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| Docket: | : | A.11-12-011 |
| Exhibit Number | : | ORA - ____ |
| Commissioner | : | M. Florio |
| Administrative Law Judge | : | J. Halligan |
| ORA Witnesses | : | R. Rauschmeier<br>L. Krannawitter<br>C. Chitadje<br>B. Goldman<br>P. Hoglund<br>R. Schwartz |

**OFFICE OF RATEPAYER ADVOCATES**
**CALIFORNIA PUBLIC UTILITIES COMMISSION**

# ORA's Report and Recommendations on the Application of Kerman Telephone Company to Review Intrastate Rates and Charges for Telephone Service within the State of California (Test Year 2016)

**CORRECTED**

**San Francisco, California**
**March 27, 2015**

1

# MEMORANDUM

This report was prepared by staff of the Communications & Water Policy Branch of the Office of Ratepayer Advocates ("ORA") under the general supervision of Program Manager, Chris Ungson, and Program & Project Supervisor, Richard Rauschmeier. ORA is represented in this proceeding by legal counsel, Travis Foss.

The table below identifies the names of ORA witnesses and the sections of this report for which they are responsible. A statement of qualifications for each ORA witness is presented in Attachment M-1 to this report.

| SECTION OF REPORT | ORA WITNESS |
|---|---|
| Executive Summary | Richard Rauschmeier |
| Chapter 1: Revenues | Laura Krannawitter |
| Chapter 2: Expenses | Charlotte Chitadje |
| Chapter 3: Plant, Depreciation, & Ratebase | Brian Goldman |
| Chapter 4: Cost of Capital | Patrick Hoglund |
| Chapter 5: Service Quality | Robert Schwartz |
| Chapter 6: Analysis of Kerman Phone Bills | Robert Schwartz |

In preparing this report, ORA prioritized analyses and recommendations based upon resources available. Therefore, the absence from this report of analysis or recommendation on any particular item contained within Application ("A.") A.11-12-011 should not be considered as ORA's agreement with any underlying request or policy position related to that item.

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# EXECUTIVE SUMMARY

In response to new ratemaking rules adopted in R.11-11-007, on January 30, 2015, the Kerman Telephone Company ("KTC") submitted supplemental testimony to update rate proposals made in A.11-12-011. In its supplemental testimony, KTC updated its previously submitted revenue and expense estimates, which resulted in the company's currently forecasted intrastate revenue requirements of $10,311,373 for the 2016 test year. Contained within its estimate of 2016 revenue requirements, KTC proposes an increase to $6,011,945 from its current California High Cost Fund-A ("CHCF-A") subsidy.[1]

After examining the books and records of KTC and testing for reasonableness and prudency, ORA recommends the Commission authorize intrastate revenue requirements totaling $6,602,548 for the 2016 test year. When combined with its forecast of other revenues, ORA calculates a total subsidy of $1,938,638 from the CHCF-A in test year 2016. A comparison of the components that comprise ORA and KTC estimates of revenue requirements is presented in Attachment ES-1 to this report. The following is a summary of ORA's foremost findings and conclusions.

## Comparable Rates for Ancillary Services

While ORA recommends only minimal adjustments in basic service rates in order to prevent disproportional rate changes between customer classes, the rates for custom calling features (i.e. call ID, wait, forward) and vertical services (i.e. inside wire maintenance) should be increased to better reflect the comparable rates of other carriers. Since custom calling features and vertical services are not "basic telephone service" the rates charged by KTC for these services should more closely approach the higher comparable rates charged by other carriers in order to

[1] The CHCF-A was established in 1987 for the purpose of minimizing any basic telephone service rate disparity between rural and metropolitan areas. Additional information pertaining to the CHCF-A can be found at: http://www.cpuc.ca.gov/puc/telco/public+programs/chcfa.htm

help reduce necessary subsidies from the CHCF-A. As discussed in Chapter 1, ORA's recommendation for increases in the rates for these services is estimated to yield approximately $270,000 in additional 2016 revenue.

**Corporate Expense Caps**

The Federal Communications Commission's ("FCC") Corporate Expense Caps should be applied without modification as adopted in Commission Decision ("D.") D.14-12-084. Although KTC devotes nearly half of its supplemental testimony to explaining why local economic conditions within the city of Kerman justify minimal increases to basic service rates – a position to which ORA largely agrees – similar logic is overlooked by KTC when explaining why it should be permitted to exceed the FCC's Corporate Expense Caps. KTC's explanation that the caps fail to consider the higher cost of doing business in California as a whole is undermined by KTC's own failure to adjust for the lower costs in the city of Kerman and county of Fresno that KTC earlier cite in support of its basic service rate proposals.[2]

Additionally, ORA's review and testing of just 3% of KTC's recorded line-item expenses revealed more than $847,000 in inappropriate corporate expenses for ratemaking purposes. Presented in detail within Chapter 2, examples of improper ratemaking expenses include KTC's sponsorship of golf tournaments, polo festivals, guest apartments, and holiday parties costing nearly $500 per ~~person~~ employee. ORA's recommendation to apply the FCC's Corporate Expense Caps without modification would reduce estimated intrastate revenue requirements in 2016 by $1,148,933.

[2] "The median income in Fresno County is 25.4% less than California overall and the median income in the City of Kerman is 18.57% less than California as a whole." Lines 11-13, page 6 of the Supplemental Testimony of David Clark.

**Allocation of Costs Proportional to Affiliate Benefits**

Similar to several of its affiliates, KTC does business under the name "Sebastian." In addition to creating a tangle of business records that are difficult to segregate, the business name and organizational structure of KTC within the parent company Sebastian Enterprises facilitates the loading of costs within the regulated entity while unregulated affiliates reap the benefits and rewards. One example which is further explained in Chapter 3 includes the regulated account "Other Work Equipment." Within this account are the costs of construction equipment that is neither used nor useful by the regulated entity but is nevertheless included in the regulated rate base. The actual equipment in this account is leased to unregulated affiliates that reimburse KTC at often just 1/10 of the competitive market rate. Further complicating this arrangement, the majority of KTC's actual construction is procured through its affiliates. In fact, more than 65% of KTC's 2014 plant additions were procured directly from affiliates.[3]

**Rate of Return**

Although the market changes that have occurred since the Commission adopted KTC's current 10% rate of return in 1997 make KTC's requested increase in rate of return to 13.63% appear counter intuitive, a far more troubling aspect of KTC's proposal resides within the individual components of KTC's proposal. As discussed in Chapter 4, the target capital structure identified within the strategic plan ORA obtained through discovery combines with KTC's actual cost of debt to yield an implied return on equity of 29.28%. Since this percentage would be far in excess of a reasonable investor return for a regulated monopoly, ORA recommends the Commission adopt an explicit return on equity of 8.79%.

[3] Response to ORA Data Request RRA-001-Q2.

# CHAPTER 1: REVENUES

## A. INTRODUCTION

Kerman Telephone Company ("KTC") earns operating revenues via the sale of telecommunication services, supplemented by federal and state subsidies. Since 2010, KTC's total operating revenue averaged $12.795 million per year[4] with the intrastate revenue portion averaging $8.08 million per year over the same time period. In this GRC, KTC seeks $10,311,373 in intrastate revenues. ORA is recommending intrastate revenues of $6,569,605. A brief overview of total company revenues is helpful.

### (a) Total Company Revenues

In this proceeding, KTC seeks 2016 total company (inter- and intrastate) revenue of $15,705,233[5], a 23% increase over the past 5-year average. KTC's revenue streams are derived from: local network services[6], access services, other miscellaneous services, subsidy support from the California High Cost Fund A ("CHCF-A"), and money from the Universal Service Fund ("USF"). Below, Chart 1 compares KTC's total company revenue streams and the corresponding percentage that each contributed to the whole, on average per year, from 2010 through 2014 with that proposed by KTC in test year 2016. For years 2010-2014, KTC has provided telephone services with 43% of its total company revenues

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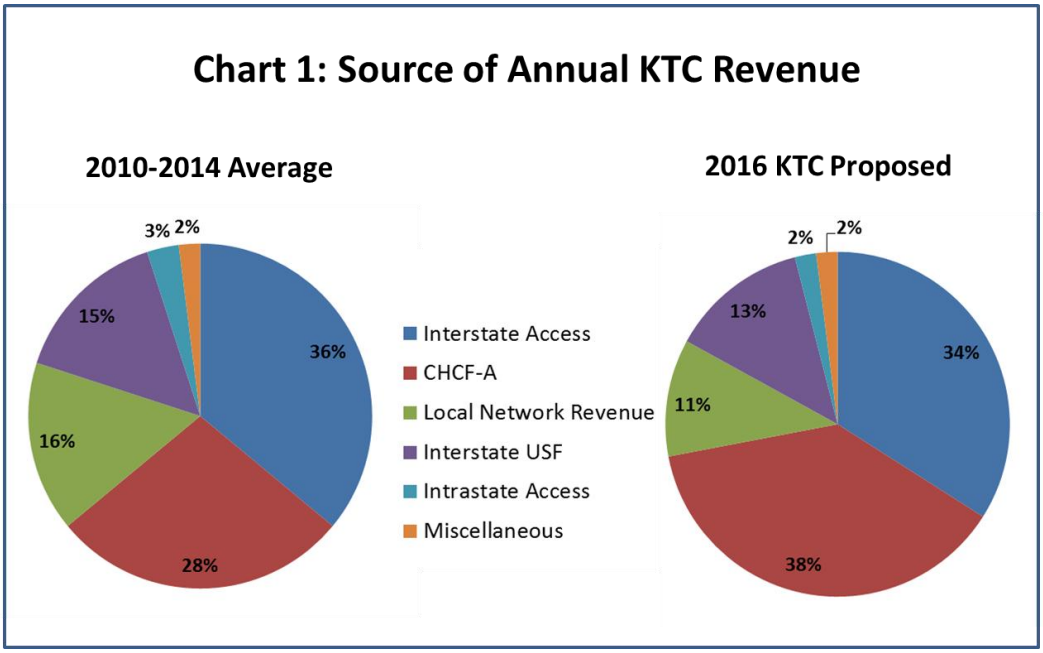
[4] $12.795 million is the average of total company revenues from 2010 – 2014 (including the dollars from out of period revenues)- aka line 12 on the revenue summary workpaper REV 1 from DC-3.

[5] ORA utilizes DC-3 to characterize Kerman's request.

[6] Local revenue amounts include the monies received from federal and state lifeline programs (accounts 5001.1 and 5001.2).

from subsidies[7]. For its current 2016 request, KTC seeks to increase the subsidy percentage to 51%.




**(b) Intrastate portion of KTC Revenues**

For the 2016 test year, KTC projects total intrastate revenues of $10,311,373,[8] which is a 28% increase over the past 5-year average. The increase in intrastate revenues is mostly due to KTC's CHCF-A subsidy request of $6,011,945. The 2016 CHCF-A request is 72% greater than the 2013 authorized subsidy amount[9] and 70% greater than the 2015 authorized subsidy amount.[10]

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[7] Subsidies are defined as CHCF-A and USF monies; they do not include Lifeline program support amounts.

[8] See tab Proforma SRO in DC-3 line 9.

[9] See Attachment 1-1: Resolution T-17081 authorized CHCF-A of $3,657,147 for 2008, see appendix C line 2; KTC Workpaper DC-3 Rev 1 shows 2013 CHCF-A of $3,499,094.

[10] Attachment 1-2: Resolution T-17461 Appendix A page A-7 line 15.

Only after excluding the increase in the CHCF-A subsidy amount (relative to historical) are 2016 intrastate revenues in line with historical amounts.

Table 1-1 compares KTC's historical amounts of intrastate revenues with and without CHCF-A subsidies to KTC's 2016 proposed revenues.

| Table 1-1: KTC Intrastate Revenues with and without CHCF-A subsidies | | | | | | |
|---|---|---|---|---|---|---|
| | **2010** | **2011** | **2012** | **2013** | **2014** | **2016 KTC PROPOSED** |
| Intrastate Revenues with CHCF-A | 8,494,437 | 8,241,475 | 8,077,221 | 7,827,107 | 7,760,714 | 10,311,373 |
| Intrastate Revenues without CHCF-A | 4,820,852 | 4,641,541 | 4,636,956 | 4,328,013 | 4,098,623 | 4,299,428 |

In response to D.14-12-084 in the rulemaking proceeding on the CHCF-A, KTC filed supplemental testimony.[11] KTC's supplemental testimony addresses the decision by projecting increases in the residential tariff A-1 and an adjustment to corporate expenses. With the revision, KTC's intrastate revenue request came down by $688,738.[12]

In its last GRC, KTC was authorized $8,801,394 in intrastate revenues for 2008.[13] Therefore, KTC's proposed 2016 intrastate revenue request translates into

[11] D14-12-084 section 2.1.1.2 references the varying stages of broadband deployment as a reason for not imputing broadband revenues. However, 10Mb broadband is 100% available in KTC territory; see Attachment 1-3. Imputing broadband revenues would reduce KTC's subsidy from the CHCF-A and decrease the 50% dependency upon subsidies that KTC is seeking in this GRC.

[12] 688,738=11,000,111-10,311,373.

[13] Resolution T-17081Appendix C line 9.

a 2% annual increase over the past eight years.[14] Although KTC's estimated number of customer access lines has decreased more than 26% over this same time period,[15] KTC seeks to increase its intrastate revenues 17%. What was once a $47 subsidy per customer per month[16] from the CHCF-A fund will become a $105 per customer per month subsidy if all of KTC's requests are approved.

## B. SUMMARY OF RECOMMENDATIONS

Table 1-2 compares the 2016 Intrastate Revenues estimated by ORA to those estimated by KTC in its December filing and January update.

**Table 1-2: Intrastate Revenue Estimates**

| Operating Revenue | KTC DC-1 (December) | KTC DC-3 (January) | ORA |
|---|---|---|---|
| Local Network Service | 1,655,910 | 1,759,865 | 2,118,030 |
| Federal/State USF | 2,032,176 | 2,032,176 | 2,032,176 |
| State CHCF-A | 6,804,638 | 6,011,945 | 1,938,638 |
| Network Access Services: | | | |
| Intrastate | 252,956 | 252,956 | 252,956 |
| Interstate | n/a | n/a | n/a |
| Miscellaneous Revenues | 259,602 | 259,602 | 265,920 |
| Less Uncollectible Revenues | (5,171) | (5,171) | (5,171) |
| **Total Intrastate Operating Revenue** | **$11,000,111** | **$10,311,373** | **$6,602,548** |

For the 2016 test year, ORA recommends local network revenue collections $358,165 greater than those proposed by KTC with $4,073,307 fewer dollars taken from the CHCF-A.

[14] Average $188,747 per year (or 2% per year) increase from 2008 to the 2016 request.

[15] Access lines went from 6,511 lines in 2008 to 4,789 lines in 2016.

[16] CHCF-A amount/access lines/12.

## C. DISCUSSION

The revenues that KTC projects for 2016 are comprised of two categories of revenue proposals. KTC proposes both a) the elimination of some current charges and b) the updating of tariffed rates. ORA addresses each category of KTC's revenue proposals (and the individual elements comprising each proposal) separately.

### (a) Elimination of charges

KTC recommends the elimination of two charges in this proceeding. First, they propose the elimination of the Extended Area Service ("EAS") charge. Second, they propose the elimination of the Access Recovery Charge ("ARC").

#### (i) Elimination of the EAS rate

In this GRC, KTC seeks to eliminate the collection of the EAS rate. This would eliminate $0.63 per access line from residential customers' bills and $4.60 per access line from business customers'. The elimination would reduce billed local network revenues in Tariff schedule A-1 by $87,200 and would allow customers to call Fresno without paying the EAS charge.

While the increases in Kerman's proposed A-1 residential tariff discussed below will make up for the lost EAS residential revenue, Kerman presented no parallel proposal for its business customers. Instead, Kerman proposes the loss of $59,092 in EAS revenues from business customers with no mitigating increase in the basic business rate.

The thrust of Kerman's argument is that EAS is outdated and should be eliminated as a separate charge and should be folded into the basic rate. They propose "building this EAS increment into the basic rate".[17]

While this is true for the residential sector, it is not carried out with its business customers.

Therefore, ORA recommends that the logic KTC applies to residential rates extend to the business customers as well. ORA proposes to increase the A-1 business rate from $30.20 to $34.80 to make up for the loss of the $4.60 EAS charge. Under Kerman's proposal, there is loss of $59,092 in business revenues from the elimination of the business EAS charge. ORA recommends a revenue neutral proposal for both residential and business customers with regard to the elimination of the EAS charge.

**(ii) Elimination of the Access Recovery Charge ("ARC")**

In this GRC, Kerman seeks to eliminate the collection of the interstate ARC[18] charge and "neutralize the ARC charge by increasing support for intrastate revenue requirement".[19] This would eliminate $1.50 per access line from both residential and business customers. The elimination *should* reduce interstate revenues in account 5081.2 in 2016.[20] At the same time, Kerman seeks to maintain a "$30.00 inclusive rate."[21] Because the ARC charge is a federal charge

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[17] David Clark supplemental testimony page 10 Q/A 17 (lines 22-23).

[18] ARC stands for access recovery charge, the charge that is collected in account 5081.2.

[19] David Clark supplemental testimony page 10 Q/A 18 (lines 27-28).

[20] Cell Z22 in tab Est Rev 15-16 of DC-3 workpaper shows 2016 ARC revenues of $85,277.

[21] David Clark supplemental testimony page 10-11.

it has federal requirements, and one of the requirements is that the "local service rate (inclusive of "additional charges") does not exceed $30."

To illustrate the point, in Table 1-3 ORA recreates the KTC response from ORA Data Request ("DR") LLK001Q5 which shows the current calculation that Kerman rates are below the $30 benchmark. Once Kerman residential rates "hit the $30 cap" ARC charges would be eliminated.

| **Table 1-3** | |
|---|---|
| Local Service Rate | $20.25 |
| Extended Area Service | $0.63 |
| Subscriber Line Charge | $6.50 |
| ARC Charge | $1.50 |
| Miscellaneous | $0.92 |
| **Total** | **$29.80** |

As Kerman is the recipient of both federal and state subsidies, it must adhere to many requirements. One of note cited by Kerman is the 2011USF/ICC Transformation Order.[22] It specifically requires conformance to the $30 cap calculation.[23]

In its proposal, Kerman proposes to increase its residential basic local revenues to $22.58. The total all inclusive rate of $22.58 proposed by KTC minus the $20.25current basic rate minus the $0.63 in lost EAS charges minus the $1.50

[22] On page 11 of David Clark supplemental testimony dated Jan 30, 2015, the USF/ICC transformation order was mentioned. http://www.fcc.gov/document/order-clarifying-aspects-usficc-transformation-order-released: "In the *USF/ICC Transformation Order*, the Commission adopted a rule reducing high-cost support for incumbent carriers receiving high-cost support that charged local rates below a nationwide rate benchmark."

[23] See data request LLK-001 Q 5. It shows that the $30 cap is made up of: local service rate + EAS +SLC+ ARC+ misc.

in lost ARC charges equals a total increase of $0.20 per month in residential local service rates. In concept, Kerman is proposing an increase in the basic rate that more than compensates for the elimination of both the EAS and ARC charges for residential customers. However, this net increase does not hold true for KTC's business customers.

The $30.20 basic commercial rate proposed by KTC minus the $30.20 current rate minus the $4.60 lost EAS charge minus the $1.50 lost ARC charge equals a total decrease of $6.10 per month per business customer. This equates to an annual loss of $60,698 in revenues from 1,071 business customers.[24]

While ORA does not oppose elimination of the ARC charge for residential customers at this time, ORA finds the proposal lacking where business customers are concerned. Therefore, ORA recommends an increase in business customer basic rates similar to KTC's increase in proposed residential rates in order to compensate for the lost revenues associated with elimination of EAS and ARC charges. As shown in Table 1-4 below, ORA recommends a basic business rate of $36.30 per month, which results in a total increase in 2016 forecasted revenues of $78,361.

**Table 1-4: Tariff A-1 Proposals**

| | Kerman | ORA |
|---|---|---|
| 1-Party Flat Residence | $22.58 | $22.58 |
| EAS Additive Residence | $0 | $0 |
| 1-Party Flat Business | $30.20 | $36.30 |
| EAS Additive Business | $0 | $0 |

[24] It is not clear that Kerman workpapers accurately reflect its proposal. ORA performed a test run and found that when ARC charges are zeroed out in 2016 (tab est 15-16 cel Z22), there are no changes represented in the PROFORMA SRO results of operations representation of revenues. Since the PROFORMA SRO is the calculation for the revenue requirement request, it is not clear why the linkage isn't functioning, see Attachment 1-4.

### (b) Updating Tariffed Rates

In discussing KTC's updated rates and resultant revenues, ORA presents (i) the projection methodology utilized by Kerman and (ii) the revenue categories utilized by Kerman. In the revenue category subsections, ORA presents its discussion of proposed changes to the local network tariff rates, volumes and resultant revenues. ORA recommends changes to the following tariffs/estimates: A-1, A-22, A-28, A-32, A-40, V-1, and CPE.

#### (i) Revenue projection Methodologies

Kerman utilized two methods to project revenue. The first method focused on revenue account totals, and the other examines individual service units and the corresponding tariffed rates. Both of these methods contain adjustments for projected growth. Kerman developed the projected growth rates based on (1) recent trends or (2) exercised judgment about the applicable growth rate.

#### (ii) Revenue Categories

KTC, in its workpaper revenue summaries, breaks down revenues by the following seven categories: local network revenue, intrastate access, interstate USF, interstate access, miscellaneous, CHCF-A, and uncollectible. Most of the following ORA discussion focuses on the local network revenue category.

##### (1) Local Network Revenue

The category of local network revenue includes traditional telephony services, such as basic local service, EAS, custom calling features, voicemail services, local private lines, and wire repair. From 2010 through 2014, local network revenue contributed approximately $2.078 million per year to KTC's operating revenues. During that same time period, local network revenue declined

by an average of 3.78% percent per year. This decline was largely a result of basic local service line attrition of 3% per year.

For test year 2016, KTC projects Local Network revenue of $1,759,865, which represents a 5.6% loss from annualized 2014 local network revenue levels due in large part to the 4.7% loss of subscriber access lines and the elimination of the EAS rate for residential and business customers.[25]

KTC developed local network revenue projections based on two approaches: (1) calculating the revenue contributions by tariff schedules using rates and units (i.e. refer to KTC workpaper DC-3, the tab labelled service units) and (2) using historic annual revenues and historic growth rates (i.e. refer to tab labelled Est Rev 15-16). The two approaches produce slightly different projections (difference of $13,878). KTC's results of operation ("RO") model utilizes the first methodology (the larger of the two projections) to develop its estimate of 2016 local network revenues.

To obtain a projected number of customers on each tariff unit, KTC calculated a variety of historical growth rates and ultimately made judgment calls about which growth rate to use. For the majority of local network services, KTC applied a growth rate equal to the growth experienced from 2012- 2013.

ORA estimates KTC will earn $2,118,030 from Local Network services during the 2016 test year. ORA's estimate exceeds KTC's estimate by $358,165. Differences between ORA's and KTC's estimates are described below.

- Tariff A-1, business rate flat service changes would add $78,361

[25] Tab "2014 Rev" in the DC-3 spreadsheet from the company showed an annualized amount of 8 months recorded for 2014.

- Tariff A-22, employee discount changes would add $5,026 to local network revenues
- Tariff A-28 custom calling features changes would add $121,410 to local network revenues
- Tariff A-32 inside wire changes would add $151,073 to local network revenues
- Tariff A-40 directory assistance changes would add $2,200 to local network revenues[26]
- Tariff V-1 visit charge changes would add $95 to local network revenues
- Customer Premise Equipment reflection of billing charges would add $6,284 to the local network revenues

ORA adjustments fall under three categories of change: (1) ORA projected different growth rates than KTC, (2) ORA proposed higher rates for the service, or (3) ORA found instances where the spreadsheet did not capture a rate and/or revenue amount. All of these adjustments were made to the tab referred to as service units in the DC-3 spreadsheet.

**Growth adjustments from ORA**

*From Tariff A-28*

KTC underestimates revenue from its Call Wait/Call ID (HCP Plan) service. This falls under the Tariff A-28 custom calling residence. KTC projects this service will generate $82,908 in revenue during 2016 from the $9.40 charge applied to 735 units. KTC's two-step process projects 2015 units of 784 and 2016 units of 686 for the calculation[27] and then averages these unit estimates to forecast

[26] Attachment 1-5: Email from David Clark dated March 02, 2014

[27] In spreadsheet DC-3 tab labelled "service units" line 100 develops the projection of units and rates for call wait/ID (HCP)- it is a two-step process whereby Kerman projects unique 2015

(continued on next page)

735 units for both 2015 and 2016. Inherent in the development of this estimate, KTC applies an annual "growth rate"[28] of 87.49% of the previous year's number of subscribers, which reflects the decrease in subscribers to this service experienced from 2012-2013. However, total Call Wait/Call ID (HCP Plan) service units grew (or declined less rapidly) at significantly different rates in other recent years. The 3-year and 5-year growth rates are 97.47% and 100.54%, respectively. The company presumes the results of 2012/2013 to represent the future. The average annual growth across years 2012-2014 is 97.47%. Projecting the Call Wait/Call ID (HCP Plan) service units using this 97.47% growth rate (instead of KTC chosen 87.49%) yields 2016 volume of 893 subscribers and revenue of $100,674 during 2016. Thus, KTC's projections underestimate the 2016 revenue from Call Wait/Call ID (HCP Plan) services by $17,766.

*From Tariff A-40*

In the category of Directory Assistance ("DA") transactions, KTC estimates zero (0) volume for each of the years (2010-2016).

This is a little disconcerting, particularly since in the last GRC, KTC reflected $12,915 in local revenues from 4,014 callers paying $0.46 per call for directory assistance in 2008.[29] Subsequent communication with Kerman suggests that "411 local directory assistance revenues have been omitted from the revenues

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(continued from previous page)
and 2016 volumes based upon growth assumptions (i.e 786, and 686) and the second step averages those two numbers to project 2015 and 2016 volumes (i.e. 735).

[28] "Growth" rate is the nomenclature used by KTC to describe changes over a period of time, usually an annual change, even if such growth rate results in a decrease in subscribers.

[29] Resolution T-17081.

filed in DC-1. Our 2014 revenue should be approximately $2,200 for this service."[30]

Therefore, ORA recommends that $2,200 in revenues be reflected in 2016 for tariff A-40. This would suggest that at least 4,783 customers will make use of directory assistance at the $0.46 charge. Kerman explains that account 5060.1 is the account for booking directory assistance revenues. In 2014, KTC collected $2,200 in revenues, therefore ORA adds $2,200 to the local network revenues in 2016 by adding 4,783 instances for tariff A-40 to represent $2,200 in revenues.

*From Tariff V-1 visit charge*

KTC estimates zero (0) volume in customer visit charges which is odd given that in this GRC, Kerman is proposing to raise the visit rate from $35 to $95. KTC asserts that the amount is designed to mirror the charges from an unregulated affiliate. By design, the service offering will be competitive with its affiliate. It is reasonable that Kerman would garner some of the business without sending all the business to the unregulated affiliate. ORA projected one charge at the $95 rate will contribute to KTC revenue requirement.

*CPE Customer Premise Equipment*

Although KTC shows no revenues from the provision of equipment at customers' premises in CPE account 5050.1 in its workpapers, an ORA review of 71 actual customer bills[31] suggests that revenues are collected for this purpose from the ratepayers of Kerman. In the small sample size reviewed by ORA, there was evidence of 5 instances where a $2 per month charge was placed on the

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[30] Email communication on March 2, 2015 from David Clark to Robert Schwartz.

[31] See ORA Chapter 6: Analysis of Kerman Phone Bills.

customer bill. Kerman, in a March 13 email to ORA witness Robert Schwartz, disclosed that, "CPE is deregulated. There is no revenue included in the workpapers in the rate case." Although there is an account in tab Est Rev 15-16 with account number 5050.1 with the heading CPE, there are no dollars recorded in the account. Presumably the CPE revenue collected from customers are logged into the non-regulated revenue account.

ORA is advocating that these CPE revenues be taken into consideration for purposes of the CHCF-A calculation. To estimate a 2016 dollar amount, ORA projects 262 instances in 2016 where a $2 CPE charge will be collected from the residential customers as unregulated revenues.[32] This revenue (estimated to be $6,284) collected from customers, would reduce the residual subsidy amounts from the CHCF-A by this amount.

**Rate adjustments from ORA**

*For Tariff A-1*

KTC makes no proposals to increase the business flat rate basic service. It currently stands at $30.20.[33] In light of the proposed elimination of the EAS and ARC charges (described previously) ORA recommends a $6.10 increase in the business rate to recover all lost EAS ($4.60) and ARC ($1.50) revenues. Therefore, ORA's projections of business revenues are $78,361 greater than KTC estimates.

*For Tariff A-22*

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[32] 5/71(sample size frequency of seeing a CPE charge) *3718 residential access lines in 2016.

[33] Other surcharges and fees are added to this amount but are not discussed here.

Elsewhere in its supplemental workpapers, KTC reflects increases required from the CHCF-A decision. KTC, however, makes **no** adjustment to the 50% employee discount in the supplemental testimony. Separately, Kerman employees also pay 50% of the subscriber line charge for interstate access revenues. Kerman workpapers show that employees will see ***a decrease*** in their basic rates because they won't be paying ARC charges of $1.50 and their basic rate remains at $10.44.

To be consistent, Kerman should at least be proposing a A-22 tariff rate of $11.29 to maintain a 50% discount for Kerman employees. ORA also suggests adding the equivalent of the proposed elimination of $1.50 ARC and $0.63 EAS charges to parallel KTC's proposal for residential customers. These recommendations result in an A-22 tariff rate of $13.42 in order for Kerman to have a consistent proposal between its employees and the residential group.

Through discovery, ORA learned that only 6 (of the 35) employees record 100% of their time to Kerman telephone.[34] Given the amount of subsidies received by the company, it is no longer reasonable for employees to get the discounts they are receiving and they certainly shouldn't be given a rate decrease while others get increases. KTC should make every effort to maximize its revenues to ensure that CHCF-A subsidies are not excessive and that employee benefits are not paid through federal and state subsidies.

ORA's recommendation is to eliminate the employee discount. This would increase revenues by $5,026.[35] If, however, tariff A-22 remains on the books, only 6 employees should receive the discount of $13.42.

*Tariff A-28*

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[34] See Attachment 1-6: Response to ORA Data Request LLK-002 Q 10.

[35] See LLK workpaper, tab Service Units, cell AG 69.

For those features in Tariff A-28, ORA looked to the charges that other providers charged in 2013,[36] as well as, those KTC charged to its own foreign exchange ("FX") customers. As these are services beyond basic service, KTC should be moving its rates closer to market rates. Because the purpose of CHCF-A is to minimize any basic telephone service rate disparity between rural and metropolitan areas, the following ancillary services provided under Tariff A-28 should be priced at comparable market rates in order to maximize the revenue that can be used to reduce KTC's subsidy from the CHCF-A:

- Caller ID - which is $9.99 for FX customers, should be same rate for residential and business customers
- Call Wait - which is $8.50 for FX customer, should be same rate for residential and business customers
- Call Forward - which was $7.50 in 2013 for AT&T, should be greater KTC's current rate of $3.23. ORA is recommending $6.50 for residential and business
- Three Way Call – which was $8.00 in 2013 for AT&T, should be greater than the $3.23 for residential and $5.00 for business charged by KTC. ORA is recommending $7.00 for both residential and business customer
- Anonymous call rejection- which was $7.50 in 2013 for AT&T, should be greater than the $3.00 for residential and $5.00 for business customers charged by KTC. ORA is recommending $6.50 for both residential and business customers.

*Tariff A-32*

This tariff addresses inside wire maintenance, both the installation of the service and the monthly maintenance charges. The installation charge is a one-time fixed charge; while the monthly maintenance would be the recurring charge

[36] See Attachment 1-7: Summary of URF ILEC Residential Service Rate Charges.

to pay for the ongoing service. Although KTC proposes increases in the customer premise work charges, it leaves the monthly recurring charge of $1.10 unchanged.

However, an ORA review of 2013 inside wire charges from AT&T, Verizon, Surewest, and Frontier suggests that an increase in KTC's monthly inside wire charge is also warranted.

This is a discretionary service that goes beyond basic service and should not be subsidized via the CHCF-A. ORA recommends setting KTC's inside wire maintenance charges at or near market rates.

Therefore, ORA is proposing an increase from $1.10 per month to a $7.50 monthly service rate for residential customers and $8.00 per month for business customers. As shown in Attachment 1-1, AT&T charged $8.00 per month in 2013 and Verizon charged $7.99 per month. KTC's Inside Wire Maintenance is an elective service and should reflect market rates. While the rates were lower for companies like Surewest and Frontier, ORA selected an amount closer AT&T's charges since it is reasonable that Kerman seek more areas where they can lessen their subsidy amounts.

This would generate an additional $151,073 in 2016 revenues compared to the projections provided by KTC in the supplemental testimony.

**Remaining Instances where the spreadsheet tab service units did not capture a rate and/or revenue amount**

*Tariff A-28*

- Residential call waiting ID - there is no rate in cell AD 85 and there is no appropriate revenue in cell AE 85 ($7008)
- FX call waiting – cells are hidden from view and the proposed revenue column does not show the appropriate revenue in cell AE 90 ($408)

- FX caller ID- cells are hidden from view and the proposed revenue column does not show the appropriate revenue in cell AE 91 ($1379)
- Business call waiting ID - there is no rate in cell AD 111 and there is no appropriate revenue in cell AE 111 ($288)
- Remote call forward- there - there is no rate in cell AD 128 and there is no appropriate revenue in cell AE 128 ($96)

**OTHER MISSING REVENUES**

- Missing CPE revenues added to the 2016 local revenues ($6294)
- Missing directory assistance revenues added to tariff A-40 ($2200)

As a result of these findings, there is a total of $9,179 in missing revenues from tariff A-28, plus $2,200 in missing revenues from missing directory assistance revenues. As a policy recommendation, ORA would also utilize estimated CPE revenues ($6,294) to offset the amounts drawn from the CHCF-A fund.

Moving on to the next category of revenues, ORA discusses intrastate access charges.

**(2) Intrastate Access**

KTC developed projections for Intrastate Access revenue by applying growth rates to an estimated 2014 annual total. KTC used a 2012-13 growth rate for the special access volume changes, but utilized unique judgment based growth rates for switching, originating and terminating volume changes.

ORA does not recommend changes to KTC's forecast of Intrastate Access Revenues at this time.

**(3) Interstate Universal Service Fund ("USF")**

ORA's discovery confirmed consistency of KTC's USF representations with those in the 2015 NECA calculation.[37]

Interstate USF fluctuated between 2010 and 2014 but averaged $1.95 million per year. KTC projects an increase in 2015 to $2 million which is forecasted to continue in 2016. ORA does not recommend a change to this forecast at this time.

Moving on to the next revenue category, ORA discusses miscellaneous revenues.

**(4) Miscellaneous**

Miscellaneous revenues are derived from the following categories of revenues: directory revenues, miscellaneous, tel-card revenue, late payments, and billing and collections.

ORA disagrees with KTC's proposed volumes for late payments in 2014. This will in turn affect volume estimates for 2015 and 2016. During discovery, it was revealed that ~~in~~ KTC did not bill any late payments for 7 of 12 months in 2014.[38] As a result, the 8 months of recorded 2014 data underreport the late payment incidences and resultant revenues that one might expect for a full year of results. KTC's estimate of $9,294 revenue in 2014 is too low. ORA utilizes the 3-year average from 2011-2013 to project $15,600 in late payment revenue in 2016.

Moving on to the next revenue category, ORA discusses the resulting revenues that Kerman should draw from the California High Cost Fund ("CHCF-A") to meet revenue requirements.

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[37] Response to ORA Data Request LLK002 Q#8.

[38] See ORA Chapter 6: Analysis of Kerman Phone Bills.

**(5) CHCF-A**

This is a residual calculation that is derived from the summary of earnings table after considerations are made about revenues, expenses, plant, ROR and taxes. ORA's proposal for CHCF-A withdrawal is $1,938,638. This amount is $4,073,307 less than the subsidy amount proposed by KTC.

## D. CONCLUSION

ORA recommends that the Commission consider all its proposed changes with regard to revenue creating streams and adopt them all. It would be sound policy from the Commission to create a strong due diligence requirement when telecommunications firms are requesting that over 50% of their revenue requirement be satisfied by subsidies. Companies should be looking at all the ways they can lower expenses and reduce their dependence on subsidies without adversely affecting the provision of safe, affordable and reliable service.

# CHAPTER 2: OPERATING EXPENSES

## A. INTRODUCTION

In an update to its application filed November 3, 2014, Kerman Telephone Company ("KTC") estimated Test Year 2016 operating expenses of $12,612,841 including $3,541,020 in total corporate expenses. The $3,541,020 in total corporate expenses includes amortized rate case expense in the amount of $175,603.[39] In general, KTC estimated 2016 operating expenses by annualizing the eight months (January to August) of actual 2014 expenses available at the time of its update, escalating the annualized estimate by a 2.0% inflation factor to estimate 2015 operating expenses and then escalating the 2015 estimate by an additional 2.4% inflation factor to reach its projected 2016 operating expenses.[40]

On December 19, 2014, Commission Decision ("D.") D.14-12-084 adopted the Federal Communications Commission's ("FCC") Corporate Expense Caps as "a rational mechanism for calculating and determining a reasonable level of corporate expenses" for those Small Incumbent Local Exchange Carriers that receive funds from the California High Cost Fund-A ("CHCF-A").[41] On January 30, 2015, KTC filed supplemental testimony to support its request to exceed the FCC's Corporate Expense Caps that were adopted by the Commission in D.14-12-084.

## B. SUMMARY OF RECOMMENDATIONS

For the 2016 Test Year, ORA recommends a $2,215,689 reduction to KTC's forecasted total intrastate operating expenses for ratemaking purposes. The

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[39] Direct Testimony of David Clark, November 3, 2014, DC-1 at EXPDET 2016 (page 3 of 3).

[40] Dave Clark's testimony dated November 3, 2014 (Answer to Q15 and Q16): A different methodology was used to forecast depreciation expenses, the costs of the current general rate case ($175,603) and the additional cost of one regulatory employee.

[41] D.14-12-084, pages 28-29.

components of ORA's recommended net adjustment to KTC's 2016 Intrastate Expenses are summarized in Table 2-1.

| Table 2-1: ORA Recommended Ratemaking Reductions | |
|---|---|
| **Description** | **Adjustment** |
| FCC Corporate Expense Caps | $1,148,933 |
| Plant Specific Expenses | 848,696 |
| Customer Operations Expenses | 235,977 |
| Affiliate Expense Credit | (17,917) |
| **Total Intrastate Expense Reduction** | $2,215,689 |

## C. DISCUSSION

### 1) FCC's Corporate Expense Caps

In D.14-12-084, the Commission determined that, "Adopting and applying the FCC Corporate Expense Caps will cap the amount of corporate expenditures that can be recovered from the CHCF-A program, and create incentives to align expenditures with the cap to reduce rate case litigation costs.[42]" However, the Commission also provided that "If a Small Incumbent Local Exchange Carrier's actual corporate expense amounts exceed the Federal Communications Commission's corporate expenses caps, that carrier has the opportunity in the General Rate Case application to rebut the presumption of unreasonableness to seek additional support from the California High Cost Fund-A Program."[43]

[42] D.14-12-084, page 28: Adopting a uniform standard for determining a reasonable level of corporate operations expenses for carriers receiving subsidies from the CHCF-A program allows the program to achieve its goals while ensuring that the level of support is not excessive or wildly disparate across companies, and avoids imposing an undue burden on California ratepayers who contribute to the fund.

[43] D.14-12-084, Ordering Paragraph No. 3.

**(a) KTC's Rebuttal to the Presumption of Unreasonableness**

After KTC applies the FCC's Corporate Expense Caps to its 2016 total estimated corporate expense of $3,365,417, the allowable or presumed reasonable level of total corporate expenses adjusted for inflation is $1,692,783 ($1,537,917 allowable corporate expense + $154,865 CPI growth allowance), which reflects a decrease of $1,672,635 from KTC's initial request.[44] However, in its supplemental testimony KTC argues that $1,692,783 in total corporate expense is unreasonable because it constitutes elimination of about 50% of its total corporate expenses and that such reduction "would seriously compromise its ability to perform necessary functions and continue to operate in an efficient and reliable manner."[45]

In order for KTC to persuasively rebut the presumption of unreasonableness, KTC should have provided information to justify that the FCC cap limits are unreasonable. However, KTC has presented contradictory and illogical positions with regards to this issue. When arguing in favor of lower basic residential service rates, KTC emphasizes both the poverty level of its customers and the lower median income in the County of Fresno and the city of Kerman as compared to California as a whole.[46] However, when arguing in favor of allowing total corporate expense above the FCC's cap, KTC fails to adjust or consider the effect of local economics in a similar manner.

For its justification of forecasted expenses in excess of the FCC Corporate Expense Caps, KTC uses the Bureau of Economic Analysis' Regional Price

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[44] David Clark's supplemental testimony, DC 0111.

[45] David Clark's Supplemental Testimony, page 29.

[46] *Id.*, page 6.

Parities index ("RPP") to illustrate that California is the fifth highest state in terms of the price of goods and services relative to the national average. KTC does not mention Fresno's RPP nor attempt an adjustment for what could be expected to be an even lower RPP for the city of Kerman. Despite having focused its previous testimony on how lower median incomes in the city of Kerman justify lower basic service rates, KTC's subsequent testimony on corporate expenses asserts "the areas in which Kerman operates and California as a whole require significantly higher labor rates."[47] Instead of making general and contradictory arguments, KTC would be better served by performing a detailed line-by-line analysis of its corporate expenses to determine where opportunities exist to control costs.

In fact, KTC's argument for why it should be permitted to exceed the FCC's corporate expense caps would have greater merit if it could be shown that its actual and forecasted corporate expenses represented reasonable and prudent expenses for ratemaking purposes. As detailed below, ORA has identified numerous areas in which KTC's forecasted corporate expenses should be lowered for ratemaking purposes. ORA's detailed analysis of just 3% of KTC's 2014 expense transactions suggests that not only should KTC be required to apply the FCC's Corporate Expense Caps as adopted in D.14-12-084 but that additional opportunities may exist to lower ratemaking expense below these caps.

**(b) ORA's Analysis of KTC's Corporate Expense**

KTC estimated 2016 operating expenses by annualizing the eight months (January to August) of actual 2014 expenses known at the time of its application update. KTC's 2014 annualized total corporate expenses totaled $3,104,451.[48] In

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[47] *Id.*, page 22.

[48] David Clark's November 3, 2014 testimony, EXPDET 2014 (page 3 of 3).

response to ORA's requests, KTC provided data that indicated that its total actual corporate expenses as of December 31, 2014 totaled $3,085,840.[49]

**(i) Executive Bonuses and Distributions**

In its data request dated December 2, 2014, ORA requested that KTC provide "Five years of recorded and proposed test year total compensation by employee." On December 30, 2014, KTC responded with a spreadsheet titled "ORA CC3001 Q17 Employee compensation." However, in this spreadsheet, KTC did not include its employee total compensation as requested. KTC provided its employee salaries but did not include employee benefits.[50] On January 16, 2015, ORA sent an email request asking KTC to update its spreadsheet "ORA CC3001 Q17 Employee compensation" to include its employee total compensation. On January 30, 2015, KTC provided a spreadsheet titled, "CC3001 Q17 Employee compensation – Updated" with the following note: "this spreadsheet has been updated with additional columns identifying benefits and/or bonuses for previously identified employees."[51] On March 6, 2015, in response to another ORA email request to verify total corporate compensation in its updated spreadsheet, KTC indicated that the updated spreadsheet provided to ORA contained some errors. KTC corrected the errors in a spreadsheet titled, "Total corporate expenses cd" on March 6, 2015. Per the data included in the March 6th spreadsheet, "Total corporate expenses cd," KTC's total actual 2014 corporate compensation expenses totaled $1,681,509.86 including benefits and/or bonuses.

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[49] Attachment 2-1: ORA's summary of "Kerman GL Detail Expense 2014 YTD 11-30", and "Preliminary Kerman GL Detail Expense December 2014 as of 1-30-15."

[50] Attachment 2-2: http://www.bls.gov/bls/glossary.htm The United State Department of Labor defines compensation as "the entire range of wages and benefits, both current and deferred, that employees receive in return for their work."

[51] Attachment 2-3: KTC's email dated January 30, 2015.

However, further ORA analysis of KTC's detailed general ledgers revealed that additional compensation of $294,705 (Table 2-2) paid to KTC's executives was not included in KTC's original response to ORA's request for total employee compensation or either of the two necessary updates. In its email dated March 13, 2015, KTC confirmed that ORA's findings were correct.[52]

As shown in the CPUC Communications Division Staff Report dated September 2014, KTC's numbers of average working lines have steadily declined from 2010 to 2013.[53] It is hard to justify increases in executive bonuses and additional rewards when this trend appears to be ongoing and KTC is unable to budget within FCC Corporate Expense limits. Furthermore, ORA is concerned with the nearly 100 days it took to receive an accurate response to a relatively straightforward request for total compensation. Since the additional and previously unidentified executive bonuses and rewards have not been justified as reasonable and prudent expenses, ORA identifies these amounts as potential rate making adjustments that would allow KTC to more easily meet the FCC's Corporate Expense Cap limits that ORA recommends be applied. Below ORA details these additional distributions paid to KTC's executives.

| Table 2-2: Additional Executive Compensation | |
|---|---|
| **Description** | **Adjustment** |
| Executive Bonuses | $200,000 |
| Board meeting Distribution | 30,705 |
| Quarterly Retainer | 64,000 |
| **Previously Unidentified Executive Compensation** | **$294,705** |

[52] **Attachment 2-4**

**(ii) Terminated Temporary Executive Position**

KTC's data reveals that KTC included in its projected 2016 corporate expense the salary, benefits and/or bonuses totaling $58,144 for one of its part time, limited-term executive positions hired in May 2013 and terminated in May 2014.[54] This amount should not be used to project KTC's 2016 total corporate expense because it was a temporary position. To more easily meet the FCC Corporate Expense Caps, KTC's forecasted total corporate expense could be reduced by the total amount included for this position.

**(iii) Salary and Benefits for New IS Manager**

KTC's previous Information Systems ("IS") Manager retired at the end of 2014. According to KTC, it is in the process of hiring a new IS Manager. Although a comparative salary & benefit analysis for this position was not provided in KTC's testimony or workpapers, the company projected a new IS Manager's salary and benefits of $138,480 using its retired IS Manager's final salary and benefits as of December 31, 2014. According to data provided by KTC, the retired IS manager's total salary and benefits increased substantially each year from 2010 to 2014 (Table 2-3).

**Table 2-3: Retired IS Manager's Total Compensation (2010 -2014)**

| | 2010 | 2011 | 2012 | 2013 | 2014 |
|---|---|---|---|---|---|
| **Compensation** | $49,778[55] | $88,468 | $108,858 | $111,993 | $138,480 |

[54] KTC's response, CC3001 - Q17 Employee Compensation Updated.

[55] The 2010 amount was annualized because KTC provided only 5 months of compensation for 2010.

It is not reasonable for KTC to project the total salary and benefits of a new IS Manager using its retired IS Manager's total final salary, benefits and bonuses at the time of retirement. The final total compensation of an employee that has grown on the job with consistent pay increases should not be the standard for a new hire. The average of the retired IS manager's total salary and benefits from 2010 to 2014 equals $99,516 and provides a more reasonable amount to use in 2014 with annual price escalation to project the new IS manager's total salary and benefits for 2016. Accordingly, KTC's forecast of total corporate expense for ratemaking purposes could be reduced by $38,964 to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied.

**(iv) SEI's Calcom Membership**

KTC's holding company Sebastian Enterprises Inc. ("SEI") is a member of Calcom, an association with a defined mission to work with service providers to accelerate broadband deployment.[56] SEI's 2014 membership dues in Calcom in the amount of $14,857 are recorded entirely as a KTC corporate expense. However, KTC does not deploy broadband. Audeamus, SEI's unregulated entity does. This appears to be an example of KTC's affiliate costs improperly included in calculating KTC's revenue requirement. Accordingly, KTC's corporate expenses for ratemaking purposes could be reduced by the entire amount of Calcom membership dues to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied.

**(v) Donations, Contributions and Sponsorships**

[56] Attachment 2-5: Excerpt from Calcom Connect 2015 Membership Directory: http://calcomassn.org/wp-content/uploads/2014CalComDirectoryWeb-FINAL.pdf and Calcom's invoice.

KTC included in proposed rates the corporate expenses incurred as a result of promoting SEI's image in the community through donations, sponsorships and contributions. For example, KTC's data provided in response to ORA discovery reveals that KTC's annualized 2014 corporate expense includes a monthly expense of $5,888 or $70,560 per year for support of Fresno State Sport teams (the Bulldog Sports Prop).[57] The Bulldog Sports Prop is just one of many organizations that SEI sponsors. Below, ORA presents a sampling of the additional organizations that receive donations, contributions or sponsorships from SEI which results in an inappropriate increase to KTC corporate expenses for ratemaking purposes:

- Kerman Christian School- Annual Auction Dinner Donation - $400
- Polo Festival (www.polofest.org) - $6,667
- Golf Tournament - $5,100
- Catering - Fresno State tailgate - $16,830
- CA Independent Telephone Political Action Committee -$6,800

Because the actual list of the organizations that SEI's sponsors is much longer,[58] the total amount for all 2014 contributions, donations and sponsorships is summarized below in Table 2-4.

**Table 2-4: KTC's 2014 Donations, Dues, and Sponsorships**

| Description | Amount |
|---|---|
| SEI Image | $123,903 |
| Sponsorships | 70,993 |
| Donation/ Contribution | 46,569 |
| **Total** | **$246,465** |

[57] Attachment 2-6

[58] Attachment 2-7: KTC's supporting documentation to ORA Data Request CC3002 and email confirmation from KTC dated March 12, 2015 (see attachment 2-4).

Far beyond what could be considered necessary to provide safe and reliable utility service, the expenses incurred to support SEI's image and charitable giving are not appropriate to include for ratemaking purposes. Consequently, KTC's corporate 2014 expense could be reduced by **$246,465** to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied.

**(vi) Corporate Event Expense**

In addition to the donations, sponsorships and contributions discussed above, SEI also organizes several events every year such as annual holiday parties, annual retreats, and annual banquets. Table 2-5 summarizes the cost of KTC events that ORA has identified through discovery.

**Table 2-5: Summary of KTC's Annual Event Costs**

| Description | Total 2014 Cost | Total Charged to KTC | % Cost to KTC |
|---|---|---|---|
| Holiday Party | $43,130 | $33,863 | 79% |
| Annual Retreat | 9,635 | $4,307 | 45% |
| Annual Banquet | 44,060 | 17,546 | 40% |
| Total | **$96,825** | **$55,716** | **58%** |

KTC has about 69 employees with 80% working part time (55 out of 69).[59] An expense of $33,863 allocated to KTC for a holiday party equates to a cost of $491 per employee. Similar to the funding of athletic booster clubs and polo festivals, the type of expenses presented in the table above totaling $55,716 should not be paid by California ratepayers. Accordingly, KTC's 2014 corporate expenses could be reduced by **$55,716** to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied.

[59] CC3001 Q17 Employee Compensation - Updated

### (vii) Corporate Education & Planning Expenses

KTC testimony indicates that total corporate expense also includes the costs of corporate education and planning.[60] ORA selected a sample of KTC's recorded education and planning expenses to test for reasonableness. Table 2-6 summarizes some of the accommodation and food expenses that were incurred for a single employee and recorded under corporate education and planning.[61]

**Table 2-6: Sample Travel Expenses for One Employee**

| Date | Destination | Room Cost per Night (before tax) | Dinner | Breakfast | Parking |
|---|---|---|---|---|---|
| 5/19/14 | San Francisco, CA | $509 | | | $50 |
| 4/6/14 | Washington, DC | $334 | $94.25 | | |
| 4/7/14 | Washington, DC | $334 | | $27.65 | |
| 2/1/14 | San Antonio, TX | $249 | | | |
| 3/24/14 | Sacramento, CA | $151 | | | |
| 5/27/14 | San Francisco, CA | $242 | | $26.35 | $50 |

The expense amounts shown in the table above do not appear reasonable for ratemaking purposes. Since KTC draws from the state's CHCF-A to subsidize revenues and meet revenue requirements, KTC's business travel expenses included in rates should be made in accordance with the lodging and *per diem* rates authorized by the state of California. Application of the state's lodging and

[60] Dave Clark's supplemental testimony, page 18

[61] Attachment 2-8: Sample of corporate of education and planning expenses

*per diem* allowances for ratemaking purposes would be another way for KTC's to more easily budget within the FCC's Corporate Expense Caps.[62]

### (viii) Apartment Rental Expense

In the 2014 expenses that KTC escalates to project 2016 test year expenses are included the costs of a KTC leased apartment for $1,175 per month or $14,100 per year in Kerman, California. KTC recorded half of this lease expense as a corporate expense.[63] The remaining balance will be discussed later in this testimony. KTC claims that it needs this apartment to host business visitors. KTC did not offer an explanation for why these "business visitors" should not be responsible for the cost of their own lodging expense. It is not reasonable to allow KTC to increase its ratemaking expenses by the cost of a lease for an apartment that may host business visitors during the course of a year. This type of expense does not appear to be necessary for provision of safe and reliable utility service. Consequently, KTC's total corporate expenses could be reduced by $7,050 to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied in this rate case.

### (ix) Maintenance Corporate Expenses – Kertel

SEI's unregulated entity, Kertel, offers a variety of services to KTC. According to KTC, one of Kertel's services is to provide NOC ("Network Operating Center") and IT ("Information Technology") Technician Labor to support KTC operations and customers. For this service, SEI bills KTC $66,091.67 per month or $793,100 per year. KTC's data reveal that in 2014,

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[62] State of California travel expense reimbursement provisions can be found at the following link: www.calhr.ca.gov/employees/pages/travel-reimbursements.aspx

[63] Attachment 2-9: KTC's apartment lease agreement.

$8,081.25 of the $66,091.67 per month or $96,975 of the $793,100 per year is allocated to KTC's total corporate expenses per month.[64] The remaining $58,010.32 per month which is allocated to other operating expenses of KTC for ratemaking purposes is discussed later in this testimony.

SEI's bill to KTC refers to a maintenance contract between KTC and Kertel.[65] However, despite ORA's repeated requests KTC was unable to produce a copy of any such maintenance contract.[66] Without adequate supporting documentation, ORA cannot determine why $96,975 of the total invoice amount is allocated to KTC's corporate expense. ORA recommends that the $8,081.25 per month or $96,975 of the $793,100 per year reflected as additional corporate expense be removed from KTC's actual 2014 corporate expenses before escalating KTC's total corporate expenses for test year 2016. Accordingly, KTC's corporate expenses could be reduced by $96,975 to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied in this rate case.

**(x) Legal Expenses**

In KTC's supplemental testimony, KTC argues that rate case costs in the amount of $175,603 should be considered outside of the corporate expense cap.[67] However, KTC's 2016 projected legal expenses of $525,475 was included in the same $3,365,417 of corporate expenses that KTC argues would be "unreasonable" to reduce by 50% as required if using the FCC's Corporate Expense Caps.[68]

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[64] Attachment 2-10: Kertel's maintenance invoice.

[65] Attachment 2-11 Page 2 of Kertel's maintenance invoice.

[66] Attachment 2-12: In the email dated February 23, 2015, KTC's attorney writes, "as explained by Mr. Clark, KTC does not have a formal agreement related to these expenses."

[67] Supplemental Testimony, dated January 30, 2015, (Page 19).

[68] *Id*, page 27.

ORA recommends that KTC not be provided a special dispensation to consider rate case or regulatory costs outside of the FCC Corporate Expense Caps. In fact, one of the specific goals of adopting the FCC Corporate Expense Caps that was articulated by the Commission in D.14-12-084 was to "create incentives to align expenditures with the cap to reduce rate case litigation costs."

During this rate case, ORA could not verify the reasonableness of KTC's legal expenses. In response to ORA's request for supporting documentation for its legal expenses, KTC replied as follow, "Kerman objects to this data request to the extent that the question presented calls for information protected by attorney-client privilege and the attorney work-product doctrine. The Commission– and ORA – are restricted by all applicable privileges and protections that limit discovery power."[69]

With its position that the Commission cannot obtain supporting documentation for its legal expenses coupled with CHCF-A subsidies being provided to meet calculated revenue requirements, KTC has little or no incentive to control the amount of money it spends on legal services. Application of the FCC's Corporate Expense Caps will motivate KTC to incur legal costs only when it is reasonable and prudent to do so.

Although ORA could not verify the overall reasonableness of KTC's legal expenses due to the lack of supporting documentation, ORA's review of 13 transactions included in the 299 item sample of KTC's 2014 legal expenses reveals that three invoices totaling $35,095 should not be included for forecasting KTC's 2016 expenses because the three invoices were for services rendered through December 31, 2013. KTC projects 2016 expenses using 2014 expenses

[69] Attachment 2-13: KTC's response to Q 41 of ORA DR CC3001.

and not 2013 expenses. Accordingly, $35,095 should be removed from KTC's corporate expenses.[70]

**(xi) One Additional Regulatory Position at $120,000 per year**

KTC argues that it needs an additional employee to help with the number of proceedings in which KTC participates. According to KTC, a regulatory employee left at the beginning of 2014 and the regulatory manager's time is currently split between KTC and its other regulated affiliate, Foresthill Telephone Company ("FTC"). The additional employee's salary and benefits is estimated by KTC to be $120,000.

KTC's request for an additional regulatory employee is not justified since KTC's regulatory manager time has been split between KTC and its affiliate since at least 2010 and not just after the regulatory employee left the company at the beginning of 2014. In addition to splitting his time between KTC and FTC, KTC's regulatory manager also splits time between SEI's other affiliated entities (e.g. Kertel and Audeamus).[71]

Since the one regulatory employee left the company at the beginning of 2014, KTC regulatory manager's total time allocated to KTC work has not varied significantly despite the fact that in 2014 alone, "KTC actively participated in several general telecommunication proceedings."[72] In Table 2-7 below, ORA shows the number of hours KTC's regulatory manager worked on KTC's activities from 2011 to 2014:[73]

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[70] Attachment 2-14: Legal expenses for services rendered in 2013.

[71] Attachment 2-15: Dave Clark's email response dated March 6, 2015.

[72] KTC's Supplemental Testimony, page 28.

[73] ORA CC3001 Q7 Employee Compensation – Updated.

| Table 2-7: Regulatory Manager's Hours for KTC Activities | | | | |
|---|---|---|---|---|
| | **2011** | **2012** | **2013** | **2014** |
| **Total Hours** | 1,213 | 1,490 | 1,347 | 1,387 |

Because KTC's regulatory manager can handle the demands of several proceedings working only part time, the need for an additional full time regulatory employee is not justified. Accordingly, the $120,000 in expense requested for one additional regulatory employee should not be approved nor included in the projected corporate expense totals as a means of justifying why KTC should be permitted to exceed the adopted FCC Corporate Expense Caps.

#### (xii) ORA Conclusion on Application of the FCC Corporate Expense Caps for Ratemaking Purposes

Table 2-8 summarizes the adjustments that ORA identified from testing just 3% of the 9,361 sample of transactions that KTC's reported as 2014 expenses. The table below of ORA's adjustments illustrates a portion of the forecasted corporate expenses that KTC could reduce for ratemaking purposes in order to more easily meet the FCC Corporate Expense Caps that ORA recommends be applied in this rate case.

| Table 2-8: Summary of ORA's Ratemaking Adjustments to KTC's 2014 Corporate Expenses | |
|---|---|
| **Description of Adjustment** | **Amount** |
| Additional Executive Compensation | $294,705 |
| Terminated Temp. Executive Position | 58,144 |
| Retired Manager Salary Adjustment | 38,964 |
| Calcom Membership | 14,857 |
| Donation/Contribution/Sponsorship | 246,465 |
| Annual Party/Banquet/Retreat | 55,716 |
| Rental Apartment | 7,050 |
| Unsubstantiated Corporate Maintenance Cost | 96,975 |
| 2013 Attorney fees | 35,095 |
| **Total Identified Adjustments** | **$847,971** |

In summary, the FCC's Corporate Expense Caps provide a reasonable and appropriate methodology for estimating the $1,692,783 in total corporate expenses the Commission should authorize for ratemaking purposes. As demonstrated above, KTC's recorded $3,365,417 in total company corporate expenses projected for 2016 includes expenses that should be removed for ratemaking. A significant portion of the corporate expenses that KTC includes in revenue requirements are more appropriately recovered from its shareholders or affiliates. Since ORA's identification of expenses inappropriate for ratepayer recovery resulted from sampling only 299 out of 9,361 line-items from KTC's general ledger of expenses, it is reasonable to assume that similar and additional inappropriate expenses could be found if the total sample of corporate expenses selected for testing was increased. More importantly, removing all inappropriate or unreasonable expenses from KTC's total corporate expenses may result in a recoverable amount less than that resulting from the application of the FCC Corporate Expense Caps. As shown in Table 2-9, ORA recommends that the FCC Corporate Expense Caps be applied as adopted in D.14-12-084 in order to reduce KTC's intrastate corporate expense by $1,148,933.

| **Table 2-9: Application of FCC's Corporate Expense Caps** | |
|---|---|
| | |
| KTC's Estimated 2016 Corporate Expense | $3,365,417 |
| FCC Corporate Expense Cap[74] | $1,692,783 |
| Total Company Corporate Expense Reduction | $1,672,635 |
| **Intrastate Factor** | **68.69%** |
| Intrastate Corporate Expense Reduction | $1,148,933 |
| Interstate Corporate Expense Reduction | $523,702 |

[74] Calculated as shown in lines 1-18 of KTC's workpaper DC-3 Corp Ops Exp Cap (DC0111).

### 2) Non-Corporate Expense Adjustments

#### (a) Central Office Building ("COB") Expenses

KTC's central office building, located at 811 S Madera Avenue in Kerman, California is owned by parent company SEI and leased to KTC (the only tenant). SEI's corporate officers are also KTC's corporate officers. Per the lease agreement effective December 1, 1999, SEI, the landlord, was represented by SEI's vice president, Ruth Barcus (also a current executive officer of KTC) and KTC, the tenant, was represented by KTC's then vice president, William Barcus (currently KTC's president).

This lease agreement provides that KTC's annual rent payment to SEI is $592,800 per year or $49,400 per month in addition to all the taxes (assessed on the premises and the real property underlying the premises) and insurance expenses (required to be maintained by Landlord on the premises). In response to ORA's email request for the total amount of taxes and insurance expenses paid by KTC on the COB located at 811 S Madera, KTC responded that, "KTC understands that ORA is asking for the total amount of taxes and insurance expenses paid by KTC on the property located at 811 S Madera (leased from SEI) […] Insurance premiums on properties leased by KTC are not assessed on an asset by asset basis, rather insurance premiums are assessed collectively for all KTC's assets […] Similarly, the property taxes assessed on this leased property is assessed by the BOE […] Kerman does not have information in its possession to determine whether asset by asset tax assessments are made by the BOE."[75] Despite this response, ORA believes that KTC should be able to calculate the taxes and insurance it pays SEI because section 3.5 of the lease agreement states: "Tenant agrees to pay to Landlord without setoff or deduction, (a) the amount of

[75] Attachment 2-16: KTC's email dated February 24, 2015.

all Taxes assessed for any reason and levied on the premises and the Real Property underlying the Premises, and (b) the cost to Landlord of the insurance required to be maintained by Landlord on the Premises […] Landlord shall pay the Taxes and insurance […] and provide Tenant with a copy of the bills and proof that the Taxes and insurance have been paid."[76] Clearly, KTC or SEI should be able to provide supporting documentation for taxes and insurance paid on the central office building at 811 S Madera Avenue to justify recovering this expense from KTC ratepayers and contributors to the CHCF-A program.

In Resolution T-17081, the Commission required a ratemaking decrease to KTC's rent payment to SEI for this building. The amount allowed by the Commission for ratemaking purposes in T-17081 was $570,941 per year. KTC data provided in response to ORA's data request reveals that KTC's rent expenses to SEI was $760,800 per year or $63,400 per month in addition to taxes and insurance in 2014.[77]

As of December 31, 2014, KTC has paid SEI at least $9,277,400 in rent plus all taxes and insurance for a building that SEI built in at a total cost of $3,221,534.[78]

Based on information ORA has reviewed, the arrangements pertaining to this lease agreement made by SEI's officers (which are the same officers for KTC) benefit primarily SEI at the expense of KTC's ratepayers and contributors to the CHCF-A. Since KTC does business as SEI and pays rent to SEI, the total rent in the amount of $570,941 as approved in Resolution T-17081 is reasonable going

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[76] Attachment 2-17: page 4 of KTC's lease agreement.

[77] Response to ORA Data Request CC3002.

[78] CPUC Resolution T-17081.

forward. As of December 31, 2014, SEI has already made a profit in the amount of $5,413,666. Therefore, the $570,941 in reasonable rent expense for ratemaking purposes will continue to be profitable to SEI. In addition to this profit, SEI does not have to pay any taxes and insurance on the building since KTC is required to pay all taxes and insurance per the lease agreement. For this item, the total non-corporate expense should be reduced by $189,859 ($760,800 - $570,941) under the category "Plant Specific".

**(b) Maintenance Non-Corporate Expenses – Kertel**

As discussed in Section (vii) above, KTC claims that SEI's unregulated entity, Kertel, provides NOC (Network Operating Center) and IT (Information Technology) Technician Labor to support KTC Operations and Customers. A portion of this maintenance expense is reported as non-corporate expenses. SEI bills KTC for this maintenance service at a price of $66,091.67 per month or $793,100 per year. Of this amount, $58,010 per month or $696,123 per year is allocated to KTC's total non-corporate expenses. As also discussed in section (vii) above, SEI's invoice to KTC refers to a maintenance contract between KTC and Kertel that KTC has been unable to produce despite ORA's repeated requests.

Without a maintenance contract between KTC and Kertel, ORA cannot determine the scope of work and resources required to meet KTC's needs. SEI's invoice to KTC is not proof that the total amount included in rates is reasonable – especially given the affiliated interests between KTC and the vendor SEI. ~~For example, affiliate Kertel routes certain traffic from its cell towers through KTC's Central Office and affiliate Audeamus connects through KTC's Central office too. Accordingly, the NOC and IT Technician Labor costs that purportedly support KTC's operations may also support at least two other unregulated entities of SEI.~~ Furthermore, KTC pays for network services from Neo Nova Network Services, a company that provides managed IP services for telecommunication companies,

municipal organizations and cable companies.[79] Without adequate supporting documentation, ORA is unable to determine the portion, if any, of SEI's invoice to KTC that can be considered reasonable and included in KTC's non-corporate expenses. Therefore, KTC's non-corporate expenses should be reduced by the full $696,124 under the category of "Plant Specific".

**(c) KTC's Warehouse Facility - 15061 W. C Street**

According to KTC, it leases a warehouse facility located at 15061 W. C Street in Kerman, California from its affiliated entities, The Barcus Family Partnership and The S&K Moran Partnership.[80] KTC pays the rent for this warehouse as follows: $17,885.59 to Barcus Family Partnership and $17,885.59 to S&K Moran Family Limited Partnership for a total of $35,771.18 per month or $429,254 per year.

In response to ORA discovery, KTC's attorney wrote, "KTC is unable to locate a copy of the signed agreement in its records, but has requested the signed copy agreement from its local outside counsel."[81] As of the date of ORA's testimony, KTC has been unable to produce a signed copy of the lease agreement. ~~In addition to the absence of an executed lease agreement, the unsigned copy provided by KTC was incomplete as it did not include Exhibit A, which was identified in the agreement as containing the actual description of the parcel of real estate that KTC was leasing~~.

Without a fully executed lease agreement and due to the lack of adequate supporting documentation from KTC, ORA contacted the County of Fresno

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[79] Response to ORA Data Request CC3002.

[80] Attachment 2-18: KTC's response to ORA's request dated February 20, 2015, page 2.

[81] Attachment 2-19: Lisa Tse's email dated February 17, 2015.

regarding the warehouse facility located at 15061 W. C Street. According to the County of Fresno, the property located at 15061 W. C Street is registered to a regulated telephone company (not the private family partnerships indicated by KTC), which makes the property exempt from taxes in the County of Fresno. The County of Fresno suggested that the only agency that can provide additional information about the identity of the utility is the BOE or the City of Kerman. In an email dated March 4, 2015, the city of Kerman confirmed that the property located at 15061 W. C Street is registered as being owned by Kerman Telephone Company. With this information from the City of Kerman, it appears that KTC actually owns this warehouse. Therefore, it will be unreasonable for KTC to include in rates any rent expense for this location. Accordingly, the total rent expense for the year 2014 in the amount of $429,254 should be removed from the total non-corporate expenses under the category of "Plant Specific".[82]

**(d) Marketing Expenses**

KTC estimated 2016 marketing expenses in the amount of $396,266 by annualizing the eight months (January to August) of actual 2014 expenses known at the time of its application update and escalating for cost inflation that KTC assumes will occur. KTC's 2014 annualized total corporate marketing expenses totaled $379,390.[83] In response to ORA discovery, KTC indicated that its total actual marketing expenses as of December 31, 2014 were $373,069.[84] A sample that ORA selected from KTC's marketing expense transactions reveals that some of SEI's marketing expenses are charged 100% to KTC, while others are allocated

[82] Attachment 2-20: City of Kerman's email response from ORA's request for confirmation of verbal communication. http://www.co.fresno.ca.us/CountyPage.aspx?id=19475

[83] Kerman Workpaper DC-1, DC 0018, Account 6610

[84] Attachment 2-21: ORA's summary of "Kerman GL Detail Expense 2014 YTD 11-30", and "Preliminary Kerman GL Detail Expense December 2014 as of 1-30-15."

between the four affiliated entities doing business as SEI: KTC, FTC, Audeamus and Kertel. However, the split between the four entities is not evenly divided (25% of total expenses each). Instead, most are allocated 66.66% to regulated entities (33.33% each to FTC and KTC) with the remaining 33.33% split between unregulated affiliates Kertel and Audeamus). More importantly, some of the items included in this category as "marketing" expenses were actually for hotel stays and restaurant meals.[85] Although the Commission may ultimately determine that no advertising or marketing expense in rates is reasonable for a regulated monopoly, at a minimum, ORA believes a more reasonable allocation of marketing expense is required. Since SEI operates as KTC, FTC, Kertel and Audeamus, the $373,069 reduced by $42,000 in fees to Audeamus (see Section f) should be allocated using a 25% split to reflect KTC's fair share of the total advertising expenses. Accordingly $248,302 ($331,069 – ($331,069/4)) should be removed from KTC's total reported non-corporate expenses for ratemaking purposes. ~~In addition, KTC's marketing expenses should be reduced by $6,321, the difference between KTC's 2014 annualized amount totaling $379,390 and its actual total marketing expenses as of December 31, 2014 totaling 373,069. Consequently, KTC's total marketing expenses should be reduced by $254,623 ($248,302+$6,321).~~

**(e) Apartment Rental Expense**

As discussed in Section (viii) above, in the 2014 expenses that KTC escalates to project 2016 test year expenses are included the costs of a KTC leased apartment for $1,175 per month or $14,100 per year in Kerman, California. KTC recorded half of this lease expense as a KTC corporate expense and half as a KTC customer operations expense. As previously explained by ORA in Section (viii), this type of expense does not appear to be necessary for provision of safe and

[85] Attachment 2-22

reliable utility service. Consequently, KTC's total customer operations expenses should be reduced by $7,050.

**(f) Fees Paid to Audeamus**

KTC's total 2014 operating expenses includes a $42,000 expense for "customer retention fees."[86] KTC pays these fees to its affiliate, Audeamus, on a monthly basis.[87] Audeamus sells broadband services, and charges KTC a "customer retention fee" for each customer it acquires where the customer also retains telephone service from KTC.[88] For ratemaking purposes, KTC's non-corporate expenses should not include this particular expense. This expense is unreasonable, in large part, due to the corporate structure of SEI, the parent company of both KTC and Audeamus.

Audeamus purchases wholesale access to KTC's local loop in order to sell retail broadband services to customers in KTC's service territory.[89] The fees that KTC charges Audeamus for wholesale access to its network are assessed according to the NECA Tariff No.5.[90] However, the "customer retention fees" that Audeamus charges KTC are not established by the aforementioned NECA tariff, nor any other tariff, even though these fees effectively offset a portion of the wholesale network access fees.

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[86] Attachment 2-23: KTC's email dated March 12, 2015 - Carolyn Dukes identifies total charges of $42,000 from Audeamus to KTC for 'customer retention fees' during 2014.

[87] Attachment 2-24: KTC's Response to Data Request ORA AJC001. See Q3 and the associated work paper "ORA AJC001 Q3 Affiliate Transactions List and documents".

[88] Attachment 2-24

[89] Q 63, Testimony of David Clark. November 3, 2015.

[90] Q 63, Testimony of David Clark. November 3, 2015.

Furthermore, the very basis for the "customer retention fees" is questionable. KTC's total working lines have steadily declined since 2010, despite the theoretical "added value" that Audeamus' services contribute.[91] Although it is possible to argue that KTC might have lost even more customers if it were not for the "added value" of Audeamus' broadband services, KTC did not sufficiently demonstrate or quantify the benefits of the "customer retention fees".

KTC and Audeamus are affiliates under the parent company, SEI. These companies are closely intertwined and share common ownership, executive management, and corporate branding.[92] Indeed, both KTC and Audeamus do business as "Sebastian", even to the point of issuing a single combined bill to customers in common. KTC's and Audeamus' expenses, revenues and profits are all considered part of SEI's business ventures.[93] Thus, any fees paid from one SEI affiliate to another have essentially a zero net effect to SEI's bottom line. It is unreasonable for KTC to inflate its regulated expenses with payments to its affiliate for suspect services and expect California ratepayers and contributors to the CHCF-A to ultimately bear the costs. The $42,000 paid by KTC, doing business as SEI, to Audeamus, also doing business as SEI, is not a reasonable expense for ratemaking purposes. These fees are essentially SEI paying itself to retain its own customers. Accordingly, KTC's total 2014 non-corporate expenses should be reduced by $42,000 under the category of "Customer Operations".

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[91] Exhibit DC-3 of the Testimony of David Clark. January 31, 2015. See the 'Service Units' worksheet.

[92] Q7, Testimony of William Barcus. November 3, 2014.

[93] Attachment 2-25: KTC's Response to Data Request ORA AJC001. See Q1 and the associated work paper "AJC001, Q.1 Sebastian Enterprises 2013."

In Table 2-10, below, ORA summarizes the adjustments that should be made to KTC's 2014 non-corporate expenses in order to forecast test year 2016 expenses.

| Table 2-10: Ratemaking Adjustments to KTC's 2014 Non-Corporate Expenses | |
|---|---|
| **Description** | **Amount** |
| Central Office Building Rent | $189,859 |
| Kertel Maintenance Expenses | 696,124 |
| Warehouse Facility Rent | 429,254 |
| Marketing Expenses | 248,302 |
| Customer Retention Fees | 42,000 |
| Rental Apartment | 7,050 |
| **Total Reduction to Non-Corporate Expenses** | **$1,612,589** |

Based upon the above table, KTC's 2014 category of "Plant Specific" expenses should be reduced by $1,315,237 ($189,859 + $696,124 + $429,254). KTC's 2014 category of Customer Operations expenses should be reduced by $297,352 ($248,302 + $42,000 + $7,050).

Table 2-11, below, summarizes the effect of these adjustments to KTC's intrastate forecasted expenses for ratemaking purposes in test year 2016.

| Table 2-11: Adjustments for 2016 Non-Corporate Intrastate Expense | |
|---|---|
| **Description** | **Amount** |
| 1. Plant Specific Expense Adjustments 2014 | $1,315,237 |
| Multiply by 2% to project 2015 | $1,341,542 |
| Multiply by 2.4% to project 2016 | $1,373,740 |
| Intrastate Factor | 61.78% |
| Intrastate Plant Specific Expense Reduction 2016 | $848,696 |
| 2. Customer Operations Expense Adjustments 2014 | $297,352 |
| Multiply by 2% to project 2015 | $303,299 |
| Multiply by 2.4% to project 2016 | $310,578 |
| Intrastate Factor | 75.98% |
| Intrastate Customer Operations Expense Adjustment 2016 | $235,977 |
| **Total Non-Corporate Expense Reduction 2016** | **$1,084,673** |

### 3) Refunded Credit for Affiliate use of KTC Plant

As discussed in ORA testimony on Plant, Ratebase, and Depreciation (Chapter 3), KTC records a credit to its expense accounts for the use by affiliates of certain construction materials recorded in KTC's plant accounts. Since ORA's plant witness recommends that such plant be removed from the ratebase on which KTC earns a rate of return, the associated expense credit of $17,917 has been removed from KTC's expenses for ratemaking purposes.

## D. CONCLUSION

As discussed above, numerous "recorded" operating expenses that KTC is attempting to include in rates are unreasonable or lack adequate supporting documentation and justification. ORA identified numerous discrepancies from sampling only 299 out of 9,361 line items in KTC's general ledger of expenses. It can be reasonably inferred that the total operating expenses reported in KTC's application contain other examples of unjustified or unreasonable costs included in KTC's estimation of 2016 expenses for ratemaking purposes.

Due to the materiality of the findings from ORA's sampling of just 3% of KTC's recorded expenses, ORA recommends that the Commission adopt the FCC Corporate Expense Caps as adopted in D.14-12-084 and reduce KTC's other operating expense by the adjustments detailed above. The result of all of ORA's recommended expense adjustments is a decrease in KTC's 2016 revenue requirement of $2,215,689. This total adjustment is comprised of (1) a reduction of $1,148,933 from application of the FCC Corporate Expense Caps, (2) a reduction of $1,084,673 in non-corporate expenses, and (3) an increase of $17,917 to refund the expense credit for affiliate use of KTC construction materials.

# CHAPTER 3: PLANT, DEPRECIATION AND RATEBASE

## A. INTRODUCTION

This chapter addresses the reasonableness and prudency of Kerman Telephone Company's ("KTC") proposed Plant in Service, Depreciation, and Ratebase for Test Year 2016. A major component of KTC's proposed Plant in Service is the "Five Year Plan" in which KTC proposes continuation of Fiber to the Home (FTTH) deployment in the Kerman Service area.[94] The total estimated construction costs for these projects over the three years considered in this rate case (2014-2016) is $7,811,197.[95]

KTC provided documentation of the associated Ratebase consisting of Plant in Service minus the Accumulated Depreciation Reserves that correlate with these and other previously completed capital projects that KTC estimates will be in service for Test Year 2016.[96] KTC's total estimated average balance for Plant in Service for Test Year 2016 is $49,698,009; with a corresponding average balance for Accumulated Depreciation Reserves of $28,871,342. The intrastate portions of these balances for Test Year 2016 are $32,237,111 and $18,425,546, respectively. Subtracting the 2016 average Accumulated Depreciation Reserve balance from the average Plant in Service Balance and adding the other components of intrastate Ratebase results in KTC's proposed Test Year Ratebase of $12,815,660.[97]

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[94] Direct Testimony of Eric Kehler, November 3, 2014, Exhibit EK-1, Attachment A, Specific Project Plans.

[95] ORA Data Request BG001 Q2 – Construction Plan Update, Feb. 13, 2015.

[96] Attachment 3-1: Kerman Workpaper DC-3, Worksheet *Ratebase*

[97] KTC proposes Construction Work in Progress of $1,025,652; Materials & Supplies of $198,257; and Working Cash of $433,000. Attachment 3-2: Kerman Workpaper DC-3, *2016*

(continued on next page)

## B. SUMMARY OF RECOMMENDATIONS

ORA supports the approval of KTC's Five Year Plan with no adjustments to the proposed capital costs of the associated projects. First, the projects have comparable costs to projects approved under the California Advanced Service Fund ("CASF"). Second, the projects support the California Public Utilities Commission's ("CPUC") goal of "bridging the gap" between rural and urban broadband development. However, with the CPUC's refocus on safety concerns, ORA recommends KTC be required to submit a report within six months of a final decision in this proceeding to the Director of CPUC's Communication Division with a copy to ORA's Director on the measures that KTC is taking to mitigate potential safety concerns and ensure that customer's service remains safe and reliable.

Despite ORA's recommendation that KTC's proposed capital projects be funded without adjustment as a component of Ratebase, ORA recommends a more equitable allocation of the depreciation expense associated with the copper networks that KTC points out will be "replaced long before they become fully depreciated under the existing lives."[98] The business benefit that KTC's unregulated affiliates will receive from the replacement of copper networks with FTTH services supports ORA's recommendation that KTC's shareholders should be responsible for a portion of KTC's proposed accelerated depreciation expense. Therefore, ORA suggests a decrease of $350,031 to KTC's proposed depreciation expense in 2016 for ratemaking purposes.

Finally, ORA recommends an adjustment in KTC's proposed 2016 Ratebase to eliminate the return that KTC earns on plant in account "Other Work

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(continued from previous page)
*Ratebase SRO.*

[98] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 11, lines 2-3

Equipment." This other work equipment is not directly used and useful to KTC but rather leased by KTC to unregulated affiliates at below-market rates. This adjustment results in a decrease of $138,852 to KTC's proposed 2016 revenue requirements.

## C. DISCUSSION

### 1) Five Year Plan – FTTH Projects

This section addresses the reasonability of KTC's "Five Year Plan" consisting of projects for the development of FTTH infrastructure throughout downtown Kerman, California and eventually to customers outside of the downtown area.[99] KTC states that it requires these projects because current plant is forty or more years old, and current trends will lead to technological obsolescence of its current copper plant.[100] Additionally, KTC states that continued use of existing facilities will necessarily decrease service quality due to increased interference noise and susceptibility to service troubles triggered by environmental issues.[101]

As detailed below, ORA recommends no adjustment to the KTC's proposed funding of the projects contained in KTC's Five Year Plan. ORA makes this recommendation based on its analysis that the proposed projects: (1) Have comparable costs to projects approved under CASF; (2) Align with the CPUC's goal of "bridging the gap" between rural and urban broadband development; and (3) Support the CPUC's focus and advancement of safety.

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[99] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 7, supplemented by Kerman's Response to BG001, Q. 2-4, exhibit ORA BG001 Q2- Construction Plan Update (Attachment 3-3).

[100] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 4-5.

[101] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 3.

### (i) Reasonableness of Price

KTC's estimated total for all of the projects over the three year considered in this rate case (2014-2016) is $7,811,197.[102] KTC's proposed projects will affect roughly 5,400 households, so its cost-per-household is $1,447.[103] This estimated cost-per-household falls well within the average of all CASF approved projects. In 2007, the CPUC established the California Advanced Services Fund ("CASF") in order to fund new broadband infrastructure to unserved and underserved areas.[104] In order to receive funding for these grants, telecommunication companies must provide a description of the project along with total costs to the CPUC, which then determines whether or not the project should be built. For example, in Resolution T-17439, the Communications Division of the CPUC recommended approval of the CASF application of The Shasta County Telecom, Inc.'s project fund award of $2,238,806, or 60% of the project's total estimated cost of $3,731,344.[105] The Shasta project provides broadband for an estimated 1,444 households for a total cost of $2,584 per household.[106] As shown in Attachments 3-4 and 3-5, the average price per household for all CASF

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[102] Direct Testimony of Erik Kehler, Nov. 3, 2014, Exhibit EK-1, Kerman Telephone Co. (DBA Sebastian) 2014 Annual 54.313 Report of High-Cost Recipient Public Interest Obligation, 543.13(f)(1)(i) Certification, pg. 6.

[103] Attachment 3-3: Kerman's Response to BG001, Q. 2-4, exhibit ORA BG001 Q2-Construction Plan Update.

[104] Interim Opinion Implementing California Advanced Services Fund, D. 07-12-054, Dec. 20, 2007.

[105] CPUC Resolution T-17439 Approval of Funding for the Grant Application of The Shasta County Telecom, Inc. (U-7129), from the California Advanced Service Fund in the Amount of $2,238,806 for the Shasta County Unserved and Underserved Broadband Project, June 26, 2014.

[106] *Id*., pg. 4.

approved projects is $4,863, well above KTC's $1,447 estimated cost per household for the three year total of the projects presented within this rate case.

**(ii) Preventing a Two Tier Communications System**

According to the Federal Communications Commission ("FCC"), 17% of all Americans, or 55 million people, lack access to the newly established minimum broadband benchmark speeds of 25 Mbps download / 3 Mbps upload.[107] The FCC also found that 53% of individuals who live in rural areas lack access to these speeds, whereas only 8% of people living in urban areas lack access.[108] There is generally wide support for closing the digital divide between urban and rural areas.[109] KTC states that it needs to build a fiber network based on FTTH technology in order to continue to provide high speed service to its customers.[110] KTC's unregulated affiliate currently advertises that it can only provide service up to 20 Mbps download and 2 Mbps upload, which is below the FCC's recently updated broadband benchmark speeds.[111] By completing the proposed projects, KTC's unregulated affiliate would be able to deliver broadband speeds to the KTC service area that match the capabilities of the best systems found in urban areas.[112]

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[107] FCC Finds US Broadband Deployment Not Keeping Pace, Jan. 29, 2015, *available at* http://www.fcc.gov/document/fcc-finds-us-broadband-deployment-not-keeping-pace .

[108] FCC Finds US Broadband Deployment Not Keeping Pace, Jan. 29, 2015, *available at* http://www.fcc.gov/document/fcc-finds-us-broadband-deployment-not-keeping-pace .

[109] Mark Baldassare, Dean Bonner, Sonja Petek, Jui Shrestha, California's Digital Divide, Public Policy Institute of California, available at: http://www.ppic.org/main/publication_show.asp?i=263

[110] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 7.

[111] Sebastian Price List For Kerman CA, *available at* http://sebastiancorp.wpengine.com/wp-content/uploads/2013/04/Sebastian-Price-List-Kerman-CA-2.10.15.pdf .

[112] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 3.

This helps advance the CPUC's goal of closing the gap in service between urban and rural broadband availability.

**(iii) Safety Considerations**

ORA is aware of safety concerns as the transition from copper to fiber networks proceeds.[113] Two major concerns identified by the CPUC are the lack of requirements governing back-up power and consumer notification and education about the impact of the transition.[114] In the event of an emergency, copper has proven to be a valuable resource since it works regardless of whether or not there is power in the affected area.[115] FTTH only lasts as long as back-up power sources allow. This can be problematic for a number of reasons. First, the current life of most back-up power sources, which are generally battery back-ups, is only 4-8 hours.[116] In protracted power outages, this means that a home could be without access to communications services, including emergency 911 services.

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[113] Comments of the California Public Utilities Commission, In The Matter of Ensuring Customer Premises Equipment Backup Power for Continuity of Communications, PS Docket No. 14-174, Feb. 26, 2015.

[114] Comments of the California Public Utilities Commission, In The Matter of Ensuring Customer Premises Equipment Backup Power for Continuity of Communications, PS Docket No. 14-174, Feb. 26, 2015, pg. 3-7.

[115] In the event of a power outage, copper based telephone systems are able to maintain service. Copper wires maintain an electric current provided by a central office and do not require any outside power. These central offices maintain multiple forms of backup power generation, from battery storage systems to diesel generators, allowing all phones in an area that are directly connected to the line (that is, excluding cordless / wireless phone systems) to remain viable methods of communication.

[116] Attachment 3-6: "Typically, any type of battery power will only last for four hours or less under constant use." Kerman Telephone Company Directory– What To Do To Make Sure You Have Phone Service In The Event Of A Power Outage; 5.1 U-Verse Equipment, Battery Backup Info, Broadband DSL Reports, http://www.dslreports.com/faq/17756 .

Second, the use of backup power changes the expectations of how telephone service is provided. The current expectation is everything outside the customer premises is provided by the telecommunications provider, while the inside wiring and phone itself is provided by the customer. In this instance, consumers are left with the additional burden of determining who is responsible for continued maintenance of the back-up battery. This is made even more difficult because there are no bright-line rules and regulations for which entity should be responsible, leaving it up to carriers to determine their policies. For example, KTC's own literature does not clearly state the procedures for battery maintenance, testing, and replacement.[117]

These concerns notwithstanding, ORA is also aware of potential benefits associated with fiber networks that might provide other safety measures. During emergency situations without extended periods of power loss, fiber systems allow for rapid communication between hospitals, first responders, and other anchor institutions that can enable better responses to situations as they arise.[118] Furthermore, many new medical and educational applications, such as Common Core online modules and telemedicine, require higher speed broadband than KTC's current copper based system can provide.[119] Even in times of emergencies, a study by the FTTH Council found that less than 1% of households currently rely on a corded phone powered by copper lines during electrical outages.[120] Having considered this information, ORA recommends KTC be

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[117] *Id.*

[118] *See, e.g.* Reply Comments of the Schools, Health and Libraries Broadband Coalition, In the Matter of A National Broadband Plan for Our Future, GN Docket No. 09-51.

[119] *See, e.g.* Reply Comments of the Schools, Health and Libraries Broadband Coalition, In the Matter of A National Broadband Plan for Our Future, GN Docket No. 09-51.

[120] Reply Comments of Fiber to the Home Council Americas on the Technology Transitions

(continued on next page)

required to submit a Tier 3 Advice Letter six months after a final decision in this proceeding proposing a plan to mitigate potential safety concerns and to educate customers about the impact of the transition (including new responsibilities that customers must assume).

**2) Depreciation Expense**

This section addresses the issue of who should bear the cost of accelerated depreciation of KTC's existing copper plant. For Test Year 2016, KTC has estimated a depreciation expense of $350,031 related to copper networks.

KTC is proposing to replace its current copper based services with FTTH technology. As part of this proposal, KTC is requesting accelerated depreciation of its Underground Metallic and Buried Metallic Cable & Wire Facilities,[121] which are the associated accounts of the copper wire infrastructure as noted in Table 3-1.

**Table 3-1: Comparison of KTC Current and Proposed Depreciation Life of Copper**

| | Underground Metallic Cable and Wire Facilities | Buried Metallic Cable and Wire Facilities |
|---|---|---|
| Current Depreciable Life | 12 years | 24 years |
| KTC Proposed Depreciable Life | 10 years | 20 years |

However, unlike many utility replacement projects that occur when the plant involved is in disrepair or can no longer provide useful service, KTC's

(continued from previous page)
NPRM, In The Matter of Technology Transitions, GN Docket No. 13-5, March 9, 2015.

[121] Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 10-11.

current copper plant is still useful and in good repair.[122] Furthermore, KTC's current plant provides an ability to exceed current CPUC and FCC minimum standards for broadband services in rural areas.[123] Additionally, more than 3,800 of the estimated 5,400 households in KTC's service territory (over 70%) can subscribe to Comcast's Xfinity broadband services that meet the FCC's new nationwide minimum thresholds of 25 Mbps download and 10 Mbps upload. As summarized in Table 3-2, below, Comcast currently advertises speeds up to 150 Mbps download and 20 Mbps upload within the city of Kerman.[124] KTC's unregulated affiliates will also receive business benefits in terms of additional work orders associated with the fiber deployment. Therefore, ORA recommends that Sebastian's shareholders bear the total cost of the $350,031 in estimated accelerated depreciation expense related to existing copper networks for Test Year 2016.[125]

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[122] "Kerman has not had any significant service quality issues… [and] the standards established by the Commission for service quality have all been met." Direct Testimony of Eric Kehler, Nov. 3, 2014, pg. 11; *ifnra*, Chapter 5: Service Quality and Reliability Performance.

[123] In The Matter of Connect America Fund, WC Docket No. 10-90, FCC 14-190, Dec. 18, 2014, pg. 6, ¶ 15; Order Instituting Rulemaking to Consider Modifications to the California Advanced Services Fund Including Those Necessary to Implement Loan Program and Other Provisions of Recent Legislation, Decision Implementing Broadband Grant and Revolving Loan Program Provisions, CPUC D. 12-02-015, Feb. 1, 2012, pg. 17; Sebastian – Kerman Price List as of 2/10/2015, *available at* http://sebastiancorp.wpengine.com/wp-content/uploads/2013/04/Sebastian-Price-List-Kerman-CA-2.10.15.pdf; Attachment 3-7: Xfinity Advertised Speed for Extreme 150 Product as of 3/13/15 for Kerman, CA.

[124] http://www.broadbandmap.ca.gov/map/; Comcast.com/xfinity-internet-offers for the City of Kerman.

[125] Kerman Workpaper DC-3, *Ratebase*.

| Table 3-2: Broadband Speeds | | | | |
|---|---|---|---|---|
| | FCC/CAF Minimum | CPUC/CASF Minimum | KTC Maximum Advertised | Comcast Maximum Advertised |
| Download | 10 Mbps | 6 Mbps | 20 Mbps | 150 Mbps |
| Upload | 1 Mbps | 1.5 Mbps | 10 Mbps | 20 Mbps |

### 3) ORA Recommended Ratebase Adustments

### Other Work Equipment

KTC's proposal for Plant In Service during the Test Year 2016 includes an account for "Other Work Equipment." This account consists of construction equipment such as: cable plows, boring rigs, cable testing equipment, work equipment trailers, splicing equipment, and concrete saws.[126] During Test Year 2016, KTC projects the "Other Work Equipment" account to have an average balance of $1,249,638, with related accumulated depreciation of $566,870 for a net total of $682,768 associated with this account included in Ratebase.[127]

For ratemaking purposes, KTC's Ratebase for the test year 2016 should exclude the entire plant balance recorded in the account "Other Work Equipment" and any related accumulated depreciation for this account. KTC does not use the equipment that has been recorded to this account to provide services to customers. In fact, KTC does not directly use this equipment at all.[128] Rather, KTC rents or leases the construction equipment to its unregulated construction affiliate, Kertel

[126] Testimony of Eric Kehler. November 3, 2014. See Question 12.

[127] Kerman Workpaper DC-3.

[128] ORA Telephone Conversation with David Clark and Carolyn Dukes, March 11, 2015.

Communications ("Kertel").[129] KTC outsources its construction to Kertel and provides Kertel with the equipment necessary to perform construction services on a time-leased basis.[130] KTC is a telephone company, not an equipment rental company, and its Ratebase should not include unnecessary Plant In Service that does not directly support KTC's provision of services.

Furthermore, the hourly lease rates that KTC charges its unregulated affiliate Kertel are problematic. The rates are far below the fair market prices offered by other construction equipment rental companies.[131] KTC purports to use a "GE-100 model" which was developed by the Commission to establish the equipment rental rates it charges its affiliate.[132] However, the "GE-100 model" is an outdated cost standard that, in this particular situation, produces unreasonable lease rates for the construction equipment.[133] Table 3-3 provides a comparison of some of the rates KTC charges Kertel versus the market rates of unaffiliated equipment rental companies that ORA researched.

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[129] Attachment 3-8: Kerman's Response to Data Request ORA RRA001. See Questions 4(a) and 4(b).

[130] Attachment 3-8: Kerman's Response to Data Request ORA RRA001. See Questions 4(a).

[131] Attachment 3-8: Kerman's Response to Data Request ORA RRA001. See Questions 4(a) and the associated work paper "OTA RRA001 Q4a OWE rental rates".

[132] Attachment 3-8: Kerman's Response to Data Request ORA RRA001. See Question 4(a).

[133] "A GE-1OO analysis form or its equivalent was in general use by the CPUC and the LECs from the early 1960s to the late 1970s to establish rates and charges based on fully allocated costs for customer premised telephone equipment and specialized telecommunications services." *See* Decision 90-11-029, at Finding of Fact no.13.

| Table 3-3: Comparison of KTC and Competitive Equipment Rental Rates | | | |
|---|---|---|---|
| **KTC Equipment Rental Rates** | | **Competitive Rental Rates** | |
| **Equipment** | **Daily Rate** | **Equipment** | **Daily Rate** |
| Generator 7200 Watt | $3.23 | Generator 7500 Watt | $66.00 [134] |
| Backhoe Deere 3000 | $36.00 | 4WD Std Backhoe | $275.00 [135] |
| Forklift 10,000 lb. | $36.95 | Forklift 10,000 lb. | $379.00 [136] |
| Ditch Witch 6510 | $56.71 | Ditch Witch 4500 | $414.00 [137] |
| Air Compressor Leroi | $24.51 | Air Compressor 375 CFM | $225.00 [138] |
| M-K Concrete Saw | $3.79 | M-K Concrete Saw | $65.00 [139] |

Irrespective of the subsidized lease rates that KTC provides its unregulated affiliate, this arrangement is problematic due to the organizational structure of Sebastian Enterprises, Inc. (SEI), the parent company of both KTC and Kertel. These companies share common ownership, executive management, and corporate branding. Both KTC and Kertel do business as "Sebastian." The transactions between KTC and Kertel, including the leasing of equipment and construction services, are two examples of the substantial vertical and horizontal integrations that Sebastian Enterprises and its affiliates enjoy. Ratepayers should not bear the

[134] Attachment 3-9.

[135] Attachment 3-10

[136] Attachment 3-11

[137] Attachment 3-12

[138] Attachment 3-13

[139] Attachment 3-14

costs of inflated ratebase or excessive expenses resulting from KTC's position within SEI's corporate structure. KTC's revenue requirements should completely exclude all ratemaking effects of the plant that KTC has recorded to account "Other Work Equipment." Accordingly, ORA has adjusted KTC's proposed 2016 Plant In Service to remove this account and its associated effects on ratebase and depreciation expense, while removing the credit to the related expense account for the $17,154 in rental fees that Kertel paid KTC in 2014. The net adjustment results in a decrease to KTC's revenue requirements in the amount of $138,852.

**D. CONCLUSION**

The proposed projects between 2014 and 2016 contained within KTC's Five Year Plan appear to be reasonable and should be funded without adjustment to estimated project costs. However, ORA recommends KTC be required to submit a Tier III Advice Letter within 6 months of a final decision in this proceeding to the CPUC's Director of Communications Division with a copy to ORA's Director on the measures that KTC is taking to mitigate potential safety concerns associated with transitioning from copper to fiber communication networks.

Sebastian's shareholders should bear the total cost of the $350,031 in estimated depreciation expense related to existing copper networks for Test Year 2016 due to the early retirement of the current copper plant.

KTC's "Other Work Equipment" Plant in Service account should be reduced to $0 for ratemaking purposes. The corresponding Accumulated Depreciation Account should also be set to $0 for ratemaking purposes. KTC's 2014 expenses (which are escalated to forecast 2016 expenses) should be credited the $17,154 in rents paid to KTC by Kertel for the use of the equipment. The net effect of this adjustment reduces KTC's CHCF-A subsidy by $138,852.

# CHAPTER 4: COST OF CAPITAL

## A. INTRODUCTION

In setting a reasonable cost of capital (also called the rate of return) the regulator generally strives to authorize a cost of capital for a regulated utility that is the lowest rate sufficient to allow the company to raise enough capital to support its efforts to provide safe and reliable service at reasonable rates. This authorized cost of capital is the rate that the utility has the opportunity to earn on its ratebase.

Calculating the cost of capital requires consideration of three components. Each component of the cost of capital (cost of equity, cost of debt, and capital structure) is important and will affect the final cost of capital. As noted earlier, the cost of capital is applied to the amount of ratebase and is incorporated into the utility's revenue requirement and thus the rates paid by customers.

The capital structure can be determined from the utility's financial statements or the Commission may impute a capital structure. The utility's cost of debt is generally its weighted average cost of existing long-term debt. The return on equity is typically calculated using one or more financial models. Both Kerman's and ORA's return on equity calculations are based on the Capital Asset Pricing Model (CAPM).

When calculating return on equity, the CAPM will consider two numbers: the forecasted risk-free rate of interest,[140] and the "equity risk premium," which is the amount of additional return required to produce a return on equity high enough to attract the necessary capital.

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[140] The "risk free rate" is generally defined as the forecasted yield on the U.S. Treasury bonds over the next several quarters.

In the current proceeding, Kerman has requested an increase from its currently authorized rate of return of 10% to 13.63%.

## B. SUMMARY OF RECOMMENDATIONS

In consideration of current market conditions and the favorable regulatory mechanisms which guarantee Kerman's revenues and reduce its risk, the company's requested 13.63% rate of return and its implied return on equity of 29.28% is unreasonable and should not be authorized.

ORA recommends the Commission adopt a return on equity of 8.79% which when combined with ORA's other recommended cost of capital components yields an overall 5.44% rate of return. The differences between Kerman's and ORA's positions are shown below in Table 4-1 and discussed in the following sections.

**Table 4-1: Comparison of Kerman and ORA Positions**

| | | Kerman | ORA |
|---|---|---|---|
| Capital Structure | Debt % | 20% | 60% |
| | Equity % | 80% | 40% |
| Cost of Debt | | 3.2% | 3.2% |
| Return on Equity | | 16.24% | 8.79% |
| | **Cost of Capital** | **13.63%** | **5.44%** |

## C. DISCUSSION

In its updated supplemental testimony,[141] Kerman has requested the Commission authorize a rate of return of 13.63% representing a significant increase from the currently authorized rate of 10.00% approved in 1997.[142] At first glance, one would expect overall costs of capital to have decreased since 1997 as lending costs and Treasury rates have generally declined.[143] However, Kerman relies upon stale data and questionable assumptions in order to assert that its costs of capital have increased.

More importantly, in developing its requested cost of capital, Kerman imputes a capital structure of 20% debt and 80% equity. However, as can be seen from the balance sheet it submitted with its application, Kerman's actual capital structure is 49.1% debt and 50.9% equity.[144] Furthermore, the company's anticipated capital structure is 60% debt and 40% equity.

As illustrated in Table 4-2 below, Kerman's requested 13.63% rate of return and 3.20% cost of debt when combined with the actual capital structure the company has indicated to be targeting implies an incredible 29.28% return on equity ("ROE") for Kerman's investors. This implied ROE is well above the ROE generally allowed for a regulated utility and simply an unrealistic expectation that serves only to increase investor profits at the expense of Kerman's customers and those ratepayers who contribute to the state and federal subsidy programs.

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[141] Supplemental Testimony of Michael C. Burke, November 3, 2014 (A.11-12-011)

[142] See D.97-04-036, 97-04-034, D.97-04-035, and D.97-04-032

[143] http://www.federalreserve.gov/releases/H15/data.htm

[144] Response of Kerman Telephone To Second Amended Scoping Memo and Ruling of

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Since the company's proposed capital structure for ratemaking purposes produces a vastly different ROE than that generated using its actual or targeted capital structure, it is important for the Commission to examine all three components of the cost of capital and not focus exclusively on the final rate of return. The Commission should focus on establishing a fair return on equity, a reasonable cost of debt, and a reasonable capital structure when determining the overall cost of capital to authorize. Disregarding the individual components that comprise the overall cost of capital and accepting Kerman's hypothetical and imputed capital structure will result in unreasonable costs that ultimately impact customer rates (and state and federal support).

**Table 4-2: Comparison of Kerman's Exhibited and Implied Return on Equity**

| | Exhibited ROE presented in Kerman Workpapers | Implied ROE using Kerman's Target Capital Structure |
|---|---|---|
| (1) Rate of Return | 13.63% | 13.63% |
| (2) Debt | 20% | 60% |
| (3) Equity | 80% | 40% |
| (4) Cost of Debt | 3.2% | 3.2% |
| **Return on Equity** [(1)-(2)*(4)]/(3) | **16.24%** | **29.28%** |

The following discussion details ORA's analysis and recommendations for each of the components comprising cost of capital.

(continued from previous page)
Assigned Commissioner and Administrative Law Judge, November 3, 2014, Exhibit A.

### 1) Cost of Capital Components

There are three variable components to the cost of capital: the capital structure, the cost of debt, and the cost of equity. The total weighted cost of capital will vary as any one of the three variables changes. Consequently, if the cost of capital is fixed and any two of the three variables are also fixed, the third variable can be found.

#### (a) Capital Structure

Kerman proposes a hypothetical capital structure of 20% debt and 80% equity. Kerman cites "increased uncertainty surrounding the future revenue streams for small local telephone companies" as support for proposing an 20% debt and 80% equity structure be used for ratemaking purposes.

ORA has significant concerns with Kerman's hypothetical capital structure of 20% debt and 80% equity being used to calculate an overall rate of return. The first concern is that Kerman's proposed capital structure is very much different from Kerman's actual capital structure of 49.1% debt and 50.9% equity.[145] Furthermore, and perhaps more telling, in the 2015 Sebastian Strategic Plan that ORA obtained through discovery, Kerman identified a target capital structure of 60% debt and 40% equity.[146] Kerman's current capital structure and the targeted capital structure identified in the Sebastian Strategic Plan differ significantly from Kerman's proposed capital structure to be used for ratemaking. Using Kerman's proposed hypothetical capital structure for ratemaking would result in an unreasonable increase in revenue requirements and an excessive actual ROE for the owners of Kerman.

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[145] Response of Kerman Telephone To Second Amended Scoping Memo and Ruling of Assigned Commissioner and Administrative Law Judge, November 3, 2014, Exhibit A.

Based on a reasonable review of the regulatory environment Kerman's statement that there exists "increased uncertainty surrounding the future revenue streams for small local telephone companies" appears to be misplaced. In fact, substantial regulatory mechanisms are in place at the state and federal level that help to ensure the recovery of authorized revenue requirements and the viability of small local telephone companies. The California High Cost Fund-A ("CHCF-A") and the federal Universal Service Fund ("USF") are two such mechanisms. Succinctly, there is no basis for incorporating an artificially high equity ratio into the cost of capital to account for perceived risks that do not exist. Furthermore, there is no reasonable basis to incorporate such a high equity ratio for ratemaking purposes when it is counter to the actual strategic direction Kerman is pursuing. Kerman's actual capital structure and stated direction on capital structure belie its concerns about increasing uncertainty.

For these reasons ORA recommends a capital structure of 60% debt and 40% equity that more accurately reflects Kerman's current actual capital structure and the capital structure it identified as targeting for strategic purposes.

**(b) Cost of Debt**

Kerman requests a cost of debt of 3.20%. Kerman's calculation is based on the company's interest expense from its 2013 audited financial statements divided by the average long term debt outstanding during 2013. ORA does not recommend any adjustment to Kerman's calculated costs of debt.

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**146** Attachment 4-1: 2015 Sebastian Strategic Plan, pg. 6

### (c) Cost of Equity (Return on Equity)

In seeking equity investors, utilities compete with other sellers of common stock, or in the case of privately held utilities, the owners (investors) have the option of making investments elsewhere. Since regulated utility stocks are generally regarded as relatively safe investments, a typical investor in utility stocks is selecting a lower risk of loss coupled with a steady stream of dividends or predictable earnings.

The ROE is the return an investor expects for the level of risk inherent in the investment. The lower the risk the lower the expected return. Despite the favorable regulatory mechanisms available which guarantee Kerman's revenues and reduce its risk, the company has proposed an effective equity return of 29.28% as shown earlier in Table 4-2. The ROE implied in Kerman's proposed rate of return is more than three times greater than the average return calculated by CAPM models used by other regulatory bodies as shown in Table 4-3 below.

**Table 4-3: Average Return on Equity Calculated by Other Regulatory Bodies**

| | Department of Revenue Washington State[147] | Federal Communications Commission[148] |
|---|---|---|
| Calculated ROE using CAPM | 8.50% | 6.31% - 7.18% |

For its analysis, Kerman calculated a cost of equity of 16.24% based on the CAPM calculation shown below in Table 4-4. ORA's calculation is shown in the table for comparison.

[147] Attachment 4-2: Excerpt from Cost of Capital Study, 2014 Assessment Year.

[148] Prescribing the Authorized Rate of Return, May 16, 2013

| Table 4-4: Cost of Equity Computations | | |
|---|---|---|
| **Description** | **Kerman** | **ORA** |
| Risk Free Rate | 4.47% | 2.91% |
| Equity Risk Premium | 6.96% | 5.88% |
| Industry Risk Premium | - 1.18% | n/a |
| Size Premium | 5.99% | n/a |
| **Cost of Equity** | **16.24%** | **8.79%** |

Kerman's recommended cost of equity is overstated due to excessively high estimates for the Risk Free Rate, Equity Risk Premium, and the Size Premium. Kerman elected to use a modified CAPM calculation that incorporates additional factors for the Industry Risk Premium and a Size Premium. As detailed below, ORA does not support using the modified CAPM in this proceeding.

**(i) Risk-Free Rate**

Kerman based its estimate of the risk-free rate on an average of the 20-year Treasury rate over the period from January 3, 2000 through October 24, 2014. The resulting average does not reflect current 20-year Treasury rates which are currently 2.32% as of January 5, 2015.[149] The recent 10-year average of 20-year Treasury rates is 3.93%. The averages of both 20-year and 30-year Treasury rates have been declining since 2000 and current rates more accurately reflect current and near term financial conditions. ORA uses the recent three-year average of the 20-year Treasury rate of 2.91% as of January 5, 2015 to estimate the risk-free rate for its analysis. Kerman's proposed risk-free rate does not adequately reflect

[149] Attachment 4-3: FRB H.15 1/9/2015

recent historical rates or current rates. ORA's recommendation is more reasonable and falls within the range of risk-free rates recommended by other regulatory agencies in recent analyses.[150] Kerman's proposed risk free rate is well above the current reasonable range and should not be adopted.

**(ii) Equity Risk Premium**

Kerman estimated an equity risk premium of 6.96%. One way to estimate the equity risk premium is to compare the mean returns on bonds and stocks over long historical periods. Measured in this manner, the equity risk premium has been in the 5% to 7% range. However, studies by leading academics indicate the forward-looking equity risk premium is actually in the 4.0% to 5.0% range.[151] These lower equity risk premium results are in line with the findings of equity risk premium surveys of CFOs, academics, analysts, companies, and financial forecasters.[152]

On May 16, 2013, the Wireline Competition Bureau of the Federal Communications Commission issued a Staff Report titled "Prescribing The Authorized Rate of Return". In this report the average market (equity) premium for the period 1928 – 2012, was shown to be 5.88%. For its 2014 Assessment

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[150] See for example: Prescribing The Authorized Rate of Return, Analysis of Methods for Establishing Just and Reasonable Rates for Local Exchange Carriers, May 16, 2013, pg. 25 (1.92% - 10-year Treasury), and 3.75% Department of Revenue Washington State, Cost of Capital, Yield Capitalization, 2014, pg. 6

[151] Testimony of Dr. J. Randall Woolridge On Behalf of the Division of Ratepayer Advocates Cost of Capital Applications 12-05-001; 12-05-002; 12-05-004; 12-05-005; San Francisco, California August 27, 2012, Attachment JRW-11, pages 5-6; www.ora.ca.gov/DrWoolridgeTest.aspx

[152] *Id.*

Year, Telecommunications The Washington Department of Revenue used an average risk premium of 5.0% derived from multiple sources.[153]

ORA recommends using an equity risk premium of 5.88%. ORA's recommendation is reasonable as it falls within the range of historical analysis, while moving closer to the findings of more recent academic studies and more recent market returns.

**(iii) Size Premium**

Kerman includes a size premium of 5.99% based on data included in the Duff & Phelps 2014 Valuation Handbook – Guide To Cost of Capital. As a rate regulated entity, supported by both state and federal mechanisms to subsidize and guarantee revenue, the risk associated with Kerman's size is moot. Furthermore, the FCC in its analysis on the issue of size premiums found that recent research indicates that the size effect seems to vary over time or even disappears, with smaller firms in the United States not performing significantly better than large ones from 1980 onward and therefore did not recommend adding a risk premium based upon firm size to the cost of equity.[154]

ORA does not include an explicit adjustment to reflect a size premium which is consistent with recent professional observations and FCC determinations. Additionally, ORA notes that its estimates reflect averages that already encompass various sized firms.

**(iv) Industry Risk Premium**

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[153] Attachment 4-2: Department of Revenue Washington State, Cost of Capital Study, Telecommunications, 2014 Assessment Year, page 6

[154] FCC, "Prescribing the Authorized Rate of Return," WC DOCKET NO. 10-90, 5/16/2013

Kerman includes an industry risk premium of -1.18% taken from the 2014 Valuation Handbook – Guide To Cost of Capital for SIC Code 4813. The **Standard Industrial Classification** (**SIC**) is a system for classifying industries. SIC Code 4813 includes telephone communications companies. Although Kerman's proposed negative adjustment would lower ROE, ORA does not include an explicit industry risk adjustment in its estimate since not all the firms included in the 4813 SIC Code are regulated telephone companies.

**2) Summary of Analysis**

ORA agrees with Kerman's proposed use of 3.2% for cost of debt. ORA's calculated cost of equity is 8.79% which is the risk free rate of 2.91% plus an equity risk premium of 5.88%. ORA also recommends 60% debt and 40% equity as a more reasonable capital structure which would better reflect both Kerman's actual and targeted capital structures.

## D. CONCLUSION

Kerman's requested cost of capital of 13.63% and its implied 29.28% investor return is excessive and unreasonable. Kerman's proposed rate of return is counter to all reasonable analysis of market changes that have occurred since 1997 when the Commission adopted 10.00% as the cost of capital for the small telephone companies.

ORA has focused its analysis on identifying a reasonable capital structure and determining a reasonable cost of equity that reflects reasonable investors' expectations. Combining the results of this analysis yields an overall cost of capital of 5.44%. The overall cost of capital calculated and recommended by ORA will result in a reduction of approximately $1.7 million in revenue requirements.

# CHAPTER 5: SERVICE QUALITY

## A. INTRODUCTION

This chapter addresses multiple components and standards for service quality and reliability such as the components of GO 133-C regarding Out of Service Repair and Installation Commitment Intervals and Customer Trouble Reports. This chapter also addresses potential gaps in security and safety, particularly as it relates to disaster planning and preparedness.

### 1) GO 133-C

General Order (GO) 133-C, "Rules Governing Telecommunications Services", contains the CPUC's minimum service quality standards for telephone carriers. The General Order has four service quality measures applicable to Small Local Exchange Carriers:

- Telephone service installation interval (five business days);
- Installation commitments met 95% of the time;
- Customer trouble reports per number of 100 working telephone lines;
- Out of service (OOS) repair interval (90% within 24 hours excluding Sundays, federal holidays, catastrophic events and widespread outages);

The following is a summary of Kerman's performance in meeting the G.O. 133-C minimum service quality standards from 2011to 2014[155] [156]

- Installation Interval – Kerman met the minimum standard.

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[155] Attachment 5-1: CPUC Communications Division Staff Report September 2014: California Wireline Telephone Service Quality Pursuant to General Order 133-C Calendar Years 2010 through 2013, p. B-2.

[156] See Attachment 5-2: California Public Utilities Commission Service Quality Standards Reporting General Order No. 133-C, Jan – Dec, 2014.

- Installation Commitments –Kerman met the minimum standard.
- Customer Trouble Report – Kerman met the minimum standard.
- Out of Service (OOS) Repair Interval – Kerman met the minimum standard with the exception of one period in 2011.

Table 5-1, below presents a sample of GO 133-C reported results for 2014.

**Table 5-1**

| 2014 | Installation Interval | Installation Commitment | Out of Service Repair Interval |
|---|---|---|---|
| January | 2.72 | 96.7% | 95% |
| February | 3.21 | 100% | 97% |
| March | 4.14 | 97.3% | 97% |
| April | 3.00 | 100% | 100% |
| May | 3.52 | 100% | 100% |
| June | 4.00 | 100% | 100% |
| July | 3.32 | 97% | 97% |
| August | 3.57 | 100% | 100% |
| September | 4.09 | 100% | 100% |
| October | 3.17 | 100% | 100% |
| November | 4.66 | 100% | 100% |
| December | 2.90 | 100% | 97% |

**2) Disaster/Service Outage Preparedness: Communications Plan and Fuel Inventory**

ORA reviewed Kerman's "Disaster/Service Outage Communications Plan" sent in response to ORA Data Request CC3001, Q. 26, and two subsequent email

requests. The Plan outlines disaster protocols and provides useful contact information. Two areas of potential concern in Kerman's Disaster Services Outage Plan are identified. The first relates to contact information for community organizations that are beneficial in times of disaster. The second regards fuel for maintaining service during an extended power outage and or disaster.

**(a) Contact Information**

Potentially valuable contact information for the Red Cross and the SPCA is absent in Kerman's Disaster/Service Outage Communications Plan, Community Contacts section.

**(i) ORA Recommendation**

ORA recommends that contact information for the American Red Cross, and animal protective services such as the SPCA be included in Community Organizations section of the Disaster/Service Outage Communication Plan. A search of "Red Cross" on the FEMA web site shows many links to the Red Cross provided by FEMA[157]. These organizations provide emergency services to the general population in times of disaster.

**(b) Fuel Inventory**

For public safety and continuity of service Kerman should ensure that an adequate supply of fuel is readily accessible at all times in the event of disaster or a prolonged power outage.

**(i) ORA Recommendation**

Kerman should be ordered to make a compliance filing describing in detail its internal standards, methods, and procedures for ensuring that an adequate and readily accessible supply of fuel is available for maintaining services during

[157] http://usasearch.fema.gov/search?query=Red+Cross&op=Search&affiliate=fema

disasters and prolonged power outages. This compliance filing should be made with the Commission within 90 days from the date a final decision is issued in this proceeding.

### 3) Safety and Security

There is one area where safety and security in Kerman's network may potentially be enhanced: adding redundancy in the automatic reporting of climate and security alarms for central office conditions such as temperature and moisture.

#### (a) Alarm Protocol

While touring the Kerman Central Office ("CO") ORA photographed signage[158] indicating that there may be a faulty manual process for detecting and reporting temperature changes which could adversely affect essential services. The photograph shows a temperature in the room of sixty-three degrees and the signage states: "the temperature range of this room needs to be between 68-70 degrees." The picture indicates a failure to remedy falling temperature promptly. This situation captured photographically is a clear indication of benefits that might be derived by an automated reporting system and redundant reporting of alarm conditions being met.

##### (i) ORA Recommendation

Kerman should be ordered to file a report with the Commission which provides an analysis of the net benefits gained from adding redundancy to its alarm notification protocol such that a call is made automatically to designated managers off site when temperature, moisture, and sprinkler activation occurs.

[158] Attachment 5-3: Photograph of temperature and signage in Kerman's Central Office.

This report should be filed with the Commission within 90 days after the decision in this proceeding is issued.

**4) Consumer Protection**

ORA is concerned about the accessibility of Kerman's tariffs.

**(a) Tariff Availability**

Kerman's tariffs are currently not available on its website and therefore not readily accessible to customers or the Commission.

**(i) ORA Recommendation**

Having tariffs readily available in searchable electronic form in Kerman's website would enable customers and prospective customers to view the rates, terms and conditions of service. General Order 96-B strongly urges all utilities to keep up-to-date tariffs on their website.[159] In order to advance customer protections, Kerman should be ordered to make its tariffs available in searchable electronic form on its website.

**B) CONCLUSION**

Kerman continues to maintain high standards of service quality and customer satisfaction. This can be seen by comparing its results for General Order 133-C to non-GRC telephone corporations.[160]

ORA recommends that Kerman include contact information for the Red Cross and SPCA in its Disaster/Service Outage Communications Plan. Kerman

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[159] General Order 96-B, section 8.1.2.

[160] Attachment 5-1: CPUC Communications Division Staff Report September 2014: California Wireline Telephone Service Quality Pursuant to General Order 133-C Calendar Years 2010 through 2013, p. B-2.

should be required to file with the Commission a document describing in detail its internal requirements, methods and procedures for ensuring that an adequate fuel supply is readily accessible in the event of disasters or prolonged power outages. Kerman should be required to file with the Commission an analysis of the net benefits gained, if any, from implementing measures for automatic reporting of significant temperature changes in its Central Office to remote designated managers. Finally, Kerman should be ordered to place and maintain a searchable electronic file of its tariffs on its website so that customers and the public have ready access to Kerman's rates, terms and conditions of service.

# CHAPTER 6: ANALYSIS OF KERMAN PHONE BILLS

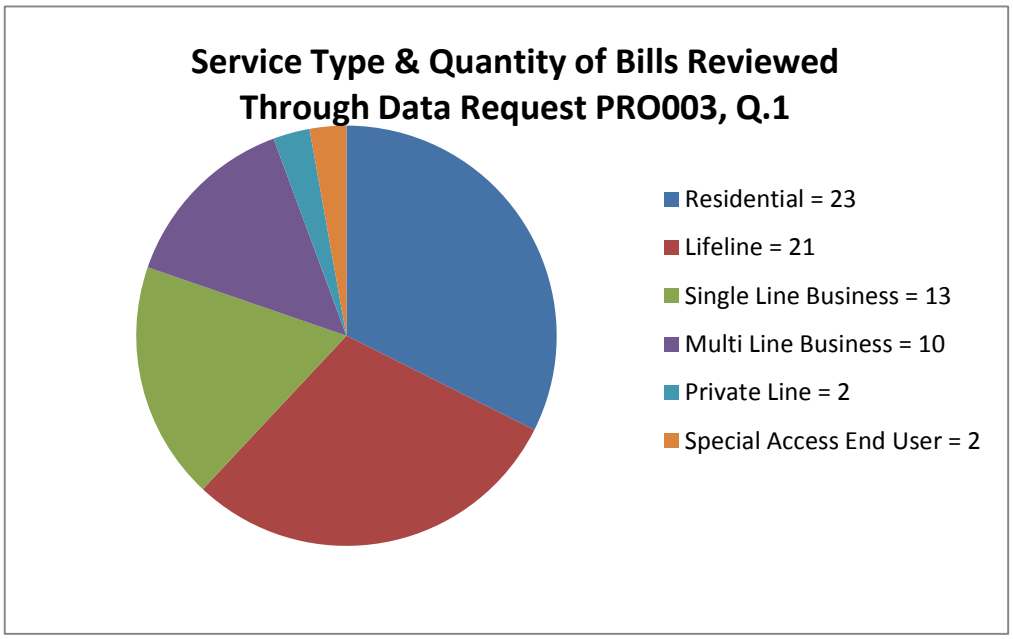
## A. INTRODUCTION

This chapter provides ORA's analysis of randomly selected customer bills for November and December 2014.

### 1) Selection of Sampled Customer Bills

Upon receiving a list of Kerman's customer accounts ORA randomly selected 71 customer accounts and requested copies of two consecutive recent bills for each account selected.

Kerman provided ORA with a total sample of 142 customer bills, as requested (see graph below).[161]




[161] Response to ORA data request PRO003, Q1.

### 2) Results of ORA's Analysis of Customer Bills

Although the customer bills sampled and reviewed by ORA appeared to accurately apply authorized rates, taxes and surcharges, some anomalies, deviations from authorized tariffs, and unreported revenues were detected.

#### (a) Late Charges Were Not Consistently Applied

Kerman tariff Rule No. 9, Section D, establishes a Late Charge of 1.5% for unpaid balances of over $20, and states that customers are required to pay Late Charges.[162] From its review of Kerman bills ORA found that Late Charges were not consistently applied. Subsequent information provided by Kerman indicates that late charges were not assessed to any customer bills for seven months in 2014 (February, March, May, August, October, November and December), even if customers were late in making payments.[163]

##### (i) ORA Recommendation

Moving forward, Kerman should comply with its tariff and assess Late Charges to overdue amounts as specified in its tariffs. If Kerman wishes to aid its customers who are late with their payments due to financial hardships it might then have the flexibility to waive late charges and establish deferred payment plans by filing a new tariff, or augmenting existing tariffs with such provisions.

#### (b) Directory Assistance Revenues Are Not Reported

From ORA's review of sampled bills and Kerman workpapers, calls to Directory Assistance were made and billed but not reported on Kerman's

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[162] See Attachment 6-1, Kerman Tariff, Rule No. 9. D, Late Payment Charge

[163] See Attachment 6-2, Email between Dave Clark of Kerman and Robert Schwartz of ORA dated February 17, 2015 and February 26, 2015.

workpapers, revenue tabs in DC-3. In addition there is no line available on DC-3 for Directory Assistance Revenues to be entered. Kerman has acknowledged that they omitted appropriate Directory Assistance charges billed and received. Kerman goes on to say that local Directory Assistance revenues for 2014: "should be approximately $2,200 for this service."[164]

#### (i) ORA Recommendation

Kerman should report Directory Assistance revenues on the appropriate line in their workpapers in revenue tabs.

### (c) Customer Premise Equipment Revenues Are Not Reported

ORA's billing analysis found that charges for Customer Premise Equipment ("CPE"), specifically Phone Rental, were collected in 2014[165] but not reported on the designated line of Kerman workpapers.

#### (i) ORA Recommendation

Kerman should report the amounts collected for CPE on the designated line available in its workpapers.

## B. CONCLUSION

Bills received from ORA Data Request PRO003 appear to be accurate with respect to charges borne by Kerman customers.

Late Charges were not applied to any delinquent accounts in seven months of 2014. This is a tariffed charge and should be applied according to tariff. ORA

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[164] Attachment 6-3: Email between Dave Clark of Kerman and Robert Schwartz of ORA dated February 27, 2015 and March 2, 2015.

[165] Attachment 6-4: Examples of invoices with CPE charges

recommends that Kerman file a new or amended tariff if they wish to extend courtesies to users undergoing financial hardship.

Further review indicates that charges for Directory Assistance calls were billed but not reported in Kerman's workpaper revenue tabs. Kerman should report Directory Assistance charges consistently.

Revenues for CPE (phone rental) were not reported on the designated line for CPE revenues in Kerman workpapers but were collected. Kerman should report CPE revenues on the designated line of its workpapers in revenue tabs.

# QUALIFICATIONS AND PREPARED TESTIMONY OF RICHARD LAWRENCE RAUSCHMEIER

Q1.Please state your name, business address, and position with the California Public Utilities Commission (Commission).

A1.My name is Richard Lawrence Rauschmeier and my business address is 505 Van Ness Avenue, San Francisco, California. I am an Auditor in the Water Branch of the Division of Ratepayer Advocates.

Q1. Please summarize your educational background.

A1.I graduated from The Johns Hopkins University with a Bachelor's degree in Environmental Earth Science. In 2000, I earned a Masters of Science in Management from Purdue University. I have received training in ratemaking from the National Association of Regulatory Utility Commissions and other organizations providing specialized training in regulatory finance and accounting.

Q3. Please summarize your business experience.

For more than 10 years, I worked as both an employee and independent consultant for numerous corporations, associations, and non-profit organizations in the development of efficient and effective business policies and practices. In December of 2008, I joined the California Public Utilities Commission, where I currently hold the position of Program and Project Supervisor within the Communications and Water Policy Branch of the Office of Ratepayer Advocates. I have been an analyst and witness in over a dozen regulatory proceedings, including general rate cases, cost of capital proceedings, and unique utility applications.

Q4.What is your responsibility in this proceeding?

A4.I am responsible for the Executive Summary of ORA's Report.

Q5. Does this conclude your prepared direct testimony?

A5. Yes, it does

# QUALIFICATIONS AND PREPARED TESTIMONY
# OF
# LAURA KRANNAWITTER

Q.1. Please state your name and business address.

A.1. My name is Laura Krannawitter. My business address is 320 West 4th Street, Suite 500, Los Angeles, California 90013.

Q. 2. By whom are you employed and in what capacity?

A. 2. I am employed by the California Public Utilities Commission as a Senior Utilities Engineer, specialist.

Q. 3. Please briefly describe your educational background and work experience.

A. 3. I graduated from San Francisco State University with a Bachelor of Science Degree in Engineering with honors, and a Master of Business Administration, with an emphasis in international business. I have a Professional Engineering license in mechanical engineering (#M27421)

I have been employed by the CPUC since 1987. For 27+ years, I have worked on Electric, Gas, Telecommunications, Transportation, and Water matters. The majority of my tenure was spent working in the advocacy division of the Commission, but I have also worked in the advisory and Executive branches as well. In addition to advocacy testimony, I have also written resolutions for advice letters, alternate decisions, and language for various OIR's. I currently work on energy, telecommunications and water matters in the Office of Ratepayer Advocates (ORA). I have worked on numerous rate cases (electric, gas, water and telephones) Since 2010, I have worked on the following rate cases: A. 10-07-019 (San Gabriel), A. 10-11-009 (Catalina), A. 10-12-005 (SDG&E), A. 11-12-001 (Kerman), A. 12-01-001(Park), A. 12-07-005 (Great Oaks), A. 13-01-003 (Valencia), A. 13-11-003 (SCE), A. 15-01-001(Park) .

Q. 4. What is your area of responsibility in this proceeding?

A. 4. I am responsible for Chapter 2: Revenues, for the general rate case of Kerman Telephone Company.

Q. 5. Does this conclude your prepared testimony?

A. 5. Yes, it does.

## QUALIFICATIONS AND PREPARED TESTIMONY
## OF
## CHARLOTTE CHITADJE

Q1. Please state your name, business address, and position with the California Public Utilities Commission (Commission).

A1. My name is ~~Brian~~ Charlotte Chitadje and my business address is 505 Van Ness Avenue, San Francisco, California. I am a Public Utility Regulatory Analyst in the Communications Branch of the Office of Ratepayer Advocates.

Q2. Please summarize your education background and professional experience.

A2. I received a Bachelor of Science degree in Business Administration with a concentration in Accounting from San Francisco State University in 2004. I received my Professional License as a Certified Public Accountant in the State of California in 2009. I joined the Office of Ratepayer Advocates (ORA) –Communications and Water Policy Branch, in September 2014. Prior to joining ORA, I was a Public Utilities Financial Examiner IV in the Division of Water and Audits –Utility Audit, Finance and Compliance Branch at the Commission, where I worked from April 2012 to September 2014. Before coming to the Commission, I worked from 2004 to March 2012 as a Corporations Examiner in the Department of Corporations.

I attended the Michigan State University Institute of Public Utilities: Basics of Utility Regulation and Ratemaking Seminar in June 2014.

Q3. What is your responsibility in this proceeding?

A3. I am the project lead and the author of the Chapter 2: Operating expenses.

Q4. Does this conclude your prepared direct testimony?

A4. Yes, it does.

# QUALIFICATIONS AND PREPARED TESTIMONY
# OF
# BRIAN GOLDMAN

Q1. Please state your name, business address, and position with the California Public Utilities Commission (Commission).

A1. My name is Brian Goldman and my business address is 505 Van Ness Avenue, San Francisco, California. I am a Public Utility Regulatory Analyst in the Communications Branch of the Office of Ratepayer Advocates.

Q2. Please summarize your education background and professional experience.

A2. I graduated from the University of Southern California in Los Angeles, California, with a Bachelor of Arts Degree in Political Science. I also have a Juris Doctor from the University of California Davis School of Law. I have worked for the ORA in various capacities for two years. Previously, I was employed by CleanPath Ventures as a Regulatory and Policy consultant. Before that, I was employed by Orrick, Herrington & Sutcliffe, LLP as a Securities Litigation paralegal. I have training in accounting, micro and macroeconomics, statistics, and regulated industry law. I have ratemaking experience as a member of the UC Student Health Insurance Program Advisory Board, which set the biannual rates of the UC campuses integrated health insurance program. More recently, I attended the Michigan State University Institute of Public Utilities: Basics of Utility Regulation and Ratemaking Seminar in 2014.

Q3. What is your responsibility in this proceeding?

A3. I am responsible for Chapter Three: Plant, Depreciation, and Ratebase.

Q4. Does this conclude your prepared direct testimony?

A4. Yes, it does.

## QUALIFICATIONS AND PREPARED TESTIMONY OF

## PATRICK E. HOGLUND

Q.1. Please state your name and business address.

A.1. My name is Patrick E. Hoglund. My business address is 505 Van Ness Avenue, San Francisco, California.

Q.2. By whom are you employed and in what capacity?

A.2. I am employed by the California Public Utilities Commission - ORA Communications and Water Policy Branch - as a Senior Utilities Engineer. My current assignment is within ORA – Communications and Water Policy Branch for 60% of my time. I am assigned solely to communications matters. I am on loan to the Energy Division for 40% of my time to work on the Water-Energy Nexus proceeding.

Q.3. Please briefly describe your educational background and work experience.

A.3. I am a graduate of the University of California, Berkeley, with a Bachelor of Science Degree in Industrial Engineering and Operations Research. I am also a graduate of the University of Rochester, William E. Simon School of Business with a Master of Business Administration Degree with concentrations in Finance and Corporate Accounting. I am a licensed professional Industrial Engineer.

I have been employed by the California Public Utilities Commission since 2005. From July 1999 through August 2004, I was a Senior Rates Analyst at Pacific Gas and Electric Company, where I worked on a variety of revenue requirements issues related to natural gas. From 1990 through 1997, I was employed by the California Public Utilities Commission. During this time I worked on small water utility rate cases, large water utility rates cases, and also worked in the Telecommunications and Energy Branches of the former Commission Advisory and Compliance Division, as well as in the Division of Ratepayer Advocates.

I have completed regulatory training provided by NARUC in 2005 and a regulatory accounting seminar provided by Financial Accounting Institute in 2009. I have prepared testimony in numerous water rate case proceedings. Most recently in A.12-07-005, A.10-07-007, A.09-01-013, and A.09-07-001.

Q.4. What are your responsibilities in this proceeding?

A.4. I am responsible for the preparation of testimony presented in Chapter 4: Cost of Capital. I was not involved in this proceeding in 2012.

Q.5. Does this conclude your prepared testimony?

A.5. Yes, it does.

**QUALIFICATIONS AND PREPARED TESTIMONY**
**OF**
**ROBERT SCHWARTZ**

Q1. Please state your name, business address, and position with the California Public Utilities Commission (Commission).

A1. My name is Robert Schwartz and my business address is 505 Van Ness Avenue, San Francisco, California. I am a Public Utility Regulatory Analyst in the Communications and Water Policy Branch - ORA.

Q2. Please summarize your education background and professional experience.

A2. I graduated from St. Mary's College, Moraga CA with a Bachelor's degree in Business Management. I have a Certificate in Telecommunications Management from Golden Gate University in San Francisco. I also have a California General Contractor's license. I have been employed by the State for 4 years.

While working in ORA I have worked on, Broadband/CASF (R.10-12-008; Service Quality (R.10-04-01); CHCF-A, CHCF_B, Basic Service (R.09-06-019); ULTS; Consumer Rights and Protection (R. 00-02-004; Public Purpose Programs; Legislative Bill Analysis & Tracking; Advice Letter Logging; ETC Applications; CPCN Bond Requirements (R. 11-11-006); served as a voting member of the TADDAC & ULTS Administrative Committees; and the Kerman GRC (A. 11-12-011).

Prior to working for the State I was employed by Bill Correctors Inc., in Marin County at an executive level. The company offered telecommunications consulting services to business. Services included auditing optimizing and managing phone bill expenses, ordering services, specialty telecom consulting, and negotiating contracts.

Q3. What is your responsibility in this proceeding?

A3. I am responsible Chapter 5: Service Quality and Chapter 6: Analysis of Kerman Phone Bills.

Q4. Does this conclude your prepared direct testimony?
A4. Yes, it does.