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BEFORE THE PUBLIC SERVICE COMMISSION OF UTAH

IN THE MATTER OF
CARBON/EMERY TELCOM, INC.'S
APPLICATION FOR AN INCREASE
IN UTAH UNVERSAL SERVICE
FUND SUPPORT

CARBON/EMERY TELCOM, INC.'S
REPLY MEMORANDUM IN SUPPORT
OF PETITION FOR REVIEW AND
CLARIFICATION

DOCKET NO. 15-2302-01

PROCEDURAL HISTORY

On October 28, 2015, Carbon/Emery Telcom, Inc. (“Carbon”) filed a Petition for Review and Clarification on the Order of the Utah Public Service Commission (“Commission”) on Carbon’s Motion for Partial Summary Judgment (“Order”). The Commission issued a scheduling order on October 28, 2015, and set a briefing schedule on the Petition for Review and Clarification. Pursuant to the Scheduling Order, the Division filed a response to Carbon’s Petition for Review and Clarification on November 13, 2015. Carbon hereby files this reply in support of its Petition for Review and Clarification pursuant to Utah Code Ann. §§54-7-15 and 63G-4-301 and Utah Administrative Code R746-100-11.

ARGUMENT

The Division of Public Utilities' (the "Division") arguments against review and clarification actually support Carbon's Petition by demonstrating the problems in the Commission's Order.

1. **The Commission's Use of "Straight-line Depreciation" When it Likely Intended "Single Asset Depreciation."** At the outset, the Division, in its Response indicates that the "Commission may clarify its order to the extent that it may have made a typographical error in using "straight line" where it apparently intended to use "single asset." This issue is not in dispute and should be clarified in the Commission's Order on Review. However, it is imperative that the Commission understand that under a group asset depreciation method, the group is depreciated in a straight-line method.

2. **Carbon's Process for Removing Fully-Depreciated Assets from its Rate Base.** In its Order, the Commission found that "*Carbon does not propose, nor does it claim to have, a process by which its fully depreciated assets might be removed from rate base—and its UUSF disbursement adjusted accordingly—in years where Carbon does not apply to have its UUSF subsidy increased or otherwise reviewed.*"¹ Carbon identified this as an error in the Commission's Order. Specifically, with group depreciation there is no such thing as a fully depreciated asset within a non-fully depreciated group. Either the group account is fully depreciated or it is not fully depreciated (since the group account is treated as a single asset). In its response, the Division agrees that groups are depreciated as a whole where some assets may have longer or shorter service lives than the group average. Further, the Division states "if group depreciation is properly

¹ *In the Matter of the Application of Carbon/Emery Telecom, Inc. for an Increase in UUSF*, Docket No. 15-2302-01, Order on Partial Summary Judgment dated October 15, 2015, p.3.

implemented this does not result in unreasonable outcomes because the depreciation rate will match the service life and the groups will never have excessive depreciated assets in them.”

Carbon and the Division are in agreement on this point. Unfortunately, however, the Commission’s Order does not properly reflect this principle. The Commission’s Order states that “Carbon does not propose, nor does it claim to have, a process by which its fully depreciated assets might be removed from rate base—and its UUSF disbursement adjusted accordingly—in years where Carbon does not apply to have its UUSF subsidy increased or otherwise reviewed.” This is not accurate and needs to be corrected.

Further, the Division, in its response, goes on to identify two components related to the Division’s disagreement with Carbon’s group depreciation method. The Division and the Commission are within their statutory and regulatory authority to identify perceived errors in Carbon’s implementation of the group depreciation method, and request adjustments to the group method of depreciation to rectify these perceived errors. Carbon, while it may not agree with the errors identified, does not take exception to an audit approach that seeks to make adjustments under a group method. If the Division feels that Carbon is reviving fully depreciated groups, rather than creating new groups, it can, and should, address this by corrections to Carbon’s groups. What Carbon objects to, and what is beyond the statutory and regulatory authority of the Division and the Commission, is for the Division and the Commission to discard the group method as an acceptable method of depreciation for State Utah Universal Service (“UUSF”) purposes and require a company to maintain two depreciation methods on the same asset with differing percentages allocated to each method on a year-by-year basis. As acknowledged by the

Commission in its Order, the Company cannot change the interstate method of depreciation without FCC approval—which Carbon does not have.

3. Reaching a Depreciation Expense Number Using Single Asset Depreciation versus Group Asset Depreciation. The Division also argues that “the Commission is calculating a revenue requirement and may use any reasonable method to establish a dollar amount for depreciation expense that is representative of the depreciation expense needed to reimburse the company for the actual diminution in the value and useful life of its assets in the test year.” While Carbon agrees that the Commission, in establishing a revenue requirement, can establish the dollar amount for depreciation expense, Carbon maintains that it is unreasonable to discard a group method of depreciation that is and has historically been used by the Company under FCC Part 32, particularly when the group method is discarded in the middle of a State UUSF case.

The State rule, R746-340-2.D, provides that the Uniform System of Accounts, as prescribed by the FCC at 47 CFR Part 32, is the prescribed system of accounts to record the results of Utah intrastate operations. It is undisputed that Carbon has been using a group method of depreciation for over 15 years. It is a matter of fundamental fairness that the regulated companies should be aware of the rules that will be imposed against them in a proceeding on UUSF application. The Division, in response to this, argues that the Division “has not and does not argue that single asset depreciation is the only possible method that Carbon may use.” Moreover, the Division states that it is not asking the Commission to require Carbon to move to a single asset depreciation method². However, the Commission’s Order stated “if the Commission finds credible

² Additionally, in its Order issued on November 12, 2015, in Docket No. 15-053-01, the Commission also stated that the Commission would be within its discretion to adopt the Division’s recommendations without ordering Strata to change any of its record-keeping practices going forward.

evidence that Carbon has improperly configured its asset groups, the Commission's rules, as currently written, allow the Commission to apply a different depreciation method to Carbon's assets and to adjust the utility's depreciation expense." This language indicates that while the Commission acknowledges that group asset depreciation is an acceptable method of calculating depreciation expense if performed correctly, if the Commission believes it has not been calculated correctly, it is not bound to correct those errors using a group method—rather it can abandon the group method and use single asset method of depreciation.

As a practical matter, if the Division and the Commission are going to use a single asset method to calculate an appropriate depreciation expense, how is a regulated company going to effectively determine the UUSF it is entitled to if it doesn't calculate its depreciation expense using the same method that will be imposed upon it by the Division and the Commission in review of any application for UUSF? Are the Division and the Commission suggesting that a company should keep three sets of books: 1) a set for interstate federal purposes that utilizes group depreciation; 2) an internal set for intrastate purposes using whatever method the company deems appropriate; and 3) a third set of books that utilizes the single asset method that the State regulators will use to review UUSF applications? This approach is absurd and if implemented would be overly burdensome.

However, even if Carbon were inclined to voluntarily switch to a single asset method of depreciation for intrastate purposes, as a practical matter, as the Commission and the Division are aware, rate of return regulated companies are required to separate their assets jurisdictionally between interstate and intrastate jurisdictions. These separations change on an annual basis—some years a company will have 48% of its assets assigned to the interstate side, with 52% assigned

to the intrastate jurisdiction. The following year, the separation percentages may change, and the company may have 51% of its assets assigned to the interstate side. If the company uses a different method of depreciation for intrastate and interstate purposes, how will the depreciation expense of the assets that “flip flop” between the federal and state jurisdictions be calculated accurately? This is why it is imperative to read State rule, R746-340-2.D as implementing the interstate and intrastate methods of depreciation into lock step. A company cannot change the interstate method of depreciation without FCC approval, and if the method of depreciation is changed only on the intrastate side, it will be difficult, if not impossible, to calculate accurate depreciation on a total company basis, particularly in the annual reports the company would file with the state of Utah. This issue is not just about Commission authority, but also about accuracy in maintaining depreciation accounts for the Company. It would be arbitrary and inaccurate for the FCC and Commission to require differing methods of depreciation on assets for which the percentage of depreciation allocated to each jurisdiction may change on a year-by-year basis. The Division, the Company, and the Commission would have no way of tracking this accurately for regulatory purposes. It would be more prudent to read State rule, R746-340-2.D as locking a company into consistent methods of depreciation for interstate and intrastate assets as prescribed by the FCC at 47 CFR Part 32.

The Division and the Commission stating that they are not requiring Carbon to move to a single asset depreciation method is a matter of semantics. Regardless of whether the Commission orders Carbon to implement a single asset method of depreciation in its daily operations is irrelevant if the depreciation expense in a UUSF application proceeding is calculated by the Division or the Commission utilizing a single asset method of calculation. Carbon agrees with the

Division that single asset depreciation is one method of setting a UUSF distribution amount that best matches Carbon's actual ongoing costs and revenues. However, since the company does not employ the single asset method of depreciation, but rather uses a group method of depreciation as required by Part 32, Carbon maintains that the more prudent course of action is for the Commission and the Division to review a companies' application of group asset depreciation rather than abandoning group asset depreciation in favor of single asset depreciation. This issue will be amplified in a non-UUSF request or rate case proceeding, as the Division reviews the books of a company using annual reports, because an in depth depreciation review is not conducted, making it difficult or impossible to implement varying depreciation methods for interstate and intrastate purposes on the same assets.

4. Group Assets with Different Service Lives.

The Division argues that the FCC rules reject placing assets with differing service values in to the same groups to depreciate assets at an accelerated rate. As support for this conclusion, the Division states that "this would be plainly inconsistent with straight-line depreciation that should assign an equal charge for depreciation in each of the period of the service life of the asset." This statement disregards the fact that in a group method of depreciation, the group is treated as one asset and a straight-line method of depreciation is applied to the group. There is absolutely no support for the premise that the FCC requires a vintage method of group depreciation, nor is that position consistent with industry practice.

Again, however, if the Division and the Commission believe that a company has failed to properly consider the remaining service life of a group, there is a remedy for this that does not require abandonment of the group method. The Division or the Commission can require a

company to apply the “FCC Method³” to existing groups to recalculate the appropriate remaining life of a group. Use of the FCC formula and review of group lives are methods by which the Division and the Commission can retain use of the group method pursuant to Part 32, while ascertaining that an appropriate depreciation expense is claimed by the company.

5. No FCC rule prohibits an asset group from including fully depreciated assets. In its Order, the Commission states that *“the FCC rule also prohibits an asset group from including fully-depreciated assets, as the expenses associated with such an asset do not fall under the definition of depreciation. FN 4 Part 32 refers to such expenses as “losses,” clearly distinguishing them from depreciation expenses.”* In its Petition, Carbon requests that the Commission clarify where this “rule” is found in Part 32. In response to this request for clarification, the Division states that retaining fully depreciated assets in a group accelerates the depreciation rates and does not distribute the loss in service value of property in a straight line method during the service life of the property. The Division argues this is prohibited by the plain language of 47 CFR 32.2000(g)(1)(i). However, as acknowledged by the Division in its Response either a group is fully depreciated or not fully depreciated--there are no individual assets to consider or exclude. Neither the language of Part 32, nor FCC practice, prohibits an asset group from including fully depreciated components. Fully depreciated component that

³The FCC Formula was identified and set forth in the Direct Testimony of Joseph Hellewell, line 223-234:

“The FCC has developed a formula that has been used to recalculate the depreciation rate based on the plants average remaining life, future net salvage, and depreciation reserve ratio. . . The depreciation rate is calculated using the following formula:

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

Additionally, 47 CFR Part 32.2000(g)(1) provides:

(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.”.

continue to be used in operations remain in the plant account until the component has been disposed of. Regular accounting methods, fully account for the “fully depreciated” nature of the component by use of the depreciation expense account. Because a fully depreciated component has a net book value of zero, it has no effect on the rate base. The Commission’s Order erroneously seems to state that a fully depreciated asset should be removed from a plant account because it is fully depreciated. Carbon requests that the Commission clarify and correct this in the Order on Review.

CONCLUSION

Carbon respectfully requests review and clarification on the issues identified herein.

Dated this 23rd day of November, 2015.

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CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the Carbon/Emery Telcom, Inc.'s Reply Memorandum in Support of Petition for Review and, Docket No. 15-2302-01 was sent to the following individuals by email and/or mailing a copy thereof via first-class mail, postage prepaid (as indicated), this 23rd day of November, 2015:

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