

Docket: : R.11-11-007
Exhibit Number : _____
Commissioner : Catherine J.K.Sandoval
Admin. Law Judge : W. Anthony Colbert
ORA Project Coordinator. : Ana Maria Johnson



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

**REPORT
INTO THE REVIEW
OF THE CALIFORNIA HIGH COST
FUND-A PROGRAM**

REPLY TESTIMONY

R.11-11-007

San Francisco, California
August 15, 2014

TABLE OF CONTENTS

INTRODUCTION.....1

EXECUTIVE SUMMARY2

IMPUTING BROADBAND REVENUES AND STANDARDIZING COSTS2

 A. Introduction2

 B. Summary of Recommendations3

 C. Discussion7

 D. Conclusion.....7

APPENDIX A – QUALIFICATIONS OF THE WITNESS

1 **INTRODUCTION**

2 This Report was prepared by the Office of Ratepayer Advocates (ORA), the
3 independent consumer advocate, within the California Public Utilities Commission
4 (Commission) in R.11-11-007. In this Rulemaking, the Commission is considering
5 possible changes to how the California High Cost Fund-A (CHCF-A or A-Fund) is
6 structured in response to market, regulatory, and technological changes which have
7 occurred since the program was created in 1987. Consistent with its Opening Testimony,
8 ORA does not here address every issue set for evidentiary hearing listed in the March 18,
9 2014, Amended Scoping Memo And Ruling Of Assigned Commissioner. ORA chose to
10 focus its analysis and testimony on several issues which it identified as important for
11 improving efficiency in the A-Fund program and expediting efficient processing of the
12 upcoming General Rate Cases (GRCs). Silence on any particular issue should not be
13 construed as agreement or disagreement with the positions of any party. ORA’s Reply
14 Testimony focuses on two issues raised by ORA in Opening Testimony and responds to
15 the Small LECs’ discussion of these issues in their Opening Testimony:

- 16 • Should the broadband revenues or profits count towards the
17 intrastate revenue requirement?
- 18 • Can and should the Commission standardize costs in considering
19 the Small LECs’ revenue requirement?

20 Ms. Ana Maria Johnson serves as ORA’s Project Manager in this proceeding.
21 ORA’s witnesses’ prepared qualifications are contained in Appendix A of this Report.
22 ORA’s legal counsel for this proceeding is Travis T. Foss.

1 identified in the March 18, 2014 Amended Scoping Memo and Ruling of Assigned
2 Commissioner.²

3 **B. Net Broadband Revenues Should be Imputed**

4 In Opening Testimony, ORA recommended that the Commission count the net
5 broadband revenue received by a Small LEC's broadband affiliate against the revenue
6 requirement of the regulated Small LEC when calculating each Small LEC's subsidy
7 from the CHCF-A.³ ORA explained why it is appropriate to impute affiliate broadband
8 *profits* when calculating the LEC's intrastate revenue requirement. In response to this
9 recommendation, the Small LECs propounded several data request questions seeking
10 clarification of this recommendation. ORA has responded to these data requests. 75% of
11 the investment in broadband-capable network equipment is assigned to the intrastate rate
12 base; it is reasonable to impute the net revenue generated by the affiliate's use of those
13 regulated assets.

14 ORA clarifies that ORA provided a table calculating the effects of imputing gross
15 revenues, and this was provided for illustrative purposes only, as the testimony noted.
16 ORA did not, and does not, recommend that affiliate gross revenues be used for
17 imputation. The table was provided merely to illustrate ORA's proposed methodology.

18 **1. Imputing Net Broadband Revenues Is Not Likely to**
19 **Cause the Small LECs to Cease Offering**
20 **Broadband Services**

21 The Small LECs' testimony claims that the Small LECs are likely to shut down
22 their affiliates who offer those broadband services if broadband revenues were imputed

² R.11-11-007 Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program, November 18, 2011.

³ ORA here follows the practice of other parties by using the term "affiliates" to include the broadband services provided by the two Small LECs who do not have affiliates but do provide broadband services. Direct Testimony Of Chad Duval (Duval) at 4; Direct Testimony Of Daniel K. Douglas (Douglas) at 7-8; Prepared Testimony Of Trevor R. Roycroft, Ph.D. (Roycroft) at 8.

1 into the revenue requirement of the regulated entity.⁴ However, this is unlikely. The
2 Small LECs customers want these services, as the subscribership trend data demonstrates.
3 All of the Small LECs who reported Digital Subscriber Line (DSL) revenues and line
4 count information, show increasing subscribership rates⁵ in years 2011 thru 2013. In
5 addition, the Small LECs themselves admit that there are no unaffiliated Internet Service
6 Providers (ISPs) in any of their service areas who could provide competitive
7 alternatives.⁶ Consequently, if a customer wants DSL service, the Small LECs provide
8 the only service available.

9 The Small LECs are required to build and maintain broadband-capable networks
10 in order to receive federal subsidies.⁷ Additionally, under Public Utilities Code section
11 275.6, they are explicitly allowed to include reasonable broadband-capable investments
12 in their rate base.⁸ It would not make sense to fail to maximize the amount of revenue
13 which can be generated by the use of those facilities, whether it is revenue to the
14 regulated entity or to the affiliate. The Small LECs have offered no persuasive evidence
15 that the broadband affiliates will cease to operate if ORA's proposal is adopted. It is
16 reasonable to expect that the Small LECs would continue to operate their affiliated
17 companies which provide broadband service, as this is a revenue growth opportunity for
18 them.

19 2. Imputing Net Broadband Revenues is Not a Tax

20 The allegation that imputation of broadband revenues amounts to a "tax" is
21 erroneous.⁹ Imputation is simply a rate design issue for the regulated LEC when

⁴ See Direct Testimony Of Dale E. Lehman (Lehman); Douglas at 12, Answer 35.

⁵ TURN Data Request Number 11; Answer 5.

⁶ Lehman at 8, Answer 14; Douglas at 10, Answer 27.

⁷ Duvall at 20, Answer 28.

⁸ P.U. Code section 275.6

⁹ Douglas at 13, Answer 37; Lehman at 13, Answer 26.

1 determining its needed A-Fund draw. Imputing broadband affiliate profits to the
2 regulated entity revenue requirement does not affect the affiliate’s profits, as the affiliate
3 would retain its actual profits. Mr. Lehman’s claim that, in the event an unaffiliated ISP
4 sought to compete with an affiliated one, the affiliate would be at a competitive
5 disadvantage because of the alleged imputation “tax” is unsupported.¹⁰ There would be
6 no competitive disadvantage because neither the affiliated or the unaffiliated ISP would
7 be facing some sort of tax (at least in the situation we are discussing here), and both
8 would be paying the same tariffed rate to the Small LEC for use of its facilities, as Mr.
9 Lehman himself points out.¹¹

10 **3. Imputing Net Broadband Revenues Does Not Mean** 11 **Imputing Broadband Losses**

12 Mr. Lehman suggests that broadband revenue imputation would also require
13 imputation of affiliate losses.¹² ORA disagrees. ORA’s proposal is to impute broadband
14 profits. If there are no broadband profits, there is nothing to impute. Imputing broadband
15 affiliate losses would be unsound policy, because it could encourage the broadband
16 affiliate to incur losses in order to receive A-Fund subsidies for the losses. ORA’s
17 recommendation to impute profits but not losses would discourage the affiliates of the
18 Small LECs from artificially incurring losses.

19 ORA’s proposal would simply mean that the broadband affiliate would not have
20 any reason to shift additional costs of jointly used resources to the regulated company,
21 because the affiliate could not use those increased expenses to offset broadband revenues.
22 Nor would imputation affect the affiliate, as only profits would be imputed to the
23 regulated Small LEC. Under ORA’s proposal, the affiliate would retain the profits as
24 well as absorb any losses.

¹⁰ Lehman at 13, Answer 26, Douglas at 15, Answer 43.

¹¹ *Id.*

¹² Lehman at 14, Answer 27.

1 **4. Imputing Net Broadband Revenues is Appropriate**
2 **and Equitable When Calculating the Small LECs**
3 **Individual Revenue Requirements**

4 Mr. Duval includes a discussion of regulatory accounting principles. In his answer
5 to Question 10 (page 7), he states that “The only reason that imputation would be
6 appropriate is if the non-regulated broadband service relied upon regulated facilities
7 without appropriate compensation for these facilities.” However, the Small LECs did not
8 dispute that the affiliated broadband provider relies upon the use of regulated facilities in
9 order to provide broadband service to its customers. It is also true that the affiliate pays
10 the regulated Small LEC for the use of those facilities pursuant to the relevant rates from
11 NECA Tariff 5. However, those regulated facilities are supported, in part, by the A-Fund
12 subsidy.

13 ORA’s proposal is simple and equitable: the A-Fund subsidy supports those
14 facilities, and consumers paying into the A-Fund to provide this support should receive a
15 benefit from profits made from the use of those facilities. This benefit would be in the
16 form of a reduction in the amount of A-Fund subsidies they pay. ORA disagrees with
17 Mr. Duval’s view that the “only reason” for imputation relates to “appropriate
18 compensation”. In ORA’s view, subsidization from California ratepayers is another
19 factor that should be taken into account, rather than merely payments from the affiliate.
20 As ORA noted in its Opening Testimony, it is inequitable to those consumers who pay
21 into the A-Fund to allow it to subsidize the costs of broadband-capable equipment
22 without taking into account the profits generated by those subsidized investments. A
23 high percentage of the overall LEC investment that is used for both voice and broadband
24 (i.e. common line investments) are included as part of the regulated entity rate base. As
25 stated in the Small LECs response to ORA’s Data Request (DR) number 007, 75%, of
26 “common line”¹³ costs are assigned to the regulated intrastate category. It would not be

¹³ ORA DR#007, Answer 4 from the Small LECs: “Multi-use facilities, including central office equipment, cable and wire facilities, and allocations of general support assets are categorized as “Common Line”.

1 possible for the affiliates to offer DSL service in the absence of the existence of the
2 regulated Small LEC network.

3 **C. FCC Expense Limits Should Be Used**

4 ORA explained in its Opening Testimony why the Commission should adopt the
5 FCC calculation methodology that limits the amount of a Small LEC's corporate
6 operations expenses that are eligible for federal subsidies.¹⁴ One of the FCC's objectives
7 in doing so is to incent these companies to operate more efficiently.¹⁵ The Commission
8 should use the FCC's formulas to calculate the amount of corporate expenses that a Small
9 LEC can include in calculating its revenue requirement. To the extent that a Small LEC's
10 expenses exceed that amount, the A-Fund should not be subsidizing them.

11 The Small LECs did not provide any specific proposals regarding standardizing
12 expenses. Rather, they stated their belief that standardizing expenses for ratemaking
13 purposes would be inappropriate. Their preferred method of dealing with expenses is to
14 litigate them individually in each Small LECs GRC.¹⁶ Using standardized expenses will
15 simplify processing GRCs and reduce the administrative burden on the agency and the
16 parties.

17 **D. Conclusion**

18 ORA continues to recommend that the Commission impute the net broadband
19 revenues received by a Small LEC's broadband affiliate when calculating the revenue
20 requirement of the regulated Small LEC, and the Small LEC's subsidy from the
21 California High Cost Fund-A. The asymmetry of allowing investments and common
22 costs of broadband-capable facilities of the Small LECs to be subsidized by the A-Fund
23 but not imputing any of affiliate revenues back to the Small LECs revenue requirements

¹⁴ ORA Opening Testimony, Chapter Two.

¹⁵ *In the Matter of Connect America Fund*, et al, WC Docket No. 10-90, FCC 11-161, (released November 18, 2011) at paragraphs 195, 207, 210, 219, and Footnote 315.

¹⁶ Douglas at 16, Answers 45 and 46.

1 is not fair to California consumers. It is inequitable to ratepayers who pay into the A-
2 Fund to allow it to subsidize the investments in broadband-capable facilities without
3 taking into account the profits generated by those investments. In addition, ORA
4 continues to recommend that the Commission adopt use of the FCC expense limit
5 calculation methodology when determining Small LEC revenue requirements which are
6 eligible for A-Fund subsidy.

7 Adopting these recommendations will meet the statutory goal of providing the
8 Small LECs with an opportunity to earn their authorized rate of return while also
9 balancing the need to ensure that the support is not excessive so that the burden on
10 contributors to the A-Fund is limited. It will also reduce the time and cost of litigating
11 these items in individual Small LEC GRCs and consequently make processing them more
12 efficient.

APPENDIX A

1 **QUALIFICATIONS AND PREPARED TESTIMONY**
2 **OF**
3 **NATALIE L. BILLINGSLEY**
4

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

6 A.1. My name is Natalie L. Billingsley. My business address is 505 Van Ness
7 Avenue, San Francisco, California.

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

9 A.2. I am employed by the California Public Utilities Commission – Office of
10 Ratepayer Advocates in the Communications and Water Policy Branch - as
11 a Program & Project Supervisor.

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

13 A.3. I am a graduate of Georgia State University in Atlanta, Georgia. I have a
14 Bachelor of Arts in German with a minor in international business and
15 economics. I also attended Friederich-Alexander Universitat in Erlangen,
16 Germany.

17 I have been employed by the California Public Utilities Commission for
18 almost 26 years, and been a supervisor since 2001. I have provided
19 testimony in a number of energy and communications cases. My focus has
20 been on communications for approximately the last 22 years. Presently I
21 supervise the Customer Programs Section in the Communications And
22 Water Policy Branch.

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

A.4. I am responsible for Chapters One and Two of ORA’s opening testimony
regarding counting broadband revenues and corporate operations expenses.
I am responsible for Chapter One of this reply testimony.

24 Q.5. Does this conclude your prepared testimony?

25 A.5. Yes, it does.
26

1
2