**BEFORE THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA**

Order Instituting Rulemaking into the Review of the California High Cost Fund-A Program.	Rulemaking 11-11-007 (Filed November 10, 2011)

OPENING BRIEF OF THE UTILITY REFORM NETWORK

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I. INTRODUCTION.

The Utility Reform Network ("TURN") files this Opening Brief on the issues outlined in the March 22, 2019 Fourth Amended Scoping Memo, as revised by the September 12, 2019 Administrative Law Judge Ruling. Today, the California High Cost Fund-A ("CHCF-A" or "A-Fund") promotes universal service through rate support to small independent telephone corporations in "furtherance of the state's universal service commitment to the continued affordability and widespread availability of safe, reliable, high-quality communications services in rural areas of the state."[1] No party to this proceeding is proposing changes to the underlying purpose and objectives of the CHCF-A. The Commission's final decision in this docket must support California's universal service goals and objectives.

Now, nearly ten years after the initiation of this proceeding, the Commission has had ample opportunity to examine all of the relevant issues associated with CHCF-A, including the Small LECs operations, their relationships with their affiliates, and the status of both voice and broadband universal service in Small LEC service areas. In response to concerns raised by the Commission, data was collected and incorporated into a report requested by the Commission in 2014.[2] Further data on the status of broadband deployment was also gathered in Phase 2 of this proceeding in response to questions raised in the September 12, 2019 ALJ ruling. In this Phase of the proceeding, parties have submitted comments, responded to hundreds of data requests, submitted thousands of pages of testimony and exhibits, participated in workshops and hearings

[1] Public Utilities Code §275.6 (unless otherwise specified, all statutory references are to the California Public Utilities Code.

[2] Decision Adopting Rules and Regulations in Phase 1 of the Rulemaking for the California High Cost Fund-A Program, Decision 14-12-084, December 19, 2014, at p. 46 ("Phase 1 Decision").

and, in general, given considerable thought to how CHCF-A should be revised in light of substantial evidence of the outcomes associated with the administration of the CHCF-A program.

Throughout the long history of the proceeding, TURN has maintained a steady position, one firmly grounded in the evidence and consistent with the statutory objectives. TURN's conclusion based on the evidence is that, unquestionably, broadband imputation is needed to reform the CHCF-A program so as to bring the program into harmony with both the statutory objectives on universal service and minimizing the burden of the fund on California ratepayers. The basic facts associated with TURN's consistent position are:

- Technological change has enabled the provision of broadband services using the same facilities that have historically provided voice services.[3]
- The Small LECs and their ISP affiliates provide voice and broadband services over shared loop facilities, and the operations of the Small LECs and their ISP affiliates are deeply integrated—the same individuals perform duties for both the Small LEC and its ISP affiliate, using the same equipment and offices and they share common family ownership and investors.[4]
- Because of the integrated nature of the companies, and because of the affiliate's ability to purchase wholesale DSL through NECA Tariff No. 5, the Small LECs' ISP affiliates have relatively little investment associated with the provision of retail broadband services.[5]
- While the Small LECs, when viewed as a group, are collecting more CHCF-A support than is reasonable, some Small LECs, due to scale disadvantages and high wholesale rates proscribed by NECA Tariff No. 5, are earning negative net income.[6]
- ISP affiliates earn substantial revenues from sales of DSL broadband services;[7] however, the affiliate does not contribute to substantial portions of the cost of local loops needed for the provision of wholesale DSL service.[8]

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[3] Ex. TURN-2 (Roycroft Public Reply) at p. 18. Ex. LEC-4 (Duval Public Opening) at p. 27.
[4] Ex. TURN-1 (Roycroft Public Opening) at p. 38. Ex. TURN-2 (Roycroft Public Reply) at pp. 27-35. Ex. LEC-9 (Aron Public Opening) at pp. 37-42.
[5] Ex. TURN-1 (Roycroft Public Opening) at pp. 37-38. TR 1446 (Boos).
[6] Ex. TURN-1 (Roycroft Public Opening) at p. 15-16.
[7] Ex. TURN-1 (Roycroft Public Opening) at p. 13.
[8] Ex. TURN-2 (Roycroft Public Reply) at pp. 16-17. TR 978 (Duval). See also Phase 1 Ex 14-C (Roycroft Direct) at pp. 16-21.

- As a result, CHCF-A is larger than it needs to be, making support "excessive" and violating Section 275.6(c)(7). Earnings information indicates that Small LECs' ISP affiliates could reasonably offset a portion of CHCF-A draws.[9]

- To remedy the problem, and to ensure that the Commission's administration of CHCF-A is consistent with the statutory provisions, TURN recommends that the Commission impute broadband revenues earned by the ISP affiliates, using a pro forma approach that evaluates the operations of each Small LEC and its ISP affiliate on an integrated basis.[10]

TURN thus urges the Commission to make very specific and substantive changes to the way in which it calculates CHCF-A support. TURN proposes that the Commission:

- Audit the operations of Small LEC ISP affiliates using the same approach as is currently applied to the Small LECs.[11]

- Impute broadband revenues and costs through a pro forma analysis that will be included in Small LEC rate cases, allowing both the Small LEC and its ISP affiliate the opportunity to earn a reasonable return on investment. For Small LEC ISP affiliates that are found to have excessive net income, the associated Small LEC's CHCF-A draws should be reduced; for Small LEC ISP affiliates that are found to have deficient net income, the associated Small LEC's CHCF-A draws should be increased.[12]

- Revise the annual Advice Letter filing to incorporate broadband revenue changes to discourage broadband rate increases.[13]

- In lieu of CHCF-A reductions, Small LECs should be permitted to submit alternative broadband imputation compliance plans that will result in lower broadband prices and higher broadband speeds for Small LEC customers.[14]

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[9] Ex. TURN-1 (Roycroft Public Opening) at p. 27.
[10] Ex. TURN-1 (Roycroft Public Opening) at pp. 14-15.
[11] Small LECs' witness Mr. Duval attempts to muddy the water on the audit issue by incorrectly claiming that TURN's proposal requires a "financial audit." Ex, LEC-1 (Duval Public Opening) at p. 9. TURN's proposal is to apply a review of the reasonableness of the ISP affiliates operating results. TR 1801 (Roycroft).
[12] Ex. TURN-1-C (Roycroft Confidential Opening) at pp. 14-16.
[13] Ex. TURN-1-C (Roycroft Confidential Opening) at pp. 16-17.
[14] Ex. TURN-1-C (Roycroft Confidential Opening) at pp. 24-26.

These changes are necessary to ensure that the Commission complies with overarching state and federal universal service objectives. To ensure that the policy and statutory objectives are satisfied, TURN urges the Commission to adopt TURN's proposals.

II. PROCEDURAL HISTORY AND FACTUAL BACKGROUND.

The Commission opened this Rulemaking in 2011 to review the California High Cost Fund A program rules, a program which was initially established in 1987. The purpose of the Commission's review was "to be forward-looking and adaptable to current and future regulatory and technological changes while still meeting the requirements of universal service and rate disparity minimization."[15] The Commission concluded Phase 1 of the proceeding with Decision, 14-12-084, and added two issues for Phase 2: "(1) a review of the Commission's preliminary conclusions not to open the areas the Small ILECs serve to competition [. . .]; and (2) a review of whether imputation of broadband revenues is appropriate for GRC cycles . . . ."[16]

On March 22, 2019, the Commission issued its Fourth Amended Scoping Memo and included the Broadband Internet and Wireline Voice Competition Study ("Mission Consulting study"), which was ordered in Decision 14-12-084 for the purposes of informing Phase 2 of the Proceeding. On July 25, 2019, the Independent Small LECs moved for evidentiary hearing on the outstanding factual issues in this proceeding, including broadband deployment and imputation proposals. On September 12, 2019, the ALJ issued a Ruling setting the time, place and scope for evidentiary hearings, including a request that parties' testimony answer further questions regarding the imputation of broadband revenues.[17] Other issues set out in the Fourth

[15] OIR at p. 22.
[16] Third Amended Scoping Memo, dated April 4, 2017, at pp. 3-4.
[17] ALJ Ruling Setting Hearing Dates and Issues for Hearing, September 12, 2019, at p. 1-2.

Amended Scoping Memo were put on a separate track with written comments.[18] The Commission held evidentiary hearings in January 2020. TURN now files this brief on those issues.

III. BROADBAND DEPLOYMENT AND SUBSCRIPTION IN INDEPENDENT SMALL LEC TERRITORIES

Scoping Memo, Issues (1)(a), (1)(e), 1(f), (9); Hearing Issues (1), (3), (4), (5)

A. The maturity of broadband deployment in the Small LEC service areas is consistent with an imputation framework

As a component of this proceeding, the Commission ordered a study of market conditions in the service areas of the Small LECs.[19] In September 2018, Communications Division staff released the Mission Consulting Study.[20] Given comments received into the record from TURN and other parties on that Study,[21] during the July 31, 2019 Prehearing Conference, the Administrative Law Judge clarified that the Study is not part of the evidentiary record.[22] The September 12, 2019 ALJ Ruling requested additional information regarding the maturity of broadband deployment in the service areas of the Small LECs.[23] In light of the availability of more recent and more comprehensive information obtained by TURN in this Phase of the

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[18] ALJ Ruling Seeking Comments on General Guidelines for Allowing Wireline Competition, November 8, 2019, at pp. 3-5; *See also*, Fifth Amended Assigned Commissioner's Scoping Memo and Ruling, December 13, 2019, at pp. 3-4 (expanding on Issue 3 re: use of CHCF-A funds in low income and tribal areas).
[19] Decision Adopting Rules and Regulations in Phase 1 of the Rulemaking for the California High Cost Fund-A Program, Decision 14-12-084, December 19, 2014, at p. 46.
[20] "Broadband Internet and Wireline Voice Competition Study in Service Territories of Small Incumbent Local Exchange Carriers," Mission Consulting, LLC, September 2018.
[21] Comments of the Utility Reform Network on the Fourth Amended Scoping Memo and Ruling of Assigned Commissioner, May 21, 2019; Small LECs' Opening Comments on the Fourth Amended Scoping Memo and Ruling and Broadband Internet and Wireline Voice Competition Study; May 21, 2019; Opening Comments of the Public Advocates Office on the Assigned Commissioner's Fourth Amended Scoping Memo and Ruling, May 21, 2019.
[22] ALJ Ruling Denying the Independent Small LECs' Motion to Strike the Study from the Evidentiary Record at p. 1 (citing to PHC transcript TR 383-384.)
[23] Administrative Law Judges' Ruling Setting Hearing Dates and Issues for Hearing, September 12, 2019, questions 1, 3, 4, and 5.

proceeding through the discovery process, TURN encourages the Commission to focus on the results of TURN's study instead of the Mission Consulting study. TURN's witness Dr. Roycroft conducted a comprehensive study of the maturity of broadband deployment in the Small LECs' service areas which resulted in the identification of key concerns in this proceeding associated with broadband deployment and adoption.[24] As a result of Dr. Roycroft's study, TURN finds that:

- There is a significant digital divide between Small LEC service areas and urban areas of the state.[25]

- There is variation in the maturity of broadband deployment among the Small LECs' service areas, with one company, Pinnacles, exhibiting substantial outlier characteristics, arising from very low-quality broadband services offered at very high prices.[26] Overall, just over 50 percent of Small LEC customers have broadband available at or above the FCC's 25/3 Mbps standard. See Table 1.

Table 1: Customer Access to Broadband Standard Speeds.[27]

	At Least 6/1.5 Mbps (State Served Standard)		**At Least 10/1 Mbps**		**FCC CAF—At Least 25/3 Mbps**		**Does not meet State Served Status**	
	Number	%	Number	%	Number	%	Number	%
Total	64,874	96.78%	62,825	93.72%	36,302	54.16%	2,158	3.22%

- Compared to broadband offerings available from other small telephone companies with similar cost characteristics operating outside of California, the Small LECs' offerings have similar characteristics but appear to lag to some extent in fiber deployment.[28]

- Small LECs have deployed some fiber-based broadband, with most using fiber to shorten copper loops to improve the performance of Digital Subscriber Line (DSL)-based

[24] TR 1854 (Roycroft).
[25] Ex. TURN-1 (Roycroft Public Opening) at pp. 28-59.
[26] Ex. TURN-1 (Roycroft Public Opening) at p. 67.
[27] Ex. TURN-1-C (Roycroft Confidential Opening) at p. 42.
[28] Ex. TURN-1 (Roycroft Public Opening) at pp. 66-67.

broadband.[29] In a limited number of cases, Small LECs have deployed fiber to the premises (FTTP). Combined, these actions make higher speed broadband available to a portion of Small LEC service areas.[30] See Table 2.

Table 2: Small LEC FTTP deployment[31]

	Total Lines	FTTP	Percent FTTP
Total	**48,774**	**5,110**	**10.5%**

- Small LEC broadband speeds have improved over time. However, for most Small LEC customers, available broadband speeds are well below those available in urban areas, and broadband prices are above those offered in urban areas.[32]

- While Small LECs have made some gains in broadband deployment, there is a significant difference between the speed levels available from the broadband services that are offered in Small LEC service areas and the speeds that have been *adopted* by Small LEC broadband customers.

  - The median download broadband speed available from the Small LEC ISP affiliates is at the 20 Mbps level. The median upload speed offering is 5 Mbps.[33]

  - However, only a small percentage of consumers are subscribing to broadband services at the FCC's broadband speed level of 25/3 Mbps or above. Data obtained from the Small LECs indicate that *96.6 percent of Small LEC broadband subscribers purchase broadband at speeds below the FCC's 25/3 Mbps standard.* Furthermore, 74.2 percent of ISP affiliate broadband subscribers purchase services *below* speeds of 10/1 Mbps, and 44.2 percent of Small LEC broadband subscribers purchase broadband services below the state minimum standard of 6/1 Mbps. Table 3 summarizes broadband adoption of Small LEC ISP affiliate broadband services.[34]

[29] Ex. TURN-1 (Roycroft Public Opening) at pp. 67-68; Ex. LEC-4 (Boos Public Opening) at p. 9; Ex. LEC-1 (Duval Public Opening) at p. 76.
[30] Ex. TURN-1 (Roycroft Public Opening) at p. 71.
[31] Ex. TURN-1-C (Roycroft Confidential Opening) at p. 43.
[32] Ex. TURN-1 (Roycroft Public Opening) at pp. 38-39.
[33] Ex. TURN-1 (Roycroft Public Opening) at pp. 45-47.
[34] Ex. TURN-1 (Roycroft Public Opening) at p. 57.

Table 3: Small LEC broadband subscriber data speeds

Broadband speed	Percent of Small LEC broadband customers subscribing at speeds below the standard.
Below the 6/1 Mbps standard.	44.2%
Below the 10/1 Mbps standard.	74.2%
Below the 25/3 Mbps standard.	96.6%

TURN believes that the outcome shown in Table 3 represents a market failure that exacerbates the digital divide. As noted by Dr. Roycroft, in addition to the lack of offerings at broadband speeds that will entice consumers to adopt high-speed broadband, high prices charged by the ISP affiliates of the Small LECs result in the suppression of demand for higher speed broadband.[35] High broadband prices charged by Small LEC ISP affiliates, combined with broadband speeds that are substantially below those available in urban areas result in a glaring digital divide in Small LEC service areas, as compared to California's urban areas.[36]

B. Small LECs Do Not Dispute TURN's Evaluation of Broadband Maturity

TURN's evaluation of the maturity of broadband deployment in the Small LECs' service areas was largely unrebutted by the Small LECs. On a relatively minor element of TURN's study, Small LEC witness Mr. Duval took issue with Dr. Roycroft's selection of a group of "peer LECs," i.e., other small independent telephone companies that are similarly classified in NECA's

[35] Ex. TURN-1 (Roycroft Public Opening) at pp. 58-59. Small LEC witness Dr. Aron agreed that higher prices for broadband lead individuals to purchase less of that service. TR 1628.
[36] Ex. TURN-1 (Roycroft Public Opening) at p. 8; Cal. Pub. Util. Code §275.6(c)(3); 453(c); 47 USC §254(b)(3)

Tariff No. 5 to the Small LECs under consideration in this proceeding.[37] However, Mr. Duval notes that Dr. Roycroft's peer group includes (1) companies that are smaller on average than the Small LECs, (2) companies with higher study area cost per loop than the Small LECs, (3) companies with lower housing unit density than the Small LECs, and (4) companies with higher costs based on NECA classification for average DSL and Special Access rate bands than the Small LECs.[38] The combined impact of these factors on the characteristics on Dr. Roycroft's selection of a peer group is a set of companies that have *higher costs* than the Small LECs. In other words, Dr. Roycroft conservatively selected a "peer group" of small telephone companies that exhibited higher costs than the Small LECs. Yet, Dr. Roycroft demonstrated that this peer group offered generally comparable broadband plans, with the peer LECs having an edge in fiber deployment.[39] Clearly, the selection of "peer" companies with higher cost characteristics does not generate bias that worked against Dr. Roycroft's evaluation of the Independent Small LECs.

With regard to other elements of TURN's evaluation of the maturity of broadband, the Small LECs are silent. Small LECs do not dispute TURN's broadband deployment figures[40] or fiber deployment numbers.[41] Nor do Small LECs dispute TURN's summary of the broadband data speeds (both download and upload) apparent in the Small LECs' service areas.[42] Small LECs also do not dispute TURN's summary of the Small LECs broadband prices.[43] Importantly, Small LECs do not dispute TURN's assessment of broadband subscription in the Small LECs' service areas, which showed the overwhelming majority of Small LEC broadband customers

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[37] Ex. LEC-2 (Duval Public Reply) at pp. 58-63.
[38] Ex. LEC-2 (Duval Public Reply) at pp. 58-61.
[39] Ex. TURN-1 (Roycroft Public Opening) at 68.
[40] Ex. TURN-1-C (Roycroft Confidential Opening) at p. 42.
[41] Ex. TURN-1-C (Roycroft Confidential Opening) at p. 43.
[42] Ex. TURN-1 (Roycroft Public Opening) at pp. 44-49.
[43] Ex. TURN-1 (Roycroft Public Opening) at pp. 49-54.

purchasing low quality broadband services, providing clear evidence of a digital divide.[44] The veracity of the information relied upon by TURN in its assessment of the maturity of broadband deployment among the Small LECs is also supported by the fact that TURN's study was based on discovery responses by the Independent Small LECs, included with Dr. Roycroft's opening testimony.[45]

While Small LECs took issue with Dr. Roycroft's reporting of broadband speeds in urban areas in the state, it was not with the accuracy of Dr. Roycroft's numbers, which illustrated the fact that consumers located in California's urban areas are observed to purchase services with download and upload speeds that are many multiples of the speeds utilized by customers in Small LEC service areas.[46] Instead, Small LEC witnesses allege that the appropriate point of comparison is between broadband speeds in the Small LEC service areas and broadband speeds in the rural areas of AT&T's service territory.[47] However, this response of the Small LECs begs the question of the nature of the "digital divide." There is no question that the Commission's evaluation of the maturity of broadband deployment in Small LEC service areas should be based on observed differences in California's urban and rural areas and Small LEC witnesses conceded this point during cross examination.[48]

What TURN's thorough evaluation of the maturity of broadband deployment clearly indicates is a market failure of the unregulated and largely monopoly broadband ISP market in Small LEC service areas—high prices and relatively low-quality broadband services are

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[44] Ex. TURN-1 (Roycroft Public Opening) at pp. 54-58.
[45] Ex. TURN-1-C (Roycroft Confidential Opening) Appendices 2 & 3.
[46] Ex. LEC-6 (Lundgren Public Reply) at pp. 7-8; Ex. LEC-3 (McNally Public Reply) at p. 11; Ex. LEC-7 (Votaw Public Reply) at pp. 8-9.
[47] Ex. LEC-6 (Lundgren Public Reply) at p. 7; Ex. LEC-3 (McNally Public Reply) at p. 11.
[48] TR, 985-986 (Duval), TR 1356 (McNally), TR 1624 (Boos).

deterring customers from adopting broadband.[49] As will be discussed in the following section, this market failure can be addressed by TURN's imputation proposal, as well as Public Advocates' proposal for a low-income broadband offering.

IV. BROADBAND IMPUTATION

Scoping Memo, Issues (1)(c), (1)(d), Hearing Issue (2)

A. Retail Imputation.

1. Broadband Net Income Should Be Included When Calculating A-Fund Recipients Intrastate Revenue Requirement.

Issue 1(c) of the Fourth Amended Scoping Memo poses the question "In light of the Study and subsidies for broadband deployment, should the Commission impute broadband revenues towards the intrastate revenue requirement?" The answer is "yes." The cost of broadband plant is now included in each of the Small LECs' intrastate rate bases.[50] It is therefore just and reasonable for the Commission to take broadband revenue into consideration when determining intrastate revenue requirement and CHCF-A draws for these carriers as is explicitly required by state statute.[51]

2. Technological and Policy Changes Have Created the Need to Take Broadband Net Income into Account When Determining the Need for CHCF-A Support

At the heart of the issues facing the Commission is the fact that telecommunications technology has changed. The Small LECs' local telephone networks are now designed to provide both voice and broadband.[52] The Small LECs primarily offer broadband service described as Digital Subscriber Line ("DSL") service. Nine of the ten Small LECs' currently receiving A-Fund subsidies offer DSL broadband through a separate corporate affiliate.[53]

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[49] Ex. TURN-1 (Roycroft Public Opening) at p. 71.
[50] Pub. Util. Code §275.6(b)(2).
[51] Pub. Util. Code sec. 275.6.
[52] Ex. TURN-2 (Roycroft Public Reply) at p. 18. Ex. LEC-4 (Duval Public Opening) at p. 27.
[53] Ex. TURN-1 (Roycroft Public Opening) at p. 3.

Public Utilities Code Section 275.6 requires the Commission to include investments in broadband facilities in the rate base of Small LECs.. More specifically, according to Section 275.6, the Commission shall include all *reasonable* investments necessary to provide for the delivery of both "high-quality voice communication services and the deployment of broadband-capable facilities in the rate base" of Small LECs.[54] However, as discussed below, the Legislature also required the Commission to "[e]nsure that support [from the A-Fund] is not excessive so that the burden on all contributors to the California High Cost Fund-A Program is limited."[55]

The inclusion of broadband *costs* in Small LEC intrastate rate base, as required under Section 275.6(c)(6) directly impacts the intrastate revenue requirement. Consequently, it is reasonable, and TURN argues necessary, for the Commission to also consider broadband *revenue* and net income when determining the intrastate revenue requirement. This necessary balancing of costs and revenues will have an impact on the A-Fund subsidy each Small LEC receives and ultimately an impact on the size of the CHCF-A.[56] This balancing is possible and necessary even though retail broadband services are not tariffed or directly regulated by the Commission. The change in network technology, as well as changes in the California Public Utilities Code, impact the intrastate revenue requirement of the Small LECs, something that the Commission *does* directly regulate.

Thus, regarding the imputation of broadband revenues, TURN's analysis indicates that several of the Small LECs' ISP affiliates can reasonably offset a portion of CHCF-A support, and

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[54] § 275.6(c)(6) (emphasis added).
[55] § 275(c)(7).
[56] Ex. TURN-1 (Roycroft Public Opening) at pp. 15, 21.

thus generate an outcome that is consistent with the statutory provisions regarding limitations on excessive CHCF-A support.

- Viewed as a group, the Small LECs are earning excessive net incomes from the integrated ISP operations. If properly addressed through imputation, about $11 million dollars in ISP net income would have been used to reduce Small LEC A-Fund draws over the past six years.[57]

- Based on data provided by the Small LECs for their ISP affiliate operations during 2018, imputation could result in reductions of CHCF-A draws by about $3 million per year.[58]

- Because the data on which TURN relies on is not audited, the Commission must audit the operations of the Small LECs' ISP affiliates, to gain a complete understanding of the potential to correct CHCF-A draws.[59]

Implementation of TURN's imputation proposal can be accomplished through the existing rate-of-return framework that governs the operations of the Small LECs. Other than a modest change in the annual advice letter filing, TURN's imputation proposal does not change the existing regulatory mechanisms that are applied to the Small LECs.

- To implement imputation, TURN recommends that the integrated operations of each Small LEC and its ISP affiliate be evaluated on a pro forma basis.[60] During general rate cases, each ISP affiliate's audited broadband revenues and expenses will be evaluated along with the corresponding Small LEC's telephone operations to determine the impact on the intrastate revenue requirement and subsequent calculation of A-Fund draws.[61]

- ISP affiliate investments will be added to rate base on a pro forma basis, with the Small LEC and the ISP affiliate given the opportunity to earn a reasonable return on those

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[57] Ex. TURN-2 (Roycroft Public Reply) at p. 27.
[58] Ex. TURN-2 (Roycroft Public Reply) at p. 13.
[59] Ex. TURN-2 (Roycroft Public Reply) at p. 16.
[60] In a financial context, pro forma statements are generated to project results associated with an event as if it had been in effect or will be in effect in the future. For example, when publicly traded companies propose a merger, a pro forma statement of the combined entity's projected revenues and costs is typically created to generate an estimate of net income of the combined companies. Ex. TURN-1 (Roycroft Public Opening) at p. 9. Regarding the Small LECs, however, it is not hypothetical that the Small LECs and their ISP affiliates operate on a combined basis. Ex. TURN-1 (Roycroft Public Opening) at p. 14.
[61] Ex. TURN-1 (Roycroft Public Opening) at pp. 14-15.

investments. The return on the ISP investment should match the return authorized for the Small LEC, unless a risk differential is demonstrated.[62]

- If the ISP affiliate raises broadband rates to offset the reduction in Small LEC A-Fund draws, those increases will be evaluated in the annual advice letter filing and means test, to ensure that the CHCF-A draws remain reasonable between rate cases and to also discourage broadband rate hikes. An advice letter adjustment similar to the current one associated with voice service rates will apply to broadband rates. If broadband rates increase, CHCF-A draws will be reduced.[63]

TURN's balanced approach to imputation of ISP affiliate net incomes will result in outcomes that are consistent with the statutory provisions governing the CHCF-A program.

In response to TURN's proposal, Small LECs' witness Mr. Duval argues that, if imputation is adopted by the Commission, a portion of the affiliated ISP's net revenues would need to be allocated to the interstate jurisdiction, using the FCC Part 36 jurisdictional separations factor. Based on Part 36 allocation rules, Mr. Duval's recommendation would result in 75% of ISP affiliate net income being allocated to the intrastate jurisdiction, with the remaining 25% allocated to the interstate jurisdiction.[64] However, as noted by Mr. Duval during cross examination, the Part 36 jurisdictional separations factor does not apply to the affiliated ISPs' retail revenues:

> The Part 36 rules require that wholesale revenues -- wholesale broadband be jurisdictionally separated. *But there's no jurisdictional separations of retail broadband revenues, because they're unregulated. Part 36 doesn't apply to those today.*[65]

Thus, Mr. Duval's jurisdictional allocation argument falls flat. Furthermore, Mr. Duval stated during cross examination that should the Commission follow this allocation plan, that the 25% allocated to the interstate would simply remain with the ISP affiliate, as the FCC does not

[62] Ex. TURN-2 (Roycroft Public Reply) at pp. 18, 21, 23.
[63] Ex. TURN-2 (Roycroft Public Reply) at pp. 16-17.
[64] EX. LEC-2 (Duval Public Reply) at p. 16. See also, TR 996-1004 (Duval).
[65] TR 959 (Duval), emphasis added.

address ISP affiliate operations.[66] TURN does not believe that the Commission should follow Mr. Duval's advice on this matter. There is no reason to apply the Part 36 jurisdictional separations factor to ISP revenues when addressing imputation of ISP retail revenues for purposes of administering CHCF-A.

3. ISP Affiliates Buying Out of NECA Tariff No. 5 Still Do Not Contribute to the Recovery of Loop Costs

While the Commission has moved into a new Phase of this proceeding, facts established in the previous phase must be kept in mind as broadband imputation is again considered. As TURN explained in the previous Phase of this proceeding, due to outdated and distorted cost allocation rules, Small LEC ISP affiliates that purchase voice and broadband loops out of NECA Tariff No. 5 do not contribute to the recovery of significant local loop costs—cable and wire facilities,[67] allowing the ISP affiliates to "ride for free" on local loops that are paid for entirely out of intrastate ratepayer charges and state and federal universal service support.[68] In this Phase of the proceeding, Small LECs' witness Mr. Boos attempted to rebut TURN's 2014 testimony.[69] However, Mr. Boos, during cross examination, deferred questions regarding the recovery of loop costs to Mr. Duval.[70] Consistent with Small LEC discovery responses and TURN's 2014 testimony, Mr. Duval explained that for the 25 percent of loop costs that are allocated to the interstate jurisdiction, NECA Tariff No. 5 rates continue to only recover the costs of electronics needed to provide broadband services, not cable and wire facilities.[71] Thus, the basic facts

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[66] TR 1004 (Duval).
[67] Specifically, the cable and wire facilities in the Category 1, Subcategory 1.3 loops that are used by the ISP affiliates of the Small LECs to deliver broadband Internet access services. See, Phase 1 Ex 14-C (Roycroft Direct) at pp. 10-18.
[68] Phase 1 Ex 14-C (Roycroft Direct) at pp. 17-18.
[69] Ex. LEC-4 (Duval Public Opening) at p. 18.
[70] TR, 1495-1496.
[71] TR 978-979.

explained by the Small LECs in 2014 regarding the “free ride” discussed by TURN have not changed:

> The revenue requirement underlying the "voice-data" option under NECA Tariff No. 5 includes only the incremental loop costs associated with delivering wholesale DSL over a loop that has already been paid for by the voice customer through voice cost recovery mechanisms. In accordance with FCC regulations, the cable and wire facilities and electronics costs necessary to provide voice services are allocated 100% to voice recovery mechanisms. Accordingly, 0% of these cable and wire facility and electronic costs are included in the revenue requirement for NECA Tariff No. 5 under the voice-data option.[72]

Broadband imputation will address the underlying unfairness of ISP affiliates failing to contribute to loop cost recovery.

4. Broadband Imputation Will Provide Incentives for Efficient Operation

While imputation will address the underlying unfairness of Small LEC ISP affiliates earning excessive returns while not reasonably contributing to the recovery of the costs of local loops, imputation will also promote the efficient operation of the Small LECs and their ISP affiliates. As noted by Dr. Roycroft, TURN’s imputation framework promotes the same incentives for Small LEC operating efficiency, regulatory lag, as currently exists for the Small LEC.[73] Small LEC witnesses Mr. Boos and Mr. Votaw recognize that TURN’s imputation proposal will operate prospectively and thus provides an incentive structure to generate profits in between imputation calculations. These witnesses envision responding to imputation with cost cutting and increased efficiencies.[74] Under TURN’s proposed imputation framework, following a rate case, the firms are free to pursue profit increases through cost cutting measures, the

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[72] Small LECs response to TURN Phase 1 Set 13, request 4. Quoted in Phase 1 Ex 14-C (Roycroft Direct) at pp. 17-18.
[73] Ex. TURN-2 (Roycroft Public Reply) at p. 21.
[74] Ex. LEC-7 (Votaw Public Opening) at p. 14; Ex. LEC-4 (Boos Public Opening) at p. 23.

introduction of new services, or efforts to increase subscription.[75] Mr. Boos also mentions broadband price increases as a potential response but downplays the potential for this strategy due to competition and the lower income profile of Ponderosa's customers.[76]

TURN's proposal to use the annual advice letter filing to deter rate increases will provide a further deterrent to broadband rate increases.[77] Specifically, the annual advice letter form would identify broadband rate increases, with the revenue impact of the rate increase offsetting the Small LEC's CHCF-A draw.[78] Given the existing framework already includes the potential for adjustments to CHCF-A associated with changes in voice rates, the addition of an evaluation of broadband rate changes will be straight forward.

5. *TURN's Balanced Proposal Will Encourage Broadband Investment and Deployment for both Small LECs and their ISP Affiliates*

While the Small LECs attempt to play down the differences between their operations,[79] there is substantial variation among the carriers in their costs of providing broadband Internet access service. TURN's imputation proposal reflects these differences and is not "one-size-fits all."[80] The cost differences among the Small LECs can be seen in NECA Tariff No. 5 rates that each Small LEC ISP affiliate must pay the Small LEC for use of the local loop. The NECA Tariff No. 5 rates reflect the "rate band" to which the Small LEC is assigned by NECA. "Rate bands" represent groups of companies that have similar costs for delivering the services.[81] Mr.

[75] Ex. TURN-1 (Roycroft Public Opening) at pp. 21, 35, 45, 62.
[76] Ex. LEC-4 (Duval Public Opening) at p. 23.
[77] Ex. TURN-1 (Roycroft Public Opening) at pp. 16-17.
[78] Ex. TURN-1 (Roycroft Public Opening) at p. 17.
[79] Ex. LEC-4 (Duval Public Opening) at pp. 4-5.
[80] Ex. TURN-1 (Roycroft Public Opening) at p. 12.
[81] Ex. TURN-1 (Roycroft Public Opening) at p. 60; Ex. LEC-4 (Duval Public Opening) at p. 28.

Duval illustrated the difference in the wholesale costs for broadband loops paid by Small LEC ISP affiliates in his reply testimony:[82]

Independent Small LEC	Broadband Customers	ADSL 6/1 Mbps (3 Yr WPP)	ADSL 25/3 Mbps (3 Yr WPP)	SDSL 10 Mbps (3 Yr WPP)	CBOL	A/SDSL Data-Only Rate	Total CBOL Rate
Calaveras	2,341	$ 22.78	$ 30.07	$ 23.54	$ 42.00	$ 12.31	$ 54.31
Cal-Ore	864	$ 67.26	$ 88.76	$ 69.48	$ 42.00	$ -	$ 42.00
Ducor	542	$ 31.96	$ 42.17	$ 33.01	$ 33.00	$ -	$ 33.00
Foresthill	1,955	$ 17.38	$ 22.94	$ 17.96	$ 42.00	$ -	$ 42.00
Kerman	1,735	$ 39.15	$ 51.66	$ 40.44	$ 42.00	$ -	$ 42.00
Pinnacles	59	$ 51.31	$ 67.71	$ 53.01	$ 42.00	$ -	$ 42.00
Ponderosa	5,019	$ 19.90	$ 26.26	$ 20.56	$ 42.00	$ -	$ 42.00
Sierra	9,946	$ 15.18	$ 20.03	$ 15.68	$ 57.80	$ 14.61	$ 72.41
Siskiyou	2,310	$ 12.39	$ 16.35	$ 12.80	$ 42.00	$ 11.55	$ 53.55
Volcano	7,512	$ 5.89	$ 7.77	$ 6.08	$ 42.00	$ -	$ 42.00
Weighted Average Rate	3,228	$ 17.27	$ 22.78	$ 17.84	$ 46.22	$ 6.22	$ 52.44

Figure 1: Rates for Small LEC ISP Affiliates for DSL loops **(Duval Reply Testimony, p. 20)**

Focusing on the ADSL 25/3 column, it is clear that the ISP affiliates face dramatically different rates, which will result in significant differences on the ability of the ISP affiliate to operate profitably. For example, Volcano's ISP affiliate pays $7.77 per month for the 25/3 Mbps wholesale service, while Cal-Ore's ISP affiliate pays $69.48 per month for the same wholesale service. These differences have significant consequences. As reported by TURN, Small LEC ISP affiliate broadband prices are generally high, when compared to rates charged in urban areas.[83] However, price differences are substantial even among the Small LECs. For example, Cal-Ore ISP affiliate charges $59.95 per month for retail broadband service at the 25/3 Mbps level, while Volcano charges $69.95 per month for 25/3 Mbps service.[84] The consequences of the wholesale DSL rates and retail DSL prices in this illustration are easy to see—for 25/3 Mbps

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[82] Ex. LEC-2 (Duval Public Reply) at p. 20.
[83] Ex. TURN-1 (Roycroft Public Opening) at p. 71.
[84] Ex. TURN-1 (Roycroft Public Opening) Appendix 2 at NC0114 to NC0143. Small LECs' response to TURN Phase 2 Set 4, data request 17.

retail service, Volcano's margin above the cost of the NECA Tariff No. 5 rate is $62.18, while Cal-Ore's margin for 25/3 Mbps service is *negative* $9.53.[85] As a result of the substantial differences in the cost structure of the Small LECs, some ISP affiliates earn substantial margins, while others lose money.[86] This distorted outcome can be corrected through TURN's imputation proposal.

TURN's imputation proposal appropriately addresses the ISP affiliates' current investment and investment incentives. Under TURN's proposal, ISP affiliates are allowed the opportunity to earn a reasonable return on their investments under the existing rate-of-return framework that governs the Small LECs.[87] While ISP affiliate investments are very small (on average, about five percent of the amount of Small LEC rate base),[88] the expense oriented nature of the ISP affiliate operations does not undermine the appropriateness of application of the rate-of-return framework. While Dr. Aron claims that the expense-intensive nature of the ISP affiliate results in "solvency risks" for the ISP affiliate,[89] Dr. Roycroft (as well as Dr. Aron and Mr. Boos), explain that the Small LECs and their ISP affiliates operate on an integrated basis.[90] As a result, the low 11 percent ratio of investment to expense ratio that Dr. Aron alleges is a problem for the ISP affiliates ignores the fact of the integrated operations of the Small LECs and

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[85] See Ex. TURN-1 (Roycroft Confidential Opening), Confidential Appendix 3 at C0169-C0170 for Cal-Ore's discussion of the ISP affiliate's operating decisions.
[86] Ex. TURN-1 (Roycroft Public Opening) at p. 15.
[87] Ex. TURN-1 (Roycroft Public Opening) at p. 15.
[88] Ex. TURN-1 (Roycroft Public Opening) at pp. 37-38.
[89] Ex. LEC-9 (Aron Public Opening) at p. 34.
[90] Ex. TURN-1 (Roycroft Public Opening) at pp. 37-38; Ex. TURN-2 (Roycroft Public Reply) at pp. 10-13. See also, Ex. LEC-9 (Aron Public Opening) at pp. 35-36, "Independent Small LECs and ISP affiliates generate economies of scope through their respective operations because they are able to share resources. Such shared resources include labor, vehicles and equipment, and billing systems." See also, Ex. LEC-4 (Boos Public Opening) at p. 23, "In practice, given the common ownership between Ponderosa and Ponderosa Cablevision, the shareholders of these companies would view their risks and investments as a whole."

their ISP affiliates. Dr. Roycroft demonstrated that the integrated Small LEC/ISP Affiliate expense to investment ratio is not 11 percent, but 160 percent.[91] Thus, there is no danger of solvency problems arising, as alleged by Dr. Aron.[92] Dr. Roycroft also testified that even if there was an increased risk of insolvency, that rate-of-return regulation can easily address that issue. The solution is an adjustment in the cost of capital to reflect the increased risk.[93] TURN's imputation proposal allows for differential risk for ISP investment, based on a finding by the Commission that one is necessary.[94]

Thus, while Dr. Aron bemoans the prospect of a Small LEC ISP affiliate losing the opportunity to earn unlimited returns under TURN's imputation framework,[95] the reasonable limits proposed by TURN in the context of the existing rate-of-return mechanism are entirely appropriate. Rate-of-return regulation has provided ample incentives for the Small LECs to make substantial investments, a fact recognized by Small LEC witness Duval. In fact, Mr. Duval sings the praises of the existing rate-of-return framework and its positive impact on investment and universal service in California and the nation:

> Absent rate of return regulation, there would likely be no telecommunications networks in many rural areas of California and throughout the country. . . . Rate of return regulation has helped ensure that the universal service principles initially adopted in the Communications Act of 1934, and later affirmed in the Telecommunications Act of 1996 and the National Broadband Plan, are a reality for all Americans.[96]

TURN's proposal extends the successful rate-of-return framework to address the integrated operations of the Small LECs and their ISP affiliates. Small LECs that are associated with ISPs

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[91] Ex. TURN-2 (Roycroft Public Reply) at pp. 37-38.
[92] Ex. TURN-2 (Roycroft Public Reply) at pp. 37-38.
[93] Ex. TURN-2 (Roycroft Public Reply) at pp. 38-40.
[94] Ex. TURN-1 (Roycroft Public Opening) at p. 23; Ex. TURN-2 (Roycroft Public Reply) at p. 40.
[95] TR 1653:17-23.
[96] Ex. LEC-4 (Duval Public Opening) at p. 24. See also, TR 988:20-23.

that earn excessive profits will have their CHCF-A draws reduced but will still have an opportunity to earn a reasonable return on investment (both for the Small LEC and for the ISP affiliate). Those Small LECs with ISP affiliates that earn losses will have the CHCF-A draws increased, providing incentives for continuing ISP affiliate operations, and opportunities to earn a reasonable return on their investments.

6. TURN's Imputation Proposal Will Promote Broadband Deployment and Adoption

TURN believes that imputation will promote broadband deployment and adoption, thus benefitting the maturity of broadband deployment among the Small LECs. Imputation will offer the potential for increased CHCF-A draws to several of the Small LECs and the optional compliance plan provides incentives for decreased broadband rates, and thus increased broadband subscription.[97]

As mentioned above, TURN's imputation proposal also includes an optional compliance plan that would provide incentives for Small LEC ISP affiliates to reduce broadband rates. Under this plan, which Small LEC witness Mr. Duval describes as "clever,"[98] Small LECs with ISPs that earn excessive net incomes would have a choice to experience reductions in their CHCF-A draws, or to opt-in to an alternative compliance plan that would reduce broadband rates and improve the speeds at which customers subscribe to broadband. Under this optional approach, broadband ISPs could use broadband rate reductions to reduce excessive profits that would otherwise cause the Small LEC to lose CHCF-A support.

- This option would still require the pro forma analysis of the integrated operations of the Small LEC and its ISP affiliate, and the identification of the appropriate adjustment to CHCF-A draws.

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[97] Ex. TURN-1 (Roycroft Public Opening) at pp. 24-26.
[98] Ex. LEC-2 (Duval Public Reply) at p. 12.

- Small LECs could then propose a compliance plan. As part of a compliance plan, customers could receive increased broadband speeds at the current rates for lower speeds. For example, customers whose broadband loops are capable of delivering 10/1 Mbps speeds but who currently take 6/1 Mbps service would receive the increased speed at a lower rate.

- This alternative, opt-in, approach would require that the Commission approve the Small LEC's compliance plan and the appropriate level of broadband rate reductions and speed increases, so that the ISP affiliate's profits come into line with those authorized for the Small LEC's intrastate operations.

- For those ISP affiliates that are not earning excessive profits, increases in CHCF-A draws, per the imputation framework, could encourage the deployment of higher quality broadband at lower prices.

- Based on data from 2018, under this alternative compliance plan, all Small LEC ISP customers could have received a 13.5 percent reduction in broadband rates with virtually no impact on the current size of CHCF-A.[99]

With this optional alternative compliance pathway, broadband imputation could play a role in closing the digital divide by reducing broadband rates and improving broadband speeds used by customers. Thus, TURN's imputation approach will appropriately address issues raised in California Public Utilities Code §275.6 regarding the inclusion of broadband-enabling investments in rate base, the evaluation of ISP affiliate revenues, and will also provide a reliable mechanism to ensure that support is not excessive, as also specified in §275.6.[100]

7. Small LECs' Disaffiliation Threats Are Not Credible

The Small LECs' witnesses discussed the "inevitability" of disaffiliation—the severance of the relationship between the Small LEC and its ISP affiliate—should they be subject to imputation.[101] For example, Small LECs state that ISPs would respond to imputation by "simply selling themselves to a different owner."[102] However, rather than making an economic case for

[99] Ex. TURN-1 (Roycroft Public Opening) at pp. 24-26.
[100] Ex. TURN-1 (Roycroft Public Opening) at pp. 24-26.
[101] Ex. LEC-9 (Aron Public Opening) at p. 18.
[102] Ex. LEC-9 (Aron Public Opening) at p. 18.

disaffiliation, Small LEC witnesses Dr. Aron, Mr. Boos, and Mr. Votaw, seeming inadvertently, offer substantial evidence that the shareholders of Small LECs would be significantly harmed by disaffiliation, thus undermining their disaffiliation claims.[103] For example, on the matter of employee headcount, Dr. Aron notes that "Independent Small LECs and ISP affiliates generate economies of scope through their respective operations because they are able to share resources. Such shared resources include labor, vehicles and equipment, and billing systems."[104] Dr. Aron also states that "Employees whose time is shared between ISPs and Independent Small LECs include human resources managers, technicians, accountants, engineers, customer service representatives, and payroll and marketing specialists."[105] Once disaffiliated, the ISP affiliate could no longer share these operational and labor synergies and the loss of efficiency associated with disaffiliation would be substantial.[106] On this matter Dr. Aron provides detailed information of the benefits of affiliated operation and the potential pitfalls to the Small LEC of disaffiliation:

> One area [where efficiencies are generated due to resource sharing] is in customer service. For example, if an ISP customer calls with a service complaint (whether he or she initially calls the telco or the ISP affiliate), it may not be clear whether the trouble is with the Independent Small LEC's network, or with the ISP affiliate's facilities. Under the current structure, the companies can jointly own the problem and can jointly resolve it. If the two companies are separate, however, solving the problem may require two truck rolls and the associated delays for the customer, if the first company to respond does not find the source of the problem. Indeed, without the coordination that occurs between the Independent Small LEC and its ISP affiliate, resolving the problem may require more than two tries, with the associated costs in the form of inefficiencies to both companies and in the form of time and frustration to the customer.[107]

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[103] Ex. TURN-2 (Roycroft Public Reply) at pp. 27-35.
[104] Ex. LEC-9 (Aron Public Opening) at pp. 35-36.
[105] Ex. LEC-9 (Aron Public Opening) at p. 37.
[106] Ex. TURN-2 (Roycroft Public Reply) at p. 30; TR 1651 15:21, TR 1666:4-7 (Aron suggests that ISP Affiliate profits will be lower if ISP disaffiliates because the ISP affiliate will lose the benefits of the economies of scope that they enjoy as an affiliate of the Small LEC and acknowledges that loss of economics of scope from disaffiliation will impact purchase price of the affiliate).
[107] Ex. LEC-9 (Aron Public Opening) at p. 38.

In this discussion Dr. Aron describes significant barriers to disaffiliation. The increase in costs and operational inefficiencies associated with customer trouble reports and repair services is just one example of an additional deterrent to disaffiliation. The ability of the Small LEC and its ISP affiliate to share resources such as repair vehicles and the expertise of repair technicians significantly reduces costs for the combined entity, and disaffiliation would result in higher costs for the unaffiliated ISP, a fact that would be recognized by any potential ISP affiliate buyer and thus be factored into the price that a potential buyer would offer.

Dr. Aron identifies other barriers to disaffiliation. For example, she points to benefits arising from the ability of integrated customer relations and network planning:

> [S]ome companies employ an individual whose job focuses on working with the community and meet with local governments and anchor institutions such as community colleges and healthcare facilities to determine their needs for capacity, speed, and services. Through these relationships, the Independent Small LECs and ISP affiliates are able to deploy their services and plan their deployment to address future expected demands. The Independent Small LECs and ISP affiliates are also able to educate their customers through these public relationships about services they offer, improving the customer experience and, potentially, increasing the efficient use of the broadband network.[108]

Dr. Aron goes on to discuss the disadvantages of disaffiliation on this area of the Small LEC's business:

> The costs of the individuals providing these functions are shared between the Independent Small LEC and the affiliated ISP. If the companies were no longer affiliated, either the Independent Small LEC would retain the employee and bear his or her full cost, or the ISP would employ the individual and bear the full cost, or neither company would be able to justify the cost and the function would not be filled.[109]

Dr. Aron also discusses the advantages of integrated operations on billing:

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[108] Ex. LEC-9 (Aron Public Opening) at p. 38.
[109] Ex. LEC-9 (Aron Public Opening) at p. 39.

> As a third example, the Independent Small LECs and their affiliated ISPs currently jointly bill their customers. A separate ISP would have to build or purchase a separate billing system or obtain access to one rather than share the Independent Small LEC's existing billing system. While, in some cases, an independent ISP may be able to jointly bill with the Independent Small LEC, it would nevertheless require its own billing system so that it could provide to the Independent Small LEC the necessary data to provide a bill and process payments.[110]

Dr. Aron also points to efficiencies associated with the integrated entity being able to afford higher quality resources, such as employees with specialized expertise,[111] which would be lost if the companies were to disaffiliate.

The operational negatives associated with disaffiliation discussed above are just the tip of the iceberg should the Small LEC and its ISP affiliate disaffiliate. As noted by Dr. Roycroft, there would be a cascade of additional negative consequences from disaffiliation:[112]

- **Disaffiliation will close the Small LECs out of the growth area of the retail wireline industry.** Through disaffiliation, Small LECs would disassociate themselves from the ability to satisfy consumer demand for retail broadband services. Broadband services are the telecommunications services that consumers find increasingly necessary to fully participate in important aspects of society, such as work, school, healthcare, access to government services, etc.[113]

- **Disaffiliation would undermine the Small 'ECs' ability to jointly market retail voice and broadband services.** All of the Small LECs jointly market voice and broadband services. Currently, about 71 percent of Small LEC access lines in service take broadband services,[114] and all of those broadband customers are required by the Small LECs to subscribe to Small LEC voice services.[115] Thus, disaffiliation would reduce the Small LECs' ability to require customers to subscribe to their voice services and Small LECs would place at risk a significant number of their voice customers. Of course, the Small LECs would still have the ability to sell wholesale broadband services, however, as will be discussed below, disaffiliation would also undermine that element of the Small LECs' business.

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110 Ex. LEC-9 (Aron Public Opening) at pp. 39-40.
111 Ex. LEC-9 (Aron Public Opening) at p. 40.
112 Ex. TURN-2 (Roycroft Public Reply) at pp. 4-10.
113 Ex. TURN-2 (Roycroft Public Reply) at p. 5.
114 Ex. TURN-1-C (Roycroft Confidential Opening) Appendix 3 at C0003-C0012 [Small LECs response to TURN Phase 2 Set 1, Data Request 4(d)] and C0067-C0082 [Phase 2 Set 4, Data Request 10].
115 Ex. TURN-1-C (Roycroft Confidential Opening) Appendix 2 at NC0003-NC0022 [Small LECs response to TURN Phase 2 Set 1, Data Request 1(b)].

- **Disaffiliation will undermine the success of the Small LECs' wholesale broadband operations.** As will be discussed in the next item, unaffiliated ISPs will not enjoy the same synergies or be able to achieve the same operating scale as the Small LECs. As a result, unaffiliated ISPs will face higher costs. Dr. Aron also indicates that unaffiliated ISPs will need to charge higher prices for broadband as a result of those higher costs,[116] thus it is likely that unaffiliated ISPs would sell fewer broadband connections. The Small LECs can reasonably expect that after disaffiliation the number of wholesale inputs sold to unaffiliated ISPs will decline.[117]

- **The elimination of the synergies that currently exist for the Small LEC and its ISP affiliate will be recognized by any potential buyer of ISP affiliate assets, leading to a greatly reduced or non-existent market value of ISP affiliate assets.** Any third-party that might consider buying a disaffiliated ISP would recognize that high costs of operation, bereft of the synergies that the Small LEC and its ISP affiliate currently enjoy, would reduce the potential profitability of the disaffiliated ISP (overlooking the fact that several of the Small LEC ISP affiliates are unprofitable even with the synergies that they enjoy). This expectation would lead to a very low willingness to pay for ISP affiliate assets and a low or non-existent market value for ISP affiliates. Also keep in mind that no unaffiliated ISP that uses NECA Tariff No. 5 wholesale DSL services operates in the Small LECs service area today, which reflects the inability of unaffiliated carriers to profitably operate in the first place.[118]

As illustrated above, any reasonable assessment of the prospects of disaffiliation can only lead to the conclusion that the choice to disaffiliate would result in a significant negative impact on the shareholders of the Small LECs. While witnesses for the Small LECs attempt to convince the Commission that they will self-inflict significant economic penalties upon themselves if they are required to impute broadband revenues,[119] their claims are not convincing.

While Dr. Roycroft shows why disaffiliation would not be pursued by the Small LECs, Dr. Aron's testimony also demonstrates that disaffiliation does not make economic sense and would not be pursued by the Small LECs. In addition to the specific operational benefits discussed above, Dr. Aron also points out that that with integrated operations, the Small LECs

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[116] Ex. LEC-9 (Aron Public Opening) at p. 50.
[117] Ex. TURN-2 (Roycroft Public Reply) at p. 10.
[118] Ex. TURN-2 (Roycroft Public Reply) at p. 9.
[119] Ex. LEC-7 (Votaw Public Opening) at p. 14; Ex. LEC-4 (Duval Public Opening) at p. 22.

and their ISP affiliate have a competitive advantage over unaffiliated ISPs.[120] Small LECs would have the Commission believe that the Small LECs would give up all of the economies of scope and competitive advantages of integrated operations. Small LECs also strain credulity with their arguments that they would find ready buyers for their ISP affiliate operations.[121]

TURN's imputation framework will provide the Small LEC and its ISP affiliate the opportunity to recover reasonable expenses and to earn reasonable returns on investment under the existing rate-of-return framework.[122] As noted by Small LEC witness Duval, the rate-of-return mechanism has provided the needed incentives for the Small LECs to make extensive investments in their networks.[123] TURN's imputation framework leaves in place all of the current scope economies,[124] and other competitive advantages,[125] to the benefit of the Small LEC and its ISP affiliate.[126] The Small LEC and its ISP affiliate will also have the opportunity to take advantage of "regulatory lag" and earn above-normal profits in the short run if it cuts costs, innovates, or expands broadband adoption. Ponderosa's Mr. Boos notes that cutting costs would "likely produce some profits for Ponderosa Cablevision in between imputation events."[127] Ducor's Mr. Votaw makes a similar statement.[128]

It is not reasonable to assume that the Small LECs fail to recognize the benefits of integrated operations. It is also not reasonable to assume that buyers would be willing to offer the Small LEC a price that reflected the current operations of a profitable ISP affiliate, making

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[120] Ex. LEC-9 (Aron Public Opening) at p. 42.
[121] Ex. TURN-2 (Roycroft Public Reply) at pp. 7-9 and pp. 32-34.
[122] Ex. TURN-1 (Roycroft Public Opening) at p. 15.
[123] TR 988.
[124] Ex. TURN-2 (Roycroft Public Reply) at pp. 14, 17, 29.
[125] Ex. TURN-2 (Roycroft Public Reply) at pp. 33-34.
[126] Ex. TURN-2 (Roycroft Public Reply) at p. 35.
[127] Ex. LEC-4 (Duval Public Opening) at p. 22.
[128] Ex. LEC-7 (Votaw Public Opening) at p. 14.

the sale of an ISP affiliate an unattractive option.[129] A potential buyer of ISP affiliate assets would believe that the profits arising from the integrated operations of the ISP affiliate would represent a reasonable expectation of future unaffiliated ISP profits, thus leading to a low value for any Small LEC that would consider selling their ISP assets.[130] In fact, the best that Dr. Aron can foretell regarding the viability prospects of an unaffiliated ISP is that "they may be."[131] While it is possible that a Small LEC might "cut off its nose to spite its face" by disaffiliating, an economically rational actor would not pursue disaffiliation.[132]

Finally, on the matter of disaffiliation, Dr. Aron stated during cross examination that it also might be possible that a disaffiliated ISP could enter into "arm's length relationships with the LEC that still allow them to have cooperative business arrangements."[133] TURN does not believe that the "just a little bit affiliated" approach hypothesized by Dr. Aron would be permitted under the FCC's affiliate transaction rules.[134] Furthermore, any "arms-length and cooperative business arrangement" that was exclusive to a Small LEC's former ISP affiliate, but not available to all other unaffiliated ISPs, would not only run afoul of the FCC's affiliate transaction rules, but also raise antitrust concerns. In the event that any Small LEC would disaffiliate in light of imputation, TURN believes that the Commission should open an investigation into the Small LEC's operational practices. Before the Commission could stop

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[129] Ex. TURN-2 (Roycroft Public Reply) at p. 35.
[130] Ex. TURN-2 (Roycroft Public Reply) at pp. 31, 33, 36.
[131] Ex. LEC-9 (Aron Public Opening) at p. 42.
[132] Ex. TURN-2 (Roycroft Public Reply) at p. 36.
[133] TR 1671.
[134] The FCC has granted waivers to affiliate transaction rules for cases where the FCC believes that the waiver is for a short period of time. The relationship envisioned by Dr. Aron is ongoing and is thus anything but short term. See, for example, *In the Matter of Qwest Services Corporation Petition for Waiver of Section 32.27(c) of the Commission's Rules*, WCB/Pricing File No. 02-32, Order, January 23, 2003. See also, *In the Matter of GTE Service Corporation Petition for Waiver of Section 32.27(c) of the Commission's Rules*, ASD File No: 01-19, Memorandum and Order, February 20, 2001.

collecting information regarding Internet access revenues TURN believes that the statutory language requires a finding that the Small LEC is no longer engaged in any element of the provision of unregulated Internet access service.[135] "Cooperative business arrangements" with formerly affiliated ISPs should be fully evaluated by the Commission to determine whether a Small LEC and its ISP affiliate continue to operate on an integrated basis, in whole or in part. Dr. Aron's suggestion that the Small LECs can game the system with her "just a little bit affiliated" proposal would not, in TURN's opinion, rise to the level of actual disaffiliation, making the continuation of broadband imputation entirely appropriate in an environment of "arm's length relationships with the LEC that still allow them to have cooperative business arrangements."

8. The FCC's Restoring Internet Freedom Order Does Not Undermine the Commission's Authority to Impose Imputation

While Small LEC witness Mr. Duval argues that the FCC's 2018 *Restoring Internet Freedom Order* prevents this Commission from addressing broadband imputation,[136] more recent case law on this matter show the opposite. TURN notes that the FCC's *Restoring Internet Freedom Order* was reviewed and vacated in part in 2019 by the federal Court of Appeals in the District of Columbia .[137] That court took issue with the FCC's preemption approach and generally concluded that the FCC could not simultaneously abandon the regulation of Internet services by placing them under Title I and also prevent the states from stepping into the regulatory vacuum created by the FCC's own action—"It just cannot completely disavow Title II

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[135] Pub. Util. Code §275.6(e).
[136] Ex. LEC-4 (Duval Public Opening) at p. 35.
[137] *Mozilla Corp. v. Federal Communications Commission et al. 940 F.3d 1 (2019)* (hereinafter *Mozilla v. FCC*).
https://www.cadc.uscourts.gov/internet/opinions.nsf/FA43C305E2B9A35485258486004F6D0F/$file/18-1051-1808766.pdf

with one hand while still clinging to Title II forbearance authority with the other."[138] According to the October 1, 2019 ruling by the D.C. Court in *Mozilla v. FCC*, the FCC's attempt to broadly preempt all elements of state regulation that were inconsistent with the FCC's deregulatory approach does not withstand scrutiny. As the D.C. Court notes:

> We vacate the portion of the 2018 Order that expressly preempts "any state or local requirements that are inconsistent with [its] deregulatory approach." . . . The Commission ignored binding precedent by failing to ground its sweeping Preemption Directive—which goes far beyond conflict preemption—in a lawful source of statutory authority. That failure is fatal.[139]

The D.C. Court goes on to state:

> Not only is the Commission lacking in its own statutory authority to preempt, but its effort to kick the States out of intrastate broadband regulation also overlooks the Communications Act's vision of dual federal-state authority and cooperation in this area specifically. …. Even the 2018 Order itself acknowledges the States' central role in "policing such matters as fraud, taxation, and general commercial dealings," 2018 Order ¶ 196, "*remedying violations of a wide variety of general state laws*," id. ¶ 196 n.732, and "enforcing fair business practices," id. ¶ 196— categories to which broadband regulation is inextricably connected.[140]

It is clear from this language that the Court of Appeals believes, consistent with federal statute, that there is a substantial role for the states to play in pursuing objectives advanced by both state legislatures and the U.S. Congress.

Not only is the Small LECs' federal preemption argument flawed, but TURN's proposal will not conflict with or require changes to existing federal cost allocation rules or separations rules that govern the operations of the Small LECs.[141] So, while it is critical to understand the role that these federal rules have in the day-to-day operations of the Small LECs and their

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[138] *Mozilla v. FCC*, at p. 80.
[139] *Mozilla v. FCC,* at p. 74.
[140] *Mozilla v. FCC,* at p. 81, emphasis added (citing to several sections of federal law that preserve the states' authority regarding broadband data collection (§1301(4)), regulatory jurisdiction generally (§1302(a)), initiatives to improve broadband availability (§1304), protection of the public safety and welfare (§253(b)), support for universal service policies, including affordable rates (§254(i))
[141] Ex. TURN-1 (Roycroft Public Opening) at pp. 14-15.

affiliates, these federal rules do not impact the adoption and implementation of TURN's proposals. . TURN's proposals impact the broadband affiliate only in so far as their operations are already inextricably linked with the regulated operations.[142] TURN's proposals for an audit and revenue imputation do not impose rate regulation or operational control over the broadband affiliate. Otherwise, each of TURN's proposals is designed to provide the Commission with tools and data to ensure that the *regulated* operations of the Small LECs are properly reviewed and deemed used and useful consistent to state statute.

Furthermore, TURN's proposals are consistent with the Commission's authority under state law over the broadband operations of the Small LEC affiliates. The Commission has previously found that broadband imputation mechanisms are well within its ratemaking authority.[143] Indeed, TURN's proposals are consistent with existing ratemaking principles, including the foundational notion of cost-based rates.[144] Moreover, TURN's proposals to audit affiliate operations and impute broadband revenues are tools for the Commission satisfy the Legislative goals under to Section 275.6 that strive for balance between the need of the Small LECs to modernize their networks and the needs of the California ratepayer to ensure that the burdens and payments to the A-Fund are reasonable and fair.[145]

To further support the Legislative intent of Section 275.6, the Commission should consider it alongside Section 701, granting the Commission broad regulatory powers over public

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[142] Ex. TURN-1 (Roycroft Public Opening) at p. 38; Ex. TURN-2 (Roycroft Public Reply) at pp. 27-35.
[143] Phase 1 Final Decision, pp. 21-24, COL 1 ("Neither state nor federal law prohibits broadband revenue imputation and the decision whether to do so is left to the Commission's judgment based on the record.")
[144] Pub. Util. Code §275.6(c)(2) (describing Commission's ratemaking authority), (b)(3), (allowing the Commission to consider "other revenue sources" in rate design for the Small LECs).
[145] Pub. Util. Code §275.6(c)(6) (directs the Commission to include all reasonable investments necessary to provide both voice and broadband-capable facilities in rate base to determine A-Fund draw), but see also, §275.6(c)(7) and (f) (requires that the surcharge burden to support the A-Fund is not excessive and that the charges reasonably equal the value to California consumers.)

utilities to act in the public interest, and Section 709, adopting state telecommunications policies to support universal service, ensure affordable telecommunications, encourage deployment of new technology, and bridge the digital divide.[146] Together these sections present a comprehensive statutory directive to the Commission that supports TURN's proposal and thus ensures that California rural basic voice service customers have access to robust broadband services while also demanding that all ratepayers supporting the A-Fund through surcharges are being treated fairly and only paying what is necessary to support regulated services.

B. Wholesale Imputation.

1. Imputation of Wholesale Revenues

Public Advocates argues that wholesale revenues should be imputed for purposes of adjusting CHCF-A draws.[147] TURN does not agree with Public Advocates' proposal.

As TURN has noted, the operations of the Small LECs are divided into three general categories: Regulated intrastate, regulated interstate, and unregulated.[148] This division is achieved through the application of the FCC's rules. Part 32 of the FCC's rules is associated with the uniform system of accounts by which telephone companies must abide.[149] Part 32 also governs telephone company affiliate transactions.[150] With accounts categorized through Part 32, telephone company costs are then allocated between regulated and non-regulated activities per the FCC's Part 64 rules.[151] With regard to the regulated components of a telephone company, costs and revenues are separated into interstate and intrastate through the FCC's Part 36

[146] Pub. Util. Code §701, §709(a), (c), (d).
[147] Ex. Cal Adv-1 (Ahlstedt Public Opening) at pp. 1-7 to 1-9.
[148] Ex. TURN-2 (Roycroft Public Reply) at p. 64.
[149] Ex. TURN-2 (Roycroft Public Reply) at p. 64, citing to 47 CFR Part 32 - Uniform System of Accounts for Telecommunications Companies, especially §32.101 to 32.4550.
[150] Ex. TURN-2 (Roycroft Public Reply) at p. 64, citing to 47 CFR § 32.27 - Transactions with affiliates.
[151] Ex. TURN-2 (Roycroft Public Reply) at p. 64, citing to 47 CFR § 64.901 - Allocation of costs.

jurisdictional separations rules.[152] This cost and revenue allocation process establishes the foundation for the development of interstate and intrastate revenue requirements.[153]

TURN believes that it is important for the Commission to abide by the rules associated with the jurisdictional separations process. The interstate operations of the Small LECs, including wholesale revenues earned from sales to affiliate ISPs through the NECA tariff, are regulated by the FCC. If the Commission were to impute jurisdictionally interstate revenues to offset the intrastate revenue requirement, the Small LECs would not be allowed the opportunity to earn their authorized *interstate* return.[154] The wholesale DSL revenues cannot be counted in both that intrastate and interstate revenue requirements.

TURN does not believe that Public Advocates' proposal to book interstate revenues as intrastate is reasonable. Both sides of the jurisdictional divisions governing the Small LECs have detailed regulatory oversight. The regulation of the intrastate and interstate operations should ensure that incurred costs and charged rates are reasonable and allow the Small LECs an opportunity to earn a reasonable return associated with the respective jurisdictional investments.[155] In summary, the jurisdictional separations process creates boundaries that should not be violated for the imputation process.

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[152] As is noted in Ex. TURN-2 (Roycroft Public Reply) at p. 64, in a 2018 Order, the FCC describes the Jurisdictional Separations process as "the third step in a four-step regulatory process." While this is somewhat of an oversimplification, there is no question that the "Part 32, Part 64, Part 36" regulatory trilogy is key to understanding telephone company ratemaking. See, *In the Matter of Jurisdictional Separations and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Report and Order and Waiver, December 17, 2018, ¶5.

[153] Small LEC witness Mr. Duval provides a similar discussion. Ex. LEC-1 (Duval Public Opening) at pp. 17-19.

[154] Ex. TURN-2 (Roycroft Public Reply) at p. 65. See also, Ex. LEC-5 (Duval Public Reply) at p. 66.

[155] Ex. TURN-2 (Roycroft Public Reply) at pp. 65-66.

While TURN encourages the Commission to refrain from the imputation of the Small LECs' wholesale revenues, TURN notes that the unregulated operations of the Small LECs, specifically the ISP affiliate operations are not currently regulated by the CPUC or FCC.[156] Because ISP affiliate revenues are treated as unregulated revenues, they are not counted in the interstate revenue requirement. Imputation of the retail net incomes of the Small LECs' ISP affiliates will not interfere with the Small LECs' ability to earn their interstate revenue requirement or with the ISP affiliate's ability to earn a reasonable return on investment.[157]

Unlike the Public Advocates' proposal, TURN is not recommending any changes to the federal cost allocation rules or separations rules that the Small LECs rely so heavily upon in their testimony, nor do TURN's proposals have any impact on the Small LECs' interstate revenue requirement.[158] The Commission has no authority to directly revise these complicated rules, including those that regulate Small LECs' wholesale services and revenue. So, while it is critical to understand the role that these federal rules have in the day-to-day operations of the Small LECs and their affiliates, these federal rules do not impact the adoption and implementation of TURN's proposals.

2. Low-Income Broadband

TURN has identified market failure associated with low rates of broadband adoption, especially at available higher speeds, in Small LEC service territories.[159] Dr. Roycroft attributes the adoption shortfalls as being attributable to high prices charged by Small LEC ISP affiliates.[160] Public Advocates propose that a low-income broadband program should be offered

[156] Ex. TURN-2 (Roycroft Public Reply) at p. 66.
[157] Ex. TURN-2 (Roycroft Public Reply) at pp. 20, 38.
[158] Ex. TURN-1 (Roycroft Public Opening) at p. 66.
[159] Ex. TURN-1 (Roycroft Public Opening) at pp. 54-59.
[160] Ex. TURN-1 (Roycroft Public Opening) at pp. 58-59.

by the Small LECs as a condition of receiving CHCF-A support.[161] TURN is generally supportive of the idea of a low-income broadband plan being made available to qualified low-income customers in the Small LECs' service areas. While TURN is supportive of a low-income broadband program, TURN believes that Public Advocates' proposal for "stand-alone service only" would be improved by also including a low-income broadband offering for households that subscribe to a landline. Due to NECA Tariff No. 5 provisions associated with the sale of stand-alone broadband, it may also be more economical to provide support to broadband that is purchased with a Small LEC landline.[162]

V. ROLE OF FEDERAL FUNDING IN RATEMAKING

Scoping Memo, Issue (6)

TURN does not have any comments to add to this issue at this time but reserves the right to comment in its reply brief.

VI. RATEMAKING TREATMENT OF EXPENSES.

A. Corporate Expense Cap.

Scoping Memo, Issues (2)(b)(i), (2)(b)(ii), (2)(b)(iv)

TURN does not have any comments to add to this issue at this time but reserves the right to comment in its reply brief.

B. Rate Case Expenses.

Scoping Memo, Issues (2)(b)(i), (2)(b)(ii), (2)(b)(iv)

TURN's imputation proposal, if adopted and implemented by the Commission, will require the Small LECs, Public Advocates, and Commission to expend resources to conduct and analyze the necessary audits, pro forma calculations, and imputation calculations. TURN

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161 Ex. Cal Adv-1 (Ahlstedt Public Opening) at pp. 2-7.
162 Ex. LEC-2 (Duval Public Reply) at p. 20.

supports adding these expenses to the rate case expense category and allow for cost recovery of these expenses.[163] When asked during hearings to clarify how TURN's proposal would address the situation when these rate case expenses cause a Small LEC to exceed Commission-imposed expense caps, TURN acknowledge that some flexibility in setting the caps would be appropriate because of the differences in operational characteristics of the various Small LECs.[164]

C. Operating Expenses.

Scoping Memo, Issue (2)(b)(iii)

TURN supports the application of the FCC's expense cap limitation as part of a reasonableness review during a general rate case. The Commission has previously found that the FCC's corporate expense caps provide a rational mechanism for creating a uniform standard to determine a reasonable level of corporate expenses for those carriers drawing from the A-Fund.[165] Under TURN's imputation proposal, this operating expense cap would also apply to the pro forma review of the integrated operations of both the Small LEC and the ISP affiliate.[166] Application of these caps provides incentives for similarly situated companies to structure expenses efficiently and consistently.[167]

Dr. Roycroft recommends, however, some flexibility in the calculation of the reasonableness of expenses in light of the wide variability among the size and efficiency of each Small LEC.[168] He also notes that TURN's imputation proposal does not turn on whether the expense caps are in

[163] TR 1819:19-28.
[164] TR 1820:8-13.
[165] Decision 14-12-084 at p.28, FOF 23-25, COL 4-5.
[166] Ex. TURN-1 (Roycroft Public Opening) at pp. 16, 74; TR 1821:24-1822:17 (Pro Forma review of integrated company include federal expense caps).
[167] TR 1825:23-28.
[168] Ex. TURN-1 (Roycroft Public Opening) at pp. 12, 29-30; TR 1822:4-13. Yet, Dr. Roycroft also notes that this variability also requires that the Commission develop a standardized audit and review process to allow for fair reasonableness reviews. Ex. TR-1 (Roycroft Public Opening) at p. 16.

place and that this is not a cornerstone of imputation.[169] Therefore, TURN recommends that the Commission maintain the rebuttable presumption adopted in 2014, allowing a Small LEC to rebut the presumed level of reasonableness in the event that its expenses exceed the cap.[170]

VII. RATEMAKING TREATMENT OF INVESTMENTS.

Scoping Memo, Issues (2)(b)(i), (2)(b)(ii), (2)(b)(iv)

TURN does not have any comments to add to this issue at this time but reserves the right to comment in its reply brief.

VIII. MODIFICATIONS TO THE RATE CASE PROCESS.

Scoping Memo, Issues (2)(b)(i), (2)(b)(iv), (8)

TURN has discussed changes to the rate case process above in Sections IV(a)(2) and (8), and VI(b). TURN does not have additional comments to add on this issue at this time but reserves the right to comment in its reply brief.

IX. BASIC SERVICE RATES AND OTHER END USER RATE PROPOSALS

Scoping Memo, Issue (4)

Both the Small LECs and Public Advocates propose to tie future rate increases to a measure of inflation. TURN disagrees with both proposals. Neither proposal would result in just and reasonable rates.

Small LECs have proposed to set rates in rate cases by establishing rate caps based on "inflation."[171] Adding a price cap element to the rate of return process is counterintuitive. Small LECs acknowledge that rates in "these rural areas are already among the highest in the country

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[169] TR 1821:26; 1827:2-10.
[170] Decision 14-12-084 at p. 29, FOF 25, COL 5.
[171] Small LECs Opening Comments, May 21, 2019, at p. 19.

and there is no basis for further rate increases." An inflation-based mechanism that has no relation to costs will not result in just and reasonable rates.[172]

Public Advocates argues that instead of setting LEC rates based on costs in general rate cases[173], the Commission should modify the annual Advice Letter process to incorporate a price cap mechanism, based on the Gross Domestic Product-Chained Price Index ("GDP-CPI"), to adjust rates.[174] Public Advocates asserts that NECA uses the GDP-PI to annually adjust rates.[175] The main justification for the proposal seems to be the assumption that this process would be more efficient than setting rates based on evidence in general rate cases and would preclude costly litigation.[176] Public Advocates claims that it's inflation adjusting approach would result in just and reasonable rates.[177] TURN disagrees with this proposal.

Public Advocates is proposing that annual rate increases would occur automatically, without relation to cost. Their proposed inflation measure is not a telephone company price index and, contrary to their claim, is not updated annually by NECA.[178] The GDP-CPI is a measure of inflation that focuses on domestically produced goods and services, as well as goods produced for export. It does not include the prices of imported goods and services.[179] Nor does it include a productivity offset to account for improvements in a telephone company's productivity.[180] The GDP-PI measure incorporates a "chain" element involving the application

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[172] Ex. TURN-1 (Roycroft Public Opening) at p. 75.
[173] Ex. Cal Adv-1 (Ahlstedt Public Opening) at pp. 3-1 to 3-6.
[174] *Id.* at p. 3-5.
[175] *Id.* at p. 3-6.
[176] *Id.* at pp. 3-2 - 3.3.
[177] *Id. at p. 3.5.*
[178] Ex TURN-2 (Roycroft Public Reply) at pp. 67 - 68.
[179] *Id.* at p. 67.
[180] *Id.* at p. 68.

of weighting factors in the price index that change, rather than remaining fixed.[181] The GDP-CPI accounts for substitution among products as prices change, but it is not appropriate for use as an index for setting basic service rates.[182] Contrary to Public Advocates claim, NECA does not use the GDP-CPI to set rates. Rather, NECA uses GDP-CPI as one component in determining the cap on interstate high-cost loop *support*, not adjustments to rates.[183] Public Advocates proposal does not differentiate between rates set for various services, but would apply rate increases to all services irrespective of costs.[184] And rates would increase in lock-step with the index even if costs declined.[185] The Public Advocates rate proposal would virtually guarantee that customers would face rate increases every year regardless of whether they are justified by cost increases.[186]

There is no evidence that Public Advocate's proposal would be more efficient than setting rates in a general rate case. Public Advocates does not explain how rates would be calculated under its proposal.[187] Advice letter filings are subject to protest, but Public Advocates did not take this aspect of the process into account in its proposal.[188] Public Advocates admits that rate increases would also require carriers to issue a public notice to customers as part of the process.[189] Public advocates witness testified that all of these details would have to be worked out later, perhaps through workshops or some other process.[190]

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[181] *Id.* at p. 67.
[182] *Id.*
[183] *Id.* at 68.
[184] TR 2127 (Ahlstedt).
[185] TR 2141- 2143.
[186] Ex. TURN-2 (Roycroft Public Reply) at p. 68.
[187] TR 2132 -2133.
[188] TR 2135-2136.
[189] TR 2140.
[190] TR 2136, 2140.

Public Advocates has presented no evidence to support the contention that raising rates automatically every year, based on a flawed inflation measure, with no reference to costs, and using an unexplained process would be a reasonable approach to setting rates. The Commission should not adopt proposals to impose price caps on Small LEC customers. Rates should be set in rate cases, governed by rate of return regulation.[191]

X. RATEMAKING TREATMENT OF MISCELLANEOUS REVENUES

Scoping Memo, Issue (5)

TURN does not have any comments to add to this issue at this time but reserves the right to comment in its reply brief.

XI. CHCF-A ANNUAL FILING PROCESS

Scoping Memo, Issue (7)

TURN has discussed changes to the Annual Advice Letter process above in Sections IV(A)(2) and (4). TURN does not have additional comments to add on this issue at this time but reserves the right to comment in its reply brief.

XII. CONCLUSION

TURN strongly supports the Commission's long-standing universal service goals and objectives. Customers in rural and high cost areas must have access to robust, reliable and affordable communications services and access to advanced services. As discussed above, TURN's proposals to revise the CHCF-A mechanisms will enable the Commission to meet its statutory and policy goals of universal service while ensuring that end user surcharges supporting

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[191] Decision 14-12-084 at OP 9.

the CHCF-A are reasonable and Small LECs are earning a reasonable rate of return on their investments. The Commission has the necessary authority and jurisdiction to move forward with the appropriate changes to the CHCF-A.

Dated: April 21, 2020

Respectfully submitted,

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Christine Mailloux