the OCS.

Q. HAVE YOU EVER TESTIFED BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH ("COMMISSION" or "PSC")?

A. Yes. I filed direct, rebuttal, and surrebuttal testimony on behalf of the OCS in Manti Telephone Company's request for UUSF in 2012,[3] and appeared

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[2] Emery Telephone (dba Emery Telcom) is a cooperative and is the entity seeking UUSF funds in this case.

[3] In the Matter of the Application for the Increase of Rates and Charges by Manti Telephone Company, Docket No. 08-046-01.

as a witness before this Commission. In addition, I have assisted and advised the OCS in UUSF applications by other rural local exchange companies ("RLECs"), although I did not file testimony or appear as a witness in these other cases which were ultimately resolved through stipulation.[4] A list of other prior UUSF proceedings in which I assisted the OCS is listed below:

- ✓ Manti Telephone Company – Docket No. 08-046-01
- ✓ Manti Telephone Company – Docket No. 13-046-01
- ✓ Hanksville Telephone Company – Docket No. 14-2303-01
- ✓ Beehive Telephone Company – Docket No. 14-051-01
- ✓ Emery Telephone Company – Docket No. 14-042-01

Q. DO YOU HAVE EXHIBITS SUPPORTING YOUR TESTIMONY?

A. Yes. OCS Exhibits 1D-1 through 1D-5 which is attached to this testimony.

Q. WHAT IS THE PURPOSE OF YOUR TESTIMONY?

A. I am addressing policy issues, adjustments, and presenting the overall revenue requirement for Emery as recommended by the OCS for the test period ending December 31, 2014. The overall revenue requirement also includes rate of return ("ROR") testimony and recommendations of David Brevitz, the other expert witness appearing on behalf of the OCS.

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[4] The OCS was not a signatory to the related stipulation in all of these other UUSF cases.

Q. CAN YOU EXPLAIN THE CURRENT AND PROPOSED INCREASE IN UUSF SOUGHT BY EMERY?

A. As a result of the Stipulation in Emery's prior UUSF case,[5] it currently receives annual UUSF revenues of $561,000 ($46,750 per month),[6] and in this proceeding Emery is seeking another $739,293, for a total of $1,300,293 in UUSF revenues.

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

A. Emery's filing shows a revenue requirement of $739,293 and a proposed increase in UUSF revenues of the same amount. The OCS adjustments currently produce a negative revenue requirement (also called excess earnings) of $719,733.[7] Because Emery's excess earnings of $719,733 are $158,733 greater than the amount Emery's current UUSF of $561,000, this means that Emery should not receive any of its requested UUSF of $739,293 or any of its existing UUSF of $561,000. OCS recommends that Emery not receive any UUSF funds, although OCS is not proposing that the

[5] In the Matter of Emery Telephone's Application for Utah Universal Service Fund Support, Docket No. 14-042-01, Order issued February 12, 2015, page 1.

[6] Emery also received a one-time reimbursement for rate case expenses of $30,959.80.

[7] Emery's profits after OCS adjustments are $1,138,200, the required return on rate base for Emery is $418,467, and because adjusted profits are $719,733 greater than the required return this means that Emery still has excess profits and is not due any UUSF.

remaining $158,733 of excess earnings be used for any rate reductions or other actions.

OCS is also aware that the Division of Public Utilities ("DPU") is proposing some additional adjustments which the OCS may support or adopt,[8] and this will produce an even lower revenue requirement or greater revenue surplus (excess earnings).

If the final revenue requirement adopted by the Commission is in the range of $0 to $739,578, then Emery will continue receiving all of its current UUSF of $561,000, plus any additional amount approved in the range of $0 to $739,578. If the Commission adopts a negative revenue requirement (excess profits) of $561,000 or more, this means that Emery is not justified in receiving any of its current UUSF revenues of $561,000 or the additional requested UUSF of $739,293.

Q. WHAT ADJUSTMENTS ARE YOU PROPOSING?

A. Below is a list of adjustments that I am supporting:

Adjustment BCO-1: Allocate Fiber/Internet-Related Common Costs from Emery to Emery Telecom Video, LLC ("ETV")/Nonregulated Affiliates

Adjustment BCO-2: Allocate Corporate Overhead Expenses from Emery to ETV/Nonregulated Affiliates

Adjustment BCO-3: Deduct Customer Deposits from Rate Base

[8] In order to be more efficient, the OCS will not sponsor testimony which duplicates some of the adjustments of DPU, and we will support some of those adjustments.

Adjustment BCO-4: Remove Prepayments from Rate Base

Adjustment BCO-5: Deduct Long-Term Liabilities from Rate Base

Adjustment BCO-6: Remove 50% of telephone plant under construction (TPUC) from Rate Base

Adjustment BCO-7: Remove 50% of materials & supplies ("M&S") from Rate Base

Adjustment BCO-8: Reverse Emery's Projected Access Line Reduction

Adjustment BCO-9: Remove Depreciation on Fully Depreciated Assets

Q. PLEASE SUMMARIZE THE OCS' FINAL POSITION.

A. After making the adjustments above and adjustments from Mr. Brevitz, the OCS' final position shows a significant negative revenue requirement (or excess profits) for Emery, and this means that Emery should not receive either the additional annual UUSF of $739,293 that it seeks in this proceeding nor its existing annual UUSF of $561,000. The primary reason for Emery's excess earnings,[9] (and which reduces the revenue requirement by **[Begin Confidential]** [redacted] **[End Confidential]**) is the Company's excessive allocation of both common internet/fiber plant facilities and corporate overhead expenses to Emery (and regulated operations in total) and the corresponding understatement of such costs to ETV and other nonregulated affiliates. Emery's cost allocation procedures are not

[9] This consists of OCS proposed Adjustments BCO-1 and BCO-2.

consistent with regulatory best practices and safeguards which are intended to help insure that a regulated telecom company does not subsidize the operations of its nonregulated affiliates. These regulatory best practices include compliance with Section 254(k) of the Federal Telecom Act, Utah Code 54-8b-6, FCC Part 32 Affiliate Transaction Rules, and FCC Part 64 Cost Allocation Procedures.

Per Adjustment BCO-1, Emery has significant fiber/internet-related facilities on its books that are used by ETV and the other nonregulated affiliates to provide retail internet and other nonregulated services to their customers, yet Emery is not properly reimbursed by affiliates (or in the alternative, there is not proper allocation of these costs from Emery to the nonregulated affiliates). Also, from a fairness standpoint, nonregulated affiliates should not be allowed to use the fiber facilities of Emery for free because it is unlikely that Emery would receive reciprocal treatment and be able to use these same facilities for free if they were transferred to the books of nonregulated affiliates.

Per Adjustment BCO-2, the Company substantially overstates the amount of corporate overhead expenses allocated to Emery Telephone (and regulated LECs). The Company has allocated corporate overhead expenses **[Begin Confidential]** [redacted] **[End Confidential]** to regulated operations and **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated; and, the OCS adjustment corrects this allocation to some degree and allocates **[Begin Confidential]** [redacted] **[End Confidential]** to regulated operations and **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated operations. The Company uses the **[Begin Confidential]** [redacted] **[End Confidential]** to allocate **[Begin Confidential]** [redacted] **[End Confidential]** of expenses to regulated operations for the related departments of **[Begin Confidential]** [redacted]. **[End Confidential]** However, the [**Begin Confidential]** [redacted] **[End Confidential]** is not related to how personnel in these departments spend their time on regulated and nonregulated operations. There is no direct or cost-causative[10] basis for this factor. Instead, I have used a 50/50 split of these costs between regulated and nonregulated operations. In fact, Total Revenues and Total Expenses are two financial statistics that support an approximate **[Begin Confidential]** [redacted] **[End Confidential]** of regulated and nonregulated costs, yet the Company does not even use these inputs in any of their allocation factors.

OCS also proposes a significant adjustment to remove and amortize some depreciation expense on fully depreciated assets. In addition, there are

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[10] FCC Part 64 supports a direct or cost-causative basis for cost allocations.

several other adjustments to correct Emery's improper inclusion or exclusion of certain amounts from rate base.

The adjustments proposed by OCS are reasonable and supports the Office's recommendation that no UUSF support is required for Emery.

Q. DO UUSF PROCEEDINGS WARRANT RIGOROUS ANALYSIS AND OVERSIGHT?

A. Yes. A telco should be required to meet a rigorous standard in a UUSF proceeding because it is seeking "public" funds from a UUSF that is funded by a significant number of citizens from all over Utah that do not get any direct or measurable benefit from the telco or its related services because they are served by other communication companies.[11] A further concern is that these consumers are being asked to fund service and capacity which they themselves cannot receive, i.e., FTTH. The broader expanse of citizens that are contributing to the UUSF (but receiving no direct benefit from the rural telcos receiving UUSF funding) at least deserve the benefit of a rigorous review of the telcos that are seeking public UUSF funds.

Q. HOW ARE COOPERATIVES DIFFERENT FROM NON-COOPERATIVE TELCOS SEEKING UUSF FUNDING?

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[11] Other communication companies may mean other telco, cable, broadband/internet, and other entities.

A. There is a difference in negative impacts and benefits as it relates to telco cooperatives like Emery, as compared to other telcos (non-cooperatives) in UUSF proceedings. In a rate case, there is a balancing act in play for Cooperative members, because the members may incur the negative impact of a rate increase but they will also receive the benefit of increased capital credit payments in the future due to the increased profitability provided by the same rate increase.[12] However, in a UUSF proceeding, there is little or no offsetting downside for cooperative members, there is only a reward. This is because cooperative members do not face the downside of potential rate increases with a UUSF proceeding,[13] but they receive the upside of increased capital credit payments stemming from increased profits produced by the additional UUUF revenues. Thus, cooperative members are more incented to support a UUSF proceeding of their cooperative, even if there are legitimate concerns of the members with cross-subsidization via inadequate allocation of common and other costs to nonregulated affiliates, along with substantive general and administrative expenses.

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[12] Capital credits are paid out of the historical profits (or "retained earnings") that are of the Company, the greater the profit, then the greater the potential capital credits to be paid to members over time.

[13] This assumes that the telco elects to receive UUSF for all of its revenue deficiency and not increase its customer rates, which has been the circumstance in all recent UUSF proceedings.

Q. WILL YOU DESCRIBE THE SERVICES PROVIDED BY EMERY AND ITS AFFILIATES?

A. Yes. The consolidated operations of Emery Telcom[14] consist of three regulated LECs (providing what is mostly traditional regulated services) and three nonregulated affiliates (providing nonregulated services) as shown below:

<u>Regulated:</u>

Emery Telephone (dba Emery Telcom) – provides basic local service via copper and fiber facilities to end users, access to long distance, and DSL/fiber wholesale services to ET&V.

Carbon Emery Telephone - provides basic local service via copper and fiber facilities to end users, access to long distance, and DSL/fiber wholesale services to ET&V.

Hanksville Telephone – provides basic local service, access to long distance, and other services.

<u>Nonregulated:</u>

Emery Telecommunications & Video, Inc. (ET&V) – Provides fiber transport services, ISP to fiber broadband and copper DSL customers, end user circuits and constructed facilities outside of existing regulated exchange area boundaries, VOIP phone service, retail sales, computer repair and maintenance, key systems, CPE and voicemail.

Emery Telecom Video, LLC (ETV LLC) - Provides cable internet, cable TV, cable, and advertising services through the operation of a local newspaper, news website, and local TV content.

Emery Telcom Long Distance (ETLC) – Provides intrastate and interstate long distance service.

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[14] Technically, Emery Telcom, Inc.(the Holding Company), is the holding company for the taxable operating companies in the group which include all affiliates except the cooperative of Emery Telcom. Regardless, all of the taxable and non-taxable companies are affiliates that share significant common costs.

OCS PROPOSED ADJUSTMENTS

Q. ARE YOU ADDRESSING ADJUSTMENTS RELATED TO ALLOCATION OF COSTS BETWEEN EMERY AND ITS AFFILIATES, AND WHAT REGULATORY BEST PRACTICES ARE YOU RELYING UPON IN THIS REGARD?

A. Yes, I am proposing two significant adjustments to address two types of allocation problems between Emery and its nonregulated affiliates that cause Emery's regulated costs to be overstated and the nonregulated affiliate costs to be understated (and Mr. Brevitz is also providing economic support for these adjustments) as shown below:

1) Adjustment BCO-1 - Adjust and allocate fiber/internet-related common costs (including related fixed assets and plant/operations related expenses) from Emery to ETV/nonregulated affiliates for use of Emery's plant to provide internet service to its retail customers.

2) Adjustment BCO-1 - Allocate additional corporate overhead/common expenses from Emery to nonregulated operations.

The underlying justification for my allocation adjustments is supported by regulatory best practices and guiding principles that are summarized below, all of which are intended to promote competition, prevent a regulated company (or regulated line of business) from "cross-subsidizing" a nonregulated company (or nonregulated line of business), and promote universal service.

1) Part 47, Section 254(k) of the Federal Telecom Act of 1996.[15]

2) Utah Statutes 54-8b-6.

3) The Federal Communications Commission's ("FCC") Uniform System of Accounts ("USoA") Part 32 Affiliate Transaction Rules.

4) The FCC's Part 64 Allocation of Costs and Cost Allocation Manual.

Q. DOES SECTION 254(K) OF THE 1996 FEDERAL TELECOM ACT ("FTA") PROTECT AGAINST CROSS-SUBSIDIZATION AND PROMOTE COMPETITION?

A. Yes, both the FCC's 1997 order that codified Section 254(k) of the FTA (Code of Federal Regulation – Title 47) and actual Section 254(k) of the FTA are addressed below:

The opening paragraph of the FCC's 1997 order that codified Section 254(k) of the FTA in its Part 64 rules states:

> In conjunction with its overarching goal of promoting competition in the telecommunications industry, the 1996 Act specifically prohibits telecommunications carriers from subsidizing competitive services with services that are not.[16]

In addition, Section 254(k) of the FTA states:

> A telecommunications carrier may not use services that are not competitive to subsidize services that are subject to competition. The Commission, with respect to interstate services, and the States, with respect to intrastate services,

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[15] Telecommunications Act of 1996, Pub. L. No. 104-104, 110 Stat. 56 (1996) (1996 Act), amending the Communications Act of 1934 (the Act). 47 U.S.C. § 254(k).
[16] Before the FCC, *In the Matter of Implementation of Section 254(k) of the Communications Act of 1934, as Amended*. Order Adopted May 8, 1997 and released May 8, 1997.

> shall establish any necessary cost allocation rules, accounting safeguards, and guidelines to ensure that service included in the definition of universal service bear no more than a reasonable share of the joint and common costs of facilities used to provide those services.[17]

Section 254(k) makes it very clear that the Utah Commission has the regulatory jurisdiction and discretion to make decisions regarding cost allocation and related safeguards to prevent Emery from subsidizing its nonregulated affiliates for the specific kinds of allocation concerns and related adjustments that I am addressing in this proceeding - - both of which relate to "common costs"[18] used to provide services to both the regulated operations of Emery and to the nonregulated affiliates.

Q. DOES UTAH LAW ALSO PROTECT AGAINST CROSS-SUBSIDIZATION?

A. Yes, Utah Code 54-8b-6 is essentially consistent with the Section 254(k) and under the section titled "Prohibition on subsidization of telecommunications services" it states that subsidization is prohibited both directions, the regulated intrastate services cannot subsidize nonregulated intrastate services (exempted from regulation) and nonregulated intrastate services cannot subsidize intrastate regulated services as indicated below:

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[17] 47 U.S.C. § 254 – Universal Service.

[18] The "common costs" relate to my adjustments addressing the allocation of fiber/internet-related common assets and expenses in Adjustment BCO-1 and allocation of corporate overhead expenses in Adjustment BCO-2.

> A telecommunications corporation providing intrastate public telecommunications services may not subsidize its intrastate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract under authority of this chapter with proceeds from its other intrastate telecommunications services not so exempted or made subject to a price list or competitive contract. Similarly, proceeds from intrastate telecommunications services which are exempted from regulation or offered pursuant to a price list or competitive contract as authorized by this chapter may not subsidize other intrastate telecommunications services not so exempted or made subject to a price list or competitive contract.

Q. CAN YOU EXPLAIN THE FCC'S PART 32 AFFILIATE TRANSACTION RULES THAT HELP PREVENT REGULATED CARRIERS FROM SUBSIDIZING THEIR NONREGULATED AFFILIATES?

A. The purpose of the FCC's USoA Part 32 Affiliate Transaction rules ("FCC § 32.27") is to protect the customers of regulated carriers from manipulative or improper practices between the regulated carrier[19] and its nonregulated affiliates. These Affiliate Transaction rules are intended to keep nonregulated affiliates from improperly shifting their costs to regulated carriers and gaming the system to recover these costs via the regulatory process in either a rate case or universal service fund proceeding. These Affiliate Transaction rules also keep nonregulated affiliates from shifting

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[19] I use the term "regulated" carrier, but this is intended to refer to the incumbent local exchange carrier that has historically provided regulated basic local service (although some or all of these local services may be subject to some form of price or other deregulation in various states). Although I use the term "regulated" carrier for simplicity purposes, technically it is the specific <u>services</u> of a carrier that are either regulated or nonregulated in part.

their costs to regulated carriers to subsidize their competitive operations, reduce their retail prices, and gain an unfair economic advantage over their competitors that do not or cannot subsidize their operations.

In summary, these rules primarily require the regulated company like Emery to record the effect of transactions with its affiliates at the higher of cost or fair market value (for services/assets sold or transferred "to" an affiliate) or at the lower of cost or fair market value (for services/assets purchased or transferred "from" an affiliate).

Q. PLEASE EXPLAIN THE FCC'S PART 64 ALLOCATION OF COST RULES THAT HELP PREVENT REGULATED CARRIERS FROM SUBSIDIZING THEIR NONREGULATED AFFILIATES?

A. The FCC's Part 64 Allocation of Costs and Cost Allocation Manual ("FCC § 64.901 - .904") requires carriers to separate their regulated costs from nonregulated costs and use the attributable cost method, whereby costs shall be directly assigned to either regulated or nonregulated activities as a first priority. Costs that cannot be directly assigned are called "common costs" and are grouped in homogenous cost categories (or "cost pools") to facilitate allocation based on direct analysis of the purpose for which the cost was incurred or based on a cost-causative link.[20]

[20] Emery's original Application was not compliant in providing proper supporting documentation for its Part 64 Cost Allocation Manual, and the OCS requested this underlying supporting documentation via various data requests.

Q. HAS EMERY (AND ITS NONREGULATED AFFILIATES) PROPERLY IMPLEMENTED THESE AFFILIATE TRANSACTION BEST PRACTICES AND RELATED SAFEGUARDS?

A. No, that is why I am proposing two significant cost allocation adjustments, and I will explain how the Company's implementation of the cost allocations is problematic when I address those specific adjustments in this testimony. Both of the cost allocation adjustments that I am addressing are related to "joint and/or common costs" that are shared and allocated between Emery, Carbon, Hanksville, and the three nonregulated affiliates. Section 254(k) of the FTA requires that local service[21] of regulated LECs bear no more than a reasonable share of joint and common costs. In this case, Emery's costs include an excessive amount of joint and common costs that should be removed via allocation from Emery's costs in this proceeding.

Q. REGARDING YOUR TWO COST ALLOCATION ADJUSTMENTS, ARE YOU RECOMMENDING THAT NONREGULATED AFFILIATES BE REQUIRED TO RECORD THESE COMMON COSTS ON THEIR BOOKS OR ADJUST THEIR RETAIL INTERNET RATES?

A. I am only recommending that these common costs be adjusted and removed from Emery's "regulated" costs in this filing via typical rate case

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[21] The FTA actually refers to all services in the "Universal Service" category, which is primarily basic local service for Emery and the LECs.

type adjustments, and I am not recommending that these common costs be placed on the books of the nonregulated affiliates or that any retail rates be adjusted.

Adjustment BCO-1: ALLOCATE FIBER/INTERNET-RELATED COMMON COSTS FROM EMERY TO NONREGULATED OPERATIONS

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT BCO-1?

A. Emery has not properly allocated fiber/internet-related common costs from its regulated operations to nonregulated affiliates providing internet/broadband operations. Therefore, I have allocated and removed 50% of the "intrastate" only portion of these common fiber costs from Emery's regulated operations, and I am proposing two possible adjustment options for allocating these costs.

Option 1 removes 50% of the "intrastate" common switching, along with cable and wire facility ("C&WF") plant costs and related expenses, and this has an impact of reducing the revenue requirement by **[Begin Confidential]** [redacted]. **[End Confidential]**

Option 2 removes 50% of the "intrastate" fiber-related C&WF common plant costs and related expenses, and this has an impact of reducing the revenue requirement by **[Begin Confidential]** [redacted]. **[End Confidential]** I am only removing the "intrastate" portion of plant and expense common costs, which makes my adjustment conservative.

Q. WHY IT IS NECESSARY TO ALLOCATE AND REMOVE A REASONABLE PORTION OF INTRASTATE FIBER/INTERNET-RELATED COMMON COSTS FROM EMERY'S REGULATED OPERATIONS?

A. It is necessary to allocate a reasonable portion of fiber/internet-related common costs from Emery's regulated operations to the nonregulated affiliate operations providing retail internet/broadband services to be compliant with both Part 32 Affiliate Transaction rules (allocate the higher of cost or market related costs to affiliates sharing in the costs) and Part 64 (properly allocate common costs between regulated and nonregulated operations). Significant fiber/internet-related common costs are being recorded on Emery's books, and these same assets are being used to provide both basic local service on Emery's books (regulated service) and internet service (nonregulated service) on ETV/nonregulated affiliate books.

These significant fiber/internet-related common costs that are recorded on the books of Emery are not generating any "new" revenues for Emery's basic local service customers, they continue to get essentially the same basic local services[22] as they had with copper facilities at the same rates.

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[22] Although the basic local service can provide better service quality.

However, customers of ETV/nonregulated affiliates benefit significantly from these same fiber/internet-related common costs on Emery's books, because they get faster internet,[23] internet TV, and other expanded services. Emery admits that **[Begin Confidential]** [redacted] **[End Confidential]**.[24] Therefore, a reasonable portion of these fiber/internet-related common costs on the books of Emery should be allocated to ETV/nonregulated affiliates (or ETV/nonregulated affiliates should reimburse Emery for a reasonable portion of these costs).

Q. WHAT PORTION OF EMERY'S INTRASTATE FIBER/INTERNET RELATED COMMON COSTS HAS EMERY ALLOCATED TO ITS NONREGULATED AFFILIATES?

A. ETV does not reimburse Emery for any "intrastate" common fiber costs (and Emery does not allocate any of these costs to ETV). ETV only reimburses Emery a relatively small amount of **[Begin Confidential]** [redacted] **[End Confidential]** that is related to **[Begin Confidential]**[redacted]) **[End Confidential]** in the Part 69 cost study (Emery refers to this as "wholesale" DSL/internet service), and which is used in part by ETV to

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[23] Internet service that is faster than any previous internet service provided via copper-based DSL service.
[24] See OCS Exhibit 1D-3, Emery's response to OCS 2-32.

provide its Internet service **[Begin Confidential]** [redacted]. **[End Confidential]**

Q. EXPLAIN WHY EMERY'S INTRASTATE FIBER/INTERNET-RELATED COMMON COSTS SHOULD NOT BE PROVIDED FREE TO ITS NONREGULATED AFFILIATES?

A. It is not reasonable that ETV/nonregulated affiliates get free use and benefit of Emery's significant "intrastate" investment in fiber/internet-related common costs on its books, especially without so much as even a contract to establish reasonable terms, conditions, and prices as would be necessary with a third-party user of these assets. This transaction does not approximate or resemble a third-party or independent transaction because no <u>intrastate</u> fiber/internet-related common costs are allocated to ETV/nonregulated affiliates.

Q. WOULD EMERY MAKE ITS FIBER/INTERNET-RELATED COMMON COSTS AVAILABLE TO THIRD-PARTIES FOR FREE?

A. I do not believe that Emery would make these same significant and valuable fiber/internet-related common costs available to another third-party for free and without any contractual terms or conditions as it does with its nonregulated affiliate ETV. If Emery was acting in an arms-length manner, it would require reasonable payment from ETV/nonregulated affiliates for the use of these valuable common fiber facilities. It is my understanding that Emery does not have a tariff on file for these same common fiber facilities, and this may be one way in which Emery avoids any exposure of providing notice and availability of these same facilities to third-party vendors at the same free arrangement that ETV/nonregulated affiliates obtain.

Q. IS THERE AN ECONOMIC BASIS FOR CONCERN WITH NONREGULATED AFFILIATES FREE USE OF EMERY'S INTRASTATE FIBER/INTERNET-RELATED ASSETS?

A. Yes. Mr. Brevitz addresses the "alternative cost avoidance" approach and other principles in regards to jointly used facilities.[25]

Q. IF ETV/NONREGULATED AFFILIATES AVOID PAYING FOR THE FIBER/INTERNET-RELATED COMMON COSTS, THEN SHOULD THIS SAME OPTION BE AVAILABLE TO EMERY?

A. This is a basic fairness issue. If it is fair for ETV to avoid paying for Emery's intrastate fiber/internet-related common costs, then it should also be fair to transfer these same common assets to the books of ETV and let Emery enjoy the use of these common assets for free. I know this example is hypothetical, but a fairness and common sense standard should prevail on such issues. There is no logical reason why the interests of a nonregulated

[25] David Brevitz Direct Testimony, pages 18-26.

affiliate should be favored over the interests of a regulated affiliate, unless the primary incentive is for the regulated entity to subsidize the operations of the nonregulated entity. As I previously indicated, because ETV gets more value in terms of long-term revenue growth with its internet service (versus Emery's stagnant local revenues despite significant FTTH and other fiber investment), this means that ETV should bear a larger proportion of such common fiber costs - - or should at least bear 50% of these costs at the very minimum.

Q. DOES ETV PAY EMERY FOR ANY INTERNET RELATED COSTS?

A. The cost allocation amounts in the table below shows the **[Begin Confidential]** [redacted] **[End Confidential]** "revenue requirement" based payment from ETV to Emery is based upon the cost of **[Begin Confidential]** [redacted] [redacted]) **[End Confidential]** of **[Begin Confidential]** [redacted] **[End Confidential]** and related interstate expenses of **[Begin Confidential]** [redacted] **[End Confidential]**.

In addition, the table shows the two options that I recommend. Option 1 removes 50% of the "intrastate" only common plant costs[26] **[Begin Confidential]** [redacted] **[End Confidential]** from rate base and removes

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[26] These plant costs include switching and other outside plant common cost facilities that would be necessary for utilization of the fiber-related cable and wire facility costs, although this does not include any "support" assets such as land, buildings, vehicles, etc.

50% of related intrastate outside plant and depreciation expenses on these same plant costs **[Begin Confidential]** [redacted] **[End Confidential]**, and this has an impact of reducing the revenue requirement by **[Begin Confidential]** [redacted] **[End Confidential]**. Option 2 reduce removes 50% of the "intrastate" fiber-related cable and wire facility ("C&WF") common plant costs **[Begin Confidential]** [redacted] **[End Confidential]** from rate base and removes 50% of related intrastate C&WF and depreciation expenses on these same plant costs **[Begin Confidential]** [redacted], **[End Confidential]** and this has an impact of reducing the revenue requirement by **[Begin Confidential]** [redacted]. **[End Confidential]**

Table BCO-1: Allocation of Fiber Common Costs:

[Begin Confidential]

Allocation of Common Costs	Emery Method Interstate	OCS Option 1 Intrastate	OCS Option 2 Intrastate
Common assets to be allocated	[redacted]	[redacted]	[redacted]
ROR (11.25% Company/8.45% OCS)	[redacted]	[redacted]	[redacted]
Return	[redacted]	[redacted]	[redacted]
Common expenses to be allocated	[redacted]	[redacted]	[redacted]
Revenue requirement before TIC	[redacted]	[redacted]	[redacted]
Interstate TIC	[redacted]	[redacted]	[redacted]
Revenue Requirement	[redacted]	[redacted]	[redacted]
50% Allocator - Emery & Nonreg.	[redacted]	[redacted]	[redacted]
Revenue requirement (payment method)	[redacted]	[redacted]	[redacted]
	[redacted]		[redacted]
Assets (allocation method)	[redacted]	[redacted]	[redacted]
Allocator	[redacted]	[redacted]	[redacted]
Assets allocated 50/50 - Emery & Nonreg.	[redacted]	[redacted]	[redacted]
	[redacted]	[redacted]	[redacted]
Expenses (allocation method)	[redacted]	[redacted]	[redacted]
Allocator	[redacted]	[redacted]	[redacted]

Expenses allocated 50/50 - Emery & Nonreg.	[redacted]	[redacted]	[redacted]

[End Confidential]

Q. HOW DID YOU DETERMINE THE INTRASTATE AMOUNT OF INTERNET/FIBER-RELATED COMMON COSTS (FROM EMERY'S BOOKS) THAT IS INCLUDED IN BOTH OPTION 1 AND 2 OF YOUR PROPOSED ADJUSTMENTS?

A. I relied on information from Emery's books and Part 36 and 69 cost studies. However, I note that Emery could not reconcile amounts from its financial records to its cost studies[27] so it is possible that there are problems with the cost study data that I relied upon.

Q. WHY IS IT REASONABLE TO ALLOCATE 50% OF INTERNET/FIBER-RELATED COMMON COSTS TO BOTH EMERY AND ETV/AFFILIATE OPERATIONS?

A. The 50/50 sharing of these common costs is very reasonable and conservative for the following reasons:

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[27] For example, OCS 2-16(d) and 3-19(a) asked Emery to reconcile the amount of its 2013 and 2014 interstate DSL/internet costs in its Part 69 cost study (the support for ETV's payment of **[Begin Confidential]** [redacted] **[End Confidential]** to Emery) to the specific account balances on its financial statements. Emery stated that it **[Begin Confidential]** [redacted]. **[End Confidential]** (See OCS Exhibits 1D-3 and 1D-5 for data request responses.)

1) ETV receives a significantly disproportional benefit by having these fiber/internet common costs recorded on the books of Emery instead of the books of ETV. For example, even with all of these fiber/internet-related common costs recorded on the books of Emery (and even when additional FTTH costs are recorded on Emery's books in the future), Emery will still generate about the same annual regulated local revenues of [**Begin Confidential]** [redacted] **[End Confidential]**[28] as it generates today because the fiber will not generate any significant new services for Emery local service customers, and the related local rates will also stay the same and not generate new revenues. However, with the assistance of these common fiber costs on Emery's books, ETV is generating at least **[Begin Confidential]** [redacted] **[End Confidential]**[29] in internet related revenues in 2014. I understand that ETV also has significant fiber assets on its books that assist in generating these revenues. Thus, while Emery's local revenues will stay relatively flat as more fiber costs are put on Emery's books, ETV will reap the continued benefit of increased internet revenues and this is not reasonable without a proper allocation of these common fiber costs to ETV's books.

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[28] Emery 2014 Annual Report, Local Network Service Revenues of **[Begin Confidential]** [redacted]. **[End Confidential]**

[29] There is 2014 fiber and internet revenues of **[Begin Confidential]** [redacted] **[End Confidential]** on ETV's books) per ETV's income statement provided in response to OCS 3-13(a). (See OCS Exhibit 1D-5.)

2) Mr. Brevitz's testimony explains that up to 95% of the fiber common costs on Emery's books could be allocated to ETV (and only a 5% allocation to Emery's books) if relative capacity use of the fiber was used as an allocator.[30] Thus, the 50% allocation of fiber common costs to ETV is very reasonable when the allocator could be as high as 95%.

3) Both Option 1 and 2 of my proposed allocation adjustments only allocate a portion of Emery's "intrastate" fiber/internet-related common costs to ETV, and do not allocate any interstate costs. All or most of the interstate revenue requirement should be recovered from federal ICLS support, the EUCL, and other revenue sources - - so I did not allocate any additional interstate fiber common costs to ETV.

Q. WHAT IS THE PROBLEM WITH USING ONLY EMERY'S [Begin Confidential] [redacted] **[End Confidential] AS THE PROPER COST ALLOCATION METHOD (OR PROPER REVENUE REIMBURSEMENT AMOUNT)?**

A. This underlying method is not consistent with cost allocation best practices, because it does not represent proper amounts to be allocated under Part 32 Affiliate Transaction rules (it is not the higher of cost or market) or Part 64 (it only allocates some **[Begin Confidential]** [redacted]

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[30] David Brevitz Direct Testimony, page 23.

[redacted] **[End Confidential]**, and not allocate any intrastate common fiber costs). Emery's approach is primarily based on the prior method it used for the settlements process when it previously participated[31] in the National Exchange Carrier's Association ("NECA") DSL/broadband pool process with other NECA carriers. Under that process, Emery's interstate Part 69 wholesale DSL/internet revenue requirement was used in determining the amount of DSL revenues it received from the companies participating in the NECA pool, and NECA in turn provided Emery with the wholesale DSL/broadband rate it should bill to its affiliate ETV. However, Emery has now voluntarily exited that pool and it no longer uses the prescribed NECA wholesale DSL/internet tariff rate, but instead now uses a monthly rate of **[Begin Confidential]** [redacted]. **[End Confidential]** [32] Thus, it is clearly inappropriate for Emery to rely on this prior method in these proceedings after it has exited the NECA pool.

Q. CAN YOU EXPLAIN THE PROBLEMS WITH RELYING ON EMERY'S PRIOR NECA SETTLEMENTS PROCESS AS A METHOD FOR PROPER COST ALLOCATION WITH AFFILIATES?

A. The prior process for DSL cost recovery under the NECA pooling process should not be relied upon at this stage. NECA is an organization that is

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[31] Emery participated in the NECA DSL pool up through June 2013.

[32] This rate of **[Begin Confidential]** [redacted] **[End Confidential]** is the interstate wholesale DSL revenue requirement divided by the number of DSL/internet customers of ETV.

owned and run by LEC interests, and so its policies can be favorable towards the LECs and can be contrary to consumer interests or reasonable cost allocation procedures. In addition, NECA is not a regulatory agency and it does not have any specific jurisdictional rights over state regulatory agencies and regulatory proceedings.

In fact, the NECA method that tells carriers to allocate DSL costs to the intrastate jurisdiction was rejected by the Regulatory Commission of Alaska (“RCA”), and these DSL costs were required to be shifted to the interstate jurisdiction in Alaska regulatory proceedings. However, the NECA policy that calls for allocating DSL costs to the intrastate jurisdiction is apparently still in place per Emery’s response to OCS 3-19.[33]

Q. ARE YOU RECOMMENDING THAT THE COMMISSION REQUIRE EMERY TO INCREASE ITS WHOLESALE DSL/BROADBAND RATE CHARGED TO ETV TO REFLECT A PROPER COST-BASED RATE?

A. No. It is more important that the Commission adopt an allocation adjustment as I propose for regulatory purposes to properly allocate costs consistent with the Section 254(k), Utah law, Part 32 affiliate transaction rules, and 64 cost allocations between regulated and nonregulated entities. Even Emery has proposed a Part 64-type adjustment in this proceeding to allocate shared support assets from ETV to Emery, so it is clear that the

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[33] The NECA policy states that if costs for ADSL and SDLS services are ordered out of an intrastate tariff, then the related costs should be allocated to the intrastate jurisdiction. See OCS Exhibit 1D-5 for the data request response to OCS 3.19.

Commission can make offsetting adjustments to properly allocate costs away from Emery for regulatory purposes.

Adjustment BCO-2: ALLOCATE GENERAL AND ADMINISTRATIVE EXPENSES FROM EMERY TO NONREGULATED OPERATIONS

Q. WILL YOU SUMMARIZE OCS ADJUSTMENT BCO-2?

A. I have revised two of the Company's CAM allocation factors that were applied to four different Departments (also called "cost pools"), and this resulted in an adjustment to decrease expenses of **[Begin Confidential]** [redacted].[34] **[End Confidential]** These two allocation factors are used to allocate the related Department cost pool between the three regulated RLECs (Emery, Carbon, and Hanksville) and the three nonregulated affiliates (ETV, ETV-LLC, and ETLD).[35] Although this adjustment primarily impacts both the Customer Operations and Corporate Operations expenses, for simplicity purposes I will periodically refer to this group of combined expenses as corporate overhead expenses.[36] The two expense allocation factors that I am revising are shown below:

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[34] **[Begin Confidential]** [redacted]. **[End Confidential]**

[35] I am not recommending that any expenses actually be shifted to nonregulated operations on the books, my adjustment is the same as other regulatory adjustments that remove or reduce expenses for regulatory purposes only. However, I will show how the reduction in regulated expenses impacts nonregulated expenses and related allocation factors.

[36] Customer Operations includes Marketing (account 6610) and Services (account 6620) expenses and Corporate Operations includes Executive and Planning (account 6710) and General and Administrative (account 6720) expenses.

1) **[Begin Confidential]** [redacted] **[End Confidential]**

2) **[Begin Confidential]** [redacted] **[End Confidential]**

The four different Departments and the related adjustments that I am proposing are shown below:

[Begin Confidential]

1) [redacted]

2) [redacted]

3) [redacted]

4) [redacted]

[End Confidential]

The table below shows the percentage of expenses allocated between regulated and nonregulated operations for each Department, and it compares the Company's allocation factors to the OCS revised allocation factors that I am supporting in this testimony.

Table BCO-2: OCS Proposed Change in Allocation Factors
[Begin Confidential]

	Per Company			Per OCS		
Department & Allocator	Co. Reg.	Co. Nonreg	Co. Total	OCS Reg.	OCS Nonreg.	OCS Total
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[End Confidential]

Q. WILL YOU EXPLAIN THE COMPANY'S COST ALLOCATION FACTORS AND COST POOLS?

A. The table below shows the Company's nine allocation factors used to allocate expenses in the ten Department/Cost Pools. Some allocation factors are used to allocate several of the Department expenses, and the table below is not intended to show which allocation factors are applied to each specific Department.

Table BCO-3: List of Allocation Factors and Department Cost Pools

[Begin Confidential]

[redacted]

[End Confidential]

The Department cost pools may include expenses from numerous USoA expense accounts. However, a Department cost pool should only aggregate homogenous expenses that have a cost-causative relationship to the related allocation factor that is used to allocate the expenses. My testimony will explain and show that there is not a cost-causative relationship between some of the allocation factors and the related Department cost pools, and this is one of the reasons supporting my adjustments.

Q. EXPLAIN THE IMPACT OF THE ALLOCATION ADJUSTMENTS YOU MADE ON EMERY AND REGULATED AND NONREGULATED OPERATIONS?

A. The table below shows the revised allocation factor percentage and the related impact on expenses for Emery (this agrees to my adjustment) and all other affiliates. I will explain in more detail the impact of my allocation adjustment on Emery, as well as regulated and nonregulated operations, following the table below.

Table BCO-4: OCS [Begin Confidential] [redacted] [End Confidential] Allocation Adjustment

[Begin Confidential]

	A	B	C	D	E	F	G	H	I
		[redacted]				OCS Adjustment			
		[redacted]	[redacted]	[redacted]	[redacted]	OCS Alloc. Adjustment	Adjusted Subject to Alloc.	Adjusted Alloc. By Company	Change in Alloc. %
1	Emery	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
2	Carbon	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
3	Hanksville	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
4	Total Reg.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
5	ETV	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
6	ETV-LLC	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
7	ETLD	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
8	Total Nonreg.	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
		[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
9	**Grand Total**	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

[End Confidential]

My proposed adjustment decreases the amount of corporate overhead expenses allocated to Emery by **[Begin Confidential]** [redacted] **[End Confidential]**[37] (Column F, line 1) and decreases the percentage of these expenses allocated to Emery from **[Begin Confidential]** [redacted] **[End Confidential]** (Column H, line 1).[38] Although the impact of my allocations adjustment does not directly impact Carbon or Hanksville in this proceeding, the total impact of my adjustment would decrease the amount of corporate overhead expenses allocated to regulated operations (Emery, Carbon, and Hanksville) by **[Begin Confidential]** [redacted] **[End Confidential]** (Column F and H, line 4, respectively).

The amounts in Column B called "Total Expenses (No Depreciation)"[39] reflect both the direct and allocated expenses (total expenses) for each company (excluding depreciation expense).[40] These Total Expenses,[41] are provided only to show that the expenses that were allocated to all affiliates of **[Begin Confidential]** [redacted] **[End Confidential]** (Column D, line 8) represents about **[Begin Confidential]** [redacted] **[End Confidential]** of the total expenses (expenses that are allocated and directly assigned) of **[Begin**

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[37] Column F, line 1 shows the decrease in **[Begin Confidential]** [redacted] **[End Confidential]**expenses allocated to Emery and related offsetting increase is re-allocated to the other nonregulated companies.

[38] Per Column E, line 1 less Column H, line 1, equals the change in Column I, line 1.

[39] These expenses also do not include any income taxes.

[40] These amounts are per the 2014 Audited Financials, Consolidated Statement of Income and Comprehensive Income.

[41] These Total Expenses are not used in calculating my corporate overhead expense adjustment.

Confidential] [redacted] **[End Confidential]**[42] for all affiliates. Thus, a substantial amount of the combined total expenses of all companies (**[Begin Confidential]** [redacted] **[End Confidential]**) is subject to some allocation factor to spread these costs to the various regulated and nonregulated affiliates, so it is possible for the Company to use allocation factors to significantly impact earnings, revenue requirements, and the amount of requested UUSF for the regulated companies.

The expenses in Column D[43] are more relevant for this adjustment because they reflect the total expenses that the Company has allocated to each regulated and nonregulated entity using its cost allocation factors. Prior to my corporate overhead allocations adjustment, the Company allocated **[Begin Confidential]** [redacted] **[End Confidential]** (Column E, line 4) of total allocable expenses to regulated operations (**[Begin Confidential]** [redacted] **[End Confidential]**to Emery) and **[Begin Confidential]** [redacted] **[End Confidential]** (Column E, line 8) to nonregulated operations. For corporate overhead expenses allocated to the regulated companies, both the amount of **[Begin Confidential]** [redacted] (**[End Confidential]** Column D, line 4) and the related percentage of **[Begin Confidential]** [redacted] **[End Confidential]** appear to be unusually high.

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[42] These excludes exclude depreciation expense and income tax expense.

[43] The amounts in Column D are from Emery's response to OCS 2-40. See OCS Exhibit 1D-3 for Emery's response to OCS 2-40.

After reflecting the impact of my corporate overhead allocations adjustment, the adjusted corporate overhead expenses reflect a **[Begin Confidential]** [redacted] **[End Confidential]** allocation to regulated expenses and a **[Begin Confidential]** [redacted] **[End Confidential]** allocation to nonregulated expenses. Although I believe this is a more reasonable allocation of expenses between regulated and nonregulated operations, the expenses allocated to regulated operations are still somewhat excessive and there are additional adjustments that I have not made at this time.

Q. DID YOUR ANALYSIS RAISE CONCERNS THAT REGULATED ALLOCATED EXPENSES ARE OVERSTATED AND NONREGULATED ALLOCATED EXPENSES ARE UNDERSTATED?

A. Yes. I reviewed and compared several years of Consolidated Financial Statements and other information, and determined that certain financial data, allocations, and changes in amounts from year-to-year appear unusual or appear to favor the nonregulated affiliates over the regulated affiliates. This type of information lends support for my adjustment to re-allocate some expenses from regulated to nonregulated operations.

From 2013 to 2014, the regulated RLECs net income **[Begin Confidential]** [redacted] **[End Confidential]** and profit margin[44] **[Begin Confidential]** [redacted] **[End Confidential]**, yet for the nonregulated affiliates net income stayed **[Begin Confidential]** [redacted] **[End Confidential]** with a profit margin of **[Begin Confidential]** [redacted] **[End Confidential]** ETV's net income only **[Begin Confidential]** [redacted] **[End Confidential]** from 2013 to 2014, yet its net income of **[Begin Confidential]** [redacted] **[End Confidential]** of the total profit among all of the regulated and nonregulated companies. In addition, from 2013 to 2014, the regulated RLECs expenses **[Begin Confidential]** [redacted] **[End Confidential]** and ETV's expenses **[Begin Confidential]** [redacted] **[End Confidential]** by about this same amount of **[Begin Confidential]** [redacted] **[End Confidential].** And although ETV's revenues **[Begin Confidential]** [redacted] **[End Confidential]** from 2013 to 2014, its profits **[Begin Confidential]** [redacted] **[End Confidential]** as the prior year due to the **[Begin Confidential]** [redacted] [**End Confidential].** From 2013 to 2014, all other entities realized **[Begin Confidential]** [redacted] **[End Confidential]** in expense, except ETV was the only entity that realized a **[Begin Confidential]** [redacted] **[End Confidential]** in expense,[45] and its **[Begin Confidential]** [redacted] **[End Confidential]** was significant.

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[44] Profit margin is net income divided by revenues.
[45] ETLD realized a relatively small decrease in expense.

ETV's actual earned rate of return on rate base ("ROR") was a rather **[Begin Confidential]** [redacted] **[End Confidential]** in 2013 and 2014, respectively[46] especially when compared to the regulated companies ROR's of **[Begin Confidential]** [redacted] **[End Confidential]** for these same years. The **[Begin Confidential]** [redacted] **[End Confidential]** in 2014 (and corresponding increase in regulated company expenses of about this same amount) played a role in ETV's **[Begin Confidential]** [redacted] **[End Confidential]** ROR.

It is possible that the **[Begin Confidential]** [redacted] **[End Confidential]** in ETV's expense of **[Begin Confidential]** [redacted] **[End Confidential]** and the corresponding **[Begin Confidential]** [redacted] **[End Confidential]** in regulated RLEC expenses of **[Begin Confidential]** [redacted] **[End Confidential]** was the result of a **[Begin Confidential]** [redacted] **[End Confidential]**, but that cannot be confirmed. Most importantly, because ETV does not bear a reasonable portion of either fiber-internet-related common plant costs (Adjustment BCO-1) or common corporate overhead expenses (Adjustment BCO-2), the related ETV profits and ROR

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[46] The ROR for all combined nonregulated companies was also **[Begin Confidential]** [redacted] **[End Confidential]**, respectively.

appear **[Begin Confidential]** [redacted] **[End Confidential]** after consideration of the analysis that I performed. ETV's profits and ROR are **[Begin Confidential]** [redacted] **[End Confidential]** the cost of the more reasonable cost allocations that I propose in Adjustment BCO-1 and BCO-2.

Q. DID YOU FIND IT UNUSUAL THAT THE COMPANY DID NOT HAVE ANY ALLOCATION FACTORS THAT ALLOCATE 50% OR MORE OF EXPENSES TO NONREGULATED OPERATIONS?

A. Yes, I did find this unusual. It appears that the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor may be the highest nonregulated allocation factor of **[Begin Confidential]** [redacted] **[End Confidential],** although this factor does not have much impact on overall allocations because **[Begin Confidential]** [redacted] **[End Confidential]** expenses are relatively small.

I also find this unusual because there are numerous important financial amounts that approximate a **[Begin Confidential]** [redacted] **[End Confidential]** between regulated and nonregulated operations, yet these amounts do not appear to have been used in any Company allocation factor. For example, the split between Total Revenues is about **[Begin Confidential]** [redacted] **[End Confidential]**, although I don't believe that revenues were used as an input in any

Company allocation factor. If Total Revenues was adopted as an allocator for some expense, it would have been the only allocation factor that actually drove **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated operations versus regulated operations. This raises concerns about the bias of the Company's allocation factors.

Also, Total Operating Expenses (excluding depreciation and income taxes) are split **[Begin Confidential]** [redacted] **[End Confidential]**. Thus, the use of both or either of the Total Revenue and Total Expense inputs in allocation factors would have **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated operations, but for some reason these two significant financial drivers do not appear to have been used by the Company in any allocator that drives significant expenses or costs.

Q. WHAT IS THE COMPANY'S [Begin Confidential] [redacted] **[End Confidential] ALLOCATION FACTOR, AND WHAT REVISED FACTOR DO YOU RECOMMEND?**

A. The Company's **[Begin Confidential]** [redacted] **[End Confidential]** factor allocates about **[Begin Confidential]** [redacted] **[End Confidential]** of the related Department cost pool expenses to regulated operations and **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated operations. I revised the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor and included inputs related to billing records, revenues, operating expenses[47], net plant, and payroll. Also, I am recommending an **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor that allocates 50% of expenses to regulated operations and 50% to nonregulated operations. More details are provided in Table BCO-5 later in this testimony.

Q. WHAT ARE THE INPUTS TO THE COMPANY'S [Begin Confidential] [redacted] **[End Confidential] ALLOCATION FACTOR AND DID YOU IDENTIFY AN [Begin Confidential]** [redacted] **[End Confidential] FACTOR USED IN PRIOR YEARS WITH INPUTS THAT ARE MORE SIMILAR TO YOUR PROPOSED A&G FACTOR?**

A. The Company's **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor appears to be based upon the **[Begin Confidential]** [redacted] **[End Confidential]** for each regulated and nonregulated company, although this analysis is somewhat **[Begin Confidential]** [redacted] **[End Confidential]** because it is based on information from **[Begin Confidential]** [redacted] **[End Confidential]**.[48] The **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor includes a number of estimates with no supporting documentation or calculations, such as giving the CABS counts an **[Begin Confidential]**

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[47] Operating expenses exclude depreciation and income taxes.

[48] The **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor is set forth at Exhibit 9 of Emery's filed application.

[redacted] **[End Confidential]**. I believe this approach of using **[Begin Confidential]** [redacted] **[End Confidential]** is flawed in relation to the Department cost pools which it is used to allocate.

OCS 2-40 asked Emery to provide supporting documentation for all CAM allocation factors, and when I reviewed the underlying Excel spreadsheets there was an **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor that was calculated using a different method in the period **[Begin Confidential]** [redacted]. **[End Confidential]**[49] The previous **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor method uses a weighting of the **[Begin Confidential]** [redacted] **[End Confidential].** The revised **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor that I propose uses inputs that are more similar to this prior Company approach, because I have used additional inputs besides **[Begin Confidential]** [redacted] **[End Confidential]**.

Q. DO THE "[Begin Confidential] [redacted]**" [End Confidential] INPUTS TO THE COMPANY'S [Begin Confidential]** [redacted] **[End Confidential] ALLOCATION FACTOR HAVE A "DIRECT" OR "COST-**

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[49] This other **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor may have been used in prior years or by a previous management team. See OCS Exhibit 1D-3 for data request response for OCS 2.40.

CAUSATIVE" RELATIONSHIP TO THE EXPENSES IN THE DEPARTMENT COST POOL THAT THEY ARE USED TO ALLOCATE?

A. No. The use of **[Begin Confidential]** [redacted] **[End Confidential]** in the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor is not compliant with Part 64 cost allocations, because **[Begin Confidential]** [redacted] **[End Confidential]** do not have either a "direct" cost relationship or a "cost-causative" relationship with the expenses in the related Department cost pools driven by the **[Begin Confidential]** [redacted] **[End Confidential]** factor. The **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor used by Emery is applied to vastly different types of Department cost pools, including the Departments of **[Begin Confidential]** [redacted] **[End Confidential]**. Also, Emery's response to OCS 2-40 shows that the **[Begin Confidential]** [redacted] **[End Confidential]** factor is applied to some other departments[50] **[Begin Confidential]** [redacted] **[End Confidential]** at the Department List at DPU 1-7, and these other departments cannot be sorted at the financial records provided in response to OCS 2-40.

I don't believe that the number of **[Begin Confidential]** [redacted] **[End Confidential]** (used as the only input in the **[Begin Confidential]** [redacted] **[End Confidential]** factor) has a direct, cost-causative, or even much of

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[50] Some of these departments include **[Begin Confidential]** [redacted] **[End Confidential]**, and others. See OCS Exhibit 1D-3 for data request response for OCS 2.36.

any relationship as a driver for the expenses in the Departments to which it is applied, such as the departments of **[Begin Confidential]** [redacted] **[End Confidential]**. For example, the amount of time spent on regulated or nonregulated issues by the executive/management officers **[Begin Confidential]** [redacted] **[End Confidential]**[51], the members of the **[Begin Confidential]** [redacted] **[End Confidential]** and **[Begin Confidential]** [redacted] **[End Confidential]** is unlikely to be affected by the number of **[Begin Confidential]** [redacted] **[End Confidential]**.

For example, I believe a CEO's time is spent more on forward-looking policy and plans, and especially issues related to nonregulated services such as Internet that particular drive total consolidated company profits, cash and ROR - - and this is not driven by the number of **[Begin Confidential]** [redacted] **[End Confidential]**. Also, regarding the **[Begin Confidential]** [redacted] **[End Confidential]** costs, a review of the Board of Director minutes appears to indicate that a **[Begin Confidential]** [redacted] **[End Confidential]**, and there is no reasonable relationship to the number of **[Begin Confidential]** [redacted] **[End**

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[51] This includes primarily the salary and other related overhead costs of **[Begin Confidential]** [redacted] **[End Confidential]**

Confidential]. Finally, **[Begin Confidential]** [redacted] **[End Confidential]** costs would appear to be more closely tied to promoting those **[Begin Confidential]** [redacted] **[End Confidential]**, and this has no reasonable relationship to the number of **[Begin Confidential]** [redacted] **[End Confidential]**.

Q. HOW DID YOU DETERMINE YOUR [Begin Confidential] [redacted] **[End Confidential] ALLOCATION FACTOR?**

A. I used an approach that is more similar to a prior **[Begin Confidential]** [redacted] **[End Confidential]** factor methodology used by the Company. My understanding is that the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor should be more of a "general or all-encompassing" allocator (instead of a specific allocator based on **[Begin Confidential]** [redacted]) **[End Confidential]** with diverse inputs that can be used to justify allocation of a wide variety of expenses in various Departments, and that is the approach that I used to calculate a **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor as shown in Table BCO-5 below.

Table BCO-5: OCS Proposed [Begin Confidential] [redacted] **[End Confidential] Allocation Factor**

[Begin Confidential]

A	B	C	D	E	F	G	H	I
			Expenses	Net			**OCS**	**OCS**
	Company	Revenues	Note 1	Plant	Records	Payroll	**Total**	**Proposed**
	Allocator	%	%	%	%	%	**%**	**Allocator**
Emery	[redacted]							
Carbon								
Hanksville								
Total Reg.								**50%**
ETV								
ETV-LLC								
ETLD								
Total Nonreg.								**50%**
Grand Total	100.00%	100%	100%	100%	100%	100%	**100%**	**100%**
Note 1 - Excludes depreciation and income taxes								

[End Confidential]

Table BCO-5 shows that I assigned the specific amounts of revenues, expenses[52], net plant, payroll, and billing records[53] to each regulated and nonregulated entity. Then I totaled these input amounts for all companies and calculated the percentage of these combined inputs for each regulated and nonregulated entity as shown at Column H at Table BCO-. These calculations result in **[Begin Confidential]** [redacted] **[End Confidential]** allocated to regulated operations and **[Begin Confidential]** [redacted] **[End Confidential]** allocated to nonregulated operations. However, I have revised these factors to a 50% allocation to regulated and 50% allocation to nonregulated (Column I), to reflect downward adjustments to expenses,

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[52] These expenses exclude depreciation and income taxes.

[53] These amounts are primarily from the 2014 Audited Financial Statements, along with additional records and information provided by Emery in other data request responses.

plant, and payroll costs that I have made in this proceeding.[54] My allocations adjustment is reasonable and further adjustments could be made to other Department cost pools.

Q. WHAT ARE THE PROBLEMS WITH THE COMPANY'S [Begin Confidential] [redacted] [End Confidential] FACTOR THAT IS USED TO ALLOCATE COSTS OF [Begin Confidential] [redacted] [End Confidential]?

A. The Company's **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor allocates expenses **[Begin Confidential]** [redacted] **[End Confidential]** to regulated and **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated, and I have essentially reversed these percentages and allocated **[Begin Confidential]** [redacted] **[End Confidential]** to regulated and **[Begin Confidential]** [redacted] **[End Confidential]** to nonregulated. There are numerous problems with Emery's **[Begin Confidential]** [redacted] **[End Confidential]** allocator as I will explain.

First, the **[Begin Confidential]** [redacted] **[End Confidential]** allocator study is outdated **[Begin Confidential]** [redacted] **[End Confidential]**.[55] The **[Begin Confidential]**

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[54] The inputs to Table BCO-5 are based on the Company's unadjusted financial amounts before adjustments that I have proposed in this proceeding.
[55] This information is included in Emery's Exhibit 9i filing with its Application.

[redacted] **[End Confidential]** may have changed significantly since **[Begin Confidential]** [redacted] **[End Confidential]** because the number of internet and local service customers served by fiber has **[Begin Confidential]** [redacted] **[End Confidential]**, and the amount of fiber in the network should have reduced service quality calls and complaints. Emery has not been able to provide any evidence that the **[Begin Confidential]** [redacted] **[End Confidential]** is still relevant and accurate today.

Second, OCS 2-40 asked Emery to provide supporting documentation and calculations regarding the CAM and related allocation factors. However, Emery did not provide any written explanation or reconciliation to show how the **[Begin Confidential]** [redacted] **[End Confidential]** regulated and **[Begin Confidential]** [redacted] **[End Confidential]** nonregulated **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor reconciles to the various Excel spreadsheets and the **[Begin Confidential]** [redacted] **[End Confidential]** that was provided. Emery did not provide any written response to OCS 2-40 other than to refer to the Excel spreadsheets that include thousands of fields of numbers, and I was not able to validate or reconcile the numerous amounts in these Excel spreadsheets to the related **[Begin Confidential]** [redacted] **[End Confidential]** allocation factors. Thus, Emery has not met a reasonable burden of proof to support its **[Begin Confidential]** [redacted] **[End Confidential]** allocation factors.

Third, Emery's response to OCS 2-40 includes a tab called **[Begin Confidential]** [redacted] **[End Confidential]** that shows how various **[Begin Confidential]** [redacted] **[End Confidential]**. For example, the type of calls included in the category of **[Begin Confidential]** [redacted] **[End Confidential]** (and within other categories) are assigned to various services such as **[Begin Confidential]** [redacted] **[End Confidential]** and various other services. As one example, the service category groupings of **[Begin Confidential]** [redacted] **[End Confidential]** are not explained, and the treatment of **[Begin Confidential]** [redacted] **[End Confidential]** in these groupings are not explained. However, **[Begin Confidential]** [redacted] **[End Confidential]** are both "nonregulated" services so it is not clear why the nonregulated services of **[Begin Confidential]** [redacted] **[End Confidential]** have been **[Begin Confidential]** [redacted] **[End Confidential]**. It is not clear if **[Begin Confidential]** [redacted] **[End Confidential]** related to this category are assigned to the nonregulated or regulated category, but this could make a significant difference in the determination of the final **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor. And if these customer inquiries were related to both **[Begin Confidential]** [redacted] **[End Confidential]** services, it is not clear how the **[Begin Confidential]** [redacted] **[End Confidential]** assigned these calls to the regulated and nonregulated categories to influence the outcome of the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor. Again, adequate supporting documentation and explanation has not been provided by Emery to justify the **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor.

Fourth, The Company has a **[Begin Confidential]** [redacted] **[End Confidential]**, with **[Begin Confidential]** [redacted] **[End Confidential]** per the response to DPU 1-4(b) (See OCS Exhibit 1D-4). It is not clear why **[Begin Confidential]** [redacted] **[End Confidential]** or a **[Begin Confidential]** [redacted] **[End Confidential]** of these **[Begin Confidential]** [redacted] **[End Confidential]** costs would be allocated to regulated operations when Emery and Carbon regulated access lines and related local revenues are declining or stagnant and fiber/internet related nonregulated services are **[Begin Confidential]** [redacted] **[End Confidential]** - - and the Company continues to place fiber in the network. Emery has not provided any explanation for the **[Begin Confidential]** [redacted] **[End Confidential]** and why their costs are being **[Begin Confidential]** [redacted] **[End Confidential]** to regulated operations, although this appears unusual.

Based on the previously identified concerns, I propose **[Begin Confidential]** [redacted] **[End Confidential]** allocation factor of 35% regulated and 65% nonregulated.

Adjustment No. 3 – Deduct Customer Deposits from Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-3?

A. Emery has incorrectly "added" customer deposits of **[Begin Confidential]** [redacted] **[End Confidential]** to rate base and I have made an adjustment to properly deduct these customer deposits from rate base to be consistent with traditional ratemaking policy and practices. Emery has not provided any explanation, documentation or cited any precedent to support this unique approach in this case.

In addition, both Emery's 2013 and 2014 Part 36 cost studies (which it relies on in this proceeding) show that customer deposits are deducted from rate base, consistent with my position. It is not clear if it is Emery's intent to have two separate regulatory positions on customer deposits in this filing, but this does indicate a fundamental inconsistency in Emery's filing.

Adjustment BCO-4: Remove Prepayments From Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-4?

A. Emery has improperly included prepayments of **[Begin Confidential]** [redacted] **[End Confidential]** in rate base, and I have made an adjustment to remove these amounts from rate base. Emery has not provided any explanation, documentation, or cited to any precedent for including prepayments in rate base.

In addition, both Emery's 2013 and 2014 Part 36 cost studies (which it relies on in this proceeding) do not include prepayments in rate base. Thus, it is not clear if it is Emery's intent to have two separate regulatory positions on prepayments in this filing, but this does indicate a fundamental inconsistency in Emery's filing.

Adjustment BCO-5: Deduct Long-Term Liabilities From Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-5?

A. Emery has failed to deduct long-term liabilities from rate base, so I have made an adjustment of **[Begin Confidential]** [redacted] **[End Confidential]** to properly deduct these amounts. In addition, both Emery's 2013 and 2014 Part 36 cost studies (which it relies on in this proceeding) show that long-term liabilities are deducted from rate base, consistent with my position. It is not clear if it is Emery's intent to have two separate regulatory positions on long-term liabilities in this filing, but this does indicate a fundamental inconsistency in Emery's filing.

Adjustment BCO-6: Remove 50% of Telephone Plant Under Construction from Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-6?

A. This adjustment removes 50% of the telephone plant under construction ("TPUC") balance of **[Begin Confidential]** [redacted] **[End Confidential]** resulting in a reduction of **[Begin Confidential]** [redacted] **[End Confidential]** from Emery's proposed rate base. I am removing 50% of TPUC from rate base for the reasons that follow.

First, Emery's TPUC balance for 2014 is overstated on a normalized basis and is **[Begin Confidential]** [redacted] **[End Confidential]** presumably due in part to Emery's current fiber construction program. For example, TPUC has increased **[Begin Confidential]** [redacted] **[End Confidential]** from **[Begin Confidential]** [redacted] **[End Confidential]** in 2013 to **[Begin Confidential]** [redacted] **[End Confidential]** in 2014. TPUC has also been as low as around **[Begin Confidential]** [redacted] **[End Confidential]** in both 2009 and 2010. When Emery's fiber program reaches an endpoint, then the TPUC balances should decrease to more reasonable levels. If Emery's draw from the UUSF is established with an unusually high level of TPUC from this proceeding, then Emery will over-recover these costs in future years from the UUSF when its TPUC balance begins to decline with the conclusion of the fiber construction program.

Second, most of this TPUC appears to be fiber-related, and Emery has not provided certain requested information in response to OCS 2-41(b) to show other related impacts of this TPUC that may be relevant regarding corresponding adjustments to be consistent with the regulatory "matching" principle.[56] The potential corresponding impacts of TPUC as set forth below have not been identified by Emery:

1) Increased revenues related to payments by affiliates to Emery use of the fiber included in TPUC, federal support revenues, and revenues from new services.

2) It is not clear if the TPUC included in this case will result in subsequent retirement of replaced copper (or other replaced assets), but at this time the Company has not made a corresponding adjustment related to this TPUC.

Adjustment BCO-7: Remove 50% of Materials and Supplies from Rate Base

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-7?

A. This adjustment removes 50% of the materials and supplies ("M&S") balance of **[Begin Confidential]** [redacted] **[End Confidential]** resulting in a reduction of **[Begin Confidential]** [redacted] **[End Confidential]** from Emery's proposed rate base. I am proposing this adjustment for most of the reasons set forth for the previous TPUC adjustment. Emery's M&S

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[56] The matching principle is also sometimes referred to as "synchronization", whereas the full impact of a transaction should be reflected in a related adjustment and the adjustment should not be limited to only the positive or negative impacts of the transaction. Thus, if TPUC increases, then the corresponding related impacts on revenues, expenses and other issues should be considered in any related adjustment. See OCS Exhibit 1D-3 for Emery's response to OCS 2.41(b).

balance for 2014 is overstated on a normalized basis and is **[Begin Confidential]** [redacted] **[End Confidential]** presumably due in part to Emery's current fiber construction program. For example, M&S has increased **[Begin Confidential]** [redacted] **[End Confidential]** from **[Begin Confidential]** [redacted] **[End Confidential]**[57] in 2013 to **[Begin Confidential]** [redacted] **[End Confidential]** in 2014. M&S has also been as low as around **[Begin Confidential]** [redacted] **[End Confidential]** in both 2009 and 2010. When Emery's fiber program reaches an endpoint, then the M&S balances will decrease to more reasonable levels. If Emery's draw from the UUSF is established with an unusually high level of M&S from this proceeding, then Emery will over-recover these costs in future years from the UUSF when it's M&S balance begins to decline with the conclusion of the fiber construction program.

<u>Adjustment BCO-8: Reverse Emery's Adjustment for Projected Decline in Access Lines</u>

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-8?

A. This adjustment increases revenues by **[Begin Confidential]** [redacted] **[End Confidential]** to reverse Emery's proposed adjustment to decrease revenues based on its 3-year projected decline in access lines through

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[57] This balance varies depending upon if the financial reports or the Annual Report is relied upon.

December 31, 2017. I am reversing this adjustment for the reasons set forth below.

First, the projection of access line loss through the three-year projected period ending December 2017 is too far beyond the test period to be allowed, and the adjustment is not known and measurable. Emery's response to OCS 2-12 admits that this line loss **[Begin Confidential]** [redacted] **[End Confidential]**, but that any **[Begin Confidential]** [redacted] **[End Confidential]**.[58] If Emery cannot provide more assurance regarding this adjustment, then it should be rejected.

Second, Emery's adjustment is not known and measurable, and even if it was accepted there is a possibility that the line loss would be offset by increased revenues related to a Commission decision to increase the affordable rate for customers. Also, Emery is installing FTTH for its local service customers and this can have the affect of slowing down the loss of customer lines, although Emery has not considered this impact in its adjustment.

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[58] See OCS Exhibit 1D-3 for Emery's response to data request question 2-12.

Third, Emery did not provide any written or detailed explanation or analysis supporting this adjustment.

Adjustment BCO-9: Remove Depreciation Expense on Fully Depreciated Assets

Q. WILL YOU EXPLAIN OCS ADJUSTMENT BCO-9?

A. This adjustment reduces depreciation expense by **[Begin Confidential]** [redacted] **[End Confidential]** on assets that are either fully depreciated or will be fully depreciated within about 2 years. The depreciation adjustment of **[Begin Confidential]** [redacted] **[End Confidential]** is net of depreciation expense of **[Begin Confidential]** [redacted] **[End Confidential]** that I already removed in Adjustment BCO-1 (Option 2), but if the Commission does not adopt Adjustment BCO-1 then the gross amount of this depreciation expense adjustment would be **[Begin Confidential]** [redacted]**[End Confidential]**.

I am relying on information at Emery's depreciation work papers at DPU 1-11 in regards to this depreciation expense adjustment. Emery's total net assets of **[Begin Confidential]** [redacted] **[End Confidential]** will be fully depreciated within about **[Begin Confidential]** [redacted] **[End Confidential]**, based on an annual depreciation expense of **[Begin**

Confidential] [redacted] **[End Confidential].**[59] This raises concerns about the amount of depreciation expense included in this filing, although I am not proposing to adjust all depreciation accounts. I am removing the full amount of depreciation expense of **[Begin Confidential]** [redacted] **[End Confidential]** and **[Begin Confidential]** [redacted] **[End Confidential]** on the current fully depreciated assets of **[Begin Confidential]** [redacted] **[End Confidential]** and **[Begin Confidential]** [redacted] **[End Confidential]**, respectively.

I am also adjusting depreciation expense on three other asset categories of **[Begin Confidential]** [redacted] **[End Confidential]** because these assets will be fully depreciated in about **[Begin Confidential]** [redacted] **[End Confidential].**[60] If Emery's depreciation expense of **[Begin Confidential]** [redacted] **[End Confidential]** on these accounts is approved in this proceeding, then they will recover annual depreciation expense and related UUSF of **[Begin Confidential]** [redacted] **[End Confidential]** in each of the next two years. However, when these assets are fully depreciated in about two years, Emery will continue to recover the same amount of **[Begin Confidential]**

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[59] Total Net Book Asset Value of **[Begin Confidential]** [redacted] **[End Confidential]** divided by annual Depreciation Expense of **[Begin Confidential]** [redacted] **[End Confidential]**. See OCS Exhibit 1D-7.

[60] Total Net Book Value of **[Begin Confidential]** [redacted] **[End Confidential]** divided by annual Depreciation Expense of **[Begin Confidential]** [redacted] **[End Confidential]**.

[redacted] **[End Confidential]** annually from the UUSF although they may not be recording any depreciation expense on the books for these accounts - - so after two years Emery could be over-recovering UUSF of about **[Begin Confidential]** [redacted] **[End Confidential]** annually.

I have taken the annual depreciation expense of **[Begin Confidential]** [redacted] **[End Confidential]** and divided this by 2.5 years (or the 2-year depreciation expense total of **[Begin Confidential]** [redacted] **[End Confidential]** divided by 5 years) to allow Emery to recover **[Begin Confidential]** [redacted] **[End Confidential]** of annual depreciation expense from the UUSF in the next 5 years (instead of recovering $**[Begin Confidential]** [redacted] **[End Confidential]** annually before and after the assets are fully depreciated). However, if Emery does not come in for another UUSF proceeding after 5 years and it stops depreciation expense on these accounts after 5 years, then it would only be over-recovering annual depreciation expense and UUSF of **[Begin Confidential]** [redacted] **[End Confidential]** instead of **[Begin Confidential]** [redacted] **[End Confidential]**. But my proposal to delay Emery's over-recovery of depreciation expense from the UUSF from a period of two years (if no action or adjustment is made in this proceeding) to a period of five years (if my adjustment is adopted) is more reasonable - - albeit with some risk after the fifth year.

My proposal results in an adjustment of **[Begin Confidential]** [redacted] **[End Confidential]**[61] to depreciation expense for these three accounts, but this is reduced by depreciation expense of **[Begin Confidential]** [redacted] **[End Confidential]** (I already removed this depreciation expense in Adjustment BCO-2 - Option 2) for a net adjustment of **[Begin Confidential]** [redacted] **[End Confidential]**. However, if the Commission did not adopt my proposed Adjustment BCO-2, then this depreciation expense adjustment would be the gross amount of **[Begin Confidential]** [redacted] **[End Confidential]** for these three accounts.

Q. DOES THIS COMPLETE YOUR PREFILED DIRECT TESTIMONY?

A. Yes.

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[61] Total depreciation expense of $939,553 less allowed amount of $375,822, equals $563,731.