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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 POST-HEARING BRIEF AND CLOSING ARGUMENT DOCKET NO. 15-2302-01

On January 26 and 27, 2016, the Public Service Commission ("Commission") held a hearing on Carbon/Emery Telcom, Inc.'s ("Carbon/Emery") Application for an Increase in Utah Universal Service Fund ("UUSF") Support. At the conclusion of the hearing the Commission agreed to permit the parties to submit post-hearing closing argument in writing to the Commission. In the post-hearing briefing the Commission also asked the parties to address two particular issues for submission to the Commission:

1. How should the Commission determine the level of UUSF Support when the conditions at the company may be changing?

Short Answer: The Commission should select a test period that accurately reflects the conditions the company will encounter during the period when the UUSF distributions will be in effect. In this case, the undisputed evidence shows that the conditions at Carbon/Emery are

accurately reflected in the 2014 test period, and will remain constant for at least 5 years. This question is addressed in further detail in Section I below.

2. How should Carbon/Emery's assets be viewed for purposes of depreciation?

a. Should the assets be viewed in groups with each component in the group being a part of the machine?

b. Or should each component be viewed as an independent asset with its own depreciable life?

Short Answer: Ultimately it doesn't matter whether Carbon/Emery's assets are viewed individually or in groups, provided the Commission does not change such view (and the method of depreciation) in the middle of the life of an asset. This question is addressed in further detail in Section II below.

I. DETERMINATION OF LEVEL OF UUSF SUPPORT

The Commission has asked the parties to address how the Commission should determine the appropriate amount of UUSF when conditions at the company may be changing. Specifically, the Commission has asked the parties whether the Commission should set the UUSF disbursement at a higher level as requested by Carbon/Emery; or whether the Commission should set the UUSF disbursement at a lower level, as suggested by the Division of Public Utilities ("Division") and the Office of Consumer Services ("Office").

The threshold question that must be determined by the Commission is whether Carbon/Emery is entitled to UUSF disbursements. The factors to be determined by the Commission in determining the UUSF eligibility and amount are set forth in Utah Code and Commission Rules. Utah Code Section 54-8b-15 establishes the Utah Universal Service Fund. Eligibility for disbursements under the fund for rate of return incumbent telephone corporations

such as Carbon/Emery is determined under rules promulgated by the Commission pursuant to Section 54-8b-15(3) and found in Commission Rule R746-360-6(2)(b) which provides:

> "Rate of return Incumbent telephone corporations shall complete a Commission review of their revenue requirement and public telecommunications services' rate structure prior to any change in their USF distribution which differs from a prior USF distribution."

R746-360-8 provides the method of calculating fund distributions for rate of return incumbent telephone corporations:

> Monies from the fund will equal the numerical difference between the Incumbent telephone corporation's total embedded costs of providing public telecommunications services, for a designated support area, less the product of the Incumbent telephone corporation's Average Revenue Per Line, for the designated support area, times the Incumbent telephone corporation's active access lines in the designated support area. "Total embedded costs" shall include a weighted average rate of return on capital of the intrastate and interstate jurisdictions.

In many instances, an Application for UUSF Distribution will be made in conjunction with an application for rate increase made under Utah Code 54-4-4. In this case, however, Carbon/Emery's rates are already at the Commission approved affordable base rate of $16.50 and $26.00 for residential and commercial service.[1] As a result, Carbon/Emery's Application for UUSF Increase is not a rate case. However, in order to determine Carbon/Emery's eligibility for UUSF disbursements, the Commission is required to review Carbon/Emery's revenue requirement, including total embedded costs, average revenue per line, and return on capital, as it would in a rate case. Therefore, the statutes governing the determination of just and reasonable rates are instructive for the calculation of UUSF disbursements.

Utah Code Annotated Section 54-4-4(3)(a) states that in determining just and reasonable rates, the Commission "shall select a test period that, on the basis of the evidence, the

1 Transcript page ("T.") 16, Lines 9-12.

commission finds best reflects the conditions that a public utility will encounter during the period when the rates determined by the commission will be in effect." Similarly, in UUSF Applications the applicant selects a proposed test period. In determining the appropriate level of UUSF to be distributed, the Commission is required, under Utah law to select a test period that best reflects the conditions the public utility will encounter during the period when the UUSF disbursement determined by the Commission will be in effect. The Commission then reviews the revenue requirement based on the appropriate test period and determines the amount of UUSF that the Company is eligible for during the test period. It is not necessary, nor is it appropriate under Utah law, to consider the UUSF distribution in terms of "going high now" or "going low now" and "truing up" in a future UUSF Application proceedings. Rather, the Commission is required under Utah to select the test period that ***on the basis of evidence***, the Commission finds ***best reflects the conditions that a public utility will encounter during effective period of the*** UUSF distribution. See UCA Section 54-4-4(3)(a).

In this case, Carbon/Emery has suggested an historical test period from January 1, 2014 through December 31, 2014,[2] adjusted for known and measurable changes as permitted by Utah Code Annotated Section 54-4-4(3)(b). Carbon has demonstrated that its regulated revenues from all sources in the test period (revenues received from the provision of services in both the interstate and intrastate jurisdictions, all revenues derived from providing network elements, services, functionalities, and all support funds received from the Federal Universal Service Support Fund) do not cover its reasonable costs of providing basic telephone service plus a

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2 T. 22, Lines 14-24.

reasonable rate of return in the test period.[3]. Pursuant to Utah Code, Carbon is statutorily entitled to USF disbursements.

The question for this Commission is the determination of the amount of the UUSF disbursement to which Carbon/Emery is statutorily entitled. Consistent with the Commission's existing practice, the Commission's determination of UUSF should not be arbitrary in approach or result, but, rather, should be based an objective and consistently applied standard in conjunction with existing laws and industry practice allowing for investment decisions to be made with confidence and reasonable certainty. As the Commission is aware, Carbon/Emery, the Division, the Office, and URTA pre-filed written testimony in this proceeding. Neither the Division nor the Office have specifically opposed Carbon/Emery's proposed test period. However, both the Division and the Office have argued for adjustments resulting from concern of events that may occur outside the test period. These adjustments will be discussed below, and Carbon/Emery will demonstrate how all of these proposed adjustments are inappropriate because they do not accurately reflect the conditions that Carbon/Emery will encounter during the effective period of the UUSF determination.

A. PROPOSED ADJUSTMENTS

As the evidence shows, there are three open issues between Carbon/Emery and the Division: (i) Depreciation Expense Calculation; (ii) Return on Equity (and thus rate of return); and (iii) the effect of the rate of return on the migration of cable customer issue.

Between the Office and Carbon/Emery, there are six open issues: (i) Depreciation Expense Adjustment; (ii) Rate of Return; (iii) Rate base adjustments for telephone plant under

3 T. 15, Lines 21-25; T. 16, Lines 1-8; T. 154, Lines 22-23; and Ostrander Surrebuttal Testimony, OCS Exh. 1S-1)

construction and materials and services; (iv) Cost allocations; (v) Adjustment for removal of landline loss calculation; and (vi) Interest Synchronization.

1. Proposed Depreciation Adjustments Do Not Accurately Reflect the Conditions at Carbon/Emery During the Effective Period of the UUSF Distribution.

Carbon/Emery has testified that its depreciation expense for the test period calculated under the group asset method of depreciation that the company has employed since its inception is accurately reflected in Exhibit CE-3.1D. Carbon has provided extensive testimony that this depreciation expense number is representative of the depreciation expense the company will experience in the next 5 years.[4]

On the other hand, the Division has testified that Carbon/Emery's depreciation expense for the test period should be reduced by approximately $560,000. The Division calculated this adjustment using what it calls a single asset straight-line method of depreciation. In fact, the undisputed testimony reveals that the Division does not calculate the depreciation expense of each individual asset, rather the Division uses a modified group asset approach in which assets are grouped together in smaller groups divided by year purchased.[5] The Division's criticism with Carbon/Emery's group depreciation method is that it manipulates Commission approved rates of depreciation and is not consistent with Utah Code Section 54-7-12.1 which provides:

> In determining the depreciation expense of a telephone corporation in any proceeding under Section 54-7-12, the commission shall consider all relevant factors, including the alteration of asset lives to better reflect changes in economic life of plant and equipment used to provide telecommunications services. A relevant factor to consider shall be the asset lives of existing and emerging competitive telecommunications providers. Nevertheless, the commission shall retain the authority to determine the depreciation expense of telecommunications corporations for ratemaking purposes.

4 T. 25, Lines 4-10.

5 Sur-Surrebuttal Testimony of Mr. Woolsey, Lines 85-88.

Specifically, the Division states:

> "The effect of the depreciation expense and method resulting from Carbon-Emery's adoption of group asset depreciation is to alter lives and rates established by the Commission and is not reasonable. The DPU's adjustment is to bring Carbon-Emery's depreciation expense into conformity with the Commission's rates and lives. The Division's main goal is to establish a reasonable depreciation expense that matches depletion of the asset's book value with its actual useful life."[6]

Although the Division has suggested a reduction in the 2014 test year depreciation expense, the undisputed testimony is that the Carbon/Emery depreciation expense for subsequent years (at least through 2019) will be higher than that proposed by the Division for the test period.[7] In fact, although the Division alluded to a depreciation expense "cliff", this is not supported by the data. The only way Carbon/Emery will suffer a depreciation expense cliff is without continued investment. However, there has been no evidence presented in this proceeding that Carbon/Emery is not planning on substantial continued investment for at least the next 5 to 7 years. On the contrary, the Division acknowledged Carbon/Emery's continued investment over the next five plus years, and testified that their proposed depreciation expense number would not be representative of the expected depreciation expense for the next several years.[8] The Division acknowledged that during the period of construction the depreciation expense would increase, but there is no evidence that Carbon/Emery is inappropriately accelerating its investments to improperly increase its depreciation expense.[9]

Therefore, the 2014 test year depreciation expense adjustment proposed by the Division does not accurately reflect the conditions that Carbon/Emery will encounter during the period

6 Surrebuttal Testimony of Hellewell, Lines 48-53.
7 T. 44, Lines 17-25, and T. 45, Lines 1-25.
8 Id.
9 T. 159, Lines 16-22; T.235, Lines 2-14.

when the UUSF distribution determined by the Commission will be in effect, as required by Utah Code Annotated Section 54-4-4. Furthermore, as demonstrated in the testimony of Mr. Woolsey, the Division in its application of the single asset straight-line method of depreciation has not considered the interstate revenue impact associated with a reduction in the depreciation expense. Carbon/Emery has determined that the interstate revenue impact associated with the Division's proposed depreciation expense adjustment is over $240,000.[10] This means that if the Division's depreciation method is used, Carbon/Emery's interstate revenue will be reduced by over $240,000, and that amount of interstate revenue will be eligible for recovery from the State UUSF.[11] Again, as a result of the interstate effect of the depreciation adjustment that has not been considered by the Division, the 2014 test year depreciation expense adjustment proposed by the Division does not accurately reflect the conditions that Carbon/Emery will encounter during the period when the UUSF distribution determined by the Commission will be in effect.

Similarly, the Office testified that Carbon/Emery's depreciation expense should be reduced by, approximately, $360,000. The Office calculated this adjustment by eliminating what the Office called "fully depreciated assets." In fact, the Office's adjustment does not address assets that were fully depreciated in the 2014 test period. Rather, the Office's adjustment considers asset that ***will be*** fully depreciated within four years of the test year.[12] As a result, the Office appears to be taking the position that the Commission should consider the full depreciation of asset groups in the period that is within 4 years of the test year, but the Office does not consider assets that will be added to the rate base in that same time period. The

10 Sur-Surrebuttal Testimony of Mr. Woolsey, Lines 274-277.
11 Id. at 283-288.
12 Ostrander Revised Direct Testimony, Lines 165-175, 1038-1099.

undisputed evidence offered by Carbon/Emery demonstrates that Carbon/Emery will be adding rate base in the next five years at a rate that exceeds the Carbon/Emery proposed test year depreciation expense.[13] Therefore, the Office's depreciation expense adjustment also does not accurately reflect the conditions that Carbon/Emery will encounter during the period when the UUSF disbursement by the Commission will be in effect.

In response to the concerns of the Division and the Office regarding the accuracy of the average remaining lives of Carbon/Emery's asset groups, Carbon/Emery recalculated the depreciation expense for the test period using the FCC method of depreciation identified by Mr. Hellewell.[14] The Division testifies that the FCC method is an appropriate alternate depreciation method, and there is no testimony that Carbon has calculated the FCC method incorrectly. Furthermore, the evidence presented in this matter demonstrates that the FCC method of depreciation includes review and adjustment of the remaining lives in its group asset accounts to properly reflect changes in the economic life of plant and equipment used to provide telecommunications services as required by Utah Code Section 54-7-12.1.[15] It is also undisputed that the remaining service lives of the asset groups, as determined by Mr. Woolsey in his Sur-Surrebuttal Testimony accurately reflect the average remaining service lives of the asset groups.[16]

Using the FCC Method, Mr. Woolsey calculated Carbon/Emery's depreciation expense, and the undisputed testimony is the depreciation expense calculated using the FCC Method for the test period ranges from a decrease in the depreciation expense of $189,000 to an *increase* in

13 T. 45, Line 3-11.
14 Hellewell Direct Testimony, Line 223-234.
15 T. 228, Line 24.
16 T. 233, Line 11.

the depreciation expense in the amount of $14,000, depending upon whether a mid-year or end of year convention were used. Therefore, calculation of the depreciation expense using the FCC method results in a depreciation expense that is not materially different from the depreciation expense included in Carbon's Application when properly taking into consideration the interstate revenue impact of the depreciation expense adjustment.

It is undisputed that all methods of depreciation are approximations of the diminution of value of the assets. Proper adjustments within Carbon/Emery's chosen depreciation method will yield the best approximation of the actual diminution of value of Carbon/Emery's assets without creating an artificial distortion by changing the depreciation method in the middle of the life of the asset group. The FCC method does a better job of approximating the actual diminution of value of the assets than the single asset method because the FCC method requires the company to consider the actual remaining life of the group asset on a periodic basis. The FCC method addresses both the Division's concerns and the Office's perceived problems with Carbon's group method.

If the Commission determines that a change in depreciation method is warranted, the Commission should adopt the FCC Method which provides for consideration of average remaining life in the asset groups. This is consistent with Utah Code Section 54-7-12.1 and addresses the concerns that the Division has about accurate depreciation lives.

While the evidence demonstrates that single asset straight-line does not adequately take into consideration alteration of asset lives to better reflect changes in economic life of plant and equipment,[17] if the Commission decides to adopt the single asset straight-line method, it should

17 Transcript p. 223, Lines 1-4.

do so on a going forward method for assets added after the test year. Carbon/Emery selected the group method and applied it since its inception with no issues from the Division until this UUSF proceeding. Under Utah Code 54-4-4(4), if the Commission considers the prudence of an action taken by a public utility, the Commission is required to focus on the reasonableness of the expense resulting from the action of the public utility judged as of the time the action was taken. In this case, Carbon/Emery carefully selected the method of depreciation and relied on that method to provide a stable predictable depreciation expense used by management to forecast and plan. If the Commission decides to require a change in depreciation methods, it should be on a prospective basis for assets added after the change is adopted[18].

2. The Rate of Return Proposed by Carbon/Emery is Conservative, Just, and Reasonable.

With regard to the Rate of Return, all parties agree on the cost of debt and the jurisdictional separations between interstate and intrastate jurisdictions.[19] With regard to capital structure, it is undisputed that Carbon/Emery currently has no debt.[20] Nevertheless, the Division and Carbon/Emery agree that use of a hypothetical capital structure of 35% debt and 65% equity as has been the practice for several years is appropriate.[21] The Office believes that the capital structure should be a hypothetical capital structure of 50% debt and 50% equity.[22] The testimony is undisputed that imputation of a hypothetical capital structure negatively affects Carbon/Emery's rate of return calculation. However, based on the recommendation of a task

18 The Utah Rural Telecom Association also supports this approach in the event the Commission requires a change in depreciation methods.
19 T. 112, Lines 13-16.
20 T. 29, Line 20.
21 T 23, Line 11; T.111, Lines 11-23.
22 T. 255, Line 12-13.

force that was convened to discuss capital structure, the Division has typically employed a hypothetical capital structure for companies who have less than 35% debt or equity.[23] It is just and reasonable for the Commission to impute a capital structure of 35% debt in Carbon/Emery's case. It is not, however, just and reasonable, to impute a capital structure of 50% debt for a company that has no debt unless the Commission is adopting an optimal capital structure to be used for all companies going forward. Of course, if the Commission is adopting an optimal capital structure, it is required to do so in a formal rulemaking proceeding under the Utah Administrative Rules Act.

The next issue related to the rate of return in this case is the interstate rate of return that is to be used pursuant to R746-360-8. With regard to the interstate rate of return, the Division and Carbon/Emery have both presented testimony that the correct interstate rate of return should be taken from the NECA form 492 that is applicable to the applicant. It is undisputed that Carbon/Emery participates only in NECA's common line pool, but does not participate in NECA's traffic sensitive and special access pools.[24] Therefore, the interstate rate or return of 11.45% is the appropriate interstate rate of return based on Carbon/Emery's participation in the NECA cost pools[25] and the interstate rate of return applicable to traffic sensitive and special access pools is not applicable to Carbon/Emery. The Office believes the interstate rate of return should be 9.4%[26]. The Office claims it is reasonable that R746-360-8 be interpreted to employ

23 T. 163, Lines 22-24.
24 T. 257, Lines 4-5.
25 T. 112, Lines 1-12.
26 T. 256, Line 16.

the rate of return on Form 492 which captures all interstate services[27]. However, it is not appropriate to use the Form 492 that is not applicable to the applicant.

None of the parties agree on the last element of the Rate of return calculation, which is return on equity. Carbon/Emery in its Application proposed a 12.13% return on equity because this is the figure that was used by the Division in the Hanksville Telcom UUSF application in May of 2014, approved by the Commission in August of 2014. However, the Direct Testimony of Douglas Meredith shows that 12.13% ROE is conservative in light of appropriate small company premiums which should be used. As identified in the testimony of Douglas Meredith, and unrebutted in this proceeding, well-established research firms such as Ibbotson & Associates or Duff and Phelps publish small company premiums. Small company premium are used by finance practitioners in the construction of forward looking cost of equity estimates.[28] It is appropriate to apply a small company premium to Carbon/Emery because the the evidence shows that the CAPM model provided by the Division does not use companies in the mode that are comparable to Carbon/Emery.[29] It is not appropriate to treat the cost of equity calculation in this case as an academic exercise. On the contrary, if the Commission uses a CAPM model for determination of the cost of equity, the Commission should look at these issues like practitioners do and apply a small company premium to account for real differences between Carbon/Emery and the companies used in the model. Furthermore, the CAPM model does not apply the governing standard in Utah for return on equity calculations. The Supreme Court has stated that the governing standard in determining the rate of return on equity is the cost of inducing capital

27 T. 256, Lines 20-22.
28 T. 113, Lines 5-11.
29 T.180, Lines 7-25; T. 181, Lines 1-16.

markets to invest in the utility—not the cost of inducing the utility to invest in Utah.[30] The Division did not analyze the cost of inducing capital markets to invest in Carbon/Emery.[31]

The Division also presented evidence that because Carbon/Emery has access to the Utah Universal Service Fund to defray the costs of providing service, that it, in fact, is considered a lower risk investment than most industries.[32] This position, however, completely overlooks the undisputed evidence that the Division and the Commission can, and do, review UUSF disbursements at any time.[33] The risk associated with UUSF is a regulatory risk that is real, as demonstrated by certain positions taken by the Division in this proceeding. Specifically, the Division in this proceeding is proposing that the Commission reject the prudent business decision of Carbon/Emery to use (continue to use) group asset depreciation, and review the UUSF application using a different method of depreciation to be applied in the middle of the asset lives. The possibility of the Commission agreeing with this position, and failing to fully and properly account for the change in depreciation methods, is a very real regulatory risk that Carbon/Emery faces. The Division's claim that Carbon/Emery's risk is reduced because it has access to UUSF doesn't consider or acknowledge this regulatory risk. The combination of small company risk, liquidity risk, and regulatory risk more than offsets any elusive "certainty" derived from state UUSF. As a result, there should be a positive adjustment to the CAPM value before assigning a disparate peer group result to Carbon/Emery.

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30 *Stewart v. Utah Public Service Commission,* 885 P.2d 759 (Utah 1994).
31 T. 185, Lines 2-4.
32 Surrebuttal Testimony of Casey Coleman, Line 334-339.
33 In fact, the Commission can take judicial notice of the fact while a company is required to prosecute a complete UUSF application to receive an increase in UUSF disbursements, historically, the Division has decreased companies' UUSF distributions by issuing a letter to such companies in a perfunctory manner.

The evidence presented by the Office on return on equity is also not persuasive. The Office relies primarily on stipulated cases out of Kansas on companies that are not even closely comparable to Carbon/Emery. There is no dispute that the actions of the Kansas Corporations Commission are not controlling on this Commission. However, the Kansas cases cited by the Office do not offer any valuable persuasive effect either since the majority of the cases did not involve a disputed return on equity.

As the testimony of Douglas Meredith proves, the 12.13% return on equity used by Carbon/Emery is consistent with the most recent UUSF cases determined by the Commission, and is conservative when considering the risks associated with small companies such as Carbon/Emery.

3. Proposed Adjustment to Materials and Supplies and Telephone Plant Under Construction Do Not Accurately Reflect the Conditions that Carbon/Emery Will Encounter During the Effective Period of the UUSF Distribution.

Two other adjustments that the Office has suggested in this Application proceeding are 50% reductions in Materials and Supplies and Telephone Plant Under Construction. The Office does not dispute that the materials and supplies and telephone plant under construction ("TPUC") as identified by Carbon/Emery in its application are not accurate for the test period. Rather, the Office claims that the level of materials and supplies and TPUC in the test period does not accurately reflect the historical level of materials and supplies and TPUC.[34] The Office claims that because the levels of materials and supplies and TPUC in the test period (and continuing for five years) are higher than historic levels, they are "temporary" and "these

34 Ostrander Direct Testimony, Lines 946-961 and 983-1003

temporary inflated costs should not be permanently built into UUSF revenue requirements."[35] Carbon/Emery has testified, and there is no evidence to the contrary, that the current level of materials and supplies, as identified in the test period, is expected to continue for at least five (5) years.[36] Furthermore, with regard to TPUC, Mr. Woolsey's testimony demonstrates that Carbon is only including actual plant expenditures which currently reside in TPUC. This is not an account that should be normalized to find an "appropriate" operating level. This account by its very nature accurately reflects actual plant expenditures in the test period.[37]

The Office is not disputing the accuracy of the plant expenditures in the test period. Rather, the Office is concerned that temporary costs are being permanently built into UUSF revenue requirements overlooks the requirement of the UUSF rules. A UUSF distribution is not permanent. Rather, a UUSF distribution is set at a particular level, based on the revenue requirement of the applicant for the selected test period. In this case, Carbon/Emery filed an application for increase in UUSF support based on a 2014 historical test year. The undisputed evidence offered in this case demonstrates that the 2014 test year accurately reflects the conditions that Carbon/Emery expects to encounter for at least 5 years. It is unreasonable to attempt to anticipate the conditions that Carbon/Emery would expect to encounter beyond five years; and it is unreasonable to suggest that the "effective period" of the UUSF distribution will exceed five years. More importantly, Carbon/Emery files annual reports with the Commission each year. These reports are reviewed by the Division. In the event that the Division believes that the conditions encountered by Carbon/Emery have changed such that Carbon/Emery's

35 Ostrander Surrebuttal Testimony, Lines 493-501.
36 Revised Confidential Rebuttal Testimony of Mr. Woolsey, Line 691-705.
37 T. 27, Lines 4-7.

revenue requirement has changed significantly, the Division can request agency action by the Commission to determine an accurate level of UUSF distribution at that time.

4. Proposed Adjustment to Cost Allocation Factors are Based on Faulty and Inaccurate Assumptions.

The Office claims that adjustments are needed for certain of Carbon/Emery's cost allocation factors. Specifically, the Office proposes a reduction in the corporate overhead Accounting and General (A&G) allocation factor from 74% regulated/26% non-regulated, to 50/50.[38] The testimony of Mr. Woolsey demonstrates that Mr. Ostrander relies on inaccurate assumptions and erroneous data in reaching this conclusion.[39] In particular, Mr. Ostrander found that "certain financial data, allocations, and changes in amounts from year to year appear unusual or appear to favor the non-regulated affiliates."[40] However, the net income figures that Mr. Ostrander used to support this claim were incorrect.[41] Further, contrary to the claims of Mr. Ostrander there was no shift in allocated costs from regulated to nonregulated operations.[42] Rather, the increase in expense is associated with an increase in amortization and depreciation expense for the non-regulated affiliate that result from non-regulated company specific plant investments—not some elusive shift of costs from the regulated operations to the non-regulated operations.[43] Additionally, Mr. Ostrander's conclusion that it is "odd" that there are no allocation factors that allocated 50% or more of the expenses to the non-regulated operations completely fails to consider that many of the costs are direct coded to non-regulated operations.[44] In short,

38 Ostrander Direct Testimony, Lines 504-509.
39 Revised Rebuttal Testimony of Mr. Woolsey, Lines 134-142.
40 Ostrander Direct Testimony, Lines 504-509.
41 Revised Rebuttal Testimony of Mr. Woolsey, Lines 156-200.
42 Id. at Lines 204-206, 211-216.
43 Id.at Lines 240-256.
44 Id. at Lines 295-306.

Mr. Ostrander has offered no accurate or credible evidence to support his adjustment of the A&G allocation factor from 74/26 regulated/non-regulated to 50/50.

Mr. Ostrander suggests that Carbon/Emery's A&G Allocation factor, which is based on billing records is inappropriate. Mr. Ostrander proposes that the A&G Allocation factor should be based on more inputs than just billing records.[45] However, Carbon/Emery demonstrated that billing records are representative of the types of services, number of customers, complexity of regulatory compliance, and issues the Carbon/Emery CEO and Board deal with on a regular basis. Additionally, the billing records identify the types of services being marketed by the Company. Finally, billing records reflect forward looking CEO plans, board decisions, and marketing efforts as measured in resulting customer growth.[46] Mr. Ostrander suggests use of expenses, revenues, net plant, billing records, and payroll to determine a 50/50 A&G Allocation factor.[47] However, Mr. Ostrander's calculation of this allocation factor is flawed for several reasons: 1) revenues are not appropriate drivers of cost because the products offered by the regulated and non-regulated companies are not homogenous;[48] 2) expenses are not appropriate drivers of costs because there are significant direct coded expenses that have no relationship to the amount of time spent by the CEO or Board (i.e. programming costs);[49] 3) payroll records can be an accurate driver of costs, however Mr. Ostrander included payroll twice (in expenses and payroll);[50] 4) plant can be an accurate driver of costs, but gross plant should be used (rather than

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45 Ostrander Direct Testimony, Lines 148-151.
46 Revised Rebuttal Testimony of Mr. Woolsey, Lines 381-391.
47 Ostrander Direct Testimony, Line 729.
48 Revised Rebuttal Testimony of Mr. Woolsey, Lines 311-357.
49 Id. at 363-378.
50 Transcript 289, Lines 11-14

net plant used by Mr. Ostrander) to capture all plant in service (including fully depreciated plant) since fully depreciated plant may still have costs associated with it;[51] and finally, 5) Mr. Ostrander failed to properly weight the cost drivers in his calculation. When Mr. Woolsey recalculated the A&G Allocation factor using billing records, gross plant, and payroll properly weighted as inputs, the allocation factor is essentially the same allocation percentage as when just billing records are used.[52] This demonstrates that when the appropriate calculations are made with accurate numbers, the A&G Allocation factor of 74% regulated is just and reasonable.

The Office also questions Carbon/Emery's Customer Service Representative ("CSR") cost allocation factor. As indicated in the testimony of Mr. Woolsey, CSR costs are allocated between regulated and nonregulated companies based first on the direct coding of CSR time to the regulated or nonregulated companies. The remaining time that is not direct coded is allocated using four cost allocation factors, including the CSR distribution currently at issue as well as three other allocators including the dispatch distribution, directory distribution, and Moab CSR distributions.[53] Carbon/Emery has shown that the Office's proposed adjustment was based on faulty and inaccurate assumptions, not supported by the data provided to the Office by Carbon/Emery. A proper review of the data demonstrates that Carbon/Emery's CSR allocation factor is supported, just and reasonable, and it is undisputed that in the 2014 test period resulted in a greater allocation of CSR department costs to Carbon/Emery's non-regulated affiliate operations than to the regulated affiliates.

51 T. 289, Lines 19-22.
52 T. 29, Lines 7-16.
53 T. 28, Lines 1-9.

The reasonableness of Carbon/Emery's allocation factors is further supported by the fact that the Division which is the entity that is statutorily charged with reviewing and auditing these issues has conducted a substantial and robust review of the expenses and allocations of Carbon/Emery and has testified that it has no issues with the companies allocation factors, no issues with the telephone plant under construction, or materials and supplies contained in rate base, and is not recommending any adjustments on these issues.[54] Finally, while Carbon/Emery does not agree with any of the Office's proposed adjustments, any expense adjustment that might be considered by the Commission must consider the interstate revenue impact associated with such reduction in expense as discussed above with regard to depreciation expense.

5. The Remaining Adjustment Issues Do Not Accurately Reflect the Conditions that Carbon/Emery Will Encounter During the Period of the UUSF Distribution.

There are two additional adjustments that the Office is proposing. The first is an adjustment for removal of landline loss calculation. The Office believes that landline loss is speculative and should therefore, not be included in the revenue requirement. Carbon/Emery and the Division believe that landline loss is known and measurable and is properly included in the 2014 test period because it best reflects the conditions that Carbon/Emery will encounter during the UUSF distribution period.

The Office is also suggesting an adjustment to account for interest synchronization. Interest synchronization proposes to make an adjustment for tax deductions for interest paid on debt that does not exist. Interest synchronization should not be applied when a company has no

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54 T. 162, Lines 1-8.

actual debt. Additionally, even if the Commission were to accept the theoretical adjustment for interest synchronization, Mr. Ostrander performed the calculation incorrectly.[55]

B. THE FINAL POSITION OF THE OFFICE.

It should be noted that the Testimony, as provided by the Office both in written form, and at the hearing does not adequately summarize the amount of UUSF that the Office believes Carbon/Emery is entitled. This is because OCS Exhibit 1S-1 provided by the Office in its Errata Testimony filed on January 25, 2016, includes the uncorrected rate of return, and has not been revised to eliminate the cable migration issue that Mr. Ostrander withdrew on the witness stand.

II. CONSIDERATION OF CARBON/EMERY'S ASSETS AS INDIVIDUAL ASSETS OR AS COMPONENT PARTS OF A LARGER GROUP.

At the Hearing, the Commission asked the parties to address whether Carbon/Emery's "assets" should be viewed in groups with component parts making up larger "machines;" or if the "assets" should be viewed individually. As discussed above, Carbon/Emery has employed a group asset method of depreciation under FCC Part 32 since its inception as a company. Carbon/Emery assigns asset units into groups based on the specific characteristics and use. Once these units are assigned to a group, the asset group becomes the asset for purposes of calculating depreciation. Carbon/Emery uses approved depreciation rates and utilizes straight-line depreciation applied to each "group asset."[56] To use the language in the Commission's inquiry, under the group asset method, it is as if all of the units in the group make up an individual "machine" and the applicable depreciation rate is applied to that one "machine."

55 Revised Rebuttal Testimony of Mr. Woolsey, Lines 1071-1087.
56 See Sur-Surrebuttal Testimony of Mr. Woolsey, Lines 17-20.

As Mr. Woolsey testified, the concept of treating individual units as one “asset” for depreciation purposes evolved in utilities because “individual components of the telecommunications network systems are too numerous to practically track on an individual basis given the small relative value of each individual component asset.”[57] Additionally, utilities have historically used the group method because the telephone networks are comprised of larger assets such as fiber or cable lines which contain numerous component parts which are impractical to track separately. The assets are often so heavily intertwined that separated alone, they are irrelevant.[58] For example, a piece of copper that is installed to repair a damaged section of the network may individually have an estimated useful life of 20 years. But when added to the network to replace the damaged section, the “new” copper fiber section becomes a component part of the entire copper network. According to the testimony of Mr. Woolsey, “While this may result in the new copper being depreciated more quickly as part of the group than if it were an individual component depreciated at the unit level, the fact is that the component has no useful life outside of the group of components with which it was installed. In other words, the group should depreciate together, because it will likely be replaced or retired as a group at some point in time. The new additions may serve to prolong such replacement, but will not be useful outside the group.”[59]

The Division has suggested that treating Carbon/Emery’s assets as individual assets and applying the Commission approved depreciation rate to individual assets, results in a more accurate depreciation expense that is not accelerated.[60]

57 Id. at Lines 29-32.
58 Id. at Lines 29-36.
59 Id. at Lines 60-66.
60 T. 215, Lines 4-8.

The fact of the matter is that whether the Commission looks at the assets as component parts of a machine, or as individual assets ultimately does not matter to Carbon/Emery. While Carbon/Emery has employed the group method because such method is required by FCC Part 32 and is used in the interstate jurisdiction, both methods ultimately result in the same amount of depreciation expense for the company. The critical point for the Commission's consideration with regard to depreciation methods is to ensure that the method of depreciation is not changed in the middle of the asset life. As discussed above, Carbon/Emery carefully selected and applied its chosen method of depreciation—group asset depreciation—in 2001 and has been utilizing that method in compliance with FCC Part 32 since that time.

Carbon/Emery's use of the group method of depreciation is permitted by Part 32;[61] consideration of assets in terms of groups has historical and current relevance given the nature of telecommunications networks and plant assets; Carbon/Emery has used the group method of depreciation since 2001 without question;[62] and Carbon/Emery's application of the group method results in a depreciation expense that is consistent with the FCC Method[63] which the Division has testified is an acceptable method of depreciation.[64] The prudence of Carbon/Emery's choice to use the group method must, pursuant to Utah law,[65] be judged at the time the action was taken. There simply is no evidence to suggest that Carbon/Emery's choice of method of depreciation was imprudent when made. In order to preserve Carbon/Emery's carefully considered choice of depreciation methods, if the Commission is considering

61 T. 24, Lines 21-25; T. 25, Lines 1-4; T. 303, Lines 3-4.
62 T.25, Lines 1-4.
63 See Sur-Surrebuttal Testimony of Mr. Woolsey, Lines 378-402.
64 See Direct Testimony of Joseph Hellewell, Lines 223-234.
65 UCA Section 54-4-4(4).

abandoning the group method of depreciation and requiring a change in depreciation methods, it should be on a prospective basis for assets added after the change is adopted.

III. CONCLUSION

Carbon/Emery is statutorily entitled to $570,643 in additional UUSF disbursements plus the customary allowance of legal and consulting fees incurred in prosecuting this Application. All of which should be awarded by the Commission in this case so that it may continue to provide quality telephone services to the customers in its area.

Dated this 2nd day of March, 2016.

BLACKBURN & STOLL, LC

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CERTIFICATE OF MAILING

I hereby certify that a true and correct copy of the Carbon/Emery Telcom, Inc.'s Post-Hearing Brief and Closing Argument, 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 2nd day of March, 2016:

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